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ABSTRACT

Can value allocation be left to managerial discretion and does corporate law provide the basis for a balanced stakeholder management and a fair allocation of results? This question is central in an age of inequality. We argue that it can be reappraised by building upon the case of maritime law. Whereas in corporate law, the board is in charge of allocating the results, maritime stipulates a clear *ex ante* rule when it allows a captain to sacrifice some goods to save the ship: the historical "rule of general averages" has emerged in Antiquity. It compels the interested parties to bear jointly the costs. This rule makes visible what we call a "partnering effect" of managerial authority and suggests that corporate law, as it currently stands, lacks a conceptualization of managerial discretion and therefore limits the possibility of a fair allocation of results. While management scholars have sought to rethink management theory with a "view from law" (Lan & Heracleous, 2010), we conclude that law could also be discussed with a view from management history.

Keywords

Stakeholder theory, managerial discretion; value allocation; corporate law; managerial authority; partnering effect; fairness

CAPTAINS OF INDUSTRY? VALUE ALLOCATION AND THE PARTNERING EFFECT OF MANAGERIAL DISCRETION

Today, there are growing inequality corporate behavior (Bivens & Mischel, 2015). A recent report noted that in France, the distribution of wealth among the stakeholders of the biggest listed companies has never been so unequal: from 2009 to 2016, the 40 biggest companies redistributed 67.4% of their profits to shareholders in the form of dividends as opposed to only 5.3% to employees (Aubry, Alliot & Ly, 2018). Income inequality can have significant effects on organizations (Bapuji & Neville, 2015; Ni, Qian & Crilly, 2014), and managerial decisions are recognized as a key factor in income inequality (Cobb, 2016), which has reached its highest level ever in the United States (Atkinson, Piketty & Saez, 2011). This situation revives the question of whether value allocation should be normatively ruled by law or left to corporate freedom and managerial discretion.

This is a challenging question for stakeholder theory. Stakeholder theorists emphasize that stakeholders should not be considered in terms of their respective power, but based on the principle of fairness (Buren, 2001; Phillips, 2003). However, they usually refrain from setting clear rules on how to allocate the value created by joint investments in the corporate ventures among the different stakeholders. They argue instead that value allocation is a managerial tool (Scott, Garza, Conlon & You Jin, 2014): managers use value sharing as a means of reducing supervision costs, limiting free riding, increasing parties' motivation (Kruse, 1996), and retaining their willful participation to foster value creation (Harrison, Bosse & Phillips, 2010).

Stakeholder theorists generally consider that it is in the interest of the company to allocate rewards in a neutral and fair way, as this determines the possibility of investments from the different constituencies in the company. In this view, the role of corporate law is not to rule on value allocation, but to protect the board, for instance by insulating directors from stakeholder pressure (Blair & Stout, 1999; Lan & Heracleous, 2010).

Yet, given the increasing level of inequality, several questions arise: Is corporate leeway sufficient to deal with value allocation? Do corporate leaders have the necessary latitude to balance rewards? And does corporate law provide the basis for stakeholder management?

In this study, we investigate the absence of a normative framework and the principle of managerial leeway in allocating value by examining the historical case of maritime law.

This historical rule is interesting because, while corporate law leaves value allocation to the discretion of companies' leaders, maritime law adopts the opposite norm: it specifies a clear *ex ante* rule on value sharing. Maritime law vests the captains with great latitude and authority: captains are legally allowed to jettison the goods they are carrying if that will save their vessel from being shipwrecked. Yet, contrary to corporate law, maritime law does not let the captain (or anyone else) decide how the loss is to be shared: it stipulates that the effects of decisions made for the common good should be jointly supported. This rule is called the rule of "general averages," as it deals with damages that are general, i.e. decided by the captain and for the collective interest, as opposed to damages that merchants bear privately.

We argue that the rule of general averages has important implications for fair value allocation. First, it provides an expanded view of managerial discretion. The literature has recognized the importance of the *distributive* managerial discretion: directors' leeway to allocate value is central to allow firm specific investment (Blair and Stout, 1999). But another type of managerial discretion, a *strategic discretion,* must be taken into account as employees, like other stakeholders, not only make firm-specific investments: their human capital may also be impacted, either positively or negatively, by managerial decisions. Such impacts generate interdependencies that to date have been overlooked, both the team production theory and by corporate law. Second, the maritime rule leads to conceptualize what we call the "partnering effect" of managerial discretion. In maritime law, the ship captain's decision binds the parties on whose behalf the decision is made. We argue that in companies, managerial discretion also has a partnering effect for those stakeholders who accept the managerial authority. Third, the partnering effect has not only implication for stakeholder theory. It has also normative implications. To date, corporate law has provided directors with the leeway to allocate value, and the team production theory considers that this normative framework allows for a fair allocation of value. However, we argue that an appropriate conceptualization of strategic discretion and its general effects should lead to a solidarity rule and a limitation on distributive discretion.

