THE ‘STAKEHOLDER APPROACH’ TO CORPORATE GOVERNANCE AND REGULATION: AN ASSESSMENT

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The framework by which organizations are governed has been changed. A reason for this change is related with the force of stakeholders that compel the political power and the business society to review the ways in which companies are governed. Stakeholder thinking has gradually put this change at the center of research into business and society relations. Based on the stakeholder thinking, the corporate regulation framework has extended a new dimension in the business and society interface. This article assesses these issues.

INTRODUCTION

Stakeholder thinking is comparatively a new approach in corporate governance and regulation landscape. It contributes in redefining the purpose of business and its mode of response to its non-economic factors. It has challenged the traditional view that corporate activities should only be reflected by the signals from markets and the economic system. While corporate governance is restricted to its shareowners and meant for profit maximization, this approach ‘offers an alternative to both business and government institutions as to what is the very purpose of a business.’

It denotes that companies are also responsible to ‘serve as a vehicle for coordinating stakeholder interests and to meet the claims of each of the group of stakeholders, who are affected by corporations’ actions.’

The basis of stakeholder thinking is the stakeholder theory which owes greatly to Edward Freeman’s works related to the advantage of strategic engagement of stakeholders in corporate regulations. Advocates of this theory argue that corporate governance (CG) should conceive that the corporate directors are not merely the agents of the shareholders and are charged with the maximization of profits. Rather, as they argue, corporate directors should act as a ‘mediating hierarch’ and should be

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2. Ibid.
responsible for allocating the surplus produced by the corporate enterprise to the various stakeholders. These proponents have further extended as a source of managerial discretion to ‘sacrifice profits in the public interest.’ They also challenge the justification for the rights of shareholders on the corporate properties as the sole ‘residual claimants’. They contend that there is nothing unique about shareholders’ equity investment. On the contrary, a variety of parties — creditors, employees, governments, and even the society as a whole — often make significant firm-specific investments. Employees may develop corporation-specific skills, and governments may invest in infrastructure to support a major corporation. These theorists maintain that these investments are not compensated by ‘complete’ contracts. This is a result of the difficulty of drafting contracts that deal with every eventuality and the fact that many parties rely on expectations not subject to complete agreements. These expectations are often long running in nature and subject to the vagaries of market fluctuation and other externalities. Stakeholders engaging in the contractual relationship often surrender a significant amount of mobility in reliance on these expectations, and their risk is therefore heavily tied to the fortunes of the contracting corporation. This means that other stakeholders also share the residual risk of corporate failure with the shareholders. These arguments elucidate the dilemma for the shareholder primacy model, as these show that situations may arise in which directors may make shareholders better off by simply appropriating value from other stakeholders. This is done despite having a negative impact on the total value of firm-specific investments and by becoming sub-optimal from a broader efficiency perspective.

Taking this concept as vital in stakeholder thinking, this approach to corporate governance and regulation offers abstract insights as to why companies should not be treated solely as their shareholders’ private property but rather as socially responsible enterprises based on sophisticated transactions and relational contracts among different stakeholders of business operations. Based on the contractarian


notion (which portrays the corporation as a voluntary ‘nexus of contracts’)\(^9\) as well as the realistic notion to the existing corporate regulation frameworks (which paints the corporation as a separate legal personality akin to a human being),\(^10\) this approach argues that corporate governance should not result in giving superior property rights only to shareholders. Rather, it posits, workers and society that invest their labor and resources as input in the company should enjoy considerable recognition of their residual interest in the company’s performance.\(^11\)

Given this, this article assess the impact of the stakeholder approach on the CG and corporate regulation frameworks. It proceeds as follows. First, it defines stakeholder approach. Second, it assesses the impact of this approach on the traditional corporate governance frameworks. Third, it assesses the nexus of stakeholder approach and CG on the corporate regulation pattern in general. Finally it concludes that stakeholder approach helps the CG frameworks to gradually extend scopes for collaboration in corporate regulation in which stakeholders, agencies and industry work together to define and revise the standards of corporate social responsibility.\(^12\)

## II Stakeholder Approach

The meanings of ‘stake’ and ‘holder’ are important within stakeholder thinking. Simply stated, the word ‘stake’ means a right to do something in response to any act or attachment. Since ‘rights’ are generally attached with liabilities, this word also denotes the liabilities a person possesses for enjoying a particular right. Hence, a stake could be a legal share of something. It could be, for instance, a financial involvement with something. From the organizational stakeholder perspective, Carroll identifies three sources of stakes: ownership at one extreme, interest in between, and legal and moral rights at the other extreme.\(^13\) The word ‘holder’ is comparatively easy to understand. It denotes a person or entity that faces some

