Sustainability, Stakeholder Governance, and Corporate Social Responsibility

Stakeholders and Corporate Social Responsibility: An Ownership Perspective

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ABSTRACT

We argue that the stakeholder and CSR literature can benefit from more systematic thinking about ownership. We discuss general notions of ownership in the economics and legal literature and the entrepreneurial notion of ownership we have developed in prior work. On this basis, we argue that stakeholder theory needs to deal more systematically with ownership as an economic function that can be exercised with greater or lesser ability, may be complementary to other economic functions, and works better when assigned to homogeneous groups. Some stakeholder groups are likely to lack what we call "ownership competence," even if they have made relationship-specific investments, in part because of a diversity of interests. We also discuss CSR from the perspective of ownership and support Friedman's original position, but with a twist. The point of Friedman's paper is not that firms "should" maximize profits, but that managerial pursuit of "socially responsible" activities in a discretionary way imposes costs on owners. We suggest this problem is exacerbated with entrepreneurial managers who can devise new ways to prop up their self-interested actions with new creative CSR initiatives.

Keywords: Ownership; economics of the firm; stakeholder theory; corporate social responsibility; ownership competence; Milton Friedman

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INTRODUCTION

Based on the neoclassical economics theory of the firm and its extension into agency theory (Jensen & Meckling, 1976), many scholarship in corporate finance and strategic management has embraced the model of shareholder primacy in which the firm's objective is to maximize shareholder value. Milton Friedman's (1970) popular and influential essay typifies this view, which became central to corporate governance in the 1980s. Around this time, however, an alternative perspective, emphasizing the role of a broader set of stakeholders, began to emerge (e.g., Freeman, 1984).[1] Both views are highly visible in the mission statements of corporations. For example, when the Fortune 500 petroleum and natural gas exploration and production company, Texas-based Anadarko, proclaims that its "mission is to deliver a competitive and sustainable rate of return to shareholders by developing, acquiring, and exploring for oil and gas resources vital to the world's health and welfare,"[2] it is straight out of the shareholder rulebook. Conversely, the world leader in toys, Denmark's family-owned Lego, announces that its "ultimate purpose is to inspire and develop children to think creatively, reason systematically, and release their potential to shape their own future – experiencing the endless human possibility."[3] Here the emphasis is on a broad set of stakeholders.

Perspectives of both shareholder and stakeholder come in positive and normative versions – the former type analyzes the performance effects of alternative governance arrangements, the latter type urges firms to adopt one structure or another.[4] For instance, normative stakeholder approaches argue that firms *should* take the interests of nonshareholder stakeholders – primarily workers and other input suppliers – into account (Freeman, 1984). Positive stakeholder approaches examine the effects of alternative ownership and governance arrangements; Klein, Mahoney, McGahan, and Pitelis (2017), for example, argue that a firm's ability to adapt to external shocks depends on which stakeholder groups are enfranchised and whether their claims are perceived by other stakeholders as legitimate. More generally, much of the positive stakeholder literature has claimed that firms which give greater decision authority to nonowner stakeholders, and which consider a variety of objectives, perform better than other firms, even on conventional financial criteria (Berman, Wicks, Kotha, & Jones, 1999). According to Blair and Stout (1999), the board of directors is best understood not as an agent for shareholders but as a "mediating hierarchy" that solves disputes among the firm's enfranchised stakeholders (see also Klein, Mahoney, McGahan, & Pitelis, 2012).

While the neoclassical theory of the firm and agency theory are conceptually clear and proffer transparent theoretical mechanisms, the discussion around stakeholders, and related discussions on corporate social responsibility has been characterized by conceptual ambiguity and lack of clarity regarding the claimed positive effects of adopting stakeholder rather than shareholder goals. A primary challenge is defining exactly who is, and who isn't, included in the set of relevant stakeholders. A recent strand of research follows property rights economics (Hart, 1995; Hart & Moore, 1990) in defining stakeholders with legitimate claims on firm value as those agents who make relationship-specific investments in the firm's activities, whether they own equity or not (Hoskisson, Gambetta, Green, & Li, 2017). Other approaches define the set of stakeholders more broadly, to include virtually any individuals or groups whose well-being is affected by the firm (see Aguinis & Glavas, 2012). This is the view reflected in the Lego corporate mission mentioned above; the emphasis is on children, and hence society's future, not simply customers whose actions contribute to the firm's bottom line. Corporate social responsibility (CSR), then, is the act of maximizing the welfare of all legitimate stakeholders.[5]

Central to stakeholder and CSR discussions are background assumptions about ownership. Thus, theories dealing with relation-specific investments and "legitimate claims" are about ownership of tangible and intangible assets. When people argue about whether shareholders should be privileged over other stakeholders, or whether this or that group should get more decision or income rights, they are essentially dealing with broad questions about ownership: Who owns the firm, and what implications does this have for how firms are run, or should be run? What do we mean by "ownership" anyway? What are the functions of ownership? We think stakeholder and CSR debates can be improved by focusing more specifically on these fundamental questions. We do so from the perspective of key ideas on ownership from economics (e.g., Coase, 1960; Hansmann, 1996; Hart, 1995) as well as from the perspective of our own theorizing which has stressed the crucial linkages between entrepreneurship and ownership (Foss & Klein, 2012).

