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THE STAKEHOLDER THEORY OF THE CORPORATION: CONCEPTS, EVIDENCE, AND IMPLICATIONS

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The stakeholder theory has been advanced and justified in the management literature on the basis of its descriptive accuracy, instrumental power, and normative validity. These three aspects of the theory, although interrelated, are quite distinct; they involve different types of evidence and argument and have different implications. In this article, we examine these three aspects of the theory and critique and integrate important contributions to the literature related to each. We conclude that the three aspects of stakeholder theory are mutually supportive and that the normative base of the theory—which includes the modern theory of property rights—is fundamental.

> If the unity of the corporate body is real, then there is reality and not simply legal fiction in the proposition that the managers of the unit are fiduciaries for it and not merely for its individual members, that they are . . . trustees for an institution [with multiple constituents] rather than attorneys for the stockholders.
>
> E. Merrick Dodd, Jr.
> *Harvard Law Review*, 1932

The idea that corporations have *stakeholders* has now become commonplace in the management literature, both academic and professional. Since the publication of Freeman's landmark book, *Strategic Management: A Stakeholder Approach* (1984), about a dozen books and more than 100 articles with primary emphasis on the stakeholder concept have appeared. (Significant recent examples include books by Alkhafaji, 1989; Anderson, 1989; and Brummer, 1991; and articles by Brenner & Cochran, 1991; Clarkson, 1991; Goodpaster, 1991; Hill & Jones, 1992; and Wood, 1991a,b; plus numerous papers by Freeman and various collaborators,

The development of this article benefited greatly from discussions held at the Conference on Stakeholder Theory at the University of Toronto, May 1993, and from the specific comments of many people, including Professors Aupperle, Carroll, Clarkson, Halal, Freeman, Jones, and Sethi.

individually cited.) *Stakeholder management* is the central theme of at least one important recent business and society text (Carroll, 1989), and a diagram purporting to represent the *stakeholder model* has become a standard element of "Introduction to Management" lectures and writings.

Unfortunately, anyone looking into this large and evolving literature with a critical eye will observe that the concepts *stakeholder, stakeholder model, stakeholder management,* and *stakeholder theory* are explained and used by various authors in very different ways and supported (or critiqued) with diverse and often contradictory evidence and arguments. Moreover, this diversity and its implications are rarely discussed—and possibly not even recognized. (The blurred character of the stakeholder concept is also emphasized by Brummer, 1991.) The purpose of this article is to point out some of the more important distinctions, problems, and implications associated with the stakeholder concept, as well as to clarify and justify its essential content and significance.

In the following section we contrast the stakeholder model of the corporation with the conventional input-output model of the firm and summarize our central thesis. We next present the three aspects of stakeholder theory—descriptive/empirical, instrumental, and normative—found in the literature and clarify the critical differences among them. We then raise the issue of justification: Why would anyone accept the stakeholder theory over alternative conceptions of the corporation? In subsequent sections, we present and evaluate the underlying evidence and arguments justifying the theory from the perspective of descriptive, instrumental, and normative justifications. We conclude that the three approaches to stakeholder theory, although quite different, are mutually supportive and that the *normative* base serves as the critical underpinning for the theory in all its forms.

THE CENTRAL THESES

We summarize our central theses here:

> *Thesis 1: The stakeholder theory is unarguably* **descriptive.** *It presents a model describing what the corporation is. It describes the corporation as a constellation of cooperative and competitive interests possessing intrinsic value. Aspects of this model may be tested for descriptive accuracy: Is this model more descriptively accurate than rival models? Moreover, do observers and participants, in fact, see the corporation this way? The model can also serve as a framework for testing any empirical claims, including instrumental predictions, relevant to the stakeholder concept (but not for testing the concept's normative base).*
>
> *Thesis 2: The stakeholder theory is also* **instrumental.** *It*

establishes a framework for examining the connections, if any, between the practice of stakeholder management and the achievement of various corporate performance goals. The principal focus of interest here has been the proposition that corporations practicing stakeholder management will, other things being equal, be relatively successful in conventional performance terms (profitability, stability, growth, etc.).

Thesis 3: Although Theses 1 and 2 are significant aspects of the stakeholder theory, its fundamental basis is ***normative*** *and involves acceptance of the following ideas:*
(a) Stakeholders are persons or groups with legitimate interests in procedural and/or substantive aspects of corporate activity. Stakeholders are identified by ***their*** *interests in the corporation, whether the corporation has any corresponding functional interest in* ***them.***
(b) The interests of all stakeholders are of ***intrinsic value.*** *That is, each group of stakeholders merits consideration for its own sake and not merely because of its ability to further the interests of some other group, such as the shareowners.*

Thesis 4: The stakeholder theory is ***managerial*** *in the broad sense of that term. It does not simply describe existing situations or predict cause-effect relationships; it also recommends attitudes, structures, and practices that, taken together, constitute stakeholder management. Stakeholder management requires, as its key attribute, simultaneous attention to the legitimate interests of all appropriate stakeholders, both in the establishment of organizational structures and general policies and in case-by-case decision making. This requirement holds for anyone managing or affecting corporate policies, including not only professional managers, but shareowners, the government, and others. Stakeholder theory does not necessarily presume that managers are the only rightful locus of corporate control and governance. Nor does the requirement of simultaneous attention to stakeholder interests resolve the long-standing problem of identifying stakeholders and evaluating their legitimate "stakes" in the corporation. The theory does not imply that all stakeholders (however they may be identified) should be equally involved in all processes and decisions.*

The distinction between a stakeholder conception of the corporation and a conventional input-output perspective is highlighted by the contrasting models displayed in Figures 1 and 2. In Figure 1, investors, employees, and suppliers are depicted as contributing inputs, which the "black box" of the firm transforms into outputs for the benefit of customers. To be sure, each contributor of inputs expects to receive appropriate compensation, but the liberal economics, or "Adam Smith" interpretation, of this model in long-run equilibrium is that input contributors, at the margin, receive only "normal" or "market competitive" benefits (i.e., the benefits that they would obtain from some alternative use of their resources and time). Individual contributors who are particularly advantaged, such as possessors of scarce locations or skills, will, of course, receive "rents," but the rewards of the marginal contributors will only be "normal." As a result of competition throughout the system, the bulk of the benefits will go to the customers. (There is, of course, a Marxist-capitalist version of this model in which both the customer and the investor arrows are reversed, and the object of the game is merely to produce benefits for the investors. This interpretation now seems to be confined almost exclusively to the field of finance.)

