Sixteenth Edition

Business *and* Society

Stakeholders, Ethics, Public Policy

Anne T. Lawrence | James Weber

McGraw Hill Education

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Anne T. Lawrence
San José State University

James Weber
Duquesne University

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About the Authors

Anne T. Lawrence *San José State University*

Anne T. Lawrence is professor of management emerita at San José State University. She holds a Ph.D. from the University of California, Berkeley, and completed two years of post-doctoral study at Stanford University. Her articles, cases, and reviews have appeared in many journals, including the *Academy of Management Review, Administrative Science Quarterly, Case Research Journal, Journal of Management Education, California Management Review, Business and Society Review, Research in Corporate Social Performance and Policy, and Journal of Corporate Citizenship.* Her cases in business and society have been reprinted in many textbooks and anthologies. She has served as guest editor of the *Case Research Journal.* She served as president of both the North American Case Research Association (NACRA) and of the Western Casewriters Association and is a Fellow of NACRA, from which she received a Distinguished Contributor Award in 2014. She received the Emerson Center Award for Outstanding Case in Business Ethics (2004) and the Curtis E. Tate Award for Outstanding Case of the Year (1998, 2009, and 2015). At San José State University, she was named Outstanding Professor of the Year in 2005. In 2015, she received a Master Teacher in Ethics Award from The Wheatley Institution at Brigham Young University. She currently serves as chair of the board of the Case Research Foundation.

James Weber *Duquesne University*

James Weber is a professor of management and business ethics at Duquesne University, where he also serves as the managing director of the Institute for Ethics in Business. He holds a Ph.D. from the University of Pittsburgh and has taught at the University of San Francisco, University of Pittsburgh, and Marquette University. His areas of interest and research include personal, managerial, and organizational values and cognitive moral reasoning. His work has appeared in *Organization Science, Human Relations, Business & Society, Journal of Business Ethics, and Business Ethics Quarterly.* He received the SIM Sumner Marcus Award for lifetime contribution to the Social Issues in Management division of the Academy of Management in 2013 and the Best Reviewer Award from *Business & Society* in 2015. He was recognized by the Social Issues in Management division with the Best Paper Award in 1989 and 1994 and received the Best Article Award from the International Association for Business and Society in 1998. He has served as division and program chair of the Social Issues in Management division of the Academy of Management. He has also served as president and program chair of the International Association of Business and Society (IABS).

Preface

In a world economy that is becoming increasingly integrated and interdependent, the relationship between business and society is becoming ever more complex. The globalization of business, the emergence of civil society organizations in many nations, and rapidly changing government regulations and international agreements have significantly altered the job of managers and the nature of strategic decision making within the firm.

At no time has business faced greater public scrutiny or more urgent demands to act in an ethical and socially responsible manner than at the present. Consider the following:

- The rise of populist and nationalist political leaders in the United States and parts of Europe and the Middle East have led to renewed debates on the proper role of government in regulating business and protecting stakeholders. As environmental, financial, employment, and consumer regulations have been rolled back, particularly in the United States, businesses have had to choose whether to take advantage of loosened rules or to follow a strategy of voluntary corporate responsibility. Long-standing trade relationships have been upended by tariffs and other barriers on imports, helping some businesses and hurting others. Changing immigration policy has required firms to rethink their policies toward their foreign-born workers, including so-called Dreamers brought to the United States illegally as children. In this rapidly changing environment, business firms have been challenged to manage in a way that remains consistent with their values.
- A host of new technologies have become part of the everyday lives of billions of the world's people. Advances in the basic sciences are stimulating extraordinary changes in agriculture, telecommunications, transportation, and pharmaceuticals, which have the potential to enhance peoples' health and quality of life. Artificial intelligence can be used to drive vehicles, diagnose illnesses, and manage investments. Technology has changed how we interact with others, bringing people closer together through social networking, instant messaging, and photo and video sharing. These innovations hold great promise. But they also raise serious ethical issues, such as those associated with the use of the Internet to exploit or defraud others, censor free expression, or invade individuals' privacy. Businesses must learn to harness powerful technologies for good, while acting responsibly and ethically toward their many stakeholders.
- Businesses in the United States and other nations are transforming the employment relationship, abandoning practices that once provided job security and guaranteed pensions in favor of highly flexible but less secure forms of employment. The rise of the "gig" economy has transformed many workers into self-employed contractors. Many jobs, including those in the service sector, are being outsourced to the emerging economies of China, India, and other nations. As jobs shift abroad, multinational corporations are challenged to address their obligations to workers in far-flung locations with very different cultures and to respond to initiatives, like the Responsible Business Alliance Code of Conduct, which call for voluntary commitment to enlightened labor standards and human rights. The #MeToo movement has focused a spotlight on sexual harassment and abusive behavior in the workplace, and led to the fall of well-known executives and media personalities and calls for change in workplace culture.
- Severe weather events—hurricanes, floods, and wildfires—have urgently focused attention on the human impact on natural systems, prompting both businesses and

governments to act. An emerging consensus about the causes and risks of climate change is leading many companies to adopt new practices, and once again the nations of the world have experimented with public policies designed to limit the emissions of greenhouse gases, most notably in the Paris Agreement. Many businesses have cut air pollution, curbed solid waste, and designed products and buildings to be more energy-efficient, saving money in the process. A better understanding of how human activities affect natural resources is producing a growing understanding that economic growth must be achieved in balance with environmental protection if development is to be sustainable.

