Part I

Theoretical and Pedagogical Issues

Chapter 1

Stakeholder Theory: The State of the Art

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Introduction

The purpose of this chapter is to examine an approach to both business and business ethics that has come to be called "stakeholder theory." While there is disagreement among stakeholder theorists about the scope and precise meaning of both "stakeholder" and "theory," we shall take "stakeholder theory" to denote the body of research which has emerged in the last 15 years by scholars in management, business and society, and business ethics, in which the idea of "stakeholders" plays a crucial role.

For those unfamiliar with the stakeholder literature, the term "stakeholder" came into wide-scale usage to describe those groups who can affect, or who are affected by, the activities of the firm (Freeman, 1984). "Stakeholder theory" began as an alternative way to understand the firm, in sharp contrast to traditional models which either:

a) depicted the world of managers in more simplistic terms (e.g. dealing with employees, suppliers and customers only), or
b) which claimed the firm existed to make profits and serve the interests of one group (i.e. shareholders) only.

In the former case, Freeman argued that the world of managers had become much more complex, and that the traditional models of managerial activity tended to divert the attention and efforts of managers away from groups who were vital to the success (or failure) of firm initiatives. It was only by embracing this broader, "stakeholder" picture of the world that managers could adequately understand this more complex reality and undertake actions that enable the firm to be successful. In terms of case (b), stakeholder theorists claim that traditional models of the firm put too much emphasis on shareholders to the exclusion of other stakeholders who deserve consideration and to whom managers have obligations. While stakeholder theorists reject neither the notion that firms need to make money, nor that managers have moral duties to shareholders, they claim that managers also have duties to these other groups. In summary, stakeholder theorists have argued for two basic premises: that to perform well, managers need to pay attention to a wide array of stakeholders (e.g. environmental lobbyists, the local community, competitors), and that managers have obligations to stakeholders which include, but extend beyond, shareholders. Regardless of which of these two perspectives individual stakeholder theorists emphasize in any given paper, almost all of them regard the "hub and spoke" model depicted in Figure 1.1 as adequately descriptive of firm-stakeholder relationships.

In terms of what follows, our analysis will be divided into four sections. We shall briefly examine the history of the idea of stakeholders and discuss the origins of some contemporary theoretical issues. Then we shall analyze the current state of the art of stakeholder theory. We go on to suggest some future directions for scholars interested in pursuing these ideas, and finally, we suggest some challenges that have emerged within stakeholder theory.

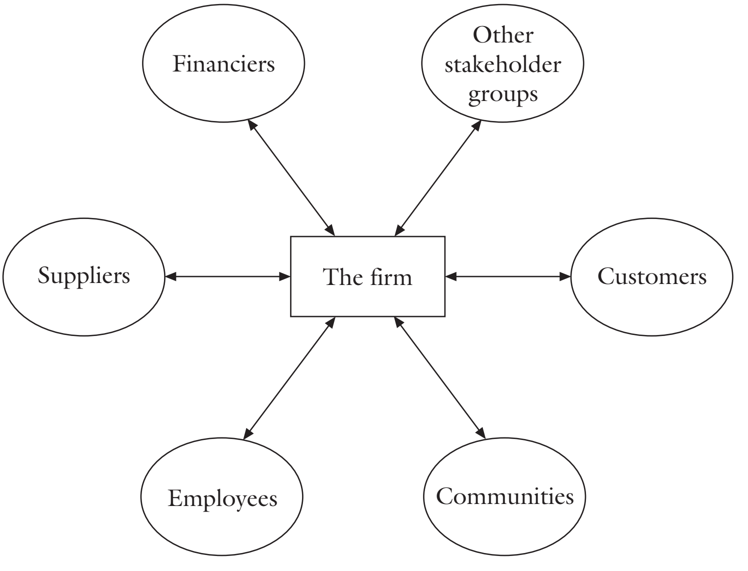

Figure 1.1 Hub and spoke stakeholder diagram

The Origins of the Stakeholder Concept

For many contemporary scholars, organized thinking about the stakeholder concept began with Freeman's seminal book, *Strategic Management: A Stakeholder Approach* (1984). But, as Freeman himself acknowledges, the general idea antedated his book by at least several years, perhaps by centuries. To gain a full understanding of the history of the concept, one first needs to explore the related notion of corporate social responsibility and some of its antecedent ideas and then review related themes from the literatures of corporate planning, systems theory, and organization theory.

