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THE PROBLEM OF STAKEHOLDER GOVERNANCE

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AN INVITED RESPONSE TO Timothy J. Hargrave and Jeffery Smith (2024), "New Avenues in Stakeholder Governance," ***Bus Ethics J Rev*** 11(1): 1–7,
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ABSTRACT

We reply to a comment by Hargrave and Smith on a paper in which we use Ostrom's design principles to develop theory about stakeholder governance. We agree with most of the issues that Hargrave and Smith raise, but disagree with their statement that the systems view of stakeholder governance that they advocate stands in contrast to our approach. The two approaches are complementary.

WE WELCOME THE opportunity to reply to Hargrave and Smith's (2024) comment on our paper 'Stakeholder Governance: Solving the Collective Action Problems in Joint Value Creation' (Bridoux and Stoelhorst 2022). As Hargrave and Smith (H&S) note, how we are to think about and implement stakeholder governance is an urgent question and their reply to our paper is a meaningful contribution to the project of formulating an answer to that question.

In fact, there is relatively little in their comment that we disagree with. Our only major point of disagreement is with the concluding sentence, in which H&S claim that a systems view of stakeholder governance stands in contrast to ours. We will argue that our approach is a necessary complement to a systems view.

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The stakeholder governance project

Let us first put our paper in perspective. We see the project of developing a theory of stakeholder governance as a crucial element in the quest for a convincing alternative to the standard economic narrative about capitalism. This narrative supports a model of governance inspired by agency theory in which firms are to be run in the interests of shareholders and the objective function of managers should be to maximize the financial market value of their firms. Stakeholder theory has positioned itself as a counterpoint to the standard narrative about capitalism, but has not yet developed a theoretically grounded alternative for the model of governance derived from agency theory. Developing such a model is especially urgent as firms are facing societal pressure to acknowledge that they are both among the causes of, and potential solutions to, many of society's grand challenges.

Our paper is a contribution to the project of developing a theoretically grounded approach to stakeholder governance, but it is far from the completion of that project. We develop a theory based on two premises. The first is that stakeholder governance is about solving collective action problems, situations in which there is a tension between the (short-term) self-interest of stakeholders and the (long-term) collective interest of the firm (for instance, contributing to team production) and/or society (for instance, imposing externalities). The second is that managers are increasingly facing situations where they do not have formal authority over some of the stakeholders who co-create value. When both premises are met, the problem of stakeholder governance becomes how managers can solve collective action problems among stakeholders over whom they do not necessarily have any formal authority. Our paper offers solutions to this particular problem by building on the design principles for the governance of collective action situations proposed by Elinor Ostrom. It is the application of these principles that H&S criticize.

Hargrave and Smith's comments

This is how we understand H&S's comments. First, they seem to agree with the importance of the project of looking for alternative ways to think about and implement stakeholder governance. Second, they also seem to agree that there is value in turning to the work of

Ostrom to theoretically ground this project. Third, however, they seem to feel that in grounding our theorizing in Ostrom's design principles, we have turned to the wrong part of her work. We understand H&S's comment as arguing that rather than theorizing about governance at the level of individual firms and their stakeholder networks on the basis of Ostrom's design principles, we should have theorized about governance at the level of the broader system of governance rules (i.e., the institutional context of laws, regulations, and norms) on the basis of the notion of polycentricity.

If this summary is correct, then there are two ways of interpreting H&S's comment. The first and weaker interpretation is that they feel that our arguments at the level of individual firms are relatively unimportant as compared to the arguments that could have been made at the institutional level. This interpretation seems warranted by the concluding paragraph of H&S's text. The second and stronger interpretation is that they feel that our arguments about governance at the level of individual firms are misguided. This interpretation is suggested by the body of their text, in which they discuss four challenges to effective governance "which thwart any quick application of Ostrom's community models of stakeholder governance to business firms in a competitive marketplace" (Hargrave and Smith 2024: 2).

