

# Stakeholder Interests from Behind the Veil: A Rawlsian Approach to Ethical Corporate Governance

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## Abstract

Every corporation and organization has stakeholders: individuals and groups to whom they owe consideration in governance decisions and who, in turn, can exert influence on the corporation and other stakeholders. Legitimate stakeholders include the owners, managers, employees, consumers, taxpayers, community members, supply chain members and society as a whole. The problem is that the interests of these stakeholders are often in conflict with one another. Although the legitimacy of stakeholder interests is well established, how to unravel the morass of conflicting stakeholder interests is not so clear due to the fact that stakeholders often argue from positions of their own self-interest. We propose an approach inspired by John Rawls' idea of fairness that proposes an original position behind a veil of ignorance. Stakeholder interests can be assessed and weighted more fairly if we begin with the assumption that we do not know which stakeholder group we will ultimately occupy. Thus, when specific governance decisions are being considered, the relative weight of stakeholder interests can be established with fairness without the confounding influence of arguments based on self-interest.

**Keywords:** *stakeholder; ethics; fairness; governance; social responsibility*

## 1. Introduction

Participants in any given economy will have relationships with many others who are similarly involved in doing business. Phillips (1997) highlights "mutual benefit" and "justice" as part of the "conception of obligations of fairness" in corporate governance. In a firm with many stakeholders, it can become difficult to determine the correct operation in an ethical dilemma. Phillips attributes this to "an approach [that] is based on the idea that all stakeholder groups are, to varying degrees, involved in the same economic cooperative scheme." In this instance, "stakeholder" is a broad term applying to many people involved in the success of a corporation. In general, the interests of all stakeholders are similar within a company: they want the firm to do well, with the potential for personal gain. Freeman (1994) explains this relationship as the *Stakeholder Enabling Principle*: "Corporations shall be managed in the interests of its stakeholders, defined as employees, financiers, customers... and communities." (Freeman, 1994 p. 417). Additionally, Dawkins (2014) goes beyond stakeholder engagement and posits the need for "operational barometers" to measure the quality of stakeholder interactions. He suggests that stakeholder conflicts are handled using the legal principle of good faith characterized by dialogue, negotiation, transparency and totally of conduct. Furthermore, mediation and non-binding arbitration can be used at tools in implementing good faith solutions to stakeholder conflicts.

These groups Freeman mentions are dear to the success of the corporation. However, these groups do not always have matching interests. Freeman with the *Principle of Director Responsibility*: "Directors of the corporation shall have a duty of care to use reasonable judgment to define and direct the affairs of the corporation in accordance with the Stakeholder Enabling Principle." (Freeman, 1994 p. 417) To Freeman, these principles, two of his six, are an attempt to create a normative basis for the relationship between stakeholders. What appears as ethical or prudent behavior to one stakeholder often appears as imprudent or unethical to other stakeholders. Freeman's idea of stakeholder pragmatism is addressed by Jensen and Sandstrom (2013) to bring the idea more in line with the idea of democratic and ethical principles. The core of their argument is a broader and more inclusive conception of what

stakeholder value is and how it can be created in a world full of contingencies.

The issue of stakeholder value and how it is created is a relatively new topic in stakeholder theory. Garriga (2014) argues that stakeholder utility functions are inadequate for defining value derived from corporate decisions and actions. Drawing on a Capability Approach, stakeholder welfare is seen as going beyond utility to include agency and freedom with an emphasis on the complexity of motivations and behavior exhibited by stakeholders. This idea of stakeholder agency was articulated by Raelin and Bondy (2013) who pointed out the double-layered nature of agency relationships in stakeholder interests. In this conception, the interests of shareholders and managers are thought to be in conflict while the interests of shareholders and society are thought to be more supportive.

