

## CHAPTER 20

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# THE DEVELOPMENT OF STAKEHOLDER THEORY AN IDIOSYNCRATIC APPROACH

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### 20.1 INTRODUCTION

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THE purpose of this chapter is to trace the development of what has come to be known as “stakeholder theory.” I intend to accomplish this in a manner that could be called “autobiographical” or “idiosyncratic” because I want to illustrate a philosophical point about the general issue of “theory development” and the importance of a role for “the author.” To claim that “the author” has an important role in the development of management theory is neither to promote the self-importance of particular individuals nor to deny the role of inter-subjective agreement that is so vital in science. Rather it is to claim that contextual factors and serendipity can be crucial in process of theory development.

In section 20.2 I shall offer a brief explanation of my interest in stakeholder theory. In particular I focus on the contextual factors around my eventual publication of *Strategic Management: A Stakeholder Approach* in 1984. Section 20.3 is a brief

summary of that book and an assessment of its strengths, weaknesses, and an analysis of some “misinterpretations” that have led to what we now know of as “stakeholder theory”. Section 20.4 is my assessment of the current state of the art of “stakeholder theory” and some suggestions for the future development of the theory.<sup>1</sup>

## 20.2 STAKEHOLDER THEORY: MY EARLY INVOLVEMENT

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After studying philosophy and mathematics at Duke University and graduate study in philosophy at Washington University in St. Louis, I accepted an appointment on the research staff at the Wharton School, University of Pennsylvania with a group called the Busch Center, run by Russell Ackoff, acknowledged as a pioneer in Operations Research and Systems Theory.<sup>2</sup> After working at the Busch Center on several projects for a few months, I moved to a new splinter group started by James R. Emshoff, a former student of Ackoff. This new group was called “the Wharton Applied Research Center,” and its mission was to serve as “Wharton’s window to the world,” a kind of real-world consulting arm that would combine research staff, students, and Wharton faculty. We organized this new center much like a traditional consulting firm, by projects and by “development areas” which were conceptual spaces where we wanted to develop both expertise and new clients to try out our ideas.<sup>3</sup>

The stakeholder concept was very much in the air at the Busch Center. Ackoff had written about the idea, extensively in *Redesigning the Future*.<sup>4</sup> And, the idea was the centerpiece of several projects underway at the Center. In particular, the

<sup>1</sup> Recently I have written about the development of stakeholder theory and its current “state of the art” in a number of places. Cf. “The Stakeholder Approach Revisited,” *Zeitschrift für Wirtschafts- und Unternehmensethik*, forthcoming. Freeman and J. McVea, “Stakeholder Theory: The State of the Art,” in Hitt, Freeman, and Harrison (eds.) *The Blackwell Handbook of Strategic Management*, Oxford: Blackwell Publishing, 2001; and Freeman, McVea, Wicks, and Parmar, “Stakeholder Theory: The State of the Art and Future Perspectives,” *Politeia*, Anno XX, No. 74, 2004. I am grateful to editors, publishers, and co-authors for permission to recast and reuse some of the material in these works.

<sup>2</sup> To illustrate what I said earlier about the role of serendipity, I would never have accepted an appointment at Wharton, indeed I didn’t even know what or where Wharton was, but for the fact that my girlfriend, Maureen Wellen, now wife of 25+ years was going to graduate school in fine arts at Pennsylvania.

<sup>3</sup> See James R. Emshoff—Busch Center paper.

<sup>4</sup> Ackoff, 1974. To further the story begun in n. 2 above, I originally got an interview at Wharton because Professor Richard Rudner’s son, an anthropology student at Penn, knew people at the Busch Center, and Rudner knew that Ackoff had a philosophy degree. (Rudner was on my dissertation

Scientific Communication and Technology Transfer project funded by the National Science Foundation, as a kind of Library of the Future design project, used the idea of getting stakeholder input into radical system redesign. More relevant to business, the idea had been used in assessing the strategic direction of a large Mexican brewer, which was dealing with its government and other key stakeholders. However, most of the uses of the idea at that time were as a way to organize thinking about the external environment, or in thinking about system design.

Around the same time Ian Mitroff was visiting at the Busch Center and he and Emshoff and Richard Mason were working on Strategic Assumptions Analysis, a project in which the stakeholder idea was used to organize the assumptions that executives made about their external environment. This use of the stakeholder idea as an organizing concept was consistent with the original use at Stanford Research Institute where it evolved under the leadership of Robert Stewart, Marion Doscher, Igor Ansoff, Eric Rhenman, and others as a way of organizing the “environmental scan” that SRI published.

