On the Nature of Stakeholders’ “stakes”

Roberto Garcia-Castro
IESE Business School
Avda. Pearson 21
08034 Barcelona-Spain
Tel.: (34) 932534200
docrgarcia@iese.edu

Miguel A. Ariño
IESE Business School
Avda. Pearson 21
08034 Barcelona-Spain
Tel.: (34) 932534200
MAArino@iese.edu

Abstract

The stakeholder view of the firm has contributed to re-define the relationship between the firm and its stakeholders. Stakeholder theory can be grounded on instrumental or normative arguments. While many recent theoretical and empirical works in the stakeholder management literature have used the generic instrumental/normative distinction, the nature of stakeholders “stake” itself has received little attention. Some stakes are instrumental in nature while others are normative. Paying higher attention to the different “stakes” in firms and their nature may lead to further advancements in the stakeholder view of the firm.

Introduction

Recent academic as well as corporate efforts have been aimed at consolidating and implementing the stakeholder view of the firm. The early writing of Freeman (1984) has led to myriad of efforts and initiatives aimed at shifting the dominant shareholder orientation in corporations. Stakeholder research falls roughly into two main categories: instrumental and normative or intrinsic commitment approaches (Donaldson and Preston, 1995; Berman, Wicks, Kotha and Jones, 1999, Margolis and Walsh, 2003). Instrumental stakeholder theory (hereinafter, IST) is only interested in how stakeholders’ value can be used for improving corporate performance and efficiency, regarding stakeholders as “means” (Jones, 1995; Jones and Wicks, 1999; Donaldson & Preston, 1995; Letza, Sun and Kirkbride, 2004; Bowen, Ducharme and Shores, 1995; Greenley and Foxall, 1997; McGuire, Sundgren and Schneeweis, 1988; Ogden and Watson, 1999). By contrast, normative stakeholder theory (hereinafter, NST) emphasizes the “intrinsic value” of stakeholders, seeing them as an end and not merely as means (Donaldson and Dunfee, 1994; Agle, Mitchell and Sonnenfel, 1999).

While the distinction between IST and NST found in the literature has much to offer to strategic management research (Asher, Mahoney and Mahoney, 2005), we think that it has contributed also to separate (and isolate) researchers working in either one of those two
streams creating a separation between instrumental- and intrinsic commitments-based research. This separation, we argue, does not fully correspond with business experience. In real firms a single stakeholder, say for example employees, may have instrumental claims on the firm --for example the payment of pension funds promised, verbally, in the past by top management-- as well as intrinsic commitment or normative claims – e.g., the right to a fair treatment based on her lifetime commitment to the firm, her loyalty, and so forth. In our view, what matters is not so much which approach we use to analyze the issue at hand --IST or NST-- but the nature of the particular stake at risk\(^1\). It is indeed possible that an originally non-instrumental stake has economic consequences and vice versa, that an initially instrumental stake has normative --intrinsic commitments—consequences. The thesis of this paper is that in order to analyze and address stakeholder’s claims more accurately, a clarification and analysis of the nature of stakeholder’s claims must first be developed. From the analysis of the different types of stakes and their nature, stakeholder theory presents itself, consistently with Donaldson and Preston (1995), as a managerial theory in the broad sense of that term. We argue that analyzing stakeholder’s stakes will prove to be more useful in academic research and managerial practice than simply sticking to the instrumental or normative paradigm.

We proceed as follows. After discussing the different nature of stakeholders’ stakes, we propose a distinction between instrumental and normative claims and discuss how these different claims can be analyzed and studied in firms. A discussion of some managerial implications follows. As usual, the paper ends up with some conclusions.

**The Nature of stakeholders claims**

Contrarily to the neoclassical view of the firm where stakeholders such as employees, suppliers or customers receive only “normal” or “market competitive” benefits in exchange for their inputs to the firm (Alchian and Demsetz, 1972; Jensen and Meckling, 1976), stakeholder theory argues that all persons or groups with legitimate interests participating in an enterprise do so to obtain benefits and that there is no prima facie priority of one set of interests and benefits over another (Donaldson and Preston, 1995: 68). This idea is depicted in figure 1 where the arrows between the firm and its stakeholders run in both directions, indicating a relational exchange –economic and non-economic— among them. The essential idea behind the notion of stake is that it involves risk: the quantity or the quality of the stake may change as a consequence of the activities of the firm (Clarkson, 1995). It is important to remark that if all payments and duties towards stakeholders can be fully specified ex-ante in a contract between the parties, then the notion of stake automatically disappears.

