2 The development of stakeholder theory: a brief history

The purpose of this chapter is to trace the development of what has come to be known as "stakeholder theory." We intend to accomplish this in what is perhaps an unusual manner. To begin we go back to Freeman's original book and retell the story, told there, of the origins of the idea of stakeholders. We then suggest a number of additions and revisions that have been made to this history in the literature of the last twenty-five years. We move to what could be called "autobiographical" or "idiosyncratic" accounts of the development of stakeholder theory, mostly from the point of view of one of the authors, Freeman. We do this because we want to illustrate a philosophical point about the general issue of "theory development" and the importance of a role for "the author." There are many different versions of "stakeholder theory" and we do not wish to try to synthesize all of them into something approximating "the correct version."[1] A viable social science has an important place for what we might call "the author." To claim that "the author" has such a role in the development of management theory is neither to promote the self-importance of particular individuals nor to deny the role of intersubjective agreement that is so vital in science. Rather it is to claim that contextual factors and serendipity can be crucial in the process of theory development. Finally, we give an assessment of Freeman's 1984 book. Fortunately Jim Walsh had begun this process in a number of recent papers and presentations; we add our voices to Walsh's assessment.

The development of stakeholder theory

The literature story in Freeman[2]

The actual word "stakeholder" first appeared in the management literature in an internal memorandum at the Stanford Research Institute (now SRI International,

[1] See Chapter 3 for the reasons why we resist finding a "correct" version.

[2] We have changed the tense from the original present tense in Freeman (1984) to the past tense for consistency and readability. We have made a number of additions and revisions to the strategy literature,

Inc.) in 1963.[3] The term was meant to generalize the notion of stockholder as the only group to whom management need be responsive. Thus the concept of the stakeholder was originally defined as "those groups without whose support the organization would cease to exist." The list of stakeholders originally included shareowners, employees, customers, suppliers, lenders, and society. Stemming from the work of Igor Ansoff and Robert Stewart in the planning department at Lockheed, and later Marion Doscher and Stewart at SRI, the original approach served an important information function in the SRI corporate planning process.[4] The SRI researchers argued that unless executives understood the needs and concerns of these stakeholder groups, they could not formulate corporate objectives which would receive the necessary support for the continued survival of the firm.[5] From the original work at SRI, the historical trail diverges in a number of directions: (i) the strategy literature; (ii) the work of Russell Ackoff, C. West Churchman and systems theorists; (iii) the literature on corporate social responsibility; and (iv) the work of Eric Rhenman and other organization theorists.

The strategy literature[6]

In his now classic book, *Corporate Strategy* (1965), Ansoff argued for a rejection of the stakeholder theory, which he explicated in the following passage:

but it should be emphasized that the next section of this chapter, "The development of stakeholder theory: additions and revisions" is the history of the idea as it appeared in the 1980s, albeit a more complete version. Subsequent sections will offer some caveats and revisions.

3 Harrison has found an even earlier use of "stakeholder" in Silbert (1952). Slinger (1998) locates it as an eighteenth century idea of the person who holds stakes of betters in a gamble, and cites *Merriam Webster's Dictionary*. The *Oxford English Dictionary* concurs.

4 The precise origins of "stakeholder" were surprisingly difficult to track down in 1982. Ackoff (1974) credits Ansoff (1965) and quotes the references in Ansoff's book to Abrams (1951) and Cyert and March (1963). Mason and Mitroff (1982) attribute the term to Rhenman (1968). An anonymous referee for *Applications of Management Science* pointed out to Freeman that the concept had originated at SRI, which he duly acknowledged in Emshoff and Freeman (1981). Soon thereafter Dr. William Royce, of SRI International, in private correspondence, recounted the story of Ansoff, Robert Stewart, and Mario N. Doscher at Lockheed and SRI in the early 1960s. Professor Kirk Hanson of Stanford then pointed out that Rhenman was visiting at Stanford while he was writing *Industrial Democracy and Industrial Management* (1968). A trip to SRI International in summer 1980 and a talk with Dr. Royce and Dr. Arnold Mitchell clarified a number of historical issues. They were gracious enough to share some original files from that period of time. In a private correspondence dated July 26, 1996, Rebecca Profit of the Centre for Strategic Business Studies notes that a letter in *Management Consultancy* (UK, March 1996) cites Robert F. Stewart and Dr. Otis J. Benepe from Lockheed Aircraft Co. as coining the "stakeholders concept" in the 1950s and developing it at Stanford Research Institute in the early 1960s. Gamble and Kelly attribute the idea to Stewart, Benepe, and Rhenman (2001: 44). We have been unable to verify this claim about Benepe from additional sources, although Stewart's and Rhenman's roles have been well known. In fact Giles Slinger credits Marion Doscher, a technical writer, with coining the term.

5 Again, Slinger substantially revises this account, as we set out later in the chapter.

6 Chapter 4 is an up to date review and assessment from 1984 to the present of the role of stakeholder theory in the strategy literature.

While as we shall see later, "responsibilities" and "objectives" are not synonymous, they have been made one in a "stakeholder theory" of objectives. This theory maintains that the objectives of the firm should be derived balancing the conflicting claims of the various "stakeholders" in the firm: managers, workers, stockholders, suppliers, vendors. (Ansoff 1965: 34)

Ansoff credited Abrams (1954) and Cyert and March (1963) with a similar view, but went on to reject the theory in favor of a view which separated objectives into "economic" and "social," the latter being a secondary, modifying and constraining influence on the former.[7] The passage quoted above clearly indicates that Ansoff has the "dominant coalition" view of organizations in mind when he explicates the stakeholder view. The point of the SRI definition is, however, somewhat different.[8] The issue is simple: survival. Without the support of these key groups the firm does not survive, by definition of what we mean by "stakeholder." Of course, whether SRI has the right groups is a different issue. Are lenders necessary for the survival of a debt-free firm? Is "society" (however that loose term may be defined) necessary for the survival of a privately owned specialty steel firm? Conversely, isn't government necessary for the survival of public utilities?

The thrust of Ansoff's criticism is to point out that the stakeholders whose support is necessary for survival are a contingent phenomenon, dependent on a number of situational variables. Ansoff rejected such a theory in favor of one which searches for a universal objective function, where stakeholders serve as constraints on the level of the objective which is obtainable at a point in time. Such a search for the real objective of the firm was to occupy a substantial part of the corporate planning literature during the subsequent years.

By the 1970s the stakeholder concept began to surface in a number of places in the strategic planning literature. In a review article on the state of the art of corporate strategy, Bernard Taylor (1971) claimed that the importance of

[7] Thus Ansoff directly appeals to what we called in Chapter 1 "the separation fallacy." The necessity of analyzing social and political issues together with economic and technological ones is argued in Ansoff (1979), Hayes and Abernathy (1980), and Charan and Freeman (1980), as well as numerous other places. The split between "economic" and "social" analysis has always been conceptually arbitrary, or at least since the beginnings of modern utility theory as a foundation for economics (von Neumann and Morgenstern 1946). Rational agents have preferences over many kinds of things, only some of which are measured in dollar terms. The concept of rationality is much broader than some business theorists pretend. See for instance Schelling (1960, 1978), Tullock and Buchanan (1962), and the work of many other "decision theorists."

[8] A word of caution about the role that definitions play in theories is appropriate here. Quine (1960) claims that "sentences do not confront the tribunal of experience alone." Austin (1962), Wisdom (1957), and Wittgenstein (1953), and the resulting literature in philosophy of language, give quite complex and sophisticated analyses of the role that definitions play in languages.

stockholders would diminish. He thought that business would eventually be run for the benefit of stakeholders (Taylor 1971). Haselhoff (1976) explored the implications for the formulation of organizational goals. King and Cleland, in their text *Strategic Planning and Policy* (1978), gave a method for analyzing "clientele groups," "claimants," or "stakeholders," which grew out of their earlier work on project management. Taylor (1977) summarized the latest SRI approach. Rothschild (1976) used the concept to explain a planning process developed at General Electric. Hussey and Langham (1978) presented a model of the organization and its environment with stakeholders being differentiated from the firm and consumers, and used it to analyze the role that management plays in effective corporate planning processes. Derkinderen and Crum (1979) used the stakeholder notion in their analysis of project set strategies, and the idea plays a central role in Heenan and Perlmutter's analysis of organization development for multinational corporations (1979). Specific applications of the concept in managerial processes in the strategic planning literature include Davis and Freeman's (1978) method for technology assessment and Mitroff and Emshoff's (1979) method for strategy formulation called "strategic assumptions analysis." This technique was later developed by Emshoff (1980) and Mason and Mitroff (1982), and Rowe, Mason, and Dickel (1985) as a method for dealing with ill-structured organizational problems. This line of inquiry suggested that managers often held divergent assumptions about their stakeholders, and suggested that deliberate analysis of a broad group of stakeholders could improve organizational decision making:

> In contrast to stockholder analysis, stakeholder analysis asks a manager to consider *all* the parties who will be affected by or who affect an important decision. It asks the manager to list as many parties or interest groups as he or she can who have a *stake* in the policy under consideration. This list of parties is typically much broader than the single category "stockholders." While important, the stockholders are only one of many contending groups having an impact on and a stake in a corporation. (Mitroff, Emshoff, and Kilmann 1979: 586, emphasis added)

Their technique was applied to the case of an industrial materials business (Emshoff and Finnel 1979), and further improvements were made to it in Mitroff and Mason (1980), Emshoff (1980), and Mason and Mitroff (1982).

In a groundbreaking article published in *Long Range Planning* in 1975, William R. Dill outlined three challenges for companies that want to be known for their "strategic prowess." Organizations need (i) to evaluate the changing environment, and (ii) to ensure an appropriate organizational response.

The third and, according to Dill, least well understood challenge is "coping with an active intrusive environment which is made up of individuals and organizations which seek to influence the strategic decisions of the enterprise" (Dill 1975: 57). Dill's work was important in developing the stakeholder concept for the strategy literature, because he defined stakeholder relationships in terms of both influences and responsibilities. He described these factors in both directions: the firm towards its stakeholders and stakeholders towards the firm. He also addressed the difficult challenge of deciding whom a firm should include as relevant stakeholders when making decisions.

In addition, Dill examined the various types of relationship that exist between a stakeholder and a firm, including owner/investor, customer/client, competitor, employee, supplier, dependent on services, circumstantial consumer of by-products, conserver, taxpayer, or student/analyst/researcher, as well as some of the ways in which stakeholders intervene in firm processes, such as through protest, balloting or ratifying, or regulating. He concluded by outlining ways in which a firm can deal more effectively with stakeholders, with an emphasis on open communications and increased interactions. Perhaps his most important insight, from the perspective of where the field of strategic management is now, is that stakeholders can be used as active participants in strategic decisions:

> For a long time, we have assumed that the views and initiatives of stakeholders could be dealt with as externalities to the strategic planning and management process: as data to help management shape decisions, or as legal and social constraints to limit them. We have been reluctant, though, to admit the idea that some of these outside stakeholders might seek and earn active roles with management to make decisions. The move today is from *stakeholder influence* toward *stakeholder participation*. (Dill 1975: 58, emphasis added)

Dill's "stakeholder participation" foreshadowed the increasing importance of interorganizational relationships such as joint ventures and strategic alliances in strategic management (Barringer and Harrison 2000).

At around the same time the stakeholder concept was also applied to strategic planning at the international level. After a thorough summary of the many strong international forces and changes that have made management more difficult, Ringbakk advises,

> The key to progress does not lie in formal planning systems or in the use of sophisticated management technology. The key is developing international managers with more environmental sensitivity and understanding – with empathy for the aspirations and demands by the multinational stakeholders MNCs [multinational corporations] in the future must serve. (Ringbakk 1976: 10)

A stakeholder approach is also evident in Heenan and Perlmutter's analysis of organizational development for multinational corporations (1979).

By the late 1970s the stakeholder concept found its way into the planning processes of some corporations. For example, Rothschild (1976) described these processes at General Electric, a pioneer in strategic planning. Stakeholder-based approaches were also included in a variety of strategic planning texts (Taylor and Sparkes 1977; Hussey and Langham 1978; King and Cleland 1978). The stakeholder concept was being introduced into many planning contexts. For example, Raymond and Greyser (1978) argued that arts organizations need good management as much as for-profit companies do, and suggested that many patrons of the arts consider themselves stakeholders of the organizations they patronize. Also, O'Toole (1979) criticized the way in which business–government relations were being handled in the United States, since stakeholders were put in the difficult position of having to take extreme and unproductive positions on issues in order to be heard.

Wommack (1979), in describing the responsibilities of the board of directors, suggested that an organization should create value for both society and the corporation and that corporate objectives should be established that satisfy the expectations of stakeholders. Puccini and Marley-Clarke examined the competing interests of stakeholders in offshore resource management zones in the United States. They proposed a model that would maximize equity among those competing interests. They also suggested that "the governments of coastal states should play the arbiter's role in attempting to rationalize the trade-offs affecting stakeholders" (Puccini and Marley-Clarke 1979: 13).

Keeley applied the stakeholder concept to performance evaluation. He defined stakeholders as groups that provide resources to the organization and examined the difficulties associated with satisfying multiple, conflicting demands. He stated directly that subordinates should be evaluated on the basis of how well they satisfy the stakeholders that are assigned to them, and placed responsibility squarely on the shoulders of firm administrators:

> It is the function of the organizational administrator to translate the demands of stakeholder groups into organizational objectives and procedures which result in consequences (output) required to sustain their contributions. Obviously, if the demands of these groups are well-defined, relatively modest, stable over time, and compatible with one another, the administrator's task is rather uncomplicated. Under such conditions, the task environment is non-ambiguous or "certain." But if organizational stakeholders press vague demands which are inconsistent over time and incompatible in the aggregate, the organizational administrator may have great

difficulty in translating these demands into objectives and procedures for subordinates. Rather, he or she may mediate these demands by holding organizational units directly accountable to stakeholders (or to other internal units which, in turn, are so accountable). (Keeley 1978: 433)

In 1980, Slatter declared,

The idea of stakeholder analysis – the process by which the expectations of various groups with which the company interacts are analysed – has tended to go out of fashion as business planning has focused on developing and maintaining sustainable competitive advantages on a product market segment or strategic business unit (SBU) basis. This development in business planning has undoubtedly been correct as it has helped firms focus on the critical economic issues facing their businesses. While some firms have paid lip service to the idea of stakeholder analysis put forward in the late 1960s and early 1970s, few firms took stakeholder analysis very seriously – largely because of the difficulty of identifying practical economic pay-offs from the analysis. (Slatter 1980: 58)

Slatter's notion that the emphasis on pure economics was "correct" is questionable. In fact, Slatter explained later in the article that the stakeholder perspective should be re-evaluated as a public relations tool because "All the firm's stakeholder groups provide the firm with both threats and opportunities" (58).

At the same time, Burton and Naylor made an early and deliberate attempt to tie economics and corporate planning together. They noted that "one finds a dearth of explicit application of microeconomics to corporate planning" (Burton and Naylor 1980: 249). Instead of rejecting the stakeholder perspective in favor of pure economics, they developed a microeconomic theory of strategic search that identifies key stakeholders and acknowledges their conflicting objectives.

Several articles in the early 1980s recognized the increasing complexity of modern corporations, the increasing intensity of stakeholder claims on those organizations, and the usefulness of stakeholder-oriented planning processes in dealing with these issues (Armstrong 1982; Carroll 1983; Charan and Freeman 1980; Fombrun and Astley 1983; MacMillan 1982, 1983; Mendelow 1983; Ruffat 1983). In addition, Mahon and Murray (1981) applied stakeholder theory to strategic planning in regulated companies. They argued that managers in those companies should expend considerable resources in wooing their external stakeholders. They also suggested that strategies based on the integration of economic, political, and social goals are more likely to be successful.

The stakeholder approach was also applied directly to the development of mission statements. Pearce (1982) argued that managers should acknowledge the legitimate claims of both internal and external stakeholders when developing a mission statement. He suggested a procedure whereby claims are identified, prioritized, and coordinated with other elements of the mission.

According to Pearce,

> Each of these interest groups has justifiable reasons to expect, and often to demand, that the company act in a responsible manner toward the satisfaction of its claims. In general, stockholders claim appropriate returns on their investments; employees seek broadly defined job satisfaction; customers want what they pay for; suppliers seek dependable buyers; governments want adherence to legislated regulations; unions seek benefits for members in proportion to their contributions to company success; competitors want fair competition; local communities want companies that are responsible "citizens"; and the general public seeks some assurance that the quality of life will be improved as a result of the firm's existence. (Pearce 1982: 22)

Although there were many definitions of "strategy," "policy," "planning," and so on at the time, the basic idea was that strategy was concerned with the configuration of an organization's resources in relation to its external environment.[9] The concept of strategy was and is inherently connected with setting some direction for the organization, based on an analysis of organizational capabilities and environmental opportunities and threats. Thus adequate information about the environment, past and future changes, and emerging strategic issues and problems is vital to an effective strategy and strategy-making process. As the literature moved from reactive policy making to proactive strategy formulation, the need for "environmental scanning" increased.

SRI's original use of stakeholder analysis was precisely in this area. By developing "measures of satisfaction" of those groups whose support was necessary for the continued survival of the organization, an important input into the planning process was made. Information systems could be developed to scan and track the responses of key stakeholder groups to changes in corporate strategy. Adjustments could be made if stakeholder expectations became far enough out of line to warrant withdrawal of their support. Stakeholder behavior was taken as given, or as a constraint on strategy, in Ansoff's terms. Strategy was formulated against this static environment,

9 Our arguments in Chapter 3 and in earlier footnotes about "what is stakeholder theory?" also apply to "what is strategic management?" For an early attempt to deal with these issues, see Freeman and Lorange (1985).

which was forecastable in principle in the long run. This use of the stakeholder concept was as an intelligence-gathering mechanism to predict more accurately environmental opportunities and threats.

A second feature of this use of "stakeholder" is that stakeholders were identified at a generic level as customers, suppliers, owners, public, society, and so on, and analysis was performed at that level of generality. Hence public-attitude surveys, stockholder interviews, and the like were the available analytical techniques. Since the major concern was with forecasting the future environment and not with changing specific stakeholder behavior, there was no need to go beyond this generic stakeholder analysis.

The concern with future forecasts of stakeholder behavior so that the corporation can plan its "best reply" assumed that there would be no radical shifts in a stakeholder's actions. Because the stakeholder environment was taken as static, and because only generic analysis was necessary, adversarial groups were not considered as stakeholders.[10] Particular "special interest groups" interested in negotiation have no place. One negotiates with Ralph Nader, not with "special interest groups" as a generic entity. Therefore the early strategic uses of stakeholder theory were really another way of getting more useable information on "friendly" groups. The use of the stakeholder concept was to provide information to strategists at a generic level about traditional "relatives" of stockholders such as employees, managers, suppliers, consumers, and the public. In the 1950s, 1960s, and early 1970s the business environment of most US firms was quite stable and few strategic surprises occurred, making this interpretation of the stakeholder concept adequate.[11]

The systems theory literature

In the mid-1970s researchers in systems theory, led by Russell Ackoff and C. West Churchman, "rediscovered" stakeholder analysis, or at least took Ansoff's admonition more seriously.[12] Stemming from their joint work in applying Jungian psychology to develop a personality theory that could be

[10] This was not true for Dill's ideas of kibitzers (Dill 1975).

[11] The mainstream of research into strategy followed quite different lines, with uses of the stakeholder concept being the exception rather than the rule. We lay out the history of strategic management as a field in Chapter 4.

[12] The precise origins of systems theory are hard to determine. Certainly Barnard (1938) is a candidate for founder. However, the systems perspective on problem solving goes much further back. Descartes (c. 1628) argued that both analysis (breaking things down into its component parts) and synthesis (building things up by seeing what they were a part of) went together in his oft derided "rational method." See Churchman (1971) for an attempt to relate the systems approach to traditional philosophy.

useful for business problem solving (Churchman, Ackoff, and Wax 1947), they were instrumental in developing systems theory into a powerful tool for addressing a number of issues in social science (Churchman 1968; Ackoff 1970). Ackoff (1974) rehashed Ansoff's argument and defined a method for stakeholder analysis of organizational systems. Propounding essentially an "open systems" view of organizations first put forward by Barnard (1938), Ackoff argued that many societal problems could be solved by the redesign of fundamental institutions with the support and interaction of the stakeholders in the system.

This notion of "stakeholders in a system" differed from the use of the concept in the strategy literature. To be concerned with the organizational level of analysis was a mistake, on the systems view. Problems should not be defined by focusing or analysis, but by enlarging or synthesis. For example, a problem of low earnings, which affected stockholders, would first of all be understood in terms of the entire stakeholder system, which formed the context of the problem. The concerns of other stakeholders as they relate to the problem of low earnings would first be explicated. Ackoff argued that system design could only be accomplished by stakeholder participation, and thereby argued for the inclusion of stakeholder groups in solving system-wide problems.[13] Ackoff (1974) contains case studies of how to use this methodology in designing large-scale projects.

The concept of corporate or organizational strategy, on this systems view, seemed to give way to that of collective strategy, a now popular concept in organization theory.[14] It would be a mistake, in systems terms, to take the point of view of planning for one organization in the system, for such a plan might optimize a sub-system and destroy larger system goals and objectives. Organizational planning should be done only so far as it is relevant to system goals.

There are two variants of this position which are important to consider. The first might be called "the co-optation" view, where an organization and its stakeholders plan together for the future of the organization. Larger system goals are ignored or postponed as the organization and its stakeholders try to reach agreements (hopefully mutually beneficial ones, as "co-optation" may imply "cooperation") on how the organization is to proceed. The second variant involves the collaboration of a subset of stakeholders planning for

[13] Ackoff here is clearly influenced by Trist, the Tavistock group, and others, at least according to Slinger (1998).

[14] See Fombrun and Astley (1983).

the future of each. This idea is best exemplified by labor-management planning of quality of work life experiments, and Trist's (1981) work on socio-technical systems.

Each of these variants tries to overcome the general problem with the systems view that there is not a starting point, or entry point, from which collaboration towards "the systems view point," which is necessarily "god-like," can proceed. Thus a utility might sit down with its "consumer advocate" stakeholder and try to plan how it should proceed with a rate increase proposal. But to create the future of the stakeholder system which includes the utility, consumer group, and other stakeholders is a much more difficult, if not impossible, task. The systems model of stakeholders, by emphasizing participation, is a far-reaching view of the nature of organizations and society. It continues to be quite useful in problem formulation, and represents an ongoing stream of research using the stakeholder concept. It is not, however, focused on solving strategic management problems which are narrower than total system design.

The corporate social responsibility literature

Another trail from the original work at SRI on the stakeholder concept was the concern of a number of researchers with the social responsibility of business organizations. The corporate social responsibility literature is too diverse to catalogue here.[15] It has spawned many ideas, concepts, and techniques and brought about both real and ephemeral change in organizations. Suffice it to say that the social movements of the sixties and seventies concerning civil rights, anti-war efforts, consumerism, environmentalism, and women's rights served as a catalyst for rethinking the role of the business enterprise in society.

The distinguishing feature of the literature on corporate social responsibility is that it can be viewed as applying the stakeholder concept to non-traditional stakeholder groups that are usually thought of as having an adversarial relationship with the firm. In particular, less emphasis is put on satisfying owners and comparatively more emphasis is put on the public, the community, or the employees.

During this period two major groups of researchers emerged to form a sub-discipline in management, variously called "business and society" or "social issues in management." In the School of Management at Berkeley a number of scholars began to address a broad range of issues. Votaw (1964) studied

[15] We undertake a partial review of this literature in Chapter 8.

corporate power in Europe. Epstein (1969) conducted a classic study of business and the political arena in the USA. Sethi (1970) analyzed the role of minorities in the firm. During roughly the same period, the Harvard Business School undertook a project on corporate social responsibility. The output of the project was voluminous, and of particular importance was the development of a pragmatic model of social responsibility called "the corporate social responsiveness model." Essentially it addressed Dill's challenge with respect to social issues, namely, how can the corporation respond proactively to the increased pressure for positive social change? By concentrating on "responsiveness" instead of "responsibility" the Harvard researchers were able to link the analysis of social issues with the traditional areas of strategy and organization (Ackerman 1975; Ackerman and Bauer 1976; Murray 1976).[16] And they avoided the clearly moral notion of "responsibility," so that the separation fallacy continued to work.

For the most part stakeholders were analyzed at a generic level, even though Ackerman and Bauer analyzed how to integrate social objectives with traditional business objectives and thus return to Ansoff's original argument. Hargreaves and Dauman (1975) coined the phrase "stakeholder audit" as a part of the more generic "corporate social audit" (Bauer and Fenn 1972). The purpose of the social audit and the resulting literature on social performance was to rethink the traditional scorecard for business. The social audit attempted to construct a social "balance sheet," and to analyze the actions of a firm in terms of social costs and benefits. Methodological problems, however, have made the search for the social analog of the balance sheet and income statement an elusive one.

In addition to these concepts that analyzed the social responsibility of business, there is a much older body of literature on which scholars in business and society have drawn. Historians, political scientists, economists (especially the more recent public-choice economists), and political philosophers have been concerned with the relationship between the corporation and government. Epstein (1969) has analyzed the literature on the role of the corporation in US politics and concluded that "at the present time, corporations should not be subject to special restrictions limiting the nature and extent of their political involvement," going on to argue that "associational political participants" should be governed by requirements on disclosure and lobbying. Epstein (1969, 1980) pointed out that there was an amazing scarcity of scholarship on corporate political activity. While kindred concepts in the

[16] For a recent update and more complete history see Frederick (2006).

political science literature, such as "constituency" (see Mitnick 1980 for a review), "interest group," "publics," and "the public interest," have been around for some time, there were few besides the "institutional economists" such as John R. Commons who recognized and dealt with the complex situation in which the modern corporation found itself.

While there were many criticisms of the research into corporate social responsibility, perhaps the most troubling aspect was the very nature of "corporate social responsibility," as if the concept were needed to augment the study of business policy. Corporate social responsibility was often looked at as an "add-on" to "business as usual," and the observation often heard from executives was that "corporate social responsibility is fine, if you can afford it." This conceptual split between the "profit-making" aspect of business and the "profit-spending" or "socially responsible" part was and continues to be mirrored in the academic world, where the Academy of Management has a division concerned with "social issues in management" and one concerned with "business policy and strategy."[17]

Given the turbulence that business organizations faced and the very nature of the external environment, consisting of economic and socio-political forces, there was a need for conceptual schemata which analyzed these forces in an integrative fashion. Isolating "social issues" as separate from the economic impact which they had, and conversely isolating economic issues as if they had no social effect, missed the mark both managerially and intellectually.

While the corporate social responsibility literature was important in bringing to the foreground in organizational research a concern with social and political issues, it failed to indicate ways of integrating these concerns into the strategic systems of the corporation in a non-ad hoc fashion.

The organization theory literature

While most organization theorists did not specifically use the term "stakeholder," their work remains a constant source of insight. In Sweden, Eric Rhenman (1968) explicitly used the stakeholder concept in his work on industrial democracy.[18] Rhenman argued,

[17] While too much cannot be made of the way in which professional organizations choose to organize themselves, it should be noted that such an organizational principle could tend to reinforce the split between "business" and "social" issues from an intellectual standpoint.

