Sailing the Dangerous Waters of Contradicting Stakeholders' Claims: A Simplified Chart

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ABSTRACT

The existing literature on stakeholder analysis examines two groups of opposing stakeholders those with rights to residual claims (shareholders) and those with implicit claims such as labor, government, non-government organizations. The vast majority of the literature focuses on how stakeholder interests are arranged in a dyadic relationship between the firm and one stakeholder. This paper moves beyond the traditional framework of stakeholder analysis introducing four aspects. First, we present stakeholders as a heterogeneous set of suppliers of particular resources (labor, fixed and working capital, raw material, technology solutions, access to public resources and legal approval of activities). Secondly asserting the proposition that all of these suppliers have contradictory interests to one and another we demonstrate how unlimited satisfaction of the claim of one stakeholder leads to the deterioration of firm performance. Thirdly, through developing a metric of relationship between a firm and a particular stakeholder we present the space where strategic decisions can be mutually acceptable to the firm and the stakeholder. Last, through the demonstration of trajectories of moving of the firm within that multidimensional space of acceptable strategic decisions we identify the strategies aimed toward simultaneous enhancing the general resource base of the firm, improving firm competitiveness, and shifting the boundaries of the existing markets.

INTRODUCTION

The Great Depression of 2008 put the end to attempts to present the interests of shareholders at the sole source of firm's purpose (see Jordi, 2010). Various arguments are developed in order "to end shareholder value tyranny" and find proper sources and models for sustainable development (see Raunor, 2009). Several models are developed concurrently proving that the objective of the company is to maximize the wealth of the entity as an entity and, at the same time, to ensure that the company is sustained financially (see Keay, 2008). However, the sources for such sustainability are still unclear and strategies to maximize the wealth of the entity are still not described in full details. This paper presents a complete model of possible firm's strategy of stakeholder management that may be used in both academic research and practice of management. The paper is organized as follow: in the first section, we redefine the notion of stakeholders and introduce the process of firm-stakeholder interaction in an input-output form. The second section is devoted to examination of the consequences of unlimited maximization of benefits of particular types of stakeholders. The third section introduces the multidimensional space of mutually accepted relationship between the firm and its stakeholders. The strategies and

techniques to navigate within that space are presented in the fourth section. Conclusions and suggestions for further research occupy the last section of the paper.

TURNING STAKESEEKERS INTO STAKEHOLDERS – FINDING THE PROPER SOURCE OF STAKEHOLDERS' CLAIMS TO DEFINE FIRM'S STRATEGIES

Stakeholder theory is still indebted to Freeman's definition of stakeholders as "any group or individual who can affect or is affected by the achievement of the firm's objectives." (Freeman, 1984: 25). However, over the last decades the emphasis of the definition has changed from merely "achievement of the firm's objectives" into "setting the firm's goals" (see a vivid discussion in Organization Science, 15 (3): 349-371). Why a stakeholder may claim that its/his/her specific interests should be taken into consideration ***before*** the firm's actions are executed, i.e. at the earlier stages of strategy definition? As usually, practice-oriented writers and researchers involved in empirical studies came ahead of theorists. Before Frooman introduced rather vague notions of "power" and "interest" in description of relations between the firm and its stakeholders (Frooman, 1999), Scholes proposed detailed measures to assess the relation between the quasi-rent of the firm and the quasi-rent of a stakeholder (Scholes, 1998); and Bendheim and her coauthors presented the relationship between the firm and its principal stakeholders (shareholders, customers, employees, environment and "community") in an input-output model (Bendheim et al., 1998). However, even Bendheim and her coauthors did not dare to introduce specific measures of stakeholders' "inputs", instead they used a dummy input for all stakeholders. We decided "to take the baton" and to follow the input-output logic. In 2006, we first presented stakeholders as merely suppliers of particular resources for the firm (Gurkov, 2006). As suppliers, they could exchange their "inputs" into corresponding "outputs" (benefits). Thus, the firm was presented as operating in various markets (capital markets, labor markets, markets for goods and services, markets of governmental patronage and public admiration) and attempting to secure the uninterrupted supply of resources. Consequently, the firm should exhibit (or rather create and develop) particular capabilities in stakeholder relations. The structure of such capabilities follows the structures of inputs provided by stakeholders so we may distinguish:

- capabilities to attract and keep the necessary financial resources (securing the input of shareholders);
- capabilities to develop new products and to offer such products at competitive prices (securing the input of customers);
- capabilities to attract the necessary workforce and to use the people in the most productive way (securing the input of employees) (see Gurkov, 2009: 52).

