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# Value, rent, and profit: A stakeholder resource-based theory

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**Abstract**

**Research Summary:** This article goes back to first principles to develop a stakeholder resource-based theory grounded in a team production view of the firm. First, the firm is conceptualized as a governance structure to facilitate stakeholder cooperation in team production and innovation. Second, value creation, value appropriation, rent, and profit are defined in ways that explicitly acknowledge the collective and dynamic nature of value creation. The resulting framework is used to explain how economic profit and stakeholder payments emerge in the interplay of value creation and appropriation. One fundamental insight is that above normal returns to shareholders result from their (privileged) position in governance structures, as opposed to a competitive market logic. Implications for resource-based theory and the notion of shareholder primacy are discussed.

**Managerial Summary:** How do firms generate profit? And what determines who appropriates this profit? These questions are answered by conceptualizing the firm as a coalition of stakeholders who provide resources to engage in team production and team innovation. Once the firm is seen in this way, two fundamental things become clear. First, profit is the result of how resource bundles are managed: profit depends on management's ability to assemble, develop, and deploy resource bundles that are unique in terms of novelty,

complementarities, and/or scale. Second, appropriation of profit is the result of pure bargaining: who appropriates the profit generated by the firm is not determined by markets, but depends on the formal and informal governance rules that guide the bargaining over profit among the firm's stakeholders.

**KEYWORDS**

resource-based view (RBV), stakeholder theory, team production, value appropriation, value creation

> *"The fields of strategy and organization are dominated by the stylized idea that the purpose of the firm is to maximize returns on investment for equity shareholders ... Stakeholder theory has been proposed as an alternative to shareholder theory. We maintain that the two views on the firm's claimants may be aligned by returning to first principles"* (Klein, Mahoney, McGahan, & Pitelis, 2012, pp. 304–305)

## 1 | INTRODUCTION

The strategy field is increasingly taking a stakeholder turn, and calls to rethink strategy theories from a stakeholder perspective (Asher, Mahoney, & Mahoney, 2005; Klein et al., 2012) have recently culminated in the argument that resource-based theory (RBT) should adopt a stakeholder view to offer a consistent treatment of how profit is generated and appropriated (Barney, 2018). At first glance, this argument may seem paradoxical: RBT was part of the so-called economic turn in strategy (Mahoney & Pandian, 1992; Rumelt, Schendel, & Teece, 1991), while stakeholder theory was specifically developed as an *alternative* to the economic narrative of capitalism (Freeman, Harrison, Wicks, Parmar, & De Colle, 2010). How, then, can these two theories possibly be reconciled? Following Klein et al.'s (2012) suggestion in the quote above, the purpose of this article is to show that a reconciliation is possible if we are willing to go back to first principles: the paper develops a stakeholder RBT by reconsidering some of RBT's most basic concepts: value, rent and profit, and, especially, its view of the firm.

One reason to develop a stakeholder RBT is to explain both value creation and value appropriation (cf. Barney, 2018), something that the traditional RBT is unable to do (Coff, 1999; Peteraf & Barney, 2003). The starting point of the paper is the recognition that what is holding RBT back from offering a consistent treatment of value creation and value appropriation is the very thing that originally gave it its rigor: the analytical approach of neoclassical price theory. Neoclassical economics offers a crucial theoretical benchmark for theorizing about firm performance in the form of its model of perfect competition (Rumelt et al., 1991: Mahoney & Qian, 2013), but also obscures the collective and dynamic nature of value creation (Teece & Winter, 1984). More specifically, its unitary agent view of the firm obscures the collective, and its equilibrium logic the dynamic aspects of value creation. The objective of the theorizing below is to retain the rigor of RBT's economic reasoning, while stepping away from the unitary agent view of the firm and recognizing the boundary conditions imposed by an equilibrium logic.

In order to capture the collective nature of value creation, the paper will adopt a team production view of the firm (Alchian & Demsetz, 1972; Blair & Stout, 1999), and in order to capture the dynamic nature of value creation, the paper will contrast the equilibrium logic of Ricardian rent (Ricardo, 1817) with the disequilibrium logic of Schumpeterian profit (Schumpeter, 1934, 1942). To draw these different strands of economic theorizing together into a rigorous framework, the paper starts from the coalitional logic of Brandenburger and Stuart (1996), which has already been adopted in both RBT (Lippman & Rumelt, 2003a, 2003b; MacDonald & Ryall, 2004) and stakeholder theory (Garcia-Castro & Aguilera, 2015). Crucially, the combination of the coalitional logic of Brandenburger and Stuart and a team production view of the firm results in a framework that captures the fundamental tension between individual and collective interests that is central to understanding the interplay between value creation and value appropriation.

With this framework in place, it is argued that a consistent treatment of value creation and value appropriation requires a number of conceptual distinctions. One crucial distinction is between (Ricardian) rent as an equilibrium-based concept that explains returns to individual resources, and (Schumpeterian) profit as a disequilibrium-based concept that explains returns to bundles of resources. Another important distinction is between what Alchian and Demsetz (1972) referred to as the "classical firm," run by an individual owner–manager–entrepreneur, and the "corporation," in which stakeholders transfer some of their control rights to an independent board that functions as a "mediating hierarch" to adjudicate among stakeholder interests (Blair & Stout, 1999). With these (and a number of other) distinctions in place, the combination of the coalitional logic of Brandenburger and Stuart and a team production view of the firm informs a theory that explains both the mechanisms underlying the generation of economic profit by the firm as a team of interdependent stakeholders, and those underlying payments to individual stakeholders.

The paper makes three contributions. First, resource-based theorists have already argued that a consistent RBT should disentangle value creation and value appropriation, and that explaining value appropriation calls for a nexus of contracts view of the firm (Barney, 2018; Coff, 1999). What is lacking is a rigorous framework that allows RBT to be redeveloped from a nexus of contracts view. The paper proposes such a framework by integrating a specific nexus of contracts view of the firm, team production theory, into the coalitional logic of Brandenburger and Stuart (1996). The fundamental contribution of this framework is that it retains the rigor of RBT's original economic reasoning (cf. Barney, 1991; Peteraf, 1993), while also allowing for an analysis of the interplay between the individual and collective, and equilibrium and disequilibrium phenomena that drive firm performance.

The second contribution is to use this framework to develop a stakeholder RBT that explains both the generation and appropriation of profit (cf. Barney, 2018). The basis for this second contribution is to use the explicit conceptual distinctions between the individual and collective levels of analysis, and between equilibrium and disequilibrium explanations, to derive a set of unambiguous and mutually consistent definitions of value, rent, and profit. One important insight from this conceptual groundwork is that profit (as opposed to rent) is fundamentally driven by dynamic (as opposed to cross-sectional) mechanisms, and that it accrues to bundles of (as opposed to individual) resources. Another is that the division of profit among stakeholders is not the result of a competitive market logic, but of pure bargaining. In line with a team production view, the essence of a firm is to provide a governance structure that helps resolve this bargaining.

This last point also brings us to the third contribution, which is to clarify the debate on shareholder primacy and the purpose of the firm (Freeman, Wicks, & Parmar, 2004; Jensen, 2002; Sundaram & Inkpen, 2004). The theory developed below supports a nuanced version of stakeholder theory's critique of shareholder primacy as a guiding principle for management. It demonstrates

that above normal returns to shareholders result from their privileged position in a firm's governance structure, as opposed to a competitive market logic. Team production theory gives an economic rationale for this privileged position for the classical firm, but not for the public corporation. The nuanced version of the critique of shareholder primacy, then, is not that shareholder primacy cannot be efficient, but that it is unlikely to be efficient when value creation makes stakeholders highly interdependent—as is typically the case in today's complex firms.

## 2 | FOUNDATIONS

To lay the foundation for a stakeholder RBT, this section restates some of RBT's basic concepts in terms of the coalitional logic of Brandenburger and Stuart (1996).

### 2.1 | Resource-based theory

The resource-based view of the firm (Barney, 1991; Conner, 1991; Wernerfelt, 1984) has spawned a rich and variegated stream of research.[1] The specific focus of this article is on the "High Church" of RBT (Barney, 1986, 1991; Peteraf, 1993; Peteraf & Barney, 2003), where the term High Church refers to work that is explicitly grounded in the logic of neoclassical price theory (Gavetti & Levinthal, 2004). One way of understanding this particular strand of RBT is in terms of its central role in the economic turn in strategy (Rumelt et al., 1991). Since this economic turn, much of the theoretical work in the strategy field takes its starting point in the rigor of economic theories and concepts, but explicitly aims to use these theories and concepts to derive managerially relevant insights (Mahoney & Qian, 2013; Rumelt et al., 1991).

