Putting stakeholders input into strategy formulation – A conceptual approach

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Abstract
Managers are not always the best strategists when the outcome is self serving or does not take into account other stakeholders and their needs. Owners including boards of directors may not always have the organization’s long term interests in mind when contributing to strategy. Other stakeholders are often ignored or marginalised by the strategy formulation 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 strategy formulation. This conceptual model enables a more constructive communication framework and universal strategy development process.

In strategic management one of the vexed Nouns is who should be the originator of strategy and its formulation. This Noun confounds many organisations with inefficient use of resources, strategic inaction, inappropriate strategies to name a few manifestations. These manifestations often result in mediocre results or even significant losses for the organisation and its stakeholders. This begs the question as to which stakeholders should be involved in strategy formulation?

Who sets strategy for whom?
Authors such as Hayek (1977) and Friedman (1985) suggest that managers are trustees or agents for shareholders. As agents, managers must carry out the principals (shareholders) wishes for which they are remunerated (Marcus, 1996). However Herman (1981) suggests that managers have “active” power and control whilst boards of directors have “latent” power that was “exercisable within limits, under constraints, and on a contingent basis.” Where boards exercise this latent power it is most certainly a power of review, which implies no strategy initiation. However directors can initiate strategy by virtue of their “connections” or expertise.

Perhaps one group should have control over strategy. The question remains who in an organization should have the power to set and direct strategy given the dichotomy at the top?

If we consider the case of owners or their representatives, (the board of directors) we see that investors have been given too much emphasis in corporate planning by management of public companies who have focused their efforts entirely on investors and creating value for them (Byrne, 1994). This in itself is not so bad, however when the value is created by short term strategies such as asset stripping, for instance Air New Zealand’s treatment of Ansett, this does not truly represent the shareholders interests, when considering sustainability of their investment.

The public trading of shares means that what constitutes “owners interests” could potentially be a “moving target” depending on who purchases those equities and their reasons for doing so. Robert (1993) noted that Institutional investors are moving money around each quarter chasing short-term profit producing lower returns in the long term. Institutional shareholders have sometimes been able to defeat anti-takeover proposals after consulting with management. This then suggests that some owners and managers have the propensity to act contrary to the strategic imperatives of the organization (Heard, 1987).

The case for managers also leaves one wondering with an observation by Williamson (1985) where he 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).
Japanese managers are driven to making a societal contribution through achieving profit for expansion which is a contrast to US managers which are dedicated to making a societal contribution through shareholder returns, in which they emphasise more than Japanese managers (Carroll, 1991). This is also supported by The Economist which states, "In America, for instance, shareholders have a comparatively big say in the running of the enterprises they own, workers...have much less influence. In many European countries, shareholders have less say and workers more...[In Japan]...managers have been left alone to run their companies as they see fit...namely for the benefit of employees and of allied companies, as much as for shareholders (1992: 92).

Payne (1991) found many inadequacies of decision and policy making processes in both public and private sectors to address social and economic threats. For instance NAB’s decision to close rural branches in order to make profit to offset the losses of its US subsidiary, HomeSide. These inequities occur due to self serving biases (Bradley, 1978, Gioia et al, 1985) and actor-observer biases (Jones et al, 1971) cause stakeholder neglect or misunderstanding (Payne, 1991). Stakeholders motives can also overlap, for instance employee shareholders in a restructure could have a significant conflict with a reduction of jobs versus returns on their investment (Duncan et al, 1997).

**Stakeholder strategy**

Arguments above 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. Profit which is a return on investment to the stockholder is one of such satisfactions, but does not receive special predominance in the objective structure" (Ansoff, 1965: 34).

LaBerge et al (2000: 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.

**Who are an organization’s stakeholders?**

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 organization’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. Whereas Morden (1999) defines stakeholders within three levels including, internal, immediately external and external to the enterprise. 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 (ATO and ACCC) since the implementation of GST.

**Value of stakeholders input into 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, however few have any empirical evidence that their inclusion has contributed in terms of acceptable outcomes to key stakeholders. Kotter et al (1992) found that companies over an eleven year period that emphasised three stakeholder groups including customers, employers, and shareholders outperformed in revenue and stock value those companies with only one or two stakeholders emphasised. This is also confirmed by Berman et al (1999)

Stakeholders "must participate in determining the future direction of the firm in which [they have] a stake" (Evan & Freeman, 1988: 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).

Can stakeholders agree to strategy?
The question must be raised of which stakeholders matter and who should, rather than could, contribute to strategy development? Freeman (1984) raises several generic strategies that serve some or all stakeholders:
- Narrow stakeholder strategy; maximise benefits to one or a small set of stakeholders,
- Financial strategy; maximise benefits to shareholders,
- Utilitarian strategy; maximise benefits to all stakeholders,
- Social justice strategy; raise the level of the worst-off stakeholders,
- Social harmony strategy; maintain or create social harmony.

"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", (Feurer et al, 1995: 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: 181).

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 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 organization.

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: 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 generalizable 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 organizations 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 stakeholder reporting process is indicated in Figure 1. As the process is circular it is based on the Total Quality Management premise of continual feedback and improvement. Apart from the “verify” (audit) step the rest of process is within the capability of most Organizations.

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).

Figure 1 about here

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.

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 performance indicators 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.

The stakeholder reporting process through the use of an improved information system means that an organization 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. (See Figure 2).

Figure 2 about here

Discussion

Most models assume that all stakeholders are at the same stage in an Noul'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 other stakeholders to educate others of the current status of Noul.

Although this stakeholder reporting process may be at an organization 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.

Feuerer et al (1994: 45) note that "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, values that will conform to their time frame orientations.

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 in the various examples in this paper suggest 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 i.e. production, inventory, sales, market share, profit. These are ambiguous and often reflect bargaining among stakeholders (Cyert et al, 1963). Trade-offs or bargaining is often a tactic 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: 12). Morally or ethically 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 to remain accountable with key stakeholders. This process allows for the collection of pertinent information, use of knowledge and expectations from key stakeholders that offers an organization rich input and a more structured approach for effective outcomes. This process has a much wider application than simply financial auditing. Managers should consider its use in obtaining and ensuring continual 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
Byrne, J (1994) ‘Time to stop toeing the same old bottom line’, Business Week, Apr 14, p 20


Stanford Research Institute, (1963)

![Diagram of the stakeholder dialogue and reporting processes](image)
Figure 2: Stakeholder reporting allows management to react faster to changes in stakeholders' behaviour - before they impact the bottom line.