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Applying Stakeholder Theory to E-Government:
Benefits and Limits

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Abstract: According to most scholars in the field, stakeholder theory is not a special theory on a firm's constituencies but sets out to replace today's prevailing neoclassical economic concept of the firm. Though stakeholder theory explicitly is a theory on a private sector entity, some scholars apply it to public sector organizations. This paper summarizes stakeholder theory, discusses its premises and justifications, compares its tracks, sheds light on recent attempts to join the two tracks, and discusses the benefits and limits of its practical applicability to the public sector using the case of a recent New York State e-Government initiative.

1. INTRODUCTION

The term "stakeholder" as Freeman acknowledged in a recent paper indicates a biased perspective. Rather than defining the unit of analysis as "interest groups" or "constituencies", the term "stakeholder" deliberately denotes a contrast to "stockholders", or "shareholders" [1]. Consequently, its proponents understand the stakeholder theory of the firm as an open challenge to the prevailing neoclassical economic theory of the firm (e.g. [2, 3]). The stakeholder research tradition began to unfold in the wake of R. Edward Freeman's seminal *book Strategic Management. A Stakeholders Approach* published in the mid-1980s [4]. The book initiated a still ongoing academic discussion. It suggested in a comprehensive fashion that strategic management of private sector firms might produce better results if managerial efforts adequately regard various stakeholders' concerns. Or, in other words, shareholders benefit long-term if other legitimate interests in the firm do not fall by the wayside.

Two distinct strands of stakeholder research have developed over the past decade and a half. The "Instrumental" or Social Science strand, and the "Business Ethics" strand. While both cover some common ground (e.g. the aforementioned bias), they differ drastically in methods used and results achieved. The Social Science strand sees itself as part of Organizational Studies partly overlapping with agency theory, network theory, and resource dependence theory, to name a few. Scholars of this strand rely on methodological rigor. The Business Ethics-based stakeholder theory implements different means and reaches for different ends. It assumes that each stakeholder of the firm has an intrinsic value regardless of her actual power or legal entitlement. It seeks to formulate correct ethical norms for managerial behavior. Though stakeholder theory roots in and pertains to the private-sector organization of the firm, there is tremendous interest in applying at least part of the findings to the managerial decision-making in public-sector organizations. While some proponents of stakeholder theory are extremely skeptical regarding this undertaking, inter and intra-governmental decision processes may benefit from the application of stakeholder principles. This seems particularly to be the case regarding large-scale investments in information technology where the risk of failure is notably high.

The paper is organized in the following fashion: In the next section, it outlines the basic ideas and concepts of the stakeholder research traditions. In the succeeding section, it compares the two strands in some detail and summarizes various justifications of stakeholder theory. In a further section, the paper discusses the general applicability of stakeholder theory to the public sector using the case of a major e-government initiative in New York State. The paper concludes that stakeholder theory, despite some deficiencies and limitations, has become increasingly influential on managerial decision-making in both the private and the public sector. It also confirms the practical value of a stakeholder approach in e-government-related settings.

2. THE UNFOLDING OF A STAKEHOLDER RESEARCH TRADITION!

The definition of the two terms "stake" and "stakeholder" needs to antecede any further discussion of the theory. A "stake" in an organization in terms of stakeholder theory rests on "legal, moral, or presumed" claims, or on the capacity to affect an organization's "behavior, direction, process, or outcomes" [5, 858]. As Reed defines, "stakes are understood to impose normative obligations....we will define a stake as 'an interest for which a valid normative claim can be advanced.'" [6, 467]. The definition of a stakeholder comes in various forms and flavors, some of which prefer a narrow interpretation, others deliberately maintain the broadest possible scope. The classical (and most frequently cited) definition is Freeman's:

> A stakeholder in an organization is (by its definition) any group or individual who can affect or is affected by the achievement of the organization's objective. [4, 25]