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consequences or need to do something because of an act or to meet a certain need. From the organization and management perspective, Freeman defines stakeholder as ‘any group or individual who can affect or is affected by the achievement of the firm’s objectives.’ His works makes the base of stakeholder theory which is the basis for stakeholder approach discussed in this article. He set forth the re-conceptualization of the notion of corporate management in the form of this theory. This theory spurred the theoretical as well as the strategic cohort of corporate management. Carroll defines stakeholder from a broader perspective, as he determines stakeholders to be ‘any individuals or groups who can affect or are affected by the actions, decisions, policies, practices or goals of an organization.’ Thus, employees, customers, owners, competitors, government, and civil society organizations could be the stakeholders of a company. Gray et al. even extend this list to include future generations and non-human life.

Within business and society relations, the core idea of stakeholder thinking is that corporate governance (CG) has the responsibility (i.e., the stakeholder has rights) to consider the views of their stakeholders in corporate self-regulation. Hence, this concept challenges the central position of managerial capitalism. Two arguments could have prompted this challenge. The first argument considers that today’s companies are no longer fit for the old model of governance. It argues that the concept of ownership has shifted from its hard strand, and hence, companies can no longer accurately be viewed by their owners as private property. The second argument develops around the power relationship between business and society. It claims that social power comes along with social responsibility, and hence, failing to mitigate the costs that arise (i.e., out of industrial pollution, hazardous products, job dissatisfaction, etc.) inevitably raises questions about the exercise and limitation of corporate power.

19. Ibid.
Taking these arguments as vital in stakeholder theory, it focuses on a particular question: ‘For whose benefit and at whose expense should the firm be managed?’

In reply, the initiators of this theory define ‘stakeholders’ as all the parties that have vested interest in, or are claimant on, the company, including proprietors, management, suppliers, customers, employees, and the local community. They argue, in accordance with Kantian philosophy, that none of these stakeholders can be treated as a means to some end, and they have the obligatory right to participate in determining the future direction of the business organizations in which they have a stake. They challenge the opinion that business organizations have no absolute right to decide on how things should be settled for their constituents by positing that ‘if the modern corporation requires treating others as means to an end, then these others must agree on, and hence participate (or chose not to participate) in, the decisions to be used as such.’ This theory has reasonably marked that the rights to property, though legitimate, are not absolute, specifically when it comes to conflict with the rights of others. It was further advocated that ‘the property rights are not a license to ignore Kant’s principle of respect for a person.’

Another dominant theme of this theory deals with the impact of managerial capitalism and the manner in which the precept of ‘modern corporation’ affects the welfare of others. In terms of corporate externalities and harmful actions, this theory extends the liabilities for these actions to the persons responsible for the corporate decisions and activities. Hence, any theory that seeks to justify the corporate form ‘must be based at least partially on the idea that the corporation and its managers as moral agents can be the cause of and can be held accountable for their actions.’

The justification for the normative basis of this theory is profoundly based on the evolving arguments regarding the concepts of property rights, though there is no single set of norms that describes the term ‘property’. ‘Property’ and ‘bundle of many rights’ are defined synonymously. However, property resembles the right with recurrent features. Ronald H. Coase clung to the view that ‘what a landowner in fact possesses is the right to carry out a circumscribed list of actions…and his rights as a land-owner are not unlimited.’ Authors such as Honore and Pejovich...

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21. Ibid.
22. Ibid. 148.
23. Ibid.
24. William M. Evan and Edward R Freeman, above n 21,6.
have extended Coase’s notion of right of property and underscored the link of property and human rights by noting that ‘the right of ownership is not an unrestricted right.’28 Another oft-quoted opinion related with the right of property is that it is a core issue of human rights and thus emphasizes the rational use of it. This opinion is also intrinsic to the concept of property rights and clearly signals the engagement of stockholders in the conception of property rights of business organizations. This opinion in the scholarly cohort creates contentions in the notion of property rights. On the one hand, it is contended that simply bringing non-owner stakeholders into the conception of property rights does not provide justification for stakeholders’ arguments assigning managerial responsibilities toward specific groups (i.e., employees, customers). On the other hand, the contemporary theoretical concept of property rights does not ascribe unlimited rights to owners or shareowners.

