BENTLEY UNIVERSITY

W. Michael Hoffman
Center for Business Ethics

Verizon Visiting Professorship in Business Ethics

The New Story of Business: Towards a More Responsible Capitalism

R. Edward Freeman
Elis and Signe Olsson Professor of Business Administration
University of Virginia Darden School of Business

November 1, 2016

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THE HOFFMAN CENTER FOR BUSINESS ETHICS at Bentley University is a nonprofit educational and consulting organization whose vision is a world in which all businesses contribute positively to society through their ethically sound and responsible operations. The center's mission is to provide leadership in the creation of organizational cultures that align effective business performance with ethical business conduct. It endeavors to do so by applying expertise, research and education and taking a collaborative approach to disseminating best practices. With a vast network of practitioners and scholars and an extensive multimedia library, the center offers an international forum for benchmarking and research in business ethics.

Through educational programs such as the Verizon Visiting Professorship in Business Ethics, the center is helping to educate a new generation of business leaders who understand from the start of their careers the importance of ethics in developing strong business and organizational cultures.

W. Michael Hoffman, PhD

Executive Director
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This year's Verizon Visiting Professorship in Business Ethics comes at a momentous moment in the history of our center. 2016 marked the 40th anniversary since its founding, and to commemorate this, the name "W. Michael Hoffman" was added to the "Center for Business Ethics at Bentley University." As the Center's founder, I was greatly honored by this, but it also provoked some serious reflection on the evolution of the field to which I've dedicated my professional life.

Forty years is not such a long time, but it does seem sufficient to spot general trajectories that cut through the noise generated in the ups and downs of daily events. The trend I see is that while business has been evolving in unpredictable ways, the trend-line of business conduct has been positive.

This idea is borne out by this year's Verizon Visiting Professor in Business Ethics, Ed Freeman, which is significant given Ed's stature in the field. Over three decades ago, he challenged the prevailing notion that the overriding purpose of business is to serve the interest of *shareholders*. Instead, he claimed that businesses operate in a complex environment in which many *stakeholders* can claim legitimate interests. Almost overnight, "stakeholder theory" became an indispensable concept in business ethics, to the extent that about five minutes into the study of business ethics, students learn of this central idea.

While no one can dispute Dr. Freeman's impact on the field of business ethics, many might dispute the impact of business ethics on the conduct of business. Given the seemingly unending procession of business scandals, one couldn't be faulted for thinking that business is stuck in a permanent "Dark Ages." Freeman, however, has continued to drive the field forward and what he found constitutes the subject of his talk. Specifically, he sees a new narrative on the nature and purpose of business emerging, and this he calls, "Responsible Capitalism." This idea may not sound revolutionary, and yet it builds on stakeholder theory and helps to corroborate the positive trend to which I referred earlier.

Strong businesses are sustainable and, as Freeman sees it, this is achieved when business contributes to stable, flourishing societies in which they are motivated not simply by profits, but by purpose, ethics, and values. The Dark Ages of unscrupulous business are limited because ultimately they are self-destructive. Responsible businesses, however, are like builders of sustainable light bulb factories — business and society benefit when we all step out of the darkness, and in the process, there are financial and social dividends that reward us all.

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R. Edward Freeman delivers the Verizon Lecture in Business Ethics to students, faculty, staff, and friends at Bentley University.

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Dr. R. Edward Freeman is University Professor and Olsson Professor of Business Administration; Academic Director of the Business Roundtable Institute for Corporate Ethics; and an Academic Director of the Institute for Business in Society at the University of Virginia Darden School of Business. He is also the Academic Director for Corporate Ethics and Co-Academic Director of the Institute for Business in Society. He is Adjunct Professor of Stakeholder Management at the Copenhagen Business School, Adjunct Professor at Monash University (Melbourne), and Visiting Professor at the International Centre for Corporate Social Responsibility (ICCSR) at Nottingham University. Dr. Freeman taught previously at the University of Minnesota, and the Wharton School at the University of Pennsylvania.

He is the author or editor of over twenty volumes and one hundred articles in the areas of stakeholder management, business strategy and business ethics. Freeman is perhaps best known for his award winning book: *Strategic Management: A Stakeholder Approach*.

(From left) Greg Miles, Director, Office of Ethics & Business Conduct, Verizon Communications; R. Edward Freeman, PhD, Elis and Signe Olsson Professor of Business Administration, University of Virginia Darden School of Business; and W. Michael Hoffman, PhD, founding Executive Director of the Hoffman Center for Business Ethics and Hieken Professor of Business and Professional Ethics at Bentley

Verizon Visiting Professorship in Business Ethics

The New Story of Business: Towards a More Responsible Capitalism

R. Edward Freeman
Elis and Signe Olsson Professor of Business Administration
University of Virginia Darden School of Business

November 1, 2016

Introduction

The last 40 years have seen great changes in our understanding of business. In our lifetime, we have seen a remarkable pace of globalization. We have seen revolutionary information technology. We have seen nothing less than a fundamental shift in the story of business. In this talk I will try to explicate what I believe is a conceptual revolution in business, and in particular, I will try to explain this "new story of business" in terms of a few fundamental principles or ideas.

While the roots of this revolution are easily traceable back to the 1980s or even earlier, they are most clearly seen in the responses to the Global Financial Crisis (GFC) of 2008. Since that time, we have seen an explosion of ideas of how to make businesses more responsible for the consequences of their actions.

