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Does Stakeholder Management have a Dark Side?

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ABSTRACT. This article is a first attempt to line out the conditions under which executives might have a real self-interest in pursuing a broad stakeholder management (SM) orientation to enlarge their power. We suggest that managers have wider latitude of action under an SM approach, even when this is instrumental to financial performance. The *causally ambiguity* of the performance effects of idiosyncratic relationships with stakeholders not only makes SM strategy difficult for competitors to imitate but also increases managerial discretion. When managers use this situation for their own benefit, they can undermine the purported goals of the SM approach. By analyzing some of the factors that might lead to such disfunctionalities, this article advances a theory of the potential *dark side* of SM.

KEY WORDS: causal ambiguity, corporate governance, managerial discretion, stakeholder management, stakeholder theory

Introduction

Recent scandals surrounding the downfall of firms such as WorldCom, Parmalat, and Enron and, more recently, the indictment of South Korean Samsung Chairman Lee Kun-Hee for tax evasion and breach of trust have sparked fresh debates on ethics and whether it can coexist with strategies designed to boost performance in highly competitive business environments (Robertson, 2008). Outraged by excessive self-indulgence, the public is appealing to corporations to do more than amass shareholder wealth and is calling for corporate social action.

Stakeholder theory is the natural forum in which management scholars can address these calls, since it holds that such a convergence, or symbiosis, between strategy and ethics is possible if the needs of a vast array of constituencies are taken into account (for a recent discussion, see Agle et al., 2008). Indeed, a central question in stakeholder management (SM) – broadly defined here as the process of managing the expectation of anyone that has an interest in a firm or will be effected by its deliverables or outputs – is how to balance the economic interests of the firm against the ethical and social concerns of stakeholders (Margolis and Walsh, 2003; Reynolds et al., 2006).

According to the normative view (Donaldson and Preston, 1995), the firm should consider and balance relevant interests of stakeholders beyond a strict economic calculation; by doing so, managers will act ethically (Jones and Wicks, 1999; Reynolds et al., 2006). On the other hand, proponents of the instrumental view (Berman et al., 1999; Hillman and Keim, 2001; Jones, 1995; Waddock and Graves, 1997) maintain that an ethical posture of this kind will also be instrumental to firm performance (Berrone et al., 2007) in that the firm will obtain economic benefits by addressing the demands of salient stakeholders (Mitchell et al., 1997) and behaving in a responsible way. For instance, Jones (1995, p. 422) suggests that "firms that contract with their stakeholders on the basis of mutual trust and cooperation will have a competitive advantage over firms that do not." In this vein, building relationships with stakeholders on the basis of ethical standards and behaving accordingly is a way to build a reputational resource, which ultimately will affect the bottom line of the firm.

Many authors (Aragón-Correa and Sharma, 2003; Buysse and Verbeke, 2003; Jones, 1995; Sharma et al., 1998; Waddock and Graves, 1997) have argued for a positive relationship between SM and the firm's competitive standing, the main argument often being that SM is a way to secure or develop superior

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resources. Higher reputation and social legitimacy are the clearest, and perhaps the most important, examples of such resources. The same complexity, uncertainty, and poor understanding of means-ends linkages in SM that engender causal ambiguity can also help to sustain competitive advantage by creating imitability barriers for rivals (Barney, 1991; Hillman and Keim, 2001; Lippman and Rumelt, 1982; Reed and Defillippi, 1990). This view has been, however, contested by other scholars (Argenti, 1993; Jensen, 2001, 2002; Sternberg, 1997), and the mixed empirical results on the SM–financial performance relationship have further stimulated the debate.

At the heart of this debate lies the role of managers. Existing SM literature generally assumes that managers have a moral obligation toward stakeholders and acts ethically by using their power in the stakeholders' interests (Aragon-Correa et al., 2003; Sharma, 2000). This may not always be the case. We concur with Greenwood (2007) that SM is morally neutral – engaging stakeholders and committing to them does not automatically imply a responsibility of the firm to act in their interests: A stakeholder-committed organization may still act out of self-interest. Some authors, mostly notable Jensen (2001, 2002), have taken the extreme position of considering a holistic stakeholder approach detrimental to the firm's value and performance as this would empower managers with unconditional discretion. Jensen's main argument (2001, 2002) is that when managers aim at the multiple objectives defined by different stakeholders' claims, they cannot be held accountable because of the trade-offs among these objectives (for a detailed discussion of Jensen's approach, see Windsor, 2002). As Jensen maintains, ''multiple objectives is no objective'' (2002, p. 10). The suggested solution is therefore to define a single-valued objective function (the enlightened value maximization) to which stakeholders' interests are subordinated (Windsor, 2002). This will put structure to executive decision making and constrain managerial discretion to more objective assessment.

We build on and expand this logic noticing that managers can still enjoy wide, unconditional discretion under a single-valued objective function. When the objective of the firm is to generate long-term value, for which SM is instrumental, the interdependence of SM practices and their effects on performance are causally ambiguous. This ambiguity is a primary source of managerial discretion – latitude of action (Hambrick and Finkelstein, 1987). Yet, wider discretion cannot be automatically conceived of as harmful for firm performance, as evidence of the contrary also exists. A case in point is Goll and Rasheed's (2004) findings, which suggest that social performance and SM–corporate performance effects are greater in contexts where managers have broader latitude of action. This is in line with Hambrick and Finkelstein's theory (1987) suggesting that managers can contribute more to firm performance precisely in contexts where they have greater latitude of action.

The effect of SM on firm performance ultimately depends on how such discretion is used. When managers exercise their enlarged power in the interest of the organization and its stakeholders, SM is likely to enhance performance; when this discretion is employed for self-serving interest, the social standing and financial performance of the organization may be affected negatively. In this article, instead of taking a stance in either of these two polar positions regarding the use of discretion, we explicitly ask under what conditions managers are most likely to use this wider discretion for self-interested behavior – an unpleasant and unethical effect we term SM's *dark side*. While we agree that a SM strategy entails certain benefits (such as good reputation, legitimacy, and the like), we argue that existing SM literature focuses mainly on its ''bright side,'' ignoring the potential costs and risks associated with its implementation (Heugens and Dentchev, 2007).

