The Stakeholder Approach to Business, Society, and Ethics

CHAPTER OBJECTIVES

After studying this chapter, you should be able to:

1. Define stake and stakeholder and describe the origins of these concepts.
2. Differentiate among the production, managerial, and stakeholder views of the firm.
3. Differentiate among the three values of the stakeholder model.
4. Discuss the concept of stakeholder management.
5. Identify and discuss the five major questions that capture the essence of stakeholder management.
6. Identify and discuss the concept of stakeholder management capability (SMC).
Life in business organizations was once simpler. First, there were the investors who put up the money to get the business started. This was in the precorporate period, when there was only one person, or a few at most, financing the business. Next, the owners needed employees to do the productive work of the firm. Because the owners themselves were frequently the managers, another group—the employees—was needed to get the business going. Then the owners needed suppliers to make raw materials available for production and customers to purchase the products or services they were providing. All in all, it was a less complex period, with minimal and understood expectations among the various parties.

It would take many books to describe how and why we got from that relatively simple period to the complex state of affairs we face in today's society. Many of the factors we discussed in the first two chapters were driving forces behind this societal transformation. The principal factor, however, has been the recognition by the public, or society, that the business organization has evolved to the point where it is no longer the sole property or interest of the founder, the founder's family, or even a group of owner-investors.

The business organization today, especially the modern corporation, is the institutional centerpiece of a complex society. Our society today consists of many people with a multitude of interests, expectations, and demands as to what major organizations ought to provide to accommodate people's lifestyles. We have seen business respond to the many expectations placed on it. We have seen an ever-changing social contract. We have seen many assorted legal, ethical, and philanthropic expectations and demands being met by organizations willing to change as long as the economic incentive was still present. What was once viewed as a specialized means of providing profit through the manufacture and distribution of goods and services has become a multipurpose social institution that many people and groups depend on for their livelihood, prosperity, and fulfillment.

In a society conscious of an always-improving lifestyle, with more groups every day laying claims to their pieces of the good life, business organizations today need to be responsive to individuals and groups they once viewed as powerless and unable to make such claims on them. We call these individuals and groups stakeholders.

The growing importance of the stakeholder concept to business was highlighted by several important conferences on stakeholder theory and thinking in the 1990s. The late Max Clarkson of the University of Toronto convened two conferences in 1993 and 1994 on stakeholder theory. In 1994, Juha Näsi convened a conference on stakeholder thinking in Finland. These conferences were predicated on the basic notion that the stakeholder approach to management was an idea poised for further development, especially in the business-and-society arena. In the academic community, advances in stakeholder theory have illustrated the crucial development of the stakeholder concept.

The stakeholder view was advanced even further in 1996 when Britain's then Labour Party Leader Tony Blair called for an economy characterized by stakeholder capitalism as opposed to traditional shareholder capitalism. All over the world, people began rethinking an age-old question: Who do companies belong to and in whose interests should they be run? These discussions sharply contrasted the traditional American and British view, wherein a public company has the overriding goal of maximizing shareholder returns, with the view held by the Japanese and much of continental Europe, wherein firms accept broader obligations that seek to balance the interests of shareholders with those of other stakeholders, notably employees, suppliers, customers, and the wider "community."

Within the context of stakeholder capitalism, David Wheeler and Maria Sillanpää have proposed a model for the "stakeholder corporation," which is discussed later in this chapter. For now, it suffices to summarize that Wheeler and Sillanpää believe "stakeholder inclusion" to be the key to company success in the twenty-first century.

More recently (2001), Steven Walker and Jeffrey Marr have published a book titled Stakeholder Power. Their book presents what they consider to be a "winning plan for building stakeholder commitment and driving corporate growth."

An outgrowth of these discussions is that it is becoming apparent that business organizations must address the legitimate needs and expectations of stakeholders if they want to be successful in the long run. Business must also address stakeholders because it is the ethical course of action to take. Stakeholders have claims, rights, and expectations that should be honored, and the stakeholder approach encourages that pursuit. It is for these reasons that the stakeholder concept and orientation have become an essential part of the vocabulary and thinking in the arena of business, society, and ethics.

**Origins of the Stakeholder Concept**

The stakeholder concept has become a central idea in understanding business and society relationships. The term "stakeholder" is a variant of the more familiar and traditional idea of stockholders—the investors in or owners of businesses. Just as a private individual might own his or her house, automobile, or video recorder, a stockholder owns a portion or a share of one or more businesses. Thus, a stockholder is also called a stakeholder. However, stakeholders are just one group of many legitimate stakeholders that business and organizations must address today to be effective.

**What Is a Stake?**

To appreciate the concept of stakeholders, it helps to understand the idea of a stake. A stake is an interest or a share in an undertaking. If a group is planning to go out to dinner and a show for the evening, each person in the group has a stake, or interest, in the group's decision. No money has yet been spent, but each member sees his or her interest (preference, taste, priority) in the decision. A stake is also a claim. A claim is an assertion to a title or a right to something. A claim is a demand for something due or believed to be due. We can see clearly that an owner or a stockholder has an interest in and an ownership of a share of a business.

The idea of a stake, therefore, can range from simply an interest in an undertaking at one extreme to a legal claim of ownership at the other extreme. In between these two extremes is a "right" to something. This right might be a legal right to certain treatment rather than a legal claim of ownership, such as that of a shareholder. Legal rights might include the right to fair treatment (e.g., not to be discriminated against) or the right to privacy (not to have one's privacy invaded or abridged). The right might be thought of as a moral right, such as that expressed by an employee: "I've got a right not to be fired because I've worked here 30 years, and I've given this firm the best years of my life." Or a consumer might say, "I've got a right to a safe product after all I've paid for this."