For instance, many companies have taken a renewed interest in corporate social responsibility and sustainability. In addition, we have seen a renewed emphasis on the idea of Conscious Capitalism as John Mackey and Raj Sisodia have argued that companies that follow the tenets of conscious capitalism will outperform those that do not. Michael Porter and a colleague have suggested that companies should focus on "shared value" where economic value and social value are seen as going hand in hand. Nestle has been the show pony for this idea. Just Capital is an NGO that is committed to rating companies on widely accepted standards of justice. Bill Gates has suggested Creative Capitalism, whereby companies forego profits for the sake of public welfare. Senator Mark Warner of Virginia has suggested that it is time for new metrics, especially around the welfare of workers and has hailed a move to Capitalism 2.0.

Meanwhile, the idea of social entrepreneurship has taken off with many millennials beginning to start businesses that address social problems. NGOs such as the Acumen Fund, Kiva, Kickstarter, and countless others have been started to provide capital for small and very small businesses and entrepreneurs who are societal change agents. Even on Wall Street, we see an increase in the movement towards what is variously called, "patient capital," "impact investing," "responsible investing," and other terms.

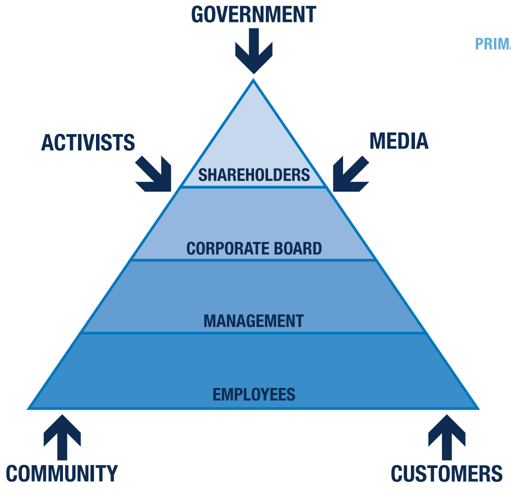
Business pundits have gotten into the act, decrying a lack of ethics that they claim brought about the GFC. Robert Reich has argued that ethics and profits have to go together. Agency Theorist pioneer, Michael Jensen, has suggested that integrity is an important element in a successful business. The Aspen Program in Business and Society has led various conversations about new business models, new governance models, and a variety of other related ideas.

At two recent meetings at the White House in 2016 sponsored by the Obama Administration's Department of Labor, 75 people from these organizations and movements gathered to discuss commonalities and whether or not there needed to be one brand that identifies this new story of business that is emerging. While such a brand may someday emerge, or perhaps it already has, for my purposes I want to focus on the underlying ideas and principles that are inspiring all of this activity. Whichever brand or brands that ultimately become the rallying cry on which this conceptual revolution will be based, the brand will have to be based on a sense of purpose and ethics that is as central to the new narrative as profit is to the old one. It will have to address how companies can simultaneously create value for all of its key stakeholders. The brand will have to take sustainability and the physical limits of business very seriously. And, it will have to recognize that people are complex and that they can and do collaborate with others to create value. I will set these ideas out more carefully in a later section. For now, let's turn to the dominant narrative or the "old story of business," and see why it is no longer applicable for the 21st Century.

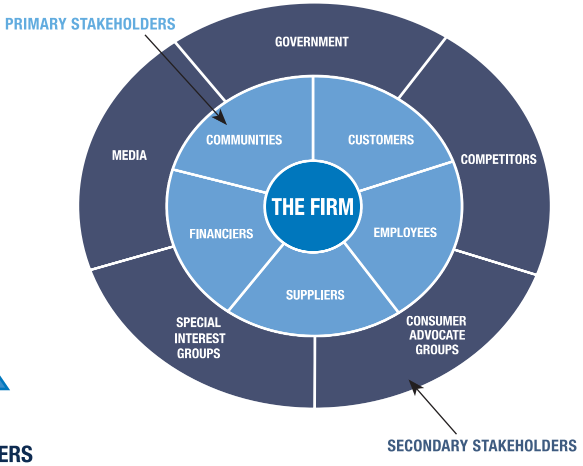
The Dominant Narrative

While all of these conversations and new business models are going on, we still see many executives and academics who are strongly committed to the idea that the main goal of any business is to make as much money as possible for its shareholders. This view was articulated best by Milton Friedman in a 1970 *New York Times* article in which he stated that the only responsibility of the executives is to make as much money as possible for shareholders. While Friedman's view is more nuanced and is often misinterpreted, the shareholder primacy idea has a real grip on both executives and academics. This dominant narrative of what we might call the old story of business is deeply rooted in business cultures around the world. Oftentimes, it is appealed to as a way of justifying almost any action that seems to harm groups other than shareholders. Consequently, especially since the GFC, there's a real struggle going on around the issue of the ethics of capitalism. Let's be a

The Old Story of Business: Built on Hierarchy and Power



The New Story of Business: Requiring Collaboration Among Key Stakeholders



little more precise here. We can talk about this old story of business in terms of five claims.

The first is that business is primarily about making money and profits for shareholders. Business on this view is the physics of money, and the language of money and profits is seen by many to be the main metaphor in talking about business. Often these theorists talk as if money is the only thing that matters, and the vocabulary of finance and accounting are the only vocabularies that tell us how to build a great business. More precisely, business is seen as a collection of economic transactions that can be fully understood using economic models and concepts. Modern economics has built some really powerful models, from general equilibrium to modern econometrics, and indeed they are useful for understanding how markets work. The problem is that they are not the only way to understand business, and they can be misleading as the GFC taught us.

