Why resource-based theory's model of profit appropriation must incorporate a stakeholder perspective

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Research Summary: Using arguments derived from transactions cost economics and incomplete contract theory, this article shows that the assumption that shareholders are a firm's only residual claimants is logically inconsistent with resource-based theory's model of profit generation. It follows from this conclusion that resource-based theory's model of profit appropriation must incorporate a stakeholder perspective. Some theoretical and empirical implications of this conclusion for resource-based theory's model of profit generation, profit appropriation, the role of managers and entrepreneurs in resource-based theory, and how conflicting interests among stakeholders can be resolved are all discussed. Finally, some continuing differences between stakeholder theory and incorporating a stakeholder perspective into resource-based theory's model of profit appropriation are also discussed.

Managerial Summary: Some argue that since shareholders are the only stakeholder who have a claim on a firm's profits, managers should focus only on maximizing shareholder wealth. Not only will this satisfy shareholders, it will also satisfy a firm's other stakeholders, since—in principle—these other stakeholders get paid before shareholders. This article shows that this logic is deeply flawed. In particular, it shows that if the only stakeholder who has a claim on a firm's economic profits is shareholders, then—in most competitive settings—a firm will not be able to attract the kinds of resources it needs to generate these profits. To attract the kinds of resources that can generate profits, managers must recognize that stakeholders, besides shareholders, have claims on the profits that their resources help generate. This, in turn, suggests that managers seeking to generate economic profits must...
adopt a stakeholder perspective in how they manage their firm. This article explores the managerial implications of this conclusion.

**KEYWORDS**

incomplete contract theory, resource-based theory, shareholder supremacy, stakeholder theory, transactions cost theory

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**1 | INTRODUCTION**

Like other theories in the field of strategic management, resource-based theory must explain both how economic profits are generated and how they are appropriated (Brandenburger & Stuart, 1996). Resource-based theory's model of profit generation builds on prior work in economics (e.g., Knight, 1921; Ricardo, 1817), the Austrian school (e.g., Mises, 1951), and anti-trust theory (Demsetz, 1973), and argues that expected economic profits can be generated when firms leverage rare, inimitable, and nonsubstitutable resources in acquiring access to additional resources (Barney, 1986a, 1988, 1991; Peteraf, 1993). Work by MacDonald and Ryall (2004) suggested that this model of profit generation is applicable in many, but not all, competitive settings within which a firm may operate.

There is less consensus concerning resource-based theory's model of profit appropriation. Some resource-based scholars, for example, adopt “shareholder supremacy” assumptions from finance (Jensen, 2002) and argue that shareholders, as a firm's only residual claimant, appropriate all the profits generated by a firm (e.g., Barney, 2011; Besanko, Dranove, Schaefer, & Shanley, 2013; Derrill, Fang, & Winter, 2003, p. 978). Other resource-based scholars (Byler & Coff, 2003; Castanias & Helfat, 1991, 1992; Coff, 1999, 2010; MacDonald & Ryall, 2004), along with a growing number of finance scholars (Cornell & Shapiro, 1987; Zingales, 2000), have adopted a contingency view and argue that if stakeholders—besides shareholders—provide access to resources that are vital to a firm generating economic profits, then these stakeholders can use their bargaining power to become residual claimants on the firm profits they help generate. There is growing empirical evidence that is consistent with these contingency arguments of profit appropriation (e.g., Cen, Dasgupta, & Sen, 2015; Chacar & Hesterly, 2008; Johnson, Karpoff, & Yi, 2015; Lieberman & Chacar, 1997; Shleifer & Summers, 1988).

This article builds on this contingency perspective by observing that without nonshareholder stakeholders providing resources that have the potential to generate economic profits, there will be no profits—generated in ways consistent with resource-based theory—for firms to distribute to shareholders. In this sense, resource-based theory's model of profit generation is logically inconsistent with a “shareholder supremacy” model of profit appropriation. Instead, this model of profit generation requires a model of profit appropriation that acknowledges that the generation of firm profits requires that stakeholders, besides shareholders, hold residual claims on firm profits (Lippman & Rumelt, 2003a, 2003b; Wang & Barney, 2006). In other words, resource-based theory's model of profit appropriation must adopt a stakeholder perspective (Freeman, Harrison, Wicks, Parmar, & Colle, 2010).

These arguments build on Lippman and Rumelt's (2003a, 2003b) "payments perspective," which argues that stakeholders will only make resources available to a firm when they are compensated for...
doing so (Castanias & Helfat, 1991, 1992). And, unlike previous efforts to introduce a stakeholder perspective into strategic management by focusing on legal (Stout, 2012), ethical (Evan & Freeman, 1993), or practical arguments, this article builds on work by Asher, Mahoney, and Mahoney (2005), Mahoney (2013), and Barney (2015) that applied incomplete contract theory (Grossman & Hart, 1986) and transactions cost theory (Williamson, 1985) to show that it is possible to build a stakeholder resource-based theory in strategic management. However, where Asher et al. (2005) and Mahoney (2013) showed that it is possible to build such a theory, this article shows that in order for resource-based theory's model of profit generation and appropriation to be logically consistent, such a theory is necessary. This approach to bringing a stakeholder perspective into strategic management does require some changes to the traditional stakeholder model (Freeman et al., 2010), changes that are described later in the article.

This article begins by defining key concepts. It then describes the economic profit generation model in resource-based theory more completely. With this background, the article next asks whether or not a model of economic profit appropriation that assumes that shareholders will appropriate all the economic profits generated by a firm is logically consistent with resource-based theory's model of economic profit generation. The answer to this question is: no. It follows that resource-based theory's model of economic profit appropriation must adopt a stakeholder perspective. The rest of the article discusses the implications of this conclusion.

2 | DEFINING KEY CONCEPTS

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

2.1 | Economic profits

The first of these concepts is economic profits. An economic profit (or loss) is equal to the difference between a firm's revenues and the total opportunity cost of the inputs used to generate those revenues. Opportunity cost, in turn, is the value of the best alternative forgone by using these inputs to generate a firm's revenues.

