The CEO SERIES

Business Leaders: Thought and Action

Corporate Governance: When More's at Stake than Meets the Eye

by William C. Steere, Jr.
Chairman of the Board and
Chief Executive Officer
Pfizer Inc.

CEO Series Issue No. 23
May 1998

CSAB
Center for the Study of American Business
Washington University in St. Louis

Corporate Governance: When More's at Stake than Meets the Eye

by William C. Steere, Jr.

William C. Steere, Jr.

At Pfizer, corporate governance is important to us. We are proud of our company, products, and people, and we take seriously the trust that our investors, employees, and customers place in us. We believe that we have both a fiduciary and moral responsibility to those who put their faith in us — and in the medicines that we discover and develop.

In a company like ours, that produces life-saving and life-enhancing drugs, we are acutely aware that millions of people depend on us for medicines that enable them to live fuller, more productive lives. We also realize that our ability to meet their needs depends on how well we run our company. This includes: the discoveries we make; the way we treat our employees; our responsiveness to our customers; the return we give our investors; our responsibilities to the community; and the amount we are able to invest in R&D to discover, develop, and bring to market the cures of tomorrow.

Clearly, for us, for other companies, and for society at large, there is a great deal at stake in corporate governance. Almost everyone in our culture deals with corporations on a daily basis, is *directly* affected by what they produce, and is *indirectly* influenced by how they are governed.

As more and more Americans have invested in the stock market — or have had pension funds invested for them — they have become increasingly attuned to the importance of corporate governance. Today topics that used to interest a very small percentage of the population — the composition of boards, executive pay, institutional investors, shareholder rights, white knights, poison pills, downsizing, and "socially responsible investing" — attract the attention of millions. As Jacob Weisberg recently observed in *The New York Times Magazine*, with more

---

William C. Steere, Jr., is Chairman of the Board and Chief Executive Officer of Pfizer Inc.

than fifty percent of adult Americans investing in stocks, "we have become a society of shareholders."[1]

Of the myriad issues involved in corporate governance, the most basic are those of ownership and authority: Who owns the corporation? and Who has the authority to run it? Closely allied to these questions are those of rights and responsibilities: What rights does ownership confer? and What responsibilities does it entail? These questions lie at the heart of what is often called the "shareholder-stakeholder" debate.

I think that this debate is one of the most important issues in corporate governance today. Moreover, I believe that the way in which it is resolved will have important implications for the business community and for society at large. In what follows, I'd like to examine the extraordinary ambiguity of the word "stakeholder," sketch out a few of the issues involved in this debate, register a couple of caveats about the use of this ambiguous word, and make a few suggestions as to when it is helpful to think in terms of "stakeholders" and when it is not.

Of the myriad issues involved in corporate governance, the most basic are those of ownership and authority.

If the "shareholder-stakeholder" debate had remained confined to the groves of academe, we might simply regard it as an interesting ideological argument, but "stakeholders" and theories based on their ostensible rights have begun to crop up everywhere. British Prime Minister Tony Blair swept to victory in 1997, promising a "stakeholder society." Policy papers and business articles regularly link "stakeholderism" to social responsibility, and everyone — from strategic managers to business ethicists — seems to be invoking "stakeholders."

Missing from this welter of invocations, however, is any precise definition of what a "stakeholder" is. Everyone knows what a shareholder is, but as Professor Alan Deacon recently pointed out, although "'[s]take-holding' has become an increasingly fashionable term in...political debates...there is scant agreement about what the term actually means."[2] In fact, the definition of the word often seems to depend upon the identity of the speaker.

Some commentators use the term to refer to all those who have a acquired a "stake" in the corporation — by virtue of the money they have invested in a company, the financial or professional risks they have run in supporting it, or the contributions they have made to its operation. Under these rubrics, "stakeholders" would include shareholders, management, and employees, as well as, in some cases, customers, suppliers, and the community where the company operates.

Some left-of-center thinkers, however, use the word "stakeholder" to refer to anyone who they think should be entitled to share in the profits that a corporation generates. Furthermore, they do not believe that sharing in these profits should be contingent on having invested any money, run any financial or professional risk, or made any contribution to the company from which the "stakeholders" would benefit. With the wave of a verbal wand, these theorists have established a whole new class of beneficiaries who have rights, but no responsibilities.

