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Neither Shareholder nor Stakeholder Management: What Happens When Firms are Run for their Short-term Salient Stakeholder?

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One of the critical distinctions between shareholder theory and stakeholder theory rests on the role of management in the resolution of the firm's internal conflicts. Whereas managers are considered as a source of conflicts by agency/shareholder theorists, they are often viewed as useful mediators in the stakeholder approach. This paper proposes an alternative theory on the role of management in corporate governance, the so-called short term salient stakeholder theory, and illustrates it with a longitudinal case study of Eurotunnel, the Channel Tunnel operator. When the firm's legitimate stakeholders have very different information levels and bargaining strengths, this theory predicts that (i) firms are governed in the interests of a unique stakeholder group (ii) managers have a minor role and are prone to collude with the most powerful interest group (iii) this autocratic type of governance is unstable in the long-term as the legitimate stakeholders expropriated at one period use influence strategies to gain power in the next period (iv) the chronic conflicts associated to short-term salient stakeholder management lead to poor organizational performance.

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Finance and strategic management theories often take divergent positions on two fundamental questions: Should firms be run in the interests of their shareholders or for *all* of their stakeholders? More broadly, what should be the objective of firms? Most of the time, the defenders of each approach rely on normative arguments and make simplifying assumptions. Shareholder theorists argue that managers should be pledged to shareholders. Because managers are self-serving and opportunistic, the governance structure should be designed so as to limit managerial discretion as strictly as possible. The stakeholder management view considers on the contrary that managers are not always opportunistic and that they should retain sufficient autonomy so as to influence corporate decisions in a way satisfying all the key stakeholders of the firm. Beyond this normative debate, little is known about the actual behavior of firms and about the connexion between corporate governance strategies and organizational performance. One of the main problems in designing a tractable test of instrumental stakeholder/shareholder theories comes from the measure of the stakeholder/shareholder orientation of firms. How to decide that a firm is run for its shareholders or alternatively for its stakeholders? Should we trust managers' speeches or rather consider the firm's actual decisions?

By considering the case of large project companies, our paper seeks to develop and illustrate an alternative theory of corporate governance, what we call short-term salient stakeholder management. Although the terminology of salient stakeholder is a direct reference to the work of Mitchell *et al.* (1997), our paper goes beyond the question of who or what constitutes a stakeholder. It also considers the link between the firm's organizational structure, the number of salient stakeholders and organizational performance. Even if they have many idiosyncratic features, large project companies are attractive research sites for people interested in evaluating the relative performance of shareholder and stakeholder theories. Their organizational structure reflects a shareholder management view of the firm (managers are strictly controlled by financiers) in the mere context where stakeholder theorists argue for the needs to consider the interests of multiple constituencies (these 'mega' investments affect numerous groups or individuals and can dramatically change the economic conditions for local citizens). Moreover, empirical evidence shows that this type of firm often exhibits bad performance (Flyvbjerg *et al.*, 2003). In this paper, we use the case of Eurotunnel (the Channel Tunnel operator and the largest project company in the world) to illustrate some of our propositions.

Short-term salient stakeholder management is defined by the following attributes: (i) firms are run in favor of one salient stakeholder group. This group is the one that simultaneously possesses the three attributes defined by Mitchell *et al.* (1997), that is legitimacy, power and urgency (ii) the identity of the salient stakeholder group can change depending on the firm considered and on the period of time. The salient stakeholder at one period is often the one that suffered the most from corporate decisions in the near past (iii) managers are pledged to the salient stakeholder group and have little discretion concerning corporate decisions (iv) short-term salient stakeholder management increases agency conflicts and may lead to poor performance.

Our theory brings insights on three fundamental questions concerning corporate governance and performance. The first question is quite classical: for whom companies are run? The answer is far from being obvious as the balance of power inside the firm can take a less trivial form than the one supposed by shareholder and stakeholder theorists. In accordance with shareholder theory, our theory suggests that firms are run for a unique stakeholder group (the ''salient stakeholder group'' in our terminology) but, contrary to the shareholder theory's core assumption, this group is not always constituted by shareholders. Obviously, the fact that corporate decisions give more importance to one stakeholder group is susceptible to increase conflicts within the firm. In other words, the autocratic governance structure associated with short-term salient stakeholder management increases the incentives of non salient stakeholders to gain authority. The Eurotunnel case illustrates clearly this dynamic dimension of short-term salient stakeholder management: since its creation the firm was successively controlled by the construction companies, banks and dispersed shareholders. Each time, the new salient stakeholder group was the one that suffered the most important losses in the preceding years.

The second insight of the paper concerns the efficiency of this autocratic type of management. In other words, is it economically efficient to concentrate power in the hands of one type of stakeholder instead of balancing power among the different key stakeholders? The answer is unambiguously yes for agency and transaction costs theorists (see for example Jensen, 2001; Williamson, 1991). For them, the concentration of decisions rights in the hands of the ''natural'' residual claimant, that is shareholders considered as an homogeneous group, economizes on agency and transaction costs. Even if stakeholder theorists are reluctant to the efficiency notion, they implicitly assume that the dispersion of control rights among all the stakeholders and favorable performance go hand in hand. Although the problem of the optimal allocation of control rights is difficult to answer on a single case basis, the Eurotunnel case suggests that the concentration of power in unique hands does not automatically reduce agency conflicts and can even exacerbate them.

Lastly, our paper sheds new light on a fundamental while understated difference between alternative theories of corporate governance, that is the role of management: should organizational structures limit managerial discretion (contractual theories) or instead expand it (see for instance Donaldson, 1990)? Is managerial discretion valuable because of the managers' ability to take pertinent strategic decisions or because of their ability to limit conflicts between the firm's multiple constituencies? The Eurotunnel case is a unique opportunity to examine these questions. Eurotunnel is indeed a typical project company, an organizational structure where managers take few strategic decisions and where long-term contracts are supposed to be an efficient tool to resolve the potential conflicts between the firm's multiple constituencies. These special features explain why shareholder management theorists consider project companies as a kind of ideal firm where agency conflicts between managers and shareholders are minimized. Our analysis shows that the successive management structures of Eurotunnel, that is a