To illustrate the relevance of ownership ideas to these discussions, note that the stakeholder view is basically suggesting that the shareholder view is wrong about the set of legitimate owners of the firm. Other individuals besides shareholders, if they make firm-specific investments, should have legitimate claims on not only residual income but also on decision-making (Blair & Stout, 1999). On commonsense as well as theoretical and normative grounds, these individuals and groups may be rightful owners. Similarly, CSR is fundamentally about what economists call externalities (external benefits or costs that are not received or born by the actor). If a company's decisions have a harmful effect on third parties – members of the nearby community, the natural environment, or other elements of society – then strict profit maximization will lead companies to make decisions that are not in the best interest of all parties. As a long stream of research, Coase (1960) has revealed that at the core of the concept of externality is the allocation of titles to ownership. Owners' interests are taken into account, while nonowners may benefit or not. Such observations suggest that stakeholder and CSR research should feature discussions of ownership as a central part of the theorizing. This, however, is often not the case.

More generally, the ownership construct is undertheorized in management research (Foss, Klein, Lien, & Zenger, 2017). Even in legal and economics scholarship, there is no unanimity regarding what exactly ownership entails. What does it mean to "own" a resource or asset? For example, while many would think of the right to exclude other individuals from using the resource as key to the notion of ownership, excludability can clearly be circumscribed by legislation, laws, and norms. How much real excludability does one need to be an owner? What kinds of resources and assets are ownable? What are the implications of ownership for the owner's rights and responsibilities, legally or ethically? How do alternative ownership arrangements affect individual behavior and firm performance? While the legal literature as well as property rights economics (Hart, 1995) have offered many answers to such questions, they have not really been at the forefront of stakeholder and CSR discussions.

We have argued that the stakeholder and CSR literatures can benefit from more systematic thinking about ownership, particularly as ownership is discussed in various branches of the theory of the firm (e.g., Fama & Jensen, 1983; Hart, 1995; Hart & Moore, 1990; Jensen & Meckling, 1976). Consider, for example, the relationship between residual decision rights and residual cash flow rights. Both sets of rights are typically held by corporate shareholders, but they are distinct. As we have argued below (see also Foss & Klein, 2012; Knight, 1921), residual decision rights – the right to decide how the firm's resources will be used in conditions not specified by prior agreement – are intrinsic to ownership itself. Residual cash flow rights, however, can be delegated to nonowners (e.g., any employee whose pay is linked to firm performance is a residual claimant). The literature also confuses ownership, as residual decision authority, with day-to-day control, which is often possessed by non-owners. It is also common to associate ownership per se with ownership ability, the skill with which ownership rights are used, though the current owners of a resource or firm may not be the optimal owners (Foss et al., 2017). Greater clarity on these points can, we think, greatly improve the stakeholder and CSR literatures.

Accordingly, in this chapter, we have discussed the meaning of "ownership." We discussed general notions of ownership in the economics and legal literature as well as the entrepreneurial notion of ownership that we have developed in prior work (Foss & Klein, 2012). We then discussed the role of ownership in stakeholder theories. We argued that, for example, Blair and Stout's (1999) influential approach mistakenly classifies nonalienable assets controlled by non-owner stakeholders as "part of the firm." Moreover, they claim that making firm-specific investments gives the investor a legitimate claim to ownership of complementary assets (particularly under conditions of team-production).

As we show below, much of contemporary stakeholder theory fails to deal with ownership as an economic function that can be exercised with greater or lesser ability, may be complementary to other economic functions, and works poorly when assigned to heterogeneous groups. We rely on what Foss et al. (2017) call *ownership competence*, the skill with which ownership activities are performed. Certain stakeholder groups are likely to be low in ownership competence, even if they have specific investments, in part because of a diversity of interests. We then discuss CSR from the perspective of ownership. Our perspective basically reinforces Friedman's original position, but with a twist. The real point of Friedman's paper is not that firms "should" maximize profits, but that managerial pursuit of "socially responsible" activities in a discretionary way imposes costs on owners. However, there is nothing in Friedman's paper, or in our ownership perspective, to suggest that owners cannot instruct managers to pursue such activities. Indeed, those activities may sometimes be means to more "enlightened value maximization" (cf. Birkinshaw, Foss, & Lindenberg, 2014; Jensen, 2002).

WHAT IS OWNERSHIP?

A Thorny Concept

Although ownership is a complex and controversial construct (e.g., Bell & Parchomovsky, 2004; Underkuffler, 2003), it is generally agreed that ownership can be conceived as a bundle of rights, the most important being possession, exclusion, and control. Ownership is thus typically seen as involving the rights to extract income from an asset (e.g., by selling it or deploying it), to exclude others from accessing it, and to transform it (e.g., in productive activities), within legal limits. Commonsense suggests that what is meant by "ownership," exactly, is determined by the prevailing institutions (cf. Demsetz, 1967). Thus, ownership can be very narrowly circumscribed or it can be quite extensive, depending, for example, on the specific society regulating ownership, the relevant class of assets (e.g., gun ownership is regulated differently from house ownership), and much else.

The multidimensional nature of ownership is recognized not only in law, but also in economics, particularly in the "economics of property rights" literature that took off after Coase (1960) (e.g., Alchian, 1965; Barzel, 1997; Hart, 1995; Libecap, 1989), and in related work on contracts such as agency theory, transaction cost theory, and incomplete contract theory. Economists and finance scholars, building largely on principal-agent theory, associate ownership with the right to derive residual income (i.e., profits). Thus, the owners of the firm are, in this conception, the shareholders. The familiar challenge to this notion of ownership is that having the right to receive residual income may be disconnected from the right to control the company, these rights being controlled by management. By granting managers ownership stakes or residual income rights, the interests of managers and shareholders can be aligned.