Corporate social responsibility

Corporate social responsibility, defined by Jones as "the notion that corporations have an obligation to constituent groups in society other than stockholders and beyond that prescribed by law or union contract" (1980, pp. 59–60), clearly has "stakeholders" at its core. The origins of corporate social responsibility also show concern for stakeholders, even if this specific term wasn't used. Eberstadt (1973) argues that concepts analogous to social responsibility have been with us for centuries, even millennia. For example, in classical Greece, business was expected to be of service to the larger community. In the Medieval period, roughly 1000–1500 AD, a good businessman was honest "in motive and actions" and used his profits in a socially responsible manner (Eberstadt, 1973). For centuries, the idea of "noblesse oblige" – roughly defined as "the responsibility of rulers to the ruled" – represented an analogous concept among members of the European aristocracy. If one assigns similar responsibilities to members of an economic aristocracy in America, a country without a hereditary aristocracy, the analogy is not farfetched. This conclusion is particularly compelling since the power wielded by corporate managers (and owners, during the "robber baron" era) may in many cases rival that of their European aristocracy counterparts.

Furthermore, although they didn't use the term corporate social responsibility, Berle and Means, in their classic work on the separation of ownership and control, *The Modern Corporation and Private Property*, invoked the general concept. They did not bemoan this separation of ownership and control as many economists did, but rather noted that it liberated managers to serve the larger interests of society. In their words:

> The control groups have, rather, cleared the way for the claims of a group far wider than either the owners or the control. They have placed the community in a position to demand that the modern corporation serve not alone the owners or the control but all society (1932, p. 312).

This conclusion must have seemed somewhat odd to followers of a debate between Berle and E. Merrick Dodd in the pages of the *Harvard Law Review* (1932) and the *University of Chicago Law Review* (1935) from 1931 to 1935. Although Dodd persuasively advocated a broader set of corporate responsibilities, Berle didn't concede the point until 1954 in *The Twentieth Century Capitalist Revolution*.

Berle and Means were not alone among scholars who advocated broader responsibilities for business executives in the 1930s. The noted author Chester I. Barnard stressed the fundamentally instrumental role of the corporation in *The Functions of the Executive* (1938). The purpose of the firm, he argued, was to serve society; corporations were means to larger ends, rather than ends in themselves.

Many businesspeople also took steps to publicly embrace the idea of social responsibility. In a post-depression (and post-WWII) fit of defensiveness about the virtues of capitalism and a propaganda blitz intended to "sell" capitalism to the American public, they began to adopt postures of broad responsibility to corporate constituents (Cheit, 1956). Included in these pronouncements, common in the 1950s, were depictions of executives as corporate "statesmen" who balance the manifold interests of society in their decisions. In some sense, corporate social responsibility, as an ideal at least, was imposed on business by business itself. It wasn't until outsiders began to question the results of this statesmanship that corporate social responsibility began to acquire a larger external group of advocates. It was also during this period that Howard Bowen published his path-breaking book, *Social Responsibilities of the Businessman* (1953). Bowen wrote of the gathering intellectual force of the doctrine that business leaders are "servants of society" and that "management merely in the interests (narrowly defined) of stockholders is not the sole end of their duties" (1953, p. 44).

Each of the historical and intellectual predecessors discussed thus far focus on what Donaldson and Preston (1995) call the normative aspects of stakeholder theory. Although no one used the term "stakeholder" at the time, these perspectives held that corporations *should* behave in ways that were quite different than those prescribed by the conventional goal of the firm. According to this alternative perspective, firms should be operated in order to serve the interests of customers, employees, lenders, suppliers, and neighboring communities as well as stockholders.

Corporate planning

Another set of antecedent ideas approached the stakeholder question from a quite different angle, however. As Freeman and Reed (1983) and Freeman (1984) carefully document, a strain of stakeholder thinking was also developing in the corporate planning literature and related work. The term "stakeholder" was first used at the Stanford Research Institute in 1963 and was employed to connote groups "without whose support the organization would cease to exist" (Freeman, 1984).[1] To SRI researchers, corporate planning could not proceed effectively without some understanding of the interests of stakeholder groups. In this view and in many views derived from it, attention to stakeholder concerns was clearly subsidiary to some other, dominant interest – stockholder returns or firm survival, for example. Ansoff's *Corporate Strategy* (1965) dealt with the stakeholder notion by arguing for the existence of two types of corporate objectives – economic and social – with social objectives being secondary to economic objectives. Although these secondary objectives might constrain or modify the pursuit of the primary (economic) objectives, they were in no way to be regarded as "responsibilities."

In the contemporary vocabulary of Donaldson and Preston (1995), managers should be concerned about stakeholders only for *instrumental* reasons – as a means to improve the financial performance of the firm. One of the extensions of this instrumental use of stakeholder thinking was environmental scanning, a process by which planners attempted to forecast changes in the social environments of firms. With better assessments of these environments, better economic forecasts and, ultimately, better corporate strategic plans could be made.

Systems theory

Freeman (1984) also points to the systems theory literature in his historical account of the development of the stakeholder concept. The works of Churchman (1968) and Ackoff (1970) figure prominently in this history. According to the systems view, many social phenomena cannot be fully understood in isolation. Rather, they must be viewed as parts of larger systems within which they interact with other elements of the system. In this context, the concept of "stakeholders in a system" has meaning quite different from that employed by authors in the strategy literature (Freeman, 1984). According to Ackoff (1974), stakeholders must play a participatory role in the solution of systemic problems. In this framework, the optimization of the goals of individual components of the system (sub-system goals) is to be pursued only to an extent compatible with the pursuit of overall system goals. The intrinsic value of subsystem interests is clearly subordinate to overall system interests.

