Stakeholder Theory As an Ethical Approach to Effective Management: Applying the Theory to Multiple Contexts

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ABSTRACT

This article provides a brief overview of some of the core ideas of stakeholder theory, and helps to clear up some widely held misconceptions about the theory. It also explains the importance of examining stakeholder theory from a variety of international, industrial, and other contextual perspectives, and how pursuing such a broad research agenda will advance management theory that will be useful to firms in a variety of international contexts. The papers published in this special issue on Stakeholder Theory in Multiple Contexts are then described. In the last section, we provide guidance for researchers interested in a research agenda that includes stakeholder theory.
INTRODUCTION

Stakeholder theory promotes a practical, efficient, effective, and ethical way to manage organizations in a highly complex and turbulent environment (Freeman, 1984; Freeman, Harrison and Wicks, 2007). It is a practical theory because all firms have to manage stakeholders – whether they are good at managing them is another issue. It is efficient because stakeholders that are treated well tend to reciprocate with positive attitudes and behaviors towards the organization, such as sharing valuable information (all stakeholders), buying more products or services (customers), providing tax breaks or other incentives (communities), providing better financial terms (financiers), buying more stock (shareholders), or working hard and remaining loyal to the organization, even during difficult times (employees). It is effective because it harnesses the energy of stakeholders towards the fulfillment of the organization’s goals. It is useful in a complex and turbulent environment because firms that manage for stakeholders have better information upon which to base their decisions and, because they are attractive to other market participants, they have a degree of strategic flexibility that is not available to competitors that do not manage for stakeholders.

All management decisions contain an ethical component, and the ethical arguments in defense of managing for stakeholders are as important to the theory as are the practical considerations. Scholars have defended stakeholder theory using a wide variety of theoretical perspectives, including integrated social contacts theory (Donaldson & Dunfee 1999), Kantianism (Evan & Freeman, 1993), the doctrine of fair contracts (Freeman, 1994), the principle of fairness (Phillips, 2003), the principle of the common good (Argandoña, 1998), feminist ethics (Wicks, Gilbert & Freeman, 1994), and pragmatism (Wicks & Freeman, 1998; Freeman, Harrison, Wicks, Parmar & deColle, 2010).

Stakeholders typically are defined as individuals, groups and organizations that have an interest in the processes and outcomes of the firm and upon whom the firm depends for the achievement of its goals (Freeman, 1984; Freeman, Harrison & Wicks, 2007). Some individuals, groups and organizations are easily defined as stakeholders because of their involvement in the value producing processes of the firm. They include employees and managers, shareholders, financiers, customers and suppliers. These stakeholders may be referred to as primary stakeholders or legitimate stakeholders (Phillips, 2003).

Stakeholder theory suggests that “managing for stakeholders” involves attending to the interests and well being of these stakeholders, at a minimum (Harrison, Bosse & Phillips, 2010). However, frequently other stakeholder groups are included, such as communities, special interest or environmental groups, the media, or even society as a whole. This latter group, society, is a little difficult to comprehend in terms of the core ideas of stakeholder theory because it is, from a practical perspective, impossible to determine what is in the best interests of such a vast and heterogeneous group.
An interesting and important aspect of stakeholder theory is that it is comprehensive in its approach. Stakeholder theory advocates for treating all stakeholders with fairness, honesty, and even generosity. As Harrison, Bosse and Phillips (2010, p. 58) put it, “A firm that manages for stakeholders allocates more resources to satisfying the needs and demands of its legitimate stakeholders than what is necessary to simply retain their willful participation in the productive activities of the firm.” Other business disciplines tend to focus on one or a subset of stakeholder groups: human resource theory focuses on employees, marketing theory focuses on customers, financial theory focuses on shareholders and financiers, and so forth. Stakeholder theory proposes that treating all stakeholders well creates a sort of synergy (Parmar, Freeman, Harrison, Wicks, Purnell & de Colle, 2010; Tantalo and Priem, 2014). In other words, how a firm treats its customers influences the attitudes and behavior of the firm’s employees, and how a firm behaves towards the communities in which it operates influences the attitudes and behavior of its suppliers and customers (Cording, Harrison, Hoskisson & Jonsen, 2014; du Luque, Washburn, Waldman & House, 2008). This concept is known as generalized exchange, and it is a core differentiating aspect of the theory (Ekeh, 1974; Harrison, Bosse & Phillips, 2010).