Freeman gave this same definition in a 1983 article under the same title in which the broader term "organization's mission" was used instead of "organization's objective" [7, 38]. This definition has been accepted, and simultaneously, criticized depending on the scholarly position. While the business ethics track generally embraces a wider definition, the social science track favors a narrow one. As Cohen observes, the use of the term in business ethics reaches beyond the one in discussions "of law, conveyance, and gambling" [8. 3]. It has been argued that such broad definitions make it possible to include even such groups as terrorists and competitors [9] who, indeed, could affect the firm painfully. This dilemma can partly be resolved by narrowing the definition in a meaningful way. By following Clarkson's argument [10], Mitchell et al. argue that the use of risk as a second defining property for the stake in an organization helps to "narrow the stakeholder field to those with legitimate claims, regardless of their power to influence the firm or the legitimacy of their relationship to the firm" [5, 857]. In a similar approach, Alkhafaji proposed focusing the stakeholder definition on only those groups that have a vested interest in the survival of the firm can be referred to as stakeholders [11]. A comprehensive, though not totally complete, development chronology of the term into the concept of stakeholder was presented by Mitchell et al. [5]. In summary, the concept is not uniformly accepted. In most cases, however, the differences refer to the scope of the definition.

In the next paragraphs, we will discuss the commonly used justifications of stakeholder theory. The ruling paradigm of corporate governance holds that those who invest their capital into whatever kind of business, and, by that token, those who risk losing their investment in parts or in total, have an entitlement (and an obligation) to govern the business they have invested into. Capital investors (principals) either govern the business themselves, or they do so with support of agents (managers) who they may appoint. As Etzioni points out, this understanding of principals' rights roots in "basically a mere extension of their natural right to own their private property" [12, 680]. However, the straightforward, unlimited transferability of individual property rights into the dimension of a corporation and its governance is increasingly questioned in the literature of various disciplines. This is also reflected in court decisions in both the US and Europe. As Etzioni remarks, "the notion that shareholders govern the corporation is largely a fiction; typically, executives have the greatest power" [12, 680]. The flames of this discussion have been further fanned by the observation that principals and agents may have conflicting interests even among themselves which has led to the development of agency theory [13] and a discussion about corporate governance as such. As Donaldson & Preston observe, "the conventional model of the corporation, in both legal and managerial forms, has failed to discipline self-serving managerial behavior" [14, 87]. Apart from this, the exclusively economic perspective on corporate governance, even though it has gotten some support in recent years through the shareholder value discussion and practices, has been seriously called into question from a number of perspectives.

According to Alkhafaji, corporate performance, power, and privileges as well as the corporate capacity to properly handle future problems of society are at the center of such criticism [11]. When it comes to corporate governance there are obviously more individuals and groups who have something important at stake than the shareowners and managers alone. Furthermore, it is not only the stake as such but more so the potential for conflict of interest [15]. Clarkson argues that such areas of conflict in which an issue is not subject to any legislation or regulation may be those of stakeholder issues rather than social issues [16]. Lastly, as Sethi pointed out, private firms impact other entities in society "above and beyond their economic sphere" [17, 19]. By doing so, they naturally have to be subjected to checks and balances.

Stakeholder theory attempts to describe, prescribe, and derive alternatives for corporate governance that include and balance a multitude of interests. The theory has drawn considerable attention and support since its early formulation. However, as discussed above, there are a least two major branches or strands of stakeholder theory. Jones & Wicks distinguish between the following elements, or better research tracks: “(1) firms/managers should behave in certain ways (normative), (2) certain outcomes are more likely if firms/managers behave in certain ways (instrumental), (3) firms/managers actually behave in certain ways (descriptive/empirical)” [18, 207].

The distinction of normative versus instrumental versus descriptive/empirical research tracks inside stakeholder theory is further elaborated by Donaldson & Preston in their frequently cited article titled *The stakeholder theory of the corporation: concepts, evidence, and implications.* The theory’s focus has been the **manager** of the firm, and how she recognizes and acts upon the various stakeholders and their claims. Freeman himself made it clear that what he had presented was an "inherently 'managerial'" concept or a framework about managerial and, organizational behavior” [4, 43].

The theory’s origins were designed to provide managers with a handle for developing more balanced and more robust strategies that reflect the unfolding changes inside the organization and in the environment of the corporate landscape. The firm was seen as the hub at the center of the spokes representing various stakeholders who were in essence equidistant to the firm. In other words, the perspective of stakeholder theory was partly oriented towards employees and managers, or towards others, viewing very much in the same fashion, corporate managers look at their firms and the world around them. However, with increasing attention to managerial power and the aftermath of managerial failure, an outside-in perspective, predominantly nurtured from and by business ethics and philosophy scholars has emerged. Among many others, Phillips voices this perspective when stating that the organizational-efficiency argument is "insufficient as a basis of normative organizational ethics study" [9, 52-53].

