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What Stakeholder Theory Is Not

Robert Phillips, R. Edward Freeman and Andrew C. Wicks

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The term "stakeholder" is a powerful one. This is due, to a significant degree, to its conceptual breadth. The term means many different things to many different people and hence evokes praise or scorn from a wide variety of scholars and practitioners of myriad academic disciplines and backgrounds. Such breadth of interpretation, though one of stakeholder theory's greatest strengths, is also one of its most prominent theoretical liabilities as a topic of reasoned discourse. Much of the power of stakeholder theory is a direct result of the fact that, when used unreflectively, its managerial prescriptions and implications are nearly limitless. When discussed in its "instrumental" variation (i.e., that managers should attend to stakeholders as a means to achieving other organizational goals such as profit or shareholder wealth maximization) stakeholder theory stands virtually unopposed (Donaldson and Preston 1995; Jensen 2000; Jones 1995; Sternberg 2000).

This interpretive breadth has also provided a rich source of fodder for those critics of the theory who remain. The same wide-pattern sieve that has allowed business ethicists and social issues in management scholars to find whatever they were originally seeking from the theory has also admitted of criticisms that either do not or need not apply to stakeholder theory. Strangely, this has created a situation in which it has been occasionally difficult to figure out who among those writing about the stakeholders are critics and who are advocates. Prominent theorists have criticized stakeholder theory only to later – in the same work – return to advocate some instrumental version of it (Williamson and Berkovitz 1996; Jensen 2000; Sternberg 1998, 2000, 2001).

This paper is the result of several sources of inspiration.[1] The most obvious is the frequent recurrence of the same distortions within the critical literature as well as less formal discussion of stakeholder theory. The notion of strict stakeholder equality, application of the theory either to the entire economy or exclusively to large, publicly held corporations, and concerns with changes in the law and corporate governance are common in the literature among stakeholder theory apologists and critics alike. The other idea motivating this paper comes from Donaldson and Preston's widely cited 1995 article. They argue that stakeholder research is "managerial". This is, at first blush, a rather straightforward proposition – that is until one tries to unpack this notion. If the stakeholder theory is managerial, what does this imply that it is NOT?[2]

In many ways, defending stakeholder theory is a bit like shadow boxing. Owing in part to the ambiguity and breadth of stakeholder theory itself, critiques are often implicit. Many of the most common, and potentially damaging, criticisms of stakeholder theory have not, to our knowledge, been formally elaborated in

the management literature. Part of what this paper attempts to do is, in addition to responding to some explicit critiques, expose some of these implicit criticisms. Therefore, there are a few points in the article at which the reader might expect to see a citation indicating who has leveled the critique in question. The criticism in these cases represents an amalgam of frequent and persistent critiques of stakeholder theory from the authors' experience discussing stakeholder theory with scholars, students and executives. Finally, some of the criticisms are our own as we are ourselves (perpetually) dissatisfied with the current state of the theory.

The goal of the current paper is like that of a controlled burn that clears away some of the underbrush of misinterpretation in the hope of denying easy fuel to the critical conflagration that would attempt to raze the theory. The aim is to attempt to narrow its technical meaning[3] for greater facility of use in management and organizational studies. By elaborating a number of common misinterpretations of the theory, we hope to render a stronger and more convincing stakeholder theory as a starting place for future research.

What Stakeholder Theory Is

Before discussing what stakeholder theory is not, we should provide an outline of the theory, as we understand it. Stakeholder theory is a theory of organizational management and ethics. Indeed all theories of strategic management have some moral content, though it is often implicit. This is not to say that all such theories are moral, as opposed to immoral. Moral content in this case means that the subject matter of the theories are inherently moral topics (i.e., they are not amoral) (Freeman 1994; Jones and Wicks 1999a). For example, in arguing that current organizational arrangements and processes should be ignored as organizations are reengineered, managers are asked to ignore existing relationships and obligations among organizational actors (Hammer and Champy 1993). These obligations may be overcome by other stronger obligations, but that is a subject of moral discourse and if implied, should be exposed and examined. Moral content is frequently taken for granted, implied, or ignored in this manner in management scholarship.

Stakeholder theory is distinct because it addresses morals and values explicitly as a central feature of managing organizations.[4] The ends of cooperative activity and the means of achieving these ends are critically examined in stakeholder theory in a way that they are not in many theories of strategic management. Stakeholder theory is conceived in terms that are "explicitly and unabashedly moral" (Jones and Wicks 1999a). This is evidenced in the branch of Stakeholder theory literature examining the moral foundations of the theory (See Table 1).

Managing for stakeholders involves attention to more than simply maximizing shareholder wealth. Attention to the interests and well-being of those who can assist or hinder the achievement of the organization's objectives is the central admonition of the theory. In this way stakeholder theory is similar in large degree with alternative models of strategic management such as resource dependence theory (Frooman 1999: Pfeffer and Salancik 1978). However, for stakeholder theory, attention to the interests and well-being of some non-shareholders is obligatory for more than the prudential and instrumental purposes of wealth maximization of equity shareholders. While there are still some stakeholder groups

Table 1: Normative justifications for stakeholder theory

Author	*Normative core*
Argandoña (1998)	Common Good
Burton and Dunn (1996)	Feminist Ethics
Wicks, Gilbert, and Freeman (1994)	
Clarkson (1994)	Risk
Donaldson and Dunfee (1999)	Integrative Social Contracts Theory
Donaldson and Preston (1995)	Property Rights
Evan and Freeman (1993)	Kantianism
Freeman (1994)	Doctrine of Fair Contracts
Phillips (1997, 2003)	Principle of Stakeholder Fairness

whose relationship with the organization remains instrumental (due largely to the power they wield) there are other normatively legitimate stakeholders than simply equity shareholders alone.

At its current stage of theoretical development, stakeholder theory may be undermined from at least two directions: distortions and friendly misinterpretations.[5] Some have sought to critique the theory based upon their own stylized conception of the theory and its implications. Though not always without some textual evidence for such characterizations, we argue that many of these distortions represent straw-person versions of the theory. At the least, the critical (mis) interpretations do not represent the strongest, most defensible variation of stakeholder theory. We will begin by discussing a number of interpretations that have provided fodder for critics as well as alternative interpretations that we believe make stakeholder theory more resilient to such attacks (See Table 2).