Stakeholder theory has converged the contradicting arguments in property rights. To be attached to the right of property that is created and maintained by the companies, this theory aligns with two principles: the principle of corporate rights and the principle of corporate effects. According to the principle of corporate rights, corporate managers who are liable for framing core corporate decisions cannot violate the legitimate rights of a company’s constituents for their personal benefit. The principle of corporate effects denotes that corporate managers and corporations as separate entities are equally responsible for the effects of their actions on others. These principles are the source of two principles for managing stakeholders of business corporations. The principle of ‘corporate legitimacy’ focuses on the rights and responsibilities of companies and their effects on others, while the ‘stakeholder fiduciary principle’ drives the managerial strategies for addressing the demands of shareholders. These principles, in fact, contribute in creating the scope of structural mechanisms to facilitate the application of the concept of stakeholder management. This management concept creates scopes to revise and reform ‘corporate regulation’ so that the companies could be managed for the benefit of the stakeholders and allow them to participate in the decision-making of the companies that affect their welfare. The proceeding section delves into these issues. First, it discusses the role of stakeholder approach in the devolution into corporate governance and second, it highlights the impact of this devolution on the regulation of corporate responsibilities in the society.

III STAKEHOLDER APPROACH TO CORPORATE GOVERNANCE

In the previous section, the stakeholder theory and approach has been defined. The aim of this section is to discuss the role of this approach into the changes in the traditional framework for corporate governance. First, it defines corporate

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governance; second, it discusses the role of this approach in the devolution into CG framework.

A Corporate Governance

Corporate governance (CG) is an umbrella term. In its narrower sense, it describes the formal system of accountability of corporate directors to the owners of companies. In the broader sense, the concept includes the entire network of formal and informal relations involving the corporate sector and the consequences of this relation for the society in general. These two senses are not concurrent, but rather are complementary. CG has been described as the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment. However, it could also implicate 'the whole set of legal, cultural, and institutional arrangements that determine what publicly traded corporations can do, who controls them, how that control is exercised, and how the risks and returns from the activities they undertake are allocated'. Taking both of these senses together, corporate governance is no longer merely about maximizing stock-value; rather, it concerns the 'relationships among the many players involved (the stakeholders) and the goals for which the corporation is governed.'

In the general CG framework, the roles, rights and responsibilities of corporate directors are vital. Particularly, the board of directors is the most appropriate body to allow and design policies for corporate management to fulfil responsibilities to societies. In most cases, this board is the sole body that communicates corporate performance to corporate owners. Moreover, with the beginning of the modern

corporate social responsibility era, its role in corporate governance has vastly extended; Eisenberg described this as the ‘board as manager’.

B Stakeholder Approach to CG Framework

In CG, stakeholder pluralism argues that the objective of the company is to benefit all those who have contributed to the development of business gains. The corporate directors are responsible for managing the company not only to ensure profits for shareholders but also in the interests of a multitude of stakeholders who can affect or be affected by the actions of a company. According to this concept, corporate directors are liable to balance the interests of various stakeholders including shareholders in deciding the appropriate course of actions required for governing a company. This approach is ‘premised on the theory that groups in addition to shareholders have claims on a company’s assets and earnings because those groups contribute to a company’s capital.’ This approach is used in many continental European jurisdictions’ CG systems, most notably, in Germany. The source of stakeholder pluralism arguments in the CG framework is the role of long-term thinking in investment policies and management decision-making. The core argument of this concept is that business corporations exist to serve a number of stakeholders rather than shareholders alone.

The notion that stakeholder pluralism critiques shareholder primacy was notably propelled in 1932 by Berle and Means, who documented the separation of ownership and control occurring in the majority of large public corporations. They showed that due to the broad dispersal of share ownership, no individual could control or adequately monitor the corporation. They concluded that this justified a

34. For details of the corporate board of directors reform and the beginning of modern corporate social responsibility, see Lawrence E Mitchell, above n 33, 284-288.
40. Andrew Keay, above n 36, 578.
fundamental reconceptualization of property, in which ‘the passive property right of today must yield before the larger interest of society.’ In this system of CG, the role of the board would be to act as ‘a purely neutral technocracy, balancing a variety of claims by various groups in the community and assigning to each a portion of the income stream on the basis of public policy rather than private cupidity.’

Other critiques of shareholder primacy in CG propound this concept. First, this concept critiques the arguments in favor of ‘shareholder value’. This concept considers that the ‘value’ produces a short-term process. This focus overshadows all else and fails to maximize social wealth. In this regard, Larry Mitchell has noted that CG in the USA is deleterious for various groups of stakeholders, as it is overly focused on turning over short-term profits in order to benefit shareholders.

Second, ‘the emphasis on the shareholders being residual risk-bearers is misplaced vis-à-vis other stakeholders.’ Other than the shareholders, as this is argued, stakeholders are also put in a vulnerable position because of their firm-specific investment. For instance, employees who have invested their time and effort in acquiring a certain skill to meet a certain company requirement may have limited prospects in the job market, as they may be unable to move to a different employer and gain from the training undertaken. This situation could create scope for ransom from the perspective of a business enterprise. Rather, there are arguments that shareholders are in a more flexible position to diversify risk more easily than other stakeholders.

