Stakeholder Reporting Process – A Link to Balance the Balanced Scorecard

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Abstract

In strategic management one of the vexed issues is how to include stakeholder input into strategy to enable more effective and accountable implementation. Implementation tools such as the Balanced Scorecard appear to be popular with organisations with widespread applications yet most stakeholders do not feature as an important balance. Should stakeholders be part of the Balanced Scorecard process? This paper attempts to create a conceptual link between Stakeholder Reporting and Kaplan and Norton’s Balanced Scorecard. From a review of Balanced Scorecard literature and case studies, stakeholder input is often restricted to some internal parties who could jeopardise an organisation’s strategy implementation. Other stakeholders are often ignored or marginalised by the strategy implementation process. This paper reviews stakeholder models, and their limitations. An examination of the adaptation of Stakeholder Reporting, (an auditing model) as a framework to include stakeholders in the balanced scorecard is proffered. Stakeholder reporting develops a process to link Balanced Scorecard with strategy resultant from critical stakeholders. This conceptual model provides more balance with different stakeholder groups to ensure strategy implementation is followed with balanced measures.

Keywords: stakeholder, strategy, balanced scorecard, accountability

Stakeholders and strategy

A number of authors (Freeman, 1984; Alkhafaji, 1989; Anderson, 1989; Brummer, 1991; Brenner et al., 1991; Clarkson, 1991; Goodpaster, 1991; Hill et al., 1992; Wood, 1991a; Wood, 1991b; Googins et al., 2000) cite the benefits of involving stakeholders in strategy making. Stakeholders "must participate in determining the future direction of the firm in which [they have] a stake", (Evan & Freeman, 1988, p. 75). However Bigelow et al. (1993) suggest that strategic decisions require consideration of stakeholder interests, the decision typically rests with the organization. Although this could be quite frustrating for stakeholders who have partial input into strategy where stakeholders, "are offering, asking and in some cases demanding to be involved in planning, production and distribution processes", (Duncan et al., 1997). LaBerge et al. (2000, p. 49) defines stakeholder strategy as, “the mechanism by which companies define their stakeholder goals, expectations and commitments. It is based on the company’s core values, overall business plan, information about the external environment, and dialogue with stakeholders”. These arguments could be synthesised into the following statement; "The objectives of the firm should be derived from balancing the conflicting claims of the various ‘stakeholders’ in the firm. The firm has a responsibility to all of these and must configure its objectives so as to give each a measure of satisfaction", (Ansoff, 1965, p. 34).

Stanford Research Institute (1963) developed a definition of stakeholders as, "those groups without whose support the organization would cease to exist". Ackoff (1994) includes employees, suppliers, customers, investors, creditors, debtors, government and the public, as an organisation’s stakeholders. Mitchell et al. (1997) defines stakeholders by their salience,
that is who or what matters, using three distinguishing dimensions of power, urgency and legitimacy. Post et al. (2002) divides them into primary (customers, suppliers, employees and investors) and secondary (government, social activist groups and others) stakeholders. Stakeholders come and go in strategic terms due to environmental changes. For instance diversity stakeholders have gained prominence since September 11 or government stakeholders (ATO and ACCC) since the implementation of GST.

"It is clear that organizations cannot maximise the achievement of the wants, needs and desires of all its stakeholders. On the other hand the optimisation of a partial group of stakeholders will not be sufficient as it will have adverse repercussions on the values of other stakeholders”, (Feuer et al., 1995, p. 47). Whilst, “broadly representative stakeholders groups are constructing collective views of complex problems and developing management strategies”, there are common implementation weaknesses such as lack of strategic direction, limited public participation, and commitment in stakeholder collaboration (Margerum, 1999, p. 181).

Balanced Scorecard and Stakeholders

The Balanced Scorecard as defined by Kaplan and Norton (1992) has received widespread acclaim from management practitioners and researchers alike. Near the end of the 1990’s it was estimated that 60% of Fortune 500 companies have in some way implemented the Balanced Scorecard, (Silk, 1998). Even a tool with such widespread support has some limitations particularly when considering stakeholders input. By its design the Balanced Scorecard process principle # 1 requires the translation of the organisation vision by senior managers (Kaplan & Norton, 2001b). Thus the Balanced Scorecard fails to recognise explicitly the contributions of important stakeholders, such as employees and suppliers, (Atkinson et al., 1997; Sa, 2002). Williamson (1985) states that Managers of a firm are one of its most important and powerful stakeholders who are likely to practice opportunistic and self aggrandizing behaviour, for instance Enron senior management with their reward entitlements. This is further compounded where there is little consensus among managers on the relative importance of a company’s stakeholders, for instance investors, customers or suppliers, (Duncan et al., 1997).

