Reimagining Profits and Stakeholder Capital
to Address Tensions among Stakeholders

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Abstract

In this article, we use ideas from stakeholder capital maintenance theory to address tensions in allocating firm profits between stockholders and other stakeholders. We utilize a mediative thought experiment to conceptualize how multiple stakeholder interests might better be served, such that genuine firm profits (from new value creation) vs. artificial firm profits (from non-wealth producing transfers) may be identified and incentivized. We thereby examine how such accounting transfers can be envisioned as stakeholder capital to be maintained for the benefit of both the firm and the economy. We present examples to illustrate the hypothetical model proposed and its implications.

Keywords: Stakeholder theory, residual stakeholders, capital maintenance theory, profits-people tension.

Capitalism is going up on trial. I think that it's clear that putting profit before people is a non-sustainable business model . . . I think giving those two equal time is the way forward . . . we need to rethink, reimagine what it is . . .

– Bono, 2016

We need some intellectual rigor, and you've got to get these metrics right.

– Bono, 2016

Profit and people. Equal attention to each. Reimagining what is. Intellectual rigor and getting the metrics right.

The field of business and society has witnessed persistent research tensions around profits-people trade-offs in both research and practice. Some of these tensions are found in research that addresses corporate social performance and financial performance issues (Griffin & Mahon, 1997; Wang, Dou, & Jia, 2015). Similar tensions are to be found in research examining the political role of firms (Pies, Beckmann, & Hielscher, 2013; Scherer, Palazzo, & Matten, 2014). Still others arise from differences in understanding the boundaries between governments and business (Dentchev, Haezendonck, & van Balen, 2017), and from differences in perspectives regarding the idea of stakeholder democracy (Moriarty, 2014). Of particular interest in this article is the ongoing conceptual tension in stakeholder theorizing, which concerns the corporate objective function—a tension arising especially from the continuing struggle to tune more finely the mechanism for deciding who benefits from business profits. Specifically, we seek to better identify *stakeholders'* share of firm profits using the corporate objective function as guide; but in this case through our employment of a *thought experiment* to examine systematically the potential economic impacts resulting from: (1) the division of profits into two categories: those applicable to managerial incentives and stockholder distributions, and those not applicable; (2) the establishment of accounts for maintaining the capital belonging to stakeholders that can be identified through making such a division; and (3) the regeneration possibilities in the economy from such reimagining of the roles of profits and stakeholder capital.

Therefore, in this article, we first develop the question we seek to analyze; discuss the nature of the mediative-type thought experiment that in our view is most suited to this analysis; and we introduce the background theory that provides the base-case theory to be utilized as the beginning point, as required in mediative-type thought experiments. Second, we present the thought experiment itself, which through two explicit conceptual manipulations enables us to extend current metrics for accounting for profits and for maintaining stakeholder capital. Third, we draw out some likely implications of the thought experiment for reimagining and rethinking the metrics related to the profit vs. people stakeholder-inclusion tension.

Approach and Background Theory

In addressing tensions in stakeholder inclusion, recent stakeholder scholarship has addressed the philosophical, practical, and theoretical viability of a pluralist conception of firm purpose that can include serving a broader set of stakeholders (e.g., Mitchell, Weaver, Agle, Bailey, & Carlson, 2016). Recent stakeholder research also has proposed solutions to problems that arise in accounting for multiple stakeholders (Atkinson, Waterhouse, & Wells, 1997; Chakravarthy, 1986, Harrison & Van der Laan Smith, 2015; Harrison & Wicks, 2013; Mitchell, Van Buren, Greenwood, & Freeman, 2015; Van der Laan Smith, Adhikari, & Tondkar, 2005). But prospective analysis of the possibilities for reimagining accounting for profits and for stakeholder capital is just beginning. We take note of recent analysis of how changes in accounting standards can be effected through institutional pressures (Harrison & Van der Laan Smith, 2015), of how the utilization of proprietary-convention (partnership) accounting (Mitchell et al., 2015) can lead to greater stakeholder inclusion, and (of particular focus in our analysis), of a short and general sketch of how accounting for stakeholder capital might affect economic outcomes (Hatherly, 2014). However, still missing is a nuanced explanation for how a pluralist conception of the firm can benefit stakeholders and society *without* having to sacrifice focus on firm profits and thereby on the residual (capital accumulation) of the corporate entity (e.g., Barney, 2016). Therefore, we agree that to get the metrics right—as suggested in the beginning epigraph—reimagining is called for.

In this section, as part of such reimagining, we set up a thought experiment of the "constructive" and mediative (vs. "destructive" and contradictive) type (Brown, 2011). A mediative thought experiment is one that moves from known and well-specified theory, to an analysis that expands the scope of theory by drawing out a new possibility (Sorenson, 1992)—in this case, for creating the incentives and capital maintenance metrics crucial to tackling the profits-people tension. Using ideas from stakeholder capital maintenance theory (i.e., Hatherly, 2014) to engage in a *what-if* exploration, we manipulate certain aspects of the accounting-metrics world (to introduce practices that do not presently exist in that world, but that might exist), in a way that enables us to reimagine and rethink the metrics that are at the core of tensions that juxtapose profit and people (e.g., Agle et al., 2008; Walsh, 2004).

Through this thought-experiment process we are then enabled: (1) to introduce into the business and society conversation a conceivable mechanism whereby several elements of theory can be recombined to produce an economic *effect*—that is, a possible new system for greater stakeholder inclusion—which is not inherent in any one element of theory alone (Davis & Marquis, 2005); but yet is an effect uniquely different from current theoretical conceptualizations; (2) to move the discussion from a narrow focus on profits (additions to capital for stockholders only), to a broader focus on capital creation and maintenance profits (the creation and maintenance of capital for all primary stakeholders); and thus (3) to enable the stakeholder field to retain the focus on inclusion, while finding conceptual solutions to the objective function issue related especially to the profits-people tension that has persisted rather tenaciously within the research conversation.