Stakeholder theory is not the same as corporate social responsibility (CSR) theory (Hillman & Keim, 2001). From its inception, it was not developed to promote policies or organizational behavior associated with social goals such as corporate philanthropy or taking care of the environment. It is a management theory based on moral treatment of stakeholders and not a moral theory that also happens to be relevant to management. This was the initial position (Freeman, 1984), although we recognize that the theory has now splintered in a number of directions and is interpreted in a number of different ways. Nonetheless, the distinction between stakeholder theory and CSR is important in the business disciplines because a large number of business scholars and practitioners still reject stakeholder theory as a core management theory simply because they believe it is about CSR, and thus they see it as something firms might do if they can afford it or if they are compelled to do so, rather than understanding that following stakeholder precepts actually helps firms create more value, even value measured in financial terms (Phillips, Freeman & Wicks, 2003; Harrison, Bosse & Phillips, 2010; Harrison & St. John, 1996; Jensen, 2001; Jones, 1995; Walsh, 2005).

This last thought, that following stakeholder precepts is associated with both good management and higher financial performance, at this point is nearly irrefutable. Numerous scholars have tested and supported this theory across a number of industries, in both domestic and international firms, and in a variety of contexts (i.e., Choi & Wang, 2009; Cording, et al, 2014; Harrison & Freeman, 1999; Henisz, Dorobantu & Narthey, 2014; Hillman & Keim, 2001; Sisodia, Wolfe & Sheth, 2007). This special issue contains two more empirical studies, in new contexts, that confirm the efficacy of managing for stakeholders in terms of both financial and social firm performance.

Although there is significant empirical evidence in support of managing for stakeholders, some scholars continue to promote shareholder value maximization as the most defensible approach to management (Brealey, Myers & Marcus, 2007; Danielson, Heck and Shaffer, 2007).
2008; Heath, 2009). This approach asserts that it is the responsibility of managers (and those who oversee managers, such as boards of directors) to maximize returns to shareholders; consequently, unnecessary allocations of money, time or other resources to other stakeholders, such as employees, suppliers, or local communities, are discouraged (or even considered immoral) (Jensen and Meckling, 1976). Because shareholder primacy and stakeholder theory are inconsistent, countless articles have been written in defense of one position against the other. Given the strength of the empirical and theoretical evidence in support of stakeholder theory, we believe it is futile to continue this debate. Instead, we advocate for research and debate that will refine stakeholder theory and help organizations determine the best tactics for implementing it.

Stakeholder theory has infiltrated many disciplines in some very useful ways. In a review of the academic literature pertaining to stakeholder theory, Freeman, et al (2010) found a critical mass of scholarly works that use stakeholder theory in strategic management, finance, accounting, human resources management, production, information technology, marketing, law, health care, public policy, business ethics and CSR. Although their review is barely half a decade old, the stakeholder literature has at least doubled since it was published. An increasing number of executives and companies are also embracing the theory and applying its concepts. In an article containing recent interviews of high level managers in large U.S.-based organizations, Wicks and Harrison (2015) quoted one executive as saying, “What we said is we’re going to bet the farm on an idea that doing good, positively impacting the lives of our associates, customers, and communities, is the best path do doing well, making money… We are betting the farm on stakeholder theory, betting the farm on it.”

STAKEHOLDER THEORY ACROSS BORDERS

Our original intention for this special issue was to attract papers that examine and compare applications of stakeholder theory across a variety of international contexts. We soon realized that not many scholars are engaging in this sort of research, so we expanded the call for papers to include research involving a broader definition of contexts, to include different industries, markets, and types of firms. We nonetheless believe there is a need for comparative research across multiple international contexts.

The institutional framework and predominant management mindset of each country reflects its distinct history and the peculiarities of its socio-political configuration (Jamali & Mirshak 2007). The bulk of the thinking on stakeholder theory has emanated from Western countries. This may be, in part, because of the predominance of the shareholder maximization perspective found in many popular Western business theories. That is, because shareholder primacy grew out of the West, stakeholder theory was necessary to provide a more balanced perspective on the objective of the corporation and how to manage it. Besides, shareholder primacy has led to a number of unfavorable outcomes for firms, economies and society (Stout, 2012).

