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# Why Stakeholder Theory is "Non-exploitative"

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**Abstract:** This essay explores the growing interest in stakeholder theory, especially its non-exploitative nature, arising out of the need to contribute to the long-term and sustainable development of corporations. As corporations continue to grow, the traditional shareholder primacy theory is increasingly challenged, many scholars believe that this theory only pays one-sided attention to the benefits of shareholders, leading to the problem of short-term and financialization of corporations. The stakeholder theory, however, takes into account the benefits of customs, manufacturers, and other stakeholders, and better avoids exploitation. However, there are also some criticisms of stakeholder theory. For example, some people argue that the implementation mechanism of stakeholder theory is not feasible, and there are still groups that are not considered under stakeholder theory, so its non-exploitative nature is questioned. Many of the existing papers focus on the content of stakeholder theory and lack to analyze whether it avoids corporate exploitation through a specific interpretation of its content. The emphasis of this essay lies in analyzing the background and content of stakeholder theory and interpreting why it is not exploitative from the two levels, theoretical basis, and practical application, and contributes to the long-term success and win-win relationship of the company. This essay concludes that stakeholder theory can reduce corporate exploitation both in theory and practice, and contribute to the long-term success and sustainable development of corporations.

**Keywords:** Stakeholder theory, Sustainability, Long-term success, Exploitation.

## 1. Introduction

Stakeholder theory has undergone a long period of development. "The term 'stakeholder' was introduced by the Stanford Research Institute (SRI) in 1963,[1]" which defined stakeholders as "those groups without whose support the organization would cease to exist.[2]" This definition demonstrates the relationship between the stakeholders and the corporation. Subsequently, in 1984, the stakeholder theory was introduced into management by Freeman, who indicated that "stakeholder theory means balancing the interests of various stakeholders.[3]" In addition, Freeman indicates that " the real challenge is to determine best practices in managing stakeholders,[4]" management is an important part of stakeholder theory, it means caring for the interests of stakeholders and treating their interests as a whole.[5] His perspective further identifies the important influence of stakeholder management on business operations. On this basis, Donaldson and Preston found that stakeholder management contributes to corporate performance from an instrumental perspective,[6] which further developed stakeholder theory. From the above studies, management from a stakeholder perspective can be seen to exhibit non-exploitative characteristics and contribute to long-term success.

However, there is much debate about the stakeholder theory, with many scholars believing that the core concepts of this theory are unclear and lack viability. Therefore, how to prove this theory has the advantages described above is an important question. The answer to this question needs to focus on the unique advantages of stakeholder theory and its mechanisms of action. Most of the existing studies on the topic have focused on the content and extent of stakeholder theory; accordingly, there is a lack of studies with comparative perspectives on this issue. Therefore, the purpose of this essay is to demonstrate the advantages of stakeholder management by comparing it with other theories from both theoretical and practical perspectives. Based on the history and development status of corporate governance theory, this essay chooses to compare stakeholder theory with shareholder primacy theory and team production theory.

This essay can be divided into three parts: (I) a thorough analysis of the stakeholder theory; (II) an analysis of the non-exploitative nature of the stakeholder theory; (III) an analysis of the significance of the stakeholder theory for the long-term success of stakeholders. We conclude that, at the theoretical and practical level, management under stakeholder theory is non-exploitative and helps build long-term success for stakeholders.

## 2. Stakeholder Theory

### 2.1. The Development of Stakeholder Theory

The origins of stakeholder theory can be traced back to the debate between Berle and Dodd on corporate social responsibility, which, in the context of the 1929 U.S. economic crisis, led to growing skepticism about the notion that making profits is the only goal of the corporations.[7] In 1963, the SRI introduced the concept of stakeholders,[8] expressing the relationship between corporations and stakeholders. Then, in 1965, Ansoff introduced the term stakeholder into the study of economics and in 1977, the Wharton School introduced stakeholder theory to the study of business management strategy.[9] Thereafter, stakeholder theory entered a phase of deeper research. In 1984, Freeman introduced stakeholder theory into management by acknowledging "the 'stakeholders' influence on a corporation.[10]" His research expanded knowledge of the connection between stakeholders and corporations and promoted the development of stakeholder theory in the field of corporate governance.

