New Models of Business in Society [1]

There's lots of change going on all around the world. More and more people are becoming entrepreneurs. More and more people are becoming involved in business, and inventing lots of ways to make a business successful, from small businesses to very large businesses. And, I believe at least, that you can make a difference.

Business in Society: The Problem

We can be the generation that makes business better. But we need a revolution!

Now, don't worry, this revolution isn't about guns or anything like that, but we need a conscious conceptual revolution. **A revolution about ideas**. We need nothing less than a different way, or different ways to think about business; we need a way to think about business that enables us to be at our best.

The overall argument here is that the standard story about business, the dominant in cultures across the world, frankly isn't very useful anymore. In the world of the 21st century there are at least four flaws in this current approach.

I'm going to suggest we go in a different direction because the good news is there are lots of alternatives to this standard story that are emerging. But first, I need to do two things. I need to tell you what a narrative or standard story is, and I need to tell you what I think the standard story about business is.

Well, there are six key assumptions in this old narrative of business.

- The first one is that **business is primarily about economics**. It's about making money and profits and it's not about being connected to other institutions in society. Business is a sort of stands alone in something like a free market land, wherever that happens to be. And when you think about business you think about money and profits.
- The second key assumption is that **the only constituency that really matters are shareholders**. Why? Because they're the ones who care about money and profits. We don't care so much about others who are affected by business. It's shareholders that matter.
- The third assumption is that **we live in a world of mostly unlimited physical resources**. So we don't need to pay much attention to our impact on the environment.
- The fourth assumption is that capitalism works because **people are kind of completely self-interested**, only in it for themselves. If you want them to act for others, for instance if you want managers to act for shareholders they've got to have the proper incentives and these incentives around money and pay and profits are what drive them to act.
- The fifth assumption is that **given the opportunity business people will cheat**, cut corners, lie, cheat and steal more than the average. This assumption about who we are as moral beings, when we put on a suit or go to business, it's almost assumed that we're non-moral, we're a-moral. *We don't care about the effects of our action on others.*

[1] This essay is based on the lectures made by Professor **R. Edward Freeman** for the MOOC course "*New Models of Business in Society*" by University of Virginia and it's purely intended to be used to better understand the idea behind the Social Business Plan template & modelling implemented during the CONSENSO project [*ASP 286P1C1*]. His relevant books on the subjects are:
- *Stakeholder Theory: The State of the Art*, published by Cambridge University Press in early 2010;
- *Strategic Management: A Stakeholder's Approach*, originally published in 1984 and reprinted in 2010 by Cambridge University Press

- And finally, the sixth assumption is that **business works because people are basically competitive or greedy**, and then somehow just by an invisible hand, the greatest good emerges [and usually one passage is quoted out of Adam Smith].

The standard story of business has at least <u>four flaws</u>.

- The first flaw is that **business is not just about economics and the money**. Business is not just about profits.

This gets dressed up sometimes as *the purpose of any business is to maximize profits for shareholders*. Every business has to make money. It, it doesn't matter if you're for profit or not for profit, you've got to pay the bills, you've got to have some way to generate cash. But it doesn't follow from that, that that's the purpose of the business.

And furthermore <u>business is part of society</u>. It's not some isolated activity that's just about money and profit. Most entrepreneurs I know don't start a business just because they want to make money and profits. Most entrepreneurs start a business because *they're absolutely <u>on fire</u> about something*. They are trying to make their lives and the people they know better. <u>That's where business get its purpose</u>. Its not just about money and profit.

- The second flaw goes all a bit like this. There's this idea in the dominant story that **business is on the one hand and ethics on the other** and they don't mix. My experience is really very different.

Most business people I know actually want to and actually do act ethically and act with integrity. **They want to do the right thing**. They're no different than you or I. They don't automatically walk in the door of their businesses and become sort of greedy and only care about money. So this idea that business and ethics are separate is *a deeply problematic idea in the old story*. Well, so it's more than about money and profits: <u>business and ethics need to be connected</u>!

- The third flaw is this idea that **people are simple and motivated by money and self interested**.

Asking executives what is the way most people are assumed to be motivated in most companies, the answer would be rewards and punishments, i.e. carrots and sticks. Then when you start treating people this way, as if rewards and punishment are the only thing that matters, they start nosing for the carrot and trying to avoid getting hit with the stick. In short you turn them into jackasses, but human beings are much more complicated! We're complex creatures.

Therefore, money's more than about profits: it's about **purposes**. Business and ethics have to be connected and human beings are complicated. We need to use those ideas to build a new story of business.

