

DOES STAKEHOLDER ORIENTATION MATTER? THE RELATIONSHIP BETWEEN STAKEHOLDER MANAGEMENT MODELS AND FIRM FINANCIAL PERFORMANCE

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Little empirical work has been done on the effect of stakeholder management on corporate performance. In this study, we contributed to stakeholder theory development by (1) deriving two distinct stakeholder management models from extant research, (2) testing the descriptive accuracy of these models, and (3) including important variables from the strategy literature in the tested models. The results provide support for a strategic stakeholder management model but no support for an intrinsic stakeholder commitment model. Implications of these findings for management practice and future research are discussed.

Freeman (1984) made a persuasive case that systematic managerial attention to stakeholder interests is critical to firm success, a claim not yet tested in the literature. Although Freeman's early work introduced many of the central themes of stakeholder-related research, the conceptual contribution of Donaldson and Preston (1995) has framed much of the recent dialogue and suggests why little serious empirical work has been attempted. Their taxonomy of stakeholder theory types—normative, instrumental, and descriptive/empirical—has required the authors of subsequent work to become more precise in their terminology and more coherent in their thinking about stakeholder relationships. Donaldson and Preston (1995) proposed that the normative realm, which concerns how managers *should* deal with corporate stakeholders, is the most important to stakeholder theory. Not surprisingly, there has been considerable discussion in both academic and practitioner circles over the normative principles firms should use to shape their relations with stakeholders (Collins & Porras, 1994;

Freeman, 1994; Paine, 1994). By contrast, relatively little theory has been advanced in the instrumental realm, which is related to what happens *if* managers treat stakeholders in a certain manner, or in the descriptive/empirical realm, which concerns how managers *actually* deal with stakeholders. Thus, on a variety of levels there is conceptual agreement that managers should proactively address stakeholder interests, yet little has been done to identify which stakeholder interests should be attended to and what managers should do to address them. Consequently, scholars wishing to do empirical work on stakeholder management have had little to go on except broadly defined models of stakeholder-related behavior.

This study is an attempt to begin empirical work in this area by comparing the descriptive accuracy of the two most commonly held views (implicit models) on the efficacy of stakeholder management practices. In one such model, which we term the *strategic stakeholder management model*, the nature and extent of managerial concern for a stakeholder group is viewed as determined solely by the perceived ability of such concern to improve firm financial performance. In the second, the *intrinsic stakeholder commitment model*, firms are viewed as having a normative (moral) commitment to treating stakeholders in a positive way, and this commitment is, in turn, seen as shaping their strategy and impacting their financial performance.

To compare the accuracy of the two models, we developed two propositions, one for each model,

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and tested them using data from the Kinder, Lydenberg, Domini, and Company (KLD) Socrates database. The KLD database has been used previously in management studies. Graves and Waddock (1994) and Waddock and Graves (1997) used these data as proxies for corporate social performance. Graves and Waddock (1994) condensed KLD ratings of eight areas of corporate social performance into a single measure and assessed the relationship between the resulting variable and institutional ownership while controlling for industry, firm size, profitability, and leverage. Results were mixed. The authors found a positive and significant relationship between the KLD measure and the number of institutions owning shares in a particular firm. They found no relationship, however, between the percentage of shares owned by institutions and KLD ratings. In a similar study, Waddock and Graves (1997) assessed the relationship between KLD ratings (again calculated as a single measure) and firm financial performance. Attempting to determine a causal relationship, they found that prior-year KLD ratings were positively related to such financial performance measures as return on assets (ROA), return on equity (ROE), and return on sales (ROS), but the reverse causal relationship was not supported. No previous researchers, however, have attempted to isolate the effects of stakeholder relationships on firm financial performance after including measures of firm strategy and controlling for operating environment.

The reported study advances understanding of stakeholder phenomena in three important ways. First, we formalized the empirical models behind much of the theorizing (explicit and implicit) done on the stakeholder concept. Second, we began testing these theoretical models, using longitudinal data. Third, we incorporated two important variables from the strategic management literature by including measures of firm strategy and operating environment in the models. In addition, this study highlights the need for future research that can build on these results and develop more refined stakeholder models. Such work is significant for both management researchers and practitioners. Addressing these questions will allow scholars to offer concrete advice on the likely outcomes of various stakeholder relationship practices.

KEY STAKEHOLDER RELATIONSHIPS AND FIRM STRATEGY

Before we describe the models that were tested in the study, we discuss the roles that key stakeholder relationships may play in corporate decision making. As the discussion of the basic theoretical models in

the following section will make clear, the connection of stakeholder relationships to firm strategy and financial performance depends on which model is being examined. We focus on five major stakeholder areas important to firm operations: employees, the natural environment, workplace diversity, customers and issues of product safety, and community relations. We briefly review the literature that suggests how each stakeholder relationship may affect firm financial performance and discuss how we conceptualize firm strategy. The models presented here examine the links among stakeholder relationships, firm strategy, and firm financial performance.

Key Stakeholder Relationships

Employees. A range of theory and some empirical evidence suggest that how a firm manages its employees can affect its financial performance (Delery & Doty, 1996; Huselid, 1995; Pfeffer, 1994; Youndt, Snell, Dean, & Lepak, 1996). Indeed, recent work explicitly positions human resources (HR) as an extremely valuable source of competitive advantage for firms (Huselid, 1995; Pfeffer, 1994). Broadly speaking, this advantage is achieved through increased efficiency or differential revenue growth (Becker & Gerhart, 1996). More specific claims include the potential for HR practices to lower turnover and absenteeism, improve productivity, and increase worker commitment and effort. There is also evidence suggesting that properly designed and integrated HR practices may, in combination, produce positive effects that go beyond what specific individual initiatives could accomplish. Although evidence indicates that there is a universal set of "best" HR practices that can benefit all organizations, some good theoretical reasons (Becker & Gerhart, 1996; Delaney & Huselid, 1996; Youndt et al., 1996) and some empirical evidence also suggest that firm strategy-HR fit is important for enhancing financial performance (Youndt et al., 1996).

Natural environment. Several different arguments have been advanced as to why concern for the natural environment could enhance firm financial performance. First, being proactive on environmental issues can lower the costs of complying with present and future environmental regulations (Dechant, Altman, Downing, & Keeney, 1994; Hart, 1995; Shrivastava, 1995). Second, environmental responsiveness can enhance firm efficiencies and drive down operating costs (Russo & Fouts, 1997; Shrivastava, 1995). Third, firms can create distinctive, "ecofriendly" products that appeal to customers, thereby creating a competitive advantage for the firms (Shrivastava, 1995). Fourth, being environmentally proactive not only avoids the costs of

negative reactions on the part of key stakeholders, but can also improve a firm's image and enhance the loyalty of such key stakeholders as customers, employees, and government (Dechant et al., 1994; Hart, 1995; Shrivastava, 1995).

Diversity. Though the rationales for the positive impact on financial performance of employing a diverse workforce are not highly developed and lack significant empirical testing, many cogent arguments have been advanced. Lack of diversity may cause higher turnover and absenteeism from disgruntled employees (Robinson & Dechant, 1997; Thomas & Ely, 1996). Diversity may enhance the ability of a firm to attract the best talent from the labor pool, regardless of race, ethnicity, or gender (Robinson & Dechant, 1997; Thomas & Ely, 1996). It has also been argued that employee diversity improves the ability of a firm to relate to a broad customer base and compete more effectively in the highly diverse global marketplace (Robinson & Dechant, 1997; Thomas & Ely, 1996). In short, a diverse workforce may: (1) create cost savings for a firm, (2) enhance its productive capabilities, and (3) expand its markets.

