

**STAKEHOLDER JUDGMENTS OF VALUE:
ADVANCING STAKEHOLDER THEORY THROUGH PROSPECT THEORY**

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Abstract

We develop stakeholder theory by producing a richer conceptualization of its central construct of stakeholder value, showing how stakeholder judgments of value – and, consequently, stakeholder reactions – are likely influenced by the cognitive biases that affect human judgment. Drawing upon prospect theory, we explain how such biases arise and suggest that stakeholders judge the value created or destroyed by firms not in absolute but in relative terms: as losses and gains against a reference state that might differ across stakeholders and change over time and where losses weigh more heavily than equally sized gains. Our theorizing results in a fundamentally different way of perceiving the value of corporate actions to stakeholders, where valuations can change radically from those that would be expected based on absolute measures of performance outcomes. It also shifts understanding of the avenues available for companies and others to try to influence stakeholder judgments of value. We conclude with implications for stakeholder theory and managerial practice and outline opportunities for further research.

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Corporations both create and destroy value for stakeholders. In so doing, a firm's actions prompt stakeholder judgments and reactions that can be difficult to anticipate unless the firm is able to correctly gauge the impact of its activities on *stakeholder value*; that is, the value of an outcome to stakeholders. Predictions of stakeholder reactions may be wrong if managers do not understand how stakeholders judge value—and possibly with dire consequences for the firm. When Canadian environmentalists campaigned against MacMillan Bloedel's logging operations in Clayoquot Sound because the trees were so old (some over 1,000 years), their judgment of value, while at odds with management perceptions, was shared by other stakeholders, including customers. Six years later, the company ceased to exist (Boutilier, 2009).

Understanding stakeholder value has important implications for the design and prioritization of corporate social responsibility (CSR) activities, where CSR is broadly defined as “a firm's commitment to maximize long-term economic, social, and environmental well-being through business practices, policies and resources” (Du, Bhattacharya & Sen, 2011: 1). It is important from a normative and an instrumental stakeholder theory perspective. Normatively, if firms are supposed to create value for stakeholders and avoid destroying value, they must understand what that value is. Instrumentally, understanding stakeholder value is required to better anticipate stakeholders' reactions, prepare for them, and prevent adverse reactions.

In addition to its practical importance, there is also theoretical interest in a better understanding of stakeholder value judgments in the context of stakeholder theory. The stakeholder approach is central to the study of corporate responsibility, if not the paradigm for the business and society field (Freeman, Harrison, Wicks, Parmar & de Colle, 2010; Jones, 1995;

Schwartz & Carroll, 2008). Yet despite more than thirty years of research, stakeholder theory is still underdeveloped and requires substantial further advancement (Agle et al., 2008; Freeman et al., 2010). Stakeholder value is a central concept in stakeholder theory; indeed, some theorists are seeking to redefine the theory of the firm to suggest that it should be founded on maximizing stakeholder value (Freeman, Harrison & Wicks, 2007; Freeman et al., 2010). Surprisingly, however, the literature lacks a precise definition of stakeholder value and has given little attention to the question of how stakeholders actually perceive and judge value. Advancing stakeholder theory thus requires improved specification and understanding of the nature of stakeholder value and how stakeholder judgments of value are made.

In this article, we adopt the instrumental perspective on stakeholder judgments of value (Donaldson & Preston, 1995). Most impacts of corporate social performance on corporate financial performance are mediated through stakeholder reactions. On the revenue side, almost all impacts are mediated through customer reactions. On the cost side, the reactions of stakeholders such as regulators, capital and insurance providers, employees, suppliers, and local populations mediate the costs of doing business. Only in the case of certain direct cost impacts, such as savings in energy, raw material or waste handling costs do the bottom line impacts generally not depend on stakeholders' reactions (Bhattacharya, Sen, & Korschun, 2011; Lankoski, 2008). Thus, how stakeholder judgments of value are formed and the subsequent reactions they trigger can be crucial for the instrumental relationship between corporate social and financial performance. Pelozo's (2009) review of the "business case for CSR" literature notes that mediating variables have been understudied and that the most important direction for future research would be to understand the mediation process between corporate social and financial performance, with attention to all stakeholder groups.

The causal path from corporate activities and decisions to stakeholder reactions consists of several cognitively distinct stages. Barnett (in press) divides these into noticing, assessing and acting. Similarly, applying the ethical decision-making model in Jones (1991), the process can be seen to consist of recognizing the issue, making a judgment, establishing intent and engaging in behavior. Within this causal path, we focus on the assessment/judgment stage to explore the cognitive processes by which stakeholders form their evaluations of business decisions and activities. Improved understanding of these judgments should allow for better predictions of stakeholder reactions, especially unanticipated negative reactions that can result in adverse reputational and economic consequences for companies, as, for example, clothing retailer the Gap found over labor rights issues in its supply chain (Smith, Ansett & Erez, 2011). Thus, we will not examine how stakeholders obtain knowledge of corporate decisions and activities and when they are likely to pay attention to them, nor will we examine the conditions under which stakeholders may fail to react according to their value judgments (as distinct from situations where not taking any particular action is consistent with the value judgment).

In sum, we examine, from the firm's instrumental perspective, value as judged by stakeholders from their standpoint. To this end, we turn to prospect theory, a psychological theory of human judgment and decision-making first proposed by Kahneman and Tversky (1979). Prospect theory argues that the contribution of an outcome to judgment may differ markedly from the objective outcome (Kahneman & Tversky, 1984). This is because people tend to judge value in terms of losses and gains against a reference state, not as absolute states. Moreover, there is a negative asymmetry in that losses are weighed more heavily than equally sized gains (Kahneman & Tversky, 1979).

Prospect theory has strong empirical support (Barberis, 2013; Jawahar & McLaughlin, 2001; Kuhberger, 1998; Starmer, 2000; Tversky & Kahneman, 1991) and has been applied to various management-related phenomena (Holmes, Bromiley, Devers, Holcomb, & McGuire, 2011). However, prospect theory has not been previously applied to stakeholder judgments of value. Stakeholder value has innate subjectivity and depends on the stakeholder's judgment of that value; judgments of value are at the core of prospect theory. It is thus both appropriate and important to incorporate a prospect theory perspective on stakeholder judgments of value.

Hence our major and novel theoretical contribution lies in advancing stakeholder theory through prospect theory by developing a rich conceptualization of how stakeholder value judgments are formed in response to corporate actions. By introducing the cognitive biases known to affect human judgment to stakeholder judgments of value we are able to more adequately specify stakeholder value, a construct central to stakeholder theory. In regard to CSR specifically, if we think about corporate responsibility outcomes solely in terms of absolute performance, rather than in relative terms (as losses and gains eliciting an asymmetric response), our picture of stakeholder value as stakeholders judge it will remain incomplete, if not inaccurate.