Thus, our study opens up new ways to manage value allocation in companies and suggests an agenda for future research on how corporate law could integrate an explicit solidarity rule. It also invites management scholars to use their comprehensive

view of management and management history to rethink corporate law in terms of stakeholder orientation.

The rest of this paper is organized as follows. The next section outlines why the literature views managerial discretion as a central condition for stakeholder management and why this needs to be reexamined. The following section develops the historical case of maritime law and the model of the partnering effect. The final section discusses the theory and implications of this model for contemporary companies. Three preliminary remarks are necessary to specify the scope of our research. First, by value allocation, we mean not only the distribution of net corporate income, but also the impacts of management decisions on stakeholders. For example, managers can increase (or decrease) share value and employees' competencies and employability. A company can either issue or buy back shares, and can either provide secure jobs or impose layoffs. Following stakeholder theory, we are thus concerned with all of the potential impacts of management decisions on stakeholders. Second, we do not deal with the general question of fairness or equity in companies, nor do we discuss the various means managers use to allocate value. Instead, we examine whether managers have the necessary leeway to be fair within existing normative frameworks and whether value allocation should be left to managerial discretion or determined by a normative rule. Therefore, our literature review focuses on stakeholder theory, managerial discretion, and value allocation in corporate law. Third, and for the same reasons, we do not make any distinction among corporate leaders. Although there are clear and important distinctions between directors, non-executive directors, and executive officers, we do not distinguish between them because we focus specifically on the corporate freedom to allocate value.

Consequently, we refer to “management” as “the team of directors and officers who shape board decisions” (Bebchuk, 2005: 842).

THE ROLE OF MANAGERIAL DISCRETION IN STAKEHOLDER MANAGEMENT

The Need for Equity: a central Issue for Stakeholder management

The term “stakeholder” was popularized by Freeman (1984), but the impetus toward stakeholder theory emerged earlier. It arose from the conviction that management’s role goes beyond a profit maximization function and that the responsibilities of managers are far broader in scope than merely maximizing shareholder value (Friedman, 1970), extending to the interests and claims of non-stockholding groups (Mitchell, Agle & Wood, 1997)).

Fundamentally, stakeholder theory views the firm as a “wealth creating team” (Kaufman & Englander, 2005) and as a nexus of team-specific assets provided by shareholders, managers, employees, and others who hope to profit from team production (Gabrielsson, Huse & Minichilli, 2007). It aims to overcome what it perceives as the shortcomings of standard organizational economic approaches that focus on ownership, contracts, and incentives (Silverman & Ingram, 2017).

In arguing that management has relationships with a variety of parties beyond their strict contractual obligations, stakeholder theory considers that the essence of the firm *goes beyond the mere nexus of contracts*. It is concerned with the alignment of the different parties rather than the divergences and conflicts that are predominant in

the economic view, to be resolved purely by market transactions and contracts, especially in agency theory (Davis *et al*., 1997: 21; see also Dean, 2001: 94). Economic and social purposes can be aligned if we accept that it is both the *raison d'être* of the firm to create value for all its constituencies and, stakeholder theory argues, a condition of its sustainable existence (Clarkson, 1995; Harrison et al., 2010; Post, Preston & Sachs, 2002) The capacity of a firm to generate sustainable wealth over time is determined by its relationships with critical stakeholders (Post et al., 2002). Hence, stakeholder management is expected to improve both the economic efficacy of the firm and the social justice among its stakeholders.

Management scholars have characterized the various sources of stakeholders' rights. Beyond the legal claims of the first stakeholders ("internal or primary" stakeholders), some stakeholders have no contractual relationships, but nonetheless are critical to the firm's operations (Clarkson, 1995). They can claim some rights to the firm's value (Asher, Mahoney & Mahoney, 2005), as they contribute to the wealth-creation process, either through specific investments (Hill & Jones, 1992) or because the value of their assets is affected by the fate of the enterprise (Kochan & Rubinstein, 2000).

Although there have been numerous debates on whether and how these rights should be recognized contractually and enforced normatively, scholars have mainly considered that stakeholder management was not a matter of legal obligations. It was assumed that management should pay attention to the various stakeholders because this was critical for the firm's long-term legitimacy and sustainability (Clarkson, 1995; Post et al., 2002) and was necessary to maximize the wealth-creation

capabilities of the firm (Phillips, Berman, Elms & Johnson-Cramer, 2010; Phillips, Berman, Johnson-Cramer & Elms, 2007). Under this approach, managerial discretion is a key condition for stakeholder management and fair value allocation.

