

# Stakeholder Theory\*

ROBERT A. PHILLIPS

*York University*

JAY B. BARNEY

*University of Utah*

R. EDWARD FREEMAN

*University of Virginia*

JEFFREY S. HARRISON

*University of Richmond*

Though there is clearly a “family resemblance” to the work that is typically done under its bailiwick, stakeholder theory continues to resist precise circumscription. Like the organizations it attempts to understand, the boundaries of the theory remain contentious. While various attempts have been made to clearly define the parameters of stakeholder theory (i.e., Clarkson Center for Business Ethics, 1999; Donaldson & Preston, 1995; Freeman, et al., 2010; Jones & Wicks, 1999; Phillips, 2003; Phillips, Freeman & Wicks, 2003), none of these efforts have gained universal acceptance. The following, which combines ideas from a variety of well-known sources (Freeman, 1984; Freeman, et al., 2010; Freeman, 2017), conveys the ideas that tie together stakeholder thinking:

Business is a set of value-creating relationships among groups that have a legitimate interest in the activities and outcomes of the firm and upon whom the firm depends to achieve its objectives. It is about how customers, suppliers, employees, financiers (stockholders, bondholders, banks, etc.), communities, and management work cooperatively to create value. Understanding a business means understanding how these relationships work. The manager’s job is to shape and direct these relationships.

With these ideas in common, stakeholder theory has struck a chord with scholars across a myriad of academic disciplines (Laplume, Sonpar, & Litz, 2008). Particularly in the current age of organizational complexity characterized by subcontracting, outsourcing, joint ventures, “doing business as”

(DBA), the “gig economy,” etc., clear thinking about the organization of stakeholders and their cooperative role in value creation is needed more now than ever. By way of setting the stage for the work to come (both within this volume and beyond), below we will examine what we see as the important lingering questions for stakeholder theory.

## Boundaries of the Firm

Perhaps the most fundamental question about stakeholder theory for management scholars is defining the boundaries of an organization. To some this is the defining challenge to stakeholder theory. Until the theory can define the boundaries of the firm, there is no “inside” that distinguishes the firm from the market. And because stakeholder theory includes actors that are typically seen as outside the boundaries of the firm (e.g., suppliers, customers, local communities), it is thought necessary that stakeholder theory present some principled way to re-define the boundaries. Critics maintain that until stakeholder theory provides a simple, elegant, binary, and parsimonious definition of the firm, it must itself remain outside the mainstream of economics and strategic management. However, rather than the defining challenge to stakeholder theory, we argue that firm boundaries are the defining challenge of stakeholder theory. That is, stakeholder theory invites us to reevaluate both what constitutes a firm boundary and what it means to be inside or outside.

At least since Coase, one of the most closely examined questions in management and economics scholarship has been why some economic interactions take place in firms rather than markets (recent reviews include Gibbons, 2005; Santos and Eisenhardt, 2005; Zenger, et al., 2011). Often taking the market as the default arena for economic value creation and trade, scholars seek to explain the conditions under which some transactions take place within the centralized, hierarchical, managerially controlled sphere of the firm. These theories include explanations of when and why markets may fail to maximize efficiency (e.g., transaction costs, complex coordination, knowledge sharing, etc.) and how collecting these activities under the control of a central hierarchy can improve efficiency.

Alternatively, these theories must also provide some answer to why there are many firms rather than simply one very large one – that is, what are the limits to efficiency gains from moving value creation inside the boundaries of the firm? According to extant scholarship, firm boundaries affect the degree of authority and control, shape social identity, influence informal organization and knowledge exchange, and permit activity coordination (Zenger, et al., 2011) and have been defended based on efficiency, power, competence, and identity (Santos and Eisenhardt, 2005).

Notwithstanding this remarkable wealth of scholarly insight, many of these questions remain under-addressed within the ambit of stakeholder theory. Indeed, for many stakeholder scholars, something called “the firm” (or the corporation, or the organization, etc.) is more or less assumed to exist and the boundaries are more or less taken for granted. This notwithstanding, the fact is that stakeholder theory’s *raison d’être* is to understand managerial behavior regarding actors typically seen as outside the firm’s direct control and the implications of these behaviors. How one thinks about the question of organizational boundaries has implications across a myriad of stakeholder theoretic concerns.

For the most part, stakeholder studies make unstated, perhaps even unrecognized, assumptions about boundaries between actors. Terms such as primary and secondary or internal and external stakeholders are used, and their implications

expounded with little or no justification given for drawing the distinction. For many organization scholars, this represents a significant gap in stakeholder theorizing. There are several reasons why this gap may matter, including, but not limited to, what processes and activities can and should be measured and how the actors involved think about themselves, others, and their relationships.

