

## **Stakeholder Primacy: The Sustainability Schema of Business**

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### **Abstract**

The purpose of this article is to highlight the sustainability imperatives of businesses against the backdrop of shareholder primacy vis-à-vis pressure on organizational leaders to maximize profit in the short-term for “owners”. It is invigorating to learn that the CEOs of the Business Roundtable are committed to expanding the purpose of their organizations to support the wellbeing of communities, workers, consumers, and the environment, as opposed to the hitherto narrow focus of shareholder primacy propagated by Milton Friedman and his acolytes. Corporations were created to serve the interest of society, however, a framework of shareholder primacy may have contributed to the persistent and expansive problems of society including poverty, income inequality, and environmental pollution that causes unfavorable climatic conditions. In this article, the writer assessed the alignment between problems of society and problems faced by organizational leaders thus the need to reject shareholder primacy and adopt a stakeholder framework. In a vibrantly competitive market of today, the purpose of serving the interest of stakeholders as opposed to the purpose of shareholder primacy may be critical to innovative performance, strategic competitiveness, and sustainable growth of businesses.

**Keywords: Sustainability, stakeholders, shareholder primacy, innovation, competition.**

## **Introduction**

Shareholder primacy, wherein the purpose of organizational leaders is to maximize profits for “owners” may be flawed as societal problems become chronic. As Lazonick (2013) pointed out, the theory of shareholder primacy is detrimental to the U.S economy. Smith (2003) identified that shareholder primacy may be blamed for corporate scandals, notably the activities of Enron and Lehman Brothers that led to the financial crisis of 2008. Businesses employ resources of society to create value needed to improve the wellbeing of consumers and community members at large. Suffices then that business leaders should seek the interest of stakeholders including consumers, employees, community members, the environment, etc., who are resources, consumers, and are affected by a business’s production process and products and services.

One may argue that businesses are taxed by the government to provide social goods and services such as roads and hospitals, needed to improve wellbeing thus the purpose of shareholder primacy may not be flawed. However, taxes accrued by the government cannot be used to replenish natural resource bases depleted by corporations or solve problems such as environmental and water pollution that the process of production may create. Government laws may only serve as deterrents against detrimental effects of the production process but not a tool to spur innovation to correct all societal ills or for that matter, dictate how business leaders use their wealth. Ethical considerations and the need to do right may be considered where laws may not cover.

In essence, it is the responsibility of business owners to ensure the sustainability of their businesses through innovative means to preserve and improve resource bases. It is the strategic purpose of businesses to be innovative to gain competitive advantage on the market, however, as

Lazonick (2013) evaluated, shareholder primacy stifles innovative investments into new markets and products. Although stakeholder theory is misinterpreted as a non-profitable venture (Smith, 2003), the problems of society serve as innovative opportunities for businesses to gain competitive advantage and sustainability (Drucker, 2008). In this article, the writer pointed out the importance of stakeholder primacy as the problems of society are the same problems faced by organizational leaders.

### **Evaluating Stakeholder and Shareholder Primacy**

A Shareholder primacy of profit maximization propagated by Milton Friedman in his popular 1970 article, *the social responsibility of business is to increase its profits*, is the accepted theory of business purpose in the U.S. The Business Roundtable, a community of CEOs of the leading businesses in the U.S., announced a departure from their profit maximization orient to a more encompassing framework of stakeholder value creation and viable economic opportunities for community members, employees, suppliers, and customers (Business Roundtable, 2019).

Economic or business growth is tied to societal development. However, the theory of shareholder primacy is at variance with business growth as a source of societal development, and the original purpose of corporations/businesses which according to Byrne (2009), is to provide goods and services to improve the wellbeing of society as a whole, not maximize profit for a few. According to Kotter (2019), shareholder primacy is risky in a flux business world of today as it stifles the innovation drive of employees who believe their efforts will not be rewarded.

A more encompassing framework of stakeholder interest aligns with the essence of a business purpose, to improve societal wellbeing. Milton Friedman may be right in advocating the shareholder primacy to ensure that ownership of businesses profits from their investment by preventing managers from misspending profits. However, in their quest to ensure profit

maximization, CEOs must invest in long-term innovative initiatives and social programs such as CSR, to ensure sustainability and profitability. A lack of sustainability is detrimental to growth and profitability. The idea propagated by Friedman (1970) that social responsibility is an unprofitable venture is flawed as Valenti, Carden, and Boyd (2014) assessed the favorable economic returns and business sustainability imperatives of engaging in CSR especially in a world of 'going green' awareness. Drucker (1984) evaluated that there are opportunities in society worth pursuing for economic gains.