Managerial discretion: a key condition for stakeholder management

"Managerial discretion can be defined as the latitude of managerial action available to a decision-maker" (Wangrow, Schepker & Barker, 2015): 100), be it latitude in terms of objectives or in terms of actions (Shen & Cho, 2005). Hambrick, Finkelstein and their co-authors first posited that managerial discretion circumscribes the options for strategic choice, and therefore determines the potential impact leaders can have on organizations, be it in relation to firm performance or value allocation (Finkelstein & Hambrick, 1990; Hambrick & Abrahamson, 1995; Hambrick & Finkelstein, 1987). Managerial discretion is seen rather negatively by agency theorists, as it leaves the door open to managerial opportunism, but it is viewed more positively by stakeholder theorists. Although stakeholder theory is not framed explicitly in terms of managerial discretion, its central premise is that managers have the leeway to pay attention to different constituencies and to promote the general welfare. For instance, stewardship is facilitated when a CEO chairs the board of directors because he/she is then given greater authority and discretionary powers (Charreaux, 2015; Donaldson & Davis, 1991).

The literature on managerial discretion has addressed both the antecedents for and the effects of managerial discretion. Regarding its antecedents, managerial discretion appears to be constrained not only by the task environment, internal organization, managerial characteristics, and activities (Finkelstein & Peteraf, 2007), but also by the

broader environment. Industry regulation and state legislation play a noticeable role in managerial discretion (Crossland & Hambrick, 2007, 2011). The impacts of managerial discretion have also been studied, especially in relation to executive compensation and firm performance (Wangrow *et al.*, 2015). However, the dynamics of managerial discretion is rarely analyzed, and this may be especially problematic for stakeholder theory, which has lofty expectations regarding managers. It is one thing to suggest that managers are expected to pay attention to the needs of different stakeholders, but do they have the discretion to do so?

The Team Production Theory of the Corporation

Legally speaking, managers are given considerable leeway to allocate value. Team production theory proposes that corporate law is designed precisely to give directors the discretion to allocate value in a fair and efficient way (Blair et al., 1999; Lan et al., 2010). According to Blair and Stout, a firm is created when a series of individual efforts are combined, with a cooperative spirit, for a joint output. Specific investments (meaning that they are difficult to recover once committed to the project) must be made by the different gains are inseparable (meaning that it is difficult to attribute any particular portion of the gains to any particular stakeholder). Under these conditions, it is difficult to draft explicit contracts regarding value allocation because it is difficult to decide on the allocation of profits beforehand, as it would reduce incentive, but if the rules for sharing are not decided in advance, there is the risk of very expensive *ex post* bargaining.

To agree on a procedure that all consider fair, what do team members do? “They form a public corporation” (Blair and Stout, 1999: 771): they voluntarily transfer

"authority over the division of production rents and surpluses to an independent body – a mediating hierarchy in the form of the board of directors – that will monitor their efforts and determine how each can best be rewarded for past contributions, as well as be incentivized for future contributions, in the process also guarding against mutual opportunism among the parties" (Lan and Heracleous, 2010: 300).

Thus, the board is conceived as a third party capable of arbitration between the stakeholders to solve potential conflicts of interest (Hillman & Dalziel, 2003; Lan et al., 2010). Its role is to encourage firm-specific investments by making sure that value is allocated in a fair way. To give it the necessary leeway to do that, corporate law aims at protecting directors' discretion in a number of ways. For instance, the business judgment rule grants that directors' decisions cannot be challenged by stakeholders in normal situations, i.e. if they were made in good faith, on an informed basis, and "in the honest belief that the action taken was in the best interest of the company" (Blair & Stout, 1999: 787).

The Managers' leeway in question

As some authors have noted, stakeholder theorists often refer to managerial discretion, but they rarely "consider whether and to what extent managers have the freedom or capacity to act according to stakeholder theory's moral and instrumental prescriptions" (Phillips, *et al.*, 2010: 176). One can, however, question the reality of the board's discretion to allocate value given the possibility of unbalanced distributional outcomes among the parties. Recent studies have analyzed the proactive way in which managers use their discretion to allocate value (Cobb, 2016) and empirically documented evidence that the latitude of the board is often constrained.

In practice, both shareholders and stakeholders can limit a manager's leeway. Shareholders are given great power to influence directors, as directors are appointed exclusively by the shareholders (Greenfield, 2008; Greenwood, 2005; Mayer, 2013). The directors are legally accountable to the firm's shareholders (Kaufman et al., 2005), and thus corporate law does not really "insulate" the board from shareholder pressure (Millon, 2000). More generally, some stakeholders, even if they do not have explicit legal rights, can influence the firm's behavior (Mitchell et al., 1997). Previous studies have described how the value that is created can be appropriated by stakeholders in accordance with their respective bargaining power (Coff, 1999; Garcia-Castro & Aguilera, 2015).