- The fourth flaw is the idea that frankly **the world has changed**. *Globalization* is part of this, but with globalization has come some *new political realities* and those have been often driven by the *information technology*. And combined, these have shifted the normal relationships that we think about in business.

What it means to be a customer, what it means to be a supplier, an employee, a community member, etc.? Now globalization isn't new, what's new really is borders and passports for the last couple a hundred years. Human beings have always traded around the world from ancient times. Nonetheless today globalization is simply undeniable. Look at *a pencil*: the graphite might be from Brazil and Mexico, the soft wood might be from Sweden, or South Africa, the rubber might be from Thailand or Malaysia and the metal could be from China or Mozambique and pencils can be manufactured pretty much anywhere in the world, fairly inexpensively. Ideas travel around the world quickly, supply chains get globalized, … and *businesses can no longer pretend that what happens in one society is irrelevant in another*.

Another good example of globalization is the increase in awareness about *state-owned enterprise*. 35% of all the business activity, in China is represented by over 145, 000 state-owned companies, and these state-owned enterprises are connected to important family and government officials at all levels. Therefore, simply you can't understand how to do business in China with the standard story: you've got to understand that these businesses are set in a social and societal context.

With globalization has come a set of *new political realities*. We've seen actually a dramatic increase in the number of countries in the world. In 1980 there were 154 members of the UN, by 2011 there are 193 members. The world has changed in terms of its political realities. With the break up of the Soviet Union taking down the iron curtain, the emergence and liberalization of economies in China and India and Brazil, the growth economies in the so called BRIC nations and the fast emerging economies in Africa, has meant an added pressure but an incredible increase in opportunity for every business, and opportunities to start new businesses. In 1990 there were roughly 69 democracies in the world; in 2010 there were 116. Global companies have to pay attention to how they're regulated in countries with very different systems!

Now most of this change has been driven in part by radical advances in *information technology*. We're now connected to each other or at least connectable more so than at any time in history. Think about the changes brought by things like the Arab Spring, the ability of masses of people to self-organize politically. This new information technology requires a whole new way of thinking about business.

Globalization, new political realities / changes and the information technology have meant <u>a change in the way we think about traditional business relationships</u>. We buy things online. We get recommendations from our friends. We rate our transactions with companies. Even product design can be crowd sourced now!

So let's go back to the standard story. You can't hold a company together by focusing on the money. You need something more like ***purpose***. Ethics issues are front and centre all over the world. Not everyone's the same around the world: some people may in fact be motivated only by money. But most of what we know is that issues around purpose and having <u>autonomy</u>, <u>autonomy and mastery</u>, issues of <u>values</u> like family and compassion.

We have to understand business as set firmly in society.

So, the old story of business is no longer useful. The good news is that a new story has been emerging for sometime. There are multiple ways to set business in society so that we can make business better. What are the elements of this new story? First of all business has to be an integral part of society: we got to see it like that and we have to expect businesses to act that way. We've got to stop separating business from ethics: when ***business and ethics*** becomes not an oxymoron, a contradiction but a pleonasm. We've got to have a more robust idea of what makes people tick. *More than just money and self-interest*.

So, these are <u>five principles</u> that are important in this new story.

- The first principle is that **business is primarily about purpose**. Get the purpose right, money and then profits follow. It's not purpose or profits. <u>It's purpose and profits</u>.
- The second principle is that any business creates and sometimes destroys value for shareholders … **but also for customers, suppliers, employees and communities and society**. Building and leading a business involves getting these interest going in the same direction, not in different directions.
- The third principle is that **capitalism works because we're complex creatures**, **we have many needs and wants**. We can cooperate to create value for each other: in fact, anthropologists tell us this is what makes human beings unique, i.e. our ability to use language and cooperate with each other. We act for selfish reasons, but sometimes we act for others as well: incentives are important, but so are values.

- The fourth principle is that **most people** tell the truth and keep their promises and **act responsibly most of the time**. Honestly, the world simply wouldn't work very well if this weren't true. We need to expect that behaviour in business: rather expecting that people are greedy and self interested all the time.
- And the final principle is that **business and capitalism are frankly the greatest system of social cooperation and value creation we've ever invented**. That's a little different than the way we normally think about it: business is the greatest system of social cooperation we've ever invented! Competition is important: in a free society it gives people options. *But the engine of business and capitalism is how we cooperate together to create value for each other*.

We can cooperate together to do things that no one of us can do alone. <u>We need to tell the story</u>. Need to expect it of our businesses and our business people and we need to start businesses that are based on this new story. The good news is I believe we can see this new story emerging all over the world.