Customers/product safety. A great deal of research has been conducted to assess the effects of firm-customer relationships on financial performance. Most of this research, however, has assessed the impact of irresponsible (and/or illegal) firm activities. Frooman (1997) noted that the evidence from event studies examining market reactions to corporate irresponsibility and illegal behavior is fairly unequivocal: the market value of firms engaged in such activity decreases. Studies investigating reactions to product recalls in particular (e.g., Bromiley & Marcus, 1989; Davidson & Worrell, 1988; Hoffer, Pruitt, & Reilly, 1988) have consistently found market reactions to be strongly negative, except for those occurring in the auto industry. These results suggest that investors expect customers to react to recall announcements with actions that directly affect the bottom line, either through lawsuits, decreased patronage, or both. There is reason to expect a positive relationship as well. For example, positive customer perceptions about product quality and safety may lead to increased sales or decreased costs associated with stakeholder relationships (Waddock & Graves, 1997).

Community. The effects of community relations on financial performance are less clear. Recent work by Altman (1998) and Waddock and Boyle (1995) suggests that companies are reorienting corporate community relations to fit broader strategic plans. Altman conducted interviews with both top managers and community relations officers and

found that many executives "believe that community involvement is a business imperative, often creating a competitive advantage" (1998: 222). The supporting research is based on case analyses, however, with broad studies of the financial impact of community involvement limited to examinations of corporate philanthropy (Wood & Jones, 1995). Although work like Gabor's (1991), detailing Kodak's commitment to revitalizing Rochester as a center for optics manufacture, stresses the strategic importance of community relations to some companies, the generalizability of such findings is debatable. Other researchers have suggested that good community relations can help a firm obtain competitive advantage through tax advantages, a decreased regulatory burden, and improvement in the quality of local labor (Waddock & Graves, 1997).

The preceding subsections demonstrate that managerial handling of the five stakeholder relationships we have discussed can affect firm financial performance. They also offer a number of extant theoretical reasons as to why one might expect a given management approach to positively or negatively affect firm financial performance. We now turn to defining firm strategy and discussing how it was operationally defined for our study and used in our models.

Strategy

To capture the broad strategic orientation of a firm, we employed Hambrick's (1983) operational definition of the strategy construct. We adopted Hambrick's approach because it was based on a strong and widely accepted theoretical foundation (e.g., Porter, 1980). Hambrick used four strategy measures along which a firm's strategy can be parsimoniously captured. They include cost efficiency, asset parsimony, differentiation, and scale/scope.

Cost efficiency measures assess the degree to which costs per unit of output are low. Asset parsimony highlights the degree to which assets per unit of output are few. Together, these measures capture a firm's cost leadership orientation. Broadly, the cost efficiency measure captures several conditions that have been linked to greater firm productivity (that is, efficiency) and profitability. To the extent that a firm succeeds in driving down costs per unit of output, thereby increasing gross margins, firm profitability should, *ceteris paribus*, increase (Miller, 1987; Porter, 1980). Capital intensity, an important measure of asset parsimony, has been shown to be a crucial strategic option (cf. Capon, Farley, & Hoenig, 1990; Gale, 1980). Also, capital intensity has often been presumed to vary inversely with direct costs (Kotha, Caledries, & Schendel, 1997; Porter, 1980). Moreover, a strong

return on assets, not just profits, is the presumed aim of most corporations (Hambrick, 1983). The two measures—cost efficiency and asset parsimony—overlap to the extent that depreciation comprises overall costs (Hambrick, 1983). Further, since the impacts of cost efficiency and asset parsimony may differ across industries, both are necessary to adequately capture a firm's approach to cost reduction activities.

Differentiation, as discussed by Hambrick (1983), broadly captures a firm's attempts to differentiate itself from its rivals using a variety of marketing and marketing-related activities. It relates to the degree to which a product and its enhancements are perceived as unique. The key to making this strategy successful is an ability to charge above-market prices, which is possible because of the customer's perception that the product is special in some way. This ability to command a premium price could, in turn, lead to greater profitability (Kotha & Vadlamani, 1995; Porter, 1980). Finally, scale/scope measures the relative size and range of activities of a business within its industry. Differentiation based on scale and scope may involve, for example, competing in a narrow segment that can be based on buyer type, product type, geography, or other factors (Hambrick, 1983; Mintzberg, 1988).

When we refer to firm strategy, therefore, we are discussing strategic resource allocation decisions, such as the mix of capital and labor (capital intensity), rather than broader strategy typologies such as those developed by Porter (1980) and Miles and Snow (1978). With our discussions of the five key stakeholder relationships and of how we conceptualized firm strategy as a foundation, we now describe the two models of stakeholder orientation implicit in the stakeholder theory literature.

STAKEHOLDER ORIENTATION MODELS

The terminology used in Freeman's (1984) work on stakeholder management establishes a useful framework for the examination of the basic empirical models that are implicit in stakeholder theory research. Freeman defined a stakeholder as "any group or individual who can affect or is affected by the achievement of the organization's objectives" (1984: 46). Groups typically cited as stakeholders include (but are not limited to) customers, suppliers, employees, local communities, governments, and shareholders. Freeman's definition suggests a two-way relationship between a firm (that is, its management) and its stakeholders. Each element of this relationship represents the foundation for a model of stakeholder management. First, if stakeholders can affect the achievement of a firm's objectives, it

follows that the firm's decisions, and hence its performance, may be affected by the activities of its stakeholders. This link suggests the possibility of an *instrumental* posture toward stakeholders on the part of the firm, with the firm seeking to manage those stakeholders in order to maximize profits (orientation 1). Second, if stakeholders are affected by the achievement of the firm's objectives, it follows that the firm's decisions affect the well-being of its stakeholders, which in turn suggests the possibility of a normative obligation to stakeholders on the firm's part. That is, managers may feel they have a fundamental moral obligation to stakeholders that grounds their managerial approach (orientation 2). For both orientations, we examine firm-stakeholder relationships from a firm-centered perspective.

Strategic Stakeholder Management: An Instrumental Approach

The first element of the firm-stakeholder relationship (how the firm is *affected by* stakeholder actions) implies that firms have a stake in the behavior of their stakeholders. Further, if prudent management of firms' operating environments, including relationships with their stakeholders, is a part of good management in general, good stakeholder management has clear instrumental value for the firms. The notion that stakeholder management has instrumental value forms the core of Freeman's original argument, as reflected in the following:

We need to worry about enterprise level strategy for the simple fact that *corporate survival depends* in part on there being some "fit" between the values of the corporation and its managers, *the expectation of stakeholders in the firm* and the societal issues which will determine the ability of the firm to sell its products. . . . *Whether such changes are socially desirable or morally praiseworthy is an important question, but it is yet a further question which an analysis of enterprise strategy does not address.* (1984: 107; emphasis added)

A fundamental assumption of this type of model is that the ultimate objective of corporate decisions is marketplace success. Firms view their stakeholders as part of an environment that must be managed in order to assure revenues, profits, and ultimately, returns to shareholders. Attention to stakeholder concerns may help a firm avoid decisions that might prompt stakeholders to undercut or thwart its objectives. This possibility arises because it is the stakeholders who control resources that can facilitate or enhance the implementation of corporate decisions (Pfeffer & Salancik, 1978); in short, stakeholder management is a means to an end. The

end, or the ultimate result, may have nothing to do with the welfare of stakeholders in general. Instead, the firm's goal is the advancement of the interests of only one stakeholder group—its shareholders. Employing the terminology used by Donaldson and Preston (1995) and Quinn and Jones (1995), we refer to the firm's interest in stakeholder relationships as instrumental and contingent on the value of those relationships to corporate financial success. As Quinn and Jones made clear, "Instrumental [strategic] ethics enters the picture as an addendum to the rule of wealth maximization for the manager-agent to follow" (1995: 25).