---

\(^1\) There are multiple and very different definitions of stakeholders and stakes in the literature (Freeman and Reed, 1983; Freeman, 1984; Carroll, 1989; Aoki, 1984, 2001; Clarke, 1998, 2004; Hill and Jones, 1992; Jones and Wicks, 1999; Mitchell, Agle and Wood, 1997; Trevino and Weaver, 1999; Post, Preston and Sachs, 2002; Phillips, Freeman and Wicks, 2003). The definitions of stakeholders and stakes go from broad definitions as the one provided by Freeman (1984: 46) defining stakeholders as “any group or individual who can affect or is affected by the achievement of the organization’s objectives” to narrow conceptualizations such as “the stakeholders in a firm are individuals and constituencies that contribute, either voluntarily or involuntarily, to its wealth creating capacities and activities, and who are therefore its potential beneficiaries and/or risk bearers” (Post et al., 2002: 8; Blair, 1995, 1998). In the present paper we define stakeholders broadly as those persons and groups who either voluntarily or involuntarily become exposed to risk from the activities of a firm (Clarkson, 1995).
Now, the problem with figure 1 is to provide some content to the arrows: what is exactly being exchange between the firm and the stakeholders? What are the stakeholders’ stakes? Firm’s owners demand dividends and share price appreciation; employees demand a competitive remuneration, good working conditions, opportunities for advancement, training, extent of discrimination; customers demand high quality, service, safety, delivery, innovation; suppliers demand payment of current indebtedness, enduring relationships; the general public demand safety of product and operation and generous contributions to the community (Woodward, Edwards and Birkin, 1996). One may think that these claims are too heterogeneous and stakeholder-specific to be able to establish a general classification. But, can we articulate a first, overarching classification of stakes?

One may think that the distinction between IST and NST (Donaldson and Preston, 1995; Berman, Wicks, Kotha and Jones, 1999, Margolis and Walsh, 2003) discussed in the introduction clarifies the question, establishing a first order distinction between instrumental and normative issues. Instrumental justifications for stakeholder theory are well established (Hill & Jones, 1992; Jones, 1995; Jones and Wicks, 1999). Jones (1995: 432) states that “trusting and cooperative relationships help solve problems related to opportunism…because the costs of opportunism and of preventing or reducing opportunism are significant, firms that contract on the basis of trust and cooperation will have a competitive advantage over those that do not use such criteria”

However, Donaldson and Preston (1995) and Jones & Wicks (1999) have argued that the instrumental logic used by IST researchers provides an inadequate basis for stakeholder theory. Instead, they argue that the normative basis is what fully acknowledges the contributions of stakeholder theory to the practice of management. NST (Evan & Freeman, 1983; Freeman, 1984, 1994; Goodpaster, 1991), grounded on different ethical theories such as Kantian ethics, distributive justice theory, virtue based or utilitarian approaches, claims that stakeholders should be treated as ends, independently of the
instrumental consequences of that decision. Normative justifications for stakeholder theory have been built on the concept of common good (Argandoña, 1998), risk (Clarkson, 1994), fair contracts and fairness (Freeman, 1994; Philips, 2003), social contracts theory (Donaldson & Dunfee, 1999), Kantianism (Evan & Freeman, 1983), or property rights (Donaldson & Preston, 1995). However, and despite the growing literature in the field of NST, there is still no agreement among scholars on which normative basis provides the best foundation for the theory.

In a similar analysis to Donaldson and Preston (1995), Archie B. Carroll (1979, 1991) suggests a three-dimensional model to analyze the relation of the firm with its stakeholders. Carroll influential categorization distinguishes between economic, legal and ethical domains in corporations. The economic domain is defined by Carroll as “perform in a manner consistent with maximizing earnings per share, being as profitable as possible, maintaining a strong competitive position and high level of operating efficiency” (Carroll, 1991: 40-42). The legal domain is defined as “obeying or complying with the law” (Carroll, 1979: 500). The ethical domain is defined broadly as those activities that are based on their adherence to a set of ethical or moral standards or principles (Carroll, 1979, 1991).

Now, is it the distinction between IST and NST literatures or the distinction between economic, legal and ethical domains suggested by Carroll (1979, 1991) useful to evaluate stakeholder’s stakes in firms? Our review of these two literatures reveals that in practice it is quite difficult to stick to one single framework, because the separation between IST and NST starts from the wrong assumption that one can analyze an entire firm using one or the other framework. Instead, we argue in this paper that each of the stakeholders’ claims must be analyzed by managers individually, case by case. For that purpose, one first order distinction must be made between instrumental and non-instrumental stakes. We propose to use a similar distinction between IST and NST but applied to individual stakes. We also review the literature on the contractarian view of the firm to better characterize the instrumental stakes as a bis the intrinsic commitment stakes. The focus on “stakes” over “general approaches” or “domains” to stakeholder theory implies that we would not talk about an IST or NST but about instrumental or normative --intrinsic commitment-- stakes. Furthermore, our approach assumes that what today represents a normative stake might be an instrumental stake in the future, because the nature of stakes is not constant, but evolves over time as stakeholders and society expectations change. The implications of this shift in focus are important for theoretical as well as for empirical research on stakeholder theory as we show next.

