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Stakeholder Theory in Strategic Management: A Retrospective

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STAKEHOLDER THEORY IN STRATEGIC MANAGEMENT: A RETROSPECTIVE

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This chapter will provide a description of the personal journey of the author who, as a newly graduated Ph.D. in strategic management in 1985, embraced stakeholder theory. Perhaps one of the interesting aspects of this narrative is that the field of strategic management itself was in its infancy at the time of my graduation. So I have "grown up" in the strategy field while simultaneously observing and to some extent participating in the development of what we now call stakeholder theory. Over the past two and a half decades I have frequently found myself frustrated by my strategy colleagues' lack of understanding of the stakeholder concept and their inability to comprehend its potential to address many of the most important problems in the strategy field. My own attempts to remedy this situation while continuing to do mainstream strategy research are described herein.[1] Of course, in recent years the stakeholder concept has begun to gain greater acceptance in the strategy field. At the end of the chapter I will describe some potentially fruitful applications of the stakeholder concept in strategic management research.

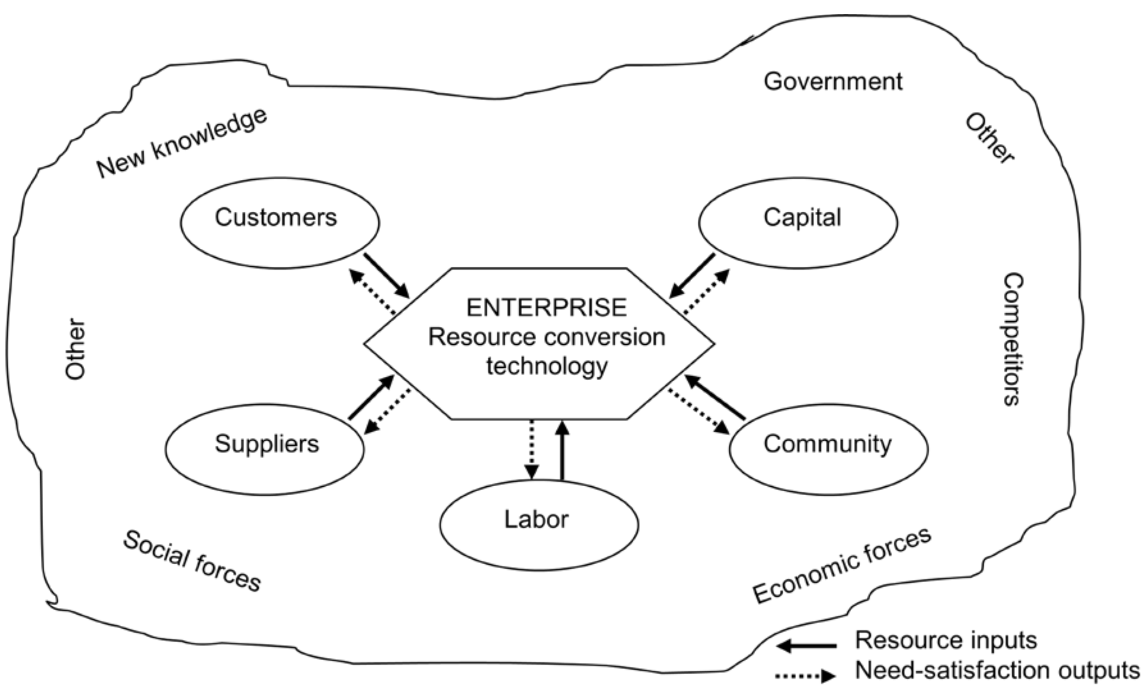
A Discipline is Born

The birth of the academic field now known as strategic management probably occurred at a conference at the University of Pittsburg in May 1977. This is not to say that scholars were not already exploring related ideas and theories, but to keep with the birth analogy, these early activities are better described as the gestation period in which the

[1] This is probably a reasonable time to acknowledge the rather obvious fact that this narrative is written from my perspective and thus contains my own biases.

baby was forming. The conference organizers, Dan Schendel and Charles Hofer, commissioned fourteen research papers to describe and define the field of strategic management, examine research methods, and provide direction for future research (Schendel and Hofer, 1979). Participants also included panelists, moderators, discussants, practitioners and a few additional members of the Business Policy and Planning division of the Academy of Management. A model that looked very much like a stakeholder map (Newman, 1979) crept into the conference as a commentary to a paper presented by Igor Ansoff on the changing shape of the strategic problem (see Figure 1).