[18] Mason and Mitroff (1982) mistakenly give Rhenman credit for developing the stakeholder concept. Professor Kirk Hanson, now of Santa Clara University, was instrumental in tracking down the influence of Rhenman on the development of the stakeholder concept. According to Hanson, in private conversation, Rhenman spent time at Stanford as a visiting scholar while he was writing *Industrial Democracy and Industrial Management* (1968). Curiously enough, the stakeholder concept does not play a role in Rhenman (1973).

> We shall be using the term "stakeholders" to designate the individuals or groups which depend on the company for the realization of their personal goals and on whom the company is dependent. In that sense employees, owners, customers, suppliers, creditors as well as many other groups can all be regarded as stakeholders in the company. (Rhenman 1968, cited in Freeman 1984: 45)

While similar to the SRI concept, Rhenman's definition was narrower, including any group that placed demands on the company and on whom the company had claims, rather than any group whose support was necessary for the survival of the firm. Rhenman went on to argue that a "stakeholder" conception of the firm could lead to a theory of industrial democracy. Rhenman's use of the stakeholder concept paralleled its use at SRI. Again, he was interested in stakeholders at the generic level or as categories of particular groups. His narrow construal of the concept, using "and" to denote the fact that the company and stakeholder must have mutual claims, could rule out important groups, most notably government and adversarial groups, who were dependent on the firm, but on whom the firm did not depend.

During the same period several other organization theorists were concerned with exploring the relationship between organization and environment. In the early 1960s William Evan began to develop the concept of "organization-set" which analyzes the interactions of an organization with "the network of organizations in its environment." Evan (1966) postulated several concepts and hypotheses which could be used to study interorganizational phenomena, arguing that the majority of organizational research had concentrated instead on intra-organizational relationships. Evan's work led to a host of subsequent research on interorganizational relationships, both conceptual and empirical. During roughly the same period important conceptual models were developed by Katz and Kahn (1966), calling for an "open-systems" approach to the study of organizations, which focused on defining the organization relative to the larger system of which it is a part, and by Emery and Trist (1965), exploring the second-order environments of organizations – the connections which occur among environmental elements which affect the organization. Lawrence and Lorsch (1967) proposed a model of "differentiation and integration," whereby organizations segmented themselves into smaller units to deal with specific parts of the external environment. Van de Ven, Emmett, and Koenig (1975) reviewed the organization–environment literature and proposed several meta-conceptual schemes for understanding the burgeoning research. Nystrom and Starbuck (1981) contained essays which assessed the state of the art in understanding the organization–environment relationship. Of particular importance in this volume was the work of Aldrich and Whetten on the concept of "populations" of organizations and their evolution, and network analysis which claimed to "go beyond" the concept of the "organization set" and the attention to stakeholders. Pennings analyzed the concept of "strategically interdependent organizations," and proposed a set of strategies which organizations could use to cope with the uncertainty that comes with interdependence. Other essays in this volume, as well as in two additional volumes of essays by Katz, Kahn and Adams (1980) and Van de Ven and Joyce (1981), were rich sources of ideas for the development of the stakeholder concept as it applied to strategic management.

James Thompson's (1967) classic study of organizations resurrected the notion of "clientele" as a way to designate outside groups, and used Dill's notion of the "task environment" of the organization. Thompson put the notion quite simply: "We are now working with those organizations in the environment which make a difference to the organization in question" (Dill 1958: 28).

It is precisely this notion of "those groups which make a difference" which was the foundation of the stakeholder concept. This is especially true from a strategic standpoint, since the main concern should be the management of the relationships of those groups which "make a difference." Mahon (1982) argued explicitly that Thompson, when his views on the social responsibilities of organizations were taken into account, anticipated the stakeholder notion.

Pfeffer and Salancik (1978) reviewed the literature and constructed a model of organization–environment interaction which depended on an analysis of the resources of the organization and the relative dependence of the organization on environmental actors to provide those resources. While they did not explicitly define "stakeholders," they did claim that

> Our position is that organizations survive to the extent that they are effective. Their effectiveness derives from the management of demands, particularly the demands of interest groups upon which the organizations depend for resources and support. (Pfeffer and Salancik 1978: 2)

They went on to argue for a "radical" external view of organizations, where theorists would look to the environment for most of the explanatory force in organization theory. They argued that while many had claimed the need to look at the external environment, few theorists had developed concepts which allowed the environment to enter into the organizational equation. Their definition of interest groups in terms of dependence and resources was quite similar to the SRI concept of stakeholders, even though there were no references to a reasonable body of work on stakeholder theory in the strategy literature. And there did seem to be a wall separating the work in organization theory from the work in strategy. As a result, the literature of organization theory stopped short of producing a framework for setting and implementing direction in organizations. There was little explicit "fit" between the organization theory literature and the strategy literature, as well as the systems theory and corporate social responsibility literatures. While these four literature streams provided a rich set of ideas for the construction of a stakeholder approach to solving the problems of value creation and trade, ethics, and mindsets, little effort was made in this direction.

The development of stakeholder theory: additions and revisions

There have been a number of additions and revisions to this now standard story of the development of the stakeholder idea. First of all, Giles Slinger has told a slightly different, but important, story about the development at SRI. Second, Juha Näsi has told a different story about the use of the idea in Scandinavia and the work of Eric Rhenman. Finally, a number of people, such as Lee Preston, Melissa Schilling, and others, have pointed out that the intellectual history of the main ideas of stakeholder theory is much richer than the relatively recent work at SRI. We shall deal with each of these in turn.

Slinger's revision of the SRI story

Giles Slinger's doctoral thesis at Cambridge retraced the original history of the stakeholder idea. Slinger began with the history as set forth in Freeman (1984), then made several important additions and reinterpretations. First of all, he re-contacted the same people at SRI as had Freeman, but Slinger obtained more detail about the origins of the stakeholder idea, as he was able to examine more of the original documents at SRI, which were unavailable to Freeman. We quote here a fascinating footnote in Slinger's dissertation which tells the story of how the word evolved.[19]

[19] Slinger's entire dissertation, "Essays on stakeholding," is worth reading, yet it has never been published as a whole. He has published several papers, but none are as inclusive about the history of the stakeholder

Bill Royce, in an unpublished paper written in January 1998, says,

"I asked Bob Stewart. His version was that in late 1962, the team that was writing *The Strategic Plan* were discussing the question of who should have an influence on the determination of 'corporate purpose' (or mission) – considered by most people the keystone on which any strategy or strategic plan must be built. They listed the various persons or groups who contributed to the success of a business and whose needs or demands must be heeded, at least to some extent, by management.

"Other authors with Stewart were J. Knight Allen, J. Morse Cavender, both senior industrial economists on the SRI staff. Marion Doscher was a staff writer with the TAPP group … I recall her as well-educated, an excellent editor and writer. She was only at SRI a few years.

"According to Stewart, it was during this discussion that Marion Doscher broke in with the assertion that:

'You mean they are all "stakeholders," because they all have a stake in the business!'

"Doscher went on to describe the term as being old Scottish, referring to those who have a legitimate claim on something of value.

"Others in the TAPP (Theory and Practice of Planning) group immediately accepted the term and the definition and it quickly became gospel around SRI. The description was included in the *Strategic Plan* report, with an illustration of a simple method of analyzing stakeholder expectations."

Second, Slinger connects the early development of the stakeholder idea with the human relations approach developed at the Tavistock Institute in London and the National Training Laboratories in Bethel, Maine, in the USA. Bion's work on the role of participation and inclusion in group work, Emery and Trist's work on self-organizing work groups in coal mining, and other mostly clinical (and sometimes psychoanalytic) studies informed most of the early development by the stakeholder theorists in the 1960s.

The Tavistock connection is an important addition to the story in Freeman (1984). Eric Trist was at the Wharton School of the University of Pennsylvania during the 1980s and was a participant in an early Wharton seminar that

idea as the first chapter of the dissertation. The question that remains is the exact connection of Rhenman with SRI. Freeman (1984) is based on a private conversation between Freeman and Professor Kirk Hanson, then of Stanford, now of Santa Clara University. Hanson told Freeman that Rhenman had been a visitor at Stanford at around the same time as the stakeholder idea was being developed at SRI. Stymne (2004) says that it was customary for Swedish doctoral students to spend a year in the USA; he does not mention where Rhenman chose to study. Stymne himself chose to go to the Institute for Social Research (ISR), University of Michigan, which at the time was still under the influence of Kurt Lewin. Hence there is a nice connection to Slinger's claim about the importance of the Tavistock Institute and the human relations view of the stakeholder idea. For purposes of full disclosure it should be noted that Freeman was the external examiner for Slinger's dissertation at Cambridge.

Freeman (2005) believed was so important to the development of the theory. Indeed, the entire approach of the researchers at Wharton – Ackoff, Emshoff, Mitroff, Freeman, and others – was a clinical one. To try to find statistical relationships between stakeholders and to "prove" that managing for stakeholders creates economic value constitute a relatively recent phenomenon. The appropriate background disciplines for stakeholder theory were, according to Slinger, psychoanalysis and social psychology, especially the theory of groups, and their allied disciplines. Business disciplines were important, but they contained built-in assumptions about why stakeholders could be ignored, and why relationships were not the basis of business.[20]

Slinger claims that the result of missing the Tavistock connection is that Freeman's definition of stakeholders relies on a later version of the idea that emerged from SRI, rather than the original definition, which he claims is as follows:

> Determination of corporate purpose requires comprehensive information about the expectations of the firm's "stakeholders." (These are all groups – such as owners, employees, and suppliers – who have something directly at stake in the company's progress.) [21]

The original idea was not a matter of firm survival but rather a way to understand how a firm could meet the expectations of groups in its environment. Thus the original intention of the stakeholder idea was less to redefine business in stakeholder terms, and more to make it responsive to external demands. In short, it looks as if the original insight is more in keeping with Barnard's (1938) and March and Simon's (1958) idea of inducements and contributions.[22]

Näsi's revision of the Scandinavian story

The late Juha Näsi (1995) recounted a slightly different history of the idea as it was brought to Scandinavia, in particular to Finland and Sweden. Näsi rightly

[20] We seek to rectify this situation in this book by showing how the stakeholder idea is relevant to the disciplines of business. However, we also believe that we need much stronger connection with the foundational disciplines such as psychoanalysis, social psychology, philosophy, history, literature, and the creative arts.

[21] Slinger at p. 49 note 146 gives the reference as Stewart, Allen, and Cavender (1963): 1.

[22] There is one difficulty here in reconciling all the parts of Slinger's view. If we go to Emery and Trist's idea of turbulent social fields, as it emerged from their Tavistock work, it does seem as if the two definitions become a matter of degree, depending on the amount of turbulence. But perhaps it is better to see the idea of stakeholders as necessary for survival as more appropriate for the more economic views of the firm that are influential in business today. What we could mean by a "behavioral stakeholder theory" is an interesting open question. We are indebted to Professor Jared Harris for this insight.

credits with the main impulses of the idea Barnard (1938), Dill (1958), March and Simon (1958), Cyert and March (1963), and Thompson (1967), though others have gone even farther back, as we shall see later. He claims that while the stakeholder idea may have been marginal in the USA and most of the rest of the world, it had a large impact in Scandinavia. Näsi locates the idea in the thinking of Eric Rhenman (1964) and in Rhenman and Stymne's book (1965), in which they "explicitly outlined the stakeholder approach or, as they themselves put it, the stakeholder theory" (Näsi 1995: 20). Rhenman in 1964 defined "stakeholder" as follows:

> Stakeholders in an organization are the individuals and groups who are depending on the firm in order to achieve their personal goals and on whom the firm is depending for its existence. (Rhenman, quoted in Näsi 1995: 22)

Interestingly enough, this original definition could be seen as including both Freeman's wide sense of stakeholders, since there are many groups on whom one's personal success depends, as well as the narrow sense, in terms of firm survival.

Näsi suggests that for these early Scandinavian theorists the concept of the transaction plays a more central role than that of overall "interests" or "stake." Näsi writes,

> The Scandinavians preferred to talk about the contributions made by the stakeholders to the company and about the rewards which the stakeholders demand from it. Both contributions and rewards can take many forms, such as money, goods, information, status, power, prestige and so on.[23] (23)

This view is corroborated in a recent autobiographical essay by Bengt Stymne (2004). Stymne tells of being a doctoral student sequestered in the attic of the Stockholm School of Economics, studying administration in the late 1950s and early 1960s. He and others such as Eric Rhenman, a fellow doctoral student, began to look at the firm from the outside in, rather than from the perspective of a set of internally defined goals. He writes that during this period they began to see that

> [G]oals are a product of the exchange process among the various stakeholders that make up the firm. What one stakeholder contributes will serve as a reward for another. Through mutual adjustments, an unstable balance between contributions and rewards is temporarily created. Like a drunk on his way from the pub, the firm is

[23] Näsi cites Rhenman (1964), Rhenman and Stymne (1965), Ahlstedt and Jahnukainen (1971), and Näsi (1979, 1982) as the key sources here.

stumbling along to regain the balance it is constantly on the verge of losing. The goal of the firm which could be imputed from this perspective, if any, is not one set by management or the owner but rather is to obtain an unstable balance so as to survive. (Stymne 2004: 39)

This passage locates the idea of stakeholders in the work of the Carnegie School and their idea of inducements and contributions. However, the idea of the "unstable balance" is quite interesting, since it leads to the idea, discussed in Chapter 1, of the equilibrating, entrepreneurial forces. Friction among stakeholders becomes the source of organizational innovation, and in fact saves the modern corporation from the bureaucratic fate envisioned by Schumpeter.

Indeed, in *Administrative Behavior* in 1947,[24] Simon identifies customers, employees, suppliers, and entrepreneurs as organizational participants in the inducement–contribution model that forms the foundation of the behavioral theory. Organizational goals are a function of these several groups, rather than of one. March and Simon's (1958) view of organizations, and Cyert and March's (1963) work on behavioral theory are important precursors of stakeholder theory. Of course these thinkers owe much, as they acknowledge, to Barnard (1938). It is Barnard, rather than his Carnegie School followers, who seems to understand more explicitly the centrality of morality – what we have called the problem of the ethics of capitalism – at least to the role of the executive. He writes, foreshadowing the development of modern views of business ethics that are grounded in stakeholder theory,

Executive positions (a) imply a complex morality, and (b) require a high capacity of responsibility, (c) under conditions of activity, necessitating (d) commensurate general and specific technical abilities as a moral factor … In addition there is required (e) the faculty of creating morals for others …

For the morality that underlies enduring cooperation is multi-dimensional. It comes from and may expand to all the world; it is rooted deeply in the past, it faces toward the endless future. As it expands, it must become more complex, its conflicts must be more numerous and deeper, its call for abilities must be higher, its failures of ideal attainment must be perhaps more tragic; but the quality of leadership, the persistence of its influence, the durability of its related organizations, the power of the coordination it incites, all express the height of moral aspirations, the breadth of moral foundations. (Barnard 1938: 272, 284)

[24] See Simon (1947). The fourth edition, which was consulted here, was published in 1997. See especially 141 ff.

Barnard here articulates the problems of value creation and trade, the ethics of capitalism, and managerial mindsets. In our view it is really Barnard who set the stage for the development of modern stakeholder theory.

Additional underlying ideas

A number of scholars have suggested that in addition to those already suggested there were many who could be seen as early stakeholder theorists. In particular, Preston and Sapienza (1990) have traced the origins of the underlying idea of stakeholders further back from SRI and Rhenman to some early documents at both Johnson and Johnson and at Sears. They write,

> The truth, however, is that the substance of the stakeholder concept, if not the term itself, has been reflected in the speeches and writings of thoughtful analysts and executives for many decades. The classic formal statement by Harvard law professor E. Merrick Dodd appeared in 1932. Dodd (1932) quoted with approval the views of General Electric executives and others who identified four major stakeholder groups: shareholders, employees, customers, and the general public. (Dodd's famous piece appeared in the course of a debate with Yale law professor A. A. Berle, who at that time defended conventional views. More than twenty years later, Berle (1954) acknowledged that Dodd had been right all along; see also Rostow (1959).) Robert Wood Johnson's list of "strictly business" stakeholders – customers, employees, managers, and shareholders (the managers were a new and subsequently significant addition) – first appeared in print in 1947 (Johnson (1947)), and ultimately evolved into the well-known Johnson and Johnson "Credo" (Buchholz (1989) at 230). In 1950, General Robert E. Wood, CEO of Sears, listed the "four parties to any business" (in, he said, "the order of their importance") as "customers, employees, community, and stockholders." (quoted in Worthy 1984: 64)

In a remarkable article in the 1956 *Dartmouth Alumni Magazine*, J. Irwin Miller, chairman of the Cummins Engine Company, articulates the responsibilities of the executive along similar lines. He claims that the power of the manager must be used responsibly towards shareholders, customers, suppliers, employees, government, community, and society. It is perhaps the clearest articulation of the modern stakeholder theory without using the term.[25]

[25] J. Irwin Miller, "The responsibilities of management," *Dartmouth Alumni Magazine* (March 1956). We are grateful to his son, Will Miller, CEO of Irwin Financial, for this reference and a conversation about the way in which the Miller family has always tried to run its companies along stakeholder lines. We discuss this version of leadership and use Will Miller as an example in Freeman, Harrison, and Wicks (2007), Chapter 6.

Slinger takes the idea even further back. He locates the concept partly in the view of business as a social institution put forward by Robert Owen, John Ruskin, and others. However, he differentiates this idea from what he calls the distinctiveness of the modern idea of stakeholders by its emphasis on "inclusiveness." He argues that the Christian communities of the 1930s focused on the company as not being the property of shareholders. He singles out the work of George Goyder and Samuel Courtauld. In a newsletter he finds as evidence: "'Shareholders are merely one of several groups of people who, each in their different ways, go to make up a company."[26] Goyder goes on to propose the concepts of social audit and responsible company at around the same time as Harold Bowen, who is generally seen as one of the originators of the idea of corporate social responsibility.[27]

Slinger, Freeman (1984), and most others simply ignore the work of Mary Parker Follet. In an important paper Melissa Schilling (2000) has convincingly argued that while the role of Barnard and the subsequent Carnegie School has been well documented in the stakeholder theory literature, theorists have overlooked Follet's ideas. Her relational view of both the self and organization is a far better starting point than Barnard's view of the role of the executive. In fact Follet can also be seen as a founder of the human relations school, which gave rise to the work of theorists such as Bion, Lewin, and others.

Finally, in a recent article Shah and Bhaskar (2008) have suggested that the basic idea of the modern stakeholder concept can be traced to ancient Indian scriptures.[28] They make a cogent argument that the very nature of business activity, what we have called "value creation and trade," can be understood in stakeholder terms. We shall return to this theme in Chapter 9.

While Freeman has often suggested that his role in the development of stakeholder theory has been to show how the concept was developed by others, and to take it seriously as a management principle, the evolution of the modern idea is often traced to his 1984 book. We believe that it is therefore instructive to look at how that book came to be written. In particular, we believe that the role of "the author"[29] and the serendipity which governs forms of life have not been thoroughly investigated. This is especially important given the diffuse nature of the development of ideas like stakeholder theory.

[26] *Christian News Letter*, Supplement to No. 242 (1943 5), 9. This note is due to Slinger.
[27] This fascinating story is told in Chapter 1 of Slinger (1998).
[28] We are grateful to Dr. Harish Srivatsava for helpful conversations on this issue and for pointing out to us the work of Professor N. Balasubramanian, "Corporate governance in India: traditional and scriptural perspectives," *Executive Chartered Secretary* (March 2005), 279 282.
[29] In the sense of "any author," not Freeman per se.

We argue that the actual lineage of an idea is relatively unimportant relative to its usefulness. However, we do need to understand more thoroughly how ideas accidentally get developed. Hence we tell the following personal and idiosyncratic story.

The development of stakeholder theory: Freeman's personal story

After studying philosophy and mathematics at Duke University and graduate study in philosophy at Washington University in St. Louis, Freeman accepted an appointment on the research staff at the Wharton School, University of Pennsylvania, with a group called the Busch Center, run by Russell Ackoff, acknowledged as a pioneer in operations research and systems theory.[30] After working at the Busch Center on several projects for a few months Freeman moved to a new splinter group started by James R. Emshoff, a former student under Ackoff. This new group was called "the Wharton Applied Research Center," and its mission was to serve as "Wharton's window to the world," a kind of real-world consulting arm that would combine research staff, students, and the Wharton faculty. This new center was organized much like a traditional consulting firm, by projects and by "development areas," which were conceptual spaces where the center wanted to develop both expertise and new clients to try out ideas.[31]

The stakeholder concept was very much in the air at the Busch Center. Ackoff had written about the idea, extensively in *Redesigning the Future* (1974).[32] And the idea was at the center of several projects under way at the Center. In particular, the Scientific Communication and Technology Transfer project funded by the National Science Foundation, as a kind of Library of the Future design project, used the idea of getting stakeholder input into radical

[30] To illustrate what we said earlier about the role of serendipity, Freeman would never have accepted an appointment at Wharton indeed, he did not even know what or where Wharton was but for the fact that his girlfriend, Maureen Wellen, now his wife of more than thirty years, was studying fine arts at graduate school at Pennsylvania.

[31] The center never got much traction with the traditional Wharton faculty, and was eventually privatized; it exists today in Philadelphia as the Applied Research Center under the leadership of Dr. Lynn Oppenheim, a psychologist.

[32] To expand on the story begun in note 30, Freeman originally got an interview at Wharton because Professor Richard Rudner's son, an anthropology student at Penn, knew people at the Busch Center, and Rudner knew that Ackoff had a philosophy degree. (Rudner was on Freeman's dissertation committee.) What no one knew was that Ackoff was in a period of reasonable hostility towards academic philosophers. But none of this mattered since he was out of the country when Freeman interviewed, and left these hiring decisions to others.

system redesign. More relevant to business, the idea had been used in assessing the strategic direction of a large Mexican brewer which was dealing with its government and other key stakeholders. However, the use of the idea at that time was mainly as a way of organizing thinking about the external environment, or in thinking about system design.

At around the same time Ian Mitroff was visiting at the Busch Center, and he and Emshoff and Richard Mason were working on strategic assumptions analysis, a project in which the stakeholder idea was used to organize the assumptions that executives made about their external environment. This use of the stakeholder idea as an organizing concept was consistent with the original use at Stanford Research Institute.

There was little in the way of a "management approach" that could help executives actually make decisions, other than at a very high level.[33] At around this same time Emshoff and Ackoff organized a "faculty seminar" around "what are we to make of this 'stakeholder' idea?" Eric Trist, Howard Perlmutter (management), Alan Shapiro (finance), and a few others attended. Freeman was a very junior person, without even a faculty appointment at the lowest level. He listened intently to these senior people discussing how they interpreted the stakeholder idea. There seemed to him to be a common thread in the seminar, and that was the reluctance of any of these management thinkers to talk about issues of values, ethics, or justice. At almost every meeting someone would draw a stakeholder "wheel and spoke" map on the board, throwing their hands up in the air and claiming, "Well, that's a normative problem of distributive justice, and we can't say anything about that." As a philosopher, Freeman was fairly naive, and had not yet experienced the fanatical concern with "method" and "positive" and "empirical" that so defines most business school intellectuals. He remembers thinking, "Well, I can certainly say something about normative and justice issues."

Emshoff encouraged Freeman to begin exploring these ideas and writing about them and, together, they prepared a working paper, entitled "Stakeholder management," that was sent out to a mailing list of companies and people. At some point in 1977, some executives from the Human Resources Department at AT&T came to the Applied Research Center to discuss developing a portion of a four-week seminar for their "leaders of the future." They had done a survey of their Bell System officers, and "how to manage the external environment" ranked high on the list of skills needed by the leaders of the future.

[33] And the idea of using stakeholder theory for "sense making" or "framing" simply had not occurred to anyone as far as we know.

While Emshoff and Freeman were novices at executive education, they believed that they had something to offer on the basis of thinking about how the stakeholder idea could anchor an approach to managerial decision making. Ram Charan, at the time from Northwestern, Fred Sturdivant from Ohio State, and Mel Horwitch from Harvard were also working with AT&T on this project, and they designed a one-week course that was aimed at sensitizing managers to the need to deal with stakeholders, giving them some tools and techniques for tasks like prioritizing stakeholders, and putting them into a decision-making simulation where they had to confront live strategic issues of importance to the company. The design involved a number of real stakeholders in the training and, over time, the team created a very successful experience.[34]

These ideas were developed in two papers. The first was a conceptual paper laying out the argument for why managers needed an active managerial approach for thinking about stakeholders. "Stakeholder" was defined in a broad strategic sense as "any group or individual that can affect or is affected by the achievement of a corporation's purpose." While this definition has been the subject of much debate in the ensuing years, the basic idea was quite simple. Freeman and Emshoff were taking the viewpoint of the executive, and the claim was that if a group or individual could affect the firm (or be affected by it, and reciprocate), then executives should worry about that group in the sense that it needed an explicit strategy for dealing with that particular stakeholder.

Emshoff and Freeman (1981) developed some of the techniques of "stakeholder management," as they began to call it, in a paper for a volume of applications of management science. In "Stakeholder management: A case study of the US brewers and the container issue," they looked at the Center's ongoing work with the United States Brewers Association and their struggle over what to do about taxes, recycling, and regulation of beverage containers. At that time Freeman and Emshoff were enamored of the promise of applying management science techniques to allocating resources among stakeholders more accurately, a view which Freeman now believes to be deeply wrongheaded and mistaken. But they did develop a useful way of thinking about stakeholder behavior in terms of thinking through actual behavior, cooperative potential, and competitive threat for each stakeholder group.[35]

[34] At least by the measure of the number of managers who were "trained," it was successful. Freeman recalls that over a period of something over six years, more than a thousand managers were trained in the one week seminars. Literally thousands more were given a one day version of the course.

[35] For a modern version of these techniques see Freeman, Harrison, and Wicks (2007), Chapter 5, and Harrison and St. John (1998).

During the same time they developed a managerial version of the same material published in the *Wharton Magazine*, entitled pretentiously, "Who's butting into your business?" (Freeman and Emshoff 1979).[36] This was an attempt to show managers that stakeholders had at least "managerial legitimacy" – that is, from a strategic standpoint executives needed to put explicit strategies into place. They drew from their clinical experiences with the Bell companies, since they had begun to carry out many consulting/applied research projects after the successful seminars in the late 1970s. And Ram Charan and Freeman published a paper, "Negotiating with stakeholders" (1980), in a magazine put out by AMACOM, that focused on what they had learned about the negotiation process with a variety of stakeholder groups.

