The Governability of Strategy: Residual-Claim Ambiguity and Strategy Selection Under Shareholder-Centric Governance

Abstract

Agency theory has long shaped strategic management by offering a logic for governing managerial discretion through shareholder-centric governance, which privileges shareholders as primary residual claimants and reduces goal conflict. Yet economic profits often depend on stakeholder-controlled resources whose marginal contributions cannot be fully specified or enforced ex ante. When such incompletely contractible inputs are essential to value creation, residual claims extend beyond shareholders, challenging the conditions under which shareholder-centric governance is efficient. This paper develops a theory of how governance shapes strategy selection in these multi-claimant settings by introducing *residual-claim ambiguity*: uncertainty over how economic profits should be allocated ex post among multiple contributors who bear residual risk. Residual-claim ambiguity expands managerial discretion over profit allocation and, under shareholder-centric governance, weakens the credibility of commitments to nonshareholder contributors. Anticipating unfavorable allocation, stakeholders respond strategically—through influence activities, bargaining frictions, effort shading, and reduced firm-specific investment—generating efficiency losses. These *distributional agency costs* are distinct from managerial agency costs, transaction costs, and bargaining costs because they arise from discretionary profit allocation under contested residual claims. This paper argues that distributional agency costs vary systematically across profit-generation mechanisms: novelty and unique complementarities heighten ambiguity because they rely on discretionary, hard-to-measure contributions, whereas scale relies more on standardized, contractible inputs that clarify expected returns. Consequently, shareholder-centric governance creates selection pressure toward scale-based profit generation and away from novelty and complementarities, even when the latter offer greater value-creation potential, reframing governance as a determinant of which value-creation pathways are sustainable.

Introduction

Agency theory has long provided a foundational explanation for how firms govern managerial discretion and align managerial actions with shareholder interests (Jensen & Meckling, 1976; Jensen, 1986). By treating shareholders as the firm's primary residual claimants (Fama & Jensen, 1983), agency theory offers an elegant framework for designing incentives, monitoring systems, and governance structures that limit managerial opportunism and maximize the economic profits captured by shareholders as residual claimants (Mahoney, 2005). This framework underpins dominant assumptions in strategic management about firm objectives (Jensen, 2001, 2002), managerial decision making (Eisenhardt, 1989; Hoskisson et al., 1999), and performance evaluation (Holmström, 1979; Mahoney & Qian, 2013).

However, recent advances in resource-based theory argue that the shareholders are not always a firm's sole residual claimants (Barney, 2018; Stoelhorst, 2023). Economic profits often depend on resources controlled by nonshareholder stakeholders—such as employees, suppliers, customers, and communities—whose marginal contributions are difficult to specify ex ante and whose value may only become apparent ex post (Barney, 1991, 2018; Coff, 1999; Hoskisson et al., 2018). Stakeholder RBT argues that when such stakeholder-controlled resources are essential to profit generation and cannot be fully specified and enforced using complete contracts, the stakeholders who control those resources hold a de facto residual claim on the economic profits they helped generate (Barney, 2018, Stoelhorst, 2023). This raises a fundamental question for strategy research: How do shareholder-centric governance systems shape firms' strategic choices when economic profits depend on incompletely contractible resources controlled by nonshareholder stakeholders?

The purpose of this paper is to show how shareholder-centric governance rooted in agency theory systematically shapes the types of value-creation strategies firms pursue. Building on stakeholder resource-based theory (Barney, 2018; Stoelhorst, 2023), this paper argues that when economic profits depend on access to stakeholder-controlled resources whose marginal contributions cannot be fully specified or verified ex ante, firms face residual-claim ambiguity: uncertainty over how economic profits should be allocated among multiple contributors ex post. This ambiguity expands managerial discretion over ex post profit allocation among residual claimants. Yet, because shareholder-centric governance evaluates and rewards managers primarily for shareholder value capture, it weakens the credibility of commitments to allocate economic profits to nonshareholder contributors when claims are difficult to verify and enforce. Accordingly, nonshareholder stakeholders may anticipate unfavorable allocation and respond strategically through influence activities, bargaining frictions, effort shading, and reduced firm-specific investment. These defensive behaviors, and firm efforts to counteract them, generate efficiency losses this paper terms *distributional agency costs*. Distributional agency costs are distinct from classic agency-, transaction cost-, and bargaining-based efficiency losses because they stem from multi-claimant contestation over ex post profit allocation, rather than managerial shirking, bilateral hold-up, or ex ante bargaining over a given surplus.

Because sources of economic profits (i.e., novelty, unique complementarities, and scale) differ in the extent to which they rely on incompletely contractible, stakeholder-controlled inputs, they also differ in the distributional agency costs they trigger under shareholder-centric governance. Novelty- and complementarity-based profit generation tends to heighten residual-claim ambiguity and distributional agency costs, whereas scale-based profit generation relies more on standardized, contractible inputs that clarify expected returns and minimize managerial discretion. Consequently, this paper argues that shareholder-centric governance creates selection pressure toward scale-based profit generation and away from novelty- and complementarity-based pathways, even when the latter offer greater value-creation potential. This pressure is likely strongest when key contributors have high outside options and weakest when firms institutionalize credible profit-allocation rules for nonshareholder stakeholder.

This paper contributes to strategy research in three ways. First, it theorizes shareholder-centric governance as a driver of strategy selection among profit-generation pathways, rather than merely a determinant of managerial behavior or value appropriation within a chosen strategy. Second, it extends stakeholder resource-based theory by specifying how residual-claim structure feeds back into ex ante strategy choice: when contracting is incomplete, the efficiency of a pathway depends on whether key contributors can form credible expectations about their share of economic profits, and these constraints vary systematically across pathways. Third, it identifies distributional agency costs as a distinct efficiency loss in multi-claimant settings, showing how contested profit allocation under more shareholder-centric governance can make novelty- and complementarity-based strategies systematically harder to govern than scale-based strategies.

This paper begins by reviewing shareholder-centric governance as a solution to managerial agency problems. It then develops residual-claim ambiguity and distributional agency costs as governance challenges that arise when profit generation depends on stakeholder-controlled, incompletely contractible resources. Next, it shows how these governance costs vary systematically across profit-generation pathways and identifies boundary conditions that shape the resulting selection pressure. The paper concludes by discussing the strategic implications of this governance–strategy compatibility mechanism.

