

STAKEHOLDER MANAGEMENT AND REPUTATION

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INTRODUCTION

The purpose of this paper is to connect two fairly recent concepts in management theory and practice: stakeholder management and reputation. What are the effects of good stakeholder management on the reputation of a business, and does a company's reputation affect its ability to engage with its key stakeholders? The paper begins with a brief history of the concepts of stakeholder management and reputation. In section three the main interpretations of stakeholder management and its connection to reputation are distinguished. It is then suggested that a new narrative about business is badly needed, in light of the changes that have taken place in the last generation of business models. Section four suggests that momentum is building for a fourth interpretation that offers a more useful idea for businesses in the 21st century. This fourth interpretation is built on the relatively recent idea of "value-creation stakeholder management" and focuses on seeing reputation as an integral part of any viable business model. The final section five outlines some challenges for business executives and researchers.

The idea of “stakeholders” first appeared in the work of the Stanford Research Institute (SRI) in the 1960s as they began to try to systematically give executives a way of understanding the changes in the business environment. ‘Stakeholders’ were defined by SRI as “those groups without whose support the organization would cease to exist.”¹

In the ensuing 20 years, a number of researchers began to experiment with the idea as they began to develop more robust views of strategic planning, and later “strategic management.” A group of researchers centered at the Wharton School in the late 1970s and early 1980s developed a more action-oriented view of “stakeholders” and called it “stakeholder management.” This group defined “stakeholders” as “any group or individual who can affect or be affected by the achievement of an organization’s objectives.” These researchers believed that in a fast-changing business environment, executives had to pay much more attention to external forces and pressures, and that strategic action required a more sophisticated version of dealing with customers, suppliers, employees, financiers, communities, society, interest groups, media, and the like. Freeman (1984) was an advocate of this view of stakeholder management.

The central principles or elements of the argument were as follows:²

1. “No matter what you stand for, no matter what your ultimate purpose is, you must take into account the effects of your actions on others, as well as their potential effects on you.” This principle is one of simple

¹ For a more nuanced history of the idea see Freeman et al. (2010, Chapter 2).

² The following paragraphs draw from Freeman et al. (2010, Chapter 2). We are grateful to Cambridge University Press for permission to recast the ideas here. For the record, I believe that most of these principles are still correct.

“common sense” that needed to be applied systematically in the business context.

2. “You have to understand stakeholder behaviors, values, and backgrounds/contexts including the societal context.” Once again this is a principle of extraordinary simplicity. You don’t have to agree with stakeholders or their behavior, but good management does require understanding it.
3. “To be successful over time it will be better to have a clear answer to the question of what do we stand for.” Freeman (1984) suggested that this question of purpose be called “enterprise strategy,” however it was not widely agreed upon, since the entire business world became enamored of the idea that the purpose of a business was to maximize profits.
4. “Stakeholder relationships work at three levels of analysis: the Rational or “organization as a whole;” the Process, or standard operating procedures; and the Transactional, or day-to-day bargaining.” Much literature in strategy has been based on what historians would call a “kings and battles” approach. It is IBM vs. NEC or Google vs. Microsoft. In reality, it is sometimes more useful to think about processes and transactions.
5. “Companies need to use the stakeholder idea to think through new structures, processes, and business functions.” Stakeholder relationships become the “unit of analysis” in organizational design.
6. “Stakeholder interests need to be balanced over time.” While the metaphor of “balance” can give the idea of making trade-offs among groups, its original connotation was one of harmony. This was not well understood in the stakeholder literature until Freeman, Harrison and Wicks (2007).

There are a number of implications of this argument. If it is correct, then the idea of “corporate social responsibility” is probably superfluous. Since stakeholders are defined widely and their concerns are integrated into the

business processes, there is simply no need for a separate CSR approach. Social-Issues Management or “issue” is simply the wrong unit of analysis. Groups and individuals behave, not issues. Issues emerge through the behavior and interactions of stakeholders, therefore “stakeholders” is a more fundamental and useful unit of analysis. Finally, the major implication of this argument, which cannot be overemphasized today given the development of stakeholder theory, is that “stakeholders are about the business, and the business is about the stakeholders.”

