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A Comparative Analysis of Capitalism of Shareholders and Stakeholders

S. Moulitharun[1,*]

Abstract

Shareholder capitalization is a system driven by the interests of shareholders and it is concerned with short-term profit maximization, whereas stakeholder capitalization is a system that concerns the interest of all the stakeholders equally and is focused on long-term value creation. The stakeholder capitalism declaration surpasses prior statements and establishes a contemporary benchmark for corporate accountability. In this research, the author will go through a detailed analysis of shareholders' capitalism and stakeholders' capitalism. This research tends to majorly deal with the comparison between shareholders' capitalism and stakeholders' capitalism and in addition, the impact of COVID-19 on both the former and latter will be elucidated. COVID-19 has adversely affected the concept of capitalism, by creating a corporate debt crisis which led to supply and production failure. Shareholders' capitalism only deals with the benefit of the shareholders, but stakeholders' capitalism is a holistic approach that ensures the benefit of "people and planet". Thus, this paper focuses on making necessary findings that will substantiate the need to shift from shareholder capitalism to stakeholder capitalism for a better society to obtain economic stability.

Keywords: Shareholders' capitalism, Stakeholders' capitalism, COVID-19

INTRODUCTION

This paper is about the topic "Comparative analysis of shareholders' capitalism and stakeholders' capitalism" And forms a part of the seminar "Comparative Corporate Governance".

A fundamental query within corporate governance revolves around defining the ultimate objective of businesses. The shareholder and stakeholder approaches stand out as the most renowned frameworks in this context. Despite the absence of a singular, precise definition for these concepts due to their numerous sub-theories with varying emphases and particulars, they both prescribe distinct philosophies for managing businesses, especially large corporations. This study will examine the impact of these ideologies on corporate governance within the United States and India. This paper will explain the shareholder and stakeholder capitalism and present their comparison during, before, and after COVID-19, and paradigm shift from shareholder capitalism to stakeholder capitalism.

***Author for Correspondence**
S. Moulitharun
E-mail: moulitharun0852@gmail.com

[1]Student, Faculty of Law, Tamil Nadu DR Ambedkar Law University, School of Excellence in Law Chennai, India

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SHAREHOLDERS' CAPITALISM

Adolf Berle and Gardiner Mean published the book *The Modern Corporation and Private Property* in 1932 regarding the foundation of United States Corporate Law. This book introduced the idea of "shareholders are the corporation's true owner". Later, economist Milton Friedman added to the theory that the main purpose of corporations is to maximize shareholders' wealth. Shareholder capitalism is based on the shareholder theory primacy and principle of shareholder.

The shareholder theory represents a significant perspective on the function of businesses in society, asserting that managers are solely accountable for optimizing shareholder interests through effective utilization of corporate resources. This viewpoint traditionally defines the corporation's purpose, as individuals invest in company shares with the primary goal of maximizing their financial gains. Within the framework of shareholder theory, managers bear an ethical obligation to create substantial value for company owners. They act on behalf of shareholders to ensure maximal returns, either in the form of dividends or heightened stock prices. Shareholder primacy is a corporate governance principle centered around prioritizing the enhancement of shareholder value above all else, without initially factoring in the concerns of other corporate stakeholders like society, the local community, consumers, and employees. This concept emphasizes that shareholders hold the primary interest in both the financial and administrative aspects of the corporation: they are considered the principal party in the principal-agent dynamic, for whom the company operates [1]. Shareholder primacy guides the board to manage the corporation exclusively with the aim of maximizing shareholder prosperity. The case of *Dodge v. Ford Motor Co.* (1919) [2] involved a dispute between Henry Ford and the Dodge brothers over whether the Ford Motor Company should pay dividends to shareholders due to enormous accumulation of capital surplus and whether the company should be permitted to make large capital investments. Ford justified his business decisions on his philosophy that a corporation should "employ still more men, to spread the benefits of this industrial system to the greatest possible number, to help them build up their lives and their homes" [3]. The Michigan Supreme Court rejected this economic philosophy and rebuked Ford: "A business corporation is organized and carried on primarily for the profit of the stockholders. The powers of the directors are to be employed for that end."