- Many regions of the world and its nations are developing at an extraordinary rate. Yet, the prosperity that accompanies economic growth is not shared equally. Access to health care, adequate nutrition, and education remain unevenly distributed among and within the world's nations, and inequalities of wealth and income have become greater than they have been in many years. These trends have challenged businesses to consider the impact of their compensation, recruitment, and professional development practices on the persistent—and in some cases, growing—gap between the haves and the have-nots. Big corporate tax cuts in the United States have required companies to decide whether to distribute their windfalls to their executives, shareholders, employees, or customers; to invest in new jobs; or to buy back stock.
- The opioid epidemic has focused attention on the role of drug companies, distributors, and pharmacies—as well as government regulators—in contributing to the scourge of addiction, disability, and death caused by narcotics. The continuing pandemic of AIDS in sub-Saharan Africa and the threat of a swine or avian flu, the Zika virus, or another Ebola outbreak have compelled drug makers to rethink both their pricing policies and their research priorities. Many businesses must consider the delicate balance between their intellectual property rights and the urgent demands of public health, particularly in the developing world.
- In many nations, legislators have questioned business's influence on politics. Business has a legitimate role to play in the public policy process, but it has on occasion shaded over into undue influence and even corruption. Technology offers candidates and political parties new ways to reach out and inform potential voters, but it has also created new opportunities for manipulation of the electoral process through deceptive messaging. Businesses the world over are challenged to determine their legitimate scope of influence and how to voice their interests most effectively in the public policy process.

The new Sixteenth Edition of *Business and Society* addresses this complex agenda of issues and their impact on business and its stakeholders. It is designed to be the required textbook in an undergraduate or graduate course in Business and Society; Business, Government, and Society; Social Issues in Management; or the Environment of Business. It may also be used, in whole or in part, in courses in Business Ethics and Public Affairs Management. This new edition of the text is also appropriate for an undergraduate sociology course that focuses on the role of business in society or on contemporary issues in business.

The core argument of *Business and Society* is that corporations serve a broad public purpose: to create value for society. All companies must make a profit for their owners. Indeed, if they did not, they would not long survive. However, corporations create many other kinds of value as well. They are responsible for professional development for their employees, innovative new products for their customers, and generosity to their communities. They must partner with a wide range of individuals and groups in society to advance collaborative goals. In our view, corporations have multiple obligations, and all stakeholders' interests must be considered.

A Tradition of Excellence

Since the 1960s, when Professors Keith Davis and Robert Blomstrom wrote the first edition of this book, *Business and Society* has maintained a position of leadership by discussing central issues of corporate social performance in a form that students and faculty have found engaging and stimulating. The leadership of the two founding authors, and later of Professors William C. Frederick and James E. Post, helped *Business and Society* to achieve a consistently high standard of quality and market acceptance. Thanks to these authors' remarkable eye for the emerging issues that shape the organizational, social, and public policy environments in which students will soon live and work, the book has added value to the business education of many thousands of students.

Business and Society has continued through several successive author teams to be the market leader in its field. The current authors bring a broad background of business and society research, teaching, consulting, and case development to the ongoing evolution of the text. The new Sixteenth Edition of *Business and Society* builds on its legacy of market leadership by reexamining such central issues as the role of business in society, the nature of corporate responsibility and global citizenship, business ethics practices, and the complex roles of government and business in a global community.

For Instructors

For instructors, this textbook offers a complete set of supplements.

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For Students

Business and Society has long been popular with students because of its lively writing, up-to-date examples, and clear explanations of theory. This textbook has benefited greatly from feedback over the years from thousands of students who have used the material in the authors' own classrooms. Its strengths are in many ways a testimony to the students who have used earlier generations of *Business and Society.*

The new Sixteenth Edition of the text is designed to be as student-friendly as always. Each chapter opens with a list of key learning objectives to help focus student reading and study. Numerous figures, exhibits, and real-world business examples (set as blocks of colored type) illustrate and elaborate the main points. A glossary at the end of the book provides definitions for bold-faced and other important terms. Internet references and a full section-by-section bibliography guide students who wish to do further research on topics of their choice, and subject and name indexes help students locate items in the book.