Table 2: What stakeholder theory is not

Critical distortions	*Friendly misinterpretations*
Stakeholder theory is an excuse for managerial opportunism (Jensen 2000; Marcoux 2000; Sternberg 2000)	Stakeholder theory requires changes to current law (Hendry 2001a, 2001b; Van Buren 2001)
Stakeholder theory cannot provide a sufficiently specific objective function for the corporation (Jensen 2000)	Stakeholder theory is socialism and refers to the entire-economy (Barnett 1997; Hutton 1995; Rustin 1997)
Stakeholder theory is primarily concerned with distribution of financial outputs (Marcoux 2000)	Stakeholder theory is a comprehensive moral doctrine (Orts and Strudler 2002)
All stakeholders must be treated equally (Gioia 1999; Marcoux 2000; Sternberg 2000)	Stakeholder theory applies only to corporations (Donaldson and Preston 1995)

As mentioned, these distortions are not without some textual basis in the literature. We argue that stakeholder theory has also suffered at the hands of well-meaning, but perhaps overzealous advocates. The wide-ranging intuitive appeal of stakeholder theory has led a number of scholars and commentators to stretch the theory beyond its proper scope rendering it more susceptible to criticism and distortion. In the second part of the paper we will address a number of friendly misinterpretations that we believe tend to weaken stakeholder theory.

Critical Distortions: Straw-Persons and Evil Genies

Finding fault with an existing theory or model is easier than creating and defending an alternative. The former activity is easier still under two time-honored and

widely used approaches to criticism. The first is the use of so-called straw-persons. A critic sets up the object of her criticism in such a way that it is easily felled by whatever rhetorical axe the critic happens to be wielding.[6]

The other well-worn implement of criticism is that of holding the objectionable theory to a higher standard than that to which the proposed alternative is subjected. Sometimes this takes the form of what some call the evil genie (alternatively evil genius or evil demon) argument. An evil genie argument is one that is no more (or less) problematic for any one theory or idea than any of the extant alternatives. In the course of casting all knowledge into radical doubt, Descartes (1641) suggested that even ideas that appear true beyond doubt (e.g., 2 + 2 = 4) may be mistaken inasmuch as there may be an omnipotent deceiver that consistently leads one to believe that 2 + 2 = 4 when in fact 2 + 2 = banjo. While an evil genie may exist, the existence of such a being is a problem for all theories and arguments equally. Critics of stakeholder theory use both tools rather liberally. Below we shall briefly mention several criticisms based on versions of the theory that are either out-dated, distorted or some combination of the two. We also suggest alternative interpretations that should help overcome the objections.

Stakeholder Theory is an Excuse for Managerial Opportunism

The shareholder wealth maximization imperative is frequently motivated by so-called agency problems: hazards arising from the separation of risk bearing and decision-making (also known as ownership and control, respectively). The concern is that without this moral imperative, managers would enrich themselves at the expense of the organization and the recipients of its residual cash flows, the shareholders.

In the hope of mitigating such opportunism, a moral (and legal) argument is proffered regarding the obligations between shareholders and the board of directors (Sternberg, 1998). The separation of risk-bearing and decision-making is the problem; a moral and legal obligation on the part of the agent to act solely in the interest of the principal is the solution. Significantly, the interest of the principal is *assumed* to be exclusively wealth maximizing.

Rather than morally superior, therefore, stakeholder theory is actually immoral inasmuch as it ignores this agency relationship – or so goes the argument.[7] This criticism is, however, the result of the over-extended metaphor of agency theory in economics. If managers are agents or fiduciaries at all, it is to the *organization* and not to the shareowners; Clark (1985) writes:

> To an experienced corporate lawyer who has studied primary legal materials, the assertion thai corporate managers are agents of investors, whether debtholders or stockholders, will seem odd or loose. The lawyer would make the following points; (1) corporate officers like the president and treasurer are agents of the corporation itself; (2) the board of directors is the ultimate decision-making body of the corporation (and in a sense is the group most appropriately identified with 'the corporation'); (3) directors are not agents of the corporation but are *sui generis*; (4) neither officers nor directors are agents of the stockholders; but (5) both officers and directors are 'fiduciaries' with respect to the corporation and its stockholders.

The corporation is not coextensive with the shareholders. It is an entity unto itself. It may enter into contracts and own property (including its own stock[8] or that of other corporations). It has standing in a court of law. Limited liability assures that shareowners are not, in general, personally liable for the debts of the organization (cf., Sollars, 2001). Top managers are agents for the corporation and this is not merely a shorthand way of saying that they are agents for the shareholders. The corporation is meaningfully distinct.[9] The same goes for other limited liability entities such limited liability partnerships to the extent that it is the partnership that has legal standing separate from that of the partners themselves and the partners enjoy immunity from personal responsibility for the actions and debts of the organization.

Some have suggested that stakeholder theory provides unscrupulous managers with a ready excuse to act in their own self-interest thus resurrecting the agency problem that the shareholder wealth maximization imperative was designed to overcome. Opportunistic managers can more easily act in their own self-interest by claiming that the action actually benefits some stakeholder group or other. (Jensen 2000; Marcoux 2000, Sternberg 2000). "All but the most egregious self-serving managerial behavior will doubtless serve the interests of *some* stakeholder constituencies and work against the interests of others" (Marcoux 2000: 97) and by appealing to the interests of those who benefit, the manager is able to justify the self-serving behavior. Hence, stakeholder theory, "effectively destroys business accountability . . . because a business that is accountable to all, is actually accountable to none" (Sternberg 2000: 51f).

The first response to this criticism is to point out that no small measure of managerial opportunism has occurred in the name of shareholder wealth maximization. In addition to the debacles at Enron and WorldCom, one need only consider the now dethroned king of shareholder wealth Al Dunlap for an illustration.[10] Dunlap grossly mismanaged at least two companies to his own significant financial gain. And every move he made was in the name of shareholder wealth. Dunlap agreed to pay $15 million to settle a lawsuit brought by the shareholders of Sunbeam Corporation.[11] There is little reason to believe that stakeholder theory will provide any more or less justification for the opportunistic manager.