Our paper responds to several calls in the extant literature. Wood (2010: 75) argues that within the corporate social performance literature there has been a “theoretically strange focus on the firm rather than stakeholders and societies” and that research efforts should be refocused towards the impacts of corporate social performance on stakeholders and society. More specifically, Freeman et al. (2010) suggest stakeholder value is inadequately understood, while various sources call for more research to better understand stakeholder actions and responses (e.g., Laplume, Sonpar & Litz, 2008; Rowley & Moldoveanu, 2003). Aguinis and Glavas (2012), noting that individual actors perceive CSR initiatives and take action as a result, identify the need

to address the microfoundations of CSR and study the underlying mechanisms at the individual level of analysis that link CSR with outcomes. Our approach is also consistent with the recommendation of Agle et al. (2008) to develop stakeholder theory by borrowing theory from other fields and that of Wood (2010) to incorporate research in other domains into the corporate social performance literature.

We divide the article into four major sections. In the first section, we discuss value in the context of stakeholder theory. Having argued that stakeholder value is insufficiently developed in the literature, we examine the construct from several perspectives to arrive at our working definition. In the second section, we outline a prospect theory perspective on stakeholder judgments of value at the level of an individual stakeholder and then extend our analysis to collective judgments. The third section discusses in more detail understanding and influencing stakeholder judgments of value based on alternative reference states. Finally, the discussion section highlights the theoretical contributions and managerial implications of our theorizing.

VALUE IN THE CONTEXT OF STAKEHOLDER THEORY

Stakeholder value is central to stakeholder theory. Freeman et al. (2010) suggest that a “stakeholder approach is about creating as much value as possible for stakeholders” (Freeman et al., 2010: 28; also see Freeman et al., 2007 and, for a critical view, Sundaram & Inkpen, 2004). While not universally accepted, this idea has found expression elsewhere, including within the finance field. Cloninger (1997: 83) proposed maximization of *stakeholder* value as a framework for financial management and claimed that “the total value of the firm is the sum of the value to its respective stakeholders... an action that benefits one constituency at the expense of another may result in reduced firm (stakeholder) value.” Thus, central to these conceptions of

stakeholder theory, at least, is business as a stakeholder value creation enterprise (see also Laplume et al., 2008).

Further, Freeman et al. (2007: 76) note that “even if you want to maximize value for shareholders, you still have to create value for stakeholders”. This core idea of instrumental stakeholder theory—that strategic management of stakeholders can lead to better financial performance—has been widely adopted and it has attention to stakeholder value as a central feature, even if the reference is often more loosely to “stakeholder interests”.

However, while creating stakeholder value is at the core of Freeman’s stakeholder theory, if not instrumental stakeholder theory more generally, what constitutes stakeholder value remains unclear, and this vagueness is evident throughout the literature. Indeed, when identifying directions for further research on stakeholder theory, Freeman et al. (2010: 288) include the questions of what value means for stakeholders and how we can better assess the value that a firm creates for its stakeholders, the issues we are attempting to shed light on. Thus we now turn to the construct of stakeholder value in more detail—its components, the role of subjectivity, individual vs. collective judgments, and the aggregation of judgments of value—as a basis for advancing our working definition.

Components of Stakeholder Value

Value is defined as “relative worth, utility, or importance” (*Merriam-Webster Dictionary*). In environmental and resource economics, several sources of value have been identified that together comprise the concept of total economic value. Essentially, this typology suggests that value can arise from actual use of a resource (use value), from its possible use in the future (option value), and from non-use-related considerations (existence value) (Braden & Kolstad, 1991; Freeman, 1993). Within these categories there are further classifications; for example,

non-use value can arise from appreciating the outcome “*per se* (intrinsic value), for the pleasure of others (altruism), or for future generations (bequest value)” (Plottu & Plottu, 2007: 53).

Noteworthy in regard to stakeholder value is that value is conceived broadly and as having multiple components that are not necessarily visible, easily quantifiable, or reflected in monetary terms. Activities by firms create (destroy) value if they positively (negatively) affect any component of total economic value. Thus Laszlo (2008: 120), for example, writes: “Value is created when a business adds to the capital or well-being of its stakeholders. It is destroyed when a business reduces their capital or undermines their well-being.”

Subjective Versus Objective Value

Stakeholder value can be considered in objective or subjective terms. Subjective valuations may differ from objective ones: for example, stakeholders may be “mistaken” in their value judgments in that they may not know, objectively speaking, what is best for them or for the issues they care about (e.g., nutrition, an environmental resource). Yet our instrumental approach to stakeholder value requires that subjective value is examined. This is because only subjective value matters for stakeholder reactions and thus for their potential impacts on the firm’s ability to achieve its objectives (this is not to say that there isn’t a possible normative obligation in some circumstances to correct stakeholder misunderstandings). Hence, throughout this paper, we consider stakeholder value from the subjective perspective of the stakeholder.

Level of Subjective Value Judgments

According to the classic definition, stakeholders are groups and individuals that can affect the company or be affected by it (Freeman, 1984). Much of the stakeholder literature focuses on stakeholder groups and many stakeholders are indeed organization-type and thus collective by nature (e.g., supplier firms and partner organizations, B-to-B customers, authorities, institutional

investors, creditors, and the traditional media). However, many other, often more important stakeholders, are clearly individuals (e.g., consumers, employees, local inhabitants, the general public, individual shareholders, and participants in social media). Although also referred to as stakeholder groups in a role-based stakeholder literature, these stakeholders do not necessarily constitute psychological collectives but are organized in more or less loose or tight groups (e.g., as NGOs, trade unions, consumer groups), if organized at all. Thus, these stakeholder “groups” are often essentially aggregations of individuals where judgment and decision-making is still at the individual level. Equally, organization-type stakeholders may or may not be highly organized (e.g., in industry federations or trade associations). As a consequence, both the individual and the collective level can be relevant when discussing judgments of stakeholder value.

With an instrumental approach, the relevant analysis level is the one where the eventual stakeholder reactions are determined. This is sometimes going to be the individual level and sometimes the collective level. With individual-type stakeholders not organized in a group, the individual perspective clearly applies. However, when individual-type stakeholders are organized in a group, the appropriate analysis level depends on whether the individuals are at liberty to choose to take action or must act in accordance with the collective judgment. For example, when an NGO calls a consumer boycott, the appropriate analysis level is still the individual if our question of interest is whether the individual decides to join the collective action. Prospect theory has been applied to collective action from this perspective in political science. Masters (2004), for example, examined support of rebellious action, noting that the role of the collective organization can include framing choices and providing resources for action, but judgment and decision-making on joining the action remains at the individual level. By contrast, if the individuals do not have the liberty of choice as to their reactions, the relevant level of

analysis is the collective level, though such situations may occur less often (e.g., a trade union declares a strike, forbidding strikebreakers).

Thus, individual stakeholder judgments of value matter in and of themselves when individuals are not organized in a group or when organized in a group and still at liberty to decide on their own reactions to the firm. By contrast, collective stakeholder judgments of value matter when individuals are organized in a group and must follow the group's judgment in their reactions. When dealing with an organization-type stakeholder, we need to take the collective perspective regardless of whether or not these stakeholders are further organized in a group (an exception would be where the decision-making is by one dominant individual—a chief executive of an organization perhaps). Significantly, while the individual level does not account for all possible instances of stakeholder value judgments, it may still account for many *important* instances from our instrumental point of view. Studies show that effects on customers and employees, where individual level judgments are likely to predominate, are particularly significant for financial performance impacts (e.g., Berman, Wicks, Kotha & Jones, 1999).