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Corporate Responsibility, Philanthropy and Building Sustainable Value: The Role of Capitalism in Society

The first thing I'd like to do is talk about a model different from the standard one, that's based on the idea of **corporate philanthropy**. So the first alternative to the standard story about business, the first new model of business in society, is the one called the **corporate philanthropy model**.

The idea goes back to *Andrew Carnegie*'s two principles of wealth and this tradition of *noblesse oblige*: those who have in society give and take care of those who have not. This idea generates the following two principles of wealth:

- the first one is the **principle of charity**, which requires the more fortunate members of society to assist the less fortunate. If you have a lot of stuff help those who don't. This principle set in almost every religious tradition has been then articulated as a way for business executives to think about 'charity'.
- the second one he called the **stewardship principle**, taken from the Christian Bible. This requires business and wealthy individuals to view themselves as *stewards* or *caretakers* of their property. They hold money in trust, they hold property in trust for the rest of society and they use it for purposes that society deems legitimate.

Now this sounds pretty good but I'm not so sure that Carnegie's motives were so pure because he thought that really most people couldn't really be trusted to do what was best for society. He thought that business people actually knew better than anyone else how to do, what's best for society. And sometimes today, if you listen to some business executives talk, they talked as if they really know best how to solve some of these problems.

Carnegie was a pretty complicated fellow who built a great companies and left behind philanthropic organization that's still there today. He articulated his business philosophy this way: if you fill the other guys basket to the brim in business, you'll never want it for profit; fill the other guys basket to the brim and you won't be sorry. So even Carnegie understood the *mutually of business relationships*, and he understood the <u>connection between business and society as a whole</u>.

Clear examples of corporate philanthropy in the same era come from Andrew Mellon who donated enough art to start the National Gallery of Art which we still enjoy today, John Rockefeller gave $60 million to restore Colonial Williamsburg and has been the single greatest funder of medical research, Henry Ford created Henry Ford Health System in 1915 and the Ford Foundation was started by his son in 1936 to improve the well being of society (it's now the third biggest charity in the US), and Milton Hershey of the Hershey chocolate company founded the Milton Hershey School Trust in 1909 (he endowed it with 60 million dollars and 486 acres) and the Milton Hershey foundation with 5.000 shares of the Hershey company.

That tradition of thinking of business in society set through its philanthropic activities is still alive today. It should cause us <u>to question this idea about business being only for shareholders</u>. Has it ever really been followed or is that just the rhetoric to the old model?

I don't want you to have the idea that corporate philanthropy is somehow a new model of business and society way back in the robber baron era. <u>Corporate philanthropy is alive and well today</u>. According to a survey by the corporate giving standard, the sum of all contributions in 2011 was more than $19.9 billion in cash and product giving. According to the Foundation Centre, there are over 108,000 foundations, corporate donors and grant-making charities. In 2011, companies gave money to health and social services, to basic education, to community and economic development, to higher education as well, to civic and public affairs and culture and arts groups, to disaster relief, etc. The Gates Foundation, as an example, has 36 billion dollars in assets. Bill Gates and Warren Buffet have led the idea, really from Andrew Carnegie, that wealthy business people pledge a great deal of their assets to improve society. The Carnegie tradition is really being carried on today. Since 2001 the Conference Board has suggested that corporate giving has reached more than 100 billion dollars, and there have been some outstanding philanthropy programs for businesses trying to make society better.

There's <u>a new model of business in society</u>, it is that **business is connected to society through philanthropy and its philanthropic activities**. But there are some issues here. In a very famous paper or article in the New York Times magazine, Nobel economist Milton Friedman argued that the only responsibility of a business is to earn profits, back to the old model. He argued against the idea of corporate philanthropy saying that this was the role of government or it was the role of private investors (private investors could take the profits from their investments and give it away however they wanted). This led in part to the popular idea that we've talked about, that <u>business is only about money and profits</u>. But it should be clear, there's a long history of business seeing it's role as contributing to making society better through its philanthropy.

Now here we're going back to argue the idea that you can make society better through the very stuff that you do, through the products and services that you do. But the corporate philanthropy model says business can make society better by donating money, and having partnerships with organizations like NGOs and others. They're trying to make society better, and that's really <u>a different story than the standard model in business</u>.

A second way to connect business in society that's emerged has been called **Corporate Social Responsibility** or **Corporate Social Responsiveness**, or sometimes just CSR. Most people date the origin in the US at least to Howard Bowen in 1953 in a book that he wrote. He said the business person produces <u>two categories of products</u>: the first consist of commercial goods and services; the second is <u>the *conditions* under which these goods and services are produced</u>. And Bowen saw these conditions as *social products of a business*, making the distinction between the economic products (the goods and services) and the social products (the conditions under which this products are made) [this gives really rise to the origins of CSR in the American context].

