

Why Resource-based Theory Must Adopt a Stakeholder Perspective¹

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The model of profit appropriation in resource-based theory has assumed that shareholders have a unique claim on the profits generated by a firm. This paper shows that if this is the case, access to all of a firm's other resources will occur through fixed claim/complete contingent claims contracts, and that the resources acquired through these contracts cannot be expected to be a source of economic profits for a firm. In this setting, it is not clear where the profits that are supposed to be distributed to shareholders come from. All this suggests that resource-based theory needs to adopt models of profit creation and appropriation that recognize the possibility of multiple claimants on a firm's profits, i.e., some sort of stakeholder perspective. The elements of this stakeholder resource-based theory are described, together with the implications of this theory for traditional resource-based theory and some current stakeholder theories.

Like other theories in the field of strategic management, resource-based theory addresses both the creation and appropriation of economic profits (Brandenburger and Stuart, 1996). In this theory, expected economic profits are created when firms leverage rare, inimitable, and non-substitutable resources in acquiring access to additional resources (Barney, 1986; 1991). The rarity, inimitability, and non-substitutability of these initial resources, in turn, enables a firm to appropriate at least some of this economic profit for the benefit of its shareholders (Barney, 1988). Shareholders, in this model of profit appropriation, are assumed to hold a unique claim on the economic profits a firm creates with the resources it leverages (Denrell, Fang, and Winter, 2003: 978).

Interestingly, while there has been significant discussion about resource-based theory's model of profit creation (MacDonald and Ryal, 2004) and model of profit appropriation (Coff, 1999) separately (Arikan and Barney, 2001), surprisingly little discussion has focused on the relationship between these two models within the theory. In particular, at least one important question about these two models has yet to be fully addressed: Is resource-based theory's model of profit appropriation logically consistent with its model of profit creation? In particular, is the assumption in resource-based theory that a firm's shareholders' hold a unique claim on its economic profits consistent with this theory's model of how a firm creates economic profits through leveraging its resource and capability advantages?

The central conclusion of this paper is, no—the assumption that shareholders hold a unique claim on a firm's economic profits is inconsistent with resource-based theory's account of how economic profits are created. The direct implication of this conclusion is clear: Resource-based theory must replace the implicit or explicit assumption that shareholders hold

such a unique claim with a model of profit appropriation that acknowledges the possible existence of several different claims on these profits, i.e., some form of stakeholder logic (Freeman, Harrison, Wicks, Parmer, and de Colle, 2010).

However, integrating stakeholder and resource-based theory in this way has a variety of other implications for resource-based theory as it is currently constituted. This paper explores some of these implications. It begins by defining some key concepts that will be used throughout. It then summarizes the profit creation model proffered in resource-based theory, and shows that this model is logically inconsistent with the assumption that shareholders have a unique claim on a firm's economic profits. This implies the need to develop a form of resource-based theory that explicitly integrates a stakeholder perspective. Several key features of this new *stakeholder resource-based theory* are then discussed. The paper concludes with a brief discussion of the ways that stakeholder resource-based theory is similar to traditional resource-based theory, and how it is different than some approaches within the stakeholder tradition.

Defining Key Concepts

Several concepts important for subsequent arguments are defined here. In each case, these concepts are defined in ways that are consistent with their current use in strategic management and related fields.

Economic Profits

The first of these concepts is economic profits. An economic profit (or loss) is equal to the difference between a firm's revenues and the total opportunity cost of the inputs used to

generate those revenues. Opportunity cost, in turn, is the value of the best alternative forgone by using these inputs to generate a firm's revenues.

Resource-based theory, at its core, seeks to explain the creation and appropriation of economic profits (Barney, 1986). However, some resource-based theorists take competitive advantage—or the ability of a firm to generate more economic profit than its competitors (Peteraf and Barney, 2003)—or sustained competitive advantage—a competitive advantage that is not competed away through imitation (Barney, 1991)—as their dependent variables. While many of the arguments developed in this paper can be generalized to the study of competitive advantage and sustained competitive advantage, the approach taken here focuses primarily on efforts to explain how firms create and appropriate economic profits.

Stakeholders

The concept of stakeholders also plays an important part in the arguments developed here. Following Freeman (1984), a stakeholder is any group or individual that affects or is affected by a firm. One way that stakeholders can affect or be affected by a firm is by providing resources to that firm. These resources can affect a firm by enabling it to accomplish its objectives. Stakeholders, in turn, can be affected by a firm in this context because of the payment they receive for making these resources available to a firm.

Lists of firm stakeholders often include employees, suppliers, customers, debtholders, and shareholders (Freeman et al., 2010). Some lists of stakeholders also include governments, communities, and the natural environment—although there is ongoing debate about whether these last three groups should be considered as firm stakeholders (Starik, 1995; Phillips, 2003). To simplify the discussion, this paper does not examine these last three groups of stakeholders.

Fixed and Residual Claims

Different stakeholders have different kinds of claims on a firm's revenues. These can be divided into two categories: Fixed claims and residual claims.

Stakeholders have a fixed claim when payments for making their resources available to a firm do not vary with the actual economic profits generated by a firm, ex post, but instead are set ex ante. Note that a stakeholder has a fixed claim does not necessarily imply that there are no payment contingencies in this relationship, only that those contingencies are specified, ex ante.

