

Chapter Two is more "academic" than the other chapters, as it concentrates on the intellectual history of the idea rather than its application.

Chapter Three, "Stakeholder Management: Framework and Philosophy," addresses the need to analyze stakeholder issues on three levels: rational, process and transactional. It argues for a framework which "fits" these three levels of analysis together. Techniques for mapping stakeholders, understanding organizational processes, and analyzing interactions with stakeholders are explained. It closes with some basic propositions for successful stakeholder management.

One

"MANAGING IN TURBULENT TIMES"

INTRODUCTION

Bob Collingwood was President and Chief Executive Officer of the U.S. subsidiary of Woodland International, a large multinational company headquartered in Europe. Bob was responsible for all of Woodland's activities in the U.S. His functional responsibilities included manufacturing as well as public affairs, as Woodland was fully integrated in its U.S. operations. Bob was measured on profitability as well as several other financial criteria. As he checked his appointment calendar for the upcoming two weeks, he could see that the schedule listed appointments with one external group after another, with agendas ranging from traditional labor-management issues to concerns with Woodland's social responsibility.

On Monday a state legislature in the Northeast where Woodland had major manufacturing facilities would open two days of hearings on a bill requiring companies to notify the state government before moving a plant out of state. A test marketing program for a new product line would be launched on Thursday, and he needed to be involved with the marketing people on some last minute decisions. On Saturday, the leaders of a coalition of consumer organizations would arrive to hear his talk about the merits and safety of several of Woodland's products. And, on Sunday an environmental group was going to hold a demonstration to protest air pollution caused by a Woodland plant.

The following week Collingwood was scheduled to go to Washington for a meeting concerning his compliance with the newest set of regulatory guidelines. When he returned, he was to meet with one of the local unions

about their upcoming new contract. It was rumored that the union leadership had begun plans to unionize Woodland's large "9 to 5" workforce. Following the meeting with the union, Bob would discuss a summer jobs program for unemployed teenagers with several minority group leaders.

The Comptroller's report was also waiting for him on his desk. Sales were down 15 percent. His profit index was 20 percent short of his first quarter goal.

Bob Collingwood had risen rapidly at Woodland International, and was headed for "stardom" in company headquarters in Europe if he so desired. However, Bob did not feel prepared for the diverse mix of situations which he now faced. The dissimilar problems with the varied pressure groups each demanded an instantaneous solution. One, or all, of them could keep Bob and his best people working even longer hours than usual. While his people were both functionally and operationally competent, there just did not seem to be a way to pull the diverse management tasks together.

While Bob and his people had the skills and abilities to meet each situation and to manage the crises when they arose, these skills were insufficient. Bob knew that he needed a framework and a strategy for managing diversity and turbulence, to get out of the crisis-reaction-crisis cycle.

This book is about Bob and the thousands of managers around the world like him who meet all the criteria for "good managers," yet who do not seem able to manage well in today's fast changing business environment. It explains a framework for management, the stakeholder framework, which offers a method for Bob and his colleagues to begin to understand their environment systematically and to begin to manage it in a positive proactive fashion. This book is theoretical in the sense that it develops a generalizable and testable approach to managerial strategic decision-making. However, it is practical in the sense that any theory of strategic decisions must be applicable in "real-world" organizations. The bridge between theory and practice is a difficult one to build. By speaking to both executives and academics, I shall attempt to build such a bridge, for the problems are too important to ignore either side.¹

TURBULENT TIMES

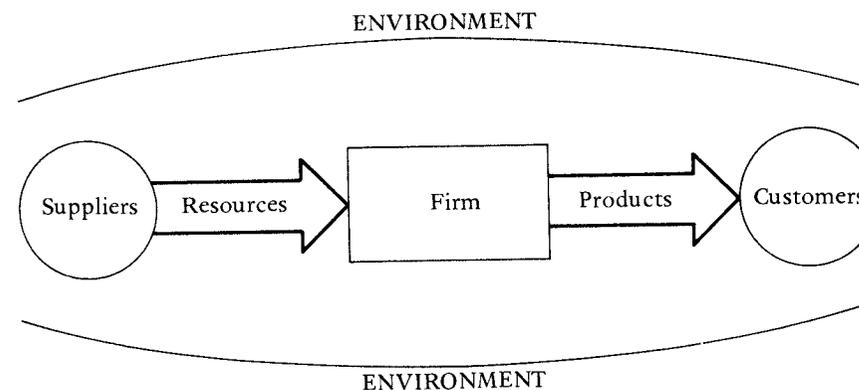
Both business and service organizations are experiencing turbulence.² Local, national and global issues and groups are having far-reaching impacts on organizations. Gone are the "good old days" of worrying only about taking products and services to market, and gone is the usefulness of management theories which concentrate on efficiency and effectiveness within this product-market framework.³

Our "world-view" or "paradigm" or "framework" or "way of looking at the world" does not encompass this turbulence.⁴ And, in fact our current theories are inconsistent with both the quantity and kinds of change which are occurring in the business environment of the 1980s. Current approaches emphasize the static nature of organizations, and the predictable and relatively certain parts of an organization's external environment.⁵ A new conceptual framework is needed.

Somewhere in the past, organizations were quite simple, and "doing business" consisted of buying raw materials from suppliers, converting it to products, and selling it to customers. Exhibit 1.1 depicts this "Production View" of the firm. For the most part owner-entrepreneurs founded such simple businesses and worked at the business along with members of their families. The family-dominated business still accounts for a large proportion of the new business starts today. The central point is that given the Production View as a conceptual framework, the owner-manager-employee need only worry about satisfying suppliers and customers in order to make the business successful.

A number of factors coalesced to make larger and larger firms more economical. The development of new production processes, such as the assembly line, meant that jobs could be specialized and more work could be accomplished. New technologies and sources of power became readily available. Demographic factors began to favor the concentration of production in urban areas. These and other social and political forces combined to require larger amounts of capital, well beyond the scope of most individual owner-manager-employees. Additionally, "workers" or non-family members began to dominate the firm and were the rule rather than the exception. Ex-

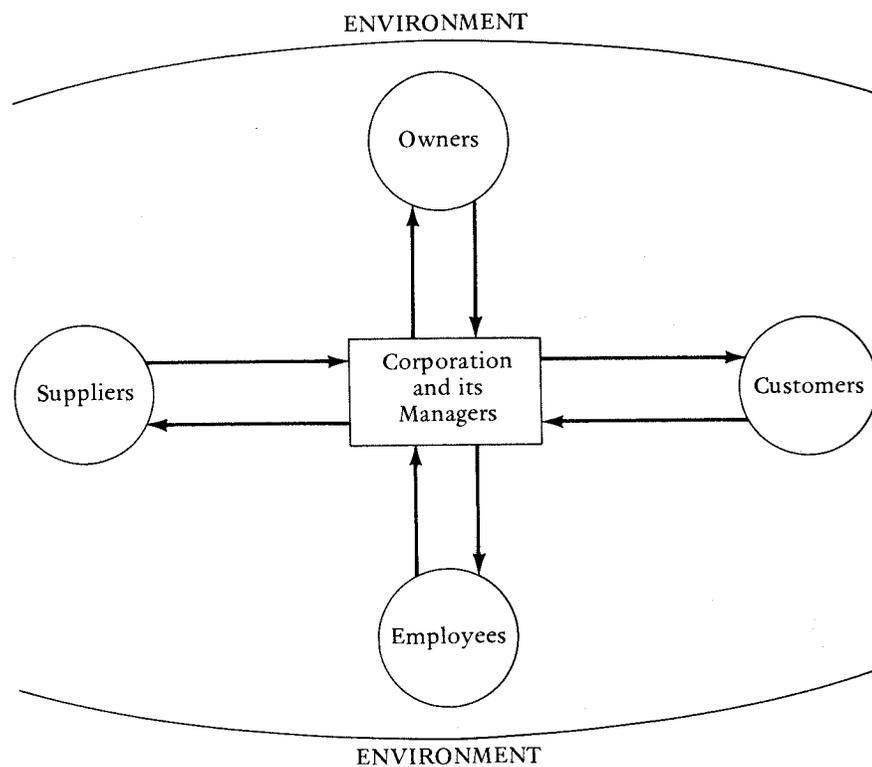
EXHIBIT 1.1 *The Production View of the Firm*



hibit 1.2 depicts the resulting separation of ownership and control, which we might call the "Managerial View" of the firm. Ownership became more dispersed, as banks, stockholders and other institutions financed the emergence of the modern corporation. In order to be successful, the top managers of the firm had to simultaneously satisfy the owners, the employees and their unions, suppliers and customers.⁶