The second claim is that the only constituency that matters is shareholders. Friedman's claim is that the only social responsibility of an executive is to make as much money as possible for shareholders. Even though Friedman was careful to also say that such a claim was subject to ethical rules and law—this part of the claim often gets left out. So, executives and pundits sometimes argue that whatever is not illegal is permissible in the name of shareholder value.

The third claim is often implicit. It is that we live in a world of fairly limitless physical resources, or that market forces will always determine which resources are economically feasible to use. We need markets for natural resources such as air, water, and carbon emissions, not regulation.

The fourth claim that we see played out in the popular press all the time is about what motivates business people. In keeping with the idea that business is about the physics of money there is a widespread idea that, given the opportunity, business people will cut corners, lie, and cheat. People, on this view, are completely self-interested. They will work for others only if they are incentivized to do so with either a threat of punishment or a promise of rewards.

The fifth claim summarizes the first four and says that business and capitalism work because people and companies are self-interested, competitive, and greedy. The greatest good emerges as if by an invisible hand. Usually homage is paid to a brief passage in Adam Smith about the butcher and baker.

What's Wrong with the Old Story?

1. Profits aren't the purpose of business.

While there has been much criticism of this so-called neo-classical view of the firm, for our purposes I want to focus on three main flaws that make it easier to see why the old story is no longer appropriate. The first flaw is the idea that business is the physics of money and that profits are and should be the purpose of any business.

While there are many businesses that have come to see making money for their "owners" as the main purpose of their business, most of these businesses didn't start out this way. Most entrepreneurs start their companies because, in John Mackey's words, "they are on fire about their business idea." No matter whether it was Steve Jobs and Bill Gates on fire about the desktop computing revolution and starting Apple and Microsoft, Mackey himself, on fire about bringing healthy food to people through what became Whole Foods Market, or my son, Ben, on fire about bringing the great rhythm and blues sound of Motown and Stax into the 21st Century with Red Goat Records, none of these entrepreneurs started the business with the purpose of making as much money as they could.

Now, of course, money and profits are important. They must exist for a business to live. Demonizing profits, as many pundits have done, is just a shortsighted, ideological mistake. Likewise, to claim that the purpose of a business is to make profits for owners is a similar and often ideological mistake.

I need to make red blood cells in order to live. However, it doesn't follow, without a lot of argument that I simple can't imagine, that the purpose of my life is to make red blood cells. Even if I have fallen on unhealthy times, and I have to actually concentrate on making red blood cells, for instance by paying a lot of attention to the iron in my diet, it still doesn't follow that the purpose of life is to make red blood cells (or to breathe, or to drink water, etc.).

Likewise, sometimes businesses fall on hard times. A competitor disrupts the industry, or mistakes have been made, or the world simply changed. In all of these cases, a business might have to focus fairly clearly on generating profits in order to stay alive, but it would be a mistake to claim that profits were the purpose of the business.

Former CEO of GE, Jack Welch, business guru, Simon Sinek, and many others have claimed that it is best to see profits as an outcome. And, I will add it is an outcome of purpose and how value gets created for stakeholders. More on that idea later.

2. Business ethics isn't a contradiction.

When I tell people that I teach business ethics you know what happens. Either they have to manage not to laugh, or they say "business ethics" I thought that was a contradiction. The idea that business and ethics don't go together has long been a part of the dominant story of business.

After all, if business is just about money, shareholders, and profits, there's not much room for ethics to be a central part of it. The way I like to put it is that of the phrase "business ethics," we only really misunderstand two of the words.

First, let's talk about business. The old story of business says to us that business is about competing, making money, and doing whatever you can get away with. The idea that business people are not trustworthy is in many cultures around the world. A recent study found that only 19% of people around the world actually trust business executives of large companies. Now, every business person that's here today knows that business is not just about making money. But even if that's all you want to do, how are you going to do it? You'd better have some products and services that customers want to buy. You need suppliers who are committed to making you better by improving your business with their products and services. You need employees who are not there just for the paycheck but are there to make your business better—employees who are engaged in their jobs. You need them not to be unengaged or actively engaged, as many studies have found is the case in a lot of businesses. And, you need to be a good citizen in the community. If you're not a good citizen in the community, communities will pass restrictive laws or ordinances to prevent your business from operating well there. If you do these things, if you have great products and services for customers, if your suppliers want to make you better, if you have employees who are engaged, and if you are a community builder, then if you put those things together the right way, profits will emerge. Again, this is the idea that profits are an outcome. So business, far from being just about the money, is about creating value for stakeholders.

Now, let's talk about ethics. Many people think that ethics is about things you talk about only on Sunday. It's about angels and organ music or very serious things talked about in hushed tones. While religion is important in ethics, I want to urge you to think about it more broadly. Ethics is really the most practical thing around. Ethics is about how I live my life and how living my life affects how you live your life. Ethics is always personal; it's about what I want and how I'm going to live. And, it's always interpersonal. It's about how we are going to live together. Many people have the idea that ethics is about rules chipped into stone, rules that never change and rules that are fairly inflexible. But sometimes these "rules" can conflict and sometimes they need to change or be interpreted in different ways as we invent new technologies or discover other previously hidden features of a situation. Ethics is, in my view, a conversation about how we are going to live together. It is a conversation that substitutes reason, dialogue, and talking together for violence. It's easy to see in many places in the world where the conversation has broken down. Violence isn't a good answer. Now, many people would argue that ethics is personal. I get to decide what my ethics are. I have to look myself in the mirror. I have to live with myself. And that's true, you do have to live with yourself. But all of us have to live with you too. And that gives us some right to join in the dialogue and conversation about how we are all going to live and thrive together. From the time when we lived in caves, we've always had conversation about what behavior is appropriate and what behavior is inappropriate in a community. We've had conversations about what are some good ideas—some good rules of thumb—to keep the order in society and to allow all of us to flourish. This is ethics at its best. Over time, we've grown quite good at ethical reasoning. But at the same time we have many challenges to our ethics in society today primarily because of technological change and the emergence of new societies to do things differently and new cases of a kind that we just haven't thought of before.