However, economists working from a transaction cost or incomplete contracting perspective focus directly on the control afforded by ownership (Grossman & Hart, 1986; Hart, 1995). A contract is said to be "complete" when it specifies what the contracting parties will do in every possible future situation. The general equilibrium theory of neoclassical economics (e.g., Debreu, 1959) and much of classical agency theory (e.g., Jensen & Meckling, 1976) model contracts as being complete in this sense. Once the contract is signed, the future plays itself out, but the contract itself never needs to be revisited. In the real world, most contracts are incomplete; they do not account for all future contingencies. Ownership, in the incomplete-contracting tradition, is defined as the "residual rights of control," that is, the right to make decisions over assets in situations not covered by contract (Hart, 1995).

Williamson (1985) famously argued that incomplete contracts expose parties to risks, especially in the presence of cospecialized investments. Once parties commit themselves to economic relationships by making nonrecoverable, relationship-specific investments, their trading partners may try to renegotiate the terms of trade, taking advantage of the fact that the party which made these investments cannot walk away without a substantial loss of value. If at least some future contingencies cannot be anticipated and included in the contract, this "hold-up" problem may arise. A solution is to give the residual rights of control to the party making the cospecialized investments so that, if unanticipated contingencies occur, the party can make decisions that protect the value of these investments – an important rationale for vertical integration.

Incomplete contracting theory suggests that ownership should be assigned to the parties whose cospecialized investments generate the most value for the relationship (Hart, 1995). Ownership is thus fundamentally linked to value creation. As ownership is ownership of alienable assets, the efficient allocation of titles to ownership is tantamount to a theory of the boundaries of firms.

We also take residual rights of control as the key defining aspect of ownership. In practice, the owners of the firm will possess two rights – the right to control the firm (via the board of directors, etc.) and the right to appropriate the firm's residual earnings, and this is indeed what is usually meant by "the owners of the firm" (Hansmann, 2012, p. 897). Indeed, the reason (apart from psychic income) that individuals seek control rights is because these are means to secure residual cash flows. And yet, such residual income rights are, perhaps counterintuitively, not essential to ownership, as they can be delegated to nonowners. Residual control rights, however, are fundamental to ownership and cannot be delegated. Ownership is the right to determine how resources will be used in conditions not specified by prior agreement. The owner can delegate decision rights to others – that is, use rights can be partitioned (Alchian, 1965) – but the owner cannot delegate the right to determine what will be delegated, for that is reserved for the owner per se. For this reason, ownership is associated with incentives, which are different from the incentives provided, for example, to agents in a principal-agent model.

The residual control rights that accompany ownership can promote value-creating efforts and investments. Specifically, the way these control rights are allocated in a relation shapes the incentives to make valuable investments in assets. The key idea is that these rights may be allocated between the parties in such a way that latent problems of the holdup are reduced. The need for the owner of one asset to make investments that are specialized to the assets of another owner creates problems of holdup. The first owner fears that these specific investments will be subject to holdup once they are made. By taking ownership of the second owner's assets, the first owner removes the threat of holdup and creates improved incentives to make specialized investments. The surplus in a relation is maximized when ownership of assets is allocated to the party who makes the most important investments. Thus, optimal ownership structures create investment incentives that maximize value creation (Hart, 1995).

A Judgment-based View of Ownership

In our work on entrepreneurship (Foss & Klein, 2012, 2015) we have articulated a view of entrepreneurship as *judgmental decision-making over the use of productive resources in pursuit of future profit*. In the tradition of Frank Knight (1921) and Ludwig von Mises (1949) we have termed this the "judgment-based view" of entrepreneurship and the firm. As in modern property rights economics (Grossman & Hart, 1986), ownership in this perspective means the right to make decisions about uses of alienable assets in situations not covered by prior agreement. While property rights economics is agnostic about the reasons why all prior contingencies are not considered in advance, we argue that deep uncertainty – famously described by Knight as "the inherent, absolute unpredictability of things" – and the complexity of combining heterogeneous resources into productive bundles, requires some party to reserve residual control over the firm's assets. That party, whether termed "shareholder," "stakeholder," or something else, is the owner of the firm.

Knightian uncertainty and resource heterogeneity are relevant to ownership because, as noted above, we cannot specify by contract, ex ante, how productive assets will be used in all possible circumstances, because we cannot imagine them all. Unlike situations of probabilistic risk such as casino gambling – we don't know what will happen next, but we know all the possible things that can happen, and the exact probabilities each – real-world decision-making takes place in an open-ended world in which genuine surprise (Shackle, 1972) is possible. Moreover, resources are heterogeneous, and can be combined in many possible bundles; they possess, as Lachmann (1956) put it, "multiple specificities." Value creation requires that someone play this role of combining them, and having the residual rights to combine them when unforeseen contingencies arise. Every firm, then, must be owned by some person or group.