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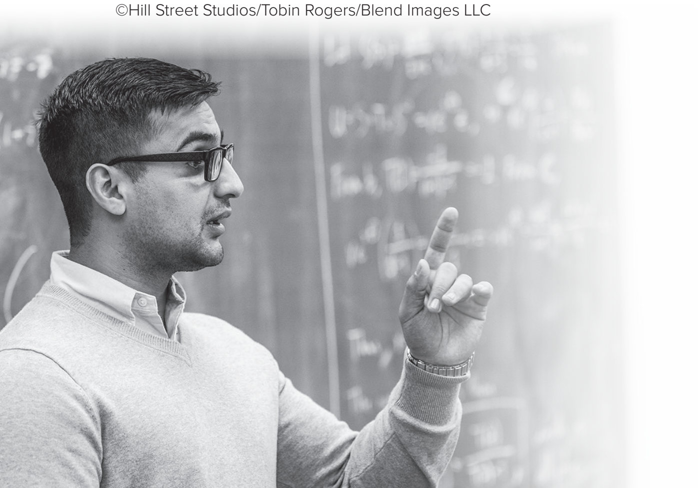

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For Students

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- Jordan Cunningham,
Eastern Washington University

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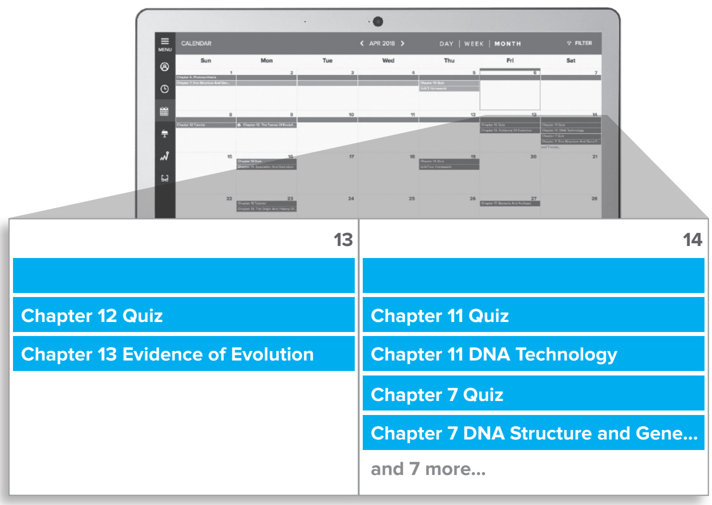

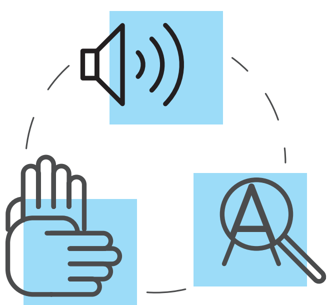

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New for the Sixteenth Edition

Over the years, the issues addressed by *Business and Society* have changed as the environment of business itself has been transformed. This Sixteenth Edition is no exception, as readers will discover. Some issues have become less compelling and others have taken their place on the business agenda, while others have endured through the years.

The Sixteenth Edition has been thoroughly revised and updated to reflect the latest theoretical work in the field and statistical data, as well as recent events. Among the new additions are:

- New discussion of theoretical advances in stakeholder theory, corporate citizenship, public affairs management, public and private regulation, corporate governance, social and environmental auditing, social investing, reputation management, business partnerships, supply chain codes of conduct, social entrepreneurship, and corporate philanthropy.
- Treatment of practical issues, such as social networking, artificial intelligence and robotics, gender diversity, political advertising and campaign contributions, public and media relations, well as the latest developments in the regulatory environment in which businesses operate.
- New discussion cases and full-length cases on such timely topics as the role of business in the unfolding opioid crisis, Wells Fargo's unauthorized consumer accounts, the Volkswagen diesel emissions scandal, the aftermath of the BP disaster in the Gulf of Mexico, the massive Equifax data breach, the consumer boycott of Stoli vodka, the business response to the movement for school safety, LaFarge's dealings in the Syrian war zone, the potential regulation of Facebook in the United States and Europe, political action by the U.S. steel industry on the issue of tariffs, the rise of autonomous vehicles, law enforcement access to mobile phone data, executive misconduct at Wynn Resorts, business response to the threat to "Dreamers," IKEA's sustainable supply chain, Salesforce's integrated philanthropy, and social media criticism of United Airlines.

Finally, this is a book with a vision. It is not simply a compendium of information and ideas. The new edition of *Business and Society* articulates the view that in a global community, where traditional buffers no longer protect business from external change, managers can create strategies that integrate stakeholder interests, respect personal values, support community development, and are implemented fairly. Most important, businesses can achieve these goals while also being economically successful. Indeed, this may be the *only* way to achieve economic success over the long term.

Anne T. Lawrence
James Weber

Acknowledgments

We are grateful for the assistance of many colleagues at universities in the United States and abroad who over the years have helped shape this book with their excellent suggestions and ideas. We also note the feedback from students in our classes and at other colleges and universities that has helped make this book as user-friendly as possible.

We especially wish to thank two esteemed colleagues who made special contributions to this edition. David M. Wasieleski, professor of management and business ethics at Duquesne University, led the revisions of Chapters 5 and 6, to which he contributed his knowledge of ethics theory and organizational practice. Vanessa D. Hill, associate professor of management at the University of Louisiana at Lafayette, generously shared with us her expertise on the employment relationship and workplace diversity and inclusion. She was the lead author of Chapters 15 and 16, which have greatly benefited from her insights. For these contributions, we are most grateful.