The questions which Freeman had during this time were pretty straightforward: (i) Could one develop a method for executives to strategically manage stakeholder relationships as a routine ongoing part of their day-to-day activities? (ii) Could strategic management as a discipline be recast along stakeholder lines rather than as the six tasks of Schendel and Hofer? And (iii) why was any of this thinking controversial, since it seemed to be complete "common sense" to Freeman?[37]

While he was not completely ignorant of management theory, Freeman had no systematic knowledge of any of the subfields. He began to read widely in strategy, organization theory, management history, systems theory, and a burgeoning literature on corporate social responsibility. It was here that he encountered what he knew to be philosophically outdated ideas of "theory," "evidence," the "normative–prescriptive" distinction, the "fact–value" distinction, and a whole host of ideas around methodology that was based on the positivist philosophy of the 1920s.[38]

[36] The article was published in the short lived *Wharton Magazine* after being rejected by the *Harvard Business Review* after multiple revisions. In the words of one of the editors at the time, "I couldn't get the others to agree." There is some irony in the paper's rejection for essentially stakeholder management reasons.

[37] In 1980 serendipity again entered the equation. Freeman's brother was killed in a car accident, and like many when faced with such a personal loss, he was "forced" to think about what he really wanted to do with his life. Did he want to continue consulting (with teaching being a part time assignment), or did he want to commit to actually trying to answer these questions, and trying to live a more scholarly life? He chose the academic route and was fortunate to be offered a position as assistant professor in the Management Department at Wharton. Freeman set himself the rather clear tasks of working out the stakeholder approach to strategy in a book, and of writing as many scholarly articles as he could to develop the ideas. It was really at this point that Freeman entered the academic world of management theory.

[38] And these ideas still drive most of the research in the business disciplines. See Chapter 3 for an outline of a different view based on philosophical pragmatism.

Essentially he ignored all these "rules and methods for research." He knew that he was dealing with a real problem, "how can executives make better decisions in a world with multiple stakeholder demands?" – what we have earlier called the problem of value creation and trade. And he knew that he was getting the clinical experience through consulting projects with real executives dealing with this real problem, what we have earlier called the problem of managerial mindsets. So Freeman decided to build from his experiences by developing more general ideas about how to systematize the stakeholder approach.

For instance, when he worked with companies whose executives were trying to deal with critical stakeholders by changing their entire points of view about the company, the idea arose that perhaps it would be more fruitful to work on small behavioral changes rather than large attitude changes. When a company expert guaranteed that he knew what a particular stakeholder group wanted from the company, and it turned out to be wrong, Freeman began to question the idea that structuring a team of stakeholder experts was necessarily the best way to run a strategic planning process. The clinical lessons were countless. Unfortunately (but maybe fortunately), Freeman knew nothing about qualitative research or grounded theory or some of the other ways to dress up intelligent observation in scientific clothes. He was stuck with such models as Graham Allison's *Essence of Decision* (1971), Selznick's book on the TVA (Selznick 1966), Freud's clinical studies, and other more classic works of "social science."

Freeman also began to get involved in the management academic community through the Academy of Management. Jim Post of Boston University invited him to give a talk to the Social Issues in Management Division in 1980 in Detroit. Even though he knew little about this group, he agreed because he had read Post's book with Lee Preston (Preston and Post 1975), and knew that it was important. In Detroit, Freeman gave a paper on the idea of stakeholder management, which argued that this was a better unit of analysis than an "issue." There was a lot of heated discussion, although Freeman himself was unsure why anything he had said was controversial.

During this time Freeman began to work with Professor William Evan, a distinguished sociologist at Penn. Evan saw collaborating with Freeman on stakeholder theory as a way to democratize the large corporation. Even though Evan was an impeccable empirical researcher, he immediately saw the normative implications of coming to see business as "serving stakeholders." Evan and Freeman began to meet weekly and talk about how to do the "next project" after *Strategic Management: A Stakeholder Approach*, even though that project was not yet finished. Indeed, they began an empirical study aimed at seeing how chief executive officers made trade-offs among stakeholders. They planned a book that would deal with the normative implications of re-conceptualizing the corporate governance debate in stakeholder terms. They offered a seminar to University of Pennsylvania students on "stakeholder management" around the 1982 academic year. While the book was never finished, they did complete a number of essays, one of which was reprinted countless times in business ethics textbooks. Freeman claims that Evan gave him the courage to tackle the normative dimension in an intellectual atmosphere – the modern, twentieth-century business school – that disdained such analysis. Freeman credits Evan for the inspiration necessary to tackle what we have called the problem of the ethics of capitalism.

In summary, Freeman spent most of his time from 1978 until 1983 teaching executives and working with them to develop very practical ways of understanding how they could be more effective in the relationship with key stakeholders. In the summer of 1982 he sat down at his home in Princeton Junction, New Jersey, and drafted the initial manuscript of *Strategic Management: A Stakeholder Approach*.[39] The purpose was to set forth a method or set of methods or techniques for executives to use to better understand how to manage key stakeholder relationships. In addition, Freeman tried to track down the origins of the stakeholder idea and give credit to its originators and the people whose work he had found so useful.

Strategic management: an assessment of the stakeholder approach

In a recent article in the *Academy of Management Review*, Jim Walsh of the University of Michigan assesses the impact of Freeman's *Strategic Management: A Stakeholder Approach* (1984). Walsh suggests that more people have cited the book than have actually read it.[40] He claims that the

[39] Bill Roberts was starting Pitman Publishing Inc. in the USA, as a subsidiary of Pitman UK. Edwin Epstein, of the University of California, Berkeley, was the editor of a new series, and had encouraged Freeman to work on these ideas. The book was published in 1983 with a 1984 copyright. During late 1982 and early 1983, Freeman made extensive revisions based on notes and conversations with Gordon Sollars, now a professor at Fairleigh Dickenson University, and Edwin Hartman, now a professor at New York University, as well as Roberts and Epstein. Of particular importance during this time was a conversation that Freeman had with William Frederick of the University of Pittsburgh, who encouraged Freeman to write the book he wanted to write, to "say what you have to say."

[40] This is surely borne out in fact. The original and only print run of the book was only 2,500. A recent check of Google Scholar suggests roughly 4,000 citations.

book is a practice-based companion to Pfeffer and Salancik's *The External Control of Organizations*, and that

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, and between the important and the small, insignificant, non-important stakeholders. Readers may cheer his recommendation to create "stakeholder managers" (p. 233) but then chafe when he talks about how they are to be used in a firm: "Stakeholder experts would ideally operate as a profit center within the corporation, selling their services to SBU managers" (p. 236). Of course, the idea of a stakeholder manager running a profit center is perfectly consistent with the business orientation of the book, but the idea of a stakeholder manager justifying her existence on the basis of a positive cash flow is not at all consistent with how so many have reconstructed this book over the past twenty years. This intensely business-first, manager-friendly, strategic management text has somehow left a generation of scholars with the idea that Freeman offered a stakeholder theory to compete with what might be called stockholder theory. (Walsh 2005: 429)

Walsh wonders how the stakeholder idea became a rallying point for issues such as corporate social responsibility when Freeman (1984) explicitly rejects them. Walsh's close reading finds two places in the text where it seems to admit the possibility of something like a stakeholder theory of the firm, but he claims these come "out of the blue." He does not see that part of the point of stakeholder theory was to integrate ethical and social issues directly into strategy, thereby enlarging the field of strategy. Freeman (1984) is not very clear on this issue and it is only articulated later in *Corporate Strategy and the Search for Ethics* (Freeman and Gilbert 1988).[41]

Walsh's conclusion about the usefulness of stakeholder theory[42] is one with which we are in agreement. He writes:

Freeman, Wicks, and Parmar (2004b) recently articulated what they called the core of stakeholder management; it captures this point very nicely: "Managers must develop relationships, inspire their stakeholders, and create communities where everyone strives to give their best to deliver the value the firm promises" (p. 364). Neo-classical economists sometimes overlook the importance of the verb "to manage," along with such attendant verbs as "to develop," "to inspire," and "to create." Stakeholder theory brings these ideas and practices to the fore. (Walsh 2005: 437)

[41] It is worth noting that Freeman thought that this book was an important sequel to Freeman (1984). However, it was not very widely read; Google Scholar lists only 235 citations.

[42] Walsh's review includes the work of Post, Preston, and Sachs (2002a, 2002b) and Phillips (2003).

Our conclusions about this work are quite similar. *Strategic Management* contained an underlying narrative about how to be a more effective executive. The "evidence" for this approach was the conversations that Freeman had had with literally thousands of executives over the previous seven years, plus the countless stories in the business press about good and bad stakeholder management, clinical experiences at Wharton with a number of clients and companies, and a small literature on the stakeholder idea. And, it was fundamentally about business – about solving what we have called here the problem of value creation and trade.

The point of the book was clear to us – in what way could executives and academics think about strategy or strategic management if they took the stakeholder concept seriously, or as the basic unit of analysis of whatever framework they applied?[43] The basic insight was to suggest that a more useful unit of analysis for thinking about strategy was the stakeholder relationship, rather than the tasks of "formulating, implementing, evaluating, etc." or the idea of "industry," or the other myriad ideas of the times. Freeman took this to be a matter of common sense and practicality, rather than some deep academic insight. Executives found thinking about stakeholder relationships very helpful for dealing with the kinds of change that were confronting their corporations. It seemed to bring some clarity to what we have called the problem of value creation and trade.

[43] Freeman (2005: 423) claims: "The approach of the book was modeled after what I took to be some of the best writing I had encountered that tried to interweave clinical cases and facts with the develop ment of insights and ideas. So, I relied on the 'clinical cases' I had worked on with a number of companies over these years, as well as my reading of the business press, case studies written by others, and my conversations with other people (experts) worried about the same phenomena. Again I was trained as a philosopher, so what was important to me was the overall logic of the argument. I found the insistence of some colleagues on empirical methods and an obsession with 'methodology' to be highly amusing and full of logic mistakes. Surely the insights of thinkers like Freud or Harry Levinson in management, or Graham Allison in politics, did not become questionable because of their methods, but because of their logic. The obsession with what Richard Rorty has called 'methodolatry' continues even in this world of critical studies, post modernism, pragmatism, and other assorted post positivist justifications of intellectual activity. I confess to paying no attention to methods. Perhaps if I had kept careful notes, interview transcripts, had a panel of experts sort all of the 'data,' I could have gained even more insight into the phenomena of businesses trying to deal with stakeholder relationships. However, I thought that all of this stuff was just silly window dressing. I never had interest in the question, 'Are you doing something that is descriptive of the way companies act, or are you prescribing how they should act, or are you suggesting that if they act in this way it will lead to these results?' Donaldson and Preston (1995) have suggested that stakeholder theory can be separated into descriptive, prescriptive, and instrumental categories. I thought I was doing all three and that any good theory or narrative ought to do all three. In short the stakeholder approach has always been what Donaldson and Preston have called 'managerial.' There is more than adequate philosophical justifica tion for such an approach and Andy Wicks and I (1998) have tried to set forth such a pragmatist 'methodology.'"

We would summarize *Strategic Management: A Stakeholder Approach* in the following logical schemata:

1. No matter what you stand for, no matter what your ultimate purpose may be, you must take into account the effects of your actions on others, as well as their potential effects on you.
2. Doing so means that you have to understand stakeholder behaviors, values, and backgrounds or contexts, including the societal context. To be successful over time it will be better to have a clear answer to the question, "what do we stand for?"
3. There are a few well-defined ways to think about stakeholder management, or focal points, that can serve as answers to the question, "what do we stand for?" or enterprise strategy.[44]
4. We need to understand how stakeholder relationships work at three levels of analysis: the rational, or "organization as a whole"; the process, or standard operating procedures; and the transactional, or day-to-day bargaining.[45]
5. We can apply these ideas to think through new structures, processes, and business functions, and we can especially rethink how the strategic planning process works to take stakeholders into account.
6. Stakeholder interests need to be balanced over time.

This argument has a number of implications. If it is correct, then the idea of "corporate social responsibility" is probably superfluous. Since stakeholders are defined widely and their concerns are integrated into the business processes, there is simply no need for a separate CSR approach. Social issues management or the "issue" is simply the wrong unit of analysis. Groups and individuals behave, not issues. Issues emerge through the behavior and interaction of stakeholders, therefore "stakeholder" is a more fundamental and useful unit of analysis. Finally, the major implication of this argument, which cannot be overemphasized today, given the development of stakeholder theory, is that "stakeholders are about the business, and the business is about the stakeholders."[46]

There are several obvious weaknesses of the book.[47] First of all, much of the language of the book was couched in the idiom of strategic planning in

[44] The book laid out a typology which no one ever took seriously, and the typology is updated in Freeman, Harrison, and Wicks (2007).

[45] These levels are just the three levels in Graham Allison's *Essence of Decision: Explaining the Cuban Missile Crisis* (1971).

[46] We are indebted to Professor John Kay for the phrasing of the issue at a conference of the European Association of Business in Society, held in Ghent in 2005.

[47] During the ensuing twenty years Freeman has continued to try and work out the implications of this basic argument, concentrating on more of the ethical and normative aspects of the stakeholder approach, while steadfastly maintaining that the normative descriptive distinction is not hard and fast. In 1983 he

general, and Lorange's (1983) version of strategic planning in particular.[48] Therefore there was far too much "process-speak" and far too much "consultant-speak," both of which served as a barrier to understanding the basic idea. Second, the book was overly analytical. One can get the view that if we draw the stakeholder maps accurately enough – model and predict their behavior – then we can cast out uncertainty from the strategic thinking process. Obviously there are limits to our ability to analyze, and just as obviously we can use analysis to hide behind, rather than going out and actively creating capabilities for dealing with, stakeholders. Again, part of this weakness came from relying on the strategic planning literature of the time. Third, there was a tension in the writing of the book between "managerial thinking" and "academic thinking." Chapter 2 was interesting only to academics, by whom it was widely read and cited. Alternatively, almost no one read Chapters 5 and 6, which were interesting only to executives who were trying actually to manage for stakeholders. This tension served neither audience very well. Fourth, the book underestimated the value of questions of purpose, values, ethics, and other elements per Walsh's criticism. While it did crudely follow Drucker (1980) and Schendel and Hofer (1979), in articulating "enterprise strategy," these issues are far more important in the day-to-day management of the enterprise than the book gave credit. Strategic management as a field universally ignored these issues for years, and many scholars continue to do so today.[49] Fifth, there was a missing level of analysis, and so

moved to the University of Minnesota with the explicit understanding that he would be teaching more Ph.D. students, and more ethics. At Wharton Freeman taught primarily business policy and principles of management. At Minnesota he had the opportunity to immerse himself in the business ethics literature, and to try and contribute to it. On reflection, given the split or separation between "business" and "ethics," this may have been a mistake, as it led to many misinterpretations of the basic argument. Once again serendipity played a large part in the decision. Freeman's wife was working for a consulting firm and traveling extensively. They were commuting three hours a day (when everything worked), and the chance for both to have jobs in Minneapolis meant that they could actually spend a lot of time together. As a result of that decision, "stakeholder theory" became more embedded in "business ethics" than it did in strategic management. In 1986 the family, now including their nine month old son, decided to move to Virginia and the Darden School. Freeman's charge at Darden was to help build the research capability of the school and the Olsson Center for Applied Ethics, which had been founded in 1967. Again, this personal move can be seen as helping to influence the interpretation of "stakeholder theory" as belonging more to ethics than to management. For the last twenty three years Freeman has worked with many colleagues at Darden in an environment that is much more like the one at the Wharton Applied Research Center. Darden is very "business oriented," and the basic argument of "stakeholder theory" that it is about helping executives make better decisions has found a friendlier home.

48 Lorange was at Wharton at the time and Freeman was heavily influenced by his ideas.

49 Once Freeman came to see this as perhaps the most important flaw in the book, he undertook to write what he hoped was a sequel with Daniel R. Gilbert, Jr., entitled *Corporate Strategy and the Search for Ethics* (1988); unfortunately almost no one reads or refers to that book today. Again the role of serendipity emerged. While he was at Minnesota, Dan Gilbert was a doctoral student. Freeman sat in on one of Gilbert's classes to assess his teaching, and the class he chose was one in which Gilbert was

virtually nothing about how business or capitalism would look if we began to understand it as consisting of "creating value for stakeholders." Sixth, there is too much concern with structure in the book. While some of the insights about corporate governance may be interesting, the chapters on recasting the functions of business along stakeholder lines were misguided. The underlying issue is the separation of business and ethics in the foundational disciplines of business, not the practical organization and working of these disciplines.

This book is an attempt to correct some of these inadequacies and resulting misinterpretations in stakeholder theory as it has developed. Like any useful idea, the development of stakeholder theory has been haphazard. There is a tendency to attribute too much intentionality to its developers. We have suggested that there are usually more idiosyncratic explanations about how knowledge evolves. In these first two chapters we have made a number of claims about how theory works, but we have failed to distinguish theories along some more usual lines, such as normative and descriptive. It is time for us to be clearer about our underlying approach and method.

using *Strategic Management: A Stakeholder Approach*, and arguing to the students that Freeman was a utilitarian. An ardent Rawlsian at the time, Freeman was appalled, and determined to fix this inadequacy in the book, so he and Gilbert began to work on *Corporate Strategy and the Search for Ethics*. There are many classes Freeman could have picked to sit in on, and many other topics were covered by the class.

3 Stakeholder theory, pragmatism, and method

Many of the arguments in this book will seem unusual to those scholars who are accustomed to reading the traditional management journals, such as *Academy of Management Review*, *Academy of Management Journal*, and *Administrative Sciences Quarterly*. Indeed, traditional philosophers who teach business ethics and read the *Journal of Business Ethics* and *Business Ethics Quarterly* may also not recognize the kind of arguments that we use here. Each of the intellectual communities of which these journals are a part has fairly well-defined ideas about the use of such terms as "theory," "method," "hypothesis," "proposition," and other philosophical concepts. While we respect, reference, and quote the bodies of literature that are contained in these and many other management and philosophy journals in the succeeding chapters, our approach is somewhat different. Consequently, we want to be as clear as possible that we are philosophical pragmatists about most issues around theory and method. In this short chapter we shall try to say what our view is about this pragmatism and why we believe that it can serve as a set of unifying ideas around a body of literature that has begun to change the underlying narrative about business.

There has been a great deal of discussion about what kind of entity "stakeholder theory" really is. Some have argued that it is not a "theory," because theories are connected sets of testable propositions. Others have suggested that there is just too much ambiguity in the definition of the central term for it ever to be admitted to the status of theory. Still others have suggested that it is an alternative "theory of the firm," contra the shareholder theory of the firm. As philosophical pragmatists we do not have much to say about these debates. We see "stakeholder theory" as a "framework," a set of ideas from which a number of theories[1] can be derived. And we often use "stakeholder theory" to refer to the rather substantial body of scholarship which depends on the centrality of the stakeholder idea or framework. For

[1] In this narrower, accepted sense of "theory" as producing a connected and established set of propositions.

some purposes it is surely advantageous to use the term in very specific ways (e.g. to facilitate certain kinds of theory development and empirical testing), but for others it is not. Think of stakeholder theory as a genre of management theory. That is, rather than being a specific theory used for one purpose (e.g. resource dependence theory in management), seeing stakeholder theory as a "genre" is to recognize the value of the variety of uses one can make of this set of ideas. There is enough commonality across these uses to see them as part of the same genre, but enough diversity to allow them to function in an array of settings and serve different purposes. In the following brief sections we shall try to clarify our pragmatist approach. We begin with an analysis of several recent critiques of business schools in general to set the context for what we hope to offer as an alternative approach. We then describe the pragmatist alternative, focusing on the recent work of philosopher Richard Rorty. Finally we summarize an argument showing how such a pragmatism can serve as a more useful way to think about business and management theory in particular.

The critique of business schools

The dominant narrative of business schools – that management is a science, and can usefully be researched, taught, and practiced in those terms – has a real grip on the hearts and minds of business school professors and administrators. A number of recent critiques have begun the process of self-examination with regard to this assumption.

Pfeffer and Fong (2002) have suggested that the whole idea of the MBA is suspect. They argue that it is neither necessary nor sufficient for business success and, further, that grades earned during this two-year period are not correlated with a flourishing career. The subtext is that much of what MBAs learn is of limited usefulness, that business school research is of limited influence, and that true "evidence-based" management is a rare species. Pfeffer and Fong suggest that most business school researchers get "good science" wrong and that the resulting MBA is overrated and does not much matter. We take Pfeffer and Fong to be arguing that business schools and business school research do not adequately address what we called the problem of value creation and trade because, according to them, researchers get "good science" wrong.

In a recent book, management theorist Henry Mintzberg (2004) has delivered a blistering critique of business education. He suggests that for the most part MBA programs have the wrong students, that students in their mid- to late 20s are simply neither ready for nor capable of learning management. Mintzberg sees management differently from Pfeffer and Fong, as a craft rather than a science. Crafts are built around "knowing how to" rather than the "knowing that" of science.[2] Hence according to Mintzberg studying management is a waste of time. One needs to be engaged in the "doing" rather than the "talking about doing." There is simply too much emphasis on both the disciplines of business and the traditional modes of teaching and learning in business schools. Consequently, MBAs have become exploiters rather than explorers and innovators. In addition, Mintzberg holds the managerial class, defined by MBAs, as responsible for what we have called the problem of the ethics of capitalism, resulting in a lot of economic misery in society. Mintzberg rightly traces much of the problem back to research and the emergence of a "cult of methodology," whereby the worthiness of a particular piece of research is based neither on its usefulness nor how it allows us to live, but on the "validity" of the methodology by which it has been executed. In short, Mintzberg suggests that we get "management" wrong and the resulting MBAs do real and lasting damage in the world.

In an influential article entitled "Bad management theories are destroying good management practices," the late Sumantra Ghoshal (2005) argued that the dominant narratives that have taken hold in business schools are the real culprits. In particular, Ghoshal singles out both the ideologues who, concentrating on the economic or financial aspects of business, propose that the only legitimate purpose of a business is to maximize shareholder value and those who propose to understand business as a complex agency problem where managers are seen as agents of shareholders. Ghoshal invokes Nobel laureate Friedrich August von Hayek's idea of "the pretense of knowledge" to suggest that we misunderstand the nature of social science. Social science theories become known – "ideas in good currency," as Trist would say – and students and business people begin to act as if these ideas are true. They enact the dominant narrative. In doing so, they implicitly enshrine the opportunistic mindset that makes ethics and "value creation for stakeholders" a drag on good business. Ghoshal writes:

> In courses on corporate governance grounded in agency theory, we have taught our students that managers cannot be trusted to do their jobs – which, of course, is to maximize shareholder value … In courses on organization design, grounded in transaction cost economics, we have preached the need for tight monitoring and

[2] A useful set of distinctions around knowledge can be found in William Dray (1964).

> control of people to prevent "opportunistic behavior." In strategy courses, we have presented the "five forces" framework to suggest that companies must compete not only with their competitors but also with their suppliers, customers, employees and regulators. (Ghoshal 2005: 75)

Ghoshal's view is that theories of business shape business itself – that is, that there is not a set of stable underlying phenomena. Business school researchers have simply misused scientific methods by pretending that business is like the physical sciences, with fixed rules and repeatable phenomena. The result is not the useless and noninfluential theory of Pfeffer and Fong, but the potentially highly destructive theory that Mintzberg's MBAs are inflicting on the world.

In an enlightening passage, Ghoshal suggests that the answer might lie in a closer connection between the great thinkers of the sciences and humanities, adopting a method of "common sense." He writes:

> In describing himself and his work, Sigmund Freud wrote: "[Y]ou often estimate me too highly. I am not really a man of science, not an experimenter, and not a thinker. I am nothing but by temperament a conquistador – an adventurer, if you want to translate the term – with the curiosity, the boldness, and the tenacity that belong to that type of being." (Ghoshal 2005: 81–82, quoted in Jones 1964: 171)
>
> Freud's inductive and iterative approach to sense making, often criticized for being ad hoc and unscientific, was scholarship of common sense. So indeed was Darwin's, who too practiced a model of research as the work of a detective, not of an experimenter, who was driven by the passions of an adventurer, not those of a mathematician. Scholarship of common sense is the epistemology of disciplined imagination, as advocated by Karl Weick (1989a), and not the epistemology of formalized falsification that was the doctrine of Karl Popper (1968).
>
> To protect the pretense of knowledge, we have created conditions under which this kind of scholarship can no longer flourish in our community. This is true of all social science disciplines but curiously, perhaps it is most intensely true in business schools where, in our desire for respect from scholars in other fields, we have become even more intolerant of the scholarship of common sense than those whose respect we seek. (Bailey and Ford 1996)

In short, Ghoshal suggests that we get theory wrong, management wrong, and social science wrong and we should not be surprised at the resulting moral decline of business. We should not be surprised by what we have called the problem of managerial mindsets.

The upshot of these critiques can be diagnosed into the three interconnected problems we suggested in Chapter 1. Freeman and Newkirk (2008) add to this diagnosis by suggesting that what the critics themselves miss is that most of the time we get "business" wrong. Business is not an independent, repeatable phenomenon, an “economic clockwork” subject to its own, discoverable rules. In fact business is a deeply human institution and to see it as anything less misses the mark. We continue that line of thought here as we try and diagnose a further level of detail in these three problems. Our three problems[3] come from both external turbulence in the business world and from the dominant narratives about business, which do not, for the most part, see it as a fundamentally human enterprise.

The result is that a kind of early twentieth-century positivism has overtaken business schools. This became clear to us after many years of writing letters for promotion and tenure for colleagues at many business schools around the world, and serving on the tenure and promotion committees at the various institutions where we have worked. Positivism, in this context, leads to a view, roughly, that research is to be modeled on the physical sciences. Only measurable, repeatable phenomena are “real.” Knowledge, on this view, results from empirical investigation. Theory is important only to the extent that it leads to testable propositions and measurable hypotheses. The results of this view are to treat method and data with a kind of reverence that ultimately leads to what Hambrick (2007) has argued is a fetishism for theory: theory that makes sense out of the data, out of what can be measured, regardless of its causal relevance.

In his Nobel lecture von Hayek has summarized the problem of applying “scientific” scholarship to human activities quite nicely:

> Unlike the position that exists in the physical sciences, in economics and other disciplines that deal with essentially complex phenomena, the aspects of the events to be accounted for about which we can get quantitative data are necessarily limited and may not include the important ones. While in the physical sciences it is generally assumed, probably with good reason, that any important factor which determines the observed events will itself be directly observable and measurable, in the study of such complex phenomena as the market, which depend on the actions of many individuals, all the circumstances which will determine the outcome of a process, for reasons which I shall explain later, will hardly ever be fully known or measurable. And while in the physical sciences the investigator will be able to measure what, on the basis of a prima facie theory, he thinks important, in the social sciences often that is treated as important which happens to be accessible to measurement. This is sometimes carried to the point where it is demanded that our theories must be formulated in such terms that they refer only to measurable magnitudes. (Hayek, 1974: 180)

[3] The three problems are the problem of value creation and trade, the problem of the ethics of capitalism, and the problem of managerial mindsets. See Chapter 1.

This is precisely the problem in business research. Simply add "organization" to Hayek's idea of the complexity of markets, and one begins to see the folly of such a view. Add the idea that business is a human institution, one that is fully situated in the real world of human complexity, morality, and human hopes and aspirations, and most importantly, one where theory shapes behavior, and the quantitative techniques of modern empirical scholarship, when they are left to their own devices, begin to seem feeble.