Thought Experiments

As Brown (2011) notes, thought experiments, as might be expected, are experiments "that are performed in the laboratory of the mind" (p. 1). The manipulations in these kinds of experiments therefore are mental, as opposed to physical experiments where manipulations done using different kinds of tangible instruments. Thought experiments are reasoned (by some at least) to be more than vivid theoretical arguments (Gendler, 1998; Brown, 2011). Indeed, those who support the notion of thought experiments see them to be distinct from logical arguments because thought experiments reflect "invitations to contemplate a way that the world might be" and "they make essential reference to particular hypothetical and sometimes counterfactual states of affairs" (Gendler, 1998, p. 399). The underlying purpose of thought experiments is to enable the thought experimenter to draw inferences based on decisions about "*what* would happen *if* the particular state of affairs described in some imaginary scenario were actually to obtain"

(Gendler, 1998, p. 398, emphasis added). These *what-if* manipulations are foundational to the kind of thought experiment we conduct herein.

Although there is no definitive typology of thought experiments, Brown (2011) provides a useful delineation of different kinds of thought experiments. He suggests that thought experiments can be divided broadly into two different kinds: destructive and constructive thought experiments. Destructive thought experiments are intended to make a case against current theory and accepted wisdom. Conversely, constructive thought experiments are intended to contribute to existing theory and expand our understanding of that theory (Sorenson, 1992), but do so in three distinct ways. First, *conjectural* thought experiments create a phenomenon in the thought experiment, and then enable the researcher to generate theory to explain that phenomenon. Second, *direct* thought experiments are similar to conjectural thought experiments in that they enable the researcher to end with theory, but instead are based on a more concrete phenomenon (as opposed to a conjectured phenomenon). Third, *mediative* thought experiments start with existing theory and the thought experiment then enables the researcher to "draw out" new insights and conclusions. In this article, we have adopted the mediative approach, and therefore begin by presenting background on the existing theory that is the starting point of this mediative thought experiment. We are then enabled to draw out new theoretical conclusions by an articulation of certain *what-if* manipulations that can emerge from specific departures from the body of existing relevant theory and assumptions.

Background on Existing Theory

The background beginning point for our thought experiment includes theory concerning the following ideas that, together but parsimoniously, explain and inform the current system of thought and action that underlies the profits-people tension in the social and economic space addressed by business and society research: (1) stakeholders, (2) value creation, (3) capital and income, (4) equity (book and market) and (5) capital maintenance. That is, in our theorizing, we consider these five elements to be both necessary and sufficient for our analytical purposes. We provide a precis of each in turn.

Stakeholders. The idea that firms have stakeholders now has become commonplace (Donaldson & Preston 1995; Freeman, 1984; Mitchell, Agle, & Wood, 1997). The stakeholder view concerns situations where the firm is seen as a network of stakeholders. The main concept is that the firm is a nexus of contracts among resource holders that comprise these stakeholders (e.g., Hill & Jones, 1992), that is, between managers who represent stockholders and the other primary stakeholder groups, "those without whose continuing participation the [firm] cannot survive as a going concern" (Clarkson, 1995, p. 106). Clarkson (1995) further states:

> Primary stakeholder groups typically are comprised of stockholders and investors, employees, customers, and suppliers, together with what is defined as the public stakeholder group: the governments and communities that provide infrastructures and markets, whose laws and regulations must be obeyed, and to whom taxes and other obligations may be due. There is a high level of interdependence between the corporation and its primary stakeholder groups (p. 106).

Primary stakeholders thus become the focus of an analysis where a value-based approach is used to address stakeholder inclusion.

Value creation. Value creation is an enduring concept in the management and organization literature specifically (e.g., Lenz, 1980) and in the political economy literature more generally (e.g., Marx, 1867). More recently, Bowman and Ambrosini (2000) building on prior research, argue that organizations experience two different types of value: use value and exchange value, which interrelate. LePak, Smith and Taylor (2007) explain this interrelationship, suggesting that "value creation depends on the relative amount of value that is subjectively realized by a target user (or buyer) who is the focus of value creation," and that "this subjective value realization must at least translate into the user's willingness to exchange a monetary amount for the value received (p. 182).

Value creation as used in stakeholder theory begins with the premise that the purpose of the firm is to create and distribute value to various stakeholders, and therefore that value creation occurs precisely *because* of stakeholder coproduction (Barney, 2016; Freeman, 1984; Freeman, Harrison, & Wicks, 2007; Freeman, Harrison, Wicks, Parmar, & de Colle, 2010; Freeman, Wicks, & Parmar, 2004; Harrison, Bosse, & Phillips, 2010; Mitchell et al., 2015). The firm's survival and continuing success therefore is asserted to depend upon "the ability of its managers to create sufficient wealth, value, or satisfaction for those who belong to each stakeholder group, so that each group continues as a part of the corporation's stakeholder system" (Clarkson, 1995, p. 107). Freeman et al. (2004) argue that value is created for stockholders when the firm creates value for non-stockholder stakeholders—through creating products and services that customers are willing to buy, offering jobs that employees are willing to fill, building relationships with suppliers that companies are eager to have, and being good citizens in the community. The effects of value creation by a firm reside in the capital of a firm, which is interwoven inexorably with its income.

Capital and income. While capital and income are distinct concepts in accounting (the former being a real account—surviving across accounting periods; and the latter being a nominal account—being computed and closed each accounting period), it nevertheless is possible to both define income in terms of changes in capital, and capital in terms of income. Consequently, two approaches appear in the literature. In the first, the assets approach, income is seen as being the change in capital (Fisher, 1896). The idea behind this approach is that income can be thought of as "the amount an individual can consume and expect to be as well off at the end of the week as at the beginning" (Hicks, 1946, p. 172). This approach has continued to influence the research conversation surrounding accounting's conceptual framework (e.g. Bromwich, Macve, & Sunder, 2010; Clarke 2010). Measuring assets at their historical cost (what was paid for them) remains important to the assets approach but measuring assets at fair value (a current market value) is also widely supported because:

> Fair value accounting reports economic income: in accordance with the widely accepted Hicksian definition of income as a change of wealth, the change in fair value of net assets on the balance sheet yields income (Penman, 2007, p. 33).