We also wish to express our appreciation for the colleagues who provided detailed reviews for this edition. These reviewers were Hossein Bidgoli, California State University, Bakersfield; Ryan Fehr, Foster School of Business, University of Washington, Seattle; Scott Jeffrey, Monmouth University; Eun-Hee Kim, Gabelli School of Business, Fordham University; Jet Mboga, William Paterson University; Stephen P. Preacher, Southern Wesleyan University; and A. J. Stagliano, Saint Joseph's University. Their insights helped guide our revision.

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These scholars' dedication to the creative teaching of business and society has been a continuing inspiration to us.

We wish to express our appreciation to James E. Post, a former author of this book, who has continued to offer valuable intellectual guidance to this project. We also wish to note, with sadness and gratitude, the passing of our mentor and a former author of this book, William C. Frederick, in 2018. His ideas live on in this book.

We continue to be grateful to the excellent editorial and production team at McGraw-Hill. We offer special thanks to Laura Hurst Spell, our associate portfolio manager, for her skillful leadership of this project. We also wish to recognize the able assistance of Marla Sussman, executive editor, and of Jeni McAtee, content project manager, whose ability to keep us on track and on time has been critical. Lisa Granger headed the excellent marketing team. Katie Reuter, content project manager (assessment); Susan K. Culbertson, buyer; Richard Wright, copy editor; Traci Vaske, content licensing specialist; and Jessica Cuevas, who designed the book cover, also played key roles. Each of these people has provided professional contributions that we deeply value and appreciate.

As always, we are profoundly grateful for the ongoing support of our spouses, Paul Roose and Sharon Green.

Anne T. Lawrence

James Weber

Brief Contents

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PART ONE

Business in Society

CHAPTER ONE

The Corporation and Its Stakeholders

Business corporations have complex relationships with many individuals and organizations in society. The term *stakeholder* refers to all those that affect, or are affected by, the actions of the firm. An important part of management's role is to identify a firm's relevant stakeholders and understand the nature of their interests, power, and alliances with one another. Building positive and mutually beneficial relationships across organizational boundaries can help enhance a company's reputation and address critical social and ethical challenges. In a world of fast-paced globalization, shifting public expectations and government policies, growing ecological concerns, and new technologies, managers face the difficult challenge of achieving economic results while simultaneously creating value for all of their diverse stakeholders.

This Chapter Focuses on These Key Learning Objectives:

LO 1-1 Understanding the relationship between business and society and the ways in which business and society are part of an interactive system.

LO 1-2 Considering the purpose of the modern corporation.

LO 1-3 Knowing what a stakeholder is and who a corporation's market and nonmarket and internal and external stakeholders are.

LO 1-4 Conducting a stakeholder analysis and understanding the basis of stakeholder interests and power.

LO 1-5 Recognizing the diverse ways in which modern corporations organize internally to interact with various stakeholders.

LO 1-6 Analyzing the forces of change that continually reshape the business and society relationship.

Amazon—which some have called the "Earth's biggest store"—is an important part of many of our lives. We browse on Amazon, watch on Amazon, and buy on Amazon. We freely disclose to Amazon our wishes, interests, and willingness to pay. You may well have purchased or rented this textbook from Amazon.

In 2018, Amazon was the largest Internet retailer in the world, measured both by annual revenue ($178 billion) and market capitalization (more than $800 billion). It was the second largest private employer in the United States (after Walmart), with more than 540,000 employees (not counting the additional 120,000 or so temporary workers the company brought on each year during the busy holiday season).[1] From its start in 1994 as a scrappy Seattle start-up selling books online, Amazon had grown at an astonishing pace; in 2017, Amazon was responsible for fully 70 percent of all growth in U.S. online commerce.[2] By 2018, the company's founder and CEO, Jeff Bezos, had become the world's richest person, with a net worth greater than $100 billion.[3] Shareholders in the company had been richly rewarded; in early 2018, the price of Amazon's stock was more than 12 times higher than it had been a decade earlier. The company was enormously popular with consumers, who turned to Amazon for one-click convenience, free and speedy delivery, and the ability to compare a seemingly endless assortment of products on the basis of price and reviews. Small businesses affiliated with Amazon Marketplace were able to tap into the company's global e-commerce platform and unrivaled logistics to reach customers they never could have reached before. No doubt, many had benefited from Amazon's success.

Yet the company had also become the target of criticism from many quarters, charged with destroying brick-and-mortar businesses, relentlessly driving their own employees, unfairly besting competitors, and pressuring communities for concessions. Consider that:

- Much of Amazon's success had come at the expense of brick-and-mortar stores. Iconic retailers—such as Macy's, JCPenney, and Target—had shed thousands of jobs as Amazon attracted ever-larger slices of consumer spending. A leading economist calculated that the rise of online commerce had caused the cumulative loss of 1.2 million retailing jobs—positions such as cashiers, salespeople, and stock clerks—in the United States.[4] Many of these jobs were held by women and minorities (who made up 60 percent and 40 percent, respectively, of department store employees).[5] Traditional retailing, concluded Scott Galloway, the author of *The Four: The Hidden DNA of Amazon, Apple, Facebook, and Google,* had been "ravaged and depopulated by a single player"—Amazon.[6]
- Amazon's own employees, by some accounts, were subject to an unusually punishing work culture. An investigative report by *The New York Times,* based on interviews with more than 100 current and former white-collar employees, found a pattern of setting "unreasonably high" performance standards, continually monitoring performance, and weeding out employees in a "rank and yank" system that one called "purposeful Darwinism." Turnover rates were among the highest in the Fortune 500. Said one former marketer, "Amazon is where overachievers go to feel bad about themselves."[7]

[1] "Amazon Is Now the Size of a Small Country," *Business Insider,* January 16, 2018.