In this formulation, stakeholder management is part of a company's strategy but in no way drives that strategy. The firm's relationships with its stakeholders enter into its strategic calculus, and the types of relationships that produce the best prospective outcomes *for the firm* are pursued. It should be noted that, although Friedman (1970) did not use the term "stakeholder theory," the approach to stakeholder management described in this section is fully compatible with his view that the "social responsibility of business is to increase its profits" (1970: 32).

Implicit in this perspective is the assumption that modes of dealing with stakeholders that prove upon adoption to be unproductive will be discontinued, as will those that involve resources that are no longer needed. For example, a firm might adopt total quality management (TQM) as part of its strategy to enhance product sales. Presumably, the firm would attempt to significantly improve its relationships with both workers and suppliers, two key stakeholders, in the process (Adler, 1992). However, if TQM did not result in improved sales through greater product quality, the firm's commitment to improved worker and supplier relations would collapse as well. Similarly, a firm might adopt an employee stock ownership plan (ESOP) to increase the stake of employees in the firm's success and hence, their commitment to its objectives. If the desired result—improved corporate financial performance—were not achieved, the firm might eliminate its ESOP.

We call the model derived from this view of stakeholder relationships the *strategic stakeholder management model* because the concerns of stakeholders enter a firm's decision-making processes only if they have strategic value to the firm. Figures 1a and 1b graphically depict the connection between stakeholder relationships, corporate strategy, and corporate financial performance (after the operating environment has been controlled for) as postulated in this model. Since we have no theoretical means of predicting the precise way that stakeholder relationships enter the performance equation, we offer two alternative formulations of strategic

stakeholder management. Both models rest on the supposition that the objective of managers is to maximize profits, not to advance the morally legitimate claims of stakeholders other than shareholders (Freeman, 1984). That is, managers care only about serving shareholder interests and treat other stakeholders only as a means to realizing that goal. In the *direct effects model*, managers' attitudes and actions toward stakeholders (their stakeholder orientation) are perceived as having a direct effect on firm financial performance, independent of firm strategy. In the *moderation model*, managerial orientation toward stakeholders does impact firm strategy by moderating the relationship between strategy and financial performance.

Thus, our first overall proposition states the strategic stakeholder management model: Managers will attend to stakeholders' interests to the extent that those stakeholders can affect firm financial performance.

Two specific hypotheses follow. The first allowed us to test the direct effects model; the second allowed tests of the moderation model:

Hypothesis 1a. Both strategy variables and stakeholder relationship variables will have direct and separate effects on firm financial performance.

Hypothesis 1b. Strategy variables will have a direct effect on firm financial performance, which will be moderated by stakeholder relationship variables.

We now turn to a model derived from perspectives in which, for normative, conceptual, and practical reasons, the strategic management of stakeholder relations is rejected.

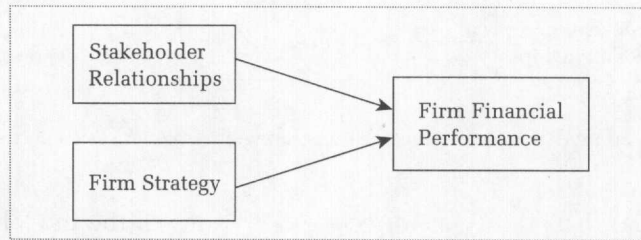
Intrinsic Stakeholder Commitment: A Normative Approach

According to the second broad perspective, the intrinsic stakeholder commitment model, managerial relationships with stakeholders are based on normative, moral commitments rather than on a desire to use those stakeholders solely to maximize profits. In short, a firm establishes certain fundamental moral principles that guide how it does business—particularly with respect to how it treats stakeholders—and uses those principles to drive decision making.

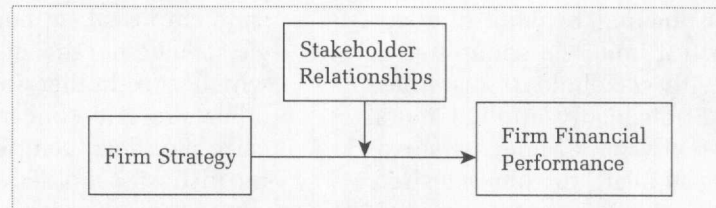
This model can be generated from two distinct, albeit related, sources within the business ethics literature. One genesis of this normative model is the fact that firm decisions affect stakeholder outcomes. Ethics, generally speaking, deals with obli-

FIGURE 1
Strategic Stakeholder Management Models^a

(1a) The Direct Effects Model



(1b) The Moderation Model



^a In all models, it is assumed that operating environment is a control variable.

gations that arise when an individual or corporate agent's decisions affect others; regardless of precisely what constitutes an ethical decision, decisions made without any consideration of their impact on others are usually thought to be unethical. Donaldson and Preston (1995) captured the implications of this view for stakeholder management quite well by stating that stakeholder interests have intrinsic worth. That is, certain claims of stakeholders are based on fundamental moral principles unrelated to the stakeholders' instrumental value to a corporation. A firm cannot ignore or abridge these claims simply because honoring them does not serve its strategic interests. In a sense, these claims are independent of, and should be addressed prior to, corporate strategic considerations. Stakeholder interests are thought to form the foundation of corporate strategy itself, representing "what we are" and "what we stand for" as a company.

Given such a stakeholder orientation, a firm shapes its strategy around certain moral obligations to its stakeholders. In this vein, a *Kantian* posture (Bowie, 1994; Evan & Freeman, 1983), a *feminist* perspective (Wicks, Gilbert, & Freeman, 1994), and a *fair contracts* approach (Freeman, 1994; Phillips, 1997) are examples of moral principles that can form the normative foundation for stakeholder-oriented management. Freeman and Gilbert explained this perspective:

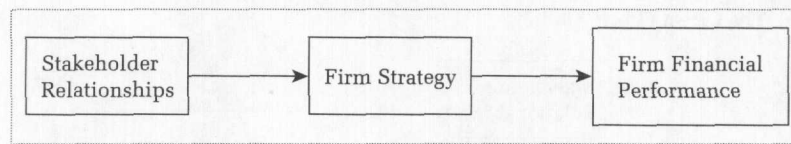
We cannot connect ethics and strategy unless there is some point of intersection between the values and ethics we hold and the business practices that exemplify these values and ethics. In order to build strategy on ethics and avoid a process that looks a

lot like post hoc rationalization of what we actually did, we need to ask "what do we stand for?" in conjunction with our strategic decisions. (1988: 70–71)

The second genesis of a normative stakeholder orientation based on moral principles is the argument that making a strategic commitment to morality is not only conceptually flawed but is also ineffective. First, *strategically applying* ethical principles—that is, acting according to moral principles only when doing so is to your advantage—is, by definition, not following ethical principles at all. In addition, Quinn and Jones (1995) argued that if the purpose of acting ethically is to acquire a good reputation that, in turn, will provide a firm with economic benefits, why not pursue the good reputation directly without the intellectual excursion into moral philosophy? In some cases, of course, the behavior called for will coincide with that dictated by ethics, but in others it may not. What difference does ethics make if one can act instrumentally without reference to ethics?

From a practical perspective, Jones (1995) argued that the instrumental benefits of stakeholder management paradoxically result only from a *genuine* commitment to ethical principles. He argued that firms that create and sustain stakeholder relationships based on mutual trust and cooperation will have a competitive advantage over those that do not (cf. Barney & Hansen, 1994). If a firm's commitment to trust and cooperation is strategic rather than intrinsic, it will be difficult for the firm to maintain the sincere manner and reputation (Frank, 1988)

FIGURE 2
The Intrinsic Stakeholder Commitment Model^a



^a In all models, it is assumed that operating environment is a control variable.

required for its differential desirability as an economic partner. In other words, trustworthiness, honesty, and integrity are difficult to fake. Thus, in order to reap the instrumental benefits of stakeholder management, a firm must be committed to ethical relationships with stakeholders regardless of expected benefits. Strategically applied moral commitments are not really moral and, paradoxically, cannot lead to the strategic outcomes desired.