The stakeholder model (Figure 2) contrasts explicitly with the input-output model in all its variations. Stakeholder analysts argue that *all* persons or groups with legitimate interests participating in an enterprise do so to obtain benefits and that there is no prima facie priority of one set of interests and benefits over another. Hence, the arrows between the firm and its stakeholder constituents run in both directions. All stakeholder relationships are depicted in the same size and shape and are equidistant from the "black box" of the firm in the center. The distinctive features of this conception, as contrasted with conventional input-output conceptions, will become apparent as our analysis proceeds.

This summary of the stakeholder theory and our discussion throughout this article refer specifically to the theory's application to the investor-

FIGURE 1
Contrasting Models of the Corporation: Input-Output Model

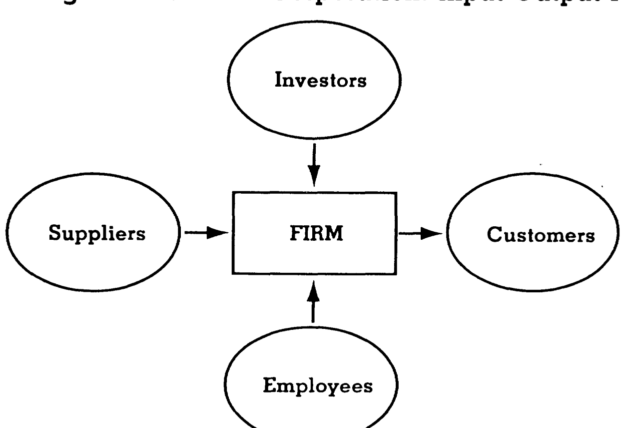
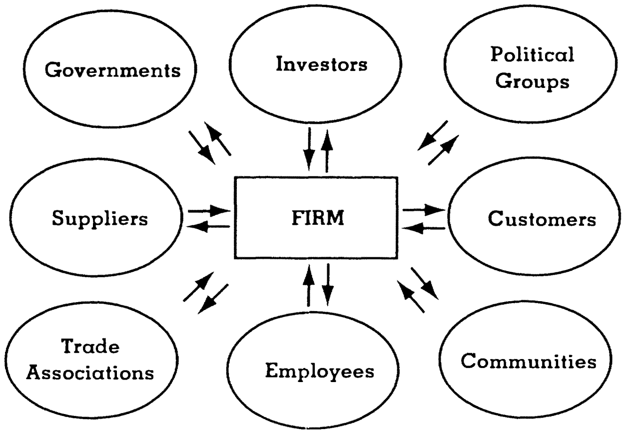


FIGURE 2
Contrasting Models of the Corporation: The Stakeholder Model



owned corporation. Although stakeholder concepts have been applied in other settings (e.g., government agencies and social programs), these situations are fundamentally different, and simultaneous discussion of a variety of possible stakeholder relationships leads, in our view, to confusion rather than clarification. The critical corporate stakeholder issues, both in theory and in practice, involve evidentiary considerations and conceptual issues (e.g., the meaning of property rights) unique to the corporate setting.

It is also worth noting at the outset that the extent to which the stakeholder theory is understood to represent a controversial or challenging approach to conventional views varies greatly among market capitalist economies. These differences are highlighted in a recent issue of *The Economist* (1993: 52):

> In America, for instance, shareholders have a comparatively big say in the running of the enterprises they own; workers . . . have much less influence. In many European countries, shareholders have less say and workers more . . . [I]n Japan . . . managers have been left alone to run their companies as they see fit—namely for the benefit of employees and of allied companies, as much as for shareholders.

ALTERNATIVE ASPECTS OF STAKEHOLDER THEORY: DESCRIPTIVE/EMPIRICAL, INSTRUMENTAL, AND NORMATIVE

One of the central problems in the evolution of stakeholder theory has been confusion about its nature and purpose. For example, stakeholder theory has been used, either explicitly or implicitly, for descriptive purposes. Brenner and Cochran (1991: 452) offered a "stakeholder theory of the firm" for "two purposes: to describe how organizations operate and to help predict organizational behavior." They contrasted this "theory," which they developed only in outline form, with other "theories of the firm," but they did not ask whether the various theories cited have comparable purposes.

In fact, different theories have different purposes and therefore different validity criteria and different implications. For example, according to Cyert and March (1963), the neoclassical theory of the firm attempts to explain the economic principles governing production, investment, and pricing decisions of established firms operating in competitive markets. In contrast, their behavioral theory of the firm attempts to explain the process of decision making in the modern firm in terms of goals, expectations, and choice-making procedures. Aoki's (1984) cooperative game theory of the firm attempts to explain internal governance, particularly the balance between owners' and workers' interests. In contrast to all of these contributions, transaction cost theory attempts to explain why firms exist (i.e., why economic activities are coordinated through formal organizations rather than simply through market contacts) (Coase, 1937; Williamson & Winter, 1991). (Although all of these theories are put forward as "positive" or "scientific" conceptions, there is a tendency for them to be used for normative purposes as well.)

The stakeholder theory differs from these and other "theories of the firm" in fundamental ways. The stakeholder theory is intended both to explain and to guide the structure and operation of the established corporation (the "going concern" in John R. Commons' famous phrase). Toward that end it views the corporation as an organizational entity through which numerous and diverse participants accomplish multiple, and not always entirely congruent, purposes. The stakeholder theory is general and comprehensive, but it is not empty; it goes well beyond the descriptive observation that "organizations have stakeholders." Unfortunately, much of what passes for stakeholder theory in the literature is implicit rather than explicit, which is one reason why diverse and sometimes confusing uses of the stakeholder concept have not attracted more attention.

The stakeholder theory can be, and has been, presented and used in a number of ways that are quite distinct and involve very different methodologies, types of evidence, and criteria of appraisal. Three types of uses are critical to our analysis.

Descriptive/Empirical

The theory is used to describe, and sometimes to explain, specific corporate characteristics and behaviors. For example, stakeholder theory has been used to describe (a) the nature of the firm (Brenner & Cochran, 1991), (b) the way managers think about managing (Brenner & Molander, 1977), (c) how board members think about the interests of corporate constituencies (Wang & Dewhirst, 1992), and (d) how some corporations are actually managed (Clarkson, 1991; Halal, 1990; Kreiner & Bhambri, 1991).