The conceptual model, depicted by the Managerial View of the firm, is more complicated than the Production View. If a manager only used the Production View to understand the world and managed the business using the concepts and techniques which resulted from it then failure would be the sure result. By paying no attention to owners and employees, each of which now had a stake in the firm, and by having no concepts with which to manage these relationships, managers could guarantee their own demise in the form of new management or debilitating strikes and work stoppages. Success in the "new" environment required a *conceptual shift*. It required

EXHIBIT 1.2 *The Managerial View of the Firm*



the adoption of new concepts and ideas which dealt with owners and employees as a matter of everyday occurrence rather than as an exception.

An analogy of such a conceptual shift being necessary may help us. Suppose that you make a New Year's resolution to do a better job of cleaning up your office. You buy a file drawer and construct a set of "categories" into which you file all of your important papers, memos and reports. Each file is carefully labeled, and let us suppose that you are religious in your zeal to keep your desk clean and your papers filed. You find that your system works quite well for some time, but you notice that as time passes the file labeled "MISCELLANEOUS" keeps getting larger and larger. You have to add new files with new categories, some of which overlap the old set of categories. Cross-referencing becomes such a nightmare that you and your secretary finally give up.

Furthermore, you find that some of your files are no longer used. You make very few additions or deletions to these old files. If these problems are left unsolved, pretty soon your filing system becomes a mess. You can't find anything "important" anymore. Your files have become an effective way of dealing with the past, but not the present and future. Your desk soon re-assumes its cluttered look and you must make another effort to start over at the New Year.⁷

What went wrong in this simple example? Your filing system became obsolete as changes took place in the world around you. Patching up the system by adding new files worked for a while, but eventually the whole file drawer needed to be "rethought," and a newer more appropriate set of files and categories needed to be established. In short you were in need of a *conceptual revolution*.

Managers in the modern corporation are in a similar position. We are in need of new concepts, new "conceptual filing systems," which reorient our way of looking at the world to encompass present and future changes. Piecemeal solutions such as calls for "increased productivity" using Japanese or European or Theory N techniques are not the answer, for they only add, subtract or refile some of the issues that need addressing. Likewise, calls for business-government-labor cooperation are only part of a solution. Such proposals for "an industrial policy" do not address the underlying conceptual revolution that is necessary.

I believe that Exhibit 1.2 is a picture of the predominant framework for the modern corporation. The corporation is viewed as a resource-conversion entity, taking raw materials and converting them into products, with dollars measuring the transactions. Returns are provided to owners in the forms of dividends or capital appreciation in the marketplace. Wages, benefits, and oftentimes job security, are provided to employees. Clearly, Exhibit 1.2 is inappropriate for the current state of the modern corporation.⁸

There have been varying degrees of recognition of the external environ-

ment which surrounds this resource-conversion entity called the modern corporation. Many have argued, from Adam Smith (1759) onward, that business is a social institution, but that its role can only be realized by an external environment which allows "laissez faire capitalism." Such a policy requires that the dominant mode of thought be oriented towards "production," while recognizing, or at least saying, that business is a social institution. On the other hand, there have been calls for the nationalization of business activity on the grounds that the modern corporation is too far removed from its social roots.⁹

Both approaches seem to miss the mark. I believe that we need to more carefully understand the causes of this external turbulence and to construct a framework which allows managers to more effectively handle turbulent external environments. The turbulence that business managers have experienced in recent years can be understood as coming from two main sources. The first, I shall call "internal change," or the changes in the relationships depicted in Exhibit 1.2. The second source of turbulence is "external change," or change in the very nature of the picture in Exhibit 1.2, so that it is no longer an appropriate picture of the external environment of the modern corporation.¹⁰ The changes that I shall catalog have not occurred all at once, nor are some of them even recent. The problem is that our conceptual system that we use to understand and deal with these issues is no longer valid. External turbulence is nothing new to managers in business. What is necessary is the development of a theory, or picture, of the world which allows us to manage these changes more effectively. We need a new filing system.

INTERNAL CHANGE

Change has occurred in each of the relationships in Exhibit 1.2. Such changes are internal to the conceptual system that the Managerial View represents. Internal change requires us to constantly reassess current objectives and policies in light of new demands by groups that we are used to dealing with such as customers, employees and their unions, stockholders and suppliers. Internal change requires action, but it does not directly challenge our conceptual map of the world.¹¹ Internal change occurs within the current "filing system"; it happens according to well-understood rules; and, difficult as it is, internal change is what we are used to dealing with on a daily basis. Let's see some examples of the internal changes that have occurred over the past few years.

Owners

No longer can management assume that the primary concern of those who own shares of stock is return on investment. The 1960s were a ripe period for owners who wanted not only returns, but control as well. Thus, the Wall Street Rule, "If you don't like the management, sell the stock," was turned on its head to "If you don't like the management, buy enough stock to throw the bums out."¹² The Wall Street Journal is filled with the latest news of mergers, takeovers and white knights. The Chief Executive Officer (CEO) who worries only about paying dividends to stockholders, or increasing the value of their equity by earnings per share and stock price increases, is sure to be a prime candidate for unemployment through takeover. Of course, if the Price/Earnings ratio is high enough, the chances of takeover will be greatly diminished, and we see that some CEOs have emphasized the P/E ratio at the expense of making needed investments for the future. The dilemma is the well-known tradeoff between short-term results and long-term health. By concentrating on the short-term, in the form of managing the P/E ratio, the CEO maintains a margin of safety from takeover. However, by doing so the company becomes vulnerable to competitive attacks, rapid declines, and eventual takeover bids, negating the very margin of safety provided by high P/E ratios.

The relationship with owners has changed in a second way, perhaps even more fundamental. In 1969 Ralph Nader announced the formation of Campaign GM, a group which bought two shares of General Motors stock and intended to wage a proxy fight on social issues including the need for public transportation, and the rights of women and minorities, and on business issues such as product design for safety and emissions control.¹³ GM executives were not alone as "shareholder activism" increased to touch most of the Fortune 500. While the direct results are difficult to measure, suffice it to say that the CEO must worry about more than returns and takeovers in managing the owner relationship.¹⁴

Customers

For many years American businesses were dominant at home and their technology was dominant worldwide. That dominance has ended. Customers have many more choices today, and their view of U.S. products has changed, in both consumer and industrial products. "Made in Japan" has set new standards of quality, and where these standards have been ignored, the customer relationships have changed dramatically.