In the 1960s and 70s in the US people began to take this idea very seriously: large firms especially began to make what became known as <u>the business case for social responsibility</u>. The business case went something like “being a good citizen, paying attention to the social effects of your business can let you gain important support from customers and communities”. You can avoid regulation or, at least, hope to constrain the regulation.

This emerges in the US at a time when there's the business part from one side and there's the ethics part on the other: business and ethics are separate. In other societies around the world this separation of business and ethics didn't go as far. For instance, in the Scandinavian countries (Denmark, Sweden, and Norway) there was never the big separation between business and the rest of society. However, by focusing on the business case, business leaders could counter Milton Friedman's argument that CSR was a waste of shareholder resources and a usurping of shareholders' prerogative and government's prerogative. Thus, most of the work on CSR was done by social issues: a company would take on an issue like racial discrimination or pollution or consumerism and try to do better with respect to its products and services. And this not just through its philanthropic contribution though that was sometimes added on.

Many companies have fought these ideas all the way since they were committed to the dominate story telling that this is a waste of money, and business it's only about money and profits. But now people began to talk about not just social responsibility but even corporate social performance and the ***connection between social performance and financial performance***. For instance, is good social performance simply a matter of being financially well off enough so that you can afford it? Or, does good social performance lead to good financial performance?

Many people have argued that CSR, if it's to have an impact it has to be institutionalized through a set of principles, and this idea has really grown over the years. These principles are set in four areas:

- first of all in **human rights** - businesses should figure out where they're not or at least they should make sure they're not complicit in human rights violations;
- around **labour** - businesses should work on the elimination of all forms of force labour or child labour;
- around the **environment**, businesses should promote greater environmental responsibility;
- around **anti-corruption**, businesses should work against corruption, extortion and bribery.

These principles make sense also in the way they are questioning the idea, in the old story, that business and society are separate, business and ethics are separate. There are some great examples of CSR programs all around the world.

This second new model, in addition to philanthropy, is that **business is connected with society by its corporate social responsibilities activities**, and maybe by its corporate social responsibility and its philanthropic activities. And that's a very different idea about business as connection with society than the dominant story.

Many companies around the world have great corporate philanthropy and corporate social responsibility programs: they do a lot of good in the world. But there is something missing here. Often times these programs are done as add-ons to the business model without having too much overlap. It's almost as if capitalism and business are fearing being morally questionable and they’ve got to do something to make up for it. And oftentimes to do something to make up for the bad is what corporate philanthropy and corporate social responsibility are aimed at, or it seems that way sometimes. Of course people’s hearts are in the right place here, but sometimes we do have this idea that they're making up for some bad stuff.

One European CEO of a big multinational said ‘corporate responsibility is the most important issue of this century: the winners are going to be those companies who act responsibly and are perceived to act responsibly’. *It's about being responsible and being perceived to be responsible*. But should companies get a pass on the ill effects of their business practices, on the bad effects of some of their business practices, just because they have a great corporate responsibility program or philanthropy program? By the way, Lehman Brothers now are bankrupt, with bankruptcy being one of the causal factors in the global financial crisis, and it had a great CSR program as well, doing a lot of good. Goldman Sachs at the same time has been one of the most vilified banks in the global financial crisis, and it has a state of the art corporate philanthropy and culture social responsibility program. They have, for instance, a program called 10,000 women, which is a five year $100 million global initiative to help grow local economies and bring about more shared prosperity by proving 10,000 underserved women entrepreneurs with business and management education, by providing access to mentors' networks helping in starting and getting into businesses.

The problem is corporate philanthropy and corporate social responsibility really don't stray very far from the dominant story: *it's still pretty much shareholders and owners that really count*. Even a recent idea by Harvard Professor Michael Porter called ‘Shared Value’ does the same thing arguing that it's not just economic value, but it's economic value <u>and</u> social value. And you have to think about a business as <u>creating both of those kinds of values</u>. This however leads to the ‘***separation fallacy***’, pretending that it makes sense to talk about business on the one hand and ethics and values and society on the other.

But, does it really make sense? If you hire someone, have you done something with economic consequences? Of course yes, he/she has now money to pay the bills, etc. But have you done also something that has social consequence? Yes, as well, by putting him/her on a track to move up in the world it may give him/her pride and autonomy, a sense of mastery over what he/she’s done. Then it can't be measured in purely economic terms! So it’s done something that's social and economical at the same time. Business creates value and it creates value for customers, for suppliers, for employees, for communities and the people with the money. And thinking about how it creates value is more interesting than thinking about what part of that values is economic, or what part of that value is social.