We call the model derived from this view of stakeholder relationships the *intrinsic stakeholder commitment model* because the interests of stakeholders have intrinsic value, enter a firm's decision making prior to strategic considerations, and form a moral foundation for corporate strategy itself. Figure 2 graphically depicts the connection between stakeholder relationships, corporate strategy, and corporate performance postulated in this model.

Thus, our second hypothesis captures the intrinsic stakeholder commitment model:

Hypothesis 2. Managerial commitment to stakeholder interests will drive strategic decision making, which in turn will affect firm financial performance.

In other words, strategy variables will mediate the association between stakeholder relationship variables and firm financial performance.

In this exploratory research, the link between these two theoretical models and the corresponding mathematical models discussed below can be described as follows: We have reasons to believe that the way in which a firm handles the various aspects of stakeholder relationships described in the beginning of this article—its treatment of employees, the natural environment, diversity, customer/product issues, and community relations—will affect its financial performance. We also have two theoretical formulations of stakeholder orientation derived from the stakeholder literature, strategic stakeholder management and intrinsic stakeholder commitment, that describe how firms might handle these relationships and the subsequent effects on financial performance. Our approach was to empirically investigate which of these two models best fitted the data. If one of the two descrip-

tions of the model in which key stakeholder variables are seen by firms as *instrumental* to their primary goals was found to be statistically significant, empirical support would be lent to the strategic stakeholder management model. If the model in which stakeholder interests are seen as prior to other strategic concerns was found to be statistically significant, empirical support would go to the intrinsic stakeholder commitment model.

METHODS

Sample and Data

Our initial sample was the top 100 firms on the 1996 *Fortune* 500 list. We chose these companies because they cover a broad range of industrial activity and account for a significant portion of the U.S. economic output. Data for these firms were collected for the years 1991 through 1996, the years for which the data on socially responsive actions are available in the KLD database.

As some firms were acquired during the period considered or were not publicly traded for the whole time period, we found complete data on 81 out of the 100 firms. These 81 firms constituted our final longitudinal data set. We collected six years of data for each firm, for a total sample size of 486. Stakeholder relationship data were collected from the KLD Socrates database. The strategy and performance data were gathered from Compact Disclosure, Standard & Poor's stock reports, and the companies' annual reports. Data for estimating the variables capturing the firms' operating environments came from the U.S. Bureau of the Census *Annual Survey of Manufactures* and the U.S. Bureau of Economic Analysis *Gross Product by Industry*. Both of these data sources are published by the Department of Commerce (DOC) and are available electronically at the DOC Web site.

Measures

Independent variable: Stakeholder relationships. The ratings provided by KLD cover a broad set of socially responsive actions taken by the firms in the database. To assess stakeholder relation-

ships, we focused on five items that were consistently reported in the KLD database for the time period 1991–96. These include measures relating to (1) *employee relations*, (2) *diversity*, (3) *local communities*, (4) the *natural environment*, and (5) *product safety/quality*. (See Appendix A for a detailed list of KLD items.)

In the KLD database, firm actions toward each of the five stakeholder groups are measured on five-point Likert-type scales; -2 suggests negative actions toward that stakeholder group, and $+2$ suggests positive actions undertaken by the firm toward the group.¹ Analysts at Kinder, Lydenberg, Domini, and Company establish these ratings by using both primary and secondary data on approximately 650 firms operating in the United States. KLD is the investment advisor for the Domini Social Equity Fund, a mutual fund investing in the firms in the Domini Social Index. The KLD database includes all firms in the Standard & Poor's 500 as well as 150 additional firms in the Domini Social Index. To determine areas of strength and concern for each company in the database, KLD relies on public records of notable socially responsible activities (such as sponsoring local educational initiatives or recycling programs) and signs of disregard for particular stakeholders (such as violations of environmental regulations or payment of civil damages for product safety). The KLD ratings are also heavily influenced by qualitative data, such as evaluations of corporate advertising and charitable giving programs. Additionally, since the primary mission of the Domini Social Equity Fund is to provide financial returns to investors by taking equity positions in socially responsible firms, analysts from KLD frequently visit corporate sites to directly observe and appraise the actions of particular firms.

Independent variables: Strategy. To isolate the impact of firms' strategic decision making on performance, we used Hambrick's (1983) measurement of the strategy construct (see Appendix B). As noted earlier, we adopted Hambrick's approach because it parsimoniously captures the classification

dimensions (cost leadership and differentiation) put forward by Porter (1980).

For a firm's cost leadership position, we used measures of cost efficiency and asset parsimony (Hambrick, 1983). The *cost efficiency* measure was the ratio of the cost of goods sold to total sales; thus, a smaller value indicates better firm operating efficiency. Therefore, we would expect a negative relationship between cost efficiency and ROA. We measured asset parsimony using capital intensity and capital expenditure variables (Gale, 1980; Kotha & Nair, 1995; MacMillan, Hambrick, & Day, 1982). The *capital intensity* variable was total firm assets for a given year divided by the number of employees for that year. The *capital expenditures* variable was the net capital expenditures made by a firm in a given year divided by its sales for that year. The capital intensity variable was divided by 100, and the capital expenditures variable was multiplied by 100, so that the means of these variables were roughly similar.

The differentiation measure was the ratio of general, selling, and administrative expenses to total sales. This measure, *selling intensity*, captures a firm's willingness to spend on marketing- and selling-related activities in an effort to differentiate itself from its rivals.

Control variables. When performance is the dependent variable of concern, the operating environment plays a significant role (Jauch & Kraft, 1986: 781; cf. Pfeffer & Salancik, 1978). Further, "One's measurement strategy should depend on what is being predicted: perceptual measures are . . . not sufficient if we wish to predict the outcome . . . of choices, since outcomes are a product of many forces, some of which are outside the control of the organization" (Scott, 1981: 173). Hence, we introduced objective measures of the operating environment as control variables to isolate their impact on performance. Following Dess and Beard (1984), Boyd (1990), and other researchers in organizational theory, we measured the operating environment at the industry level.

The theoretical organizing concept for our operating environment construct was environmental uncertainty (e.g., Dess & Beard, 1984; Scott, 1981; Thompson, 1967), and the structural conditions leading to environmental uncertainty include munificence, power, and dynamism (Dess & Beard, 1984; Jurkovich, 1974; Scott, 1981; Thompson, 1967). We followed Boyd's (1990) procedures for measuring these three constructs. *Munificence* was the coefficient (slope) of the regression of industry-level sales for the period 1987–95. We normalized this variable by dividing the coefficient by the mean of industry sales for the nine-year period. For *dynamism*, we took the standard error of the regression used to calculate munificence and divided it

¹ Other measures collected by KLD, such as the existence of firm operations in South Africa and the sales generated through military contracts, were not included in this study for two reasons. First, these measures were not available for the entire time period under consideration. Second, the literature has yet to provide strong theoretical arguments for including some of these measures (that is, military contracts) as part of the large set of items that measure a firm's stakeholder responsiveness.

by the mean of industry sales during the 1987–95 period. Finally, *power* was measured at the four-firm concentration level, calculated as the percentage of sales generated by the top four firms relative to total industry sales. Each operating environment variable was calculated for all four-digit Standard Industrial Classification (SIC) codes present in our data set (see Appendix B).

Dependent variable. Financial performance was operationally defined as *return on assets (ROA)* (cf. Venkatraman & Ramanujam, 1986), computed as the ratio of operating income to total assets.