Organization theory

According to Freeman (1984), organization theorists were also important forerunners of the formal development of the stakeholder concept. In particular, he considers Rhenman (1968), who offers a formulation of stakeholder-based ideas very similar to that of the corporate planners. A leading edge thinker of his era. Rhenman[2] designates "the individuals and groups which depend on the company for the realization of their personal [and, presumably, group] goals and on whom the company is dependant" as stakeholders (Freeman, 1984, p. 41). Other "pre-stakeholder" ideas from organization theorists include the notion of "organization-sets" (Evan, 1966), an "open-systems" approach (Katz and Kahn, 1966; Yuchtman and Seashore, 1967), organizational "clientele" (Thompson, 1967), as well as contributions by Emery and Trist (1965) and Dill (1958), among others. The work of Pfeffer and Salancik (1978) is probably the organization theory most directly analogous to a stakeholder approach. Their concept of "resource dependence" captures the reliance of organizations on providers of key resources and support in a formal way. The reliance of other groups on "resources" from the firm is not emphasized in resource dependence theory, although many of the relationships in question are clearly reciprocal in nature.

However, some organization theorists (Pennings and Goodman, 1977) were concerned with the full range of "outputs" of organizations, rather than just efficiency or, in the case of corporations, profit. These scholars often stressed the difference between efficiency and effectiveness, the latter being defined in terms of the appropriateness of an organization's output. Nord (1983) made explicit the normative nature of any measurement of organizational output. In the process, he (perhaps inadvertently) linked the organizational effectiveness literature to the explicitly normative literature of corporate responsibility. A more detailed account of developments in organizational effectiveness can be found in Ehreth, who argues that "organizational effectiveness is not an objective state but is a relational construct that fits the needs and interests of constituencies" (1987, p. 9).

Although this brief summary cannot do justice to the intellectual antecedents of stakeholder theory, it does suggest that those who have done academic work on stakeholder theory have not done so without guidance from scholars in related fields. Those contributions are hereby gratefully, if not fully, acknowledged. And, it is noted that some of the ongoing arguments within the stakeholder theory literature – many of which cut to the core of its purpose and design – are indebted to its multidisciplinary origin. Each discipline brings a slightly different set of assumptions, implicit norms, and methods to the development of stakeholder theory.

The Current State of the Art of Stakeholder Theory

The past 15 years have seen the development of the idea of stakeholders into an "idea in good currency." Talk of stakeholders is increasingly common within business and academic circles. There are scores of essays focusing on stakeholders within management as ethics and social issues become more salient, and as our attention expands beyond the strict focus on shareholders. Even restricting our attention to academic writings still leaves a myriad of different work (spanning empirical and normative research), the exact relationships among which are often difficult to identify. The question is, what kind of shared underlying themes and ideas make up stakeholder theory? That is, if we examine the current state of the art within this field, what sort of theory do we find?

Donaldson and Preston (1995) provided one influential method for synthesizing the array of work that had been done to date. They advanced four key ideas that they claimed were central to stakeholder theory which make it a distinctive theory rather than a set of disparate ideas about "stakeholders." According to Donaldson and Preston (1995), stakeholder theory is *descriptive, instrumental, normative* and *managerial*. It is *descriptive* in the sense that researchers advancing stakeholder theory attempt to talk about, or describe, what the corporation is (i.e. how people at the corporation behave). They then compare that to some larger schematic to evaluate their performance (e.g. do they act as though the stakeholder or shareholder model is driving their behavior?). Stakeholder theory is *instrumental* in that researchers advance "if . . . then" types of propositions, specifically, that acting according to stakeholder management principles will be associated with positive outcomes for the corporation. Donaldson and Preston (1995) then claim that the central strand of stakeholder theory, and the "glue" which holds the theory together, is its *normative* content – claims that focus on what managers ought to do. Stakeholder management principles set out the legitimate interests of various stakeholders (including but going beyond shareholders) in the corporation and use these as a basis for determining how managers should behave. Indeed, it is this distinctive normative core which helps give shape and substance to the first two strands. This normative strand provides a descriptive story or script (i.e. respect the legitimate interests of stakeholders) one could use to compare to real managerial behavior to see if they are similar or different. These normative commitments provide a set of behaviors one might test to see the performance implications (i.e. the "if . . . then" statements characteristic of instrumental theory). Finally, Donaldson and Preston (1995) claim that stakeholder theory is *managerial*, in that it aims to shape and direct the behaviors of managers at the corporate in a specific and systematic way.