Fixed claims are a specific example of a complete contingent claims contract. According to Williamson (1979: 236), such contracts exist when "all relevant future contingencies pertaining to the supply of a good or service are described and discounted with respect to both likelihood and futurity." This means that both stakeholders who provide resources and firms that obtain access to resources know, ex ante, the quality of the resources a stakeholder is to provide, the revenues these resources will create, and the payment this stakeholder is to receive for access to these resources.

Stakeholders have a residual claim when payments for making their resources available to a firm do vary with the actual economic profits generated by a firm, ex post. Because the actual payment for access to these resources cannot be precisely specified, ex ante, residual claims are an example of an incomplete contract. Residual claimants agree, in these incomplete contracts, to be compensated for the resources they make available to a firm after all of a firm's fixed claims are paid (Jensen, 2002).

The Creation of Economic Profits in Resource-based Theory

As suggested earlier, resource-based theory has a particular model of how economic profits are created (Barney, 1991). This model distinguishes resource-based theory from other theories in strategic management and related fields (Mahoney and Qian, 2013) that have different models for how economic profits are created (e.g., positioning theory (Porter, 1980) with its emphasis on market power and monopoly profits in product markets; theories of profit creation in equity markets that emphasize arbitrage, insider information, and exploiting temporary market inefficiencies (Ahern, 2016; Grinold and Kahn, 2000)).

Resource-based theory starts by observing that if those that sell and purchase access to resources in a factor market have the same, and accurate, expectations about the revenues those resources will create when used to implement strategies in product markets, then the sale and acquisition of access to these resources will not create economic profits.² If, on the other hand, a small number of firms in these markets have more accurate expectations about the future revenues created by these resources compared to those selling access to them and others looking to acquire access to them, then these resources can be a source of economic profits (Barney, 1986a). This is because the cost of acquiring these resources—determined by those with less accurate expectations—can be less than the revenues expected by those with more accurate expectations.

Why would these firms have more accurate expectations than others selling access and looking to gain access to these resources? Resource-based theory suggests two possible

² Implicitly this model of profit creation assumes that both those selling and those buying access to resources on these markets are trying to maximize their economic profits. Unless otherwise noted, this assumption is adopted throughout this paper. Note however that there are examples of factor markets where this assumption does not always hold, e.g. labor markets where those selling access to their human capital have interests besides maximizing their income (Campbell, Coff, and Kryscynski, 2012; Molloy and Barney, 2016).

reasons why this might happen. First, firms may not have expectation advantages, ex ante, but turn out to have such advantages, ex post. This can happen when all those selling and buying access to new resources have what turn out to be, ex post, inaccurate expectations about the revenue these resources will create in the future. If these expectations underestimate the true level of revenues generated by these resources, then the firm (or firms) that actually acquires access to them at what turns out to be a discount, ex post, can create an economic profit (Barney; 1986). However, the economic profits generated by these ex post superior expectations are a manifestation of a firm's good fortune and luck.

Second, it may be the case that those looking to gain access to a new resource may control other resources and capabilities that can be used, in combination with the new resource, to generate more revenue than would be the case if this new resource was exploited by itself. If these already existing resources are path dependent, socially complex, or causally ambiguous (Barney, 1986b; Dierickx and Cool, 1989; Barney, 1991), they may be rare, inimitable, and non-substitutable (Barney, 1991). In these settings, those with access to these special resources may have expectation advantages over others seeking to sell or buy access to new resources, but do not control such rare, inimitable, and non-substitutable resources. In such settings, competition for these new resources is likely to be attenuated, and the price paid for access to the new resources by the firm that already controls special resources is likely to be less than the future revenue they will generate when combined with those special resources—and economic profits are created. These economic profits reflect ex ante expectation advantages of the firm that controls rare, inimitable, and non-substitutable resources and are not ex post expectation advantages.

Recent efforts to reconcile resource-based and transaction costs theories of profit generation (Argyres and Zenger, 2012) suggest that the rare, inimitable, and non-substitutable resources controlled by a firm often reflect prior specific investments made by those associated with that firm. For this reason, firms that seek to leverage their rare, inimitable, and non-substitutable resources in acquiring access to new resources will often face many of the transaction hazards associated with exchanges characterized by high levels of specificity (Williamson, 1979; 1985). These observations become important later in this paper.

Residual Claims in Resource-based Theory

The central research question in this paper is: “Is resource-based theory’s model of how economic profits are created logically consistent with the assumption that shareholders have a unique claim on a firm’s economic profits.” For the moment, adopt the assumption that shareholders have this unique claim. This is an extension of the shareholder supremacy assumption that characterizes much of finance (Jensen, 2002) and strategic management (Besanko, Dranove, Schaefer, and Shanley, 2013). If this assumption is correct, then firms need only maximize returns to shareholders in their decision making, since maximizing returns to shareholders insures that those with fixed claims will receive their agreed to compensation (Jensen, 2002). Any revenue left after paying fixed claims will be appropriated by shareholders.