Hayes and Abernathy (1980) have argued effectively that U.S. managers have concentrated on designing and producing imitative, rather than innovative products. Our flair for technological innovation has been dampened, as U.S. managers have overemphasized the philosophy of being market-driven. The emphasis on trivial differences of product differentiation and packaging has made true innovations such as the laser and transistor almost unable to be managed in our corporations, and have given way to concerns of image and short-term returns from different customer perceptions. Combined with a penchant for making backward integration the major investment program, and a reluctance to invest in new manufacturing processes, Hayes and Abernathy claim that it is no wonder that U.S. managers find themselves coming out second best to foreign competitors in a marketplace that emphasizes quality.¹⁵

Employees

The United States has experienced an unprecedented drop in productivity over the past few years. While this phenomenon is a complicated one, and not easily understood or reducible to single causes, it should force scholars and managers alike to rethink the "manager-employee" relationship.¹⁶ *Business Week* (1980) talks of the "new industrial relations" and even high productivity companies such as AT&T have begun to experiment, as part of their contracts with their unions, with "quality circles" and "quality of work life." The work force in the U.S. is younger, and its values are changing. Many have argued that authoritarian management styles must be replaced with a more "human" approach, or that the concept of "participation" must be explored in practice. In particular, Peters and Waterman (1982) have argued that managing the "culture" or "shared values" of employees is more important than understanding strategy and structure. Their study of companies with "excellent performance" is remarkable in the finding of a managerial style that emphasizes the importance of employees to the company.

The changing nature of the employee relationship must be understood for each business, and we must act, for low productivity is a warning signal of decline that cannot be ignored. However, the issue is not so simple as understanding the needs of employees qua employees. Employees are often-times customers, stockholders, and members of special interest groups. The internal change in this relationship, therefore, must be analyzed in conjunction with the external changes surrounding the organization.¹⁷

Suppliers

OPEC is one of many symbols of the changing nature of the business-supplier relationship.¹⁸ Raw materials come from around the world, and no longer can a country such as the U.S. depend solely on its abundance within its shores. The transnational corporation has evolved to deal with the world-wide markets in raw materials.¹⁹ Yet the issue is not one of "where is the market," for as OPEC so expensively illustrates, there is much more at issue than the price and quality of commodities. Political issues and the politics of control are as important in managing supplier relationships as are price-quality relationships. Even though OPEC has lost some of its effectiveness recently, as markets have adjusted to higher prices by a decrease in the rate of growth, and as alternative energy sources have become more cost-effective, from a managerial standpoint the locus of control has shifted from the oil companies to the OPEC nations.

Where are the OPECs of 1990, today? After all, OPEC was formed in 1960 and for 13 years gradually usurped power and control from the major oil companies until the "crisis" of 1973. These strategic surprises are not confined to the exciting world of international politics and finance. In the fast growing "silicon chip" industry managers must also cope with "managing with scarcity." Public organization executives feel the same pressure when budgets are drastically reduced. How can service levels be maintained with scarce resources?

Thus, changes have occurred within the comfortable framework of the firm. Owners, customers, employees and suppliers are not what they once were, and the implications for management theory and practice are for change to accommodate these shifts.

EXTERNAL CHANGE

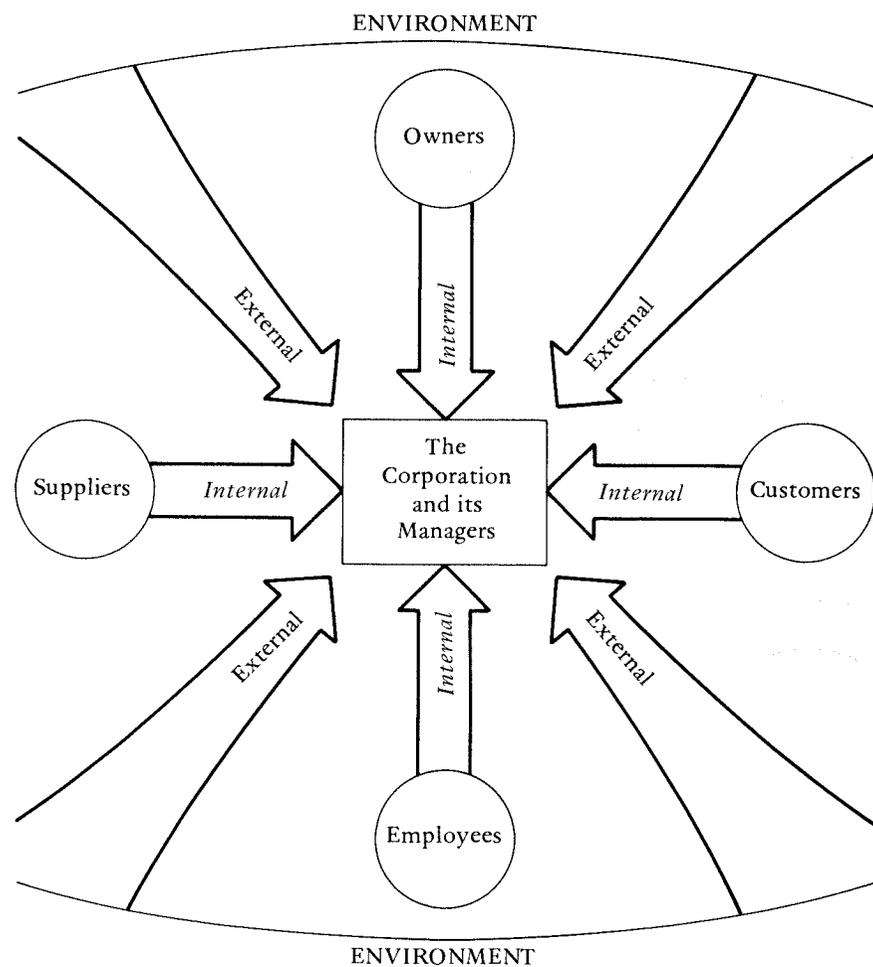
We can no longer assume that each of the groups depicted in Exhibit 1.2 continues to want the traditional outputs of the corporation and expects the same kinds of decisions from management. However, the more difficult assignment is understanding external change—change that affects the very nature of Exhibit 1.2—change that originates in that murky area labeled "environment" and affects our ability to cope with internal changes. *When external change is added to internal change, a redrawing of Exhibit 1.2 will be needed.* But first, let us examine these external changes more closely.

External change is the emergence of new groups, events and issues which cannot be readily understood within the framework of an existing

model or theory. It represents the need for new file folders in our conceptual system, and eventually for a whole new filing system. It is that dark and dangerous area known as "the environment," which serves as a convenient label for our ignorance, and which is as likely to serve up an OPEC as a Republican President. It is that abstruse area of the corporate plan that forecasts regulatory changes, increases in inflation and interest rates and changes in demographics.

External change produces uncertainty. It makes us uncomfortable

EXHIBIT 1.3 *Internal and External Change*



because it cannot be readily assimilated into the relatively more comfortable relationships with suppliers, owners, customers and employees. Exhibit 1.3 depicts the difference between internal and external change. It is important to note that the distinction between internal and external change is relative to a particular framework or theory. Using the Production View of Exhibit 1.1 we simply cannot understand the emergence of owners and employees without adding to, or changing, our theory. When enough external changes have occurred so that our current theory no longer gives us valid answers then we must abandon the theory and turn to a new set of concepts which explains both external and internal change. In short, what we need is a theory or set of concepts which can turn external change into internal change, thereby reducing uncertainty and discomfort. Such an "intellectual" or "conceptual" move serves as a legitimizing force so that such changes can be positively managed. It also allows our scanning systems to look for broader newer kinds of external change. External change is depicted as a set of arrows from the environment that affect our comfortable relationships with suppliers, owners, customers and employees. External change can be understood in terms of the emergence of several new groups and the restructuring of old relationships of lesser importance, who have come to have a stake in the actions or inactions of the corporation. Many of these changes have been around for some time, yet we have been quite slow to incorporate them into our framework for managing the firm. So, events and pressure groups with which we should be familiar become crises because we have not incorporated the idea of their existence into our day-to-day routine.