The fact that stakeholders often have conflicting interests as well as shared interests prompted Hendry (2001) to conclude that normative stakeholder theory “appears to be in considerable disarray”. In his attempt to bring clarity to the issue, he proposes three kinds of normative stakeholder theories: descriptive, instrumental and normative. From an ethical perspective normative theories address “how should firms be governed, and to whom should managers be responsible?” (Hendry, 2001, p 162) This approach introduces the idea that different ethical questions and thus, different governance decisions may place differing weight on the interests of one group of stakeholders relative to other stakeholders. Cragg (2002) points out that corporations are legal artifacts resulting in legal obligations that are “pragmatically and normatively incoherent.” (p 113)

Philips (2003) responds by introducing the idea of stakeholder legitimacy and that the degree of legitimacy may differ depending on the specific claims a stakeholder may have based on the nature of their relationship to the corporation and the nature of their claim to legitimacy. He makes a distinction between normative and derivative stakeholder legitimacy. Normative stakeholders, according to Philips, “are those stakeholders to whom the organization has a moral obligation, an obligation of stakeholder fairness, over and above that due other social actors simply by virtue of their being human”. The issue of normative stakeholders answers the question: “for whose benefit should the firm be managed?” (See Freeman, 1984) Derivative stakeholders are others who lack normative interests but, none the less, must be considered stakeholders because of their potential to impact the organization or its normative stakeholders. Derivative stakeholders may exert either positive or negative influence over the organization or its normative stakeholders and both types of influence must be considered. This concept of normative and derivative stakeholders reinforces the idea that fairness implies a ranking or “pecking order” of stakeholder interests given the specific nature and context of governance decisions.

Corporate social responsibility expands the idea of derivative stakeholders to include the larger community or society within which an organization exists. Renouard (2011) defines corporate social responsibility to include the relationships that exist both within and between various stakeholder groups. These relational interests are often derivative rather than normative in that societal relationships can often have an impact on corporations and thus must be considered in the governance process. However, corporate social responsibility can be normative in instances where the corporation has a direct impact on societal welfare in areas like environmental responsibility or consumer product safety.

The difficulty in unraveling the complexity of the claims various stakeholders may exert on a corporation or organization is that stakeholders often make their claims from a position of self-interest. Equity stakeholders want higher financial returns, employees want higher compensation and benefits, consumers want safer less expensive products, the community wants jobs and a clean environment and society wants social responsibility. These interests are often in conflict with each other. This led Enyinna (2013) to question the ethical adequacy of stakeholder theory pointing out that stakeholder theory is essentially philosophical and thus provides only general guidance for ethical decision making. To be normative, that is to provide specific guidance to practical decision, a theory must be prescriptive. Normative theories of ethics must provide guidance for action and thus not be merely hypothetical. The only way to unravel these conflicting interests is through a thorough understanding of the idea of fairness.

Many authors have applied the work of modern and classical philosophers to the issues relevant to stakeholder theory. Aristotle’s idea that ethical virtues are derived from the practice and articulation of constraints on action has given rise to the critique of capitalistic economics in the context of social justice (Gruoni, 2014). Kant more directly addressed the idea of the status of stakeholders in his ‘duty of beneficence’ in which in which one individual or group owes unconditional obligation to regard the interests of other persons and groups (see Castro, 2014 and Mansell, 2013). Others have applied a neo-utilitarian approach to stakeholder conflict that attempts to enhance stakeholder happiness by implementing principled choices when faced with policy options (Jones and Felps, 2013). We are suggesting a similar application of modern philosophy to balance the often conflicting interests of diverse stakeholder groups.

## 2. Rawls and the Veil of Ignorance

John Rawls's influential *A Theory of Justice* (1971) has been a catalyst for much of the ethical debate in modern philosophy. Rawls has several main ideas relating to ethics that we will discuss for this paper. In general, his philosophical argument is designed to create a fair and unbiased way to decide upon ethical principles. Note that Rawls is not specifically talking about corporations or business ethics when discussing his moral theory; instead, his theory is interested in more universal claims about morality and justification. For the purposes of this paper, there are a few key elements that are directly applicable to corporate decision making involving many stakeholders.