The previous reasoning leads us to formulate the separation thesis as follows:

---

2 Carroll (1979, 1991) distinguished a fourth dimension, the philanthropic one, however in more recent works he recommends to integrate that dimension within the economic or the ethical domain depending on the cases (Schwartz and Carroll, 2003).

3 Thus, the conclusions reached by this paper are consistent with Donaldson and Preston (1995) in that stakeholder theory is essentially a managerial theory and it recommends attitudes, structures and practices that taken together constitute a stakeholder management philosophy.

4 The legal domain discussed by Carroll falls into the instrumental-economic domain as a firm complies with the law mainly to avoid litigation and the costs derived from it in terms of economic sanctions but also in terms of firm reputation and credibility in the market. If a law is not followed because of the economic consequences but because it is believed by the firm that one should always observe such norm in business, then, in that case, that action would fall within the ethical domain.
Proposition 1: In firms it is possible to distinguish between instrumental and normative (intrinsic commitment) stakes

In table 1 we show what we consider to be the main differences between instrumental and intrinsic commitment stakes based on differences in nature, stakeholder’s preferences, decision-making and value creation mechanisms, corporate governance systems, external enforcement mechanisms and management philosophy.

<table>
<thead>
<tr>
<th></th>
<th>Instrumental stakes</th>
<th>Normative or intrinsic commitment stakes</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Nature</strong></td>
<td>Economic</td>
<td>Non-economic</td>
</tr>
<tr>
<td></td>
<td>Measurable**(ex-ante and/or ex-post)*</td>
<td>Non measurable</td>
</tr>
<tr>
<td><strong>Stakeholder’s Preferences</strong></td>
<td>Stakeholders typically know what it is in their best self-interest</td>
<td>Stakeholders may not know what it is in their best self-interest</td>
</tr>
<tr>
<td><strong>Decision-making</strong></td>
<td>Economic analysis of firm specific investments</td>
<td>Managerial judgment</td>
</tr>
<tr>
<td><strong>Value creation mechanism</strong></td>
<td>Incentive to make firm-specific investments</td>
<td>-Motivation to contribute -Loyalty, Identification with firm objectives</td>
</tr>
<tr>
<td><strong>Corporate Governance</strong></td>
<td>Formal mechanisms: -Co-determination -Measurement of total value creation -External constrains on managerial decision-making Informal mechanisms: -Reputation, trust, commitment, loyalty,... -Managerial discretion -Self-control</td>
<td>Informal mechanisms: -Reputation, trust, commitment, loyalty,... -Managerial discretion -Self-control</td>
</tr>
<tr>
<td><strong>External enforcement mechanisms</strong></td>
<td>-External enforcement, if they lead to firm-specific investments, will benefit both stakeholders and shareholders</td>
<td>-External enforcement may damage stakeholders welfare and firm’s value creation</td>
</tr>
<tr>
<td><strong>Management philosophy</strong></td>
<td>“Enlightened value maximization”</td>
<td>“Humanistic management”</td>
</tr>
</tbody>
</table>

In the following section we attempt to characterize in greater detail instrumental stakes in corporations. For that purpose we review the economic theory of the firm as a nexus of explicit and implicit contracts in order to understand the origin of instrumental stakes in modern firms.
Instrumental stakes

Explicit contracts

The neoclassical construal of the firm as a nexus of explicit contracts (Alchian and Demsetz, 1972; Jensen and Meckling, 1976) typically assumes that the net present values (NPVs) for all stakeholders (other than shareholders) are zero in competitive strategic factor markets (Asher et al., 2005). In competitive strategic factor markets employees get paid a fixed competitive market salary for their work, suppliers get paid a fixed price for their commodities and so forth. Thus, by definition, maximizing NPV refers to maximizing the NPV exclusively in terms of shareholder value (Asher et al., 2005; Blair, 1995, 1998). Under this view, the only residual claimants are the shareholders and therefore shareholders warrant the control rights to make decisions (Asher et al., 2005) because it neglects the problem of stakeholders’ “residual claims” by assuming that they can be compensated by means of complete contracts (Fama & Jensen, 1983). For example, an employee can be compensated by means of a fixed employment contract that insulates him from the risks derived from stock market or macroeconomic fluctuations. As a result, the workforce would be insulated from market risks and shareholders would be the only risk bearers and residual claimants.