Hence, shareholder capitalism characterizes a capitalist system where the preferences of a specific stakeholder, namely the shareholder, take precedence over those of all other stakeholders.

STAKEHOLDERS' CAPITALISM

Professor Klaus Schwab wrote about stakeholder capitalism in his book *Modern Company Management in Mechanical Engineering* in 1971. It represents a type of capitalism where corporations aim not only to maximize immediate shareholder profits but also strive for enduring value generation by considering the requirements of all their stakeholders and the broader society.

The global community is confronting an array of social, economic, and health-related emergencies, and the most effective way to address these difficulties would involve all members of society expanding their perspective beyond individual, limited, and immediate concerns, and instead focusing on the overall welfare of the broader society.

The principle of stakeholder capitalism requires businessmen to define their mission as creating long-term value not only for shareholders but also for customers, suppliers, employees, communities, and others. Stakeholder capitalism defines "value" in broader terms, for example, creating a safe and healthy work environment would save money in the form of reduced workers' compensation payments and also create more subtle benefits like greater employee security.

Stakeholder capitalism does benefit the company by good reputation and by increased performance. In a study that looked at 615 large- and mid-cap US publicly listed companies from 2001 to 2015, the McKinsey Global Institute concluded that those with a long-term view outperformed the rest in earnings, revenue, investment, and job growth. Other McKinsey research found that companies with strong environmental, social, and governance (ESG) norms recorded higher performance and credit ratings; other research has found that such companies perform better during crises [4].

McKinsey has identified five key ways in which companies can influence stakeholders: financial and operational, environmental, health (both organizational and personal), capacity building, and level of satisfaction. The foundation for all these endeavors lies in the financial stability of the company. For every category of influence, companies should take into account the primary requirements of stakeholders, utilizing metrics whenever feasible to assess the company's current standing and the potential advantages that enhancements could offer.

Financial and operational impact refers to improving the stakeholder's long-term financial well-being.

Shareholder capitalism has concentrated on this effect through dividends and stock values. In the case of other stakeholders, the financial influence could manifest as elevated employee salaries or the provision of educational grants for nearby students. In recent years, a number of major retailers and other companies have raised entry-level wages well above local mandates; they report seeing more employee engagement and less turnover [5]. For the economy as a whole, it can mean greater purchasing power.

In 2019, PayPal committed to improving its employees' financial wellness and net disposable income by increasing pay for many employees, lowering the cost of healthcare for hourly workers, and giving restricted stock units. Although this was expensive, CEO Dan Schulman has no regrets: "I believe it's worth every dollar and every resource and that it's been essential to making our workforce more resilient in the face of COVID-19" [6]. In the year after implementation, PayPal found that its employees were four times more engaged and three times less likely to leave the company, and profitability grew 28% [7].

Environmental impact considers waste, pollution, emissions, land use, consumption of natural resources and other ways in which its operations affect the health of the environment.

Many companies are already capturing this type of impact through their ESG reporting. For example, Swedish electric-vehicle-battery manufacturer Northvolt, founded in 2015, has raised $1 billion in financing and recently received a $14 billion order from Volkswagen [8]. Investing in environmental sustainability can also reduce costs by increasing resource efficiency.

Health has two dimensions: the organizational health of the company and the personal well- being of the individuals. The well-being of an organization is tied to fundamental management approaches. It encompasses a company's ability to establish shared goals, execute them, and adjust to shifts in the market. Enhancing market emphasis, for instance, enhances organizational health by reinforcing the outward focus on customers, rivals, business associates, regulators, and the local community.

Human well-being is intricate and shaped by various social and economic circumstances. Individual health is linked with dedicating resources to employee well-being, establishing diverse and welcoming work atmospheres, and actively participating in the advancement of thriving communities. Investments in health and well-being of employees pay off for the individual as well as for the companies. During the COVID-19 pandemic, some manufacturing plants that invested in health protocols which went beyond public-health guidance have been able to minimize shutdowns [9].