The two world views expressed in this debate are radically different, and the consequences that derive from each are far-reaching. The "share-holder model," which emphasizes rights that derive from responsibilities, grows out of a concept of property based on centuries of English common law. Moreover, the basic *quid pro quo* on which shareholder investing is based is the very foundation of the free-market economy.

The basic quid pro quo *on which shareholder investing is based is the very foundation of the free-market economy.*

The "stakeholder model," on the other hand, is rooted in a socialist world view that separates rights from responsibilities, assigning virtually all the responsibilities to the corporation and most of the rights to anyone deemed to have a stake in its operation.

Those who are new to the "shareholder-stakeholder" debate might think that no one would support such an inclusive definition of "stakeholdership," but they would be wrong. As far back as the 1930s, E. Merrick Dodd, a legal scholar, challenged shareholders' preeminence in corporate governance, arguing that all those with an interest in a company's operations should be considered "absentee owners."[3]

Although not many thinkers picked up on Mr. Dodd's idea at that time, a whole cadre of scholars in the '80s and '90s have begun to build on his work. In 1984, for example, the University of Virginia's R. Edward Freeman defined "stakeholders" as "any group or individual who can affect or is affected by the achievements of an organization's objectives," even including a company's competitors in that category.[4]

In recent years, the definition has become even more inclusive. As Professor Marianne Jennings of the Lincoln Center for

Applied Ethics observes, "In the academic literature, the definition of stakeholders has expanded to include all of God's creatures." In support of her observation, she cites a 1995 article from *The Journal of Business Ethics* entitled "Should Trees Have Managerial Standing? Toward Stakeholder Status for Non-Human Nature."[5] Other scholars are currently arguing that a variety of species and the environment itself should also have "stakeholder" status.

Ambiguities and excessive inclusiveness aside, there is also a basic philosophical contradiction in putting those who somehow have a "stake" in a company on an equal footing with its shareholders. As Constance J. Horner of the Brookings Institution points out, one cannot equate the positive action of shareholders — who save their money, study investment opportunities, and choose to support a particular company to promote economic growth — with the status of an individual who, by accident of geography or other random occurrence, happens to be influenced by a particular business.

There is also a basic philosophical contradiction in putting those who somehow have a "stake" in a company on an equal footing with its shareholders.

As Mrs. Horner astutely observes, "There is no moral equivalence between the two. In the first case, an individual uses his will and acts to attain a positive good. In the other, he simply and passively has stakeholder status conferred on him — independent of his own will or action." She also points out that the attempt to equate shareholders with stakeholders and the confusion over the latter term may not be accidental because "when people want to change policy, they first capture the vocabulary."[6] Indeed, as Sir Samuel Brittan aptly observed a few years ago in the *Financial Times*, "There is...a deliberate ambiguity about the pronouncements of stakeholder *theorists*."[7]

I believe that confusion about what the word "stakeholder" actually means grows out of contradictions implicit in the idea itself. These become readily apparent if we ask a few questions about how "stakeholderism" would operate in practice:

- Who would decide who the "stakeholders" are?
- Would some be "more equal" than others?
- What function would they perform?
- Would they be allowed to vote as shareholders do?
- What would happen when the interests of the various "stakeholders" did not coincide?

- Who would then determine what course the company would follow?
- What would occur when the interests of some of the stakeholders conflict with the company's long-term growth and profit maximization? and, finally,
- Why would investors put money into a company when they know that thousands — maybe even millions — of other stakeholders will have a say equal or superior to theirs and that a slew of other issues may be considered ahead of profitability?

In theory as well as practice, "stake-holderism" is fraught with contradictions. That is one of the reasons I think it is often wise to avoid the term, and speak instead about a company's "constituencies." As the CEO of a publicly held company, I believe that Pfizer has responsibilities to a variety of groups. Clearly, we have a fiduciary responsibility to those who have invested in our company. We also have a responsibility to our customers and employees, as well as the communities in which we operate. Our "customers" include "traditional" ones — like patients, doctors, and hospitals — as well as the agencies with whose regulations we must comply, groups like the FDA, EPA, OSHA, and the SEC.

I think it is often wise to avoid the term, "stakeholders," and speak instead about a company's "constituencies."