Figure 1
Generalized Contributor Group Interaction between the Firm and its Environment



Source: Newman, W.H. 1979. Commentary. In Schendel, D.E. & Hofer, C.W. *Strategic Management: A New View of Business Policy and Planning*. Boston: Little, Brown and Company, p. 45.

Porter published the first of his now-classic books in 1980, and by the mid-1980s both the proceedings of the Pittsburgh conference and Porter's work were among a few standard texts for doctoral students in the growing field of strategic management. I remember at the time that scholars in our newly emerging discipline were obsessed with gaining acceptance from other business disciplines as a credible academic field. The field itself had emerged, in part, from a need for practical guidance in making high-level corporate decisions, and much of the literature had a practical focus (even Porter's work). Since the strategy field did not have much in the way of its own theory to build upon, it was not surprising that many scholars were building on theory that was largely economics based (Chandler, 1962; Jensen and Meckling, 1976; Pfeffer and Salancik, 1982; Porter, 1985; Rumelt, 1974; Williamson, 1975).[2] Early scholars also applied empirical research methods from other disciplines, especially finance and organizational behavior. Financial performance became (and still is) the most important dependent variable in the field.

Consistent with the economics foundation, the widely-accepted theories and prescriptions in strategic management at the time tended to be amoral. This probably was more of a practical consideration rather than an intentional oversight. Moral considerations are an added dimension that slow down and complicate the research process. It is much easier to assume they don't exist. To fill the void, a group of scholars with interest in the moral dimensions of management was forming a separate interest group at the Academy of Management. This allowed the two camps, Business Policy and

[2] This retrospective is not intended to be a review of the strategic management literature nor is it a detailed review of the stakeholder concept in the field of strategic management (which can be found in Chapter 4 of Freeman, et al., 2010). Consequently, the citations found in this chapter are merely representative of those that influenced the thinking of the author.

Business and Society (now called Social Issues in Management), to pursue their own agendas without much cross-fertilization of ideas.

A Stakeholder Approach to Strategic Management

I graduated in 1985 and read *Strategic Management: A Stakeholder Approach* (Freeman, 1984) shortly thereafter. The book transformed my thinking about strategic management, which had an impact on my teaching and research. To me, a stakeholder-based perspective of strategic management was completely intuitive. After all, managing stakeholders is precisely what managers do and stakeholders are the obvious building blocks of a competitive firm. I could not understand why many of my colleagues in strategic management did not recognize the potential of the stakeholder perspective in explaining competitive performance. In addition, I was drawn to the stakeholder approach because of its moral appeal.

The practicality of a stakeholder approach to strategic management made it very appealing to me as a teaching tool, yet it was not represented in any of the mainstream strategy textbooks of the time, so in the early 1990s I began talking to publishers about writing a book with stakeholder theory as the foundation. Since my experience was in corporate-level strategy, I sought a co-author who could complement me by providing more of a micro view of the field. Caron St. John, who was trained in operations management, agreed to work with me on the project by managing all the cases and writing the implementation chapters. This left me eight chapters to write, covering internal and external analysis, strategic direction (missions, visions and purpose), business-level strategy, corporate-level strategy, and strategic control and restructuring.

My approach to writing my eight chapters was to start with a basic stakeholder foundation and then build on it the other topics and ideas that were important in the strategic management field at the time. For instance, the external analysis chapter was built on a foundation of external stakeholder analysis. Stakeholders with which a firm has reciprocal influence based on regular transactions were treated as part of the operating environment, while other stakeholders were a part of the firm's broad environment. Porter's (1985) Five Forces became a part of the operating environment: suppliers, customers, and three types of competitors (existing, substitute and potential). Consistent with stakeholder theory, the chapter also advocated for both evaluating and managing relationships with stakeholders. Stakeholder management included strategies for communication and formation of various types of alliances. The internal analysis chapter viewed employees, managers, directors and owners as internal stakeholders. And, of course, the strategic direction chapter included a heavy dose of ethics and enterprise strategy.