The core appeal of the Donaldson and Preston (1995) article is that it provided order and coherence where many saw chaos and confusion. Stakeholder researchers in business ethics, business and society, strategy, human resources, and other disciplines intuitively sensed that there was a connection to the writings of their peers, but there were few theoretically developed ideas linking their work together beyond the recognition that groups beyond shareholders had legitimacy at the corporation. Though it didn't resolve a number of key looming problems,[3] the Donaldson and Preston (1995) typology appeared to provide part of this missing link. It offered an umbrella to cover existing research in stakeholder theory, organize it into distinct strands (i.e. descriptive, instrumental, normative), and direct future work (i.e. to make sure it is coherent and follows the typology set out in their article). It also helped to combat the perception that stakeholder theory was an amorphous and ill-defined construct, born of good intentions, but doomed to fail for its breadth, its emphasis on people rather than profits, and its inability to direct the day-to-day behavior of managers.

However, there emerged voices of dissent to this grand reconciliation. Freeman (1994, 1999, 2000) took direct aim at the Donaldson and Preston (1995) typology for two main reasons. First, Freeman saw their work as reinforcing, rather than overcoming, the separation thesis. Second, he thought the sharp conceptual separation among normative, descriptive and instrumental was untenable.

In terms of the first criticism, Freeman has long been concerned with the importance of language and metaphor and how this shapes existing practice. The separation thesis posits that people, for the most part, tend to see the language and concepts of ethics and business as separate and that they occupy distinct realms (e.g. ethics deals with altruism and concern for others; business deals with selfishness and profits). The difficulty is trying to find a way to get these two realms back together, or at least to overlap enough so that you can convince managers that being good at their job doesn't mean they have to be a-, or im-moral. Freeman points out that the problem with the two realms is not that some people are happy to keep them separate while others want to bring them closer together, but that this metaphor for thinking about business and ethics is fundamentally misguided. Business ethics should instead be about how we understand the nature of business, as a morally compelling and interesting domain of human activity that could never be devoid of morality (i.e. so the divide never occurs in a wholesale or systematic way). For Freeman, the Donaldson and Preston (1995) article makes the mistake of setting up stakeholder theory as the foil to shareholder theory, thereby reinforcing the idea that ethics (i.e. stakeholder theory) is fundamentally different from business (i.e. shareholder theory) and managers have to choose between them. For this reason, Freeman (1994, 1999, 2000) didn't want to make stakeholder a specific and singular theory that could be compared to shareholder theory. Rather, he sought to make stakeholder theory a genre of research in which any account of the firm that posits a purpose for the firm and a set of responsibilities of managers is a "stakeholder theory." Under this view, the shareholder theory is itself a "stakeholder theory." The purpose of this move is to underscore the normative underpinnings of any theory of the firm and to help make us all better critics of corporations by forcing us to evaluate whether a given corporation has a compelling answer to questions regarding the purpose of the firm and the obligations of managers to stakeholders.

Freeman also objected to Donaldson and Preston's (1995) work because he claimed it sharply divided conceptual categories that are not fundamentally different. Following Quine, Davidson, Rorty, and other modern pragmatists, Freeman argued that a sharp separation of these modes of inquiry is neither conceptually plausible nor pragmatically desirable. Indeed, sharply separating facts and values, normative and empirical inquiry, risks reinforcing the separation thesis all over again (Wicks and Freeman, 1998). Freeman claims that these modes of inquiry are interrelated and together make up a coherent answer to the stakeholder question: what is the purpose of the corporation and in whose interests should it be run? Any adequate answer to that question, he claims, is a normative core or narrative. It will have aspects of what Donaldson and Preston (1995) call descriptive, instrumental and normative discourse and all play a key role in providing a compelling theory or narrative. No one element can be sharply separated and no one strand does the primary "work" of creating a compelling and justified theory.

A recent article by Jones and Wicks (1999) attempted to reconcile these viewpoints on stakeholder theory. They identified two distinct strands within the literature: the "single-theory" view expressed by Donaldson and Preston (1995) and the genre of normative cores view laid out by Freeman (1994). The authors (Jones and Wicks) claim that there is room to see significant convergence among these competing perspectives, even as the underlying methods, paradigms, and assumptions may differ significantly. They argue that stakeholder theorists are committed to developing normative cores (i.e. accounts of the purpose of the firm and obligations of managers) that can lay some persuasive claim to instrumental soundness (i.e. that firms running on these principles can survive and thrive in a competitive economy). To make the case that these views are convergent, the authors appeal to the normative interests of core stakeholders. Jones and Wicks (1999) argue that whatever else these groups want, they also wish to see the firm be profitable, and thus, they have a normative interest in the instrumental outcomes associated with the firm's normative core. The authors use this argument as the basis for positing that core stakeholder principles should not just be morally sound, but capable of keeping the firm economically viable.