### **The effects of boundaries on accounting measures**

– It is a well-recognized difficulty for stakeholder theory that standard metrics of firm success are inadequate to capture total value created by the organization (Coff, 1999; Garcia-Castro and Aguilera, 2015). For example, some financial investments in stakeholders are considered expenses for the purposes of standard financial accounting and profitability measurement. Employee salaries are the most obvious case of stakeholders receiving (appropriating) funds that might otherwise be counted as profit. R&D and customer support are investments in customer utility that are nevertheless considered expenses, as are financial outlays for improving local communities (Hatherly, et al., 2018). Whether each of these stakeholders is considered inside the organization or outside (e.g., private contractor) will have different implications for recorded accounting profits and total value creation and the perceived difference between the two.

Speaking to the relationship between organizational boundaries and accounting, Miles (Chapter 11) writes,

The boundary of reporting is based on ownership, control and significant influence within the definition of the legal entity. This determines what is, and, is not considered to be part of the organization and therefore what activities are reasonable to expect an organization to report on.

We can see from this quote that how boundaries are conceived plays a significant, even determinative, role in what is measured and reported in accounting statements. Work is well underway in the management and accounting disciplines to adapt accounting measures to the needs of stakeholders (Harrison and van der Laan Smith, 2015), but greater refinement is needed.

We would hasten to add that we are in the early stages of this stakeholder accounting process and that the early days of financial accounting were fraught with questions of accuracy, consistency, validity, reliability, and comparability. Eventually, those with some use for financial accounting reports came to agree – in general – on the proper metrics, but even today controversies remain both within and across financial accounting regimes.

It is also important to remember that accounting measures originally emerged to answer specific, typically financial, questions (e.g., comparability across time periods and between firms). In some ways, the demands of comparability from financial stakeholders and regulatory actors “outside” the firm precipitated the emergence of financial accounting. Managerial and cost accounting within the firm emulates this model. Measures designed for reporting on the *outcomes* of value creation processes became goals (*objective functions*) in their own right. The apparent accuracy, precision, and immediacy of the measures allowed them to emerge – and in some cases supplant – seemingly more nebulous firm purposes and sources of value. The mirage of measurability (methodolatry) and the power imputed by modern society to mathematical quantification is both an opportunity and a danger to managers.

As accountants and practitioners continue to refine their definitions of the firm – and perhaps even more so after agreement is reached on stakeholder metrics – managers and scholars would be well-advised to question what role accounting (and legal) definitions of the firm play in their own thinking. With an explicit and critical emphasis on values, stakeholder theory seeks to correct the psychological tendency toward “*displacement of goals*” whereby ‘an instrumental value becomes a terminal value’” (Merton, 1957/1968: 253 – emphasis in original). More below on terminal values and the role of purpose in stakeholder theory, but first there is more to say about the psychology of firm boundaries.

**The effects of boundaries on actors’ psychological processes** – In addition to their influence on what is reported in financial documents, perceptions of organizational boundaries have profound psychological

impacts. At the most fundamental level, ideas about who is inside and who is outside these boundaries affect who is and who is not considered a stakeholder as well as their relative managerial salience. This assessment, in turn, affects how actors interact. Miles writes, “Accounting also serves as a bonding mechanism designed to increase goal congruence through the construction of contracts tied to accounting ratios” (Chapter 11). In-group bias, perceptions of equity, fairness and reciprocity, social identity, and who does and does not “fit” within these boundaries are all influenced by where one draws the lines around a firm.

Much of this is familiar in some forms to management scholars (e.g., Ashforth and Mael, 1989; Blau and Scott, 1962; Ouchi, 1980), and has emerged as among the most influential directions in recent stakeholder scholarship (Bosse, Phillips, and Harrison; 2009; Brickson, 2005, 2007; Bridoux & Stoelhorst, 2014, 2016; Bundy, Vogel, & Zachary, 2018; Bundy, Shropshire, & Buchholtz, 2013; Crane and Ruebottom, 2011; Harrison, Bosse & Phillips, 2010; Korschun, 2015; Nason, Bacq & Gras, 2018). Work nevertheless remains to more precisely, holistically, and critically capture the influence of perceived boundaries on actors’ psychological conceptions of their place in networks of value creation.

The prospects for behaviorally informed stakeholder theory is a common refrain within this volume as well. Bhattacharya and Korschun (Chapter 9) consider, among other contributions from marketing, the role of boundary-spanning employees. The boundary being spanned by these employees is that between internal and external stakeholders – the boundary itself is assumed. Similarly, Crilly (Chapter 16) concludes that, “The stakeholder problem is as much one of managing attention *within* the firm as it is one of managing external demands upon the firm” (emphasis original). Bosse and Sutton (Chapter 12) and Bundy (Chapter 15) join the call for an increased role for behavioral and cognitive science in the future of stakeholder scholarship.

The potential contributions will depend a great deal on the continuing viability of, and justification

for, where and how to draw firm boundaries. Indeed, the want of such justifications and rationales has led some to conclude that we should abandon the search for firm boundaries. As we elaborate below, the question of boundaries – indeed all stakeholder questions – should be examined from a pragmatic perspective with boundaries being ultimately justified by their practical, managerial relevance. Pragmatism also informs our perspective on the role of values, norms, and ethics in stakeholder theory to which we now turn.