To our delight, the first edition (Harrison and St. John, 1994) was widely adopted across most of the fifty U.S. states. Equally satisfying, the adoption list included many of the best universities. However, between the first and second edition two things happened. First, and most important, a competing textbook based on the resource-based perspective was launched by the same publisher. Second, our publisher was acquired just before the second edition came out. There was a lot of confusion at the company at the time, and the sales representatives were focusing on the other textbook. At one point a few months after our second edition came out a publisher representative actually tried to sell me the competing book. When I mentioned that I was an author for his company and that our second edition had come out recently he was really surprised. So it was not unexpected that the second edition did not sell particularly well. Nevertheless, I was very happy to observe that most of the strategic management texts at the time immediately or eventually added the stakeholder perspective. This outcome was consistent with my original purpose for writing the book.

Also satisfying during this period was a publication that grew out of some theory Caron and I developed as we wrote the book (Harrison and St. John, 1996). The paper suggests that firms should partner with (as opposed to monitor) stakeholders that have a large impact on the environmental uncertainty they face. It also helps to define which stakeholders are likely to have that sort of impact, based on the power they possess.

A Period of Misconceptions

As I alluded to previously, the resource-based view of the firm was sweeping the strategy field in the early 1990s (Barney, 1991). There was so much interest in the resource-based perspective that it was difficult for me to engage other strategy scholars in meaningful discussions about the stakeholder approach. In addition, misconceptions regarding the stakeholder perspective were so ingrained at the time (Phillips, Freeman and Wicks, 2003) that stakeholder theory was all but ignored in the mainstream strategic management literature. This is manifest by the fact that not one article with the word "stakeholder" in the title was published in Strategic Management Journal during the 1990s.

Later in the decade the relational view (Dyer and Singh, 1998; Gulati and Singh, 1998), now sometimes referred to as network strategy (Hitt, 2005), was introduced. In spite of strong conceptual similarities between the relational view and stakeholder theory, these scholars did not cite Freeman (1984), nor did they acknowledging the growing literature on stakeholder theory in the management literature (Donaldson and Preston, 1995; Jones, 1995; Greenley and Foxall, 1997; Hill and Jones, 1992; Mitchell, Agle and Wood, 1997). This was very frustrating to me and, I assume, to other strategy scholars who were advocates of a stakeholder perspective.

Discussions with colleagues drew me to the conclusion that most strategic management scholars genuinely did not understand stakeholder theory in the 1990s. Most of them envisioned it as a purely ethical theory with little strategic value. Misconceptions such as a belief that stakeholder theory requires that all stakeholders be given equal priority in strategic decisions led them to determine that the theory is impractical. The fact that members of the Social Issues in Management Division in the Academy of Management wholeheartedly embraced stakeholder theory did not really help the battle for acceptance of stakeholder theory in strategic management. Instead, it reinforced the perception that the theory is only about social responsibility. Also reinforcing this perception were publications in management journals that made use of stakeholder theory under the label of social responsibility (i.e., Waddock and Graves, 1997; Turban and Greening, 1996; see also Elms et al., 2011 current volume).

Nevertheless, a growing group of strategy scholars were friendly to stakeholder theory because they thought of it as a public relations tool that could help build a firm's reputation. Since the resource-based view suggests that hard-to-imitate resources are valuable to competitive advantage, and reputation is hard to imitate (Fombrun and Shanley, 1990), these strategists began to see value in the stakeholder approach as a means to gaining a better reputation. Also, some scholars became interested in the influence of stakeholders on organizational strategy and the distribution of value (Coff, 1999; Frooman, 1999; Rowley, 1997).

A Special Issue

By the late 1990s there were enough management scholars examining the stakeholder approach to warrant special issues in management journals. I was serving on the editorial board of the Academy of Management Journal at the time, and the editor Anne Tsui was very supportive of a special issue on a stakeholder theme. Ed Freeman and I had become friends as he generously allowed Caron and I to use his material in our textbook. When I contacted Ed, he was excited about the prospect of co-editing a special issue on stakeholder theory. Firm performance was included in the call for papers because it is the primary dependent variable of interest to strategy scholars. We added the concept of social responsibility to the call to increase interest and ensure an adequate number of submissions. I realized then as I do now that this addition also served to reinforce the perception among strategy scholars that stakeholder theory is about social responsibility. However, the decision represented a tradeoff and we wanted to ensure the success of the issue as much as possible. The final topic of the research forum was Stakeholders, Social Responsibility and Performance.