As stakeholder theory has become more of a worldwide phenomenon, one of the first questions is to what extent the institutional and regulatory frameworks of various
countries support or even compel companies to pursue more balanced objectives that include a variety of stakeholders (Campbell, 2007; DiMaggio & Powell, 1991; Hoffman, 2001; Jamali & Neville, 2011). This sort of research can help inform governments and their regulators, NGOs, lobbyists, reporting agencies and other types of institutions regarding the desirability of various types of legal and political structures. This also raises questions regarding whether free markets and the firms that populate them will eventually find their way to a more balanced stakeholder approach, or the extent to which such behavior should be compelled (Scott 2008). Cross-country and cross-cultural studies can begin to answer some of these important questions.

At the firm level, organizations that operate in countries that are different from the home country may contribute a great deal in terms of novel ideas about how to manage stakeholders. Some of these contributions may come from overcoming the gridlock of traditional thinking, as well as the institutions that cause organizations to conform to widely held norms (Abreu, Cunha & Barlow, 2015; Matten & Moon, 2008). As we have travelled the world, we have noticed that a lot of the management techniques firms use within particular countries are a result of tradition in those countries. Internationalization is changing this phenomenon to some extent, as multi-national companies apply management techniques developed in one country to their business units operating in different companies. But the learning process is slow, and learning is stifled because of the strength of institutions in those countries (Jamali & Neville 2011). Also, although the parent company may believe that management techniques developed in their home country are superior to those found in host countries, this belief may be more a function of manager hubris than reality. Western ideologies and management techniques tend to be widely adopted in developing nations. Perhaps cross-border research may discover that some of these ideologies and techniques are not superior, but in fact destroy more value than they create.

Because developing nations tend to be much more resource constrained compared to nations that are highly industrialized, stakeholder theory would suggest that firms in these nations are likely to benefit greatly from the value creating processes associated with managing for stakeholders. However, under situations characterized by resource scarcity there is a tendency for managers to cut back on the types of resource allocations that facilitate the creation of additional value. For example, a firm may attempt to offer its employees just the bare minimum wages and benefits that will allow them to maintain a workforce. However, in this situation turnover is likely to be high as employees find better compensation elsewhere. This means training costs will also be high. In addition, morale will be low, and positive reciprocity will be absent.

Contrast this situation with a firm that compensates its employees at a level that is noticeably but not greatly higher than competitors in the same industry (Harrison & Bosse, 2013). The cost savings from lower turnover and the value creating benefits associated with positive reciprocity should more than compensate for the higher costs of compensation (Bosse, Phillips & Harrison, 2009; Fehr & Gachter, 2000). The problem is that managers need to be educated on this sort of stakeholder philosophy, and they need to be convinced that it works not just in a general sense, but in their own countries,
industries, and competitive situations. Or perhaps in some competitive situations such a strategy will not work. We won’t know until we test such ideas in multiple contexts. We challenge scholars reading this article to do the hard work of cross-border and multiple context research on the specifics of best practices in the management of stakeholders, and to work to communicate the results to other scholars and especially to practitioners.

**ARTICLES IN THIS SPECIAL ISSUE**

This issue reflects the theme of applying stakeholder theory in multiple contexts, which include cooperatives, the artisanal *cachaça* sector, governance structures, a tax consulting firm, and transnational corporations. A variety of research approaches are included, among them a single case study, a multi-case study, sophisticated empirical methods, and a network approach. All of the articles are very interesting and we recommend you read them. This section will provide brief introductions for the articles.

One of the most interesting contexts in which stakeholder theory was applied was in Brazilian Cooperatives. The paper “Stakeholder Management Capability and Performance in Brazilian Cooperatives” describes a study by Yeda Maria Pereira Pavão and Carlos Ricardo Rossetto in which they collected data from 26 states and the Federal District of Brazil, and across 13 sectors of Brazil’s economy, to test the relationship between Stakeholder Management Capability (SMC) and both social/environmental and economic performance. To our knowledge this is the first empirical test of these relationships within the context of cooperative organizations. It would seem to be an especially appropriate context for a test of stakeholder theory because cooperatives tend to be more balanced in their objectives between non-economic and economic enrichment of their members. Consistent with this thinking, the authors found support for a positive relationship between SMC and both types of performance.