We argue that the SM–performance causal ambiguity has a dark side, in the sense that it also prevents the focal firm's managers from leveraging resources for competitive advantage (King and Zeithaml, 2001; Powell et al., 2006). The firm has limited information about stakeholders' preferences and does not know accurately how those preferences relate to corporate reputation and, ultimately, performance. Second, what matters to some members of a stakeholder group might not be significant to others, so conflicts are an inevitable mechanism through which coalitions compete to resolve internal inconsistencies and establish what the group should pursue (Coff, 1999; Cyert and March, 1963; Eisenhardt and Zbaracki, 1992; Narayanan and Fahey, 1982). This accentuates the tension between the ethical and managerial concern about who should have consideration and

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how, at the strategic level. Finally, stakeholders' preferences are not absolute, but relative (Buysse and Verbeke, 2003), and they are not stable. Buysse and Verbeke (2003), for instance, argue that stakeholder salience changes frequently and depends on individual issues, which are likely to change across time, a finding confirmed by Parent and Deephouse's (2007) study on stakeholder identification. This makes stakeholders' desires irrelevant *per se*; they become strategically salient only when brought to top management's attention (Dutton and Ashford, 1993; Mitchell et al., 1997). All these elements together transfer greater discretion to managers.

Our work contributes to stakeholder theory by providing a complementary perspective on the potential hidden costs of SM. We draw on corporate governance literature and the notion of causal ambiguity and argue that the latter can make moral hazard more likely to manifest itself (Carson et al., 2006; Coff, 1999; Ouchi, 1980). Under ambiguity, managers can gain unconditional discretion (Hambrick and Finkelstein, 1987), since control mechanisms are likely to be ineffective given the uncertainty of task programmability and outcome measurability (Eisenhardt, 1989). This logic is consistent, for instance, with Jensen's argument (2001, 2002). Since the ambiguity surrounding stakeholders' preferences and SM–performance linkages provides managers with wider discretion over the firm's operations and weakens the constraints of control mechanisms, executives *might* have a real (self-)interest in pursuing a broad SM orientation to enlarge their power. They can, accordingly, use SM to change the power structure within the firm and reinforce their dominant position (Coff, 1999). This article is a first attempt to line out the conditions under which this incentive is higher and advances a theory of the potential dark side of SM.

Our article does not attempt to reject SM theory. On the contrary, by examining the potential hidden costs and related unethical consequences that this perspective entails, we offer research propositions with the intention of stimulating inquiry into such issues. We consider this analysis necessary to further develop stakeholder theory, for only when benefits *and* costs are fully weighed can one assess the true contribution of a strategy from both a socio-ethical and an economic perspective. Regarding economic implications, our conclusion is that traditional governance mechanisms may be insufficient to overcome the costs and risks of SM practices. As a consequence, an SM approach may fail to provide the expected benefits when managers abuse the unconditional discretion and power they enjoy in these contexts. From a business ethics point of view, our article points to the following complex trade-off: Should firms engage *all* stakeholders – as implied by the normative stakeholder view – so widening managers' discretion with the potential risks this implies, or should they limit these negative implications by restricting attention only to those stakeholders with a clear and measurable link to performance – as suggested by the instrumental view?

The remainder of the article is structured as follows. In the next section, to provide a background, we review the literature on causal ambiguity and integrate it with SM. Next, building on this integrated framework, we present our research propositions about the dark side of SM. The article concludes by considering implications for future research in the strategic–economic and business ethics field.

Stakeholder management and causal ambiguity

According to the instrumental stakeholder theory, all other things being equal, a firm that systematically considers all stakeholders' interests can outperform rivals (Freeman, 1984). However, empirical tests are far from conclusive (Margolis and Walsh, 2003; Waddock and Graves, 1997). A fundamental problem in SM is how to define and identify relevant stakeholders (Parent and Deephouse, 2007).

Mitchell et al. (1997) review different approaches to the subject and propose some rules. Essentially, to have its claims heard, a stakeholder must be salient to managers; to be salient to managers, it must have power, legitimacy, and urgent claims. This is how a manager knows ''who really counts'' among stakeholders. Moreover, managers should have enough discretion to decide which claims to accommodate and which interests to pursue in particular contingencies. Since stakeholders' salience is endogenous, context dependent (Buysse and Verbeke, 2003) and changing over time (Mitchell et al., 1997; Parent and Deephouse, 2007), salient stakeholders cannot be defined ex-ante (Hall and Vredenburg, 2005) and

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the causal relation with the firm's performance is difficult to establish. This, in turn, makes it difficult to design SM practices to properly manage stakeholders. In this regard, Hall and Vredenburg maintain that ''although much management literature represents stakeholder engagement as a panacea for a variety of ills and a means of accessing untapped opportunity, [it] is difficult to manage because it is idiosyncratic and context-specific'' (2005, p. 11).

Strategic management studies have generally framed causal ambiguity within the resource-based view of the firm (King and Zeithaml, 2001; Lippman and Rumelt, 1982; McEvily et al., 2000; Mosakowski, 1997; Powell et al., 2006; Reed and Defillippi, 1990). When the firm's resources and capabilities are tacit, complex, and specific, rivals cannot assess how these resources cause superior performance (Barney, 1991; Peteraf and Barney, 2003). Thus, causal ambiguity can be conceived of as an isolating mechanism that creates effective barriers to imitation (Reed and Defillippi, 1990). This argument rests ultimately on the assumption that causal ambiguity is asymmetric: the focal firm understands the link between its competencies and performance better than its rivals do.