We are not arguing that data-driven research offers no interesting insights. And we are not arguing that empirical investigations into business phenomena do not yield interesting insights. In fact, we want to argue that when those investigations are grounded in the practice of business they can lead to quite interesting and useful results. However, we are suggesting that the kind of positivism that has overtaken business research has run its course. It is surely not the only way to understand business phenomena, and it is based on an untenable distinction between "normative" and "positive."

We argued in Chapter 1 that the separation fallacy undergirded much of the current narratives about business, and it is easy to see how the problem of the ethics of capitalism arose, especially in business schools which adopted this new positivism. As Sandberg (2008b: 230) notes, values are "embedded in social contexts from which they cannot be removed." We cannot single out particular "facts" from their underlying narratives.[4] As Searle pointed out, the "inclination to accept a rigid distinction between 'is' and 'ought,' between descriptive and evaluative, rests on a certain picture of the way words relate to the world" that ignores contextual notions such as "commitment, responsibility, and obligation" (Searle 1964: 52, 54). In other words, statements about the external world do not "face the tribunal of sense experience" alone (Quine 1951: 38). James and Dewey, Putnam and Rawls, Rorty and Goodman have all put forward similar arguments. Philosophers of science such as Kuhn (1962) and Feyerabend (1975) have highlighted the challenge this poses to the very concept of scientific inquiry as being solely descriptive and objective.

Similarly, in *The Collapse of the Fact–Value Dichotomy*, Hilary Putnam (2002: 27, 61–62) suggests that facts and values are deeply "entangled" and, as a result, "the picture of our language in which nothing can be *both* a fact *and* value-laden is wholly inadequate." As an illustration, Putnam's analysis of the word "cruel" as being both descriptive and value-laden illustrates how a great deal of language works, and demonstrates the limitation of employing a sterile, objectivist view of language and meaning. Putnam then analyzes

[4] This section draws heavily on Jared Harris and R. Edward Freeman (2008).

Amartya Sen's *On Ethics and Economics*, in which Sen (1987) specifically suggests that we have forgotten that economics is inherently entangled with matters of ethics, and argues that the false dichotomization of the two has impoverished discipline-based analysis in both economics and ethics.

Yet the entanglement of facts and values has implications beyond our mere conception of "business" language as being both normative and descriptive. Such entangled concepts apply directly to actual practices, which always embody both facts ("business" considerations) and values ("ethical" considerations). Consider, for example, the arrangement by which a business firm provides employment to a particular individual. Has the corporation provided economic value, or moral value? How can such things be disentangled?[5] Along these lines, any economic assertion is ultimately both descriptive and value-laden. Furthermore – and ironically – any *explicit* contention that commerce and morals involve mutually exclusive considerations (e.g. Friedman 1970; Jensen 2002) is *also* both descriptive and value laden.

Finally we argued that the problem of managerial mindset arises in part because the first two problems make what we teach managers more problematic. This is precisely the point of the critiques of business schools, that a false sense of knowledge pervades them. We teach and act as if we have created complete, or near-complete, causal theories about business. We act on, and teach students to act on, "the pretense of knowledge." And there is a self-reinforcing cycle to this knowledge which makes it particularly troublesome.

For instance, if we teach that business decisions and ethical decisions have nothing to do with each other, then we have created a generation of business leaders who look for business and ethics to conflict. Open questions are answered with "this is business," or "this is a business decision," or "I've got to do this for the good of the business." Thus Ghoshal (2005) and others (e.g. Ferraro, Pfeffer, and Sutton 2005; Frank, Gilovich, and Regan 1993), in showing that we enact the very theories of social science that we propose – and therefore demonstrating that the moral consequences are indistinguishable from the theories themselves – highlight the danger of *attempting* to separate business from ethics. When theorists suggest and managers enact an approach that views "business" decisions as if there are no moral consequences to them (e.g. describing unfettered profit maximization as the "single objective function" of business firms), this inculcates a societal narrative about business and ethics in which ethical considerations are no less real, but merely devalued and

[5] And if they cannot be disentangled, what are the implications for ideas such as "corporate social responsibility" and "triple bottom line," or even "economic value"?

denatured. If we treat the world of business as discovered, not created, we absolve managers of their responsibility for its structure. Is the view that owners of firms and their employees are one-dimensional maximizers of self-interest with convex utility functions for monetary wealth simply a matter of fact? Is the assumption that incentives effectively ameliorate agency conflicts unassailable? While some research (e.g. Frank 1988; Harris and Bromiley 2007) calls into question the prima facie descriptive accuracy of such assertions, important implications also arise from the assumptions about morality that are embedded *within* such statements, and their reifying influence on managerial behavior and social norms. That business decisions have moral content is inescapable; pretending that the two are divisible at best obscures important considerations and at worst paradoxically encourages a particular set of ethical norms that may be unintended.

The pragmatist alternative

In the philosophical literature pragmatism is usually credited to its "founders" or "pioneers" such as Charles Peirce, William James, and John Dewey.[6] For our purposes we rely on the more recent work of the philosopher Richard Rorty and those who have become known as "the new pragmatists."

Analytic philosophy was dominant in most American philosophy departments during the twentieth century and took as its wellspring the idea that the philosopher's job was to serve as the clarifier of conceptual schemes, a so-called "handmaiden to the sciences," an analyzer of language and logic. The mantra was "if it can be said, it can be said clearly." Philosophers worried about "meaning" rather than Socrates' question, "How should we live?" Ethics itself was turned into meta-ethics or the analysis of the meanings of words such as "good" and "right." Rorty was part of the center of this analytic mainstream as a full professor at Princeton University, one of the top American philosophy departments. His main insight, which he credits to Dewey and others, but which was really crystallized in *Philosophy and the Mirror of Nature* (Rorty 1979), was that most of this way of doing philosophy rested on a set of distinctions we inherited from the Greeks and a view of language as representing the world. He argued that the idea of representation made no sense, that it was based on taking vision as a foundational sense, and

[6] See Rosenthal and Buchholz (2000); Gutting (1999); Westbrook (1991); and Rorty (1982) for a complete history.

that, at least since Wittgenstein (1953), we should know that language does not work that way. Rather, language is a tool, not a representation. There simply is no other way to deal with the world other than through language. To assume otherwise is to invoke the "appearance versus reality" distinction common to philosophers since Plato and crystallized in Kant. According to Rorty, we needed to return to Dewey and see the intellectual's task as producing social hope and of always trying to figure out how we could live better. In short, Rorty turns us back to Socrates, focused on how we should live.[7]

The controversial way in which Rorty often explains what he is up to is to claim that we need to replace the idea of "truth" as the goal of inquiry with the goals of "hope" and "freedom." Intellectual life matters precisely because we can offer descriptions and re-descriptions of what we humans do that allows us to live better. Rorty claims that we should adopt Dewey's goal for inquiry as "increasingly free societies and increasingly diverse individuals within them" (Rorty 1999: 49). He argues,

> Pragmatists … treat inquiry in both physics and ethics as the search for adjustment … [Pragmatists ask] the practical question, "Are our ways of describing things, of relating them to other things as to make them fulfill our needs more adequately, as good as possible? Or, can we do better? Can our future be made better than our present?" (Rorty 1999: 72)

In short, it is up to us to figure out which projects to pursue, which descriptions and re-descriptions might serve us better, and there are no guarantees that we shall be successful.

Pragmatists like Rorty believe that there are only two interesting projects for us to engage. The first is ever more useful descriptions and re-descriptions of "self"; the second is ever more useful descriptions and re-descriptions of "community." Indeed, some have suggested that these twin pragmatist projects are just two sides of the same coin, since "selves exist in communities" and since communities without "individuals" are pretty uninteresting.[8]

Rorty's view of humanity is a thoroughly Darwinian one in which we are a species of "souped-up" chimpanzees or bonobos who can cleverly adjust what we do in collaboration with each other through language. He recommends that

> [W]e see ourselves as having the beliefs and emotions we do including our (potentially) "specifically moral" beliefs and emotions because of some very particular

7 Rorty has a nuanced view here. "How should we live?" is not a question that admits of an answer true for all time. Rather, we are constantly trying to find better ways to live; we struggle for adjustment.

8 See Freeman (1998). Rorty makes his first foray into business ethics in the same volume, replying to a former student, Cornell West.

> idiosyncratic things that have happened in the history of the race, and to ourselves in the course of growing up … It [pragmatism] lets one see oneself as a Rube Goldberg machine that requires much tinkering, rather than as a substance with a precious essence to be discovered and cherished. (Rorty 1986: 9)

Rorty claims that rather than trendy postmodern theorizing, we need to reread Nietzsche and Emerson on how we can undertake the project of self-creation. Indeed, he quotes (1989: 29) literary theorist Harold Bloom on the existence of strong poets who are horrified at "finding oneself to be only a copy or replica." We want to make more of ourselves than a copy of someone else. Equally, we need to read Whitman and Dewey, who emphasize that we must have solidarity with others for the individual to be able to accomplish any of her projects, implying that we are constantly trying to remake our communication.

This positivist view of management theory, decried by at least Ghoshal and Mintzberg, simply eschews individual difference. We search to find the theory, even a contingency theory, about how every organization has to work, how every employee is motivated, how all top teams work together or do not. Rorty is suggesting that a more fruitful course would be to produce some fine-grained narratives that focus on how we could live together better. Management theorists should be in the thick of this re-description, not at its periphery.

A Rortian and Deweyan vision of inquiry is quite far from where we find "management science." Management thinkers seem to debate tirelessly the "empirical vs. normative" distinction, and they argue endlessly and with obvious delight about definition and "proper method." While this is not the occasion to address all these issues, one suggestion is to simply give up such distinctions as "theory" and "practice," or "empirical" and "normative." We would need to develop criteria by which we judge the usefulness of work, but it would be connected to, rather than divorced from, how value actually gets created for stakeholders. That is a long story, but one that needs telling, and the current volume is offered in this spirit.

Pragmatism for stakeholder theorists

Wicks and Freeman (1998) outline a new approach to research in organization studies research, using pragmatism as a way of reshaping research to create a viable presence of ethics. Their pragmatism highlights the moral dimensions of organizing and helps to discredit embedded assumptions that make research less useful and less capable of creating a viable role for ethics.

Positivism is their prime target, since it enshrines critical assumptions that delude researchers into believing that they can conduct value-free scientific inquiry that advances knowledge without directly examining the presuppositions or implications of their work from a moral point of view. Wicks and Freeman argue that positivism in effect leads researchers – because they do not address the subject and try to remain value-neutral – to do ethics badly. At the same time, researchers who have come to reject the core assumptions of positivism and instead embrace "anti-positivism" as the basis for their research have not addressed the core problems raised by positivism. Indeed, rather than solving the problem, they have merely inverted problematic views and created new difficulties (e.g. moral relativism). While some researchers argue that future research can find a viable place for ethics if we simply "split the difference" between positivism and anti-positivism (e.g. Zald 1993), Wicks and Freeman argue that we have to move beyond the assumptions of both views as well as develop conceptual innovations that create a more intentional and substantive place for ethics.

The approach they offer is Rorty's "pragmatic experimentation." The focus of pragmatic experimentation is away from methodology and the devotion to science as a special and privileged form of inquiry and towards a focus on research as a tool that can help us lead better lives (1998: 124). It is "experimental" in that researchers should continually be looking for newer and better ways of organizing that advance human flourishing and employ a wide array of methods (quantitative and qualitative) that can be of help.

In their critique of positivism, Wicks and Freeman isolate a range of problematic assumptions related to the core belief that science is the only method of generating knowledge. More specifically, positivism enshrines sharp distinctions between finding (the world is given and science simply objectively reveals that truth without any influence from perspective, culture, or language) and making (all human inquiry, even science, is shaped by human perspective, culture, or language); descriptive (simply talking about something as it is) and prescriptive (talking about something as it should be); and science (knowledge creation done using the methods of scientific inquiry) and nonscience (any other inquiry that does not use the methods of science). In contrast to positivists, pragmatists do not draw sharp distinctions between these categories, and instead maintain four ideas central to their vision of "epistemology": "the world is 'out there' but not 'objective'" (there is no method of getting outside human experience to describe reality); "facts and sentences are intertwined" (any "facts" are embedded within language, culture, human artifact); "all inquiry is fundamentally interpretive or narrative" (science is part of the "narrative" tradition, not categorically separate from it); "science as a language game" (there are predetermined ground rules that shape all inquiry and its "progress").

In short, science is simply one more tool that can provide us with a set of narratives that can be incredibly useful as we sort out how to live well. Science becomes, on this view, a fully moral endeavor, as Rudner (1953) laid out many years ago. Ethics and science are grounded in the world, in the human institutions we have created. Ethics and other (nonscience) disciplines are not categorically below (or above) science as a method of inquiry to help generate knowledge of the world. Science is especially helpful in testing existing beliefs and allowing us to discern reasons to come up with better explanations. However, it is not a privileged form of discourse; it is part of our efforts to make sense of the world (like other non-science disciplines), and it cannot address the important questions for us (i.e. "What shall we do and how shall we live?" as expressed by Tolstoy). Another way of expressing this is to say that we need to dissolve the distinction between science and ethics, keeping what is best and most useful about each.[9]

Anti-positivism provides a well-intentioned alternative to positivism, particularly in highlighting the subjectivity of all scientific inquiry and the impossibility of true "objectivity." However, the problem with anti-positivism is twofold: first, it retains the problematic assumptions and categories of positivism even as it inverts them (i.e. towards subjectivity and away from objectivity); second, in its emphasis on the subjectivity and particularity of all knowledge, anti-positivism fosters a relativism that is both problematic and counter-productive. Rather than generating "liberation" and unleashing human creativity, anti-positivism pushes us to simply create as many views as possible without offering any method for deciding which are preferred or best (see, e.g., Astley 1985; Morgan 1986). One narrative is as good as the next – leaving us as unable to ask directly and systematically whether or how research advances human purposes as we were able to with positivism. Anti-positivists elevate the human-ness of all inquiry, even that based in science, but it undercuts our ability to tackle questions of values and meaning by making all points of view equally valid and any effort to establish a "better" or "best" narrative little more than a power grab. It throws out the intersubjective agreement that is so important to any form of inquiry, especially science, for the sake of human purpose.

[9] We realize that there is much more to be said about these issues.

In this context pragmatism is offered as a way of shifting the conversation. Rather than seeing research as being about the generation of objective knowledge, or the proliferation of competing narratives (all of which are as valid as the others), pragmatists see the goal of inquiry as generating insights that help us to lead better lives. If an insight or method is "useful" in this sense (i.e. this is not a simple form of utilitarianism), then the pragmatist would embrace it, but there is a strong desire to get beyond a focus on strong assumptions, categories, and methods as the starting point for inquiry. Instead, the pragmatist would push us to address front and center the larger purposes of inquiry and the importance of values to the study of organizations. In thinking about usefulness, the pragmatism of Wicks and Freeman encompasses two dimensions simultaneously: the epistemological (is it useful in terms of providing credible, reliable information on the subjects at issue?) and the normative (is it useful in making our lives better?). It is the criterion of usefulness that allows the pragmatist to make judgments about inquiry where the positivist and anti-positivist could not. Research becomes a vehicle to express human hope and push people to think about their larger purposes, how they want to live, and how they can cooperate with others to make us all better off. It is decidedly "experimental," in getting past existing constraints on research, in pushing us to ask new questions about whether and how particular research helps us live better, and in looking for insights that are better for us (rather than just more efficient, moving us further down the path of an existing paradigm).

In thinking about pragmatism and how it might move the conversation forward in a different direction, Wicks and Freeman highlight some of its core features. One central challenge is how to address the emphasis on purpose that is characteristic of ethics, without crippling inquiry or leading research down the relativist path laid out by anti-positivism. Pragmatism puts a priority on the "political," in the sense that conversations around purpose should be focused primarily on the tasks at hand (e.g. terms for our cooperation in getting a particular job or task done at a company), rather than on trying to get agreement on larger issues such as epistemology, the meaning of life, or religious belief. Especially in a pluralistic society there will be widespread disagreement about such matters. Instead of getting caught up in endless debates about whether Protestantism or Catholicism provides a more compelling case for endorsing capitalism, people should focus on the terms for their cooperation – whether it be on the ground rules for their economy, a corporation, or getting along with their team – and specific processes that allow them to reach agreement. Such an approach makes the task of researchers more akin to how we get along in life in other domains, and while the questions may be hard and generate intense disagreements, resolving them in constructive ways is critical if our efforts are going to help us live better.

Beyond this broad perspective on pragmatism, Wicks and Freeman also try to lay out some other details to help envision how research might proceed differently. They emphasize the work of Karl Weick (1979, 1989b, 1993) and some of the major themes within his work, refined by the authors' emphasis on pragmatism.

One key concept is equivocality, the notion that phenomena admit of multiple interpretations and that there is no one underlying "truth." Another core concept is to see "organizations as social," which is an extension of the equivocality idea. If experience of phenomena is equivocal, then a key issue for researchers is how individuals share and create meaning out of their experiences – that is, the social aspect of organizations becomes central rather than the search for ahistorical underlying laws and structures. A third notion is enactment. For Weick, reality is enacted rather than discovered. People make choices and impose meaning on their experiences rather than having meaning determined for them by nonhuman forces. This puts emphasis on human choice, language, and agency within the larger context of a community, culture, and patterns of discourse – all things that are central to pragmatism.

A final element of Weick's work that is helpful is justification – that is, the efforts to create new forms of sense-making do not come from an "anything goes" attitude (à la anti-positivism). Rather, sense-making occurs within existing social structures and practices, such that any new efforts need to be understood and evaluated in terms of what already is. It is only on that basis that the community can determine whether the new meanings are an improvement or a regression. At bottom, all these innovations put an emphasis on narrative, on particular human beings and human communities, and on the choices individuals make – factors that highlight the centrality of ethics.

In looking at the broader domain of organization studies and how they can be reshaped, pragmatism provides guidance as well. Several key insights shape a pragmatist view of the "macro"-level changes needed for research:

A pragmatic understanding of multiple interpretations

Researchers need to be cognizant of the multiple concepts and classificatory schemes that can be brought to bear on a given phenomenon. Rather than begin with the idea that one provides a privileged perspective, researchers need to consider the merits of multiple perspectives and to evaluate them in terms of their usefulness.

The importance of conceptual framing or categorization

Pragmatism puts emphasis on the choice of words and categories in terms of what we see and find. Being critical of language and aware of key assumptions is essential for inquiry to bear fruit, and also puts ethics at the center of research (what are good assumptions? what are the value implications of these choices?) – something that is especially true in terms of the behavioral assumptions and core concepts we attribute to business.

Strengthen the theory–practice link

Pragmatism does not take sides in debates between theory and practice, seeing instead that both are important touchstones in sorting out how we live better. Practice reminds us of the importance of what can be done, while theory pushes us to explore beyond existing horizons and consider more radical possibilities. Each becomes stagnant without the other.

Multiple methods and forms of evidence

Rather than focusing strictly either on particular methods as privileged or on claiming that all methods are as good as each other, pragmatism puts an emphasis on asking good questions and allowing the mode of inquiry to emerge from that, recognizing that there is room for both qualitative and quantitative methods. It is essential to maintain strong standards for research inquiry that are appropriate to the methods used, but this should not be used to confuse us regarding the limited nature of all research inquiry and the role that a variety of perspectives and methods play in any robust research agenda.

Direct linkage of ethics and mainstream management literature

The pragmatic criterion of value provides the impetus to bring together both the ethics and management literatures. Management scholars cannot escape the fundamentally moral quality of their work, both in terms of their assumptions and the implications. At the same time, ethicists need the insights and resources of management scholars to deepen their understanding of business and the practice of management – to make their inquiry more relevant and useful to real managers and real companies. Linkages across the normative and empirical divide, and the importance that both play in discerning useful practices, underscores the need for cooperation and collaboration across domains of research.

Pragmatism creates a context for thinking about how organization studies might move forward in a way that makes ethics, science, and other disciplines central and essential players.

To take advantage of the pluralism that is a part of pragmatic experimentalism we must avoid the temptation of hubris. No one mode, and no single discipline, has a monopoly on insight. An analysis of markets tells us a lot about business, but it does not give us the whole story. An understanding of creativity and its sources may help us to develop leaders, but it will not speak to the purpose of business. Similarly, deep insights into the human condition and how we make joint meaning gives much insight into how business works, but again, it is not the whole story. Indeed, we would surmise that there never is "the whole story." Each mode of research and their combinations are always subject to revision and the generation of new insights. In fact, by applying to another the methods and thinking of one mode we can sometimes generate useful ideas. By being explicit about the underlying narratives in the empirical mode, we can generate new narratives and, perhaps, new testable propositions.

We must keep Ghoshal's warning about the self-reinforcing nature of social science in mind. No theory is without impact, and no powerful idea leaves the observed phenomenon unchanged. In fact, we believe that any piece of research always leaves a certain set of questions open. And we suggest that these open questions begin to be explicitly acknowledged and answered. We want to build on the ideas of Michael Gonin (2007), and suggest that the following set of questions become routine ones:

(1) Does this work answer the question(s) it proposes?
(2) Was the question meaningful and appropriate?
(3) Are there alternative modes of research that could lend insight into the question(s)?
(4) What are the direct consequences of this research?
(5) If we teach this insight to managers and students, what might be the result if they act on it?
(6) What is the background narrative(s) of this research?
(7) How will we begin to see ourselves and others if we act on this work?
(8) How will this work shape the context in which value creation and trade takes place?

Modeled after questions in the field of technology assessment (Davis and Freeman 1978), these become a kind of "research assessment." We are not suggesting that every piece of research must actually answer these questions, but instead that we open up a line of research that is devoted to asking and answering these questions. It is problematic that such a critical line of inquiry does not exist in many business disciplines. Most simply stop after the first two questions on the list, which are devoted to the efficiency and effectiveness of research, but leave unaddressed the subsequent questions on its assumptions and impact.

We see these changes as implications of pragmatism, developed with an eye to seeing the role of ethics in human affairs, for all domains of research on organizations. While this includes stakeholder theory, we want to mention a few items specific to stakeholder theory, some of which will be developed later in this volume. First, it is a mistake to see stakeholder theory as a specific theory with a single purpose. Researchers would do well to see stakeholder theory as a set of shared ideas that can serve a range of purposes within different disciplines and address different questions. Second, stakeholder theory provides a powerful vehicle for the pragmatists' injunction to put questions regarding priorities and purpose front and center for organizations. Rather than starting with a clear and predetermined sense of why they exist, stakeholder theory echoes the idea that people need jointly to seek and create meaning within organizations. Third, in seeing the plurality of theories that emerge under the umbrella of stakeholder theory, researchers need to adopt the pragmatist mindset of asking good questions as the starting point of inquiry and letting methods play a supporting role in shaping a research agenda, rather than vice versa. Fourth, the pragmatist mindset suggests that stakeholder theorists need to bring a large portion of humility to their craft. Rather than celebrating or privileging the inquiry of the academy, pragmatism reminds us that the perspective of the manager matters and should be an important touchstone for helping to define what counts as a good question. Research needs to be "useful," even if it is not always directly applicable to a manager operating in an organizational context.

Part II

Stakeholder theory and the traditional disciplines of business

4 Stakeholder theory and strategic management

Stakeholder theory has much to say about strategic management. The stakeholder perspective offers an alternative that can enhance the economic perspectives of modern strategic management. We have already argued in Chapter 1 that the idea of stakeholder theory is consistent with strategy theories such as Michael Porter's industrial economics and Oliver Williamson's transactions cost theory. The body of work that we have called "stakeholder theory" was developed during approximately the same time frame as the economic approaches that are more mainstream today.

Although the stakeholder approach to strategic management has influenced thinking in the field, there are numerous interpretations of it, the results of which are that it sometimes still struggles for acceptance among mainstream strategic management scholars.[1] For example, Michael Hitt (2005), a widely acknowledged expert in the field, reviewed the development of the strategic management discipline and highlighted important areas for future research and discussion. His review suggested that the most important theoretical perspectives include industrial organization economics, corporate strategy and diversification, transaction cost economics, evolutionary economics, resource dependence, and the behavioral theory of the firm. Within these perspectives, he mentioned dozens of individual topics such as agency theory, corporate governance, mergers and acquisitions, international strategy, and the resource-based view. Not once did he mention the stakeholder perspective, although he did refer to the closely related concept of network strategies (Dyer and Singh 1998; Gulati and Singh 1998; Ireland, Hitt, and Vaidyanath 2002). His omission did not come from lack of awareness of the

[1] One probable cause of this reluctance is that many stakeholder theorists, including the authors of this book, have refused to accept the "purely scientific" approach that affects much of strategic management. In the zeal to be as rigorous as economics, which has a similar zeal to be as rigorous as physics, it is often forgotten that the human sciences may be developed along multiple lines. We are not arguing that the "scientific" approach to strategic management, largely developed by a group of scholars around the *Strategic Management Journal*, is not useful but, rather, that it is not the only useful approach. See Chapter 3.

topic (Hitt, Harrison, and Ireland 2001; Hitt, Freeman, and Harrison, 2001), but more likely from the view of many strategic management scholars that stakeholder theory is a part of the social responsibility literature and not central to strategic management theory.[2] Recently this has changed, as strategic management scholars have "rediscovered" stakeholder theory. This renewed interest has been led by scholars who have been able to see that a stakeholder approach to value creation is consistent with economic theories and may provide a more robust foundation for strategic management.

This chapter will trace the influence of the stakeholder concept in the strategic management discipline. We begin with a brief history of the emergence of the strategic management concept up to 1984, to augment what we have said about the history of the stakeholder idea in Chapter 2. The history is not intended to be exhaustive, but rather to provide a context, so that readers can understand how the stakeholder perspective was received and how it related to the major ideas in the field at the time. We shall examine the key themes in the strategic management literature as they relate to stakeholder theory, including how practitioners have made use of the stakeholder concept. Finally, we shall offer an overall assessment and suggest some future research directions.

The rise of modern strategic management

Surprisingly, strategic management as an academic discipline has its roots in a business school course. Fairly early in the twentieth century, many business schools began offering a course called "business policy." Based on a study of business school curricula sponsored by the Ford Foundation, Gordon and Howell (1959) suggested that

> [The] capstone of the core curriculum should be a course in "business policy" which will give the students the opportunity to pull together what they have learned in the separate business fields and utilize this knowledge in the analysis of business problems. Without the responsibility of having to transmit some specific body of knowledge, the business policy course can concentrate on the integrating of what has already been acquired and on developing further the student's skill in using that knowledge. (Gordon and Howell 1959: 206)

[2] Strategic management as a field of inquiry is built on the separation fallacy, as we discussed in Chapters 1 and 2.

Standard E of the American Assembly of Collegiate Schools of Business made the business policy course a requirement for accreditation. Also, the Academy of Management formed a Business Policy and Planning Division to support academic pursuits in this area.