Aggregation: Of What and by Whom?

Stakeholder value can refer to the value that one action of a firm creates (destroys) for a stakeholder. Stakeholders may react to isolated actions, but these instances are likely rare (e.g., a consumer responding to a one-off event such as a fatal fire in a garment factory that manufactures for a brand available in the market but previously unknown to this consumer). However, there can be (and usually are) multiple actions of a firm that affect a particular stakeholder, who may take several such impacts into account when making an overall evaluation. Godfrey (2005) argues that stakeholders account for positive moral capital accrued through philanthropic activities and Barnett (2007) suggests that they account for the historical record of

the firm's socially responsible and irresponsible acts. Thus stakeholders likely aggregate value judgments across multiple actions by any one firm.

In forming an overall evaluation, the stakeholder often must make trade-offs, especially if the value impacts of the actions under consideration are conflicting. This requires commensuration, the "comparison of different entities according to a common metric" (Espeland & Stevens, 1998: 313). Such commensuration happens all the time, but its form may vary (Espeland & Stevens, 1998), ranging in the stakeholder context from the explicit and elaborated calculations of a sustainability ratings agency to the implicit, unconscious, even irrational "gut feeling" of some consumers. How stakeholders judge individual firm actions and how they then pool those judgments are treated here as two separate questions. The former judgment activity is our focus; the latter aggregation task is beyond the scope of this paper.

In addition to the possible pooling of impacts by individual stakeholders, a second type of aggregation can be identified in the context of stakeholder theorizing. Rowley (1997: 906-907) observes that "firms do not respond to each stakeholder individually, but instead must answer the simultaneous demands of multiple stakeholders." Stakeholders may have divergent views of the value created, either because the impacts indeed are different (e.g., employees suffer from low wages while consumers benefit from cheap prices), or because they have been judged differently (e.g., customers care more about the environmental impacts of production than investors do). Thus, there is a requirement for aggregation by the firm in its instrumental assessment of different stakeholder value judgments and it may need to make trade-offs among stakeholders (e.g., weighing employee versus customer judgments). Given the firm has knowledge of these judgments, questions of stakeholder power enter (see Mitchell, Agle & Wood, 1997). While

again beyond the scope of this paper, Rowley (1997), for example, applied social network analysis to explain multiple interdependent stakeholder demands and predict corporate responses.

Our Definition of Stakeholder Value

Based on the preceding discussion, for our purposes of examining stakeholder value from the firm's instrumental perspective, we define it as: *the subjective judgment of a stakeholder, occurring at the individual or collective level depending on the situation, of the total monetary and non-monetary value experienced as a result of one or more of a firm's actions.*

Finally, we stress again that our theorizing is from the perspective of instrumental stakeholder theory. Were we to take the perspective of normative stakeholder theory, important features would be treated differently. For example, regarding subjectivity, to what extent one should consider subjective and to what extent objective value in a normative analysis could be debated; while the aggregation by a firm of value judgments of multiple stakeholders should then not be based on power but rather on the two other key stakeholder characteristics of legitimacy and urgency (Mitchell et al., 1997).

PROSPECT THEORY AND STAKEHOLDER JUDGMENTS OF VALUE

Judgments of value are at the core of prospect theory. The theory makes three key claims about such judgments: reference dependence, loss aversion, and diminishing sensitivity (Tversky & Kahneman, 1991). Reference dependence—the cornerstone of prospect theory—argues that people do not normally judge value in terms of absolute states of the outcomes but rather in terms of gains and losses against a reference state (Kahneman & Tversky, 1979). Speaking of corporate practices this would mean, for example, that it is not the absolute level of environmental impacts per se that determines stakeholder value (and stakeholder reactions) but how these impacts relate to the reference state employed by stakeholders. The concept of

reference dependence implies that value is a function in two arguments: the reference state that is being employed and the positive or negative distance from that reference state (Kahneman & Tversky, 1979). Thus, what is the reference state and how the outcome thereby gets to be framed has an important effect on judgments of value.

The second key element in prospect theory is loss aversion. Loss aversion makes the point that the value function is asymmetric, being steeper for losses than for gains. In practice this means that “losses loom larger than gains” (Kahneman & Tversky, 1979: 279): the negative impact of losing something, for example, a stakeholder’s loss of annual philanthropic contributions from a local firm, is greater than the positive impact of gaining the same thing. Doh, Howton, Howton and Siegel (2010) found that a firm’s addition to a social index did not affect shareholder wealth, but deletion from such an index did reduce shareholder wealth, which would seem to be consistent with loss aversion. Evidence suggests that this negative asymmetry is typically twofold (Kahneman, 2003; Starmer, 2000), meaning that when people judge value, they tend to be twice as sensitive to outcomes framed in terms of losses than to corresponding outcomes framed in terms of gains.

A third element in prospect theory is diminishing sensitivity. This means that the marginal value of both gains and losses decreases with their size, thus producing a value function that is concave for gains, convex for losses, and steepest at the reference point (Kahneman & Tversky, 1979). In other words, people are relatively more sensitive to changes that occur near the reference point than to changes that occur far from it. Diminishing sensitivity implies, for example, that against a reference state of a permitted amount of effluent discharges, stakeholders are likely to be more sensitive to a firm improving its modest track record than to another firm improving its strong track record even further. Indeed, Doh et al. (2010) found that firms with

strong CSR reputations had the least to gain from addition to a social index, and also the least to lose from a deletion from a social index, as diminishing sensitivity would predict.

While prospect theory is mainly associated with understanding risky choices between monetary outcomes by individuals, it can be applied to stakeholder value without compromising its authority. Prospect theory can be applied in the context of stakeholder value if situations are riskless rather than risky (Kahneman, 2003; Tversky & Kahneman, 1991), when we are dealing with judgments rather than choices (Kahneman, 2003), and when some considerations are related to non-monetary rather than monetary outcomes (Kahneman & Tversky, 1979). There is the question of its application to collective judgments and we return to this below.

Judgments of Value by Individual Stakeholders

Prospect theory was developed as an individual-level theory (Holmes et al., 2011) and, as we have shown, in many instances stakeholders do act as individuals in their judgment of stakeholder value. This is the case, for example, when a customer prefers some product over the alternatives for corporate responsibility reasons or when an employee becomes demotivated because of an employer's bad corporate responsibility record. When the three key elements of prospect theory are applied to stakeholder judgments of value, this produces stakeholder value functions as shown in Figure 1. The stakeholder value function is formed around some reference point R. Because losses are judged differently from gains, the function is asymmetrical, with the loss section steeper than the gain section. The S-shape of the function reflects the diminishing sensitivity of losses and gains.

Insert Figure 1 about here

Key observations about stakeholder judgments of value can be made directly from Figure 1. First, let us examine the stakeholder value associated with a particular absolute corporate performance level C_1 . Judged against reference level R_A , the corporate performance level C_1 represents a gain and produces stakeholder value $V_A(C_1)$. However, judged against an alternative reference level R_B , the same absolute performance level is a loss and produces much lower stakeholder value $V_B(C_1)$. Thus, more favorable judgments result from framing corporate performance outcomes as gains rather than losses.