In the second, income approach, it is possible (see, e.g., Steele, 2014: describing the work of the economists Hayek and Jevons) to define capital in terms of income. Using this approach, income is the difference between the value of outputs delivered and matching inputs. In real (physical) terms capital formation becomes the (re)direction of inputs from the generation of current outputs to the generation of future outputs. In financial terms, capital is formed from the original capital plus retained income. In practice, accounting is a partial hybrid that functions between the two approaches with, ideally, the income approach retained for the reporting of operating profit within an overall comprehensive income, and the assets approach used to report changes in the fair value of certain assets and liabilities (Whittington. 2015).

Equity (book and market). Generally accepted accounting principles utilize either historical cost (e.g., how much was paid for an asset) or market value (e.g., what that asset is actually worth at a given point in time) in the presentation of individual assets in the financial statements. The computation of (net) assets (i.e., assets minus liabilities) is referred to as book equity. Market equity purports to represent, however, not the total of individual assets reported in the financial statements, but the market value of all the assets taken together as an aggregation. Where one assumes that *income* determines capital (i.e., where one utilizes the income approach previously described to define capital in terms of income), it follows that market equity depends not just on current income but also on market expectations of future income. In this respect, then, market equity diverges from book equity.

However, Penman (2007, p. 37) provides an elementary example of how current earnings (income) can be used to value equity, where value equals *expected* earnings divided by the required return on equity. He states this "is a legitimate model in valuation theory in the sense that it gives the same value as that based upon expected dividends." He then postulates that expected earnings equal current earnings (an earnings persistence of one). In such circumstances, and assuming profits are paid as dividends, value equals current earnings divided by the required return on equity. It follows that the maintenance of stockholder value requires the maintenance of corporate income.

Capital maintenance. The notion of capital maintenance has a long history in the accounting literature (as noted by Bromwich et al., 2010; Clarke, 2010; Nobes, 2015). This notion has been applied in a variety of ways, especially to give measures of results (Hicks, 1946) based upon the central idea: that income ought to be thought of as "the amount an individual can consume and expect to be as well off at the end of the week as at the beginning" (1946, p. 172). When this application is made within the context of a firm rather than an individual, income therefore becomes the amount a firm can distribute or add to capital and still be as well off at the period's end as at the beginning.[1] This is capital maintenance for the firm as an entity. Broadly speaking, then the firm typically is thought of in terms of stockholders and the maintenance of the (market) value of their equity—the conventional view.

Consistent with the work of Edwards and Bell (1961) and Peasnell (1981, 1982), Ohlson (1995) introduced the idea of clean surplus accounting in which changes in book value between two dates equals earnings (profits) minus dividends. Ohlson (1995) shows how the clean surplus relation allows the change in the market value of equity between two dates to be equated with the sum of: the change in book value of equity, plus the change in the present value of the expected flow of future abnormal earnings. Thus, capital maintenance from the point of view of stockholders, being the maintenance of equity's market value, depends upon both the maintenance of book equity and the maintenance of future abnormal earnings. However, accounting as defined by the International Accounting Standards Board (IASB) regards income

[1] A possible confusion might exist regarding the timing of distributions or additions to capital. Since, adding to capital, by definition, makes one better off (interest rates being constant); it therefore is important to situate the timing of the end-point assessment of income to be *immediately before closing* the books for the period. (We thank an anonymous reviewer for pointing out the need for this clarification.)

as the increase in the net assets (equity book value) of a firm. Under this conceptualization, it is only the book equity that represents the capital maintained without reference to the value of future earnings.

The emergent enquiry. The existing theory from which we prepare to depart in the thought experiment that follows, consists then of the following concepts: a primary-stakeholder-based value creation objective, where income is computed as the difference between the value of outputs delivered and matching inputs, where maintenance of income equates to maintenance of capital,[2] and where firm exists to maintain (market) value for stockholders. In the following thought experiment, we examine the (hypothetical) effects of departing from the foregoing existing theory in two specific ways to examine the following questions: What if profits from non-value creating income are ineligible for management incentives and stockholder distributions ("turned off")? And what if accounting metrics were expanded to identify, as "stakeholder capital," the amounts excluded ("turned off")? What would these *what-ifs* mean for addressing profits-people tensions in business and society research? We discuss each of these hypothetical *what-if* manipulations in turn.

Reimagining Profits and Capital: A Thought Experiment

In our view, tensions in stakeholder theory related to stakeholder inclusion and the corporate objective function (e.g., Agle et al., 2008; Jensen, 2002; Mitchell et al., 2016) stem from the question of what to do with profits. In this regard, Freeman (within his section of Agle, et al., 2008) asserts that:

> If a business tries to maximize profits, in fact, profits don't get maximized, at least in the real world. The reason may be clear: tradeoffs are made in favor of financiers, and the tradeoffs are false ones due to complexity, uncertainty and bounded rationality … Managing the stakeholders is about creating as much value as possible for stakeholders without resorting to tradeoffs, or fraud and deception (Agle et al., 2008, p. 166).

So, what if we tried instead to give equal time and attention both to profits and to people by reimagining and rethinking how we use managerial and stockholder incentives and the metrics that trigger them? What might such a world look like? In such a world, would researchers, managers, and policy makers be enabled to distinguish reliably between firm profit that is genuine (i.e., creates actual capital) and firm profit that is artificial (i.e., does not create actual capital but merely is an artifact of astute exploitation of accounting rules)? What would that mean? What if, in addition, we could compute, track, and accordingly could recognize the contributions to genuine profits of each primary stakeholder group and thereby maintain their capital? As we have described previously, the creation and examination of such *what-if* manipulations is the province of mediative thought experiments, which can enable researchers to arrive at new conclusions based on existing theory.