AGENCY THEORY AS A SHAREHOLDER-CENTRIC GOVERNANCE SYSTEM

A central insight of agency theory is that when ownership and control are separated, managers do not bear the full financial consequences of their decisions (Jensen & Meckling, 1976). Accordingly, managers may pursue actions that diverge from owners' financial interests, generating agency costs in the form of shirking, perquisite consumption, or suboptimal investment (Jensen, 1986). To address this problem, agency theory conceptualizes the firm as a governance arrangement and emphasizes incentive and monitoring mechanisms designed to align managerial decision making with the interests of a firm's residual claimants (Fama & Jensen, 1983a, 1983b; Eisenhardt, 1989). As residual claimants receive the residual cash flows that remain after all contractual claims have been satisfied, agency theory treats protecting and maximizing the value of residual claims as an efficient proxy for maximizing the firm's overall economic surplus (Fama & Jensen, 1983; Jensen, 2001).

Agency theory typically assumes that the returns to shareholders are inherently non-contractible and treats them as residual claimants (Fama & Jensen, 1983a; Fama, 1980). Because agency theory treats many transactions with nonshareholder stakeholders as governable through explicit contracts or market mechanisms (Fama, 1980), and because it emphasizes a single-valued objective to minimize goal conflict (Jensen 2000, 2001), agency theory often frames shareholders as a firm's primary residual claimants (Fama & Jensen, 1983a). Thus, under these assumptions, privileging shareholders' residual claimant status and orienting governance mechanisms toward their interests reduces ambiguity about the firm's objective and creates a clear benchmark against which managerial performance can be evaluated (Jensen 2000, 2001).

This shareholder-centric orientation is often reflected in the incentive, monitoring, and control mechanisms emphasized by agency theory (Jensen & Meckling, 1976; Fama & Jensen, 1983). Managerial compensation typically is tied to shareholder returns (Jensen & Murphy, 1990), boards are charged with representing shareholder interests (Fama & Jensen, 1983b), and capital markets are treated as disciplinary forces that reward or penalize managers based on their success in delivering shareholder value (Manne, 1965; Eisenhardt, 1989). Collectively, these mechanisms are designed to minimize agency costs arising from managerial opportunism and to channel managerial effort toward actions that increase the value of the shareholders' residual claims (Jensen & Meckling, 1976; Eisenhardt, 1989; Fama & Jensen, 1983a). This form of shareholder-centric governance is best understood as a continuum reflecting how strongly managerial incentives, monitoring, and capital allocation decisions are tethered to shareholder value capture. Treating shareholder-centric governance as varying in degree helps clarify the scope of the argument and provides concrete anchors for operationalization in future empirical tests.[1]

Agency theory's focus on shareholder value capture is not merely normative but functional: privileging shareholders as residual claimants reduces goal conflict and enables managerial accountability (Jensen, 2001; Eisenhardt, 1989; Fama & Jensen, 1983). However, this governance efficiency rests on the premise that most nonshareholder stakeholder claims can be governed through explicit contracts or market mechanisms and therefore do not constitute the central governance problem agency theory was developed to address (Fama, 1980; Eisenhardt, 1989). When that premise holds, shareholder-centric governance can efficiently align managerial behavior with shareholder objectives; when it does not, the same mechanisms can generate

[1] Shareholder-centric governance is stronger when managerial evaluation and incentives are highly sensitive to shareholder-return metrics (e.g., pay–performance sensitivity tied to stock price/TSR), when boards and external monitors (e.g., activist pressure or takeover exposure) discipline managers primarily for deviations from shareholder value maximization, and when payout policies (e.g., buybacks/dividends relative to reinvestment) make shareholder returns the dominant organizing objective. It is weaker when incentives and monitoring are less exclusively keyed to shareholder-return metrics, and when institutionalized commitments constrain discretion over ex post allocation. These features provide observable indicators of "more" versus "less" shareholder-centric governance and clarify how the strength of the paper's mechanisms can be assessed in future empirical work.

inefficiencies by privileging shareholder claims over other contributors to economic profit. This is not a critique of agency theory's internal logic, but rather a scope condition relevant when profits depend on incompletely contractible, stakeholder-controlled resources. The sections that follow examine this boundary condition and its implications for which value-creation strategies are more or less governable under shareholder-centric governance.

INCOMPLETE CONTRACTING AND THE EMERGENCE OF MULTIPLE RESIDUAL CLAIMANTS

A growing body of research in resource-based theory challenges the assumption that nonshareholder stakeholders' claims can be largely governed through explicit contracts or market mechanisms ex ante, emphasizing that economic profits often depend on gaining access to the valuable resources they control under conditions of incomplete contracting (Barney, 1991, 2018; Coff, 1999). Many of the resources that generate economic profits—such as specialized human capital, relational assets, tacit knowledge, and cooperative effort—are difficult to specify and enforce contractually ex ante, because their marginal contributions are often revealed through use and combination with other resources (Coff, 1997; Hart & Moore, 1990; Wang, He, & Mahoney, 2009). As a result, contracts governing access to these resources often leave substantial discretion over how any resulting economic surplus will be allocated ex post (Coff, 1999; Hoskisson et al., 2018).

When access to stakeholder-controlled resources is essential to profit generation and their contribution cannot be fully specified and enforced ex ante, the stakeholders who control them bear residual risk alongside shareholders (Barney, 2018; Coff, 1999; Hoskisson et al., 2018). That is, the returns for these stakeholders depend not only on fixed contractual payments but also on how economic profits are allocated ex post. From a governance perspective, this means that nonshareholder stakeholders may hold economic (de facto) residual claims on economic profits relative to their contributions, even in the absence of formal ownership or legal residual claim rights (Barney, 2018; Stoelhorst, 2023).

This logic does not imply that all stakeholders are always residual claimants, nor that residual claims are evenly distributed across stakeholders. Rather, residual claimancy depends on which stakeholder-controlled resources the firm must access to generate economic profits, and how difficult the terms of access to those resources are to specify and enforce ex ante. The more a firm's economic profits depend on stakeholder-controlled resources that are difficult to fully specify and enforce ex ante, the more residual risk and residual claimancy extend beyond shareholders to include those stakeholders (Barney, 2018; Stoelhorst, 2023). In such settings, the firm faces multiple residual claimants to its economic profits, weakening the assumptions that make shareholder-centric governance systems efficient (Coff, 1999; Barney, 2018).