Stakeholders is defined as any group or individual who can affect or be affected by the achievement of an organization’s objectives

At some level business executives have always been concerned about their reputation. The simple truth is that if a buyer does not believe that what a seller is offering is genuine, there is no deal. And, likewise, if a seller does not believe that a buyer actually is going to pay or trade, then there is no deal. If a buyer or seller gets the reputation of always giving less than agreed to, it becomes difficult to close transactions. And, this has been a fact since the emergence of the first markets. Concern with reputation is as old as business itself. Trading in traditional villages depended on reputation where sanctions could be applied, since everyone knew everyone else (McMillan 2002). As trade flourished between villages, and between cities, sanctions were harder to apply, as some traders could take the money and run. However, they could never return to trade again. To sustain value-creation over time, a good reputation is necessary for any business, and for any businessperson.

The rise of corporate philanthropy in the early days of the Industrial Revolution can be partially explained by the fact that the early industrialists were at least concerned with their personal reputations.

Andrew Carnegie (1889) suggested that business people should hold excess profits in trust for society. He said,

This, then, is held to be the duty of the man of Wealth: First, to set an example of modest, unostentatious living, shunning display or extravagance; to provide moderately for the legitimate wants of those dependent upon him; and after doing so to consider all surplus revenues which come to him simply as trust funds, which he is called upon to administer, and strictly bound as a matter of duty to administer in the manner which, in his judgment, is best calculated to produce the most beneficial result for the community—the man of wealth thus becoming the sole agent and trustee for his poorer brethren, bringing to their service his superior wisdom, experience, and ability to administer—doing for them better than they would or could do for themselves.

This view of corporate philanthropy has been carried forward to the modern day, with Bill Gates seeking to give away a great deal of his fortune to help those less fortunate. The Bill and Melinda Gates Foundation has enlisted a number of billionaires in the world at large to support their principles. Their guiding principle #14 is connected to Carnegie's earlier articulation of what has come to be known as philanthrocapitalism. The foundation says,³

Meeting our mission—to increase opportunity and equity for those most in need—requires great stewardship of the money we have available.

³ <http://www.gatesfoundation.org/about/Pages/guiding-principles.aspx> (accessed August 2011)

While corporate philanthropy continues to be important, it was not enough to build a company's reputation through philanthropy. Often philanthropy happened after a company was already subject to criticism for its actions. In the early part of the 20th Century we see the emergence of public relations as a discipline to begin to manage the reputation of a business as it grew and developed. In the United States Edward Bernays and Ivy Lee are often seen as the founders of public relations. Perhaps one of the most famous internal public-relations executives was Arthur Page of the Bell Telephone Company who is recognized as the first person to hold a high executive office as a public relations executive. Page's principles for public relations are inscribed in the Arthur Page Society today, a society for senior PR executives:⁴

1. Tell the truth.
2. Prove it with action.
3. Listen to the customer.
4. Manage for tomorrow.
5. Conduct public relations as if the whole company depends on it.
6. Realize that a company's true character is expressed by its people.
7. Remain calm, patient and good humored.

In more modern times, the idea of reputation has become more generalized, and it has come to mean the perceptions that key stakeholders have of the actions of a particular business. Many scholars argue that reputation is a key resource of a firm, that it helps attract investors, customers and employees, and can create competitive advantage (Fombrun and Van Riel 2004). Since reputation is seen as a "soft" concept, there is much concern with showing that paying attention to reputation "pays off." There are numerous studies that suggest that having a good reputation ultimately returns profits to shareholders, making what has come to be called "the business case" for reputation

⁴ http://www.awpagesociety.com/site/about/page_principles/.

management. Making the business case for reputation management points out the underlying flaws in the model of “business,” which the evolution of stakeholder theory has begun to correct.

THE EVOLUTION OF STAKEHOLDER MANAGEMENT AND REPUTATION

Since the early days when the stakeholder idea was used as an organizing principle in strategic planning, stakeholder management, or as it is commonly known, “stakeholder theory,” has developed along a number of dimensions: as a strategic tool; as a corporate communications idea; and as a way of thinking about corporate social responsibility. All three have evolved separate academic and practitioner literatures.