Second, let us examine the impacts on stakeholder judgments of value associated with a particular corporate decision or activity that results in a change in corporate performance. Besides the extent of absolute change in performance, stakeholder value impacts depend on whether the change is perceived in terms of gains or losses, as well as on the distance from the reference level. (Note that in referring here to gains (losses), we also include forgone gains (avoided losses).) Because of the asymmetry between losses and gains, the same performance change has larger stakeholder value impacts when interpreted from the loss frame than when interpreted from the gain frame. Further, because of diminishing sensitivity, changes near the reference level have larger stakeholder value impacts than changes far from the reference level. Therefore, for example, as we see from Figure 1, the same corporate performance change ΔC (such as increasing annual charitable contributions to the local community from \$70,000 to \$75,000) produces a very large change in stakeholder value ΔV_L if it gets to be framed in terms of (avoided) losses near the reference point (which would be the case for someone whose reference level was \$75,000), but only a small change in stakeholder value ΔV_S if against another reference state it gets to be interpreted in terms of gains far from the reference level (by someone whose reference point is, say, \$10,000). This holds true regardless of whether the

change in question represents an improvement or a deterioration in performance, and demonstrates again the crucial role of the reference state for judgments of value.

We have so far discussed the general form of the stakeholder value function. However, within this general idea of an asymmetrical, s-shaped value function for a given reference state, these functions still can vary in terms of how steep the sections are, how strong the diminishing sensitivity is, or whether thresholds or other complexities are involved, such as category-boundary effects (Diecidue & van de Ven, 2008; Kahneman & Tversky, 1984) and the presence of a neutral zone (Klein & Oglethorpe, 1987).

Judgments of Value by Stakeholder Collectives

Earlier we distinguished psychological collectives from mere aggregations of people and showed how sometimes it is the collective rather than individual judgment of value that is relevant for stakeholder reactions. Prospect theory, however, is not directly applicable to the collective level (unless there is a strong unitary actor; Levy, 2003). While prospect theory sometimes has been casually overextended to organization-level research (Holmes et al., 2011), it does have some explanatory power in the context of organizational decisions (Bromiley, Miller & Rau, 2001; ref. Shimizu, 2007). However, a more rigorous approach would call for prospect theory to be complemented with organization-level factors for fuller explanations (Shimizu, 2007). While there is nothing in principle that prevents prospect theory from being developed into a theory of collective choice, and while this would be very welcome, it would be a large and complex task (Levy, 1997, 2003).

The question thus arises of how our analysis of individual judgments translates to or influences collective outcomes. We argue that the individual-level cognitive biases identified by prospect theory are transported to the collective level and do affect the collective judgment. At

the same time, we also argue that the collective deliberations can affect individual judgments. Thus, there are two-way interactions between the judgment levels. The individual and collective cognitive processes can be seen to be in an iterative loop where both influence each other: individuals make up the collective judgment and the collective influences individuals' judgments.

The collective judgment process generally consists of collective deliberation and the resulting collective judgment, though it might also be more implicit (Holmes et al., 2011). Kerr, MacCoun & Kramer (1996: 694), using the influential social decision scheme model by Davis (1973) argue that “groups’ final decisions depend on two things: (a) where group members begin deliberation... which depends entirely on individual judgments... and (b) the process whereby group members combine their preferences to define a group decision.” Thus, members arrive at the collective deliberations with their individual-level judgments, which are affected by the cognitive biases specified by prospect theory.

After this starting point, the ensuing group deliberation and decision-making can amplify, attenuate, or reproduce the initial, individual-level biases (Kerr et al., 1996). Which of these happens depends centrally on the social decision scheme that is being employed. For example, for the kind of judgmental tasks that we are dealing with here, Kerr et al. (1996) find that a majority scheme (where the view with the majority of supporters becomes the collective outcome) amplifies individual biases, but an equiprobability scheme (where any view with at least one supporter can become the collective outcome) attenuates individual biases. Whatever the effect of the group, it becomes more pronounced with increasing group size. According to Kerr et al. (1996), the majority decision scheme has the most empirical support and has been argued to apply especially to judgmental tasks. Indeed, empirical studies suggest that groups are even more susceptible than individuals to the framing effects predicted by prospect theory (e.g.,

Cheng & Chiou, 2008). In addition to the actual decision-making scheme, the outcome of the process depends on the nature of the collective interaction process (e.g., does it occur in person, can all members participate equally, is it time-constrained?), the nature and composition of the collective, as well as the nature of the judgment task at hand (e.g., its importance).

However, the collective deliberation and judgment stage does not have to be seen to merely pool initial, fixed individual judgments into a collective judgment according to some decision rule. Whenever there is interaction between the collective members during deliberations, this can produce a choice shift that alters individual judgments (Shupp & Williams, 2008; for empirical evidence, see e.g., Baker, Laury & Williams, 2008). In other words, social influence processes can have an effect on individual judgments. According to a recent review, group discussion often results in an intensification of existing individual attitude and judgment (Kugler, Kausel & Kocher, 2012), but it is also possible that the group deliberations induce the individual to change his or her original judgment. Even if the original individual judgments are reconsidered in light of the collective deliberations, these renewed judgments are still likely to be subject to the framing biases of prospect theory. Of course, being exposed to collective deliberations can influence individual judgments in this way even in those situations where it is the individual judgment that matters for stakeholders' reactions. We return to how stakeholder collectives can influence individuals' judgments later.

UNDERSTANDING AND INFLUENCING STAKEHOLDER JUDGMENTS OF VALUE

A causal path has been identified whereby perceived corporate performance gives rise to stakeholder judgments of value, which in turn trigger stakeholder reactions, as we described in the introduction and consistent with prior literature. This path is shown at the bottom of Figure 2, which also shows how our use of prospect theory can complement this understanding by

incorporating the reference state that is being employed and the perceived level of the relevant reference state at the moment of judgment, both of which affect stakeholder valuations. Consequently, new avenues for influencing stakeholder judgments of value—and thus stakeholder reactions—are also opened up by our analysis, as illustrated outside the dotted line in Figure 2. We acknowledge that other variables besides those shown in Figure 2 are likely to influence stakeholder judgments of value. For example, Lange and Washburn (2012) discuss the roles of effect undesirability, corporate culpability, and affected party noncomplicity in attributions of corporate social irresponsibility, and Bitektine (2011) explores social and cognitive influences on social judgments of organizations. Our objective in this paper, however, is to highlight how prospect theory can inform the understanding of stakeholder judgments of value. We now examine the elements in Figure 2 more closely.

Insert Figure 2 about here

Alternative Reference States

Whether outcomes are framed as losses or gains depends on the reference state employed. Prospect theory allows for several possible reference states. Most intuitive is the status quo and this is often used in prospect theory research (Holmes et al., 2011), but Tversky and Kahneman (1991: 1046-1047) write: “Although the reference state usually corresponds to the decision maker’s current position, it can also be influenced by aspirations, expectations, norms, and social comparisons.” Reference states other than the status quo have been used in prior theoretical work (e.g., Whyte, 1986; Wiseman & Gomez-Mejia, 1998) and empirical studies (e.g., Fiegenbaum & Thomas, 1988; Wiseman & Catanach, 1997; Zhang et al., 2008).