As another fascinating application of stakeholder theory, Daiane Mulling Neutzling, Manoela Silveira Santos, dos, Marcia Dutra Barcellos, and Anna Lauren Land examined value creation through internationalization of the artisanal *cachaça* sector. "Value Creation from Internationalization of Sugar Cane By-products: A Multi-stakeholder View of Artisinal *Cachaça* Production" describes a multi-case, multi-stakeholder analysis of strategies developed for internationalizing *cachaça* from a network perspective. Consistent with this perspective, they apply Snowball sampling to identify stakeholders that are most important to the process. They then conducted in-depth, semi-structured interviews with these stakeholders about relationships among stakeholders, the roles and contributions of each stakeholder to the internationalization process, the *cachaçarias’* internationalization strategies, production processes and the market for *cachaça*. The study is exploratory, and provides an excellent knowledge base for future research because it describes what is inherently a very complicated initiative from a wide assortment of perspectives, and it links these perspectives in a very realistic fashion (see their Figure 1). It is also interesting that lack of regulation in this sector is actually a deterrent rather than a facilitator of internationalization because it gives the big drinks companies all of the bargaining power.
Stakeholder theory, at its core, is about creating more value. However, managers tend to have varying perspectives about who should share in the value that is created. Narrow value creation models suggest that the focus should be on a small set of stakeholders, such as shareholders or customers. Broad models focus on a much larger group of relevant stakeholders. In “Stakeholder Theory and Value Creation Models in Brazilian Firms,” Natalia Giugni Vidal, Shawn Berman and Harry Van Buren use qualitative content analysis to analyze the sustainability or integrated annual reports of top Brazilian firms with the intent to identify their value creation models as fundamentally narrow, broad or something in between. They find that many of the firms they study are currently in a transition state between narrow and broad. They also identify seven areas in which firms are attempting to create value for stakeholders: better stakeholder relationships, stakeholder dialogue, better work environment, environmental preservation, increased customer base, local development, and improved reputation.

While the Vidal, et al. paper is based in part on the concept of stakeholder salience, or determining who counts to managers, stakeholder salience is examined directly in “Exploring Stakeholder Salience for the Adoption of Principles and Tools for Cleaner Production in Brazilian Companies,” by Geraldo Cardoso Oliveira Neto, Moacir Godinho Filho, Gilberto Miller Devós Ganga and Benny Kramer Costa. They run an exploratory survey in 102 Brazilian firms and use multiple correspondent analysis to test the influence of stakeholder salience on companies’ decisions to implement cleaner production (CP) tools and principles. The Brazilian companies they surveyed identified financial agents as “definitive stakeholders” because they possess power, legitimacy and urgency attributes to influence CP adoption. In the case of Government influence, companies indicated that environmental legislation and enforcement (power) in conjunction with environmental education (influence) lead them to adopt CP principles and tools. On the other hand, the companies did not consider Brazilian society’s influences and awareness significant. They also do not believe that a pro-environmental reputation can enhance a competitive advantage and make them financially attractive. Furthermore, these findings seem to indicate that Brazilian society does not have sufficient power to change a company’s behavior. One lesson, then, is that stronger enforcement of regulations may be required, which demands a more consistent and transparent approach by the government. Also, more negotiation and consensus among corporations, governments and other actors would enhance understanding of their respective positions and of achievable joint outcomes. This knowledge could then be applied in other countries.