The business policy approach

The business policy course, as it was usually taught, focused on developing policies that would solve business problems through an integrated, multi-functional approach. As the quotation from Gordon and Howell suggests, there were no widely accepted models for developing these policies. Rather, the course gave students experience, through business cases, in dealing with business issues from a number of perspectives simultaneously. As late as 1972, Schendel and Hatten noted that business policy was still thought of as a course rather than a field of study or an academic discipline (Schendel and Hatten 1972).

The standard business policy approach did not provide sufficient training to help executives deal with the complex and dynamic management problems that became evident in the post-World War II era (Schendel and Hofer 1979). This era has been filled with dramatic advances in technology, especially in communications and transportation, as well as increasing national and global competition. Rapid social, political, and economic changes have created a turbulent business environment, making effective management very difficult. In addition, the sheer size and complexity of modern business firms has made them difficult to manage. Scholars, in concert with large consulting firms such as the Boston Consulting Group, recognized the need for development of theory to support business policy as a separate discipline. Specifically, there was an acknowledgement that organizational success was dependent on successfully navigating an increasingly difficult external environment.

Definitions of strategy

Chandler's work was among the most influential in guiding early business policy scholarship. A business historian, Chandler defined strategy as "determination of the basic long-term goals and objectives of an enterprise, and the adoption of courses of action and the allocation of resources necessary for carrying out these goals" (Chandler 1962: 16). This definition embraced the notion that a firm should establish goals, strategies to achieve them, and an implementation (allocation) plan, but it did not address the essential role strategy plays in linking the firm to its environment. Shortly thereafter, Ansoff discussed strategy in terms of product/market scope, growth vector, competitive advantage, and synergy (Ansoff 1965). With its emphasis on market factors, Ansoff's definition is more oriented towards the external environment. Ansoff rejected the core of stakeholder theory by establishing a typology of objectives as "economic" or "social," with the social objectives playing the less important role of constraining or modifying economic objectives.[3]

Around the same time, Learned, Christensen, Andrews, and Guth defined strategy as "the pattern of objectives, purposes, or goals and major policies and plans for achieving these goals, stated in such a way as to define what business the company is in or is to be in and the kind of company it is or is to be" (Learned, Christensen, Andrews, and Guth 1965: 17). They also identified four components of strategy: "(1) market opportunity, (2) corporate competences and resources, (3) personal values and aspirations, and (4) acknowledged obligations to segments of society other than stockholders" (21). This treatment of the strategy concept was well ahead of its time, in that it foreshadowed the importance of a resource-based perspective (Barney 1991), acknowledged external obligations beyond those owed to stockholders, and suggested the importance of values and purpose.

Political strategy formulation, organizational learning, and resource dependence

Also important to the early strategy literature was recognition that strategy formulation contains both rational-deductive and political processes (Thompson, 1967; MacMillan 1974, 1978; Katz and Kahn, 1978). MacMillan (1978) drew from this literature to create a practical set of tools that managers could use to devise a political strategy. He argued that organizations should not concentrate exclusively on customers, markets, and products when they are formulating strategy, but should also include analysis of "symbionts" such as shareholders, employee groups and unions, competitors, and suppliers. He defined symbionts as "those elements of the environment on which the organization is dependent for inputs" (MacMillan 1978: 66). His perspective, like stakeholder theory, viewed organizations as systems that are dependent on external stakeholders for survival (Ackoff 1974; Barnard 1938; March and Simon 1958). "Thus, all organizations are dependent upon the environment for the provision of certain inputs; which the organization then

[3] See Chapter 2.

transforms into outputs; which it, in turn, uses to get more inputs" (MacMillan 1978: 66).

MacMillan (1978) defined the steps in political strategy formulation as (i) systems analysis to identify key actors; (ii) analysis of the power, influence, and negotiating base of the firm; (iii) selection and analysis of allies and negotiation with them; (iv) analysis of political systems of opponents; (v) formulation of offensive and defensive strategies; (vi) anticipation of resistance from opponents and negotiation with them; and (vii) monitoring of results. MacMillan's model, like stakeholder theory, was very deliberate with regard to assessing stakeholders and working with them to achieve organizational goals. However, he took "no specific ethical stance" (MacMillan 1978: 5). He acknowledged that his political strategies could be used for unethical or ethical purposes. Stakeholder theory, in contrast, joins ethics and economics in a deliberate fashion. Furthermore, MacMillan admonished, "It cannot be stressed too strongly that the fundamental basis of long-run survival lies in a sound economic strategy, which strategy is the reason for the firm's very existence in society. So the purpose of political strategy is to enhance and complement the economic strategy" (MacMillan 1978: 110). On the other hand, stakeholder theory is intended to be the central organizing paradigm for strategic management and not a supplemental theory. So although MacMillan's work established the importance of developing deliberate strategies for dealing with a broad group of stakeholders, its premises were fundamentally different from those found in stakeholder theory.

Mintzberg's work also had a significant impact on early scholarship in business policy (Mintzberg 1971, 1978). He challenged the assumption that strategies are always the result of deliberate plans conceived in advance of particular organizational decisions. Instead, he advanced the perspective that organizations learn what works through a process of trial and error. In his view, strategy is "a pattern in a stream of decisions" (Mintzberg 1978: 934). His organizational learning approach is consistent with the stakeholder-based argument that firms can learn from their external stakeholders. Some of Mintzberg's earlier work is also stakeholder-friendly. Based on week-long observations of five CEOs in different industries, he identified ten work roles (Mintzberg 1971). Half of the roles he identified dealt directly with managing external stakeholders. For example, he discovered that CEOs serve as liaisons with external stakeholders in an effort to bring favors to the organization and spokespersons that transmit company information to outsiders. They also negotiate with stakeholders and serve as figureheads in receiving visitors from outside the organization, signing contracts, and presiding at ceremonial events. In addition, they collect and evaluate information from the external environment. The other roles focused on managing internal stakeholders and resources. Mintzberg's work helped to establish that CEOs, the primary architects of firm strategy, are basically stakeholder managers.[4]

Also important is agency theory (Jensen and Meckling 1976), based on the idea that managers serve as agents for the owners or shareholders. If managers take actions that are in their own best interests rather than the shareholders, an agency problem is said to exist. In the strictest interpretation of this theory, managers are considered irresponsible if they take any substantive action that is in the best interests of anyone other than the shareholders. The popularity of agency theory seemed to motivate strategic management scholars to stay focused on the shareholder as the principal beneficiary of managerial action. Several years later, Jensen would admit that satisfying multiple stakeholders is essential to maximizing the objective function of wealth maximization for shareholders (Jensen 2001).

"Strategic management" is born

In the 1960s and 1970s, scholars who were teaching and doing research in the business policy area began to meet and share their ideas. Around this time the term "strategic management" began to replace "business policy." Strategic management is a broader term that implies that simply establishing business policies to integrate functional strategies was not an adequate solution to the problems executives and their organizations were facing (Schendel and Hofer 1979). An important meeting of these scholars occurred in May 1977 at the University of Pittsburgh. Experts in fourteen topic areas associated with strategic management gathered to share their work and discuss ideas. This meeting set the stage for what we now think of as strategic management. It is interesting to note that the Pittsburgh meeting did not include papers specifically on social responsibility. According to the conference organizers, there simply was not space on the program (Schendel and Hofer 1979: viii).

[4] Unfortunately, Mintzberg has always had a stylized view of stakeholder theory. He continuously identifies stakeholder theory with an overly control oriented view of the importance of planning and forecasting. While there is some evidence for this view in, for instance, Emshoff and Freeman (1978) and even in Freeman (1984), there is much more to the theory. Surely Freeman and Gilbert (1987) made this clear, as did Wicks, Gilbert, and Freeman (1994), as did many of the other developers of stakeholder theory. Mintzberg is simply laboring under a misapprehension here.

In Pittsburgh Schendel and Hofer presented a model containing the basic activities in the strategic management process that, with some variations, continues to be used today (Schendel and Hofer 1979). The activities included organizational goal formulation, environmental analysis, strategy formulation, strategy evaluation, strategy implementation and strategic control. Environmental analysis, as they defined it, included an evaluation of a firm's competitive and "more general environments," with the intention of determining opportunities and threats facing the firm (Hofer and Schendel 1978). External stakeholder groups would presumably fall into these more general environments. The general premise underlying their formulation process was that the most effective firm strategies were those that best "fit" the environment. In other words, a firm should adapt to its environment because that environment determines the most appropriate strategies to pursue (for excellent analyses of this issue and its weaknesses, see Bourgeois 1984; Hrebiniak and Joyce 1985).

The deterministic perspective of strategy formulation was challenged by Bourgeois, who stated,

> [T]he strategy of a firm cannot be predicted, nor is it predestined; the strategic decisions made by managers cannot be assumed to be the product of deterministic forces in their environments … On the contrary, the very nature of the concept of strategy assumes a human agent who is able to take actions that attempt to distinguish one's firm from the competitors. (Bourgeois 1984: 589)[5]

These early arguments regarding environmental determinism were important to the relationship between business policy and stakeholder theory because they reinforced the idea that although firms are dependent on their environment for success, they still chart their own course and, in large part, determine their own destiny. The careful balance between allowing external influences (stakeholders) to determine completely organizational strategies and totally ignoring them is at the heart of modern stakeholder theory.

Also at the Pittsburgh meeting, Newman (1979) presented what amounts to a stakeholder map, although he never mentioned the word "stakeholder" (see Figure 4.1). He identified several external groups that the company needs, including customers, suppliers, stockholders, unions, and tax officials. He suggested that a key to successful management is obtaining a mutually acceptable relationship with these groups and that doing so is a "never-ending task." Commenting on Figure 4.1, he stated,

[5] See also Hrebiniak and Joyce (1985).

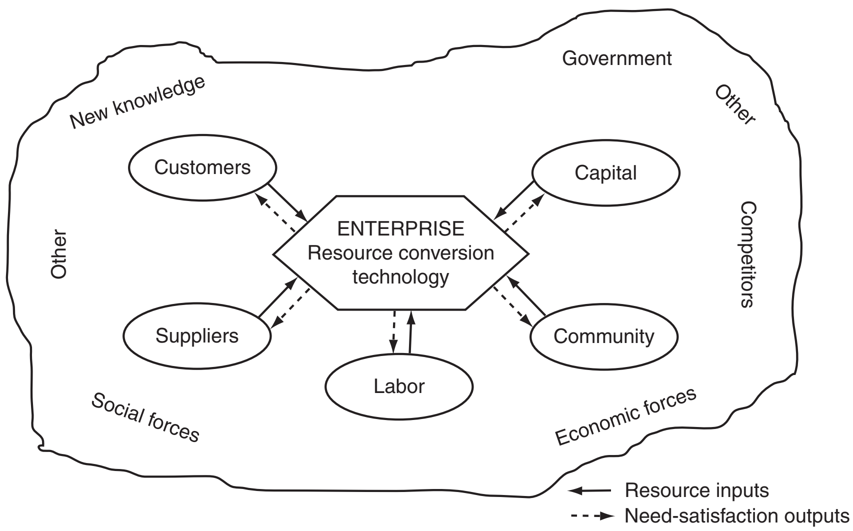

Figure 4.1. Generalized contributor group interaction between the firm and its environment
Source: W. H. Newman 1979. Commentary. In D. E. Schendel and C. W. Hofer, *Strategic Management: A New View of Business Policy and Planning.* Boston: Little, Brown. 45.

Strategy deals in large part, but not entirely, with a configuration of relationships between the company and such external "contributors." They may be called resources, or interest groups, or in systems jargon, "inputs." Since the company benefits from, and is dependent upon, a continuing cooperative exchange relationship with each contributor group, wise strategy formulation and implementation is vital to the company's existence. (Newman 1979: 45)

Economics and strategy

In the early 1980s Porter's work captured a lot of attention from strategic management scholars and practitioners. His influential book (1980) combined the emerging competitive strategy literature with industrial organization economics. "Competitive strategy is an area of primary concern to managers, depending on a subtle understanding of industries and competitors. Yet the strategy field has offered few analytical techniques for gaining this understanding, and those that have emerged lack breadth and comprehensiveness" (Porter 1980: ix). To fill the void, Porter (1980) articulated three "generic" competitive strategies – low-cost leadership, differentiation, and focus – and provided detailed tools based on competitive intelligence gathering to guide managers in determining which strategies are most appropriate in a variety of industry contexts.

Porter's work had the effect of reinforcing the economic theory upon which much of the field of strategic management was already based (e.g. Andrews 1980; Christensen, Andrews, and Bower 1980; Schendel and Hofer 1979). The primary, and to some scholars the only, important dependent variable was economic performance, typically measured in terms of profitability or shareholder returns. Studies were conducted to determine how high economic performance was achieved. This perspective is important to understanding why the stakeholder approach has struggled for broad acceptance in the field of strategic management. The only way to convince many strategy scholars of the importance of stakeholder theory is to demonstrate a strong positive link between following its precepts and economic performance, measured in traditional terms. As we shall demonstrate in the discussion that follows, supporters of the stakeholder approach have spent much of their intellectual time trying to establish that link in theory and in empirical tests.

Freeman (1984) offered an alternative approach to strategic management that addressed many of the concerns the field had identified as important. The stakeholder approach (i) embraced external analysis as a way to help firms deal with an increasingly turbulent environment (Schendel and Hofer 1979); (ii) "acknowledged obligations to segments of society other than stockholders" (Learned et al. 1965: 17); (iii) integrated economic with political strategy-making processes (MacMillan 1978); (iv) was consistent with Newman's (1979) "contributor group" approach; (v) contained elements of both adaptation and enactment (Bourgeois 1984); (vi) was consistent with what managers actually do (Mintzberg 1971); (vii) incorporated an organizational learning perspective (Mintzberg 1978); and (viii) included the concept of resource dependence (Pfeffer and Salancik 1978). In his final paragraph, Freeman summarizes,

> The business environment of the 1980s and beyond is complex, to say the least. If the corporation is to successfully meet the challenges posed by this environment, it must begin to adapt integrative strategic management processes which focus the attention of management externally as a matter of routine. (Freeman 1984: 249)

So far we have traced the emergence of modern strategic management up to the early 1980s and of the stakeholder concept in that emerging field during the same time frame. We have found that most of the mainstream strategic management writers did not use the term "stakeholder," but that many of their ideas were friendly to the stakeholder approach. Simultaneously, a literature was growing that included stakeholder concepts directly.

Freeman's book (1984) summarized and extended the early work on stakeholder theory. It offered a viable approach to the strategic management process that was very different from the economics-based approaches popular at the time.

In the same year Carroll and Hoy (1984) developed a model that integrated corporate social policy into the strategic management process. They acknowledged the responsibility of an organization to generate profits for its shareholders, but also suggested that managers should ask, "What responsibilities do we have to consumers, environmentalists, minorities, government, employees, and other stakeholders while we pursue profits?" (Carroll and Hoy 1984: 53). According to Carroll and Hoy, social policy should be established simultaneously with other corporate policies. Their work addressed the prevailing practice in strategic management at the time in which separate social policies were established (Hofer, Murray, Charan, and Pitts 1980), possibly a continuation of the idea that social objectives should act only as constraints on economic objectives (Ansoff, 1965). In contrast, stakeholder relationships are the central organizing framework for Freeman's (1984) strategic management approach.

Astley (1984) further elaborated on the concept of collective strategy as a tool for managing organization–environment relations. He identified the most common approaches to managing these relations as responding to environmental opportunities and threats, negotiating resource interdependencies with external stakeholders, and competitive maneuvering. He offered an alternative approach that consisted of jointly formulating and implementing strategies with external stakeholders, which he called "interorganizational collectivities" (Astley 1984: 526). Collective strategies are an important aspect of the stakeholder-based approach to strategic management.

Finally, MacMillan and Jones (1984), citing a statistic that 90 percent of American corporations had been unsuccessful in formulating and implementing strategies (Kiechel 1979), attributed the very high failure rate to implementation problems. Their solution involved a series of questions that organizations should ask when designing a competitive strategy. Stakeholders played a key role in their process. Specifically, stakeholder impact was to be identified and managed. Their process also involved deliberate management of internal and external stakeholder support and specific strategies for dealing with both positive and negative reactions.

The rest of the 1980s did not see many significant advances in the stakeholder concept in the mainstream strategy literature. Several things seem to have caused this void. First, Porter's (1985) highly successful second book further established the importance of the economic approach to strategic management. Second, while Freeman (1984) had both summarized and advanced the stakeholder approach to strategic management, the best we could say is that the field was evaluating what he said rather than trying to add to it. Third, a lot of attention was focused on social responsibility and whether firms that are good corporate citizens also have high financial performance (e.g. Aupperle, Carroll and Hatfield 1985; McGuire, Sundgren, and Schneeweis 1988; O'Neill 1989; Ullman 1985; Wokutch and Spencer 1987).

The results of the early empirical studies of the relationship between social and financial performance were mixed and inconclusive. This seemed to have a double effect on strategy scholars. First, they started to equate stakeholder theory with social responsibility and, as a consequence of the poor empirical results, they began to be skeptical about whether the stakeholder approach was economically viable and therefore worthwhile. Of course, the social responsibility literature tends to focus on the environment, special interest groups, social causes, community, and employee interests. In contrast, Freeman's approach considers the needs of these stakeholders as well as shareholders, customers, suppliers, and any other group "who can affect or is affected by the organization's purpose" (1984: 52). Consequently, the concerns of strategic management scholars were based on faulty assumptions, yet these concerns continue to persist in the minds of many scholars today.

Chakravarthy (1986) suggested measures of strategic performance that go beyond traditional profitability measures. Specifically, he suggested that firms might measure performance in terms of their ability to satisfy all their relevant stakeholders rather than just the stockholders. Along these lines, Malekzadeh and Nahavandi (1987) examined outcomes from corporate takeovers in terms of their influence on multiple stakeholders. Similarly, Vincent (1988) suggested that the key to realizing strategic advantage is to balance stakeholder interests so that all parties benefit.

As the Chakravarthy article suggests, the stockholders vs. stakeholders debate was ongoing during this time (Freeman and Reed 1983; Jensen 1989), stemming from the belief held by some that the social responsibility of a business is to increase profits (Friedman 1962). Efforts and resources directed at doing anything other than increasing profits limit the ability of the firm to be competitive in the market. According to Jensen, if the advocates of the stakeholder approach "argue for spending corporate funds on constituencies without any expectation of long-term benefit to the company, then they're advocating the waste of corporate resources" (Jensen 1989: 187). He goes on to explain that resources should be allocated to increase social benefits only if the benefits to the organization exceed the costs, but that there is no system in place to ensure that managers will allocate resources in this manner. He does acknowledge that shareholder needs cannot be met without satisfying, to some degree, the needs of other stakeholders such as customers, suppliers, financiers, and government regulators, a point that he would later reaffirm (Jensen 2001). Jensen's arguments bring us back to the importance to many strategic management scholars of providing an economic rationale for the stakeholder approach.

One other development during this period is worthy of discussion. Jansen and Von Glinow (1985) carefully examined the values conflicts that may emerge between a firm and its stakeholders. They defined ethical ambivalence as a situation "in which (a) the behaviors, attitudes, and norms that are shaped and maintained by the organizational reward system conflict with (b) the behaviors, attitudes, and norms congruent with the ethical values and judgments of organizational stakeholders" (Jansen and Von Glinow 1985: 814). Ethical ambivalence occurs "when the espoused values behind dominant norms conflict with reward system practices" (817). For example, stakeholders need honest and open reporting, yet organizational rewards systems may encourage behaviors such as falsification of data. Effective stakeholder management requires that managers be very deliberate in addressing value conflicts with stakeholders. Jansen and Von Glinow (1985) focus attention on rewards systems as a tool for addressing these conflicts.

The resource-based view of strategic management

During the mid- to late 1980s the resource-based view was gaining a lot of attention in the strategic management literature (Barney, 1986; Dierickx and Cool 1989; Wernerfelt 1984). The perspective assumes that firms are heterogeneous in their resources, that those resources cannot be transferred from firm to firm without cost, and that their characteristics determine, in part, firm outcomes such as performance (Barney 1991; Penrose 1959). Consequently, a primary task of managers is to acquire, develop, and manage firm resources. With regard to firm performance, Barney (1991) argued that resources that have market value, are scarce and nonsubstitutable, and are difficult to imitate have the potential to lead to a sustainable competitive advantage. These ideas, often referred to as "resource-based theory," led to an abundance of research on the nature of resources that lead to superior firm performance (Barney and Arikan 2001).

The resource-based and stakeholder perspectives are complementary rather than competing. Firm competitiveness requires effective management of both organizational resources and stakeholder relationships. Furthermore, a firm is dependent on its stakeholder network for most of the resources it acquires. Consequently, resource dependence theory (Pfeffer and Salancik 1978) provides a bridge between the two theories. However, the theoretical links between stakeholder theory and the resource-based view have not been adequately established in the minds of many strategic management scholars. As the resource-based view became a driving force in the strategic management literature, stakeholder theory was pushed to the side as a tangential theory associated with social responsibility and business ethics. Nevertheless, a relatively smaller group of scholars continued to advance the stakeholder concept in the strategy literature.

Key themes relating stakeholder theory to strategic management

We have examined the birth of modern strategic management and its concepts as they relate to stakeholder theory. While this history is ongoing, we shall switch to an examination of themes that relate stakeholder theory to strategic management. We shall begin with a discussion of the economic justification for a stakeholder approach to strategic management.

Economic justification for a stakeholder approach

The resource-based approach, with its emphasis on developing competitive advantage to enhance the creation of economic rents, reinforced the field's obsession with economic performance as the most important dependent variable. To gain wide acceptance in the strategic management field as it is currently situated, the stakeholder theory probably has to be justified in economic terms (Clarke 1998). Fortunately, many reasons exist to explain why stakeholder management should be associated with higher financial performance (Jones 1995). As Post, Preston, and Sachs argued, "Mutually beneficial stakeholder relationships can enhance the wealth-creating capacity of the corporation" (Post, Preston, and Sachs 2002a: 36), while "failure to establish and maintain productive relationships with all of the firm's stakeholders is a failure to effectively manage the organization's capacity to generate future wealth" (53).

Some researchers have argued that responsible stakeholder treatment can help a firm to avoid value-destroying outcomes associated with stakeholder actions such as legal suits, adverse regulation, consumer boycotts, strikes, walkouts, and bad press (Cornell and Shapiro 1987; Harrison and St. John 1996; Shane and Spicer 1983; Spicer 1978; Steadman, Zimmerer, and Green 1995). Avoiding negative outcomes reduces expenses as well as reducing the risks associated with variations in returns. Risk reduction enhances the value of a firm's securities because investors consider both future cash flows and risk simultaneously when assessing the value of a security (Fama 1970; Graves and Waddock 1994). Also, to the extent that firms are able to manage risk effectively, stakeholders may be more inclined to invest in the organization, whether these investments involve the efforts expended by employees, purchases by customers, sales from suppliers, or capital provided by market participants (Wang, Barney, and Reuer 2003). All other things being equal, stakeholders prefer to conduct business with stable organizations.

Based on the perspective that firms are collections of multilateral contracts over time, Freeman and Evan (1990) demonstrated how effective stakeholder management puts firms in a stronger position to adapt to external demands. The firm enjoys greater efficiency through an enhanced ability not only to create and satisfy individual contracts, but also to coordinate multiple contracts simultaneously. As Post, Preston, and Sachs explain, "The long-term survival and success of a firm is determined by its ability to establish and maintain relationships within its entire network of stakeholders" (Post, Preston, and Sachs 2002a: 7). Excellent relationships and effective management of the entire network can enhance organizational flexibility (Harrison and St. John 1996). Along similar lines, Hill and Jones (1992) extended agency theory (Jensen and Meckling 1976) by suggesting that managers have a responsibility to act as trustworthy agents to multiple stakeholders rather than just the stockholders. In their view, managers have the responsibility to draw together stakeholders to accomplish tasks in an efficient manner. Explicit and implicit negotiating processes serve as monitoring and enforcement devices that motivate managers to stay focused on financial objectives.

An excellent reputation in the marketplace can be a source of competitive advantage and increased economic value (Fischer and Reuber 2007; Fombrun 2001; Fombrun and Shanley 1990; Jones 1995; Puncheva 2008). One reason is that firms that have reputations as good citizens across a broad group of stakeholders are more attractive business partners and associates (Hosmer 1994). For example, customers may be more likely to shop at a store with an excellent reputation or suppliers may offer greater discounts to a firm that is known to be responsible in its treatment of stakeholders. Similarly, the best potential employees may be drawn to firms with reputations for excellent employee treatment (Moskowitz 1972; Turban and Greening 1996). It also seems probable that firms with excellent customer relationships should be able to tap those relationships such that their new product success rates will be higher (Harrison and St. John 1996).

In addition, responsible corporate behavior can facilitate the formation of alliances, long-term contracts and joint ventures (Barringer and Harrison 2000; Harrison and St. John 1996). A trustworthy reputation becomes a source of competitive advantage as the firm is presented with a larger number of better business opportunities from which to select. It seems likely also that increased trust leads to fewer transactions costs (Williamson 1975), by reducing the resources needed to create and enforce contracts and by eliminating the need for elaborate safeguards and contingencies that require detailed monitoring (Post, Preston, and Sachs 2002a).

The resource-based view also supports the relationship between responsible stakeholder management and firm performance. Intangible assets such as a reputation for trustworthiness and efficient contracting increase the ability of a firm to acquire and develop valuable resources (Sussland 2001). These assets provide a source of sustainable competitive advantage for the firm because they appear to satisfy Barney's (1991) conditions of market value, uniqueness, nonsubstitutability, and inimitability (Post, Preston, and Sachs 2002). The market value of a strong reputation and the ability to acquire resources efficiently is evident. In addition, no two reputations are the same, nor can a firm substitute something else for its reputation or precisely copy the reputation of another firm. However, the advantages accruing to the firm through efficient resource acquisition are not as clear-cut. Competing firms may be able to use other means such as technology to enhance their own processes, in essence substituting technology for strong relationships to achieve a similar level of efficiency in resource acquisition. To the extent that the technologies they employ are easy to imitate, whereas strong relationships with stakeholders are not, it is still arguable that relationships provide a more sustainable source of advantage. Consequently, if a firm has a greater capacity to acquire valuable resources due to its reputation and the strength of its stakeholder network, then it should have a greater capacity to develop a competitive advantage, leading to higher financial performance (Barringer and Harrison 2000; Lorca and Garcia-Diez 2004; Ruf, Muralidhar, Brown, Janney, and Paul 2001).

Along these lines, Bosse, Phillips, and Harrison (2009) challenged the widely held assumption in strategic management theory that economic actors are exclusively self-interested utility maximizers. Instead, they drew on research from numerous disciplines to argue that people tend to assess fairness in their interactions with others and reciprocate by rewarding those they deem fair. They used this assumption of "bounded self interest" to explain why firms that exhibit patterns of distributional, procedural, and interactional justice are likely to have higher financial performance. Bosse, Phillips, and Harrison (2009) also developed a model that explains that stakeholders are more likely to reveal a nuanced understanding of their own utility functions to trustworthy firms that exhibit these types of justice. This knowledge can then be used by the firm to envision actions it can take to create value, thus enhancing firm performance. In other words, nuanced knowledge of stakeholder utility functions can unlock the potential for product and/or process innovation and the creation of new interorganizational relationships (Barringer and Harrison 2000).