### Values, Norms, and Ethics in Stakeholder Theory

The emphasis on the “legal entity” in the Miles quote above suggests a role for law in defining the boundaries of the firm. This is consistent with influential theories of firm boundaries emphasizing efficiency. Santos and Eisenhardt (2005) write, “Focusing on minimizing governance costs, the efficiency conception asks whether a transaction should be governed by a market or organization. This conception is grounded in a *legal* understanding of organizations as governance mechanisms distinct from markets.” (2005: 492 – emphasis original). However, upon close examination, the legal status of firm boundaries is itself a complex question.

In Chapter 7, Rönnegard and Smith address the firm as an Anglo-American legal entity (see also Heminway, 2017). They conclude that even if there is no legal requirement to maximize shareholder wealth, the normative belief that shareholder wealth is the right and proper objective function of management has become such a pervasive norm that the legal requirement may be irrelevant. In fact, the shareholder primacy norm (SPN) determines, in part, how managers are evaluated and compensated through stock grants and options. Much work remains in assessing and adapting legal regimes and public policy to the realities of global commerce (see Wicks, et al., Chapter 6), but what is clear is that normative considerations also play a prominent role in understanding organizational boundaries.

The role of norms, values, and ethics have been fundamental to stakeholder theory from the earliest days. In his original elaboration, Freeman writes,

Every manager knows that value judgements are a primary ingredient of a successful strategy. Not only must values be taken into consideration when formulating strategy, but if the strategy is to be implemented the values of those affected by it must also be factored into the equation. When values are shared throughout an organization, implementation or strategy execution is relatively simple. (1984: 89 f)

The role of ethics in stakeholder theory became a more prominent – and contentious – element of the theory in subsequent decades. In perhaps the most influential stakeholder theoretic journal article to date, Donaldson and Preston (1995) write that, “stakeholder theory is fundamentally normative” (1995: 86) and “the ultimate justification for the stakeholder theory is to be found in its normative base” (1995: 87 f).<sup>1</sup> Similarly, Jones and Wicks (1999) write of their “convergent” stakeholder theory that its “normative foundation (‘core’) is explicitly and unabashedly moral and has to be explicitly defended in moral terms” (1999: 215). As the commentaries that accompany the Jones and Wicks article attest (Freeman, 1999; Gioia, 1999; Trevino and Weaver, 1999), the place of normative concepts within stakeholder theory has been hotly debated.

Why the role of norms, values, and ethics in stakeholder theory has been such lightning rod for debate is itself a point of contention. Some maintain that including normative considerations has no place in positive (“empirical”) scientific inquiry (Treviño and Weaver, 1999). This objection seems to ignore the fact that norms are clearly amenable to empirical observation. Entire fields of study (e.g., sociology, anthropology) are premised on the ability to observe social and cultural norms. While it is true that there is a metaphysically dependent way of looking at ethics as valid only *a priori* and some prominent stakeholder scholars (many trained as moral philosophers) have reinforced this narrow, disciplinarily specific perspective, this is far from the only way to think about ethics. American Pragmatism vigorously defends ethics as an altogether empirical phenomenon. We return to the role of pragmatism below.

**Norms and Contracts** – Many of the above questions are thought to be rendered moot by the existence of contracts (or “complete contingent claims

contracts”). The boundaries of the organization are contractually defined. Measurement and performance are defined in reference to these contractual terms and the underlying psychology of the actors is thought to be largely irrelevant to contracts and their enforcement. A nexus of contracts understanding of the firm has provided innumerable insights, but also suffers from severe shortcomings. Indeed, Barney (2018) argues that it is only because contracts evidence a measure of uncertainty, information asymmetry, and resource co-specialization that economic profits are even possible. He concludes that resource-based theory must adopt a stakeholder perspective. In addition to this logic, other theoretical gaps can be filled with a more nuanced and explicit consideration of empirical norms.

We are far from the first to point out this potential. Others have argued that “. . . detailed negotiated contracts can get in the way of creating good exchange relations” and “legalistic remedies can erode the interpersonal foundations of relationship[s]” (quoted in Zenger et al., 2011). Stakeholder theory seeks to bring these managerial issues to the fore. Norms are particularly relevant in the event of *ex post* contractual holdup opportunities by one of the parties. Parties create contracts to coordinate their future transactions, but in many cases one or both parties inaccurately predicts the surplus created (Barney, 1986) through the transaction and seeks to “re-negotiate” or even “efficiently breach” the contract when the inaccuracy becomes manifest. In still other instances, one of the actors is simply more powerful and can impose new terms on the less powerful transaction partners. Two things are interesting in such cases for our purposes.

In the former context – that of good faith misapprehension of future surplus – norms of fairness will pervade this new round (Bosse & Sutton, Chapter 12). And perceptions of the fairness of the newly renegotiated terms will influence the likelihood of future contracts between the parties. These perceptions may also affect the terms of future contracts between the parties and others not directly involved through the process of “generalized reciprocity.” The advantaged party in this re-negotiation would handicap their future

opportunities by failing to recognize the role of fairness norms.