One of the most important, but sometimes neglected, aspects of stakeholder theory is that stakeholders are not generic, nor are they homogeneous within groups. That is, the customers of one firm typically are not the same as the customers of another firm, even if they compete in the same industry. And within customers groups, one customer is not going to have the same values, desires, or utility function as other customers. From this perspective, in-depth case studies are helpful in understanding both the tensions among stakeholders and their varied interests and values. “Looking at Organizational Change Through the Construction and Reconstruction of the Underpinning Values of the Organization Through Its Interactions With Stakeholders,” by Sueli dos Santos Leitão and Silvia Marcia Russi De Domenico, offers an in-depth narrative of the changes that took place
over a period of several years. They used real-time and retrospective data gained through interviews with numerous stakeholders of a tax consulting firm, including the founder, partners, other leaders, employees, employees of client firms, and suppliers. They also acquired data through non-participant observations of firm processes and interactions with stakeholders. The firm was founded with the intention of striking an even balance between providing value for stakeholders and profitability. The specific values these researchers studied related primarily to how the firm would compete. Their rich narrative is an interesting story, but it also demonstrates how interactions among stakeholders lead to the evolution of values over an extended period of time. As the authors put it, values are “not static but are rather reconstructed as the stakeholders strive to make sense of routine events in the organization by their interactions and through language.”

In “The Influence of Ownership Concentration on Firm Resource Allocations to Employee Relations, External Social Actions, and Environmental Actions,” Vicente Lima Crisóstomo, Fátima de Souza Freire, and Paulo Henrique Nobre Parente examine the notion that ownership concentration is positively associated with corporate social responsibility (CSR) measured, as the title suggests, across three areas of importance in the stakeholder literature. The authors argue that, due to increasing pressure on firms to act responsibly towards stakeholders and the environment, important firm stakeholders are likewise becoming more interested in the conduct of the firms with which they affiliate. This is likely to be especially true for stakeholders that have a large interest in the firm, such as shareholders who hold large blocks of stock. These stakeholders’ reputations are inseparably intertwined with the reputations of the firms in which they hold a large interest, so they are expected to closely monitor the activities of these firms to make sure their reputations are not soiled through problems with employees, societal expectations or environmental concerns. The paper contains empirical evidence based on a sample of Brazilian firms to support the claims of the authors, as well as a few interesting and counterintuitive findings that we will leave to the readers of this issue to discover for themselves.

As we mentioned in the previous section, managing stakeholder interests is a complex task, and even more daunting in organizations that span multiple countries. In “An Innovative Approach to Stakeholder Theory Application in Spanish Transnational Corporations,” Jose Luis Retolaza, Maite Ruiz-Roqueñi, and Leire San-Jose simplify the task by concentrating on the interests of stakeholders rather than both their interests and the roles they play. This emphasis provides them an opportunity to develop ideas for an integrated accounting system that incorporates both economic and social issues while employing a common (monetary) language that focuses on stakeholder interests.

FUTURE RESEARCH DIRECTIONS

As we mentioned in the introduction, stakeholder theory research is growing in importance across a number of disciplines. Our collective experience with this topic exceeds 80 years. Consequently, we would like to take this opportunity to provide some observations that researchers interested in stakeholder theory may find useful (for a more
detailed treatment see Freeman, et al. 2010, Chapter 10). We already addressed the need for more comparative cross-country research in a previous section. Here we will mention some of the other research areas we believe are of the highest importance to continuing a productive conversation about stakeholder theory and its applications.

While there is still some room for testing whether managing for stakeholders is effective in new contexts, even more interesting research will examine how a stakeholder approach is being applied, with the objective of establishing best practices for those contexts (Wicks & Harrison, 2015). Basically this means accepting the overwhelmingly supportive empirical research that demonstrates the efficacy of the general stakeholder approach, and moving on to other topics. For example, it would be helpful if researchers would develop theory around practices that might then be applied in other contexts. In particular, currently there is a lot of interest in stakeholder engagement strategies among scholars and practitioners. This term, like so many others, means different things to different people. However, the meanings all have in common the notion of getting stakeholders more involved with the organization. We believe it would be useful to both record and categorize various types of engagement strategies currently in use, and to relate these strategies to particular outcomes.

Recognizing that stakeholders are not generic in their interests, and that those interests may not be in harmony with firm interests, there is a need for more work that examines both combined and divergent interests, and how they influence stakeholder relationships. Along these same lines, there is an urgent need for creation of new metrics that reflect stakeholder relationships. How can they be classified, and how are those classifications related to both interests and management strategies? Also, how can the overlapping interests of various stakeholders be addressed and coordinated?