Explicit and implicit contracts

There is, however, a second version of the firm as a nexus of contracts that includes explicit and implicit contracts (Zingales, 2000; Asher et al. 2005). Implicit contracts are understood in the context of incomplete contacting (Aghion and Bolton, 2002; Baker, Gibbons and Murphy, 2002; Hart and Moore, 1990). Due to asymmetric information (Akerlof, 1970) and bounded rationality (Simon, 1947) the contract that governs exchange of services between the firm and its stakeholders has to be necessarily incomplete, that is it has to leave out many of the potential contingencies that can arise along the transaction. In such a context is where implicit contracts between the firm and its stakeholders can create value. An often cited example is a firm with the reputation for upholding the “implicit contract” of not expropriating “quasi-rents” that have been generated by employees investing in firm-specific human assets (Klein, Crawford and Alchian, 1978; Williamson, 1985). This reputation means that the firm will reward its employees “fairly” on the basis of their economic contribution to the firm, regardless of what the economic value of these specialized human skills is in the market. Employees will invest in those human skills based on the firm reputation and their previous experience with the firm. To the extent that those firm-specific investments are economically valuable, and could not have been elicited by explicit contracting, the firm’s reputation adds economic value and represents an organizational asset. The difference of the value of the firm with the implicit contracts and without them is what is often called organizational capital (Zingales, 2000) and it can be an important part of the firm total capital. For example, Blair (1995) found in an empirical study that accounting profits represent less than 60 percent of the total economic rents and quasi-rents generated by corporate activities in US in 1993. The remainder of economic rents went to employees as returns for specialized human capital.

The problem with implicit contracts is that they can not, by definition, be enforced. The very implicit nature of implicit contracts increase the risk for stakeholders, who see how the rents and quasi-rents jointly created can be expropriated by the managers in the firm.
Therefore, stakeholders that invest in firm-specific skills or assets are vulnerable to arbitrary firm’s decisions. Some scholars have suggested that stakeholders that have an *instrumental stake* in the firm also become residual claimants (Blair, 1998), and hence, they should be given residual decision rights so that they have incentives to make their firm-specific investments and some protection from expropriation of their investment in the distribution of the value jointly created (Blair, 1995, 1998). To see the risks associated with implicit contracts in the firm consider the case of employee’s pension funds and hostile takeovers. There are empirical results consistent with the view that hostile takeovers may in some cases be primarily intended to breach implicit contracts between the firm (i.e., managers) and employees –pension funds reverted after hostile takeovers, new management teams breaking with long-lasting no-layoffs policies, etc-- (Shleifer and Summers, 1988; Pontiff, Shleifer and Weisbach, 1990)\(^5\).

Given the existence of implicit contracts in the firm, much of the debates about corporate governance revolve around the question of how to design mechanisms and structures that force managers to internalize the welfare of corporate constituencies who invest in firm-specific skills and assets (Tirole, 2001)\(^6\). These mechanisms are typically based on increasing the residual decision rights of critical stakeholders with firm-specific investments at risk. Practical examples of how this can be accomplished are for instance the changes in the law of corporations to increase the voice and power of employees at the board level (Blair and Stout, 1999) or the co-determination schemes in large German and Dutch firms that may warrant some residual decision rights to employees (Osterloh and Frey, 2006).

The very economic nature of instrumental stakes makes it easier to measure this stakes. Indeed, Lieberman and Balasubramanian (2008) and Lieberman and Chacar (1997) provide a novel methodology that allows us to measure, more or less precisely, value creation and its distribution among stakeholders of the firm. These and other novel measures could replace traditional shareholder value creation metrics in the provision of managerial incentives or in the design of financial accounting reports and governance structures in the firm

\(^5\) In a sample of 413 takeovers, Pontiff, Shleifer and Weisbach (1990) found that 15.1\% of acquirers reverted employees’ pension funds in the two years following the hostile takeover compared to 8.4\% in the two years following friendly takeovers.