The latter context includes cases of powerful customers who contract with suppliers, perhaps inducing relationally specific investments, then opportunistically take advantage of these investments by altering the terms to the benefit of the more powerful party. Increasingly common, however, are cases where firms demand terms of their contractual partners based on societal calls for responsible business practices. Contractual demands of this sort (e.g., supplier codes of conduct) include stipulations involving how and where raw materials are sourced, how supplier or subcontractor employees are treated, environmental and ecological practices and similar issues relating to the contract partners’ own stakeholders further down the value chain.

Such matters have historically been considered within the discretionary purview of each contracting party. The increasing prevalence of outsourcing, independent contracting, sharing economy, and other creative arrangements of economic activity make claims of arm’s length contracts increasingly difficult to sustain and are substantially altering the managerial landscape. In these cases, the boundaries of the firm are blurred. The ability to control and direct how personnel and resources are combined and deployed are among the defining characteristics of being “inside” the firm. Where “market contracts” contain clauses that permit the fiat direction of employment conditions, raw materials acquisition, selection of other business partners, and a myriad of other matters, it is unclear what “outside” or “market” mean.

Determining which people and processes to bring inside the boundaries of the organization (make or buy) has been central to strategic management scholarship for decades. Practicing managers, meanwhile, have been working hard to find innovative forms of organization that largely ignore these very boundaries. “Though hybrids are commonly framed as ‘intermediate’ forms, manager’s real objective is not crafting governance that is intermediate to markets and hierarchies, but rather crafting governance that enjoys the virtues of both markets and hierarchies.” (Zenger, et al., 2011: 115)

Critical and explicit examination of operative norms is among the avenues of greatest potential of stakeholder theory. We opened this discussion of values, norms, and ethics in stakeholder theory by reference to the role of shareholder primacy as a norm rather than a legal requirement (Rönnegard and Smith, Chapter 7). If shareholder wealth maximization is not a legally mandated objective function of for-profit firms, then what is the firm's proper objective function? In the complex world of stakeholder relationships, is the concept of an objective function functional?

### Stakeholder Theory and Objective Functions

How to understand a firm's objective function from a stakeholder theoretic perspective is a matter of great interest among stakeholder scholars. Consistent with the preceding, much of this interest has been framed by normative concerns. Even where the objective function is implied or even taken for granted, there must be some underlying normative justification. Prominent examples of normative justifications include the obligations of stakeholder fairness (Phillips, 2003), the power of contracts and consent (above) and property rights (Asher, Mahoney, and Mahoney, 2005). As Donaldson and Preston write, "Even Friedman's (1970) famous attack on the concept of corporate social responsibility was cast in normative terms." (1995: 71).

Jones and Harrison (Chapter 5) take up this challenge of critically examining the role of firms in promoting social welfare and introduce what we will call "Jones Optimality" (cf., Pareto and Kaldor/Hicks optimality). Jones and Harrison write, "*how* a firm generates additional profits matters a great deal with respect to enhancing social welfare." (Chapter 5 – emphasis theirs). They go on to write:

We premise our discussion of alternative corporate objectives on three fundamental principles. First, aggregate wealth must never be destroyed in the "wealth creation" process; profit should not be pursued in cases where social/economic welfare, including effects on all corporate stakeholders, is reduced. Second, the baseline

condition for comparison purposes must be the set of existing entitlements of current normatively legitimate stakeholders<sup>2</sup> of the firm ... Third, the profit motive must be retained. The economic incentive provided to those who seek to gain from the creation of new wealth should not be replaced. (footnote original)

... an appropriate corporate objective is that the firm should increase the wealth of its shareholders without reducing (and presumably increasing) the aggregate wealth of its other stakeholder groups.

Relating the firm's objective function to broader societal well-being is echoed among other stakeholder scholars. Greenwood and Mir (Chapter 3) present a deep critical challenge to what they see as the narrowly constricted and simplistic view presented by much extant stakeholder scholarship, writing, "The simple idea of a claim or investment, which brings with it exposure to risk, when interpreted in the broadest sense, might take us some distance to making us think differently about the purpose of the firm and its relations with those who affect or are affected by it." How broadly to define the scope of stakeholders (i.e., broad vs. narrow interpretations, see Phillips, 2003) has been among the more persistent questions for stakeholder theory and continues in these pages.

Referring to it as "the question, at the core of a theory of the firm" Freeman (1994: 67) framed the relationship between stakeholder identification and objective functions more than two decades ago asking, "for whose benefit and at whose expense should the firm be managed?" Mitchell and Lee (Chapter 4) describe stakeholder identification as a fundamental element of "stakeholder work." Hörisch & Schaltegger (Chapter 8) examine the prospects and perils of how the natural environment might be explicitly included as a stakeholder. A case can be made that the concept of an objective function is inextricably intertwined with the question of "for whose benefit and at whose expense should the firm be managed?" returning the question of firm boundaries to the fore.

Venkataraman (Chapter 10) provocatively resists this interpretation writing,

From an entrepreneurship perspective, the central question of stakeholder theory, namely, "for

whose benefit and at whose expense should the firm be managed?" is moot. The central assertion of the entrepreneurial process is that, even if the fiduciary duty of the manager is to the stockholder, the process of entrepreneurial discovery and exploitation will ensure that the corporation will be managed as if for the benefit of all the stakeholders to the enterprise.