This view does not take sides on the merits of the normative, instrumental, and descriptive typology, nor does it embrace the single theory or genre of theories view. It does, however, directly challenge a central claim of the Donaldson and Preston (1995) account, that normative and instrumental are clearly distinct and that the normative is the only arena where one can find justification for stakeholder theory. Jones and Wicks (1999) give the theory a more pragmatic orientation by claiming that both normative and instrumental theory provide critical resources in creating a justified stakeholder theory.

The remaining question from this discussion is what makes stakeholder theory unique? What stands out that is not common to other theories within management? Clearly, other theories talk about stakeholders, at some level. As simple descriptive terminology, the term "stakeholders" has thoroughly infected our language, particularly because of the growing need to attend to groups beyond shareholders to operate the firm as a going concern. Given this conceptual innovation, it makes little sense to talk about theories where managers don't manage stakeholders (i.e. all management theories do, at some level), or where firms lack stakeholders (i.e. all firms do have stakeholders). Thus, the terminology of stakeholder, by itself, is not what distinguishes stakeholder theory. Rather, as Donaldson and Preston (1995), Freeman (1994, 1999, 2000), and Jones and Wicks (1999), seem to agree, the distinctive element to stakeholder theory is its normative focus. Though the questions posed by each are different, all three papers center on the importance of answering the question: what is the purpose of the firm and to whom are managers obligated? In itself, posing this question is a considerable shift from existing theories of management that seek almost exclusively to address descriptive and/or instrumental claims. Stakeholder theory provides an effort to make theories of management explicitly accountable for their normative content and to highlight the moral underpinnings of "business" as we know it.

Perspectives on the Future of Stakeholder Theory

Although stakeholder theory has made substantial advances over the past decade, much work remains to be done. To begin with, the vast majority of stakeholder-based research papers that have been published to date are either theoretical or conceptual in nature. Given that theory building in a stakeholder framework can take on several forms, three of which – normative, instrumental, and descriptive – were described by Donaldson and Preston (1995), it is no surprise that theoretical perspectives dominate the literature.

This dominance notwithstanding, more theoretical work is needed. For example, narrative interpretation, advocated by Freeman (1994), and described by Jones and Wicks as ". . . the creation of narrative accounts of moral behavior in a stakeholder context" (1999, p. 209), has not been exhausted as a genre of research. In particular, we are aware of no narrative stakeholder theories based on theories of distributive justice. Although unconventional even in the already unconventional world of narrative stakeholder theories, such distributive justice-based accounts – for example, a Rawlsian "difference principle" based theory or an "entitlements" based theory derived from the work of Nozick (1975) are not beyond imagination. An account based on "effortocracy" could also be formulated in a narrative format.

According to Donaldson and Preston, instrumental stakeholder theory "is used to identify the connections, or lack of connections, between stakeholder management and the achievement of traditional corporate objectives (e.g., profitability, growth) (1995, p. 71). To date, only one formally presented instrumental stakeholder theory has been advanced. Jones (1995) argues that firms whose managers are able to create and sustain mutually trusting and cooperative relationships with their stakeholders will achieve competitive advantage over firms whose managers cannot. Other instrumental stakeholder theories are certainly possible and the instrumental realm might constitute a fertile ground for new stakeholder theory development.

According to Jones and Wicks (1999), the real challenge to stakeholder theorists is the creation of "convergent" stakeholder theory. Convergent stakeholder theory is theory that is simultaneously morally sound in its behavioral prescriptions and instrumentally viable in its economic outcomes. According to these authors, narrative accounts (or, for that matter, any normative stakeholder theory) without some evidence (broadly defined) as to their practicability, are of little value. Similarly, instrumental stakeholder theory that calls for adherence to behavioral standards that are not morally sound should also have little appeal to scholars with a stakeholder orientation. Recall that the most basic normative tenet of stakeholder theory is the view that the claims of all legitimate stakeholders have intrinsic value. It follows that stakeholder theory with serious moral deficiencies should not be acceptable to stakeholder theory advocates. Although Jones and Wicks (1999) do not fully develop Jones's (1995) "mutual trust and cooperation" instrumental theory into a formal convergent theory, they do suggest the general outlines of an extension of that type. Extending the idea of possible development of additional normative theories presented above, convergent theory based on these normative premises – the difference principle, entitlements, and effortocracy – is also possible. Finally, Donaldson and Dunfee's (1994) Integrative Social Contracts Theory (ISCT) would seem to be a good candidate for development into a convergent stakeholder theory.

The world of business practice also provides some potentially rich sources for doing stakeholder theory research. Works like Collins and Porras' *Built to Last* (1994) and Paine's "Managing for Organizational Integrity" (1994) both focus on companies that provide the more complex and morally interesting approaches to running a firm that are at the heart of stakeholder theory. Indeed, much of what drives the work of the authors of these works is a sense of the limitations and shallowness of describing the corporation as solely about making profits and enriching shareholders. One could describe the "corporate ideology" of the firms profiled by Collins and Porras (1994) and the "integrity strategy" of the firms described by Paine, as (at least partial) normative cores. These works, and others like it from the practitioner realm, hold special promise to address the managerial and practical challenges of stakeholder theory. That is, such work draws clear connection between values and purpose on the one hand and managerial activity on the other (i.e. it is managerial), and these resources provide credible conceptual and anecdotal evidence as to how a given firm's normative core may enable it to be highly competitive within the marketplace (i.e. it is practical/workable).