Reference states can arise externally or internally (Tversky & Kahneman, 1991). External reference states are based on comparisons to some external benchmark; internal reference states

are based on some internal yardstick that the stakeholder has in mind. For example, in the context of consumer decision making, different reference prices can be identified, such as the price I paid last time, the average retail price and the price I would like to pay, corresponding to the status quo, external and internal reference states respectively (Klein & Oglethorpe, 1987).

Status quo. In the status quo reference state, the comparison in the stakeholder's mind is to the current performance level of the company (e.g., number of workplace accidents at the company), when judging a proposed action, or to past performance (e.g., number of workplace accidents in the previous year) when judging an action already implemented.

External comparisons. In the case of reference states based on external comparisons, the stakeholder takes an external benchmark and uses it as the reference state against which the performance of the company is compared. Such benchmarks can be taken from norms, markets, or ideals. Norms refer to the performance level specified by regulations or, perhaps, ethical norms. From markets, the stakeholder can take the performance of other relevant firms or actors as the benchmark. This can be, for example, the performance of competitors, firms operating in the same geographical area, firms across industry sectors facing the same corporate responsibility issue, or industry average performance. To illustrate, dramatically different stakeholder judgments of a mining company's workplace safety performance could follow from these various possible external reference states; contrast statistics for mining accidents in high- versus low-income countries and occupational safety data for mining versus other industries (ILO, 2011). Further benchmarks are offered by widely held ideals; such as using best available technology (e.g. a production system with minimal effluent discharges), or best available practices (e.g. no use of child labor in own operations and in the supply chain). This might extend to no acceptance of trade-offs, as in the context of absolute or "protected" values (e.g.

with regard to the natural environment, human or animal life, human rights, etc.) that trump all other values (Ritov & Baron, 1999).

A particular example of reference states based on an external ideal is what we call the *zero state*. Here the comparison in the mind of the stakeholder is to a hypothetical situation without the existence of the company. This is analogous to Donaldson's (1982) "state of individual production", a hypothetical pre-agreement condition that would prompt moral agents to develop a social contract for business such that they would consent to the development of productive organizations largely as we know them today (subject to certain constraints consistent with the terms of the contract). More prosaically, it is reflective of the views of some anti-business NGO stakeholders who believe the world would be a better place without big business.

Internal aspirations. In addition to external benchmarks, the reference state can be based on internal aspirations of the stakeholder and the performance level of the company assessed relative to this aspired-to level. Indeed, according to Wood and Jones (1995), stakeholders are the source of expectations about desirable and undesirable firm performance, and they also evaluate how well firms have met these expectations. The internal aspiration can coincide with or be influenced by some external yardsticks, but also reflect other elements less obvious to the firm. For example, a stakeholder may have the aspiration that a natural area be preserved as it was in his or her childhood.

Framing relative to a reference state. Once a reference state is chosen, framing occurs relative to this reference state and the outcome is interpreted from a loss or gain perspective (Kahneman & Tversky, 1979); however, these are not necessarily conscious processes. This has important implications when applied to stakeholder value. Companies can engage in activities that objectively represent either improvements or deteriorations in performance (e.g., increase or

reduction in CO₂ emissions). A simple view would suggest that improvement in performance is a gain for the stakeholder and deterioration in performance is a loss. However, framing is more complicated than this and points to a more nuanced perceptual process. Depending on how the change is framed, a performance improvement can also be interpreted as an avoided loss (e.g., reduced CO₂ emissions are framed as avoided environmental harm), and deterioration in performance can be interpreted as a forgone gain (e.g., increased CO₂ emissions are framed as forgoing an improved environmental situation). In other words, performance improvements and deteriorations can be both interpreted from a loss frame and a gain frame (see Table 1). In judgments of value, losses are different from forgone gains and gains are different from avoided losses (Tversky & Kahneman, 1991: 1057).

Insert Table 1 about here

Regardless of which reference state is employed, the logic of framing remains the same. When the company is perceived as better than or operating “above” the reference level, it is in the gain area (see Figure 1). Stakeholder value will be judged in terms of gains: performance improvements as gains and performance deteriorations as forgone gains. By contrast, when the company is perceived as worse than or operating “below” the reference level, it is in the loss area. Then stakeholder value will be judged in terms of losses such that performance deteriorations become losses and performance improvements become avoided losses.

This logic leads to certain situations worth highlighting. First, with status quo as the reference state, improvements below the reference level and deteriorations above the reference level cannot exist in practice. The framing here is straightforward: performance improvements appear as gains and performance deteriorations appear as losses. Second, with zero state as the

reference state, the impacts that the existence of a company has on its stakeholders can be inherently positive (“doing good”), such as paying wages, making available useful products, or giving money for charitable purposes. They can also be inherently negative (“doing harm”), like polluting the environment or violating human rights. All negative impacts of business are “below” the reference level and get to be interpreted from the loss frame so that “doing harm” is a loss and “doing less harm” is an avoided loss. For example, producing hazardous waste is a loss for the stakeholder; reducing this waste is an avoided loss (instead of a gain). Similarly, the positive impacts of business are “above” the reference level: “doing good” is a gain but “doing less good” is a forgone gain. For example, giving money for the local school is a gain for the stakeholder; giving less money than last year is a forgone gain.

Finally, framing with regard to ideal performance is also interesting. Some ideals have a natural floor or ceiling, like those based on a zero state (for example, zero tolerance of fatalities in mining accidents), and the company cannot in practice be operating above the reference level. In these situations, all judgments are from a loss frame. Performance improvements can reduce the gap from the ideal but cannot exceed the reference level and turn outcomes into gains. With the mining accidents example, increased fatalities are clearly framed as losses, while efforts that reduce fatalities produce avoided losses. Occasionally, ideals can be exceeded; for example, with climate change, a commonly quoted ideal is carbon neutrality, but it is possible that some firms or sectors are in fact net absorbers of carbon dioxide. As we discuss later, ideals set by current best available technology are not fixed but may be exceeded with technological change (but the result of exceeding such an ideal is that it adjusts and shifts to the new, higher level). In these situations, framing in terms of gains is also possible.

However, even with such consistent framing logic, it is hard for managers to predict in practice how stakeholders will judge and respond, because it is difficult to identify the reference state(s) that stakeholders are using (Barberis, 2013; Wood & Jones, 1995). In fact, a unique reference state often cannot be found across all stakeholders. For example, with regard to fur farming, the reference state for the authorities might be based on laws and regulations, but for an NGO campaigning for a moratorium on fur farming it might be the zero state. In their study of the French nuclear industry, Banerjee and Bonnefous (2011) found that stakeholders could be classified in three groups: passive, supportive, and obstructive stakeholders. While the passive and supportive stakeholders might have expectations regarding sustainability, the objective of the obstructive stakeholders was not improved sustainability performance but “the cessation of all nuclear activities” (p. 130), reflective of a “zero state” reference state. Further, stakeholder groups are not necessarily internally homogenous (Wolfe & Putler, 2002) and different people within the group (or in organizations) may employ different reference states (Holmes et al., 2011). For example, for one customer the reference state may be the past performance level of the firm, for another the performance level of a key competitor, and for a third the performance level of the most proactive company that he or she is aware of. Which reference state gets to be adopted under what circumstances is ultimately an empirical question (Whyte, 1986) and identifying reference states is an important unresolved issue in prospect theory (Barberis, 2013; Holmes et al., 2011; Köszegi & Rabin, 2006; Luce, Mellers & Chang, 1993). Equally, however, these biases in judgment cannot be ignored (Barberis, 2013).