As we have seen, there are several different types of stakes. Figure 3-1 summarizes various categories or types of stakes.
What Is a Stakeholder?

A stakeholder, then, is an individual or a group that has one or more of the various kinds of stakes in a business. Just as stakeholders may be affected by the actions, decisions, policies, or practices of the business firm, these stakeholders also may affect the organization's actions, decisions, policies, or practices. With stakeholders, therefore, there is a potential two-way interaction or exchange of influence. In short, a stakeholder may be thought of as "any individual or group who can affect, or is affected by the actions, decisions, policies, practices, or goals of the organization."^1

Who Are Business's Stakeholders?

In today's competitive, global business environment, there are many individuals and groups who are business's stakeholders. From the business point of view, there are certain individuals and groups that have legitimacy in the eyes of management. That is, they have a legitimate interest in, or claim on, the operations of the firm. The most obvious of these groups are stockholders, employees, and customers. From the point of view of a highly pluralistic society, stakeholders include not only these groups, but other groups as well. These other groups include competitors, suppliers, the community, special-interest groups, the media, and society or the public at large. It has also been strongly argued by Mark Starik that the natural environment, nonhuman species, and future generations should be considered among business's important stakeholders.^1

Primary and Secondary Stakeholders

Wheeler and Sillanpää have presented a useful way to categorize stakeholders. Using such categories as primary and secondary and social and nonsocial, they propose defining stakeholders as follows:^17

Primary social stakeholders include:
- Shareholders and investors
- Employees and managers
- Customers
- Local communities
- Suppliers and other business partners

Secondary social stakeholders include:
- Government and regulators
- Civic institutions
- Social pressure groups
- Media and academic commentators
- Trade bodies
- Competitors

Primary social stakeholders have a direct stake in the organization and its success and therefore are influential. Secondary social stakeholders may be extremely influential as well, especially in affecting reputation and public standing, but their stake in the organization is more representational of public or special interests than direct. Therefore, the level of accountability to a secondary stakeholder tends to be lower, but these groups may wield significant power and quite often represent legitimate public concerns.^18

Primary nonsocial stakeholders include:
- The natural environment
- Future generations
- Nonhuman species
Core, Strategic, and Environmental Stakeholders

There are other ways to categorize stakeholders. At the Second Toronto Conference on Stakeholder Theory, for example, a working group came up with an alternative scheme for classifying stakeholders. In this scheme, stakeholders were thought of as being core, strategic, or environmental. Core stakeholders are a specific subset of strategic stakeholders that are essential for the survival of the organization. Strategic stakeholders are those stakeholders groups that are vital to the organization and the particular set of threats and opportunities it faces at a particular point in time. Environmental stakeholders are all others in the organization's environment that are not core or strategic.

One could conceptualize the relationship among these three groups of stakeholders by thinking of a series of concentric circles with core stakeholders in the middle and with strategic and environmental stakeholders moving out from the middle.
Part One  Business, Society, and Stakeholders

The working group went on to assert that whether stakeholders were core, strategic, or environmental would depend on their characteristics or attributes, such as legitimacy, power, or urgency. Thus, stakeholders could move from category to category in a dynamic, fluid, and time-dependent fashion. It was thought that this set of terms for describing stakeholders would be useful because it captured, to some degree, the contingencies and dynamics that must be considered in an actual situation.

Legitimacy, Power, Urgency: A Typology of Stakeholder Attributes

Expanding on the idea that stakeholders have such attributes as legitimacy, power, and urgency, Mitchell, Agle, and Wood generated a typology of stakeholders based on these three attributes.¹ When these three attributes are superimposed, as depicted in Figure 3-4, seven stakeholder categories result.

A brief look at the three attributes of legitimacy, power, and urgency helps us to see how stakeholders may be thought of and analyzed in these key terms. Legitimacy refers to the perceived validity or appropriateness of a stakeholder's claim to a stake. Therefore, owners, employees, and customers represent a high degree of legitimacy due to their explicit, formal, and direct relationships with a company. Stakeholders that are more distant from the firm, such as social activist groups, competitors, or the media, might be thought to have less legitimacy.

Power refers to the ability or capacity to produce an effect—to get something done that otherwise may not be done. Therefore, whether one has legitimacy or not, power means that the stakeholder could affect the business. For example, with the help of the media, a large, vocal, social activist group such as People for the Ethical Treatment of Animals (PETA) could wield extraordinary power over a business firm.

Urgency refers to the degree to which the stakeholder claim on the business calls for the business's immediate attention or response. Urgency may imply that something is critical—it really needs to get done. Or, it may imply that something needs to be done immediately, or on a timely basis. A management group may perceive a union strike, a consumer boycott, or a social activist group picketing outside headquarters as urgent.

An interesting example of a stakeholder action that illustrates both power and urgency occurred recently in several dozen Home Depot stores around the country. In each of the stores, strange announcements began blaring from the intercom systems: "Attention shoppers, on aisle seven you'll find mahogany ripped from the heart of the Amazon." Shocked store managers raced through the aisles trying to apprehend the environmental activists who were behind the stunt. The activists had apparently gotten the access codes to the intercoms. After months of similar antics, Home Depot bowed to the demands of the environmental group and announced that it would stop selling wood chopped from endangered forests and, instead, stock wood products certified by a new organization called the Forest Stewardship Council (FSC).¹ This newly founded group wasn't even on The Home Depot's radar screen and then, all of a sudden, it had to capitulate to selling wood only certified by the FSC.

Mitchell, Agle, and Wood take the position that managers must attend to stakeholders based on their assessment of the extent to which competing stakeholder claims are characterized by legitimacy, power, and urgency. Using the categories in Figure 3-4, therefore, the stakeholder groups represented by overlapping circles (for example, those with two or three attributes, such as Categories 4, 5, 6, and 7) are highly "salient" to management and would likely receive priority attention.