Instrumental

The theory, in conjunction with descriptive/empirical data where available, is used to identify the connections, or lack of connections, between stakeholder management and the achievement of traditional corporate objectives (e.g., profitability, growth). Many recent instrumental studies of corporate social responsibility, all of which make explicit or implicit reference to stakeholder perspectives, use conventional statistical methodologies (Aupperle, Carroll, & Hatfield, 1985; Barton, Hill, & Sundaram, 1989; Cochran & Wood, 1984; Cornell & Shapiro, 1987; McGuire, Sundgren, & Schneeweis, 1988; Preston & Sapienza, 1990; Preston, Sapienza, & Miller, 1991). Other studies are based on direct observation and interviews (Kotter & Heskett, 1992; O'Toole, 1985; see also, O'Toole, 1991). Whatever their methodologies, these studies have tended to generate "implications" suggesting that adherence to stakeholder principles and practices achieves conventional corporate performance objectives as well or better than rival approaches. Kotter and Heskett (1992) specifically observed that such highly successful companies as Hewlett-Packard, Wal-Mart, and Dayton Hudson—although very diverse in other ways—share a stakeholder perspective. Kotter and Heskett (1992: 59) wrote that "[a]lmost all [their] managers care strongly about people who have a stake in the business—customers, employees, stockholders, suppliers, etc."

Normative

The theory is used to interpret the function of the corporation, including the identification of moral or philosophical guidelines for the operation and management of corporations. Normative concerns dominated the classic stakeholder theory statements from the beginning (Dodd, 1932), and this tradition has been continued in the most recent versions (Carroll, 1989; Kuhn & Shriver, 1991; Marcus, 1993). Even Friedman's (1970) famous attack on the concept of corporate social responsibility was cast in normative terms.

Contrasting/Combining Approaches

Each of these uses of stakeholder theory is of some value, but the values differ in each use. The *descriptive* aspect of stakeholder theory reflects and explains past, present, and future states of affairs of corporations and their stakeholders. Simple description is common and desirable in the exploration of new areas and usually expands to generate explanatory and predictive propositions. (All such activities shall be called *descriptive* for our purposes.) *Instrumental* uses of stakeholder theory make a connection between stakeholder approaches and commonly desired objectives such as profitability. Instrumental uses usually stop short of exploring specific links between cause (i.e., stakeholder management) and effect (i.e., corporate performance) in detail, but such linkage is certainly implicit. The much-quoted Stanford Research Institute's (SRI) definition of stakeholders as "those groups without whose support the organization would cease to exist" (SRI, 1963; quoted in Freeman, 1984: 31) clearly implies that corporate managers must induce constructive contributions from their stakeholders to accomplish their own desired results (e.g., perpetuation of the organization, profitability, stability, growth).

In *normative* uses, the correspondence between the theory and the observed facts of corporate life is not a significant issue, nor is the association between stakeholder management and conventional performance measures a critical test. Instead, a normative theory attempts to interpret the function of, and offer guidance about, the investor-owned corporation on the basis of some underlying moral or philosophical principles. Although both normative and instrumental analyses may be "prescriptive" (i.e., they may express or imply more or less appropriate choices on the part of decision makers), they rest on entirely different bases. An instrumental approach is essentially hypothetical; it says, in effect, "If you want to achieve (avoid) results X, Y, or Z, then adopt (don't adopt) principles and practices A, B, or C." The normative approach, in contrast, is not hypothetical but categorical; it says, in effect, "Do (Don't do) this because it is the right (wrong) thing to do." Much of the stakeholder literature, including the contributions of both proponents and critics, is clearly normative, although the fundamental normative principles involved are often unexamined.

A striking characteristic of the stakeholder literature is that diverse theoretical approaches are often combined without acknowledgement. Indeed, the temptation to seek a three-in-one theory—or at least to slide easily from one theoretical base to another—is strong. Clarkson (1991: 349), for example, asserted an explicit connection among all three when he concluded that his stakeholder management model represents a new framework for "describing, evaluating, and managing corporate social performance."

All three types of theory are also to be found in the work of Freeman, whom many regard as the leading contributor to the stakeholder literature. In his original treatise, he asserted that changing events create a descriptive fit for the theory:

> Just as the separation of the owner-manager-employee required a rethinking of the concept of control and private property as analyzed by Berle and Means (1932), so does the emergence of numerous stakeholder groups and new strategic issues require a rethinking of our traditional picture of the firm. . . . We must redraw the picture in a way that accounts for the changes. (1984: 24)

At the same time, he also endorsed the theory's *instrumental basis*. We should, he noted, "explore the logic of this concept in practical terms, i.e., in terms of how organizations can succeed in the current and future business environment" (1984: 25). Instrumental concerns are also reflected in Freeman's extensive discussion of stakeholder management implementation techniques, both in his 1984 treatise and in other papers (Freeman & Gilbert, 1987; Freeman & Reed, 1983). In a later work, however, Evan and Freeman (1988: 97) justified stakeholder theory on normative grounds, specifically its power to satisfy the moral rights of individuals. They asserted that the theory of the firm must be reconceptualized "along essentially Kantian lines." This means each stakeholder group has a right to be treated as an end in itself, and not as means to some other end, "and therefore must participate in determining the future direction of the firm in which [it has] a stake."

The muddling of theoretical bases and objectives, although often understandable, has led to less rigorous thinking and analysis than the stakeholder concept requires. To see the significance of the distinctions among descriptive, instrumental, and normative uses of the stakeholder concept, consider the current controversy over the special privileges of top managers in large corporations, particularly in connection with mergers and acquisitions. There is considerable evidence that in the burst of large corporate takeovers during the 1980s, share values typically rose for acquired firms and fell for acquiring firms. Many observers have speculated that self-serving managerial activity accounts for both results (Jensen, 1989; Weidenbaum & Vogt, 1987). The acquired firms gain in value because, prior to the takeover, they were burdened by inefficient, self-serving managers, and the acquiring firms lose in value because the impetus for the acquisition was not return on investment for owners but ego gratification and career advancement for their top managers. If this analysis is accurate, and if managers' nests are often feathered in other ways (e.g., salaries, bonuses) at the expense of shareowners, then it is descriptively true that managers' interests have priority over those of other stakeholders, including shareowners. But we cannot move directly from an *is* claim—the de facto priority of managers' interests—to an *ought* claim in either instrumental or normative contexts. Moreover, even if it were true that higher paid managers did, in fact, achieve higher levels of profitability (thus meeting instrumental criteria), it would still not follow that higher pay/profit results were normatively justifiable. (Witness the near-universal condemnation of the income/profit achievements of the 19th-century robber barons.)