Three weak points, however, remained – the first was related to the specific claims of particular stakeholders, as even within one group of stakeholders their interests may differ (controlling and minority shareholders, qualified and unskilled employees, poor and affluent customers). We overcame that shortcoming by introducing the excessive lists of ***intrinsic*** benefits, common to all stakeholders within a particular type (see Table 1).

Table 1. Intrinsic costs and benefits for particular classes of stakeholders

Stakeholders	**Costs**	**Benefits**
Founders	Time, intellectual effort and other efforts, the risks	Entrepreneurial rent
Other shareholders	Risk, opportunity cost of capital	Dividends and increase in the value of assets (TSR)
Customers	Perceived price of goods	Perceived use value of goods or services purchased
Creditors	Risk loan default	Interest received on loan
Employees	Operating time, efforts, moral discomfort	Material and moral compensation, congruence with organizational climate, rise in employability
Suppliers	Quality of goods and services supplied	Revenue generated from goods and services supplied

The second weakness was an unclear composition of the set of stakeholders for a particular firm. No firm may exist without capital and labor, but introduction of other types of suppliers into the set of strategic actors depends largely on specificity of a business. For example,

- software developers have virtually no suppliers (a computer algorithm may be developed using a pencil and paper),
- a firm may totally avoid bank credits,
- a firm may have no survived founders or the initial business idea and technologies may change dramatically,

- a firm may prefer to work for a prolonged time without sales, stockpiling its products for a unique market opportunity (this is usual for painters and other independent artists).

We supposed that the firm (i.e. its key strategists) routinely consider the range of ***key resources*** necessary for company development and thus routinely redefine the sets of stakeholders those interests are taken into consideration in strategy development. Thus the sustainability of the firm depends on accumulation of capabilities to provide sufficient return to key stakeholders at decreasing costs for the firm, but as the sets of key stakeholders may differ even for the firm in the same industry (line of business), enhancing maximization of the wealth of the entity means "competing of (largely different) capabilities".

The third weakness was the unclear position of the government as a stakeholder. Most Western social scientists take for granted that the business firm exists in democratic societies. However, the realities of global markets demonstrate that the same marketplaces are shared by the firms operating in different political regimes (like the open control of the Communist Party, invisible control of ayatollahs, softer or harder regulations imposed on national companies by "elected dictators" etc.). Our model was incomplete unless we clearly identify the government's interest in different political settings. Here we took a rather cynical approach. In our view, democratically elected government will follow the wishes of the most numerous group of voters. The long struggles about "grain laws" in Britain in 19th century are just an example. Modern cases suggest that the democratic government may act as the powerful ally of shareholders (Enron's case), customers and employees (GM bankruptcy), communities (BP Mexican Golf disaster). Corrupt authoritarian government will rather prefer to act as an additional controlling owner of a business located within its reach. The worst case, however, is presented by "no corrupt ideologically affected authoritarian regimes". They may have interests totally separated from interests of other stakeholders (word supremacy etc.). Fortunately for many markets, such regimes focus their attention on a few largest national businesses leaving smaller businesses intact.

Now we may formulate a definition of a stakeholder as ***"a person, group of persons, organization, network or institution that supplies crucial resource for the very existence of the firm and is capable to claim for an adequate return for the resource supplied".***