[2] "U.S. E-Commerce Sales Grow 16.0% in 2017," *Internet Retailer,* at *www.digitalcommerce360.com*, February 16, 2018.

[3] "Jeff Bezos Is Now the Richest Person in History," *http://money.cnn.com*, January 9, 2018.

[4] Michael Feroli, chief U.S. economist at J.P. Morgan, cited in "Amazon to Add 100,000 Jobs as Brick-and-Mortar Retail Crumbles," *The New York Times,* January 12, 2017.

[5] "The Silent Crisis of Retail Employment," *The Atlantic,* April 18, 2017, and "Decline in Retail Jobs Felt Entirely by Women," *Institute for Women's Policy Research,* December 2017.

[6] Scott Galloway, *The Four:* Scott Galloway, *The Four: The Hidden DNA of Amazon, Apple, Facebook, and Google* (New York: Penguin, 2017), Chapter 2.

[7] "Inside Amazon: Wrestling Big Ideas in a Bruising Workplace," *The New York Times,* August 15, 2015.

- Amazon's control of both online and voice-activated search gave it powerful advantages—leading to what some saw as unfair competition. One study found that under some conditions, products displayed under "customers who bought this item also bought" were dominated by Amazon's own private-label brands.[8] Alexa, Amazon's voice-activated virtual assistant on Echo and other digital devices, also gave the company an edge. The consulting firm Bain & Company found that Alexa's recommendations were biased toward "Amazon's Choice" and the company's own private-label products (after products the customer had previously ordered). "The 'endless aisle' just got a lot smaller," Bain concluded.[9]
- In 2017, Amazon announced it would invest $5 billion to open a second North American headquarters outside Seattle, promising to create 50,000 new jobs paying $100,000 or more. This was a tantalizing prospect, and 238 cities and regions submitted proposals, with at least six offering financial incentives of $1 billion or more. Some public officials thought this was well worth it, but others thought taxpayer money should not be used to subsidize such a successful company. "Blindly giving away the farm isn't our style," said the mayor of San Antonio, Texas, which dropped out of the race.[10]

Amazon's experience illustrates, on a particularly large scale, the challenges of managing successfully in a complex network of stakeholders. The company's actions affected not only itself, but also many other people, groups, and organizations in society. Customers, employees, business partners and suppliers, competitors, shareholders, creditors, governments, and local communities all had a stake in Amazon's decisions.

Every modern company, whether small or large, is part of a vast global business system. Whether a firm has 50 employees or, like Amazon, more than half a million—its links to customers, suppliers, employees, and communities are certain to be numerous, diverse, and vital to its success. This is why the relationship between business and society is important for you to understand as both a citizen and a manager.

Business and Society

Business today is arguably the most dominant institution in the world. The term *business* refers here to any organization that is engaged in making a product or providing a service for a profit. Consider that in the United States today there are 6 million businesses, according to government estimates, and in the world as a whole, there are uncounted millions more. Of course, these businesses vary greatly in size and impact. They range from a woman who helps support her family by selling handmade tortillas by the side of the road in Mexico City for a few pesos, to ExxonMobil, a huge corporation that employs almost 75,000 workers and earns annual revenues approaching $237 billion in almost every nation in the world.

Society, in its broadest sense, refers to human beings and to the social structures they collectively create. In a more specific sense, the term is used to refer to segments of humankind, such as members of a particular community, nation, or interest group. As a set of organizations created by humans, business is clearly a part of society. At the same time, it is also a distinct entity, separated from the rest of society by clear boundaries. Business

[8] "The Antitrust Case Against Facebook, Google, and Amazon," *The Wall Street Journal,* January 16, 2018, and "How Amazon Steers Shoppers to Its Own Products," *The Wall Street Journal,* June 23, 2018; see also Galloway, op. cit.

[9] "Dreaming of an Amazon Christmas?" Bain & Company, November 9, 2017.

[10] "Amazon Just Revealed the Top Cities for HQ2—Here Are the Ones Throwing Hundreds of Millions to Land It," *Business Insider,* January 18, 2018, and "As Cities Woo Amazon to Build Second Headquarters, Incentives Are Key," *The Wall Street Journal,* October 19, 2017.