According to Gering et al. (2000) inherent in its design each dimension of the balanced scorecard represents a stakeholder group such as: shareholders (finance), customers (customer), management (operations) and learning and growth (employees). This then suggests that “The Balanced Scorecard as a tool fails when it tries to balance the interests of stakeholders. When this happens, the Balanced Scorecard ceases to become a focused operationalisation of a coherent strategy. Instead, it has a tendency to become a list of indicators reflecting the preferences of each stakeholder. These scorecards balance the interests of the stakeholders against each other”, (Gering et al., 2000, p. 19). An adaptation to accommodate stakeholders is proposed by O’Neil et al. (1999) where the Customer dimension is substituted with the heading of Stakeholder. This implies that stakeholders have no interest in the other three dimensions.

If management fails to properly communicate strategy (one way as opposed to two way [Atkinson et al., 1997]) to its value chain such as distributors then the Balanced Scorecard measures become inaccurate or subjective; benchmarking is inappropriate; conflict and tension arise; resulting in the forfeiture of management control benefits. In a study involving an organisation’s distributors that there was no opportunity in the Balanced Scorecard process
for stakeholders to participate in the setting of the measures. In a subsequent period the company revised the measures in consultation with distributors, improvements in distributor performance and a reduction of conflict occurred (Malina et al., 2001)

Kaplan and Norton (2001a) recognised that establishing effective relationships with external stakeholders is a high level process albeit an internal business perspective. Although Atkinson et al. point out that the Balanced Scorecard should also, “identify the role of the community in defining the environment within which the company works”, (1997, p. 26). Attempts have been made to include stakeholders into the Balanced Scorecard process with the development of Stakeholder Scorecards (Atkinson et al., 1997). However Kaplan and Norton (2001a) point out that this approach is inadequate to describe the strategy of an organisation. Stakeholder scorecards do not include drivers to achieve goals such as innovation or enhanced customer management. This as Kaplan and Norton (2001a) put it, is the ‘how’ behind strategy.

The only way at present to integrate external stakeholder strategy needs with the Balanced Scorecard is the process of collaboration with key stakeholders to derive a common strategy with common key performance indicators before the application of the Balanced Scorecard process. Kaplan conducted this technique in the development of the National Women’s Health Quality Initiative (Inamdar et al., 2000). The deficiency of this technique is the quashing of differences and disparate outcomes that is often the root of disparate stakeholders and their causes. This is also reinforced by Margerum’s (1999) criticism earlier. Could stakeholder involvement models be instigated before the Balanced Scorecard?

**Stakeholder involvement models**

Some models (Freeman, 1984; Frederick et al., 1992; LaBerge et al., 2000) by their inherent design are still flawed and succumb to Williamson’s (1985) criticism of management practices with managers interpreting and implementing strategy without being accountable to stakeholders for their actions. Even where models (Koch et al., 1998; McDaniels et al., 1999; Supalla, 2000; Stoney, 2001) do have a more transparent process for decision making, problems occur. These models have problems in that they are cumbersome and involve the monitoring, intervention or interpretation by a specialist. Also some stakeholder decision making models (Keeney et al., 1999; Sinclair et al., 1999; Gregory, 2000; Walters, 2000) are project specific with usually one major decision rather than the ongoing management of an organisation. Other models (Blair et al., 1992; Koch et al., 1998; Sinclair et al., 1999) are industry specific and lack general application. Huse et al. (1996, p. 215) lament that, “few studies, either empirical or theoretical have tried to integrate the various perspectives of principles and processes of stakeholder management into a holistic dynamic model”. What is required is a generalisable process that involves all stakeholders in a continual cycle for setting strategy that is also easy to understand and implement.

**Stakeholder Reporting Approach**

Stuart (1997) says that calls have been made for stakeholder reporting to be of the same quality as stockholder reporting. Partly in response to these calls, In November 1999 the Copenhagen Charter was launched. This Charter more formally known as Social auditing AA1000 - Stakeholder Reporting standard was a collaborative effort between Ernst & Young, KPMG, Price Waterhouse, and the House of Mandag Morgen. It began with research from eleven Danish private and public organisations where they desired to not only communicate their values but also prove that they are living up to such values (Ernst et al., 1999). The
The stakeholder reporting process is indicated in Figure 1. Apart from the 'verify' (audit) step the rest of process is within the capability of most Organisations.