The use of the stakeholder idea in strategic management has continued to evolve. While Freeman (1984) and others suggested a path for strategic management as a field to take if it was to be stakeholder oriented, in fact the field adopted a view of strategy that has come to be known as “the resource-based view” and it is only recently that these two views have been reconciled (Sachs and Ruhli 2011). However, many companies actually adopted some version of the stakeholder idea in their strategic planning and strategic-management processes.

As in the emergence of the reputation concept there was much concern over making “the business case” for stakeholder management. In an early study Preston and Sapienza (1990) connected data about reputation from the Fortune index to financial performance. The reputation index was identified with “good stakeholder management” and then correlated with financial returns. They found positive support looking at ten-year composite returns. Other studies have suggested a variety of nuances here.⁵

⁵ For a complete list of these studies see Freeman et al. (2010, Chapter 4).

While Freeman's (1984) view of stakeholder management held that it was most useful as a strategic tool, much of the academic world, as well as the world of managerial practice, adopted it as a more fine-grained view of corporate communications. Fombrun (1996) suggests several multi-stakeholder models that have been developed around corporate communications and public relations. Welch and Jackson (2007) outline a stakeholder approach to internal communications within a business. And, a number of public relations textbooks began to organize around the stakeholder idea as well as the idea that public relations was better understood as "how to engage stakeholders."

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Another development was the emergence of the stakeholder idea as a key force in understanding corporate social responsibility (CSR). As the movement to demand more responsibility of companies gathered steam, more scholars began to see stakeholder management as central in the development of CSR. Wood's (1991) important article set the tone for CSR scholars to take stakeholder management seriously as more integrative of how to deal with the external environment in a responsible way. Ironically, Freeman (1984) suggests that if stakeholder management is seen as an integrative business model, then CSR may well be a superfluous idea. Similarly one of the main arguments for reputation management linked the idea to CSR. If a company is seen as responsible, then it gains more trust from its stakeholders, and ultimately improves its business.

As these two ideas developed in an intertwined way, it is easy to see how they are connected in terms of the evolution of the fields of strategic

management, corporate communications, and CSR. A more recent development in stakeholder theory, however, points out shortcomings in this earlier work, and the need to develop a new theory about business.

VALUE-CREATION STAKEHOLDER MANAGEMENT

The recent global financial crisis has called much of our common wisdom into question. Perhaps the biggest challenge is to our very idea of how to think about business. The dominant story about capitalism has been for some time that business is primarily about making money. The participants in business are seen as self-interested and extremely opportunistic. The only legitimate purpose of a business, in this view is to maximize profits for shareholders. This traditional view sharply distinguishes between “business” on the one hand, and “ethics” on the other—so much so that the phrase “business ethics” often elicits a laugh or a comment of “that’s an oxymoron.”

Freeman (1994) and Harris and Freeman (2008) have suggested that an appeal to such a “separation fallacy” is fraught with difficulty. As we have seen in the development of both stakeholder theory and the idea of reputation, if the “business case” is separated from the ethical nature of what a company is doing, we will need concepts like “corporate philanthropy” or “corporate social responsibility” to make amends for any damage done by the business. Such a separation assumes that we can clearly divide the consequences of a business into two disjunctive sets: the economic consequences, and the social (or ethical) consequences. However, simple examples point out the folly of such a logical division. If a company hires an employee, clearly there are economic consequences, but just as clearly there are social consequences. Similarly, selling products and services have clear economic consequences, and even clearer social consequences. Trying to “prove” that doing good things

socially or ethically can lead to good economic consequences is thus a fool's errand. It is impossible to divide up consequences into "economic" and "social." It is far better to adopt "stakeholder" as a unit of analysis, and to admit that stakeholder relationships are complex. All include economic, political, social, ethical, and other factors. Manage the stakeholder relationships and the "business case" takes care of itself.