Resource-based theory, at its core, seeks to explain the generation and appropriation of economic profits (Barney, 1986a; Rumelt, 1984). However, some resource-based theorists take competitive advantage—when a firm generates more economic profit than its competitors (Peteraf & Barney, 2003)—or sustained competitive advantage—when a firm's competitive advantage that is not competed away through imitation (Barney, 1991; Rumelt, 1984)—as their dependent variables. While many of the arguments developed in this article can be generalized to the study of competitive advantage and sustained competitive advantage, the approach taken here focuses primarily on efforts to explain the generation and appropriation of economic profits.1

1These are ex post definitions of different ways of characterizing firm performance (Peteraf & Barney, 2003). In this context, the resources and capabilities that enable a firm to generate different levels of performance are more accurately described as "comparative advantages" and not "competitive advantages" (Barney & Mackey, 2018).
2.2 | Stakeholders

The concept of stakeholders also plays an important part in the arguments developed here. Following Freeman (1984), a stakeholder is any group that or individual who affects or is affected by a firm. One way that stakeholders can affect or be affected by a firm is by providing access to resources to that firm. These resources can affect a firm by enabling it to accomplish its objectives. Stakeholders, in turn, can be affected by a firm in this context because of the payment they receive for making these resources available to a firm. Given this definition of stakeholders, it is clear that shareholders are one example of a firm's stakeholders, although a firm typically has nonshareholder stakeholders as well.

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

2.3 | Fixed and residual claims

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

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

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

Stakeholders have a residual claim when payments for making their resources available to a firm do vary with the actual economic profits generated by a firm ex post. Because the actual payment for access to these resources cannot be precisely specified ex ante, residual claims are an example of an incomplete contract (Hart, 1988). Residual claimants agree, in these incomplete contracts, to be compensated for the resources they make available to a firm after all of a firm's fixed claims are paid (Jensen, 2002).

3 | THE GENERATION OF ECONOMIC PROFITS IN RESOURCE-BASED THEORY

As suggested earlier, resource-based theory has a specific model of how economic profits are generated (Barney, 1986a, 1988, 1991; Peteraf, 1993). This model distinguishes resource-based theory

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2 Various definitions of a firm exist. The arguments in this article are most consistent with the idea that a firm is a nexus of contracts among factors of production (Jensen & Meckling, 1976). As noted by Stout (2012) et al., this nexus can sometimes have legal standing.
from other theories in strategic management and related fields (Mahoney & Qian, 2013) that have different models for how economic profits are generated—for example, positioning theory (Porter, 1980) with its emphasis on market power in product markets and monopoly profits.

Resource-based theory starts by observing that if firms that sell and purchase access to resources in a factor market have the same, and accurate, expectations about the revenues those resources will create when used to implement strategies in product markets, then the sale and acquisition of access to these resources will not generate economic profits (Barney, 1986a; Wernerfelt, 1984). If, on the other hand, a small number of firms in these markets have more accurate expectations about the future revenues created by these resources compared to those selling access to them and others looking to acquire access to them, then acquiring access to these resources can be a source of economic profits. This is because the cost of acquiring access to these resources—determined by those with less accurate expectations—can be less than the revenues expected by those with more accurate expectations.

Why would some firms have more accurate expectations about the value of accessing resources than those selling this access and others looking to gain access to these resources? Resource-based theory suggests two possible reasons why this might happen: (a) Uncertainty about the revenue generating potential of these resources, and (b) the value created by combining resources—created by specific investments accumulated within a firm over time—with access to these new resources. Each of these sources of economic profits are discussed in the following.

3.1 | Uncertainty, asymmetric information, and economic profit

First, firms may not have expectation advantages ex ante, but turn out to have such advantages ex post. This can happen when there is uncertainty ex ante about how gaining access to resources might generate economic value ex post (Barney, 1988). With uncertainty, those selling and buying access to new resources may have what turn out to be ex post, inaccurate expectations about the revenue access to these resources will create in the future. If these expectations underestimate the true level of revenues generated by access to these resources, then the firm (or firms) that actually acquires access to them at what turns out to be a discount ex post can generate an economic profit (Barney, 1986a). In this sense, ex ante uncertainty about the future value of resources can create what turn out to be ex post information asymmetries in the market for access to new resources that, in turn, can generate economic profits.

3.2 | Accumulated specific investments, information asymmetry, and economic profits

Second, it may be the case that those looking to gain access to a new resource may control other resources and capabilities that can be used, in combination with this new resource, to generate more revenue compared to what could be generated by other firms combining their resources with access to this new resource. Moreover, these unusually valuable resources may have developed through the accumulation of specific investments (Argyres & Zenger, 2012) over time within a firm (Dierickx & Cool, 1989). Such resources tend to be path dependent, socially complex, and/or causally ambiguous (Amit & Schoemaker, 1993; Barney, 1986b, 1991; Lippman & Rumelt, 1982), and thus, costly to

1Implicitly, this model of profit generation assumes that both those selling and those buying access to resources in these markets are trying to maximize their economic profits. Unless otherwise noted, this assumption is adopted throughout this article. Note, however, that there are examples of factor markets where this assumption does not always hold, for example, labor markets where those selling access to their human capital often have interests besides maximizing their income (Campbell, Coff, & Kryscynski, 2012; Molloy & Barney, 2015).
imitate. They may also be rare among firms looking to create value by gaining access to a particular set of new resources, and have no close substitutes.

Firms that already control valuable, rare, inimitable, and nonsubstitutable resources developed over time by the accumulation of specific investments are likely to have more accurate expectations about how much additional revenue will be generated by combining these resources with access to new resources, compared to firms without these resources. This information asymmetry can enable these firms to avoid economic losses—when the cost of access to these new resources is greater than the additional revenues access to them would generate—and to realize economic profits—when the cost of access to these new resources is less than the additional revenues access to them would generate (Barney, 1986a).

