CHAPTER 2

Strategic Management of Stakeholder Relationships

PURPOSE AND PERSPECTIVE

The purpose of this chapter is to fully examine the concept of stakeholders and explore why these groups are important for today's businesses. First, we define stakeholders and examine primary, secondary, and global stakeholders. Then, we examine the concept of a stakeholder orientation to enhance social responsibility. Next, we consider the impact of corporate reputation and crisis situations on stakeholder relationships, including the importance of understanding ethical misconduct disasters. Finally, we examine the development of stakeholder relationships implementing a stakeholder perspective and the link between stakeholder relationships and social responsibility.

LECTURE OUTLINE

I. Stakeholders Defined
  A. Stakeholders are those people and groups to whom an organization is responsible.
    1. The historical view of business defined a relatively small group of stakeholders known as market constituencies.
      a. Shareholders and other investors provide the financial foundation for business and expect something in return; therefore, managers and executives strive to maintain positive relationships with them.
      b. Customers, who provide a revenue stream, are also viewed as primary constituents by all types of organizations.
      c. Employees are fundamental to the operations of any firm.
      d. Suppliers and other business partners have a clear role in any business enterprise because they provide goods and services that are necessary for an organization to function effectively and efficiently.
    2. In the latter half of the twentieth century, perceptions of business accountability evolved toward an expanded model of the role and responsibilities of business in society, resulting in a more broadly defined group of stakeholders that includes nonmarket constituencies.
      a. When a business also cares about the well-being of nonmarket groups, it earns trust and cooperation that ultimately reduce costs and increase productivity.
      b. Nonmarket groups include the general community, the media, government, special-interest groups, and others that are not always directly tied to issues of profitability and performance.

II. Stakeholder Issues and Interaction
  A. Identifying Stakeholders
    1. *Primary stakeholders* are those stakeholders without whom a company would not be able to continue its fundamental operations.
      a. Groups that are primary stakeholders include shareholders and investors, employees, customers, and suppliers, as well as public stakeholders, such as government and the community.

b. There is a high degree of interdependence among these groups, so serious dissatisfaction, withdrawal from the relationship, or other disruption may threaten the existence of the firm.

2. *Secondary stakeholders*, while they influence and/or are affected by the company, are neither engaged in economic exchanges with the firm nor fundamental to its daily survival.
   a. Media and special-interest groups are usually considered secondary stakeholders.
   b. Although they do not have as much influence on the day-to-day concerns of the firm, secondary groups cannot be ignored or given less consideration in the social responsibility process.
3. In the *stakeholder interaction model*, there are two-way relationships between the firm and a host of stakeholders. In addition to the fundamental input of investors, employees, and suppliers, this approach recognizes other stakeholders and explicitly acknowledges the dialog that exists between a firm's internal and external environments.

B. Stakeholder Orientation
1. *Stakeholder orientation* involves three sets of activities.
   a. The organization generates data about stakeholder groups and provides an assessment of the firm's effects on these groups.
   b. This information is distributed throughout the firm.
   c. The organization has a certain level of responsiveness to this intelligence.
2. A stakeholder orientation is not complete unless it includes activities that actually address stakeholder issues.

C. Stakeholder Attributes
1. Stakeholder attributes include power, legitimacy, and urgency, which change over time.
2. Power—A stakeholder has *power* to the extent that it can gain access to coercive, utilitarian, or symbolic means to impose or communicate its views to an organization.
   a. Coercive power involves the use of physical force, violence, or some type of restraint.
   b. Utilitarian power involves financial or material control, such as boycotts, that affect a company's bottom line.
   c. Symbolic power relies on the use of symbols that connote social acceptance, prestige, or some other attribute.
3. Legitimacy—*Legitimacy* is the perception or belief that a stakeholder's actions are proper, desirable, or appropriate within a given context.
   a. Legitimacy is gained through the stakeholder's ability and willingness to explore the issue from a variety of perspectives and then to communicate in an effective and respectful manner on the desire for change.
4. Urgency—Stakeholders exercise greater pressures on managers and organizations when they stress the *urgency* of their claims.
   a. Time sensitivity usually heightens the stakeholder's effort and may compress an organization's ability to research and react to a claim.
   b. A stakeholder's personal perception of a claim's importance will affect the urgency with which the stakeholder presents the claim to the firm.
5. The power, legitimacy, and urgency that stakeholders possess help a firm and its employees judge the relative importance of various stakeholders' claims.

III. Performance with Stakeholders

A. Reputation Management
1. *Reputation management* is the process of building and sustaining a company's good name and generating positive feedback from stakeholders.
2. Reputations take a long time to build or change, and it is far more important to monitor reputation than many companies believe.