There was little in the way of a “management approach” that could help executives actually make decisions, other than at a very high level. Around this same time Emshoff and Ackoff organized a “faculty seminar” around “what are we to make of this stakeholder idea.” Eric Trist, Howard Perlmutter (management), Alan Shipiro (finance), and a few others attended. I was a very junior person and listened intently to these senior people discuss how they interpreted the stakeholder idea. There seemed to me to be a common thread in the seminar, and that was the reluctance of any of these management thinkers to talk about issues of values, ethics, or justice. I remember vividly, someone drawing a stakeholder “wheel and spoke” map on the board, throwing their hands up in the air and claiming “Well, that’s a normative problem of distributive justice, and we can’t say anything about that.” As a philosopher, I was fairly naive. I had not yet experienced the fanatical concern with “method” and “positive” and “empirical” that so defines most business school intellectuals. I remember thinking, “Well, I can certainly say something about normative and justice issues.”

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

committee.) What none of us knew was that Ackoff was in a period of reasonable hostility towards academic philosophers. But, none of this mattered since he was out of the country when I interviewed and left these hiring decisions to others.

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

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

We developed some of the techniques of "stakeholder management," as we began to call it, in a paper for a volume of applications of management science. In "Stakeholder Management: A Case Study of the U.S. Brewers and the Container Issue," we looked at our ongoing work with the United States Brewers Association and their struggle over what to do about taxes, recycling, and regulation of beverage containers. At that time, we were enamored of the promise of applying management science techniques to more accurately allocate resources among stakeholders, a view which I now believe to be deeply wrongheaded and mistaken. But, we did develop a useful way of thinking about stakeholder behavior in terms of thinking through concrete actual behavior, cooperative potential, and competitive threat for each stakeholder group.

During the same time, we developed a managerial version of the same material published in *The Wharton Magazine*, entitled pretentiously, "Who's Butting Into Your Business." This was an attempt to show managers that stakeholders had at least "managerial legitimacy," i.e., that from a strategic standpoint executives needed to put explicit strategies into place. We drew from our clinical experiences with the Bell companies, since we began to do many consulting/applied research projects after our successful seminars in the late 1970s. And, Ram Charan and I published a paper called "Negotiating with Stakeholders" in a magazine put out by AMACOM that focused on what we had learned about the negotiation process with a variety of stakeholder groups.

The burning questions, which I had during this time, were pretty straightforward: (1) Could I develop a method for executives to strategically manage stakeholder relationships as a routine ongoing part of their day to day activities? (2) Could

strategic management as a discipline be recast along stakeholder lines, rather than the six tasks of Schendel and Hofer? And, (3) Why was any of this thinking controversial, since it seemed like complete “common sense” to me?

In 1980, serendipity again entered the equation. My brother was killed in a car accident, and like many when faced with such a personal loss, I was “forced” to think about what I really wanted to do with my life. Did I want to continue to do consulting (with teaching being a part-time assignment), or did I want to commit to actually trying to answer these “burning questions,” and trying to live a more scholarly life? I chose the academic route and was fortunate to be offered a position as Assistant Professor in the Management Department at Wharton. I set myself the rather clear task of working out the stakeholder approach to strategy in a book, and to write as many scholarly articles as I could to develop the ideas.

It was really here that I entered the academic world of management theory. While I was not completely ignorant of management theory, I had no systematic knowledge of any of the subfields. I began to read widely in strategy, organization theory, management history, systems theory and a burgeoning literature on corporate social responsibility. It was here that I encountered what I knew to be philosophically outdated ideas of “theory,” “evidence,” the “normative–prescriptive” distinction, the “fact–value” distinction, and a whole host of ideas around methodology that took me back to the positivists of the 1920s in philosophy.

Essentially I ignored all these “rules and methods for research.” I knew that I was dealing with a real problem, “How can executives make better decisions in a world with multiple stakeholder demands?” And, I knew that I was getting the clinical experience with my consulting projects with real executives dealing with this real problem. So, I decided to build from my experiences into more general ideas about how to systematize the stakeholder approach.