We start from the previously presented background theory relating to: (1) stakeholders, (2) value creation, (3) capital and income, (4) equity, and (5) capital maintenance. In the *first* manipulation, we manipulate an element of the theory related to capital and income

[2] Although this simplifying idea—that a constant relationship between income and capital is preserved in the analysis of existing theory as compared to theory resulting from the thought experiment—may not represent the full complexity of the real world; it nevertheless permits clarity of comparison where it is part of both the *before* and *after* cases.

hypothetically to exclude ("turn off") certain profits currently eligible for management incentives and stockholder distributions. As discussed later in this article, the excluded profits are those associated with non-wealth producing transfers. In the *second* manipulation, we retain the manipulation related to capital and income, but also manipulate theory related to capital maintenance to move from firm capital maintenance to stakeholder capital maintenance. Our expectation through this two-step thought experiment is to identify a new theoretical mechanism (i.e., new theory that is not inherent in the existing background theory) to explain how firm profits can be conceptualized to benefit both stockholders and stakeholders, while additionally redounding to the benefit of society. In the following sections, we explore each of these two *what-if* manipulations.

Exclude Some Profits?

To motivate our first manipulation, we therefore ask: what if certain items that traditionally have been included in profit are artificial (merely accounting transfers *inside* the firm that do not actually create new value) and therefore are excluded from profit for managerial incentives and stockholder distributions? What if such an exclusion were to be justified because these items are—in terms of value creation—merely transfers producing an unfair and non-value-producing advantage to stockholders over other stakeholders. Such transfers move income from non-stockholder stakeholders to stockholders, making non-stockholder stakeholders less "well off" than at the beginning of the period. What would be expected in this *what-if* case?

By excluding (from incentive-profits) accounting transfers *inside* the firm that do not actually create value, we expect that attention will turn from value transfer to value creation to the benefit of all concerned. Since one standard for judging such benefits is *Pareto* optimality—making at least one party better off while not making any party worse off (e.g. Jones et al., 2016), we anticipate that non-shareholder stakeholders will (as a class) be made better off by the focus on value creation. However, we also anticipate shareholders to become better off as well, according to the following expectations.

Consistent with Freeman et al. (2004), we anticipate that under conditions to be expected after Manipulation 1, value would still be created for stockholders when the firm creates value for non-stockholder stakeholders—that is, for resource providers. The exclusion of accounting transfers from incentive-inducing profits would be appropriate, based on the expectation that superior performance through sustained competitive advantage would be likely, due to the firm having access to the appropriate resources (Barney, 1991; Dierickx & Cool, 1989; Nelson & Winter, 1982; Wernerfelt, 1984). It stands to reason, then, that where non-value-creating transfers dis-incentivize stakeholders who are the providers of such resources, then competitive potential might be expected to be increased where such transfers are excluded from profits eligible for management incentives and stockholder distributions. We might also anticipate that in this *what-if* case, the exclusion of (non-value-producing) transfer income from profits also would account more adequately for and would allocate more fairly the downside (residual) risk of stockholders, thereby allowing other stakeholder commitments to be made with added relative certainty—addressing a problem with current strategic stakeholder theory (see e.g., Barney, 2016). Thus, we can envision, in this new case, that the profits-people tension might be alleviated, while not abandoning a focus on firm profits.

We illustrate with a case in point in particular: the case of transfers associated with unequal power relations between a firm and its suppliers. We have noted previously that where transfers are included (rather than being excluded from profits for incentive and distribution purposes), management may be able to pursue such transfers in favor of stockholders (and of themselves if there is a profit-sharing scheme). This might occur, for example, whenever there is a shift in the retailer/supplier market relationship, especially when such a shift is backed by unequal power relations in favor of the firm. As a case in point, John Lewis and Co., a chain of department stores in the UK[3], recently wrote to suppliers with a change in the terms of trade establishing reduced prices for increased volumes. This is a to-be-expected action for an entity with market power. For the sake of illustration assume that the increased volume promised as part of the change in the terms of trade resulted in greater supplier efficiency, and thereby that a given supplier would experience the consequences of the new contract in three ways.

The *price* consequence of the imposition of new terms of trade in the retailer/supplier relationship would be that profit would be transferred from the supplier stakeholder to the retailer, because the retailer would be buying at a lower price. However, for the supplier, the increased *volume* resulting from the increased purchases promised in the new contract and any favorable *efficiency* consequences expected to result (i.e. economies of scale), also might indicate the possibility for profit creation for the supplier. But if the supplier's adverse price consequences (the lower price imposed by the retailer's market power) exceed their favorable volume and efficiency gains (e.g., from economies of scale), then the excess (the amount by which the income loss is not made up by an efficiency gain) results in a loss of profit for the supplier and a profit/wealth transfer from the supplier to the retailer.

In Manipulation 1 of our thought experiment, then, profit transferred from supplier to retailer in this way (i.e., the amount by which the income loss is not made up by an efficiency gain) would be excluded ("turned off" in our parlance) in the retailer's accounting for profits used for computing management incentives and for distribution purposes. In this example, the extraction of a market-power-based transfer of profit from a weaker (supplier) entity, when not available for incentives computation (either managerial bonuses or stockholder distributions) would, we expect, have the effect of *providing incentive* to the retailer to *include* supplier stakeholders in its value-chain pricing plans. Where efficiency gains are possible and the price reduction is beneficial to all concerned, then the increased profits would not be excluded. But where there is a market-power-instigated loss to the supplier, then there would be little incentive for the retailer to insist on imposing the new terms of trade. Thus, in this first (mind-only-based) thought-experiment manipulation, the effects are expected to be tension resolving: that is, both profits and people expected to benefit, and accordingly, we offer:

> *Proposition 1: Excluding non-value-creating transfers from profits (for purposes of distributions, results measurement, and additions to capital), should lead to incentive-based benefits for both the firm and all stakeholders (benefits for both profits and people).*

This portion of our thought experiment thus also identifies and illustrates how non-value-creating transfers can be overcome through incentive alignment (the management and stockholders of the retailer receive no benefit from the extraction of the supplier stakeholder's income), and thereby can enable the focus of managers to shift: to attend more to genuine vs. artificial firm profits. As we discuss later, this shift can have profound consequences for business and society.