Given these conditions, two main options have been considered in addressing inequality. The first consists of reinforcing managerial discretion against external pressure. Various corporate laws have been amended, such as the constituency statutes that strengthen managers' leeway and allow them to pay attention to interests other than those of the shareholders (Bainbridge, 2004). New legal forms of corporations, such as benefit corporations, have also been introduced in a number of states to provide a "safe harbor" to allow managers of companies to pursue social or environmental objectives (Bromberger, 2011; Mac Cormac & Haney, 2012, 2012). The alternative is to make managers accountable to various stakeholders (Wells, 2002) by extending measures of performance beyond mere shareholder value, broadening fiduciary duties, or broadening the control rights of various parties by allowing them to sit on the board (Asher et al., 2005). These proposals have been implemented locally, but have given rise to a number of criticisms. For instance, it has

been argued that managers can hardly be asked to pursue all stakeholders' interests, as this could lead to significant control issues (Boatright, 1994; Jensen, 2001). The need to attend to multiple stakeholders would likely diminish managers' accountability. Any attempt to challenge directors would become illusory, as any decision could be justified in terms of its potential impact on at least one stakeholder (Sternberg, 2009).

While managerial discretion has been seen as a fundamental condition for fair value allocation, it is necessary to revisit this concept and reexamine how corporate law should handle managerial discretion, either by providing greater protection for it or by providing clear rules on how it can be exercised in a fair way.

THE CASE OF MARITIME LAW: THE RULE OF GENERAL AVERAGES

To reexamine the legitimacy of normative principles regarding value allocation and the soundness of distributive discretion, we use the specific example of maritime law. We are particularly interested in one of the rules of maritime law, the so-called "rule of general averages," as it concerns the way in which the consequences of the captain's decisions are shared among the various parties involved. This rule explicitly connects the discretionary power of the captain with a specific rule regarding value allocation. The captain's decisions that are taken for the "common good" imply rules that contrast with those of corporate law in that they do not leave the allocation of the value to the discretion of the captain.

The captain's situation is very different from that of a business manager, but the analogy is interesting, from a methodological point of view, in terms of thinking about the implications of discretion in relation to value allocation. Following Ketokivi

et al. (2017), this is a "novel analogy" in the sense that it can lead to fruitful theoretical insights and challenge existing theories. Ketokivi et al. (2017) propose a methodology to evaluate such an analogy, which must meet three criteria: 1) relevance ("Does the analogy offer potential for insight? Is the analogy familiar enough to be understood by the audience?"), 2) structural soundness ("Does the analogy lend itself to multiple related research questions?"), and 3) factual validity ("Does the analogy lend itself to empirical research?").

Before presenting the theoretical insights provided by the historical case, some remarks are necessary in relation to the relevance of the case. First, maritime law helps us to explore the effects of a ship captain's discretion, which represents an extreme case of discretion. Ship captains historically enjoy exceptional powers when at sea (Tarrade, 1999). For instance, the 1276 Malacca Code stipulates that "the captain at sea is like the sovereign on land who carries the title of Commander of the Faithful." Second, maritime law makes visible a class of decisions that are at the same time critical from an efficiency point of view and problematic in terms of fairness. These decisions are the expenditures or sacrifices managers can be required to make for the common wealth. For instance, in the event of a storm, the captain has full authority to jettison cargo to stabilize the ship. The resulting damage is called the "general average" because the damage is incurred for the collective interest. This kind of decision has a more general relevance in companies, where managers not only make decisions to "sacrifice" assets (for instance, through layoffs or restructuring plans), but can also proceed with beneficial actions (for instance, investing in research that develops employees' competencies or making decisions that increase shareholder value). Finally, maritime law has adopted rules that differ fundamentally from those

of corporate law regarding value allocation. In the case of companies, there is no norm on how the impacts of managerial decisions on different parties are shared collectively. Corporate law leaves the question of allocation up to the board of directors. On the contrary, maritime law defines *ex ante* rules. When a ship's captain decides to jettison cargo, all parties that are affected by this decision become interdependent and mutually liable. Thus, it is worth examining the rationale of maritime law regarding general averages.

As we will now demonstrate, the historical case is also relevant because it provides a theoretical model of the "partnering effect" that explains why the rule of general averages is both efficient and fair in relation to the various stakeholders.

The Rule of General Averages

The exact origin of the rule of general averages is unknown, but traces have been found in ancient laws, and it seems to have been applied by most seagoing nations. The rule is apparently an example of *lex maritima*, dating back to the unwritten Rhodian Law of c. 800–900, but actual evidence has only been found from Roman Law onwards. Several authors have shown that the rule, which concerns "general" damages, was in permanent use from *Lex Rhodia de Jactu* (Rhodian Law of Jettison) to the York Antwerp Rules, which are still incorporated into international contracts of carriage today (BIMCO, 2002; Dusserre, 2004; Frignet, 1859; Hatchuel, 1997; Szramkiewicz, 1989; Tetley, 2003). Under maritime law, the owners of goods are responsible for covering certain maintenance and repair costs, but all those concerned with a maritime shipment must share the costs arising from the damages that are referred to as gross or "general averages."