Managers may well presume that stakeholders are using a status quo reference state, not least because this is likely to be a performance metric used within the firm (e.g., managers are evaluated on the basis of a year-on-year reduction in workplace accidents). The diagnosticity of

reference states becomes more difficult where external comparisons are being used because of the multiple possible comparison points (although this notion is at least familiar to managers who benchmark their firm's performance against other companies). It becomes more difficult still where the reference state is internal to the stakeholder and thereby far less accessible. Thus, it seems reasonable to hypothesize that managers are more likely to be surprised by adverse stakeholder reactions where stakeholders are using external comparisons or internal aspirations, as opposed to a status quo reference state.

Choice of Reference State

Human reasoning is widely seen to comprise a dual process: logical thinking and intuition (for a review of dual-process theories, see Kahneman, 2011; Osman, 2004). Similarly, the choice of the reference state to be employed may be affected by deliberate or subconscious processes (Holmes et al., 2011). One stakeholder may have carefully selected his or her reference point, while another may not even be aware of what yardstick he or she is using when judging corporate performance – or that a yardstick is being used in the first place. With subconscious choice, the operant reference state is not deliberately chosen but has emerged on the basis of environmental cues. For example, presenting information on corporate performance in terms of improvements from past levels is likely to evoke a status quo reference state. An external comparison reference state is made more salient by an announcement of a breakthrough in performance by a competitor, and an NGO campaign for a moratorium for a controversial field of business will strengthen the prominence of the zero state (e.g., no oil drilling in the Arctic wilderness). Thus, which reference state is subconsciously adopted depends on the competing messages in the environment and on their relative strength. Organizational visibility might also play a role in shaping societal expectations for corporate behavior (Chiu and Sharfman, 2011).

However, sometimes a stakeholder consciously establishes a reference point, explicitly considering what kind of performance he or she expects of a company. Such deliberate choice requires that the issue at stake is important for the stakeholder and that the stakeholder is sufficiently involved such that there is conscious goal-setting with regard to the issue (Klein & Oglethorpe, 1987). Whether this is the case depends on issue and stakeholder characteristics; for example, involvement is likely to be higher when the moral intensity of the issue is high (Jones, 1991) or when stakeholders exhibit the characteristics of urgency (Mitchell et al., 1997; Rowley & Moldoveanu 2003).

Level of Relevant Reference State

Given an operant reference state, stakeholder judgments will be determined by the perceived level of that reference state at the moment of judgment. However, most reference states are dynamic so their levels can change with time. As such they can represent moving targets. The status quo is prone to change with time, as are norms, the performance levels of other companies, and stakeholders' aspirations. Even ideals can change with time, as we noted earlier; for example, with new knowledge or changing technological possibilities. Prior to the 2011 Fukushima disaster, at least, nuclear power had become more acceptable to former skeptics in light of climate change, reflective of a shift in reference state level (the acceptability of nuclear power risks relative to climate change risks). Only the zero state is absolute and stable.

Stakeholders will adapt to the changed level of the reference state and begin to use this new level as the basis for framing (Kahneman & Tversky, 1979). Indeed, the concept of a hedonic treadmill proposed by Brickman and Campbell (1971; ref. Kahneman & Tversky, 1984: 349-350) suggests "rapid adaptation will cause the effects of any objective improvement to be short-lived". This idea of adaptation is also captured in the endowment effect by Thaler (1980;

also see Kahneman, Knetsch & Thaler, 1991), according to which the incorporation of a good into one's endowment results in a change of value if the reference state is based on status quo.

Because of the adaptation to the new status quo, giving up something is framed as a loss and the value of this loss is greater than the value of the original gain in receiving the same thing (Tversky & Kahneman, 1991; see Levin, Schreiber, Lauriola & Gaeth, 2002 for an empirical validation in the context of “building up” or “scaling down” product components). Consider, for example, employment. When a company provides new employment, this is originally a gain for those who become employed as well as for the whole local community. However, if later there are layoffs, they may not be framed as forgone gains but as losses. This is because there has been adaptation to the new status quo; the jobs have become part of the endowment of the employees and the community. The negative impacts on stakeholder value of losses are greater than those of forgone gains. Thus, if adaptation has taken place, the stakeholder value impact of the layoff is greater than that of the original gain of job creation.

Knowing what is the *perceived* level of the relevant reference state at the moment of stakeholder value judgment is a further consideration. All reference states require some degree of information (e.g., about competitor performance, past performance, or technological possibilities, depending on the reference state). The availability and complexity of such information can vary, as can the information processing ability of different stakeholders. Hence, the perceived level of the reference state may not coincide with the true level of the reference state, or with what the firm considers to be the true level. It might also be approximate and anecdotal. For example, whereas a firm might have quantified measures of its pollution impacts, stakeholder perceptions might amount to no more than a sense that one company is a “heavy” polluter relative to another.

Influencing Stakeholder Judgments

Managerial interest in stakeholder judgments of value is not limited to understanding these judgments, even if an improved understanding is already an important step forward. Managers may also wish to influence the value judgments and consequently the stakeholder reactions that these judgments trigger. It is well established that judgments of value can be changed by changing corporate performance, information about it, or both (see Figure 2). While this remains an important consideration, our analysis points to additional options, to be used alone or in various combinations, for potentially influencing stakeholder judgments.

One such option is to attempt to change the perceived level of the reference state that is being employed. Certain reference states (e.g., best available practices) are such that a company can affect their level through its own actions, perhaps by investing in R&D. Other reference states, however, do not lend themselves to being defined by the company (e.g., competitor performance). But even in these cases, it may still be possible to influence the *perceived* level of the reference state through communications. This might be, for example, by clarifying information or correcting a misunderstanding (quite possibly, management might determine that by some objective criterion, stakeholders are mistaken in their perception of the level of the reference state that they apply: for example, in what is technologically possible, what is nutritionally healthy, what is permitted by law, or what the competition is doing). As we have discussed, a change in the perceived level of the reference state can change stakeholder judgments even if the reference state stays the same. This is what Shell attempted – albeit without success – in the Brent Spar case (see e.g., Heath, 1998). The reference level for Greenpeace and the general public was some kind of ideal state (“what is best for the environment”). Shell did not argue that the decision ought to be made against some other

benchmark, but that its solution was the best for the environment; i.e., corresponding to the same reference state but at a different level to that widely perceived.