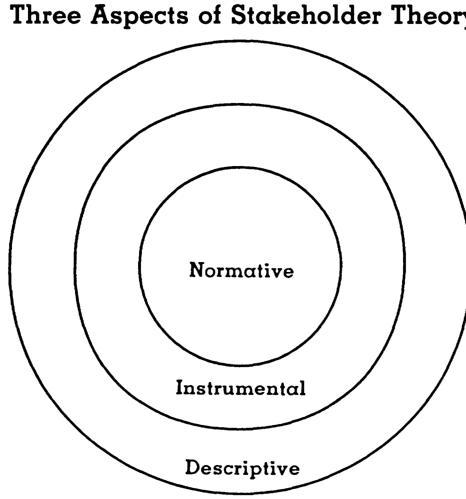
THE PROBLEM OF JUSTIFICATION

The underlying epistemiological issue in the stakeholder literature is the problem of justification: Why should the stakeholder theory be accepted or preferred over alternative conceptions? Until this question is addressed, the distinctions among empirical, instrumental, and normative approaches can be papered over. Moreover, the answer to this question must be related to the distinct purpose that the theory is intended to serve. That is, reasons to accept the stakeholder theory as a descriptive account of how managers behave, or of how the business world is constituted, are different from reasons to accept the stakeholder theory as a guide for managerial behavior, and so on.

The stakeholder theory is justified in the literature, explicitly or implicitly, in ways that correspond directly to the three approaches to the theory set out in the previous section: descriptive, instrumental, and normative. Descriptive justifications attempt to show that the concepts embedded in the theory correspond to observed reality. Instrumental justifications point to evidence of the connection between stakeholder management and corporate performance. Normative justifications appeal to underlying concepts such as individual or group "rights," "social contract," or utilitarianism. (Brummer's recent survey of this literature ignores descriptive issues but emphasizes "power and performance," i.e., instrumental, and "deontological," i.e., normative, arguments; cf. Brummer, 1991.)

In our view, the three aspects of the stakeholder theory are nested within each other, as suggested by Figure 3. The external shell of the theory is its descriptive aspect; the theory presents and explains relationships that are observed in the external world. The theory's descriptive accuracy is supported, at the second level, by its instrumental and predictive value; *if* certain practices are carried out, *then* certain results will be obtained. The central core of the theory is, however, normative. The descriptive accuracy of the theory presumes the truth of the core normative conception, insofar as it presumes that managers and other agents act *as if* all stakeholders' interests have intrinsic value. In turn, recognition of these ultimate moral values and obligations gives stakeholder management its fundamental normative base. In the following sections,

FIGURE 3
Three Aspects of Stakeholder Theory



we survey the evidence and argument involved in each of these approaches to the justification of the stakeholder theory.

DESCRIPTIVE JUSTIFICATIONS

There is ample descriptive evidence, some of which has already been cited, that many managers believe themselves, or are believed by others, to be practicing stakeholder management. Indeed, as early as the mid-1960s, Raymond Baumhart's (1968) survey of upper-level managers revealed that about 80 percent regarded it as unethical management behavior to focus solely in the interest of shareowners and not in the interest of employees and customers. Since then, other surveys asking similar questions about the stakeholder sensitivity of managers have returned similar results (Brenner & Molander, 1977; Posner & Schmidt, 1984). Ongoing empirical studies by both Clarkson (1991) and Halal (1990) attempt to distinguish firms that practice stakeholder management from those that do not, and both investigators found significant numbers of firms in the first category. Managers may not make explicit reference to "stakeholder theory," but the vast majority of them apparently adhere in practice to one of the central tenets of the stakeholder theory, namely, that their role is to satisfy a wider set of stakeholders, not simply the shareowners. (Note, however, that the 171 managers surveyed by Alkhafaji, 1989, did not believe that the corporate governance roles of any stakeholders, including shareowners, should be increased. Perhaps not surprisingly, they strongly favored increased dominance of corporate governance by management).

Another kind of descriptive justification for the stakeholder theory stems from the role it plays as the implicit basis for existing practices and institutions, including legal opinion and statutory law. Recent court decisions and new legislation have weakened the so-called "business judgment rule," which vests management with exclusive authority over the conduct of a company's affairs only on the condition that the financial welfare of stockholders is single-mindedly pursued (Chirelstein, 1974: 60). At last count, at least 29 states have adopted statutes that extend the range of permissible concern by boards of directors to a host of non-shareowner constituencies, including employees, creditors, suppliers, customers, and local communities (Orts, 1992). Furthermore, courts have tended to support these statutes. For example, the well-known Delaware Supreme Court decision in Unocal, although requiring corporate directors to show that a "reasonable" threat exists before fighting hostile takeover offers, nonetheless allowed a number of concerns to affect the determination of such "reasonableness," including "the impact [of the takeover] on 'constituencies' other than shareholders (i.e., creditors, customers, employees, and perhaps even the community generally)" (*Unocal Corp. v. Mesa Petroleum Co.*, 1985). In a more recent Delaware case, *Paramount Communications, Inc. v. Time, Inc.* (1990), the Unocal rationale was expanded to allow directors to include factors such as long-range business plans and a corporation's "culture." In one of the most dramatic challenges to the ownership rights of hostile acquirers, the Supreme Court of the United States upheld an Indiana statute that in the Court's own words "condition[s] acquisition of control of a corporation on approval of a majority of the *pre-existing* disinterested shareholders" (emphasis added) (*CTCS Corp. v. Dynamics Corp. of America*, 1987).

As Orts noted, this trend toward stakeholder law is not solely a U.S. phenomenon and is reflected in the existing and emerging laws of many developed countries. The so-called codetermination laws of Germany require employee representation on second-tier boards of directors. The Companies Act of Great Britain mandates that company directors shall include the interests of employees in their decision making (*Companies Act*, 1980). The new "harmonization" laws of the European Community (EC) will, when approved, include provisions permitting corporations to take into account the interests of creditors, customers, potential investors, and employees (Orts, 1992). Finally, the well-known corporate governance model in Japan—through both law and custom—presumes that Japanese corporations exist within a tightly connected and interrelated set of stakeholders, including suppliers, customers, lending institutions, and friendly corporations.

Another series of legal developments in the U.S. asserts the interests of third-party stakeholders—specifically, unsuccessful job applicants—in business operations. Title VII of the Civil Rights Act of 1964 explicitly makes it a violation of law for an employer "to fail or refuse to hire . . . any individual" on the basis of discriminatory criteria (42 U.S.C. §§ 2000e-2a(1) & (2), 1982). This legislation has become the focus of numerous legal complaints and some substantial settlements. In a class action suit involving Potomac Electric Power Co., Washington, DC, complainants charged that the company had hired far fewer Blacks from its applicant pool than would have been expected on statistical grounds. The judge certified a "class" of more than 7,000 unsuccessful Black applicants, most of whom will be eligible for compensation out of a $38.4 million settlement pool (which is also available to employees experiencing discrimination) (*The Washington Post*, 21 February 1993).