The resource-based view would also suggest that firms with an ability to develop unique stakeholder-satisfying resources internally can also enjoy competitive advantages (Russo and Fouts 1997). Stakeholders make firm-specific investments that are essential to the competitiveness of the firm (Blair 1998; Wang, Barney, and Reuer 2003; Wheeler and Sillanpää 1998). To the extent that a firm can motivate its stakeholders to invest more in the firm, it can enhance its competitive strength.

The empirical evidence

A clear definition of stakeholder management is essential to understanding the empirical evidence that does or does not provide support for the idea that managing for stakeholders is related to financial performance. As one would expect, there are multiple interpretations of stakeholder management in the empirical literature. For the purposes of this section, we shall take our starting definition from what is probably the first effort to validate empirically the basic concepts found in Freeman (1984). Preston and Sapienza defined stakeholder management as "the proposition that business corporations can and should serve the interests of multiple stakeholders" (Preston and Sapienza 1990: 361). They also identified a "related notion that corporate management involves the balancing of multiple (and at least partially conflicting) stakeholder interests" (362). They suggested that this notion was a key to organizational success and had not really been tested previously.

Preston and Sapienza used data collected by *Fortune* magazine, based on a survey of senior executives, directors, and analysts. These experts rate the ten largest companies in their own industries on a scale of 1 to 10 for eight attributes of reputation. The model that they developed and tested was based on variables they created from the data, which represented four stakeholder groups: shareholders, employees, customers, and the community. As expected, Preston and Sapienza (1990) found positive correlations between ten-year rates of return and each of the other stakeholder variables, as well as among the stakeholder variables themselves. They also found that pursuit of the interests of shareholders, employees, and customers was positively related to sales growth. They concluded that their results offered evidence in support of stakeholder management.

Two other studies published around the same time made use of *Fortune*'s reputation system and substantiated the results of Preston and Sapienza. Riahi-Belkaoui (1991) argued that organizational effectiveness and social performance are conceptually similar. He measured organizational effectiveness using a combined scale that included all eight of the factors that *Fortune*'s reputation survey measures. He also tested a model that used only the social performance part of the reputation index. His conclusions were the same for both models. He found that both organizational effectiveness and social performance were positively related to size and profitability and negatively related to risk, measured as the beta of the stock. Fombrun and Shanley (1990) also provided strong evidence in support of the idea that the eight different dimensions of *Fortune*'s survey are highly related. They used factor analysis and extracted a single factor with an eigenvalue of 6.68 that accounted for 84 percent of the variance. They concluded that the eight attributes were components of a single factor of reputation.

The *Fortune* data have been criticized in the social responsibility literature because of the possibility of a "halo" effect (Fombrun and Shanley 1990; Brown and Perry 1995; Baucus 1995). The high correlation between the individual attribute representing social responsibility and the other attributes has been interpreted by some to mean that it is more a function of the overall perception of the firm than the socially desirable behavior of the firm (Fryxell and Wang 1994). However, this issue is not a problem for stakeholder theory as Freeman (1984) conceptualized it, because the theory specifically predicts that there will be a positive relationship between the variables. Another concern with the *Fortune* measures is that they are subjective in both their measurement and assessment criteria (Cochran and Wood 1984; McGuire, Sundgren, and Schneeweis 1988). However, Brown and Perry (1995) argued that their subjectivity may be a source of strength rather than weakness. Experts are more familiar with the specific situations of a firm and its industry. Consequently, they may be better able to adjust for those situations in their ratings, as opposed to a purely objective measure.

Several other empirical studies have added support for the idea that stakeholder management leads to higher levels of organizational performance. Greenley and Foxall (1997) surveyed top executives of British companies to test the idea that a multiple stakeholder managerial orientation would be positively associated with company performance. Specifically, they measured the importance of formal research for understanding the interests of each stakeholder group, the importance of manager understanding of stakeholder interests, the extent of planned strategies for addressing stakeholder interests, the extent of managerial discussions about each stakeholder group, and the relative importance of each stakeholder group in the corporate missions of their firms. They used cluster analysis to form groups based on their stakeholder orientations.

In tests carried out on the clusters, Greenley and Foxall (1997) discovered that the cluster of companies with the highest multiple stakeholder orientations had a larger proportion of high-performing firms and the smallest proportion of low performers for sales growth, market share, and new product success, but not return on investment. Furthermore, these differences were statistically significant when compared with the cluster containing firms that were low on the multiple stakeholder orientation dimension. Differences between the other clusters were not statistically significant. These results are not overwhelming, but the methods may have contributed to weak findings. Cluster analysis is probably better suited to descriptive research than the testing of hypotheses. Furthermore, examining proportions of high- and low-performing firms within the clusters reduces test precision by eliminating the continuous properties of the original performance data.

Kotter and Heskett (1992) found that the managers of a small number of highly performing companies tended to consider the interests of all major stakeholders in their important business decisions. Along these same lines, Mitchell, Agle, and Wood (1997) identified three attributes that give particular stakeholders salience in the eyes of managers: power, legitimacy, and urgency. A model was tested using the three salience attributes for five stakeholder groups: shareholders, employees, customers, government, and communities (Agle, Mitchell, and Sonnenfeld 1999). They also looked at resulting performance outcomes.

To measure salience, the research team asked CEOs to respond to statements based on their firm's interactions with each stakeholder during the previous month. They included measures of corporate performance along dimensions related to each of the stakeholders: industry-adjusted financial performance to represent shareholder interests, and a set of stakeholder measures based on data collected by Kinder, Lydenberg, Domini and Co. (KLD).[6] CEO values were assessed and used as a moderating variable, although this variable did not turn out to be important to the model. They found strong support for the hypothesis that the stakeholder attributes of power, legitimacy, and urgency were related to stakeholder salience, but little support for the link between salience and social or financial performance. The only exception was a significant positive relationship between community salience and community performance.

Over a decade earlier, Aupperle, Carroll, and Hatfield (1985) were similarly disappointed to find no relationship between social orientation and performance. This earlier citation is relevant because of methodological similarities between the studies in the way they collected social orientation data. Specifically, Aupperle et al. also carried out a survey of CEOs to determine their orientations towards a number of social issues. The social issues do not correspond exactly with the salience items of Agle et al. (1999); however, there are enough similarities to raise the issue of whether CEO orientation is really an accurate reflection of the stakeholder orientation of the whole firm. Other measures of stakeholder orientation are needed to sort out this situation, since the Aupperle et al. (1985) and Agle et al. (1999) results are inconsistent with Kotter and Heskett (1992) and with the rest of the empirical literature, which seems to indicate that firms that pay attention to a broad group of stakeholder interests have higher performance. For example, measures based on actual corporate behaviors would be a step in the right direction.

Ogden and Watson (1999) took advantage of the privatization of the water industry in the United Kingdom, using the event as a case study to determine whether water companies were able to balance competing interests. They used government information on levels of customer service as well as accounting and market performance data to study the issue. Their results indicated that

[6] Kinder, Lydenberg, Domini and Co. (KLD) conducts regular audits of the social performance of companies on the basis of several attributes. They include community relations, employee relations, environmental issues, product issues, treatment of women and minorities, military contracts, and involvement in nuclear power or other socially undesirable activities. KLD makes its ratings on the basis of consistent and objective screening criteria (Graves and Waddock 1994). They use publicly available information as well as follow up contacts with firms to establish the rankings. Beginning in the mid 1990s, much of the research on the relationship between stakeholder management and performance has made use of these measures. They also have widespread use in social responsibility research. Ultimately, these data rest on the separation fallacy. But this line of research is surely useful for particular purposes.

higher levels of customer service had a detrimental effect on accounting-based performance over the short term due to the costs involved. However, share prices increased as a result of improved customer service, an indication that investors could anticipate the longer-term economic consequences. Ogden and Watson (1999) concluded that the water companies were able to balance the interests of customers and shareholders, in spite of the associated short-term costs.

Berman, Wicks, Kotha, and Jones (1999) explored the validity of two different models of the relationship between firms' concern for stakeholders and their financial performance. The strategic stakeholder model suggests that firms address stakeholder concerns when they believe that doing so will enhance financial performance. On the other hand, intrinsic stakeholder commitment suggests that firms address stakeholder concerns because it is morally correct to do so. Furthermore, in the intrinsic model, this commitment should drive strategic decision making. Berman et al. used KLD data to measure stakeholder relationships with employees, customers (product safety/quality), special interests (diversity), society (natural environment), and the community. Return on assets was the dependent variable for performance. Four variables were used to reflect the business strategy of each firm: selling intensity, capital expenditures, efficiency, and capital intensity. These variables are indicative of whether a firm has more of a cost leadership or differentiation orientation. They also controlled for environmental variables (dynamism, munificence, and power). The initial sample was the top 100 firms listed on the *Fortune* 500 for 1996. Six years of data were collected for each firm. Missing data reduced the sample to eighty-one firms.

Berman et al. (1999) found that two of the five KLD variables – employees and product safety/quality – were significant predictors of financial performance in a direct test. However, in secondary tests, all five stakeholder variables moderated the relationship between strategy and performance. They concluded that the moderated regression result offered support for the strategic stakeholder management perspective. They also applied a mediation model to the data and found no support for the intrinsic stakeholder commitment view.

Berman and his colleagues were disappointed that not all five of the stakeholder variables were significant in their direct test. However, the environmental variable may not have worked out because the importance of environmental programs varies a lot by industry, which may have created error in their model. In addition, diversity, while important, may have had a negligible effect on overall firm performance. Of the three nonsignificant stakeholder variables, community is the hardest to understand in the stakeholder context. Nonetheless, the stakeholder variables representing employees and customers were significantly positive. Furthermore, the most important contribution of the study was probably the finding that stakeholder relationships serve as moderators between business strategy and performance.

Hillman and Keim (2001) decided to separate stakeholder management attributes from social issue attributes in the KLD data. They hypothesized that attending to employees, customers, the community, and suppliers would likely have a positive effect on shareholder value creation, while paying attention to social issues by avoiding investments in particular industries (e.g. alcohol, gambling, military weapons, nuclear power) or particular countries (e.g. Burma, Mexico), or providing very low compensation to top management would not influence shareholder value. Using market value-added (MVA) as the performance variable (market value minus invested capital), they found that stakeholder management was positively associated with value creation while social issue participation had a negative effect.

In this chapter we have deliberately avoided studies that focus only on social responsibility and performance, except as they have added clarity to our discussion. Social responsibility will be treated in depth in Chapter 8. Instead, our focus has been on models that incorporate multiple stakeholders and test the proposition that addressing a broad group of stakeholder interests simultaneously enhances financial performance. However, we would like to point out that much of the social responsibility literature is closely tied to the proposition (Ruf, Muralidhar, Brown, Janney, and Paul 2001). Few strategic management scholars would dispute the idea that firms must treat customers, suppliers, and employees well if they want to prosper. On the other hand, issues associated with social responsibility, such as community and the environment, lead to criticism of the stakeholder management approach. From this perspective, we would like to add that the social responsibility empirical literature is generally but not completely supportive of the idea that firms that are strong in social performance are also high performers (Orlitzky, Schmidt, and Rynes 2003; Orlitzky and Benjamin 2001). An interesting advancement in this literature came from Barnett (2007), who developed a compelling argument that the relationship between social and financial performance is not direct; rather, social performance influences the nature of stakeholder relationships, which, in turn, influences financial performance. He uses this argument to explain why empirical results regarding social performance and financial performance can be inconsistent.

In addition to the social performance studies, we should acknowledge some recent work from marketing scholars that provides fairly convincing evidence that stakeholder management is associated with higher firm performance (Sisodia, Wolfe, and Sheth 2007). Their work is reviewed in Chapter 5.

In conclusion, some fairly strong theoretical and empirical support exists for the notion that business organizations "can and should serve the interests of multiple stakeholders" (Preston and Sapienza 1990: 361), and that such service is associated with higher financial performance. The empirical literature on social responsibility and performance adds support to this notion. However, there is also evidence that measuring the salience given by top management to particular stakeholder groups may not be the best way to capture the phenomenon (Agle et al. 1999). Instead, the phenomenon is best measured through actual corporate behaviors such as strategies for addressing the interests of stakeholders (Greenley and Foxall 1997). As a final caveat, there is some evidence that CEOs of the largest corporations may not receive higher financial rewards for satisfying the needs of a broad group of stakeholders (Coombs and Gilley 2005). However, this issue requires further study.

The influence of stakeholder theory on the strategic management process

Many of the early stakeholder theorists provided stakeholder-based strategic management tools. Freeman's (1984) model of the strategic management process began with evaluation of stakeholders, continued with a set of tools for managing stakeholders to facilitate the accomplishment of organizational objectives, and ended with measuring stakeholder satisfaction with organizational outcomes. Harrison and St. John (1994) provided further development of this approach by integrating stakeholder-based perspectives with a variety of other strategic perspectives, based on the theories of industrial organization economics, the resource-based view, cognitive theory, institutional theory, organization theory, transactions cost economics, and agency theory. They used the stakeholder approach as an overarching framework within which traditional approaches operated as strategic tools. According to Harrison and St. John, who used dozens of company examples in their book, it was not a difficult integration process:

> The process of integrating the traditional theory of strategic management with stakeholder analysis and management was as natural as applying Porter's Five Forces to the study of industry competition. Everything fits. In fact, we discovered

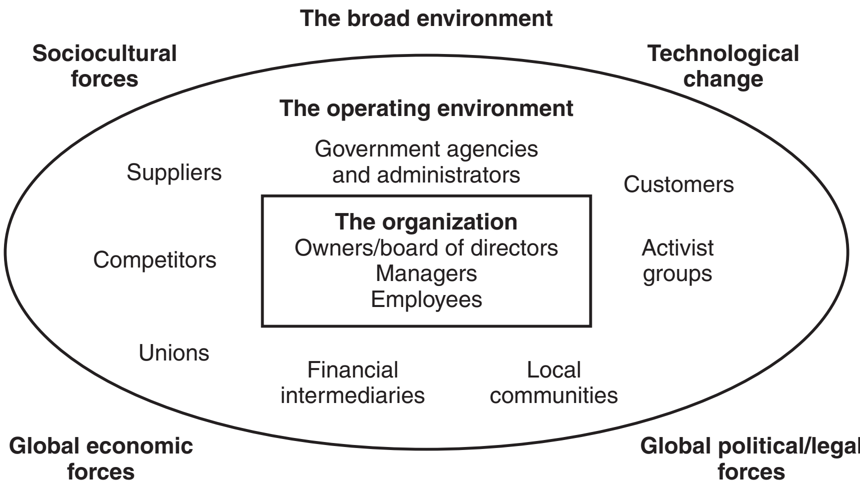

Figure 4.2. The organization and its primary stakeholders
Source: J. S. Harrison and C. H. St. John 1998. *Strategic Management of Organizations and Stakeholders: Concepts and Cases.* Cincinnati, OH: Southwestern College Publishing. 8.

that many of the best-run organizations have already integrated comprehensive stakeholder analysis and management processes into their organizational planning. (Harrison and St. John 1994: xiii)

Harrison and St. John (1994, 1998) divided the stakeholder environment into three regions (see Figure 4.2). The broad environment (society, technology, economy, and political/legal) forms the context in which the firm and its operating environment exist. The firm has little or no influence over components of the broad environment. The operating environment consists of external stakeholders that influence the firm and over which the firm has some influence. Finally, the internal organization is made up of stakeholders with formal ties to the firm. In Harrison and St. John's strategic management process model, the resource-based view is a tool to help managers determine how internal stakeholders may be used to create competitive advantage. Porter's (1985) five forces are integrated into an analysis of external stakeholders, and traditional economic approaches are used to analyze the remote environment (Harrison and St. John 1994, 1998). As might be expected, their chapter on strategic direction is infused with the stakeholder-friendly concepts associated with enterprise strategy, or the joining of ethics with strategy (Freeman and Gilbert 1988). Later, Post et al. (2002a) would refer to the three regions identified by Harrison and St. John as the social political arena, the industry structure, and the organizational resource base.

Harrison and St. John (1994) also applied organization theory and industrial organization economics to the task of prioritizing and managing stakeholders as a part of the strategic management process. They argued that priority should be given to external stakeholders based on their ability to influence the environmental uncertainty facing the firm and its managers, which is a function of their economic and political power, as well as strategic choice. Furthermore, they outlined the two basic postures for managing stakeholders: buffering and bridging (Daft 1992). Buffering is a low-interaction stakeholder management approach with the purpose of containing the effects of stakeholders on the firm. It involves monitoring activities such as market research, public relations, and planning. On the other hand, bridging is more appropriate for high-priority stakeholders because of their potential influence on uncertainty. Bridging includes the formation of longer-term interorganizational relationships such as joint ventures, alliances, and strategic partnerships (Barringer and Harrison 2000). This approach recognizes common goals, lowers organizational barriers, and builds on interdependencies among stakeholders.

The establishment of strategic direction, as evidenced by a firm's mission and vision statements, is probably the component of the strategic management process that is most closely linked to the stakeholder perspective (Copulsky 1991; Campbell and Yeung 1991; Klemm, Sanderson, and Luffman 1991). It would be hard to define a mission without including statements about how a firm treats several stakeholder groups. Even a firm that claims in its mission statement that its purpose is to maximize shareholder returns is, by default, suggesting that the claims of other stakeholders are not given as much weight. However, mission statements with a single shareholder focus are no longer fashionable. Firms typically include broad goals dealing with customers and employees, and may also discuss community, suppliers, other stakeholders, or the environment. One of the ways to envision a firm's broad purpose is through its enterprise strategy, which joins ethical and strategic thinking (Freeman and Gilbert 1988; Hosmer 1994; Schendel and Hofer 1979). Enterprise strategy provides the organization with the best possible reason for its existence by stating how the firm will satisfy the interests of a broad group of stakeholders.

Another development in the strategic management process related to the stakeholder perspective is scenario planning (Schoemaker 1993, 1995; Wack 1985; Huss 1988). Building from the well-understood idea that uncertainties in the environment make strategic planning difficult, Schoemaker (1995) proposed that developing scenarios based on basic trends and uncertainties can help decision makers avoid "tunnel vision" and therefore reduce the number of poor decisions they make. Scenario planning is viewed as collective learning and therefore incorporates many stakeholder-based processes. For example, early in the process the key stakeholders and their positions are identified. Later in the process their positions are used as a tool to determine consistency in and plausibility of the scenarios. Potential stakeholder reactions to the actions of the firm are also forecast. More recently, Strand (2008) proposed that firms develop what he called a "stakeholder dashboard" to track stakeholder perceptions about the firm as a way to enhance firm decisions.

Finally, the processes associated with the generation of strategic alternatives have benefited greatly from the stakeholder perspective. Nutt (2004) suggested that strategic decision makers can expand the number of alternatives they consider, thus reducing their rush to judgment, by identifying key stakeholders and examining their concerns and claims. Hart and Sharma argued that even fringe stakeholders can be used to increase the number of strategic options available to the firm. They proposed a concept referred to as radical transactiveness to help organizations deal with the volatile business environment:

> Moreover, the knowledge needed to generate competitive imagination and to manage disruptive change increasingly lies outside the organization, at the periphery of firms' established stakeholder networks. Unfortunately, most companies still tend to focus management attention only on known, salient, or powerful actors to protect their advantages in existing businesses. In recognition of these challenges, we develop the concept of Radical Transactiveness (RT). RT is a dynamic capability which seeks to systematically identify, explore, and integrate the views of stakeholders on the "fringe" – the poor, weak, isolated, non-legitimate, and even non-human – for the express purpose of managing disruptive change and building imagination about future competitive business models. (Hart and Sharma 2004: 7)

Related to these process issues, some strategists have engaged in a discussion about "nonmarket" strategies as a source of competitive advantage (Baron 1995; Shaffer, Quasney, and Grimm 2000; Jones and Kunz 2005). These strategies encompass how a firm deals with government, interest groups, activists, and the public. In reality, nonmarket strategies are just strategies for dealing with corporate social responsibility, which has its own literature (reviewed elsewhere in this volume). One possible advantage of the different label could be that it will increase the interest of some strategic management scholars and practitioners. However, the exclusive focus on nonmarket stakeholders could also solidify the incorrect impression that this is what stakeholder theory advocates. Of course, stakeholder theory is much more comprehensive in its scope, including both market and nonmarket stakeholders.

Stakeholder theory and the relational view

Dyer and Singh offer "a relational view of competitive advantage that focuses on dyad/network routines and processes as an important unit of analysis for understanding competitive advantage" (Dyer and Singh 1998: 661). In a footnote attached to that sentence they explain, "For the convenience of exposition, we use two firms, rather than multiple firms, as the unit of analysis." They argue that interorganizational competitive advantage comes from relationship-specific assets, knowledge sharing, effective governance, and complementary resources and capabilities. Lavie (2006), using the resource-based view as a guide, further develops this view by distinguishing shared from nonshared resources and examining how various firm-, relation-, and partner-specific factors determine the rents that may be extracted from collaborative relationships. He concludes that the nature of relationships is more important than the nature of the resources. In support of this idea, Hardy, Phillips, and Lawrence (2003) find that embeddedness and involvement facilitate knowledge transfer across networks.

Dyer and Singh provide evidence in support of their relational view (Dyer and Nobeoka 2000; Kale, Dyer, and Singh 2001; Dyer and Hatch 2004). However, there is a very real question regarding whether the view is unique or whether it is simply an application of stakeholder theory with a different set of labels. Some management scholars seem to believe that the stakeholder perspective is an extension of Dyer and Singh's work. For example, in Mattingly's review of Post et al. (2002a), he states:

> Fundamentally, the SHV (stakeholder view) is partly an extension of the relational view of the firm (Dyer and Singh 1998) to sociopolitical stakeholders – especially local communities and governmental and regulatory agencies, as well as private organizations such as citizen interest groups. The relational view suggests that the interfirm relationships a firm develops – particularly among participants in its supply chain – provide a potentially sustainable source of competitive advantage. (Mattingly 2004: 520)

In reality, although Dyer and Singh do not acknowledge it, this concept has always been at the heart of stakeholder theory. Many scholars have directly applied stakeholder theory to the study of interorganizational relationships in a similar fashion (e.g. Barringer and Harrison 2000; Kochan and Rubenstein

2000; Kanter 1994; Lorange, Roos, and Bronn 1992; Mills and Chen 1996). Also, the stakeholder perspective has always included customers and suppliers, the focal stakeholders in Dyer and Singh's article (1998). The development and increasing popularity of the relational view in the strategic management literature may be evidence that the field is reaching for stakeholder theory without even knowing it, believing instead that stakeholder theory deals largely with noneconomic stakeholders.

Stakeholder influence on firm strategies

From its inception, the stakeholder perspective has envisioned the firm and its stakeholders in two-way relationships. While much of the attention in the literature has been directed towards a firm's management of its stakeholders, some scholars have focused specifically on the influence stakeholders have on the firm and its strategies. Clearly, the influence of external stakeholders on a firm's strategies has increased dramatically in recent years (Scholes and Clutterbuck 1998; Sharma and Henriques 2005; Rodgers and Gago 2004; Wright and Ferris 1997).

Early stakeholder theorists such as Dill (1975) and Freeman and Reed (1983) examined the ability of stakeholders to influence the firm in terms of the nature of their stakes and the source of their power. Harrison and St. John (1996) added stakeholder influence on environmental uncertainty, which is partly a function of power. Mitchell, Agle, and Wood (1997) identified urgency, power, and legitimacy as factors that determine how much attention management will give to various stakeholders. Rowley (1997) further developed the idea that multiple stakeholders influence the firm simultaneously. Using social network analysis (Granovetter 1985; Wasserman and Glaskiewicz 1994) and institutional and resource dependence theories (Oliver 1991), he argued that the density of a firm's stakeholder network (number of ties among stakeholders) and the firm's network centrality influence its level of resistance to stakeholder demands.

Frooman (1999) uses resource dependence theory (Pfeffer and Salancik 1978) to identify four types of stakeholder influence strategies: withholding, usage, direct, and indirect. Withholding strategies give stakeholders influence only if their threat of withdrawal is credible. Usage strategies involve attaching conditions to supply contracts. Direct influence strategies are defined as those in which stakeholders directly manipulate the flow of resources, whereas indirect strategies involve influence on resource flows by third parties. Frooman also develops theory to predict which strategy stakeholders will use, based on the two-way dependence relationships that exist between the firm and its stakeholders. Along this same line of reasoning, Coff (1999) examines the extent to which stakeholders are able to extract economic rents from the firm. According to Coff, "bargaining power is highest when stakeholders (1) are capable of acting in a unified manner, (2) have access to key information, (3) have a very high replacement cost to the firm, and (4) face low costs if they move to another firm" (Coff 1999: 122).

Murillo-Luna, Garcés-Ayerbe, and Rivera-Torres (2008) added additional empirical evidence regarding the ability of stakeholders to influence firm decisions. Specifically, they analyzed the influence of stakeholders or "pressure agents" on the strategies adopted by 240 industrial firms as they responded to environmental requirements. They classified response patterns based on the level of proactivity of firms, as indicated by the scope of their environmental objectives and their allocation of internal resources. Their results demonstrated that stakeholders had an impact on which of four response patterns the firms adopted. A related study found that aspects of the general business environment moderated the relationship between the stakeholder integration capability of 134 service firms in the ski industry and their environmental strategies (Rueda-Manzanares, Aragón-Correa, and Sharma 2008).

Corporate governance from a stakeholder perspective

Interest in the topic of corporate governance has blossomed in recent years (Chatterjee and Harrison 2001), possibly due to the increasing number of large corporate scandals that have been plaguing the business community. Because of the vastness of the strategy literature on corporate governance, we shall pare down our discussion by focusing specifically on the intersection between governance and stakeholder theory, and shall leave the legal implications for Chapter 6.

From a strategic management perspective, corporate governance deals with the forces that influence how firms and their managers behave in the execution of their responsibilities. Some of these forces are completely external to the firm. For example, the market for corporate control, as manifested in attempted or completed takeovers, is considered a governance mechanism. From this perspective, incumbent managers of poorly performing public corporations are motivated by a potential takeover to improve the performance of their firms, because they fear that after the acquisition they will lose their jobs (Chatterjee, Harrison, and Bergh 2003; Denis, Denis, and Sarin 1997). Large block stockholders, bond rating agencies, and even government regulators are other examples of external governance forces.

Governance may also be internally derived, as in a board of directors. Although board members also provide resources and advice, most scholars believe that the most important function of board members is to monitor top managers to make sure that they are acting responsibly with respect to the interests of the stockholders who elected them. Managers are perceived as agents for the shareholders, and agency problems exist to the extent that they act in their own interests rather than the interests of the shareholders (Jensen and Meckling 1976; Williamson 1984a; Fama and Jensen 1983; Vilanova 2007). When these situations become extreme, the governance system is examined to determine why the inappropriate behavior was not corrected.