Third, a vital drawback of the concept of shareholder primacy is that it has undermined the very idea that companies are separate and independent legal entities. Shares are clearly shareholders’ property, but the company is not. According to the scholarship and practice related to the concept of ‘company’,

43. Ibid.
46. Andrew Keay, above n 37,585.
47. Andrew Keay, above n 37,586.
48. Ibid.
shareholders do not have rights to point to any property held by the company and assert ownership rights over it. Hence, the control of the shareholders over the corporate boards does not match the concept of company.

Finally, companies should serve broader social purposes than simply generating profits for shareholders, as these are involved in, and dealing with, companies that include human beings, and hence, CG should not be de-personalized. Communitarian theorists relate social and political values in CG, as they argue that the assessment of whether the company is useful is measured by its performance to gain a richer understanding of community and respect for human dignity and overall welfare.\textsuperscript{49} They contend that people are part of a shared community who ‘inherit the benefits, values and goals of the community; thus the cultural milieu in which people find themselves cannot be ignored.’\textsuperscript{50} Hence, they regard the concept of company as ‘a community of interdependence, mutual trust, and reciprocal benefits.’\textsuperscript{51} Moreover, they consider that the effect of invoking the shareholder value approach in CG damages the chance of non-shareholder contribution in corporate development; this preference would subordinate the non-shareholder stakeholders’ firm-specific investments at all times.\textsuperscript{52} Lyman Johnson’s comment is prominent in this respect. He mentions, ‘a radically pro-shareholder vision of corporate endeavor [is] substantially out of line with prevailing social norms’,\textsuperscript{53} and therefore, the meaning of corporate endeavor should embrace the norms ‘wider than the thin thread of shareholder primacy.’\textsuperscript{54}

Stakeholder pluralism in CG suggests that the role of directors would be to mediate the competing interests of various stakeholders.\textsuperscript{55} This includes both contractual


\textsuperscript{54.} Ibid., 934.

\textsuperscript{55.} There are some models that describe the strategies for incorporating stakeholders in corporate regulation. Amongst these models, Clarkson’s Risk-based Models, the Normative Stakeholder Accountability Model and the Managerial Stakeholder Model are noteworthy. The underlying notion in Clarkson’s Risk-based Model is that ‘a stake represents some form of risk and that without risk there is no stake’ and hence the rights of stakeholders in any strategy should be based on the stakeholder’s liabilities. On the basis of this notion, this model divides stakeholders into two
stakeholders (e.g., shareholders, employees, customers, distributors, suppliers, and lenders) and community stakeholders (e.g., customers, regulators, governments, pressure groups, the media, and local communities). Each of these parties has different expectations from the corporation, and the corporation is accountable to each in different ways. For instance, shareholders expect dividends and share price appreciation, and the corporation is accountable by means of annual reports and continuous disclosure obligations, while the general public expects safe corporate operations and corporate accountability. The leading advocate of this approach, Edward Freeman, and his co-author express the rationale of this approach in this way:

Business is about putting together a deal so that suppliers, customers, employees, communities, managers and shareholders all win continuously over time. In short, at some level, stakeholder interests have to be joint — they must be traveling in the same direction — or else there will be exit, and a new collaboration formed.

The stakeholder pluralism arguments in CG have shifted the rights of a person or a group from an acceptable proposition to the idea that this right is enforceable and CG is also within the purview of the ideas for ethics, social justice, and moral sense. Germany and Japan are prominent for maintaining a scale of values based on different types of moral sense and ethics. In Germany, co-determination and worker representation on the supervisory boards of companies are common, while in the UK, CG allows corporate directors to consider employee issues that are beyond the contractual agreement. In recent days, even a number of states in the

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USA have created constituency statues that allow consideration of a broad range of stakeholders.\(^5^9\) This devolution in the scholarship of CG has paved the way for enlightened shareholder primacy, a considerably new concept which is flexible to incorporate stakeholder concern in the CG framework.