An alternative, clearly, is to attempt to influence a change in the stakeholder reference state. The susceptibility to such influence and how a switch could be brought about depend on how the reference state was originally established (Klein & Oglethorpe, 1987). Subconsciously formed reference states emerge based on environmental cues and firms might potentially modify such cues and prime particular reference states. If the priming messages by the firm “overwrite” previous environmental cues, they can become the basis for the new subconsciously formed reference state. For example, Levin and Gaeth (1988) found that consumers evaluated beef more favorably if it was labeled “75% lean” rather than “25% fat” and observe that a major role of advertising is to frame the subsequent product experience (for a framing typology and broader discussion, see Levin, Schneider & Gaeth, 1998; also see Levin et al., 2002). With subconscious original reference states, it might also be possible to influence stakeholders to *consciously* choose particular reference states, through persuasion and education. When the original reference state was based on a deliberate choice, persuasion and education is likely the only route to influencing reference state choice.

In practice, a firm (or others) may not have detailed knowledge of the reference states its various stakeholders are using, how they have arrived at these reference states, and what they perceive the level of these reference states to be. Nevertheless, these are empirical questions and, when answered, there are clear possibilities to influence stakeholder judgments of value by changing the stakeholder’s reference state, its level, or perception about its level.

So far, we have discussed the firm influencing stakeholder judgments by itself. However, as pointed out earlier, stakeholder collectives also can influence these judgments, and so can

third parties like competing firms and civil society (e.g., labor unions, NGOs). With the exception of changing actual corporate performance, the same avenues are available for these actors as for the firm. Stakeholder collectives or third parties can be a source of information and thus change an individual's perceived level of corporate performance (e.g., an NGO brings to light labor rights problems with a company operating in a foreign country). McWilliams and Siegel (2011: 1491) note that especially through viral media such as blogs, YouTube and Twitter, activists and journalists can easily alert consumers to "the good, the bad, and the ugly in corporate behavior". Furthermore, stakeholder collectives or third parties can provide information that affects the perceived level of the relevant reference state (e.g., the NGO explains that a particular labor practice is forbidden according to the local regulations of that country). They can also influence the reference state that an individual employs, either through the priming messages they send (e.g., the NGO presents all information and argumentation in reference to the applicable local regulations) or purposefully educating and persuading individuals to adopt a particular reference frame (e.g., the NGO argues that compliance with local regulations is what should be expected of companies operating in foreign countries). Doh et al., (2010) point out that many stakeholders rely on institutional assessments of third parties such as ratings agencies to inform their own judgments; both a reference state and information about performance with respect to that reference state are often built-in to such rankings and ratings.

DISCUSSION

Stakeholder judgments of value are central to stakeholder theory and stakeholder management, but how they are formed is insufficiently understood. Because stakeholder reactions are based on stakeholder judgments of value, this lack of understanding results in managers potentially failing to anticipate or interpret the type and extent of stakeholders'

reactions. From a theory-building point of view, while there are calls for further development of stakeholder theory, progress is hampered if there is only vague understanding of a key construct.

In this paper, we set out to strengthen specifically theorizing around stakeholder judgments of value. We argue that the value of corporate actions to stakeholders is fundamentally a social and psychological construction with subjective as well as objective qualities and influenced by the cognitive biases that affect human judgment. We draw upon prospect theory—a particularly relevant and influential theory—to explain how such cognitive biases affect stakeholder value judgments and, by extension, possible stakeholder reactions that might result. We suggest that stakeholders judge value not in absolute but in relative terms: as losses and gains against a reference state that might differ across stakeholders and change over time and where losses weigh more heavily than equally sized gains. To fine-tune this general argument, we discuss how reference states are chosen, how perception of the level of the reference state is separate from the choice of reference state, potential complexities in the stakeholder value function, and how individual and collective judgments interact and become relevant in different situations. Our resulting contribution is novel and has both scientific and managerial relevance, as we discuss further below.

While prospect theory itself is well-established, joining stakeholder theory with prospect theory is new and produces important new insights. Indeed, as noted by Wood (2010), focusing on stakeholders rather than on the firm represents a change of perspective in the literature. Applying a prospect theory lens to stakeholder judgments of value results in a radically different way of perceiving the value of corporate actions for stakeholders. Seen from this perspective, value judgments depend critically on the chosen reference state, and valuations can change dramatically from those that would be expected based on absolute performance outcomes alone.

Consider a construction company that complies with all relevant regulations but has an above average number of accidents on site and despite a reduction following a recent safety initiative: it could be considered responsible by stakeholders with status quo or legal compliance as the reference state, but irresponsible by those stakeholders whose reference state is the competitors' performance or some ideal state. Our analysis also alters understanding of the avenues available for companies to try to influence stakeholder judgments of value (and, consequently, stakeholder reactions), since realizing how valuations depend on more than perceived corporate performance alone opens up the possibility of a variety of different additional interventions by firms.

This new perspective on stakeholder judgments of value goes against conventional practice in the stakeholder literature where value to stakeholders is conceived in terms of absolute performance outcomes; a practice that becomes evident by looking at the corporate social performance variables in many of the studies reviewed by Margolis and Walsh (2003) or by Wood (2010). It also challenges the prevailing (implicit) assumption that changes in corporate performance are judged relative to the status quo which, as we show, is only one of a number of possible reference states. Such an assumption is evident in the strong tendency to report changes as improvements from past levels (e.g. in social responsibility reports or in management systems such as the ISO 14000), rather than compared to some other yardstick.

Prospect theory is not without its limitations. While ample empirical evidence supports the major tenets of prospect theory, as Barberis observes (2013: 178), "it is not always obvious how, exactly, to apply it... it is often unclear how to define precisely what a gain or loss is, not least because Kahneman and Tversky offered relatively little guidance on how the reference point is determined." Similarly, Holmes et al. (2011: 1082) note that prospect theory "lacks a theory of reference points". Nonetheless, we agree with Barberis (and, implicitly, Holmes et al.)

that research in real-world settings is the best way to shed light on these uncertainties, as we now discuss in relation to prospect theory predictions of stakeholder judgments.

Implications for Research

Stakeholder judgments of value have not previously been given much attention in stakeholder theory. Our arguments alter the understanding of how these valuations are formed and how they can be influenced. Through our theorizing, we respond to broad calls to strengthen stakeholder theory (e.g., Agle et al., 2008) as well as to specific research recommendations such as those of Aguinis and Glavas (2012) who invite more research on the microfoundations of CSR, and Freeman et al. (2010: 288), who ask: “What does ‘value’ mean for a particular group of stakeholders?” We do this by more adequately specifying the key construct of stakeholder value, which makes stakeholder theory conceptually more rigorous. Further, we develop generally applicable principles governing how stakeholder valuations are made, as well as identify boundary conditions for such principles. Integrating these insights in models of stakeholder theory can enrich those models by providing a more accurate picture of the value that is perceived by stakeholders and used as a basis for their reactions.

Our theorizing points to significant unexplored research opportunities and important new research questions. Empirically, our analysis allows for a greater potential for the value of corporate decisions and activities to stakeholders to be accurately operationalized and tested. Several avenues for empirical work arise (see Figure 2). Since our analysis suggests a new way of perceiving stakeholder value, it also invites new descriptive empirical studies to shed more light on this phenomenon. One set of questions concerns the usage of different reference states: What reference states are being used in practice, and how widely? Are some reference states more likely to be associated with particular stakeholders or certain types of corporate activities?