Of course, if shareholders have a unique claim on a firm’s profits, it follows—by definition—that all of a firm’s other stakeholders must have no claims on these profits. Since these other stakeholders have made resources available to a firm—and thus must have some claim on a firm’s revenues—but do not have a claim on any of a firm’s profits, it follows that these other stakeholders must have fixed claims on a firm’s revenues (Mahoney, McGahan, and

Pitelis, 2009). Thus, for example, in some settings, a particular supplier may receive a fixed claim worth \$10 for supplying a resource to a firm that has an ex ante opportunity cost equal to \$10. If this resource generates \$25 of value, ex post, this supplier will still receive \$10 (the value of the fixed claim), and shareholders will appropriate the remaining economic profit of \$15 (\$25 in revenue - \$10 in opportunity cost). Payment to this supplier is fixed because it does not vary with the amount of economic profit its resources generate, ex post.

In a world where every stakeholder, besides shareholders, is a fixed claimant—the world created by assuming that shareholders have a unique claim on firm profits—is it possible for a firm to generate economic profits in the way described by resource-based theory? This question can be refined even further. Recall that fixed claims are a specific type of complete contingent claims contract. Thus, this question can be restated as: In a world where resources from every stakeholder, besides shareholders, are obtained through complete contingent claims contracts, is it possible for a firm to create economic profits in the way described by resource-based theory?

Transactions cost economics tells us when complete contingent claims contracts—like fixed claims—can be used to efficiently protect the interests of all the parties associated with an exchange (Williamson, 1975; 1979; 1985). These kinds of contracts are efficient when both buyers and sellers of resources can fully anticipate and specify, ex ante, all contingencies that might affect the value created by an exchange. This means, in particular, that these transactions are *not* characterized by high levels of uncertainty, informational asymmetries, or transaction specific investment. If a transaction has these attributes, then a complete

contingent claims contract will fail to protect the interests of all parties to that exchange, and will be replaced by some other type of contract (Williamson, 1985).

Recall, however, that fixed claims are a specific example of a complete contingent claims contract. If, in fact, all resources obtained from fixed claims are obtained through a complete contingent claims contract—as the assumption that shareholders have a unique claim on a firm’s economic profits implies—it follows that these exchanges must *not* be characterized by uncertainty, information asymmetry, or transaction specific investment. If they were, transactions cost logic suggests that these transactions would not be governed by complete contingent claims contracts.

However, resource-based theory’s model of how economic profits are created explicitly requires that those acquiring access to resources have more accurate expectations about the future revenues that will be created by those resources than others operating in that market. Those more accurate expectations may reflect uncertainty—where those acquiring access to resources pay less than what both they and others in a factor market thought these resources were worth (Barney, 1986)—or information asymmetry—where those who control rare, inimitable, and non-substitutable resources have superior information about the revenues that access to new resources will create (Barney, 1986; 1991)—or transaction specific investment—where those who have made specific investments may know more about how that investment may generate revenues more than those who have not made this investment (Argyres and Zenger, 2012). If none of these conditions hold, some firms cannot have superior expectations about the revenues access to new resources will generate, compared to other firms. And

without these superior expectations, there can be no economic profits—at least none created in a way consistent with resource-based theory.

Thus, assuming that shareholders have a unique claim on a firm's economic profit is logically inconsistent with resource-based theory's model for how economic profits are created. Assuming that only shareholders have this unique claim implies that all other stakeholders are fixed claimants. If all other stakeholders are fixed claimants, then the sale and acquisition of access to the resources controlled by these fixed claimants is, by definition, managed through some type of complete contingent claims contracts. But complete contingent claims contracts can only be efficiently used to manage transactions when, among other things, there is no uncertainty, information asymmetry or transaction specific investment in an exchange. However, if there is no uncertainty, information asymmetry, or transaction specific investment in the process of selling and acquiring access to resources, resource-based theory's model of profit creation says that no profits will be created. Thus, the assumption that shareholders hold a unique claim on firm profits contradicts resource-based theory's model of how economic profits are created.

This argument can be restated in a different, but equivalent way. If both those buying and selling access to resources are looking to maximize their profits, and if these exchanges are characterized by no uncertainty (i.e., both buyers and sellers know the future revenues that will be generated by resources) and no specificity (i.e., there are several equally skilled potential buyers and sellers)—as must be the case if fixed claims contracts are being used to gain access to these resources—then the factor market within which these exchanges occur will be highly competitive and the price paid for access to these resources will approximately equal their

opportunity cost (Barney, 1986). This implies that these exchanges will not be a source of economic profit. Only when exchanges are characterized by uncertainty and/or specificity—that is, when fixed claims contracts are not efficient—can acquiring access to resources generate economic profits. Thus, a model of profit appropriation that assumes that shareholders have a unique claim on a firm's profits (and thus, all other stakeholders are fixed claimants) is inconsistent with resource-based theory's model of profit creation.

Note that this argument does not suggest economic profits cannot be created in this setting in other ways. Some alternative theories of how economic profits may be operating (e.g., profits created by monopoly positions in product markets; profits created by arbitrage, insider trading, or market inefficiencies in equity markets). All this argument suggests is that resource-based theory's account of how profits are created does not work when a firm acquires resources from fixed claim/complete contingent claims contracts, i.e., when it is assumed that shareholders have a unique claim on a firm's economic profits.