\(^6\) In the same way that the separation of ownership and control early described by Berle and Means (1932) led to the emergence of strong board of directors, the development of a market for corporate control or the managerial performance based incentive schemes such as the stock options in order to discipline managers bis a bis the shareholders, these scholars suggest that we need other analogous structures to discipline managers under the new pressures imposed by the firm’s stakeholders (e.g., employees, customers, suppliers, community, environmental activists…). A profound reading of the origins of the corporate governance literature shows that there was a time where managers’ interests did not favour the interests of the firm’s stockholders but only their own self-interest (e.g., empire building). Therefore, when it comes to large, modern corporations the debate is not between shareholders vs. stakeholders but rather how the different corporate constituencies compete for managers’ attention and priorities in their allocation of resources and decision-making. Most of the above mentioned scholars (Mahoney, Blair, Zingales, Tirole) aware of the conflict as presented in this paper suggested some necessary changes in the governance of corporations so that an effective integration of stakeholders’ interests in the managerial decision-making process can take place. The practical implications of that research include the application of co-determination schemes, reforms of corporate law, changes in managerial incentives, creation of CSR committees, social audit committees, or steering committees, among others (Tirole, 2001; Blair 1995, 1998; Asher et al., 2005; Zingales, 2000).
However, and despite the obvious potential impact that some of those reforms may have at the corporate level, we are afraid that they will only contribute to address one part of the problem modern corporations face today because the claims that stakeholders’ make on the organization are very different from the claims made by shareholders. Shareholders main interest is the consecution of a return above the market risk-free rate and, from that point of view, the introduction of managerial market-based incentives, the strong boards and the market for corporate control have been quite effective to discipline managers towards the consecution of that goal. Financial returns are purely economic claims that can be measured and thus enforced by the formal system of governance. The question is: is the claim of non-financial stakeholders of the same nature? While an important portion of stakeholder’s claims on the firm are of an instrumental nature –hence these stakes can be analyzed according to the firm-specific investments made by each stakeholder-- there is a second group of stakes that are non instrumental in nature but that may have, nevertheless, long run instrumental consequences for the firm. The mechanisms of why this is so are complex and a complete explanation requires going beyond IST, something we do in the next section.

Summarizing all the previous discussion we propose:

Proposition 2: Economic stakes are well structured and tractable stakeholder’s claims and, therefore, they can be evaluated according to the explicit and implicit contracts analysis.

As a corollary to proposition 2, we argue that the main task for firms is to ensure that managers and stakeholders do not engage in opportunistic behaviour to maximize short-run profits at the expense of destroying the explicit and implicit contracts that allow value creation in the long run. The protection of those explicit and implicit contracts in the interest of the firm’ long run performance is what Michael Jensen (2002) calls ‘enlightened value maximization’ or ‘enlightened stakeholder theory’. The provision of long-term managerial incentives and external governance mechanisms (co-determination schemes, employee voting rights, etc) will lead to more efficient solutions when the existence and fulfilment of explicit and implicit contracts do matter for firm’ value creation.

Intrinsic commitment (normative) stakes

Contrarily to instrumental stakes, intrinsic commitment stakes can not be reduced to a cost-benefit economic analysis of contributions made by stakeholders and retributions obtained from the firm. Intrinsic commitment stakes go beyond that to capture all the commitments, loyalties, trust and identification with the firm’s goals of a firm’s stakeholders, all of which are investments made by stakeholder’s that may be at risk -- hence the use of the word stake-- to the extent that corporate managers decide to free ride over them. We may think of employees who identify with the firm’s goals or the general public who trust in corporate managers to address important environmental and social issues related to firm’s activities. No stakeholder is more vulnerable to corporate actions than those who have genuinely invested all their loyalty and their trust to corporate

\[\text{And even in these situations one may question if all shareholders want short-term financial gains or if there is a subgroup of shareholders who prefers long-term stock returns while other sub-group prefers short term returns.}\]
managers. These stakeholders will expect to receive something in exchange for their commitment to the firm now or in the future.

Now, why are intrinsic commitment stakes different from instrumental ones? To answer the question, let’s first review in detail two main attributes of instrumental stakes. As we have seen so far, two main features of instrumental stakes are:

1. **Instrumental stakes** are mainly economic in nature and can be measured (ex-post)

2. **Instrumental stakes** are typically known by stakeholders and are time consistent: stakeholders typically know what they need and what it is in their best self-interest now and in the future

The economic nature of instrumental stakes was previously discussed. Instrumental stakes are mainly economic and can be measured ex-post --for instance, the value of the firm-specific investments and the resulting increase in productivity made by employees in one given year (Blair, 1995; Lieberman and Balasubramanian, 2008). However, there are more stakes in a firm than purely economic ones (Donaldson and Preston, 1995; Donaldson, 1999). Things such as employees’ or suppliers’ goodwill, trust and commitment, although hard to measure, are factors of long-run competitiveness in any firm in any industry. These intangible assets are built over time as stakeholders interact with the firm.

We focus now on the second issue of perfect information and time consistency. Instrumental stakes assume that stakeholders typically know their needs and preferences, and thus, they know what is good for them now and in the future. The only exception to this is the case of short-run profit maximization by stakeholders at the expense of long-run value creation (e.g., employees seeking a disproportionate increase in salaries today that will damage the competitive position of the firm in the future, and hence, the capacity of the firm to pay their employees their salaries in the future). In this last case, we argued before, that an “enlightened value maximization” approach was needed (Jensen, 2002).

