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Title: “Stakeholder accountability in strategy – a conceptual approach to disparate groups and organizational decision making” refereed paper presented at the 31st Annual Meeting of the Western Decision Sciences Institute Conference Las Vegas, Nevada, USA, April 2-5 2002.

by

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Abstract

A number of instances where stakeholder needs have not been taken account in strategy resulting in the waste of resources, lost opportunities and inappropriate activities are highlighted. A discussion on who is and who should be included in strategy development is made. Managers may not be the best to set strategy in isolation as this may become self-serving, whilst owners or their representatives, the board may not always have the organization’s long term interests in mind when contributing to strategy. Other stakeholders are often ignored by the process of strategy setting that in a number of cases has resulted in strategic problems. This paper proposes the adaptation of Stakeholder reporting as a framework to include stakeholders to enable a constructive communication framework and more appropriate strategy development process. This paper looks at the merits of such an application.

When does strategy fail due to disparate stakeholder expectations

The development of a commercial intranet that the author was involved in as project manager in the early 1990’s had strategic issues with various stakeholders having significantly different agendas. The telecommunications carrier wanting to maximise line usage with many users paying a premium for services. The employers association wanting the carrier to develop the infrastructure whilst not contributing any capital itself. This association also wanted revenue from industry suppliers, yet providing content to members for little cost. Industry players wanting cheap exclusive access to the network, whilst the members wanted access to a number of options. The stakeholder expectations proved so difficult to meet that the project never went beyond feasibility and was subsequently wound up.

In another instance of the author’s experience is where the management of an Insurance company had a significant dilemma with their owners. The owners required growth and profit, yet on the other hand they were not prepared to invest any more capital or offer part ownership to other organizations on the board which were precursors to significant growth.

A board member of a pharmaceutical company, had shares in a mining company which owned a biotech company. This board member pushing to have the organization develop a joint venture with the biotech company to produce generic pharmaceuticals, which the Biotech company had no experience. A number of organization resources were wasted to investigate and subsequently reject this proposed venture.

Then there is the situation of Management ignoring stakeholders including the owners with the requirement of having a new building. There was no compelling case to replace the old building except that to be noticed in Canberra, an organization needed a new building. This decision was undertaken by management carefully manipulating the case by trading off with the owners represented at the board table.

A vocational college that specialises in industry training and education had a number of disparate stakeholders. Some were represented on the board, whilst some were not. Board meetings resembled a battle ground with each group represented having in some cases opposite views on the strategic direction of the organization, for instance
employers groups and unions were on the board, as were heavy resource users and conservators. This made setting of a strategic direction acceptable to all near impossible. Of those who were not represented on the board went about developing their own training facilities often resulting in duplication of resources.

In another situation an agricultural processing company did not include one significant group of stakeholders in its decision making. In this case it was transport operators in the design on the inwards goods bay of a new crushing plant. After the truck drivers had unloaded they were unable to continue to drive through the bay as it was designed and were forced to reverse their 18 wheelers instead. This situation negated the cost reduction benefits of faster inwards goods receipt and the subsequent productivity due to this oversight.

A case study of an insurance company included the abuse of power by being the largest investor in Norway and a breach of ethics in a merger and acquisitions. This case also indicates one way corporate control on other stakeholders. In addition the case also indicates a failure of institutional control mechanisms on big business (Huse & Eide 1996).

"Scores of large organizations-businesses of all kinds but also government agencies, hospitals and universities-have sharply cut staff these past few years. But few have realized the expected cost savings. In some cases costs have even gone up. In many more performance has suffered…” (Drucker 1991 pA10). "Corporate downsizing has a lot in common with dieting: Nearly everyone does it, but few get the desired results. Three out of four companies slimmed down their staff in the last five years. But the majority saw little improvement in either business or productivity…” (Knox 1992 pD1).

Abuse of power by some stakeholders and waste of resources as a result of inappropriate strategies suggests that approaches to the development of corporate strategy by considering various stakeholders, needs overhauling.

**Who sets strategy for whom?**

Some authors such as Hayek (1977) and Friedman (1985) suggest that managers are trustees or agents for stockholders. As agents, managers must carry out the principal's (stockholders) 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.” Whilst boards have this latent power it is most certainly a power of review, which implies no strategy initiation, yet in the former examples board members can initiate strategy too. This does put doubt on Herman’s assertions.

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

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 this does make not truly represent the stockholders interests, when considering sustainability of their investment.

Robert (1993) noted that Institutional investors are moving money around each quarter chasing short-term profit producing lower returns in the long term. Institutional stockholders 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).

Consider also that the public trading of stocks/shares means that what constitutes “owners interests” could potentially be a “moving target” depending on who purchases those stocks and their reasons for doing so.