Organization values and strategies can be formed by the input of key stakeholders through a dialogue process. This ensures that stakeholders needs are noted and acted on as part of the organization’s implementation of strategy. The organization’s goals, mission and vision form the foundation for stakeholder accountability by measuring these against stakeholders expectations, demands and values. By matching these values an organization builds an identity, sense of belonging and loyalty in its most important relationships (Ernst et al., 1999).

The fourth step in the Stakeholder reporting model could include the establishment of key measures for the Balanced Scorecard dimensions. In this way stakeholders are not categorised according to the Balanced Scorecard dimensions therefore stakeholders can have access to one or more Balanced Scorecard dimensions and their associated key measures. For instance an ethical investor may be interested in outcomes in both financial and internal business process dimensions of the Balanced Scorecard.

Organizations will be able to perform their duties with more confidence knowing that the measures of achievement have been promulgated and are acceptable to key stakeholders. The fact that key stakeholders have an input into which key measures are used has enabled better relations and accountability. Another benefit of this process is the transparency of decisions that should avoid strategic surprises from stakeholders occurring. Ernst et al. (1999) suggest that Stakeholder Reporting works with the preparation of verified (audited) stakeholder reports. These reports quantify and comment on objectives for previous and future years. Whilst the process of audit requires the verification step, managers in practice do not require this step although it could be useful where trust is an issue between some stakeholders.
The stakeholder reporting process through the use of an improved information system means that an organisation could react quicker than a traditional information system such as financial reporting. This is due to stakeholder dialogue rather than poor financial results being the catalyst for investigation and subsequent strategy.

Most models assume that all stakeholders are at the same stage in an issue's life cycle at the same time (Bigelow et al., 1993). Due to its cyclic nature of stakeholder reporting the ‘dialogue with stakeholders’ allows the ability of some stakeholders to educate others of the current status of issues.

Although this stakeholder reporting process may be at an organisation level, decisions made at a divisional or SBU level could still escape the scrutiny of the Stakeholder Reporting process. This is problematic if the stakeholder reporting process is kept for the top level only. If this process is applied at lower levels such as divisional or SBU yet linked to the upper level then inconsistencies in terms of single stakeholder driven strategy would not occur.

Feurer et al. (1994, p. 45) note, "the value system of each of the organization's stakeholders comprises short-term and long-term characteristics". This is not hard to accommodate in stakeholder reporting as stakeholders are invited to set their evaluative criteria along the way. Incumbent on each stakeholder is the postulation of criteria such as critical success factors, key performance indicators, objectives, targets, and values that will conform to their time frames.

Donaldson et al. (1995) conclude that there are three approaches to stakeholder theory: descriptive/empirical, instrumental and normative although different are mutually supportive and that normative (logic & rationality) is the basis underpinning stakeholder theory. The stakeholder reporting model has logic and rationality although at times it is suggested that another dynamic is at work which at times is irrational. This irrationality is more to do with power, greed, politics or other non rational manifestations. This model may not alert stakeholders to circumstances such as these particularly if they are covertly managed by some stakeholders. Behavioural theory assumes firms have multiple centres of power, from groups within and outside. There are many sub-goals for an organization ie production, inventory, sales, market share, profit. These can be ambiguous and often reflect bargaining among stakeholders (Cyert et al., 1963). Trade-offs or bargaining are often tactics to avoid total rejection of strategy. This would not change under this stakeholder reporting model. “The dilemma that is often faced by managers is the degree to which there may be a trade-off between the efficient strategy and the moral strategy”, (Stainer et al., 1996, p. 12). Morally acceptable strategies whilst desired would not necessarily be guaranteed by this stakeholder reporting process unless all stakeholders were committed to these particular aims at the outset.

**Conclusion**

The stakeholder reporting process is a strategic tool that managers can use in conjunction with the Balanced Scorecard process to remain accountable with key stakeholders. This process allows for the collection of stakeholders information, use of knowledge and expectations from key stakeholders that offers an organisation strategic input and a more structured approach for effective outcomes. This stakeholder reporting process has a much wider application than simply financial auditing. Managers should consider its use in obtaining and ensuring balanced stakeholder driven strategy. The stakeholder accountability process proposed in this
paper has normative roots in its implicit design. What is now needed is a thorough field test to give it some empirical support. This should be the focus of future work in the area.

References


Stanford Research Institute, 1963.