Governments

The recent past has seen an increase in the awareness of the role of government in the business enterprise. So much so, that public officials have been elected on the promise of curtailing this role, and seeking a return to "free enterprise." The business-government relationship in the U.S. has been founded on the principles of the "watch-dog," i.e., it is the legitimate role of government to regulate business in the public interest, and to enforce strict anti-trust laws to insure adherence to market principles. In addition the Congress and the Courts have always played a major role, at least indirectly, in shaping the strategies and policies of the modern corporation. Epstein (1969), Lindbloom (1977), McQuaid (1982) and many others have debunked the myth of the separation of the business and political arenas.²⁰

While business has always had to contend with government in some form or other, current perceptions of its pervasive influence require a closer examination. It used to be sufficient to have a couple of lawyers or lobbyists

or even public relations people whose role was to insure compliance with regulations, or respond to legal challenges, or represent the firm before Congress and state legislatures. However, the explosion in the scope of government in the post World War II economy of the U.S. has made this method of coping ineffective. No longer do most firms rely solely on the abilities of several trade organizations and lobbying groups such as the U.S. Chamber of Commerce and the National Association of Manufacturers to manage their relationship with multiple actors in the government.

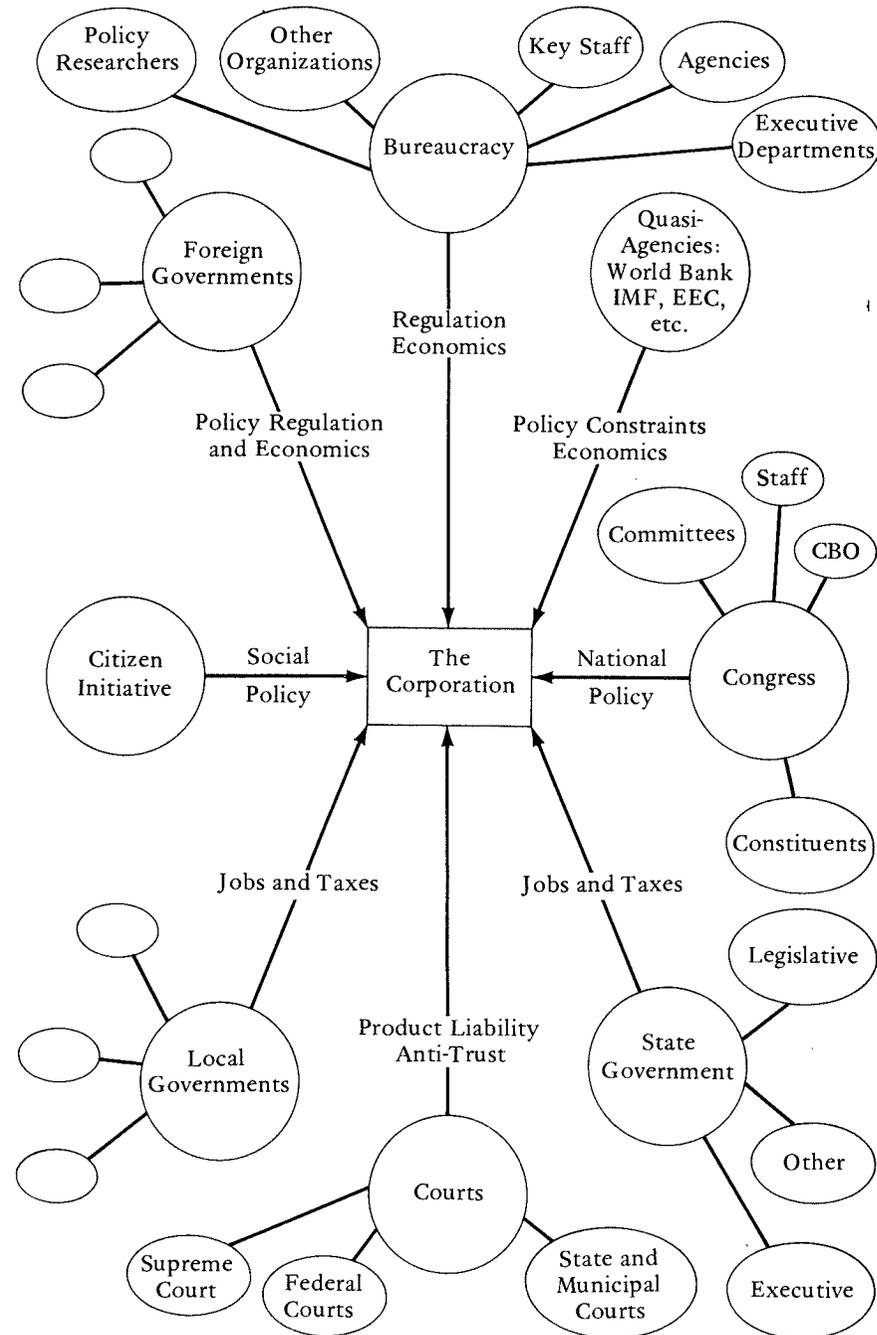
Critics of "big government" such as Weidenbaum (1980) have estimated the cost of regulation to business at over \$100 billion, and a recent study of the incremental costs of six agencies, EPA, EEO, OSHA, DOE, ERISA and the FTC has been estimated at \$2.6 billion.²¹

Of course, these numbers are easily disputed and bitter exchanges among a number of interested parties have taken place regarding how to measure the costs and benefits of government. Critics of "laissez faire capitalism" have claimed that business attacks on the ills of government are misfounded, and that if we look closely we will see that regulatory agencies often benefit and protect the industries that are regulated. Furthermore, some critics argue that government intervention in the marketplace has real social benefits that would not have occurred without government action. Thus, cleaner air and water, safer automobiles and a general increase in the standard of living are attributed in part to government action.

The issues here are far from settled and political scientists and policy makers continue to debate cause and effect. I believe that from the managerial standpoint these repartees miss the major issue: how to manage in a world where there are multiple influences from various levels of government, or more properly from governments, and where the corporation and its managers can in turn affect the direction of public policy and government action? A necessary condition for answering this question is that we understand the interactions that are possible among business and various government actors. Government is not a monolithic entity, and it does not exist in a vacuum. Agencies, Congressional Committees, Presidential Commissions, Staff Members are all susceptible to multiple influences. (Each must be responsive to those groups and individuals who can affect it.) Exhibit 1.4 is a partial and enormously simplified diagram of some of the key government actors and their stakes in business.²²

Most of the talk of reform centers on the so-called "harassment" agencies of the Business Roundtable study. Yet the U.S. federal bureaucracy is a large and fragmented "entity." The common boss of many agencies is the President, and conflicts among competing agencies simply cannot be resolved by the standard business practice of escalation, because the decision-making

EXHIBIT 1.4 The U.S. Business-Government Relationship: A Simplified Picture



system would be paralyzed. So, many contradictory regulations are written, and it seems as if the bureaucracy has a life of its own.

Additionally there are many "quasi-agencies" which affect business such as the World Bank, the IMF, the U.N., the O.A.S., etc. These organizations are not entirely U.S. dominated, and they sometimes propose policy constraints, for example, by de facto determining the amount of credit available to some countries to purchase goods and services.

Foreign governments are structures in themselves which we must understand if we are to be successful in other countries. The most often heard complaint is that other governments don't "play fair," meaning that there are different sets of rules for home companies and for foreign companies. "How can we compete with Japan, Inc. when we must spend resources overcoming government obstacles, and Japanese companies not only have no obstacles, but have protection and assistance in access to markets, capital and basic research and development?"

The Congress considers several thousand pieces of legislation every session, some of which can have drastic effects on businesses. In addition, national policy changes, such as tax and depreciation schedules, capital formation incentives, and the creation of new forms of regulation affect the business community as a whole, even if the marginal effect on a single firm is slight. Hence, today's CEO must spend a good deal of time and resources worrying about proposed public policy legislation from Congress.