In the face of this conclusion, resource-based theorists have two choices. First, they can retain the current assumption that shareholders have a unique claim on a firm's economic profits and abandon the effort to use resource-based theory to explain the creation of these profits. Second, they can abandon the assumption that shareholders have this unique claim and acknowledge that other stakeholders, besides shareholders, may have claims on a firm's profits. This second outcome is equivalent to acknowledging that resource-based theory must adopt some sort of stakeholder model of profit appropriation.

Toward Stakeholder Resource-based Theory

The argument thus far has shown that resource-based theory must incorporate a stakeholder perspective in its model of profit appropriation if that model is to be logically consistent with its model of profit creation. What this “stakeholder resource-based theory” would look like, and how it would differ from received resource-based theory has yet to be discussed. These are the topics addressed in this section of the paper.

A Model of Profit Creation in Stakeholder Resource-based Theory

At the broadest level, the arguments developed here suggest that models of profit creation and appropriation must share a common theoretical logic and vocabulary to insure internal consistency (Brandenburger and Stuart, 1996). If, in fact, resource-based theory’s model of profit appropriation must adopt a stakeholder perspective, it follows that it must also be possible—and even necessary—that this theory’s model of profit creation can also be positioned within stakeholder logic.

In fact, it is not hard to see that the traditional resource-based theory model of profit creation can be generalized to a stakeholder context. Traditional resource-based logic examines how the cost of acquiring access to one resource can be affected by other resources a firm already controls. A stakeholder version of this model begins by recognizing that firms must gain access to critical resources from many stakeholders. To create profits, the sum of the cost of acquiring access to each of these resources must be less than the total revenues these resources create together.

In traditional resource-based theory, the extra revenues generated by acquiring access to a new resource stem from the ability a particular firm has to leverage resources it currently

controls with a new resource.³ In a stakeholder context, this is equivalent to asserting that for there to be a positive difference between the total revenues created by a bundle of resources and the cost of gaining access to each of these resources, there must be some form of co-specialization among them. Two or more assets are co-specialized when each is more productive when used together compared to when they are used separately (Milgrom and Roberts, 1992).

Co-specialization means that the revenues created by a bundle of resources is greater than the revenues each resource would generate separately. If the cost of acquiring access to these resources is based on the revenues they generate separately, then the total revenues generated by the co-specialized bundle will be greater than the sum of the cost of acquiring access to each resource separately, and economic profits can be created. But why would those that provide access to the resources needed to create co-specialization be willing to do so for a price less than the value of the extra revenues that co-specialization creates?

The answer to this question depends on asymmetric expectations between those assembling access to a bundle of co-specialized resources and those providing access to each of these individual resources. In particular, those who assemble access to a bundle of co-specialized resources may have more accurate expectations about the revenues this bundle will create than each stakeholder, separately, or others who are considering forming a similar bundle. As long as these expectations are rare, inimitable, and non-substitutable, they can lead to the creation of economic profits because those assembling access to this bundle of resources will have more accurate expectations about the revenues this bundle will create than anyone

³ For simplicity, profits attributable to a firm's good fortune are ignored here.

else seeking to create this bundle, and more accurate expectations about this revenue than those stakeholders that control access to each resource separately. If this is not the case, then the cost of acquiring access to these co-specialized resources will rise to equal the revenues they create, and no economic profits will be created (Barney, 1988).

A Model of Profit Appropriation in Stakeholder Resource-based Theory

Stakeholder resource-based theory's model of profit creation is based on the observation that, sometimes, those assembling the resources needed to generate co-specialization may have more accurate expectations about the revenues bundles of resources are likely to generate, compared to other actors in these factor markets. However, while these stakeholders may not know, with certainty, the future revenues that bundles of resources may generate, they do know the context within which they made their individual resources available to a firm—namely, a context with high uncertainty, information asymmetry, and high levels of specific investment.

Transactions cost logic suggests that these stakeholders will be unwilling to make their resources available to a firm in these settings using a fixed claim/complete contingent claims contract. In short, these stakeholders will require some sort of residual claims contract to make their resources available to a firm. When this is the case, a firm's shareholders will no longer have a unique claim on its profits.

Any, or all, of the stakeholders identified earlier in this paper and the prior literature, including some employees, suppliers, customers, debtholders, and shareholders can have these kinds of claims on a firm's profits. All that is required is that these stakeholders provide access

to resources that, when combined with other resources in the firm, generate co-specialization that can lead to economic profits.

Note, however, that this theory of profit appropriation retains one thing in common with the shareholder supremacy model: It assumes that all of a firm's profits—revenues after all fixed claims are satisfied—are appropriated by those with claims on these profits. However, in stakeholder resource-based theory, these profits are appropriated by stakeholders that have provided access to critical profit-generating resources, and not just by shareholders.

How these profits are divided among different stakeholders is likely to depend on a variety of factors. These include how important access to a particular stakeholder's resources is thought to be for creating economic profits, *ex ante*; how important they turn out to be for creating those profits, *ex post*; and a stakeholder's negotiating skills (Milgrom and Roberts, 1992). However, dividing profits among multiple stakeholders will always be difficult because the co-specialization that exists among the resources in question that helps generate economic profits implies that the marginal product of each resource will be very difficult—if not impossible—to calculate (Alchian and Demsetz, 1972).