4 | ECONOMIC PROFITS, RESOURCE-BASED THEORY, AND SHAREHOLDER SUPREMACY

Now, consider whether or not a “shareholder supremacy” model of profit appropriation is consistent with resource-based theory's model of profit generation. This article addresses this question in two ways—first, through the application of transaction cost economics to the analysis of the kinds of resources that can be accessed through fixed claim contracts (Williamson, 1975, 1985), and second, through the application of incomplete contract theory to the kinds of resources that are likely to generate the most value in a given economic exchange (Hart & Moore, 1999).

4.1 | Transactions cost economics and shareholder supremacy

For the moment, adopt the assumption that shareholders have a unique claim on a firm's economic profits. This is the shareholder supremacy assumption that characterizes much of finance (Jensen, 2002) and some strategic management research (Besanko et al., 2013; Denrell et al., 2003). If this assumption is correct, then firms need only maximize returns to shareholders in their decision-making since maximizing returns to shareholders ensures that those with fixed claims will receive their agreed to compensation (Jensen, 2002). Any revenue left after paying fixed claims will be appropriated by shareholders.

Of course, if shareholders have a unique claim on a firm's profits, it follows—by definition—that all of a firm's other stakeholders must have no claims on these profits. Since these other stakeholders have made resources available to a firm—and thus, must have some claim on a firm's revenues—but do not have a claim on any of a firm's profits, it follows that these other stakeholders must have fixed claims on a firm's revenues (Mahoney, McGahan, & Pitelis, 2009).

Thus, for example, in some settings, a particular supplier may receive a fixed claim worth $10 for supplying a resource to a firm that has an ex ante opportunity cost equal to $10. If this resource generates $25 of value ex post, this supplier will still receive $10 (the value of the fixed claim), and shareholders will appropriate the remaining economic profit of $15 ($25 in revenue - $10 in opportunity cost). Payment to this supplier is fixed because it does not vary with the amount of economic profit access to its resources generate ex post.4

In a world where every stakeholder, besides shareholders, is a fixed claimant—the world created by assuming that shareholders have a unique claim on firm profits—is it possible for a firm to

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4Of course, a given supplier can provide access to resources through both fixed and residual claims. The arguments developed in this article generalize to this setting. Also, over time, fixed claims can evolve into residual claims, especially if the resources provided to a firm begin to have profit generating potential. See the discussion that follows.
generate economic profits in the way described by resource-based theory? This question can be refined even further. Recall that fixed claims are a specific type of complete contingent claims contract. Thus, this question can be restated as: In a world where access to resources from every stakeholder, besides shareholders, is obtained through complete contingent claims contracts, is it possible for a firm to generate economic profits in the way described by resource-based theory?

Transactions cost economics tells us when complete contingent claims contracts—like fixed claims—can be used to efficiently protect the interests of all the parties associated with an exchange (Williamson, 1975, 1979, 1985). These kinds of contracts are efficient when both buyers and sellers of access to resources can fully anticipate and specify ex ante all contingencies that might affect the value created by this exchange. This means, in particular, that these transactions are not characterized by high levels of uncertainty, specific investment, or informational asymmetries. If a transaction had any of these attributes, then a complete contingent claims contract would fail to protect at least some parties to that exchange from threats of opportunism, and would be replaced by some other type of contract (Williamson, 1985). In this setting, the alternative to a complete contingent claims contract is a residual claims contract.

Recall, however, that fixed claims are a specific example of a complete contingent claims contract. If, in fact, all resources obtained from fixed claims are obtained through a complete contingent claims contract—as the assumption that shareholders have a unique claim on a firm's economic profits implies—it follows that these exchanges must not be characterized by uncertainty, specific investment, or information asymmetry. If they were, transactions cost logic suggests that parties to these transactions would not be protected from opportunism and other exchange hazards by a complete contingent claims contract/fixed claim contract. Absent other constraints, parties would choose to not enter into such contracts when there was uncertainty, specific investment, or information asymmetry associated with an exchange (Williamson, 1975, 1985).

However, resource-based theory's model of how economic profits are generated explicitly requires that those acquiring access to resources have more accurate expectations about the future revenues that will be created by access to those resources than others operating in that market. Those more accurate expectations reflect uncertainty or specific investments, or more generally, information asymmetry associated with acquiring access to these new resources. If none of these conditions hold, some firms cannot have superior expectations about the revenues access to new resources will create compared to other firms. And without these superior expectations, a firm cannot generate economic profits—at least in a way consistent with resource-based theory.

Assuming that only shareholders have a unique claim on a firm's profits implies that all other stakeholders are fixed claimants. If all other stakeholders are fixed claimants, then the sale and acquisition of access to the resources controlled by these fixed claimants is, by definition, managed through some type of complete contingent claims contracts. But complete contingent claims contracts can only be efficiently used to manage transactions when, among other things, there is no uncertainty, specific investment, or information asymmetry in an exchange. However, if there is no uncertainty, specific investment, or information asymmetry in the process of selling and acquiring access to resources, resource-based theory’s model of profit generation says that firms will not generate profits. Thus, a model of profit appropriation that assumes that shareholders hold a unique claim on firm profits contradicts resource-based theory's model of how economic profits are generated.

This argument can be restated in a different, but equivalent way. If both those buying and selling access to resources are looking to maximize their profits, and if these exchanges are characterized by no uncertainty (i.e., both buyers and sellers know the future revenues that will be generated by access to resources), no information asymmetry (i.e., both buyers and sellers have the same information
about the value that will be generated by access to resources), and no specificity (i.e., there are several equally skilled potential buyers and sellers)—as must be the case if fixed claims contracts are being used to gain access to these resources—then the factor market within which these exchanges occur will be highly competitive and the price paid for access to these resources will approximately equal their opportunity cost (Barney, 1986a). This implies that these exchanges will not be a source of economic profit. Only when exchanges are characterized by uncertainty, information asymmetry, and/or specificity—that is, when fixed claims contracts are not efficient—can acquiring access to resources generate economic profits. Thus, a model of profit appropriation that assumes that shareholders have a unique claim on a firm's profits (and thus, all other stakeholders are fixed claimants) is inconsistent with resource-based theory's model of profit generation.