What, then, is the "firm" that owners own? The judgment-based view agrees with property rights theory (Hart, 1995; Hart & Moore, 1990) that, from an economic point of view, the core of the firm is asset ownership. This contrasts with the Coasean tradition in which the essence of the firm is an authority, and hence the employment relationship. As Coase (1937, p. 387) famously pointed out, in a market system "the allocation of factors of production between different uses is determined by the price mechanism." Within a firm, however, "[i]f a workman moves from department Y to department X, he does not go because of a change in relative prices, but because he is ordered to do so." A firm must thus have at least two employees, a manager and a worker, and labor is the only relevant input.

In our approach, however, the essence of the firm is ownership, not employment.[6] A firm is an entrepreneur plus the assets she owns and controls, even if she has no employees. (An electrician who owns his own tools is a firm; an electrician who works with someone else's tools is an employee.) The judgment-based perspective also agrees with the property rights idea that owners own the firm's *alienable* assets – those that can be partitioned and exchanged or given a way. This normally refers to land, plant, equipment, and legally appropriable intangibles such as patents, licenses, securities, and so on. It does not include the firm's reputation, its intangible resources and capabilities, the human capital of employees, and other valuable but nontradeable assets.

The judgment-based view departs from property rights economics in several respects, however. First, while only alienable assets are owned, traded, and priced in markets, we can also understand the owner's fundamental business idea – that is, her judgments about the future – as a kind of asset. Indeed, this judgment is the core organizing principle for the firm's existence and operations. Second, while the owner cannot own other people's human or social capital, the firm's reputation, and other nonalienable assets, she can still exert an influence over such assets. In fact, asset ownership may be a partial means to control the use of nonalienable assets. Consider, for example, a superior CSR reputation. Such a reputation may be harmed by poor working conditions, such as the use of sweatshops in developing countries, which provide private benefits to the local subsidiary (Brammer & Pavelin, 2006). Managers can seek to protect this reputation by threatening to fire employees (e.g., subsidiary managers) whose actions harm the firm's reputation for CSR – thus denying them access to the firm's (alienable) assets. With positive information costs, not all harmful actions will be detected, but control over access to the firm's own assets can mitigate opportunistic behavior by employees.

Conversely, the value of the alienable assets may be enhanced by the presence of the nonalienable assets; the firm's plant, equipment, proprietary technologies, and so on are more productive when used by workers with significant investments in firm-specific knowledge and experience (Hart, 1995). Thus, although ownership only attaches to alienable assets, the sphere of influence of ownership reaches beyond those assets (Rajan & Zingales, 1998).

Moreover, given resource heterogeneity, cost of measurement/information, and fundamental uncertainty, all the valuable attributes or uses of an asset are not known *ex ante* (Barzel, 1997). While the property rights view argues, correctly, that ownership provides strong incentives for investment in, and maintenance of, assets, we emphasize that ownership also provides incentives for the creation or discovery of new and valuable attributes. Who owns and how ownership is exercised may, therefore, influence innovation and organizational learning (Foss & Klein, 2012; Foss et al., 2017).

OWNERSHIP AND STAKEHOLDER THEORY

From a Shareholder to an Owner Perspective

Most stakeholder approaches position themselves relative to the shareholder primacy model associated with agency theory. However, shareholder primacy is hotly debated in corporate law (e.g., Bainbridge, 2003; Baird & Henderson, 2008; Fisch, 2006). Some of the debate revolves around the common-law "business-judgment rule," which states that courts will generally not second-guess the decisions of directors, even if these directors take the interests of nonshareholders into account. Blair and Stout (1999) take the business-judgment rule as evidence against a norm of shareholder primacy, while Bainbridge (2003) argues that a general protection for directors against court interference does, in fact, serve the interest of shareholders. Other legal scholars claim that while the fiduciary duty of managers and directors is indeed to maximize firm value, this maximand does not always correspond to shareholder wealth (Fisch, 2006). More generally, in Anglo-American law, the duty of directors is to exercise the "duty of care" (being well informed, deliberating carefully, etc.) and the "duty of loyalty" (putting the interests of the corporation above their personal interests). These duties do not necessarily imply a duty to consider only shareholder interests.

We think these discussions can benefit from focusing not on shareholders per se, but on owners. Who are the owners of the firm? What does it mean to own a firm, that is, what are the specific rights and responsibilities accruing to ownership? What are the consequences for efficiency and value creation of various ownership arrangements? From a normative perspective, should the firm be run in the interests of its owners, or of nonowner stakeholders? Once we have answers to these questions, we can ask if shareholders or other groups are the most suitable owners of the corporation. From there, we can draw out further implications for social responsibility.

A useful concept is Hansmann's (1996) counter-intuitive idea of the corporation as a kind of cooperative – specifically, a lenders' cooperative. We are familiar with workers' cooperatives (e.g., employee-owned firms), buyers' cooperatives (patron-owned grocery stores or insurance companies), or producers' cooperatives (farmer-owned processing facilities), in which a group of input suppliers or customers owns the equity. As Hansmann points out, however, there is nothing special about a corporation in this regard – it too is owned by a group of input suppliers, the suppliers of capital. In Hansmann's analysis, the optimal form of ownership depends on the characteristics of the firm's resources and markets, and on the characteristics of potential owner groups. Specifically, he argues that what makes a group well-suited to ownership is the relative homogeneity of interests among group members, which reduces the transaction costs of collective decision-making (see also Cook, 1995; Cook & Iliopoulos, 2000).