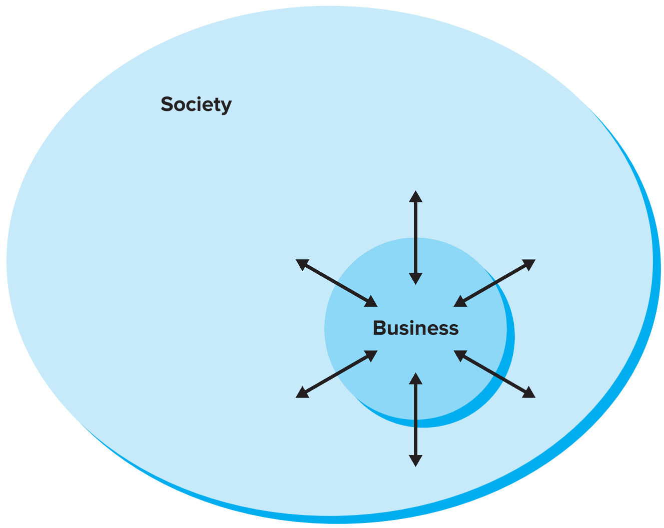

FIGURE 1.1
Business and Society: An Interactive System

is engaged in ongoing exchanges with its external environment across these dividing lines. For example, businesses recruit workers, buy supplies, and borrow money; they also sell products, donate time, and pay taxes. This book is broadly concerned with the relationship between business and society. A simple diagram of the relationship between the two appears in Figure 1.1.

As the Amazon example that opened this chapter illustrates, business and society are highly interdependent. Business activities impact other activities in society, and actions by various social actors and governments continuously affect business. To manage these interdependencies, managers need an understanding of their company's key relationships and how the social and economic system of which they are a part affects, and is affected by, their decisions.

A Systems Perspective

General systems theory, first introduced in the 1940s, argues that all organisms are open to, and interact with, their external environments. Although most organisms have clear boundaries, they cannot be understood in isolation, but only in relationship to their surroundings. This simple but powerful idea can be applied to many disciplines. For example, in botany, the growth of a plant cannot be explained without reference to soil, light, oxygen, moisture, and other characteristics of its environment. As applied to management theory, the systems concept implies that business firms (social organisms) are embedded in a broader social structure (external environment) with which they constantly interact. Corporations have ongoing boundary exchanges with customers, governments, competitors, suppliers, communities, and many other individuals and groups. Just as good soil, water, and light help a plant grow, positive interactions with society benefit a business firm.

Like biological organisms, moreover, businesses must adapt to changes in the environment. Plants growing in low-moisture environments must develop survival strategies, like the cactus that evolves to store water in its leaves. Similarly, a telecommunications company in a newly deregulated market must learn to compete by changing the products and services it offers. The key to business survival is often this ability to adapt effectively to changing conditions. In business, systems theory provides a powerful tool to help managers conceptualize the relationship between their companies and their external environments.

Systems theory helps us understand how business and society, taken together, form an **interactive social system**. Each needs the other, and each influences the other. They are entwined so completely that any action taken by one will surely affect the other. They are both separate and connected. Business is part of society, and society penetrates far and often into business decisions. In a world where global communication is rapidly expanding, the connections are closer than ever before. Throughout this book we discuss examples of organizations and people that are grappling with the challenges of, and helping to shape, business–society relationships.

The Stakeholder Theory of the Firm

What is the purpose of the modern corporation? To whom, or what, should the firm be responsible?[11] No question is more central to the relationship between business and society.

In the **shareholder theory of the firm** (sometimes also called the ownership theory), the firm is seen as the property of its owners. The purpose of the firm is to maximize its long-term market value, that is, to make the most money it can for shareholders who own stock in the company. Managers and boards of directors are agents of shareholders and have no obligations to others, other than those directly specified by law. In this view, owners' interests are paramount and take precedence over the interests of others.

A contrasting view, called the **stakeholder theory of the firm**, argues that corporations serve a broad public purpose: to create value for society. All companies must make a profit for their owners; indeed, if they did not, they would not long survive. However, corporations create many other kinds of value as well, such as professional development for their employees and innovative new products for their customers. In this view, corporations have multiple obligations, and all stakeholders' interests must be taken into account. This perspective was well expressed by Laurence Fink, the CEO of BlackRock, a global firm that manages more than $5 trillion worth of assets for its clients. In his 2018 letter to CEOs, Fink stated that ". . . every company must not only deliver financial performance, but also show how it makes a positive contribution to society. Companies must benefit all of their stakeholders, including shareholders, employees, customers, and the communities in which they operate."[12]

Supporters of the stakeholder theory of the firm make three core arguments for their position: *descriptive, instrumental,* and *normative.*[13]

The *descriptive argument* says that the stakeholder view is simply a more realistic description of how companies really work. Managers have to pay keen attention, of course, to their quarterly and annual financial performance. Keeping Wall Street satisfied by managing for growth—thereby attracting more investors and increasing the stock price—is a core part of any top manager's job. But the job of management is much more complex than this. In order to produce consistent results, managers have to be concerned with producing high-quality and innovative products and services for their customers, attracting

[11] For summaries of contrasting theories of the purpose of the firm, see Margaret M. Blair, "Whose Interests Should Corporations Serve," in Margaret M. Blair and Bruce K. MacLaury, *Ownership and Control: Rethinking Corporate Governance for the Twenty-First Century* (Washington, DC: Brookings Institution, 1995), Ch. 6, pp. 202–34; and James E. Post, Lee E. Preston, and Sybille Sachs, *Redefining the Corporation: Stakeholder Management and Organizational Wealth* (Palo Alto, CA: Stanford University Press, 2002).