This is also the approach of RBT (Mahoney & Pandian, 1992). As a theory of competitive strategy, it explains "competitive heterogeneity": differences in performance among firms and the underlying heterogeneity that explains these differences (Hoopes, Madsen, & Walker, 2003). The benchmark in explaining differences in performance is the model of perfect competition, which specifies the conditions under which all firms earn zero economic profit.[2] It follows that generating positive economic profit requires market imperfections. In line with this, RBT points to factor market imperfections as a crucial source of economic profit (Barney, 1986; Peteraf, 1993).[3]

[1]On a broad definition of the RBV, it includes work that explains firm performance (e.g., Barney, 1991), the existence of firms (e.g., Conner, 1991) and diversification (e.g., Montgomery, 1994), as well as different schools of thought (Barney, 2001; Foss, 2000; Gavetti & Levinthal, 2004). These schools of thought either stay close to the economic logic of neoclassical price theory that inspired early contributions to RBT (e.g., Barney, 1986, 1991; Lippman & Rumelt, 1982; Peteraf, 1993)—what Gavetti & Levinthal, 2004 refer to as the "High Church" of RBT—or explicitly move away from it (e.g., Dierickx & Cool, 1989; Grant, 1996; Kogut & Zander, 1992; Penrose, 1995; Teece, Pisano, & Shuen, 1997)—what Gavetti & Levinthal, 2004 refer to as the "Low Church" of RBT.

[2]These conditions include the large numbers assumption (all agents are price takers); the homogeneity assumption (products are undifferentiated); the perfect mobility assumption (entry and exit are costless); and the no frictions assumption (there are no transactions costs).

[3]The central ideas of the theory are: that economic profit results from a firm's ability to create more value than competitors and/or to do so at lower costs (Conner, 1991; Peteraf, 1993; Peteraf & Barney, 2003); that this ability derives from the control of superior resources (Barney, 1991; Peteraf, 1993); that control of these superior resources only leads to economic profit if resources have been acquired below their economic cost (Barney, 1986; Peteraf, 1993); and that this economic profit can be sustained if the resources in question cannot be easily imitated or substituted (Barney, 1991; Lippman & Rumelt, 1982; Peteraf, 1993).

The neoclassical logic that supports RBT is rigorous, but does depend on a number of features, in particular an equilibrium logic and a unitary agent view of the firm, that impose boundary conditions on RBT.[4] The specific boundary condition that a *stakeholder* RBT must overcome is that the unitary agent view of the firm in the neoclassical logic does not allow RBT to explain value appropriation by the firm's stakeholders (cf. Coff, 1999; Peteraf & Barney, 2003). In keeping with the unitary agent view of the firm, RBT has tended to refer to "firms" either without further specifying the term, or, adopting an agency theory view, by equating the firm with the interests of shareholders. As Coff (1999) has pointed out, this approach limits the power of RBT as a theory of firm performance, and as Barney (2018) has recently argued, it implies an RBT with inconsistent models of how profit is generated and how it is appropriated.

Resource-based theorists have suggested two steps to overcome the boundary condition that a unitary agent view of the firm imposes on RBT: taking a nexus of contracts view of the firm and explicitly disentangling value creation and value appropriation (Barney, 2018; Coff, 1999). That is also the approach taken here: the theory developed below sees the firm as a nexus of contracts to govern value creation and value appropriation by stakeholders, and then asks how economic profit and stakeholder payments arise in this nexus. It retains the notion of perfect competition as a theoretical benchmark, defining "economic profit" as profits in excess of what the firm, as a legal entity, would earn in perfectly competitive markets, and "rents" as payments in excess of opportunity costs to stakeholders supplying resources to the firm.

## 2.2 | A coalitional logic

The first question we face is how to analyze the firm as a nexus of contracts for value creation and value appropriation while retaining the rigor of High Church RBT. The framework of Brandenburger and Stuart (1996) provides a useful starting point. Grounded in cooperative game theory (CGT), it is based on a coalitional logic: economic agents form coalitions in which they simultaneously cooperate to create value and compete to appropriate it.[5] The framework reduces the complexity of real world economic interactions to a three-way assignment game among buyers, firms, and suppliers (Figure 1). Based on CGT, it retains an equilibrium logic, but is more amenable than neoclassical economics to incorporating insights about market frictions and entrepreneurial dynamics (Makowski & Ostroy, 2001).

One advantage of this framework is that it is nicely in line with RBT: it pictures the role of the firm as transforming resources acquired in factor markets into products sold in product markets (Conner, 1991) and emphasizes the symmetrical importance of product and factor markets (Barney, 1986; Wernerfelt, 1984). Another advantage is that it offers a clearly defined set of

[4]Much of the theory development in the Low Church of RBT can be understood in terms of stepping away from these two features of the model of perfect competition. We will come back to the link between the stakeholder RBT developed here and the Low Church of RBT below.

[5]Note that in taking Brandenburger and Stuart's framework as its staring point, the paper also adopts the typical assumptions of economic analysis, unless explicitly stated otherwise. Among others, it is assumed that economic agents are self-interested and will, through the assumption of unrestricted bargaining (Brandenburger & Stuart, 1996), make choices that maximize their individual pay-offs. We will relax this assumption in the discussion.

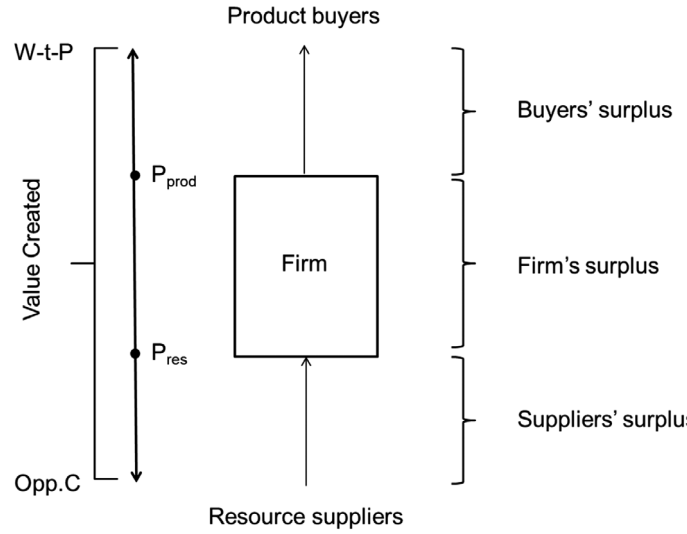


**FIGURE 1** The coalitional logic of value creation and value appropriation (after Brandenburger and Stuart (1996))

concepts. "Value created" is defined as the difference between the willingness-to-pay for products of buyers (W-t-P) and the opportunity costs of resource suppliers (Opp.C). Note that this is the surplus value that the coalition of buyers, the firm, and suppliers creates over and above the value that the resources used in the coalition could create in their best outside option (as captured in the notion of suppliers' opportunity costs).[6] There is thus a close correspondence between value created and the notion of general economic welfare (cf. Makowski & Ostroy, 2001). "Value appropriated" is defined in terms of how the overall surplus of value created by the coalition is divided among buyers, the firm, and suppliers. This division depends on the prices paid by buyers in product markets ($P_{prod}$) and the prices paid to suppliers in factor markets ($P_{res}$).

Brandenburger and Stuart's concepts can easily be related to RBT's dependent variables, economic profit and rent, as defined above. While there is a tendency in RBT to use terms like value, profit and rent as if they are interchangeable, Figure 1 helps us see how profit and rent relate to, but are *different* from, value created and value appropriated. Specifically, supplier surplus consists of rent payments as defined above (i.e., payments above opportunity costs), and firm surplus consists of economic profits accruing to the firm as a legal entity.

## 2.3 | A team production view of the firm

While this may be intuitive, the consequences of adopting a nexus of contracts view are not. In fact, other than being in line with RBT's view of the firm as an input combiner (Conner, 1991), it is not necessarily clear how we are to understand the firm as it features in Brandenburger and Stuart's framework. Most of the strategy literature based on CGT (for a review, see Gans & Ryall, 2017) treats the firm in the same way as RBT has traditionally done: as a unitary agent

[6]Opportunity costs are defined by the best option *outside* the focal assignment game. In that sense, the analysis resembles a partial equilibrium analysis (Brandenburger & Stuart, 1996: fn. 6).

whose interests are associated with the interests of shareholders.[7] However, adopting a nexus of contracts view means taking a bottom-up approach to understanding firms: firms are simply legally supported governance structures to help free individuals solve the contracting problems that may stand in the way of mutually beneficial cooperation (Alchian & Demsetz, 1972; Jensen & Meckling, 1976). Taking the bottom-up approach of a nexus of contracts view seriously has an important implication: in terms of Brandenburger and Stuart's framework, *all* resource suppliers, including shareholders, are at the bottom of Figure 1.