CONSEQUENCES OF UNLIMITED SATISFACTION OF STAKEHOLDERS' CLAIMS

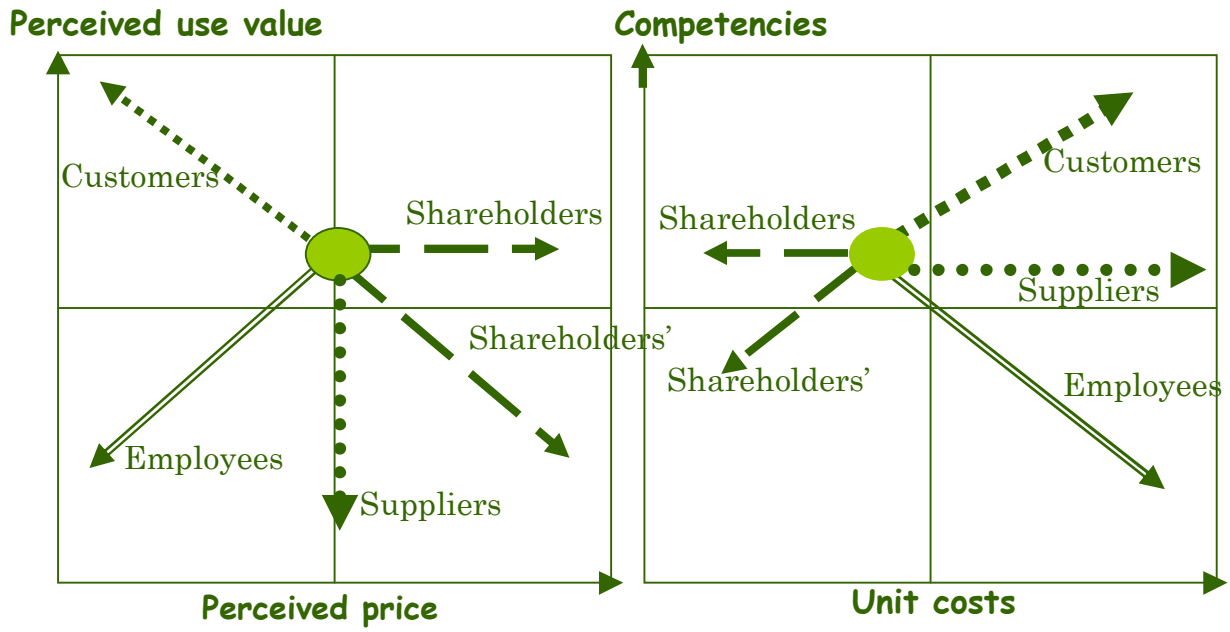
Each of stakeholder presents reasonable and, probably, legitimate claims for a proper return on its "investment" – the resource purchased or just leased by the firm (as for capital, labor force, bank loans and, in some cases, land, air frequencies, operating licenses etc.). However, an opportunistic pursuit for benefits of a particular stakeholder leads in very unpleasant consequences for the firm. To illustrate that phenomenon we use the model first introduced by Bowman and Faulkner (Bowman and Faulkner, 1997) that depicts the competitive position of a firm along four dimensions – perceived use value of goods offered to customers, perceived prices of such goods, unit costs of goods produced, competencies used by the firm (know-how, systems, unique relationships).

We may distinguish here between ultimate and lagged consequences of shareholders' claims. For example, ***customers*** ask for higher perceived use value of firm's products. This demand leads to necessary increase of firm's technical and marketing competences that usually comes at higher unit costs. As simultaneously, customers also demand to low down prices, the competitive position of the firm is improved at the expenses of decreasing profitability of sales and return on capital employed. This clearly contradicts to the claims of ***shareholders***, who demand higher return on investments. However, if shareholders' demands are pursued unlimited, the ultimate result is suppression of unit costs and increase in prices. The medium-term results of excessive saving of costs are compromises in quality (perceived use value) and destruction of firm's competencies. The long-term results of the unlimited quest for shareholders' value is moving the firms towards situation of higher prices and lower quality of products and services, that may be achieved only in monopolistic markets.

The opportunistic demands of ***employees*** are to increase remuneration and to decrease efforts. The decrease of efforts results in destruction of firm's competencies while increased remuneration is translated into higher unit costs. Again, the competitive position of the firm is changing, this time towards the lowest segments of markets, while profitability is suffering.

Suppliers of raw materials, equipment and solutions on the way of opportunistic pursuit of their interests are inclined to demand higher prices for their supplies and to compromise on quality of deliveries (including timing of physical deliveries, accuracy of agreed assortment of deliveries etc.). This directly leads towards increasing firm's unit costs and decreasing quality. All these effects are presented in Figure 1.

Figure 1. Direct and lagged consequences of unlimited pursuit of stakeholders' claims



Source: Adapted from (Gurkov, 2010a)

Note: lagged consequences are marked with (').