Divergent stakeholders' interests, difficulty in individualizing and addressing stakeholders' salience and claims, and uncertainty in establishing idiosyncratic and trustable relationships explain why, once formed, these relationships may become hard-to-imitate resources and give the firm an advantage. Hillman and Keim (2001), for instance, claim that only when social practices are complex and hard to imitate do they provide the firm with valuable resources that can affect performance positively. On the same ground, Sharma and Vredenburg's (1998) study offers evidence that companies can improve their economic value via SM when SM provides opportunities to develop firm-specific resources and capabilities. When complex and valuable capabilities are developed through SM practices, the focal firm may understand the link between those practices and the bottom line. Ambiguity about means-ends linkages can then help sustain the SM-based advantage of the focal firm (Aragon-Correa et al., 2003) by reducing rivals understanding and their ability to imitate these practices (Barney, 1991; Lippman and Rumelt, 1982; Reed and Defillippi, 1990) and acquire the underlying resources and capabilities.

Yet, casual ambiguity masks certain drawbacks. Even Reed and Defillippi stated that ''ambiguity may be so great that not even managers within the firm understand the relationship between actions and outcomes. [In those circumstances] it may be impossible to utilize competencies for advantage'' (1990, pp. 90–91). Szulanski (1996), King and Zeithaml (2001), and McEvily et al. (2000) hold a similar view and find that causal ambiguity also impedes the internal diffusion and creation of resources and capabilities. Furthermore, in a causally ambiguous environment, managers could overestimate their own abilities and the firm's capabilities and neglect competitors' qualities, harming sustainable performance in the long run (Powell et al., 2006). Keeping these ideas in mind, it is reasonable to assume that if the relationship between SM and firm performance is loose (Bird et al., 2007; McGuire et al., 2003), executives may easily misattribute importance to courses of action that, in fact, may have no effect at all on the successful implementation of SM. Moreover, if stakeholder groups are divergent in their interests (Margolis and Walsh, 2003) and executives' perception of those interests is highly ambiguous (Hall and Vredenburg, 2003, 2005), executives will be very uncertain about the relative importance of strategic factors.

At the same time, rather than restricting their latitude of action (Hambrick and Finkelstein, 1987), this uncertainty and the ambiguity surrounding SM in general will expand managerial discretion and control over the firm's operations (Jensen, 2001). Owing to this condition, the design and implementation of SM practices are ultimately shaped by the CEO's vision and beliefs. Moreover, if managers experience this ambiguity, board members and other influential stakeholders (e.g., large shareholders) are likely to face it too. Their power to monitor the CEO's decisions and actions may be reduced, tipping the balance of power in favor of the CEO. *When* managers use this power opportunistically, commitment to SM may mask self-interested behavior rather than responsibility and an ethical concern for stakeholders: the dark side of SM may likely manifest. We develop these arguments and offer our research propositions in the next section. Figure 1 provides a graphic representation of the proposed extended model.

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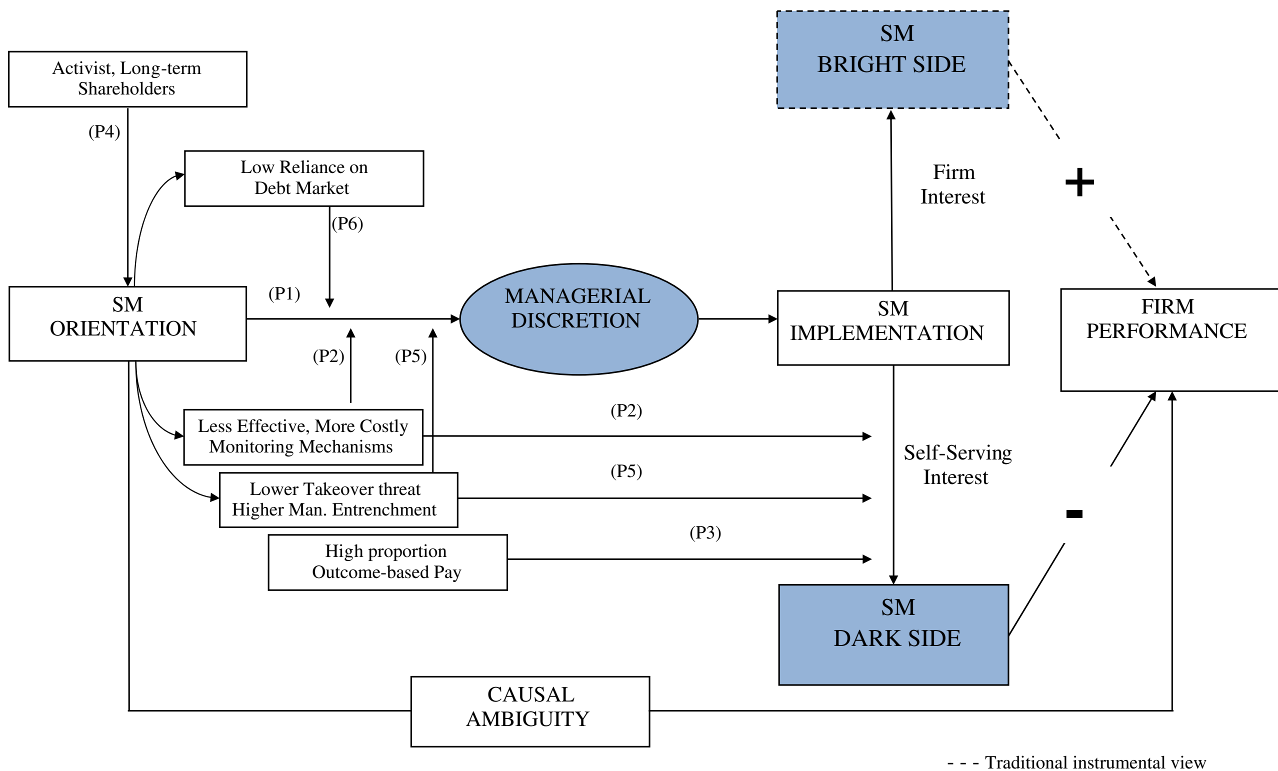

Figure 1. The SM extended instrumental model.