For instance, when I worked with companies whose executives were trying to deal with critical stakeholders by changing their entire points of view about the company, the idea arose that perhaps it would be more fruitful to work on small behavioral changes, rather than large attitude changes. When a company expert guaranteed that he knew what a particular stakeholder group wanted from the company, and it turned out to be wrong, I began to question the idea that structuring a team of stakeholder experts was necessarily the best way to run a strategic planning process. The clinical lessons were countless. Unfortunately (but maybe fortunately), I didn’t know anything about qualitative research or grounded theory or some of the other ways to dress up intelligent observation into scientific clothes. I was stuck with the role models like Graham Allison’s *Essence of Decision*; Selznick’s book on the TVA; Freud’s clinical studies; and other more classic works of “social science.”

I also began to get involved in the management academic community through the Academy of Management. Jim Post of Boston University had invited me to give a talk to the Social Issues in Management Division in 1980 in Detroit. Even though I knew little about this group, I agreed because I had read Post’s book with Lee Preston, and knew that it was an important book. I gave a paper on the idea of

stakeholder management, which argued that this was a better unit of analysis than an “issue.” I remember the paper as being controversial and there being lots of heated discussion—so much so that I was reminded of philosophy meetings. Clearly I had found an intellectual home, even if I was unsure of why anything I had said was controversial.

During this time, I began to work with Professor William Evan, a distinguished sociologist at Penn. I was very flattered when Evan called me one day and asked to meet to discuss the stakeholder idea. Evan saw this project as a way to democratize the large corporation. Even though he was an impeccable empirical researcher, he immediately saw the normative implications of coming to see business as “serving stakeholders.” We began to meet weekly and talk about how to do the “next project” after *Strategic Management: A Stakeholder Approach*, even though that project wasn’t yet finished. We began an empirical study aimed at seeing how Chief Executive Officers made trade-offs among stakeholders and we began to plan a book that would deal with the normative implications of reconceptualizing the corporate governance debate in stakeholder terms. While we never finished the book, we did complete a number of essays, one of which is reprinted countless times in business ethics textbooks. What I learned from Bill Evan was invaluable: to be the philosopher that I was, rather than some positivist version of a social scientist. Evan gave me the courage to tackle the normative dimension, in an intellectual atmosphere, the modern twentieth-century Business School that had disdain for such analysis.

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

## 20.3 STRATEGIC MANAGEMENT: A STAKEHOLDER APPROACH. AN ASSESSMENT

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I am not sure what to make of what is now called “stakeholder theory.” I was never certain that my book contained a “theory” as it is understood by the management

thinkers represented in this volume. I recently listened to a panel at the Academy of Management debate whether stakeholder theory was “a theory,” “a framework,” or “a paradigm.” As a pragmatist, these questions do not seem very interesting to me. I have come to believe that whatever the academic verdict is on what is now called stakeholder theory, at least from a “managerial point of view” it is simply “a good idea that is useful to executives and stakeholders.” At the time of writing the book, I was less interested in “theory development” than in trying to say something systematic about what worked.

*Strategic Management* contains an underlying narrative or story about how to be a more effective executive. The “evidence” for this approach was the conversations that I had had with literally thousands of executives over the previous seven years, plus the countless stories in the business press about good and bad stakeholder management, plus my own clinical experience with a number of clients.

The point of the book was and remains very clear to me—how could executives and academics think about strategy or strategic management if they took the stakeholder concept seriously, or as the basic unit of analysis of whatever framework they applied? The basic insight was to suggest that a more useful unit of analysis for thinking about strategy was the stakeholder relationship, rather than the tasks of “formulating, implementing, evaluating, etc.” or the idea of “industry,” or the other myriad ideas of the times. I took this to be a matter of common sense and practicality, rather than some deep academic insight. The executives that I was working with found thinking about stakeholder relationships very helpful for dealing with the kinds of change that was confronting their corporations.

The approach of the book was modeled after what I took to be some of the best writing I had encountered that tried to interweave clinical cases and facts with the development of insights and ideas. So, I relied on the “clinical cases” I had worked on with a number of companies over these years, as well as my reading of the business press, case studies written by others, and my conversations with other people (experts) worried about the same phenomena. Again, I was trained as a philosopher, so what was important to me was the overall logic of the argument. I found the insistence by some colleagues on empirical methods and an obsession with “methodology” to be highly amusing and full of logic mistakes. Surely the insights of thinkers like Freud or Harry Levinson in management, or Graham Allison in politics, did not become questionable because of their methods, but because of their logic. The obsession with what Richard Rorty has called “methodolatry” continues even in this world of critical studies, post-modernism, pragmatism, and other assorted post-positivist justifications of intellectual activity. I confess to paying no attention to methods. Perhaps if I had kept careful notes, interview transcripts, had a panel of experts sort all of the “data,” I could have gained even more insight into the phenomena of businesses trying to deal with stakeholder relationships. However, I thought that all of this stuff was just silly window dressing. I never had interest in the question, “Are you doing something that is descriptive of