The concept of value emerged as important in this special issue (Vidal, et al), and it is of increasing interest to scholars (Harrison & Wicks, 2013; Harrison & Thompson, 2015). There is still much work to be done. What does value mean for different stakeholders? And how can value be measured from multiple stakeholder perspectives? What types of value should be included when managers are making decisions? And, of course, once value is created, what are the guiding principles with regard to its distribution (Blyler & Coff, 2003).

Stakeholder theory also offers an opportunity to reinterpret a variety of concepts, models and phenomena across many different disciplines, including economics, public administration, finance, philosophy, marketing, law, and management, among others. In particular, stakeholder theory is multi-faceted, and offers the opportunity to reinterpret situations from a variety of new perspectives, including perspectives that involve multiple stakeholders simultaneously. Academic theories are often based on unrealistic and limiting assumptions in an effort to simplify the world and make it conform to models that can be tested empirically. The problem is that the world is a complex place, and oversimplified theories are not reflective of that complexity, and therefore tend to be of limited usefulness in explaining reality or predicting outcomes.
As an example of the limited usefulness of oversimplified theory, consider the efficient markets hypothesis, which is foundational to the field of finance (Fama, 1970). One popular version of this theory explains that all of the relevant information about the value of a common stock is reflected in its price at a given point in time. Continuing with this logic, when an announcement is made about an event of some consequence to a firm, such as an acquisition, joint venture, or the appointment of a new chief executive, the stock price will immediately and accurately adjust to reflect the market's assessment of that event on the future financial performance of the stock (Shelton, 1988; Reuer & Miller, 1997; Capron & Pistre, 2002; Shen & Canella, 2003). In other words, all of the relevant information is immediately absorbed into the stock price. Using this theory as a basis, many researchers have used immediate changes in stock prices to test theories about the characteristics of acquisitions that will lead to higher performance (Datta, Pinches & Narayan, 1992; Haleblian, Dever, McNamara, Carpenter & Davison, 2009). However, there is strong evidence that immediate changes in stock prices are not accurate predictors of the financial performance of acquiring firms, even in the simplest acquisitions (Oler, Harrison & Allen, 2008).

Now consider how the application of stakeholder theory can improve this situation. First, stakeholder theory would suggest that shareholder value, reflected in the share price, is not a sufficiently broad measure of the changes in value a complex event such as an acquisition is likely to create. Second, stakeholder theory would advocate for consideration of the influence of an acquisition on all of the relevant stakeholders that are likely to be affected, to include employees, customers, communities in which both firms operate, financiers, shareholders, managers, suppliers, and others. Third, stakeholder theory provides a rationale for integrating these multiple perspectives – basically, for explaining why managers should care about the influence of an acquisition on these stakeholders. Ultimately, a stakeholder perspective is more likely to be of use in determining which acquisitions are likely to be successful from a number of perspectives, even financially, and is also in a better position to offer guidance in successfully integrating an acquisition once it has been consummated.

Of course, stakeholder theory’s foundation on ethics and morality offers a wide range of possibilities as well. The CSR literature has found stakeholder theory especially useful in defending its basic premise that firms should do well from a societal perspective. However, the theory is much broader than this, both as a management theory and as an ethical theory. If we accept the stakeholder premise that stakeholders are basically moral, then how does this alter our ideas about people in our complex world? What happens to the widely accepted idea in the business and economics literatures that people tend to be self-serving and opportunistic? If we envision capitalism as a system in which companies create value for stakeholders, how does this change our perspective on the history of capitalism and its usefulness in evoking positive changes in economies and their underlying societies? Finally, how can stakeholder theory influence one of the great international debates of our day – the distribution and/or redistribution of value created by economic enterprises?

As stakeholder theory comes of age, there is much work to be done. We are grateful to the scholars who have, in this issue, contributed to a useful discussion about stakeholder
theory. We also appreciate that other scholars submitted their hard work to this issue, but their papers were not yet in a state of readiness for publication. We say to both groups – keep up your good work. The field needs you. We would also like to thank the dozens of reviewers whose helpful insights were instrumental to what you are about to read. Finally, we are grateful to senior editor João Mauricio Boaventura for both inviting us to edit this special issue and helping us along the way. We are also indebted to Tatiane da Rocha Carlos for handling the myriad details associated with managing the flow of manuscripts. We hope you enjoy this issue and that it will help promote excellent scholarship on stakeholder theory from multiple perspectives.
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