Another set of questions relates to the details of the stakeholder value function: How strong is the negative asymmetry between losses and gains? How strongly does diminishing sensitivity set in? An improved empirical understanding of stakeholder judgments of value can be usefully complemented by further studies on how and when judgments of value prompt stakeholder reactions.

Studies about influencing the choice of reference state also present interesting research possibilities. From a strategy perspective, there are research opportunities in regard to potential strategic or competitive moves by companies or stakeholder groups who attempt to impose certain reference states. For example, a company could make a strategic investment such that stakeholders use an external comparison reference state with the company's performance as the reference level and thus the firm imposes that state on its competitors. HP might be said to have done this with product reuse and recycling in the electronics sector. However, HP has found that this can also easily backfire when something negative happens (Wagner, Lutz & Weitz, 2009). Equally, an NGO could try to impose a zero state to gain influence. Thus, further research could usefully explore how companies and other organizations might attempt to impose reference states on others in a competitive context and the wisdom of trying to do so. Further, we would expect that individual stakeholder use of particular reference states is closely related to communication by the firm, stakeholder groups, and the media, including stakeholder use of social media (Hunter, Van Wassenhove, Besiou & Van Halderen, 2011).

Implications for Management

Understanding stakeholder judgments of value is not only important from a theoretical perspective, it is also a critical managerial consideration. Managers make decisions about how to allocate resources and this affects the value that stakeholders receive. It is well established within

instrumental stakeholder theory that managers should look to stakeholders for guidance on which activities to prioritize in a resource-constrained environment (Jones, 1995). To be able to do so, managers need to grasp the concept of stakeholder value in its full complexity and to be able to understand how stakeholders value particular actions, not least when our theorizing suggests that stakeholders may not value corporate performance in the same way as managers expect.

Insights from our theorizing have direct managerial relevance. In terms of predicting stakeholder reactions, managers need at least to be aware of, if not specifically identify, the various reference states used by stakeholders (and by themselves, for that matter). This would better enable managers to create value for stakeholders in the first place, to communicate about that value creation to stakeholders, and to anticipate stakeholder reactions when considering an activity. Adverse stakeholder reactions potentially can be avoided, or at least be less surprising when understood relative to the reference state(s) being employed.

Managers wishing to take a more active role in attempting to manage stakeholders' value judgments and the consequent stakeholder reactions can take note of the avenues for managing such judgments that we have identified. To support and complement actions that are taken to achieve changes in perceived performance, managers should also pay attention to possibilities for influencing the stakeholders' reference states as well as the perception stakeholders have about the level of the relevant reference state. However, managers should also be aware that these possibilities are equally available to others wishing to influence stakeholder judgments.

That said, we would not wish to understate the considerable challenges involved in identifying operant reference states and reference levels as perceived by stakeholders. Our managerial implications are thus premised on an assumption of progress in identifying real world usage of reference states by stakeholders. Moreover, our managerial implications are more

clearly applicable in the case of individual (vs. collective) stakeholder judgments and we do not speak to how stakeholders aggregate their judgments across multiple actions by a firm or to how managers aggregate multiple stakeholder judgments, which are also topics for further research.

In conclusion, if business is about stakeholder value creation, it is crucial to understand how such value is created in the eyes of the stakeholders. We have shown how the widely-established biases described by prospect theory likely inform stakeholder judgments of value, thus enriching understanding of this critical concept for stakeholder theory, corporate responsibility, and, perhaps, more broadly.

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TABLE 1

Interpretation of Corporate Performance Changes from a Loss Frame and a Gain Frame

	Loss frame	Gain frame
Corporate performance improvement	Avoided loss	Gain
Corporate performance deterioration	Loss	Forgone gain

FIGURE 1

General Stakeholder Value Functions

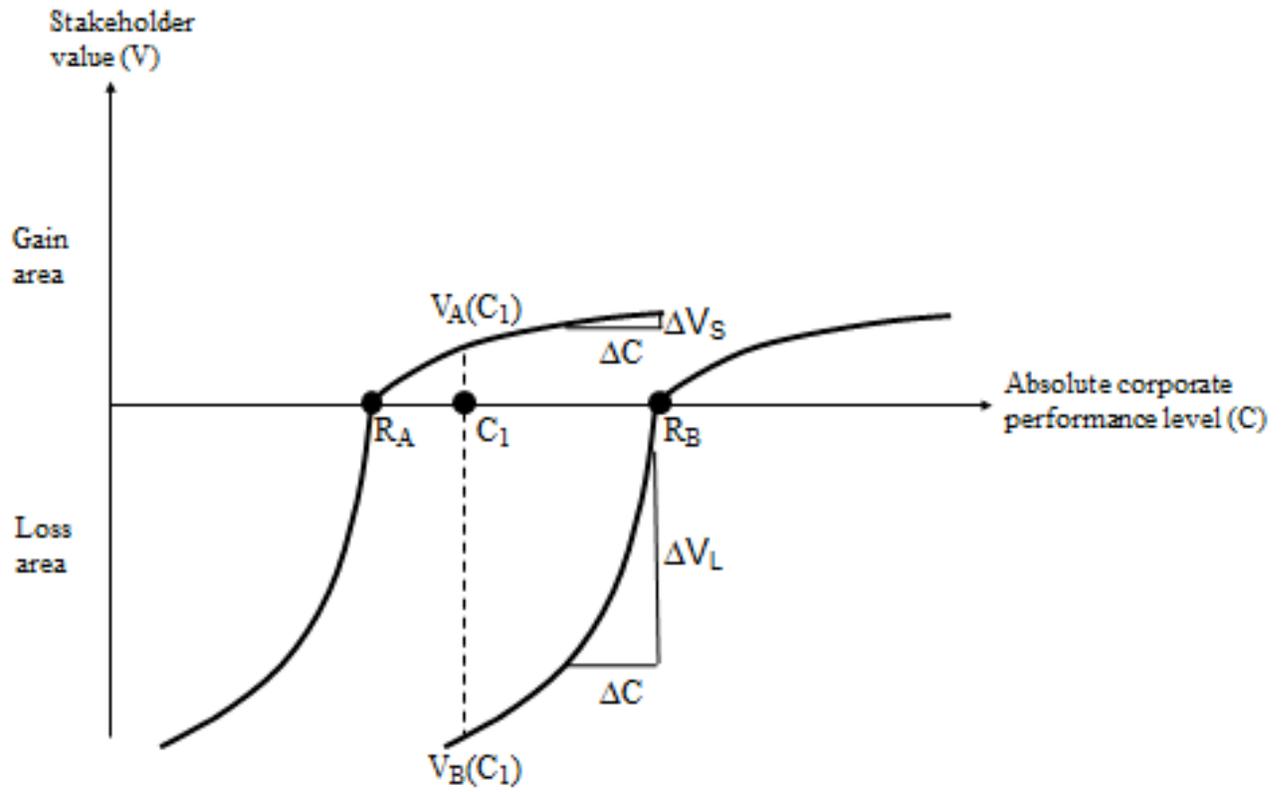


FIGURE 2

Understanding and Influencing Stakeholder Judgments of Value