For instance, I learned ethics at my grandmother's knee in the 1950s in Georgia, but we didn't have any conversations about intellectual-property that could be digitally reproduced for no cost. We didn't have any conversation about end-of-life technology that could prolong life at a great cost. We didn't have any conversations about abortion or things like file-sharing and Napster or what's appropriate on Facebook and Twitter. Those things simply didn't exist. Now, one thing you can say is know your ethics and your values and you won't have to have much of a conversation. The problem with this is that it is very hard to do in today's world. Human beings are very good at fooling themselves and saying one thing and doing something else. We need each other in this conversation about how we are going to live together.

What does all this have to do with business? If you ask people around the world to write down their three most important values that they would like to teach their children, or their three most important ethical principles, they all pretty much actually write the same thing. There is some version of respect, honesty and integrity, caring and love, and responsibility. Of course, what it means to show respect in Jakarta is very different than what it means in Charlottesville, so there is always a cultural context. But, it is difficult to imagine doing business without these values. Try to think what it would be like to do business always with people you did not respect, or on whose honesty you couldn't rely, or who didn't care about others. It would be impossible.

Adam Smith knew how important ethics was to business. Indeed, in *The Theory of Moral Sentiments* and in *The Wealth of Nations*, Smith makes it clear that without a sense of justice, markets just won't work very well at all. Thinking that business ethics is a contradiction is a deep flaw in the dominant narrative of business.

3. People are complicated.

There is ample scientific evidence that human beings are not the rational economic beings that much of our economic and business theory assumes. We're not always driven by extrinsic if-then rewards. We want to be engaged in doing something that has meaning and purpose. Some have argued that we understand human motivation in terms of three ideas: Mastery, the sheer joy we take out of getting better at something; Autonomy, the freedom to live our own lives to try new things; and Purpose, the idea that we stand for something greater than just ourselves and our self-interest. By thinking about mastery, autonomy, and purpose, we get a much more realistic view of what motivates people in business. The old story's insistence on human beings being motivated primarily by money is really not appropriate in the 21st-century if it ever was appropriate. Certainly, the new generation that we call Millennials want to do something that has meaning, that has purpose, that is not just making money.

Psychologist, Harry Levinson, used to hang out at the Harvard Business School. He was a crusty old guy and would often ask executives what was the main way people are motivated inside corporations. Most executives would say to him rewards and punishments or carrots and sticks. Levinson would draw on the board a carrot at one end and a stick at the other. In the middle, he would put a question mark. He would ask what animal do you imagine between the carrot and the stick? Most people would say a jackass. So, Levinson coined the idea that he called the great jackass fallacy. It goes like this: maybe… just maybe, human beings are slightly more complex than jackasses. Maybe they have social, spiritual, sexual, political, ethical lives as well as economic lives. But it's even a little more difficult than that. If you treat people like jackasses, they begin to act like jackasses. They nose around for the carrots and they try to avoid getting the stick. Think of all of the productivity that gets left on the table, and, indeed, think of all of the human misery that results from treating people like jackasses. Human beings are more complex than the dominant story would have us believe. We will say more about this as we move to thinking about the principles that underlie this new story of business.

There are at least three flaws in the current story of business. First, the purpose of a business is not only to make money. Second, business and ethics need to go hand in hand. And, third, human beings are complicated. The time has passed for these flaws. The new story of business that is being built by thousands of entrepreneurs and executives around the world, eschews these flaws and takes a different approach. Let's turn to understanding the ideas that are behind the new narrative.

The Ideas behind the New Story

I have identified at least six new ideas that undergird the new story of business that is emerging. They are:

1. **The Unit of Analysis is Stakeholder Relationships**
2. **Stakeholders are Interdependent**
3. **Trade-offs are Managerial Failures of Creative Imagination**
4. **Purpose, Values, and Ethics must be Embedded in Organizations**
5. **Business Exists in the Physical World**
6. **People are Complicated**

Let’s look at each in turn and see how they are connected with each other and this new story.

1. The Unit of Analysis is Stakeholder Relationships.

One of the cornerstone ideas behind the new story of business that is emerging is the importance of looking beyond shareholders to a broader group of stakeholders. As we saw earlier, creating value for stakeholders is something that every successful business has actually done. As we become more aware of this fact, we can build into our business models more nuanced ways to create value.

The key difference is that in a relationship there is a presumption that the relationship will continue over time, other things being equal. Businesses need relationships with their stakeholders so that each has some attachment to the other. You want customers to have some degree of loyalty. You want employees to give you the benefit of the doubt, and you want shareholders who will stick by you when things are tough. Seeing these relationships through the lens of “discrete transactions unrelated to each other” does not build loyalty. In fact, it encourages exit when things get tough. Building loyalty with stakeholders mitigates the risks of difficult times.

Company X had built a relationship with a stakeholder group that often criticized the company. The stakeholder was targeting X with a campaign and called to tell them. The executive at Company X asked for help in solving the problem that the campaign was about, and the company and stakeholder were able to introduce an innovative program that went a long way towards solving the problem. All of this happened because there was a relational mind set.