This criticism of stakeholder theory is a version of the evil genie argument. Managerial opportunism is a problem, but it is no more a problem for stakeholder theory than the alternatives. Indeed, there may be some reason to believe stakeholder theory more resistant to managerial self-dealing. In their discussion of "stakeholder-agency" theory Hill & Jones (1992) argue that managers' interest in organizational growth (citing remuneration, power, job security and status as motivating this interest) runs contrary not only to the interests of stockholders, but also contrary to the interests of stakeholders. They write, "[o]bviously, the claims of different groups may conflict. . . . However, on a more general level, each group can be seen as having a stake in the continued existence of the firm." (1992: 145). Stakeholder theory, therefore, does not advocate the service of two masters. Rather, managers serve the interest of one master: the organization.

One could make a case that having to answer to multiple constituencies will increase accountability rather than mitigate it. That a manager can *attempt* to justify self-serving behavior by reference to some stakeholder group does not mean that the justification is a persuasive or viable one. Indeed, those stakeholders against

whose interests the manager has acted will certainly have reasons for doubting her justifications and she will be answerable to these groups as well. Hence, stakeholder groups will maintain managerial accountability in much the same way described by James Madison in Federalist No. 10 – various stakeholder "factions" will monitor management as well as one another (Handy, 1992).[12]

Stakeholder Theory Cannot Provide a Specific Objective Function for the Corporation

Another common critique concerns the "radical under-determinism" of stakeholder theory. That is, "In rejecting the maximisation of long-term owner value as the purpose of business, and requiring business instead simply to 'balance' the interests of all stakeholders, stakeholder theory discards the objective basis for evaluating business action" (Sternberg 2000: 51) and the theory fails to be "illuminatingly action-guiding" (Marcoux 2000).

In one sense, this critique is accurate. Stakeholder theory does fail to provide an algorithm for day-to-day managerial decision-making. This is due to the level of abstraction at which the discussion is taking place. Stakeholder theory provides method by which stakeholder obligations are derived and an admonition that managers must account for the interests of these stakeholders when making decisions. It is impossible to say *a priori* what these interests will be and how they may be accounted for due to the myriad ways that an organization might be arranged. Hence, it is impossible for such a theory to dictate specific action in the abstract.

However, this is another example of an evil genie criticism. The same critique may be leveled at the conventional shareholder-centered view. That is, the managerial dictate to maximize shareholder wealth stands mute when queried, How? This is because there are innumerable ways to do so.[13] Indeed, this indeterminacy and the impossibility of a one right way to manage is the reason for the business judgment rule discussed above and the courts hesitance to pierce the corporate veil.

Ostensible critics of stakeholder theory, including Jensen and Sternberg, eagerly embrace an instrumental variation of stakeholder management as a means to "maximize the total market value of the firm", or "maximize long-term owner value", respectively. In his critique of stakeholder theory, Jensen concedes that. "value maximizing says nothing about how to create a superior vision or strategy" (2000: 49), though "Maximizing the total market value of the firm – that is the sum of the market values of the equity, debt and any other contingent claims outstanding on the firm – is one objective function that will resolve the tradeoff problem among multiple constituencies." (Jensen 2000: 42).

Perhaps taking the organization's objective function to be the maximization of total market value (or profits or wealth) does make *ex post* measurement of success more determinate than optimizing the well-being of multiple stakeholders.[14] Distributing the value thus created is a simpler matter for "shareholder theory" than for stakeholder theory as well. Shareholder theory could, thus, be considered superior in light of the fact of bounded rationality and the limits on human cognitive capacity. There is no reason to believe, however, that stakeholder management would be any easier or the theory more determinate *ex ante* when undertaken for instrumental rather than normative reasons. Moreover, every

ex post decision provides the *ex ante* circumstances for the next set of decisions. Even considering value maximization as a scorekeeping device (Jensen. 2002) is problematic when the score for the current game determines how subsequent games are played and coached.

As for the argument from simplicity, Albert Einstein is quoted as advising, "Make things as simple as possible – but no simpler." The theory and practice of management certainly can be simplified – consider bookstore shelves packed with books on how to manage in a minute. Simplicity, however, is not the lone criterion of usefulness. There is no reason to believe that stakeholder management would be any easier or the theory more determinate when undertaken for instrumental rather than normative reasons.

The belief that maximizing "the total market value of the firm" or "long-term owner value" is more determinate than the balancing of stakeholder interests may itself prove dangerous due to what we may term the delusion of determinacy. That is, under conditions of uncertainty and bounded rationality, managers may be led to believe that the standard objective function dictates action in a way that is more specific than stakeholder theory. It does not – and the belief that it does gives managers an unfounded sense of confidence in their decisions. Managerial wisdom and judgment are replaced with a false sense of mathematical precision.

After independently and collaboratively criticizing stakeholder theory for its ambiguity, longtime friendly critics of stakeholder theory Donaldson & Dunfee choose to conclude their book *Ties That Bind*, with the following:

> As should be clear from the discussion above, an ISCT-based lintegrative social contracts theory] stakeholder theory will not provide concrete external guidance for resolving every difficult question found in stakeholder management. *No theory or approach can, or even should, do that.* An internal revenue code level of detail in defining who is a stakeholder is neither possible nor desirable. (1999: 262; emphasis added)

As Donaldson and Dunfee indicate, it is important that scholars recognized the limitations of stakeholder theory. Unfortunately, as we will see in later sections, many writers sympathetic to stakeholder theory have failed to recognize these limitations.

Finally, stakeholder theory, when applied to for-profit business organizations, is consistent with value maximization. We should distinguish, however, between value maximization and *maximizing shareholder wealth* or *stock value/share price*. Maximizing value says nothing about who gets a say in the decision-making or who gets how much of this value, so maximized. It is only when the primary beneficiary of this profitability is constantly and exclusively a single stakeholder (e.g., equity share owners) that there is conflict between the theories. An organization that is managed for stakeholders will distribute the fruits of organizational success (and failure) among all legitimate stakeholders (Mitchell, et al., 1997; Phillips, 2003). Moreover, managing for stakeholders will include communication between managers and stakeholders concerning *how* profits should be maximized. Granting the imperative of profitability, there remain distributive and procedural issues to which stakeholder theory would draw attention. We turn now to an elaboration of this important distinclion.