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[3] Although we could cite also similar examples in many advanced economies, e.g. Canada, France, the USA, etc.

Compute, Track, and Recognize Stakeholder Capital?

In the prior section (first manipulation), we sought to understand what would likely happen if we excluded ("turned off") non-value-creating transfers from profits eligible for management incentives and stockholder distributions. But this new condition leads us to ask: what would the business be expected to do with the "turned off" profits that are credited to capital? And what might be the result in the profits-people tension? In this section, while retaining the first manipulation, we now explain the second *what-if* manipulation in this thought experiment; and in doing so explore outcomes possible by *maintaining stakeholder capital*.[4] In this thought experiment manipulation, we introduce capital maintenance from the point of view of non-stockholder stakeholders. Since at the beginning point—pre-manipulations—this group would not possess any book equity, it follows that our focus will be on maintaining (future) stakeholder capital.

Extending, then, the conventional notion of capital maintenance as previously applied to the firm—the amount a firm can distribute or add to capital and still be as well off at the period's end as at the beginning—to then apply to primary stakeholders; maintaining stakeholder capital could then be defined to be *the amount a firm can distribute or add to the capital of each primary stakeholder and for that stakeholder still to be as well off at the period's end as at the beginning*. As part of this second manipulation turned-off profits would be placed into a *stakeholder capital maintenance fund*—a partitioned section of the capital account—which would be (by definition, prudence, and standards of fairness and reciprocity, e.g. Phillips, 2003) non-distributable to any stakeholder in any form. Thus, by placement into this separate fund in the firm's equity, the profits from transfers would not benefit any specific primary stakeholder but remain invested in the firm (i.e., in the capital maintenance fund) for the benefit of all stakeholders (thus including stockholders and the firm itself). The term "turning off" thus has captured the idea that the "profit" corresponding to transfers remains active as it pertains to its being invested in the firm; but is deactivated only for purposes of stockholder distributions or results-measurement rewards to management.

Interpreting the establishment of a stakeholder capital maintenance fund, is aided when considered within the context of the firm as a network of primary stakeholders bound within a nexus of contracts (Hill & Jones, 1992); a network that is focused on the continuity of the firm as a going concern (Clarkson, 1995). We therefore suppose, consistent with Hicks (1946), that, consistent with the related definition in the preceding paragraph, income using the stakeholder capital maintenance concept can be thought of in general terms as: *the amount a firm can distribute whilst keeping its stakeholders as well off at the end of a given period as at the beginning*. Additionally, it then follows—for purposes of this manipulation—that within the equity section of the balance sheet, accounts would be established for the capital of each primary stakeholder group. (Of course, as also previously noted, under this proposed arrangement, the firm also would be treated as a stakeholder in its own network, so that the firm as a whole would also remain as well off at the end as at the beginning of a given period.)

[4] Extending the firm capital maintenance concept to stakeholders, we expect as part of our manipulation that the maintenance of stockholders' capital implies that accounting profit can be maintained in future given an assumption of relative stability in the marketplace.

Thus, continuing the previous illustration, the consequences of a regimen by which stakeholder capital would be computed, tracked, and accordingly would be recognized as such in the equity section of the balance sheet, could be viewed as follows. Recall in this example that the transfer-based profit (the profits that came from a market-power-based price reduction by a retailer in payments to its supplier) were to be "turned off." In this second manipulation, we ask: what if these profits ("turned-off" for managerial incentive and stockholder distribution purposes) were to be recorded in the retailer's books in a stakeholder capital maintenance fund (segregated within to include a sub-fund for each primary stakeholder)? Furthermore—as we have previously argued—it also follows that to be beneficial to all concerned, then, in future operations an equivalent charge or "turning off" would be made to the retailer's profit each year that the lost profit of the supplier-stakeholder (in the foregoing example) persists; and each year this charge would then be credited to the supplier-stakeholder fund in the equity section of the retailer's financial statements. Thus, rather than there being incentive for management/owners to transfer income from suppliers; incentive would be redirected toward the effective value-creation utilization of the capital resident, active, and available in the stakeholder capital maintenance fund. What would this mean at the profits-people nexus? It likely would mean that retailer and supplier would work more closely together to maximize total value of the supply chain.

Hence, as a conceptual result of this second manipulation, we can expect that this stakeholder capital maintenance approach would necessitate that the retailer work with each major supplier to establish the impact of the supply-chain changes (e.g., in terms and conditions) upon suppliers' profits. This approach would be expected to produce an effective relationship-driven firm; and if stakeholder capital maintenance accounting and recording were to be operating as suggested in this manipulation, then the resulting reciprocity would be expected to lessen the resistance of suppliers to being open about profits. Stakeholder capital maintenance could thereby become an integral part of supply chain management. Thus, in this second thought-experiment manipulation, and given the exclusion of non-value-creating transfers from profits for purposes of distributions, results measurement, and additions to capital (Manipulation 1), we therefore expect:

> *Proposition 2: Additions to unrestricted firm capital would be recognized only after the income flow to each group of primary non-stockholder stakeholders necessary to maintain their capital has been credited to the stakeholder capital maintenance fund, and should benefit both the firm and its primary stakeholders (benefits for both profits and people).*[5]

This second manipulation in our thought experiment helps further to identify and to illustrate how non-value-creating transfers can be excluded from incentive-profits, but remain active in contributing to value creation; and thereby can further enable the inclusion of stakeholders' capital in the accounting records of the firm.

New insights and effects. In this thought experiment, we started from a beginning point of relevant theory and assumptions related to: (1) stakeholders, (2) value creation, (3) capital and income, (4) equity, and (5) capital maintenance. The first manipulation excluded ("turned off") non-value-creating profits currently eligible for management incentives and stockholder distributions. And the second manipulation then retained Manipulation 1, and changed the notion

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[5] Thus, in terms of the firm's ability to maintain its income, we recognize that computationally this undertaking may imply the use of some form of replacement cost accounting.

of capital maintenance by introducing the concept of the stakeholder capital maintenance fund. As summarized below, the thought experiment provides new insights that effect changes in existing theoretical conceptualizations in a way that begins to resolve the profits-people tension. The new insights generated through this thought experiment can be seen in each of the theoretical elements that formed the beginning point of our mediative thought experiment.