From a stakeholder RBT perspective, the emergence of multiple residual claimants is not a failure of contracting or governance, but a predictable consequence of profit generation strategies that depend on access to stakeholder-controlled resources that cannot be fully specified and enforced ex ante (Barney, 2018; Stoelhorst, 2023). Accordingly, governance systems must manage not only managerial discretion over effort, risk, and private benefits (Jensen & Meckling, 1976; Jensen, 1986), but also discretion over the distribution of economic profits among stakeholders with contested residual claims (Coff, 1999; Stoelhorst, 2023).

This shift from a single residual claimant to multiple residual claimants has important implications for governance efficiency. Governance arrangements designed to align managers with a single class of residual claimants may perform well when residual claims are concentrated, but may be less effective when residual claims are dispersed across multiple contributors whose continued participation depends on expectations regarding ex post profit allocation. Because profit-generation strategies differ in the extent to which they rely on incompletely contractible, stakeholder-controlled resources, they differ systematically in the likelihood that residual claims extend beyond shareholders. The next section explores the problems created by ambiguity over residual claims and the distinct type of agency costs that arise in multi-claimant settings.

RESIDUAL-CLAIM AMBIGUITY AND DISTRIBUTIONAL AGENCY COSTS

When economic profit generation depends on access to resources controlled by multiple residual claimants (i.e., shareholders with formalized claims and non-shareholder stakeholders with de facto claims on economic profits), firms are faced with a governance problem that lies outside the traditional manager–shareholder focus of agency theory. Specifically, multi-claimant settings such as these give rise to residual-claim ambiguity: uncertainty over contributors' residual claims to economic profits and therefore over how they should be allocated ex post. Residual-claim ambiguity arises when 1) stakeholder-controlled resources are essential to profit generation, 2) the marginal contributions of those resources cannot be fully specified or verified ex ante, and 3) governance systems do not provide a clear, credible, and mutually accepted basis for allocating economic profits among contributors when contributions are difficult to measure (Coff, 1999; Barney, 2018; Ouchi, 1980). By extension, residual-claim ambiguity is lower when firms rely on more measurable contributions and allocation rules that are standardized, enforceable, and widely accepted by contributing stakeholders. In the absence of clear, credible, and mutually accepted ex ante rules for allocating economic profits, residual claims must be determined by discretionary ex post decisions instead.

Residual-claim ambiguity is conceptually distinct from contractual incompleteness alone. Incomplete contracts are a common feature of economic exchange (Grossman & Hart, 1986; Hart & Moore, 1990), but they do not necessarily generate ambiguity over residual claims if governance arrangements provide a clear, credible, and mutually accepted basis for allocating any economic profits among contributors. One context in which residual-claim ambiguity does emerge is when nonshareholder stakeholders bear residual risk and reasonably expect to share in economic profits, yet governance systems privilege shareholders as the primary residual claimants. In such cases, residual-claim ambiguity concerns not whether contracts are incomplete, but whether those residual claims can be clearly defined and credibly honored through governance.

Residual-claim ambiguity expands managerial discretion in a way that differs from the canonical manager–owner agency problem (Jensen & Meckling, 1976; Jensen, 1986). Rather than discretion over effort provision or private benefit extraction, managers may also exercise discretion over the allocation of economic profits among stakeholders with residual claims (Coff, 1999; Stoelhorst, 2023). When facing residual-claim ambiguity, managers act as agents mediating between multiple principals whose interests diverge with respect to the division of economic profits (Coff, 1999; Eisenhardt, 1989)[2]. Because profit allocation affects stakeholders' realized returns and their future willingness to contribute resources, these distributional decisions have direct implications for firm efficiency and value creation (Barney, 2018; Coff, 1999; Hoskisson et al., 2018).

[2] Bernheim and Whinston (1986) study a related but distinct common-agency setting in which multiple principals offer incentive schemes to a shared agent. I reference this work solely to highlight the general multi-principal logic and not to import their specific assumptions or results. The scope of the present argument only concerns governance frictions over profit allocation among formal and de facto residual claimants under incomplete contracting.

This paper refers to the efficiency losses that arise from discretionary profit allocation under contested residual claims as distributional agency costs. These costs can manifest as influence activities intended to shape profit allocation, bargaining frictions that delay coordination and adaptation, strategic shading or withholding of effort by stakeholders who anticipate unfavorable treatment, and weakened incentives for firm-specific investment ex ante (Coff, 1999; Hoskisson et al., 2018). Importantly, distributional agency costs can arise even in the absence of managerial shirking or self-dealing. They reflect coordination and commitment problems over profit allocation among competing residual claimants, rather than managerial opportunism alone.

Unlike bargaining/appropriation costs, which primarily concern how a given surplus is divided through bargaining power and negotiated terms, distributional agency costs capture surplus destruction that arises because profit allocation is delegated to managerial discretion under contested residual claims. Profit allocation in multi-claimant settings necessarily involves discretionary decisions about how to allocate economic profits when marginal contributions and residual claims cannot be fully specified or verified ex ante. Under shareholder-centric governance, the authority to make such decisions is delegated to managers, who must act as allocators and mediators among competing residual claimants while still acting as agents charged with maximizing shareholder value. This delegated discretion creates an agency problem—even absent self-dealing—because stakeholders recognize that allocation decisions will reflect the objectives embedded in the governance system and respond strategically in their ex ante investment, effort, and participation decisions to protect their expected claims. Residual-claim ambiguity increases distributional agency costs by expanding managerial discretion over ex post economic profit allocation in multi-claimant settings. Thus:

Proposition 1: *Residual-claim ambiguity surrounding a strategic initiative is positively associated with distributional agency costs, and this association is stronger under more shareholder-centric governance.*

Table 1 clarifies how distributional agency costs differ from related governance cost concepts—transaction costs, managerial agency costs, multiple-principal agency problems, and value appropriation or bargaining costs—in their underlying problem, unit of analysis, governance levers, and predicted consequences.