State governments offer a different set of issues for management, and these issues vary from region to region. Companies who operate on a national scale often find themselves with numerous sets of regulations. Most national breweries, for example, ship to multiple states from large regional breweries, yet tax and packaging requirements vary from state to state, even to the kind of packaging which is permissible. State legislatures consider several hundred thousand pieces of legislation every session, and the resources expended just to stay informed, much less to try to actively participate, are enormous. Concerns with jobs and taxes permeate the Northeast, while concerns with how to manage the enormous recent growth permeate the Southwest. Laws which encourage plant location and penalize plant closings are proposed in each legislative session, making it difficult to formulate and implement policy in the traditional piecemeal legislative fashion.

The courts offer yet another source of government influence on business. The old model learned from the grammar school civics books of the separation of executive, legislative and judicial branches of government simply does not apply in today's world; and no amount of tears will bring about that pristine Jeffersonian world.²³ From historic products liability

decisions and equal opportunity cases, to anti-trust issues, the courts, at the state and federal levels can affect the nature of business.

Local government also gets into the act, as it depends more than other governments directly on the revenue generated by business for its lifeblood. One need only visit the decaying urban areas in the Northeast to see this point. Not only does the tax base erode when business no longer operates, but more importantly, revenue producing jobs are gone and the local economy takes a nosedive.

Finally, there is the matter of direct government through citizen initiative. There have been initiatives on the ballots in a number of states which would directly affect business. These range from bottle deposit bills passed in several states to bills to curtail smoking in public. An amendment to the Constitution of the U.S. has even been proposed for a system of national referenda, similar to the system used in several European countries. Needless to say the effect on an individual business can be considerable.

The point of Exhibit 1.4 is not merely to reaffirm that any one government or piece of government can affect a firm but rather, when taken in conjunction, we see that the cumulative effect is enormous. Management simply must undertake an organized effort to deal with governments in a strategic fashion, and if the model of the firm is that of Exhibit 1.2, then it is almost impossible to do so. They will react to events and crises in the short term and will not play their necessary role in the public policy process.²⁴

Competitors

Competition has been the cornerstone of our system of managerial capitalism and perhaps the change in the nature of competition which has taken place in recent years should more properly be understood as an internal change. However, the major factor has been an external one, that U.S. business has not had to deal with in the past: foreign competition. Hence, the denotation as external change. In the 1950s "Made in Japan" meant "junk" or "cheap" or some such derogatory term, while in the 1980s it is perceived to be the hallmark of quality. The effect on the automobile industry has been debilitating. The real competition for GM is hardly the traditional new model from Ford or Chrysler, but rather the market leading behavior of Honda, Nissan, Toyota and Volkswagen. Nor, is this phenomenon specific to automobiles. There is competition from abroad in almost every "U.S. dominant" industry. The most difficult issue with foreign competition is that they do not play by the same rules, in terms of

government, culture and other factors. Hence, to know the competition is a gargantuan task which requires an ability to understand other cultures from the ground up, from language to other ways of life.

In part, it is the emergence of foreign competition which makes the necessity to abandon the Managerial View of the firm so urgent. As long as all significant competition is domestic, everyone must play by the same rules. Each competitor bears the burden and shares the benefits of government, a fickle consumer population, environmentalists, etc. There is an "umbrella effect" by which firms in an industry can implicitly or explicitly coordinate their response to various issues. No one is at a competitive disadvantage, hence everyone can afford to proceed as if the Managerial View were still appropriate. When foreign competitors figure out how to satisfy customers and government with high quality products that are less expensive and meet all requirements, then the umbrella folds. This scenario has already taken place in several businesses.

Consumer Advocates

Much has happened since the early 1960s when President Kennedy announced the "Consumer Bill of Rights" beginning the modern "consumer movement." Consumer advocates today affect almost every industry involved in consumer goods marketing. Most executives are familiar with the story of Ralph Nader and General Motors' Corvair, which resulted in national prominence for Nader and the end of a product line for GM. Other activists have taken on other industries from pharmaceuticals and infant formula to utilities, many perhaps spurred by Nader's original success.²⁵ Even with today's "New Right" approach to public policy that has been favored in many quarters, we still find the voice of the consumer advocate—though the ability to get swift action via government agencies such as the FTC has waned.²⁶

However, the problem is really much deeper. The consumer movement can be viewed on the one hand as merely a means to publicity and national prominence for aspiring politicians, following Nader's example. These consumer advocates constantly seek attention and media coverage; they will have to find issues which appeal to both media and the majority of the public. No doubt there are some consumer advocates who fit this mold.

An alternative view of the consumer movement is perhaps better understood using Hirschman's (1970) model of exit, voice and loyalty.²⁷ Hirschman argues that social phenomena can be understood in terms of people who can choose one of three possible strategies in most situations. Let us consider the customer of a firm, and suppose that for whatever

reason, the customer is unhappy with the product. He or she can exit, simply take the business elsewhere and buy from another producer, given that there is a reasonable number of competing firms. Exit is the paradigm of the "economic" strategy. When enough customers exit, the firm gets the message that its product is no longer viable, that it is not producing at the "efficient frontier." Feedback to managers who rely solely on the exit strategies of their customers is "poor, nasty, brutish and short."

Alternatively, the customer can exercise "voice," that is, complain and try to get the firm to change or give redress. "Voice" is the paradigm of the political strategy, or using the political process to achieve change. It comes in multiple forms. Voters exercise voice at the ballot box. Interest groups try to exercise voice by pressuring government or business to act. Consumer groups may bring suit against a manufacturer, or they may use the political process to initiate change via intervention with regulatory agencies, initiatives, Congressional lobbying, etc. Feedback to the manager when customers use the voice strategy is more immediate (and in fact could conceivably be too immediate if the customer has not given the product time to work, or gotten accustomed to its side effects, or whatever quirk it may have).

Hirschman argues that the degree of organizational loyalty will determine the mix of exit and voice that is used. He argues that both exit and voice are necessary for the efficient functioning of the marketplace, for the costs of exit alone may well be too high, because the firm never has a chance to recover. Voice becomes the signal for management that change may be in order. Of course, voice, too, has a cost. The information that voice provides does not come free to the managers who need it. Voice mechanisms must be assessed in part in terms of whether they are cost effective, and in terms of the available alternatives.

Hirschman's model yields an interesting analysis of the consumer movement. We should not view it as adversarial, or to be avoided, but as a rational response. Voice should be encouraged and complaints welcomed with open arms. By announcing to management that some actions or particular policies or products are unacceptable, consumer advocates force management to continually be responsive to changing marketplace needs.

Many successful companies recognize the importance of the consumer movement. Proctor and Gamble expends a great deal of resources handling consumer complaints, and AT&T has formed Consumer Advisory Panels (CAPs) to assist them in diagnosing consumer reactions to possible changes in rate structures and new products and services. These companies have not had an easy time in dealing with consumer leaders, but they now know that the alternatives are not pleasant. A recent session with several Japanese managers elicited a list of those groups who could affect the company in

Japan. Further discussion revealed that "consumer advocates" were considered to be most important. When questioned as to why, the response of the Japanese managers was simple and revealing, "we want to listen so that we can fix what is wrong with the product."

Many consumer leaders want change in the marketplace. They know that, if necessary, government can be brought into the picture. However, the cost ultimately would be borne by the consumer, either through higher taxes or higher product costs. Therefore, they are amenable to real voluntarism, and to negotiation outside the formal arena of government. The predominant response of business leaders to consumer advocates has been adversarial, which in turn heightens the wariness of consumer leaders, which in turn. . . . conflict escalates, and both sides lose. If we believe that the consumer movement is here to stay, and given Hirschman's analysis it is rational to hope that it is here to stay, then it becomes a major managerial challenge to take advantage of the opportunities presented by the consumer movement.