That shareholders do not have a unique residual claim on a firm's profits does not mean that shareholders are irrelevant in generating these profits. Indeed, financial capital is often required to gain access to resources that, in turn, can be a source of economic profits for a firm. However, in efficient capital markets (Fama, 1970), one of the reasons that firms will be able to obtain financial capital is precisely because they have assembled, or are likely to be able to assemble, a bundle of other kinds of resources that have the potential to generate economic profit.5

Also, that resources provided to a firm through fixed claims contracts cannot be expected to be a source of economic profits does not make these resources strategically irrelevant. Indeed, firms must typically gain access to these kinds of resources if they are to gain at least competitive parity. However, the process of acquiring access to these “fixed claim” resources is typically very different than acquiring access to “residual claim” resources.

For example, a firm in the freight transportation industry must gain access to fuel to power its trucks. In most developed economies, fuel is a commodity that can be purchased from many suppliers. Suppliers can, in turn, sell to many different customers. Also, there is typically little quality uncertainty about fuel. For all these reasons, it is usually possible to purchase fuel through a fixed claim contract—trucks are driven to gas stations where they purchase fuel for listed prices. It would be unusual for firms in this industry to earn economic profits from purchasing fuel. However, failure to purchase fuel in these settings would be disastrous for a firm (Barney, 2017).

Of course, these conditions do not exist in all markets for fuel at all times. When there is uncertainty in supply, when quality is difficult to ascertain, or when purchasing fuel requires transactions specific investments, then fixed claims contracts will fail to protect buyers and sellers, the possibility of economic profits may exist, and residual claims contracts may emerge. For example, when there is supply uncertainty and information uncertainty, firms may choose to compensate employees who purchase fuel based on arbitrage profits they generate through exploiting fuel price differences in different geographic markets.

4.2 | Incomplete contracting theory and shareholder supremacy

The logic in the article to this point builds on traditional transactions cost theory's (Williamson, 1975, 1985) analysis of the kinds of exchanges that can be managed through complete contingent claims/fixed claim contracts to conclude that, in order for there to be economic profits, shareholders cannot be a firm's only residual claimant. This conclusion is also supported by an independent application of incomplete contract theory (Hart, 1988; Hart & Moore, 1990; Grossman & Hart, 1986).6

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5Financial capital is more likely to be a source of economic profits if capital markets are not efficient. This point is discussed in more detail later.

6The outlines of this argument were first suggested by P. Puranam (personal communication, October 2017). This argument also builds on the work of Mahoney (2013), Asher et al. (2005), Kim and Mahoney (2005), and Klein, Mahoney, McGahan, and Pitelis (2012).
Incomplete contract theory builds on the assumption that parties in the economy voluntarily cooperate when they recognize the opportunity to create economic value from doing so. The relationships among these cooperating parties are typically managed through some type of contract—formal, informal, implicit, or explicit. However, since these exchanges often evolve in ways that are difficult, if not impossible, to anticipate, these contracts are (almost) always incomplete. In the face of this incompleteness, an important question becomes: Who should decide how to employ the assets that are made available in these exchanges when conditions that were not specified in contracts ex ante exist? Using language from the theory, this question can be restated as: Who should have residual rights of control in an exchange?

One of the central conclusions of incomplete contract theory is that parties to an exchange that have the largest impact on the value created by that exchange have the strongest incentive to maximize the total value created by that exchange. This is because these parties typically have the most to gain if an exchange is managed in a way that maximizes the value it creates (Grossman & Hart, 1986). It follows that this party to the exchange should have residual rights of control, and in particular, that other parties to this exchange will find it in their self-interest to assign these residual rights to this actor.7 Among other things, these residual rights of control include decisions—not contractually specified ex ante—about how to allocate a firm's economic profits ex post among those cooperating in an exchange.

In order for the assumption of shareholder primacy to be consistent with incomplete contract theory, the resources shareholders bring to an exchange—financial capital—must always have a larger impact on the total value created in an exchange than the resources any other stakeholders bring to that exchange. While acknowledging that it is, in principle, possible for this to be the case—for example, when capital markets operate very inefficiently (Fama, 1970)—resource-based theory's model of the generation of economic profits suggests that access to nonfinancial resources are more likely to be a source of such profits. This is because nonfinancial resources are more likely to be socially complex, path dependent, and causally ambiguous in nature, compared to financial resources (Barney, 1986b, 1991; Dierickx & Cool, 1989; Lippman & Rumelt, 1982).

When it is the case that access to nonfinancial resources creates more economic value in an exchange than access to financial resources, incomplete contract theory suggests that residual rights of control will be assigned to those who control access to these nonfinancial resources. Since these residual rights of control typically include decisions about how to allocate economic profits, it follows that the sources of these nonfinancial resources will claim at least some of this profit. Thus, according to incomplete contract theory, resource-based theory's model of how economic profits can be generated suggests that a firm's shareholders will often not be the only firm stakeholder to appropriate economic profits, that is, shareholders will not always be a firm's only residual claimant. This conclusion contradicts models of profit appropriation in resource-based theory that assume that shareholders are a firm's only residual claimant.