Stakeholder Theory is Primarily Concerned with the Distribution of Financial Outputs

Debates regarding stakeholder theory frequently focus on how much each group gets (typically monetarily) from the organization.[15] That is, who gets how much and why? However, also important is the matter of who is allowed to take part in decision-making concerning organizational objectives and strategies. At least since Freeman (1984), the importance of procedural justice has been recognized. Who gets how much of the organizational outcomes pie is an important question, but so is who gets a say in how the pie is baked. Stakeholder theory is concerned with who has input in decision-making as well as with who benefits from the outcomes of such decisions. Procedure is as important to stakeholder theory as the final distribution.

Social psychologists have long studied the distinction between distributive and procedural justice (Colquitt et al. 2001; Greenberg 1990). Not only have people been found to have an interest in the fairness of the final outcomes of a distributive process, but evidence also suggests that people are concerned about the justness of the process of distribution itself. Among the major findings of procedural justice research is that people are more accepting of outcomes when the procedure for distribution is perceived as fair – even in situations where the outcome itself is poor (Lind and Tyler 1988). Hence, contrary to the suggestions of earlier work on distributive justice (e.g., Adams 1963), outcomes are not the only thing that matters in perceptions of justice. The fairness of the *procedures* employed is also determinative of fairness judgments.

Among the most important determinants of the fairness of a particular procedure is the degree of control within the process. That is, people find procedures that allow for greater participation in decision making to be fairer. As the perceived justice of outcomes is substantially determined by the perceived fairness of the process used in distribution, it follows that greater participation in decision making leads to an increase in the perceived fairness of the outcomes. Among the prescriptions of much of stakeholder theory is that relevant stakeholders should have input in the decision-making processes of the organization. This may be for either instrumental reasons (e.g., achieving "buy in") or for normative reasons – the organization has a moral obligation to its stakeholders requiring that they have input into how the organization is run. Thus, stakeholder theorists and critics should be fully cognizant of the procedural prescriptions of the theory as well as the distributive.

Focus on *distribution* and a de-emphasizing of *procedure* is not the only manner in which focus on distribution of outputs is a limitation on stakeholder theory – material outputs are not the sole subject of distribution. Information is another vital good that is distributed among stakeholders by the organization. This non-zero-sum subject of distribution also plays a role in perceptions of fairness among stakeholders to the extent that full information contributes to the decision-making process among stakeholders. As discussions of stakeholder theory become preoccupied with the distribution of typically financial outputs, important issues of procedural fairness as well as the distribution of non-financial, informational goods are underemphasized. And stakeholder theory achieves significantly less than its full capacity.

Stakeholder Management Means that All Stakeholders Must Be Treated Equally

It is commonly asserted that stakeholder theory implies that all stakeholders must be treated equally irrespective of the fact that some obviously contribute more than others to the organization (Gioia 1999; Marcoux 2000; Sternberg 2000; cf. Jones and Wicks 1999b). Prescriptions of equality have been inferred from discussions of "balancing" stakeholder interests and are in direct conflict with the advice of some experts on organizational design and reward systems (e.g., Nadler and Tushman 1997).

Marcoux is among those who make this criticism in his analysis of the concept of balance in stakeholder theory. He begins by outlining three potential interpretations of balance (or equity) on a stakeholder account:

> Egalitarianism – Distribution based on something like Rawls's difference principle (Rawls 1971).[16]
>
> Equalitarianism – Equal shares for all stakeholders
>
> Pareto-Consequentialism – making at least one better without diminishing anyone

Marcoux's arguments against these three candidates are largely sound. However, he misses one of the more obvious – and indeed strongest – interpretations of balance among organizational stakeholders: meritocracy.[17] On the most defensible conception of stakeholder theory, benefits are distributed based on relative contribution to the organization. This interpretation is suggested in a quotation from the Sloan Colloquy[18]. They write, "Corporations should attempt to distribute the benefits of their activities as equitably as possible among stakeholders, *in light of their respective contributions, costs, and risks.*" Inasmuch as this quote was used early in the paper to exemplify the centrality of balance to stakeholder theory, it is surprising that Marcoux fails to appeal to it in his own interpretations of balance.

Similarly, Sternberg argues that "in maintaining that all stakeholders are of equal importance to a business, and that business ought to be answerable equally to them all, stakeholder theory confounds business with government" (2000: 50). She cites no author, however, who argues for such equality of importance or managerial answerability. This is, again, suggestive of a straw-person argument. A meritocratic interpretation of stakeholder balance overcomes the objection that a stakeholder-based firm using either the egalitarian or equaliarian interpretation would be unable to obtain equity or any other manner of financing. Certainly equity financing is centrally important to organizations and, as such, providers of this capital would garner a substantial portion of the economic benefits of the firm as well as receive a great deal of managerial attention in organizational decision-making. On the conception of stakeholder theory proffered here, shareholders would get a fair return on their investment without managerial concern that is exclusive of other groups to whom an obligation is due.[19] Still less does the stakeholder theory confuse an organization with the state. As discussed below, stakeholder theory is a theory of organizational strategy and ethics and NOT a theory of the whole political economy.

This meritocratic hierarchy isn't the only criterion by which stakeholders may be arranged. Phillips (2003) has suggested that stakeholders may usefully be separated into normative and derivative stakeholders. Normative stakeholders are those to whom the organization has a direct moral obligation to attend to their well-being. They provide the answer to seminal stakeholder query "For whose benefit ought the firm be managed?" Typically normative stakeholders are those most frequently cited in stakeholder discussions such as financiers, employees, customers, suppliers and local communities.

Alternatively, derivative stakeholders are those groups or individuals who can either harm or benefit the organization, but to whom the organization has no direct moral obligation as stakeholders.[20] This latter group might include such groups as competitors, activists, terrorists, and the media.[21] The organization is not managed for the benefit of derivative stakeholders, but to the extent that they may influence the organization or its normative stakeholders, managers are obliged to account for them in their decision-making. Far from strict equality, therefore, there are a number of more convincing ways that stakeholder theory may distinguish between and among constituency groups.