Environmentalists

Yet another outgrowth of the turbulent 1960s is the concern with environmental quality: clean air, water and land, as well as conservation of natural resources. The "environmental movement" has roots that are as old as the pioneers. Several prominent organizations such as the Sierra Club and the Audubon Society have been around for some time. Several events of the 1960s heightened the consciousness of many members of the public, and gave rise to the environmental advocates which many executives now face.

Throughout the early part of our history, and spurred more recently by Sputnik and its aftermath, technology was seen as unalterably good. The possibility of unintended consequences occurring simply was not taken into account. Few questioned the costs of polluting water and air supplies for it seemed as if nature was infinitely self-renewable. Rachel Carson's *The Silent Spring*, published in 1962, questioned whether or not our society was in for trouble due to pollution and its aftereffects. The "culprits" naturally enough, were "Big Businesses," and the answer to the problem was government regulation.

During this period the U.S. was proceeding with plans to land someone on the moon and to build a colossal supersonic transport (SST) aircraft which was an order of magnitude more sophisticated technologically than the British-French Concorde (Horwitch, 1982). Activists attacked this latter

effort as wasteful and harmful to the environment. Controversial issues such as the sonic boom, and harm to the ozone layer and oceans were raised. Government departments sponsored studies which tried to prove the critics wrong, thereby intensifying the debate. The important issue about the SST controversy was that for the first time there was a national debate over the costs and benefits of a particular technology, and over these costs and benefits in environmental terms. This debate was followed by the Clean Air Act of 1970 and the Clean Water Act of 1972. The Environmental Protection Agency was formed and environmental concerns were institutionalized.

Executives complained of onerous regulations. Automobile manufacturers were again hurt, and the cost of automobiles climbed. Foreign competitors could meet the new standards much more effectively than U.S. manufacturers, in part because their product lines did not depend on the large "gas guzzler," making the industry vulnerable to competition from Germany and Japan. Some companies tried to respond to environmental demands, yet the cleanup costs of generations of neglect were staggering.

There are no easy answers to the questions and issues raised by environmentalists. The need to take this external change into account is still with us, despite recent political shifts to the right. The Managerial View of the firm, depicted by Exhibit 1.2, becomes overloaded again when the cumulative effect of these changes is considered.

Special Interest Groups

There is a more general phenomenon that underlies the shifts in the business environment engendered by government, foreign competition, consumer advocates and environmentalists, that is the concern with "special interest groups" (SIGs) or "social interest groups" or "single issue politics." The idea behind SIGs is that a group or individual can use the political process to further a position on a particular issue such as gun control, abortion, women's rights, prayer in schools, or Congressional veto of the FTC, or any of hundreds of other issues. The problem which SIGs represent for the manager is that one can never be sure that an ad hoc group will not form to oppose the company on any particular issue.

Special interest politics is not a new phenomenon.²⁸ However, changes in modern communications technology and the financing of elections makes it especially important for managers to be aware of the agendas of interest groups. Epstein (1980) has analyzed the emergence and impact of Political Action Committees (PACs) who by their very nature can get the ear of legislators. Organized protest groups can attract media attention nation-

wide, and can use the political process to their advantage. Thus, the ability of business managers to respond to a variety of issues and events is crucial to success in industries that are vulnerable to special interest groups.

Today's managers need theories and realistic help in dealing with special interest groups as they affect their businesses. In particular they need to take this external change into account when setting their business strategy.

Media

Little stirs the anger in an executive more than an "unfair" story in the press. When one's company or products, or even one's character has been attacked in a forum where there is little chance of reply, the feeling of anger quickly turns to helplessness. More and more post-Watergate investigative reporters have turned their attention to the private sector. There, spurred onward by such films as *The China Syndrome*, new seminars on "how to handle the press" have emerged. It is quite easy to wake up in a cold sweat from the nightmare of the "60 Minutes" crew showing up unannounced at corporate headquarters to investigate the latest consumer or employee complaint.

Mass communications technology has indeed changed the role of the media with regard to business. More than ever, large organizations live in a fishbowl with their every action open to some form of public scrutiny. The media represents another form of external change for the executive who wishes to succeed in today's environment.

THE NEED FOR A FRAMEWORK

As managers like Bob Collingwood try to formulate coherent strategic plans and to implement these plans in some semblance of their original form, all too often they run afoul of the external environment. The Managerial View of the firm simply provides no cohesive way of understanding the changes that have and will occur. Managers have a difficult time separating real from trivial changes, and in deciding where a response is called for, and where preventive measures need to be taken.

The external events, furthermore, have not merely happened and then gone away, but rather, they have had a lasting effect on business-as-usual. The differing effects of external change are of intensity, and not of kind. For example, the environmentalist concerns affect industries that are involved directly in "exploiting" the environment, such as the forest products and petroleum industries who use products of those industries. But most

businesses are dependent on transportation systems to some extent, where environmental concerns have altered both product design and other strategic variables.

The temptation is for executives and theorists to engage in a version of the more popular TV game shows, that I like to call, "Blame the Stakeholder." In "Blame the Stakeholder," contestants who must be managers in companies that have experienced some of the changes cited above, are asked to pick a stakeholder group and to blame the position of the company on that stakeholder group. Of course "Government" is a favorite, as is "Special Interest Groups." "Blame the Stakeholder" makes little progress, however good it makes us feel, and we must take a more careful look at the kinds of responses that are open to us.

① Freud (1933) has cautioned us about the false comforts of denial and projection. Denial occurs when we refuse to admit that the external world is the way that it is. In our case, it is a refusal to admit that external groups really do have a stake in the firm, and that they can affect the firm. Denial involves not considering stakeholders to be legitimate in the very weak sense of the term: it is legitimate for us to spend time worrying about our strategy for stakeholders because they can affect the accomplishment of our goals and plans. Projection occurs when we blame someone else, or some external event for our own shortcomings. It is easy to project our inability to satisfy stakeholders' concerns and demands on the group itself, and to call it "unreasonable" or "irrational."

③ Another response pattern is available and it was summarized best in the comic strip "Pogo": we have met the enemy and he is us. It is the role of the manager to accept and own the problems which result from the failure of the organization to meet stakeholder needs. Not all needs can or should be met, and we cannot avoid horrible mistakes at times, yet our own fallibility is little excuse for failing to acknowledge the inadequacy of continually playing "Blame the Stakeholder."

The response of organizations to these changes in the environment has been as varied as the changes themselves. Ackoff (1974) and Post (1978) have argued that organizations have four basic modes for coping with a changing external environment. The first mode, *inactivity*, involves ignoring the changes and continuing business as usual. The second mode, *reactivity*, involves waiting for something to occur and responding to that change; however, response must be stimulated by an external force. The third mode, *proactivity*, involves trying to predict the external changes that will occur and positioning the organization towards those changes before the fact. The proactive mode is anticipatory. The fourth mode for coping with external forces is the *interactive* mode, that is, active involvement with the external forces and pressures that seeks to create the future for all con-

cerned. While each of these response modes is appropriate for certain sets of circumstances, they all presume the existence of a set of ideas for dealing with any external change, even in the inactive mode. *In short, a necessary condition for adopting one or another of these response modes is to be able to understand the changes that have occurred.*

The very foundation of our ability to respond to change is in need of repair, and the magnitude of change outlined above requires new ideas and practices before we can formulate meaningful responses, regardless of the mode. (Imagine someone adopting an inactive mode, and because of the lack of the proper conceptual apparatus, the inactive mode turned out to yield proactive responses!)

If the dominant conceptual model of the modern business firm is that depicted by Exhibit 1.2, we cannot possibly assimilate the strategic shifts that have occurred, either for the business community as a whole, or for a particular set of businesses. *Major strategic shifts in the business environment require conceptual shifts in the minds of managers* (Emshoff, 1978; McCaskey, 1982). Just as the separation of the owner-manager-employee required a rethinking of the concept of control and private property as analyzed by Berle and Means (1932), so does the emergence of numerous stakeholder groups and new strategic issues require a rethinking of our traditional picture of the firm.