However, the assumption of perfect information and time consistency is even more problematic when applied to intrinsic commitment stakes. Given the accumulated literature on self-control and time inconsistent preferences (for a review see Bazerman, Tenbrunsel & Wade-Benzoni, 1998), we now have ample empirical evidence for the existence of a tendency for immediate rewards which, although they may appear misleadingly attractive, are inconsistent with stakeholder’s long-run interest. This problem has been termed the self-control problem or multiple selves in the literature (Schelling, 1984; Elster, 1985; Frank, 1988; 1992; Bazerman, Tenbrunsel & Wade-Benzoni, 1998). There are many examples of this motivational problem, such as smoking behavior, household saving, or sales forces pushing for short-term sales that negatively affect customer retention and loyalty (e.g., when small reductions are made in quality standards that the client only discovers subsequently). In all these cases, the problem is that due to bounded rationality (1947) or asymmetric information (Akerlof, 1970) stakeholders may impose certain decisions on firm’s managers that go against their “enlightened” self-interest.

There are well documented examples of how stakeholder’s decisions were proven, after time, to be wrong for the company and for stakeholders themselves. Consider for example

---

8Schelling (1984) has explored the implications of the self-control problem in different scenarios: smoking, gambling, drinking, over-eating, scratching, procrastinating, exercising and shopping.
the case of Shell Oil and the Brent Spar. Shell after consulting with relevant stakeholders (scientists, environmentalists, politicians) obtained the necessary approvals from the British government to sink the decommissioned oilrig in the North Sea. However Greenpeace challenge Shell’s action and engaged in strategies designed to influence public opinion, organized boycotts and so on. As a consequence of this stakeholder’s pressures Shell was forced to abandon its plans and tow the rig to a Norwegian fjord. Obviously all this imposed substantial costs on Shell, its shareholders and its reputation. The problem is that years later it was shown that Greenpeace was fundamentally wrong on the scientific facts. Shell’s initial action plan would have been the optimal solution in the light of the new scientific evidence (Bowie and Dunfee, 2002). As a consequence, neither environmentalist groups, consumers, scientists, nor the environment, and obviously neither Shell’s shareholders nor employees, were better served by Greenpeace interventions in the strategic decisions of Shell. Shell’s case illustrates that managers may have in many situations better information and better incentives to decide than stakeholders have.

Cases like Shell and many others highlight the limitations of external stakeholder pressures to discipline and inform manager’s decisions. Indeed, those external pressures may be proven to be counterproductive. Interestingly enough, these limitations were long time ago remarked by Mary Parker Follett: “The public will of a particular community may have to be educated to appreciate certain standards. That is exactly what is going to make business management a profession: to realize that it is responsible to something higher than the public will of a community, that its service to the public does not lie wholly in obeying the public” (M.P. Follett, 1925). Follett’s point is that although managers should take into account the public—or using current terminology, stakeholders—they should ultimately evaluate their claims in the light of the best long run interests of the firm. Her remarks have a strong ethical character: the obligation of managers to adhere to a set of professional standards of what should be and should not be done (Rosanas and Velilla, 2003).

Many authors have made remarks along the same lines as M.P. Follett some years later emphasizing the role of managerial judgment to decide over conflicting stakeholder demands. Andrews noted: “coming to terms with the morality of choice may be the most strenuous undertaking in strategic decision” (1980: 89). Barnard argued that executive leadership requires the personal capacity for affirming decisions that lend quality and morality to the coordination of organized activity and to the formulation of purpose (Barnard, 1938). Along similar lines Selznick (1957: 139-139) maintained that: “this process of becoming infused with value is part of what is meant by institutionalization. As this occurs, organization management becomes institutionalized leadership. The latter’s main responsibility is not so much technical administrative management as the maintenance of institutional integrity. The building of integrity is part of what we have called the institutional embodiment of purpose and its protection is a major function of leadership”.

Along similar lines the Perez-Lopez anthropological model of organizations (Perez-Lopez, 1991, 1993) offers a valid framework to analyze the intrinsic stakes in organizations. In particular it offers managers a heuristic model to evaluate how their decisions affect firm’s stakeholders current and future needs. It introduces the notion of stakeholder learning as a

9 The detail explanation of that model is out of the scope of the current paper. A full presentation of the model can be found in Perez-Lopez (1991, 1993) and some recent academic articles building on that model can be found in Argandoña (1998), Rosanas and Velilla (2003) and Mele (2003).
consequence of several interactions between the stakeholders and the firm, something that current theories overly ignore (Rosanas and Velilla, 2003; Perez-Lopez, 1993). According to Perez-Lopez the main task of managers does not consist of satisfying stakeholder’s current claims but to consistently apply a decision rule so that stakeholders are in better conditions each time to satisfy their current as well as their future claims. Thus, learning plays a fundamental role in a theory that explains how stakeholders formulate their current claims and how those claims evolve over time. Perez-Lopez’s work (1991, 1993) represents a major contribution to understand such learning.