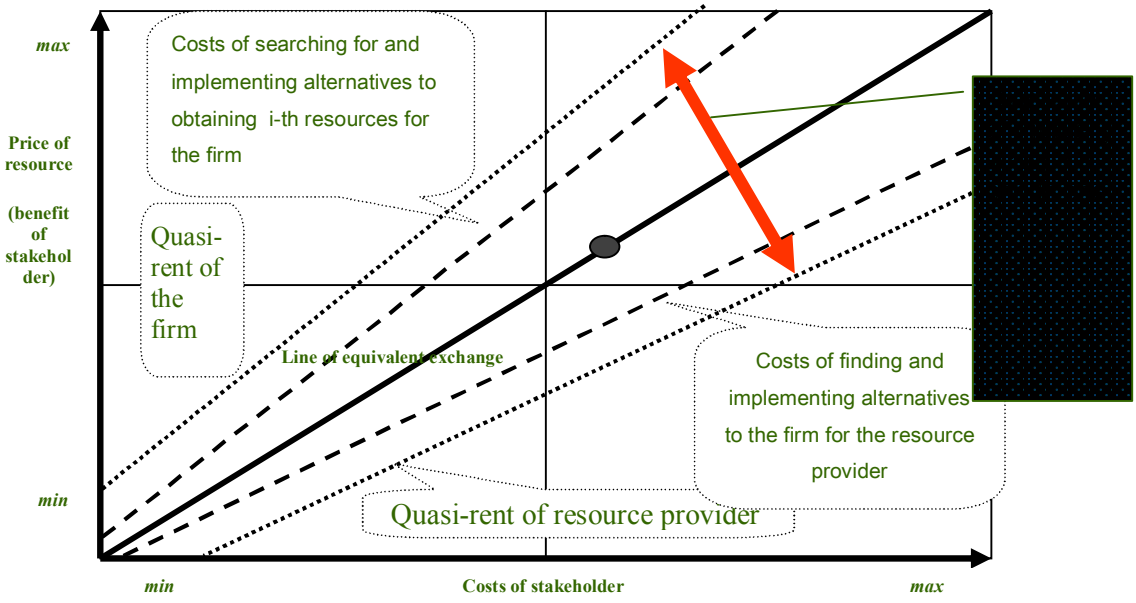
The abovementioned speculations have both theoretical and practical implications. As for theory, it is easy to demonstrate that the techniques of prioritizing shareholders' claims proposed in (Frooman, 1999) are not a panacea – the unlimited claims of any dominant shareholder will deteriorate the competitive position of the firm. Manipulative techniques proposed in (Scholes, 1998) when the company management is trying to counterbalance the confronting interests of various stakeholders is more promising, but usually distract time and efforts from developing firm's competences other than intriguing skills of its top managers. Thus, universal techniques for accepting shareholders' claims without compromising on firm's competitive position are required.

DEFINING THE SPACE OF MUTUAL ACCEPTANCE

Let us to present the relationship between the firm and its particular stakeholder on a two-dimensional matrix. The axes of the matrix are respectively benefits and costs of a particular supplier of resources to the firm. The bisecting line of the matrix that extends to the upper right hand corner reflects the situation where the stakeholder receives the adequate return for its supply of resources to the firm. For example, who supplies funds to the firm through the purchase of the good or services receives adequate amount of perceived use value of the good or

service for the price paid. Employees receive adequate compensation for their time and work effort supplied to the firm. The line above the equilibrium line depends on the switching cost that the firm and the supplier face in its relationship. The switching costs depend not only on transaction costs but also on the quasi-rent that the firm has accumulated from its relationship with the supplier and discovery costs. As far as the rent-seeking claims of the supplier will not reach this boundary, the firm will prefer to keep the relationship with the particular supplier. Similarly, the line below the equilibrium represents the switching costs of the supplier which include supplier costs such as transaction, discovery and quasi-rents of the supplier. As far as contractual terms of the firm and supplier remain between these two lines, the relationship is considered as perhaps not perfect but reasonable and the resource base remains stable over time (see Figure 2).