Clearly more work is required on the question of firm objective functions in stakeholder theory, including whether or not the concept of "objective function" could be usefully replaced by the idea of firm purpose. Purpose may contain multiple objectives potentially responding to Mitchell and Lee's (Chapter 4) call for more "pluralistic-objective decision making and stakeholder inclusiveness." It is even possible that one implication of stakeholder theory is that both objective functions and firm boundaries are no longer necessary to describe and prescribe the stakeholder firm. Perhaps what is needed is a firm defined by value creation and values alignment. Your authors/editors disagree on the relative usefulness of these questions, suggesting a ripe space for future research.

## Pragmatism and Managerial Stakeholder Theory

One widely recognized feature of stakeholder theory is that it draws on disciplines that some find quite distinct – perhaps even opposed or "essentially contested" (Miles, 2012). Prominent contributions to stakeholder theory have drawn on strategic management, economics, psychology, moral philosophy, sociology, ecology, etc. For some, this represents a promiscuous dilettantism. For others, managing the complexity of twenty-first century firms requires command of as many tools as cognition, judgment and technology permit. We maintain that this disciplinary cross-fertilization, though a challenge, is a source of strength of stakeholder theory. It is a challenge because it requires scholars and practitioners to use ideas outside their normal zones of comfort and familiarity. The difficulties of adjusting sense-making frames are legion and widely studied – so too are the potential advantages of the effort.

Rather than retreating to the relative comfort and heuristics of disciplinary training, we and others recommend theory based on the principles of pragmatism (see also Godfrey and Lewis, Chapter 2). Pragmatism allows scholars, analysts, and practitioners to think about boundaries according to the needs of the question being asked. Consider again the question of boundaries. Pragmatism sees boundaries – both around the firm and between disciplines – in terms of what these boundaries allow us to do. Pragmatism demands that we take account of the implications of drawing the boundaries one way rather than another. While boundaries help us see some elements more clearly, other features are obfuscated or, by design, ignored entirely.

One stakeholder corollary to pragmatism is the claim that the theory is *managerial* (Donaldson & Preston, 1994). The idea that stakeholder theory can be either descriptive, instrumental, or normative has been extraordinarily influential among stakeholder scholars. A closer reading of Donaldson and Preston's seminal article reveals a fourth element: stakeholder theory is **managerial**. Arriving at a similar conclusion from a different direction, Barney (2018) writes, "firm managers and entrepreneurs often have a special role to play in a resource-based theory that explicitly incorporates a stakeholder perspective."

Though there is more to say about what this fourth element of the taxonomy means, one pragmatist conclusion is that if the answer makes no difference to managerial practice, then the question is irrelevant. Managerial stakeholder theory, on our interpretation, echoes William James's conclusions from 1907:

The pragmatic method in such cases is to try to interpret each notion by tracing its respective practical consequences. What difference would it practically make to any one if this notion rather than that notion were true? If no practical difference whatever can be traced, then the alternatives mean practically the same thing and all dispute is idle. Whenever a dispute is serious, we ought to be able to show some practical difference that must follow from one side or the other's being right. (1907: 26)

In fact, scholars have debated the pragmatic value of Donaldson and Preston's tripartite distinction

itself. Reacting to Jones & Wicks's "convergent stakeholder theory," Freeman writes, "if we drop the tripartite typology of Donaldson and Preston, then plainly there is no need for anything like convergent stakeholder theory" (Freeman, 1999: 234; see also, Phillips, 2003, esp. pp. 67ff).

For current purposes, we would also like to re-emphasize that pragmatism is fundamentally empirical – if not always quantitative. Given the preceding discussion of the (empirical) role of values, norms, and ethics in stakeholder theory, we may still ask if the descriptive-instrumental-normative distinction itself is managerial. Even this extraordinarily influential taxonomy is not beyond the critical reach of pragmatic contingency. Again, we take this capacity for contingency and contest as essential to pragmatic, managerial stakeholder theory.

There remain challenges to a multi-disciplinary approach (Berman and Johnson-Cramer, 2017). Any path that crosses boundaries is destined to be fraught with peril including different languages, currencies, and guardians of the faith. But we need not make the trip blind. In the next sections, we describe the "traps" that have plagued stakeholder theory in the past and lie in wait still for the unsuspecting traveler.

## Theoretical Traps

Though an exciting time in the development of theory and practice around stakeholder management, this period of ambiguity brings with it the potential for theoretical traps. Here we will mention three that merit particular attention for stakeholder scholars. The first trap is a "not invented here" (NIH) trap. Though generally intelligent, curious, and critical, scholars may also suffer from a need to fit phenomena into the categories they have found successful in the past. Occasionally, when we seek to understand something like managing stakeholder relationships, we feel compelled to define the phenomenon, to build boundaries around it, and to defend our interpretation as superior to all comers. This can mean shaping the phenomenon into well-worn channels (Ketokivi & Mahoney, 2016). For others it can mean a (more or less fundamental)

change to how preferred theories are understood (e.g., Barney, 2018; Hill & Jones, 1992; Williamson & Bercovitz, 1996).