General averages correspond to expenditure, investments, or sacrifices made intentionally by the captain in the face of peril at sea or events that endanger the shipment. The York Antwerp Rules state that: *"There is a general average act when, and only when, any extraordinary sacrifice or expenditure is intentionally and reasonably made or incurred for the common safety for the purpose of preserving from peril the property involved in a common maritime adventure" (York Antwerp Rules, 2004).*

The rules are as follows:

- The captain can make expenditures or sacrifices if they are needed and if they are made in the reasonable interests of ensuring "the common safety." In this event, the costs are shared in the common interest of the ship and its cargo.
- A principle of fairness is then applied, obliging all of the people involved in the shipment to share the costs incurred by the captain or the damages suffered by the owner of the sacrificed goods. The owners of the ship and the cargo must share the sacrifice collectively. The contribution of each party is calculated *pro rata* based on the value of their property at the end of the voyage.

The Partnering Effect of the Captain's Discretion: a model

At first sight, the rules seem relatively close to the partnership or corporate framework: the partners or the shareowners embark on a shared enterprise and in the event of losses, these are shared among the participants. However, the rules are quite original. Here, we identify three specificities.

Captains' discretion for the common good.

Throughout the voyage, the merchants still own their goods, but they no longer manage them. The captain is entrusted by the different parties (the merchants and the ship owner) to make decision on their goods when necessary. The parties do not transfer their property rights, but transfer control of their goods to the captain, whose mission is to ensure that the goods arrive safe and sound.

The discretion given to the captain is efficient because it provides the captain with the latitude necessary to make decisions. Thanks to this latitude, the captain can minimize damage. For instance, if one of the merchants issued instructions that influenced the order in which goods were jettisoned, this would be counterproductive, as in practice it would restrict the captain's choices. The captain would be forced to jettison the goods in the prescribed order until the danger was averted. However, the total amount of cargo that was jettisoned would likely not be kept to a minimum, possibly leading to situations in which more goods were jettisoned than was strictly necessary. Overall, the system would be inefficient. Hence, the captain's discretion means that the safeguarding of the shipment can be maximized in the event of danger, and the collective damages minimized.

However, there is a condition necessary for this efficiency to occur: the captain's discretion implies that the parties entrust him with authority on their behalf, and thus abandon their prerogative of control over their goods.

General averages and the "partnering effect".

The merchants are not related to each other *a priori*. Dispatching goods on the same ship is not partnering. However, maritime law views the damages incurred as a

result of the decisions of the captain as "general" instead of personal. This means that the merchants become related in the event that the captain decides to jettison goods. This act brings them together in relation to the goods whose loss saved the ship. The rule of general averages introduces a form of partnership, but *this partnership is generated by the captain's strategic intervention.* Although they did not choose to come together, they are partnered in the sense that ***they are jointly liable for the general averages***.

Note that the partnering effect only covers damages resulting from the captain's decisions. If the merchants and the captain had formed a company, they would pool the total proceeds of the sales made at the destination and, after deducting any losses and "general averages," would share the profits in proportion to the initial shares of the goods sold. The rule of general averages does not work in quite the same way. Only the damages caused by the captain's decision to jettison are pooled, and are shared by the merchants in proportion to the *final* value of the goods, not the *initial* value of the goods embarked.

A solidarity rule: no distributive discretion.

Any damages are to be shared when they result from decisions that are made by the management (captain) for the collective interests. The rule is fair because, in practice, damages are shared between the merchants and because the losses are not borne by the merchants in proportion to the value of the goods on board at the port of embarkation, but in proportion to the *value of the goods at destination*. The lost value is not the value of the goods at the outset of the journey, but the value they would have had if they had reached their destination. Note that the rule of general averages

does not apply to cases when goods are no longer fit for use or consumption on arrival at their destination. This is considered a “private” rather than a general average, and there are no grounds for compensating the owner. In addition, if the merchants had to share the losses in proportion to the initial value of the goods, this would rapidly give rise to unfair situations. Merchants whose goods had been saved and had increased in value during the voyage would be favored, while a merchant whose cargo had no value on arrival (e.g. food no longer fit for consumption, etc.) could not compensate others.

The rule is therefore justified for all parties. It is preferable for each of the merchants, since the sharing of losses helps to limit their individual risk. In terms of probabilities, the expectations of gains are the same, but the shared risk is preferable in terms of risk aversion. The rule whereby losses are shared makes the sacrifice acceptable because of the understanding that it is a collective rather than an arbitrary sacrifice. Hence, it also makes the captain’s discretion acceptable.

To summarize, maritime law provides the captain with great strategic discretion, but it restricts distributive discretion. Maritime law does not provide the captain with excessive leeway. It defines an *ex ante* rule to ensure that strategic discretion is exercised in a fair way. The discretionary power of the captain is legitimate only to the extent that the effects of his/her decisions are shared. In other words, because it acknowledges strategic discretion and its partnering effect, maritime law limits distributive discretion in favor of a solidarity rule.