Figure 2. Space of mutually accepted relationship between the firm and stakeholders

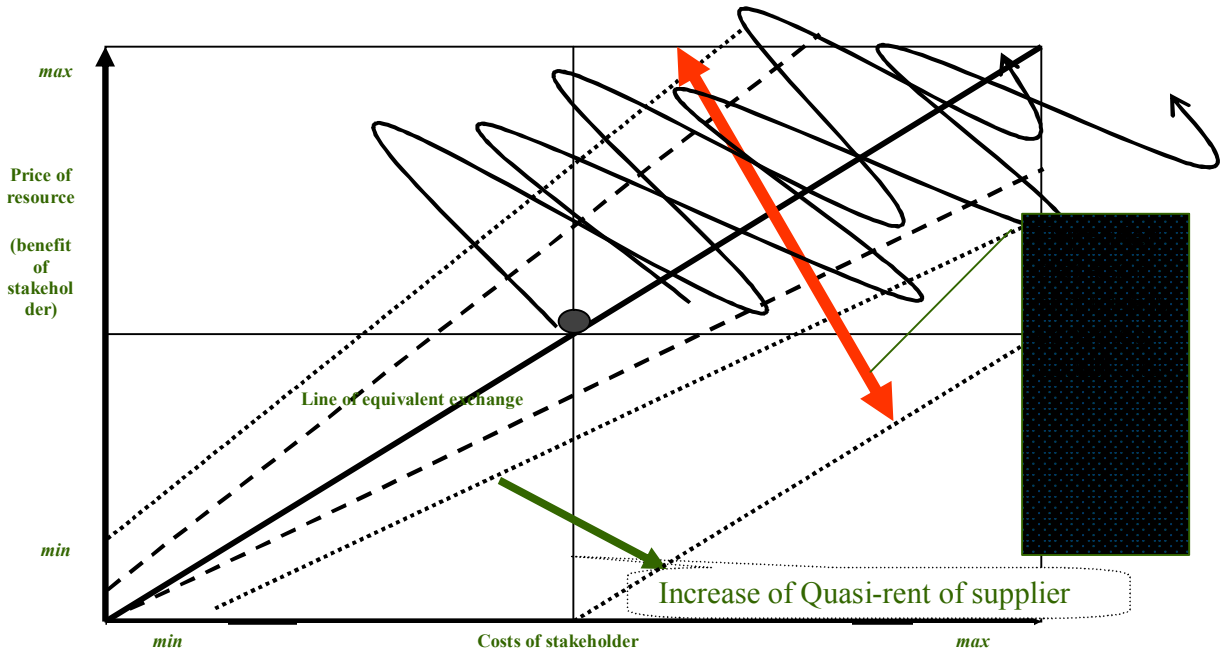


This model may easily illustrate not only the static but also the dynamic relationship between the firm and the supplier. As we argued in Figure 1 unlimited pursuit of the interests of one stakeholder leads to the deterioration of the competitive position of the firm. Instead, we propose that the firm may tack towards their corners of the acceptance zones.

The firm may achieve the greatest stability by moving into lower left hand corner that provides minimum return to stakeholder but accepting the minimum quality of the resources supplied.

You may imagine a firm that would accept the raw materials as far as it is supplied at the lowest price possible. We may also imagine investors that require the minimal return on their capital on complete risk free investments. Going further you may see the scenario made when the company or the whole industry requires only minimal skills and efforts from their work force recruited from minimal wage. However, we believe that the movement toward the upper right hand corner of our model is also possible (see Figure 3).