The problems of society may be detrimental to the efficient administration of a business. As assessed in this article, the problems of society align with the problems that organizational leaders face in developing their businesses. There is a need for sustainability initiatives that encapsulate stakeholder interest to improve the wellbeing of society and the financial bottom-line of businesses. Turning the problems of society such as poverty, income inequality, education, pollution, healthcare, into economic opportunities may mitigate business problems of uncertainty due to competition on the market as well-compensated, knowledgeable, and healthy employees reach a level of self-actualization thus become innovative to meet changing trends and demand. Sustainability initiatives of serving stakeholder interests may be viewed as a strategic mechanism to gain a competitive advantage on the market through innovation.

### **The sustainability schema of business**

Business leaders must strategize to engage in sustainability initiatives to improve and extend their competitive advantages. Sustainability initiatives are long-term strategies, policies, and programs by organizational leaders to improve the financial bottom-line through the production of quality and innovative goods and services as dictated by market trends. Avoiding obsolescence by constantly changing the methods or system of production to align with

changing customer demand (Drucker, 2008) may be the manifest function of businesses and aligns with the concept of competitive advantage and sustainable production.

A framework to spur business sustainability for long-term competitive advantage may hinge on turning societal problems into economic opportunities through innovation, as opposed to the current structure of shareholder primacy, whereby organizational leaders aim at maximizing immediate or short-term economic returns for their stockholders, thus target a wealthy customer base with expensive and luxury items. Hoffman (2018) identified through a survey that over 90% of CEOs emphasized on the importance of sustainability to the growth and profitability of their businesses. A long-term strategic initiative of businesses to gain a sustainable advantage may be a better fit in a flux market or economy and also to societal problems.

### **Innovation to improve stakeholder wellbeing**

Innovation is at the core of gaining competitive advantage as businesses lower cost, increase quality, create new products, and find new markets. The issue herein is the strategic enterprise of innovation, against the backdrop of profit maximization. As Porter (1990) expatiated, gaining competitive advantage involves investing in innovative mechanisms such as industrialization, higher education, and infrastructure, to create wealth to meet changing customer demand (Porter, 1990). Innovation as Porter (1990) articulated and I herein emphasis, hinges on the educational levels and infrastructural development within a country. Quality of healthcare, higher and equitable income distribution levels, availability of resources, improved education and skills, and the overall wellbeing of society are pathways towards the efficient creation of an innovative culture or structure within organizations. In essence, the pathway to innovation lies in the wellbeing of stakeholders and may be measured by how improved the

wellbeing of stakeholders are, not a few shareholders.

Long-term sustainable growth initiatives aimed at improving the wellbeing of stakeholders should be the undergirding factor in the strategic enterprise of business innovation. Fairbanks and Lindsey (1997) analyzed that the future of business growth will be dependent on cooperation and teamwork to promote and maintain sustainable factors of production devoid of harmful consequences to humans and the environment. According to the authors, “the challenge in the 21<sup>st</sup> century will be to work together to create sustainable sources of growth in a way that neither degrades the environment nor exploits human beings.”

Innovative enterprise to gain sustainable growth of business that extends to societal development involves preserving of natural resources, improving efficiency of human resources, investing in research and development to create new products, improving existing products, and finding new customers, the essence of which is the creation of value for stakeholders and in effect mitigate the problem of poverty, income inequality, and lack of economic opportunities etc. Essentially, stakeholder primacy is the long-term innovative mechanism for business growth and profit maximization as opposed to the short-term shareholder orient of profit maximization for stockholders, without regard to the wellbeing and sustainable growth structure of a business and societal existence.

### **Business problems are societal problems**

The foundation and success of every business is society, which serves as a resource and consumption base for products and services. Drucker (1994) assessed that the reason for the failure of businesses is because leaders fail to transform with current trends leading to an obsolete business mission and modus operandi. That is, business leaders fail to recognize changing trends or harness new opportunities in society. Another reason for business failure may

be a lack of sustainability initiative wherein resources are depleted or not developed. The problems of business leaders as assessed below are not at variance with societal problems.

Jackson (2018) reported in a survey that millennials who attended the 2017 World Economic Forum indicated that societal problems they are most concerned about included severe weather, destruction of natural resources, poverty, income inequality, lack of economic opportunities, food and water shortage, safety concerns, and lack of education. In a report by Lean Methods Group (2018), problems business leaders face included uncertainty about the future, hiring and improving skills of employees, finding creative and innovative ideas, knowing customers, supply chain and natural resource management, complex information management, and diverse culture of employee management.

