STRATEGIC MANAGEMENT OF ORGANIZATIONS AND STAKEHOLDERS:
THEORY AND CASES

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THE STRATEGIC MANAGEMENT PROCESS

In general, firms pass through four phases in their planning processes, in response to increasing size, diversity, and environmental complexity.

Phase 1: *Basic Financial Planning.* In this phase, organizations are internally oriented, with a focus on meeting budgets and developing financial plans.

Phase 2: *Forecast-Based Planning.* Organizations begin to look outward to the external environment for trends and developments that may impact the future.

Phase 3: *Externally Oriented Planning.* At this point organizations begin to think strategically; that is, devise strategies in response to markets and competitors.

Phase 4: *Strategic Management.* In the final phase, organizations manage all of their resources in an attempt to develop sustainable competitive advantages and "create the future."[10]

In this framework, organizations move from an internal to an external focus in their planning, first by responding to the environment and ultimately by attempting to control it. Responding to the environment is often referred to as **adaptation,** while the processes associated with attempting to control the environment to make it less hostile and more conducive to organizational success are called **enactment.**[11] Organizations that have reached Phase 4 in their planning efforts engage in significant amounts of both adaptation and enactment, as opposed to organizations in earlier phases that focus primarily on adaptation.

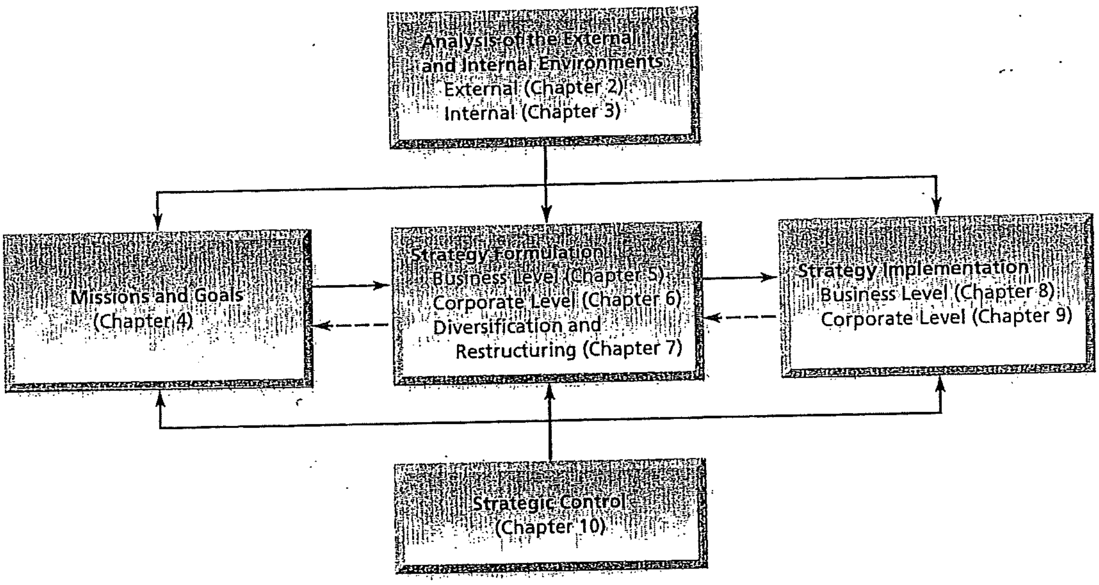
Adaptation
The process of responding to the environment

Enactment
The process of controlling the environment to make it less hostile and more conducive to organizational success

A simple model of the strategic management process is contained in Figure 1.1. The typical sequence of activities begins with analysis of the external and internal organizational environments, followed by the establishment or fine tuning of the firm's mission and goals, formulation of strategies and, finally, implementation of these strategies, with strategic control a part of all of these processes. However, many organizations participate in these activities in a different order or simultaneously. Also, the dotted arrows in Figure 1.1 indicate that organizations often cycle back to earlier activities during the strategic management process. For instance, an organization may attempt to develop strategies to achieve its goals and, after a trial period, discover that the goals were either too high or too low. Also, an organization may discover rather quickly (or over a longer period of time) that a proposed strategy cannot be implemented feasibly. As a result, the organization may have to cycle back to the formulation stage to fine tune its strategic approach. In other words, organizations can learn.