Social psychology may also contribute to the question of equality among stakeholders as well as the question of prioritizing among competing stakeholder claims. In a sense, this question underlies (is logically prior to) the question of procedural and distributive justice raised above. The question of what proportion of the organizational outputs should go to a given stakeholder group or how much procedural input each constituency ought to have in a given decision presupposes agreement on the appropriate distributive scheme. Are all stakeholders equal (all deserving an equal proportion of organizational outputs and equal voice in decision-making) or do some stakeholder groups deserve a greater proportion of the outputs and more consideration in decision-making due to some notion of unequal input and merit?

Psychological studies of organizational justice have also considered the instrumental effects of different distributive values on the achievement of goals. (Deutsch 1975, 1985; Elster, 1992; Leventhal, 1976; Walzer, 1983). Leventhal and Deutsch have argued separately that differences in the method of distribution have instrumental effects on the relevant group among which the goods are distributed.[22]

A number of studies bear out these hypotheses (Deutsch 1985). The question of stakeholder prioritization depends – at least in part – upon the reasons and goals underlying the use of a stakeholder approach to management. If a stakeholder approach is employed in order to improve performance in the standard business senses, then equity is more appropriate as a distributive value. On the other hand, if greater harmony or a decrease in discord among stakeholders is the more important proximal goal of the stakeholder approach, then equality as a basis for distribution better conduces to this goal. In the case of the for-profit organization we would expect that performance goals would be primary and thus we suggest that equity will be the most commonly appropriate mode of distribution.

The method of stakeholder input is an open question. Everything from stakeholder representation on boards of directors to informal and non-specific "concern" for stakeholders by decision-makers has been suggested. However it is achieved, it is important for the sake of ethics, psychological well-being, and

organizational success that stakeholders be accorded some say in determining not only how much of the organization's outputs they receive, but how those outputs are created.

Friendly Misinterpretations

Many who would label themselves sympathetic to stakeholder theory have also contributed arrows to the critic's quiver through overextension of stakeholder theory. We address a few such overextensions, as well as at least one case of unwarranted limitation, of stakeholder theory below.[23]

Stakeholder Theory Requires Changes to Current Law

The focus on corporations discussed above has prompted calls for changes in the law. These changes may be of two sorts. On the one hand, it might be argued that managing for stakeholders may be contrary to the legal requirement that managers maximize shareholder wealth.[24] If it is the case that managing for stakeholders is illegal, the stakeholder theorist would argue the need for changes in the law so that it is at least *permissible* for managers to consider non-shareholders in their decision-making. On the other hand, the stakeholder theorist might argue that the moral superiority of stakeholder theory demands legislation *requiring* managers to consider stakeholder interests in their decision-making.

Regarding the legality of managing for stakeholders, Marens and Wicks (1999) argue convincingly that the business judgment rule allows managers to manage for stakeholders as the law currently stands. Codifying their point is the explicit allowance in the statues of the majority of states (Orts, 1992, 1997) that managers *may* consider stakeholders in their decision-making. Most importantly for the purposes of this paper, all of this may well be beside the point. Observation of business practice as well as the concession of many stakeholder critics (Jensen 2000; Williamson and Bercovitz, 1996) suggests that managing for stakeholders is, in fact, the most effective way to run a business for *all* stakeholders, including shareholders. If this is the case, changes in the laws are superfluous.

A potentially controversial result of this point among business ethics and corporate social responsibility scholars is that stakeholder theory, as a managerial theory, does not *require* changing the structure of corporate governance (cf. Hendry 2001a, 2001b; Van Buren 2001). The theory can reasonably remain agnostic, for example, concerning stakeholder representation on corporate boards of directors. This doesn't rule out the possibility, or even advantage, of having stakeholder representation on boards. The requirement of such representation is not, however, theoretically necessary nor intrinsic to stakeholder theory, *per se*. If stakeholder theory is interpreted as a theory of strategic management, changes in law would be no more necessary than laws requiring organizations to be visionary (Collins and Porras 1994), excellent (Peters and Waterman 1982), or learning (Senge 1990).

We recognize that the topic of stakeholder legislation may be the knottiest log we herein hew. As a managerial theory, with at least some roots in classical liberalism (i.e., libertarianism, see Freeman and Phillips 2002), stakeholder theory

is neither legally prohibited nor in need of permissive or demanding legislation and regulation. In short, discourse concerning the legal relationship between the organization and its stakeholders is welcome, but the theory does not *require* a change in the law to remain viable.

Stakeholder Theory is Thinly-Veiled Socialism and Refers to the Entire Economy

Though a popular subject for discussion in the United Kingdom and Europe, the "stakeholder economy" is not the more humble variation of stakeholder theory advocated in this paper. Stakeholder theory as we understand it is a theory of organizational strategy and ethics (Phillips and Margolis 1999) and not a theory of political economy. "Stakeholder" is not synonymous with "citizen" or "moral agent" as some wish to interpret it. Rather, a particular and much closer relationship between an organization and a constituency group is required for stakeholder status. The theory is delimited and non-stakeholder should remain a meaningful category.

Some commentators and politicians argue for an interpretation of stakeholder theory in a broad socio-political context. Perhaps most famous among these interpretations is a 1996 speech by then British Labour Party leader Tony Blair entitled "The Stakeholder Economy" which continues to receive a great deal of subsequent attention both in favor and in opposition. Supporters of this concept suggest that although stakeholder theory was originally applied to the private sector, they believe expanding stakeholder theory to include public institutions is a conceptual advance (see, e.g., Barnett 1997; Hutton 1995; Rustin 1997). While the effort to take business organizations seriously in political theory should be applauded, this particular translation from organization theory to political theory represents an unwarranted dilution of stakeholder theory. Further, this watering down makes stakeholder theory more susceptible to charges that it is overly broad and meaningless; or, if meaningful, the stakeholder economy amounts to little more than the "new socialism" – its contribution to the stakeholder debate being the sparse and occasional insertion of the word "stakeholder" into a tract about liberal macroeconomic policy (e.g., Corry 1997).