From the perspective of the *stakeholder* theoretical element, whereas under existing theory we have seen stakeholders, whose contributions to expected profits are essential (Barney, 2016) excluded from participation in the firm residual; we would now expect to see greater inclusion of previously excluded stakeholders in the profit equation. From the perspective of the *value creation* element, whereas under existing theory we have seen overstatement of firm value creation due to the presence transfers in firm profits; we would now expect to see greater increases in actual value for the "firm" and the economy. From the perspective of the *capital and income* elements, under existing theory we have seen the income approach retained for the reporting of operating profit within an overall comprehensive income, and the assets approach used to report changes in the fair value of certain assets and liabilities. But under this existing approach, artificial income ends up being included in operating profit and in stockholder capital. We see in the thought experiment that artificial income would be excluded ("turned off"), and these excluded amounts would be credited to stakeholder capital. We would then expect both capital and income to be enhanced by refinement of incentives that lead away from a focus on artificial vs. real profit creation. From the perspective of the *equity* element, whereas under existing theory we have seen that the maintenance of the value of stockholder equity requires the maintenance of corporate income; we would now expect to see greater mobilization of equity toward value-creation-based increases in equity vs. artificial income-based increases. From the perspective of the *capital maintenance* element, whereas under existing theory we have seen that book equity only represents capital maintained without reference to the value of future earnings; we would now expect to see broader options for capital deployment that focus on future earnings from real value created.

Implications

As noted in the Call for Papers for this Special Issue, "although [stakeholder theory] has been used to guide both public policy and business decisions, there is no consensus about its general applicability." In the prior section, we have—through the thought experiment presented—conceptualized two possible manipulations from which new insights emerge that can address the more-general applicability of stakeholder theory, and in doing so also address the more-specific profits-people tension in business and society research. In this section, we now illustrate these claims by discussing three implications of our analysis for questions of general applicability that we might be able to see as innovative extensions of our mediative thought experiment analysis of the profits-people tension using the capital maintenance lens. In each of these cases, we have tried to draw out expected thought-experimental effects of consequence to business and society. Our selections, however, are by no means exhaustive. We nevertheless hope that they are sufficiently extensive to illustrate the broad potential impacts of stakeholder capital maintenance-based thinking. Accordingly, we present implications in terms of: (1) investment, (2) the global company, and (3) executive compensation, should ways be found to actualize in practice the manipulations hypothesized in our thought experiment.

Implications for Investment

We see as axiomatic the idea that today's investment in fixed assets and intangible assets is a key determining factor in the GDP of tomorrow. Many democracies, due (we think) to populist pressures, are particularly poor at investing for the future. According to one report (O'Connor, 2013), the UK is second lowest of advanced nations when it comes to investing today, for tomorrow. Other highly developed economies also can be seen as being in a similar situation of under investment. We therefore also note the possibility of inter-temporal transfers, where reduction in investment today in order to help current profits in the present is in effect a transfer to current stockholders, from the firm's stakeholders of tomorrow. The stakeholder capital maintenance approach to developing better accounting metrics might also justify treating future generations as a separate stakeholder category and invoking the principle of maintaining stakeholder capital. For example, when depreciation charges are in excess of recorded fixed asset additions, and thereby investment in fixed assets is reduced, then it is necessary—if applying stakeholder capital maintenance principles—to exclude/ "turn off" an appropriate amount of current profit. The appropriate amount is the shortfall of fixed asset additions times the applicable rate of depreciation: to protect the productive capacity of tomorrow.

Similar arguments apply to the investment in research and development and in other intangible assets such as branding, business methodologies, copyrights, patents, trademarks, etc. If, for example, investment in research and development drops year-on-year in absolute terms, then, according to the principles of stakeholder capital maintenance, the profit corresponding to the drop should be "turned off." It is plausible that the objective of certain expenditures on intangibles may achieve more in the nature of income transfer than income creation. For example, Harding (2013a) poses the question: "If one organization invests in a brand to boost profits, does that not mean another organization will lose profits, with no change to the economy overall?" We can see how such an investment might result as suggested, especially in a mature market; but then again, the branding might serve to raise awareness and be a symbol of the product's competitive advantages for particular target customers. Much depends upon the context as the new insights from our thought experiment are considered further.

According to Harding (2013a), net investment in the US economy[6] is barely 4 per cent of output having been about 9 per cent of GDP until the late 1980's. Profits, however, over the same time rose from 9 per cent of GDP to around 12 per cent. It is not clear whether investment has been declining in absolute terms, but the purpose of "turning off" profits in relation to reduced investment is to help discourage any absolute decline in investment. Organizational investment in fixed assets is a factor in the calculation of GDP, and recently the US has revised this equation to include spending on research and development (Harding 2013b), hopefully as encouragement for investment goal setting in the future.

Implications for the Global Company

The global firm has stakeholders in different countries, and these stakeholders (as previously noted) can include communities, customers, employees, financiers/stockholders, and suppliers. Herein we now argue that the stakeholder capital maintenance approach to the development of metrics for accounting for stakeholder capital can conceivably be applied globally by

[6] No comparable figures are given in this cited article for the UK or other advanced economies.

maintaining the income flows for each class of stakeholder without considering national boundaries. Of course, these considerations are preliminary and intended to open additional capital-maintenance-focused dialogue.

We therefore explore the idea that alternatively (and based upon user needs and requirements), country boundaries could be considered with stakeholder capital maintenance being applied to each stakeholder group in a given country by, for instance, a commitment to maintain income separately for suppliers (and also for other classes of stakeholders) in country A, suppliers in country B, etc. Such an application of stakeholder capital maintenance could consider country boundaries but not stakeholder boundaries by committing to maintain the contribution to income in each country. In such a case, contribution of the firm to income in any given country would be the firm's total expenditure in that country to communities, customers, employees, financiers/stockholders, and suppliers. These might then be regarded as the input stakeholders with customers as the output stakeholder.