Ownership and Stakeholder Theory

Stakeholder theory has traditionally revolved around the questions of "who are the firm's stakeholders?" and "what rights should stakeholders have" (Donaldson & Preston, 1995)? These are thorny questions (Miles, 2012), the former because of the general absence in the literature of a clear standard for deciding who is a stakeholder, the latter because rights justification can be approached in different ways (notably, depending on ethical starting point). For example, Mitchell, Agle, and Wood (1997) construct a typology of stakeholders based on three different attributes. One such attribute is "power," which is defined by Mitchell et al. as the ability of a party in a relation to impose its will. The other attributes are "legitimacy" (i.e., what is deemed socially accepted and expected), and "urgency" (i.e., the time sensitivity or criticality of the stakeholder's claims). By juxtaposing these attributes in a binary way, Mitchell et al. derive eight types of stakeholders and how each stakeholder may impact organizational performance.

However, it is not clear that the three attributes are orthogonal. Thus, property rights economics suggests that "power" may derive from ownership. Ownership confers the right to decide over asset use in situations not covered by the contract (Hart, 1995). Additionally, property rights economics argues that ownership titles and property rights, in general, are supported by institutions that confer legitimacy (Demsetz, 1967). Finally, transaction cost economics (Williamson, 1996) indicates that "power" and "urgency" may be very closely related (e.g., the notion of time-specificity). The implication, we surmise, is that ownership is a central analytical category in discussions of what it means to be a stakeholder.

More generally, a key reason both questions have been so difficult is that there are two more fundamental questions (from which answers to the above two questions may be derived): What does it mean to be an owner, and what are the performance consequences of alternative ownership arrangements?[7] Note that "performance consequences" can be understood broadly, i.e., in terms of how much value is created by different ownership arrangement for the firm's entire set of stakeholders. However, to address these questions we obviously need a perspective on ownership. Having offered such a view in the preceding section, we now ask, what are its consequences for stakeholder theory?

Ownership for All

From our ownership perspective, the key questions are "who owns the firm?" and "what are the performance consequences of alternative ownership arrangements?" In Anglo-American corporate law, only equity holders have residual decision and control rights over the firm's alienable assets so, as in the standard shareholder perspective, equity holders are the firm's owners. Employees, suppliers, customers, members of the local community, and other stakeholders may, of course, make investments that are specific to an ongoing relationship with the focal firm. Such investments increase the value of assets that are owned by the relevant stakeholders. For example, when members of Lego's online user communities engage repeatedly with the firm and with each other, their efforts constitute investments that may become increasingly specialized to the community, benefiting Lego. Employees own themselves, that is, they own their own human and social capital.

Blair and Stout (1999) make an influential case for why, under conditions of team production (i.e., asset investments are supermodular in the value of production), the firm-specific investments undertaken by employees make them rightful holders of rights of ownership. Blair and Stout summarize their analysis this way:

> We argue that public corporation law can offer a second-best solution to team production problems because it allows rational individuals who hope to profit from team production to overcome shirking and rent-seeking by opting into an internal governance structure we call

> the "mediating hierarchy." In essence, the mediating hierarchy solution requires team members to give up important rights (including property rights over the team's joint output and over team inputs such as financial capital and firm-specific human capital) to a legal entity created by the act of incorporation. In other words, corporate assets belong not to shareholders but to *the corporation itself*. Within the corporation, control over those assets is exercised by an internal hierarchy whose job is to coordinate the activities of the team members, allocate the resulting production, and mediate disputes among team members over that allocation. At the peak of this hierarchy sits a board of directors whose authority over the use of corporate assets is virtually absolute and whose independence from individual team members – as we demonstrate later in this Article – is protected by law (1999, pp. 250–251; emphasis in original).

The "mediating hierarchy" construct assigns equal weight to the interests of owners and nonowners. However, ownership of complementary, specific assets is not the same as ownership of the assets of the firm itself. We argue, contrary to Blair and Stout (1999), that giving ownership rights to the firm – residual decision rights over the firm's assets under uncertainty – to owners of complementary assets introduces important inefficiencies and typically destroys value.[8]

Blair and Stout (1999) are concerned mainly with the *incentive* effects of ownership (rather than with the competence with which ownership is exercised). Their view follows from applying a simple property rights model along the lines of Hart and Moore (1990) and Hart (1995). This model is designed to analyze optimal ownership arrangements between a dyad of firms (or individuals) within a value chain. Blair and Stout (1999) also build upon a "team production" theory of the firm (Alchian & Demsetz, 1972) to apply property rights reasoning to the broader issue of how to incentivize stakeholders who make investments that are specific to the firm. In this model, individuals make effort choices that are costly to observe. The well-known 1/N problem leads to inefficient shirking or free-riding. The model is intended to show first, how such inefficiencies increase in team size and second, how they can be mitigated by concentrating bundles of rights (i.e., rights to monitor and sanction team members) in the hands of an owner. While this team-production model is superficially like the property rights model (both stress complementarities and actions that cannot be contracted in advance), the models are designed for different purposes. However, these models do not explain why these ownership rights should be allocated to employees making firm-specific investments.

A more central problem, from the perspective of the judgment-based view, is that the property rights model (Hart & Moore, 1990) only considers one cost of ownership, namely the weakened investment incentives of nonowners. Of course, giving ownership rights to a group of stakeholders reduce the incentive of others to engage in opportunistic "hold up." But there are other costs of ownership. Some types of owners may be better than others at keeping agency costs low (Hansmann, 2012). For example, owners of capital may be better than the firm's customers at monitoring management; their "ownership competence" is higher (Foss et al., 2017). Additionally, they may be in a better situation to shoulder the risk associated with ownership.