The dark side of stakeholder management

Given the uncertainty of task programmability and outcome measurability (Eisenhardt, 1989), managers' actions are not confined to carrying out a specific task and their performance is not measured by a fixed benchmark (Jensen, 2001, 2002). Under SM they have more options, so they need greater managerial discretion, as it is unclear which option will produce the best results. The range of possible actions, both substantive (e.g., resource allocation) and symbolic (e.g., language and personal actions aimed at altering or reinforcing standards, norms, and values), is indeed greater under SM.

Managerial discretion and power

Hambrick and Finkelstein (1987) identify organizational legitimacy, internal political conditions, managerial power base, and tolerance of ambiguity as key determinants of managerial discretion. As SM is aimed, among other things, at increasing the firm's legitimacy, engaging in SM may allow executives to broaden their discretion. When internal political control is in the hands of powerful shareholders or a group of non-share-owning stakeholders, managers are constrained to act only in ways these groups accept. However, the ambiguity inherent in SM and the relatively wider discretion it requires may offer managers unparalleled opportunities to change the power structure within the firm and create or reinforce a dominant position (Coff, 1999) within the firm–stakeholder network. Once a CEO gains credibility among stakeholders, it is more likely that the ambiguity of the cause–effect relationships will be resolved in favor of the CEO's personal responsibility for the firm's performance (Hayward et al., 2004; Wade et al., 2006). When a CEO enjoys a central position within the stakeholder network due to her commitment to SM practices, stakeholders will generally have positive perceptions of the CEO's capabilities and are likely to attribute merits to her, while failure will be attributed to external factors and contingencies. Accordingly, the CEO is able to internalize success, further increasing her prestige among stakeholders, who will consequently

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"grant the CEO greater control over organizational activities and decision processes" (Hayward et al., 2004, p. 645).

Moreover, the uncertainty regarding the causal link between events and outcomes can actually stimulate the need for a charismatic or *romanticized conception* of leadership (Meindl et al., 1985). Several options for managing stakeholders are available, but none stand out ex-ante as the best. By dealing with this uncertainty, the CEO can play a charismatic role (and be perceived as a charismatic leader) in supervising, designing, and implementing the firm's SM orientation. All this will further strengthen the CEO's powerful central position in the firm–stakeholder network. Such a manager "faces only limited barriers in exercising discretion because, by force of personal reputation, he or she is able to act where many others would not even get the opportunity" (Hambrick and Finkelstein, 1987, p. 388). When managers can influence stakeholders' opinions – for instance, by co-opting the business press to gain "celebrity status" (Hayward et al., 2004) or gaining financial analysts' endorsement (e.g., Farrell and Whidbee, 2002, 2003) – they may create an exaggerated perception of their own value, further increasing their discretion and power. These arguments suggest that managers might have wider latitude of action under an SM approach, even when such approach is instrumentally aimed at enhancing performance. Expanding Jensen's idea (2001, 2002), we formally propose the following:

Proposition 1: Managers enjoy higher power and discretion in firms committed to SM.

Control mechanisms

As argued above, the enhancement to a firm's reputation deriving from SM strategy has an ambiguous link to the firm's performance function, making it hard for competitors, but also for insiders, to understand the firm's source of superior performance (King and Zeithaml, 2001). In ambiguous strategic contexts, uncertainty about the courses of action is very high, making it more difficult to unequivocally evaluate a manager's impact on and responsibility for firm performance (Powell et al., 2006). For these reasons, control mechanisms may be less effective and more demanding in terms of resources and information needed to overcome the aforementioned ambiguity.

Employees' and managers' effort can be diverted from an organization's objective when the link between the two becomes less clear (Barney and Hesterly, 1996). When cause–effect relationships are difficult to establish, it is hard to judge how much of an outcome is due to the agent's effort and capabilities and how much is affected by unpredictable events and external factors. In those circumstances, the opportunity for the agent to pursue self-interest without being sanctioned increases (Carson et al., 2006; Ouchi, 1980). When the contribution of the employee cannot be assessed unambiguously, opportunism will go unnoticed (Ouchi, 1980). When this is the case, an unethical agent could exploit the circumstance and "free-ride." Carson et al. (2006) find that the likelihood of opportunistic behavior is higher under ambiguity since it limits the detection and control of opportunistic behavior. This is a general problem that may arise when undertaking commitments under bounded rationality, unforeseen events, and unclear cause–effect linkages (Sacconi, 2007).

Moreover, the principal may be reluctant to sanction the agent because of the lack of appropriate information (Carson et al., 2006). Because of the causal ambiguity of the SM–performance relationship, the board of directors faces a higher informational disadvantage in understanding and monitoring management actions (Finkelstein and Boyd, 1998). In fact, the board will have dubious information even ex-post, after observing the outcome. If management decisions can be causally linked to performance consequences (i.e., the outcome) with little uncertainty, causal ambiguity would be absent. To overcome the problem, directors need to acquire more information and put in place more control systems or fortify those already established. Hence, bureaucratic and monitoring costs rise – perhaps to no purpose, given the difficulty of unequivocally assessing management's faults when performance's consequences of a strategy are highly ambiguous, like in the SM case. Formally stated,

Proposition 2: Monitoring mechanisms are less effective and more costly for firms that are committed to SM.

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Outcome-based compensation and firm risk

Long-term outcome-based compensation has been proposed as an adequate indirect control mechanism as it provides CEOs with implicit incentives to focus on activities and strategies that enhance the long-term value of the company, hence the underlying value of its stock (Tosi et al., 1999). Moreover, since one of the limits to the promotion of a stakeholder society rests on CEOs' low extrinsic incentive to commit resources to practices that have no visible results in the short term, this pay scheme, by enlarging CEO's horizon, has also been suggested as in line with stakeholders interests (Kane, 2002).