Model Specification

We used the following regression model to estimate the performance effect of the independent (stakeholder relationship, strategy, and operating environment) variables:

$$Y_{it} = a'C + b_1'Env_{it} + b_2'St_{it} + b_3'StR_{it} + e_{it}.$$

The subscript i indexes the firms ($i = 1, \dots, 81$), and t indexes the time periods ($t = 1$ [1991], $\dots, 6$ [1996]). Y_t defines the dependent (performance) variable for year t . C is a constant. Env_{it} represents the vector of operating environment variables, St_{it} the vector of strategy variables, and StR_{it} the vector of stakeholder relationship variables. Finally, e_{it} is the error term associated with each firm-year.

To analyze the data, we used a pooled time series model. In such models, error terms may be correlated over time (autocorrelation) and over cross-sectional units (heteroskedasticity). Under conditions of both heteroskedasticity and autocorrelation, the ordinary least squares (OLS) estimators of the regression coefficients are unbiased and consistent. Clearly, these are desirable properties. The problem with respect to the use of OLS rests with the estimated variances of the regression coefficients. The principal objective is to find consistent estimates of the variance-covariance matrix. Kmenta (1986: 618–622) showed that such consistent estimates can be found by subjecting the original data set to a double transformation.

We implemented Kmenta's double transformation approach for correcting heteroskedasticity and autocorrelation problems using the time series cross section (TSCS) procedure in LIMDEP (Greene, 1992), in which the coefficient vector is assumed to be constant over time for all firms and "groupwise" heteroskedasticity, cross-group correlation, and within-group autocorrelation are controlled for (Kmenta, 1986).

We tested the validity of the two stakeholder orientation models presented in the preceding theory section by using the KLD stakeholder relation-

ship and strategy variables, after controlling for the operating environment. In this examination, a fundamental theoretical question arose: Should we expect stakeholder relationships to affect the firm strategy variables defined here? We believed they would, because our measurement of firm strategy captured the generic strategic resource allocation decisions made by firms as they attempt to successfully compete in their marketplaces (Hambrick, 1983; Porter, 1980). The strategy variables used in this study—cost efficiency, capital intensity, cost expenditures, and selling intensity—have been shown to have consistent impacts on firm financial performance in prior studies (Capon et al., 1990). The first three variables capture a firm's fundamental cost posture, and the fourth variable, selling intensity, captures the firm's (marketing) differentiation posture vis-à-vis its competitors.

Earlier, we noted that Freeman (1984) made a persuasive case that systematic managerial attention to stakeholder interests is critical to financial success. But translating systematic managerial attention into action involves making the necessary changes in the strategic resource allocation decisions of a firm. In other words, these actions should manifest themselves in the variables that we used to measure a firm's strategic resource allocations. For example, being proactive on environmental issues can lower the costs of complying with present and future environmental regulations (Dechant et al., 1994; Hart, 1995). Also, environmental responsiveness can enhance firm efficiencies and drive down operating costs (Shrivastava, 1995). In sum, such actions improve the firm's overall cost posture.

The opportunity for dramatic improvement in operating costs comes only with new buildings and facilities. Such improvement may also require redesigning production systems to reduce environmental impacts by such means as cleaner technologies and more efficient production techniques (Shrivastava, 1995). Additionally, improvement may require more preventive maintenance, safer working conditions for employees, and enhanced ecological and health conditions in the organization (United Nations Educational, Scientific, and Cultural Organization, 1992). In general, such actions tend to increase the cost of operations. Ultimately, however, the overall impact of these actions will be reflected in the realized cost efficiency and asset parsimony (capital intensity and cost expenditures) measures of the firm.

We also noted that firms might create distinctive, ecofriendly products that appeal to customers, thereby creating competitive advantage. Shrivastava (1995) highlighted the concept of design for disassembly as one of the techniques that

firms use to realize this objective. Products designed for disassembly have the maximum useful life and are easy to disassemble and recycle. They are ecofriendly in the sense that they maximize the use of material in the form of products and recycled materials. But to benefit from these activities, a firm has to effectively communicate its ecofriendly approach to its relevant customer groups. It can do so through marketing and advertising campaigns that differentiate its approach from its rivals'. It is reasonable, therefore, to expect that these sorts of actions will be reflected in strategic allocation decisions pertaining to marketing and selling costs.

We recognize that the complex relationship between attitudes toward stakeholders and strategic resource allocation decisions is open to other interpretations. By focusing on capital intensity and capital expenditures, a firm may be investing in automation to replace workers, a stance that is not usually associated with a commitment to workers. Similarly, firms may undertake capital expenditures to increase production capacity without any concern about the impact increased production activity has on the natural environment. In each of the cases above, however, the associated rating on the KLD variables would be less favorable. It is the myriad interactions between the strategy and stakeholder relationship variables that make empirical explorations such as the study undertaken here necessary.

The stakeholder orientation models help explain how the interactions between stakeholder relationships and strategy variables occur. We tested for causal relationships in the interactions to see which model best explained the data. We could then make broader claims about the associated managerial decision making. For instance, if the data best fitted the strategic stakeholder management model, then we would infer that it was concern with profits that was dictating how and to what extent managers paid attention to a given stakeholder (for example, the natural environment). If the data fitted the intrinsic stakeholder commitment model, then we had reason to believe that an ongoing moral commitment to a stakeholder or stakeholders drove strategic decision making and the ultimate impact on financial performance.

Analysis

Methodological techniques to test for the mediating and moderating relationships implicit in stakeholder theory are well established. To explore the exact association between resource allocation decisions and stakeholder relationships, however, would require analysis of additional

information, such as data on managerial intentions. The current study provides a foundation for inferring such relationships, which could be supplemented by such additional data, should it become available.

To test the three hypotheses, it was necessary to estimate four different regression models. In all cases, we controlled for the operating environment with the measures of munificence, dynamism, and power explained above. Testing Hypothesis 1a, the direct effects model, was relatively straightforward. All relevant strategy and stakeholder relationship variables were entered into the model simultaneously, as independent variables. The hypothesis would be supported if variables from both groups were significantly related to firm financial performance. Testing Hypothesis 1b, the moderation model, was similarly clear. This test required the inclusion of all interactions between the stakeholder relationship and strategy variables in the regression equation. Moderation would be supported if this model represented a statistically significant improvement over the model including only the direct effects.

Hypothesis 2, the mediation model, was tested using a method outlined by Baron and Kenny (1986) and requiring the estimation of at least two regression models, one containing only the stakeholder relationship variables and one including both the stakeholder relationship and strategy variables. If strategy mediated the association between stakeholder relationships and firm financial performance, the significance of the stakeholder relationship variables would be suppressed when strategy variables were included in the regression equation. In other words, perfect mediation would hold if the stakeholder relationship variables had no effect on performance when the mediating variables (in this case, the strategy variables) were included in the equation. If this proved true, then a third model would have to be estimated, with the stakeholder relationship variables regressed on the strategy variables to determine which aspects of firm strategy mediated the association between stakeholder relationships and performance.²

²To test the significance of each model, we employed likelihood ratio tests. The goodness-of-fit statistic, G^2 , is -2 times the "log likelihood" function reported for that model. The difference between the G^2 values of the nested models is the likelihood ratio test statistic, which is asymptotically distributed as chi-square (χ^2 ; Seabright, Levinthal, & Fichman, 1992). In the discussion that follows and in the tables, we report model results in terms of the significance of the chi-square statistic. The significance of individual variables is reported using standard t -statistics.