Following Hansmann (1996), we note that assigning ownership to equity holders usually has several important efficiency advantages. Equity holders have mostly homogeneous interests: maximizing the value of the firm's equity. While there can be conflicts among different types of equity holders – owners of preferred versus common stock, owners with more or less diversified portfolios, owners with different preferences over risk and return – these conflicts are secondary to the shared goal of increasing firm value.

Consider, by contrast, other kinds of ownership arrangements. Cooperatives are specifically chartered to give ownership rights to employees, customers, or suppliers. Corporate law in many countries allocates control rights associated with ownerships to employees *via* mandatory board representation. How do these alternative ownership models affect performance and firm value? As noted above, giving other groups residual decision or control rights may improve their incentives for performance and encourages coinvestment in relationship-specific human and tangible investments (which they themselves own anyway as noted above). Consider the earlier example of the advanced Lego users and their specific investments in online Lego communities. Should these advanced users be among the owners of Lego? On the one hand, ownership would surely strengthen their incentives to specialize their human capital even more to the user communities and perhaps to Lego's development efforts more generally. On the cost side of such ownership is that many of these users care only about Lego products, not about Lego's operations, management, marketing, etc. And they may have low competence in these matters. Additionally, they may, partly because of their lack of interest and low competence, hold very different opinions about strategic and operational matters.

More generally, as Hansmann (1996) points out, the heterogeneity of interests among, and even within, stakeholder groups, such as Lego advanced users is an important cost. In a worker-owned firm, for example, each owner has interests as an owner (increased profits and equity value) and interests as a worker (higher pay, better working conditions, and so on), and these interests are frequently in conflict (see also Furubotn, 1976, 1988). Older workers close to retirement prefer higher payrolls, while younger workers may prefer more of the firm's earnings to be retained and reinvested. More generally, if employees vary in their characteristics (age/experience, degree of firm-specific investment, outside opportunities, and risk preferences), they will have very different preferences about how the firm should be run, which implies high costs of collective action. And, of course, expanding the set of relevant stakeholders to include suppliers, members of the local community, and broader segments of society, and giving them residual decision rights, greatly exacerbates this problem.[9]

How to react to unforeseen contingencies poses difficulties, leading to bargaining and even hold-ups of some stakeholders against other stakeholders (Williamson, 1996). Lack of adaptability and internal power struggles may result, both harming overall performance. In fact, Lopez-De-Pedro and Rimbau-Gilabert (2012) argue that the stakeholder approach basically assumes that company decisions have foreseeable and known consequences for stakeholders, which means that key issues of bargaining, the internal distribution of power, and holdup seem strangely outside the orbit of stakeholder theory.

Other dynamic issues related to organizational learning and innovation. The judgment-based view holds that resources have multiple attributes (functionalities, uses, etc.) and that owning a resource provides incentives for the creation or discovery of new and valuable ways of using the resource. Allocating ownership titles through financial markets mean that those with a comparative advantage in exercising their ownership to promote learning and innovation will assume ownership, and shareholders can easily adjust their interests in the firm, exit etc. in case they realize that current resource holdings may not be favorable to learning and innovation.

Moreover, the cost of exit for various stakeholder groups is generally much higher than the exit costs for shareholders, who can simply sell their stock. A departing worker-owner, for example, loses his job along with his ownership claim on the firm. As exit costs are high, disagreements tend to be expressed by voice and are costly to resolve. Likewise, different types of consumer−owners or supplier−owners have multiple and conflicting interests and the fact that ownership is tied to patronage or sales makes exit costly and contributes to organizational conflict.[10] Hansmann argues that, for these reasons, workers, suppliers, customers, community members, and others who contribute to firm value directly are usually better off protecting their economic interests through law and contract, rather than ownership.

We note here two caveats. First, while (as in the stakeholder literature) we are talking mainly about corporations, our arguments refer to ownership in a more general sense. In other words, shareholders *do* own the corporation − in Hansmann's (1996) terminology, lenders own the lenders' cooperative − just as proprietors own the proprietorship, partners own the partnership, buyers own the buyers' cooperative, and so on. These are all legitimate and valuable forms of organization, but the most valuable form depends on the circumstances. Ownership is an important economic function, so in competitive markets, ownership claims will tend to be (and, in our view, should be) assigned according to ownership ability (Foss et al., 2017).

Second, while we disagree that parties making firm-specific investments in nonalienable assets will normally have a strong case of owning the firm itself (for reasons set out above), we fully acknowledge that there are concerns associated with incentivizing such investor−stakeholders (Williamson, 1996). This is a very general problem: as Jensen (2002, p. 246) points out, "it is obvious that we cannot maximize the long-term market value of an organization if we ignore or mistreat any important constituency." In the specific case of employees who make highly firm-specific investments in their own human capital may be incentivized by getting "access" to core assets (e.g., client lists) (Rajan & Zingales, 1998). Thus, while they do not obtain ownership, these stakeholders obtain certain use rights that benefit them not just because they increase their productivity, but more importantly because they increase their bargaining power, allowing them to capture a larger portion of the created value. This, in turn, improves their incentives to make firm-specific investments, in the interests of all parties. In other words, limiting residual decision and ultimate control rights to equity holders benefits not only the equity holders, but also the firm itself and hence the nonshareholder stakeholders as well. At the same time, firms can allocate the use of rights of various kinds of assets to improve the incentives of various stakeholders.