### 2.1 The Corporation as a "Social Contract"

Rawls believes that society is an arrangement of agreements, implicit and explicit, that are to be followed by individuals within a society. Social Contract Theory is a fundamental part of American government, with principles borrowed from Smith (1776) and Rousseau (1762) serving cornerstones of the modern republic. Rawls explains the social contract as such: "[T]he principles of justice for the basic structure of society are the object of the original agreement. They are the principles that free and rational persons... would accept." (Rawls, 1971, 10) Agreement and cooperation are some of the fundamental building blocks of a corporation. Furthermore, there is an expectation that all participants in various stakeholder groups are "free and rational persons." Business is based upon mutual agreement and trusting relationships. If there is coercion or foul play in a particular economy, this can cause great damage to an economy. Regulations and laws are put in place to discourage this kind of foul play, allowing virtually all relationships in business to be forthright. Furthermore, corporations also have a duty of responsibility to society as a whole, not just to other firms. In the event of product failure, industrial disaster, or other errors, corporations have obligations to their communities, or to society as a whole. Part of the contract of business dictates that a firm should be responsible for its customers, ensuring products work properly, contract options are deemed fair, and all services are safe for the public. There is a similar responsibility to the environment as a whole. Corporations that do not uphold their end of this social contract often draw the ire of entire demographics. Consider the *Animal Farm*-like (See Orwell, 1946) transformation of cell phone companies into the vile, disgusting phone companies they replaced. Unfair contract options and escalating costs cause outrage because the firm is perceived to violate a contract with their customers.

### 2.2 Justice as Fairness

In seeking an ethical framework to guide any sort of social contract, it is important first to decide what is going to be the goal of such a contract. Rawls frames this as "Justice as Fairness," which he utilizes as a term to specify a contract that can be rationally agreed upon by all members of society. Rawls is adamant about the principles of his social contract being universally agreed upon: "They are the principles that free and rational persons concerned to further their own interests would accept... as defining the fundamental terms of their association. "These principles are to regulate all further agreements" (Rawls 1971, 10). Not only does Rawls want universal agreement, but he wants these principles to be agreed upon out of self-interest. The social contract should be one wherein all members of society feel that they, personally, are getting a fair deal out of the social construct.

In terms of corporate stakeholders, this seems to be a similar set of reasons for participation in the corporation as a whole. While certain altruistic individuals may serve as exceptions, the majority of business is conducted out of self-interest. We deem self-interested parties to be acting in rational ways, a core concept within economics. This idea of self-interest is of particular note for our application. In a corporate environment, stakeholder groups will inevitably hold differing conceptions of what is "fair" for the firm to do. An executive's notion of fair could differ greatly from a customer's conception. When mediating between these groups, compromises will often dictate the course of action. Ideally, all disagreeing parties would feel these compromises were a "good deal" for their particular stakeholder group. This could be true for more general principles a company holds: consider the famous Google slogan "Don't be evil." (See Google, 2000) As appropriate as this statement may be for public relations, the sound governance of a firm is oftentimes based on grandiose statements such as these. The interests of the customer empower our understanding of both quality and service.

### 2.3 The Veil of Ignorance

Rawls knows how he wishes to establish the principles for greater fairness and equality in society. There remains a problem, in his mind, that will prevent individuals from coming to agreement on the principles that will serve "justice as fairness" best. He instead wishes to conduct a kind of thought-experiment, wherein the general goal will be empathy between individuals. He refers to the "veil of ignorance," which is to be used in this thought experiment (Rawls 1971, 118). In order to reach principles of social justice, Rawls wishes to strip away some of the self-identity

that may cloud our decisions about principles with our own inherent biases. The Veil of Ignorance is intended to remove one's ability to see their position within an already functioning society. Rawls's reasons for this are the subject of numerous ethical debates in philosophy, but we wish to demonstrate how such an idea is useful in terms of stakeholder theory. The various stakeholder groups, comprised of individuals, have an interconnecting duty to each other through the form of the corporation. However, there remain initial conflicts between particular groups. When the corporation is first beginning, there are financiers and initial partners who have risked more for the creation of the corporation. These stakeholder groups will care drastically more about the initial influx of revenue, due to their involvement in the first stages of the corporation. Since there will be few initial customers, it would seem, that there would be little influence of customer stakeholders in the sound governance. The Veil of Ignorance is an opportunity for these initial stakeholder groups to empathize with the long-term customer base they wish to attract. For Rawls, this Veil of Ignorance is a step towards social justice, but our conception sees it as a way for stakeholder groups to empathize. We would further add that this is a fundamental step to take when looking at the complex interests of many firms as a whole. Through the web-like dealings of industry, businesses find themselves on different sides of many equations. The firm is a customer when it purchases its wares from suppliers. It is the seller once its products are ready for the market. It is employer to its individual workers, and an employee when it lands a big government contract. The firm has a vested interest in preserving the fairness of dealings within its stakeholder groups because all stakeholder groups expect fairness of the firm's dealings with other corporations.