Another avenue of theoretical development in stakeholder theory involves descriptive theory – theory that purports to explain and (perhaps) predict how managers will actually behave in the context of stakeholder relations. It must be acknowledged that neoclassical microeconomic theory, based on the assumption of rational self-interested behavior on the part of economic actors, represents a legitimate and highly developed version of this type of theory. The fact that many stakeholder theory advocates dispute the moral foundations of both the processes and outcomes of the theory notwithstanding, neoclassical theory is authentic descriptive stakeholder theory. Although Jones and Wicks (1999) express doubt that a theory with the breadth and depth of neoclassical economic theory will emerge from the stakeholder theory framework, several other approaches are possible. Papers currently working their way through the review process at various journals show considerable promise. For example, one manuscript merges prospect theory, resource dependence theory, and organizational life cycle theory in an attempt to explain which stakeholder groups will be attended to at various points in a firm's development. Another paper, an empirical effort, examines the relative preference (of student groups) for "across-decision" attention to stakeholder interests as opposed to "within-decision" methods. Within-decision methods attempt to strike a balance among the interests of stakeholder groups within individual decisions; across-decision methods merely attempt to balance those interests over time, in essence, relying on an implicit set of IOUs to produce long-term equity among stakeholder groups. A descriptive stakeholder theory based on Donaldson and Dunfee's (1994) Integrative Social Contracts Theory is conceivable as well.

The emphasis to date on theoretical work should not understate the importance of empirical efforts in the interest of advancing stakeholder theory. As noted by Jones and Wicks (1999), instrumental theory is empirical theory. It matters a great deal whether or not the establishment and maintenance of mutually trusting and cooperative relationships do, in fact, lead to competitive advantage as predicted by Jones (1995). In addition, empirical evidence is one means of addressing the "practicability" facet of convergent stakeholder theory (Jones and Wicks, 1999). Economically disastrous outcomes resulting from normative prescriptions do not meet the test of good convergent theory. Similarly, descriptive theory, as it begins to emerge, will need to be tested. As noted above, one form of descriptive theory – within-decision versus between-decision methods – has already been subjected to empirical testing. The Academy of Management Journal published a recent collection of such papers.

"Large N" statistical studies are not the only way of producing empirical evidence, however. Case studies can also shed useful light on empirical questions. Case studies have the added advantage of the potential development of "grounded" theory, wherein theoretical possibilities are developed from the study of actual business practices and actual managerial behavior. Participant-observer studies of actual firms, particularly exemplary ones, may well be a productive extension of the case study method. Kochan and Rubenstein's (2000) participant observation study of Saturn is an example of a recent powerful contribution.

Another means of enhancing understanding of stakeholder relationships is through computer simulations. By nature, stakeholder relationships are multilateral and multifaceted, making them fertile ground for computer modeling, albeit modeling of a fairly sophisticated type. Despite the difficulties of programming such relationships, computer simulations hold out the promise of the rapid examination of very complex phenomena, and hence for a net increase in our knowledge of the value of stakeholder theory.

Challenges for Stakeholder Theory

There are four main theoretical challenges for stakeholder theory that will ultimately affect the usefulness of stakeholder theory for academics, business people, or both:

1 The problem of definitions
2 The background theory problem
3 The problem of pluralism
4 The problem of value creation and trade, and ethical theory

We shall explain each in turn, but we caution that these issues are interrelated, and that within each are complex theoretical and practical problems.

The problem of definition

Much has been written about the original definitions of "stakeholder" as "any group or individual who can affect or is affected by the achievement of an organization's objectives" (Freeman, 1984). Such a definition is implicitly appealing to strategic management scholars and executives. These are precisely the groups that can affect the firm, hence, precisely the groups whose relationships with the firm need to be shaped and influenced. However, some have argued that such a wide definition implies that "terrorists" are stakeholders, thus making "stakeholder" lose its implicit legitimacy. Others have argued that the term should be restricted to those groups who are definitional of the firm. For instance, in most businesses, customers, suppliers, communities, financiers, and employees all have a clear stake in the firm.

Recently, Phillips (2001) has suggested that such stakeholders be called "intrinsic" or "definitional" while other groups are stakeholders instrumentally, in so far as they affect the definitional stakeholders. He argues that firms have common moral obligations to both definitional and instrumental stakeholders, but have special obligations only to definitional stakeholders. Thus, the interesting question, on this analysis, becomes what does the firm owe to a customer, (and the reciprocal question of what a customer owes to a firm by virtue of being a customer).