All this line of thought from M. P. Follet to Perez-Lopez belongs to what could be called the “humanistic management” approach. Humanistic management acknowledges the existence of this intrinsic commitment or normative stakes in the firm and it is manager’s responsibility to recognize them and give a proper response to the owners of such stakes. What this line of thought suggests is that external mechanisms imposed on managers to internalize stakeholders’ claims will not be sufficient to satisfy stakeholders’ demands on the firm because there are needs --current or future needs-- that those external mechanisms do not --and arguably can not-- contemplate. An analysis of stakeholder firm-specific investments in those cases is not the best guide for action because the link between cause and effect can be ambiguous or too complex to understand due to the presence of non-economic motivations by stakeholders, loyalty to the firm, etc. Only in a humanistic model can we incorporate these non-economic stakeholders’ needs in the analysis and only in a humanistic model can we understand how stakeholder’s current needs may go against their enlightened long run self-interest.

When managers and corporations face intrinsic commitment stakes a certain managerial discretion will be needed so that managers can take into account both the current and future claims of firm’s stakeholders as well as the effect that satisfaction of current claims will have on the satisfaction of all the other claims of stakeholders now or in the future. In certain situations it may be needed that managers will be allowed to make decisions against the will of stakeholders if those actions can be overly demonstrated to be in the long run interest of those stakeholders. Here the main difficulty is the impossibility to quantify the impact of those decisions making almost impossible any kind of economic, instrumental analysis. In fact, recent empirical works found that although many companies do invest in social responsible actions to satisfy stakeholder’s claims, the correlation of those corporate actions with financial performance is dubious when proper controls are introduced and endogeneity is taken into account in econometric models (Garcia-Castro et al., 2008). Therefore, this empirical evidence may suggest that part of CSR actions are, to a large extent, motivated by non-instrumental considerations.

Thus, we propose:

Proposition 3: Normative (intrinsic commitment) stakes will produce intended and non-intended consequences on firm performance sufficiently ambiguous and over a period of time long enough so that their evaluation can not be done according to the explicit and implicit contracts analysis.

As a corollary to proposition 3, it follows that an alternative logic to the explicit and implicit contracts analysis must be used by managers if they are to fully satisfy the claims of the stakeholders. Such logic can be found in the so called “humanistic management”
tradition based on a rigorous analysis by managers of stakeholder’s current and future needs and the selection of the best means to satisfy those needs.

**Managerial implications: Managerial discretion and decision-making**

The existence of different types of stakes of a very different nature forces us to think about alternative managerial approaches to decision-making. On the one hand, *instrumental stakes* must be recognized in the firm and decisions should be made according to firm-specific investments of firm’s stakeholders something that, unfortunately, is not done in all corporations when this is feasible. As CSR budgets increase in many large corporations there is a need to rationalize investments, focus in the most profitable initiatives, disregard the ones that do not contribute to the firm value creation and so on (Porter and Kramer, 2007). For example, if there are two alternative plans affecting, let’s say, employees, then, if the stake is only instrumental, managers should chose the alternative that will lead to a higher value creation for the firm, taking into account that what is relevant here is the “enlightened value maximization” (Jensen, 2002). For that purpose methodologies such as the one suggested by Lieberman and Balasubramanian (2008) that measures total value creation and appropriation by stakeholders may prove to be an invaluable tool for managers and firms.

On the other hand, *intrinsic commitment* stakes must be dealt with in a very different fashion. Corporations must ensure that their managers have better knowledge about stakeholder current and future claims, right incentives to make the right decisions and discretion enough --absence of external stakeholder constraints-- as to be able to make the right decisions both in the short and in the long run. Managerial judgment is to *intrinsic commitment* stakes what the analysis of explicit and implicit contracts and stakeholder’s firm-specific investments is to *instrumental* stakes. The demands on management here are higher as stakeholders expect from them high ethical behaviour and also a good knowledge of their current and potential claims on the firm. Issues such as reputation and trust on top management will be essential. That is why this approach can be label as “humanistic management approach”.