Of course, one response is to ask what could "the business case" be other than how a company creates value for its key stakeholders, and it is here that stakeholder theory suggests we begin. What has come to be called "Value-Creation Stakeholder Management" (VCSM) is based on a number of principles that taken together begin the construction of a new narrative about business.

The first principle is that businesses are successful (or fail) because they create (or destroy) value for at least customers, suppliers, employees, communities and financiers (shareholders, etc.). And, this has always been the case (Freeman, 2011). One of the major features of most thinking about business, among academics, is that they assume that "markets" are the dominant business metaphor. Complex economic models are developed to explain the behavior of self-interested firms in highly competitive situations. And, while "markets" are one metaphor to use in understanding how real businesses work, they aren't the only one. Companies create real value for customers and other stakeholders. Assuming that the only value created is economic value for shareholders is simply no longer useful. Even avowed financial markets experts such as Henry Kravis, co-founder of Kohlberg, Kravis Roberts and Co. (KKR) the buyout experts said recently (Primack 2008):

You have to focus on all the stakeholders. It's a new thing for us and something we're really hammering. Long-term value is only achieved if growth benefits all stakeholders in a company, from

owners to employees, communities and even governments. We are also conscious we are fiduciaries to millions of hard-working men and women and university endowments ... Trust must be earned over the long haul and maintained constantly. We have not always adequately explained what we do to the man on the street. Even some of our investors, although happy with the returns we deliver, don't fully understand what we do and why they should invest with us.

The second principle is that most human beings are fairly complex creatures. While it should not be necessary to state this principle so explicitly, in fact the assumption of "rational self-interest" has a real grip on the hearts and minds of business people and business thinkers. Of course, human beings are self-interested, but they also care for others, as every parent knows. Most of the time we are motivated by a mixture of self-interest and interest in others. This second principle suggests that ethics and responsibility are always a part of what we need to think about in business. Focusing solely on narrow ideas of self-interest can detract from our very humanity.

The third principle of VCSM says that customers, suppliers, employees, communities, and financiers have a joint stake in the business. Their interests go roughly in the same direction. Much of the early strategic research and CSR research in stakeholder theory has spent time trying to elucidate how trade-offs among stakeholders are to be made. VCSM suggests that the key to understanding a business is figuring out how to create value for all key stakeholders simultaneously. How does a new product or service, which creates value for customers, also create value for communities, suppliers, employees and financiers? Of course in the real world trade-offs sometimes have to be made, but VCSM suggests that the next question after a trade-off is how to improve the trade-off for all sides. Great companies keep stakeholder interests in harmony over time.

If one stakeholder is constantly denied a part of the value-creation process, then either that stakeholder leaves the business to find another, or uses the political process to appropriate value. Neither outcome is good for business. As former CEO of Medtronic, Bill George (2003, 104) put it quite eloquently,

Serving all your stakeholders is the best way to produce long-term results and create a growing, prosperous company ... Let me be very clear about this: there is no conflict between serving all your stakeholders and providing excellent returns for shareholders. In the long term it is impossible to have one without the other. However, serving all these stakeholder groups requires discipline, vision, and committed leadership.

If a company is seen as responsible, then it gains more trust from its stakeholders, and ultimately improves its business

The fourth principle is that businesses are sustainable over time if they have a purpose. This purpose must appeal to customers, suppliers, employees, communities, and financiers. Usually, maximizing profits is more usefully thought of as an outcome, rather than a purpose. In a similar manner, humans need red blood cells to live, but the purpose of life is not to make red blood cells. Of course VCSM does not deny that profits are important, but they are a result. As Jack Welch, former CEO of General Electric (GE) told the *Financial Times* (Guerrera 2009):

On the face of it, shareholder value is the dumbest idea in the world ... Shareholder value is a result, not a strategy ... Your main constituencies are your employees, your customers and your products.”

When these principles are taken together we have the foundations of a new model of capitalism, or a new narrative about business. VCSM offers a way to solve three of the main challenges to business. First of all we need to understand how value-creation and trade can be sustained over time in a rapidly changing global business environment. VCSM suggests that taking “stakeholders” as the unit of analysis is a good start. Further it suggests that focusing on satisfying multiple stakeholder interests simultaneously creates business models that are closely aligned with stakeholders, and that are sustainable.