4.3 | The choice facing resource-based theorists

The implications of transactions cost economics and incomplete contract theory for a resource-based model of profit appropriation that assumes shareholders are a firm's only residual claimants creates a dilemma for this theory. On the one hand, resource-based theorists can adopt the shareholder supremacy assumption in their model of profit appropriation, but to do so they will need to abandon

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7Alvarez and Barney (2005) examined the predictions of this model when it is difficult for parties to an exchange to know ex ante which has the most to gain from an exchange.
resource-based theory's model of how economic profits are generated. On the other hand, they can retain this model of how economic profits are generated, but then they cannot use a shareholder supremacy assumption in this theory's model of profit appropriation. This second choice is equivalent to acknowledging that since resource-based theory already (implicitly) adopts a stakeholder perspective in its model of profit generation, it must also adopt some sort of stakeholder perspective in its model of profit appropriation. Some of the important implications of this second choice are examined in the following.

5  |  EXPLICITLY INCORPORATING A STAKEHOLDER PERSPECTIVE IN RESOURCE-BASED THEORY

Suppose resource-based theory explicitly incorporated a stakeholder perspective in its models of profit generation and appropriation. What would this “stakeholder resource-based theory” look like, and how would it differ from received resource-based theory? These questions are addressed in this section of the article.

5.1  |  A stakeholder model of profit generation in resource-based theory

Since resource-based theory's model of profit generation implicitly adopts a stakeholder perspective, it is not difficult to make this aspect of resource-based theory more explicit. This can be done by recognizing that traditional resource-based logic examines how acquiring access to one resource can enable a firm to generate an economic profit (Barney, 1986a). A stakeholder version of this model begins by recognizing that the ability to generate economic profits often requires access to critical resources from several stakeholders, both within and outside the boundaries of a firm. To generate profits, the sum of the cost of acquiring access to each of these resources must be less than the total revenues these resources create together.

But, when will the sum of the cost of acquiring access to each of these resources be less than the total revenues they create together? One way this can happen is when the resources in question are co-specialized, that is, when each is more productive when bundled together compared to when they are used separately (Conner & Prahalad, 1991; Milgrom & Roberts, 1992; Teece, 1986). This emphasis on bundling multiple co-specialized resources together to generate economic profits is already an important part of many versions of resource-based theory (e.g., Adner & Helfat, 2003; Barney, 1991; Rumelt, 1984; Sirmon, Hitt, & Ireland, 2007; Sirmon, Hitt, Ireland, & Gilbert, 2011).

Consider, for example, five resources, each of which—by itself—can create $5 in value. If this is the second best use of these resources, $5 can be thought of as these resources’ opportunity cost. However, suppose—because of co-specialization and bundling—these resources operating together create, say, $45 in value. The difference between this $45 and the total of $25 in opportunity cost is an economic profit generated by the co-specialization and bundling of these resources.

Of course, if multiple firms expect that these five resources, when bundled in a co-specialized way, will generate $45 in total value, then competition for access to these resources will emerge, and the price of this bundle of resources will rise toward $45—at which point, they no longer generate an economic profit. Only when those assembling, or re-assembling, a bundle of resources have different, and more accurate, expectations about how a bundle of co-specialized resources will create value, compared to others who might try to create this bundle and to those that provide individual resources to this bundle, can the creation of this bundle of co-specialized resources be a source of economic profits (Barney, 1986a).
Of course, the differential ability of firms to anticipate the value of bundling, or re-bundling, co-specialized resources has been the primary research topic of those who study firm-level “dynamic capabilities” (e.g., Helfat, 1997; Helfat & Peteraf, 2003; Teece, Pisano, & Shuen, 1997). This work suggests that such capabilities often have the attributes—they are socially complex, causally ambiguous, path dependent, and so forth—that make them rare, costly to imitate, and nonsubstitutable (Barney, 1991). In this sense, explicitly incorporating a stakeholder perspective into resource-based theory’s model of profit generation makes research on these dynamic capabilities even more important.

Another implication of explicitly adopting a stakeholder perspective in resource-based theory’s model of profit generation has to do with the unit of analysis in this model. Much of prior resource-based theory has adopted the assumption that the unit of profit generation in the theory are resources (or bundles of resources) that exist within a firm (Barney, 1986a). However, this may not be the case when the ability of a firm to generate economic profits depends on bundling co-specialized resources from multiple stakeholders—some of which may be outside a firm’s boundaries. In this setting, the unit of profit generation is not a firm’s resource (or bundle of resources), but rather, the co-specialized resources and capabilities created by a firm and its stakeholders (Amit & Schoemaker, 1993; Helfat & Peteraf, 2003).

This observation is consistent with the growing emphasis in the strategic management literature of the importance of ecosystems (Adner, Oxley, & Silverman, 2013), network organizations (Hansen, 2002; Nohria & Eccles, 1993), multi-sided markets (Hagiu, 2006; Hagiu & Wright, 2015), value nets (Brandenburger & Nalebuff, 2006), open innovation (Chesbrough, 2003), and relations among firms (Dyer & Singh, 1998) as sources of economic profits. However, this analysis also suggests that these co-specialized resources per se will not be a source of economic profits. Rather, they will be a source of such profits when the ability to create and manage them is rare, costly to imitate, and nonsubstitutable (Barney, 1991).

For example, empirical work on the emergence of Silicon Valley has focused on the unique historical conditions that led to the development of this valuable ecosystem (Arthur, 1989, 1994). Resource-based theory suggests that it is the path dependent nature of the emergence of this ecosystem, in combination with the value it creates for firms operating within it, that generates economic profits. If other “Silicon Valleys” could be created at low cost, then the value that these ecosystems can create would not be rare, and thus, not a source of economic profits.8

5.2 A stakeholder model of profit appropriation in resource-based theory

A stakeholder model of profit generation in resource-based theory suggests that the process of assembling a bundle of co-specialized resources can be a source of economic profits for firms. But, how will these profits be divided among those stakeholders who provided access to these resources? In other words, what is resource-based theory’s stakeholder model of profit appropriation?

Such a model of profit appropriation can be derived from the incomplete contract analysis presented previously. Incomplete contract theory suggests that the stakeholder that provides access to resources that create the most value in a bundle of co-specialized resources will have residual rights of control in this exchange. In the simple example previously developed, this stakeholder will decide how to allocate at least part of the $20 of economic profit ($45 to $25) that was generated when this bundle of resources was assembled in the way described earlier—namely, that part of profits whose distribution was not contracted for ex ante.