As assessed below, the problems of society are not at variance with that of business leaders. An encompassing business purpose involving the interest of all stakeholders as opposed to a shareholder primacy theory may suffice. There is a need for a long-term economic structure to mitigate or alleviate the problems of society and businesses to ensure sustainable socio-economic growth.

### **Aligning the Problems of Business Leaders with Society**

*Business leaders' problems of uncertainty about the future, government regulations, and market competition align with societal problems of destruction of natural resources, severe weather phenomenon, and lack of education.* Uncertainty about the future may be a result of competition on the market wherein profit margins and growth opportunities may be erased by the entrance of other businesses into the market. Uncertainty may also be attributed to the depletion of natural resources bases, the effect of severe weather that may lead to destruction of property and natural resources bases. A lack of educational opportunities may result in

unskilled labor which stifles innovative tendencies in organizations thus creating a situation of uncertainty about the future growth and profitability of a business.

Business leaders may be more certain about the future by employing sustainable programs including the use of alternative sources of power to reduce coal fumes that contribute to severe weather phenomena culminating in the destruction of natural resources. According to Jaramillo and Muller (2016) damages caused by air pollution from manufacturing corporations were about \$131 billion in 2011. Sustainability initiatives such as recycling, efficient water management and supply chain management to reduce waste may be assuring measures to mitigate uncertainty. Investing in employee education to revamp their skills, improving work conditions may boost employee performance and innovative acumen as theorized by Maslow (2014) in his model of employee self-actualization.

***Business leadership's problem of hiring the right personnel and improving employee efficiency may align with the societal problem of lack of education and economic opportunities.*** Business leaders depend on the skills and knowledge of their employees to improve the production and the innovation needed for profit-growth and business sustainability. A survey by McKinsey revealed that 94% of business executives are not satisfied with their firm's innovation output (Anthony, Cobban, Nair, & Painchaud, (2019). A lack of educational opportunities in a society or country may transform into problems of an incompetent employee-base thus stifling innovative virtues and productivity, leading to the collapse of a business. Contributing to employee education and providing training programs are strategies to improve innovation and gain sustainability advantage. Supporting the educational and skill requirements of potential and current employees may improve innovation thus business expansion to new



markets, and sustenance needed to mitigate the problem of lack of economic opportunities in communities.

***Business leaders' strategy to better "know" customers may lead to creative and innovative ideas needed to solve the problems of poverty, water and food shortage, and safety in society.*** In a flux market, a constant study of customer behavior, trends, and needs is important to the innovative structure and formation of a strategy to ensure sustainable business growth. Christensen, Ojomo, and Dillon (2019) cited an example wherein the leadership of Sony asked employees to observe customers in their natural settings to better know their tendencies and needs. Market-creating innovations by business leaders are the result of improved knowledge by researchers of customers and especially noncustomers to provide goods and services according to their needs (Christensen, et al., 2019).

Finding new markets and developing new products to solve particular problems of society are important innovative initiatives for a firm's competitive advantage bottom-line and, sustainability needed to ensure continuous profit maximization. However, as Anthony et al. (2019) pointed out, business leaders cite a lack of skills, intolerance of a trial-and-error culture, and inadequate infrastructure as their main impediments to innovation in the workplace. Societal problems such as lack of economic and educational opportunities, poverty, inadequate infrastructure, and sources of energy may be mitigated if business leaders adopt an innovative program based on sustainability or the creation of economic opportunities in deprived communities in a phenomenon termed market-creating innovation by Christensen et al. (2019).

Innovation based on knowledge of the customer and the noncustomer and manifested in a mechanism to find new customers, create new products, and reducing cost, to meet the needs of

noncustomers and the evolving customer is needed for business profitability and societal wellbeing. Creating economic opportunities by finding new markets and uses for a product and locating firms in the deprived community may lead to societal development in the region, needed to sustain a business and in cases grow it as innovative ideas from a hitherto disenfranchised demand and knowledge base may be added to the business process. For example, firms in the U.S. relocated to China to take advantage of cheap labor and the potential market that a large population offers. In the process, China's economy has developed and now ranks second in the world.

Corporations such as Sealed Air have innovated efficient packaging for food to extend shelf-life and reach people living in poverty (Sealed Air Corporation, 2018). Other companies produce bottles that are made of recycled material with fewer carbon-footprints, the purpose of which, among others, is to improve health by reducing carbon monoxide in landfills and preserving natural resources. Coca-Cola has embraced organic production by introducing manure on farms to grow products (The Coca-Cola Sustainability Report, 2018). This adaptation was necessary because of current trends that emphasize the importance of organic eating for health improvement.