Looking then to the new models of business in society that counts against this old idea that it's just about profits and the money we come to the third model based on the idea that <u>**environmentalism**</u>, taking care of the environment, paying attention to the environment, can help us <u>see and situate business in society</u>.

The assumption is that there is an environmental crisis. Is climate change something to worry about? What about pollution? What air, water, land pollution? What about hazardous waste? What about over population? What about biodiversity? Well, one way to think about this is to think that we have to wait for the facts: science will tell us whether or not there's an environmental crisis, and we just have to wait for more studies. But we know that science itself, the questions that we ask and the way we frame these questions, even the methods we use, <u>have values built into them</u>. The scientists have to make value judgments, and this is true in the environment too. So this idea that the scientists will tell us the facts and then we get on with, it doesn't exactly work. That's not to say the scientific studies aren't relevant. But using judgment to sort out which are relevant, what they tell us and then trying to make wise policy decisions, it's a very complicated process.

The subtext of these arguments in environmentalism is that it its really the dominant story of business in the background. <u>*Business is often assumed to be the problem, not the solution*</u> … and it’s possible to turn the tables on that partially.

Blaise Pascal not being a Christian formulated an argument that said: ‘suppose all these people talking about Christianity are right, suppose there really is a hell and hell is hot and eternity's a long time to be spent in hell, and at the same time living a Christian life is not too bad … so, *maybe we should do that just in case*’. Well, what if all these environmentalists are right? Our children deserve to have the same prospects for a future that we do. Can business leaders act as if there's an environmental crisis, regardless of how the facts, if there are any, turn out? Can we continue to create value and trade with each other? Can we continue to improve the well being of our stakeholders?

In other words, is there an environmental crisis? And is there a ***green capitalism***? Can we think about capitalism from the stand point of how we make the world cleaner, safer, better for our children, and how our companies can make our societies better? A capitalism which Improve the standard of living for its stakeholders and make money?

We're trying here to discover and build *new models of business in society*, new models that are not just theoretical models, but new models where there are real companies actually doing this. And environmentalism is a great place to look for some of these new models. There are some assumptions, some presuppositions here, to be kept in mind. If we're going to look for ways to solve the environmental problems we have, <u>business has to be a part of the solution</u>.

Order often emerges out of lots of experiments, it's very hard to plan. The right thing to do here, where there's so much uncertainty and there are multiple sets of green value, is to believe that there are lots of ways to think about green capitalism. More precisely we can think about four kinds of **green values** which will give us four **different models** on how business can be set in society on environmentalism:

- the first one is about <u>efficiency and the duty to obey the law</u> – this leads to the **Legal Green model** based on the idea of efficiency, the duty to obey the law. It says that you can craft a green company around the idea of simply obeying the law, and using the law to be more efficient and effective. The regulation forces companies to be innovative, so rather than seeing it as a cost, it can also be seen as an <u>opportunity for innovation</u>;
- the second one is to <u>think about customer service</u>, and a purpose aimed at what's best for customers [*customers have green value*] – this lead to the **Customer Green model** based on the idea that I can craft a green company <u>by responding to, and even anticipating, the green values of the customers</u>. A really good example of this would be something like the development of the Prius car at Toyota responding to the customers' wants for driving a car that they perceive as more environmentally friendly, as more fuel efficient as doing less emitting less green house gas;
- the third is to think about <u>harmonizing the interests of stakeholders</u>, generalizing the customer service value to other stakeholders – this lead to the **Stakeholder Green model** where the basic idea is that I can craft a green company <u>by responding to, and anticipating again, the green values of the stakeholders</u>. For instance, Nike needs to have a sustainable growth business plan and in the process of creating a sustainable business (what they call *ecosystems*) they involve all their suppliers and stakeholders;
- the fourth is <u>living in harmony with nature</u>, making companies more sustainable with the planet – this lead to the **Dark Green model** based on the idea that I can craft a green company <u>by orienting the value creation equation</u> (= how we create value for our stakeholders) <u>to living in harmony with the earth</u>.

So the argument here is, yes a green capitalism is possible, and its not only possible but its happening in the world today, and its *one of the most exciting ways to think about how business is set inside society*.

If you take a look at any website of a big company today, you'll see page after page about its environmental programs; and sure some of these are just puff and PR, but many of them are real! There's a lot of managers who are not just greedy, muddy, money grubbing self-interested people, as in the old story, but they're husbands and wives and mothers and fathers and citizens as well. So to say, they are fully human, they are worried about the environment too.