---

Strategic, Multifiduciary, and Synthesis Views

One challenge embedded in the stakeholder approach is to determine whether it should be perceived primarily as a way to manage better those groups known as stakeholders or as a way to treat more ethically those groups known as stakeholders. Kenneth Goodpaster has addressed this issue by distinguishing among the strategic approach, the multifiduciary approach, and the stakeholder synthesis approach. Goodpaster uses the term "strategic" in a sense slightly different from that in which it was used in the previous discussion.

The strategic approach views stakeholders primarily as factors to be taken into consideration and managed while the firm is pursuing profits for its shareholders. In this view, managers might take stakeholders into account because offended stakeholders might resist or retaliate (for example, through political action, protest, or boycott). This approach sees stakeholders as instruments that may facilitate or impede the firm's pursuit of its strategic objectives. Thus, it is an instrumental view.

The multifiduciary approach views stakeholders as more than just individuals or groups who can wield economic or legal power. This view holds that management has a fiduciary responsibility to stakeholders just as it has this responsibility to shareholders. Here, management's traditional fiduciary, or trust, duty is expanded to embrace stakeholders on roughly equal footing with shareholders. Thus, shareholders are no longer of exclusive importance as they would be under the strategic approach.

This view expands the idea of a fiduciary responsibility to include stockholders and other important stakeholders. Goodpaster recommends that business organizations take neither of these extreme postures but rather pursue a new stakeholder synthesis approach. This new view holds that business does have moral responsibilities to stakeholders but that they should not be seen as part of a fiduciary obligation. Thus, management's basic fiduciary responsibility to shareholders is kept intact, but it is also expected to be implemented within a context of ethical responsibility. This ethical responsibility is its duty not to harm, coerce, lie, cheat, steal, and so on. Thus, the result is the same in the multifiduciary and stakeholder synthesis views. However, the reasoning is different.

As we continue our discussion of stakeholder management, it should be clear that we are pursuing it from a balanced perspective. This balanced perspective suggests that we are integrating the strategic approach with the stakeholder synthesis approach such that they are compatible. We should be managing strategically and morally at the same time.

The stakeholder approach should not be just a better way to manage, it also should be a more ethical way to manage.

Three Values of the Stakeholder Model

As an alternative to Goodpaster's strategic, multifiduciary, and stakeholder synthesis views, Donaldson and Preston have articulated three aspects or values of the stakeholder model of the firm. These three aspects, although interrelated, are distinct. They differentiate among the descriptive, instrumental, and normative aspects of stakeholder theory or the stakeholder model. First, the stakeholder model is descriptive. That is, it provides language and concepts to effectively describe the corporation or organization. The corporation is a constellation of cooperative and competitive interests possessing both instrumental and intrinsic value. Understanding organizations in this way allows us to have a fuller description or explanation of how they function. The language and terms used in stakeholder theory are useful in helping us to understand organizations.

Second, the stakeholder model is instrumental. It is useful in establishing the connections between the practice of stakeholder management and the resulting achievement of corporate performance goals. The fundamental premise here is that practicing effective stakeholder management should lead to the achievement of traditional goals, such as profitability, stability, and growth.

Third, the stakeholder model is normative. In the normative perspective, stakeholders are identified by their interest in the organization whether or not the organization has any corresponding interest in them. Thus, the interests of all stakeholders are of intrinsic value. Stakeholders are seen as possessing value irrespective of their instrumental use to management. The normative view is often thought of as the moral or ethical view because it emphasizes the idea of an obligation, or ethical view because it emphasizes how stakeholders should be regarded.

In summarizing, Donaldson and Preston assert that stakeholder theory is managerial in the broad sense of the term. It is managerial in the sense that it does not simply describe or predict but also recommends attitudes, structures, and practices that constitute stakeholder management. Such management necessitates the simultaneous attention to the legitimate interests of all appropriate stakeholders in the creation of organizational structures and policies.

Key Questions in Stakeholder Management

The managers of a business firm have the responsibility of establishing the firm's overall direction (its strategies, goals, and policies) and seeing to it that these plans are carried out. As a consequence, managers have some long-term responsibilities and many that are of more immediate concern. Before the stakeholder environment became as turbulent and rapidly changing as it now is, the managerial task was relatively straightforward and the external environment was stable. As we have evolved to the stakeholder view of the firm, however, we see the managerial task as an inevitable consequence of the trends and developments we described in our first two chapters.

Stakeholder management has become important as managers have discovered the many groups that have to be relatively satisfied for the firm to meet its objectives. Without question, we still recognize the significance and necessity of profits as a return on the stockholders' investments, but we also see the growing claims of other stakeholder groups and the success they have had in getting what they want.

The challenge of stakeholder management, therefore, is to see to it that the firm's primary stakeholders achieve their objectives and that other stakeholders are dealt with ethically and are also satisfied. At the same time, the firm is expected to be profitable. This is the classic "win-win" situation. It does not always occur, but it is a legitimate goal for management to pursue to protect its long-term best interests. Management's second-best alternative is to meet the goals of its primary stakeholders, keeping in mind the important role of its owner-investors. Without economic viability, all other stakeholders' interests are lost.

With these perspectives in mind, let us approach stakeholder management with the idea that managers can become successful stewards of their stakeholders' resources by gaining knowledge about stakeholders and using this knowledge to predict and deal with their behavior and actions. Ultimately, we should manage the situation in such a way
we achieve our objectives ethically and effectively. Thus, the important functions of stakeholder management are to describe, to understand, to analyze, and, finally, to manage.