Of course, relationships are two-way streets. Companies have to stand by their suppliers and their employees when times are tough for them. And, they have to share in the rewards of success, in a broad manner, not just in terms of rewarding senior management. Whole Foods Market uses gain-sharing to reward the employees who work to bring things in under budget. They also give most of the stock options to non-top management employees.

2. Stakeholders are Interdependent.

It has often been said that the key insight of stakeholder theory is that there are groups that are important other than shareholders. And, while this is one insight that the theory has brought to management thinkers, another is more important. It is that stakeholder interests have a certain interdependence. And, when management can capture this interdependence and push it forward, great results are likely to occur. Wal-Mart was for many years a poster child for this interdependence. By negotiating tough deals with suppliers, Wal-Mart could offer customers everyday low prices, and even though the margins were thin for suppliers, there was a great deal of volume that could lead to profitability. Employees were better off since there were more customers coming to take advantage of the everyday low prices, and the stock price saw a steady increase. Unfortunately, Wal-Mart paid little attention to communities as stakeholders, focusing on citizens as customers. Many outside groups began to be formed and Wal-Mart was blamed for many social ills. Today, Wal-Mart is working hard to repair its relationships with communities and to integrate ideas that make communities better off into the rest of its business model. The progress that has been made with sustainability is but one of several examples where Wal-Mart has taken a leadership role.

Even the companies who do CSR and who have adopted Michael Porter's view of shared value have begun to see stakeholders as interdependent. For a long time, CSR was seen as something of a public relations move, unconnected to the main business model. More recently, we have begun to see how CSR can be connected to the basics of what a company knows how to do. Nestle has pioneered this idea with shared value, as it has sought to introduce the creation of social value all the way down its economic value chain.

3. Trade-offs are Managerial Failures of Creative Imagination.

Economists love trade-offs. In fact, one of the hallmarks of modern economics is that one can always calculate trade-offs. I have become increasingly skeptical of trade-off thinking. In fact, I believe that the drive to collaborate and avoid trade-off thinking is far more powerful. When we see the task of the executive as getting stakeholder interests all going in the same direction over time, trade-offs will disappear. Of course, sometimes they have to be made, because we can't imagine an alternative, but when we make a trade-off we need to immediately begin the process of making the trade-off better for both sides.

I've often told the story of a large chemical company who decided to commit to being more sustainable and cleaner. The CEO announced a large and lofty

Collaboration is essential to the new story of business.

sustainability goal and proceeds around to the divisions and plant sites to let them know that he was very serious about this. There were interim goals and plans in a very businesslike approach. In one facility, as he told the story to a symposium at Dartmouth in the 1990s, the engineers came up to him and said, “Sorry but we can't meet these interim goals. This process is too dirty, this equipment is too old, and we can't meet the first target.” The CEO said that they were serious about this program, and they would have to close the plant. What I understood from that was that he was willing to make a trade-off, environment or community on the one hand versus employees on the other. The CEO’s trade-off was that the environment was a serious issue and it was going to be the winner. So, he told the engineers to prepare to close the plant. A few weeks later the engineers came back and said that a miracle had occurred. They figured out how to do it. When the CEO asked what it would cost, the engineers actually were embarrassed to say that the new method would save money.

When trade-off thinking becomes unacceptable we kick into gear the only infinite resource we really have, which is our creative imagination. The use of the creative imagination is radically underutilized in most companies today. Trade-offs are easy. In the new story of business with the stakeholder mindset, trade-offs become managerial failures. As more and more companies are thinking about the new story of business, they're discovering ways to satisfy multiple stakeholders. Simultaneously, this is one of the key ideas in the new story.

What this means is that conflict, often avoided in many companies, is precisely the place where value creation can take place. When there's conflict among stakeholders, where there's conflict among core values, where there is conflict among competitors or products this is exactly the place where we can re-imagine that conflict and create more value. We have to come to see conflict as a good thing. Recall the story above about company X who had conflict with the stakeholder group but kept up the relationship because that stakeholder group could help them figure out how to solve a problem. A lot of value was created.

4. Purpose, Values, and Ethics Must be Embedded in the Organization.

One of the great things about business as an institution is that many different purposes are possible. Novo Nordisk wants to rid the world of diabetes. Whole Foods Market wants to help people be healthier with better choices for food. Tastings, a small restaurant in my hometown, wants to bring the joy of good French country cooking to its customers. The founders of the company Relish MBA want to make it easier for companies and MBA students to find a good match. The only limit to the purpose of a business is our imagination. Of course, purposes don't have to be all good. We have plenty of examples from human history about organizations that were of high purpose, but whose purpose was morally evil. A sense of values and ethics has to go alongside purpose. There are many organizations in the pantheon of new story organizations who are addressing precisely this issue. Just Capital is rating organizations based on a notion of "Justice." However it shakes out, we can no longer make the mistake that the pursuit of profits is the sole purpose of business. Real purpose inspires both employees and other stakeholders who come to share that purpose. And, this new story of business is an inspirational story.

5. Businesses Exist in the Physical World.

While many who write about sustainability and the environment sound a caution about the physical limits of the world, I want to suggest that this is only part of the story. We do need to come to see business as embodied in the world, and hence, there are constraints imposed by the physical world. However, we also need to see business as capable of transforming those constraints into new opportunities. We have seen this time and again as companies such as 3M figure out how to turn waste streams into products and services. Obviously, we need to tackle climate change, but seeing it as giving us limits to growth is forgetting the creative imagination that has solved so many of our problems in the past. Adopting some kind of green values, and integrating respect for the environment into our purpose and values, can be a powerful elixir for creativity.