#### *2.4 Establishing the Original Position*

Rawls wishes to establish some ethical guidelines that all people can agree upon, but he sees a problem in reaching consensus. All individuals (or for our method, stakeholder groups) must accept the principles of society (sound governance) for self-interested reasons. Rawls believes this will make for an unbalanced discussion of these central principles. He has concerns for several confounding factors, which he attempts to take care of via the Veil of Ignorance.

Rawls has some conclusions about the nature of justice in society and the principles by which all those in this thought experiment will accept a few key principles regarding the nature of society as a whole. The conclusions he offers up are not so useful to our understanding of stakeholder theory, as they are elevated and proper ideas about ethics in society in general. However, it would be nice for us to borrow his term, the "Stakeholder Original Position." We can use this to refer to the decision-making ability of the stakeholder groups when engaged in this kind of discussion. Rawls may go on to argue for specific principles, but that's more than we are attempting to do by borrowing his thought experiment. Instead, as we will see in our application section, we are able to find some case-by-case decisions that could point to some greater principles.

### **3. Application and Stakeholder Relations**

Note that, for the purposes of our model, we are not aiming to reach any sort of principles in the way Rawls is. Instead, we are suggesting that the stakeholders are able to value the needs and concerns of the various groups. With the Stakeholder Original Position, there is an even playing field for making decisions that have conflicting interests within stakeholder groups. As stakeholders are all a part of the same corporation, we can safely say they value a few common goals: that the corporation stay operational, that the corporation be successful, and other general "good" things for the corporation. They also, though, in the Stakeholder Original Position, have another common goal or value for the corporation: that it treat stakeholder groups fairly when mediating conflict between them. That is to say, in instances that harm certain stakeholder groups, the other groups should acknowledge that it is best to undo that harm through the policy of the entire corporation. Using this method of thinking, we can look at some case studies to explore the consequences.

#### *3.1 Financial Adjustments*

As each stakeholder group is connected to the corporation as a whole, there are many inter-connected relationships between these groups. Though it is essentially a decision made by upper-level management, issuing a stock dividend can affect many people throughout the corporation. Many employees are likely to have stock portfolios as part of their benefits plans. Financial firms and hedge fund managers outside of the corporation will see the dividend alter their own financial dealings. Finally, there are the investors and shareholders themselves. All of these stakeholder groups are involved, directly or indirectly, in the dividend. By applying the Stakeholder Original Position, the various groups are able to see which group should have priority in making this decision. The announcement of a new dividend, it should be noted, is not typically the mark of a company doing poorly. If a firm is able to release a

dividend, there are not as many negative consequences as with some of the other case studies. However, the stakeholder would also recognize that the dividend is, essentially, rewarding individuals who have invested in the company. The dividend, then, is a way of thanking these investors for a risk that had already been taken. When the stock was first purchased, investors were taking some kind of risk in the profitability of the firm in the long run. The Stakeholder Original Position would note that the investors in the firm are, via the previously discussed Corporate Social Contract, owed something in return for their assistance.

### *3.2 Employee Benefits*

Since the Financial Crash in 2008, stories about the changing nature of employee benefits have become a common headline for American corporations. Combined with the implications of the Affordable Care Act, it has been an uncertain time for many businesses as they attempt to address the needs of their employees. Employee benefits could mean a wide range of things in terms of the stakeholder groups. Everything from medical insurance to hourly wages, the things employees receive as compensation from a firm could be construed as their rightful due. However, these benefits and remuneration come at the expense of the firm as a whole. It creates a conflict between stakeholder groups within the firm, a conflict that has led to collective bargaining in order to create a more equitable means of negotiation.

Under the Stakeholder Original Position, there are a few key things the individual groups would recognize. The first is the opportunity cost of the employees, choosing to work for a particular corporation drastically limits the means by which a person can make a living. With salaried jobs, individuals are expected to perform certain duties with less concern for the hours that are needed. Smartphones and 3G networks mean one is never more than a phone call or email away from their work responsibilities. There is opportunity cost for the employees that could be leisure, time improving personal skills, or more gainful employment. Through the Stakeholder Original Position, all parties can identify the sacrifices employees make to improve the company. That being said, this Rawlsian model also reminds the employees of their commitment to the other stakeholder groups. In return for a sustainable living, with benefits that allow the employee to live a productive and comfortable life, there is the expectation of quality and commitment to the corporation as a whole.