the way companies act, or are you prescribing how they should act, or are you suggesting that if they act in this way it will lead to these results?" Donaldson and Preston (1995) have suggested that stakeholder theory can be separated into descriptive, prescriptive, and instrumental categories. I thought I was doing all three and that any good theory or narrative ought to do all three. In short the stakeholder approach has always been what Donaldson and Preston have called "managerial." There is more than adequate philosophical justification for such an approach and Andy Wicks and I (1998) have tried to set forth such a pragmatist "methodology."

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

1. No matter what you stand for, no matter what your ultimate purpose may be, you must take into account the effects of your actions on others, as well as their potential effects on you.
2. Doing so means you have to understand stakeholder behaviors, values, and backgrounds/contexts including the societal context. To be successful over time it will be better to have a clear answer to the question "what do we stand for."
3. There are some focal points that can serve as answers to the question "what do we stand for" or Enterprise Strategy. (The book laid out a typology which no one ever took seriously.)
4. We need to understand how stakeholder relationships work at three levels of analysis: the Rational or "organization as a whole"; the Process, or standard operating procedures; and the transactional, or day to day bargaining. (These levels are just the three levels in Graham Allison's *Missiles of October*.)
5. We can apply these ideas to think through new structures, processes, and business functions, and we can especially rethink how the strategic planning process works to take stakeholders into account.
6. Stakeholder interests need to be balanced over time.

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

During the ensuing twenty years, I have continued to try and work out the implications of this basic argument, concentrating on more of the ethical and normative aspects of the stakeholder approach, while steadfastly maintaining that the normative-descriptive distinction is not hard and fast. In 1983, I moved to the



University of Minnesota with the explicit understanding that I would be teaching more Ph.D. students, and more ethics. At Wharton, I had taught primarily Business Policy and Principles of Management. I had the opportunity to immerse myself in the business ethics literature, and to try and contribute to it. On reflection, given the split or separation between “business” and “ethics,” this may have been a mistake, as it led to many misinterpretations of the basic argument.

Once again serendipity played a large part in the decision. My wife was working for a consulting firm and traveling extensively. We were commuting three hours a day (when everything worked), and the chance to both have jobs in Minneapolis meant that we could actually spend a lot of time together. As a result of our decision, “stakeholder theory” became more embedded in “business ethics” than it did in strategic management.

In 1986, we decided to move to Virginia and the Darden School, together with our 9-month-old son. My charge at Darden was to help build the research capability of the school and the Olsson Center which had been founded in 1967. Again this personal move can be seen as helping to influence the interpretation of “stakeholder theory” as belonging more to ethics than to management.<sup>5</sup> For the last eighteen years I have had the privilege to work with lots of colleagues at Darden in an environment that is much more like the one at the Wharton Applied Research Center. Darden is very “business oriented,” and the basic argument of “stakeholder theory” that it is about helping executives make better decisions, has found a friendlier home.

To answer some of the more obvious misinterpretations, at least from my point of view Robert Phillips, Andrew Wicks, and I (2003) have published a paper entitled “What Stakeholder Theory is Not.” Some of the more obvious misinterpretations are: (1) Stakeholders are critics and other non-business entities; (2) there is a conflict between shareholders and the other stakeholders; and (3) the stakeholder concept can and should be used to formulate a new, non-shareholder theory of the firm. Obviously (1) completely cuts against both the actual formulation of the theory and the spirit in which it was developed. Andrew Wicks, Bidhan Parmar, and I (2004) have recently offered a rebuttal of (2), since shareholders are stakeholders, and the whole point is that stakeholder interests have to move in the same general direction over time. (3) is a trickier matter, and I have published a number of papers in which it seems I am claiming that there is one univalent “stakeholder theory” that will work for all businesses. However, I believe that it is more useful to consider “stakeholder theory” as a genre (Freeman, 1994). There may be many particular “stakeholder narratives,” and indeed that is the original insight behind

<sup>5</sup> Serendipity played a large role here. We were unsure about moving to Virginia, and were having fairly intense discussions about it. My wife’s career had stalled unless she was willing to move, and I was unsatisfied at Minnesota. Literally, one day we looked out the back window, saw the station wagon, which quickly became a symbol of suburban middle age, and decided that we needed some new challenges. So, we moved on to Charlottesville and the University of Virginia.