In recent years, stakeholder theory has gained more traction due to the changing economic environment, which has shown that the shareholder perspective is sometimes no longer appropriate and has led to various problems.[11] As Clarke points out "shareholder primacy leads to financialization and short-termism, undermines the sustainability of companies.[12]" In this context, the stakeholder theory is seen as more conducive to achieving long-term corporate success. As The UK Corporate Governance Code (2018) states: "Companies do not exist in isolation. Successful and sustainable businesses underpin our economy and society.[13]" Protecting the interests of corporate stakeholders is an important way to achieve sustainable long-term growth.

## 2.2. The Content of Stakeholder Theory and its Features

Stakeholder theory believes that the interests of the company are created by various participants and the core view is that: " Boards of directors should be accountable to all stakeholders, not just shareholders.[14]" Corporate governance should pursue the maximisation of the overall interests of the company.

One of the key issues of the stakeholder theory is what groups are included in "stakeholders". Originally SRI defined it as groups with a dependency on the company.[15] This definition indicates that stakeholders are seen as groups supported by the institution. Freeman believes that "the definition of stakeholders is based on consideration of the external environment and relationships of the firm".[16] Based on this conclusion, he defines a stakeholder as "any group or individual who can influence or is influenced by the achievement of the organization's goals".[17] In addition, Freeman also points out that "stakeholders can be divided into primary stakeholders and secondary stakeholders. The former includes groups and individuals who directly influence the corporation, while the latter includes indirect influencers such as the media and NGOs.[18]" By analysing these definitions, it can be found that the scope of stakeholders is not always the same and it will be adjusted in different business economic situations. For these different stakeholders, the stakeholder theory argues that we should protect their interests and consider stakeholders as a whole, hoping to meet the interests of different stakeholders simultaneously, rather than satisfying the interests of some stakeholders at the expense of others.[19]

# 3. Non-exploitative Feature of Stakeholder Theory

The above analysis gives us a deeper understanding of stakeholder theory, which we can use to analyze its non-exploitative and long-term success characteristics. In the following sections we will explain separately why management from a stakeholder perspective is non-exploitative and conducive to long-term success.

## 3.1. A Theoretical Analysis of the Non-exploitative Nature of Stakeholder Theory

The non-exploitative nature of the stakeholder theory is determined by its corporate governance objectives and its methods of management. Freeman began his study of stakeholder theory by asking the question: "For whose benefit and at whose cost should the firm be managed?[20]" The different answers to this question are the essence of the controversy between shareholder primacy theory and stakeholder theory. Specifically, the shareholder primacy theory is the basis of the principal-agent model,[21] which holds that "shareholders are the owners of the company,[22]" directors need to do their best to achieve the interests of shareholders, even at the expense of stakeholders. However, such governance decisions that pursue purely shareholder interests may lead to exploitation. Since the current corporate governance environment has changed. Directors need to pay more attention to the interests of stakeholders and realize that "the interests of stakeholders can be achieved simultaneously, there is no need to pursue the interests of shareholders at the expense of other stakeholders.[23]" Therefore, We need new theories to guide corporate governance practices.[24]

In contrast to the shareholder primacy theory, the stakeholder theory assumes that" companies need resources from different stakeholders to create value[25]" Which emphasises that the interests of all participants in the company's management under stakeholder theory affect the long-term success of the company, and "different stakeholders are not in conflict and their interests can be achieved simultaneously,[26]" so we don't have to exploit other stakeholders to achieve one side's interests. Specifically, more people than just shareholders can influence the firm's goal of maximising profits, "suppliers determine the quality of products, customers provide revenue for the firm, and the community grants the firm the right to build facilities.[27]" Balancing the interests of all parties is the best way to maximise the interests of the company. In this context, exploitation is greatly reduced, and management under stakeholder theory reflects its non-exploitative character.

In summary, at the theoretical level, the goal of stakeholder theory is to maximize the interests of the company, and the management approach is to balance the interests of all parties, which reflects non-exploitative characteristics. In the following subsection, this characteristics will be analysed at the practical level.