Notwithstanding the potential incentive value of such mechanisms, it is our contention that they are not suitable for aligning managers' interests with those of stakeholders and are to some extent detrimental to the social standing of the firm. The reason for this is twofold: excessive risk propensity, including an increase in fraudulent activities, and stakeholders' perception of high compensation levels as unethical practices, which might damage the firm's reputation and relationships with stakeholders.

Research has shown the potential negative effects this incentive scheme can have on managers' behavior: what some authors have termed the ''perverse incentives'' (Deyà-Tortella et al., 2005). Heavy use of stock-based compensation may induce managers to take more optimal risk when expecting sure losses in their underlying stock value (Deyà-Tortella et al., 2005) and manipulate accounting figures (Zangh et al., 2008). Prior studies (Denis et al., 2006; O'Connor et al., 2006) find a direct association between large option-based managerial pay and the likelihood of fraud allegations, concluding that there is a dark side to incentive compensation. This point is stressed by Zangh et al., who state that such incentive ''may not always be effective in aligning the interests of CEOs and stakeholders. Rather, they may actually encourage the pursuit of self-interest'' (2008, p. 242).

As Cennamo notes, ''this riskier posture is not consistent with a SM approach'' (2008, p. 107). Stakeholders make specific investments into the firm (Etzioni, 1998) and are interested in securing part of the quasi-rents generated as a result of their relationships with the firm (Sundaram and Inkpen, 2004; Zingales, 1998). Accordingly, they might likely favor conservative or risk-averse strategies. The excessive risk propensity stock-based compensation may cause would be contrary to the interests of the majority of stakeholders, who are rather risk averse. This can lead to inconsistencies in SM strategies, destabilize relationships with stakeholders, and ultimately cause the firm's corporate social standing to deteriorate (Cennamo, 2008). To visualize this, it is sufficient to think of the negative effects on the ethical standing and reputation of a firm whose managers are accused of manipulating accounting figures or engaging in short-term trading merely to boost the value of the stock to which their compensation is linked. There is scant research on the compensation–corporate social performance (CSP) relationship (Berrone, 2008). Existing empirical studies, however, seems to suggest that this relationship is indeed negative. Mahoney and Thorne (2005) and McGuire et al. (2003) provide evidence that higher levels of stock-based compensation are negatively correlated with CSP.

At the same time, outcome-based compensation levels in SM-committed firms may be higher, giving rise to negative stakeholder perceptions of the firms' ethical position. Firms engaging in SM are likely to be characterized by highly politicized decision-making processes (Jensen, 2002), in which multiple, possibly conflicting stakeholders' interests must be systematically considered. This constitutes a more complex, uncertain, and risky environment that is more difficult to manage. Indeed, in uncertain environments, executives must cope with less predictable outcomes. When managers are compensated mainly on an outcome basis, the firm's risk and uncertainty are transferred entirely onto managers (Eisenhardt, 1989). Managers will then require higher compensation for bearing this greater risk and for the capabilities and effort required to manage the complex environment (Finkelstein and Boyd, 1998). In ambiguous and high-discretion contexts, managers will in fact ''earn more than their counterparts in low-discretion firms because higher pay levels are needed to compensate these CEOs for bearing this greater risk'' (Finkelstein and Boyd, 1998, p. 181).

It will be more costly, therefore, to provide managers with the right incentive to manage the ambiguity SM entails. These higher levels of managerial compensation might be perceived by stakeholders as unethical practices and will eventually

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have a negative impact on SM implementation and the corporate social standing of the firm as a whole. On this ground, Jones (1995) contends that excessive executive compensation harms relationships with stakeholders and breaches the underlying implicit contract. This is so because stakeholders will perceive it as incompatible with the ethical values on which the contract with the firm is based and as an abuse of their trust.

The foregoing arguments suggest that heavy use of outcome-based compensation can harm SM implementation and the social standing of the firm because of high executive risk bearing which may foster real or perceived unethical practices (e.g., earnings manipulation and excessive compensation levels). Formally stated,

Proposition 3: Heavy reliance on outcome-based compensation plans weakens the SM implementation process by increasing executive risk bearing, firm risk posture and stakeholders' perception of firm's unethical practices.

Ownership concentration and managerial power

Numerous studies (among others Daily and Dalton, 1994; Graves and Waddock, 1994; Grossman and Hart, 1986; La Porta et al., 1999; Neubaum and Zahra, 2006; Ryan and Schneider, 2002) have analyzed the impact of the concentration and composition of a firm's ownership. One of the core ideas in this stream of research is that the more diffuse ownership is the less shareholders will be able to influence and control managers. A straightforward prediction is that in firms with diffused ownership, agency problems will be more pronounced because managers enjoy higher discretion and power (e.g., Berle and Means, 1932). As they already have power and control over the firm's operations, they might not have ''dark'' incentives in implementing SM strategies. Nonetheless, this subtle incentive may still be present. The ambiguity surrounding SM will further weaken the firm's control mechanisms (as per Proposition 2). SM can still be an incremental way for managers to maintain and secure their existing power.

The incentive is stronger, however, when managers' actions are constrained by the preferences of influential owners and tight control. While in firms with diffused ownership managers may hold unconditional discretion, this is unlikely to be the case in closely held firms. Controlling shareholders are influential, and in countries such as Italy, Spain, or Germany, they usually sit on the board of directors (La Porta et al., 1999). They can therefore be very active in their monitoring task, question managers' decisions, and actions and influence the firm's strategy according to their own vision and preferences. When control is tight, executives have limited latitude and so may seek discretion in other organizational areas (Hambrick and Finkelstein, 1987) or through persuasion and ingratiation tactics (McDonald and Westphal, 2003; Westphal, 1998). SM may be one such other area and serve the executives' purpose very well.