It should be noted that start-up firms seldom exhibit the sophisticated planning processes associated with Phase 4 planning. Consequently, they may not engage in all of the processes depicted in Figure 1.1. Start-ups typically begin with an entrepreneur who has an idea for a product or service that he or she believes will lead to market success. Venture capital is raised through a variety of public or private sources and a new business is born. The entrepreneur may establish a formal or informal mission statement and some goals, but the rest of the formal strategy process may be overlooked. If the business is successful, which is rare, it will typically expand in both sales and personnel until it reaches a critical point where the original entrepreneur feels a loss of control. At this point, the entrepreneur may attempt to formalize

FIGURE 1.1 The Strategic Management Process



various aspects of strategic planning, either by hiring outside consultants or by creating planning positions within the firm. This same process is typical of nonprofit start-ups as well, except that the nature of the cause (i.e., humanitarian, educational) places tighter constraints on the way the firm is financed and organized.

Consequently, the model in Figure 1.1 is not intended to be a rigid representation of the strategic management process in all organizations as they currently operate. Nevertheless, the progression of activities provides a logical way to study strategic management. Furthermore, the activities relate equally well to for-profit, nonprofit, and service organizations, although some of the differences in the way these organizations approach strategic management will be described throughout the text. Now that the strategic management process has been introduced, it is time to get more specific about each of the components of this process—external and internal environmental analysis, missions and goals, strategy formulation, strategy implementation, and strategic control.

External and Internal Environmental Analysis

This book utilizes a stakeholder approach to strategic management. Just as the chief aim of an organization is the satisfaction of its stakeholders, these stakeholders form the basis for analysis of the external and internal environments. In the strictest sense of the word, the environment includes *everything and everyone* that exists in the universe; however, some parts of the environment are obviously more important to the strategy of a firm than others. For the purposes of this book, an organization's environment includes groups and individuals that are significantly influenced by or have a major impact on the organization.[12]

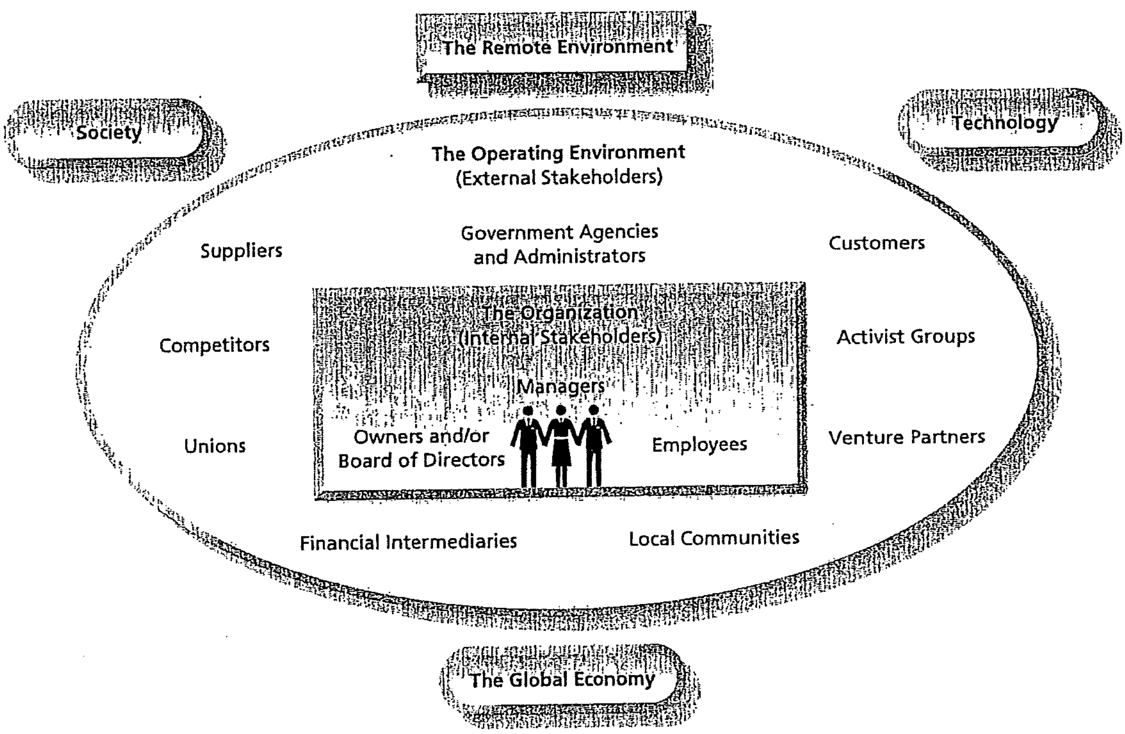
Many of the stakeholders that have the potential to be most important to organizations are shown in Figure 1.2. Examples of key internal stakeholders are managers, employees, and owners. These groups will be discussed in Chapter 3. External stakeholders, which are a part of an organization's **operating environment**, include competitors, customers, financial intermediaries, venture partners, local communities, unions, activist groups, and government agencies and administrators. The broader external or **remote environment** forms the context in which the organization and its operating environment exist. One organization, acting independently, can have very little influence on this environment; however, the remote environment can have a tremendous impact on the organization. The major components of the remote environment include society, the global economy, and the state of technology. External stakeholders and the remote environment will be discussed in Chapter 2.