Perraton (1997) exemplifies the dilution of stakeholder theory in arguing that "there needs to be frameworks for constructing stakeholder arrangements not just at the local and national levels, but also at the regional and global levels." Arguments adduced for this position are:

> First, that globalisation has undermined the relations within a national economy that the concept of a stakeholder economy was based upon, and second that agents are now enmeshed in a range of relationships that extend beyond national boundaries. Although this implies that the project of constructing a national stakeholders economy is no longer tenable, it does not necessarily mean that the idea of stakeholding has become obsolete. (1997: 232)

Quite so. We maintain that these same conditions imply a greater need for *organizational-level* policies and individual responsibility and recognition of stakeholder obligations rather than super-national laws, taxes, and regulations.

When everyone in the world is a stakeholder of everyone else, the term adds little if any value and the critics' charge of conceptual emptiness becomes a rather convincing one.

The justification of stakeholder-based social policy is frequently couched in terms of the need for legislation/regulation to *permit* the stakeholder economy to flourish (e.g., Soskice 1997). These discussions often proceed to describe a stakeholder economy in which the stakeholder model is *enforced* by the state. This is an important distinction. The several state-level "other constituency statutes" in the U.S. (probably unnecessarily) render stakeholder organizations *permissible* under the law, but only one state requires consideration of other stakeholders (Orts 1997, 1992; Marens and Wicks 1999). A managerial (or libertarian) stakeholder theory would fully assent to permissive stakeholder legislation or the alteration of laws that preclude stakeholder organizations), but the version advanced by advocates of a stakeholder society would attempt to enforce, by fiat of slate, stakeholder management. If managing for stakeholders is a superior method for running most organizations (as even critics such as Sternberg and Jensen suggest), enforcement is inefficient and superfluous.

Another significant point of departure between managerial stakeholder theory and the stakeholder society is the relationship between benefits (rights) and obligations. For advocates of the stakeholder society, "the benefits of stakeholding for the individual stakeholder are contingent on the carrying out of associated obligations" (Soskice 1997: 223). Kelly, Kelly, and Gamble suggest similarly that, "much stricter obligations are being enforced on the recipient to find work or undertake training." (1997: 249). For a managerial stakeholder theory, this gets the contingency backwards – obligations arise from the voluntary activities of individuals and organizations. On a least one justification of stakeholder obligations, it is precisely the acceptance of benefits that create obligations (Phillips 1997) rather than the benefits being contingent upon carrying out obligations. Of course the continued provision of benefits requires the fulfillment of obligations among stakeholders on both accounts, as stakeholder relationships are reciprocal. The difference lies in how obligations are originally generated among individuals and organizations. On the stakeholder society account, obligations – and the associated benefits – simply exist among people. As here conceived, stakeholder obligations require some voluntary action and, in contrast to duties, obligations exist between discrete entities rather than as a diffuse, all-inclusive concept (on the distinction between obligations and duties, see Rawls 1971: Simmons 1979; Phillips 1997).

Stakeholder Theory is a Comprehensive Moral Doctrine

In his discussion of the idea of an overlapping consensus, Rawls (1993) distinguishes between his own theory and what he terms comprehensive moral doctrines. A comprehensive moral doctrine is one that is able to cover the entirety of the moral universe without reference to any other theory. All moral questions can be answered from within a comprehensive moral doctrine. Rawls claims that not only does his conception not depend on a single religious, national, cultural or moral theory for its foundation, but that it is consistent with a "reasonable pluralism" of such doctrines. One need not convert from her preferred doctrine in order to accept justice as fairness. All reasonable moral doctrines already accept it from within their own conception.

Moreover, not only is stakeholder theory not a comprehensive moral doctrine, but it is yet another step removed even from Rawls's own theory. Stakeholder theory is a *theory of organizational ethics*. As described by Phillips and Margolis (1999), theories of organizational ethics are distinct from moral and political theories due to the difference in the subject matter of the various disciplines.[25] Contrary to the assumptions of political theory, organizations are, to use Rawls's (1993) terms, voluntary associations rather than a part of the basic structure of society. Further, interaction within and among organizations creale moral obligations over and above those duties that arise due simply to one's status as a human being or citizen of a nation.

Stakeholder theory is not intended to provide an answer to all moral questions. Stakeholder-based obligations do not even take precedence in all moral questions in an organizational context. Violations of the human rights of a constituency group by commercial organizations and the gratuitous destruction of the natural environment are morally wrong, but such judgments rely on concepts outside of stakeholder theory as herein delimited (Orts and Strudler 2002; Phillips and Reichart 2000). Stakeholder theory shares this delimitation with its supposed rival theory of shareholder wealth maximization – at least as elaborated by Friedman (1971). Friedman's defense of shareholder wealth maximization is a moral one based on the property rights of shareholders. Noteworthy for our purposes, Freidman's admonition includes the condition that shareholder wealth maximization must take place within the constraints of law and morality. This suggests that there is another level of analysis operative in Friedman's system. So too is the case with stakeholder theory.

Consider, for example, Donaldson and Dunfee (1999) when they write,

> All organizations, wherever situated, and whatever their characteristics, *must recognize the interests of stakeholders whenever failing to do so may* violate a hypernorm. . . . [I]t then becomes the obligation of all organizations to recognize this principle in regard to stakeholders. Thus, as DeGeorge suggests, an organization that sells carcinogen-contaminated pajamas in the Third World, knowing that they are prohibited for sale in the United States and Europe and are unacceptable dangerous to the intended users, fails to recognize a mandatory stakeholder duty. (1999: 246f)

A hypernorm, according to Donaldson and Dunfee, indicates a duty that applies to all organizations and individuals irrespective of their context. Though clearly an important moral idea, violation of a hypernorm lies outside the scope of stakeholder theory as a theory of organizational ethics. This is evident from the fact that it is a mandatory obligation/duty of all organizations. The action described is a violation of human rights irrespective of the stakeholder status of the customer. Though it may be a violation of a stakeholder obligation, this violation is secondary to the hypernorm violation. Stakeholder theory adds liltle to the question of carcinogen-contaminated pajamas.