Not every large shareholder is an active monitor, however (Hoskisson et al., 2002; Ryan and Schneider, 2002). Some significant shareholders may have no incentive to exercise their vote, finding it more efficient to liquidate their position via the stock market – the ''Wall Street Walk'' (Ryan and Schneider, 2002). These shareholders are usually professional investors, such as mutual funds, with a short-term focus on financial performance, which they ''fine-tune'' by continuously adjusting their portfolio. Ryan and Schneider (2002, p. 560) maintain that these investors ''tend to rely on market forces rather than influence as the means of improving fund performance'' and are less likely to question directly the management (i.e., exercise voice) than investors with longer investment time horizons and mixed financial and nonfinancial performance expectations, such as public pension funds.

These arguments suggest that we should expect activist tight control when ownership is concentrated in the hands of shareholders with long-term investment horizon and mixed (social and financial) performance expectations (Ryan and Schneider, 2002). Given these mixed preferences and their long-term focus, such shareholders may have a strong interest in SM as a value-enhancing strategy and a risk-reducing measure (Graves and Waddock, 1994). Accordingly, they may be more willing to provide managers with the necessary discretion to implement a SM strategy.

Institutional investors such as pension funds are one type of activist influential shareholder with a long-term investment horizon (Johnson and

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Greening, 1999; Ryan and Schneider, 2002). Graves and Waddock (1994) argue that these investors may consider CSP as a risk-reducing measure and favor it, *ceteris paribus*. Johnson and Greening (1999) present a similar argument and find that pension funds appeared to induce firms to assume a more responsible position on environmental and people issues. Neubaum and Zahra (2006) find a significant and positive relationship between long-term institutional ownership and CSP. Evidence from these studies also shows, consistent with the arguments presented above, that other types of institutional investors, such as investment and mutual funds, are not always interested in improving SM practices but are more oriented to short-term financial results. Moreover, they tend not to directly influence managerial discretion, preferring to exit the investment.

Family ownership is a shareholder typology that also matches the characteristics of long-term investment horizon and mixed (social and financial) performance expectations. Family firms – firms in which ownership is concentrated in the hands of family members – usually value dimensions other than financial performance (Schulze et al., 2001) and want to be well regarded in their local environment (Berrone et al., 2008a; Gomez-Mejia et al., 2001, 2007). For family-controlled firms, corporate reputation overlaps to some extent with the family's image and reputation (Berrone et al., 2008a) and is part of what Gomez-Mejia et al. (2007) have called "socioemotional wealth." Wealth concentration and the desire to preserve this socioemotional capital can induce firms with family ownership concentration to adopt a broad stakeholder orientation as a way to build strong relationships with stakeholders to support the firm's reputation and provide the sort of continuity these shareholders are looking for.

In summary, firms with higher ownership concentration held by long-term oriented and activist shareholders may show higher levels of SM orientation. This, obviously, need not be considered a negative outcome *per se*. However, if there is ambiguity about the causal link between managerial actions toward stakeholders and (social and financial) corporate performance, the control power of these shareholders is diluted; agent opportunism may manifest via SM practices. The higher SM orientation may in part reflect the (unethical) intention of managers to use SM in order to enlarge their discretion and alleviate the tight control of main shareholders (e.g., Cespa and Cestone, 2007). This subtle incentive may indeed be the "true" or major managerial motive for engaging in SM practices. Managers have, in fact, a strong interest in adopting a broad SM approach and persuading large shareholders of its value and relevance. As argued above, causal ambiguity about SM–performance linkages weakens control mechanisms (as per Proposition 2), widens the CEO's discretion and power (as per Proposition 1), and may lead to an increase in managerial compensation for coping with the more complex environment (see arguments preceding Proposition 3). Firms with large, activist, long-term-focused shareholders may adopt a broad SM orientation, which enlarges managers' discretion and gives them opportunities to pursue their personal agenda. Formally stated,

Proposition 4: Managers in firms with ownership concentrated in the hands of activist, long-term-oriented investors are more likely to

(a) adopt a broad SM orientation, and
(b) as a consequence, gain a wider discretion.

External control markets

Besides internal mechanisms, there are three external systems for controlling agency problems: the stock market, the market for corporate control (takeovers), and the labor market. The stock market, by pricing common stocks and transferring them at low cost, exerts pressure to orient corporate decisions toward the interests of residual claimants. A similar effect is produced by takeovers (Jensen, 1986): when managers are not acting on behalf of principals, the latter can circumvent existing managers and the board by a direct offer to purchase stocks or by campaigning to elect new directors. The job market, by properly reflecting the value of human capital, is said to induce managers and external directors to provide the "optimal" effort, knowing that their personal market value depends on their past and current performance (Fama, 1980; Jensen and Meckling, 1976).

Of particular importance is the takeover market since it is the one that represents the greatest threat to a manager's continuity in the firm (i.e., it

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increases the employment risk). An inefficiently managed firm is generally undervalued on the stock market and could be an investment opportunity for external investors, who might bid for the company at a price higher than the current one but less than its potential value. Consequently, they can eventually restructure the firm and pursue more profitable activities in order to generate a surplus on their initial investment (the takeover bid). Takeovers are generally seen as positive by shareholders, who are paid a higher price than they would get under the current management. But, for managers, the takeover represents a threat to their jobs and benefits.