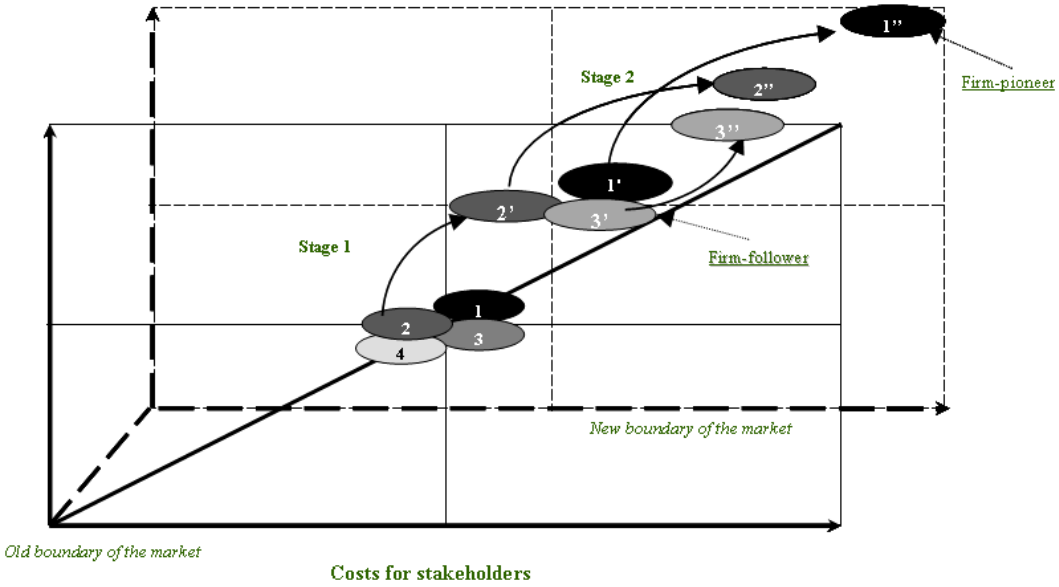
Figure 3. Counterbalancing the interests of various stakeholders by temporary increasing the price of resources



The most important part of this movement is that the company is eager to acquire resources from one or several classes of stakeholders at the prices ***above*** the equilibrium line. The reason for such a strategy is the belief that the additional benefits of a stakeholder will make the basis for acquiring its quasi-rent. This quasi-rent will enable the firm in the next period to set the price for the supplier temporary ***below*** the equilibrium line that creates savings that will be used in increasing the price paid for the next class of suppliers. Apple Inc.'s relationship with customers is a good illustration of such a strategy in creating the devices beyond the customer's current expectations Apple created a pool of loyal customers that later will accept less successful innovations. On example of such a product where loyal customers put up with poor service is iPhone version 4 that still drops calls and tracks it users but sells out immediately and dominates the market. Customers and Apple have reached an equilibrium of sorts.

We as the authors should note that constantly repeated movement toward the upper right handed corner may have a shifting affect for the whole market for a particular resource as the firm may not only provide unique remuneration for the stakeholders such as quality, compensation, balance between risk and return, etc but also make unacceptable large segments in the lower left hand corner of the relationship (see Figure 4).

Figure 4. Shifts in markets as the result of repeated temporary increase of prices for resources



Such affects are especially visible in congested market where the general distance between the upper right and lower left is small.

CONTRIBUTION OF THE RESEARCH, PRACTICAL IMPLICATIONS AND FUTURE RESEARCH DIRECTIONS

The principle contribution of this research is the extension of stakeholder resource model to explain multi-stakeholder management characteristics that allow for the acquisition particular types of resources while retaining stakeholder/resource providers. The reconceptualization of stakeholders as resources supplier provides a novel approach to understanding how firms manage all resources suppliers (customers, suppliers, workers, shareholders, interest groups, etc.) to provide the necessary financial, material and normative resources to survive. The adaptation of firm strategies to the relative power of stakeholders due to their influence on the firm (i.e.

Frooman, 1999) leads to zero-sum game. A firms movement tacking back and forth crossing the equilibrium line for all stakeholders (one by one) allows the firm to survive and prosper and perhaps to move beyond the limits of the existing markets, providing unique benefits for stakeholders that later request from them more costs, like increasing wages beyond the exiting ones in the labor market and then demanding more energy and skills applied from employees.

Based on this model we can envision that adjustments to how management practices in terms of interaction with stakeholders. The redefinition of stakeholders as "investors" or resources providers jibes the conversation concerning stakeholder management for top managers and owners away from the concept that stakeholders 'take' from the firm towards an understanding the stakeholders provide resources and need to be managed appropriately through the distribution of benefits so that they continue to provide these resources. A course can be charted through incorporation of the resource provider model in the relationship between firms and both internal and external stakeholders. The importance of salience of stakeholder though should not be lost in how a firm set its long term tack in regards to balancing the interests of resource providers (stakeholders) over time. We find that stakeholder theory as applied in stakeholder engagement and strategic planning actions by firms places the firm at the center as a resource provider. Our model shifts that framework on its head and revitalizes the concept as a tool to understand the firm's dynamic relationship to internal and external environment.

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