To our delight, we received 49 submissions, which led to a strong issue (Harrison and Freeman, 1999). Among the outstanding papers we had the good fortune to accept were several studies that focused on important stakeholder questions. One was an empirical test of the stakeholder salience model developed by Mitchell, Agle and Wood (1997). Agle, Mitchell and Sonnenfeld (1999) collected primary data from CEOs and discovered that particular stakeholder attributes increase their salience to managers.

Another fascinating paper examined the motives behind a firm's attempts to address the interests of their stakeholders (Berman, Wicks, Kotha and Jones, 1999). They discovered support for the instrumental view that firms advance stakeholder interests because they believe that doing so can enhance firm performance and not because of a moral commitment to those stakeholders.

The four other papers in the special issue also deserve mention. Luoma and Goodstein (1999) investigated factors that influence the proportion of board seats filled by nonshareholding stakeholders. Ogden and Watson (1999) examined the attempts of U.K. water companies to balance the interests of customers and shareholders and discovered that shareholders were able to compensate for short-term losses associated with customer satisfaction possibly because of the anticipated positive longer-term effects of the firm actions that created the losses. In another paper, Weaver, Treviño, and Cochran (1999) examined the influence of external pressure and top management commitment on the nature of ethics programs within firms. Finally, Johnson and Greening (1999) tested the effects of institutional influences and other governance factors on corporate social performance. These last two papers were focused more on social responsibility the way the term is traditionally used.

An Explanation for Competitive Performance

Somewhere around the time of the special issue I began putting on paper my own thoughts regarding the relationship between the way a firm manages its stakeholders and competitive performance. As one would expect from a strategist, my approach was very practical and instrumental and strongly influenced by the work of Tom Jones (1995). In my mind, the positive relationship between treating a broad group of stakeholders well and high firm performance was obvious—my goal was to help explain why the relationship exists in terms that a strategist could appreciate. Consistent with some of the work I did with Caron (Harrison and St. John, 1994, 1996), I began to examine what it is about particular types of relationships that can enhance firm performance. Others had already provided some excellent ideas on this issue, but they had not yet achieved the level of acceptance in the strategy field that I thought they deserved. I built on their ideas, and a paper cycled through several meetings and countless peer reviews. At the University of Richmond I was able to convince two outstanding co-authors, Doug Bosse and Robert Phillips, to join me.

To date, two papers have come out of our collaboration, both published at Strategic Management Journal. The first of these papers provides a social justice foundation upon which the second paper builds (Bosse, Phillips and Harrison, 2009). The core idea of paper one is that the widely-held assumption that economic actors are self-interested is bounded by norms of fairness. Reciprocity stemming from distributional, procedural and interactional justice may allow some firms to enjoy competitive benefits that other firms do not enjoy.

Building from the foundation created in the first paper, Harrison, Bosse and Phillips (2010) define firms that "manage for stakeholders" as those that allocate more resources to satisfying the needs and demands of their important stakeholders than what is needed to ensure their continued participation in the value-adding processes of the firm. In this context, resources include time, information, attention, and respect, as well as tangible allocations of value. Stakeholders of firms that exhibit this sort of social justice are more likely to share nuanced information about their utility functions. This knowledge can be used by firms to allocate resources more efficiently, to innovate, and to deal better with changes in the environment. The paper also integrates resource-based theory. It explains that the competitive advantages coming from knowledge about stakeholder utility functions are sustainable because they are associated with causal ambiguity and path dependence.

A Surge of Interest

The first ten years of this Century have been satisfying in terms of spreading the word about the stakeholder perspective. Corporate scandals and an increasing awareness of the value of ethical business practices have encouraged strategy scholars to give more attention to stakeholder theory. Several stakeholder-oriented works published in top journals seem to be recognized more widely by strategists than previous publications (i.e., Hillman and Keim, 2001; Jones, Felps and Bigley, 2007; Walsh, 2005). In addition, some new and very convincing empirical evidence has added support to previous work that demonstrates a positive relationship between managing for stakeholders and high firm performance (Choi and Wang, 2009; Sisodia, Wolfe and Sheth, 2007).