Governance gains much of its importance through the separation of ownership from control in modern corporations, where individual shareholders typically have little influence over the decisions of managers (Berle and Means 1932). Close scrutiny of managers would be costly for the shareholders relative to the size of their investments in the firm. Consequently, they are compelled in most cases to trust that the directors will ensure that agency problems are not serious. Williamson (1985) argues that shareholders occupy a unique position with managers because their entire investment is at risk, they have no formal contracts that offer protection or safeguards, as do suppliers or creditors, and their contracts do not come up for renewal so that they do not have the opportunity to renegotiate terms.

Hill and Jones argue that nonshareholder stakeholders also deserve representation by managers:

> Whatever the magnitude of their stake, each stakeholder is a part of the nexus of implicit and explicit contracts that constitutes the firm. However, as a group, managers are unique in this respect because of their position at the centre of the nexus of contracts. Managers are the only group of stakeholders who enter into a contractual relationship with all other stakeholders. Managers are also the only group of stakeholders with *direct* control over the decision-making apparatus of the firm (although some stakeholders, and particularly the suppliers of capital, have indirect control). Therefore it is incumbent upon managers to make strategic decisions and allocate resources in the manner most consistent with the claims of the other stakeholder groups. (Hill and Jones 1992: 134)

Hill and Jones (1992) base this argument on the idea that a power differential exists between the firm and its stakeholders. Agency theory is based on the assumption that efficient markets adjust rapidly when conditions change (Barney and Ouchi 1986). If actors in a firm's nexus of contracts can easily enter into or withdraw from contracts with the firm, then they are able to exit a relationship if they are not satisfied with the way they are treated. However, lack of other business opportunities for stakeholders, combined with sources of friction such as organizational inertia and entry and exit barriers, make the market inefficient by reducing the ability of a stakeholder to exit a relationship. It is interesting to note that shareholders may actually be in the strongest position to exit from a relationship with the firm, since they have very low switching costs and many other favorable options for investment.

With regard to Williamson's (1985) concern that shareholder contracts never come up for renewal, it is arguable that their contracts come up for renewal on a daily basis and that shareholders renew their contracts each time they decide to retain their shares.[7] They also have voting rights not enjoyed by other stakeholders (Boatright 1994). In addition, Marens and Wicks (1999) argue that the fiduciary duties owed to shareholders do not prevent managers from being sensitive to and generous with other stakeholders. They point out that managers have a wide range of legal responsibilities to other stakeholder groups. Consequently, both legal and intellectual arguments support the idea that managers should care for the needs of all of their stakeholders. Along these lines, Lubatkin (2007) developed a revised framework for corporate governance that includes all an organization's stakeholders.

Boards that consist largely of independent (nonemployee) directors are expected to be better monitors of executive actions (Bainbridge 1993; Baysinger and Butler 1985). In stakeholder terms, these directors could be external stakeholders. In theory, independence should lead managers to be more responsible as agents for the firm, which should lead to higher firm performance. However, Dalton, Daily, Ellstrand, and Johnson (1998), in a meta-analysis, found little evidence to support this relationship. On the other hand, there is some evidence that governance characteristics such as board independence matter more in time of organizational stress than during good times (Chatterjee and Harrison 2001; Daily 1996; Daily and Dalton 1994, 1995).

The other, less studied, function of a board of directors is to provide the firm with resources such as links to other organizations, advice, and legitimacy (Hillman and Dalziel 2003; Chatterjee and Harrison 2001; Pfeffer and Salancik 1978). For this function, stakeholder theory would advocate appointing external stakeholders to the board. Research evidence supports this proposition. For example, appointing representatives from financial institutions can facilitate capital acquisition (Johnson, Daily, and Ellstrand 1996; Stearns

[7] See Chapter 1.

and Mizruchi 1993). Entrepreneurial firms have far fewer resources and may especially benefit from such appointments (Johnson, Daily, and Ellstrand 1996).

The influence of the stakeholder perspective on management practice

Given the practical orientation of the stakeholder approach to strategic management, it is no surprise that stakeholder terms and concepts have been embraced fairly broadly by practicing managers and management consultants. As developed societies around the world have become increasingly sensitive to issues such as corporate wrongdoing, environmentalism and sustainability, and the treatment of workers, the stakeholder perspective has gained popularity. In this regard, the social responsibility movement has been a two-edged sword. As we mentioned previously in this chapter, it may have distracted strategic management scholars away from a more comprehensive approach to the theory as they came to believe that the stakeholder theory was all about social responsibility. On the other hand, the popularity of the theory in the corporate world is at least partly a result of this belief, coupled with the reality that the application of stakeholder theory really does lead to better results from a societal perspective. Consequently, many business organizations throughout the world directly address the needs of multiple stakeholders during their strategic management processes. The publicly available artifacts of these processes are found on many websites as statements of "stakeholder goals" or "corporate sustainability principles" or "corporate purpose."

Stakeholder-themed books targeted at managers have also influenced business practitioners. While many practitioner books since Freeman (1984) have included stakeholder concepts and terminology, four are focused mainly on the stakeholder management approach to business. Freeman and Gilbert (1988) further developed the notion of an enterprise strategy as a statement of corporate purpose, seen through the lenses of multiple stakeholder groups. Nearly a decade later Wheeler and Sillanpää (1997) examined numerous case studies of successful businesses that embraced stakeholder-inclusive management as a central philosophy. Chief among the companies highlighted in their book is the Body Shop (UK). Both Wheeler and Sillanpää had been involved in a number of independently verified audits of the Body Shop's social and environmental performance. The book also includes a practical management system for both auditing and improving relationships with a variety of stakeholders. Post et al. (2002a) also use cases to drive home points about the importance of taking care of the needs of a broad group of stakeholders as a prerequisite for both business success and survival. They examine Cummins, Shell, and Motorola in some depth to demonstrate that firms can use their productive relationships with stakeholders to enhance wealth both by creating new opportunities and by avoiding, reducing, and controlling costs. Finally, Graham Kenny (2001) presents an entire management system around what he refers to as "strategic factors." Strategic factors are the things an organization has to get right in order to succeed with its key stakeholders. Managers look at the organization from the outside in. They ask how their stakeholders evaluate firm performance and what they look for from the firm. In Kenny's view, strategic factors provide a logical link between strategic planning and performance measurement.

These and other practitioner books have been accompanied by countless articles directed at managers both in the popular business press and in the practitioner-oriented academic literature in strategic management. In 1998, *Long Range Planning* devoted an entire issue to the "stakeholder corporation" (Clarke 1998). The *Harvard Business Review* has published articles dealing with how effective management of stakeholders and stakeholder networks can lead to the creation of value (Florida and Goodnight 2005; Ibarra and Hunter 2007). The *California Management Review* (e.g. Freeman and Reed 1983; Post, Preston, and Sachs 2002b) and the *MIT Sloan Management Review* (e.g. Atkinson, Waterhouse, and Wells 1997; Hall and Vredenburg 2005; Pirson and Malhotra 2008) have also published articles that contribute to the practitioner literature on stakeholder management.

Organizational interest in the principles of stakeholder management has prompted the consulting industry to provide guidance in how to develop, monitor, and manage relationships with a broad group of stakeholders. CoreRelation Consulting[8] focuses specifically on stakeholder strategy development and stakeholder engagement. They have developed what they call a "co-creative engagement model" that is network-focused as opposed to organization-centric (Svendsen and Laberge, 2006). As another example, Walker Information,[9] a research and consulting firm, has a vision that they "will continue to be recognized as the global authority in stakeholder measurement and management." Many other consulting firms have incorporated stakeholder concepts and tools into the services they provide. The point of this section is not to provide a comprehensive review of the influence of the stakeholder concept on business. Rather, we would like to reinforce the idea

[8] http://www.corerelation.com. [9] http://www.walkerinfo.com.

that the stakeholder approach to management has been found to be quite useful by real managers, regardless of the theoretical verdict.

Critical evaluation and future directions

From the inception of what we now call strategic management, scholars have been interested in stakeholder concepts. However, writers of the mainstream literature have tended to develop their own models and terminology to deal with the idea that organizations are at the center of a network of constituencies that require attention. In the early development of the field, we saw discussions of configurations of relationships, with stakeholders being called external contributors, resources, interest groups, or inputs. Environmental analysis included many stakeholder groups. Even Porter's (1985) five forces model, from a stakeholder perspective, is an evaluation of the power of three critical stakeholders: customers, suppliers, and competitors. Most recently, the relational approach has emerged (Dyer and Singh 1998). With some very notable and important exceptions, the strategic management discipline has tended to view stakeholder theory as the domain of business ethics and social responsibility, and efforts to apply stakeholder theory to strategic management have been undercut by the widely held belief that there is a conflict between serving shareholders and serving a broad group of stakeholders (Argenti 1997), as well as a misconception that stakeholder theory advocates equal treatment of all stakeholders (Gioia 1999).

What is most interesting in this debate is that the field of strategic management now seems to be moving towards stakeholder theory in a more deliberate way, possibly out of necessity. Corporate scandals have created more interest in the problem of the ethics of capitalism and "ethical management processes." Also, the sheer complexity and volatility of the business environment – what we have called the problem of value creation and trade – calls for newer and more comprehensive models (Lowendahl and Revang 1998; Hitt, Keats, and DeMarie 1998). External stakeholders have become much more proactive in exerting pressure on organizations, and scholars are struggling to find ways to incorporate these multiple influences into their theories and planning models. Of course, it is also obvious that companies are not likely to survive unless they deliver value to a fairly broad group of stakeholders (Campbell 1997). Finally, stakeholder management concepts have found their way into the planning processes of many, or perhaps the most highly visible, business organizations in the USA and many other countries. In spite of all this, stakeholder theory still seems to have to prove its economic efficiency in the minds of many strategy theorists before it will be perceived as a completely viable set of ideas.

This chapter has provided substantial evidence in support of the concept that serving the needs of a broad group of stakeholders can and does enhance economic performance. Several forces are moving the field towards stakeholder theory and an important part of this process will be the direct integration of stakeholder theory into other mainstream theories. The highly popular resource-based view of the firm holds particular promise in this regard.

While resource-based theory has been pervasive in its influence on strategic management and other disciplines, it has been criticized for not providing much guidance with regard to *how* firms should manage resources to achieve competitive advantage (Priem and Butler 2001). Another limitation of resource-based theory is that it does little to help researchers understand how resulting economic rents are or should be distributed once they are created (Barney and Arikan 2001: 175). Stakeholder theory can help to enhance resource-based thinking by addressing these limitations. It provides a reasoned perspective of how firms should manage their stakeholders to facilitate the development of competitive resources. The stakeholder perspective also explains how a firm's stakeholder network can itself be a source of sustainable competitive advantage (Harrison, Bosse, and Phillips 2009). In addition, stakeholder-based reasoning provides a practical motivation for firms to act responsibly with regard to stakeholder interests, including fair distribution of economic rents (Harrison, Bosse, and Phillips 2009). Specifically, fair treatment and reasonable compensation of stakeholders helps to ensure their continued cooperation. Compensation is viewed as a multidimensional construct that includes economic rents as well as accommodating behavior (i.e. behavior that is desirable from the perspective of specific stakeholders).

The resource-based and stakeholder views are complementary rather than competing. The resource-based view envisions firms as bundles of resources, while the stakeholder perspective views firms as networks of stakeholders. In reality, firm competitiveness requires effective management of both organizational resources and stakeholder relationships. Furthermore, a firm is dependent on its stakeholder network for most of the resources it acquires. Consequently, resource dependence theory (Pfeffer and Salancik 1978) provides a natural bridge between the two theories. Basically, the resource-based view *needs* stakeholder theory to be complete. Furthermore, because the resource-based view has economic performance as its dependent variable, integrating the two theories will enhance the position of stakeholder theory in the minds of many scholars.

Also important to advancing the economic expediency of the stakeholder approach will be the application of longer-term methods. Current evidence comes largely from case histories or cross-sectional studies. Even if the studies include multiple years of data, the relationships are tested such that each year is an observation, with multiple years representing multiple observations within the same companies. For example, a study may include a measure of community responsiveness, with a corresponding economic variable for each year. The assumption is that community responsiveness will have an immediate positive effect on performance. At most, researchers may apply a lag of a year or two, forward or backward, in their tests. However, effective stakeholder management may take years to pay off in economic terms.

There is also a need in the field to develop better models for managing stakeholder relationships. Stakeholder management means that organizations serve a broad range of stakeholders, but does not specify what is meant by this service. We have suggested in Chapter 1 that trying to create as much value as possible without resorting to trade-offs is a starting point. However, we need more fine-grained conceptual models of this idea. Bosse, Phillips, and Harrison (2009) moved in this direction by defining stakeholder treatment in terms of distributive, procedural, and interactional justice. Also, Jones, Felps, and Bigley (2007) developed a scheme for classifying firm cultures based on how they treat stakeholders. They explain that the cultures lie on a continuum from individually self-interested (agency culture) at one end to other-regarding (altruist culture) at the other.

Competitors present a point of confusion for strategists interested in stakeholder theory. Most models of the stakeholder perspective envision competitors alongside other types of stakeholder (e.g. Freeman 1984; Harrison and St. John 1994, 1998). A more useful conceptualization would have competing networks of stakeholders, where one competitor's network is in competition with the others (see Figure 4.3). This conceptualization also addresses the economic efficiency issue, since the economic performance of competing networks of stakeholders could be directly compared. Of course, competitors can still play other roles, such as supplier, customer, or joint venture partner, but working out these multiplicities would just enrich the competitive models. For example, Lado, Boyd, and Hanlon (1997) have conceptualized competition and cooperation as interrelated dimensions and developed a typology of rent-seeking strategic behaviors.

The notion of sustainability also seems to hold the potential to engage more strategists in stakeholder-based thinking. Sustainability is a multidimensional construct that involves all of the key stakeholders, as well as the environment and society at large.

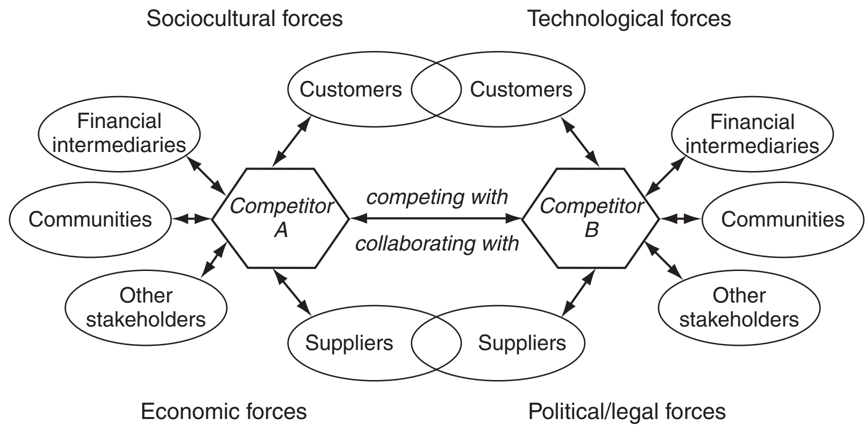

Figure 4.3. Competing stakeholder networks
Note: The overlapping ovals are an indication that competitors are likely to share some of the same customers and suppliers. We acknowledge that overlaps may also occur with other types of stakeholders as well.

According to Stead and Stead,

> The economic dimension of sustainability also involves the need to create for posterity an ecologically balanced and socially just economic system that provides humans with the goods, services, economic justice, and meaningful employment necessary for a high quality of life … the rapid entropy associated with high economic growth rates is not sustainable over the long run. (Stead and Stead 2004: 22)

Sustainability has already received a considerable amount of attention in the strategic management literature (e.g. Boutilier 2007; Frost and Mensik 1991; Bansal 2005; Sharma and Henriques 2005; Kolk and Pinkse 2007). Buysse and Verbeke (2003) directly integrated environmental strategy with stakeholder management in an empirical test. Based on a sample of 197 firms operating in Belgium, they found that more proactive environmental strategies are associated with a deeper and broader coverage of stakeholders. Nevertheless, the sustainability literature also carries the risk of further reinforcing the idea that stakeholder theory deals only with social responsibility. In this regard, the one important difference between the social responsibility and sustainability literatures seems to be that sustainability puts more emphasis on the economic dimension of firm performance as an essential element of the theory. Perhaps, then, the sustainability literature is not as risky as was the social responsibility literature with regard to sidetracking stakeholder theory.

This chapter has emphasized the economic implications of stakeholder management because economic performance is the most important dependent variable in the strategic management literature. However, as Donaldson and Preston point out, "the notion that stakeholder management contributes to economic performance … is insufficient to stand alone as a basis for the stakeholder theory" (Donaldson and Preston 1995: 87). The alternative approach, an exclusive focus on shareholder interests, makes no sense from an instrumental perspective because the cooperation of a broad group of stakeholders is required in order to achieve high shareholder returns (Jensen 2001). In addition, such a perspective is morally untenable (Donaldson and Preston 1995). Stakeholder theory is in a strong position relative to other strategic management theories, because it deliberately addresses ethics and values (Phillips, Freeman, and Wicks 2003).

An obvious solution to the field's obsession with purely economic performance measures is to build a strong case for measuring performance along multiple stakeholder dimensions simultaneously, or maximizing total value creation in the system (Atkinson, Waterhouse, and Wells, 1997; Chakravarthy 1986; Freeman 1984; Greenhalgh 2001; Vincent 1988; Cameron 1980). For example, the study we mentioned previously, by Malekzadeh and Nahavandi (1987), looked at multiple stakeholder outcomes from corporate takeovers. Also, Mills and Chen (1996) measured joint venture outcomes across multiple stakeholder dimensions. Such an approach can be used in determining general corporate performance or it can be applied to other organizational changes such as implementation of particular strategies. The key is to use several measures simultaneously in the same study so that the strengths and weaknesses of the phenomenon, as well as any trade-offs, may be understood.

The case for including multiple stakeholder dimensions can be built on the basis of solving the problem of value creation and trade. From a realistic perspective, managers face simultaneous pressure from multiple stakeholders. It is also a better way to understand longer-term implications of firm actions, since ignoring or harming any of a firm's key stakeholders can lead to negative implications for the firm in the future. For example, a corporate restructuring that hurts trust between employees and management could lead to cost savings in the short term, but to serious problems with employee turnover and productivity in the future. As broadly-based performance measures are developed, it will be important to avoid the assumption that they are all treated equally (Phillips, Freeman, and Wicks 2003). Instead, evaluation of a firm based on multiple stakeholder dimensions might be accompanied by an analysis of their respective contributions, costs, and risks.

We began this journey through the stakeholder-based strategic management literature by suggesting that some strategic management scholars do not see stakeholder theory as central to the strategic management literature (Hitt 2005). We have demonstrated that some of the most common tenets of stakeholder theory have been a part of mainstream strategy literature since its inception, although sometimes disguised with other labels. Going forward, the theory is well poised to address some of the most important issues in strategic management. In fact, Ireland and Hitt suggest that ethical, stakeholder-based practices will be essential to strategic leadership in the future. They argue,

> An understanding of the interests of all legitimate stakeholders will come only through analysis of and sensitivity to cultural diversity. A strategic leader's commitment to serve stakeholders' legitimate claims will contribute to the establishment and continuation of an ethical organizational culture. (Ireland and Hitt 2005: 72)

9 Stakeholder theory and capitalism[1]

We live in the age of markets. While they have been around for thousands of years, we are just beginning to understand their power for organizing society and creating value. In the last two hundred years markets have unleashed a tremendous amount of innovation and progress in the West. The industrial revolution, the rise of consumerism, and the dawn of the global marketplace have each in their own way made life better for millions of people. Many of us now know comforts, skills, and technologies that our ancestors could only dream of.

Alongside these great strides forward are a set of deeply troubling issues. Capitalism, understood in the sense of "how markets work," has also notoriously increased the divide between rich and poor, both within and across nations. We have become blind to some of the consequences of our actions that are harmful to others, such as environmental degradation, dominance of less privileged groups, and the inequitable distribution of opportunities. The seeds from these deeply troubling issues are beginning to germinate. Global warming, global financial crises, and global terrorism threaten to destabilize our world. It is more imperative than ever to study carefully and understand the power of markets and capitalism, and begin the construction of a new narrative about how capitalism can be a force for good in the world.

We have suggested that we need a new story, a new narrative, about business, and the previous chapters can be thought of as an assessment or progress report on the construction of the new narrative that is unfolding. We have argued that if stakeholder theory comes to occupy a central place in the disciplines of business, we shall have a more useful account of business. We shall be able to address the problems of value creation and trade, the ethics of capitalism, and the mindsets of managers. If we put stakeholder theory at the

[1] Some of the ideas in this chapter have appeared earlier, in Freeman (2000), Freeman and Phillips (2002), and Freeman, Martin, and Parmar (2006). We are grateful to the editors and publishers for their permission to recast here some of the ideas in these papers.

center of our thinking about business we can avoid the mindless pursuit of gains for shareholders at the expense of other stakeholders, a pursuit which ultimately destroys both shareholder and stakeholder value. In this chapter we suggest that putting stakeholder theory at the center of our thinking about business leads to a new understanding of capitalism. We shall propose that what is emerging can be called by a variety of names: creative capitalism, responsible capitalism, conscious capitalism,[2] or, as we prefer, stakeholder capitalism. We shall outline the principles of stakeholder capitalism and describe how this view rejects problematic assumptions in the current narratives of capitalism.

Traditional narratives of capitalism rely on assuming that competition, limited resources, and a winner-takes-all mentality are fundamental to business and economic activity. These approaches leave little room for ethical analysis, take a simplistic view of human beings, and focus on value capture rather than value creation. In short, these assumptions are inadequate for understanding the twenty-first-century world, and they create the very problems that we have argued form the raison d'être of stakeholder theory. We shall begin the reframing of the narrative of capitalism around the concepts of stakeholder theory.[3] If we think about how a society can sustain a system of voluntary value creation and trade that creates value for multiple stakeholders, then capitalism can once more become a useful concept.

Our strategy is as follows. First, we present five contemporary narratives of capitalism and show that each privileges the rights of one group over the others. In addition, all five narratives share a common set of assumptions about markets and capitalism that we believe to be counterproductive. Our claim is that the great strides forward and the deeply concerning issues about markets and capitalism are connected to these assumptions. The majority of current conversations about capitalism are not about these fundamental assumptions but about designing the best enforcement mechanisms. We are told that institutions and legal structure can solve the troubling consequences that arise in a market. Are property rights enforced? Transaction costs reduced? Designing good rules for markets to work does help to foster good behavior on the part of market participants. Institutional structure and the

[2] This is the phrase preferred by many businesses surrounding entrepreneurs such as John Mackey of Whole Foods Market.

[3] We can only begin such a reframing here. There is much more to be said about all the issues that we raise in this chapter, and there is much more literature than we present here. Take this chapter as a promissory note on a more fully worked out version of stakeholder capitalism. We are most grateful to our colleague, Professor Kirsten Martin of Catholic University, who is our collaborator in thinking about stakeholder capitalism.

rules of the game do matter. We want to add that the way we talk about markets and the assumptions we make about value creation also play a role in creating the outcomes we want as well those we do not.

In the final section of this chapter we offer a new narrative of capitalism, based on the ideas from earlier chapters, one that builds in morality and ethics from the foundations, and acknowledges stakeholders as essential to value creation and trade, rather than trying to put the rights of one group beyond discussion. Stakeholder capitalism is one way to resolve some of the deep tensions within capitalism, and to better foster the powerful innovations that can help us all to live better.

The narratives of capitalism

In this section we examine five contemporary narratives of capitalism that dominate academic, political, and practitioner discourse and thinking. Each of these current narratives falls short in addressing the concerns of a broad set of stakeholders, and makes a series of assumptions that perpetuate many of the problems of capitalism.[4] The classic narratives of capitalism – labor, government, investor, managerial, and entrepreneurial – retell the story of value creation and trade from the perspective of one stakeholder, whose views become inseparable from and ultimately stand in for the larger story.

Labor capitalism

Since the revolutionary writings of Marx and Engels, the term capitalism has been tied to class division, specifically the self-aggrandizement of the capitalist at the expense of the proletariat. The division of society into capitalist and labor has always played a central role in Marxist writings, from examinations of the American Civil War to detailed investigations of pricing. Marxism, and its political derivatives socialism and communism, turn on the dialectic between the capitalists (or bourgeoisie) who own property and the means of production and the laborers (or proletariat) who own no property and are obligated to sell their labor to the bourgeoisie to gain subsistence (Marx and Engels 1847a, 1847b). For Marx and Engels, this labor market is inherently

[4] We fully acknowledge that our discussion does not represent a complete survey of thought on capitalism. We have chosen these views because they are most prevalent in modern discourse, and we are indebted to their authors for furthering our thinking and that of countless other academics on the subject.

fraught with tension, since the interests of the capitalist and the laborer are diametrically opposed. Within these competing interests, those of the laborer dominate Marx and Engels' view of capitalism. Engels points out in the *Principles of Communism*, which later became the foundation for the *Communist Manifesto*, that

> To say that "the worker has an interest in the rapid growth of capital" means only this: that the more speedily the worker augments the wealth of the capitalist, the larger will be the crumbs which fall to him, the greater will be the number of workers that can be called into existence, the more can the mass of slaves dependent upon capital be increased. (Marx and Engels 1847a)

Ethics and moral language are obscured when viewed through the Marxist lens. Noted Marx scholar David McLellan comments on the apparent paradox in his introduction to *Socialism and Morality*:

> Morality has been viewed by Marxists as a form of ideology reflective of class interests and of changing social patterns. Such a stance ruled out appeal to moral principles by Marxism, which was viewed as a science of society and therefore as indifferent to morality as was, say, the science of biology. On the other hand, the works of Marxists from Marx himself onwards have contained bitter condemnations of the injustices of capitalism, and have been shot through with moral terms such as "alienation" and "exploitation". (McLellan and Sayers 1990: 1)

The Marxist version of capitalism tells a story in which the opposing groups of labor and capital fight over the fixed resources of productive assets. Economic and business activity itself is amoral and the only inevitable solution is for labor to take control of those productive assets by force.

Government capitalism

Born the year Marx died, economist John Maynard Keynes was concerned with the vagaries of the labor market, specifically the stability in national unemployment rates. In his acclaimed *General Theory of Employment, Interest and Money* (Keynes 1936), Keynes traced the connections between unemployment, consumption, and investment (Stewart 1999). Keynes's revolutionary shift of economic thought from a micro view (pricing and cost mechanisms) to a macro view (national income and employment) has had tremendous policy implications for political economists and theoretical implications for business academics (Romano and Leiman 1970). To the requisite institutions of capitalism he added the idea that capitalism could and should be managed by government.

For Keynes the world was far too complex for individuals to bring about the necessary changes for a good society. Since Keynes believed that a government that heavily regulated economic affairs could achieve optimal levels of wealth and employment, we credit him with the creation of *government capitalism*, where the government and its rights dominate the needs of all other stakeholders in the narrative of capitalism.