Figure 1 shows a model of the partnering effect that we derive from the case of maritime law.

-----INSERT FIGURE 1 --------

DISCUSSION: THE PARTNERING EFFECT IN A CORPORATE SETTING

The rule of general averages provides important new insights into the way in which value is allocated in companies and helps us to analyze the relationship between managerial discretion and stakeholder management. To discuss the "structural soundness" of the analogy, we develop its theoretical and normative implications for companies along three lines. First, the analogy enriches our view of managerial discretion and makes visible the "general" impacts of managerial decisions upon stakeholders. Second, we argue that managerial discretion has a "partnering effect", which leads to discriminate, among the stakeholders, those who are effectively partnered. Third, the analogy challenges both the team production theory of the corporation and corporate law by calling for a solidarity rule.

Toward an expanded view of managerial discretion

Building on the model of the ship captain's authority, we distinguish two types of discretion. *Distributive discretion* is the latitude to "divide the pie" (Bailey, Hecht & Towry, 2011) and to allocate the production rents. In corporate law, the board has this latitude, as the various parties accept the transfer of property rights over the surplus to the corporation. The distributive discretion is seen as central in the literature to allow firm-specific investments by the parties. The board, as a "mediating hierarch" will monitor the efforts of each party to determine "how each can best be rewarded for past contributions, as well as be incentivized for future contributions, in the

process also guarding against mutual opportunism among the parties" (Lan and Heracleous, 2010: 300).

Strategic discretion refers to the options available to managers (ship captains) to manage the business (ship) in the best interests of the company (for the common good). Strategic discretion does not imply the transfer of property rights, but rather control rights. This happens when the parties, while maintaining ownership of their assets, transfer their control rights so that management can use them for a collective strategy. For instance, shareholders own their share but entrust business leaders with the management of their capital. Similarly, workers own their competencies but their employment contract makes them subordinate. They are required to follow managerial prescriptions even when the strategy may impact them either positively (e.g. increase in human capital through learning processes) or negatively (e.g. limited employability).

Distinguishing between these two forms of discretion leads to a different appreciation of the individual risks involved. It is generally acknowledged that stakeholders can make risky firm-specific investments. For instance, employees might invest in specialized learning processes whose outcomes only have value in their particular team (Rajan & Zingales, 1998). In this view, investment decisions are made by individuals and the risks they take derive directly from their investment decisions or from the opportunism of the other team members. However, this view overlooks that the investments of the stakeholders are often not decided by the parties themselves: the risks can result from the decisions made by the managers instead of them.

Managers, by their hierarchical function and by contract, are entitled to make decisions that may impact the potential (assets or capabilities) of some stakeholders. For instance, managers' decisions can strengthen the human capital of some employees but it can also lead sometime to decrease the employability of employees. They can also increase or decrease the value of the company's shares. As the consequences of their decisions are uncertain, managerial authority is a source of risk, at least for those who submit to their authority. However, neither the negative nor positive impacts of management decisions are usually seen as "general" averages. On the contrary, stakeholders generally appropriate the various assets that are (collectively) accumulated by a firm in accordance with their respective bargaining power (Coff, 1999). These assets are not considered as "general averages."

Conceptualizing strategic discretion leads us to identify what we term, by analogy with the rule of general averages, the "general impacts" of managerial discretion. These are the impacts on stakeholders of the managerial decisions that are made for collective purposes.

The "Partnering Effect" of Managerial Discretion

Managers are given strategic discretion to make decisions for the joint welfare, and their decisions inevitably have both positive and negative consequences for various individuals. However, these consequences should be considered as "general" rather than "personal." Therefore, as in the case of maritime law, they should be viewed as collective, and shared among the team members. Under these conditions, we argue that the partnering effect should also be considered in the case of companies.

Conceptually, the *partnering effect* characterizes the interdependencies generated by the strategic discretion among the stakeholders that submit to hierarchy of managers. While all stakeholders can be impacted by management decisions, not all stakeholders transfer their control rights over their capital to management. Not all of them submit to hierarchy or consent to managerial discretion. We need to distinguish the parties which entitle managers to make decisions on their behalf, from those which keep their control rights and can sue management if they are negatively affected by a management decision.

The partnering effect leads us to suggest that managerial discretion introduces differentiation among stakeholders. Stakeholder theorists have a broader view that includes the parties affected by management. Many typologies seek to account for managerial priorities (or to prioritize parties). For instance, internal/external or primary/secondary stakeholders are often distinguished. Kochan *et al.* (2000) come closer to the notion of team production by focusing on the stakeholders "who put something at risk" and speaking about "genuine stakeholders." Other authors suggest different categories, such as stakewatchers and stakekeepers, and further outline the reciprocal obligations that some stakeholders can have toward the firm (Fassin, 2012). When Blair and Stout (1999) talk of a "production team," they are referring to those who contribute, by their specific investment, to the production process. However, to the best of our knowledge, no distinction has been suggested that differentiates stakeholders based on their level of commitment to managerial authority. A distinction must then be made between those stakeholders who transfer their control rights to management and others. In other words, parties who formally accept

managerial authority and allow managerial discretion, i.e. give their consent (Phillips 1997), entrust managers, and accept that their resources and capabilities are used in the common interest, are partnered. The other stakeholders can still be affected by the collective action but they continue to manage their resources on their own: they are not concerned by the partnering effect.