The existence of *intrinsic commitment* stakes also contributes to explain why stakeholder theory is managerial in nature (Donaldson and Preston, 1995; Jones and Wicks, 1999). By managerial we mean that managers are the ones that have to balance stakeholder’ interests in their daily decision-making as well as “coming to terms with the morality of choice (Andrews, 1980: 89). Thus, stakeholder theory does not simply predict cause-effect relationships but it recommends attitudes, structures and practices that taken together constitute stakeholder management (Donaldson and Preston, 1995: 67). A careful examination of *intrinsic commitment* stakes reveals that constraints imposed from the outside by stakeholders on manager’s decision may lead low-quality decision-making by managers with negative consequences for stakeholders now or in the future as the example of Shell Oil illustrates. This is perhaps one of the most interesting implications of our analysis.

Finally, stakes are not petrified over time. They can experience some evolution. Archie Carroll (1991) suggests a hierarchy of stakeholders’ claims: there is a migration of responsibilities from discretionary-ethical-legal-economic. What today is an ethical issue tomorrow may be economic or legal... Managers and firms must pay attention to the way that different stakeholder’s claims evolve over time and how market and non-market
forces shape those claims. For example, when Toyota started to develop its hybrid technology some years ago they made the numbers and it did not pay off. They decided to invest in that technology as a part of a company commitment with the environment and sustainable growth. It was a normative stake. Nowadays, Hybrid technologies are becoming profitable and many auto manufacturers including GM, Ford or Lexus are investing on them based on a positive cost-benefit analysis. Hence, with the evolution of the market and society needs, hybrid technologies and their impact on stakeholders have become a purely instrumental stake. Of course, the initial commitment to hybrid systems has given Toyota a substantial first-mover advantage in the development and commercialization of this technology. Indeed, nowadays Ford is licensing Toyota’s hybrid technology (Porter and Kramer, 2007). Finally, this migration of responsibilities firstly suggested by Archie Carroll (1991) does not invalidate the fact that in a given moment a “stake” must be either instrumental or normative, and hence, it should be treated as discussed above.

Conclusions

The distinction between IST and NST has led to separation in the way scholars and practitioners treat stakeholder management in their articles and in their firms respectively: the reality is typically analyzed either as a problem of instrumental efficiency or as normative-ethical imperative. This paper’s starting point is rather different because it focuses on individual stakes in a firm and not in the overarching framework typically used to approach stakeholder issues. When attention is paid to individual stakes two main groups emerge depending on their nature: instrumental and intrinsic commitment or normative stakes.

As summarized in table 1 these two groups of stakes differ in several aspects such as their nature, assumptions about stakeholder’s preferences, decision-making criteria, value-creation mechanism and so on. Arguably the single most important difference is that instrumental stakes can be analyzed according to the firm-specific investments framework whereas intrinsic commitment stakes requires additional managerial judgment in the evaluation of stakeholder’s current and potential claims. This is so because given bounded rationality (Simon, 1947) and asymmetric information (Akerlof, 1970) in addition to problems of self-control and motivation (Schelling, 1984; Elster, 1985; Frank, 1988; 1992; Bazerman et al., 1998) stakeholders may not know what their best interest is now and in the long run. If stakeholder’s claims are proven to be “wrong” and they are given excessive control over the firm strategic decisions, then the financial situation of the firm will be at risk. Cases like Shell and many others illustrate how stakeholder’s external pressures may negatively affect a firm’s financial results when their knowledge or their motivation are wrong.

In conclusion, the main idea posited by this paper is that stakeholder’s claims can not be internalized in the firm only by means of external enforcement mechanisms or managerial incentives. The internalization of those claims has to be made according to the nature of the stake. In the case of instrumental stakes external enforcement mechanisms will, in many cases, contribute to firm value creation when those mechanisms lead to higher firm-specific investments in the firm, following the logic posited by the contractarian (explicit and implicit contracts) view of the firm (Asher et al., 2005). In the case of intrinsic commitment stakes the internalization of those claims can not be left to external market forces but it is managers’ responsibility to understand and balance the different
stakeholder’s claims on the firm, taking into account not only the current claims but also how the satisfaction of today’s claims will affect the satisfaction of future ones and also the satisfaction of all the other claims of a particular stakeholder. That is a titanic demand on managers with important ethical implications that urges us to review some of the classical authors in management (Mary Parker Follett, Chester I. Barnard or Kenneth Andrews) as well as other non-mainstream authors (Perez-Lopez, 1991, 1993) in order to understand better what those ethical implications are from a “humanistic management” perspective.


Follett, M.P.: 1925, How must management develop in order to become a profession, Chapter Eleven in Graham, 1996.


Osterloh, M. and B. Frey: 2006, Shareholders should welcome knowledge workers as directors. Journal of Management & Governance, 10 (3): 325-345,