We believe in treating our customers — and all those with whom we do business — well. Respect for people is one of the eight core values on which our company is based, and we apply it across the board. At Pfizer, we have a long-standing tradition of reaching out to the neighborhoods where we operate. As a company — and as individuals — we give generously of our time, money, and talents to enhance the communities where we live and work.

Some people believe that this kind of commitment is unnecessary, and that the money companies invest in philanthropy should go back to the shareholders. But I think that giving communities the right kind of support is good social policy as well as good business. It's good for the company's reputation. It's good for employee morale. And because it helps the communities in which we operate, it's good for us.

Pfizer's philanthropic activities not only burnish our company's reputation and demonstrate our commitment to helping others. They also add to shareholder value by improving our standing with our customers, as well as with regulatory and legislative authorities.

For example, the support that we have given a whole array of projects in Brooklyn has benefited our company enormously. A few years ago, when most other companies abandoned the Williamsburg section of Brooklyn, Pfizer decided to stay. By operating our plant 24-hours-a-day with three shifts, we helped keep crucial jobs in the community. We also began a redevelopment program—revitalizing the neighborhood around our plant, and working to improve safety, housing, education, and commercial development. In addition, we converted one of Pfizer's buildings into a kind of charter elementary school—which has achieved outstanding results.

But Pfizer's commitment to our society extends far beyond the immediate areas where we do business. Our company is devoted to saving, protecting, and enhancing lives, and caring for others grows naturally out of that mission. In a sense, everyone has a "stake" in the work we do because everyone can potentially benefit from the medicines we discover and develop. But there is a big difference between trying to do whatever we can to help the largest number of people and letting anyone who believes he or she has a "stake" in Pfizer's work run the company.

I think it's a good thing that our society has become more interested in corporate governance, and I applaud the active interest that institutional investors have taken in how companies are run. But for the sake of clarity, it is important to know when thinking in terms of "stakeholders" is helpful and when it is not. When a company is doing a strategic analysis before making an important decision, it is imperative to think about all "stakeholders" — about everyone who may be affected and about the resulting ramifications. On the other hand, using "stakeholder theory" as a blueprint for governing a company is both philosophically and practically untenable.

In the early days of the American West, pioneers were often encouraged to stake a claim on territory that the government gave away "free." If the settlers did not build on, live on, farm, or in some way cultivate the land, however, they often lost their stake. This transaction was governed by the underlying assumption that the rights of these literal stakeholders were contingent upon their fulfilling their responsibilities. I think that the principle holds true today as well. If corporate governance is about ownership and authority, then it also is about rights and responsibilities, and it would be a grave error to try to separate them — *especially* when more's at stake than meets the eye.

Notes

1. Jacob Weisberg, "United Shareholders of America," *The New York Times Magazine* (January 25, 1998), p. 29.
2. Frank Field, *Stakeholder Welfare* (London: IEA Health and Welfare Unit, 1996), p. 3.
3. Merrick Dodd, "For Whom Are Corporate Managers Trustees?" 45 *Harvard Law Review* 1145 (1932); Marianne Jennings cites Dodd in her article, "Trendy Causes Are No Substitute for Ethics," *The Wall Street Journal* (December 1, 1997), p. A-22, as well as in an unpublished paper entitled "Teaching Stakeholder Theory: It's For Strategy, Not Business Ethics."
4. R. Edward Freeman, *Strategic Management: A Stakeholder Approach* (Boston: Pitman, 1984). Jennings, in the article cited above, quotes Freeman and gives additional information concerning the influence of his work.
5. Marianne Jennings,"Trendy Causes Are No Substitute for Ethics," p. A-22.
6. Unpublished Remarks by Constance J. Horner, Guest Scholar in the Governmental Studies Program at the Brookings Institution, October 24, 1997.
7. Quoted in David Willets, *Blair's Gurus: an examination of Labour's rhetoric* (London: Centre for Policy Studies, 1996), p. 19.

The Center for the Study of American Business is a nonprofit, nonpartisan organization, funded entirely by grants from foundations, business firms, and private citizens. It is an integral unit of Washington University. The opinions expressed herein are those of the author and do not necessarily reflect the position of the Center or Washington University. Address inquiries to: Center for the Study of American Business, Washington University, Campus Box 1027, One Brookings Dr., St. Louis, MO 63130-4899, (314) 935-5630.

Washington

WASHINGTON · UNIVERSITY · IN · ST · LOUIS