Seeing this reinforces just how crucial the conceptual move of adopting a nexus of contracts view of the firm is. For instance, on a nexus of contracts view, there is no meaningful distinction between internal and external resource suppliers. Similarly, a phrase like "the firm appropriates" becomes meaningless: only individual stakeholders appropriate. However, this also raises a fundamental question: if all suppliers of resources, including those of equity, are treated alike, then how should we interpret the box representing "the firm" in Figure 1? To answer this question we turn to a specific nexus of contracts view: team production theory.

Team production theory (Alchian & Demsetz, 1972; Blair & Stout, 1999) explains the existence of firms in general (Alchian & Demsetz, 1972; Demsetz, 1988), and of the public corporation in particular (Blair & Stout, 1999), in terms of the need to overcome the contracting problems that emerge when value creation makes stakeholders interdependent. Team production is defined as production where "(a) several types of resources are used, (b) the product is not a sum of separable outputs of each cooperating resource, and (c) not all resources used in team production belong to one person" (Alchian & Demsetz, 1972, p. 779). The essence of team production is that, in popular terms, it involves synergies: the product of the team is not the sum of the separable outputs ($1 + 1 = 2$), but is superadditive ($1 + 1 = 5$).

While team members can create more value by cooperating, their interdependence also creates a problem. The efficiency of the market depends on rewarding the marginal productivity of economic agents,[8] but in the case of team production, the market can only reward the output of the team as a whole. The result is a "metering problem": it is impossible, or at least (very) costly, to assess how much each member of the team contributed to the value of the team's output (Alchian & Demsetz, 1972). This leads to contracting problems with respect to the division of the value that is jointly created, which are further exacerbated if team production also involves the need to make team-specific investments (Blair & Stout, 1999). Specifically, an ex ante equal division of the value that is jointly created opens the door to shirking (Alchian & Demsetz, 1972; Blair & Stout, 1999): if a team member knows that she will get an equal share of the team output regardless of her individual contribution to that output, she has an incentive to free ride on the efforts of the other team members. In contrast, not specifying the division of

[7]This is not necessarily in line with how Brandenburger and Stuart themselves saw the firm: "It is frequently suggested that the appropriate corporate objective is shareholder value maximization. The objective imputed to the firm in this paper is maximal value appropriation ... Which, then, is the correct objective? The answer depends on the perspective adopted. If the firm is thought of as an 'entrepreneurial' endeavor, the second objective is the more meaningful one. In this case, shareholders are viewed as suppliers (of capital), and payments to them should be treated as deductions from the residual value accruing to entrepreneurship. If, on the other hand, the firm is viewed as the vehicle of shareholders ..., the first objective comes into play. However, in fact, the two objectives can be made to coincide in this case, provided the second is somewhat modified. Specifically, payments to shareholders should no longer be treated as deductions from firm value appropriation, but the opportunity cost of the shareholders' capital should be deducted." (Brandenburger & Stuart, 1996, pp. 20–21). Seeing the firm as an "entrepreneurial endeavor" (also see Makowski & Ostroy, 2001), is fully in line with the theory developed here. Also note the link between the two views of the firm in this quote and the distinction between the "classical firm" and the "corporation" below.

[8]Or in CGT terms: their added value.

value created ex ante will lead to costly haggling and rent-seeking ex-post, which will discourage team members from making the team-specific investments that make them vulnerable to hold-up (Blair & Stout, 1999; Williamson, 1985).

Team production theory holds that firms exist to solve these problems.[9] In essence, firms are legally supported contracting templates to govern the team use of inputs, characterized by "a centralized position of some party in the contractual arrangements of all other inputs" (Alchian & Demsetz, 1972, p. 778). This answers our earlier question about how we are to understand the firm in Figure 1: the firm is a governance structure that allows stakeholders to reap the benefits of cooperation in the face of the contracting problems inherent in team production.

## 3 | A TEAM PRODUCTION VIEW OF VALUE CREATION AND APPROPRIATION

Figure 2 visualizes the framework resulting from integrating RBT and team production theory into the coalitional logic of Brandenburger and Stuart. To see how this framework highlights the collective and dynamic nature of the generation and appropriation of profit, we must first consider how it helps us understand the process of value creation and value appropriation.

### 3.1 | How is value created?

This simple question immediately highlights an important limitation of any theory based on an equilibrium logic: perhaps counterintuitively, the CGT logic underlying Figure 1 does *not* really allow us to explain value creation (cf. Lippman & Rumelt, 2003b). The important thing to realize is that while the CGT logic helps define value created, it has relatively little to say about the process of value creation.[10] For as far as there is an explanation of value creation, it is implicit in the assumption of unrestricted bargaining underlying the logic: that buyers, firms, and suppliers will form the mutually beneficial coalitions that create the most value (Brandenburger & Stuart, 1996). In other words, value created is conceptualized as resulting from optimal exchanges across product and factor markets, but these exchanges are in fact assumed to take place.

If we want to *explain* rather than *assume* value creation, we need to acknowledge the central role of the firm in the framework. It is the firm that is able to turn resources into products for which the willingness-to-pay of buyers exceeds the sum of the opportunity costs of resource suppliers. Take this ability out, and no value will be created. However, this ability, too, must necessarily be assumed. Define "productive knowledge" as the ability of the firm to turn

[9]Team production theory can be understood as bridging the concern with realizing the upside of cooperation in resource and knowledge-based theories of the firm (Connner, 1991; Kogut & Zander, 1992), with the concern of avoiding the downside of transaction costs in transaction cost economics (Coase, 1937; Williamson, 1985). It does so by highlighting that value creation in teams has the upside of synergy effects, but the downside of making agents interdependent, resulting in collective action problems like shirking and hold-up. The purpose of the firm is to offer a governance structure that allocates control rights (as in modern property rights theory (Hart, 1989)) and income rights among stakeholders in ways that mitigate these collective action problems and maximize value creation.

[10]In the words of Lippman and Rumelt (2003b, p. 1083): "[T]he CGT approach to resource analysis ... serves to clarify the subject of business strategy, but it does not strike at its heart. At the center of the subject is the problem of judging, discovering, and creating the values of resources."

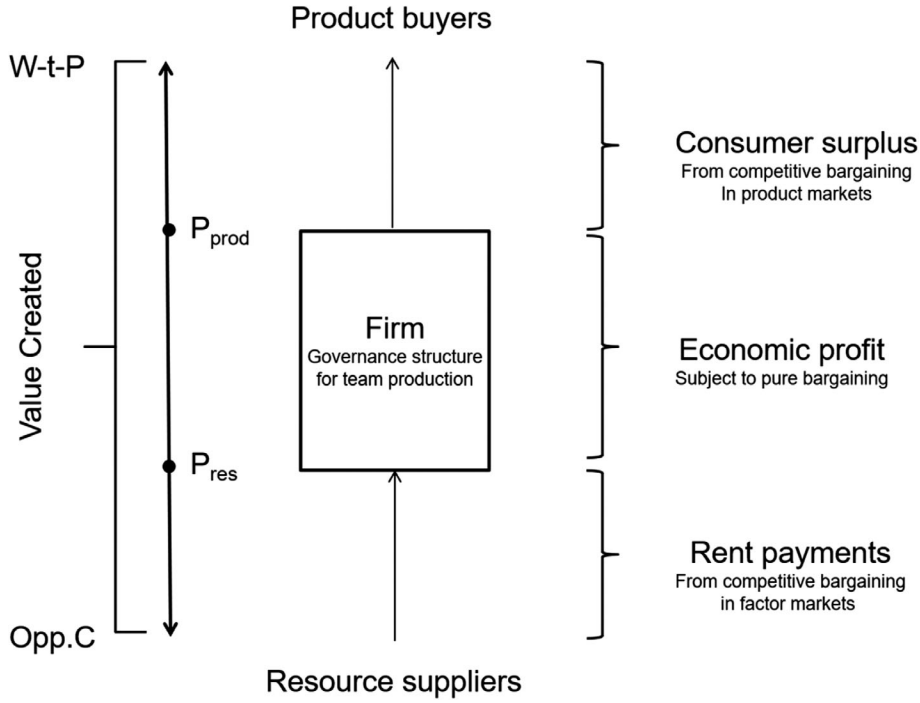


**FIGURE 2** A team production view of value creation and value appropriation

resources into products. In keeping with a long tradition in economic theorizing (viz., the notion of a production function in neoclassical economics) the CGT logic takes the firm's productive knowledge as a given. In other words, in a world in which willingness-to-pay, opportunity costs, and productive knowledge are given, unrestricted bargaining will (by definition) result in those market exchanges among buyers, firms and suppliers that will maximize value created. Let us refer to this view of value creation as "value-realized-in-exchange."