Table 1

Comparing Distributional Agency Costs to Related Governance Cost Concepts

Concept & Key Cites	Core Problem	Unit of Analysis	Behavioral Manifestations	Primary Governance Levers	Predicted Strategic Consequences
Transaction Costs (Coase, 1937; Williamson 1975, 1985, 1991)	Efficiency losses (hazards) from governing exchanges under contractual incompleteness and opportunism.	Transaction or exchange relationship	Haggling, maladaptation, hold-up threats, renegotiation	Contract design, asset specificity mitigation, vertical integration	Shifts governance form toward structures that better align exchange hazards and safeguards.
Managerial Agency Costs (Jensen & Meckling, 1976; Fama & Jensen, 1983; Fama, 1980; Jensen, 1986)	Efficiency losses (misalignment) from managerial discretion under separation of ownership and control.	Manager–principal relationship	Shirking, perquisite consumption, empire building, risk aversion	Incentive alignment, monitoring, performance-based pay	Shapes managerial effort and investment choices within a chosen strategy.
Multiple Principals/ Agency (Bernheim & Whinston, 1986; Holmström & Milgrom, 1991)	Efficiency losses (distorted agent action) from competing directives/incentives under multiple principals.	Agent-multiple principals relationship	Compliance distortion, divided attention, selective responsiveness, gaming	Authority allocation, task partitioning, hierarchy among principals	Distorts agent action quality under conflicting objectives.
Value Appropriation/ Bargaining Costs (Coff, 1999; Chatain & Zemsky, 2011; Brandenburger & Stuart, 1996)	Division of jointly created value (capture) given bargaining power.	Bargaining among contributors	Bargaining/ renegotiation, rent seeking, hold-up threats, delayed agreement	Bargaining power, ownership/control of critical assets, claim-allocation arrangements (often specified ex ante)	Determines division/value capture split; shapes ex ante investment via expected shares.
Distributional Agency Costs (This paper)	Efficiency losses (profit destruction) from discretionary profit allocation under contested residual claims	Initiative-/ Firm-level governance of profit allocation among residual claimants	Influence activities, bargaining frictions, shading/withholding, underinvestment in firm-specific assets	Institutionalized ex post allocation rules, constraints on managerial discretion, stakeholder voice/representation mechanisms	Shifts strategy selection toward pathways that constrain discretion and reduce residual-claim ambiguity.

Taken together, these distinctions imply that governance systems designed to minimize managerial agency costs may not minimize total governance costs when firms rely on incompletely contractible, stakeholder-controlled resources. While shareholder-centric governance can effectively reduce shirking and monitoring costs (Jensen & Meckling, 1976; Fama & Jensen, 1983b; Eisenhardt, 1989), it can also intensify distributional agency costs by privileging shareholder claims over those of other contributors. When stakeholders perceive that their residual claims are insecure or undervalued, their willingness to provide, deploy, or specialize valuable resources correspondingly declines ex ante (Coff, 1999; Barney, 2018; Stoelhorst, 2023). This extends appropriation-based accounts by emphasizing an ex ante selection logic: residual-claim ambiguity affects the governance costs of profit-generation strategies under shareholder-centric governance, not just how rents are divided conditional on strategy (Coff, 1999).

It is important to note that residual-claim ambiguity is not a fixed attribute of a firm, but is systematically shaped by the profit-generation strategies a firm employs. Sources of economic profits (novelty, unique complementarities, and scale) differ in the extent to which they rely on incompletely contractible, stakeholder-controlled resources and thus in the degree to which residual claims extend beyond shareholders. Profits from novelty are often associated with limited measurement and verification, as well as ex post uncertainty over marginal contributions, while the marginal contributions of individual stakeholders to profits from complementarities are often difficult to disentangle. On the other hand, higher levels of standardization and contractibility in strategies that generate profits through scale may reduce this ambiguity. This variation in distributional agency costs creates a link between governance and strategy selection: shareholder-centric governance systems are likely to favor profit-generation pathways that limit residual-claim ambiguity and distributional agency costs, even when alternative strategies may offer greater potential for value creation. The next section develops this argument by examining how different sources of economic profits impose systematically different governance demands.

PROFIT-GENERATION STRATEGIES AND THEIR GOVERNANCE DEMANDS

Strategies that generate economic profits through novelty, unique complementarities, and scale differ in the extent to which they depend on incompletely contractible inputs. Consequently, the degree of ambiguity surrounding marginal contributions and the clarity of residual claims also varies across these sources of economic profits. As a result, strategies that rely on different profit-generation mechanisms expose the firm to different levels of residual-claim ambiguity and distributional agency costs under shareholder-centric governance.

This paper focuses on novelty, unique complementarities, and scale as stylized profit-generation mechanisms because they provide a way to capture systematic variation on two dimensions that are central to the degree of residual-claim ambiguity each mechanism generates: (1) the measurability/attribution of marginal contributions and (2) reliance on stakeholder-controlled, incompletely contractible inputs. The third factor, the absence of clear, credible, and mutually accepted ex post allocation rules, is a product of the governance arrangement being employed, rather than varying systematically with the profit-generation mechanism. In this sense, the typology is not intended as an exhaustive taxonomy but as a minimal set of mechanisms that differ predictably in the conditions under which distributional agency costs arise. These mechanisms are intended as ideal-types, and the argument's predictions are comparative: even scale-based initiatives may generate residual-claim ambiguity when standardized metrics do not map cleanly onto marginal contribution, while some novelty-based initiatives may become more governable as attribution improves.

Novelty-Based Profit Generation

Profits derived from novelty arise when firms introduce new products, services, or organizational forms that depart from existing market offerings and generate economic profits under ex ante uncertainty, with value and marginal contributions becoming clearer ex post (Stoelhorst, 2023; Makadok, 2001). Such strategies may be characterized by high uncertainty regarding market demand and production processes (Eisenhardt & Tabrizi, 1995; March, 1991), as well as limited ex ante knowledge about which resources–and whose contributions–will ultimately prove valuable (Barney 1986; Makadok, 2001). Because the contribution of stakeholder-controlled resources to novel outcomes is often difficult to measure or verify ex ante (Holmström & Milgrom, 1991; Ouchi, 1980; Coff, 1999), novelty-based strategies often rely heavily on discretionary effort, experimentation, and adaptation by nonshareholder stakeholders.

When economic profits from novelty are generated through uncertain or iterative, learning-intensive processes, governance systems have limited ability to specify or credibly commit to allocation rules ex ante, and marginal contributions may remain difficult to attribute to specific stakeholders, even ex post. This can create residual-claim ambiguity, which in turn requires that economic profits be allocated through discretionary ex post decisions. Under shareholder-centric governance, this discretion is concentrated in managers and exercised in ways that tend to privilege shareholder claims. This arrangement makes commitments about profit allocation less credible to nonshareholder stakeholders and weakens their confidence that their contributions will be rewarded in proportion to realized value, thereby amplifying distributional agency costs. As a result, novelty-based strategies are likely to generate relatively high distributional agency costs when they depend on incompletely contractible stakeholder resources.