The quest for stakeholder management embraces social, ethical, and economic considerations. Normative as well as instrumental objectives and perspectives are essential. Five major questions must be asked if we are to capture the essential information we need for stakeholder management:

1. Who are our stakeholders?
2. What are our stakeholders' stakes?
3. What opportunities and challenges do our stakeholders present to the firm?
4. What responsibilities (economic, legal, ethical, and philanthropic) does the firm have to its stakeholders?
5. What strategies or actions should the firm take to best handle stakeholder challenges and opportunities?

Who Are Our Stakeholders?

To this point, we have described the likely primary and secondary stakeholder groups of a business organization. To manage them effectively, each firm and its management group must ask and answer this question for itself: Who are our stakeholders? To answer this question fully, management must identify not only generic stakeholder groups but also the specific subgroups. A generic stakeholder group is simply a broad grouping, such as employees, shareholders, environmental groups, or consumers. Within each of these generic categories there may be a few or many specific subgroups. Figure 3-5 illustrates some of the generic and specific stakeholder subgroups of a very large organization.

To illustrate the process of stakeholder identification, we will consider some events in the life of the McDonald’s Corporation that resulted in their broadening significantly who were considered their stakeholders. The case study starts in the fall of 1999 when the social-activist group PETA (People for the Ethical Treatment of Animals), which claims 700,000 members, decided it was dissatisfied with some of McDonald’s practices and decided it would launch a billboard and bumper-sticker campaign against the hamburger giant. PETA felt McDonald’s was dragging its feet on animal welfare issues, and so PETA went on the attack. PETA announced it would put up billboards saying “The animals deserve a break today” and “McDonald’s Cruelty to Go” in Norfolk, Virginia, PETA’s home city. The ad campaign was announced when talks broke down between PETA and McDonald’s.

The organizations also planned a full-page ad in the Miami Herald attacking McDonald’s. It came out that during the ensuing year, PETA escalated its pressure tactics against the firm. PETA began distributing “unhappy meals” at restaurant playgrounds and outside the company’s shareholder meeting. The kits, which came in boxes similar to McDonald’s Happy Meals, were intended to sell to children, were covered with pictures of slaughtered animals. It also depicted a bloody, knife-wielding “Son of Ron” doll that resembled the Ronald McDonald clown, as well as toy farm animals with slashed throats.

As a result of this example, we can see how the set of stakeholders that McDonald’s had to deal with grew significantly from its traditional stakeholders to include powerful groups such as PETA. With the aid of the media, especially major newspapers and magazines, PETA moved from being a secondary stakeholder to a primary stakeholder in McDonald’s life.

In 2001, members of PETA and the Animal Rights Foundation of Florida (ARFF) began an attack on Burger King, similar to the attack on McDonald’s. They greeted Burger King’s new CEO with signs and banners reading “Burger King: King of Cruelty,” while showing a video documenting the abuses that PETA hopes Burger King will put a stop to. The organizations also planned a full-page ad in The Miami Herald asking the new CEO to take action to reduce the suffering of chickens, pigs, and other animals on farms that supply the company’s meat and eggs. This is the latest volley in PETA’s “Murder King” campaign, in which hundreds of demonstrations against Burger King have taken place in more than a dozen countries and in every U.S. state.
The purpose of this discussion has been to illustrate the evolving nature of the question, "Who are our stakeholders?" In actuality, stakeholder identification is an unfolding process. However, by recognizing early the potential of failure if one does not think in stakeholder terms, the value and usefulness of stakeholder thinking can be readily seen. Had McDonald's perceived PETA as a stakeholder earlier on, perhaps it could have dealt with this situation more effectively.

Once stakeholders have been identified, the next step is to answer the question: What are our stakeholders' stakes? Even groups in the same generic category frequently have different specific interests, concerns, perceptions of rights, and expectations. Management's challenge here is to identify the nature and legitimacy of a group's stake(s) and the group's power to affect the organization. As we discussed earlier, urgency is another critical factor.

Identifying the Nature/Legitimacy of a Group's Stakes. Let's consider an example of stakeholders who possess varying stakes. Assume that we are considering corporate owners as a generic group of stakeholders and that the corporation is large, with several million shares of stock outstanding. Among the ownership population are these more specific subgroups:

1. Institutional owners (trusts, foundations, churches, universities)
2. Large mutual fund organizations
3. Board of director members who own shares
4. Members of management who own shares
5. Tens of thousands of small, individual shareholders

For all these groups, the nature of stakeholder claims on this corporation is ownership. All these groups have legitimate claims—they are all owners.

Identifying the Power of a Group's Stakes. When we examine power, we see significant differences. Which of the groups in the previous list are the most powerful? Certainly not the thousands of small, individual investors, unless they have found a way to organize and thus wield considerable power. The powerful stakeholders in this case are (1) the institutional owners and mutual fund organizations, because of the sheer magnitude of their investments, and (2) the board and management shareholders, because of their dual roles of ownership and management (control).

However, if the individual shareholders could somehow form a coalition based on some interest they have in common, they could exert significant influence on management decisions. This is the day and age of dissident shareholder groups filing shareholder suits and proposing shareholder resolutions. These shareholder resolutions address issues ranging from complaints of excessive executive compensation to demands that firms improve their environmental protection policies or cease making illegal campaign contributions.