“enterprise strategy.” Surely there are lots of ways to run a firm. All of these ways have to ultimately generate profits and satisfy some set of stakeholders, but context and other factors may well determine which kind of narrative works best.

While I believe that much of the basic logic of the book is still valid, especially if the misinterpretations are clarified, there are several obvious weaknesses in it. First of all much of the language of the book is couched in the idiom of strategic planning in general, and Vancil and Lorange’s (1975) version of strategic planning in particular. Lorange was at Wharton at the time and I was heavily influenced by his ideas. Therefore, there is far too much “process-speak” and far too much “consultant-speak,” both of which have served as a barrier to understanding the basic idea. Second, the book was overly analytical. Henry Mintzberg seems never to tire of repeating the criticism that I seem to believe that if we draw the stakeholder maps accurately enough, and model and predict their behavior, we can cast out uncertainty from the strategic thinking process. While this was never my aim, I do understand how Mintzberg and others read this into the work. I simply wanted to suggest that we could think about stakeholders systematically. Obviously, there are limits to our ability to analyze, and just as obviously we can use analysis to hide behind, rather than for going out and actively creating capabilities for dealing with stakeholders. Again, part of this weakness, I believe, comes from the reliance on the strategic planning literature of the time. Third, there is a tension in the writing of the book between “managerial thinking” and “academic thinking.” I believe that chapter two could only be interesting to academics, and that chapters five and six could only be interesting to executives who were trying to “do it.” I’m afraid that this tension served neither audience very well. Fourth, I have come to believe that questions of purpose, values, ethics, and other elements of which I crudely following Drucker and Schendel and Hofer, called “enterprise strategy,” are far more important than I originally anticipated. Strategic management as a field universally ignored these issues for years, and many continue to do so today. Once I came to see this as perhaps the most important part of the book, I undertook to write what I hoped was a sequel to the book with Daniel R. Gilbert, Jr. (1988), entitled *Corporate Strategy and the Search for Ethics*.<sup>6</sup> Unfortunately, almost no one reads or refers to that book today. Fifth, there was a missing level of analysis. I said virtually nothing about how business or capitalism would look if we began to understand it as consisting of “creating value for stakeholders.” Sixth, there is too much concern with structure in the book. While I still find some of the insights about corporate governance interesting, the chapters on recasting the functions of

<sup>6</sup> Again the role of serendipity emerged. While I was at Minnesota, Dan Gilbert was a doctoral student. I sat in on one of his classes to assess his teaching, and the class I chose was one in which he was using my book, and arguing to the students that I was a Utilitarian. As an ardent Rawlsian, at the time, I was appalled, and determined to fix this inadequacy in the book, so we began to work on *Corporate Strategy and the Search for Ethics*. There are many classes I could have picked to sit in and there were many other topics in the class.

business along stakeholder lines were misguided. The underlying issue is the separation of business and ethics in the foundational disciplines of business, not the practical organization and working of these disciplines. I'm certain there are even more flaws, bad writing, mistakes, and bad ideas in the book, but these are at least some of the major weaknesses from my point of view.