Now the public debate is fractured on clean-up, on who did what to whom and on who pays, but all these questions are all looking to the past. But we have to about business as looking to the future. Looking to say, well, what are the kinds of things we can do to make the world cleaner? To make it better for our children, so we can be sure that our children have the same kind of future, possibilities that we do. **Environmentalism** becomes in a way a special case of a more general question about ***how value creation and trade are sustainable over time***.

To think about environmental sustainability, we might also have to think about moral or ethical sustainability. If we don't, environmentalism and environmental sustainability runs the risk of politicizing the idea of valued creation and trade.

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Creating Value for Stakeholders

What I'd like to do now is put these models of business and society in perspective and suggest there is a more comprehensive way to reorient the dominant story of business, which depends on the emergence of the idea of **stakeholders**. Now most of you have probably heard of the idea of stakeholders, but 40 years ago almost no one had heard of that! It really grew out of people thinking about business strategy, as the business environment began to change and get more global and people began to be aware of things outside of their companies.

In that moment people needed a way to organize these sort of things, and so a group of people at the Stanford Research Institute in the 1960s came up with this idea: "well let's organize it by ***customers, suppliers, employees, communities*** and ***financiers***, the people with the money, and let's call those groups stakeholders". In the same period in the Scandinavian countries, primarily in Sweden, a thinker named Eric Renman began to be worried about not only the environment, and how changes in the environment changed what you needed to in a company, but also about the role of employee around the whole movement in Scandinavian countries of *industrial democracy*.

From these roots came the idea that businesses needed to pay attention to their stake holders, and this for a lots of reasons: you can think businesses need to pay attention to stakeholders simply because it's the right thing to do or because it's the smart thing to do or you might have some other reason. It doesn't depend on a particular political ideology one way or the other: what's important here is that the stakeholder theory comes from what companies actually do.

I define stakeholder as '***any group or individual who can affect or be affected by the achievement of a company's purpose***'. Sometime it's useful to think in a very broad terms so that *NGOs, interest groups, governments, media* and even *competitors* are stakeholders; and sometimes it's useful to think more narrowly. to think about really just customers, suppliers, employees, communities and financiers. How you define stakeholders in part depends on what you're trying to do: if you want to get a broad scan of who can affect you, then you need to think broadly. If you want a narrower idea, then you need to think more narrowly. Every company has a picture roughly like this.

More in details, stakeholder theory is an idea about how business really works. It says that for any business to be successful it has to create value for customers, suppliers, employees, communities and financiers, shareholders, banks and others to people with the money. It says that you can't look at anyone of those stakes or stakeholders like in isolation: their interest has to go together. A job of a manager or an entrepreneur is to figure out how the interest of customers, suppliers, communities, employees and financiers go in the same direction.

We have to think about how important each of these groups is for a business to be successful:

- think about a business that's lost its edge with its *customers*, that has products and services that the customers don't want as much, or that they don't want at all: that's a business in decline,
- think about a business who manages *suppliers* in a way that the suppliers don't make them better, the suppliers just take orders and sell stuff but the suppliers aren't trying to make a business more innovative, more creative: that's a business in a holding pattern and probably in decline,
- think about a business whose *employees* don't want to be there everyday, who aren't using 100% of their effort and their energy and their creativity to make the business better: that's a business in decline,
- think about a business that's not a good *citizen* in their *community*, that routinely ignores or violates local custom and law, that doesn't pay attention to the quality of life in the community and it doesn't pay attention to issues of corporate responsibility, of sustainability of its effects on civil society: that's a business that's soon to be regulated into decline,
- and think about a business that doesn't create value, doesn't create profits for its *financiers, its shareholders, banks* and others: that's a business in decline.

So, stakeholder theory is the idea that each one of these groups is important to the success of a business, and figuring out where their interests go in the same direction is what the managerial task and the entrepreneurial task is all about. Stakeholder in theory says: *if you just focus on financiers you miss what makes capitalism tick, and what makes capitalism tick is that shareholders and financiers, customers, suppliers, employers, communities can together create something that no one of them can create alone*.

Thus the basic ideas here are that all businesses create or sometimes destroy value for its stakeholders and knowing where how that value is created and what it is turns out to be important. Successful companies constantly look for the **intersection of stakeholder interests**.

So thinking about stakeholders forms the basis for how we really can understand the role of business in society. But that's not the whole thing: **purpose** actually turns out to be really important. Thinking about stakeholders without thinking about purpose doesn’t allow to even answer the question who are your stakeholders.

One way to think about purpose is that it's an answer to a question of why till eventually you'll come to something you just can't answer anymore, an end to the string of why questions. Here at the end we finally get the real ‘will’, so to say we've got a purpose. Many companies have *identities*, they have an answer to a why question, they put a stake in the ground and said this is who we are, this is *what makes us distinct*, it sets us apart, it's how it gives the driving force. This is the wellspring for how we manage our stakeholder relationships, how we create value for our stakeholders, it makes us ask and answer why our business matters.