Identifying Specific Groups Within a Generic Group. Let us now look at a manufacturing firm in an industry in Pennsylvania that is faced with a generic group of environmental stakeholders. Within the generic group of environmental stakeholders might be the following specific groups:

1. Residents who live within a 15-mile radius of the plant
2. Other residents in the city
3. Residents who live in the path of the jet stream hundreds of miles away (some in Canada) who are being impacted by acid rain
4. Environmental Protection Agency (federal government)
5. Pennsylvania Environmental Protection Division (state government)
6. Friends of the Earth (social activist group)
7. The Wilderness Society (social activist group)
8. Pennsylvanians Against Smokestack Emissions (social activist group)

It would require some degree of care to identify the nature, legitimacy, power, and urgency of each of these specific groups. However, it could and should be done if the firm wants to get a handle on its environmental stakeholders. Furthermore, we should stress that companies have an ethical responsibility to be sensitive to legitimate stakeholder claims even if the stakeholders have no power or leverage with management.

If we return for a moment to the McDonald's example, we would have to conclude that PETA, as a special-interest, animal welfare group, did not have much legitimacy vis-à-vis McDonald's. PETA did claim animal's rights and treatment as a moral issue, however, and thus had some general legitimacy through the concerns it represented. Unfortunately for PETA, not all of the public shares its concerns or degree of concern with these issues. However, PETA had tremendous power and urgency. It was this power, wielded in the form of adverse publicity and media attention, that doubtless played a significant role in bringing about changes in McDonald's policies.

What Opportunities and Challenges Do Our Stakeholders Present to the Firm?

In many respects, opportunities and challenges represent opposite sides of the coin when it comes to stakeholders. Essentially, the opportunities are to build good, productive working relationships with the stakeholders. Challenges, on the other hand, usually present themselves in such a way that the firm must handle the stakeholders well or be hurt in some way—financially (short term or long term) or in terms of its public image or reputation in the community. Therefore, it is understandable why our emphasis is on challenges rather than on opportunities posed by stakeholders.

These challenges typically take the form of varying degrees of expectations or demands. In most instances, they arise because stakeholders think or believe that their needs are not being met adequately. The challenges also arise when stakeholders think that any crisis that occurs is the responsibility of the firm or that the firm caused the crisis in some way. Examples of some stakeholder crises from the 1990s and early 2000s include:

- Citigroup. During morning rush hour in Manhattan, commuters in April 2001 were greeted with the sight of two activists unfurling a 20-foot banner from flag poles outside of Citigroup's (Citi) headquarters reading, "Hey, Citi, not with my money!" The
climbers were drawing attention to the growing controversy surrounding Citi's leading role in financing environmentally and socially destructive projects around the globe. This event followed a recent student-led boycott against Citi credit cards and protests in more than 80 cities in 12 countries.

- **Coca-Cola.** In June 1999, Coke faced a major crisis when reports came in that their world-famous product was causing illnesses among consumers in Europe. Dozens of consumers who drank the soft drinks became sick. The governments of France, Belgium, Luxembourg, and The Netherlands ordered Coca-Cola products off their shelves as a result of the reports. Coke executives later pinpointed the problem along two points in its bottling system controlled by Coca-Cola Enterprises in Belgium. The crisis occurred at a time when Coke products were already suffering declining sales in some regions. The biggest recall in Coke's history hurt its reputation in European markets.

- **Home Depot.** In 1998-1999, under pressure from social activist groups such as Rainforest Action Network and staged "Days of Action" by protestors, the Atlanta-based chain agreed to stop selling products made from old-growth wood. The environmentalists threatened to follow up with newspaper ads, frequent pickets, and civil disobedience if the company did not agree.

- **Texaco.** Taped evidence of executive-level race discrimination set off national protests against the company in 1996. A lawsuit settlement for $176 million was one result. This created a crisis for Texaco that took years to overcome.

If one looks at the business experiences of the past couple of decades, including the crises mentioned here, it is evident that there is a need to think in stakeholder terms to fully understand the potential threats that businesses of all kinds face on a daily basis. Opportunities and challenges might also be viewed in terms of potential for cooperation and potential for threat. Savage and colleagues have argued that such assessments of cooperation and threat are necessary so that managers might identify strategies for dealing with stakeholders. In terms of potential for threat, Savage et al. assert that managers need to consider the stakeholder's relative power and its relevance to a particular issue confronting the organization. In terms of potential for cooperation, the firm needs to be sensitive to the possibility of joining forces with other stakeholders for the advantage of all parties involved.

Savage et al. cite how Ross Laboratories, a division of Abbott Laboratories, was able to develop a cooperative relationship with some critics of its sales of infant formula in Third World countries. Ross and Abbott convinced these stakeholder groups (UNICEF and the World Health Organization) to join them in a program to promote infant health. Other firms, such as Nestlé, did not develop the potential to cooperate and suffered from consumer boycotts.

Figure 3-6 presents a list of the factors that Savage and colleagues claim will increase or decrease a stakeholder’s potential for threat or cooperation. By carefully analyzing these factors, managers should be able to better assess such potentials.

### What Responsibilities Does the Firm Have to Its Stakeholders?

Once threats and opportunities of stakeholders have been identified and understood, the next logical question is, "What responsibilities does the firm have in its relationships with all stakeholders?" Responsibilities here could be thought of in terms of the concepts presented in Chapter 2. What economic, legal, ethical, and philanthropic responsibilities does management have to each stakeholder? Because most of the firm’s economic responsibilities are principally to itself, the analysis really begins to focus on legal, ethical, and philanthropic questions. The most pressing threats present themselves as legal and ethical questions. We should stress, however, that the firm itself has an economic stake in the legal and ethical issues it faces. For example, when Johnson & Johnson (J&J) was faced with the Tylenol poisoning incident, it had to decide what legal and ethical actions to take and what actions were in the firm’s best economic interests. J&J probably judged that recalling the Tylenol products was not only the ethical action to take but also would ensure its reputation for being concerned about consumers’ health and well-being.