As in any takeover, managers will try to persuade the board and shareholders that the offer does not reflect the true potential value of the firm; given the information asymmetry between agent and principal, in some cases managers' allegations may be successful. In the case of firms adopting an SM strategy, they are more likely to succeed in their attempt. Owing to the ambiguity regarding the SM–performance relationship, managers have an easier task in convincing shareholders that the stock market does not fully reflect the value of this strategy (for a discussion and analysis of what social practices are valued and recognized by the stock market, see Bird et al., 2007). Second, the takeover will impair the implementation of the SM strategy and thus destroy existing value. Changes in ownership and management may disrupt the established implicit contracts with stakeholders, who may lose confidence in the mutual commitment. Moreover, since stakeholders may see their firm-specific investments at risk under the potential change in ownership and management and may therefore be against the takeover (Cespa and Cestone, 2007; Schneper and Guillén, 2004), managers and stakeholders can successfully coalesce to fend off the bid. In various cases, the law encompasses constituency statutes or a series of norms that allow the board of directors to consider non-shareholder interests in specific situations, such as takeovers or restructuring decisions (for a comprehensive review on the topic see Springer, 1999). This provides a way for executives and board members to converge on stakeholder interests rather than prioritizing only shareholders' claims. As a case in point, in large German firms – usually mentioned as exemplars of the stakeholder-centered model – a system of codetermination is in place, in which employees elect half of the members of the supervisory board. One of the main duties of the supervisory board is to select and supervise the managing board. Since employees' interests – which generally are not well served by corporate reorganizations and the ensuing disruption (Schneper and Guillén, 2004) – are directly represented at the apex of the corporation by board members, in SM-committed firms executives can more easily endorse these interests over those of shareholders to oppose hostile takeovers.

Indeed, Schneper and Guillén (2004) find that, even under inefficient management, firms with strong stakeholder orientation are more likely to defy a takeover. Therefore, takeovers may be less likely to succeed when the targeted firm has adopted an SM strategy and so may lose their monitoring force. Managers can therefore leverage this situation to consolidate their position within the firm and remain in office (Cespa and Cestone, 2007; Surroca and Tribó, 2008). Formally stated,

Proposition 5: External market control is less effective for firms committed to SM. In particular,

(a) Takeover bids for firms with a broader SM orientation are more likely to fail.
(b) Management is more likely to become entrenched in firms with a broader SM orientation.

Jensen (1986) notices that a conflict of interest arises between shareholders and managers when organizations generate free cash flows but have low growth prospects. ''In these organizations the pressures to waste cash flows by investing them in uneconomic projects is most serious'' (Jensen, 1986, p. 324). Jensen also suggests that firm debt limits managers' discretion to use free cash flow, while the threat of failure to make debt service payments pushes organizations to be more efficient. Hence, debt plays an important role in controlling managerial power and discretion. Debt financing is also desirable from a shareholder perspective as it increases firm value by providing a tax shield and by reducing the free cash flow (Morellec, 2004). The disciplining and value-enhancing effects must, nonetheless, be weighed with the hidden costs of debt; among others, higher expected bankruptcy costs. The

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primary objectives of firms with high debt are efficiency (cost reduction) and financial performance (value-enhancing activities), which may be achieved by various means, including massive restructuring, lay-offs, investment cutbacks in R&D, stakeholder benefits and social spending, and the like.

However, for firms committed to SM many of these possibilities are not available, unless the firm is willing to breach implicit contracts with stakeholders and jeopardize firm–stakeholder relationships. Stakeholders directly affected by the restructuring changes will obviously manifest high resistance and disappointment at the firm's behavior. This attitude might be echoed also by other stakeholders, who will fear for their firm-specific investments. The higher default risk implicit in the debt-leverage is at conflict with risk-averse stakeholders. Executives facing such conditions are unwilling to take unpopular decisions such as firing or closing offices/plants, first because they have to cope with stakeholders' protests and second, and most importantly, because they will lose the support of the stakeholders and, with it, the discretion and power they might enjoy otherwise.

In firms committed to SM, the internal political environment, the need for consistency in the commitment to stakeholders and SM practices, and executives' private concern not to lose stakeholders' support and their own discretion will reduce the firm's reliance on the debt market, and, with it, the efficiency that the financial pressure of debt is said to encourage. Although it might be optimal for shareholders to increase leverage in order to constrain managers' opportunities to follow personal objectives (Morellec, 2004), efficiency and financial performance could be perceived as secondary to stakeholders' needs in SM committed firms. Morellec (2004, p. 258), for instance, shows that when managers do enjoy higher discretion over firm policies, "firms will issue less debt than optimal." Accordingly, we predict the following:

Proposition 6: Managers in firms committed to SM,

(a) are less likely to rely heavily on the debt market, and
(b) as a consequence, experience lower constraints to their discretion relative to peers in high leveraged firms.

Discussion

Stakeholder theory's assumption that engagement and commitment to stakeholders will naturally translate into benefits for stakeholders and the firm is not straightforward (Greenwood, 2007; Heugens and Dentchev, 2007). Greenwood, for instance, mentions the possibility that "stakeholder engagement may be used…in an immoral way" (2007, p. 320). In this article we contend that unfavorable outcomes driven by opportunistic use of SM may arise due to the subtle incentives an SM strategy can provide to executives.

Taking stakeholders into account is a complex task that, when properly accomplished, may establish strong relationships with stakeholders, which, in turn, may help the firm acquire and/or build valuable capabilities and resources, most notably legitimacy, and reputation (Jones, 1995; Sharma et al., 1998). By contracting with stakeholders on an ethical basis, executives can accumulate corporate reputational capital, which will benefit the firm also in economic terms. Nonetheless, managers also have private reasons for pursuing a broad SM orientation. In short, we argue that the task complexity of stakeholder engagement and the ambiguous causal link between SM and the performance of the firm enlarge executives' field of action and power over the firm's operations, dilute control mechanisms, and may mask the CEO's opportunistic behavior under the guise of practices designed to safeguard stakeholders' interests (e.g., entrenchment interest in takeover defenses). This *dark side* of SM strategy complements the models presented in the stakeholder literature, which are mainly centered on the beneficial effects of SM. Our research propositions have several implications, both from a strict strategic–economic point of view and for research with a normative focus and for business ethics.

Strategic-performance implications

Once managers have secured the support of stakeholders via SM practices, they can use (and abuse) stakeholders' trust to pursue personal goals. This opportunistic behavior can go unnoticed because of the complexity and causal ambiguity SM entails.