The Firm in Stakeholder Resource-based Theory

Traditional resource-based theory has adopted, almost by default, a traditional definition of what constitutes a firm. This definition, widely used in strategic management and economics, defines a firm relative to authority relationships that exist between economic actors (Coase; 1937; Williamson 1975, 1985). In these settings, subordinates agree (within the bounds of the law and general practice) to follow the directions of those to whom they have granted authority (Alchian and Demsetz, 1972). These authority relations, in turn, define the

boundary of the firm: When authority can be exercised, an exchange is within the boundary of the firm; when it cannot be exercised, an exchange is not within the boundary of the firm (Byland, 2015).

However, the logic of stakeholder resource-based theory seems more consistent with a second way of defining a firm, that is, a firm as a “nexus of contracts” among various factors of production (Jensen and Meckling, 1976). These contracts can be formal or informal, implicit or explicit, complete or incomplete, or strongly personal or purely instrumental in character (Poppo and Zenger, 2002; Baker, Gibbons, and Murphey, 2002). Some of these contracts may even specify authority relationships between some members of the nexus and other members of the nexus. However, contracts need not specify such an authority relationship to be in the nexus and thus authority relations, in and of themselves, do not define the boundary of the firm using this nexus of contracts definition of the firm (Byland, 2015).

Indeed, the boundary of the firm, per se, is less important in the “nexus of contracts” approach to defining the firm. What is more important is that the nexus includes contracts—of some type—for all those factors of production that are necessary if a firm is to generate economic profits. The firm is the context within which the co-specialization that creates the potential for economic profits is realized.

Generally, contracts in this nexus can be divided into the fixed and residual claims categories defined earlier in the paper. Because the value of access to resources acquired through fixed claims is known ex ante, they typically cannot be sources of economic profits—though they are still an important part of the nexus. In particular, failure to gain access to

resources from fixed claims can prevent a nexus from creating economic profits, although having access to such resources does not mean that a nexus will be able to create such profits.

Adopting this nexus of contracts definition of the firm has very important implications for stakeholder resource-based theory.⁴ For example, in traditional resource-based theory, the traditional firm—as defined by authority relationships—is the unit of accrual. That is, the traditional firm is the place where revenue is collected and then divided between fixed and residual claimants. In stakeholder resource-based theory, the nexus is the unit of accrual. It may be the case, for example, that a particular nexus is generating significant economic profits, but that the traditional firm associated with this nexus appears to not be profitable at all. This can be because members of the nexus have appropriated all the economic profits that have been created by the nexus. A traditional firm, in this context, may appear to not be creating economic profits, but the nexus may be creating substantial profits (Coff, 1999).

Empirically, adopting the nexus of contracts definition of the firm creates significant difficulties.⁵ Accounting measures of firm performance have always been problematic (Barney, 2010). Financial measures of firm performance do not suffer the same limitations as accounting measures, but they adopt both the traditional definition of the firm (Coase, 1937; Williamson, 1975; 1985) and the shareholder supremacy model (Jensen, 2002). Neither of these assumptions are consistent with the stakeholder resource-based theory developed here.

⁴ Throughout the remainder of this paper, the term “firm” will be used in this “nexus of contracts” way unless otherwise specified.

⁵ This is probably why finance theorists, who originally developed the nexus of contracts approach (Jensen and Meckling, 1976) almost immediately opted to adopt the shareholder supremacy assumption. This assumption significantly simplifies empirical analysis. However, some finance scholars are beginning to recognize that the advantages of adopting this assumption are outweighed by its disadvantages (see Zingales, 2000).

Practically, empirical research on stakeholder resource-based theory may need to focus on how access to a few resources from a few critical stakeholders can be combined to generate co-specialization and economic profits and, in turn, how these economic profits are distributed among these stakeholders. This is exactly the kind of work that is currently ongoing in understanding the relationship between star employee salaries and the performance of stars in a nexus of contracts firm (Groysberg, 2010), the relationship between CEO compensation and (traditional) firm value (Coff, 1999), and the total returns—to shareholders, to employees, to customers, and so forth-- associated with acquiring another firm (Arikan, 2004; Wang and Barney, 2006).⁶

Conflicting Interests in Stakeholder Resource-based Theory

If a (traditional) firm's only residual claimants are shareholders, the objective of the (traditional) firm is clear: Choose and implement strategies that maximize the wealth of these stakeholders (Jensen, 2002). Because shareholders can diversify the risks associated with investing in a particular (traditional) firm at low cost, they will generally prefer these firms to choose and implement more risky strategies rather than less risky strategies (Faccio, Marchica, Mura, 2011).

However, some of the non-shareholder stakeholders identified in stakeholder resource-based theory cannot diversify the risks associated with their investments in a nexus of contracts in the same way as shareholders in (traditional) firms. For example, employees sometimes invest much of their human capital in a single nexus where it can be combined in highly co-specialized ways with other resources to create economic profits (Molloy and Barney, 2015).

⁶ Note that some of these examples suggest that the traditional firm is not irrelevant in empirical tests of a stakeholder resource-based theory.