Both of these sets of legal developments reinforce our initial statement that stakeholders are defined by *their* legitimate interest in the corporation, rather than simply by the corporation's interest in *them*. But neither the legal developments nor the management survey results provide definitive epistemological justification for the stakeholder theory. Managers adopting the stakeholder approach may be relieved to learn that they are not alone, and indeed that they are conforming to the latest management or legal trends, but both the survey results and legal developments are, at bottom, simply facts. They do not constitute the basis for the stakeholder (or any other) theory of management. Indeed, even if the stakeholder concept is implicit in current legal trends (a proposition that is not universally accepted), one cannot derive a stakeholder theory of management from a stakeholder theory of law any more than one can derive a "tort" theory of management from the tort theory of law.

The hazards of using purely descriptive data, whether jurisprudential or otherwise, as justification for a broad theory are well known. There is the problem of the so-called "naturalistic fallacy," moving from *is* to *ought* or from *describe* to *evaluate*, without the necessary intervening analysis and explanation (Moore, 1959/1903: 15–16). Then, again, there is the simple problem of hasty generalization. By the logic of descriptive justification, if new surveys showed that managers were abandoning stakeholder orientations, or if the legal support for broad stakeholder interests were to weaken, the theory would be invalidated. But this observation offers a significant clue about the nature of the theory itself, because few if any of its adherents would be likely to abandon it, even if current legal or managerial trends were to shift. This suggests that the descriptive support for the stakeholder theory, as well as the critiques of this support to be found in the literature, are of limited significance and that the most important issues for stakeholder theory lie elsewhere.

INSTRUMENTAL JUSTIFICATIONS

Because the descriptive approach to grounding a stakeholder theory is inadequate, justifications based on a connection between stakeholder strategies and organizational performance should be examined. Consider, for example, the simple hypothesis that corporations whose managers adopt stakeholder principles and practices will perform better financially than those that do not. This hypothesis has never been tested directly, and its testing involves some formidable challenges. (Clarkson's ongoing work is the only significant effort of this type known to us; cf. Clarkson, Deck, & Shiner, 1992.) The view that stakeholder management and favorable performance go hand in hand has, however, become commonplace in the management literature, both professional and academic. The earliest direct statement is probably that of General Robert E. Wood, then-CEO of Sears, in 1950: "All I can say is that if the other three parties named above [customers, employees, community] are properly taken care of, the stockholder will benefit in the long pull" (quoted in Worthy, 1984: 64). A recent effort to introduce practicing managers to the stakeholder concept and to improve their ability to implement stakeholder management practices is the work by Savage, Nix, Whitehead, and Blair (1991). Brummer (1991) cited not only Freeman (1989) but also Ackoff; Manning; Maslow; Peters and Waterman; Starling; Sturdivant; and others in support of stakeholder theory's instrumental base.

Unfortunately, the large body of literature dealing with the connections, if any, between various aspects of corporate social performance or ethics, on one hand, and conventional financial and market performance indicators, on the other, does not translate easily into a stakeholder theory context. Whatever value the social/financial performance studies may have on their own merits, most of them do not include reliable indicators of the stakeholder management (i.e., the independent variable) side of the relationship. There is some evidence, based on analysis of the *Fortune* corporate reputation surveys, that the satisfaction of multiple stakeholders need not be a zero sum game (i.e., that benefits to one stakeholder group need not come entirely at the expense of another) (Preston & Sapienza, 1990). As previously noted, Kotter and Heskett's (1992) case studies of a small number of high-performance companies indicated that the managers of those companies tend to emphasize the interests of all major stakeholder groups in their decision making. However, there is as yet no compelling empirical evidence that the optimal strategy for maximizing a firm's conventional financial and market performance is stakeholder management.

Analytical Arguments

Even without empirical verification, however, stakeholder management can be linked to conventional concepts of organizational success through analytical argument. The main focus of this effort in the recent literature builds on established concepts of principal-agent relations (Jensen & Mechling, 1976) and the firm as a nexus of contracts (Williamson & Winter, 1991). Agency theory and firm-as-contract theory, although arising from different sources, are closely related and share a common emphasis: efficiency. (They also share the terminology and methodology of the new transaction cost literature; cf. Williamson, 1985.) Agency theorists argue that corporations are structured to minimize the costs of getting some participants (the agents) to do what other participants (the principals) desire. Firm-as-contract theorists argue that participants agree to cooperate with each other within organizations (i.e., through contracts), rather than simply deal with each other through the market, to minimize the costs of search, coordination, insecurity, etc.

Hill and Jones (1992: 132, 134) are responsible for the most ambitious attempt to integrate the stakeholder concept with agency theory (see also, Sharplin & Phelps, 1989). These authors enlarged the standard principal-agent paradigm of financial economics, which emphasizes the relationship between shareowners and managers, to create "stakeholder-agency theory," which constitutes, in their view, "a generalized theory of agency." According to this conception, managers "can be seen as the agents of [all] other stakeholders." They noted that stakeholders differ among themselves with respect to (a) the *importance* (to them) of their stake in the firm and (b) their *power* vis-à-vis the managers. They also noted that there is considerable friction within the stakeholder-agent negotiation process—some of it because of some participants' ability to retard equilibrating adjustments that are unfavorable to themselves. They therefore argued that there is no reason to assume that stakeholder-agent relationships are in equilibrium at any particular time. (This contrasts sharply with the "perfect markets" hypothesis favored in the finance literature.) In their view, the process, direction, and speed of adaptation in stakeholder-agent relationships, rather than the equilibrium set of contributions and rewards, should be the primary focus of analysis. This brief summary cannot do justice to their rich conception, but the key point for current purposes is that the stakeholders are drawn into relationships with the managers to accomplish organizational tasks as efficiently as possible; hence, the stakeholder model is linked instrumentally to organizational performance.

A similar theme emerges from the firm-as-contract analysis of Freeman and Evan (1990; see also Evan & Freeman, 1988). They recommended integrating the stakeholder concept with the Coasian view of the firm-as-contract and a Williamson-style analysis of transaction costs to "conceptualize the firm as a set of multilateral contracts over time." According to Freeman and Evan,

> Managers administer contracts among employees, owners, suppliers, customers, and the community. Since each of these groups can invest in asset specific transactions which affect the other groups, methods of conflict resolution, or safeguards must be found. (1990: 352)

They emphasized that all parties have an equal right to bargain and, therefore, that a minimal condition for the acceptance of such multipartite arrangements by each contracting party is a notion of "fair contract," i.e., governance rules that "ensure that the interests of all parties are at least taken into consideration" (1990: 3[illegible] Once again, the stakeholder model (and its implementation through a set of acceptable implicit contracts) is seen as essential to successful organizational performance.