On a team production view of the firm, it may be clear that the "value-realized-in-exchange" emphasized in the CGT logic is actually the result of "value-created-in-production." In a fundamental sense, market exchanges merely *realize* the value that is actually *created* in team production. Value-created-in-production hinges on two things: productive knowledge—a central concern in the Low Church of RBT (Grant, 1996; Kogut & Zander, 1992)—and a judicious governance structure—the central concern of a stakeholder RBT.

Next, note that "value-created-in-production" and "value-realized-in-exchange" are static, cross-sectional concepts: Figure 1 explains how much value is created at a particular point in time. If we also want to explain how an increase of value created may come about over time, we need to step away from the equilibrium logic of CGT and consider how productive knowledge may increase over time—another central concern in the Low Church of RBT (Rumelt, 1987; Teece et al., 1997). Define "innovation" as the act of creating new productive knowledge. It may be clear that innovation is the ultimate source of value creation: over time an economic system can only create additional value if firms develop new productive knowledge—or in other words, new ways of increasing buyers willingness-to-pay and/or lowering the sum of the opportunity costs of the resources used in creating the products for which buyers are willing to pay.

**Principle 1.** *Value is created in production and innovation and realized in exchange.*

Linking Principle 1 to Figure 2 underscores the fact that value creation is a collective and dynamic phenomenon that typically takes the form of team production and team innovation.[11]

## 3.2 | How is value appropriated?

As Figure 1 shows, how value created is divided into buyer surplus, firm surplus, and supplier surplus is determined by prices in product and factor markets. In other words, to understand how value is appropriated, we need to understand how prices are established. On this, the CGT logic is very clear. In fact, the main value of CGT is that it offers a way to rethink traditional neoclassical price theory on the basis of more realistic assumptions about how markets work (Makowski & Ostroy, 2001). In CGT, rather than passively reacting to prices that are externally given, as in neoclassical theory (viz., the notion of the Walrasian auctioneer), stakeholders actively bargain (Brandenburger & Stuart, 1996; Makowski & Ostroy, 2001).

However, the CGT framework also implies that this bargaining takes two distinct forms. The first, "competitive bargaining," is bargaining determined by market competition (i.e., the law of supply and demand). It is this type of bargaining for which CGT offers predictions (Gans & Ryall, 2017). In some cases, these predictions are exact (i.e., supply and demand will lead to an exact prediction of the price that will result from the bargaining process among stakeholders), but in other cases the predictions are "indeterminate" and only give a lower and upper bound within which the price will fall. A simple example of the former, exact, case is a monopoly: when there is only one firm with a production capacity of one product for which there are two buyers with equal willingness-to-pay, then the price paid for the product will be the willingness-to-pay of the buyers. This is the case because the two buyers will compete with each other for access to the product. A simple example of the latter, indeterminate, case is a bilateral monopoly: when there is only one seller of a product and one buyer willing to pay for that product then there is no competition. In this case, the most the CGT logic can say is that the price for the product will be somewhere in between the opportunity costs of the seller and the willingness-to-pay of the buyer. Where the price will come out within this range depends on "pure bargaining."

An important implication of CGT is that in the case of pure bargaining, there is no market logic to the bargaining outcome: that outcome is rather the result of a process that is outside of the formal analysis. While in "competitive bargaining" value appropriation is determined by players' relative bargaining power resulting from their competitive market positions, in "pure bargaining," it is the outcome of a sociopolitical process, where anything that a player may use to convince its counterpart(s) to cede some of the residual value that remains after competitive bargaining may impact the division of value created—what Ryall (2013) has referred to as a player's "persuasive resources." The first thing that may come to mind are bargaining skills, that is, "how 'tough' a bargainer each player is" (Brandenburger & Stuart, 1996, p. 11). However, the outcome of pure bargaining also depends on both informal institutions (i.e., shared norms) and formal institutions (i.e., legal rules). Central among these institutions is how firms are governed.

[11]The exception to this statement is the case of the single person firm.

**Principle 2.** *Value is appropriated through competitive bargaining and pure bargaining.*

Linking Principle 2 to Figure 2 leads to an important insight: we can understand the prices paid in product and factor markets as the outcome of competitive bargaining, and the team production surplus (i.e., economic profit) as the residual that remains after competitive bargaining. The further division of this residual is the outcome of pure bargaining, and the legal rules and shared norms of (corporate) governance exist precisely to channel and resolve this bargaining.

## 3.3 | How does the firm resolve pure bargaining?

There are, in principle, an infinite number of ways to govern team production, but, both in theory and practice, two solutions stand out: the "classical firm" (Alchian & Demsetz, 1972) and the "corporation" (cf. Blair & Stout, 1999). In the classical firm, the central position in the nexus of contracts is taken by an individual owner–manager–entrepreneur. This person can be thought of as the entrepreneur in the sense that she assembles the team, as the manager in the sense that she monitors the team, and as the owner in the sense that she "has rights to renegotiate any input's contract independently of contracts with other input owners; ... holds the residual claim; and ... has the right to sell [her] central contractual residual status." (Alchian & Demsetz, 1972, p. 783). The idea is that the classical firm can solve the problem of shirking that is inherent in team production because the owner–manager–entrepreneur specializes in monitoring the input of team members. In order to incentive this monitoring, the owner–manager–entrepreneur is given the residual claim on the team's earnings, and in order to give monitoring its "bite," the owner–manager–entrepreneur has the sole authority to change the size, composition, and performance (i.e., the allocation of the tasks) of the team.

While the classical firm may solve the shirking problem, it can only do so if (a) team members' inputs can in fact be monitored, and (b) these inputs are fairly closely related to team members' contribution to the team's output. This may be problematic in knowledge-intensive production (Alchian & Demsetz, 1972; Demsetz, 1988). Moreover, the classical firm is not a good solution to the problem of team-specific investments (Blair & Stout, 1999). In fact, giving the owner–manager–entrepreneur the residual claim on the team's earnings exacerbates this problem, because it makes team members vulnerable to hold-up. Blair and Stout (1999) explain the legal form of the corporation as a solution to these problems.

The essential feature of the corporation is that team members do not submit to the authority of an individual owner–manager–entrepreneur, but to a mediating hierarchy culminating in an *independent* board. More specifically, "the mediating hierarchy solution requires team members to give up important rights (including property rights over the team's joint output and over team inputs such as financial capital and firm-specific human capital) to a legal entity created by the act of incorporation. In other words, corporate assets belong ... to *the corporation itself*. Within the corporation, control over those assets is exercised by an internal hierarchy whose job is to coordinate the activities of the team members, allocate the resulting [value created in] production, and mediate disputes among team members over that allocation. At the peak of this hierarchy sits a board of directors whose authority over the use of corporate assets is virtually absolute and whose independence from individual team members ... is protected by law." (Blair & Stout, 1999, pp. 250–251—emphasis in original).

Note that of these two models for governing firms, the classical firm uses a contractual structure that is consistent with shareholder primacy, albeit with the important caveat that the

shareholder is one person that combines the roles of owner, manager, and entrepreneur. In contrast, the governance structure of the corporation is inconsistent with shareholder primacy (Stout, 2012) and aligns with a stakeholder perspective on the purpose of the firm (Blair, 1998). The essential thing to realize is that the corporation does *not* have owners: it is the corporation itself, as a legal person, that owns the (non-human) resources that are used to create value. The mediating hierarchy oversees both how value is created and how it is divided among the stakeholders participating in the value creation. The essence of this governance form is the independence of the board at the apex of this hierarchy from the interests of any particular group of stakeholders, including shareholders (Blair & Stout, 1999).[12]

**Principle 3.** *Firms allow stakeholders to create value by offering a governance form to resolve the pure bargaining over the surplus created by team production and team innovation.*

Looking across Principles 1–3, we now have a clear understanding of the role of the firm in value creation and value appropriation processes. Our next question is how to explain the emergence of rent and profit in the process of value creation and appropriation.