Alternatively, if the narrow definition defines who has a stake, then it is incumbent to give an account of who and what counts as a "community." In a recent paper, Dunham et al. (2001) have suggested that if "community" is interpreted widely enough, then the narrow definition of stakeholders expands into the wide definition, once community is understood to consist of a collection of those interests that share some commons, or a political entity defined by competing interest groups.

This argument raises the next challenge; namely, it is imperative to pay more attention to the background theories that are at work. The upshot of these differing views of definition is that it is difficult to say what kinds of moral obligations are at work, when the very nature of who has the obligation is obscure. More practically, if who is a stakeholder is imprecise, it is difficult to formulate priority rules about whose interests count and when they come into play. However, since definitions are embedded in the background normative theory shaping such inquiry, perhaps an analysis of the background theory problem will provide some useful resources for addressing these issues as well.

The background theory problem

Given its multidisciplinary origins, much of the disagreement about stakeholder theory is diagnosable as differing sets of background theories at work. For instance, in the strategy literature there has traditionally been little concern with ethics and values, so the more subtle problems of definition are difficult to appreciate. (One solution to this problem is to define strategy theorists out of the stakeholder theory realm and note their much closer affinity to resource dependence theory.) Mitchell et al. (1997) have suggested a typology of features that determine which stakeholders are most important from three different points of view. However, this very typology assumes that managers are the best judges of stakeholder interests and/or behavior, and implicitly assumes that managers' or firms' judgments are the ones that should be used to determine stakeholder salience.

There are some scholars who have suggested that stakeholder analysis of the corporation must proceed from within a framework that acknowledges that the corporation is a legal entity – a legal fiction. Thus, corporate law and its itinerant compatriots, the law of torts, contracts, and agency, must serve a central role in any stakeholder theory that is to have practical significance. At this point, those who advocate this position have the burden of demonstrating that the legal view aids understanding of stakeholder phenomena. It is useful, however to note with Orts (1997) that "the law" in the form of dozens of "stakeholder statutes" no longer clings to a model that holds shareholder hegemony as a central value.

Philosophers and economists, such as Donaldson and Preston, have suggested that both philosophy and economics are the critical foundational fields, and Donaldson and Dunfee discuss cultural norms that can be shared and justified across particular cultures, making the social sciences, writ large, appropriate background disciplines. Scholars concerned with environmental issues have suggested that the environment be seen as a stakeholder. Such claims, and the background assumptions behind them, are based in environmental sciences (writ large) and bring it into play as a background theory.

With such an impressive array of potential background theories, perhaps it is foolhardy to wish for one, univalent *stakeholder theory*. Indeed, some stakeholder theorists (Freeman, 1994, 1999, 2000; Jones and Wicks, 1999) have already abandoned the quest. In an overlooked part of Donaldson and Preston's (1995) seminal paper, they suggest that ultimately stakeholder theory must be managerial. They write:

> The stakeholder theory is **managerial** in the broad sense of that term. It does not simply describe existing situations or predict cause-effect relationships; it also recommends attitudes, structures, and practices that, taken together, constitute stakeholder management. Stakeholder management requires, as its key attribute, simultaneous attention to the legitimate interests of all appropriate stakeholders, both in the establishment of organizational structures and general policies and in case-by-case decision making. This requirement holds for anyone managing or affecting corporate policies, including not only professional managers, but shareowners, the government, and others. Stakeholder theory does not necessarily presume that managers are the only rightful locus of corporate control and governance. Nor does the requirement of simultaneous attention to stakeholder interests resolve the longstanding problem of identifying stakeholders and evaluating their legitimate "stakes" in the corporation. The theory does not imply that all stakeholders (however they may be identified) should be equally involved in all processes and decisions (p. 67).

If stakeholder theory is managerial in this sense, a point readily conceded by many stakeholder scholars, we have to open the possibility that it is possible to have more than one theory that is useful. In fact, we might propose that any particular stakeholder theory is a function of a set of background conditions and a particular normative core, as articulated in so-called "convergent stakeholder theory" (Jones and Wicks, 1999). What would be necessary is a typology of stakeholder theories, each of which would contain a set of propositions that spell out the connections between the particular way that a set of firms can do business from within a particular normative core. Such an approach would naturally lead us to the third challenge to stakeholder theory.

The problem of pluralism

Suppose that there can be multiple stakeholder theories, each based on a normative core and a set of background disciplines. Each theory would describe how firms might actually realize that normative core, and the propositions that connect the normative core to other facets of the enterprise. In addition each particular stakeholder theory might have a set of instrumental propositions, such as "if you want to create shareholder value, you should manage the firm in a sustainable manner" or "if you want to manage the firm in a sustainable manner, you must pay a great deal of attention to environmentalists-critics of the corporation." The very language used to frame these propositions might differ depending on the framing assumptions that make up the particular theory. Each particular theory might well produce a different set of tradeoffs or priorities among stakeholder groups.