Operating Environment
An organization's external stakeholders: competitors, customers, suppliers, financial sources, local communities, venture partners, activists, unions, and government agencies

Remote Environment
The context in which the organization and its operating environment exist

All of the external and internal stakeholders should be analyzed at both domestic and foreign locations. In all countries in which a company operates, managers must interact with government agencies, employees, competitors, and activist groups. In addition, the global perspective certainly applies to

FIGURE 1.2 The Organization and its Primary Stakeholders



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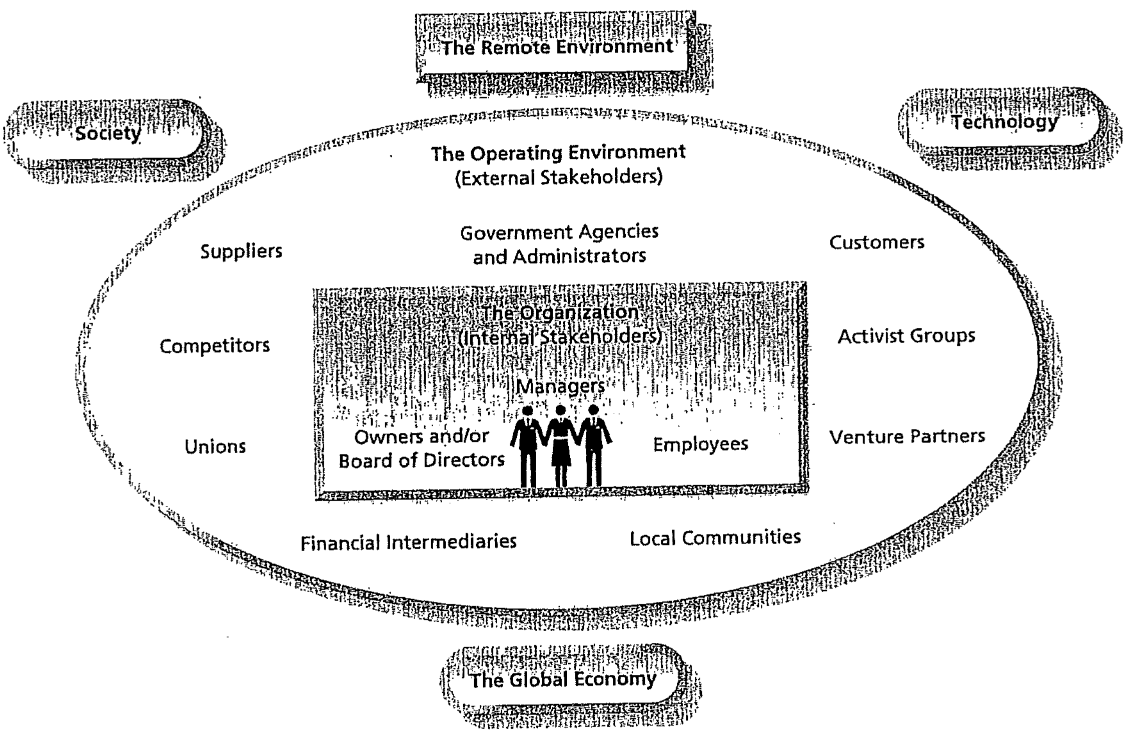