The NIH trap manifests in at least two ways. The first is that much early theorizing was largely of the big-picture theory variety. It sought general principles and axioms that would apply to all (or nearly all) business organizations. This makes sense if one sees prior theories as having, like Athena, sprung fully grown from the head of their originators. More often, however, these scholars and fellow-travelers worked on more narrow and specific elements before rendering their broader theory. We believe that work is now underway (including within this volume) to backfill some of this foundation. Because disagreement remains on the precise definition and boundaries of stakeholder theory, avoiding this part of the NIH trap involves identifying an important research question – one that matters to managers' efforts at value creation – and then building on a particular stakeholder foundation to explore it. This foundation can be built on any useful way of thinking about stakeholder theory, as long as we clearly explain it and correctly cite any work upon which it is based.

Which brings us to the second manifestation of the NIH trap – reinventing the wheel. Because important contributions to stakeholder theory have arisen from groups of people who have not necessarily read the same books nor been influenced by the same ideas, there is a tendency to neglect or even dismiss scholarship outside a particular stream. Above we discussed the perceived challenges of engaging with normative stakeholder theory. We have witnessed otherwise excellent stakeholder scholarship forced into contortions of rhetoric to avoid the perceived challenges (e.g., calling a theory "instrumental" in order to avoid hard questions of norms, values, and ethics). It is our duty as scholars to understand influential ideas as comprehensively as possible irrespective of what journal published the articles. There are more than enough interesting new questions remaining in stakeholder theory to intentionally re-slog previously well-mapped terrain.

The second trap is "what we think we know" – as in "the only thing more dangerous than what we



don't know is what we think we know that's wrong." It is common in many academic disciplines but seems to particularly afflict stakeholder theory. Scholars tend to learn from other scholars. This can be efficient but can also be problematic, not least when a scholar cites someone's work incorrectly, and then others, in a game of bibliographic telephone, use the same citation incorrectly in their own work and so on. This mistake is repeated until the original misconception is treated as fact. Much of the perceived lack of theoretical agreement within stakeholder theory can be traced to spurious quotations and "courtesy cites" being repeated until taken for true. Even prior to its 2010 reissue, Freeman's 1984 book was cited thousands of times more than there are copies of the book in print (Elms, et al., 2011).

Much has been attributed to Freeman (1984) – and stakeholder theory more generally – that represents neither the original work nor what most would consider the theory's mainstream. Perhaps most prominently, Freeman (1984) is frequently cited in the corporate social responsibility (CSR) literature (cf., Elms, et al., 2011). Stakeholder theory and CSR have some common elements leading many to see the two as synonymous (see also Phillips, et al., 2003). This misperceived synonymy has prevented, and continues to prevent, many management scholars from embracing stakeholder theory.

In an exemplary case of NOT falling into the "what we think we know" trap, Walsh reviewed three books of stakeholder scholarship for *Academy of Management Review* (2005). After admirably close readings of the three works (*viz.*, Freeman, 1984; Post, Preston & Sauter-Sachs, 2002; Phillips, 2003), Walsh expressed explicit surprise at what he found there no fewer than three times, including writing, "Many readers may be surprised to learn that the father of stakeholder theory draws such a clear distinction between 'real' strategic issues and social responsibility issues" (2005: 429). Likewise, based on careful readings of their own, Greenwood and Mir (Chapter 3) and others (e.g., Henriques, Chapter 13) would like to see a more socially and environmentally ambitious stakeholder theory than what they found. Others will disagree for other

reasons – our plea is that these reasons be informed by careful readings of extant scholarship rather than stylized and impressionistic cherry-picking and bibliographic telephone games.

The third trap is the obsession with trying to prove that managing for stakeholders is more profitable than other management approaches – the "business case" trap. In talking to other scholars about stakeholder theory, especially in the strategic management domain, we are often told that the evidence regarding stakeholder theory is inconclusive. When we dig deeper, we find that they often base their conclusion on studies testing the relationship between CSR and financial performance (see Margolis and Walsh, 2001; Orlitzky, Schmidt, & Rynes, 2003). Most studies of CSR include variables dealing with the environment or social phenomena such as the nature of the industry in which a firm competes (i.e., tobacco, gambling). A study based more specifically on a stakeholder theory of creating value through relationships may not necessarily include those variables. Misunderstanding regarding stakeholder management and performance is closely related with the misconception that stakeholder theory and CSR are essentially the same. As Hillman and Keim (2001) demonstrated, they are not, nor do they have the same influence on firm financial performance.

There is, in fact, substantial evidence of a positive relationship between practicing the principles found in the stakeholder management literature and firm financial performance across a wide range of companies and industries (i.e., Berman, et al., 1999; Choi & Wang, 2009; de Luque, et al., 2008; Henisz, Dorobantu, & Nartey, 2014; Ogden & Watson, 1999; Preston & Sapienza, 1990; Sisodia, Wolfe, & Sheth, 2007). There is also recent evidence that context matters (Garcia-Castro & Francoeur, 2016).