Let us first respond to the weaker interpretation of H&S's comment, that our arguments at the level of individual firms are relatively unimportant as compared to the arguments that could have been made at the level of a polycentric system of nested and overlapping governance arrangements. This interpretation reduces H&S's comment to the critique that we wrote the wrong paper. The irony of this critique is that the original submission of our paper developed a multi-level model that also included arguments at the level of the broader institutional environment. However, the subsequent review process resulted in a much more focused paper. Thus, we certainly agree with H&S that a more complete understanding of stakeholder governance would also have to address the role of the institutional environment. In fact, we do so in some of our other work. For instance, Bridoux and Stoelhorst (2023), which is largely based on the materials that featured in the initial submission of our paper but were cut in the review process, discusses in some detail the tensions between the current institutional context in Western economies and Ostrom's design principles. And Stoelhorst and Viswanathan (2024) discusses links between stakeholder governance and principles of corporate governance law.

Let us next consider the stronger interpretation of H&S's comment, that our approach of applying Ostrom's design principles to the governance of a firm's network of stakeholders is misguided. This is where we disagree. This is not to say that we disagree with H&S's point that there are challenges when applying Ostrom's design rules to firms. There are indeed. Neither do we disagree with the four points that they identify as posing such challenges. Of these four points ('ease of exit', 'lack of legacy social capital', 'heterogeneity of interests', and 'power imbalances'), we have explicitly addressed the first and last in other publications. The challenges posed by these two points are among the issues addressed in Bridoux and Stoelhorst (2023). And the point that power imbalances pose a challenge is the main topic of Bridoux and Vishwanathan (2020). However, we do not think that these challenges warrant the stronger interpretation of H&S's arguments, that applying Ostrom's design principles to stakeholder governance by firms would somehow be misguided. In fact, we think that there is a rather convincing argument to the contrary.

The problem of stakeholder governance

The argument for grounding a theory of stakeholder governance in Ostrom's design principles rests on two premises: first, that the governance of firms is essentially about solving collective action problems, and second, that Ostrom's design principles are a general guide to solving such problems. We have argued for the first point elsewhere (e.g., Bridoux and Stoelhorst 2016, 2022; Stoelhorst and Vishwanathan 2024), while Ostrom herself has argued for the second point (Wilson, Ostrom et al 2013). It follows that, in contrast to the stronger interpretation of H&S's comment, applying Ostrom's design principles to stakeholder governance should at least be a meaningful exercise.

But we would go one step further. We would argue that Ostrom's design rules are not just a possible, but currently the best way of thinking about the governance of collective action problems. This raises a challenge for H&S: to propose a better alternative for thinking about solving the collective action problems that firms face. We don't see such an alternative in H&S's comment. The polycentric systems view of governance that they advocate, in which institutional pressures on firms take center stage, would help make a stakeholder-oriented approach to governance both more likely and more robust. But it would not, in and of itself, offer any guidance on how to actually solve the collective action problems that managers face when implementing stakeholder governance. It is in this sense that both parts of Ostrom's work, her design principles and the notion of polycentricity, are necessary complements.

If stakeholder theory is to offer a convincing alternative to the economic narrative of capitalism, then we cannot simply put our hopes for stakeholder governance on 'the system'. In fact, this is exactly the strategy of traditional economic theorizing: moral issues are relegated to the government so that managers can freely pursue profit maximization. In contrast, rather than giving managers the moral license to ignore the difficult ethical issues that are inherent in running firms, we should put these ethical issues center stage, while at the same time offering ways to think about resolving them. Many of the relevant ethical issues are the result of the collective action problems that firms face, in which the interests of particular stakeholders conflict with the collective interests of the firm and/or society. The value of Ostrom's design principles is that they offer managers guidelines for governing these conflicts.

Conclusion

The main problem of governance is solving collective action problems. Our paper developed theory about how managers can solve these problems when facing stakeholders over whom they may not have formal authority. Ostrom's design principles are particularly well-suited to those situations, although their applicability to stakeholder governance does not stop there: the principles can also be applied to theorizing about the more formal relationships of traditional corporate governance (see Deakin 2011). A polycentric institutional system that helps firms implement stakeholder governance, as H&S advocate, is a complement to theorizing in terms of the design principles, as it is in Ostrom's own work. It is not a substitute, because such a system would still have to fill in the details of how to design stakeholder governance so that it solves collective action problems, which is what the design principles are for.

If H&S's point is that our paper is misguided, then we obviously disagree. But on the weaker interpretation of their comment there is no disagreement between us. If their point is that there are additional papers to write about how to best implement stakeholder governance, and that in writing these papers we should also consider how to design the broader governance system, then we agree. As noted above, we already have published some of these papers ourselves, but many more will be needed. We hope that H&S and others will join us in writing them.

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