8Path dependence of this variety can also be a source of sustained competitive disadvantage (Pierce & Snyder, 2017a, 2017b).
One way that these profits could be distributed is for the stakeholder with residual rights of control to appropriate all of them. However, this is likely to make the cooperative exchange that generated these profits difficult to form, and even more difficult to sustain. Instead, this stakeholder is more likely to allocate at least some of these profits to others who have provided access to resources to the co-specialized bundle. In principle, the simplest way to do this would be to allocate profits to stakeholders proportional to their marginal contributions to the economic profits generated by this bundle of resources (Grossman & Hart, 1986; Hart, 1988; Hart & Moore, 1990). However, because of co-specialization in the bundle of resources, the marginal productivity of each resource in the bundle often cannot be estimated precisely (Alchian & Demsetz, 1972; Conner & Prahalad, 1991; Milgrom & Roberts, 1992). In this sense, those that provide resources to a co-specialized bundle may not fully understand the opportunity costs of doing so (Alchian, 1950; Lippman & Rumelt, 2003a, 2003b).

In this context, the allocation of profits generated by a bundle of resources to those that control access to those resources is likely to be a function of a variety of factors, including: (a) the perceived importance, both ex ante and ex post, of individual resources on the ability of a bundle of co-specialized resources to generate profit (Grossman & Hart, 1986); (b) whether the resources in question are generally valuable or only create value with the specific other resources in the current bundle (Becker, 1964; Molloy & Barney, 2015); and (c) the negotiation skills of those that control access to these resources (Bazerman & Neale, 1992). In effect, these characteristics of the setting within which a bundle of co-specialized resources generates economic profits determine the bargaining power of different stakeholders in appropriating these profits. Moreover, how economic profits are allocated to stakeholders is also likely to change over time as these three determinants of profit allocation also change. Of course, if profit allocations among stakeholders are widely seen as unfair and inequitable, the stability of a particular bundle of co-specialized resources can deteriorate as stakeholders may withdraw, or threaten to withdraw, their resources and make them available to other bundles of resources (Wade, O'Reilly, & Pollock, 2006).

A growing empirical literature has examined how certain stakeholders—most frequently certain kinds of employees—are able to appropriate more or less of the profits their human capital helps generate (Molloy & Barney, 2015). This research suggests that—controlling for negotiation skills—those with general human capital that is seen as very important in creating economic profits in large numbers of firms tend to be able to appropriate more of the profits their human capital helps generate. It also suggests that those with firm specific human capital that is seen as creating economic profits in smaller numbers of firms tend to be able to appropriate less of the profits their human capital helps create (Chacar & Hesterly, 2008; Groysberg, 2010). These results are consistent with the stakeholder resource-based model of profit appropriation developed here.

Just as was the case with resource-based theory's model of profit generation, explicitly recognizing stakeholders in resource-based theory's model of profit appropriation also has important unit of analysis implications. In particular, if a bundle of co-specialized resources from a network of stakeholders is responsible for the generation of economic profits, then each of the stakeholders that are part of this network will expect to appropriate at least some of the profits they collectively generate. In the aggregate, it is this network of stakeholders that appropriates these economic profits (Lieberman & Chacar, 1997), although, typically, each member of this network will appropriate at least some of them (Castanias & Helfat, 1991; Lippman & Rumelt, 2003a, 2003b).

These observations can have important implications for empirical tests of resource-based theory. For example, it may be that a particular firm has assembled the co-specialized resources that generate an economic profit, but for a variety of reasons—mentioned earlier—does not appropriate much of
the profits this bundle generates. Examining the performance of just this firm might lead to the conclusion that economic profits were not generated by this bundle of co-specialized resources—what Coff (1999) has called the “competitive advantage without profits problem.” However, examining the performance of all the stakeholders in the bundle—including some nonfirm members of the network—could lead to the opposite conclusion.

Thus, for example, a particular bio-tech firm may have assembled five critical resources—embodied by five scientists—who, working together, generate substantial economic profit. However, if other bio-tech firms have the same complementary resources (e.g., manufacturing or marketing capabilities) as this particular firm, they would have been able to generate this same level of economic profit with these scientists. Also, the scientists, together, may understand how they collectively generate economic profits. In this setting, competition from other firms and the bargaining power of the scientists suggest that the scientists, not the firm, will appropriate most of the economic profit they generate. Looking only at the accounting profit of this one firm could lead to the conclusion that this firm’s strategy failed to generate any economic profits. This is incorrect. However, most of these profits were appropriated by the resources that generated them, in this case, the five scientists.

5.3 Managers and entrepreneurs in stakeholder resource-based theory

Incomplete contract theory suggests that stakeholders who control resources that create the most value in a bundle of co-specialized resources will typically have residual rights of control, rights that include deciding how to allocate economic profits among stakeholders who provided access to resources in the co-specialized bundle. In principle, any stakeholder—including, for example, a critical supplier or customer, could take on this role. However, in practice, it seems likely that firm managers (and entrepreneurs) will often have these residual rights. This suggests that firm managers and entrepreneurs often have a special role to play in a resource-based theory that explicitly incorporates a stakeholder perspective.

Firm managers (and entrepreneurs) are likely to often have residual rights of control because they often have the responsibility for constituting and managing a bundle of co-specialized resources that has the potential to generate economic profits (Sirmon et al., 2007, 2011). Decisions about which resources to assemble can reflect these managers' (or entrepreneurs') unique theory of how a particular bundle of resources can create value. Without this theory, and managers (or entrepreneurs) to implement this theory, resources are never bundled together, co-specialization cannot occur, and economic profits are not generated. For this reason, managers (and entrepreneurs) will often be seen as creating the most value in a bundle of co-specialized resources, and thus, will often take on residual rights of control. This is especially the case when the theory of how a bundle of co-specialized resources can create economic value is either new or changing.