Second we need to address the issue of the ethics of capitalism, as it has come under increasing attack due to recent scandals and the global financial crisis. Ethics and responsibility can’t be seen as an “add-on” but they must be intimately connected in the business model. By seeing stakeholders as human beings, who are complex in their own right, we begin the process of putting ethics and responsibility into the very center of our way of thinking about business.

Finally we need to address the issue of what to teach in business schools. The rise of the MBA, world-wide, has resulted in the spreading of a view of business that is centered on economics and finance. While these are important disciplines, they are incomplete. Business is a deeply human activity, requiring insights and theories from all the human sciences, from economics to the creative arts. Seeing capitalism as a cooperative system of value-creation for stakeholders opens many doors to disciplines and key ideas that have stayed on the sidelines for too long.

Where is the idea of reputation in this new stakeholder narrative about business? VCSM suggests that reputation is a function of the underlying business model. Reputation is managed by paying attention to the basics of the underlying model. Companies which adopt a business model of creating value for customers, employees, suppliers, communities, and

financiers will see their reputations grow or diminish according to how they engage these stakeholders, and how they create value for them. Of course, executives have to pay attention to perception, increased role of media and social media in the 24/7/365 news cycle, new and powerful technologies, and a growing diverse workforce. Yet the easiest way to be perceived as an X is to be an X. At least authenticity is where executives must start. In VCSM reputation is a function of purpose and identity, of what a business stands for, what its values and principles are, and how it engages others. These questions are at the very center of VCSM. Let's consider the following examples.⁶

For many years company ABC ignored some of the harmful effects of its products. ABC was exceptionally profitable, but as the science surrounding its products progressed, increasing concern was expressed about their use over time. After years of focusing on creating value for shareholders, ABC began to be more stakeholder-focused. Initially, this concern was based on a desire to improve its reputation so that profitable growth would continue. Over time some key executives began to see that such a "strategic view" was not enough, even though there were some indications that the company's overall reputation was better than that of its competitors. Consequently there was some conflict within the ranks of the company. ABC went so far as to undertake an extensive campaign on corporate social responsibility. However, without reexamining its purpose and values, ABC was unable to create as much value as it could have otherwise done. Critics of the company often refuse to meet with executives. And the company will be vulnerable to breakthroughs in the industry that mitigate the harmful effects of its products. Strategy and CSR simply aren't enough.

⁶ The following examples are based on the experience of the author with real companies. The companies have been thoroughly disguised.

Company DEF also has critics of its products and services. However, DEF has spent a great deal of time engaging with its critics, as well as with its key stakeholders: customers, employees, communities, suppliers and financiers. DEF is very clear about its principles and values, and, it spends a lot of time and effort in stimulating conversation about these ideas throughout the company. DEF often (not always) listens to its critics and makes improvements to its business processes. It also changes its products and services to give its customers better value. DEF clearly sees itself as creating value for its stakeholders. Of course, it is also quite profitable.

Communities want Company XYZ in their area. Not only do the target-market customers love their products and services, but the company is known as a community builder. The CEO sees stakeholder interests as “synergistic” rather than subject to trade-offs. He also sees employees as “team members” who are in it together with management to serve customers, make suppliers (and their communities) better, and create better communities around the world. Of course, XYZ is also profitable.

These companies are rewriting the story of business, and as ABC shows, it is not an easy task, especially to take an established company that has begun to have fundamental questions asked about its business. In the following section some of the challenges of this new VCSM story will be addressed.

FUTURE CHALLENGES

There are five main challenges to the further development of VCSM and its related idea of reputation. Each is worthy of multiple research programs, and each should bear fruitful inquiry for years to come. The first challenge is to rethink the question of “what is the total performance

of a business?” For too long we have simply assumed that aggregate accounting and finance measures like profit and stock price adequately measure total performance. Accounting systems are conventional and built from the point of view of investors rather than stakeholders. Profits, stock price, free cash flow, and the like are functions of these investor-centric accounting systems. Given our earlier arguments about the impossibility of sorting out economic effects from social effects, progress is not likely to be made by leavening these accounting measures with ideas of “social performance” or even “triple bottom line.” We need new proposals for how to measure all the effects of a business on customers, suppliers, employees and communities, as well as investors and other financiers.