C Enlightened Shareholder Primacy (ESP)

The development of ESP dates back to the debate between Professor Adolf Berle and E. Merrick Dodd concerning the objective of a company. Berle argued that corporate directors should not, as managers of companies, have any responsibilities other than to shareholders and that their focus should be only upon making money.\(^6^0\) On the other hand, Dodd argued that companies are economic institutions and that they should therefore have liabilities to contribute to social development along with the responsibility of generating profits for investments.\(^6^1\) While the arguments of Berle have largely been adapted, especially in the USA, the arguments of Dodd have successfully paved the way for a chorus of scholarship on the societal approach in CG. This seminal debate and the practice following the proponents of this debate gradually raised the argument for ESP that allows corporate directors to consider the interests of constituencies, other than shareholders, in the actions they take. This has also created the scope for the directors to design their strategies for the long-term well-being of a company. In this regard, in many jurisdictions, courts have stated that CG can have commercial judgment based on the interest of non-shareholder interest in the management of the company.\(^6^2\) Accordingly, this concept in shareholder primacy has moderated directors’ obligations to manage the company to ensure only short-term benefits, such as maximizing immediate profits.\(^6^3\)

The narrow approach of shareholder primacy in CG, a contemporary variation of shareholder primacy theory, is the main source of the development of ESP. Recent


\(^6^1\) E Merrick Dodd, 'For whom are corporate managers trustees?' (1932) 45(7) *Harvard Law Review* 1145, 1148; See also E Merrick Dodd, 'Is Effective Enforcement of the Fiduciary Duties of Corporate Managers Practicable?' (1935) *The University of Chicago Law Review* 194.

\(^6^2\) For some instances of court decisions, see Provident International Corporation v International Leasing Corp Ltd [1969] 1 NSWR 424 at 440; Paramount Communications Inc v time Inc 571 A. 2d 1140.

literature has utilized the term ‘enlightened shareholder value’ or ‘enlightened self-interest’ to indicate that although shareholder value is paramount, careful consideration of stakeholder interests is usually in the interest of the company.64 This development in shareholder primacy accepts that ‘good management’ should involve assessing the impact of a particular decision considering the likely consequences for corporate reputation. It has paved the way for corporate management to attract and retain employees and minimize transaction cost and risk by incorporating social policy goals at the core of their strategies.65

ESP suggests that corporate directors ought to be empowered to consider the interests of stakeholders while maintaining shareholder primacy. This has added a new insight into how companies are run and operated on a daily basis and within the precepts of CG. It relates with the social welfare-driven approaches to CG and policy and proposes that business efficiency should not only aim at higher stock prices but also at internalizing environmental and social externalities and acknowledging the often-unequal distributive consequences of creating corporate surpluses.66 This concept, however, does not undermine the interests of the shareholders. Rather, it adds stakeholders’ interests to the CG framework along with the shareholders’ interests. To avoid ambiguity, consider the following instance in this regard. Where there are two routes a company can take, ‘X’ and ‘Y’, where both benefit the company equally but where X may benefit one or more constituency interests and Y may not, then according to this concept, X should be adopted. Corporate management ought not take a course of action that clearly provides benefit to a number of constituencies but does not provide any benefits to shareholders. This concept emphasizes moral arguments associated with justice, fairness, and communitarianism67 and endorses doctrinal approaches that reject the exclusivity of cost-benefit analysis and the exclusion of distributive aspects from efficiency models focused on maximizing each transaction’s dollar value.68

There are other arguments for ESP. First, this approach legitimizes the far-sighted strategies in CG; it supports corporate directors and senior managers’ initiatives by

65. UK Steering Group, above n 65, 3.16-3.61.
68. For a recent critique of the existing scholarship of corporate regulation thought, see generally Kent Greenfield, The failure of corporate law: Fundamental flaws and progressive possibilities (2006).
considering the interests of non-shareholder stakeholders as long as these initiatives foster corporate profits. In its report ‘Corporate Responsibility: Managing Risk and Creating Value’, the Australian Parliamentary Joint Committee on Corporations and Financial Services observed that the rate of social responsibility in business decision-making has increased in recent days. This report mentions that many directors of Australian companies take decisions founded on social responsibility as well as the interests of shareholders. The Committee mentions in this report: ‘[p]rogressive, innovative directors, in seeking to add value for their shareholders, will engage with and take account of the interests of stakeholders other than shareholders.’ 69 Fiona Buffini reports a comment of Meredith Hellicar, the Chairwoman of the substantive James Hardie Group. The business executive mentions that corporate directors are aware of the threat from the shareholders and the possibility of being the object of legal suits, even though they are engaging more in CSR plans with the belief that the shareholders are enlightened and that the majority of them agree with the nexus of CSR and long-term profit. 70

Second, ESP permits corporate directors to focus on long-term interests. It is perceived that most of the shareholders prefer to earn a stable rate of profit for a long term; not all shareholders want directors to focus on short-term benefits. 71 The Australian Parliamentary Joint Committee on Corporations and Financial Services is of the view that most shareholders prefer to support corporate responsibility, as they believe that this will lead to long-term gain for shareholders. 72 At this point, Hansmann and Kraakman mention that there is ‘no longer any serious competitor to the view that corporate law should principally strive to increase long-term shareholder value.’ 73

Finally, ESP allows corporate directors to decide corporate issues based on their own conscience and economic justification; it does not require the directors to

72. Parliamentary Joint Committee on Corporations and Financial Services, above n 70, 50.
balance the interests of a wide range of constituents. According to this approach, ‘directors merely have to state that what they did was a result of balancing interests, and no one could challenge the conclusion at which they arrived.’\textsuperscript{74} The move towards this enlightened approach has contributed to the incorporation of NG notions in CG.\textsuperscript{75} NG defines this transformation as a convergence of business self-interest and the interest of the society to make companies perform their social responsibilities.