Capability-building impact refers to improving the skills and competences of stakeholders. For example, in 2011, Unilever's largest food brand, Knorr, established the Knorr Sustainability Partnership, which works with its suppliers and growers to promote agricultural sustainability. The partnership monitors farms to ensure they meet guidelines on factors such as soil quality, water and fertilizer use, animal welfare, working conditions and biodiversity. Top performing farms are awarded 'benchmark' status and Knorr packaging will have a logo when more than half of the ingredients are from sustainable sources [10].

Satisfaction impact means improving stakeholder interaction with a company or its products and services. The concept of customer satisfaction is also below the horizon of stakeholder capitalism. For communities, it could mean being part of an effort to improve traffic around corporate buildings or subsidize a local service. For employees, this could be asking them what they like and dislike about their job and looking for ways to improve it. In the context of suppliers, this could involve providing assistance during challenging phases by extending credit, adjusting payment schedules, or introducing novel technological solutions. Research indicates a direct connection between employee engagement, customer contentment, and business outcomes.

Stakeholder Capitalism at the 2019 Business Roundtable

In August 2019, the Business Roundtable issued the new Principles of Corporate Governance, which it calls a "modern standard for corporate responsibility” [11]. These principles have moved from a shareholder model, focused solely on financial and operational costs and benefits, to a broader stakeholder-driven model, with particular attention to environmental and social risks and opportunities. In January 2020, the Annual World Economic Forum (WEF) convened in Davos under the theme of "Stakeholders for a Cohesive and Sustainable World" sought to renew "the concept of stakeholder capitalism to overcome income inequality, societal division and the climate crisis” [12]. Based on the 2020 Manifesto, the program focused on achieving maximum impact on the forum's platform for public-private partnership on six main activities: ecology, economy, society, industry, technology, and geopolitics.

Stakeholder Capitalism at Davos 2020

The 50th annual meeting of the WEF in Davos focused on stakeholder capitalism with the central theme "Stakeholders for a cohesive and sustainable world".

Professor Klaus Schwab, founder and executive chair of the WEF and longtime advocate of stakeholder theory, said: "People are revolting against the economic ‘elites’ they believe have betrayed them, and our efforts to keep global warming limited to 1.5°C are falling dangerously short” [13].

The WEF has updated its "Davos Manifesto", a set of principles behind the event, for the first time in over 40 years. Now it clearly states at the top: "the goal of a company is to involve all its stakeholders in the creation of shared and sustainable value" and states that companies must have zero tolerance for corruption, respect human rights, and pay a fair share of taxes [14].

Both the organization and the prominent "big four" accounting firms are collaboratively formulating a standardized collection of data and disclosures, which companies can incorporate into their annual reports for evaluating their social and environmental accomplishments. Brian Moynihan, the CEO of Bank of America and Chair of the WEF International Business Council (IBC), emphasized that by uniting companies with asset owners and managers through shared, concise, and significant metrics, they will guarantee the availability of adequate capital to fulfill the Sustainable Development Goals [15].

During a panel discussion in Davos 2020, Kevin Sneader, McKinsey & Company's Global Managing Partner, said economist Adam Smith made it clear that the responsibility of the businessman is to give to the community and enrich everyone. "And I think we lost our way a bit in forgetting that," he added. "Every CEO needs to sit down and come to grips with the fact that if I don’t have teachers to teach the children of my employees, then the best employees aren’t going to come work for our company," said Cisco Chair and CEO Chuck Robbins during the same session. "We have to ensure as businesses that we have strategies to apply our capabilities, our skill sets, our employee base, and our financial resources to actually solve these issues” [16].

IMPACT OF COVID-19

The COVID crisis has revealed several internal failures in the current economic system, including the precariousness of work, high private debt, and vulnerable situation of working citizens and infrastructure. The dominant corporate governance model - shareholder value maximization – combined with financialization has led to a neglect of broader stakeholders and societal challenges.

The economic fallout is mounting globally after the pandemic situation experienced and a lockdown measure adopted by most of the countries in the world. The world economy and other processes have gone in the opposite direction as compared to the previous one. Business communities have already laid off employees and have canceled various services to reduce overhead costs. The question over stakeholder capitalism resides basically on the reassurance of long-term value preservation and resilience of the company that embeds a corporation in society [17]. Stakeholder capitalism allows a company to serve the needs of all its stakeholders, not only their shareholders but also the employees. The stakeholders include employees, vendors, customers, the communities being served and the shareholders in a very proper perspective [18].