TABLE 1
Descriptive Statistics and Zero-Order Correlations^a

Variables	Mean	s.d.	Variance Inflation Factor														
				1	2	3	4	5	6	7	8	9	10	11	12		
1. ROA	9.52	6.90															
2. Dynamism	0.04	0.04	1.58	.10*													
3. Munificence	0.01	0.01	1.42	-.10*	-.09												
4. Power	0.22	0.24	1.65	-.05	-.46**	.39**											
5. Selling intensity	25.32	17.30	1.23	.01	-.08	-.24**	-.06										
6. Capital expenditures	18.76	33.28	1.05	.05	-.04	.01	-.05	.09*									
7. Efficiency	0.63	0.19	1.54	-.20**	-.11*	.29**	.08	-.34**	-.03								
8. Capital intensity	7.97	20.02	1.07	-.26**	.09	-.05	.03	.07	-.09	-.17**							
9. Employees	0.20	1.03	1.29	.22**	.07	-.08	-.06	.08	.03	-.30**	.04						
10. Product safety/quality	-0.33	0.87	1.15	.10*	.07	.02	-.06	-.07	.00	.07	-.01	.25**					
11. Diversity	0.77	0.89	1.42	.01	.07	-.05	.09	.23**	.14**	-.40**	-.01	.28**	-.03				
12. Natural environment	-0.42	0.94	1.53	.07	.37**	-.26**	-.16**	.08	.00	-.22**	.11*	.24**	.21**	.17**			
13. Community	0.82	0.85	1.54	.04	-.04	.01	.20**	.23**	.05	-.35**	.08	.27**	-.04	.49**	.20**		

^a $N = 486$.

* $p < .05$, two-tailed tests

** $p < .01$, two-tailed tests

RESULTS

Models

Table 1 provides the descriptive statistics for the strategy, stakeholder relationship, performance, and control variables. Examining the variance inflation factors, we found no multicollinearity problems in the data set, as the observed values of these factors never exceeded the critical limit of 10 (Neter, Wasserman, & Kutner, 1989).

Tables 2, 3, and 4 provide the results of the various regression models. Table 2 reports the models used to test Hypothesis 1a, which states that stakeholder relationships and strategy each have direct and separate impacts on firm financial performance. Model 1, the restricted model, includes the control and strategy variables. Model 2, the full model, includes the control, stakeholder relationship, and strategy variables. Model 2 does not represent a significant improvement over model 1 ($\chi^2_5 = 3.58$, n.s.); however, out of the five stakeholder relationships, two are significant: the employees and the product safety/quality measures. We therefore estimated a third model including only these stakeholder relationship variables. This model, model 3, is a significant improvement over model 1 ($\chi^2_2 = 6.54$, $p < .05$).

Table 3 presents the regression models necessary to test Hypothesis 1b, which states that stakeholder relationships moderate the strategy-performance relationship. Table 3 includes the full model (model 4) and model 5, which includes all the variables in the full model and all the interaction terms be-

tween the strategy and stakeholder relationship variables. Model 5 is a significant improvement over model 4 ($\chi^2_{20} = 30.90$, $p < .10$). In other words, the addition of the interaction terms significantly improved explanatory power.

The regression results presented in Table 4 test Hypothesis 2, which states that firm strategy mediates the relationship between stakeholder relationships and firm financial performance. Model 6 is a restricted model including only the control and stakeholder relationship variables. Strategy variables are included in the full model, model 7. If strategy mediated the stakeholder relationship-performance link, any statistically significant stakeholder relationship variables in model 6 should no longer be significant in model 7. The results lend little support to the intrinsic stakeholder commitment model since both of the variables significant in model 6 (employees and product safety/quality) are still significant in model 7.

Tests of Hypotheses

Strategic stakeholder management. Hypothesis 1a states that stakeholder relationships will be positively related to performance, after strategy and operating environment (control) effects are accounted for. Results provided in Table 2 (model 2) indicate that two stakeholder relationship variables, employees ($b = 0.33$, $p < .01$) and product safety/quality ($b = 0.27$, $p < .05$), are positively and significantly related to firm financial performance and, importantly, that model 3, the parsimonious model, is a significant

TABLE 2
Results of Two-Step GLS Regression Results on ROA: Tests for Direct Effects^a

Variable	Model 1, Strategy and Environment	Model 2, Full Model	Model 3, Parsimonious Model
Constant	16.9200*** (0.9902)	16.3920*** (1.1070)	16.8130*** (1.0320)
Environment			
Dynamism	4.0518 (7.4910)	5.4765 (7.4960)	9.2091 (7.2100)
Munificence	-56.8870 [†] (33.8700)	-60.1760 [†] (34.1400)	-81.1410* (33.0800)
Power	0.6856 (0.9245)	1.4564 [†] (0.8086)	1.6727* (0.8484)
Strategy			
Selling intensity	-0.0337** (0.0120)	-0.0296* (0.0129)	-0.0363** (0.0125)
Capital expenditures	-0.0050 (0.0038)	-0.0040 (0.0040)	-0.0029 (0.0041)
Efficiency	-8.5607*** (1.0190)	-7.8130*** (1.1910)	-8.4055*** (1.1110)
Capital intensity	-0.0005*** (0.0001)	-0.0006*** (0.0001)	-0.0006*** (0.0001)
Stakeholder relationships			
Employees		0.3270** (0.1162)	0.3747** (0.1161)
Product safety/quality		0.2652* (0.1359)	0.2471 [†] (0.1352)
Diversity		0.1335 (0.1229)	
Natural environment		0.0736 (0.1658)	
Community		0.1499 (0.1443)	
Model statistics			
G ²	1,495.84	1,492.26	1,489.30
Δχ ²		3.58	6.54
df		5	2

^a N = 486. Unstandardized regression coefficients are shown, with standard errors in parentheses.

[†] p < .10

* p < .05

** p < .01

*** p < .001

improvement over model 1. Taken together, these results provide support for Hypothesis 1a.

Hypothesis 1b states that stakeholder relationships moderate the relationship between strategy and performance. To test the impact of moderation, we introduced interaction terms in model 5 (Table 3). We found that model 5 is a significant improvement over model 4 and that 9 of 20 interaction terms are significant at $p < .10$ or above. Specifically, we found that these interactions were significant and related to firm financial performance: employees and efficiency; product safety/quality and capital intensity, selling intensity, and efficiency; diversity and selling intensity, capital expenditures, and efficiency; the natural environment and capital expenditures; and community and capital expenditures. These results confirm our argument that stakeholder relationships moderate the relationship between strategy and firm financial performance.

Intrinsic stakeholder commitment. Based on the intrinsic stakeholder commitment model, Hypothesis 2 states that commitment to multiple stakeholders mediates the relationship between strategy and performance, after the impact of the operating environment is controlled for. An examination of Table 4 yields little support for this hypothesis.

Thus, the results do not support the intrinsic stakeholder commitment model.

Operating environment and strategy variables.

It is interesting to note that the cost efficiency variable is negative and strongly related to performance. As noted earlier, the smaller this ratio, the better a firm's operating efficiency; thus, the negative sign is in the expected direction. Additionally, capital intensity is negatively related to performance and is significant. Previous studies have shown that capital intensity is generally negatively related to financial performance.³ Among the variables controlling for the operating environment, munificence is negatively related to performance, and power exhibits a positive relationship, findings that are consistent with prior strategy studies (e.g., Capon et al., 1990).

In sum, the results suggest that stakeholder rela-

³ According to Buzzell and Gale (1987), a negative relationship emerges because (1) capital intensity leads to aggressive and often destructive competition, (2) heavy capital investment acts as a barrier to exit from unprofitable businesses, (3) management often sets a normal profit-to-sales target for businesses exhibiting higher-than-normal investment/sales ratios, and (4) capital-intensive businesses may be less efficient in using fixed or working capital.