This analysis invites to reconsider the perimeter of the team:

- Typically, workers and stockholders will *a priori* be the most partnered stakeholders. Workers, as subordinates, permit management to define the actions that must be performed in doing their jobs. They are clearly subject to managerial discretion. Stockholders formally permit the board to make decisions to develop their capital on their behalf, although here, the legal status is less clear, and we can question whether all shareholders are partnered. Do those shareholders who remain anonymous and whose shareholding is only for a very short period really grant the board strategic discretion?
- Similarly, we could consider some suppliers, subcontractors or service providers, even though they are *a priori* external to the company, as partnered parties if they agree to follow the company's strategic orientations.

The need for a solidarity rule

Corporate law does not stipulate any general *ex ante* rule regarding the individual impact of managerial decisions. Thus, there are some cases where a solidarity rule could be interpreted as a rule of general averages. For instance, some legislation requires companies to negotiate agreements in relation to profit sharing. In France, when profits allow for an increase in equity, big companies must allocate a portion of

the newly created shares to their employees, who have made this increase in equity possible (Baghdadi, Bellakhal & Diaye, 2016). However, these are exceptions, and most of the time there is no solidarity regarding the "general" impact of managerial decisions.

For instance, some employees can be laid off for economic reasons, that is, their sacrifice is considered necessary for the firm to survive. By law, they receive severance pay, but neither the loss they bear through being laid off nor the future profits of the company are shared. There is no such thing as the solidarity rule that we observed in the case of maritime law. Note that even among shareholders, there is no solidarity rule. The value of the company's shares can vary significantly as a result of managerial decisions, but if one shareholder realizes a significant gain by selling his/her shares, he/she does not share his/her gain with the other shareholders (who do not sell), or with the other stakeholders.

Here, the rule of general averages provides a compelling reason for challenging the adequacy of corporate law as a basis for stakeholder theory. Blair and Stout (1999) assume that corporate law was designed to give directors the leeway to allocate the results in a fair way. The board, as a "mediating hierarch" has the duty of promoting the interest of the corporation and of protecting it from various private demands and interests. Yet, as noted earlier, the interest of the corporation is not defined, and the neutrality of the board is somewhat hypothetical, and rarely verified, as only the shareholders can appoint directors. Theoretically, our analysis shows that while the team production theory relies on distributive discretion, it does not conceptualize strategic discretion and its related impacts. Thus, corporate law allows

for managerial discretion without requiring any solidarity between those who are affected by the related "general impacts" of managerial decisions.

Under these conditions, we argue that distributive discretion is neither natural nor necessary. If strategic discretion has a "partnering effect," then it binds together those stakeholders who actually recognize and accept managerial strategic discretion. Thus, it calls for a limitation of distributive discretion and for a solidarity rule to share the impacts of managerial decisions on "partnered stakeholders."

In practice, this rule would require *ex ante* that any strategy designed by corporate leaders must achieve a balance between employees and shareholders. Management should also be required to report on how they integrate fairness into their strategic thinking. *Ex post*, corporate officers should also be obliged to account for the general impacts of their decisions and to organize some form of redistribution when these impacts are not balanced. Some form of redistributive mechanism should be set up.

For instance, when employees are made redundant for economic reasons, their layoffs are meant to enable the firm to survive. The solidarity principle would suggest that they should benefit at a later date from the profits that are made possible by their sacrifice. In practice, this could be achieved by a distribution of free shares to enable them to share in future dividends. However, one could also imagine the creation of a "solidarity fund." All partnered stakeholders could contribute to this fund when their assets increased. For example, shareholders could be required to contribute a percentage to the fund when they sold their shares if the performance of the firm had increased the value of their shares. This fund could then be used to compensate the

partnered parties when they suffered "general damages." Such mechanisms need to be further examined and tested. Our intention is not to formulate detailed mechanisms, but to suggest a general duty of fairness on the part of corporate leaders and to suggest that such a duty should be mandated by law.

CONCLUSION

Stakeholder theory suggests that multiple groups have a stake in the activities of the firm and merit consideration in managerial decision-making. It emphasizes the importance of non-stockholder groups to the success of companies. However, not all stakeholders who have legitimate claims receive the consideration they merit. To date, the freedom that managers have to allocate value among stakeholders has remained relatively unchallenged. However, given the inequalities that can be generated by corporate behavior, as scholars, we need to question this freedom and its foundations.