Complementarity-Based Profit Generation

Profits derived from unique complementarities arise when heterogeneous resources interact in ways that generate value beyond their standalone contributions (Barney, 1986; Peteraf, 1993). In such settings, economic profits depend not only on access to individual resources but also on the specific manner in which they are combined and coordinated. This interdependence complicates the attribution of marginal contributions, as the value generated by any single resource is contingent on the participation and alignment of others (Coff, 1999).

Because complementarities obscure lines of contribution, complementarity-based strategies tend to give rise to contested residual claims among stakeholders whose resources are jointly necessary for value creation. Even when the relevant resources are known ex ante, the incremental contribution of each stakeholder may only become apparent ex post, or remain difficult to disentangle even after complementarities are realized (Barney, 2018). This creates persistent ambiguity over profit allocation that, under shareholder-centric governance, increases the likelihood of bargaining frictions, influence activities, and underinvestment in firm-specific assets as stakeholders anticipate an unfavorable ex post allocation (Coff 1999; Hoskisson et al. 2018). Consequently, complementarity-based profit generation can entail substantial distributional agency costs when it relies on stakeholder-controlled, incompletely contractible resources.

Scale-Based Profit Generation

By contrast, profits derived from scale primarily depend on the volume and efficient deployment of resources under management, rather than on unique or unexpected attributes of individual resources (Porter, 1980; Stoelhorst, 2023). Scale-based strategies often emphasize process optimization, routinization, and measurable performance outcomes, which facilitate contractual specification and monitoring (Eisenhardt, 1989; Ouchi, 1980). As a result, stakeholder-controlled inputs in scale-based strategies are more likely to be observable, verifiable, and compensable through explicit contracts or performance-based incentives.

These features tend to reduce residual-claim ambiguity by limiting managerial discretion over profit allocation and clarifying stakeholders' expected returns. When contribution and compensation are more tightly linked through standardized metrics, stakeholders face lower residual risk and weaker incentives to contest profit allocation ex post. Under shareholder-centric governance, scale-based strategies therefore tend to generate lower distributional agency costs–relative to novelty-based or complementarity based strategies–even when they rely on resources controlled by nonshareholder stakeholders. This relative governability creates a systematic advantage for scale-based profit-generation mechanisms under shareholder-centric governance, setting the stage for a selection pressure toward scale and away from novelty and complementarities. Thus:

Proposition 2a: *Under shareholder-centric governance, novelty-oriented strategic initiatives will, on average, generate higher distributional agency costs than scale-oriented initiatives.*

Proposition 2b: *Under shareholder-centric governance, complementarity-oriented strategic initiatives will, on average, generate higher distributional agency costs than scale-oriented initiatives.*

GOVERNANCE COSTS AS A DETERMINANT OF STRATEGY SELECTION

Residual-claim ambiguity arises when economic profits depend on stakeholder-controlled resources whose marginal contributions are difficult to specify or verify, and when governance does not provide a clear, credible, and mutually accepted basis for allocating profits among contributors ex ante. These conditions are especially likely to hold when profit generation depends on novelty or unique complementarities, because both mechanisms heighten attribution problems and intensify contestation over residual claims.

A central implication of this logic is that governance systems shape not only how profits are divided within a given strategy, but also which profit-generation pathways firms are willing and able to pursue. When profit generation depends on access to stakeholder-controlled resources that are incompletely contractible and stakeholders bear residual risk, their willingness to contribute, specialize, and coordinate depends on expectations about ex post economic profit allocation (Barney, 2018; Coff, 1999; Stoelhorst, 2023). Shareholder-centric governance—designed to prioritize shareholder residual claims and to evaluate managers by shareholder value capture—weakens the credibility of commitments to allocate economic profits to nonshareholder residual claimants when stakeholders' marginal contributions are difficult to attribute and verify. As a result, strategies that depend on such credible commitments become more costly to sustain under shareholder-centric governance.

This credibility problem operates ex ante through stakeholders' investment and effort decisions. When stakeholders anticipate that profit allocation will be discretionary (due to residual-claim ambiguity) and that discretion will be exercised in ways that privilege shareholder claims (due to shareholder-centric governance), they have weaker incentives to make firm-specific investments, provide discretionary effort, reveal private information, or engage in cooperative adaptation. These weakened incentives may cause stakeholders to participate more cautiously, engage in defensive contracting, reduce specialization, or exit the firm altogether. The resulting efficiency losses from both stakeholders' defensive responses and from firms' efforts to counteract them represent a central channel through which residual-claim ambiguity generates distributional agency costs under shareholder-centric governance. Strategies that generate economic profits through novelty or complementarity are particularly susceptible to these costs, due to the relatively higher level of residual-claim ambiguity they tend to generate.

In contrast, scale-based strategies tend to generate lower levels of residual-claim ambiguity because access to stakeholder-controlled resources can be governed more readily through standardized, verifiable metrics and ex ante contracting. As a result, nonshareholder stakeholders face lower residual risk and have weaker incentives to contest ex post profit allocation. Accordingly, scale-based strategies impose comparatively lower distributional agency costs than novelty- or complementarity-based strategies under shareholder-centric governance, even when nonshareholder stakeholders remain central to profit generation.

Taken together, these differences create a selection pressure in strategy choice by shaping the relative emphasis, persistence, and scaling of profit-generation mechanisms under shareholder-centric governance. When shareholder-centric governance raises the governance costs of strategies that generate high residual-claim ambiguity, firms are more likely to favor mechanisms that minimize such ambiguity, even when alternative pathways could potentially generate greater total economic value. This extends appropriation-centered accounts (e.g., bargaining over rents conditional on joint value creation) by shifting the outcome of interest from rent capture within a given governance arrangement to which forms of value creation are pursued and sustained in the first place.