Sometimes companies have purposes like … the best: I'm going to be the best in my industry, specializing in satisfied customers. Well, that's just something you have to do, it's not inspiring. It's not an answer to a why question. Sometimes even setting good purposes leads to fail on the track to pursue the same. But it doesn't mean because sometimes we fail, that purpose isn't important: it's the most important thing that we can do. To think about what our purpose is and to think about how what we do realizes that is the real heart of the issue. Think about an airline company that tries to maximize stakeholder value, for instance, by providing the highest level of customer satisfaction, safety, and security and being committed to corporate and social responsibility. Purpose is thus incredibly important: if we're really going to make business better, it's because we're going to realize the purpose, not the profit.

So we thought about how stakeholders let's us see business and society as going together. And by the way, thinking about stakeholders isn't separate from thinking about philanthropy and corporate social responsibility and the environment. Usually these things build together.

We've talked about how thinking about stakeholders has to go along with purpose and I want to add to that two principles that often times are a little counterintuitive, because the standard story just can't deal with these principles. But they're worth spelling out because they are really important in building these new models:

- The first principle is the **Interconnection Principle**. Because stakeholder interests go together over time, we need solutions to issues that satisfy multiple stakeholders simultaneously. Companies need to figure out how to creating value for one stakeholder implies value creation for another. It's about win, win, win, win, win. It's about how when you do something for customers you also make the community greener, etc.
- The second principle that's involved in this is that you can't think about trade-offs. It's something I want to call the **No Trade-off Principle**. If we take the stakeholder idea seriously, we try to never trade off the interest of one stakeholder versus another; certainly not, continuously over time. If you always make trade offs in favour of shareholders versus employees, what happens? In a relatively free society it's straight forward: employers would use the political mechanism to have their rights enforced. If you always trade off the interest of a customers over suppliers, what's going to happen? Suppliers are going to go to your competitors and help make your competitors better, simply because you're not creating enough value for them. So the idea here is the *No Trade-off Principle* says, whey you make customers better off how does that make suppliers better off? And when you make customers and suppliers better off how does that make employees better off? And when you do that how does that make communities off? And when you do that, how do you make shareholders or financiers better off? When you have to make a trade-off the next question is how do I improve the trade-offs for both sides.

To make stakeholder theory really work you need intensive communication and dialogue, and engagement with your stakeholders; but not just those who agree with you. **Critics** are an important source of value creation, and **friction** if you like, sometimes among values you think you believe, and friction even among your time horizon. The **Friction Principle** is based on the idea that the conflict between and among stakeholders, conflicts around values critics and even time horizons, can all be sources of value creation. Lots of times we just want friction to go away, it's uncomfortable, it's conflict and in different societies we have different ways of handling it. But if we think about value creation in business, *understanding friction can be a really important resource*. A clear story about the golden arches, McDonald's: Greenpeace started a program against them because soy farmers were deforesting the Amazon. McDonald's worked with Greenpeace to develop what they've called a zero deforestation plan, knowing that this put pressure on other people in the industry, but McDonald's was willing to ask the value creation question: *how can we use this critic to get better at what we do*?

We know dealing with critics is just good management when we think about how companies deal with their customers: gets feedbacks from customers, so that we could take that feedback and input it into the value creation process. That same idea applies when we think about business as broader than just customers: getting feedbacks as to how we can have a better relationship with suppliers, for instance, thinking if we have a better relationship with suppliers how it feeds a better relationship with customers or even with employees. Getting feedbacks and treating critics as sources of value creation enhances employees' engagement with you, and ultimately means, you're more likely to realize your purpose.

So what makes a company successful?

- you've got to have *customers* whose lives are better because of your products and services,

- you’ve got to have *employees* who are engaged and hopefully inspired,
- you’ve got to have *suppliers* that want to make you better,
- you’ve got to have *communities* that are supportive, who want you there because you make the community better,
- and you’ve got to have *investors* who make money.

And you’ve got to manage these stakeholder relationships simultaneously, finding the *intersection* and *avoiding trade-offs*. You’ve also got to look for *friction of conflicting interests*, for *critics* to produce innovation. This is then the new story far away from the old one.