### *3.3 Customer Safety*

As we have discussed, there are some stakeholder groups in a corporation that are outside of the structure of the business itself. These groups, such as the customers, are still an integral part of stakeholder analysis, with the customer in particular being one of the most valuable stakeholder groups to consider. The customer may be always right, as the adage goes, but sometimes the desires and needs of the customers can be taxing on the other groups within the firm. In the case of a product recall, there is the potential for a financial and legal catastrophe for the whole company. Recalls are costly, to put it simply. The firm loses face as a whole, and these negative consequences affect all stakeholder groups within the corporation. There may be a temptation, then, to gloss over some minor safety concerns, so as not to go forth with the recall. However, the Veil of Ignorance allows for a few key understandings about the role of customers in the stakeholder model. To begin with, the firm understands that customers are the source of revenue and (hopefully) profit. This in itself warrants a certain respect towards customer interests. A product that could harm the source of income for the firm is perhaps worth spending a short-term amount of cash to solve. There are matters of the firm's reputation, as well. Though mistakes happen, and faulty products are certainly unintentional, the firm should desire a reputation of honesty and forthright action with its customers. In this instance, the company itself is the seller of merchandise, but the Stakeholder Original Position also can give some highly applicable insight into being the buyer of a faulty product. As is the nature of business, the firm purchases goods and services from other companies to support their own operation. The corporation relies on these goods and services to be given in a reliable manner. Though the recall will hurt the firm in the short term, it is the better decision for the longevity of all the stakeholders.

### *3.4 Public Concerns*

The general public is perhaps the most tangentially-related stakeholder group to the corporation, but they serve an integral part of the decision making process for any firm. First and foremost, the general public represents customers-to-be, the opportunity for growth into new markets, and other beacons of success for the company. The general public is the target of advertising efforts from the company. Expansions and capitalization are the cornerstones of the firm's function, and the public at-large is the way to achieve these things. In some cases, the public is also affected by the actions of the corporation as a whole. Environmental disasters are a classic way in which a corporation does not take into consideration the interests of public stakeholders. Negligence and corner-cutting are factors in such disasters, where the legal and public relations fallout can damage the reputation of

some companies for good. Environmental concerns have always been a difficult issue to balance on philosophical grounds, but the corporation has some better guidelines for making such decisions given a few commonalities between the stakeholder groups. First, environmental concerns affect all other stakeholder groups in the corporation, albeit in a more general sense. Employees must live in the same area as the corporate offices. Customers are members of the general public, as are investors. The corporation can also consider the ill effects of other firms operating in ways damaging to the general environment. If, for instance, automobile makers were collectively releasing vehicles that were woefully unsafe, the public as a whole would be leery of buying cars. The stakeholders can have a self-interested reason to protect the general public: the firm's target market is out there in the public, and it is a valuable asset to protect.

#### 4. Conclusion

We use Rawls in this article as a kind of framework for understanding stakeholder relationships and interests with regard to each other. To use his ethical framework within the context of stakeholder analysis, we can see the ways in which certain corporate ethical dilemmas can solve themselves. By paying attention to the concerns of the stakeholder group being "wronged" in a particular case, the corporation as a whole can chase the resolution that provides a fair and balanced outcome for all members of the firm. Stakeholder relationships, though typically occurring in more abstract terms, can be seen here in terms of fair and unbiased negotiations, wherein individuals in certain groups can reach principles out of self-interest. Rawlsian methodology for ethical concerns, in this case, does not yield principles of operations, but instead gives an operational framework for unraveling stakeholder interests.

Clearly, the legitimacy of the interests of any one stakeholder group is neither singular nor constant; they change depending on the governance issue being considered. The primacy of stockholder interests must be subordinated to those of the consumer when product safety is at issue. Employee interests must be given primary weight when workplace safety is considered and the community at large must hold sway when environmental quality is addressed. When, from behind the veil of ignorance, reasonable individuals decide on the relative weight of various stakeholder interests, the positive and negative impacts of governance decisions on various stakeholders must be balance to achieve a uniform idea of fairness and justice.

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