[12] "Larry Fink's Annual [2018] Letter to CEOs: A Sense of Purpose," at *www.blackrock.com*.

[13] The descriptive, instrumental, and normative arguments are summarized in Thomas Donaldson and Lee E. Preston, "The Stakeholder Theory of the Corporation: Concepts, Evidence and Implications," *Academy of Management Review* 20, no. 1 (1995), pp. 65–71. See also, Post, Preston, and Sachs, *Redefining the Corporation,* Ch. 1.

and retaining talented employees, and complying with a plethora of complex government regulations. As a practical matter, managers direct their energies toward all stakeholders, not just owners.

> In what became known as the "dollar store wars," two companies made competing bids to buy Family Dollar, a U.S. discount retail chain based in Charlotte, North Carolina—each with very different consequences for stakeholders. One suitor, Dollar Tree, offered $76.50 per share for the company, while the other, Dollar General, offered $80—seemingly a better deal for shareholders. But the Dollar General deal faced likely government antitrust scrutiny and would probably have required the closure of thousands of stores, throwing employees out of work and depriving low-income communities of access to a discount store. In the end, after considering the impact on all stakeholders, Family Dollar's management recommended the lower-priced offer, and three-quarters of its shareholders agreed.[14]

The *instrumental argument* says that stakeholder management is more effective as a corporate strategy. A wide range of studies have shown that companies that behave responsibly toward multiple stakeholder groups perform better financially, over the long run, than those that do not. (This empirical evidence is further explored in Chapter 3.) These findings make sense, because good relationships with stakeholders are themselves a source of value for the firm. Attention to stakeholders' rights and concerns can help produce motivated employees, satisfied customers, committed suppliers, and supportive communities, all good for the company's bottom line.

The *normative argument* says that stakeholder management is simply the right thing to do. Corporations have great power and control vast resources; these privileges carry with them a duty toward all those affected by a corporation's actions. Moreover, all stakeholders, not just owners, contribute something of value to the corporation. A skilled engineer at Microsoft who applies his or her creativity to solving a difficult programming problem has made a kind of investment in the company, even if it is not a monetary investment. Any individual or group who makes a contribution, or takes a risk, has a moral right to some claim on the corporation's rewards.[15]

A basis for both the shareholder and stakeholder theories of the firm exists in law. The legal term *fiduciary* means a person who exercises power on behalf of another, that is, who acts as the other's agent. In U.S. law, managers are considered fiduciaries of the owners of the firm (its shareholders) and have an obligation to run the business in their interest. These legal concepts are clearly consistent with the shareholder theory of the firm. However, other laws and court cases have given managers broad latitude in the exercise of their fiduciary duties. In the United States (where corporations are chartered not by the federal government but by the states), most states have passed laws that permit managers to take into consideration a wide range of other stakeholders' interests, including those of employees, customers, creditors, suppliers, and communities. (Benefit corporations, firms with a special legal status that obligates them to do so, are further discussed in Chapter 3.)

[14] "Family Dollar Shareholders Approve Sale to Dollar Tree," *Charlotte Observer,* January 22, 2015.

[15] Abe Zakhem and Daniel E. Palmer, "Normative Stakeholder Theory," in David M. Wasieleski and James Weber (eds.), *Stakeholder Management, Business and Society 360: Volume 1,* pages 49–74 (Bingley, United Kingdom: Emerald Publishing Ltd., 2017). Another formulation of this point has been offered by Robert Phillips, who argues for a principle of stakeholder fairness. This states that "when people are engaged in a cooperative effort and the benefits of this cooperative effort are accepted, obligations are created on the part of the group accepting the benefit" [i.e., the business firm]. Robert Phillips, *Stakeholder Theory and Organizational Ethics* (San Francisco: Berrett-Koehler, 2003), p. 9 and Ch. 5.

In addition, many federal laws extend specific protections to various groups of stakeholders, such as those that prohibit discrimination against employees or grant consumers the right to sue if harmed by a product.

In other nations, the legal rights of nonowner stakeholders are often more fully developed than in the United States. For example, a number of European countries—including Germany, Norway, Austria, Denmark, Finland, and Sweden—require public companies to include employee members on their boards of directors, so that their interests will be explicitly represented. Under the European Union's so-called harmonization statutes, managers are specifically permitted to take into account the interests of customers, employees, creditors, and others.

In short, while the law requires managers to act on behalf of shareholders, it also gives them wide discretion—and in some instances requires them—to manage on behalf of the full range of stakeholder groups. The next section provides a more formal definition and an expanded discussion of the stakeholder concept.