Since I am currently engaged in the process of rewriting *Strategic Management: A Stakeholder Approach*, I want to suggest what my current thinking is, and how I'm going about this new project. First of all there will be two books, both of them will be written by a team consisting of myself, Jeffrey Harrison, Robert Phillips, and Andrew Wicks. The initial book is tentatively titled, *Managing for Stakeholders: Business in the 21st Century* (Freeman, et al., forthcoming). It is written purely for managers and executives. There will be no academic arguments, not much discussion of the finer points of how stakeholders are defined, and no mention of most of the literature and debates that have developed over the last twenty years. The basic argument remains intact except that, given the changes wrought by globalization, information technology, and the recent ethics related scandals, there is more urgency in adopting a stakeholder approach to value creation and trade (our name for "business"). We spend a fair amount of time laying out the argument that concern for stakeholders is just what the business is about. We suggest that there is a "stakeholder mind-set" that consists of a number of key principles that more clearly guide the implementation of stakeholder thinking. We connect the stakeholder idea to ethics and values very explicitly, by suggesting that one of the key questions of enterprise strategy is: How does your firm make each stakeholder better off, and what are you doing to improve any tradeoffs that may exist between stakeholders? We distill the process and techniques of the earlier book and our experiences over the last twenty years, into eight techniques for creating value for stakeholders. Then, we end with an explicit call for "ethical leadership" that is required by the stakeholder mind-set. We are hoping to include an appendix with FAQs that will prevent a number of the misinterpretations of the first book. The second book is tentatively titled, *Stakeholder Theory: The State of the Art* (Freeman, et al., forthcoming). We plan for this book to be "everything a doctoral student ever wants to know about stakeholder theory." We will cover a number of disciplines, from law to marketing, including some outside the mainstream of business such as healthcare and public administration. We plan both to summarize and evaluate the research that has been done, and to suggest what some interesting avenues of research might be. I want to emphasize, as I tried to do in my earlier book, that the thinking on which these books are based has been done by many people, academics and executives alike, over many years. What we are trying to do is to distill this thinking into a useful form, and in doing so continue in the spirit of the early founders of the idea. With that in mind, I want to set forth some of the developments by a host of scholars who have taken the stakeholder concept and placed it squarely in the mainstream of management thinking, though I want to caution that this section is very abbreviated and incomplete.

## 20.4 STAKEHOLDER THEORY: THE CURRENT LANDSCAPE AND FUTURE DIRECTIONS

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Since 1984, academic interest in a stakeholder approach has both grown and broadened. Indeed, the number of citations using the word stakeholder has increased enormously as suggested by Donaldson and Preston (1995). Most of the research on the stakeholder concept has taken place in four sub-fields: (1) normative theories of business; (2) corporate governance and organizational theory; (3) corporate social responsibility and performance; and (4) strategic management.<sup>7</sup>

### 20.4.1 A Stakeholder Approach to Normative Theories of Business

This approach emphasizes the importance of investing in the relationships with those who have a stake in the firm. The stability of these relationships depends on the sharing of, at least, a core of principles or values. Thus, stakeholder theory allows managers to incorporate personal values into the formulation and implementation of strategic plans. An example of this is the concept of an enterprise strategy. An enterprise strategy (Schendel and Hofer, 1979, building on Drucker) describes the relationship between the firm and society by answering the question “What do we stand for?” In its original form a stakeholder approach emphasized the importance of developing an enterprise strategy, while leaving open the question of which type of values are the most appropriate.

It is very easy to misinterpret the foregoing analysis as yet another call for corporate social responsibility or business ethics. While these issues are important in their own right, enterprise level strategy is a different concept. We need to worry about the enterprise level strategy for the simple fact that corporate survival depends in part on there being some “fit” between the values of the corporation and its managers, the expectations of stakeholders in the firm and the societal issues which will determine the ability of the firm to sell its products. (Freeman, 1984: 107)

However, the illustration that values are an essential ingredient to strategic management has, indeed, set in train an inquiry into the normative roots of stakeholder theory.

The question this research stream is trying to answer is: “Above and beyond the consequences of stakeholder management, is there a fundamental moral

<sup>7</sup> Portions of this section are from R. Edward Freeman and John McVea, “Stakeholder Theory: The State of the Art,” in M. Hitt, E. Freeman, and J. Harrison (eds.), *The Blackwell Handbook of Strategic Management*, Oxford: Blackwell Publishing, 2001. I am grateful to my co-author and my co-editors and publishers for permission to include this material here.

requirement to adopt this style of management?" Various attempts have been made to ground stakeholder management in a broad range of philosophical foundations. Evan and Freeman (1993) developed a justification of a stakeholder approach based on Kantian principles. In its simplest form this approach argued that we are required to treat people "as ends unto themselves." This framework has been further developed by Norman Bowie (1999) into a fully fledged ethical theory of business. From a different perspective Phillips (1997) has grounded a stakeholder approach in the principle of fairness. Others (Wicks, Freeman, and Gilbert, 1994; Burton and Dunn, 1996) have tried to justify a stakeholder approach through the ethics of care. Finally, Donaldson and Dunfee (1999) have developed a justification for a stakeholder approach that is based on social contract theory.

Recently, Kochan and Rubenstein (2000) have developed a normative stakeholder theory based on an extensive study of the Saturn automotive manufacturer. In this study they try and answer the question: "Why should stakeholder models be given serious consideration at this moment in history?" Stakeholder firms will only be sustainable when leaders' incentives encourage responsiveness to stakeholders and when stakeholder legitimacy can overcome society's skeptical ideological legacy towards stakeholder management.