## 3.2. A Practical Analysis of the Non-exploitative Nature of Stakeholder Theory

The protection of stakeholders' interests makes stakeholder theory non-exploitative in practice as well. A pure interest perspective under the shareholder primacy theory " leads to financialization and short-termism.[28]" This has been demonstrated in many cases. For example, in the case of BP, in pursuit of profits, its employees and suppliers improperly cut costs, which has not only led to explosions and oil spill scandals that have harmed the interests of stakeholders, but also caused serious environmental damage.[29] On the surface, this appears to be due to poor decision-making by the directors, but in fact, these blind cost-cutting actions were supported by the company, indicating that it is only pursuing shareholder interests.[30] BP is not an isolated case. In Dodge vs. Ford Motor,[31] Dodge and Ford litigated a dividend dispute, with Ford arguing that the corporation's development funds could be obtained through price cuts, "the shareholders were making more than enough money, and it was not honourable to go after profits.[32]" He wanted to serve the community. At trial, the court ruled that "Ford had to pay the dividend to its shareholders instead of using it for humanitarian projects,[33]" a decision that indicated an attitude that the court at the time agreed that shareholder interests took precedence over other participants. And in recent years, in 2016, Volkswagen implanted special software in its engines to circumvent emissions inspections[34], the consequence of this action is that vehicles that seriously exceed emission standards are sold, causing great environmental pollution. The common feature that can be seen in these cases is that the pursuit of shareholders' interests brings about a detrimental effect on the interests of other participants, which can also be described as the exploitation of other stakeholders.

Management in stakeholder theory has been widely criticised for its lack of realistic feasibility, and many scholars believe that it is difficult to establish an effective balancing mechanism. However, there have been many studies and practical examples showing that firms that care more about the interests of their participants tend to further expand their market share and improve their performance. For example, Donaldson and Preston's research identified a link between the protection of stakeholder interests and firm performance, and that firms that pay more attention to stakeholder interests tend to perform better.[35] Moreover, David and Sillanpa conducted a study of various companies in Japan, the UK, and Europe, finding that "In North America, Europe, and the Far East, companies with engaged stakeholders are among the most successful businesses today.[36]" All of these studies show the practical guidance of stakeholder theory and that focusing on the interests of stakeholders will be able to enhance corporate reputation.

This section discusses the non-exploitative nature of stakeholder theory at both theoretical and practical levels. In the next section, this essay will describe the role of stakeholder theory in promoting long-term stakeholder success.

# 4. Long-term Success Feature of Stakeholder Theory

The non-exploitative nature of stakeholder theory is analyzed above, which not only allows the benefits of stakeholders to be better protected, but also allows the corporations to avoid short-sightedness and consider the corporations' development from the perspective of overall interests, which will be more conducive to the long-term success of the corporations.

## 4.1. A Theoretical Analysis of Stakeholder Theory Promotes Log-term Success

The important difference between stakeholder theory and team production theory is the different understanding of the middle class and stakeholders' participation in corporate governance. Stakeholder theory place more emphasis on stakeholders' participation, especially key stakeholders, in the hope of achieving their long-term success simultaneously.[37] Arguing that contractual relationships based on contracts are not sufficcent to protect stakeholders,[38] only by allowing stakeholders to truly participate in corporate governance can they play a better supervisory role and enable all stakeholders to succeed over time. However, team production theory believes that "the contribution of each team member is difficult to quantify, so a mediating class is needed to address this problem.[39]" Team production theory, emphasises the role of intermediaries, treating managers as professional agents and hoping to rely on a neutral body to monitor and balance interests for the success of corporate governance activities.

Despite the team production theory recognised that various stakeholders contribute to a company's profits, it relies excessively on industry experts and a class such as independent directors. However, under the principal-agent model, shareholders and management often have more power than neutral directors. Therefore, Neutrals may be more inclined or even forced to serve the interests of management and do not play a good monitoring role.[40] In addition, the monolithic nature of the board structure under the team production theory and the lack of participation of directors from different areas and genders makes it difficult to identify problems and balance interests.

Stakeholder theory can better address this issue by focusing on participation in corporate governance, especially for key stakeholders, this is because, in practice, key stakeholders will contribute more directly to value creation.[41] This can be reflected in Freeman's six principles of governance,[42] Whether it is the "access principle", the "governance principle" or the "externality principle", the underlying logic of them is to call on stakeholders to protect their interests and actively participate in corporate governance.[43] In addition, stakeholder theory also proposes "The stakeholder enabling principle" and "The principle of stakeholder responsibility[44]" as methods of enhancing the practicality of stakeholder participation in corporate governance. Under this mechanism, corporate performance affects and even determines the self-interest of stakeholders, motivating them to become more proactive in monitoring management behavior. This makes it more difficult for management to act in their personal interest and encourages them to work towards the overall benefits of the company, thus promoting a long-term win-win situation for all parties involved.