The stakeholder interpretations of both agency theory and firm-as-contract theory give special attention to the differential position and special role of managers vis-à-vis all other stakeholders. Hill and Jones (1992: 140) emphasized "information asymmetry" between managers and other stakeholders and contrasted the concentration of resource control by managers with the diffusion of control within stakeholder groups in which there may be no mechanism to gain command over a significant portion of the group's total resources. Evan and Freeman (1993: 102–103) asserted that "management has a duty of safeguarding the welfare of the abstract entity that is the corporation" and of balancing the conflicting claims of multiple stakeholders to achieve this goal. They further declared:

> A stakeholder theory of the firm must redefine the purpose of the firm. . . . The very purpose of the firm is, in our view, to serve as a vehicle for coordinating stakeholder interests. (102–103)

According to this perspective, success in satisfying multiple stakeholder interests—rather than in meeting conventional economic and financial criteria—would constitute the ultimate test of corporate performance.

But how will multiple and diverse stakeholders be assured that their interests are being coordinated in ways that lead to the most favorable possible results for themselves (i.e., the most favorable results consistent with the requirements of other stakeholders)? Hill and Jones (1992: 140–143) stressed the importance of (a) monitoring devices that have the effect of reducing information asymmetry (e.g., public reporting requirements) and (b) enforcement mechanisms, including law, "exit" (the possibility, or credible threat, of withdrawal from the relationship), and "voice." Freeman and Evan (1993) emphasized the notion of fairness. Going beyond the notion of "fair contracting," they recommended that the criterion of "fairness" in stakeholder bargains be a Rawlsian "veil of ignorance." Under a "veil of ignorance," parties to a bargain agree upon a set of possible outcomes prior to determining which outcome will be received by which party (e.g., one person cuts the cake, another takes the first slice) (Rawls, 1971, cited in Freeman & Evan, 1990: 352–353).

Both pairs of analysts, Hill and Jones and Freeman and Evan, placed greater emphasis on the process of multiple-stakeholder coordination than on the specific agreements/bargains. Both groups stressed that mutual and voluntary acceptability of bargains by all contracting stakeholders is the necessary criterion for efficient contracts. Both neglected the roles of potential stakeholders not conspicuously involved in explicit or implicit contracts with the firm. The two pairs of authors differed slightly in one respect: Hill and Jones saw the network of relationships as consisting of separate implicit contracts between each stakeholder group and "management" (as a central node), whereas Freeman and Evan ultimately viewed the firm "as a series of multilateral contracts among [all] stakeholders" (1990: 354).

Weaknesses of Instrumental Justifications

Perhaps the most important similarity between these two independent attempts to justify the stakeholder model lies in the fact that although they draw initially on the conceptual apparatus of instrumental or efficiency-based theories (i.e., principal-agent relations and "firm-as-contract" theory), they ultimately rely upon noninstrumental or normative arguments. This shift is less conspicuous in the case of Hill and Jones, who implied that monitoring and enforcement mechanisms will be sufficient to curb opportunistic behavior by managers at the expense of other stakeholders. The authors would no doubt agree, however, that the ultimate success of stakeholder-agency theory would require a fundamental shift in managerial objectives away from shareowners and toward the interests of all stakeholders; such a shift would necessarily involve normative, rather than purely instrumental, considerations. Freeman and Evan's recourse to a Rawlsian concept of "fairness" as the ultimate criterion for stakeholder bargains is an overt elevation of normative criteria over instrumental ones. No theorist, including Rawls, has ever maintained that bargains reached on the basis of a "veil of ignorance" would maximize efficiency. By elevating the fairness principle to a central role, Freeman and Evan shifted their attention from ordinary economic contracts of the sort envisaged by Coase, Williamson, and the mainstream agency theorists, which are governed by individual efficiency considerations. Instead, they emphasized what have been called "heuristic" or "social" contracts that rest upon broad normative principles governing human conduct (Donaldson & Dunfee, In press, 1994).

It should come as no surprise that stakeholder theory cannot be fully justified by instrumental considerations. The empirical evidence is inadequate, and the analytical arguments, although of considerable substance, ultimately rest on more than purely instrumental grounds. This conclusion carries an important implication: Although those who use the stakeholder concept often cite its consistency with the pursuit of conventional corporate performance objectives (and there is no notable evidence of its *in*consistency), few of them would abandon the concept if it turned out to be only as *equally* efficacious as other conceptions. O'Toole (1991: 18–19), for example, examined a case in which the economic consequences of stakeholder versus conventional management "ended up neutral"; he stressed that "it is the *moral consequences* that are at issue" and described stakeholder analysis as "the sine quo non of business virtue" (emphasis in the original).

NORMATIVE JUSTIFICATIONS

The normative basis for stakeholder theory involves its connection with more fundamental and better-accepted philosophical concepts. The normative assumptions of traditional economic theory are too feeble to support stakeholder theory, and the concept of a free market populated with free and rational preference seekers, however correct and important, is compatible with both stakeholder and nonstakeholder perspectives. Of course, the two normative propositions stated at the beginning of this article—that stakeholders are identified by *their* interest in the affairs of the corporation and that the interests of all stakeholders have intrinsic value—can be viewed as axiomatic principles that require no further justification. Unfortunately, this approach provides no basis for responding to critics who reject these propositions out of hand.

One way to construct a normative foundation for the stakeholder model is to examine its principal competitor, the model of *management* control in the interests of shareowners, as represented by the business judgment rule. As noted in previous sections, there is considerable criticism of this model on descriptive grounds. Pejovich (1990: 58) noted that in the modern corporation (as opposed to the owner-managed firm) the rights of shareowners are "attenuated" by the dispersion of ownership and by high agency costs; he stressed that "the *economic system*," not "the *legal system*," is responsible for this "attenuation of the right of ownership" (emphasis in original). Many direct observers (e.g., Geneen & Moscow, 1984; Pickens, 1987) have questioned managers' devotion to shareowner welfare, and survey results such as those of Alkhafaji (1989) and Posner and Schmidt (1992) provide statistical support for these perceptions.