### 20.4.2 A Stakeholder Approach to Corporate Governance and Organizational Theory

This stream of research has grown out of the contrast between the traditional view that it is the fiduciary duty of management to protect the interests of the shareholder and the stakeholder view that management should make decisions for the benefit of all stakeholders. Williamson (1984) used a transaction cost framework to show that shareholders deserved special consideration over other stakeholders because of "asset specificity." Freeman and Evan (1990) have argued, to the contrary, that Williamson's approach to corporate governance can indeed be used to explain all stakeholders' relationships. Many other stakeholders have stakes that are, to a degree, firm specific. Furthermore, shareholders have a more liquid market (the stock market) for exit than most other stakeholders. Thus, asset specificity alone does not grant a prime responsibility towards stockholders at the expense of all others.

Goodpaster (1991) outlined an apparent paradox that accompanies the stakeholder approach. Management appears to have a contractual duty to manage the firm in the interests of the stockholders and at the same time management seems to have a moral duty to take other stakeholders into account. This stakeholder paradox has been attacked by Boatright (1994) and Marens and Wicks (1999) and defended by Goodpaster and Holloran (1994). Others have explored the legal

standing of the fiduciary duty of management towards stockholders (Orts, 1997; Blair, 1995). Many of these debates are ongoing, with some advocating fundamental changes to corporate governance and with others rejecting the relevance of the whole debate to a stakeholder approach.

There have also been a number of attempts to expand stakeholder theory into what Jones (1995) has referred to as a “central paradigm” that links together theories such as agency theory, transactions costs, and contracts theory into a coherent whole (Jones, 1995; Clarkson, 1995). From this perspective stakeholder theory can be used as a counterpoint to traditional shareholder-based theory. While it is generally accepted that stakeholder theory could constitute good management practice, its main value for these theorists is to expose the traditional model as being morally untenable or at least too accommodating to immoral behavior. More recently Jones and Wicks (1999) have explicitly tried to pull together diverging research streams in their paper “Convergent Stakeholder Theory.”

### **20.4.3 A Stakeholder Approach to Social Responsibility and Social Performance**

A significant area of interests for theorists of social responsibility has been the definition of legitimate stakeholders. It has been stated that “one glaring shortcoming is the problem of stakeholder identity. That is, that the theory is often unable to distinguish those individuals and groups that are stakeholders from those that are not” (Phillips and Reichart, 1998). Mitchell, Agle, and Wood (1997) addressed this issue by developing a framework for stakeholder identification. Using qualitative criteria of power, legitimacy and urgency, they develop what they refer to as “the principle of who and what really counts.” This line of research is particularly relevant in areas such as the environment and grassroots political activism. The critical question is whether there is such a thing as an illegitimate stakeholder, and if so how legitimacy should be defined. Agle, Mitchell, and Sonnenfeld (1999) have taken an opposite approach. Rather than try and theoretically define stakeholder legitimacy, they have conducted an empirical study to identify which stakeholders managers actually consider to be legitimate.

A large body of research has been carried out in order to test the “instrumental” claim that managing for stakeholders is just good management practice. This claim infers that firms that practice stakeholder management would outperform firms that do not practice stakeholder management. Wood (1995) pointed out that causality is complex and that the relationship between corporate social performance (CSP) and financial performance is ambiguous. Graves and Waddock (1990) have demonstrated the growth in importance of institutional stakeholders over the last twenty years. On further investigation they found that firms that demonstrated

a high level of corporate social performance (CSP) tends to lead to an increase in the number of institutions that invest in the stock (Graves and Waddock, 1994).

A range of recent studies have been carried out using new data and techniques to try and shed light on the links between stakeholder management and social and financial performance (Berman, et al. (1999), Harrison and Fiet (1999), Luoma and Goodstein (1999). At a more practitioner level, Ogden and Watson (1999) have carried out a detailed case study into corporate and stakeholder management in the UK water industry. At present, most conclusions in this area are somewhat tentative as the precision of techniques and data sources continue to be developed.

#### 20.4.4 A Stakeholder Approach to Strategic Management

Harrison and St. John (1994) have been the leaders in developing an integrated approach with many of the conceptual frameworks of mainstream strategy theory, a task which I quickly abandoned after publishing my 1984 book.