OWNERSHIP AND CORPORATE SOCIAL RESPONSIBILITY

Ownership has often been invoked in discussions of CSR, specifically, in two different ways. First, researchers have examined whether the form of ownership (e.g., dispersed or concentrated) influences the extent to which firms pursue CSR strategies (Berman et al., 1999). Second, ownership has appeared as more of an overall positioning device, namely in contrasting CSR with a view of ownership as maximizing the residual claims of shareholders and with the "social responsibility" of the corporation being that of maximizing profits (Friedman, 1970). We here focus on the second set of issues.

Friedman's (1970) famous essay argued that "The Social Responsibility of Business Is to Increase Its Profits." Not surprisingly, the essay was interpreted in terms of the long-running debate on how to understand the business firm. Neoclassical economists held that firms can be described in terms of production, cost, and profit functions, and that managers operate firms to maximize current-period profits, or can be modeled as if they do (Friedman, 1953).[11]

The emphasis on profit maximization has, however, obscured the main point of Friedman's essay on social responsibility. His argument was not that financial objectives are more important than broader, societal goals, and that firms play no role in the latter (cf. also Hart & Zingales, 2017). On the contrary, he believed that the value created by for-profit companies was essential to pro-social behavior. The mandate for managers to maximize money profits was meant to solve an agency problem. Rather than task corporate manager with deciding which socially responsible activities, programs, charities, etc. are worth funding, Friedman thought managers should focus on efficiency and return the resulting profits to shareholders, who would participate in the socially responsible activities they value the most, funding these activities from their dividends and capital gains.

Friedman argued that managers are mere stewards of the capital entrusted to them by the firm's owners. Just as managers should not pursue growth or diversification to satisfy their own interests – growth to increase their status or control, at the expense of profits; diversification to reduce their unemployment risk, while shareholders can reduce their own risks via portfolio diversification (Amihud & Lev, 1981) – managers should not act as philanthropic agents for owners. In other words, Friedman was opposed not to socially responsible behavior, but to managers using owners' funds for socially responsible behavior without consent.[12]

In the judgment-based view of the firm, as described above, ownership is understood as a means by which individuals can exercise judgment about resource use under uncertainty. Individuals (and groups of individuals with relatively homogenous interests) skilled at performing the ownership function will tend to increase their ownership and use of productive assets. These uses can, and typically do, involve socially responsible activities – donations to charities, investments in for-profit and nonprofit organizations that pursue social objectives, and so on. The more skilled the owner at exercising this ownership function, the greater the opportunity to pursue nonfinancial objectives. For this reason, the best way to encourage CSR is to allow competitive markets to allocate capital and other resources to their highest valued uses, which generates the wealth necessary to pursue social objectives. Thus, the judgment-based view of the firm sides with Friedman here. The main issue is not whether social objectives are worthy, but how social objectives should be selected and supported. The judgment-based perspective argues that this function is most effectively performed by owners, and not by nonowner managers.

However, neither Friedman nor the judgment-based view opposes managers pursuing CSR activities if equity holders have explicitly or implicitly delegated such authority to managers. Jensen (2002) argues that under certain circumstances, CSR is, in fact, consistent with owners' interests (Jensen, 2002). Birkinshaw et al. (2014) discuss examples of companies (e.g., Svenska Handelsbanken, Tata Group, Lego) that manage to combine "social purposes" (as embodied, e.g., in mission statements) and high levels of profitability, and in which the pursuit of social purposes take place in full agreement with owners (some of the companies are foundation-owned). Birkinshaw et al. (2014) interpret the pursuit of profit in these companies as taking place in a highly oblique, yet effective manner, in which the dedication to social purposes influences employee motivation in a beneficial way. One could also imagine cases in which there are economies of scale in pursuing certain social objectives and shareholders, rather than investing in nonprofits or similar groups, prefer managers to perform these objectives on the owners' behalf.

A subtle issue is that in some cases, managers have superior private knowledge about the link between employee motivation and "social purposes," such that CSR activities improve the firm's financial performance. If shareholders do not understand these links, they will veto the firm's investments in social purposes, even when these investments would be in the owners' interests. In such a case, CSR is efficient. The problem does not arise in Friedman's thinking, because, as Hart and Zingales (2017) suggest, he assumes that CSR activities and profit-making activities are independent. Does this mean we may not always wish to give shareholders the last word?

The answer depends in part on the costs of implementing CSR, particularly in the case of entrepreneurial managers. First, while agency theory and its applications stress that managers may use their private information to pursue self-interest at the expense of owners, this reasoning is modeled within the "closed" models of mainstream economics. Owners are assumed to know the set of actions available to managers and to be able to incentivize optimal employee decisions. However, the judgment-based view stresses that managers are also entrepreneurial in coming up with new and creative ways of using company resources to their advantage, ways unanticipated and perhaps not even understood by equity holders (Foss & Klein, 2012, chapter 8). It is likely that many, perhaps most, CSR activities fall under this rubric. For example, managers may make investments in activities they claim benefit society, but actually satisfy some private interest of the manager (say, investments in beautifying the neighborhood where the manager lives, or donations to political causes the manager favors). Given the Knightian uncertainty, it is difficult for owners to limit, or even detect, such conflicts of interest.