The dominant position of shareholder primacy in CG has been minimized in the CG framework. In the CG framework, issues related with companies’ public policy and social responsibilities are now significant at the board of business corporations. Of late, ethical norms and need for accountability have been two driving sources of CG, and CSR being adapted in existing business practices, a potential convergence between them comes to the foreground. Whereas there had been two separate sets of mechanisms of CG — one catering to ‘hardcore’ corporate decision-making and the other to ‘soft’, people-friendly business strategies — scholars now consider a more hybridized, synthesized body of laws and norms that regulate corporate practices. NG provides scope of such convergence in CG frameworks.

IV THE NEXUS OF STAKEHOLDER APPROACH AND CG

A To Corporate Regulation

The definition of regulation is unclear, as it covers very broad areas of state control over social and economic activities, including various forms of unintentional and non-state actions.\textsuperscript{76} Nonetheless, it is widely accepted that regulation refers to

\textsuperscript{74} Andrew Keay, above n 37, 602.

\textsuperscript{75} Based on the notion of this approach, different countries are incorporating different strategies into their corporate regulation. For instance, the Operational and Financial Review completed in the UK was built on the concept of enlightened shareholder value, that is, it was supposed to provide shareholders with better information concerning company’s performance. EU adopted this approach into its Modernisation Directive that requires a balanced review of a company’s non-financial key performance indicators including information relating to environmental and employee matters. European Management Audit Scheme and the Companies Act 2006 (UK) are some other instances within which considerable weight has been given to this approach to facilitate corporate governance to hold the core notion of it. For details, see Filip Gregor, ‘How can reporting become a relevant tool for corporate accountability at European level?’ (2007) Discussion paper for European Coalition for Corporate Justice <http://ec.europa.eu/enterprise/policies/sustainable-business/corporate-social-responsibility/reporting-disclosure/swedish-presidency/files/position_papers/how_can_reporting_become_a_relevant_tool_en.pdf> at 14 July 2011

\textsuperscript{76} Robert Baldwin, Colin Scott and C Hood, A Reader on Regulation (1998); For a detailed study on regulation, see generally Julia Black, ‘Critical reflections on
anything that controls or influences the activities in which society is an important aspect. Such control or influence is purported to prevent undesirable behaviour, actions, and activities or to enable and encourage desirable ones. To this end, it may include policies, norms, market principles, institutional/international principles, or covenants designed to affect social and economic behaviour and activities. Accordingly, all law is regulatory in nature and corporate regulation is limited to the corporate affairs.

The aim of regulation varies with the varied objectives of regulators in different contexts. One of the predominant aims of creating regulation is to make the behaviour of regulatees consistent with market principles and widely valued social norms by emphasizing greater efficiency and flexibility in internal management. Accordingly, in the regulatory landscape, the manner in which regulatory strategies could improve compliance at the generic level without being intrusive in usual business practice is an ever-growing issue. In this backdrop, regulatory strategies are increasingly used to improve compliance with environmental standards.


77. P Selznick, Focusing Organizational Research on Regulation, Regulatory policy and the social sciences (1985); Keith Hawkins and Bridget Hutter divide the landscape of regulation into two major parts: the economic regulation and social regulation. They define economic regulation as regulation of financial markets, price and profits, and the social regulation as laws protecting the environment, consumer, social values, employees. For details, see Keith Hawkins and Bridget M Hutter, The Response of Business to Social Regulation in England and Wales: An Enforcement Perspective' (1993) 15(3) Law & Policy 199; Bridget M Hutter, Compliance: Regulation and environment (1997).


79. Anthony I Ogus sees regulation as ‘fundamentally a politico-economic concept and, as such, can best be understood by reference to different systems of economic organization and the legal forms which maintain them.’ For details, see Anthony I Ogus, Regulation: Legal form and economic theory (1994); Peter C Yeager, The limits of law: the public regulation of private pollution (1993)24.


implementation of occupational health and safety (OHS) guidelines, the involvement of stakeholders/inclusion of equal opportunities, ethical standards, and the adherence to principles of fair competition in business and society.