The second challenge is to take seriously the idea that the interests of stakeholders must go in the same direction. Firms exist because stakeholder interests coincide. How can we understand this “intersection of interests”? How can we enhance the integration of stakeholder interests? And, how can we begin to understand how stakeholders reinforce each other’s interests? One of the most important issues is how innovation emerges to meld together a set of interests which might look disparate at first glance. How can Werhane’s (1999) idea of “moral imagination” be used to solve conflicts of interest? What is the role of critics, of purpose, principles and values, as well as stakeholder engagement in the process of value-creation?

The third challenge is how to understand the influence of the growing network of stakeholders who are not customers, employees, suppliers, communities or financiers. In short how do we engage with NGOs, governments, and other third parties who can influence those primary stakeholders? And, how are these groups relevant to the value-creation process? They all surely affect the reputation of a business, but simply trying to ameliorate these effects is not sufficient. Today’s technology is

too powerful. VCSM suggests that behind most of these groups is an idea about how to make a business better, even though these ideas may be masked by difficult criticisms. And, it is not possible for a business to respond to all groups. However, there is value to be created by learning how to craft engagements with these groups, and as public trust in business wanes, the trust in for instance, NGOs seems to grow.

Seeing capitalism as a cooperative system of value-creation for stakeholders opens many doors to disciplines and key ideas that have stayed on the sidelines for too long

The fourth challenge is to figure out what we teach in business education. If the main premises of this paper are correct, there is much to be changed. Seeing capitalism as a system of social cooperation, where value is created for stakeholders, is a sea change in the story of business as it is told in business schools. Seeing ethics and responsibility as at least as important as profits will require the wholesale rethinking of the disciplines of business. For instance, in marketing we might begin this process by seeing brands as promises and seeing consumers as human beings with names, faces and children. In finance, we need to return to seeing markets as the socially-embedded phenomena that they have always been. In organization studies we need to banish the idea of “human resources” and “human capital,” and replace these with the simply idea of “human beings.” By focusing on stakeholder relationships, and by using “thick” moral concepts to amplify traditional business ones, we can and must build a better business theory to teach the next generation.

The final challenge, and perhaps the hardest one of all, is to change the narrative about business in society at large. How can we come to see businesses (and expect them) to be fully embedded in a societal context?

There is too much rhetoric about “free markets” and too little rhetoric about value-creation (except for investors and other Wall Street entities). If we continue to divorce Wall Street from Main Street, we can expect a populist revolt that may harm the very idea of capitalism as free people cooperating together to create value for each other. Of course in a free society there is healthy competition as everyone has options. However, the narrow interpretation of the old story of capitalism as only about money, “free markets set outside of a societal context,” greed, and competition, has surely run its course. We need a view of capitalism that recognizes that: 1. purpose and profits go together; 2. reputation is a function of a business model that creates value for stakeholders; 3. human beings are complex and not solely self-interested; 4. cooperative value-creation and healthy competition are two sides of the same coin; and, 5. business is a complex societal institution full of morally complex human beings creating value and trading with each other. There is a great deal of work to be done.

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>> This paper suggests linkages between recent work in stakeholder management and the idea of reputation. After a brief historical section, the paper suggests that we need a new narrative about how business actually works. Both “stakeholders” and “reputation” are central to this new narrative that is beginning to emerge post-financial crisis. By focusing on how the interests of customers, suppliers, employees, communities, and financiers are joint, executives can begin to see their role as how to create as much value for stakeholders as possible. Stakeholders and reputation become part of the underlying business model, rather than part of add-on ideas like “corporate social responsibility” and “corporate communications.” The paper ends with some challenges to executives and business thinkers as this new model of business is realized.

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