## 4 | RENT AND PROFIT IN THE CLASSICAL FIRM

RBT has tended to use the term "rent" as a catchall for both economic profit and rent payments as defined in Figure 2. This is defensible on the unitary agent view of the firm in the original RBT, but problematic for a stakeholder RBT based on a nexus of contracts view. On the latter view, we need to explicitly distinguish rent and profit mechanisms. To illustrate the difference between them, this section goes back to Ricardo's (1817) seminal analysis of rent and Schumpeter (1934) and Knight's (1921) seminal analyses of profit. The fundamental insight to emerge from juxtaposing these analyses is that (Ricardian) rent is a cross-sectional/equilibrium concept that explains payments above opportunity costs that derive from heterogeneity of *individual* resources, while (Schumpeterian) profit is a dynamic/disequilibrium concept that explains payments above opportunity costs that derive from heterogeneity of resource *bundles*.

In this section, our question is how value creation and value appropriation may result in economic profit and rent payments as pictured in Figure 2 in the case of the classical firm (the next section will generalize the analysis to the corporation). Note that in the classical firm, the economic profit that accrues to the firm (as the legal entity governing the nexus of contracts) equals a payment to the individual owner–manager–entrepreneur: in the classical firm, the specific contracting solution to govern the nexus is that this individual is the sole residual claimant. This means that the owner–manager–entrepreneur appropriates any profit that accrues to the firm, as a legal entity, after she has paid the other resource suppliers their contractual fixed claims. For analytical purposes, Figure 2 equates these fixed claims with the prices established in the factor market on the basis of competitive bargaining, excluding any contractual claims that may result from (previous) pure bargaining.

[12]It should be noted that the accuracy of Blair and Stout's model as a description of U.S. corporate law, in particular their insistence that U.S. law does not prescribe maximizing shareholder wealth, is contested (e.g., Bainbridge, 2003). This debate has no direct bearing on the theory developed here. The theory only requires that we accept that in a corporation (a) the firm itself (as a legal person) owns the nonhuman resources used in value creation; (b) the board plays the central role in governing the use of these resources; and (c) how the profit generated by the firm is divided among stakeholders depends on the formal and informal rules that determine the board's decisions.

To see how economic profit and rent payments may emerge in the context of the classical firm, let us start with our theoretical benchmark: the case of perfect competition. This is the case in which there is no economic profit, nor any rent: all resource suppliers, including the owner–manager–entrepreneur (who supplies her monitoring skills to the nexus) earn their opportunity costs. In terms of Figure 2, value created is entirely appropriated by buyers as consumer surplus. Alchian and Demsetz's (1972) base case of team production, a two-person team loading trucks, may serve as an example. For the sake of simplicity, assume that the opportunity cost of labor (the going wage rate) is its marginal productivity in other industries where physical strength does not matter. Because we assume perfect competition, the product of the team is undifferentiated (simply the number of trucks loaded) and the resources employed are homogeneous (the workers loading the trucks are of equal strength—an assumption that will soon be relaxed). Also assume that there is a perfectly competitive market for monitoring skills, with the opportunity cost of monitoring determined by its marginal productivity in other industries. It may be clear that given these assumptions, there is no room for economic profit or rent payments: competition in the product and factor markets (in the form of entry and exit) will result in an equilibrium in which both the owner–manager–entrepreneur and the workers earn their opportunity costs.[13]

Now consider how our owner–manager–entrepreneur *could* earn an economic profit. RBT is fundamentally about heterogeneous resources (Barney, 1991; Peteraf, 1993), but introducing such resources is neither a necessary nor a sufficient condition for economic profit to emerge. That heterogeneous resources are not a necessary condition for economic profit becomes clear if we allow for uncertainty. So far, we have reasoned in terms of the equilibrium that obtains after competition has played out (cf. Barney, 1991). Things change if we allow the system to be moved out of equilibrium. This puts the entrepreneurial role of the owner–manager–entrepreneur center stage and brings us to Schumpeter's and Knight's analyses of profit.

In Schumpeter's (1934) analysis, profit is possible when the entrepreneur moves the economy away from a prevailing competitive equilibrium by combining resources in a new way. More specifically, entrepreneurship is the act of bringing new combinations to market—alternatively referred to as "innovation." If (and only if) the new way of combining resources creates more value than before, this will result in an economic profit: the entrepreneur only needs to pay resource suppliers their opportunity costs and appropriates the residual. In our simple case of truck loading, take one step back from the situation of perfect competition described above and imagine an economy in a previous equilibrium where no one has yet thought of assembling multiperson teams to load and unload trucks. If assembling and deploying these teams creates more value than the sum of the opportunity costs of the resources (the going wage rate for labor), then our entrepreneur can earn an economic profit.

There are three important things to note about entrepreneurial profit. First, as our simple example demonstrates, it does not require heterogeneous resources (we assumed a world in which the quality of labor was homogeneous). The reason for the entrepreneurial profit is not that there is something special about any of the resources that are used, but that there is something special about the *bundle* of resources (in this case the mere fact of assembling a multiperson team to reap advantages of scale). Second, note that Schumpeter's analysis only holds under conditions of *uncertainty* (Knight, 1921). Without uncertainty, why would the

[13]Note that for the sake of simplicity, we are assuming that the gains to monitoring (i.e., the additional productivity of the team resulting from appointing a monitor) are at least equal to the opportunity costs of the monitor. This may not necessarily be realistic for a two-person team, but is likely to be the case in larger teams.

entrepreneur be able to appropriate the value created by the bundle of resources that she assembles? The assumption is that the entrepreneur, in organizing resources in a new way, only needs to pay resource suppliers their opportunity costs. However, why would the residual between these opportunity costs and the prices paid for the new product not be subject to ex ante bargaining between the entrepreneur and resource suppliers? In Knight's view, if the residual was generally anticipated, this is exactly what would happen: the economy would adjust its relative prices and the profit opportunity would disappear. Knight's fundamental insight was that entrepreneurial profit can only result when it is not generally anticipated. This insight also leads into the third point about entrepreneurial profit, which is that it is likely to be a *temporary* phenomenon. This is the case because once the entrepreneur's innovation proves successful, the previous uncertainty is eliminated. In that sense, we can understand successful innovation as revealing new productive knowledge. Unless there are "isolating mechanisms" (Rumelt, 1984) that prevent the dissemination of this new productive knowledge, the economic system will adapt: imitation will eliminate the entrepreneurial profit. In our simple truck loading case, such imitation will surely happen, and we will find ourselves back in a new perfect competition equilibrium.

Next, consider Ricardo's analysis of rent. As he noted "...the laws that regulate the progress of rent are widely different from those which regulate the progress of profits, and seldom operate in the same direction" (Ricardo, 1817, p. 34). Ricardo's analysis explains the financial return to the owner of a resource that is scarce, heterogeneous, and in fixed supply. The classical case is land. Like labor and capital, land is a source of payment for the resource owner when it is scarce in relation to the demand for its services. However, in contrast to labor and capital, which are assumed to be homogeneous, land can be heterogeneous: some plots of land are inherently more fertile than others. And, in contrast to labor and capital, whose supply is assumed to be elastic, land is in fixed supply. Under the assumption that all markets other than the market for land (the labor, capital, and product markets) are perfectly competitive, the law of rent formulated by Ricardo states that the rent on land is determined by the excess of production obtained by using the land in its most productive use, relative to the production obtained by the marginal land used for the same purpose, given the same inputs of labor and capital. In other words, superior land results in an above normal return simply because it is more productive than other land. Moreover, and in contrast to the temporary and disequilibrium nature of Schumpeterian profit, the rent that accrues to superior land cannot be competed away. Because the supply of superior land is fixed, Ricardian rent is a phenomenon that persists in equilibrium.

The original RBT is in large part an extension of Ricardo's analysis into a broader theory of efficiency rent (cf. Peteraf, 1993; Peteraf & Barney, 2003; Rumelt, 1987). The original RBT starts from the condition of heterogeneity and then generalizes the condition of land being in fixed supply to the condition of resources being in inelastic supply. In the words of Barney, "... the resource-based view is simply an extension of Ricardian economics but with the assertion that many more factors of production—besides land—are inelastic in supply" (Barney, 2001, p. 645). The fundamental insight is that heterogeneous (i.e., superior) resources that are in inelastic supply can be sources of above normal returns in equilibrium (Barney, 1991; Peteraf, 1993). On a unitary agent view of the firm it would be tempting to conclude from this that, even if heterogeneity is not a necessary condition for economic profit (as we saw in the analysis of economic profit), at least it is a sufficient condition. However, it is not that either (cf. Coff, 1999).