Harrison and St. John are able to combine traditional and stakeholder approaches because they use the stakeholder approach as an overarching framework within which traditional approaches can operate as strategic tools. For example, they divide the environment into the operating environment and the broader environment. Within the operating environment, the “resource-based view of the firm” can operate as a useful framework to study the relationships of internal stakeholders such as management and employees. Equally, Porter’s five-force model (Porter, 1998) can be used to shed light on the relationships of many external stakeholders such as competitors and suppliers. However, strategic management does not stop at this analytical/descriptive phase. Prioritizing stakeholders is more than a complex task of assessing the strength of their stake on the basis of economic or political power. The values and the enterprise strategy of a firm may dictate priorities for particular partnerships and discourage others. Thus, a stakeholder approach allows management to infuse traditional strategic analysis with the values and direction that are unique to that organization.

## 20.5 CONCLUSION

There are many promising developments in stakeholder theory. The purpose of this section is to set forth a few of these ideas and point the reader to this emerging

literature. Sandra Waddock and a number of colleagues have used the stakeholder idea as one of the conceptual centerpieces for their work on corporate citizenship, and have been involved with a number of NGOs, such as the United Nations, to develop a consensus around a set of stakeholder principles that corporations could adopt voluntarily. A compendium of essays, *Understanding Stakeholder Thinking* (Andriof, et al., 2002) is a good starting point for this very promising work. Jeanne Liedtka, Laura Dunham, and I have suggested that citizenship may well be a problematic concept if it is restricted to an analysis of the “community” stakeholder, and Waddock may well offer a way out of this morass. “Community” may well be the “soft underbelly” of stakeholder theory since it is very difficult to pin down a meaning in today’s world which is nearly absent of a “sense of place” (Dunham, Liedtka, and Freeman, 2005).

Andrew Wicks and Bidhan Parmar have suggested that one of the central tasks of both stakeholder theory and business ethics is to put “business” and “ethics” together in a coherent and practical way (Wicks, Freeman, and Parmar, 2004). Kirsten Martin has suggested that the separation of business and ethics which is so central to the stakeholder debate needs to be expanded to take the role of technology into account in an explicit manner (Martin and Freeman, forthcoming). Venkataraman (2002) has argued that thinking about entrepreneurship would hasten this combination, strengthening both stakeholder theory and entrepreneurship as important fields of inquiry.

Open questions remain. For instance:

1. Is there a useful typology of enterprise strategy or answers to questions of purpose?
2. How can we understand the relationship between fine-grained narratives of how firms create value for stakeholders, and the idea of stakeholder theory as a genre or set of loosely connected narratives?
3. If we understand business, broadly, as “creating value for stakeholders” what are the appropriate background disciplines? And, in particular what are the connections between the traditional “social sciences” and “humanities”?
4. How can the traditional disciplines of business such as marketing and finance develop conceptual schemes that do not separate “business” from “ethics” and can the stakeholder concept be useful in developing these schemes?
5. If we understand “business,” broadly, as “creating value for stakeholders,” under what conditions is value creation stable over time?
6. Can we take as the foundational question of political philosophy, “how is value creation and trade sustainable over time” rather than “how is the state justified”?

I am certain that there are many additional research questions, and many more people working on these questions than I have mentioned here. I hope this paper has clarified some of my own writing in the stakeholder area, and provoked others to respond.



If I try to summarize the lessons for management theorists of the development of stakeholder theory they would be four. First, don't underestimate the role of serendipity and context. My role would have been very different, indeed probably nonexistent, if a few key life events had unfolded differently. Second, don't underestimate the contributions of others. Really, my own contribution has been to try and synthesize the contributions of many others. I am always amused and somewhat horrified when I'm at a conference and am introduced as the "father of stakeholder theory." Many others did far more work, and more important work than I did, and that continues today as stakeholder theory unfolds in a number of fields. Third, pay attention to the real world of what managers, executives, and stakeholders are doing and saying. Our role as intellectuals is to interpret what is going on, and to give better, more coherent accounts of management practice, so that ultimately we can improve how we create value for each other, and how we live. That, I believe is a kind of pragmatist's credo. Finally, surely the author has a role in management theory. Overemphasis on reviews, reviewers, revisions, and the socialization of the paper-writing process can lead to a kind of collective group think. I believe that I could not have published the work in *Strategic Management: A Stakeholder Approach* as a set of A-journal articles. By publishing a book, I managed to create a voice, building heavily on the voices of others that could express a point of view. I believe that in today's business school world, that is much more difficult, and that we need to return to a more ancient idea of the author in management theory.

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