Moreover, when managers have the responsibility to form this co-specialized bundle of resources, they may have more information about the marginal productivity of each of the resources in a co-specialized bundle. While this superior information may not enable managers to measure this marginal product precisely (Alchian & Demsetz, 1972; Milgrom & Roberts, 1992), it can enable them to measure marginal product more accurately than other stakeholders.

Of course, not all managers in a firm have responsibility for conceptualizing and then assembling a set of co-specialized resources to generate economic profits. For example, managers (and other employees) who have fixed claims contracts for making their human capital available to a firm are

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9Consider, for example, Apple's impact—as a critical customer—on the distribution of the economic profits among various suppliers in its value chain (Spence, 2016).
unlikely to have these kinds of profit generating responsibilities. Indeed, in some organizations, a residual claims employment contract may be more of a signal of an employee's status in a firm then a clear signal that this employee is part of the profit generating activity in a firm (Gomez-Mejia, Berrone, & Franco-Santos, 2010). However, while not all managers in a firm will have these profit generating responsibilities, it is likely that at least some of them will. When this is the case, these managers are likely to take on residual control rights.

Most entrepreneurs—and especially those early in the history of an entrepreneurial endeavor—will have this profit generating responsibility, and thus, will often take on residual rights of control. In this context, these entrepreneurs can be thought of as those individuals who create a new theory about how a particular bundle of co-specialized resources can generate economic value (Alvarez & Barney, 2007), and then assemble this bundle by enrolling the relevant stakeholders (Burns, Barney, Angus, & Herrick, 2016).

Of course, an entrepreneur's theory about how a particular bundle of co-specialized resources may generate economic profits can have an important impact on the enrollment process—both who needs to be enrolled and how enrollment occurs (Burns et al., 2016). Moreover, this enrollment process can also have an impact on an entrepreneur's theory about how to generate economic profit: As access to resources from stakeholders are added to the profit generating bundle, the ways that a co-specialization among resources in a bundle can generate economic profits may change in difficult to anticipate ways. This is especially likely under conditions of Knightian uncertainty, when the opportunities entrepreneurs are seeking to exploit are being created endogenously (Alvarez, Barney, & Anderson, 2013).

5.4 Resolving conflicting interests among stakeholders in resource-based theory

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

However, some of the nonshareholder stakeholders identified in stakeholder resource-based theory cannot diversify the risks associated with their investments in a firm in the same way as shareholders. For example, employees sometimes invest much of their human capital in a single firm where it can be bundled in highly co-specialized ways with other resources to generate economic profits (Molloy & Barney, 2015). But it is often difficult for these employees to invest their human capital this way in multiple firms, and thus, it is often difficult for these employees to diversify the risks associated with their investments in a single firm (Wang & Barney, 2006). Thus, all things being equal, these types of employees will be more risk averse in the strategies they would prefer a firm to pursue than shareholders who have also invested in this firm.

Other nonshareholder stakeholders may be able to partially diversify the risks of making highly specific investments in a particular firm. Suppliers and customers, for example, may be able to make these kinds of investments in a few firms, and thus, will gain some of the downside risk mitigation advantages of diversification. Thus, these kinds of stakeholders will often be more comfortable with a firm choosing and implementing risky strategies than employees. However, to the extent that

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10This implies that stakeholders may be part of several profit-generating bundles of co-specialized resources simultaneously. Also, to the extent that stakeholders are themselves firms, they too can have stakeholders from whom they acquire access to the resources they need to provide resources that are part of the profit generating co-specialized bundle of resources at another firm, and so on.
these other stakeholders cannot fully diversify these risks, they will typically be more risk averse in the strategies they would like to see a firm pursue compared to shareholders.

Fixed claimants, because they do not share in any profits generated by a firm, will generally be very risk averse with regard to the strategies they would like a firm to pursue. In particular, they will typically prefer that firms pursue strategies that reduce the probability of bankruptcy. Such strategies increase the probability that a firm will be able to pay off its fixed claimants (Titman, 1984).

The different risk preferences of multiple stakeholders with claims on a firm’s economic profit present a challenge for those who are tasked with bringing together the resources needed to generate the co-specialization required to create economic profits—often a firm's managers or its entrepreneurs. It would be much simpler to ignore all such claims except those of shareholders and adopt more risky strategies, but such an approach will make it difficult to attract the resources of more risk averse stakeholders to a firm. And without all the stakeholders needed to generate co-specialization, a bundle of resources cannot be expected to generate economic profits.

Thus, to attract nonshareholder stakeholders to a firm, shareholders will often find it in their self-interest to let the firm choose and implement less risky strategies than what they would otherwise prefer (Wang & Barney, 2006). In addition, to attract shareholders to a firm, nonshareholder stakeholders will often find it in their self-interest to let a firm choose and implement more risky strategies than what they would otherwise prefer. If profit generation requires access to all the co-specialized resources in a bundle, it is important for those making these resources available to a firm to accommodate—at least to some extent—each other's risk preferences (Kogut, 1991; Wang & Barney, 2006).

Some firms have tried to resolve the risk preference conflicts among their employees and shareholders by compensating some employees—with stock and stock options—in ways that should make these employees more comfortable with risk taking (Daniels, Coles, & Naveen, 2006). While this form of compensation could enable employees to diversify the riskiness of the financial outcomes created by their human capital investments in a firm, they do not enable employees to diversify the risks associated with the sources of these financial outcomes, namely, their human capital investments in a firm. Thus, it seems likely that using stock and stock options to compensate employees may not fully reconcile the risk preference conflicts between a firm's employees and shareholders.

Moreover, such employee compensation may actually exacerbate risk preference differences between employees compensated in this manner and those with fixed claims on a firm's profits. Recall that while fixed claims are typically not part of the profit generating bundle of co-specialized resources in a firm, failure to attract the resources controlled by fixed claimants to a firm can prevent a firm from generating economic profits.