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. This is further compounded where there is little consensus among managers on the relative importance of a company's stakeholders (Duncan & Moriarty 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 stockholder 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[stockholders] have a comparatively big say in the running of the enterprises they own, workers…have much less influence. In many European countries, shareholders[stockholders] have less say and workers more…[I]n 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[stockholders] (1992 p92).

Payne (1991) found many inadequacies of decision and policy making processes in both public and private sectors to address social and economic threats. These biases occur due self serving biases (Bradley 1978, Gioia & Sims 1985) and actor-observer biases (Jones & Nisbitt 1971) cause stakeholder neglect or misunderstanding (Payne 1991).

"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 p34).

Managers have a wider responsibility to groups apart from stockholders.
Who are an organization’s stakeholders?
The question begs as to how to identify these groups.

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. However stakeholders can overlap, for instance employee stockholders in a restructure could have a significant conflict with a reduction of jobs versus returns on their investment (Duncan & Moriarty 1997).

Do stakeholders matter?
A number of authors (Freeman 1984, Alkhafaji 1989, Anderson 1989, Brummer 1991, Brenner & Cochran 1991, Clarkson 1991, Goodpaster 1991, Hill & Jones 1992, Wood 1991a, Wood 1991b, Googins & Rochlin 2000, ) cite the benefits of involving stakeholders, few have any empirical evidence that their inclusion has contributed in terms of acceptable outcomes to key stakeholders. Kotter & Haskett (1992) found that companies over an eleven year period that emphasised three stakeholder groups including customers, employers, and stockholders outperformed in revenue and stock value those companies with only one or two stakeholders emphasised.

Stakeholders "must participate in determining the future direction of the firm in which [they have] a stake" (Evan & Freeman 1988). However Bigelow & Fahey (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 & Moriaty 1997).

Can stakeholders agree to strategy?
Marcus (1996) 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 stockholders,
- 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.

Whilst, “broadly representative stakeholders groups are constructing collective views of complex problems and developing management strategies” there are common weaknesses in stakeholder collaboration. In this instance the weaknesses appear to be mainly in strategy implementation both in Australian and US applications (Margerum 1999).
LaBerge & Svendsen (2000) defines stakeholder strategy as, “the mechanism by which companies define their stakeholder goals, expectations and commitments. It is based on company’s core values, overall business plan, information about the external environment, and dialogue with stakeholders.

The question must be raised of which stakeholders matter and who should rather than could contribute to strategy development? "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 & Chaharbaghi 1995).

**Stakeholder involvement models**

Some models (Freeman, 1984, Frederick et al 1992, LaBerge & Svendsen 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 the 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 & McDaniels 1999, Sinclair & Smith 1999, Gregory 2000, Walters 2000) are project specific usually one major decision rather than the ongoing management of an organization.

Other models (Blair et al 1992, Koch et al 1998, Sinclair & Smith 1999) are industry specific and lack general application.

Huse and Eide (1996) 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.
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 lacking with some stakeholders.

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).

Day (1990, p356) laments that “the bulk of the evidence (Webster 1981, Yankelovich et al 1984) suggests that management of most big businesses – and many that are not so big – don’t know how to energize their organizations to be market driven”. Yet with Stakeholder Reporting the benefits of such a process where customers are key stakeholders means that by virtue of their early input will ensure customer driven strategy will automatically ensue at an early enduring stage rather than be an occasional input at environmental analysis. This will lead to more customer centric process such as service delivery. In addition this process is continual therefore customer needs as they change will also be factored into future strategy as well.

The fact that key stakeholders also have an input into which key performance indicators are used also enables for better relations and value to all parties. 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.
Another benefit of this process is the transparency of decisions that should avoid strategic surprises from 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).

**Discussion**

Most models assume that all stakeholders are at the same stage in an issue's life cycle at the same time (Bigelow & Fahey 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 issues.

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 allowed to be 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 and Chaharbaghi (1994) 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 all along 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 term characteristics.
Donaldson and Preston (1995) concludes that the 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 illustrations at the beginning of 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.

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 are ambiguous and often reflect bargaining among stakeholders (Cyert, & March 1963). Trade-offs or bargaining is often a tactic to avoid total rejection of strategy. This would not change under the Stakeholder reporting model as proposed by this paper.

“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 & Stainer 1996). 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 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.

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 quality 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 customer driven strategy.

"Our greatest challenge for public or private sector initiative is the resolution of any one important issue such as the drug problem, global environmental threat or economic concerns of inflation or unemployment. What is common to these and all social and business controversies are decision and policy making processes that need to be more carefully considered and improved. Management theorists and practitioners, must discover more powerful, and yet sensitive, decision and policy-making processes that can more effectively address our most troubling social and economic threats. The discipline of management has an important role to play in suggesting improved decision and policy-making forums that will provide the public with a greater sense of confidence in corporate and government leadership”, (Payne, 1991, p7).

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