6. People are Complicated.

I don't want to repeat the arguments I gave earlier about the flaws in the old story. Rather, I want to suggest that there is a much more inspirational view of human beings that is emerging. People are using business models and ideas to attack age old problems of poverty, education, disease, and more participation in society. Often these problems are attacked by these "new story companies" in conjunction with NGOs, governments, and other private organizations. We have seen a wave of "social entrepreneurs" and "impact investing" where the explicit idea is to use business to make society better and to solve social problems. I believe that we are fast crafting a new idea about what it is to be human. Let me illustrate.

What is this smartphone, really? The way I see it, it's some bits of sand and metal, some vocabularies that we have invented to solve problems, and the fact that we can work together collaboratively to achieve things that no one of us can achieve alone. In short, I see the world not as a world of scarcity, but as one of abundance. We have an almost infinite capacity to invent ways to solve our problems, whether we take on poverty, space travel, climate change, or understanding the rules of cricket. But, we are not in it alone. We invent mutually beneficial vocabularies with others to solve our problems. And, this is true whether we are scientists or politicians. We are surely more than narrow economic creatures, and in fact, capitalism works just because of this complex human dimension.

Towards a More Responsible Capitalism

If we are to move our system to a more responsible capitalism, we need a few more ideas that will transcend these particular ones aimed at creating and sustaining a successful business. First of all, we need some broadly defined principles of responsibility throughout our society. Responsibility is an idea that comes with the more libertarian idea of freedom that underpins market systems. We need to see people and companies as responsible for the effects of their actions on others. That is the moral cornerstone of the stakeholder idea. Unless we are willing to take responsibility and to be willing to justify our actions to our fellow humans, our society will not continue to flourish.

The second idea is that we need to continue to see business as a voluntary enterprise. No one is forced to do business with anyone else. This idea of choice as applied to multiple stakeholders is central in creating a system of business that works for everyone. Competition should celebrate the choice that customers have. Restricting that choice artificially through institutions like crony capitalism should have strong sanctions.

Finally, we need a new idea of the role of government. While we have clear theories about how government plays its role as both regulator and redistributor, there is another role that is often overlooked. Government can be a facilitator of value creation. It does this via infrastructure and other programs such as enforcing civil rights and ensuring that crony capitalism doesn't take hold. We have only begun to explore this idea of government as facilitator of value creation, so stay tuned.

What Can You and Your Company Do?

Let me wrap up by taking these ideas down to an extremely practical level. There are at least five ways to begin to practice this more responsible capitalism in your businesses.

First, you can rediscover your purpose and the values that go with it. No less a company than Unilever has begun this process, and while it takes time, the payoffs are large. Employees become inspired, and the innovative ideas begin to flow. How do you rediscover your purpose? Well, the first thing to do is to have a look at history. What are the founders' stories that are told in the company? Why do people actually show up for work? What really helps them when they are at their best? It takes a concerted effort if a company has lost its way, but it is an exciting process to rediscover the purpose of an organization. Values go along with purpose and are often seen as the "how" we are going to realize the purpose.

Second, you can perform a systems/process check on the purpose and values. Purpose and values live in the systems and processes of an organization. Talk is cheap. The first places to look are the HR and expense reimbursement systems. Think about an organization that trumpeted its respect for employees but required them to get a receipt for a $2 toll on the Mass Pike, a task that is mostly dangerous if not impossible. Or consider an organization who is very proud of its stand on values, yet waits 60 days to reimburse employees, and pays suppliers in even later terms.

Third, you can begin live conversations about the purpose and values. Small groups of employees can help to clarify what values are actually in force at the company, and there are known techniques for creating a conversation about these values, such as which ones are we really serious about, and which ones are we just giving lip service to. Some companies have begun to encourage meetings where employees bring "values vignettes," or sticky problems, to groups of peers to try and get insights. Based on Johnson and Johnson's original "challenge meetings," discussions of these vignettes helps to clarify what are the true meaning and intention of quite general values statements.

Fourth, you can be a community builder. There are many ways to help build the communities in which you operate. Giving employees time off to volunteer, hiring some of the least well off members of a community and giving them training, and donating to charities, are all viable strategies. However, figuring out what you know how to do, can be used to build community, brings the power of the business model to bear on tough problems. We are beginning to see more and more companies working with stakeholder groups in the non-business sector to jointly tackle societal issues. Such multi-sector collaborations are one of the best ways to build community.

Finally, you can communicate how your organization makes the world a better place. We need business organizations to inspire us. We need business to become an institution of hope. We need business executive to try and remake their organizations to be places where we would one day want our children to work. Asking anything else is to set the bar too low.

Note: The ideas in this talk have been partially developed in a number of places, especially Freeman, Martin, and Parmar (2007); Freeman, Parmar, and Martin (2016); Freeman and Ginena (2015); and, Freeman (forthcoming). I am grateful to editors and co-authors for their permission to more carefully develop these ideas here for a public audience. This paper will be a part of a forthcoming book, tentatively titled: *The New Story of Business: Responsible Capitalism*, co-authored with Bidhan Parmar and Kirsten Martin, in 2018.

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Q&A

Below are highlights of question-and-answer session with Prof. R. Edward Freeman and Bentley University students, faculty, staff, and guests.