Proposition 3: *Conditional on comparable early performance signals and opportunity quality, novelty- and complementarity-oriented initiatives will be less likely than scale-oriented initiatives to be replicated, routinized, or sustained over time under shareholder-centric governance because they generate higher distributional agency costs.*

Because firms often pursue multiple strategic initiatives in parallel, the selection pressure described here operates most directly at the level of strategic initiatives and project portfolios rather than strictly at the level of firms. Strategic initiatives differ in their profit-generation mechanisms (e.g., novelty, unique complementarities, and scale) and therefore in the extent to which they rely on stakeholder-controlled, incompletely contractible inputs, implying that residual-claim ambiguity—and the distributional agency costs it triggers—varies within firms across concurrent efforts. Shareholder-centric governance shapes these within-firm portfolio decisions by influencing which initiatives receive funding, managerial attention, and organizational commitment, and which are scaled, repeated, or abandoned when contested residual claims threaten profitability. Over time, these initiative-level allocation and continuation choices aggregate into firm-level strategic trajectories, making governance-driven selection pressure observable both within firms and across firms.

One alternative interpretation of this argument is that strategy may drive governance instead: firms oriented toward scale-based profit generation may tend to adopt shareholder-centric governance because standardized, contractible inputs make shareholder-oriented control comparatively efficient. This paper is consistent with such co-selection, as the core argument is that scale-based strategies are more efficiently governed under shareholder-centric governance compared with other sources of profit generation. Crucially, however, the governance–strategy compatibility mechanism developed here also implies within-firm drift: even when firms pursue novelty- or complementarity-based initiatives, shareholder-centric governance shapes which initiatives are funded, scaled, and repeated because it conditions stakeholders' expectations about ex post allocation and therefore the distributional agency costs those initiatives trigger. The consequence of this within-firm drift is that novelty-and complementarity-based initiatives are less likely to be scaled, repeated, or institutionalized over time, even when initially pursued, producing path-dependent strategic trajectories biased toward governance-compatible, scale-based profit generation.

Consistent with this within-firm drift, selection pressure can arise through boundedly rational learning and organizational adaptation as firms scale, replicate, and discontinue initiatives over time. Strategic initiatives characterized by repeated stakeholder dissatisfaction, elevated turnover among critical contributors, delays from bargaining frictions, or chronic underinvestment are less likely to be expanded or repeated, while initiatives that generate profits while keeping allocation relatively uncontested are more likely to be resourced, replicated, and embedded in organizational routines. Over time, internal selection processes (such as capital allocation routines, performance evaluation systems, and retention patterns) and external selection pressures (such as capital market discipline, takeover threats, and activist pressure) can jointly reinforce an orientation toward strategies whose profit-generation mechanisms are more compatible with shareholder-centric governance.

The strength of this selection pressure should vary systematically. It is likely stronger when novelty- or complementarity-driven initiatives rely heavily on stakeholder-controlled resources whose marginal contributions are difficult to observe, measure, and reward through contractible metrics, thereby expanding managerial discretion over profit allocation (Holmström & Milgrom, 1991; Ouchi, 1980). The pressure is also likely amplified when pivotal contributors have high opportunity costs or credible exit options, making their participation especially sensitive to expectations about ex post allocation (Hirschman, 1970).

Conversely, selection pressure should be weaker when firms can reduce residual-claim ambiguity or credibly constrain managerial discretion over profit allocation. This is more likely when contribution measurability and attribution improve (e.g., modularization, clear IP ownership and crediting, reliable contribution metrics), and when firms institutionalize credible allocation commitments (e.g., formula-based profit-sharing, stakeholder voice/representation mechanisms, relational governance) that make promised returns to pivotal contributors credible. These scope conditions clarify that novelty and complementarities are not inherently unattractive; rather, their viability depends on whether governance can make stakeholder participation and profit allocation sufficiently predictable under shareholder-centric governance. Accordingly:

Proposition 4: *The selection pressure toward scale-based profit-generation mechanisms under shareholder-centric governance will be stronger when pivotal nonshareholder contributors have higher outside options and weaker when firms establish credible profit-allocation commitments—formal or relational—that reduce residual-claim ambiguity for those contributors.*

In sum, shareholder-centric governance shapes the firm's strategic trajectory by privileging profit-generation pathways that minimize residual-claim ambiguity and associated distributional agency costs. This governance–strategy compatibility mechanism helps explain why scale-based strategies may be disproportionately selected and sustained in companies with shareholder-centric governance, and why novelty- and complementarity-based value creation may be persistently underpursued even when their technical or market potential appears substantial.

IMPLICATIONS FOR STRATEGIC HETEROGENEITY AND UNDEREXPLOITED VALUE CREATION

The selection pressure theorized above has important implications for understanding persistent differences in firms' strategic trajectories and the exploitation of value-creation opportunities. Strategy research attributes heterogeneity in strategic choices to a variety of sources, such as differences in resource endowments (Barney, 1991; Peteraf, 1993), managerial cognition (Hambrick & Mason, 1984; Gavetti, 2012), competitive positioning (Porter, 1980, 1996), and environmental constraints (Hannan & Freeman, 1977; Hrebiniak & Joyce, 1985). The present framework highlights an additional source of heterogeneity: differences in the compatibility between firms' governance systems and alternative profit-generation mechanisms. Related work has examined governance–strategy fit and shown that governance arrangements can shape strategic orientation (Yin & Zajac, 2004), but it has not specified how governance costs associated with contested residual claims affect the viability of different profit-generation pathways.

Under shareholder-centric governance, novelty- and complementarity-based strategies tend to impose higher governance costs because they more often rely on stakeholder-controlled, incompletely contractible resources, which heightens residual-claim ambiguity and the associated distributional agency costs (Barney, 2018; Stoelhorst, 2023). As a result, firms operating under similar market conditions and with access to similar resources may nonetheless diverge in their strategic choices depending on how governable different value-creation pathways are under their governance arrangement. Firms operating under shareholder-centric governance are more likely to select, expand, and sustain scale-based strategies, compared with similar firms operating under stakeholder governance that provides clear, credible, and mutually acceptable rules for ex post profit allocation among residual claimants (Stoelhorst & Vishwanathan, 2024).

This perspective helps explain why some valuable value-creation opportunities may be systematically underpursued and underdeveloped in practice. Strategies grounded in novelty or unique complementarities often promise high upside but require sustained cooperation, specialization, and discretionary effort from stakeholders whose contributions are difficult to measure and reward through contractible metrics (Barney, 2018; Coff, 1999; Stoelhorst, 2023). When governance systems cannot credibly commit to allocating economic profits in line with these contributions, stakeholders rationally hedge, withdraw, or avoid deep engagement. Over time, these responses make such strategies appear fragile, costly, or "hard to execute," reinforcing managerial preferences for more governable, scale-based approaches. What may appear ex post as managerial conservatism or missed opportunity can instead reflect ex ante governance constraints rather than failures of foresight or ambition (Gavetti, 2012; March, 1991).