## 4.2. A Practical Analysis of Stakeholder Theory Promotes Log-term Success

The participatory nature of stakeholder theory is also more beneficial in practice to the long-term success of stakeholders. The team production theory relies too much on a professionally neutral class, but "directors are more like management's lapdogs than stakeholders' watchdogs.[45]" In many cases, management does not play the role of monitoring and balancing interests. They can be "short-term" to pursue management interests. The Enron scandal can be seen as a typical example of directors' failure.[46] Enron, went bankrupt in a matter of weeks, in addition to financial fraud and a failed audit by Arthur Andersen, independent directors were also to blame. Firstly, Enron's internal audit committee had a lack of independence.[47] Enron "allowed its internal audit committee's members to receive stock-based compensation,[48]" which makes the remuneration of independent directors subject to the performance of the company, so they will conceal Enron's financial failings to avoid a fall in the share price after the issue is announced.[49] In addition, The Companies Act 2006 requires that "A listed company should disclose the financial dealings of audit committee members,[50]" Enron, however, failed to disclose this, which seriously undermined the "substantive independence." Therefore, it can be seen that a neutral class is not always reliable, too much reliance may have an adverse impact on long-term success.

Stakeholder theory can contribute to the long-term success of a company by emphasising the involvement of all parties to avoid the problems of neutral directors. For example, Publix, "one of the largest supermarket chains in the United States, emphasising employee involvement and using employee ownership to establish a balance of interest mechanisms, protecting the interests of its employees and customers and hiring managers within the company.[51]" This approach has brought its great success, "Publix has beaten Wal-Mart to become the largest employee-owned supermarket and is well ahead of its competitors with a net profit margin of 5.6%.[52]" The essay argues that Publix's success largely reflects the participation in stakeholder theory is practical and contributes to long-term success, since rational people will try their best to avoid damage to their interests, this will motivate them to improve the level of supervision of corporate governance. And "the costs the corporation spend on protecting stakeholders participation can be far outweighed by the benefits stakeholders bring to them.[53]" Moreover, stakeholder theory emphasises the participation of all parties can promote the diversity of board members, which means that a wider range of stakeholders can be taken into account. For example, Catalyst reports that "companies with female executives give more to charity.[54]" These practices will enhance the company's reputation, thus contributing to its long-term success and a win-win situation for all parties.

On the other hand, it is important to note that many corporations make a distinction between primary stakeholders and secondary stakeholders[55], the focus on the interests of the key stakeholder, may result in other stakeholders not being well protected. This can be seen as an aspect of stakeholder theory that needs continuous research in the future in terms of promoting long-term stakeholder success.

In general, stakeholder theory is more conducive to promoting the long-term success of companies than team production theory, both in theory and in practice. However, it is undeniable that the stakeholder theory also has some flaws, so further research is needed.

# 5. Conclusion

Stakeholder theory has a profound impact on corporate governance in the UK. And return to the original question this essay concludes that on both theoretical and practical levels, management from a stakeholder perspective is non-exploitative and is conducive to long-term stakeholder success. In response to non-exploitation, compared with shareholder primacy theory, stakeholder theory places more emphasis on considering the interests of stakeholders as a whole, rather than exploiting some stakeholders to achieve the interests of shareholders. In response to long-term success, stakeholder theory emphasizes the participation of stakeholders rather than relying on a neutral class, as opposed to team production theory, and then builds a balance of values through stakeholder participation to achieve a win-win situation. It is undeniable that stakeholder theory also has some drawbacks, which calls for a greater focus on corporate governance structures in the future development of stakeholder theory.

The limitations of this essay are that stakeholder theory also suffers from many shortcomings such as a lack of clarity of key concepts and practical feasibility, and the perspective of this paper focuses on the comparative advantages of stakeholder theory, which lacks comprehensiveness. In response to this issue, this essay argues that there could be more research in the future on stakeholder deficiencies and comparative perspectives to help it achieve better corporate governance goals.

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