QUESTION: *Dr. Freeman, oftentimes in our textbooks, stakeholder theory and shareholder theory are pitted against each other. What do you think Milton Friedman's perception would be of stakeholder theory?*

R. EDWARD FREEMAN: Milton Friedman is one of my heroes, but he's an economist trying to understand how markets work. Markets might work as if people maximize shareholder value, and markets are one way to think about business, but it's not the only metaphor that's there. I think the difference between us is that I have a different view of what business is. Friedman says that if a particular program adds shareholder value, it's okay. I think most of what I'm talking about adds shareholder value. So, I don't see a contradiction here. In fact, I would argue, if you want to maximize shareholder value, worry about your stakeholders. Shareholder value is an outcome, just like happiness is an outcome of how you live. There's a great article in *Reason* magazine. It's a debate between John Mackey, the CEO of Whole Foods and a real stakeholder theorist and a libertarian, and Friedman. Mackey makes this argument that the way to create the most shareholder value is to create value for stakeholders. Friedman's critique was about people who confused corporate social responsibility (CSR) with doing things they didn't know anything about. In the late '60s and the early '70s, when there was another run of people talking about corporate social responsibility, you had businesses taking on things that they didn't know much about. Today, CSR is much more relevant to the core of the business. I don't really see much debate about that anymore. To the extent that businesses are doing things they don't know anything about, then I agree with Friedman. To the extent that creating stakeholder value creates shareholder value, I don't think Friedman would disagree with me. I wrote a piece called, "Ending the So-Called 'Friedman-Freeman' Debate," in which I tried to forever end that debate. Unfortunately, no one read it, and so there you have it.

QUESTION: *In the last question you suggested that incorporating the stakeholder model is actually beneficial for shareholders. How do you defend this theory when it's not the fiscally responsible thing to do?*

R. EDWARD FREEMAN: First of all, the scholar, Raj Sisodia, who was here at Bentley for a long time, did a study in a book called "Firms of Endearment," which offers a proof of possibility. The question is, if you worry about stakeholders, care about them, and try to create value for them, is it possible that you'll do well? The answer is, yes. These companies outperform the S&P by a factor of eleven to one. So the proof of possibility has been done. Will that always be the case? No. A lot of the time, trying to maximize shareholder value is not in the interest of shareholders. That's what Lehman Brothers was about. They thought they were maximizing shareholder value when they were leveraged thirty to one. They made a mistake. People make mistakes all the time. I think the question becomes not can you prove that the stakeholder orientation always pays—that's the question in the old story where the only thing that matters is what pays—but, is it possible for the stakeholder orientation to pay? Sure, companies have to make money. There's no question about that. There are many people who want to show—or want me to show—that if you take these ideas seriously, then you absolutely will always do the best for the shareholders. I don't think you could ever show that. You can't show that always taking shareholder ideas seriously will always do best for the shareholder. Instead, I look for proof of possibility. If we ask, "Can we run a great business if we run the company in a way that we know is the right way to do things?" The answer to that is absolutely yes. And there's company after company that's doing that. But the academics will continue to criticize it.

QUESTION: *What made you want to get involved in business ethics in the first place?*

R. EDWARD FREEMAN: Do you want the truth or the press release?

QUESTION: *Both!*

R. EDWARD FREEMAN: The press release is that I did a PhD in Philosophy, and I was interested in decision theory and ethics and a person on my PhD committee convinced me to go to Wharton where I did a post doc and taught business ethics. The truth is that the only reason I actually went to Wharton was because my girlfriend was at Penn [i.e., the University of Pennsylvania]. She's now my wife of 40 years, so it worked out. But I had no idea what Wharton was. In fact, I said, "Wharton? What's that?" He said, "It's a business school." "Ohhh," I said, "Is it a good one?" He said, "It's one of the best." "But," I said, "it's a business school.... Where is it?" He said "Philadelphia, University of Pennsylvania." I said, "I might be interested." That's just a long way of saying, sometimes you have to follow your heart. You got to follow the serendipity that's there, and sometimes it works out. I was very lucky that it worked out for me. When I got to Wharton, it was around 1976. Business ethics wasn't really a field. I just happened to start writing about this stakeholder idea. It just fell in place. There was no plan—it just happened.

QUESTION: *If we want to live in a world where firms create shared value for everyone, what are the barriers? Do we need more NGO activism? Do we need to be boycotting certain firms? Or do we need more government intervention? Where do we need to push? What are the levers?*

R. EDWARD FREEMAN: I think the barriers are the story. For instance, we've been trying to change the narrative about women in society for a long time—that men and women are morally equal. We've come a long way in that, but certainly this presidential election has shown we have a long way to go. Changing the narrative takes time. You have to push in lots of different directions. I'm a little bit skeptical of trying to legislate it into happening only because there are always unforeseen consequences and the road to totalitarianism is a short one.

I actually think we've reached a tipping point. There are so many people starting businesses, being social entrepreneurs, and there are big companies, like Unilever, being purpose-driven. I think businesses have to recognize that they are purpose-driven enterprises and this shareholder story, which they may still have to tell to Wall Street, doesn't actually create much value. I think the big barrier is in the story that we tell, which is why I'm excited that there are so many different ways to tell the story now. But, it's going to take another generation. We've come a long way from the days when no one knew what a stakeholder was, but there's a long way to go, too. And all those ways you suggested [i.e., NGO activism, boycotting firms, more government intervention, etc.] are probably good ways to try to find new ideas. One of the most exciting things is all of the multi-sector partnerships that you see going on now, such as when NGOs work collaboratively with companies, because what that says is that it's not just business set outside of society, but it's business within society, embedded in society. As we see more of those ideas come up, I think we'll get there faster.