Dysfunctional Public-Private Economic Relations

The COVID-19 pandemic underscores the significance of the interaction between the public and private sectors. Governments have the ability to assist private enterprises through emergency interventions, as well as by subsidizing investments and safeguarding innovation (such as through patent protection). However, this relationship often prioritizes delivering corporate profits rather than serving the broader public good. While government aid redistributes corporate risks to society, the benefits are frequently retained within the private realm. The ongoing crisis offers an opportunity to redefine the problematic dynamics between the public and private sectors. As public support facilitates fresh value generation within the private domain, governments should ensure that the resulting outcomes contribute to societal well-being. This interdependent connection should commence with the current emergency aid granted to businesses. Rather than encouraging value extraction, bailouts should incentivize value creation. The time has come to establish economic partnerships between the public and private sectors with a focus on public objectives. Various strategies are being employed to sustain business operations and preserve employment continuity. Multiple nations, such as Australia, Denmark, Poland, Singapore, and the United Kingdom, are offering wage compensation to companies to maintain their workforce.

Supply and Production Failures

The COVID crisis has disproportionately affected a number of countries due to a lack of preparedness, foresight and skills to manage economic activity. In both the United Kingdom and the United States, the production systems have exposed notable vulnerabilities, with widespread challenges in scaling up production and effectively coordinating supply chains for essential items like food, medicine, ventilators, protective gear, and testing kits. The incapacity of companies to handle supply chain disruptions has been amplified by business cultures focused on efficiency. Approaches such as just-in-time and lean management systems view surplus capacity as inefficient, yet the elimination of these critical buffer zones has left many businesses less capable of responding to unexpected shocks. In contrast, certain nations like Germany and South Korea have demonstrated greater resilience in their production systems. This resilience is partially attributed to domestic manufacturing capabilities but also stems from the government's ability to coordinate private sector actions when market forces falter.

Simultaneously, the pharmaceutical industry has faltered in providing society with established treatments or vaccines for diseases like coronavirus, despite the recurrence of such virus outbreaks roughly once a decade (as seen with SARS in 2002 and MERS in 2012). This is linked to the prevailing "monopoly model" in health research, where drug companies are motivated by exclusive patent rights. In practice, this encourages pharmaceutical firms to prioritize maximizing profits over public health concerns. Given the limited potential for revenue from infectious diseases, there were merely six potential coronavirus vaccines undergoing clinical trials before the current pandemic, and all relied on public assistance. This disregard has left us ill-equipped to promptly develop the urgently required vaccine [19].

Corporate Debt Crisis

Private companies around the world are under severe financial pressure. Various financialized practices have crippled many heavily indebted companies. Such practices encompass actions such as incurring debt to distribute dividends, repurchasing shares, or executing leveraged acquisitions of firms. Consequently, the corporate landscape has become more delicate and susceptible to declines in income and credit. In the wake of the pandemic's repercussions, heavily leveraged companies are grappling with the dual impact of reduced earnings and heightened interest rates prompted by escalated risk perceptions. Meeting repayment obligations often necessitates the issuance of fresh bonds. However, with notably deteriorated credit circumstances, refinancing raises the peril of bankruptcy. Companies holding a 'BBB' rating are considered just secure enough to attain 'investment grade' status, a pivotal criterion for significant institutional investors to retain their bond holdings. As substantial institutional investors are compelled to sell their bonds, debt expenses will surge. The ensuing chain of bankruptcies might set off additional instances of public financial rescues. This gloomy prospect for global corporations underscores the necessity for a strategy that employs strategic conditions when companies seek public assistance.

Public Bailouts Program

Globally, government support for businesses ranges from direct cash grants and equity investments to tax breaks and loans on concessional terms or with a government guarantee. Monetary policy has also been used to support businesses through massive purchases of corporate bonds. A wide range of countries have authorized direct payments to firms to subsidize wages – including Australia, Denmark, Poland, Singapore, Saudi Arabia, and the United Kingdom – in order to preserve productive capacity whilst maintaining household incomes. Some countries have included additional conditionalities. The European Union has banned dividends, share buybacks, M&A (mergers and acquisition) activity, and bonus payments as part of a temporary extension to its state aid rules. Denmark, Poland, and France have stipulated that public funds will not go to companies headquartered in tax havens [20].