But it is often difficult for these employees to invest their human capital this way in multiples nexuses, and thus it is often difficult for these employees to diversify the risks associated with their investments in a single nexus (Wang and Barney, 2006). Thus, all things being equal, these types of employees will be more risk averse in the strategies they would prefer a nexus to pursue than shareholders who have also invested in this nexus.

Other non-shareholder stakeholders may be able to partially diversify the risks of making highly specific investments in a particular nexus. Suppliers and customers, for example, may be able to make these kinds of investments in a few nexuses, and thus will gain some of the downside risk mitigation advantages of diversification.⁷ Thus, these kinds of stakeholders will often be more comfortable with a nexus choosing and implementing risky strategies than employees. However, to the extent that these other stakeholders cannot fully diversify these risks, they will typically be more risk averse in the strategies they would like to see a nexus pursue compared to shareholders.⁸

These different risk preferences of those multiple stakeholders with claims on a nexus' economic profit presents a challenge for those who are tasked with bringing together the resources needed to generate the co-specialization required to create economic profits in a nexus of contracts. It would be much simpler to ignore all such claims except those of shareholders and adopt more risky strategies, but such an approach will make it difficult to attract more cautious stakeholders to the nexus. And without all the stakeholders needed to

⁷ This implies that stakeholders may be part of several nexus of contracts simultaneously.

⁸ Fixed claimants, because they do not share in any profits generated by a nexus, will generally be very risk averse with regard to the strategies they would like a nexus to pursue.

generate co-specialization, a nexus of contracts cannot be expected to generate economic profits.

Thus, in order to attract non-shareholder stakeholders to a nexus of contracts, shareholders will often find it in their self-interest to let the nexus choose and implement less risky strategies than what they would otherwise prefer. In addition, to attract shareholders to a nexus, non-shareholder stakeholders will often find it in their self-interest to let the nexus choose and implement more risky strategies than what they would otherwise prefer. If co-specialization requires access to all the resources in the nexus, it is important for those in the nexus to accommodate—at least to some extent—each other's risk preferences (Wang and Barney, 2006; Kogut, 1991).

Some (traditional) firms have tried to resolve the risk preference conflicts among their employees and shareholders by compensating some employees—with stock and stock options—in ways that should make these employees more comfortable with risk taking. If the only resources that need to be combined to co-create economic profits in a firm (as a nexus) are the human capital of these few employees and the capital of shareholders, then such compensation schemes could solve conflicts between these two stakeholder groups, and riskier strategies would be chosen and implemented (Coles, Domid, and Naveron, 2006).

If, on the other hand, there are other stakeholders who control resources that are necessary if the nexus is to create economic profits, then compensating a few employees in ways that increases their risk tolerance may not reduce the risk preference conflicts among this broader group of stakeholders. Indeed, such actions can exacerbate these conflicts. In these settings, those with fixed claims, and those with costly to diversify claims on a firm's profits will

be reluctant to make their resources available to a nexus, except at much higher cost. If the nexus is unable to attract these stakeholders in a cost effective way, then the nexus as a whole may not be able to create economic profits.

Of course, firm stakeholders may have other conflicting interests in how they would like to see a nexus managed, besides conflicting risk preferences. For example, a supplier may have an interest in seeing the efficacy of a new technology it has developed demonstrated by the use of this technology in new products produced by the nexus. This may give this supplier advantages in its relations with other customers. Such a supplier may push for the use of this technology even though superior alternatives may exist.

Despite these numerous potential conflicts of interest, it is important to remember that these different claimants always have two self-interests to balance: their narrow self-interest in extracting as much of the profit generated by a nexus as possible, and their broader self-interest, which suggests that, without cooperation that leads to co-specialization, there will not be any expected economic profits to distribute.⁹

Entrepreneurs and Employees in Stakeholder Resource-based Theory

The role of entrepreneurs and employees in stakeholder resource-based theory has already been suggested. Entrepreneurs, in this context, can be thought of as those individuals who create a theory about how a particular nexus among resources may create economic profits (Alvarez and Barney, 2007). In the end, this theory is a theory about how co-specialization can generate economic profits. In the process of implementing this theory,

⁹ This logic suggests that the process of cooperating to realize profits from co-specialization and the allocation of profits to members of the nexus may have much in common with the general problem of organizing the creation and appropriation of the value associated with collective goods (Ostrom, 1990). See Habermas (1979) and Axelrod (1984) for alternative approaches for analyzing how cooperation evolves among otherwise competitive agents.

entrepreneurs also enroll the various stakeholders that are required for this co-creation into the nexus (Burns et al., 2016). To the extent that the compensation received by entrepreneurs from creating and implementing this theory depend on the economic profits generated by the nexus, ex post, entrepreneurs, themselves, have a claim on a firm's profits.

Obviously, an entrepreneur's theory about how a nexus may create economic profits can have an important impact on the enrollment process—both who needs to be enrolled and how enrollment occurs (Burns et al., 2016). However, it is also likely that this theory of how a nexus may create economic profits may co-evolve with enrollment: As stakeholders are added to the nexus, the ways that a nexus can create economic profits may change in difficult to anticipate ways. This is especially likely under conditions of Knightian uncertainty, when the opportunities that a nexus is designed to exploit are themselves being created (Alvarez and Barney, 2007; 2013).