Also, Orts writes,

> Corporations have had a long-standing right to give away a portion of their earnings to philanthropic organizations chosen by management. If is not easy to see how this recognised right of gift-giving by business firms fits

> with stakeholder theory. The best response of stakeholder theory would be to expand the definition of stakeholder to include society as a whole, but at this point the theory begins to lose its shape. If the entire society is a stakeholder, then how can any decision be made on the basis of comparing different stakeholders within a business? (1997: 175)

But, as indicate above, this "best response" is not one shared by the present authors for the same reasons that Orts provides (i.e., the problem of stakeholder identity). However, philanthropy would not and need not be justified by reference to a theory of the obligatory such as stakeholder theory. Rather, charitable giving stands above and outside of a description of what is required of organizations.

Moreover, stakeholder theory need not address issues of supererogation. There will always be actions that organizations *may* take but that are not obligatory from a stakeholder perspective. Such activities are what Carroll[26] refers to as "Voluntary/Discretionary" and Donaldson and Dunfee (1999) call "moral free space" and are neither prohibited nor required by stakeholder theory.

Stakeholder Theory Applies Only to Corporations

Whereas the preceding friendly misinterpretations tend toward overextension of the theory, we would argue that this final misinterpretation represents an unnecessary limitation on the scope of stakeholder theory. Though not always the case (the SRI definition uses "organizations" as their subject domain) the word stakeholder has come to focus primarily on the publicly owned corporation. Indeed, in the most commonly quoted work of stakeholder theory since Freeman (1984), Donaldson and Preston write:

> a normative [stakeholder] 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. (1995: 72, emphasis added)

This focus is only intensified by the tendency of management scholars more generally to concentrate on targe, multinational corporations as the objects of their research. This has led to a disproportionate, nearly exclusive, attention on the part of stakeholder theorists within business schools on the corporation. Relatively less attention has been paid to stakeholder theory in the context of other organizational forms such as small or family owned businesses, privately owned concerns of any size, partnerships, non-profit and governmental organizations. This may appear appropriate if stakeholder theory's primary role is its opposition to the shareholder wealth maximization view. However, for stakeholder theory to truly come into its own as a theory of strategic management and organizational ethics, it will need to be applied to more than just the large, publicly held corporation.

Other Challenges to Stakeholder Theory

So far we have described a number of ways in which we believe stakeholder theory to be misinterpreted, by both is critics and advocates. We have also indicated alternatives to these misinterpretations that make the theory stronger, more

robust and more rigorous. Having said that, however, there remain a number of difficulties with stakeholder theory even under the most generous and coherent interpretations. In this section we suggest a number of areas where the theory remains in need of further elaboration or defense if it is to remain viable. We discuss these weaknesses in the hope of motivating future study of the theory.

At several points herein we have suggested that stakeholder theory falls victim to some criticisms in no greater degree than alternative conceptions (e.g., the shareholder wealth maximization view). We argued, for example, that managerial opportunism represents no greater threat to stakeholder theory than to the alternatives. That said, however, managerial opportunism still represents a threat to organizational effectiveness under any current approach. Work proceeds apace – under the rubrics of the theory of the firm, agency theory and transaction cost economics among others – on the question of how best to minimize managerial opportunism within a shareholder wealth maximization regime. Similar work might well be undertaken from the perspective of stakeholder theory. Indeed, the tools and concepts employed under the rubric of agency theory could be usefully applied within a stakeholder theoretical framework once the connotations of corporate ownership described earlier are clarified and rectified (Hill and Jones 1992).

It would be tempting to place the question of adjudicating among stakeholder demands in the same category. While no more a problem for normative stakeholder theory (i.e., managing in stakeholder's interests for reasons intrinsic to the stakeholders themselves) than for instrumental stakeholder theory (i.e., managing stakeholder interests in order to maximize the outcomes of another) or shareholder wealth maximization theory, it is tempting to say that adjudicating among stakeholder interests is another problem in need of *ex ante* solution. We suggest, however, that this is not especially problematic for either stakeholder theory *or the alternatives.* The "corporate veil" and "business judgment rule" are not necessary evils, but positive contributions to the spirit of pragmatic experimentalism. We argue that *ex ante* rules for deriving a hierarchy of stakeholders – in the abstract – is as misguided in stakeholder theory as is the presumption of the dominion of shareholders. Managing for stakeholders, indeed all top-level strategic management, is organic in its nature. As much as we may believe that we want a definite heuristic for management, one is neither available nor likely even desirable.

That said, there may be a potentially more damaging aspect to the question of stakeholder adjudication. Those who argue for a narrow conception of stakeholders argue for the importance of distinguishing between stakeholders and non-stakeholders (Mitchell et al., 1997: Phillips 1997). The earlier argument suggesting that stakeholder theory should not be considered a comprehensive moral scheme suggests that managers will also face conflicts between stakeholder and non-stakeholder issues. Orts and Strudler (2002) examine the relationship between stakeholder theory and the natural environment and conclude, like Phillips and Reichart (2000), that stakeholder theory cannot account for duties to non-humans. This leads to the question of how obligations to stakeholders should be weighed against other moral duties to non-stakeholders. This is rather similar to the question that stakeholder theorists ask of shareholder wealth maximization advocates with different in-groups and out-groups and stands in need of some elaboration.

Little has also been written about the role of "community" as stakeholder – surely the most controversial of customer, supplier, employee, financier and

community. Berman, Wicks, Kotha, and Jones (1999) found no significant effect between community relations and financial performance. Orts and Strudler's version of stakeholder theory "denies that government and members of the community in which it [the firm] operates must be regarded as stakeholders, even if their economic interests are affected by the firm." (2002: 219). Systematic ambiguity in notion of "community" has recently begun to be explored (Freeman, Dunham, and Liedtka 2001) but there much is left to do.

These are but a few of the questions which can be raised and on which we need much further thinking. Getting away from the now tiresome tirades of "stockholders vs. stakeholders", "single objective vs. multiple objective", "empirical vs. normative", and other limiting dualities may lend a hand in the project to define and redefine ourselves as, in part, value creators and traders.

Conclusion

This paper attempts to add clarity to stakeholder theory by addressing a number of straw-person objections posed by critics of the theory as well as a few friendly overextensions and distortions averred by stakeholder theory advocates. We do not presume to dictate the research agenda of other scholars. However, we believe that it is important lo avoid talking past the many intelligent and thoughtful opponents of stakeholder theory as well as avoid "preaching to choir" by offering extensions that will only convince one who already advocates some version of the theory. By clearing away some of the most common misconceptions of stakeholder theory, we suggest that we are in a better position to see both the power and the limitations of this approach.