This argument also sheds light on why strategic heterogeneity can persist even within the same industry or competitive environment. Firms differ not only in their resources and capabilities, but also in the degree to which their governance systems create credible commitments to nonshareholder residual claimants and constrain discretion over ex post allocation. These governance differences shape firms' strategic trajectories by affecting which initiatives can be sustained and scaled without triggering prohibitive distributional agency costs. Strategic heterogeneity, in this view, reflects variation in governance–strategy compatibility that conditions the feasibility of alternative value-creation pathways.

More broadly, the argument shifts attention from governance as an ex post appropriation device to governance as a determinant of which value-creation pathways can be sustained without triggering prohibitive distributional agency costs. Over time, these governance frictions shape which strategic initiatives are funded, replicated and embedded in organizational routines. This helps explain why novelty- and complementarity-based sources of economic profit—despite their central role in theoretical accounts of competitive advantage—may remain underrepresented in firms' realized strategies.

CONCLUSION

This paper argues that governance shapes strategy selection by altering the costs of sustaining stakeholder participation in profit generation. When economic profits depend on access to incompletely contractible, stakeholder-controlled resources, residual claims on any economic profits extend beyond shareholders. These multi-claimant settings often produce residual-claim ambiguity—uncertainty over how economic profits will be allocated ex post among multiple residual claimants. Residual-claim ambiguity expands managerial discretion over ex post profit allocation and, under shareholder-centric governance, triggers strategic stakeholder responses (e.g., influence activity, bargaining frictions, shading, and reduced firm-specific investment). This paper conceptualizes these efficiency losses as distributional agency costs, which arise from managerial discretion over contested residual claims rather than shirking or self-dealing.

A central implication of this logic is that distributional agency costs vary systematically across profit-generation mechanisms. Scale-based strategies rely more heavily on standardized processes and measurable contributions, which reduce ambiguity over returns and limit ex post contestation. By contrast, novelty- and complementarity-based strategies depend on discretionary effort, experimentation, and resource co-specialization by stakeholders whose marginal contributions cannot be fully specified or verified ex ante, and may remain difficult to attribute ex post. Under shareholder-centric governance, these conditions amplify residual-claim ambiguity and distributional agency costs, weakening stakeholders' incentives to contribute critical resources and creating selection pressure towards scale-based strategies. Governance therefore shapes not only how value is captured once created, but also which profit-generation pathways firms are most likely to pursue.

This paper contributes to strategy research in three ways. First, it establishes shareholder-centric governance as a driver of selection among profit-generation pathways by shaping which initiatives can be credibly sustained and scaled. Second, it extends stakeholder RBT by showing how residual-claim structure constrains value creation ex ante through pathway-specific governance costs. Third, it clarifies distributional agency costs as a distinct inefficiency in multi-claimant settings, helping explain why governance arrangements that support scale-based profit generation may perform poorly when value creation depends on incompletely contractible, stakeholder-controlled resources.

The strength of this selection pressure is contingent on a number of factors. Distributional agency costs are likely higher when contributions are difficult to verify, stakeholders' outside options are strong, and governance grants managers wide discretion over ex post allocation. These costs should be attenuated when firms adopt credible allocation rules and commitment devices, such as transparent profit-sharing formulas, representation or voice mechanisms, or ownership structures that clarify stakeholders' expected returns, thereby reducing residual-claim ambiguity. Importantly, our claim is one of selection pressure, not determinism: firms can pursue novelty- or complementarity-based strategies under shareholder-centric governance, but typically must incur governance costs to make stakeholder participation credible and stable.

This paper also has scope conditions that clarify what it does and does not claim. The argument assumes that at least some stakeholders condition participation on expectations about ex post allocation; it does not require perfect foresight. Residual claims extend beyond shareholders only when profit generation depends on stakeholder-controlled resources whose marginal contributions cannot be fully specified or verified ex ante. Moreover, shareholder-centric governance varies in the extent to which it constrains managerial discretion and provides credible commitments, implying corresponding variation in residual-claim ambiguity and distributional agency costs. Finally, these mechanisms are likely conditioned by institutional contexts that shape stakeholders' outside options and the feasibility of credible allocation rules (e.g., labor market regimes, legal protections, norms regarding stakeholder claims, etc.).

These insights open several avenues for future research. Empirical work can operationalize distributional agency costs by examining influence activity, bargaining delays, stakeholder underinvestment, or the mobility and withholding of effort by key contributors, and test whether these costs are systematically higher in initiatives reliant on discretionary, jointly produced value. Initiative-level longitudinal designs can assess whether shareholder-centric governance predicts which projects are scaled, redesigned, or terminated, holding opportunity quality constant. Comparative studies across governance forms (e.g., partnerships, cooperatives, family firms, hybrids) can identify how residual-claim clarity expands the feasible set of profit-generation strategies.

In closing, this paper highlights a foundational link between governance and strategy: by shaping residual-claim ambiguity and distributional agency costs, governance systems influence the relative viability of alternative profit-generation mechanisms. Accounting for this interaction helps explain persistent heterogeneity in strategic choices and why some opportunities for joint value creation remain systematically underexploited.

REFERENCES

Barney, J. B. 1986. Strategic factor markets: Expectations, luck, and business strategy. *Management Science*, 32(10): 1231–1241.

Barney, J. B. 1991. Firm resources and sustained competitive advantage. *Journal of Management*, 17(1): 99–120.

Barney, J. B. 2018. Why resource-based theory's model of profit appropriation must incorporate a stakeholder perspective. *Strategic Management Journal*, 39(13): 3305–3325.

Bernheim, B. D., & Whinston, M. D. 1986. Common agency. *Econometrica*, 54(4): 923–942.

Brandenburger, A. M., & Stuart, H. W., Jr. 1996. Value-based business strategy. *Journal of Economics & Management Strategy*, 5(1): 5–24.

Chatain, O., & Zemsky, P. 2011. Value creation and value capture: A dynamic model of bargaining power. *Strategic Management Journal*, 32(10): 1060–1081.

Coase, R. H. 1937. The nature of the firm. *Economica*, 4(16): 386–405.