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Nonetheless, when managers make an opportunistic use of SM, effort and organizational resources can be diverted from corporate goals, especially from financial objectives, to provide greater benefits to stakeholders, with the subtle aim of ''winning'' their support. The dark side of SM described here can be conceived of as a circular flow: managers engage in SM practices and expand firms' social concessions to stakeholders, who may pay back the manager by supporting her decisions (including highly contested decisions, such as anti-takeover amendments, perks, and the like). Though a higher stakeholder orientation may appear desirable from a normative point of view, when used opportunistically by managers, it is both unethical and detrimental to performance. This opportunistic stakeholder engagement will translate into social ''overinvestment,'' which may negatively affect the firm's resource acquisition and allocation process. Compared to other socially responsible firms that undertake ''optimal'' levels of investment in strategies devoted to stakeholder issues, the focal firm may face a disadvantage in terms of resource endowment and organizational flexibility and may find its long-term competitive standing is eroded.

A focus on the dark side aspect of the stakeholder model may at least partly explain the mixed results of the literature on the SM–firm performance relationship. Our model simply points out that SM can have hidden costs. It would be logical to expect that, if the costs exceed the benefits, SM can have a negative effect on firm performance. By contrast, when the costs are minimized, because of ethical use of discretion and power by executives, we see the bright side of SM, reflected in higher corporate social and financial performance. Future research needs to examine these conjectures in more detail and sketch contexts and contingencies, in both the external and the internal organizational environment, where this is more likely to be the case compared to conditions where the power imbalance is used to serve the CEO's self-interest.

Ethical implications

According to the normative view (Donaldson and Preston, 1995), the firm should consider and balance relevant interests of stakeholders beyond the strict economic calculation. This implicitly suggests that the more firms engage stakeholders, the better. By attending to stakeholders' claims through a broader SM orientation and SM practices, managers will indeed act ethically (Jones and Wicks, 1999; Reynolds et al., 2006). We have suggested here that in practice there may be exceptions to this assumption. As previously argued, stakeholder management ''is primarily a morally neutral activity'' (Greenwood, 2007, p. 325). Our model suggests that higher stakeholder engagement may also involve an opportunistic incentive on the side of management.

We have argued that managers can *legitimately* receive higher compensation in firms committed to SM for bearing the higher complexity, uncertainty, and causal ambiguity of such a strategy. Paradoxically, where SM is used opportunistically by executives, the firm would offer an incentive to managers for undertaking actions for which they already have a ''dark'' incentive. Thus, an unethical economic double cost can arise. Given the potential for abuse by managers, this incentive is not justified from an ethical point of view. Moreover, authors such as Jones (1995) have questioned high managerial compensation levels, since they are perceived as unethical practices by stakeholders and run contrary to the spirit of the stakeholder model. Few studies (for notable exceptions see Berrone and Gomez-Mejia, 2009; Coombs and Gilley, 2005; Mahoney and Thorne, 2005; McGuire et al., 2003) have analyzed the relationship between executive compensation and CSP. More research is required on the topic in order to separate out pure economic incentive effects of higher compensation from ethical determinants (Berrone et al., 2008b).

Another area that may be fruitful for furthering research on ethical concerns regarding SM strategy is the definition of stakeholders and its normative implications. The debate is still open between those campaigning for a narrow view of stakeholders on the basis of the practical limitations of resources and managerial capabilities to systematically balance comprehensible and disparate sets of claims and those supporting the opposite broad view because of the empirical reality that any stakeholder's claim can affect others and the firm. This debate reflects in part an objective tension between the ethical concerns of addressing *all* stakeholders' claims and the practical complexity such management involves. Shortly, if a

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firm aims to address all stakeholders' claims, it may show a high ethical propensity but is likely to suffer management problems in balancing disparate interests. If it addresses only the claims of primary stakeholders, it will limit these problems, albeit at the expense of some stakeholders' issues, which will be neglected at the corporate level. In this regard, the firm may appear to be behaving unethically toward these stakeholders.

This problem has no easy solution. Our arguments suggest that the trade-off may indeed be even more pronounced once the hidden costs of SM are taken into account. However, looking at the dark side of SM may prove useful and provide new directions for the definitional problem. Acclaimed stakeholder theorists (Agle et al., 2008) recently suggested that stakeholder theory is about what good management is and that we should look at how value is created for stakeholders. When higher value is created through illegal or unethical practices, this should be considered as contrary to the spirit of stakeholder theory, even when it implies higher benefits for stakeholders. In line with these thoughts, higher SM orientation should be disqualified when driven by the self-serving objectives of executives. This can imply that when the dark side risk associated with SM is higher and is the dominant motive, it may be preferable from an ethical point of view to restrict managerial discretion by restricting the range of stakeholders the firm should consider. The issue is fairly complex and we suspect that the debate will not find a happy end in the short term. Nonetheless, scholars may find it useful to also consider these hidden aspects of the problem in their future inquiry.

Final comments

In this article we have presented the potential hidden costs of an SM approach. In particular, we have pointed to the causal ambiguity inherent in the SM–performance relationship as primary source of the wider discretion managers enjoy in firms committed to SM and discussed the factors that might provide them with self-interests to pursue a broad SM orientation to enlarge their power. Rather than discrediting the SM perspective, our work intends to complement it. Only by recognizing the costs and risks associated with SM, firms will be able to successfully implement this approach and obtain the purported benefits.

This poses the challenge for future studies to go beyond the *myth of corporate responsibility* (Greenwood, 2007) and balance the *good* of stakeholder engagement with its potential shortcomings. Several authors have called for such a shift by stating that "stakeholder theory…needs to focus on cases where things go wrong" (Agle et al., 2008, p. 166). The research propositions advanced here provide a first theoretical examination of such cases and point to a fascinating and intriguing research agenda. By further exploring the details of the SM implementation process and the incentives of the parties involved, we may gain a clearer understanding of why and when stakeholder engagement fails to yield the expected benefits to the firm *and* its stakeholders.

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