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

Despite these numerous potential conflicts, it is important to remember that these different stakeholders always have two self-interests to balance: their narrow self-interest in extracting as much of the profit generated by a firm as possible, and their broader self-interest, which suggests that, without cooperation that leads to co-specialization, there will not be any expected economic profits to distribute. This logic suggests that the process of cooperating to realize profits from co-specialization and the allocation of profits to stakeholders may have much in common with the general problem of
organizing the generation and appropriation of the value associated with collective goods (Ostrom, 1990). A variety of approaches for analyzing how cooperation evolves among otherwise competitive agents has already been developed in the literature (e.g., Axelrod, 1984; Brandenburger & Nalebuff, 1996; Habermas, 1979) and may be applicable in understanding how conflicts among stakeholders in this version of resource-based theory can be resolved.

6 | STAKEHOLDER THEORY AND A STAKEHOLDER PERSPECTIVE IN RESOURCE-BASED THEORY

Stakeholder theory is a well-established and diverse theoretical tradition in organizational research (Freeman, 1984; Freeman et al., 2010). While the arguments developed in this article are consistent with some of the central conclusions of stakeholder theory—including, for example, that stakeholders besides shareholders will have residual claims on a firm's profits—there remain important differences between stakeholder theory, on the one hand, and resource-based theory that incorporates a stakeholder perspective, on the other. Two of these differences are discussed here.

The first difference has to do with the kinds of stakeholders that are important in the two theories. Some versions of stakeholder theory (Freeman et al., 2010) assert that firms need to consider the interests of large groups of stakeholders—all employees, customers, and suppliers—when making decisions. While acknowledging that these individuals and institutions are all stakeholders (Freeman, 1984) and that some may even have fixed claims, incorporating a stakeholder perspective into resource-based theory focuses mostly on those subsets of individuals and institutions who can help generate economic profits by making resources that can become part of a co-specialized bundle available to a firm. Not all stakeholders control access to resources that have this potential.

This narrower view of what constitutes “essential” stakeholders helps avoid a difficult problem associated with some versions of stakeholder theory (Freeman et al., 2010). These versions of stakeholder theory assert that the legitimate interests of many different types of stakeholders must be recognized in making strategic and operational choices. However, the interests of these stakeholders, both between stakeholder categories and within those categories, can be very diverse. Harmonizing these many conflicting interests to make a decision can sometimes appear daunting, if not impossible. This is one reason why a theory of how conflicts among broad groups of stakeholders can be resolved has never been proposed (Freeman et al., 2010).

Incorporating a stakeholder perspective into resource-based theory does not require a model of how the conflicting interests of many thousands—if not hundreds of thousands—of stakeholders need to be harmonized for decisions to be made. Rather, the task is much narrower: To harmonize the conflicting interests of just those stakeholders whose resources are part of the co-specialized bundle that generates economic profits. While, as noted earlier, there may be important conflicts among this smaller group of stakeholders, they do all have one interest in common: By cooperating to create co-specialization, they can generate economic profits, some of which they may be able to appropriate.

As suggested earlier, none of this implies that resources not included in this co-specialized bundle are unimportant. For example, they may be necessary for a firm to gain competitive parity (Barney, 1991). However, because they are not part of the co-specialized bundle of profit generating resources, information asymmetry about their value creating potential cannot arise from this co-specialization, and this source of information asymmetry cannot be a source of economic profits.

11This view of stakeholders is more consistent with instrumental stakeholder theory (Donaldson & Preston, 1995).
Second, some stakeholder theorists have tried to use this approach to develop more ethical and socially responsible approaches to strategic decision-making (Walsh, 2003). While there remains some controversy regarding the appropriateness of this effort (e.g., Phillips, 2003), its underlying logic is straightforward: If the interests of all stakeholders are taken into consideration, then it seems less likely that strategies that systematically disadvantage some of those stakeholders will be chosen (Clarkson, 1995; Donaldson & Dunfee, 1999; Harrison & Freeman, 1999). If those stakeholders include the community, the environment, and so forth, then this does seem to form the basis for a more socially responsible and ethical approach to business decision-making (Freeman et al., 2010), at least compared to the shareholder supremacy approach.

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

Thus, unlike some who argue for shareholder supremacy (Jensen, 2002) or for incorporating a stakeholder perspective into managerial decision-making (Freeman et al., 2010), stakeholder resource-based theory takes less of a normative perspective, and much more of a positive perspective. That is, rather than attempting to provide a moral standard against which to judge a firm's actions, stakeholder resource-based theory makes specific predictions about how profit-maximizing firms will operate. In fact, it generates two broad empirical propositions: First, that firms that assemble co-specialized resource bundles and treat stakeholders that provide access to these resources as residual claimants will generate more economic profits than firms that do not behave in these ways; and second, how much of these profits a firm is able to appropriate depends on the collective bargaining power of its nonshareholder stakeholders. In some settings, these empirical assertions may also have prescriptive implications for managers. However, these prescriptions do not claim any moral or ethical superiority.

7 CONCLUSION

Despite calls for their integration, stakeholder theory and strategic management theory have remained on largely parallel developmental paths (Freeman et al., 2010). However, several strategic management scholars—including Byler and Coff (2003), Castanias and Helfat (1991, 1992), Coff (1999, 2010), and MacDonald and Ryall (2004)—have noted potentially important links between resource-based theory's model of profit appropriation and stakeholder theory. This has led other scholars—including Asher et al. (2005) and Mahoney (2013)—to suggest the possibility of developing a stakeholder theory of strategic management.

This article argues that not only is such a theory possible, but that it is logically required if resource-based theory's model of profit appropriation is to be consistent with its model of profit generation. The resulting stakeholder resource-based theory has important theoretical and empirical implications for resource-based theory as it currently exists within the field of strategic management.
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