TABLE 3
Results of Two-Step GLS Regression Results on ROA: Tests for Moderation Effects^a

Variable	Model 4, Full Model	Model 5, Moderated Model
Constant	16.3920*** (1.1070)	11.6550*** (1.3730)
Environment		
Dynamism	5.4765 (7.4960)	6.2912 (7.8360)
Munificence	-60.1760 [†] (34.1400)	-68.9760 [†] (35.3300)
Power	1.4564 [†] (0.8086)	1.8167 [†] (0.9292)
Strategy		
Selling intensity	-0.0296* (0.0129)	0.0196 (0.0171)
Capital expenditures	-0.0040 (0.0040)	0.0044 (0.0064)
Efficiency	-7.8130*** (1.1910)	-2.9202 [†] (1.6050)
Capital intensity	-0.0006*** (0.0001)	-0.0007*** (0.0002)
Stakeholder relationships		
Employees	0.3270** (0.1162)	-0.4987 (0.7639)
Product safety/quality	0.2652* (0.1359)	-3.1098*** (0.9404)
Diversity	0.1335 (0.1229)	2.6160** (0.9266)
Natural environment	0.0736 (0.1658)	0.7350 (0.9999)
Community	0.1499 (0.1443)	0.6450 (0.9136)
Interactions		
Capital intensity × employees		0.0000 (0.0002)
Capital intensity × product safety/quality		0.0004* (0.0002)
Capital intensity × diversity		0.0000 (0.0001)
Capital intensity × natural environment		-0.0000 (0.0001)
Capital intensity × community		-0.0001 (0.0001)
Selling intensity × employees		-0.0016 (0.0090)
Selling intensity × product safety/quality		0.0275* (0.0116)
Selling intensity × diversity		-0.0321** (0.0103)
Selling intensity × natural environment		-0.0087 (0.0108)
Selling intensity × community		-0.0106 (0.0113)
Capital expenditures × employees		-0.0065 (0.0043)
Capital expenditures × product safety/quality		0.0031 (0.0063)
Capital expenditures × diversity		0.0083 [†] (0.0049)
Capital expenditures × natural environment		0.0095* (0.0046)
Capital expenditures × community		-0.0093 [†] (0.0056)
Efficiency × employees		1.5485 [†] (0.9218)
Efficiency × product safety/quality		3.9532*** (1.0820)
Efficiency × diversity		-2.6631* (1.1380)
Efficiency × natural environment		-0.8834 (1.2530)
Efficiency × community		-0.4112 (1.0970)
Model statistics		
G ²	1,492.26	1,461.36
Δχ ²		30.90
df		20

^a N = 486. Unstandardized regression coefficients are shown, with standard errors in parentheses.

[†] p < .10

* p < .05

** p < .01

*** p < .001

tionships have both direct and indirect (moderation) effects on firm financial performance. Interestingly, all five of the stakeholder relationship variables used in the study have indirect (that is, moderating) effects on firm performance. Given that nine of the interaction terms employed in the

regression model are significant, these findings suggest that the connections among stakeholder relationships, strategy, and financial performance are fairly complex. Finally, our results provided no support for the intrinsic stakeholder commitment (mediation) model of stakeholder management.

TABLE 4
Results of Two-Step GLS Regression on ROA: Tests for Mediation Effects^a

Variable	Model 7, Stakeholder Relationships and Environment		Model 8, Full Model	
Constant	10.2340*** (0.4612)		16.3920*** (1.1070)	
Environment				
Dynamism	3.6288	(7.3720)	5.4765	(7.4960)
Munificence	-87.1050*	(34.7300)	-60.1760 [†]	(34.1400)
Power	1.1494	(0.7881)	1.4564 [†]	(0.8086)
Strategy				
Selling intensity			-0.0296*	(0.0129)
Capital expenditures			-0.0040	(0.0040)
Efficiency			-7.8130***	(1.1910)
Capital intensity			-0.0006***	(0.0001)
Stakeholder relationships				
Employees	0.4045***	(0.1068)	0.3270**	(0.1162)
Product safety/quality	0.2331 [†]	(0.1337)	0.2652*	(0.1359)
Diversity	0.0974	(0.1087)	0.1335	(0.1229)
Natural environment	0.0645	(0.1526)	0.0736	(0.1658)
Community	0.1658	(0.1391)	0.1499	(0.1443)
Model statistics				
G ²	1,505.74		1,492.26	
Δχ ²			13.48	
df			4	

^a N = 486. Unstandardized regression coefficients are shown, with standard errors in parentheses.

[†] p < .10

* p < .05

** p < .01

*** p < .001

DISCUSSION AND CONCLUSION

The purpose of this article is to advance theoretical and empirical research in stakeholder theory. We began by (1) highlighting two theoretical approaches to a firm's stakeholder orientation and (2) showing how these two approaches could be empirically tested using longitudinal data available in external databases. Although much has been written on stakeholder theory, no previous research has specified the models implicit in the writings of normative theorists or sought to test the empirical relationships they assume. This research also provides an important advance in the empirical testing of these distinct stakeholder theory models, particularly their instrumental and empirical/descriptive strands.

To measure our constructs of stakeholder relationships, we employed the KLD database, which uses five broad variables to capture a firm's stakeholder posture. We found that only two of these five variables, employees and product safety/quality, directly affected financial performance. These results reinforce the perception of stakeholder theorists that emphasizing how a firm manages its

relationships with employees and customers (especially product safety/quality issues) can have a significant impact on financial performance. The results also support previous management research containing arguments for a connection between the treatment of a given stakeholder (such as customers or employees) and firm financial performance (e.g., Huselid, 1995; Pfeffer, 1994; Waddock & Graves, 1997). More specifically, these two variables can be a source of differentiation for an individual firm and improve its financial performance.

It is surprising that the other three variables—community, diversity, and the natural environment—failed to exhibit statistically significant impacts on firm financial performance. This is particularly true for the measures relating to community relations and diversity. In the theory section, we pointed to prior research (e.g., Robinson & Dechant, 1997; Waddock & Graves, 1997) that suggests these variables should be positively related to an organization's achievement of its financial goals.

It may be that we found no direct effects for community relations and diversity because isolat-

ing these variables does not help to differentiate an individual firm. That is, even though these two variables are normatively important, their ability to directly enhance financial performance may be negligible. It is also possible that other contextual factors not examined here, such as the geographic location of a corporation, can determine the importance of these two variables.

A plausible explanation for the lack of significance of the natural environment variable may be that our sample contained firms from many industries. It is likely that environmental regulations do not have a uniform impact across industries and thus are industry-specific. Concern for the natural environment may also vary across industries' cultures. That is, some industries may take environmental actions more seriously than others, regardless of regulatory regime. Such a stance within a particular industry may be obscured by our sample. Therefore, focusing on a broad cross section of industries, as we did in this study, does little to isolate the direct impact of this variable on financial performance.

Finally, as the results of the moderated models discussed below suggest, although these three variables had no direct effect on financial performance, they did in fact moderate the relationship between strategy and performance.

Strategic stakeholder management. We argued that with strategic stakeholder management, firms address stakeholder concerns when they believe doing so will enhance firm financial performance. To isolate the impact of stakeholder relationships on performance, we developed two distinct models—the direct effects model and the moderated model.

The results for the direct effects model show that only two of the five variables tested exhibited strong effects on financial performance. In other words, the findings indicate that managerial attention to two important stakeholder variables, employees and product safety/quality, can help improve firm financial performance. This result suggests that managers may be better off isolating these two stakeholder relationships from other strategy dimensions such as cost efficiency, asset parsimony, and (marketing) differentiation in order to improve performance.

Results from the moderated model indicate that nine interaction effects are significant. Also, all five stakeholder relationship variables moderate the strategy-performance relationship. This suggests that the associations among stakeholder relationships, strategy (that is, resource allocation decisions), and financial performance are more complex than those suggested by the direct effects model. Although the stance a firm takes toward its key stakeholders is important in its own right (as noted in our arguments

for the direct effects model), managers should not ignore the interdependence between strategy and stakeholder relationships. For example, although three of five stakeholder variables (diversity, natural environment, and community) exhibited no direct effects, they did moderate the strategy-performance relationship.