If each country were regarded as a stakeholder in the global business, then stakeholder capital maintenance might require the firm's profit contribution to the country spread over all input stakeholders to be maintained. Still greater flexibility could be enabled by allowing the (input) spend in the country to be reduced by sales in the country and requiring this net figure to be maintained. The net figure is the firm's contribution to the country if positive and the country's contribution to the firm if negative. The idea of stakeholder capital maintenance applied in the case of the global firm is to reduce the temptation to play one country against another and then also to encourage the firm to work with the governments of the various countries to improve the firm's commitment to each country.

Implications for Executive Compensation

By treating stockholders as a class of stakeholder and then applying stakeholder capital maintenance metrics to stockholders, it follows that stockholder capital would be maintained if profits are maintained, and that stockholders are "better off" to the extent that profits are increased. Given the new insights from our thought experiment, the profits, after "turning off" transfers, would likely be the profits that management should be motivated to increase. According to these new insights, then, management rewards therefore would be tied to goals based upon such profit increases. At present, many executive compensation contracts are tied instead to share price increases and returns on equity. Interestingly, it is the absolute size of profit that relates to GDP and not returns on equity or assets. It thus follows that an economy where the productive sector seeks primarily to maximize returns will not maximize GDP. Based on the stakeholder capital maintenance approach, moving away from rates of return as a measure of results and prioritizing growth in profits measured after transfers is indicated. This ensures that the incentive is for profit created rather than income transferred.

Possibilities for Future Research

One helpful result of thought experiments is that they can be a fruitful source for future research possibilities.[7] We suggest that the insights from our thought experiment can address the profits-

[7] We thank the Editor and three anonymous reviewers for several helpful suggestions that have contributed to this section of the paper.

people tension and have implications for future research as well as for the practical and mechanical issues of accounting.

Thus, with respect to the practical and mechanical issues of accounting, it is clear to us that a great deal of additional discussion is made possible. For example, as a case in point, a deeper discussion of the “stakeholder capital maintenance fund” would be helpful. If a firm is retaining capital for stakeholder capital maintenance, a more in-depth development of how such a retention of capital can help stakeholders would be both helpful and interesting. Could there be a concept of dividends in some form to the stakeholders? This idea would fit within the current accounting framework. Additional development in this regard therefore would be required. Further to this issue; then at the very least, we can envisage transfers from the appropriate section of the stakeholder fund to stockholder equity taking place when at a later date payments to that stakeholder group recover and start to go beyond the capital maintenance level. If these transfers back to equity pass through reported profit then there is an incentive for management to accept the subsequent higher stakeholder payments more readily. However, as this brief analysis suggests, while a clearer discussion of the stakeholder fund and its operation is needed in the literature, our focus in this article has not been to seek to propose these accounting methods; but rather to examine critically a capital maintenance based philosophy of addressing the profits-people tension.

Then, within the business and society field itself, we also see opportunities for future research. We therefore consider additionally three likely areas where future business and society research can benefit from the theorizing in this article and/or where potential progress in addressing other tensions in stakeholder research might be possible. Specifically, we discuss: (1) putting government into stakeholder-based explanations by theorizing it as an essential enabler of value creation; (2) appealing to social movement theory to better explain how those primary stakeholders included within the stakeholder capital maintenance concept may engage in strategic collective action to convince firms to adopt this approach; and (3) utilizing institutional theory to develop better explanations for how the idea of stakeholder capital maintenance may be institutionalized.

Future research on an expanded role for government in stakeholder theory. Recently, scholars have begun to pay more attention to the important issue of stakeholder inclusion and accounting for stakeholders (see Mitchell et al., 2015). In this article, we have developed insights that come from the idea of creating and maintaining capital for all primary stakeholders (e.g., communities, customers, employees, financiers/stockholders, suppliers), moving beyond additions to capital for stockholders only. However, one primary stakeholder not generally included as a target for value creation in our insights is government (Clarkson, 1995). This omission does not mean that we ignore the role of government; but rather, we see government as an external enabler of the profits-people reconciliation. For example, government can serve as a regulatory enabler of stakeholder capital maintenance-focused practices (e.g., see Harrison & Van der Laan Smith, 2015). Yet important questions remain, such as: How would, for instance, government act as an enabler of stakeholder capital maintenance in conjunction with, in opposition to, and/or alongside, institutional structures such as accounting standard setting bodies? We believe this can be a fruitful area for additional future scholarship.

Future research on strategic collective action. Another avenue for future research concerns how stakeholders emerge and exert influence in firms when reimagining the metrics and the profits-people tension. A potential theory to explain the emergence and influence of stakeholders in this process might be social movement theory (Rowley & Moldoveanu, 2003; Tilly, 1978; Walker, 1991). King (2008), for example, argues that collective action that binds individual stakeholders together and assists in forming common identity and interests provides the means for stakeholder strategic action. This link between collective identity and social movements (see e.g., Polletta & Jasper, 2001) provides a pathway for understanding the specific stakeholders that might act collectively with respect to the metrics related to the profits-people tension. We would expect that those who share a collective identity that is supportive of giving attention to both people and profits might be more likely to act collectively to promote metrics that support this balance. Future research can also seek to understand who might be more likely to act collectively and the conditions under which these stakeholders might establish the collective identity that would enable such collective action to influence government regulation (see e.g., Suddaby, Cooper & Greenwood, 2007; Cooper & Robson, 2006).

Future research on the institutionalization of stakeholder capital maintenance. Future studies also can examine the process of diffusion and adoption of the institutions that enable stakeholder capital maintenance insights to become generally accepted and to operate effectively—what has been termed institutional work (Lawrence & Suddaby, 2006) and stakeholder work (Lee, 2015). In the case of institutionalization that proceeds toward general acceptance, institutional theory suggests three likely mechanisms through which the kind of institutional isomorphism suggested by the notion of general acceptance can occur, each with its own antecedent: (1) coercive isomorphism that stems from political influence and the problem of legitimacy; (2) mimetic isomorphism resulting from standard responses to uncertainty; and (3) normative isomorphism associated with professionalization (DiMaggio & Powell, 1983, p. 150). In this respect, institutional theory explains how institutions affect human action (Lawrence, Suddaby, & Leca, 2009).