That heterogeneity it is not a sufficient condition for economic profit becomes clear when we consider what happens if we allow for differences in physical strength among workers in

our truck loading example. Stronger workers are a superior resource when loading trucks, and will thus give a team employing them an advantage over other teams. However, this advantage will not translate into economic profit for the owner–manager–entrepreneur, but into a rent payment for the stronger workers. This is the case because, in Peteraf's (1993, p. 180) terms, these resources are not "bound to the firm" (the condition of "imperfect mobility" is not satisfied): there will be competition for the superior resources in the factor market, and competing entrepreneurs will drive up the price for the stronger workers. As a result, these workers will be paid more than their opportunity costs (i.e., their outside option: the general wage rate for undifferentiated labor), and our owner–manager–entrepreneur is back to making zero economic profit.

We can derive two conclusions from the analysis above. The first is that rent and profit are driven by different mechanisms. Rent is an equilibrium notion that hinges on heterogeneity, while profit is a disequilibrium notion that hinges on uncertainty. RBT has discussed both (e.g., Barney (1986) primarily analyzes profit, and Barney (1991) primarily rent), but without always being explicit about how they differ.[14] The second conclusion is that rent and profit play out at different levels of analysis. Rent is a source of payments above opportunity costs that results from heterogeneity of individual resources, and profit is a source of payments above opportunity costs that results from heterogeneity of resource bundles. Hence:

**Principle 4.** *Profit is a disequilibrium phenomenon resulting from heterogeneity of resource bundles.*

**Principle 5.** *Rent is an equilibrium phenomenon resulting from heterogeneity of individual resources.*

A final point about the case of the classical firm is that there is yet another possible source of profit. This is when there is a *unique complementarity* between the team members and the monitoring skills of the owner–manager–entrepreneur. This would be the case if the monitoring by the owner–manager–entrepreneur would work especially well with the particular team of workers she has assembled. In other words, her monitoring skills would be specialized to the team, or, perhaps, the way of working of the team members and the way of monitoring by the owner–manager–entrepreneur would be co-specialized. When this would be the case, team production theory holds that the classical firm is no longer the most efficient governance form and that our team should turn to the mediating hierarchy solution of the corporation.

## 5 | PROFIT AND PAYMENTS IN THE CORPORATION

How do the insights from principles four and five generalize to the case of the corporation? Remember that in the governance structure of the corporation, all stakeholders, including shareholders, are at the bottom of Figure 2. The firm is a legal person that owns the collective-

[14]That the distinction is important can be further illustrated by also allowing for heterogeneity in the monitoring skills of owner-manager-entrepreneurs. This is another way in which our owner–manager–entrepreneur could earn an above normal return: her superior skills in monitoring truck loading teams would result in a payment above opportunity costs. However, this would not be a temporary Schumpeterian/entrepreneurial profit, but (assuming inelastic supply of superior monitoring skills) a sustainable Ricardian/efficiency rent.

level resources (such as physical assets and brand names) and that is governed by a mediating hierarchy in which managers assemble and monitor teams under the supervision of an independent board to which resource suppliers (including shareholders, employees, and managers themselves) have given up control rights. In terms of Figure 2, the central task of this governance structure is to help interdependent stakeholders generate economic profit and divide this profit into payments to the members of the team. We now face two questions. Extending Principle 4, that profit accrues to resources *bundles* (i.e., at the collective level of the firm), we need to understand which mechanisms lead to resource bundles that result in economic profit. Extending Principle 5, that rent accrues to *individual* resources, we need to understand which mechanisms drive payments to the stakeholders that supply these individual-level resources.

The answers to these questions are visualized in Table 1 and Figure 3, and summarized in Principles 6 and 7.[15] Table 1 organizes six mechanisms that drive payments to stakeholders. On the left side of the table (Mechanisms 1–3) are three mechanisms related to "value-realized-in exchange." For these mechanisms, value appropriation is a matter of competitive bargaining in product and factor markets. On the right side of the table (Mechanisms 4–6) are two mechanisms related to "value-created-production" and one mechanism related to "value-created-in-innovation." For these mechanisms, value appropriation is a matter of pure bargaining.

First, consider Mechanisms 4–6, which drive profits. All three mechanisms result in a unique bundle of resources, which is a necessary condition for economic profit. More precisely, these mechanisms make the firm uniquely capable of producing products for which consumers are willing to pay more than for products of competing firms, and/or to produce these products at lower economic costs (where economic cost is the sum of the opportunity costs of the resources used in production). We already discussed one of these mechanisms: novelty resulting from investment under uncertainty (Mechanism 6). If a firm finds new ways of employing existing resources that increase the value that is created with these resources, then this will result in an entrepreneurial profit. The analysis is the same as for the classical firm above, with the important exception that innovation is no longer the act of an individual owner–manager–entrepreneur, but of the firm as whole. In line with Schumpeter's (1942) later work, in which he acknowledged that innovation had become institutionalized in larger firms, think of innovation in the corporation as "team innovation": innovation is the outcome of the joint actions of the firm as a team of stakeholders, rather than the actions of an individual entrepreneur.

Novelty may only result in temporary uniqueness. A successful innovation eliminates uncertainty and reveals new productive knowledge that can be imitated. However, imitation may be difficult if the resource bundle that is assembled and deployed is characterized by unique complementarities (Mechanism 5). This is a familiar theme in RBT (e.g., Adegbesan, 2009; Amit & Schoemaker, 1993; Conner, 1991). Unique complementarities imply firm-specific investments (e.g., Hoskisson, Gambeta, Green, & Li, 2018). Firm-specific investments give rise to what the organizational economics literature has referred to as "appropriable quasi-rents" (Klein, Crawford, & Alchian, 1978). Note, however, that the typical analysis in the organizational economics literature is of contracting between firms (viz., the famous General Electric and Fisher Bodies case). In contrast, here the point of the appropriability of rents is that we are dealing with a source of economic profit for the firm as a team, and that, like any source of economic profit, appropriable quasi-rents are up for pure bargaining among the team members (cf. Blair & Stout, 1999; Rajan & Zingales, 1998).

[15]An online Appendix illustrates and further details the theory by applying it to a number of examples.

**TABLE 1** The six components of stakeholder payments

| | "Normal" return | Rent | | Profit | | |
|---|---|---|---|---|---|---|
| *Component of payment* | 1. Opportunity cost | 2. Efficiency rent | 3. Monopoly rent | 4. Entrepreneurial profit | 5. Appropriable quasi-rent | 6. Returns to scale |
| *The mechanism that drives payments* | Scarcity | Heterogeneity | Market power | Novelty | Unique complementarity | Scale advantage |
| *The actions (and conditions) from which payments arise* | Market transaction (with outside option) | Market transaction (with inelastic supply) | Market transaction (with [artificially] restricted supply) | Investment (under uncertainty) | Investment (with firm-specific component) | Investment (with increasing returns) |
| *Value appropriation process* | Competitive bargaining | Competitive bargaining | Competitive bargaining | Pure bargaining | Pure bargaining | Pure bargaining |
| *Value creation process* | Exchange | Exchange | Exchange | Innovation | Production | Production |

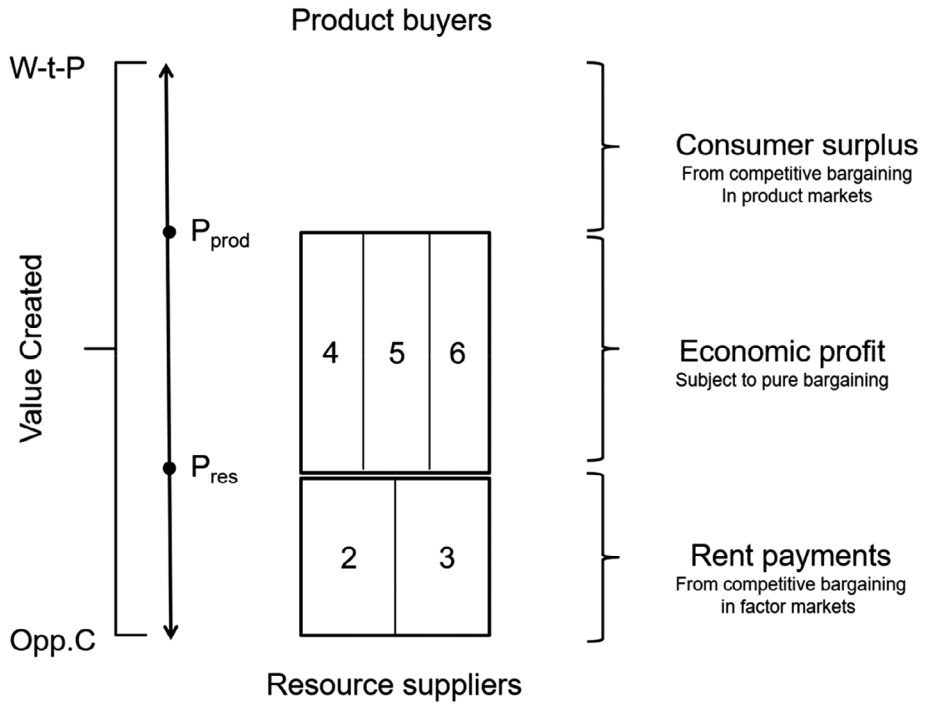


**FIGURE 3** The mechanisms underlying economic profit and stakeholder payments (numbers refer to the components of payment in Table 1)

A third mechanism that may give rise to economic profit, but that has received less attention in RBT than complementarities, is scale advantages resulting from increasing returns (Arthur, 1994). Increasing returns are mechanisms of positive feedback and come in two varieties: demand-side mechanisms (such as network externalities and technological complementarities) and supply-side mechanisms (such as scale economies and experience effects). Demand-side mechanisms increase the willingness-to-pay of buyers, and supply-side mechanisms lower (economic) costs, as a function of the scale of a firm's activities. Again, we have a source of economic profit (returns-to-scale) that depends on a unique collective-level characteristic: the scale of the resource bundle assembled in the firm.