Employees are also part of the nexus and can have fixed and/or residual claims. Employees are especially likely to have claims on the profits generated by a nexus when the theory about how a nexus can create economic profits is evolving, and/or when those who need to be enrolled to realize this theory is changing. In either of these cases, since compensation for employee efforts to maintain or reconstitute a nexus depends on the creation of economic profits, ex post, these employees have a claim on the profits generated by a nexus.

However, while employees are almost always part of the nexus, they may not always have claims on profits. Employees are likely to have fixed claims when their specific responsibilities, and the value they create for a nexus, are both known with a high degree of

certainty, *ex ante*. In these settings, the levels of uncertainty, information asymmetry and transaction specific investment will be low enough so that employees will be willing to grant access to the resources they control through a complete contingent claims contract.

Symmetrically, the nexus will also be willing to gain access to these resources through these kinds of contracts (because, in these settings, such contracts protect the interests of members of the nexus as well).

It would be tempting to conclude that a firm's senior managers will typically hold a claim on a firm's profits. This certainly may be the case. However, it is not an employee's position in the formal hierarchy of a traditional firm that determines whether or not she has a claim on the profits generated by a nexus. That status depends, instead, on whether or not an employee is part of the co-specialization within the nexus that creates economic profits. Some senior managers may have claims on profits, others may have fixed claims instead. Moreover, some employees who are not senior managers may be part of the profit creation process, and thus have claims on the economic profits it generates.

Discussion

For several decades now, scholars who study the stakeholder perspective have called on the field of strategic management to apply stakeholder thinking in strategic management research and practice (Freeman et al., 2010; Mahoney, 2013). These scholars have argued that such integration can be done (Harrison and St. John, 1994), is being done in practice by managers (e.g., Wheeler and Sillanpaa, 1997; Post, Preston, and Sachs, 2002), and, from a moral and ethical point of view, should be done (Evan and Freeman, 1993).

Despite these calls, relatively few strategic management scholars have adopted stakeholder thinking in their research (Mahoney, 2013; Margolis and Walsh, 2003). Some have rejected stakeholder logic by arguing that firms have a legal responsibility to maximize shareholders wealth¹⁰—even though some have argued that this is not the case in most countries (Stout, 2012). Others have argued that since shareholders are a firm’s only residual claimant, maximizing shareholder’s wealth insures that the fixed claims of its other stakeholders will be fully satisfied, and thus incorporating these other stakeholders into a manager’s decision making calculus is unnecessary (Jensen, 2002). Finally, others acknowledge the limitations of the shareholder supremacy model, but prefer the inaccurate simplicity of maximizing shareholder wealth to the more accurate, but much more complex task of addressing the possibly conflicting interests of all of a firm’s stakeholders when making business decisions (Zingales, 2000). And thus, for the last several decades, the stakeholder perspective and much of strategic management research and practice have remained largely disconnected.

This paper suggests that the separation of strategic management and stakeholder logic is deeply problematic for at least one theory in the field of strategic management: Resource-based theory. In the end, resource-based theory’s model of profit creation is inconsistent with a model of profit appropriation that assumes that shareholders have a unique claim on a firm’s profits. This conclusion requires that a stakeholder perspective be incorporated into resource-based theory’s model of profit appropriation, and by implication, this theory’s model of profit

¹⁰ The legal justification for this point of view in the United States was established in *Dodge v. Ford Motor Company*, 170 N.W. 668 (Michigan, 1919). While acknowledging that directors and managers can exercise “business judgement” in how they make decisions, the court stated “There should be no confusion . . . A business corporation is organized and carried on primarily for the profit of the shareholders” (p. 684). Stout (2008) argues that the conclusion of the court, and in particular, the way that it has been applied, are both problematic.

creation. The result is a different kind of resource-based theory—something that is called *stakeholder resource-based theory* in this paper.

How Resource-based and Stakeholder Resource-based Theories are Similar

Thus far, the differences between traditional resource-based theory and stakeholder resource-based theory have been highlighted in this paper. These have included, for example, important differences in the model for profit creation and appropriation, a different definition of the firm, the role of entrepreneurs and employees in forming a nexus of contracts that has the potential to create economic profits, and so forth. Undoubtedly, there are additional important differences.

As important as these differences are, some of the central features of received resource-based theory—including an emphasis on leveraging rare, costly to imitate, and non-substitutable resources in gaining access to new resources to generate economic profits—remain in stakeholder resource-based theory. Of course, these common elements are modified to some degree. For example, instead of leveraging a currently available resource to generate profits from acquiring access to a new resource, stakeholder resource-based theory focuses on co-specialization among a bundle of resources that generates revenues greater than what would be the case if each of these resources were considered on their own. Also, instead of taking the (traditional) firm as the unit of accrual, stakeholder resource-based theory takes the nexus of contracts as the unit of accrual.

That these elements of traditional resource-based theory continue in stakeholder resource-based theory suggests that the traditional theory had embedded in it many elements that were already consistent with a stakeholder perspective (Harrison and St. John, 1994). For

example, the original definition of resources in Barney (1991) include the notion of bundles of resources, although the implications of this bundling notion have to date not been fully explored in resource-based literature. If they had, it may very well have been the case that a stakeholder perspective would have been introduced into resource-based theory sooner.