Thus, the environmental shifts that have occurred have given rise to a dilemma. On the one hand it is necessary to understand each of these shifts individually in order to adjust the position of the firm as it now stands relative to the individual shift. However, on the other hand, if enough of these small changes take place, piecemeal responses will not be adequate. The changes, both internal and external, that have taken place yield a need for a radical rethinking of our model of the firm. This rethinking, or conceptual revolution, is a subtle point. Like the dilemma it is intended to dissolve, it must redraw the boundaries of the manager's job in terms that he or she can understand, while taking into account the sum of all the changes that have occurred. The concepts that we need to employ must help us to understand the changes in the individual relationships of groups that affect the corporation, and they must assist in putting the pieces together again. The ship must stay afloat even while it is being repaired.

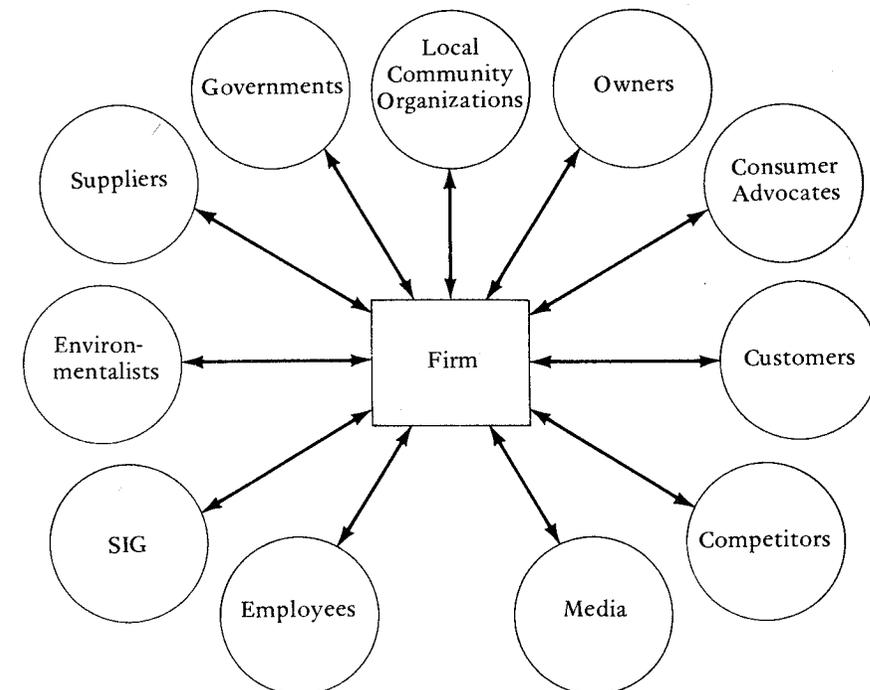
THE STAKEHOLDER CONCEPT

One possible approach to this conceptual problem of dealing with the external environment of the firm is to redraw our picture of the firm, Exhibit 1.2, in a way that accounts for the changes described in this chapter.

Exhibit 1.5 is a map of the firm which takes into account all of those groups and individuals that can affect, or are affected by, the accomplishment of organizational purpose. Each of these groups plays a vital role in the success of the business enterprise in today's environment. Each of these groups has a stake in the modern corporation, hence, the term, "stakeholder," and "the stakeholder model or framework" or "stakeholder management." The Stakeholder View depicted in Exhibit 1.5 is enormously oversimplified, for each category of stakeholder groups can be broken down into several useful smaller categories. All employees are not alike, just as all government is not alike. We shall see more of the complications of Exhibit 1.5 in chapter 3.

If we explore the logic of this concept in practical terms, i.e., in terms of how organizations can succeed in the current and future business environment, we are on the proper road to understanding and managing in turbulent times. However, the road is not an easy one. Cherished myths die

EXHIBIT 1.5 Stakeholder* View of Firm



*Stakeholder = Any group or individual who can affect or is affected by the achievement of the firm's objectives. The groups listed here are examples of categories of stakeholders.

hard, and for good reason: they have served us well in the past. The cost of error, given the current situation, is quite high. No longer will U.S. business merely see the results of using the old model in a new environment in terms of law suits and regulations, but also in terms of foreign competition with better products and services who can satisfy a variety of stakeholder needs.

Two issues immediately come to mind from Exhibit 1.5. The first is the need for new theories and models about certain non-traditional groups, and the need for organizational processes to put these conceptual models to work. Thus, managers must understand how government really works, as opposed to the "7th Grade Civics Book" model that most of us have (Fenn, 1979; Horwitch, 1982). We must understand how new issues arise and get on the agenda of Congresspersons and other government officials, and we must understand what organizational mechanisms are necessary for helping to shape the agenda. Tradition, in terms of "lobbying" or "voting Republican" or more recently "organizing PACs" need not be thrown away, but unless we are satisfied with the state of current business-government relations the need to rethink these strategies in other terms is critical.

A similar argument can be constructed for each stakeholder group. The point is that we must understand our strategy for each group and must assess the strategy in real terms. Just as in the Managerial View where we have well defined management concepts for each group, so must we develop expertise in new areas to deal with consumer advocates, environmentalists, the media, SIGs, etc. We must understand how stakeholder groups and the issues of each are started, the importance of key issues and the willingness of groups to expend resources either helping or hurting the corporation on these issues.

The second major area for analysis is the need for integration. We can no more manage in isolation than Alfred Sloan could manage GM in isolation given the turbulence caused by the managerial revolution and the need for the concepts expressed in Exhibit 1.2. Thus, we need concepts and processes which give integrated approaches for dealing with multiple stakeholders on multiple issues. For each major strategic issue we must think through the effects on a number of stakeholders, and therefore, we need processes which help take into account the concerns of many groups. For each major stakeholder, those managers responsible for that stakeholder relationship must identify the strategic issues that affect that stakeholder and must understand how to formulate, implement and monitor strategies for dealing with that stakeholder group. Many organizations do this well with one stakeholder group, viz., IBM with customers, AT&T with regulators, Campbell Soup with suppliers, etc. Integrative metaphors are necessary which take into account the tried and true wisdom

of "Customer Service," "Employee Participation," "Return to Owners," etc. However, these metaphors or organizational values must seek to integrate a number of stakeholder concerns.

SUMMARY AND PROLOGUE

This chapter has shown that changes have occurred in the external environment of business which necessitate changes in the way that executives think about their organizations and their jobs. In particular, I have suggested that shifts in traditional relationships with external groups such as suppliers, customers, owners and employees, as well as the emergence and renewed importance of government, foreign competition, environmentalists, consumer advocates, special interest groups, media and others, mean that a new conceptual approach is needed.

This book is to explore the new approach, called "the stakeholder approach," in practical terms. My focus is on how executives can use the concept, framework, philosophy and processes of the stakeholder approach to manage their organizations more effectively. It is, however, a beginning rather than a panacea. I shall draw on the work of many others and seek to use their insights to begin the construction of a stakeholder model of the firm. I shall pay particular attention to the problems identified above: the need for theories and strategies for dealing with particular groups and issues, and the need for processes for integration across issues and groups.

The remaining chapters in Part I are a further description of the building blocks of the stakeholder model. Chapter 2 sets forth the conceptual history of the stakeholder approach and related concepts. Chapter 3 describes the stakeholder framework and philosophy in more detail. Part II focuses on the managerial processes necessary to use the stakeholder concept. Chapter 4 explicates "direction-setting" processes. Chapter 5 describes a process for formulating strategic programs for specific stakeholders. Chapter 6 focuses on implementation and control and describes the experiences of one large organization which has begun to implement the stakeholder approach. The chapters in Part III explore the implications for management practice and theory, if we move the stakeholder concept from the periphery to the center. Chapter 7 examines the work of the board of directors. Chapter 8 looks at the issue of the functional disciplines of management. Chapter 9 explicates the need for a new concept of the role of the executive, given the stakeholder approach. It also contains a brief summing up and a discussion of future research.