A narrow focus on shareholder wealth maximization may not be strictly optimal, but given the ways managerial discretion can be used opportunistically, particularly under conditions of dispersed knowledge and uncertainty, giving shareholders the residual decision rights may be second-best. Although managers may sometimes know better than owners about how to invest the owners' funds to pursue socially responsible objectives, the costs of that kind of discretion likely exceed the benefits.

Second, as Matsusaka (2017) points out, there are massive challenges (see also Jensen, 2002) in implementing other schemes, even the seemingly Friedmanite proposal of maximizing shareholder welfare, rather than wealth (i.e., allowing shareholders' preferences, including preferences for socially responsible activities, to be reflected in the company mission) (Hart & Zingales, 2017). While this may not decisively call for shareholder wealth maximization, it does suggest the need for clear, transparent, and time-consistent ways of committing to CSR policies.[13]

CONCLUSIONS

Ownership is at the heart of any discussion of stakeholder management and corporate social responsibility. The former is fundamentally about extending rights of ownership to other input owners than the owners of capital, while the latter is either a moral instruction to shareholders to follow certain corporate objectives or an attempt to legitimize that managers use income streams that accrue to shareholders on purposes with which these may not agree. Our key purpose in this article has been to call for a reorientation of extant discussion so that these points become more prominent.

We have, however, made several points that call for further research. Thus, we have argued that ownership can be exercised with varying degrees of competence and that, in the typical corporate setting, equity holders are usually best suited for performing the ownership function. Adding uncertainty and entrepreneurial judgment to existing discussions of alternative organizational forms (Cook, 1995; Hansmann, 1996) should help to elucidate circumstances under which proprietorships, partnerships, cooperatives, and other structures (e.g., family firms) are effective means of achieving owners' nonfinancial objectives. In the process, this approach clarifies important differences between publicly and privately held firms. Moreover, our approach holds implications for comparing private versus public (state) ownership in terms of stakeholder engagement and CSR practices. A long tradition in property rights economics (e.g., Alchian, 1965) holds that because property rights in the public sector are diluted (e.g., owner-citizens cannot sell their shares of state enterprises), decision makers face weaker incentives to make efficient decisions, including decisions relating to stakeholder involvement and CSR practices. However, depending on context, this may mean both more or less stakeholder involvement and CSR. Similar issues are investigated in other contributions to this volume.

More generally, we think the stakeholder and CSR literature can benefit from moving beyond exhortations for businesses to take stakeholder and socially responsible objectives into account and focus instead on how the interests of nonowner stakeholders, and broader social issues, are best promoted. To draw a parallel with the entrepreneurship literature: entrepreneurship is clearly important for society, but not everyone wants to be an entrepreneur, is good at entrepreneurship, or should be an entrepreneur. Likewise, a dynamic, competitive, innovative market system provides huge social benefits, but not everyone wants to, is good at, or should be an owner of productive assets, bearing ultimate responsibility for decisions about the use of these assets under uncertainty.

NOTES

1. For an overview of the early discussion see Daily, Dalton, and Cannella (2003).
2. http://www.anardarko.com
3. htttp://www.lego.com
4. The underlying ethical issues are both deontological and utilitarian. The stakeholder approach is sometimes seen as a business ethics perspective in its own right (e.g., Lopez-de-Pedro & Rimbaud-Gilambert, 2012).
5. Klein et al. (2017) point out that which stakeholders are enfranchised, *de facto*, may differ from those with formal, *de jure* claims to residual decision authority, due to custom, enforcement, etc.
6. A basic problem of using employment as a criterion for firms is that it excludes the phenomenon of one-person firms, which are highly important, empirically.
7. Admittedly, the latter question is unabashedly utilitarian in nature, and if one rejects (one of the many variants of) utilitarianism, our refocusing effort is less successful.
8. It is entirely conceivable that from a nonutilitarian moral position, ownership of such assets may mean that the firm assumes neighborly responsibilities. However, this lies outside of this essay. And, assuming such responsibilities still doesn't imply that owners of specific assets become owners of the firm.
9. In the limit, if we include all members of society in the set of relevant stakeholders, we no longer have a market-based economy, but a socialist economy which – as famously demonstrated by Mises (1920) and Hayek (1945), among others – has no means of allocating resources efficiently.
10. In Cook's (1995) terminology, patron-owned firms suffer from a unique set of free-rider, horizon, portfolio, control, and influence-cost problems, all resulting from the core issue of "vaguely defined property rights."
11. Other economists argued for more realistic descriptions of behavior (Cyert & March, 1963; Williamson, 1964) and institutions (Hutchison, 1956) or for different kinds of abstractions (Rothbard, 1957).
12. This use of the firm's resources would not typically fall under the business-judgment rule.
13. Specifically, Matsusaka (2017) suggests that corporate law "permit non-value-maximizing policies that are explicit when the company goes public, but require managers to gain shareholder approval before they initiate new actions to advance non-value goals. In terms of the pursuit of nonpecuniary objectives, such a rule would be more expansive in some respects and less expansive in other respects. It would be more expansive by allowing managers to explicitly pursue nonfinancial objective and not be in violation of their fiduciary duties when shareholders give the green light. It would be more restrictive in that a variety of current practices, such as charitable contributions, could not be pursued by managers acting unilaterally, but would require shareholder approval in the future."

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