But the management serving the shareowners model (i.e., the principal-agent model in its standard financial economics form) is not only descriptively inaccurate; careful analysis reveals that it is normatively unacceptable as well. Changes in state incorporation laws to reflect a "constituency" perspective have been mentioned. The normative basis for these changes in current mainstream legal thinking is articulated in the recent American Law Institute report, *Principles of Corporate Governance* (1992). The relevant portion of this document begins by affirming the central corporate objective of "enhancing corporate profit and shareholder gain," but it immediately introduces qualifications: "Even if corporate profit and shareholder gain are not thereby enhanced," the corporation *must* abide by law and *may* "take into account ethical considerations" and engage in philanthropy (Sec.2.01(a)(b); 1992: 69). The accompanying commentary explicitly affirmed the stakeholder concept:

> The modern corporation by its nature creates interdependencies with a variety of groups with whom the corporation has a legitimate concern, such as employees, customers, suppliers, and members of the communities in which the corporation operates. (1992: 72)

The commentary further noted that response to social and ethical considerations is often consistent with long-run (if not short-run) increases in profit and value, but it continues:

> Nevertheless, observation suggests that corporate decisions are not infrequently made on the basis of ethical consideration even when doing so would not enhance corporate profit or shareholder gain. *Such behavior is not only appropriate, but desirable. Corporate officials are not less morally obliged than any other citizens to take ethical considerations into account, and it would be unwise social policy to preclude them from doing so* . . . . [The text] does not impose a legal obligation to take ethical considerations into account. However, the absence of a legal obligation to follow ethical principles does not mean that corporate decisionmakers are not subject to the same ethical considerations as other members of society. (American Law Institute, 1992: 80–82, emphasis added)

FORMAL ANALYSIS: THEORY OF PROPERTY

To go beyond this practical rejection of the "management serving the shareowners" model, more formal normative justifications of stakeholder theory might be based either on broad theories of philosophical ethics, such as utilitarianism, or on narrower "middle-level" theories derived from the notion that a "social contract" exists between corporations and society. A comprehensive survey of this terrain would go far beyond the scope of this article, and much of it has been recently traversed by others (Brummer, 1991; Freeman, 1991; see also, Donaldson, 1982). Here, we offer a brief sketch of a normative basis for the stakeholder theory that combines several different philosophical approaches and that is, we believe, original in the literature. We argue that the stakeholder theory can be normatively based on the evolving theory of property.

There is a subtle irony in proposing that the stakeholder model can be justified on the basis of the theory of property, because the traditional view has been that a focus on property rights justifies the dominance of shareowners' interests. Indeed, the fact that property rights are the critical base for conventional shareowner-dominance views makes it all the more significant that the current trend of thinking with respect to the philosophy of property runs in the opposite direction. In fact, this trend—as presented in the now-classic contributions of Coase (1960) and Honore (1961) and in more recent works by Becker (1978, 1992a,b,c) and Munzer (1992)—runs strongly counter to the conception that private property exclusively enshrines the interests of owners.

Considerable agreement now exists as to the theoretical definition of property as a "bundle" of many rights, some of which may be limited. More than 30 years ago, Coase (1960: 44) chided economists for adhering to a simplistic concept of ownership:

> We may speak of a person owning land . . . but what the land-owner in fact possesses is the right to carry out a circumscribed list of actions. The rights of a land-owner are not unlimited . . . [This] would be true under any system of law. A system in which the rights of individuals were unlimited would be one in which there were no rights to acquire.

Honore (1961) specifically included the notion of restrictions against harmful uses within the definition of property itself. Pejovich (1990: 27–28), probably the most conservative economic theorist working in this area, emphasized that "property rights are relations between individuals" and thus "it is wrong to separate human rights from property rights"; he further noted that "the right of ownership is not an unrestricted right."

The notion that property rights are embedded in human rights and that restrictions against harmful uses are intrinsic to the property rights concept clearly brings the interests of others (i.e., of non-owner stakeholders) into the picture. Of course, *which* uses of property should be restricted and *which* persons should count as stakeholders remain unspecified. Simply bringing nonowner stakeholders into the conception of property does not provide by itself justification for stakeholder arguments assigning managerial responsibilities toward specific groups, such as employees and customers. The important point, however, is that the contemporary theoretical concept of private property clearly does not ascribe unlimited rights to owners and hence does not support the popular claim that the responsibility of managers is to act solely as agents for the share-owners. (The necessary compromise between individual property rights and other considerations is highlighted in the "takings" issue—i.e., modified to protect the interests of others or society in general. For a survey of current views on this complex matter, see Mercuro, 1992.)

These comments examine the *scope* of property rights, but it is also relevant to examine their *source* (i.e., What basic principles determine *who* should get [and be allowed to keep] *what* in society?). Unless property rights are regarded as simple, self-evident moral conceptions, they must be based on more fundamental ideas of distributive justice. The main contending theories of distributive justice include Utilitarianism, Libertarianism, and social contract theory (Becker, 1992). The battle among competing theories of distributive justice is most often a battle over which characteristics highlighted by the theories—such as need, ability, effort, and mutual agreement—are most relevant for determining fair distributions of wealth, income, etc. (The role of theories of justice within organizations is attracting considerable current attention; cf. Greenberg, 1987.)

For example, when the characteristic of *need* (a feature highlighted by Utilitarianism) is the criterion, the resulting theory of property places formidable demands upon property owners to mitigate their self-interest in favor of enhancing the interests (i.e., meeting the needs) of others. When *ability* or *effort* (features highlighted by Libertarianism) is the criterion, the resulting theory leaves property owners freer to use their resources (acquired, it is assumed, as a result of ability and effort) as they see fit. Social contract theory places primary emphasis on expressed or implied understandings among individuals and groups as to appropriate distributions and uses of property.

Many of the most respected contemporary analysts of property rights reject the notion that any *single* theory of distributive justice is universally applicable. Indeed, it seems counterintuitive that any one principle could account for all aspects of the complex bundle of rights and responsibilities that constitutes "property." Beginning with Becker's (1978) analysis, the trend is toward theories that are pluralistic, allowing more than one fundamental principle to play a role (Becker, 1992a; see also, Munzer, 1992). But if a pluralistic theory of property rights is accepted, then the connection between the theory of property and the stakeholder theory becomes explicit. All critical characteristics underlying the classic theories of distributive justice are present among the stakeholders of a corporation, as they are conventionally conceived and presented in contemporary stakeholder theory. For example, the "stake" of long-term employees who have worked to build and maintain a successful business operation is essentially based on effort. The stake of people living in the surrounding community may be based on their need, say, for clean air or the maintenance of their civic infrastructure. Customer stakes are based on the satisfactions and protections implicitly promised in the market offer, and so on. One need not make the more radical assertion that such stakes constitute formal or legal property rights, although some forceful critics of current corporate governance arrangements appear to hold this view (Nader & Green, 1973). All that is necessary is to show that such characteristics, which are the same as those giving rise to fundamental concepts of property rights, give various groups a moral interest, commonly referred to as a "stake," in the affairs of the corporation. Thus, the normative principles that underlie the contemporary pluralistic theory of property rights also provide the foundation for the stakeholder theory as well.