COMPARISON

The following text presents the comparison between shareholders' capitalism and stakeholders' capitalism.

Meaning

Shareholder capitalism means an economic system in which the dominant form of business is legally independent companies that can pool the capital of many limited liability shareholders, complemented by an open stock market to freely trade these shares.

Stakeholder capitalism is a system in which companies focus on serving the interests of all their stakeholders. Key stakeholders include customers, suppliers, employees, shareholders, and local communities. Under this system, a company's goal is to create long-term value.

Supporters

Milton Friedman, a professor at the University of Chicago, is often referred to as the "godfather" of shareholder capitalism. His opinion holds that the sole responsibility of a company's executives is to ensure that the owners see the profits. Friedman, who is a Nobel laureate, made this point as early as the 1970s when he published a *New York Times* essay on the same subject.

His point of view centers on the ability to measure and define returns for shareholders, while he expects business leaders to consider other social responsibilities to "spend someone else's money for the common good." He likens it to an unelected official who taxes shareholders and then spends that money as they please, with very little accountability. With conflicting interests between shareholders and stakeholders, companies would struggle to satisfy everyone.

One of the biggest advocates of stakeholder capitalism is the Business Roundtable, a coalition of some of America's top business leaders. The board also includes Klaus Schwab, founder of the WEF. Schwab stresses that corporate leaders must consider interests beyond for-profit shareholders in order to act in an ethical, fair and sustainable manner.

BlackRock founder and CEO Larry Fink has publicly acknowledged that since the financial crash of 2008, the wealthy have prospered while "ordinary people" have lost stability. As CEO of the world's largest wealth manager, his words prove effective. In 2018, he wrote, "Companies must benefit all their stakeholders, including shareholders, employees, customers and the communities in which they operate." This year, they argued for a greater investor focus on sustainable values.

Joseph Stiglitz, a professor at Columbia University and a Nobel Prize winner, conducted substantial research in response to the ideas of his colleague Friedman in the 1970s. In his research with Sandy Grossman, Stiglitz showed that "maximizing shareholder wealth does not maximize the well-being of society." Instead, he continues to advocate a focus on all stakeholders [21].

Benefiters

Shareholders capitalism primarily benefits the shareholders and not any other party related to the business or organization. Whereas stakeholder capitalism benefits all the stakeholders, that is, the society as a whole. Stakeholder capitalism is based on the concept of people and planet and is a wider concept than shareholders capitalism.

Objective

The shareholder capitalism has a single objective that is to maximize the benefit of the shareholders. By that means the decision makers are accountable only to shareholders.

The stakeholder capitalism approach lacks a distinct goal. Its challenge lies in its partial vagueness, as it does not precisely outline the methodology for managing stakeholder relationships and, consequently, the overall business [22]. Multiple objectives will cloud the judgment of the decision makers.

Fiduciary Duty of the Managers

"Stakeholder paradox" found by Goodpaster, evolves from the fiduciary duties the managers have in relation to the shareholders. From his understanding of the stakeholder approach the management is supposed to have a multi-fiduciary position, meaning that managers have fiduciary duties to all the stakeholders of the corporation [23]. And since a fiduciary duty requires one party to act solely in the interest of another it cannot work if the fiduciary has those types of duties to more than one party [24]. Thus, in terms of maintaining a fiduciary relationship shareholder capitalism has benefit over the stakeholder capitalism.

Discretion

The shareholders have a wide range of discretionary power in the shareholder capitalism approach whereas the stakeholder capitalism restricts such freedom and discretionary power of the shareholders as it concerns the interest of the society as a whole.

Value Creation

The value created in shareholder capitalism is in terms of profits and it is distributed to the shareholders by means of dividend and increase in share price. Under stakeholder capitalism the company's purpose is to create long-term value. The value that is created is for the society as a whole, all the stakeholders are benefitted.