To make it sound and operative with the multifarious dimension in corporate regulation, the pioneers of stakeholder theory develop three main operational approaches: a normative, an instrumental, and a descriptive/empirical approach. The normative approach defines the manner in which management deals with different stakeholders. The instrumental approach describes the outcome of the particular managerial treatment of stakeholders. The descriptive perspective is concerned with the stakeholder-management activities of companies. This approach is used to describe and sometimes explain specific corporate characteristics and behaviors. The instrumental approach is used to identify the connections or lack of connections between stakeholder management and the achievement of traditional corporate objectives (i.e., profitability and growth). Considering these, the basic tenets that stakeholder approaches provide to corporate regulation are as follows:


1) the corporation has relationships with many constituent groups (‘stakeholders’) that affect and are affected by its decisions;
2) it is important to be concerned with the nature of the relationship the company and its stakeholder in terms of both processes and outcomes;
3) the interests of all (legitimate) stakeholders have intrinsic value, and no set of interests is assumed to dominate the others;
4) the focuses on managerial decision-making are vital in the company-stakeholder relationship.

Based on the research findings on the above-mentioned tenets, Berman et al. suggested two distinct stakeholder approaches that amplify the casual relationship between the groups of stakeholders and the company. The first approach, the strategic stakeholder management approach, suggests that companies are interested in stakeholders, because they are part of the corporate constituents and consumers and hence necessary for developing financial performance. The second approach, the intrinsic stakeholder commitment approach, suggests that ‘managerial relationships with stakeholders are based on normative, moral commitments rather than on a desire to use those stakeholders solely to maximize profits.’ Freeman’s definition of stakeholders noted above also suggests a two-way relationship between companies and their stakeholders. The first element, whereby stakeholders can affect companies, relates to the first approach of Berman et al., and the second element, whereby stakeholders are affected by companies’ activities, relates to the stakeholder commitment.

Focusing more on the strategic relationship between the stakeholders and the companies while they are considering their social responsibilities, Arieh A Ullmann suggested a three-dimensional conceptual approach of stakeholders towards corporate regulation in society. The first approach — stakeholder power — maintains that corporate regulation is responsive to the intensity of stakeholder demands. It is worth mentioning here that the stakeholders’ power to influence corporate behaviour depends on the degree of stakeholders’ control over the decisive assets in societies essential for the companies. This dimension emphasizes a positive correlation between

91. Berman S L et al, above n 90.
92. Ibid, 492; For a detailed discussion on this view of Freeman, Ataur Rahman Belal, 'Stakeholder accountability or stakeholder management: a review of UK firms' social and ethical accounting, auditing and reporting (SEAAR) practices' (2002) 9(1) Corporate Social Responsibility and Environmental Management 8
93. R Edward Freeman, above n 14; Berman S L et al, above n 90; Ataur Rahman Belal, above n 55,19.
95. Ataur Rahman Belal, above n 55,19.
96. Ibid.
stakeholders’ social power and companies’ self-regulation. This correlation could be measured through the companies’ social performance disclosures. The second approach — the ‘strategic posture (active vs. passive) adopted’ by the companies towards corporate social activities — holds that ‘an active company would pursue a policy of influencing the key stakeholders through [self-regulation strategies], whereas a [company] possessing a passive strategic posture would not continuously monitor its relationship with the stakeholders and engage in minimal social activities.’ Here, there is scope for companies to bypass their responsibilities to the stakeholders and mislead the stakeholder approach. At this point, a complete set of internal regulation guidelines could enhance a greater level of corporate social activity and disclosure of companies and create differences between the active and passive strategic postures of companies towards their stakeholders. The dimension of the third approach is concerned with the financial regulation of companies. Ullmann argues that the economic potency of companies affects the corporate capacity to undertake stakeholder oriented practices and disclosure, since the economic strength could settle the proportional weight of a stakeholder demand and the attention it receives from top decision-makers of the company. Indeed, in situations in which the profitability of a company is less and the company is struggling with high debt, business strategies focus less on social demands than on economic demands. Pointing to these perspectives, Deegan divides stakeholder approaches to corporate regulation into two: ethical and managerial approaches. The ethical approach emphasizes the continuous responsibility of business corporations to society and denotes directions in terms of how to deal with stakeholders, irrespective of their status. The managerial approach highlights the managerial strategies to respond to stakeholder issues and denotes the details of the strategies to deal with different types of stakeholders. In this approach, the corporate responses to the stakeholders are determined according to the extent to which the corporate managers consider the stakeholders to further the goals of the company.