Coff, R. W. 1997. Human assets and management dilemmas: Coping with hazards on the road to resource-based theory. *Academy of Management Review*, 22(2): 374–402.

Coff, R. W. 1999. When competitive advantage doesn't lead to performance: The resource-based view and stakeholder bargaining power. *Organization Science*, 10(2): 119–133.

Eisenhardt, K. M. 1989. Agency theory: An assessment and review. *Academy of Management Review*, 14(1): 57–74.

Eisenhardt, K. M., & Tabrizi, B. N. 1995. Accelerating adaptive processes: Product innovation in the global computer industry. *Administrative Science Quarterly,* 40(1): 84–110.

Fama, E. F. 1980. Agency problems and the theory of the firm. *Journal of Political Economy*, 88(2): 288–307.

Fama, E. F., & Jensen, M. C. 1983a. Agency problems and residual claims. *Journal of Law and Economics*, 26(2): 327–349.

Fama, E. F., & Jensen, M. C. 1983b. Separation of ownership and control. *Journal of Law and Economics*, 26(2): 301–325.

Gavetti, G. 2012. Toward a behavioral theory of strategy. *Organization Science*, 23(1): 267–285.

Grossman, S. J., & Hart, O. D. 1986. The costs and benefits of ownership: A theory of vertical and lateral integration. *Journal of Political Economy*, 94(4): 691–719.

Hambrick, D. C., & Mason, P. A. 1984. Upper echelons: The organization as a reflection of its top managers. *Academy of Management Review*, 9(2): 193–206.

Hannan, M. T., & Freeman, J. 1977. The population ecology of organizations. *American Journal of Sociology*, 82(5): 929–964.

Hart, O., & Moore, J. 1990. Property rights and the nature of the firm. *Journal of Political Economy*, 98(6): 1119–1158.

Hirschman, A. O. 1970. *Exit, Voice, and Loyalty: Responses to Decline in Firms, Organizations, and States*. Cambridge, MA: Harvard University Press.

Holmström, B. 1979. Moral hazard and observability. *Bell Journal of Economics*, 10(1): 74–91.

Holmström, B., & Milgrom, P. 1991. Multitask principal–agent analyses: Incentive contracts, asset ownership, and job design. *Journal of Law, Economics, & Organization*, 7(Special Issue): 24–52.

Hoskisson, R. E., Gambeta, E., Green, C. D., & Li, T. X. 2018. Is my firm-specific investment protected? Overcoming the stakeholder investment dilemma in the resource-based view. *Academy of Management Review*, 43(2): 284–306.

Hoskisson, R. E., Hitt, M. A., Wan, W. P., & Yiu, D. 1999. Theory and research in strategic management: Swings of a pendulum. *Journal of Management,* 25(3): 417–456.

Hrebiniak, L. G., & Joyce, W. F. 1985. Organizational adaptation: Strategic choice and environmental determinism. *Administrative Science Quarterly*, 30(3): 336–349.

Jensen, M. C. 1986. Agency costs of free cash flow, corporate finance, and takeovers. *American Economic Review*, 76(2): 323–329.

Jensen, M. C. 2000. Value maximization, stakeholder theory, and the corporate objective function. *Journal of Applied Corporate Finance*, 12(4): 8–21.

Jensen, M. C. 2001. Value maximization, stakeholder theory, and the corporate objective function. *European Financial Management*, 7(3): 297–317.

Jensen, M. C. 2002. Value maximization, stakeholder theory, and the corporate objective function. *Business Ethics Quarterly*, 12(2): 235–256.

Jensen, M. C., & Meckling, W. H. 1976. Theory of the firm: Managerial behavior, agency costs and ownership structure. *Journal of Financial Economics*, 3(4): 305–360.

Jensen, M. C., & Murphy, K. J. 1990. Performance pay and top-management incentives. *Journal of Political Economy*, 98(2): 225–264.

Mahoney, J. T. 2005. *Economic foundations of strategy*. Thousand Oaks, CA: Sage Publications.

Mahoney, J. T., & Qian, L. 2013. Market frictions as building blocks of an organizational economics approach to strategic management. *Strategic Management Journal*, 34(9): 1019–1041.

Makadok, R. 2001. Toward a synthesis of the resource-based and dynamic-capability views of rent creation. *Strategic Management Journal*, 22(5): 387–401.

Manne, H. G. 1965. Mergers and the market for corporate control. *Journal of Political Economy*, 73(2): 110–120.

March, J. G. 1991. Exploration and exploitation in organizational learning. *Organization Science*, 2(1): 71–87.

Ouchi, W. G. 1980. Markets, bureaucracies, and clans. *Administrative Science Quarterly*, 25(1): 129–141.

Peteraf, M. A. 1993. The cornerstones of competitive advantage: A resource-based view. *Strategic Management Journal*, 14(3): 179–191.

Poppo, L., & Zenger, T. 2002. Do formal contracts and relational governance function as substitutes or complements? *Strategic Management Journal*, 23(8): 707–725.

Porter, M. E. 1980. *Competitive Strategy: Techniques for Analyzing Industries and Competitors*. New York: Free Press.

Porter, M. E. 1996. *What is strategy?* Harvard Business Review, 74(6): 61–78.

Stoelhorst, J. W. 2023. Value, rent, and profit: A stakeholder resource-based theory. *Strategic Management Journal*, 44(6): 1488–1513.

Stoelhorst, J. W., & Vishwanathan, P. 2024. Beyond primacy: A stakeholder theory of corporate governance. *Academy of Management Review*, 49(1): 107–134.

Wang, H., He, J., & Mahoney, J. T. 2009. Firm-specific knowledge resources and competitive advantage: The roles of economic- and relationship-based employee governance mechanisms. *Strategic Management Journal*, 30(12): 1265–1285.

Williamson, O. E. 1975. *Markets and Hierarchies: Analysis and Antitrust Implications*. New York: Free Press.

Williamson, O. E. 1985. *The Economic Institutions of Capitalism: Firms, Markets, Relational Contracting*. New York: Free Press.

Williamson, O. E. 1991. Comparative economic organization: The analysis of discrete structural alternatives. *Administrative Science Quarterly*, 36(2): 269–296.

Yin, X., & Zajac, E. J. 2004. The strategy/governance structure fit relationship: Theory and evidence in franchising arrangements. *Strategic Management Journal*, 25(4): 365–383.