Other words:
Substantive?

NOTES

1. The profile of Bob Collingwood is a composite taken from the executives who have participated in the research on which this book is based. During the past five years I have had the opportunity to talk with several thousand managers in a number of industries. These talks have taken various forms, from structured interviews on which I have files of data to informal conversations during executive education programs. I have tried to wander around a number of organizations to try and get a conceptual handle on the kinds of external problems which their managers deal with on a day to day basis. My goal is to begin to construct a theory, so I have been trying to understand the entities which the theory is about. For a more sophisticated view of theory construction with which I am in general agreement, even though the present effort must fall short of its criteria, see Goodman (1955), Quine (1960) and Rudner (1966). I have tried to differentiate between theory construction and theory validation in Freeman (1977). Quine (1960) using Neurath's metaphor, has put the point elegantly by likening theory change to rebuilding a ship while it remains afloat: "The ship may owe its structure partly to blundering predecessors who missed scuttling it only by fools' luck. But we are not in a position to jettison any part of it, except as we have substitute devices ready to hand that will serve the same essential purpose" (Quine, 1960, p. 124).
2. While what I have to say applies to both business and non business organizations I shall concentrate on the applications of the stakeholder concept to corporations, and in particular, for profit corporations. It should be equally clear that government agencies have stakeholders, as do not-for-profit organizations and volunteer organizations. For an example of applying this methodology to hospitals see Freeman, Banker and Lee (1981).
3. Of course, this is a tremendous oversimplification of the issues. Business has always dealt with non-marketplace stakeholders. Joseph Wharton, himself, was heavily involved in lobbying the government for import protection laws (Sass, 1982). For an even earlier view of the essentially social nature of capitalism see Braudel (1981).
4. "Paradigm" is a completely overused and misunderstood term, especially in the social sciences. For a discussion of why "paradigms" are not the tidy little animals they are often supposed to be see Kuhn (1970), Lakatos and Musgrave (1970), Feyerabend (1975) and Gutting (1980). Alternatively see Barnes (1982) and Mohr (1982) for more direct applications to social science. McCaskey (1982) uses the notion of "conceptual maps" which may be more applicable to the argument being developed here.
5. There are relatively few studies of organization-environment relationships over time, for the obvious reasons that longitudinal studies are quite difficult and expensive. See Van de Ven and Joyce (1981) for reviews of several longitudinal research programs. Emery and Trist (1965) analyzed the underlying reasons for environmental turbulence and proposed a framework for understanding the relationships in the environment which did not directly affect the organization,

- but which could determine how turbulent the organization's environment happened to be. The contributions of organization theorists in general are discussed in chapter two.
6. The literature on the emergence of the modern corporation is extensive. Chandler (1962; 1977) provides a readable account with a guide to many other sources contained in the footnotes.
 7. I am grateful to Professor Mariann Jellinek of McGill University for the file drawer analogy.
 8. My argument here is a conceptual one. I know of no logical guarantee which could be issued to support the claim that a "weltanschauung" was of a certain sort. Quine (1960) discusses the resulting "translation problem" among persons who have different world-views or, in his case, speak different languages. There is weaker evidence that Exhibit 1.2 does depict the intended world-view of managers from the viewpoint of writers of textbooks on business. I only claim that if Exhibit 1.2 is the predominant world-view, then the organization-environment turbulence which we see today for most corporations is a logical consequence.
 9. It is often overlooked that Renault, owned by the French government, owns 51% of American Motors, Inc., and that British Petroleum, owned by the British government, owns a majority position in SOHIO. There are other cases of this phenomenon.
 10. My distinction between internal and external change is directly indebted to Watzlawick, Weakland and Fisch (1974). However, the two kinds of change are quite ancient relating to Aristotle's distinction between differences in degree (internal) and differences in kind (external).
 11. See McCaskey (1982) for a discussion of conceptual maps.
 12. See chapter seven, below, for a "stakeholder" approach to stockholders. I am grateful to David Reed for helping me to understand that the stakeholder concept can be used to analyze the business-owner relationship.
 13. For an account of the Nader episode see Nader (1972) and Hay, Gray and Gates (1976).
 14. For an account of stockholder activism see Vogel (1978).
 15. The argument is quite complicated here. A number of criticisms of U.S. management practices have surfaced in recent years. For a sample see Hayes and Abernathy (1980), Charan and Freeman (1980), Ouchi (1981), Pascale and Athos (1981) and Peters (1981). In reality these critiques go back to fundamentals enunciated by Barnard (1938).
 16. Recent commentators include Lasch (1978) and Yankelovich (1981) as well as the economic argument by Calleo (1982).
 17. This point applies equally well to all stakeholders.
 18. The formation of OPEC has been well documented. See, for example, Stobaugh and Yergin (1979).
 19. One account of the rise of the multinationals is Vernon (1977).
 20. It is really quite difficult to imagine how "business" and "politics" could be anything but inherently bound. Nonetheless, there are countless executives, whom I have spoken with in the past few years, who insist that business and

government have (should have) nothing in common. "Markets are markets and politics is politics!"

21. The study of regulation that was sponsored by the Business Roundtable, was conducted by Arthur Andersen and Co., an accounting firm. It relied on the reports of managers in the affected industries, and aggregated the costs across industries. The study is available from the Business Roundtable and Arthur Andersen and Co.
22. I wish to thank Professor Dan Fenn, Professor Ed Epstein and Professor Paul Tiffany for helping me to understand the business-government relationship.
23. See Fenn (1979).
24. See Epstein (1969) for an analysis of the role of the corporation in the public policy process.
25. For an account of the rise of the consumer movement which goes well beyond the popular belief that it started in the 1960s with Ralph Nader, see the collections of essays edited by Kelley (1973) and Aaker and Day (1974). I am grateful to Professor Currin Shields of Arizona University and past president of the Conference of Consumer Organizations, and to Ms. Esther Shapiro, Consumer Advocate for the City of Detroit, for many helpful discussions of the consumer movement.
26. See Pertschuck (1982) for an analysis of the current state of the consumer movement.
27. I believe that Hirschman's analysis is applicable to a number of stakeholder groups. There has been a great deal of discussion of his ideas in the economics and sociology literature. See Hirschman (1981) for a collection of essays that expand on Hirschman (1970). Evan (1975) applies Hirschman's analysis to a model of organizational constitutionalism.
28. For an account of special interests in the U.S. see Wilson (1981).

Two

THE STAKEHOLDER CONCEPT AND STRATEGIC MANAGEMENT

The changes catalogued in the previous chapter have spawned conceptual chaos in the management discipline. From the canned packages developed by management consulting firms to the theoretical treatises of academics, there has been an explosion in available advice to the practicing manager. Sorting out what is real from what is ephemeral is not an easy task, given that the fundamental assumptions on which theories of management and organization are based are undergoing radical shifts. Therefore, in setting out a brief history of the concept of stakeholder, I will cover a number of uses of the concept in the academic and non-academic literature, as well as relate the development of the concept to the strategic planning and strategic management literature. I shall try to help Bob Collingwood and the managers like him through the maze of academic literature and practical jargon.

HISTORY OF "STAKEHOLDER"

The actual word "stakeholder" first appeared in the management literature in an internal memorandum at the Stanford Research Institute (now SRI International, Inc.), in 1963.¹ The term was meant to generalize the notion of stockholder as the only group to whom management need be responsive. Thus, the stakeholder concept was originally defined as "those groups without whose support the organization would cease to exist." The list of

↳ Shapiro