Even the notion that shareholders do not have a unique claim on a firm's profits is an idea that has been introduced in resource-based discussions previously. Thus, for example, Coff's (1999) analysis of competitive advantages without profits implicitly acknowledges that other factors of production, besides shareholders, may have claims on economic profits created by firms. And in their commentary on resource-based theory, Lippman and Rumelt (2003a, 2003b) suggest the importance of tracking payments to each of the factors of production that combine to generate economic profits. This payment perspective has much in common with stakeholder resource-based theory.

How Stakeholder Resource-based Theory and Stakeholder Theory Differ

While the arguments presented in this paper call for a much closer integration between resource-based theory and stakeholder thinking, important differences between these theoretical traditions remain. However, because stakeholder thinking is, itself, diverse and evolving rapidly (Freeman et al., 2010), only a few differences between stakeholder resource-based theory and traditional stakeholder theory will be noted here.

One of the most obvious differences between stakeholder resource-based theory and stakeholder theory has to do with which specific stakeholders are relevant in the analysis. Some versions of stakeholder theory (Freeman et al., 2010) assert that firms need to consider the interests of large groups of stakeholders, e.g., employees, customers, suppliers, when

making decisions. While acknowledging that these individuals and institutions are all firm stakeholders (Freeman, 1984) and that some may even have fixed claims, stakeholder resource-based theory focuses mostly on those subsets of individuals and institutions who can create economic profits by becoming part of a co-specialized nexus of contracts. Not all of a firm's stakeholders control access to resources that have this potential.

The disaggregated view of stakeholders that characterizes stakeholder resource-based theory avoids a difficult problem associated with some traditional versions of stakeholder theory (Freeman et al., 2010). These versions of stakeholder theory assert that the legitimate interests of many different types of stakeholders must be recognized in making choices. However, the interests of these stakeholders, both between stakeholder categories and within those categories, can be very diverse. Harmonizing these many conflicting interests to make a decision can sometimes appear daunting, if not impossible. This is one reason why a theory of how conflicts among stakeholders can be resolved has never been proposed (Freeman et al., 2010).

Stakeholder resource-based theory does not require that the conflicting interests of many thousands—if not hundreds of thousands—of stakeholders need to be harmonized for decisions to be made. Rather, the task is much narrower: To harmonize the conflicting interests of just those stakeholders whose participation in the nexus is essential if the nexus is to generate economic profits. And while there may be important conflicts among this smaller group of stakeholders, they do all have one interest in common: By cooperating to create co-specialization, they can create economic profits, some of which they may be able to appropriate. This common interest may help enroll essential stakeholders in the nexus.

In this context, the resources accessed through fixed claims are also important as part of the nexus. However, since access to these resources does not take place in a highly uncertain, informationally asymmetric, high specific investment context, it will typically be less difficult for the nexus to gain access to these kinds of resources. Of course, the nexus may not like the price it has to pay for some of these fixed claim resources, but it will typically be less difficult to write the contracts needed to gain access to these resources.

Another important difference between stakeholder resource-based theory and at least some traditional stakeholder theories concerns the distinction between the firm and stakeholders. At least some of these theories (Freeman et al., 2010) seem to adopt the traditional definition of a firm. This, in turn, implies that a firm—defined traditionally—and its stakeholders are analytically distinct, e.g., that it is the responsibility of the “firm” to address the legitimate interests of its stakeholders (Freeman, 1984).

Stakeholder resource-based theory suggests that, in an important way, a firm is a nexus of stakeholders, and thus that it makes little sense to talk about firms, on the one hand, and stakeholders, on the other. The point, thus, is not to understand how “firms” are influenced by the legitimate interests of multiple stakeholders, but rather, to understand how multiple stakeholders can cooperate in a nexus of contracts to create economic profits which are then appropriated by these stakeholders.

Finally, some stakeholder theorists have tried to use this approach to develop more ethical and socially responsible approaches to strategic decision making (Margolis and Walsh, 2003). While there remains some controversy regarding the appropriateness of this effort (e.g., Phillips, 2003), its underlying logic is straightforward: if the interests of all stakeholders are

taken into consideration, then it seems less likely that strategies that systematically disadvantage some of those stakeholders will be chosen (Clarkson, 1995; Donaldson and Dunfee, 1994; Harrison and Freeman, 1999). If those stakeholders include the community, the environment, and so forth, then this does seem to form the basis for a more socially responsible and ethical approach to business decision making (Freeman et al., 2010), at least compared to the shareholder supremacy approach.

However, it is not clear if stakeholder resource-based theory has these same ethical implications. It may well be the case that a particular stakeholder who is necessary if a particular nexus is to create the co-specialization needed to generate economic profits has a strong interest in decisions that are socially responsible, benefit the environment, or in some other way are ethical in nature. In this setting, it may be that decisions made by this nexus will be deeply influenced by these socially responsible/ethical considerations. However, it may also be the case that in another nexus, such stakeholders do not have these interests, or indeed, may include stakeholders with interests that are antithetical to ethical or socially responsible decision making. In these settings, ethical or socially responsible decision making may be much less important in the nexus. In this sense, the theory developed in this paper is not likely to be a general theory of ethical or socially responsible decision making.

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