3. While a strong reputation may take years to build, it can be destroyed seemingly overnight if a company does not handle crises to the satisfaction of the various stakeholders involved.
4. Various trends may affect how companies manage their reputations.
    a. Market factors, such as increased consumer knowledge and community access to information influence reputation management.
    b. Workplace factors, including technological advances, closer vendor relationships, and more inquisitive employees, also impact a company's policy of reputation management.
5. The importance of corporate reputation has created a need for accurate reputation measures.
6. The process of reputation management involves four components that work together: organizational identity, image, performance, and ultimately, reputation.
    a. Organizational identity refers to how an organization wants to be viewed by its stakeholders.
    b. Organizational image is how stakeholders interpret the various aspects of a company in order to form an overall impression of it.
    c. Organizational performance involves the actual interaction between the company and its stakeholders.
    d. The interaction of organizational image and performance result in organizational reputation, the collective view of all stakeholders after their image of the firm is shaped through interactions with the company.
    e. These four components must be aligned in order to build and manage a good reputation.

B. Crisis Management

Crisis management is the process of handling a high-impact event characterized by ambiguity and the need for swift action.

1. An *ethical misconduct disaster* (EMD) can be an unexpected organizational crisis that results from employee misconduct, illegal activities such as fraud, or unethical decisions that significantly disrupt operations and threaten or are perceived to threaten the firm's continuity of operations.
2. Organizational crises are characterized by a threat to a company's high-priority goals, surprise to its membership, and stakeholder demands for a short response time.
    a. Crises have widespread implications not only for the organization but also for each stakeholder group affected by the crisis.
    b. Organizations have a responsibility to manage the competing interests of stakeholders to ensure that all stakeholder groups are treated fairly in the aftermath of a crisis.
1. A company must communicate quickly and effectively to stakeholders during and after a disaster.
    a. First, leadership should express remorse for the event.
    b. Second, the organization should express guidelines regarding how it intends to address the crisis so that stakeholders can be confident that the situation will not escalate or recur.
    c. Finally, the company should provide explicit criteria to stakeholders regarding how each group will be compensated for any negative effects it experiences as a result of the crisis.

IIV. Development of Stakeholder Relationships

A. The concept of relationships in business has gained much acceptance.

1. Instead of just pursuing one-time transactions, companies are now searching for ways to develop long-term and collaborative relationships with their customers and business partners through tangible and intangible investments.

2. Tangible investments include buildings, equipment, new tools, and other elements dedicated to a particular relationship.
3. The time, effort, trust, and commitment required to develop a relationship are intangible investments.
   a. Investments and lessons learned through the process of developing a dialog and solid relationship with one stakeholder results in *social capital*, an asset that resides in relationships and is characterized by mutual goals and trust.

V. Implementing a Stakeholder Perspective in Social Responsibility
   A. Several steps are involved in utilizing the stakeholder framework in managing responsibility and business ethics.
      1. The steps include (1) assessing the corporate culture, (2) identifying stakeholder groups, (3) identifying stakeholder issues, (4) assessing the organization's commitment to social responsibility, (5) identifying resources and determining urgency, and (6) gaining stakeholder feedback.

V. Link Between Stakeholder Relationships and Social Responsibility
   A. Performance, which can be measured and evaluated, shows what companies are actually doing for their stakeholders and their interests.
   B. The Reactive-Defensive-Accommodative-Proactive Scale provides a method for assessing a company's strategy and performance with each stakeholder.
      1. This scale is based on a continuum of strategy options and performance outcomes with respect to stakeholders.
         a. The reactive approach involves denying responsibility and doing less than is required.
         b. An organization with a defensive strategy fulfills basic legal obligations and demonstrates minimal responsibility by acknowledging reluctantly and partially the responsibility issues that may be raised by its stakeholders.
         c. With an accommodative strategy, a company attempts to satisfy stakeholder demands by doing all that is required and may be seen as progressive since it is obviously open to this expanded model of business relationships.
         d. The proactive approach not only accepts but also anticipates stakeholder interests. In this case, a company sincerely aligns legitimate stakeholder views with its responsibilities and will do more than is required to meet them.
   C. Results from a stakeholder assessment should be included in the *social audit,* which assesses and reports a firm's performance in adopting a strategic focus for fulfilling the economic, legal, ethical, and philanthropic social responsibilities expected of it by its stakeholders.

ANSWERS TO THE DISCUSSION QUESTIONS

1. Define *stakeholder* in your own terms. Compare your definition with the definition used in this chapter.

   A stakeholder is someone who may affect or be affected by a company. This is a very broad definition that offers little detail on what is meant by *company,* such as its operations, productions, employees, suppliers, shareholders, and customers. These are considered in more depth in this chapter.

2. What is the difference between primary and secondary stakeholders? Why is it important for companies to make this distinction?

   Primary stakeholders are groups that are fundamental to a company's operations and survival. Secondary stakeholders are influenced by and influence the firm but are not engaged in economic exchanges with the firm or fundamental to its daily survival. It is important for the managers to understand that, although primary groups may present more day-to-day concerns, secondary groups cannot be ignored or consistently given less consideration in the social responsibility process. Secondary stakeholders can still greatly influence the company.

3. How do legitimacy, urgency, and power attributes positively and negatively affect a stakeholder's ability to develop relationships with organizations?