We cite this evidence for the convenience of the readers of this volume but would also hasten to add that financial performance is not the only – nor the most – interesting dependent variable. As we have mentioned elsewhere, and will address in a later section, what is needed most in the stakeholder literature is a broadening of the dependent variable in stakeholder-based studies to include more

dimensions of the value that is both created and destroyed. Stakeholders get much more than financial value through their relationships with a firm and may also lose value in many forms through these relationships.

## Future Directions

The authors of the chapters in this volume have provided excellent advice about promising research questions within their topic areas. We also have at various times and contexts written regarding stakeholder topics that need further attention (i.e., Barney & Harrison, 2018; Freeman, 2017; Freeman, et al., 2010; Wicks & Harrison, 2017). We will not repeat all these suggestions here. Instead, we would like to focus on a limited number of the topics that we believe are most essential to the advancement of stakeholder theory at this time. We will then discuss some measurement issues facing the field.

**High potential research topics** – Because of social, political, and economic differences, we do not believe that stakeholder management practices are likely to be equally successful across various regions of the world. For example, distributive and procedural justice (Harrison, et al., 2010) are likely to have much different interpretations for stakeholders in China, India, Europe, or Central America. We cannot simply assume that stakeholder management practices that work in the USA or some other country will work elsewhere. This idea suggests a need for cross-border comparative studies of stakeholder management philosophies and practices of the sort envisioned by Nartey in Chapter 18. What can Western firms learn from Eastern firms and vice versa in terms of creating more value through stakeholder management? Also, Devinney, McGahan, and Zollo (2013) suggest that a global perspective means not only examining stakeholder management at various locations across the globe, but multinationals as truly global stakeholders.

Second, there is a need for more work that engages with other important management

theories, such as transaction cost economics (Williamson, 1975), the resource-based perspective (Barney, 1991), industrial organization economics (Porter, 1985), evolutionary theory of economic change (Nelson & Winter, 1982), or upper echelons theory (Hambrick & Mason, 1984). This work may seek to integrate stakeholder theory with other theories or new theorizing may deploy the findings from these theories for new and novel uses. Stakeholder theory takes a comprehensive view of the firm that is very complex, and therefore accommodates a wide range of theoretical perspectives.

Third, as demonstrated in our “New Voices” section (Bundy, Chapter 10; Crilly, Chapter 11), there is widespread interest in stakeholders as people, with all that implies. We believe that this stream of micro/behavioral research is vital to understanding how to manage stakeholder relationships to enhance the creation of value. Important research streams that stakeholder scholars can tap into include, but are not limited to, expectancy theory (Vroom, 1964), escalating commitment (Staw, 1976), cognition (Tversky & Kahneman, 1974), sense making (Weick, 1995), exchange rules (Meeker, 1971), and goal setting (Locke & Latham, 1990). Ideas from these streams have already found their way into some of the stakeholder research, but there is much more to be done.

Fourth, measurement of firm outcomes continues to be a vital issue. One issue around which all stakeholder scholars seem to agree is that what a firm does influences outcomes for more than just financial stakeholders such as shareholders, and that other stakeholders matter. Furthermore, as mentioned previously, stakeholders receive much more than purely economic value through their relationships and interactions with firms. However, much of the stakeholder research continues to adopt financial returns as the primary dependent variable. We need both better theory and better data to help define the value a firm creates (or destroys) in much broader stakeholder terms (Freeman, 2017; Harrison & van der Laan Smith, 2015; Harrison & Wicks, 2013; Mitchell, et al., 2015; Priem, 2007). Phillips, et al. (2010 &

2011) use work from upper-echelons theory to propose a stakeholder model using managerial discretion as a dependent variable. Jones and Felps (2013) consider stakeholder happiness as a candidate variable. We suspect there are other non-financial measures of interest deriving from previous scholarship that could be of great interest.

**Measurement** – Continuing with the theme of the last paragraph, it is one thing to conceptualize value more broadly and quite another thing to measure it. The most commonly used database in stakeholder research is what is known (though under other names as ownership and stewardship has changed) as the Kinder, Lydenberg, Domini (KLD) social ratings database (for a review, see Mattingly, 2017). In our experience, most other large databases compiled by private companies (and not academic researchers) are very similar (i.e., Asset4, Just Capital). The data are compiled based on publicly available information about a firm’s activities related to social performance, as well as direct contact with the firms that are being rated. The data are not collected to support academic research. They are collected largely to help client firms such as mutual fund managers or investment advisors (partially explaining, perhaps, how financial returns continue to be the dominant dependent variable) screen companies based on social criteria. The advantage is that the data collectors are not biased by a specific research objective (beyond their interest in financial outcomes) as an academic researcher might be.