In this article, we have built upon a historical case to discuss how stakeholder theory and corporate law connect value allocation and managerial discretion. Our aim in using this case was to show that managerial discretion has normative implications, and should lead to a solidarity rule. When stakeholders allow strategic discretion by recognizing managerial authority, they are made interdependent by the "partnering effect" of managerial discretion. As a result, they should jointly support the impacts of managerial decisions made for collective purposes.

Obviously, managerial authority differs from a ship captain's authority, and its legal framework is, of course, highly specific (including rules such as the business judgment rule). The analogy does not build a case for transposing the rule of general averages from maritime law to the corporate setting. Rather, it offers creative theoretical insights through its contribution to the theorization of the partnering effect of strategic discretion. It also makes visible the implications of managerial discretion that to date have been ignored by both stakeholder theory and corporate law, and it helps us to discuss multiple related research questions such as managerial discretion, stakeholder theory, and solidarity in corporate law. Thus, it provides new insights into how we should conceptualize managerial discretion, and how to differentiate among the stakeholders partnered by strategic managerial discretion and the possible normative implications of this effect.

Our study clearly calls for further research, especially empirical research (the third criterion of factual validity, according to Ketokivi et al., (2017)). The rule of general averages suggests a research agenda aimed at identifying the general impacts of managerial decisions that need to be considered and shared. Beyond financial profits, a variety of assets (e.g. cognitive, financial, and relational) would need to be taken into consideration. Here, both evaluation methods and management techniques need to be elaborated, as do the criteria for assessing what is meant by fair. For instance, the rewards do not need to be allocated equally among stakeholders. They can vary according to the level, length, and importance of the investments made by the various constituencies. New ways to design balanced strategies, to define fairness, and to organize solidarity also need to be explored.

More generally, our study opens up new avenues for research at the crossroads between management and law. By modelling the partnering effect of strategic discretion, our study questions how corporate law conceptualizes management and managerial discretion. The role of law is not to impose new duties or restrictions on the latitude of managers, but it has to build upon a comprehensive view of management to make sure managerial discretion can be exercised in an efficient and legitimate way. It is therefore necessary that research in management inspires more corporate law. While management scholars have sought to rethink management theory with a "view from law" (Lan and Heracleous, 2007), they could also question corporate law with a view from management and management history.

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FIGURE

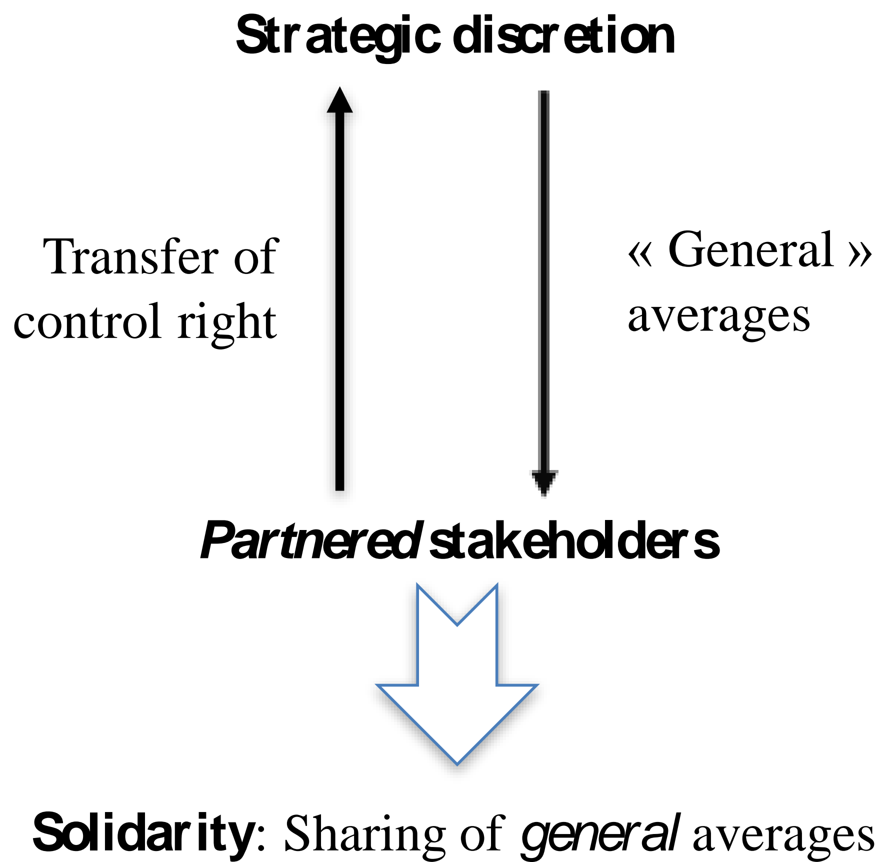

Figure 1: A model of the "partnering effect" derived from Maritime Law