**What Strategies or Actions Should Management Take?**

Once responsibilities have been assessed, a business must contemplate strategies and actions for dealing with its stakeholders. In every decision situation, a multitude of alternative courses of action are available, and management must choose one or several that seem best. MacMillan and Jones suggest that management has before it a number of basic strategies or approaches in dealing with stakeholders. Important questions or decision choices include:
Savage et al. argue that development of specific strategies may be based on a classification of stakeholders according to the classification of the potentials for cooperation and threat. If we use these two dimensions, four stakeholder types and resultant generic strategies emerge. These stakeholder types and corresponding strategies are shown in Figure 3-8.

Stakeholder Type 1—the supportive stakeholder—is high on potential for cooperation and low on potential for threat. This is the ideal stakeholder. To a well-managed organization, supportive stakeholders might include its board, managers, employees, and customers. Others might be suppliers and service providers. The strategy here is one of involvement. An example of this might be the strategy of involving employee stakeholders through participative management or decentralization of authority.

Stakeholder Type 2—the marginal stakeholder—is low on both potential for threat and potential for cooperation. For large organizations, these stakeholders might include professional associations of employees, consumer interest groups, or stockholders—especially those who are not organized. The strategy here is for the organization to monitor the marginal stakeholder. Monitoring is especially called for to make sure circumstances do not change. Careful monitoring could avert later problems.

Stakeholder Type 3—the nonsupportive stakeholder—is high on potential for threat but low on potential for cooperation. Examples of this group could include competing organizations, unions, federal or other levels of government, and the media. The authors' recommended strategy here is to defend against the nonsupportive stakeholder.

Stakeholder Type 4—the mixed blessing stakeholder—is high on both potential for threat and potential for cooperation. Examples of this group, in a well-managed organization, might include employees who are in short supply, clients, or customers. A mixed blessing stakeholder could become a supportive or a nonsupportive stakeholder. The recommended strategy here is to collaborate with the mixed blessing stakeholder. By maximizing collaboration, the likelihood is enhanced that this stakeholder will remain supportive.

The authors summarize their position regarding these four stakeholder types as follows:

- Do we deal directly or indirectly with stakeholders?
- Do we take the offense or the defense in dealing with stakeholders?
- Do we accommodate, negotiate, manipulate, or resist stakeholder overtures?
- Do we employ a combination of the above strategies or pursue a singular course of action?

Savage et al. argue that development of specific strategies may be based on a classification of stakeholders according to the classification of the potentials for cooperation and threat. If we use these two dimensions, four stakeholder types and resultant generic strategies emerge. These stakeholder types and corresponding strategies are shown in Figure 3-8.
While in college I worked part-time for a prominent tax preparation service. I prepared customers' taxes along with about twenty other employees at different offices. Bill had been working with the service about three seasons but this was my first tax season. Bill was very good at tax preparation and had a pretty good reputation. He was respected by management and seemed to do what he was asked to do.

On a few occasions I had customers come in and wait to see Bill. When I explained that Bill was not at the office that day and asked if I could assist them with any questions, they would want to wait for Bill before continuing any further. This struck me as odd because all of the files were located in the office as well as on the hard drives of the firm's computers. Any employee can assist any customer, no matter who did the actual return.

When I later asked Bill about these customers, he told me that he did a few on his own time for people that couldn't afford the company's fees. This was bothersome to me because there is no telling how many times Bill had done this and how many customers he took away from the business.

1. Who are the stakeholders in this case and what are their stakes?
2. Was it unethical for Bill to be doing these taxes on his own time?
3. Was Bill actually doing the taxes on his own time or on company time when he wasn't otherwise busy?
4. Should I have told the manager the little bit of information I knew about this situation?

Contributed Anonymously

Effective Stakeholder Management

Effective stakeholder management requires the careful assessment of the five core questions we have posed. To deal successfully with those who assert claims on the organization, managers must understand these core questions at least at a basic level. It is tempting to wish to accept the production or managerial view of the firm, and these views are no longer tenable. Business today cannot turn back the clock to a simpler period. Business has been and will continue to be subjected to careful scrutiny of its actions, practices, policies, and ethics. This is the real world in which management lives, and management must accept it and deal with it. Critics of business and calls for better corporate citizenship have been the consequences of the changes in the business/society relationship, and the stakeholder approach to viewing the organization has become one needed response. To do less is to decline to accept the realities of business's plight in the modern world and to fail to see the kinds of adaptations that are essential if business is to prosper in the present and in the future.

In fairness, we should also note that there are criticisms and limitations of the stakeholder management approach. One major criticism relates to the complexity and time-consuming nature of identifying, assessing, and responding to stakeholder claims, which constitute an extremely difficult process. Also, the ranking of stakeholder claims is no easy task. Some managers continue to think in stockholder terms because this is easier. To think in stockholder terms increases the complexity of decision making, and it is overly taxing for some managers to determine which stakeholders' claims take priority in a given situation. Despite its complexity, however, the stakeholder management view is most consistent with the environment that business faces today.

Ethics In Practice

STAKEHOLDER MANAGEMENT

STAKEHOLDER MANAGEMENT CAPABILITY

Another way of thinking about effective stakeholder management is in terms of the extent to which the organization has developed its stakeholder management capability (SMC). Stakeholder management capability, as described by Freeman, may reside at one of three levels of increasing sophistication.

Level 1—the Rational Level. This simply entails the company identifying who their stakeholders are and what their stakes happen to be. This is the level of stakeholder maps. The rational level is descriptive and somewhat analytical, because the nature of stakeholders, their power, and urgency are identified. This actually represents a low level of SMC. Most organizations have at least identified who their stakeholders are, but not all have analyzed the nature of the stakes or the stakeholders' power. Mark Starik has referred to Freeman's first level as the component of familiarization and comprehensiveness, because management operating at Level 1 is seeking to become familiar with their stakeholders and to develop a comprehensive assessment as to their identification and stakes.