The Stakeholder Concept

The term **stakeholder** refers to persons and groups that affect, or are affected by, an organization's decisions, policies, and operations.[16] The word *stake* originally meant a pointed stick or post. The word later became used as a verb, as when a person was said to mark territory with a stake to assert ownership—that is, to stake a claim.[17] In the context of management theory, *stake* is used more abstractly to mean an interest in—or claim on—a business enterprise. Those with a stake in the firm's actions include such diverse groups as customers, employees, shareholders (also called stockholders), governments, suppliers, professional and trade associations, social and environmental activists, and nongovernmental organizations. The term *stakeholder* is not the same as *stockholder,* although the words sound similar. Stockholders—individuals or organizations that own shares of a company's stock—are one of several kinds of stakeholders.

Business organizations are embedded in networks involving many participants. Each of these participants has a relationship with the firm, based on ongoing interactions. Each of them shares, to some degree, in both the risks and rewards of the firm's activities. And each has some kind of claim on the firm's resources and attention, based on law, moral right, or both. The number of these stakeholders and the variety of their interests can be large, making a company's decisions very complex, as the Amazon example illustrates.

Managers make good decisions when they pay attention to the effects of their decisions on stakeholders, as well as stakeholders' effects on the company. On the positive side, strong relationships between a corporation and its stakeholders are an asset that adds value. On the negative side, some companies disregard stakeholders' interests, either out of the belief that the stakeholder is wrong or out of the misguided notion that an unhappy customer, employee, or regulator does not matter. Such attitudes often prove costly to the company involved. Today, for example, companies know that they cannot locate a factory or store in a community that strongly objects. They also know that making a product that is perceived as unsafe invites lawsuits and jeopardizes market share.

[16] The term *stakeholder* was first introduced in 1963 but was not widely used in the management literature until the publication of R. Edward Freeman's *Strategic Management: A Stakeholder Approach* (Marshfield, MA: Pitman, 1984). For a comprehensive review of the stakeholder management literature, see Samantha Miles, "Stakeholder Theory Classification, Definitions and Essential Contestability," in David M. Wasieleski and James Weber (eds.) *Stakeholder Management, Business and Society 360: Volume 1,* pages 21–48 (Bingley, United Kingdom: Emerald Publishing Limited, 2017).

[17] "Origin and Meaning of Stake," Online Etymology Dictionary, at *www.etymonline.com*.

Exhibit 1.A

Are Managers Stakeholders?

Are managers, especially top executives, stakeholders? This has been a contentious issue in stakeholder theory.

On one hand, the answer clearly is "yes" Like other stakeholders, managers are impacted by the firm's decisions. As employees of the firm, managers receive compensation—often very generous compensation, as shown in Chapter 13. Their managerial roles confer opportunities for professional advancement, social status, and power over others. Managers benefit from the company's success and are hurt by its failure. For these reasons, they might properly be classified as employees.

On the other hand, top executives are agents of the firm and are responsible for acting on its behalf. In the stakeholder theory of the firm, their role is to integrate stakeholder interests, rather than to promote their own more narrow, selfish goals. For these reasons, they might properly be classified as representatives of the firm itself, rather than as one of its stakeholders.

Management theory has long recognized that these two roles of managers potentially conflict. The main job of executives is to act for the company, but all too often they act primarily for themselves. Consider, for example, the many top executives of Lehman Brothers, MF Global, and Merrrill Lynch, who enriched themselves personally at the expense of shareholders, employees, customers, and other stakeholders. The challenge of persuading top managers to act in the firm's best interest is further discussed in Chapter 13.

Different Kinds of Stakeholders

Business interacts with society in many diverse ways, and a company's relationships with various stakeholders differ.

Market stakeholders are those that engage in economic transactions with the company as it carries out its purpose of providing society with goods and services. Each relationship between a business and one of its market stakeholders is based on a unique transaction, or two-way exchange. Shareholders invest in the firm and in return receive the potential for dividends and capital gains. Creditors loan money and collect payments of interest and principal. Employees contribute their skills and knowledge in exchange for wages, benefits, and the opportunity for personal satisfaction and professional development. In return for payment, suppliers provide raw materials, energy, services, finished products, and other inputs; and wholesalers, distributors, and retailers engage in market transactions with the firm as they help move the product from plant to sales outlets to customers. All businesses need customers who are willing to buy their products or services.

The puzzling question of whether or not managers should be classified as stakeholders along with other employees is discussed in Exhibit 1.A.

Nonmarket stakeholders, by contrast, are people and groups who—although they do not engage in direct economic exchange with the firm—are nonetheless affected by or can affect its actions. Nonmarket stakeholders include the community, various levels of government, nongovernmental organizations, business support groups, competitors, and the general public. Nonmarket stakeholders are not necessarily less important than others, simply because they do not engage in direct economic exchange with a business. On the contrary, interactions with such groups can be critical to a firm's success or failure, as shown in the following example.

> In late 2017, a company called Energy Management Inc. (EMI) said it would finally call off its sixteen-year effort to build a wind farm off the shore of Cape Cod, Massachusetts, to supply clean, renewable power to New England customers. The project, called Cape Wind, had generated intense opposition from residents of Cape