***The business problem of managing a diversity of culture and the complexity of information may align with the societal problem of lack of economic opportunities.*** The era of globalization has culminated in increased diversity, cross-culturalism, and improved and complex information systems, leading to uncertainty on the part of business leaders as they seek a global customer and resource base. Business leaders may not know how to deal with a multi-cultural customer base and a pool of potential employees thus fail to utilize their skills and

knowledge leading to a situation of lack of economic opportunities and business innovation needed to spur further growth.

Efficiency in managing a multi-cultural employee-base and a complex information structure as a result of globalization may be a sustainability strategy by business leaders. Business leaders may not attain sustainable growth without expanding their markets thus improving demand by producing for a global customer base and utilizing the innovative ideas and acumen that a multi-cultural employee base may bring to a business in their innovative processes. A cross-cultural training program and culture formation suffice in a global era. This involves expanding into countries and finding economic opportunities in the social needs of communities. Hiring a cross-cultural employee such as a Japanese in an American corporation may help provide knowledge to meet the needs, tastes, and preferences of a Japanese customer-base.

**The societal problem of income inequality may correspond with the business leadership problem of uncertainty as a result of a lack of innovation to spur growth and ensure the sustainability and profitability of businesses.** As Maslow (2014) noted employees reach a level of creativity and innovation when they can afford basic, security, love, and esteemed needs. Sehgal (2019) stated that "nothing excites the brain quite like money". There's no doubt that employees are motivated by money. However, in America, CEOs receive \$13.94 million a year while the average employee is paid \$38, 613, a figure which has remained stagnant for over 50 years despite an increase in inflation during that time (Quinnell, 2018). A higher and equal pay structure will excite and motivate employees to perform at their best and become innovative. Strategizing to improve the wellbeing of employees through higher

compensation, improved healthcare, education and skills-revamping may spur production and innovation needed for business sustenance may reduce the uncertainty of organizational leaders and also solve the critical societal problem of inequality and poverty

### **The manifest and latent functions of a business**

The manifest function or core mission of every business organization involves satisfying the needs of consumers. The strategic purpose of businesses is to improve the quality, reduce the cost of, and create new products and services through investment in innovation, to maintain current customers and attract noncustomers. Profit maximization for owners or shareholders is predicated on the success of business in satisfying the needs of customers and attracting noncustomers. The tool for producing quality goods and services to attract demand is the employee thus the need to improve their wellbeing through high compensation, support of education, and healthcare.

The latent function of every business is to improve the wellbeing of all stakeholders including community members, employees, and the environment. There may be a thin and fading line between a business latent and manifest functions as according to Schein (2004), businesses are dependent on stakeholders, including customers, suppliers, community, government, employees, and stockholders for their economic survival and growth. A viable community of improved healthcare, infrastructure, and education is a critical support mechanism for business growth and sustainability. There's no doubt that shareholders who provide the capital and subsequent financial support for the business should be profited, however, profitability is an

instrument of stakeholders resourcefulness and ingenuity especially employees and natural resources of the environment thus stakeholders deserve an equitable share.

Per the manifest or core function of businesses, the tool for achieving profit maximization, the natural resources, and support mechanism, suffices then to conclude that there's the need for equitable distribution of profit based on value to the purpose of the business. The latent function of business is a critical support mechanism for attaining business growth and sustainability. As Drucker (2008) stated, business is a function of society. A vibrant business exists in a vibrant society. Business leaders may consider community relations programs such as corporate social responsibility to improve relations with customers and especially noncustomers. Understanding and luring noncustomers may be key to gaining a sustainability advantage on the market.

### **Conclusion**

The theory of shareholder primacy, profit maximization for shareholders, has contributed to problems of society as stakeholders' wellbeing is not the priority of business leaders. Gaining and maintaining a competitive advantage in a flux market of uncertainty requires innovation with a primary focus on sustainability initiatives that encompass the improvement of the wellbeing of all stakeholders. The theory of shareholder primacy is at variance with stakeholder wellbeing as corporate leaders are under constant pressure to maximize profit for shareholders in the short-term, thus stifling innovative investments for long-term growth and sustainability. Problems of business leaders such as uncertainty over future growth potentials, lack of skills and cost of training, depleting resource base, and deficiency in innovative acumen directly align with

societal problems of poverty, lack of economic and educational opportunities, income inequality, and devastating weather phenomena. The CEOs of the Business Roundtable have pledged a change in the purpose of business from shareholder primacy to stakeholder orient to ensure sustainable growth and societal wellbeing. Let's hope they are not engaging in greenwashing to suppress public frustration.

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