Although complementary, the institutional work literature (e.g., Lawrence & Suddaby, 2006) does the opposite, and examines the mechanisms whereby human actions can affect institutions (Lawrence et al., 2009). Based on this view of institutional theory, Harrison and Van der Laan Smith (2015) argue that the development of institutions around accounting for stakeholders and the forces supporting it will lead to changes in the public accounting profession. Specifically, the mechanisms of institutional work concern the creation, maintenance, and disruption of institutions. Scholars in future can examine the extent to which these bi-directional institutionalization processes may be applicable to the case of utilizing the stakeholder capital maintenance concept to resolve stakeholder/stockholder tensions and to benefit both firms and society.

Limitations

By its very nature, a thought experiment exists in the mind (Brown, 2011) and is not intended to offer completeness, but instead is intended to contribute to existing theory and expand our understanding of that theory (Sorenson, 1992). But because it exists in the mind, there will remain raise questions and issues that cannot be addressed within a given thought experiment. In this section, we therefore approach the limitations that are beyond the capacity of this article/thought experiment to address. Specifically, these relate to limitations concerning: (1) motivations for managers, (2) short-term incentives to managers, and (3) practical steps for adoption.

Motivations for managers. In this article, we assert that the stakeholder capital maintenance concept should be used to motivate managers to generate actual vs. artificial profits. We are limited in our discussion of managers' motivation; but we also are optimistic that the realignment of incentives toward rewarding genuine profits is possible and feasible over the long term. The point we are making concerns the importance of protecting the future of the company by not transferring artificially generated profits to benefit management and/or stockholders, and that stakeholder capital maintenance assists in that effort. We agree that the market should be the means to match supply and demand; and we suggest that—as with most incentive systems—a case-by case approach will be necessary; and further that firm-by-firm incentive system development is an area for further research that the methods employed in the analysis reported in this article are not intended to address.

Short-term incentives to managers. Further to the foregoing point, in the article we argue that better incentive alignment will result from the use of the stakeholder capital maintenance concept. We are limited in our discussion of the short-term incentives system needed to induce managers to "turn off" profits. We therefore have argued that the incentives for management should be changed so that managers are rewarded on profits net of the profit that is "turned off," and we are concerned that under present incentive regimes, this result will be unlikely.

However, the results of our thought experiment would lead us to argue strongly for changing the management incentives through changing the concept of profit available for distribution. It is about closing a loophole where payments presently are made for value not created. We wonder how one can expect to get support for closing a loophole from those who benefit from that loophole. We therefore also wonder whether there can be any change in our societal way of thinking about stakeholders' relationship with stockholders without such theorizing and subsequent willingness to intervene on the part of society (e.g., through legislation or the disruption of present institutions). We believe that this question is exactly on point in addressing the profits-people tension in stakeholder theory; and within the confines of this article we have explored many of the possible changes. However, further exploration herein, of legislative or institutional requirements, is beyond the scope of our thought experiment.

Practical steps for adoption. In this article, we have conducted a thought experiment that has resulted in an outline of a stakeholder capital maintenance-focused world in which a variety of new accounting and management methods would be required. But again, while hopefully provoking interest in them, the explication of such accounting and management methods is beyond the scope of this article. For example, the issue of how a firm would treat stakeholders that do not have a transactional relationship with the firm (e.g., the community) remains beyond the scope of this article. Nonetheless, we believe that there is much that can be done to develop the concept and the application of stakeholder capital maintenance for both firms and society (e.g., at the national economy level). The virtue of stakeholder capital maintenance at the firm level is that it separates inward income transfer to the stockholders from actual income creation that benefits all stakeholders. Herein we have argued that profits from income transfer should be excluded ("turned off") or disregarded for purposes of goal setting (e.g., measuring management results) and of calculating distributable profit. The reason, as we have explained, is to discourage management and stockholders from seeking compensation through the artificial profits that may be garnered through transfers from their stakeholders, and instead to focus their attention on real profit and wealth creation.

Again, we emphasize that those profits that are “turned off” under stakeholder capital maintenance to maintain stakeholder capital are not distributed or paid to the stakeholders concerned. Rather, they would be conserved and mobilized through use of a “stakeholder capital maintenance fund” retained in the firm in order to help it through a period during which market forces have made it difficult for the firm to maintain income for all its stakeholders. In a sense, the stakeholders thereby are “bailed in” to protect the firm’s future. Not unlike the “golden handcuffs” used by stockholders (through directors) to retain the commitment of talented managers, the stakeholder fund symbolizes both a commitment of the firm to its non-stockholder stakeholders and a commitment by those stakeholders to help the firm when necessary. How this is to be done remains to be explored further, but the results of our thought experiment would lead us to suggest that such commitment should serve to strengthen the firm as a stakeholder network and put the firm in a stronger position to pursue growth strategies based upon the development and leverage of that stakeholder network.

Conclusion

We therefore see the foregoing thought experiment and its implications as illustrative of how the re-imagination of accounting for profits and stakeholder capital can be expected to affect the general system of addressing the profits-people tension. Hence, we suggest that reimagining accounting for profits and stakeholder capital, in ways such as we have done in this thought experiment, can result in further correcting the misalignment in incentives in the firm originally noted by Jensen and Meckling (1976). The stakeholder capital maintenance approach thus identifies a possibility to give both profits and people “equal time” as a “way forward,” to “rethink, and reimagine what it is,” as suggested in our opening epigraph (Bono, 2016). Consequently, the stakeholder capital maintenance idea becomes complementary to stakeholder agency theory (Hill & Jones, 1992; Mitchell, et al., 2016). With better metrics available for the interests of each “principal” to be accounted for, it seems likely to us that the building of a new common ground between stockholders and stakeholders—profits and people—can be the result, thereby helping to resolve a seminal tension in stakeholder theory.

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