Level 2—the Process Level. At the process level, organizations go a step further than Level 1 and actually develop and implement organizational processes (approaches, procedures, policies, practices) by which the firm may scan the environment and receive relevant information about stakeholders, which is then used for decision-making purposes. Typical approaches at this level include portfolio analysis processes, strategic review processes, and environmental scanning processes, which are used to assist managers in their strategic management processes. Other approaches, such as issues management or crisis management (Chapter 5), might also be considered examples of Level 2 SMC. This second level has been described by Starik as planning integrativeness, because management does focus on planning processes for stakeholders and integrating a consideration for stakeholders into organizational decision making.

Level 3—the Transactional Level. The transactional level is the highest and most developed of the three levels. This is the bottom line for stakeholder management—the extent to which managers actually engage in transactions (relationships) with stakeholders. At this highest level of SMC, management must take the initiative in meeting stakeholders face to face and attempting to be responsive to their needs. Starik refers to this as the communication level, which is characterized by communication proactiveness, interactivenss, genuineness, frequency, satisfaction, and resource adequacy. Resource adequacy refers to management actually spending resources on stakeholder transactions.

Steven F. Walker and Jeff Marr, in their new book Stakeholder Power: A Winning Plan for Building Stakeholder Commitment and Driving Corporate Growth, argue that companies should compete on the basis of intangible assets—a company's priceless relationships with customers, employees, suppliers, and shareholders. Based on their own firm's 60-year history as a pioneer in corporate reputation and market research and from case studies of organizations as diverse as LensCrafters, DHL, and Edison International, the authors offer a practical model for hardwiring stakeholder management into company strategy and reaping the rewards through continuous innovation, learning, and profitable growth. It appears that Walker and Marr would subscribe to the essential nature of Level 3—the transactional level—of stakeholder management capability.

An example of Level 3 is provided in the recent agreement between the Mitsubishi group and an environmentalist organization, the Rainforest Action Network (RAN),
based in San Francisco. Mitsubishi agreed to curb its pollution and protect the rain forest in an agreement that was the result of 5 years of negotiations and meetings with RAN. The agreement would never have been possible if the two groups had not been willing to establish a relationship in which each side made certain concessions. 

**The Stakeholder Corporation**

Perhaps the ultimate form of the stakeholder approach or stakeholder management is the "stakeholder corporation," a concept argued persuasively by Wheeler and Sillanpää. The primary element of this concept is stakeholder inclusiveness. The authors argue this position as follows.41

> In the future, development of loyal relationships with customers, employees, shareholders, and other stakeholders will become one of the most important determinants of commercial viability and business success. Increasing shareholder value will be best served if your company cultivates the support of all who may influence its importance.

Advocates of the stakeholder corporation would doubtless believe in "stakeholder symbiosis," which has been discussed widely by a consortium of organizations in their inaugural year activities of the Best Practices for Global Competitiveness Initiative (BPI), created and launched in 1997 by the American Productivity and Quality Center, the European Foundation for Quality Management, Arthur Andersen, and Fortune Custom Projects. Stakeholder symbiosis is an idea that recognizes that all stakeholders depend on each other for their success and financial well-being. Executives who have a problem with this concept would probably also have trouble becoming parts of stakeholder corporations.

**Stakeholder Power: Four Gates of Engagement**

Building upon these ideas, Steven Walker and Jeffrey Marr, in their book Stakeholder Power, have presented a practical framework for assessing the commitment level of each stakeholder group and moving them through a series of "gates." It is the view of Walker and Marr that companies need to be proactive in their relationships with potential stakeholders such that these groups desire to be in relationships with the company. They hold that great stakeholder relationships evolve through different stages of development, and this knowledge helps management be proactive. They assert that every successful stakeholder relationship passes through four stages, which they refer to as the "four gates of engagement." These four gates include: Awareness, Knowledge, Admiration, and Action. The gates are generally sequential and each stage builds upon the previous stages.

**Awareness** is gate one. This means knowing that something or someone exists. This first gate seems fairly obvious. They argue, however, that there are often "hidden stakeholders" who may not be aware of the firm. These hidden stakeholders may include others behind the scenes, who bear influence on decisions. How familiar are they with your firm?

**Knowledge** is gate two. Developing knowledge among stakeholders addresses not only products and services but also knowledge about corporate character. This refers to the company's values, integrity, culture, and practices. At gate two, customers would see the "fit" for your product/service; employees would know your values, mission, and strategies and what the firm stands for; the community would know what you do and how you do it.

**Gate three** is Admiration. Once a relationship has been established via awareness and knowledge, the potential for stakeholder admiration of the organization exists. To reach this stage, stakeholders must come to trust the firm. Loyalty and commitment are likely effects. Walker and Marr argue that this stage is an excellent time to "close" stakeholders—meaning to seal their trust in you by taking the next step of initiating or deepening the business relationship. This puts them in position for the final stage, which is action. Action is gate four. By taking steps to further collaboration, the company can build partnerships that benefit both of you. At this stage, you might get referrals from customers and employees, investors interested in recommending your stock or expanding their current positions, or suppliers entering into true collaboration and trust. The main implication of the "four gates" model is the need to effectively manage communications with stakeholders of all types. Management's responsibility in the model is to guide the stakeholders' progress through the gates so that strong, visible relationships may be established and maintained.