   Power can be used both positively and negatively and involves coercive, utilitarian, and symbolic measures. Symbolic power is the least threatening because it involves the use of letters, advertising, websites, and other media to generate awareness on an issue. If power is used in concert with disparagement or violence, the stakeholder's means may overshadow its ends or desired goals. By having a valid concern and the ability to communicate effectively, a stakeholder gains legitimacy and can positively influence its relationships with organizations. However, a stakeholder who presents false or inaccurate information will suffer from illegitimacy. This could cause organizations and other stakeholders to turn their backs on the group that is trying to negotiate or communicate. Urgency might cause a stakeholder group to start protests and actions in advance of having full information or legitimacy. This situation would negatively affect its relationship with the organization. However, urgency could help the company recognize an emerging issue, and the group with an urgent claim that has legitimacy and positive power may assist the company in becoming a better corporate citizen.

4. What is reputation management? Explain why companies are concerned about their reputation and its effects on stakeholders. What are the four elements of reputation management? Why is it important to manage these elements?

   Reputation management is the process of building and sustaining a company's good name and generating positive feedback from stakeholders. If a company's reputation is mangled, it will take a long time for it to return to its former status, if ever it does. When reputations are damaged or questioned, trust is often a central issue. The loss of trust with key stakeholders has the potential to affect most aspects of the business. The four elements of reputation management are identity, image, performance, and reputation. These elements must be aligned and are determined by various stakeholders' views of the company. Recognizing the importance and salience of stakeholder views and beliefs is central to reputation management.

5. Define crisis management. What should a company facing a crisis do to satisfy its stakeholders and protect its reputation?

   Crisis management is the process of handling a high-impact event characterized by ambiguity and the need for swift action. The company facing the crisis should provide accurate and timely information to stakeholders as events and decisions unfold. Most experts recommend that a company be relatively ambiguous in initial statements so that the company won't be embarrassed or harmed by incomplete or erroneous information. Company actions and words throughout the crisis will have an effect on reputation, so this period requires solid planning, research, and consideration of the social responsibility philosophy and stakeholder concerns.

6. Describe the process of developing stakeholder relationships. What parts of the process seem most important? What parts seem most difficult?

   The steps include: (1) assessing the corporate culture, (2) identifying stakeholder groups, (3) identifying stakeholder issues, (4) assessing the organization's commitment to social responsibility, (5) identifying resources and determining urgency, and (6) gaining stakeholder feedback. The importance of these steps is to include feedback from relevant stakeholders in formulating organizational strategy and implementation. Although there is a "last step," the process does not begin and end in a distinct way. Instead, relationships need constant and consistent attention. The most important step is to monitor and acknowledge the issues of the legitimate stakeholders. This is also the most difficult step because both the concerns and the legitimate groups could be constantly changing.

7. How can a stakeholder orientation be implemented to improve social responsibility?

   The degree to which a firm understands and addresses stakeholder demands can be referred to as a stakeholder orientation. This orientation comprises three sets of activities: (1) the organizationwide generation of data about stakeholder groups and assessment of the firm's effects on these groups; (2) the distribution of this information throughout the firm; and (3) the organization's responsiveness as a whole to this intelligence. Ultimately, a strong stakeholder orientation will improve social responsibility.

8. What are the differences among the reactive, defensive, accommodative, and proactive approaches to stakeholder relationships?

   These approaches assume different levels of social responsibility and stakeholder orientation. The reactive approach to stakeholder relationships is the least effective because it denies responsibility. The defensive approach admits responsibility but fights it. The accommodative approach accepts responsibility. The proactive approach anticipates responsibility and is most aligned with the concept of strategic responsibility in Chapter 1. For example, in the *E. coli* outbreak at Jack in the Box restaurants, the company initially used a defensive strategy when it claimed that children may have unwittingly spread the bacteria. The firm also publicized the fact that hundreds of cases of *E. coli* poisoning occur every year. Later, the firm may have migrated to an accommodative approach, but it still suffered financial losses and a tarnished reputation.

COMMENTS ON THE EXPERIENTIAL EXERCISE

Choose two companies in different industries and visit their respective websites. Peruse these sites for information that is directed at three company stakeholders—employees, customers, and the media. For example, a company that places its annual reports online may be appealing primarily to the interests of investors. Make a list of the types of information that are on the site and indicate how the information might be used and perceived by these three stakeholder groups. What differences and similarities did you find between the two companies?

This exercise requires the ability to compare and contrast different firms' approaches to communicating with and about stakeholders and their concerns. Students will peruse two company websites for information that may be useful or enlightening to employees, customers, and the media. The information types should be listed and categorized by the potential use and applicability to the three stakeholder groups. Finally, differences and similarities between the two companies' approaches will be noted.

COMMENTS ON THE *WHAT WOULD YOU DO?* EXERCISE

This exercise focuses on four executives of Global Amusements who are researching the possibility of developing a cultural amusement center on Phuket Island in Thailand. The island has much natural beauty and cultural value, so the executives need to meet with a number of constituents before planning the project. Students must provide a list of primary and secondary stakeholders and indicate the various concerns or stakes that each might have with the proposed project.