In the past few years thus emerged the idea called **Conscious Capitalism**.[2] Capitalism is a way of organizing economic relationships, but in short conscious capitalism is based on the idea that economic relationships are not merely happening automatically and through merely the invisible hand. A *conscious busines*s has four key principles to that:

- the business has a purpose besides maximizing profits;
- secondly business is about the stakeholders, and there are major stakeholders who are interdependent on one another;
- thirdly we need a *Conscious Leadership* by meaning that the management's job is not primarily self interested, when too many businesses' leadership today tries to take as much out of the business as possible (back to the old ‘greedy’ story). In the conscious business the leadership, in a sense, is serving the mission or purpose of the business, is serving the stakeholders, being at the same time a good steward of the resources that have been entrusted to them by the shareholders and investors;
- fourthly, there’s no conscious business unless we create *Conscious Culture* affecting the strategies, the processes and the structures.

These last two principles are all putting **employee engagement** in the very centre! Understanding the role of employees and the importance of that it is absolutely central in rebuilding a new way to think about business, in making business better. Of course happy and productive employees who share your purpose do great things for other stakeholders as well and we all want to be treated with dignity and respect. Employment engagement is not only about reimbursement and financial benefits: that's not high on the list for most people when they go to work. They want to have a purpose that they believe in, they want to work with people they love working with, they want a job and challenges that are exciting, they want the flexibility to get their work done in the way they want to get it done.

Engagement starts with recruiting, making sure you're getting people who are passionate about your purpose, making sure you're getting people that are going to work well with others, that are interested in the dynamics of the workplace that you've created. More than 70% of people around the world are saying that they're disengaged and either *indifferent* to the work they're doing or they're even *negative*. Let’s imagine those people being able to choose their project, to choose the people the work with, to choose the person that they report to. Clearly that puts a huge demand on the organization to figure out logistically how to make that work, but once you get those systems in place you're liberating a huge increase in productivity.

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[2] *Conscious Capitalism: Liberating the Heroic Spirit of Business*, John Mackey and Rajendra Sisodia - Paperback – 2014

Becoming a Stakeholder Entrepreneur

Now, one of the models we've seen emerging in the past ten years is this idea of **social entrepreneurship**, which focuses on people who primarily care about doing good, not so much about making money. Social entrepreneurship and what it really does is very much in keeping with what we've seen so far, that it's about *finding some stakeholders and creating value for them*. And it doesn't matter whether it's for profit or not for profit. In this sense, **a stakeholder entrepreneur is somebody who starts or improves an organization by making it responsive to a stakeholder's needs or a set of stakeholder's needs**. You can be a stakeholder entrepreneur in an existing business or you can be one in a start up: anyway stakeholder entrepreneurs understand that their organizations are firmly set within society. They're not in some free market land and they're not just doing government programs. They're set in society where they have clear stakeholders and clear purposes. They also understand that they have to have a business model that satisfies stakeholders and generates self-sustaining funds. And it doesn't matter whether these funds go to shareholders or whether there is satisfaction to donors, but you've got to be able to essentially pay the bills. Stakeholder entrepreneurs want to make the world better and they have to make money to sustain that: it encompasses both traditional entrepreneurship and social entrepreneurship.

One of the things it takes to be a stakeholder entrepreneur isn't just a life of pain points. The second thing you can do is think not only about your pain, but think about the pain of other people. Go to the web sometime and find some websites that depict a sort of human misery. Think through what are the kinds of businesses that might be available to be started to alleviate some of that suffering: that's the idea behind stakeholder entrepreneurship, *but it isn't just pain*.

People have said Dr. Martin Luther King said *I had a dream*, not I had a plan. So it's, you don't have to have everything sort of locked up and nailed down before you start something. You have a dream, you have an idea and you go out in the world and you make it happen. Whether it's a small thing about music or whether it's a big thing like giving shoes to poor people.

I think you can make a difference as an entrepreneur, as a customer, as an employee, as a citizen and a community member. I know not everyone wants to start a business but everyone can make a difference. Stakeholder entrepreneurship is a way to think differently about a business, first as an entrepreneur. And you can start something that matters. Maybe it starts with a pain point in your life, but the idea behind being an entrepreneur is often times you don't think about risk. You feel the passion to do something and the risk is in not doing it.

As a customer, you can pay attention to the companies you do business with: you give them your hard earned dollars. You can pay attention to how their products are made. You can pay attention to the conditions under which those products are made and sold. You can pay attention to what those companies are doing, how they're making society better, how they're making your life better.

As an employee, you can engage: so many people in the world today go to work every day and they are not engaged in what their companies are doing. Of course it's not always their fault, but sometimes you can push, you can try to make your company purpose oriented.

You can think about as a citizen, as a community member, about being active, about the companies that are in your community. What are they doing? Are they community destroyers? Are they community builders? Are they good citizens?

There's a lot that needs to be changed in the world. Business has to be a part of that change, and we need to be able to do it for ourselves, as well as our companies.