These different points of departure between the "inside-out" and "outside-in" perspectives have both considerably contributed to the formulation of "the" theory. Nevertheless, the two tracks share only a few basic insights, and also come quite frequently to different, sometimes even contrary, conclusions as emphasized by Donaldson & Preston:

> 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 from one theoretical base to another - is strong...The muddling of theoretical bases and objectives, although often understandable, has led to less rigorous thinking and analysis than the stakeholder concept requires. [14, 72-73]

Treviño & Weaver hence suggest referring to a stakeholder research tradition, rather than a unified theory [19]. Not surprisingly, stakeholder theory (and particularly its business ethics strand) has drawn outspoken criticism from leading economists. As early as 1970, Milton Friedman in an irresistibly rhetorical article in the New York Times Magazine made his point utterly clear: "The social responsibility of business is to increase its profits" [20]. But critics from inside the field also bluntly state that "it is time to get off the veranda and require stakeholder theory to ground itself in more data" [21, 230], aiming particularly at the social science track.

3. THE TWO STRANDS

The **social science track** encompasses the two areas of descriptive/empirical and instrumental research. Frooman offers this short formula: stakeholder theory asks, "(1) Who are they? (2) What do they want? (3) How are they going to try to get it?" [15, 193]. Jones & Wicks describe the first strand as revolving around the two claims that managers regard stakeholders because of the "intrinsic justice" of their claims, and because information on stakeholder interests makes the firm more manageable [18, 208]. Donaldson & Preston support the view of the descriptive nature of stakeholder theory. They see the organization as a "constellation of cooperative and competitive interests possessing intrinsic value" [14, 66]. Treviño & Weaver, however, doubt the theoretical originality of this branch of the theory and argue that the fundamentals of descriptive stakeholder theory are ill defined. They conclude that descriptive stakeholder theory looks just like a derivative of other social science theories [19].

The *instrumental* strand links managerial actions to outcomes and attempts to explain how these links work. As Donaldson observes–given the intrinsic value of all stakeholders' interests–those organizations that actively "manage" stakeholder interests fare far better in traditional measures such as return on investment than those who do not [22, 238]. As Jones asserts, instrumental stakeholder theory comes to exactly opposite conclusions as neoclassical economic theory does: Trusting, trustworthy, and cooperative behavior, he maintains, leads to superior results than opportunistic and selfish behavior [13, 432]. Weston & Copeland, on the other hand, see a compatibility of the two theories to the end, that financial managers, for example, have the goal "to maximize the value of the organization" [23, 5] They concede that "value maximization is subject to the constraints of the legitimate claims of the different stakeholders" [23, 12]. Cloninger adds that the reputational capital of the firm is at stake if stakeholders are not properly managed [24]. The instrumental branch helps corporate managers manage stakeholders in practice. It is about "Who and What Really Counts". Under this label, Mitchell et al develop a dynamic perspective on stakeholders than the inevitably static hub-and-spoke view. Their approach distinguishes between attributes of power, legitimacy, and urgency. With help of these attributes seven classes of stakeholders are identified who need different managerial attention at different times [5].

The normative or **business ethics track** deducts norms and principles for corporations in a more or less axiomatic fashion from philosophical vantage points. Kant's categorical imperative is a center pillar in building the theory of the firm's stakeholders. Others ground it on the theory of the common good [25], or on the principle of fairness [9]. Reed proposes to anchor the theory normatively on Critical Theory [6, 455]. He argues that all citizens have a general stake, namely, that their "political equality (is) assured." A firm may even operate within the legal framework but may still become a threat to just this political equality. Reed further advances his argument by pointing to the need that all humans have a legitimate interest in securing their physical and material lives. On this basis, he claims, any economic system must have the capacity to benefit everybody. Consequently, everybody must have a fair economic opportunity. Since firms can undermine this fair opportunity, a legitimate stake in the activity of the firm can be assumed. This, he continues, encompasses forming and maintaining one's own identity and choosing one's own life projects. On this basis, Reed formulates a very general stake: "(W)e all have a stake in all members of the communities to which we belong living in accord with the norms and values of our shared identity" [6, 470].