Although Keynesian economics has become less popular in the post-cold war period (although experiencing a resurgence in 2008 and 2009 with the various debates on how to address the worldwide economic crisis), Keynes's deeper view of capitalism still holds strong among liberals and academics. It is explicit in Keynes's views that capitalism without interventions by the government would lead society astray from "ideal values." In fact, capitalism, according to Keynes, fosters a counterproductive love of money:

> The love of money as a possession – as distinguished from the love of money as a means to the enjoyments and realities of life – will be recognized for what it is, a somewhat disgusting morbidity, one of those semi-criminal, semi-pathological propensities which one hands over with a shudder to the specialists in mental disease. (Hoover 2003: 84)

The metaphor in this narrative is of a garden, that capitalism left to its own devices would produce chaos and unchecked dominance through a love of money. The government is seen as the gardener, who through his skill, knowledge, and wise management keeps the productive powers of capitalism under control, and creates a utopia by enacting policies that keep growth and weeds in balance.

Keynes's view of utopia and ideal values were heavily influenced by the moral philosopher G. E. Moore. Both viewed certain mental states as morally good in themselves. It was these states that Keynes hoped to foster in the American public through his economic policies. A closer look at these mental states shows "Keynes's belief in the rationality of ends and the homogeneity of values"; in short, for Keynes there was a finite moral answer, which he believed everyone should attain (Skidelsky 1995). Ethics in this view becomes about one person's interpretation of the good that is made to stand for everyone and thus becomes unattainable in a diverse and changing world. Furthermore, ethics is imposed by government through the amoral tool of economic policies – to regulate a system that is seen as actively leading society astray from the good.

Keynes's view of capitalism is conflicted – the system can do good, but this requires government intervention:

> I think that capitalism, wisely managed, can probably be made more efficient for attaining economic ends than any alternative system yet in sight, but that in itself it is

> in many ways extremely objectionable. Our problem is to work out a social organization which shall be as efficient as possible without offending our notions of a satisfactory way of life. (Romano and Leiman 1970: 119)

The concept of the welfare state is a descendant of Keynes's vision for capitalism. Today, many echo Keynes's distrust of capitalism and reassure their faith in the government to solve problems created by the market.

Investor capitalism

In direct opposition to many of Keynes's conclusions, Milton Friedman advocates a return to laissez-faire economic policies and a reliance on the market mechanisms to achieve "fair" distributions. Economic freedom – the ability to buy and sell without interference from the government – becomes central to Friedman's vision. It is important to note that Friedman believes in economic freedom for particular groups, namely shareholders. To facilitate this view, Friedman limits the role and rights of the government in his narrative about how capitalism should function. In Friedman's view, government's role should be relegated to eliminating monopolies, reforming the tax laws in favor of corporations, and maintaining law and order.

As Friedman shifts focus away from government and its regulation of capital, he focuses on a new dominant group: investors. In fact the whole of commercial business activity has one specific purpose: "to use its resources and engage in activities designed to increase its profits, so long as it stays within the rules of the game, which is to say, engages in free and open competition, without deception or fraud" (Friedman 1962: 133). This goal is the investor's goal, and it is assumed to be in competition with alternative stakeholders' goals. In Friedman's view shareholders who are better off will continue to invest in the market and produce better results for all. Friedman and those who give priority to the concerns of investors above and beyond the concerns of other stakeholders, subscribe to *investor capitalism*.

Friedman's writings suggest that he views the inner workings of capitalism as amoral. His analysis and description of capitalism is given in monetary terms and in the language of economics, a grammar that avoids "non-factual" value distinctions (Romano and Leiman 1970). Nevertheless, ethics and morality play a large role in justifying Friedman's claims about the importance of free enterprise and actions against a centrally mandated economy:

> The fundamental threat to freedom is power to coerce, be it in the hands of a monarch, a dictator, an oligarchy, or a momentary majority. The preservation of

freedom requires the elimination of such concentration of power to the fullest possible extent and the dispersal and distribution of whatever power cannot be eliminated. (Friedman 1962: 17)

Managerial capitalism

For scholars studying capitalism and the corporation, the owner of the private property is in control. Keynes, Marx, and Friedman all assume that the investor (or stockholder) is the owner of the means of production and has responsibility for and control over its use. Managerial capitalism, on the other hand, clearly differentiates the managers of the organization from the investors and other stakeholders. Berle and Means (1932) see traditional economic theory as inadequate in handling the newly differentiated roles between ownership and control of assets. To them we are now dealing with distinct functions: ownership on the one side, control on the other. This control tends to move further and further away from ownership and ultimately to lie in the hands of the management itself, a management capable of perpetuating its own position. These distinct functions of ownership and control now lie in the hands of opposing groups with competing interests.

Similarly, Marris (1964) positions managers as separate and distinct from all other stakeholders including investors. Managers, as those who both control and have responsibility for the corporation, are the dominant group of interest for this view of modern capitalism. This line of scholarship is continued through the literature on agency theory, where owners of corporations are seen as property holders of the organization and managers are the agents of those stockholders. Managers have a contractual or fiduciary duty to shareholder interests above and beyond any other relationship in managing the shareholder's property (the organization in this case). Continuing within this narrative, agency theory positions the managers' interests to be in competition with other stakeholders.

Managerial capitalism's view on business ethics is more complicated. As Berle and Means state, "Neither the claims of ownership nor those of control can stand against the paramount interests of the community" (Berle and Means 1932). While acknowledging the community interests as an important consideration for the functioning of the firm, the authors also believe it essential for the "control" (or management) of the corporation to develop into a purely neutral technocracy. As with Friedman, the process of business is considered amoral, with a reconciliation with morality or community interests required.

Marris continues by stating that directors or managers who pay attention to competing social interests to the detriment of profits may be popular. However, he also believes that managers have growth and productivity as primary goals and constraints for their actions. Marris's view of morality and motivation outlines the financial motivations of managers in their role as controllers of the corporation. Marris does, however, find the rules of the game to be open and flexible, giving managers the opportunity to pursue alternative goals to those which are financial.

Entrepreneurial capitalism

The entrepreneur is missing from many of the views of capitalism outlined above. Yet the entrepreneur becomes an important stakeholder to ignore, as she epitomizes the role of value creation in the capitalist system. Within modern theory, economists such as Schumpeter (1942), Kirzner (1979), and more recently Baumol (1990) emphasize the role of the entrepreneur within capitalism and epitomize what we are calling *entrepreneurial capitalism*. For these authors, the entrepreneur functions as the dominant player within the capitalist system, who shapes economic power (Kirzner 1985).

Schumpeter (1942) argues that the entrepreneur is part of the process of *creative destruction* – the destruction of the current market to introduce a new market. In doing so, Schumpeter posits the entrepreneur in opposition to the status quo interests of other stakeholders and in competition over resources. Others, within this same narrative, do not take such a view. Kirzner allows for the entrepreneur to be a part of *creative discovery* and focuses on a more positive vision of capitalism within the "Austrian" tradition of modern economic thought. Such a narrative of capitalism leaves open the possibility of a strong role for business ethics. However, such a role is not explicitly stated by these scholars.

Each author differentiates the entrepreneur and singles her out from capitalists, property owners, managers, and laborers. Entrepreneurs for these economists are decidedly different – and each has their own interpretation of that difference. Something that is common to all, however, is the importance of the role of the entrepreneur in the capitalist system as the agitator who leads all others away from the status quo.

The current financial crisis offers an interesting case study on these partial narratives. Many have suggested that it is investor capitalism which has led to the current set of problems. However, at the same time, it is these very "investors" who have lost so much of their wealth through the financial crisis.

It is tempting to combine the five narratives and say that things have gotten out of balance. Some commentators have suggested that labor has proportionately too much power in key industries such as automobiles, while others have suggested that we need more government controls on this investor capitalism. Still others have argued that we need a return to a more entrepreneurial economy to work our way out of the difficulties. And there is the age-old argument about managerial control. In today's crisis this argument is found in endless editorials about top management compensation and corporate governance effectiveness. We believe that these calls for trade-offs and balance miss the underlying issues.

Problems with the traditional narratives

All five narratives make a similar set of assumptions about markets and capitalism that we believe to be counterproductive. Each narrative assumes that market participants have a naïve version of self-interest (that one's self-interest is not connected to, or does not take into account, the self-interests of others), that morality is separate from (or even antithetical to) economic prosperity, and that competition for limited resources (value as a zero-sum game) is the dominant mode of prosperity. These assumptions yield several new aspects of the three problems that stakeholder theory tries to solve.

The problem of value creation and trade: competition

By pitting individuals against one another within the survival-of-the-fittest atmosphere, narrators of the traditional approach to capitalism foster the notion of competition as a *prerequisite* to capitalist society. Competition is necessary, it is argued, because of the many individuals fighting over the same resources. Other individuals are seen as a threat to survival rather than as potential partners for value creation, and capitalists are left with the problem of resolving competitor demands and threats. Capitalism is to be defined primarily by the assumption of scarcity. And value creation and trade are to be defined primarily, on this view, through the lens of competition.

This focus on competition rather than cooperation is mistaken on two counts. First, focusing on how to beat stakeholders and retain power in any relationship leaves out those many instances where collaboration is necessary in order to survive. For many entrepreneurial ventures, strong collaborational relationships are necessary to create sustainable organizations. According to

Sarasvathy (2001), entrepreneurs rely on noncompetitive stakeholder relationships to navigate the perils of extreme uncertainty and to bolster their legitimacy. Those creating markets for future goods and services (Shane and Venkataraman 2000) simply cannot ignore value-creating relationships as a means of creating a sustainable competitive advantage. While entrepreneurs are the lifeblood of capitalism, the traditional story of capitalism does not tell their story of collaboration and mutually beneficial relationships for survival. Using their imagination to create sustainable collaborative relationships can lead managers to be more effective even within highly competitive markets. Large gains in prosperity throughout history are associated more with mutually beneficial trade (which creates value) than with dominance (which tries to capture value).

The problem of value creation and trade: the dominant group

This competitive framing of capitalism leads to debates over who is the "dominant" group in a market – the ideas of competition tumble over to those intimately involved in the organization. The focus is on the conflicting needs and demands of labor, government, investors, and managers in the hope of resolving the "inherent" conflicts. As such, one group must dominate in order to win the conflict and thereby prioritize its demands. The ensuing relationships are "fraught with tension" (Freeman, Martin, and Parmar 2006).

The problem of the dominant group is that there must be one group whose rights trump the rights of others. The wishful thinking behind this view goes something like, "If only we were all to follow the right leading group and align our interests with theirs, the ills of capitalism would be solved, and we would become more prosperous."

For Keynes, the government's rights and responsibilities supersede all others. For Marx, the laborers' rights have been ignored for too long. Berle and Means' major contribution was in securing separate rights for management. Friedman's focus on investor rights diminished the role of all other stakeholders including government. After securing dominant rights, each narrative positions the organization in existence to serve the needs of the corresponding dominant group. Not only must the goals of the dominant group become the goal of the organization, but all organizational decisions must then take into account the rights of this dominant group.

These narratives do not simply ignore other stakeholders. Rather, each narrative presumes that by focusing on the interests and rights of their dominant group, all other stakeholders will benefit. Friedman is particularly pointed when he argues that in allowing investors to prosper, all others will benefit as a result. We see many benefits in meeting the needs of a dominant group in these narratives, including the following:

- The economy is prevented "from falling into a rut and precludes those who constitute the economy from falling into lethargy" (Baumol).
- Society is led towards ideal values (Keynes).
- All other stakeholders see better results (Friedman).
- Economic growth rises (Friedman, Schumpeter).
- Income is distributed fairly to other stakeholders (Berle and Means).
- Alternative, nonproductive interests are kept in balance (Marx, Berle and Means).

Though such a paternalistic treatment of stakeholders acknowledges the existence of stakeholders and their need to thrive, it subsumes stakeholders' interests to those of the dominant group. Each of these views improperly focuses on one group to the detriment of all others. We may encounter specific instances where the needs of one group – for example the investor – trumps those of others. However, entering every decision-making situation with this type of a priori prioritization leads academics and practitioners to make decisions that can hurt the long-term value creation of the company. In practice, placing stakeholders in opposition to one another leads to a focus on winning and losing as opposed to working together. Situations are analyzed with an either/or mentality, since the requirements of the different groups are assumed to be in opposition.

The problem of the ethics of capitalism

In Chapter 1 we suggested that stakeholder theory has emerged to solve, in part, the problem of the ethics of capitalism. We see this even more clearly in the current narrative of capitalism, where individuals are in a constant survival mode with value being "distributed" rather than "created." Ethics is assumed to have a limited (and even detrimental) role in capitalism. We are faced with a continual "ethics crisis" as we have mistakenly taught managers that business within capitalism is by its very nature amoral.[5] Individuals are in competition with others for limited resources and societal rules are assumed to be of limited value. The traditional models of capitalism

[5] In our relatively brief careers we can remember the calls for corporate social responsibility in the late 1960s and early 1970s; the associated scandals such as Lockheed, Firestone 500, and others; the insider trading scandals of the 1980s; the excesses of the Internet boom of the 1990s; the Enron, WorldCom, Adelphia, Parmalat, second Firestone tire scandal, and so on; and, now, the current financial scandals.

needlessly separate it from ethics by making the foundations of capitalism competition and autonomy.

The problem of the ethics of capitalism is that ethics is left out of the story of capitalism, just as in Chapter 1 we suggested that it was left out of our understanding of business. Rather than acknowledging the moral dimensions of every decision – whether in business or not – academics and practitioners have created a separate sphere of norms, rules, and morals, naming it “capitalism,” where competition and winning dictate the rules of the game.

Ironically, the arguments against acknowledging values or morality within a survival of the fittest narrative of capitalism ignores the fact that moral concepts such as relationships, mutually beneficial agreements, teams, trust, honesty, and care are necessary in those instances when the survival of the individual, group, or organization is at stake. As Daniel Dennett (1995) illustrates, evolutionary theory or jungle metaphors do not negate ethics and morality in themselves. Mutually beneficial agreements (versus opportunism), group focus (versus individualism), and empathy (versus narcissism) foster surviving and thriving. This approach guides managers to ignore the ethical implications of their decisions. It does not, however, make their decisions amoral; rather, it causes managers to “do ethics badly” (Wicks and Freeman 1998). Business ethicists are left to add ethics back into the story of capitalism, but, as we argued in Chapters 3 and 7, they often do so at their own peril of accepting the dominant narratives about business.

The problems of value creation and trade and the ethics of capitalism: business in a liberal democracy

When we fail to address adequately the problems we have outlined, we also generate the corresponding role for government to fix them. This creates the issue of the proper role of business in a liberal democracy. It usually results in creating larger, more intrusive government in a system that is founded on a liberal democracy.

The state has three primary roles in relation to the problems created above. First, the government *resolves conflicts* between stakeholders. With winners, losers, and limited resources (the problem of competition) comes the role of the referee to resolve those conflicts. Rather than allowing organizations and individuals to create their own relationships, the state becomes the place where conflict is resolved, because individuals “cannot be trusted to find solutions that will benefit society.”

Second, the state *legislates the morality* of capitalism. If capitalism is seen as amoral, then it necessitates the legislation of morality for business, organizations, and individuals. This is most commonly seen through the legal system, where the boundaries of propriety are laid out, clear as night and day. It is assumed that individuals and organizations are allowed to move freely and with moral norms within the bounds set by legislators.

Third, the state *redistributes resources*. When one group is assumed to dominate all others in the acquisition of resources, the government is called upon to redistribute those resources when they become too unbalanced. One group is assumed to be constantly taking from all others, and the government exists to protect these disadvantaged groups and redistribute the resources through a tax code.

Ironically, these roles for the state are self-perpetuating. As government fulfills its role, the consequence is a continuation of a problem rather than a solution. If we set up rules governing the morality of individuals and organizations, we absolve those agents of their responsibility to conduct business according to community norms. That is now the government's job. Individuals and organizations in a capitalist society are expected to behave poorly and without a personal value-system as long as they stay within the moral code as legislated – Keynes noted that capitalism without government intervention would lead society astray from ideal values. As Berle and Means state, the role of the organization is "balancing a variety of claims by various groups in the community and assigning to each a portion of the income stream on the basis of public policy rather than private cupidity" (Berle and Means 1932: 313). But, as Ghoshal has suggested, we act out our theories of how the world works. So we actually find capitalists who justify or at least excuse their actions by asserting that "in the end the market will correct unethical behavior."

If we rely on the state to redistribute wealth, we find that it will inevitably make mistakes and create a further need to reredistribute wealth. Milton Friedman, the Nobel laureate in economics, warns, "In fiscal policy as in monetary policy, all political considerations aside, we simply do not know enough to be able to use deliberate changes in taxation or expenditures as a sensitive stabilizing mechanism. In the process of trying to do so, we almost surely make matters worse" (Friedman, quoted in Romano and Leiman 1970: 58).

If we rely on the state to resolve stakeholder conflicts, individuals and organizations would never develop the imagination required to create different, mutually beneficial relationships. In addition, the parties are not expected to learn how to resolve issues themselves when the court system was created for such a purpose.

Further, individuals and organizations game and manipulate the legislative system to their advantage. As evidenced by the proliferation of civil court cases, the lobbying for favorable legislation, and industry writing its own regulations (later enforced by the state), businesses have not allowed government to be the dictator of capitalism. However, the involvement of business with government also enlarges and perpetuates the role of government. Collusion and civil lawsuits become strategic tools.

This view of government omits a role for the state as a part of value creation. Rather than solving disputes and reallocating resources, the state could be a player in the capitalist system in knocking down barriers to value creation and trade. However, as it stands, government is too busy solving problems that need not exist.

Stakeholder capitalism

We wish to sketch a new vision of capitalism – stakeholder capitalism – founded on libertarian and pragmatist lines. Stakeholder capitalism is not based solely on private property, self-interest, competition, and free markets – such a view requires constant justification based on achieving good outcomes or avoiding authoritarian alternatives.

We argue that we do not need to justify capitalistic systems based on the outcome or the alternatives – the principles of capitalism are worthy goals in and of themselves. Rather, stakeholder capitalism is "based on freedom, rights, and the creation by consent of positive obligations."

First, adults have *freedom* to do what they want, including making voluntary agreements that are sustainable over time. Rather than focusing on individuals in competition over limited resources as in traditional narratives of capitalism, stakeholder capitalism focuses on individuals voluntarily working together to create sustainable relationships in the pursuit of value creation.

Second, individuals have *rights* protecting them in those agreements. One group's rights do not prima facie dominate the narrative of capitalism. Rather, each stakeholder should be protected within their voluntary agreements.

Finally, those individuals can decide to cooperate and *obligate themselves* to others through those voluntary agreements. These obligations can take the form of formal written contracts or social contracts with assumed responsibilities. The relationships are sustainable when these obligations and responsibilities are upheld.

With freedom comes responsibility. Indeed, we believe that most people are responsible for themselves. Equal liberty for all makes no sense if one person may do whatever she likes to another. The libertarian must assume that people are capable of controlling their actions so that they do not harm others. Second, when such boundary crossings or harms occur, the offending party must make some attempt at reparation. The alternative to this strong notion of individual responsibility is to make some collective, such as the state, responsible for repairing any damage that is done; but the whole point of the minimal state is that such "collective responsibility" carries severe "freedom denying" penalties. So, libertarians do or ought to accept some variant responsibility as inextricable from liberty.[6]

We offer six principles that together build a framework for our value creation and trade that infuses ethics at the foundations, respects the complexity of human beings, fosters innovation, and can help us move beyond the problems outlined above. These principles are not offered in any kind of foundationalist sense, given our philosophical commitments, but as guides to the way in which many people who engage in business and value creation can, should, and do think about capitalism. Our argument is that if people on the ground make sense of their activities and their system of value creation in this way, they will act in ways that will make our capitalism more responsible and more resilient.

Principles of stakeholder capitalism

1. The principle of stakeholder cooperation

"Value can be created, traded, and sustained because stakeholders can jointly satisfy their needs and desires by making voluntary agreements with each other that for the most part are kept."

Rather than assume that we are all first and foremost self-interested and out to maximize our own benefit, this principle highlights the social nature of value creation. Value is not "discovered" lying around in the market, but created through shared assumptions and beliefs in a community. Value, any value, is a social phenomenon. We must create value in a context, with the help of others and with others who value what we create. This principle

[6] We might call this kind of libertarian ethics "responsible libertarianism." We are grateful to John Mackey and Michael Strong for inspiring this label, though they may not approve of it.

acknowledges that business activity is explicitly social and uses that to enhance the process of value creation. Foregrounding the social nature of business gives us insight into the problem of value creation and trade, because it puts the focus on human relationships and the shared sense making that creates value.

2. The principle of stakeholder engagement

"To successfully create, trade, and sustain value, a business must engage its stakeholders. Almost every business transaction involves customers, suppliers, communities, employees, and financiers. Other stakeholders such as media, additional civil society representatives, NGOs, and so on are often affected or can affect value creation."

Rather than argue over whose rights trump whose, this principle acknowledges that a large cast of stakeholders is necessary to sustain value creation. As often as possible, the needs of multiple stakeholders must be met. There may be specific situations in which privileging the rights of one group can benefit others in the long term, but this is not clear prima facie, and must be decided upon by the effected parties. Recognizing the role of a multitude of stakeholders in the value-creation process diminishes the problem of the dominant group. Instead of trying to find and create arguments for one group's right to trump the rest, engaging stakeholders in creating as many win–win situations as possible lies at the heart of creating sustainable value.

3. The principle of stakeholder responsibility

"Value can be created, traded, and sustained because parties to an agreement are willing to accept responsibility for the consequences of their actions. When third parties are harmed, they must be compensated, or a new agreement must be negotiated with all of those parties who are affected."

This principle rejects the view that business is amoral or even immoral. If business is a social process, then morality is at its center. Scandals and selfish behavior are a breach of the trust and transparency that is the norm for business to flourish. We can all think of notable lapses in managerial responsibility, but the successes are less visible. Being proactive about effects on others, rather than waiting for government recourse, will help managers build stakeholder trust and loyalty, both of which will help create more sustainable business. The stakeholder responsibility principle brings ethics into the heart of capitalism and reduces the problem of ethics and capitalism. It also helps to resolve the problem of business in a liberal democracy, because if ethics is inherent to business, then the role of government as an "ethics watchdog" is lessened. Responsible business does not need the external imposition of morality. Finally, this redescription of capitalism helps managers to embed ethics in the way they think about their day-to-day activities.

4. The principle of complexity

"Value can be created, traded, and sustained because human beings are complex psychological creatures capable of acting from many different values and points of view." Individuals are socially situated and their values are connected to their social context.

This principle rejects the cardboard view of human nature at the heart of the current narratives of capitalism. People are complex; they act for a variety of reasons. Their actions benefit themselves and others, and people usually take that into account. It is also important to note that since we are complex, we are able to differentiate consequences based on who is being affected. It is part of human nature to care more about consequences that affect those we are close to rather than others. The view of human nature that we hold has a tendency to become a self-fulfilling prophecy – when we expect managers to be self-interested they meet those expectations. By raising the bar for human complexity in business we allow for a broader conceptualization of "value" and create more space for ethics. That is another reason why the principle of stakeholder responsibility is important. It helps to balance our natural tendency to discriminate and reminds us that despite our differences and separation we still can have profound effects on each other.

Based on these principles, capitalism becomes "the voluntary associations of fair, responsible, cooperation, consenting, and complex adults" and does not include competition or self-interest as foundational assumptions.

5. The principle of continuous creation

"Business as an institution is a source of the creation of value. Cooperating with stakeholders and motivated by values, businesspeople continuously create new sources of value."

Self-interest is not the only source of innovation or progress. Working with others and for others can be a stronger motivation to enhance the pace of progress. Managers will encounter difficult trade-offs in this process, but with transparency and imagination they may be able to dissolve those trade-offs as well. This kind of innovation typically comes from engaging with stakeholders to generate new ideas and understanding how they will evaluate the new alternatives. This principle also sheds light on the problem of ethics and capitalism, because as managers see the value of acting with integrity and responsibility, they will be better able to incorporate those strategies into their actions. Business is a source of innovation, and it can be a source of moral innovation as well.

6. The principle of emergent competition

"Competition emerges from a relatively free society so that stakeholders have options. Competition is an emergent property rather than a necessary assumption to capitalism."

This principle also highlights the ways in which our assumption of competition can affect our behavior. Not every interaction is a zero-sum game and not every interaction has a win–win solution. We should do our best to look for the win–win before jumping to other sub-optimal solutions. By backgrounding competition in our description of capitalism, we reduce the potential of the problem of the dominant group to hijack value creation. Choice is an important element in markets, but choice does not always lead to zero-sum solutions.

Finally, these principles and the stakeholder capitalism view do not claim to be a panacea. There will always be a small minority who are focused on their own self-interest at the expense of others. Our claim is that we should set the bar for capitalism at the best we can achieve, not limit it by trying only to avoid the worst. Talking about capitalism this way can foster behavior along these lines. Those who choose to exploit the trust of their stakeholders for their own gain are doing so at their own peril.

We are not claiming that by adopting these principles we shall remove conflict from capitalism and from then on things will be easy. In some ways explicitly dealing with stakeholders is harder than ignoring them. Participants in the value-creation process will have to have a thick skin and patience, and be comfortable with conflict and change. These things are not easy. But creating value necessitates them. They provide the opportunity for real leadership.

The recent credit crisis offers an illustration of how forgetting these basic principles can jeopardize the entire global economy. The seventeen-year increase in house prices was fueled by the perverse incentives to maximize short-term profits by executives of banks, analysts, rating agents, mortgage brokers, home appraisers, and many others, who forgot their obligations to broader stakeholder groups. The harm to third parties of these actions was wished away in a system which selected for irresponsibility. As new debt instruments and mortgage-backed securities were created, the basic consequences were dismissed (e.g. what would happen if house prices fell?) and their broad effects on other stakeholders and on the long-term viability of the economy were blatantly ignored. To restore confidence in the markets will take more than just an infusion of money – increasing the throughput in a corrupt system will only increase the amount of corruption. Lasting confidence will require that responsibility to stakeholders be placed back at the heart of what we mean by value creation and trade.

Conclusion

In the social sciences the way we talk affects what we see and how we live. The theories we create and the stories we tell become self-fulfilling. We argue that the same process is at work in our discussions of capitalism. The current narratives of capitalism assume naïve self-interest, the separation of business and morality, and the limited nature of valuable resources. These assumptions form the core of four problems that we currently face: competition, business ethics, dominant groups, and business in a liberal democracy. If we are to overcome these problems, we shall have to change the way we talk about business as well as the way we actually conduct it. The stories we tell and the assumptions we make about business affects how business is actually carried out. By making these assumptions explicit and optional rather than implicit and mandatory, we hope that we can move a step closer to overcoming the deeply troubling issues that surface in our current practice of value creation.

Business should be about the best that we can create together, rather than about avoiding the worst. If we critically embrace a new set of assumptions about how value is created, the practice of business will soon follow. We do not have to sacrifice the great strides forward to solve some of the deeply troubling issues with capitalism. We need to think critically, acknowledge the social nature of value creation, and work with an insatiable passion to create value for our stakeholders.