SHIFT TO STAKEHOLDERS' CAPITALISM FROM SHAREHOLDERS' CAPITALISM

Increasing inequality, climate change, and the repercussions of the COVID-19 pandemic are among the factors driving the pressing necessity for a shift in paradigm, transitioning from shareholder capitalism to a more inclusive form of capitalism. Companies, as stakeholders, must contribute to addressing the challenges faced by the communities they operate within. Adopting stakeholder capitalism will enable them to establish a viable business model that genuinely generates value and remains sustainable. The central theme of the Davos 2020 declaration centers around stakeholder capitalism, a framework where companies are motivated to cater to the welfare of all stakeholders and foster enduring value.

Shareholder capitalism creates harmful social, economic, and environmental impacts on society in the long run. The Business Roundtable in 2019 rejected the idea of maximizing one value to the exclusion of all others. Furthermore, serving all stakeholders is a good moral and can also be a source of competitive advantage. COVID-19 has demonstrated how an interdependent world is needed to meet economic, environmental, social and technological challenges. Therefore, the fault lines caused by the 2020 pandemic are critical crossroads. Shareholder capitalism can be aptly summed up in the words of the Nobel Prize–winning economist Milton Friedman – "the business of the enterprise is the business".

This principle has guided the global economy since the 1970s and focuses primarily on short-term shareholder returns. However, recent years have seen growing suspicion and resentment towards the concept of a form of "capitalism" and corporate responsibility in many societies. In August 2019, the Business Roundtable, a non-profit organization whose members are CEOs of major corporations in the United States (a nation recognized by all as a stronghold of capitalism). shareholder capital), redefined its statement of corporate purpose to guide businesses administration This statement was signed by 181 CEOs who are committed to leading their businesses by integrating the interests of all stakeholders, including employees, customers, suppliers, shareholders, and the community. More recently, the World Economic Forum's Davos Agenda 2020 has driven this transition from shareholder capitalism to COVID-19 stakeholder capitalism, reflecting the heart of the industry current political situation. The Davos Agenda is a pioneering movement of world leaders who have come together to work together practically for a more cohesive, sustainable, and inclusive future.

The Need for Transmute

Stakeholder capitalism encompasses the creation of sustained value for all stakeholders, encompassing shareholders, clients, suppliers, workforce, communities, and additional entities. This involves fostering a secure and healthy workplace environment, enhancing employee well-being and assurance. As an illustration, the Japanese electronics firm OMRON promotes the exchange and collaborative development of ideas among employees to address societal issues through its OMRON Global Awards (TOGA) initiative, whereas Microsoft employs an Inclusion Index to gauge employees' sense of belonging within the workplace [25].

In order to restore the waning legitimacy of commercial and political institutions, stakeholder capitalism is necessary. Growing inequality, the financial crisis, climatic change, and the community's loss of faith in populist politics can all be partially blamed on how firms have been operating in a self-centered fashion. Customers and society therefore expect corporations to take on obligations that benefit shareholders as well.

Shareholder capitalism restraints productive investments. According to the Chief Executive of BlackRock, the world’s largest asset manager, the pressure to keep the share prices high leads to corporate leaders ‘underinvesting in innovation, skilled workforces, or essential capital expenditures.’ Shareholder capitalism can also be held responsible for environmental destruction by pursuing short-term risky behavior, such as fossil fuel extraction or overexploitation of groundwater reserves, which are a prominent threat to the environment [26].

The horrific problems that our civilization faces have been made clear by COVID-19. Tens of thousands of migrants heading back to their communities in India served as a somber reminder of the country's people's struggle. While white-collar workers complained about "Zoom fatigue," millions of impoverished Indians were forced to give up their source of income. The administrative and financial resources available to the governments of emerging nations like India are insufficient to meet the problems faced by low-income populations. Hence, it is imperative for the private sector to take the lead in creation of stakeholder value.

CONCLUSION

The COVID-19 was a wakeup call for the shift from traditional shareholders' capitalism to Stakeholders' capitalism. The shareholders' capitalism is based on short term value creation for the benefit of the shareholders whereas stakeholders' capitalism focuses on long-term value creation and on the well-being of the society as a whole. Thus, in any pandemic, a company or an organization following the concept of stakeholders' capitalism would flourish and will also benefit society.

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