MANAGERIAL IMPLICATIONS

A full discussion of the managerial implications of this analysis would require much more discussion. As a summary, the two points we emphasize are (a) the recognition of specific stakeholders and their stakes by managers and other stakeholders and (b) the role of managers and the *management function*, as distinct from the *persons* involved, within the stakeholder model. These two issues are intimately intertwined.

It is the responsibility of managers, and the management function, to select activities and direct resources to obtain benefits for legitimate stakeholders. The question is, Who are the legitimate stakeholders? Some answers in the literature are, in our view, too narrow; others are too broad. The firm-as-contract view holds that legitimate stakeholders are identified by the existence of a contract, expressed or implied, between them and the firm. Direct input contributors are included, but environmental interests such as communities are also believed to have at least loose quasi-contracts (and, of course, sometimes very specific ones) with their business constituents.

We believe that the firm-as-contract perspective, although correct, is incomplete as a description of the corporation. For example, many business relationships with "communities" are so vague as to pass beyond even the broadest conception of "contract." The plant-closing controversy of the last couple of decades clearly shows that some communities had come to expect—and sometimes were able to enforce—stakeholder claims that some firms clearly did not recognize. As another example, potential job applicants, unknown to the firm, nevertheless have a stake in being considered for a job (but not necessarily to *get* a job). Lacking any connection to the firm, these potential employees are difficult to view as participating in the firm by reason of a *contract*, either implied or explicit. (We do not mean, however, to rule out possible relevance of so-called social contracts to such situations; cf. Donaldson & Dunfee, 1994b.) Stakeholders are identified through the actual or potential harms and benefits that they experience or anticipate experiencing as a result of the firm's actions or inactions. In practice, and in addition to legal requirements, appraisal of the legitimacy of such expectations is an important function of management, often in concert with other already recognized stakeholders.

Excessive breadth in the identification of stakeholders has arisen from a tendency to adopt definitions such as "anything influencing or influenced by" the firm (Freeman, 1984, quoting with approval Thompson, 1967). This definition opens the stakeholder set to actors that form part of the firm's environment—and that, indeed, may have some impact on its activities—but that have no specific stake in the firm itself. That is, they stand to gain no particular benefit from the firm's successful operation. The two types of interests that have cropped up most frequently in this connection are (a) competitors and (b) the media. Competitors were introduced as factors that have "an influence on managerial autonomy" in Dill's (1958) article, which is appropriately cited in the literature as a precursor of stakeholder analysis. However, neither the term *stakeholder* nor the notion of a *stake* (i.e., potential benefit) was explicitly introduced in Dill's analysis. In any event, in the normal course of events, competitors do not seek benefits from the focal firm's success; on the contrary, they may stand to lose whatever the focal firm gains. Competitive firms may, of course, join in common collaborative activities (e.g., through trade associations), but here the shared (noncompetitive) interests account for the stakeholder relationship. The notion that the media should be routinely recognized as stakeholders was originally introduced by Freeman (1984), but it seems to have been eliminated (without explicit explanation) from his later writings. It is essential to draw a clear distinction between influencers and stakeholders: some actors in the enterprise (e.g., large investors) may be both, but some recognizable stakeholders (e.g., the job applicants) have no influence, and some influencers (e.g., the media) have no stakes.

The role of managers within the stakeholder framework described in the literature is also contradictory. Aoki (1984), for example, recognized only investors and employees as significant stakeholders and saw managers as essentially "referees" between these two stakeholder groups. He acknowledged neither (a) the essential role of management in the identification of stakeholders nor (b) the fact that managers are, themselves, stakeholders—and, indeed, a very privileged class of stakeholders—in the enterprise. Williamson (1985) is almost alone among academic analysts in emphasizing the fact that the managers of a firm are one of its most important and powerful constituencies and that—wittingly or unwittingly—they are extremely likely to practice opportunistic and self-aggrandizing behavior.

This last point is absolutely critical for our argument, and recognition of it confirms our most important proposition: that the stakeholder theory is fundamentally normative. We observed at the close of our discussion of instrumental justifications that the instrumental case for stakeholder management cannot be satisfactorily proved. Here we restate that observation and add that the ultimate managerial implication of the stakeholder theory is that managers *should* acknowledge the validity of diverse stakeholder interests and *should* attempt to respond to them within a mutually supportive framework, because that is a moral requirement for the legitimacy of the management function.

It is feared by some that a shift from the traditional shareowner orientation to a stakeholder orientation will make it more difficult to detect and discipline self-serving behavior by managers, who may always claim to be serving some broad set of stakeholder interests while they increase their powers and emoluments. Indeed, Orts (1992: 123) saw this as the "greatest danger" of the new "constituency statutes" for corporate governance, although he nevertheless supported the constituency approach.

Our response to this fear is twofold: First, the conventional model of the corporation, in both legal and managerial forms, has failed to discipline self-serving managerial behavior. In this era of multimillion dollar CEO compensation packages that continue to increase even when profits and wages decline (Bok, 1993), it is difficult to conceive of managers having greater scope for self-serving behavior than they have already. Second, the stakeholder model we have advanced here entails comprehensive restrictions on such behavior. Indeed, its very foundation prohibits any undue attention to the interests of any single constituency. To be sure, it remains to implement in law the sanctions, rules, and precedents that support the stakeholder conception of the corporation; in short, it remains to develop the legal version of the stakeholder model. (See, for example, Eisenberg's [1976] attempt to restructure the legal model of the corporation.) Yet over time, statutory and common law are almost certainly capable of achieving arrangements that encourage a broader, stakeholder conception of management—one which eschews single-minded subservience to shareowners' interests—while at the same time restraining the moral hazard of self-serving managers.

CONCLUSION

We have argued that the stakeholder theory is "managerial" and recommends the attitudes, structures, and practices that, taken together, constitute a *stakeholder* management philosophy. The theory goes beyond the purely descriptive observation that "organizations have stakeholders," which, although true, carries no direct managerial implications. Furthermore, the notion that stakeholder management contributes to successful economic performance, although widely believed (and not patently inaccurate), is insufficient to stand alone as a basis for the stakeholder theory. Indeed, the most thoughtful analyses of why stakeholder management might be casually related to corporate performance ultimately resort to normative arguments in support of their views. For these reasons, we believe that the ultimate justification for the stakeholder theory is to be found in its normative base. The plain truth is that the most prominent alternative to the stakeholder theory (i.e., the "management serving the shareowners" theory) is morally untenable. The theory of property rights, which is commonly supposed to support the conventional view, in fact—in its modern and pluralistic form–supports the stakeholder theory instead.

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