Though the normative track is mainly concerned with ethical appropriateness of corporate and managerial activity, it does not completely ignore economic necessities. As Jones & Wicks emphasize, it does not seek "to shift the focus of firms away from marketplace success toward human decency but to come up with understandings of business in which these objectives are linked and mutually reinforcing" [18, 209]. However, as Treviño and Weaver almost provokingly ask, "(w)ouldn't normative stakeholder theory's concern for the intrinsic interests of all legitimate stakeholders sometimes dictate that a firm should go out of business?" [19, 225]. They conclude that normative foundations are not essentially necessary to demonstrate the superior performance of corporations who honor and properly treat their stakeholders. Donaldson & Preston, on the other hand, find the three approaches "mutually supportive" [14, 66].

Most scholars agree that ultimately stakeholder theory relies on normative foundations. The social science track, as pointed out earlier, heavily leans up on other social science theories such as agency theory, network theory, game theory, corporate social performance theory, resource-based theory, transaction cost theory, company-as-contract theory, private property theory, to name just a few. Even in the normative track organizational justice theory or fairness theory or the theory of the common good among others are proposed as foundations. This may lead to the conclusion that stakeholder theory is a hybrid with unclear parenthood.

The considerable number of attempts and proposals indicates, at least, a diverse and even controversial understanding the foundations any stakeholder theory rests on. Jones [13, 422] argues that firms that treat stakeholders in a trustworthy manner will develop a competitive advantage since they are able to reduce costs; in other words, good stakeholder management translates into good business. Donaldson & Preston [14, 77] point out that the instrumental justification (as good business) has not been verified, and that there is no compelling evidence for superior performance in terms of traditional measures when proper stakeholder management is employed. Along the same (i.e., instrumental) lines, Clarkson claims that the corporation defined as a system of primary stakeholder groups can only survive in the long run if, and only if, it maintains its ability to create wealth and value for the whole primary stakeholder system of the firm [16]. This proposition, of course, is the most far-reaching and needs to be rigorously tested. If confirmed, the justification of stakeholder theory from an instrumental perspective would no longer be in question.

Justifications from normative quarters may be more compelling as evidenced by unfolding case law, for example, in the United States. The instrumental perspective is concerned with a management issue: "Will the firm, I am managing be better off, if I factor in other stakeholders' interests?". Normative theory rather looks upon the firm from the outside, and is concerned whether or not this form of human organization does produce more harm than good for a broader community of stakeholders. There are different avenues to anchor this perspective. One is, ironically or not, rooted in the property rights themselves–Donaldson and Preston observe:

> 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. [14, 83]

Etzioni comes to similar conclusions pointing at the changing interpretation of property laws that increasingly attach strings to property rights and emphasize societal obligations. "Corporations are a societal creation, and society grants shareholders a valuable privilege in exchange for which the society can seek some specific consideration [12, 681]. Shankman also argues that "the concept of property rights includes duties to multiple stakeholders, not just the shareholders of the firm" [26, 327]. Philips, in turn, anchors normative stakeholder theory on the principle of fairness [9]. Cohen sees the obligation of informed consent, if individuals or groups are affected, as the basis for normative stakeholder legitimacy [8]. Quinn & Jones, as well as Shankman, maintain that there are four core principles "antecedent" to law or any contract of whatever nature (e.g. between principal and agent)

> –which include "avoid harm to others," "respect the autonomy of others," "avoid lying," and "honor agreements," ... Acting with regard to these principles is the moral obligation of all humans, no matter what profession or position [27, 30]

The absence of respective law does not forsake any of these fundamental principles. That is, individuals are entitled to demand protection under such normative principles regardless of the legal framework that they may live under. On this basis, Reed [6, 474] presents a very fundamental (and conclusive) justification of stakeholder theory on normative grounds: since a firm may threaten the individual and the community in at least two dimensions ("harm", "autonomy"), there are stakes in the activity of any firm. Reed stresses, that capitalist business practice is not self-justified or granted *per se.* It may only represent a generalizable interest as long as it provides efficient markets, fair distribution, limited marginalization (in terms of minorities), limited colonization, and limited hierarchical management. Reed also emphasizes that these norms hold, even if they are not, or not yet, backed up by common law.