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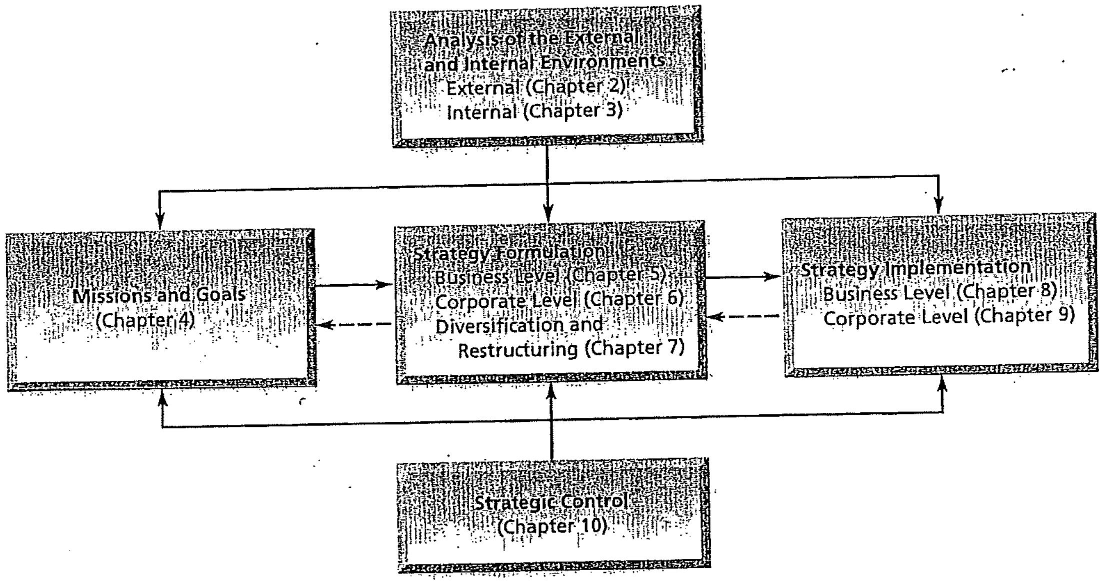

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As illustrated by the downward pointing arrows in Figure 1.1, stakeholder analysis is central not only to determining the needs and desires of individuals and groups with vested interests in the organization, but to most of the tasks of strategic management. For example, organizations should formulate strategies and implement plans in the context of the opportunities and threats presented by key stakeholder groups.

Opportunities
Alternatives that can be implemented to achieve strategic ends

Opportunities help move the organization towards its mission. They represent alternatives an organization or business unit can implement to achieve its goals. Organizations can often identify opportunities through analysis of the external and remote environments. Unfilled customer needs provide opportunities, as does new technology. Likewise, opportunities can turn up in the financial community, from social trends, from joint venture partners, or as a result of the actions of competitors. Even activist groups, which are generally viewed as threats to an organization, can provide ideas that turn into opportunities. For example, an activist group may provide insight concerning alternative ways to reduce pollution or other externalities, which in turn may give an organization a head start on the competition.

Threats
Any obstacle standing in the way of organizational progress toward mission and goals

Threats can be defined as anything that stands in the way of organizational progress toward missions or goals. Any external or internal stakeholder group can pose a threat to an organization, as can forces from the remote environment. Managers must carefully evaluate these impediments and ways to overcome them when selecting strategy. For example, foreign competitors may threaten to retaliate if prices are lowered, which could result in a price war. Or suppliers could threaten to integrate forward and become direct competitors. Customers also become a threat when they file a legal suit against an organization or boycott its products. Certainly, many organizations are aware of the threat of government regulation and intervention, which is even stronger in some foreign countries than in the United States.

Strength
An internal capacity or resource that may lead to competitive advantage

Competitive Parity
Competitors develop the same strength

Weaknesses
Activities a firm does not do well or resources it does not possess, leading to a strategic disadvantage

Stakeholder analysis is also helpful in determining organizational strengths and weaknesses. A **strength** is an internal capability or resource that may lead to a competitive advantage. From a strategic management perspective, a strength is most important if it is not easily imitated by competitors. This type of strength can lead to a long-term competitive advantage. On the other hand, a situation in which other competitors have developed the same strength is called **competitive parity.**

Likewise, a **weakness** is something a firm does not do well or a resource it does not possess that leads to a strategic disadvantage. Effective strategies make use of an organization's strengths, while neutralizing or overcoming weaknesses. Another important application of stakeholder analysis is in formulating the mission and goals of the organization.

Corporate Mission and Goals

Mission
An organization's overall purpose, broad goals, and the scope of its operations

The **mission** of the organization contains its purpose. Unlike shorter term goals and strategies, the mission is an enduring part of planning processes within the organization. The mission statement should also mention the areas or industries in which the organization operates. For example, the mission of the New York Stock Exchange is as follows:

> Support the capital-raising and asset-management processes by providing the highest-quality and most cost-effective, self-regulated marketplace for

the trading of financial instruments; promote confidence in and understanding of that process; and serve as a forum for discussion of relevant national and international policy issues.[13]

Operating Goals
Specific statements of an organization's desired achievements to be reached within certain time periods

Operating goals are more specific than a mission statement. They refer to specific ends that are to be achieved within the different areas of the organization and are established for a specific time period such as one year, five years, or six months. Goals provide check points that allow managers to track the progress of their organizations. For example, an organization may set a goal to increase sales and profitability by 20 percent during the next fiscal year. Goals and mission statements are the central topics of Chapter 4.