In this thicket of pluralism, what would be the role of an overarching "stakeholder theory"? Perhaps it would simply be, as we argued above, the role of genre: pointing out what a set of related theories have in common, and then coming to see them as related along particular dimensions.

Suppose however, that we assume that a particular stakeholder theory in its well-worked out form, might give an executive or a stakeholder a reason for acting in a certain manner. Surely, there is room for conflict among fully specified stakeholder theories. Indeed, any stakeholder theory based on normative theory from moral philosophy will almost certainly be in conflict with other such theories, given that the conflicts among normative theories are well documented. The existence of such "a reasonable pluralism" may well induce the search for a "minimalist" stakeholder theory, or a set of basic conditions that all normative cores must meet to be legitimate. This would both constrain and direct the creative, pluralistic drive to find an array, perhaps a wide array, of normative cores within stakeholder theory (Freeman, 1994, 1999, 2000; Wicks and Freeman, 1998). Akin to the public-private distinction on which political philosophers such as Rawls (1993) have relied, we could evaluate actions across (and perhaps independent of) various stakeholder genres according to such criteria. Some candidates for such a minimalist or public set of reasons would include those principles articulated by Freeman (2000) as giving rise to stakeholder capitalism, or the suggestions by Jones and Wicks (1999) for convergent stakeholder theory.

The problem of value creation and trade, and ethical theory

Traditionally, theories of business have begun and ended with economic logic. Business has been seen, wrongly as we argued above, as a way of creating "economic" value, with ethics perhaps serving as a side constraint. And, business ethics in general, and stakeholder theory in particular, have been developed within a framework of existing ethical theory that assumes that business is primarily concerned with its economic (narrowly defined) logic. Not surprisingly, ethical theory has little to say about business, or the way that value is created and traded. Yet, human beings have been value-creators and traders long before they were political philosophers. The practice of business has a long history, yet the existing body of ethical theory on which most business ethicists and stakeholder theorists rely pays almost no attention to the cultural and moral norms of value creation and trade. Werhane (1991) has suggested that Adam Smith saw the centrality of ethics to business, but even Adam Smith did not see the centrality of business to ethics. If the institution (i.e. business) in which most people spend the majority of their lives working, finding meaning (intrinsic and instrumental) and forging relationships with others is not central to the development of principles about how human beings interact and should interact, then the resulting ethics is likely to be sterile at best, and extremely difficult to apply at worst.

It seems to us that once we admit that business has to be responsible in some sense to stakeholders, and that stakeholders are moral agents as well as members of groups such as "customers," "communities," "shareholders," etc., then the door is opened for a complete rethinking of ethics and ethical theory. Certainly anyone reading this essay will conclude that this rethinking is well under way. Such a project is large in scope, and probably generalizable across the "disciplines" of applied ethics. We need to understand from an historical perspective just how value creation and trade have come about. We need to understand its different forms, how it has emerged across nation states, and why it appears to be a remarkably resilient institution. Connecting stakeholder theory to the very foundations of value creation of trade, to the foundations of entrepreneurship, is an important future project, one begun by Venkataraman (2001). Much work, however, remains to be done.

Conclusion

Though it is relatively new, we have shown that stakeholder theory has a rich heritage and a promising future. We traced the intellectual and historical roots of stakeholder theory in order to give the reader a deeper appreciation of what stakeholder theory is and what it may become. It seeks to do what no other theory within business and organization studies has tried: to openly address the critical questions about what firms ought to do, and to make such questions central to any account of the firm. We have ended with an array of possibilities for where scholars may take future research, knowing that we have only scratched the surface. While the diversity of backgrounds, methodologies, and perspectives of stakeholder theorists creates numerous difficulties, it also opens up tremendous opportunities for interesting and innovative work. It is with the challenge of taking on these creative endeavors that we leave the reader, and where we see the greatest promise for both stakeholder theory and organization studies.

Notes

1 Recently, Mr. Giles Slinger has revisited the early history of the idea of stakeholders. Through more extensive interviews, and the examination of a number of historical documents, Slinger rewrites the history as told in Freeman (1984). The essential difference is that the early use of the stakeholder idea was not particularly oriented towards the survival of the firm. Slinger's argument can be found in his doctoral dissertation, Essays on *Stakeholders and Takeovers*, (Slinger, 2001). An abridged version is in "Spanning the Gap: The Theoretical Principles Connecting Stakeholder Policies to Business Performance" (Slinger, 1998).

2 For a history of the development of the stakeholder concept in Scandinavia, and Rhenman's role in that development, see Nasi (1995).

3 Their typology claims that groups other than shareholders have legitimate interests, but it doesn't specify who these groups are, how we determine what their legitimate interests are, or how we resolve conflicts among stakeholder interests. It also didn't provide a specific answer to the definitional problem that threatened to make stakeholder theory vacuous: who is a stakeholder and why does the firm have a special obligation to them? Finally, though it claims to be managerial, it is not immediately clear how the central claims of this article would translate into any managerially specific behaviors.

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