These normative lines of reasoning have had a major impact on legislation in many of the United States in the last two decades of the 20^{th} century. Before this background it is amazing that there is still a debate about the justification of stakeholder theory. Effective legislation has been passed (and successive case law has developed) that mandates the consideration of stakeholder interests, or at least, off-burdens management from serving shareholder interests alone. With the advent of stakeholder statutes, and evolving case law in this area, the scenery has changed in favor of advocates of stakeholder interests.

4. STAKEHOLDER THEORY AND THE PUBLIC SECTOR

Despite the opposition from prominent proponents of the theory, the stakeholder concept has even found its way into the scholarly discussion of the public administration literature [28] and public sector practice. Donaldson & Preston completely doubt the value and appropriateness of such undertaking [14] because they see the theory as merely one of the (private-sector) firm governed by fundamentally different principles and implications than any public sector organization.

However, even though most public-sector managers perform their tasks for different reasons (e.g., public interest) as opposed to their private-sector counterparts (e.g., survival of the firm, or profit), their decisions have the same capacity to affect individuals or groups pursuing their organization's objective. Also, others–as in the private sector– can affect public managers and governmental organizations. In other words, Freeman's stakeholder definition applies to managerial decision-making also in a governmental context. Instrumental and normative considerations can be applied to public-sector stakeholder scenarios as much as in the private sector. However, as Tennert & Schroeder [28] find, public sector managers lack a proper toolkit for stakeholder identification and management. This leads to "difficult stakeholder situations" after public-sector decisions have been made (p. 3). Since the public sector manager's self-understanding is shifting from being a public administrator towards the one of a public facilitator, the authors see an even greater necessity for a solid grounding of stakeholder management in the public sector. "Working in the public sector has become a multi-jurisdictional and multi-sector endeavor" (p. 5) according to the two authors. In other words, the shift from a more hierarchical to a more network-type organizations further demands inclusion and management of constituencies.

Tennert & Schroeder propose the combination of Mitchell et al.'s concept of stakeholder identification along the lines of power, legitimacy, and urgency (cf. [5]) with Blair & Whitehead's [29] diagnostic topology of stakeholders' potential for collaboration versus their potential for threatening the organization. The authors propose a questionnaire by which these five capacities can be assessed [28, 33].

This framework has been tested in the context of a major e-Government initiative in New York State (cf. [30]): The Central Accounting System of the State is currently based on two-decade old mainframe technology. This system has not only reached its limits in terms of expandability and maintainability (user interface, service, etc.) but it also lacks integration and functionality in important areas of contemporary financial management. Since the system is the spine of the State's financial management and as such a mission-critical system to the State's overall functioning, utmost caution has to accompany any repair, any addition, or any overhaul of this system. On the other hand, New York State officials understand the necessity for a major overhaul and the potential for business process redesign and integration across government agencies, government levels, and government branches when overhauling the Central Accounting System (CAS) and expanding its scope. One vision is to have a streamlined and integrated (in terms of business processes and data structures) Intranet and Extranet-based accounting system that serves the State as a hub of transaction and financial management for governmental entities as well as private-sector firms (contractors, vendors). Such a system would be a highly sophisticated government-to-government (g2g), and partly government-to-business (g2b), e-government application with a high potential for reducing costs, integrating processes and services, increasing response time, and enhancing transparency and accessibility.

However, before an ambitious project of this scale and scope can be launched, it is mandatory to understand the needs of the primary and secondary stakeholders in such a setting. This consideration led to a stakeholder needs analysis which was conducted by the University at Albany based Center for Technology in Government. In this project, the Tennert & Schroeder framework was used to identify primary stakeholders (also referred to as strategic partners) as well as secondary and tertiary stakeholders. A joint project team was formed with members from the Office of the State Comptroller (which has the statutory authority over the State's Central Accounting System) and the Center for Technology in Government. This team identified five primary stakeholders to the project: the State Assembly, the State Senate, the Division of the Budget, the Office for Technology, and the Leadership of the Office of the State Comptroller. These primary stakeholders jointly or alone command (1) the power, (2) the legitimacy, and (3) the urgency to advance or to shut down the CAS overhaul project at almost any given point in time. In other words, without the support (or at least friendly indulgence) of any one of these primary stakeholders the project would be doomed.