Intrinsic stakeholder commitment. We argued that with intrinsic stakeholder commitment, firms address stakeholder concerns because of a moral commitment to stakeholder groups and that this commitment will drive strategic decision making, which in turn impacts firm financial performance. We tested this proposal via a mediated regression model. Our findings indicate no support for the intrinsic stakeholder commitment model; stakeholder relationships did not empirically drive strategy in our sample. It is possible the firms used in the study did not view stakeholder relationships as a normative driver for strategy formulation and implementation. Alternatively, a more complex model incorporating a range of managerial motivations/values may be required to better capture the intrinsic stakeholder commitment orientation.

Taken together, these results suggest many avenues for future empirical work in stakeholder theory. First, the most obvious extension is that future work could include survey data capturing managerial motivations and intentions pertaining to strategy decisions and stakeholder orientation. Capturing intentions could provide valuable insights both to help categorize the commitment of firms (as supporting either the strategic stakeholder management or the intrinsic stakeholder commitment model) and to compare motives with observed behavior (are firms' acts consistent with their stated intentions?). Second, a related line of research that appears relevant is the role trust plays in stakeholder relations. For example, Barney and Hansen (1994), Hill (1995), Jones (1995), and Wicks, Berman, and Jones (1999) argued that establishing trusting relationships with key stakeholders can significantly lower costs and, therefore, impact firm performance. Further, Calton and Lad (1995) argued that the approach a firm uses to interact with one stakeholder group (the trust or mistrust that is established) may influence how other stakeholder groups perceive the firm (cf. Jones, 1995). Empirical explorations of trust and its spillover effects could enhance understanding of firm-stakeholder relations further. Therefore, studies examining the role trust plays in such relationships seem warranted.

Third, although we focused on a rather narrow financial definition of firm performance, researchers examining corporate social performance have argued for expanding the definition of firm performance to include more than financial measures

(e.g., Bendheim, Waddock, & Graves, 1998). A more inclusive measure of performance might enhance the validity of the intrinsic stakeholder commitment model. Indeed, if the normative elements of stakeholder theory are to be taken seriously and the intrinsic worth of all stakeholders acknowledged, such a measure of performance seems a necessary step. We recognize that such attempts can greatly complicate what constitutes the dependent or independent variable. Broadening the definition of performance, however, may allow researchers to better understand the important links among stakeholder relationships, strategy, and performance.

There are also implications for research on firm strategy. We relied on Hambrick's (1983) operational definitions of Porter's (1980) generic strategies. Using measures like capital intensity reveals a great deal about the allocation of resources at the corporate level, but Porter's typology was meant to describe business-level strategies. An examination of the links at the level of the strategic business unit would also appear fruitful. Finally, the generalizability of this study is limited, because of the sample employed to uncover the relationships of interest. Future work should attempt to expand the sample to include smaller firms and to better control for specific industry effects.

The inferences for managers seem clear. Relationships with stakeholders have a direct impact on financial performance. Fostering positive connections with key stakeholders can help firm profitability. More importantly, stakeholder relationships and resource allocation decisions are inseparable, because how managers distribute resources inevitably has implications for the strength of stakeholder relationships, and these sets of variables interact to affect firm financial performance. Managers not currently considering the effects of decisions regarding resource allocations vis-à-vis key stakeholders are at a competitive disadvantage to those whose thinking is more holistic.

This study adds value to the existing work in stakeholder theory on a number of fronts. We began by constructing models that make explicit the theory implicit within stakeholder research, thus opening up the possibility of empirically testing the validity of these models. Additionally, we were able to test these models using the KLD database, after including measures of strategy and controlling for operating environment. Examining the relationships among strategic decision making, a firm's stakeholder relationships, and financial performance represents an important link in the process of gaining understanding of firm-stakeholder relations. The current results support the idea that managerial attention to multiple stakeholder interests can affect firm financial perfor-

mance, providing concrete support for an argument long advanced by stakeholder theorists (e.g., Freeman, 1984; Freeman & Gilbert, 1988). This study provides a foundation future empirical researchers can use to further explore the relationships between attention to stakeholders and firm performance, an agenda that has considerable significance for theorists and managers alike.

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APPENDIX A
KLD Rating Criteria^a

Measure ^b	Area of Concern	Area of Strength
Community	Payment of substantial fines or civil penalties, or involvement in major litigation relating to a community in which the firm operates. Company relations with local community have become notably strained due to plant closings or other breach of agreements with local community.	Corporate giving of over 1.5 percent of net earnings before taxes, innovative giving, participating in public/private partnerships aimed at providing housing for the disadvantaged, and support for local primary and secondary education.
Diversity	Payment of fines or civil penalties as a result of affirmative action controversies. No members of traditionally underrepresented groups on the board of directors or among senior line management.	Promotion of women and people of color within the organization, representation of women, people of color, and/or the physically and mentally challenged on the board of directors. This also includes generous family benefits addressing work/family issues, employment of the physically and mentally challenged, and progressive policies toward gay and lesbian employees.
Employees	Notably poor union relations, payment of substantial fines regarding worker safety conditions, dramatic workforce reductions, and underfunded pension/benefit programs.	Strong union relations, cash profit sharing, employee involvement in decision-making processes, and strong retirement benefits.
Natural environment	Current liabilities for hazardous waste sites exceed \$50 million, or the company has recently paid substantial fines or civil penalties for waste management violations. Also, a consistent pattern of violations of air, water, and other environmental regulations, the use of ozone-depleting chemicals, or the release of high levels of toxic chemicals.	Production of environmentally safe products or involvement in the environmental services industry. Aggressive pollution prevention and recycling programs.
Product safety	Payment of substantial fines or civil penalties relating to product safety or antitrust violations, also involvement in controversial advertising programs.	Ongoing commitment to quality through a well-developed, company-wide quality program. Also, leadership in industry research and development and innovation or direct involvement in providing products and services to the economically disadvantaged.

^a Source: Domini Social Investments (1997); adapted and used by permission.

^b For each measure, KLD assigns a rating of -2 (major concern) to +2 (major strength) to a firm, using the criteria summarized here.

APPENDIX B
Theoretical Variables, Measures, and Sources: Strategy and Operating Environment

Theoretical Variable	Empirical Proxy	Source
Strategy		
Selling intensity	<i>General, selling, and administrative expenses_{it}/net sales_{it}</i>	Compact Disclosure, 1997, supplemented by annual reports.
Capital expenditures	$(\text{Net capital expenditures}_{it}/\text{net sales}_{it}) \times 100$	Compact Disclosure, 1997.
Efficiency	<i>Cost of goods sold_{it}/net sales_{it}</i>	Compact Disclosure, 1997, supplemented by annual reports.
Capital intensity	<i>Total assets_{it}/number of employees_{it}</i>	Assets: Compact Disclosure, 1997. Employees: Standard & Poor's stock reports, year <i>t</i> .
Operating environment		
Dynamism	Regression of time on the value of shipments or total industry gross product. Standard error of the regression slope coefficient (S_{b_1}) divided by mean value; 1987-95.	SIC codes 20-39 (value of shipments), <i>Annual Survey of Manufactures</i> . All other SIC codes (total industry gross product), <i>Gross Product by Industry</i> .
Munificence	Regression of time on the value of shipments or total industry gross product. Regression slope coefficient (B_1) divided by mean value; 1987-95.	SIC codes 20-39 (value of shipments), <i>Annual Survey of Manufactures</i> . All other SIC codes (total industry gross product), <i>Gross Product by Industry</i> .
Power	Four-firm concentration ratio: Sales of four leading firms divided by total industry sales.	<i>Dun & Bradstreet's Business Rankings</i> .