Summarizing the sources of economic profit: firms may earn above normal returns (a) from novelty that results from investments under uncertainty; (b) from unique complementarities that results from firm-specific investments, and/or (c) from scale advantages that result from investments with increasing returns. Note that all of these mechanisms are related to investments in the bundle of resources controlled by the firm (as a legal person) and play out over time: they are collective-level and dynamic/disequilibrium phenomena

**Principle 6.** *Economic profit is the result of resource bundles characterized by (1) novelty, (2) unique complementarities, and/or (3) scale advantages.*

Next, consider Mechanisms 1–3. These three mechanisms translate competitive positions in product or factor markets into prices. Focus, for the moment, on prices in factor markets. Here the firm, as a legal person, engages in competitive bargaining with its resource suppliers

(i.e., managers act on behalf of the firm as a legal entity). Payments to resource suppliers first of all reflect their opportunity costs (Mechanism 1). In addition, suppliers may be paid a rent (i.e., receive a payment above their opportunity costs) if they are in a favorable competitive bargaining position. We already discussed one source of rent (an efficiency rent) in our discussion of rent in the classical firm: resource suppliers may be paid above their opportunity costs for the superior quality of their resources (Mechanism 2). The other type of rent is also familiar, even though it is not always associated with RBT: a supplier may also be paid above her opportunity costs if she is in a monopoly position (Mechanism 3).

So we have three sources of stakeholder payments that play out through competitive bargaining, one of which is the opportunity costs of the resources supplied, and two of which are rent mechanisms. Of course, these three components of payments do not exhaust all the possible sources of payments: another component of a stakeholder's total payment is the outcome of pure bargaining over the economic profit of the firm. Depending on how this bargaining plays out, a stakeholder can also share in any economic profit resulting from novelty, unique complementarities, and scale advantages

**Principle 7.** *Stakeholder payments are the sum of (1) opportunity costs, (2) rent payments, and (3) the outcome of pure bargaining over economic profit.*

Finally, consider product markets. In addition to engaging in competitive bargaining with suppliers of resources in factor markets, the firm, as a legal person, also engages in competitive bargaining with buyers in product markets. As was the case for factor markets, what this means in practice is that managers engage in this bargaining on behalf of the firm. In order for the firm to make a profit, the price resulting from competitive bargaining in the product market needs to exceed the sum of the prices for the resources used in production resulting from competitive bargaining in the factor market. As illustrated in Figure 3, the possible sources of such a positive difference between the price in the product market and the prices in the factor market are the three profit mechanisms discussed above (novelty, complementarity, and scale).[16]

Figure 3 visualizes how the six mechanisms play out in a coalitional logic based on a team production view of the firm. Remember that in this figure the firm is a legal entity that governs a nexus of contracts. The firm, as a legal person, is represented by a mediating hierarchy. This mediating hierarchy serves two tasks. First, the managers in this hierarchy act on behalf of the firm and contract with resource suppliers in factor markets and buyers in product markets. Second, the independent board at the apex of the hierarchy oversees the pure bargaining over the economic profit generated by the firm as a team of interdependent stakeholders, and channels this bargaining in ways that stakeholders find fair and that engender the trust that is necessary to stimulate firm-specific investments and counteract shirking.

An important implication of Figure 3 is that it provides us with a sharp understanding of the sources of above normal returns to shareholders of a corporation.[17] Like any group of stakeholders that supplies resources to the firm, shareholders are at the bottom of the figure. And like any group of stakeholders, their payments are the sum of opportunity costs, rent payments,

[16]To be precise, we should distinguish characteristics of the *bundle* of resources (novelty, unique complementarities, and scale advantage) from single resources such as a brand name or patent that the firm, as a legal person, owns. Such single resources can also be a source of profit, but all the theoretical arguments developed above apply: these resources result from collective-level investments over time and the profit they generate is up for pure bargaining.

[17]The online Appendix develops this point in more detail.

and the outcome of pure bargaining over the economic profit that may accrue to the firm as a team (Principle 7). The first of these, opportunity costs, will (by definition) only result in a normal return (say, the going interest rate, plus a compensation for the relative risk of the investment). Note that money is a homogeneous resource, and that there is therefore no room for a rent payment. In liquid capital markets, monopoly rents are also ruled out. It follows that above normal returns to shareholders derive entirely from pure bargaining over the economic profit that accrues to the firm as a team. Consider that the central purpose of the firm's governance structure is to provide a fair division of this profit in order to reduce shirking and stimulate firm-specific investments. Note that shareholders do, in principle, make firm-specific investments (the corporate form locks in their capital), but that liquid markets for their shares largely protect shareholders from hold-up by other stakeholders. Based on this analysis, it is difficult to see why shareholder primacy would result in an efficient governance system for the corporation.

## 6 | DISCUSSION

This article has gone back to first principles to develop a stakeholder RBT that explains both the generation and appropriation of profit. In doing so, the explicit objective has been to retain the rigor of RBT's economic reasoning, while highlighting the collective and dynamic nature of value creation. This has been done by integrating a team production view of the firm into the coalitional logic of Brandenburger and Stuart (1996).

The first contribution of the paper is to the integrative potential of RBT in the context of the economic turn in strategy (Rumelt et al., 1991). The essence of this economic turn is the balancing act between the rigor of economic reasoning and the managerial relevance of the theories that can be derived from such reasoning. The general strategy is to accept the model of perfect competition as an essential theoretical benchmark and to explain the existence of and heterogeneity among firms in terms of market frictions (i.e., deviations from perfect competition) (Mahoney & Qian, 2013; Rumelt et al., 1991). This has also been the strategy followed here. However, in order to capture the collective and dynamic nature of value creation, the starting point of the theorizing has not been the neoclassical approach to analyzing competition that informed the early and seminal contributions to RBT (Barney, 1986, 1991; Peteraf, 1993), but its reinterpretation in terms of CGT (Makowski & Ostroy, 2001), as reflected in the coalition logic of Brandenburger and Stuart (1996).

While the application of CGT to strategy has already resulted in a fertile stream of research (Gans & Ryall, 2017), this research, like the early RBT, takes a unitary agent view of the firm.[18] In contrast, the theory developed here follows suggestions that RBT should adopt a nexus of contracts view of the firm (Barney, 2018; Coff, 1999). The crucial conceptual move has been to integrate a specific nexus of contracts view, team production theory, into Brandenburger and Stuart's coalitional logic. In the context of the economic turn in strategy, the resulting framework can be understood as putting one particular, and arguably the most fundamental market friction center stage: the contracting problems that emerge when team production and team innovation make stakeholders interdependent. Once we step away from the unitary agent view

[18]Lippman and Rumelt (2003a, 2003b) are a partial exception in the sense that they apply CGT to imputing returns to individual resources. They do not, however, adopt a nexus of contracts view of the firm and do not provide an explanation of returns to the stakeholders that supply resources.

of the firm and acknowledge that the essence of the firm is to provide a governance structure to overcome contracting problems among stakeholders, we have a rigorous framework (Figure 2) that explicitly revolves around the tension between individual and collective interests that is central to understanding the interplay between value creation and value appropriation.