Though rather easily available from these private companies, there remain weaknesses with ratings data as they pertain to stakeholder-theoretic research. First, continuing the theme, they are oriented towards social performance rather than stakeholders. This means that there is a lot of valuable information in these databases, but much of it is better suited to CSR studies than stakeholder studies (i.e., environmental policy and performance, participation in “sin” industries, governance data such as the composition of the board). Indeed, MSCI (owner of the KLD data at the time) made substantial changes to its database in 2010 to

make it even more CSR oriented. If that type of data is collapsed into the measurement of what is supposed to be a stakeholder construct – such as adding environmental dimensions to the product dimensions to come up with a measure of customer performance – then the result is a measure that is far from its theoretical counterpart. Often the KLD data are combined into a single measure of what is called “stakeholder performance” (cf. Rowley and Berman, 2000). Nor does KLD contain measures relating to firm-supplier relations.<sup>3</sup> It is no wonder, then, that findings regarding stakeholder performance and financial performance are mixed.

There is also a larger problem in many of these studies. To explain, we will use a specific example using human relations, which is probably the most comprehensive and stakeholder-oriented category in the KLD database. Firms are rated on:

- strong union relations
- cash profit sharing
- participation through means such as stock options or ownership
- strong health and safety programs
- strong record on human rights in their supply chain
- other (a miscellaneous category)

These are scored as 0,1 variables, which are then summed for a total employee score. This score and scores in other areas are summed, and then typically used as the independent variable measuring stakeholder performance, with the dependent variable some version of financial performance. But isn’t this variable really measuring value distributed to stakeholders? Isn’t it an outcome variable? If stakeholder theory is really about relationships with stakeholders, is that what is being measured? We suspect that returns to future study of these databases for stakeholder theoretic uses is limited.

As difficult as it may be, quantitative studies will be better specified when collecting their own data for stakeholder theoretic questions. Henisz, Dorobantu, and Nartey (2014) coded over 50,000 stakeholder events from media reports to determine the levels of cooperation or conflict gold

mining companies have with their stakeholders. Large-scale collection of survey data also has promise. De Luque and colleagues (2008) analyzed data from 520 firms in seventeen countries to assess the role of stakeholder values on perceptions of visionary leadership. Case studies may also have potential, as long as they are conducted using rigorous methods (Eisenhardt, 1989; Langley & Abdallah, 2011; Yin, 2009).

Here is a short list of potentially interesting questions that would lend themselves to a variety of different research methods:

- 1) To what extent do stakeholders make decisions about engaging with a firm based on how the firm treats other types of stakeholders (suppliers, customers, communities, employees) or is economic value the principal driver for these decisions? What are the stakeholder and contextual characteristics that determine these types of choices?
- 2) How are a firm's operations influenced if it applies the same values and/or decisions rules when engaging with different types of stakeholders vs. if it treats various stakeholders differently?
- 3) What are some of the ways a stakeholder-oriented global company can successfully convey its stakeholder culture and values to subsidiaries in other nations?
- 4) What are best practices for stakeholder management in various national contexts and to what extent can these best practices be applied elsewhere?
- 5) Are entrepreneurs that focus on building a stakeholder-oriented culture early in the process more successful in engaging new stakeholders in their ventures?
- 6) When firms harm stakeholders (inadvertently or knowingly), what are the factors that influence how they respond?

**Different Questions** – The preceding may well lead one to some radical conclusions. At the extreme, one potential conclusion is that firm boundaries no longer matter. Ink has been spilled and Nobel Prizes awarded, but the bright-line

distinctions between firm and market apply to a time that has passed. The days of lifetime employment, robust intellectual property protections, stable financial investments, and company towns have gone the way of the pre-Darwinian “essentialism” clearing the way for outsourcing, subcontracting, and the network economy. One could conclude that the corporate form was a useful fiction whose usefulness has waned. This seems too strong. The continued value-creating utility of enduring, trusting, reciprocal relationships – within and between organizations – and the norms, values, and ethics that underlie, inform, and facilitate these relationships is evident. The slightly less radical conclusion is that strategy, law, accounting, and ethics all need a new definition of the firm to match the world of commerce as we find it today: a value-creation theory of the firm.

Scholars have long recognized the porous nature of organizational boundaries, but nevertheless persisted in the search for such boundaries as well as their antecedents and implications. Indeed, most management scholars would agree with Granovetter (1985) that the way forward in understanding economic organization will cross legacy disciplinary lines. Stakeholder theory provides an opportunity to disaggregate these antecedents and implications and break down the conceptual silos that currently create artificial barriers to insight.

## Notes

- \* Thanks to Heather Elms, Michael Johnson-Cramer, and Thomas Jones for helpful comments.
1. According to Google Scholar (accessed via Harzing's Publish or Perish 24 May 2018), the Donaldson and Preston article has been cited 11,769 times. The other contender for most influential peer-reviewed stakeholder article is Mitchell, et al., 1997 with 11,414 cites. They are the 8th and 9th most cited in AMR history. Of note, Dyer and Singh (1998) – occasionally cited in the context of stakeholder research – has been cited 12,990 times, but it does not use the word stakeholder.
  2. See Phillips (2003) for a definitive discussion of normative (and derivative) legitimacy.
  3. Thanks to Thomas Jones for pointing this out.

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