Notes

This paper has benefited significantly from careful readings by Heather Elms and Joshua Margolis. Of course, any errors in either form or content remain those of the authors.

1. The title of the article is borrowed from Sutton and Staw's (1995) article "What Theory is *Not.*"
2. This is not to say that those pursuing stakeholder research in non-managerial areas (e.g., law and regulation or political economy) are doing so illicitly. We are merely proposing a set of limitations that we believe make the theory better able to answer one set of common critiques. Others pursuing research in other areas will provide other responses to these criticisms or else fall victim to them.
3. It is unrealistic to attempt to change or limit the use of the term "stakeholder" in the common parlance.
4. There are studies done under the rubric of stakeholder theory that are more descriptive or instrumental and rely on ends and values that arc implicit or assumed. We argue that, although many such studies are quite useful, it is the explicit reference to moral language and acknowledgement of a moral foundation that makes stakeholder theory distinct. Thanks to an anonymous reviewer at *Business Ethics Quarterly* for this point.
5. This categorization emerged during correspondence with Joshua Margolis.
6. For example, in making a similar point with reference to straw-person versions of utilitarianism. Russell Hardin writes, "Utilitarianism permits us to override the norm of promise keeping in order to enhance welfare. But we know that it is immoral to break a promise. Q.E.D., utilitarianism is an immoral theory." (1988: *x*)

7. Even should our arguments about agency and stakeholder theory prove unconvincing, we are not the first to address the issue. Previous accounts include Quinn and Jones (1995), Jones (1995), and the articles in Bowie and Freeman (1992).
8. We might test the proposition that shareholders own the corporation through a thought experiment: Who would own the corporation if it bought back all of its own stock?
9. See also Orts (1997).
10. Albert J. Dunlap, *Mean Business*, (New York: Simon & Schuster): John A. Byrne, *Chainsaw* (New York: HarperBusiness).
11. "Former Sunbeam Chief Exec Settles Hldr Lawsuit for $15M". Dow Jones Newswire, January 14, 2002.
12. It would be interesting, though outside the scope of this paper, to consider the implications of granting legal standing to some stakeholders in derivative lawsuits as a way of ensuring accountability. A derivative lawsuit is typically brought by a shareholder against an opportunistic manager or director *on behalf of the corporation*. If this legal right were extended (possibly one at a lime beginning with employees) to other stakeholders, managerial accountability would be maintained, as would the agency relationship between managers (agents) and the corporation (principal) without great trauma to the existing legal framework. Such suits would not be brought on behalf of the stakeholders, however. The legal standing of stakeholders would be as representatives of the organization in which they have a stake.
13. There are also multiple means of measurement (e.g., accounting profits, firm value, dividends, long and short term market value for shares). Thanks to an anonymous reviewer for pointing this out.
14. Jensen refers to value maximization as a "scorekeeping device."
15. The reader may expect to see a citation of a critic who has suggested this interpretation. This "critical distortion" relies on the authors' experience in myriad conversations about stakeholder theory in which the subject of stakeholder input is almost universally ignored and concern over distribution nearly exclusive. It would, perhaps, be more accurate to characterize this idea as a point of overemphasis among critics. Thanks to an anonymous reviewer for this clarification.
16. Rawls's Difference Principle says that social institutions should be arranged such that any inequalities in the distribution of social goods must redound to the benefit of the least well off.
17. Paul Glezen has also suggested "balance" may be insightfully interpreted in the sense meant when discussing balance in wine. We do not pursue this interpretation, but merely point it out as an interesting variation.
18. Sloan Stakeholder Colloquy, 1999, "Clarkson Principles" http://mgmt.utoronto.ca/~stake/Principles.htm. The Sloan Stakeholder Colloquy was a broad and important effort to promote and organize research on issues surrounding stakeholder theory.
19. Notably, when profits are discussed among the visionary companies of Collins and Porras (1994), it is not in terms of maximization, but "*reasonable*" (Ford), "*fair*" (Johnson & Johnson), "*adequate*" (Motorola), and "*attractive*" (Marriott).
20. The organization may have other duties or obligations to non-stakeholders, such as the duty to not cause harm to, lie to, or steal from them. These duties exist prior to and separate from stakeholder obligations and are not considered when establishing stakeholder status. See Phillips 1997.
21. These lists of typical stakeholders is only a for the purpose of generic example. Which specific groups are what sort of stakeholder, or indeed which are stakeholders at all, cannot be determined in the abstract. This can only be determined by reference to actual organizations in actual relationships with other groups.
22. Deutsch suggests the following hypotheses:

    In cooperative relations in which economic productivity is a primary goal, equity rather than equality or need will be the dominant principle of distributive justice.

    In cooperative relations in which the fostering or maintenance of enjoyable social relations is the common goal, equality will be the dominant principle of distributive justice. (Deutsch 1975: 145)

Similarly, Greenberg suggests

> people believe that the maintenance of social harmony is promoted through the use of equal reward allocations, whereas the maximization of performance is promoted by systems that allocate outcomes equitably – that is, in proportion to relative performance (Deutsch 1975; 1985; Levanthal, 1976b). (Greenberg 1990: 401)

23. Those accused of overextension might reasonably respond that the more narrow version implied here is too thin to merit acceptance. Frequently, however, breadth and richness are purchased at the price of theoretical rigor. We believe this to be the case in the examples to follow. There are plenty of theories of political economy and moral philosophy available. What is needed – and what stakeholder theory duly pruned may provide – is a better theory of ethics at the organizational level (Phillips and Margolis 1999).
24. The subject of agency and fiduciary relationships between managers and shareholders was discussed in a previous section.
25. Orts (1997) traces scholarly interest in "intermediate associations" back to German sociologist Johannes Althusius, 1614/1964, *The Politics of Johannes Althusius*, Frederick S. Carney (trans.).
26. A. B. Carroll, 1991, "The Pyramid of Corporate Social Responsibility: Toward the Moral Management of Organizational Stakeholders," *Business Horizons* 34(4), 39–48.

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