**Principles of Stakeholder Management**

Based upon years of observation and research, a set of "principles of stakeholder management" has been developed. These principles, known as "The Clarkson Principles," were named after the late Max Clarkson, a dedicated researcher on the topic of stakeholder management. The principles are intended to provide managers with guiding precepts regarding how stakeholders should be treated. Figure 3-9 summarizes these principles. The key words in the principles suggest the kind of cooperative spirit that should be used in building stakeholder relationships: acknowledge, monitor, listen, communicate, adopt, recognize, work, avoid, acknowledge conflicts.

**Figure 3-9**

**PRINCIPLES OF STAKEHOLDER MANAGEMENT—"THE CLARKSON PRINCIPLES"**

<table>
<thead>
<tr>
<th>PRINCIPLE</th>
<th>DESCRIPTION</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Managers should acknowledge and actively monitor the concerns of all legitimate stakeholders, and should take their interests appropriately into account in decision making and operations.</td>
</tr>
<tr>
<td>2</td>
<td>Managers should listen to and openly communicate with stakeholders about their respective concerns and contributions, and about the risks that they assume because of their involvement with the corporation.</td>
</tr>
<tr>
<td>3</td>
<td>Managers should adopt processes and modes of behavior that are sensitive to the concerns and capabilities of each stakeholder constituency.</td>
</tr>
<tr>
<td>4</td>
<td>Managers should recognize the interdependence of efforts and rewards among stakeholders, and should attempt to achieve a fair distribution of the benefits and burdens of corporate activity among them, taking into account their respective risks and vulnerabilities.</td>
</tr>
<tr>
<td>5</td>
<td>Managers should work cooperatively with other entities, both public and private, to ensure that risks and harms arising from corporate activities are minimized and, where they cannot be avoided, appropriately compensated.</td>
</tr>
<tr>
<td>6</td>
<td>Managers should avoid altogether activities that might jeopardize inalienable human rights (e.g., the right to life) or give rise to risks which, if clearly understood, would be patently unacceptable to relevant stakeholders.</td>
</tr>
<tr>
<td>7</td>
<td>Managers should acknowledge the potential conflicts between (a) their own role as corporate stakeholders, and (b) their legal and moral responsibilities for the interests of stakeholders, and should address such conflicts through open communication, appropriate reporting, and incentive systems and, where necessary, third-party review.</td>
</tr>
</tbody>
</table>

A stakeholder is an individual or a group that claims to have one or more stakes in an organization. Stakeholders may affect the organization and, in turn, be affected by the organization’s actions, policies, practices, and decisions. The stakeholder approach extends beyond the traditional production and managerial views of the firm and warrants a much broader conception of the parties involved in the organization’s functioning and success. Both primary and secondary social and nonsocial stakeholders assume important roles in the eyes of management. A typology of stakeholders suggests that three attributes are especially important: legitimacy, power, and urgency.

Strategic, multifaceted, and stakeholder views help us appreciate the perspectives that may be adopted with regard to stakeholders. The stakeholder synthesis perspective is recommended because it highlights the ethical responsibility business has to its stakeholders. The stakeholder model of the firm has three values: descriptive, instrumental, and normative.

Five key questions aid managers in stakeholder management: (1) Who are our stakeholders? (2) What are our stakeholders’ stakes? (3) What challenges or opportunities are presented to our firm by our stakeholders? (4) What responsibilities does our firm have to its stakeholders? (5) What strategies or actions should our firm take with respect to our stakeholders? The concept of stakeholder management capability (SMC) illustrates how firms can grow and mature in their approach to stakeholder management. Seven principles of stakeholder management were set forth. Although the stakeholder management approach is quite complex and time-consuming, it is a way of managing that is in tune with the complex environment that business organizations face today. The stakeholder corporation is a model that represents stakeholder thinking in its most advanced form.

**Key Terms**

- core stakeholders (page 73)
- environmental stakeholders (page 73)
- legitimacy (page 74)
- managerial view of the firm (page 71)
- power (page 74)
- principles of stakeholder management (page 89)
- process level (page 87)
- production view of the firm (page 71)
- rational level (page 87)
- stake (page 69)
- stakeholder (page 70)
- stakeholder inclusiveness (page 88)
- stakeholder management capability (SMC) (page 87)
- stakeholder symbiosis (page 88)
- stakeholder view of the firm (page 71)
- strategic stakeholders (page 73)
- transactional level (page 87)
- urgency (page 74)

**Discussion Questions**

1. Explain the concepts of stake and stakeholder from your perspective as an individual. What kinds of stakes and stakeholders do you have? Discuss.
2. Differentiate between primary and secondary social and nonsocial stakeholders in a corporate situation.
3. Define the terms core stakeholders, strategic stakeholders, and environmental stakeholders. What factors affect into which of these groups stakeholders are categorized?
4. Explain in your own words the differences among the production, managerial, and stakeholder views of the firm.
5. Choose any group of stakeholders listed in the stakeholder/responsibility matrix in Figure 3-7 and identify the four types of responsibilities the firm has to that stakeholder group.
6. Is the stakeholder corporation a realistic model for business firms? Will stakeholder corporations become more prevalent in the twenty-first century? Why or why not?

**Endnotes**

7. ibid.
8. This definition is similar to that of R. Edward Freeman in Strategic Management: A Stakeholder Approach (Boston: Pitman, 1984), 25.
10. Freeman, 5.
11. Freeman, 24-25.
13. ibid., 168.
18. ibid.
20. ibid.
Part One  Business, Society, and Stakeholders


28. Ibid., 64.
29. MacMillan and Jones, 66-70.
30. Savage, Nix, Whitehead, and Blair, 65.
31. Ibid., 72.
32. Freeman, 53.
34. Freeman, 64.
36. Freeman, 69-70.
37. Starik, 1990, 36-42.
43. Ibid.