However, secondary stakeholders (those who do not rank high on all three scales of power, legitimacy, and urgency), and even tertiary stakeholders (those who only score high on one of the scales), have a capacity to contribute or to impede the project to various degrees as well. State agencies that process over 17.5 millions transaction per day using the CAS, local governments (such as counties, cities, towns, and villages but also the Federal government), and finally non-governemental entities, that is, in total several thousand organizations, fall into these latter two categories. Applying Blair & Whitehead's diagnostic topology helped the joint project team to understand (in a fairly detailed fashion) the potential for collaboration with and threat from the primary stakeholders, and, in more general terms, for the other two stakeholder groups. It was found that there are eight distinct types of CAS users. These types vary in terms of their dependence on CAS, the scale and scope of its usage, and the nature of usage (transactional, analytical/informational).

In a series of 13 uniformly facilitated half-day workshops over 200 experts from 41 State agencies and 10 non-governmental entities were asked about their specific transactional and informational requirements. Six themes turned out to be the high-priority needs: (1) data access and manipulation capabilities, (2) real-time workflow support, (3) improvement in basic financial processes, (4) support for electronic business, (5) usability/ease of use/user friendliness, and (6) consistency within and across related systems. The stakeholder needs analysis further uncovered and confirmed major deficiencies of the existing system such as the lack of data access and tracking capabilities, the lack of data integration, the lack of business process integration, the lack of a user-friendly interface, the lack of important functionality, and finally the existence of numerous redundancies.

As a result of this exercise (in which the primary stakeholders were integrated and supportive throughout the process) the joint project team made four recommendations for further action: (1) analyze the fragmentation of existing business processes and workflows, (2) conduct best and current practices studies, (3) continue involving stakeholders into the process, and (4) maintain the current system to gain time for a potentially multiyear transformation process. Though the project is still in its infancy, the stakeholder needs analysis demonstrated the usefulness of the stakeholder management approach in a public-sector setting: first, an abundance of relevant information results from the workshop series; second, the integration and support of primary stakeholder furthers the process and the project in significant ways (for example, budgeting the succeeding steps); third, other stakeholders begin to support the overhaul project discontinuing costly and redundant local efforts, and fourth, the statewide visibility of the project leads to high levels of attention and expectation.

5. CONCLUDING REMARKS

This paper's intent has been to review stakeholder theory and its potential applicability to e-government, and more generally, public-sector managerial decision-making. It has demonstrated that a unified stakeholder theory does not exist. Instead two divergent [1] rather than convergent [18] strands of stakeholder theory exist. Though these two strands may have been originated from the same source, their implications and prescriptions differ in various ways. Stakeholder theory is primarily a theory of the private-sector firm. In its instrumental interpretation it mainly challenges the neoclassical economic theory of the firm and maintains that those firms that are managed for optimal stakeholder satisfaction thrive better than those firms that only maximize shareholder interests (that is, profit). Through its normative branch, stakeholder theory has become ever more influential upon legislative and evolving case law trends in the past two decades. In other words, stakeholder theory, of whatever flavor, has made a major impact in both the private and public spheres.

Despite the fact that stakeholder theory primarily applies to the private-sector firm, the insights from this area can be applied in part to public sector settings, and in particular, to the context of managerial decisions regarding major e-government initiatives. This is due to the circumstance that public management responsibilities begin to resemble private-sector management tasks not only formally but also regarding the emerging network-nature of organizations in both spheres. Future research may attempt to better understand the differences between private and public-sector stakeholder scenarios. While the cross-sector application of insights of instrumental stakeholder theory may be somewhat straightforward between g2g and g2b scenarios, this may not be the case in government-to-citizen (g2c) scenarios (since g2c is obviously not the equivalent to business-to-consumer (b2c), that is, consumer is not equivalent to citizen). The role of citizens in e-government and e-democracy settings may be more than just as a primary stakeholder who needs to be "managed" in some sort of paternalistic fashion. However, stakeholder theory (in its two strands) may have the capacity to broaden the understanding of the presumably increasing importance of citizens in e-government and e-democracy scenarios.

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