The integrative potential of this framework lies in its compatibility with at least two major strands of RBT scholarship other than the "High Church" of RBT that has been the main focus of the paper. First, the view of the firm as a governance structure is consistent with a property rights perspective on RBT (Foss & Foss, 2005; Kim & Mahoney, 2010) and future research could use the framework developed here to further explore the link between RBT, property rights theory, and a stakeholder approach to governance (cf. Amis, Barney, Mahoney, & Wang, 2020; Bridoux & Stoelhorst, in press; Hoskisson et al., 2018; Klein et al., 2012). Second, although the theory developed above is purely verbal, it is compatible with more formal analyses based on a CGT logic (Gans & Ryall, 2017; Lippman & Rumelt, 2003a, 2003b; MacDonald & Ryall, 2004). Future work in this stream of research could benefit from adopting a team production view of the firm. For instance, given the importance of fairness concerns in the process of pure bargaining over the profits generated by the firm as a team, such research could capitalize on CGT models that explicitly combine efficiency and fairness criteria (e.g., Ostmann & Meinhardt, 2008).

The second contribution of the paper is to use the framework in Figure 2 to develop a stakeholder RBT that explains both the generation and appropriation of profit (cf. Barney, 2018). This theory is a stakeholder theory in the sense that it does not equate the firm with the interests of shareholders, or any other group of stakeholders. In fact, the essence of taking a nexus of contracts view of the firm is that all stakeholders that supply resources to the firm, including shareholders, are at the bottom of Figure 2. What is left in the box representing the firm in the figure is the governance structure that channels the pure bargaining over the surplus that the firm, as a team of interdependent stakeholders, generates. The theory uses this view to derive a set of unambiguous and mutually coherent definitions of RBT's core concepts.

The upshot of this conceptual groundwork is that it explicitly distinguishes individual-level from collective-level, and equilibrium from disequilibrium concepts. Over its 30-year history, RBT has ranged across a number of dependent variables, including economic profit (e.g., Barney, 1986, 2018), competitive advantage (Barney, 1991; Peteraf, 1993), various types of rent (e.g., Amit & Schoemaker, 1993; Rumelt, 1987), and payments (Lippman & Rumelt, 2003a). RBT scholarship has similarly ranged across a number of mechanisms that may explain these dependent variables. These mechanisms include uncertainty (e.g., Barney, 1986), heterogeneity (e.g., Barney, 1991; Peteraf, 1993) and complementarities (e.g., Adegbesan, 2009; Amit & Schoemaker, 1993; Conner, 1991). By going back to first principles, the theory developed here contributes to earlier work that has sought to clarify the relationships among some of these variables (e.g., Becerra, 2008; Foss & Knudsen, 2003; Peteraf & Barney, 2003). It does so by giving them all a clearly defined place in one integrated theoretical framework.[19] The important insight that emerges from this is that profit is driven by dynamic and collective-level mechanisms and that its division is a matter of pure bargaining. The

[19]Based on Figures 2 and 3, the apparent exception is "competitive advantage." This is in keeping with the more recent RBT scholarship (for instance, in Barney (2018), the dependent variable is profit), which seems to have largely given up on the earlier focus on competitive advantage (for critiques of competitive advantage as a concept, see Lippman & Rumelt, 2003a, 2003b; Coff, 1999). However, the "added value" concept that is central to the CGT logic underlying Figure 1 is closely related to competitive advantage (Brandenburger & Stuart, 1996) and can be used to clearly define the concept (MacDonald & Ryall, 2004).

corollary is that the quality of a firm's governance can itself be a source of economic profit: firms that are able to resolve the pure bargaining over profit in ways that stakeholders consider fair are more likely to counteract shirking and stimulate firm specific investments—and thus more likely to generate profit.

That profit is driven by dynamic mechanisms also points to an important boundary condition of the theory. In essence, the theory has taken Figure 2 as its starting point and then pushed its underlying equilibrium logic as far as it can go. This approach ultimately runs into a boundary condition that applies to all High Church theorizing: to retain its rigor it has to treat resources and capabilities as exogenously given. This points to the need for a complementary RBT in which capabilities emerge endogenously (e.g., Zollo & Winter, 2002). One way of seeing the Low Church of RBT (e.g., Grant, 1996; Penrose, 1959; Teece et al., 1997) is in these terms. The *team* production view of the firm and the emphasis on the importance of unique *bundles* of resources above are compatible with the focus on collective knowledge and capabilities in the Low Church. Future research in the Low Church could complement the theory developed here by taking a team production view as a starting point for a theory of the development of collective knowledge and capabilities based on an evolutionary, as opposed to equilibrium logic.

The third contribution of the paper is to clarify the debate about shareholder primacy (Freeman et al., 2004; Jensen, 2002; Sundaram & Inkpen, 2004). Stakeholder theorists have long argued against the idea of putting the interests of shareholders above those of other stakeholders, but their arguments have mostly been formulated in terms of normative ethics. In contrast, the theory developed above results in a purely economic argument against shareholder primacy, albeit in nuanced form. An important insight from the paper is that above normal returns to shareholders result from their privileged position in a firm's governance structure, as opposed to a competitive market logic. Team production theory gives an economic rationale for this privileged position for the classical firm, but not for the public corporation. The nuanced critique of shareholder primacy resulting from a team production view of the firm, then, is that shareholder primacy is unlikely to be efficient when value creation makes stakeholders highly interdependent.

This also clarifies Barney's (2018) fundamental point that an RBT based on a shareholder primacy view implies an inconsistency between the theory's models of profit generation and appropriation. The theory developed above suggests that Barney's point can be understood as articulating the insight that no rational actor will submit to a governance structure in which she has no claim on the firm's economic profit—defined as the residual value that remains after competitive bargaining. Team production theory corroborates this point for the corporation, but not for the classical firm. In the classical firm the governance structure is such that an individual owner–manager–entrepreneur appropriates the residual value that remains after other resource suppliers have been paid their opportunity costs. This is a governance solution that is similar to shareholder primacy and to which RBT still applies. The point is rather (and this is in line with Barney's analysis) that the classical firm is unlikely to be an efficient governance structure in firms where stakeholders are highly interdependent, effort is difficult to monitor or imperfectly related to outcomes, and value creation requires firm-specific investments. Of course, in modern knowledge-driven firms this is likely to be the case.

What the current paper also ads to Barney's (2018) point is that it helps explain why we still see governance practices aimed at maximizing shareholder value. This is important because if the theoretical argument is correct, and shareholder primacy is an inefficient governance form for a knowledge economy that no rational actor would accept, then why do we still see it in practice? The answer to this question suggested by the theory above is that the division of

economic profit is determined by pure bargaining, and that understanding the outcome of pure bargaining takes us beyond the behavioral model of a rational self-interested actor that underpins the economic logic from which we derive the insight that shareholder primacy is likely to be inefficient. Pure bargaining is not a process driven by a purely economic logic, but by morality. Therefore, understanding the outcome of pure bargaining forces us to go beyond the behavioral model of *Homo economicus* and consider the role of fairness norms, as well as the role of sociopolitical contestation in shaping these norms.

An implication of the theory above is that if stakeholders can somehow be convinced that shareholder primacy is fair, then it can still be an efficient form of governance, despite the lack of an economic rationale. The institutional economist Veblen (1899, p. 190) referred to institutions as ultimately taking the form of "habits of thought." Our habits of thought about corporate governance derive from both formal institutions (i.e., legal rules) and informal institutions (i.e., shared norms), but these are themselves outcomes of past sociopolitical contestation. Seen in this light, discussions about the purpose of the firm emerge as part of the sociopolitical contestation about how governance should work and, ultimately, as part of the pure bargaining over firms' profits. Arguments for and against shareholder primacy are part of this bargaining.

Strategy theory, and the central place that teaching this theory has in business schools, has arguably been one of the conduits for promulgating the idea that the purpose of the firm is to maximize shareholder value. In fact, that there is an *economic* argument against shareholder primacy may be the most controversial message of a stakeholder RBT for at least some strategy scholars—simply because their habits of thought have been formed by an economic literature that has long been dominated by the agency theory view of the firm, in which shareholders are the putative owners of firms and managers their agents. However, an RBT grounded in a team production view of the firm demonstrates that the notion of shareholder primacy is exactly that: a habit of thought. The popular notion that shareholders are the owners of corporations is denied by legal scholars (Bainbridge, 2003; Blair & Stout, 1999; Heminway, 2017), and, as the theory developed in this article shows, the argument that shareholder primacy is the most efficient form of governance (cf. Jensen, 2002) only holds for the relatively simple context of the classical firm. One implication of a stakeholder RBT, then, is that the strategy field may need to reconsider its position on shareholder primacy and confront the reality of the tough moral questions about the distribution of the welfare generated by firms that are at the heart of any economic system.

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