QUESTION: *We see a lot of short term thinking with businesses. Do you think that changing that way of thinking would help get us on path that we need?*

R. EDWARD FREEMAN: I just did a short paper on how boards and directors are suspicious of the short term vs. long term distinction. I've heard for a lot of years something that goes like this: "Ed, this stakeholder and ethics stuff works in the long term, but not in the short term." Well, now think about this for a bit, if it works in the long term, at some point it's got to work in the short term. Otherwise, it just doesn't work. I think this claim that it only works in the long term is just an excuse for not doing what needs to be done now. I'm going to tell you the secret to having a great long term: Have a great short term, and keep it up. Replacing short term-ism with long term-ism is problematic. For those of you who want to study this, there are many finance theorists who have said, "But we didn't mean short term shareholder value, we meant long term shareholder value." But of course, that's completely unobservable. Life exists in the short term. It exists in the now. And if we don't make things work right now, we can't ever make them better in the long term. The time horizon is important but it's too easy to put this off and say, well that'll work in the long term. I'm a big fan of the short term, probably because I'm older. The long term is: "What will you do in 10 years?" My answer: "Be alive." We have to figure out how to do this in the short term, and not just put it off to the long term.

QUESTION: *What sort of theory is stakeholder theory? You can think of it in two distinct ways. You can either think of it as an empirical theory—this is what businesses are and then the verification and fortification of the theory will depend on empirical evidence. Alternatively, you can think of stakeholder theory in a very different way, as a normative theory, an ethical theory that makes claims, concerning what businesses ought to be. Then the confirmation of the theory will depend on moral considerations. So which is the case you're actually making? Do we want to make the case that this works economically or that this is a morally good thing to do?*

R. EDWARD FREEMAN: I'm a pragmatist as a philosopher, and pragmatists will have none of the distinctions on which your question is based. The world doesn't divide itself into descriptive and prescriptive, into facts and values. Facts and values are always entangled with each other and they're always entangled with the interpretation of theory. So, surely there's some stuff that counts as evidence, surely there's some stuff that counts as good ideas because we can live better that way. So is it normative? Yes. The mere use of the word "stakeholder" is normative. It says they have a stake. But if I call you cruel, because let's say you murder cats, of course, I've done something that's descriptive, because you *are* cruel. But I've done something that's normative too. The most interesting theory is both descriptive and normative at the same time and that means the test of it isn't the p-value of a hypotheses, etc. The test of it is how it allows us to live. The theory has to hang together, in some sense, with our other ideas. This is not the view of philosophy that is well-known in management theory. The ruling view in management theory is called positivism, which posits, as you said, that there's normative stuff and empirical stuff. Pragmatists have tried to undercut that idea. There's a little book by Hilary Putnam, who just passed away last spring, called *The Collapse of the Fact/Value Dichotomy*. It makes the ideas of truth and justification a much more problematic question to solve than simply doing some empirical test or trying to ask if it fits our normative view of the world—it has to do both of those things at the same time. There's a much longer answer to that question that I won't bore you with.

QUESTION: *I'm wondering about the effect of the stakeholder theory on managerial behavior. Enron, WorldCom, and Tyco happened a long time ago, but they are not historical relics. Volkswagen, Wells Fargo, Toshiba, Tesco and many others are scandals of even larger proportions that all took place recently. So my question is twofold: What has been the impact of stakeholder theory on managerial thinking? And number two, beyond human greed for profits and power, what other explanations are there for these crazy managerial behaviors?*

R. EDWARD FREEMAN: My view is that business ethics as a discipline has been in the grip of the problem of scandal. Even back in the Teapot Dome scandal, you can trace the pattern of scandal, politicians react, and their reaction usually produces the next scandal. Thank you to Sarbanes-Oxley for, in part, giving us the global financial crisis. The cycle of scandal, supposed reform, etc., is continuing. Business ethics as a discipline feeds off of that. But what it doesn’t feed off of are the thousands of businesses where there are no scandals, the thousands of businesses in which people are just trying to do the right thing. I’m not so sure that there are more scandals than there ever were. Every institution has scandals: the priests in the church, professors at universities. Business doesn’t have the monopoly on scandals, and sometimes I think business ethicists make it worse by focusing on the scandal. If I say to you, “I’ve got an ethics issue I want to talk to you about,” how many of you just thought, “Wow, somebody must have done something really good.” Almost no one, right? Because there’s the presumption of business ethics that something bad has happened. [Reaching into his pocket, Dr. Freeman shows his smartphone to the audience and says…] This is pretty good. I think there’s a problem with focusing on the scandals. Now, has stakeholder theory had any impact? I’ll have to let other people answer that question. I didn’t just cook up a theory and look at how to apply it. I tried to describe and make sense of what I saw going on in the world and tried to improve it. It’s a sense-making idea. I think the only way to make sense of what’s happening in business is to see business as purpose driven, value creating, etc.

Now, the second part of your question: how do you explain the scandals? I typically try to go back to someone like Stanley Milgram and try to understand how a “situation overcomes self.” I think those kinds of explanations are more powerful and more nuanced than the “Greedy Little Bastard” explanations. Regarding those explanations from Milgram, I have a brilliant young colleague, Bobby [Bidhan] Parmar, who managed to get the tapes from Milgram's experiments, which we didn’t know existed, and analyzed them to try to understand not only why people obeyed authority, but why they disobeyed. Part of the idea in Parmar’s research is the more I see myself as an agent able to act autonomously, the more I see myself as responsible for the harm that’s done, the more likely I am to disobey. I find those explanations much more powerful than the greedy evil Mr. Slate businessperson from the Flintstones cartoons.

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