The power of stakeholder approaches and the strategic posture of companies are interrelated, depending on the economic impact of such a relationship. The dimensions of the stakeholder approach described by Ullmann show that economically stronger companies are in a stronger position to have a stakeholder oriented internal

98. Ataur Rahman Belal, above n 55, 19.
102. Craig Deegan and Jeffrey Unerman, above n 46, 272.
regulation. After testing this situation, Roberts argues that the unique features of the stakeholder approach highlight the possibility for companies to incorporate their stakeholders’ strengths and therefore contribute within their context.104 Companies could strengthen themselves in the issues of stakeholders if the intricacies of the relationship between stakeholder and company were gradually embedded into their day-to-day progress and spread over their surroundings.

The regulatory provisions and policy options that could relate stakeholders with corporate strategies are considered one of the best strategies to ensure that companies have the required systems to fulfill their social responsibilities.105 Effective stakeholder engagement in corporate governance can minimize the role of policing by governmental agencies and the use of coercive modes in corporate regulation. The Proper Prokasih Program of Indonesia, for instance, exemplifies this notion. Under this program, regulators rank the performance of individual company using surveys, a pollution database of team reports, and independent audits. They also make their findings (based on a color-coded system of business activities that have environmental impact) available to the public. The instruments of this program also allow stakeholders to question the companies whose performance is not satisfactory considering the standards of a particular community. Therefore, if an enterprise is marked as black, blue, or red, that enterprise usually needs to negotiate its pollution-control strategies with the teams comprised of public agencies, environmental groups, and community representatives.

The basis of the stakeholder-based regulating strategy is a combination of a few socio-economic precepts: business operations need to be legitimate to ensure their free flow where the stakeholders are the most suitable source of gaining legitimacy of business operations in the society. Moreover, since the stakeholders are also the consumers, their collective initiatives have the ability to affect the business performance of an enterprise. This notion is important to corporate regulation in the market-based economic framework. Neil Gunningham mentions in a recent study that examined community engagement in corporate regulation that stakeholder engagement, negative media attention, and increased likelihood of obtaining certificates from standardization authorities are the major stimuli for the improved

103. Arieh A Ullmann, above n 96, 553.
104. There are many definitions of stakeholders. According to Freeman, a stakeholder is a group or individual that can affect or be affected by the implementation of the organization’s objectives. Mitchell et al. includes only those as stakeholders who are prominent and legitimate. Clarkson defines stakeholders into two groups: primary stakeholders are those who are more related with organization and the second group of stakeholders are those who are not directly related with a particular organization but are indirectly related with companies’ performance. For details, see R.E. Freeman, *Strategic Management: A Stakeholder Approach* (1984); M.B.E. Clarkson, 'A stakeholder framework for analyzing and evaluating corporate social performance' (1995) 20(1) *Academy of Management Review* 92.
environmental performance of companies. Based on the strength of the stakeholder role in society, corporate regulation could use stakeholders to police as well as to shape business activities in addition to using the traditional modes of regulations. Corporate regulation with this approach could pave the way for a tacit bargain between the stakeholders and the business society; that is, if the companies commit to reaching the expected performance through their own plans, the stakeholders will hold off on interfering in corporate plans. Here, the role of regulating is to provide legal sanctions for stakeholder interference in corporate strategies that touch the lives of stakeholders. With this legal footing, stakeholders typically help companies reach the most viable strategy for all.

In sum, though it cannot be argued that the traditional form of corporate regulation has totally failed in both its legal and managerial terms, it could safely be argued that the conventional approach of the company’s self-serving regulation has been challenged by stakeholder approach. The core themes of this approach entail comprehensive restrictions on such form of internal regulation; all its arguments prohibit any single attention to the interests of any single constituent of any company.

V CONCLUSION

Stakeholder approach is buttressed by adequate theories and grounded in a philosophical basis and is based on moral arguments associated with justice, fairness, and communitarianism. As it has been discussed in this article, this approach is endorsed by the doctrinal approaches that reject the exclusivity of cost-benefit analysis and include distributive aspects in efficiency models focused on maximizing profits. Based on the normative basis of this approach, scholars and practitioners in many fields have started looking beyond their traditional perceptions to explore how synthesizing regulation and responsibility may change existing practices in business and social advocacy.

Changes to the dominant position of shareholder primacy and the rise of stakeholder pluralism arguments have resulted in the development of the enlightened shareholder primacy. This enlightenment is the source of the changes to the traditional precepts in CG. While corporate directors were only assigned to look after the return of investment within the traditional framework of CG, stakeholder approach has created the scope for them to look beyond the set of contractual liabilities. It has combined the contradicting arguments of shareholder primacy and stakeholder pluralism. In this flux, corporate regulation is gradually relating with the existing political and economic landscape and helping CG to adopt ethical

guidelines, to incorporate stakeholder concerns, and social accountability in their internal strategies.\textsuperscript{108}

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