Also helpful in advancing the stakeholder perspective are several highly talented scholars that have joined the movement.[3] In addition, supporters of the stakeholder perspective have been appointed to positions in which they are helping to decide which papers will get published in the top research journals. In terms of publication volume, only 10 papers have been published in Strategic Management Journal with the word "stakeholder" in their title and all of those have been published since 2001. If we use a

[3] I am not going to name them here because I do not want to offend anyone by leaving them off the list.

more generous criterion of having “stakeholder” anywhere in the abstract, 27 papers have been published in SMJ, with 2 of them in the 1980s, 4 in the 1990s and 21 since 2001.

Because so much excellent work related to the stakeholder concept has been published, Ed Freeman, Andy Wicks and I formed a partnership to write two books. The first, Managing for Stakeholders: Survival, Reputation and Success (2007), is an update to Freeman (1984). The second book is a comprehensive examination of the work that has been done on the subject across all disciplines, including strategic management, marketing, finance, management, accounting, law, health care, public administration, environmental policy, business ethics and corporate social responsibility. The book also includes some introductory material that places stakeholder theory in its appropriate theoretical context, a treatise on stakeholder theory and capitalism, and suggestions for future research directions. Bidhan Parmar and Simone de Colle joined us in the effort. The extent of reach of stakeholder theory into such a wide variety of disciplines was astounding to each of us (Freeman, Harrison, Wicks, Parmar and de Colle, 2010).

Of course, there is much work still to be done, and the stakeholder approach seems well suited to many of the issues strategic management scholars and practitioners are attempting to address. The “Great Recession” and its causes, combined with a general moral meltdown in business, have caused many to rethink the efficacy of current models upon which much of business is conducted. One set of questions that would appear to have great value deal with the influence of various approaches to managing stakeholders on firms’ longevity (or sustainability), risk and risk propensity, governance structures, relationships with regulators, or ability to adapt to rapid, hostile environmental changes.

Strategic management researchers may also benefit from research on how value creation can be measured. The field of strategic management is focused primarily on financial performance as a dependent variable. However, financial returns merely scratch the surface of the value a firm creates (or destroys) through its actions. A multi-stakeholder perspective has the potential to broaden the field's definition of performance. For instance, rather than focusing exclusively on financial outcomes from firm actions such as mergers, alliances or international diversification, researchers could examine other outcomes that are important to employees, suppliers, communities, or customers. With a broader perspective on value creation, tradeoffs associated with firm actions can be better addressed.

Another fruitful avenue for research may be the integration of stakeholder theory with other popular theories in strategic management, such as the resource-based perspective. The resource-based perspective and stakeholder theory seem to be more complementary than competing (Freeman, et al., 2010; Harrison, et al, 2010). Also, as mentioned previously, there are some obvious parallels between network theory and stakeholder theory. Because it is such a broad-based perspective, stakeholder theory joined with any other theory may have the potential to provide a better explanation of firm performance, broadly defined.

In addition, stakeholder theory is also applicable to strategic management from an ethical perspective. At its core, strategic management is about people making decisions that influence people. There are ethical implications associated with every phase of the strategic management process, from collecting information about the internal and external environment, to the processes through which information is evaluated and decisions made, to the manner in which decisions are communicated, implemented and evaluated. My impression is that both practitioners and scholars in the strategy arena are interested in ways to join ethics and efficacy. Stakeholder theory is well suited to this task.

A Simple and Compelling Topic

From my perspective, stakeholder theory is both a simple and a compelling topic and one that has the potential to transform thinking in the field of strategic management just as it transformed my own thinking. I am glad to be a part of the movement and grateful to be included in such a bright group of scholars. I continue to believe that stakeholder theory eventually will come to be accepted as a theoretical underpinning for strategic management in much the same way as industrial organization economics, resource-based theory, agency theory or transactions costs economics.

As I conclude, I ask the forgiveness of readers for taking such a personal (self-promoting) approach to the topic. However, I think there may be value to readers in understanding the struggle for acceptance of the stakeholder concept in the field of strategic management, especially since it is likely to become even more important in the field in the future. My entrance into strategic management coincided with the publication of Freeman (1984). Consequently, in some ways my own personal struggle to get the theory accepted by my colleagues is similar to the path the stakeholder concept has taken in strategic management. I have always been grateful to the trailblazers, most of whom I have cited herein, for the energy and talent they have brought to the fight.

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