Business-Level and Corporate-Level Strategy Formulation

Strategy
An organizational plan of action intended to move an organization toward its goals and to achieve its mission

Corporate-level Strategy Formulation where
Selection of business areas in which the organization will compete

Business-level Strategy Formulation How
How organizations will compete in the areas they have selected

Functional-level Strategy Formulation detail for implement
How an organization's functional areas should work together to achieve business-level strategy

The next logical step in the strategic management process is strategy formulation. A **strategy** is an organizational plan of action intended to move an organization toward the goals it has established and, ultimately, toward the achievement of its mission. Strategy formulation is often divided into three levels—corporate, business, and functional.

Corporate-level strategy formulation refers primarily to domain definition, or the selection of business areas in which the organization will compete. Diversified organizations are involved in several different markets and serve a variety of customer groups. Corporate-level strategy formulation is the topic of Chapters 6 and 7. **Business-level strategy formulation,** on the other hand, pertains to domain navigation, or how businesses compete in the areas they have selected. Business-level strategy formulation is covered in Chapter 5. **Functional-level strategy formulation** contains the details of how the functional areas should work together to achieve the business-level strategy. Thus, functional-level strategy is most closely associated with business-level strategy implementation, which is treated in Chapter 8.

Another way to distinguish among the three levels is to determine the level at which decisions are made. Corporate-level decisions are typically made at the highest levels of the organization by the CEO and/or board of directors, although these individuals may receive input from managers at other levels. If an organization is only involved in one area of business, then business-level decisions tend to be made by the same people. However, in organizations that have diversified into many areas, which are represented by different operating divisions or lines-of-business, business-level decisions are made by division heads or business unit managers. Functional-level decisions are made by functional managers, who represent organizational areas such as operations, finance, personnel, accounting, research and development, or information systems. These individuals are sometimes called department heads.

Strategy Implementation

Strategy Implementation
Functional strategies, systems, structures, and processes of the organization used to achieve strategic ends

Strategy formulation results in a plan of action for the organization and its various levels. On the other hand, strategy implementation represents a pattern of decisions that are intended to carry out the plan. **Strategy implementation** refers to the functional strategies, systems, structures, and processes of the organization that are used to achieve strategic ends. Functional strategies outline the specific actions that each function must undertake to convert business- and corporate-level strategies into actions. Organizational systems are developed to train and compensate employees, assist in planning efforts, reinforce organizational values, and gather, analyze, and convey information. Structures embody the way people are organized, which includes reporting relationships and formation into work groups, teams, and departments. Processes, such as standard operating procedures, are developed to create uniformity across the organization and promote efficiency. Strategy implementation, which will be discussed in depth in Chapters 8 and 9, may require changes to any of these organizational factors.

Some strategy scholars believe that implementation is the most important strategic management activity because even a well-devised strategy will fail if it is poorly executed. However, all of the strategic management activities must be carried out effectively for an organization to prosper over the long term. For example, strategic control helps an organization measure progress toward the achievement of its mission and goals.

Strategic Control

Good control is critical to organizational success. Strategic control is an ongoing process that, like stakeholder analysis, pertains to all parts of the strategic management process. In fact, stakeholder analysis is also a part of a well-devised strategic control system, because information gathered from and about stakeholders can be used to regulate the system.

Strategic Control
Ongoing evaluation and appropriate adjustments of the mission, goals, strategies, or implementation plan.

In our definition of the strategic management process, **strategic control** refers to the processes that lead to adjustments in the mission, goals, strategies, or implementation plan when necessary. Thus, managers may collect information that leads them to believe that the organizational mission is no longer appropriate or its strategies are not leading to the desired outcomes. On the other hand, the strategic control system may tell managers that the mission and strategies are appropriate, but they have not been well executed. Therefore, adjustments should be made in the implementation process. Strategic control will be the subject of Chapter 10.

Strategic Application 1.1 contains a review of the major activities in the strategic management process. While a majority of the larger organizations in the United States participate in all of the activities of the strategic management process to one degree or another, they often occur simultaneously. For example, a planning, research, or information systems staff typically collects information about stakeholders such as competitors, suppliers, and customers on an ongoing basis. Then, as the need arises or in accordance with a particular schedule (for example, annually or semi-annually), top managers meet to discuss goals, strategies, and implementation plans. Typically, the mission of the organization is used as a guide for other planning activities in these meetings, or top management may decide to alter the mission of the organization if it is inconsistent with the environment or current plans of the organization. Strategic control systems can then be developed to ensure that the plans of the organization are carried out and that they are still relevant to the mission of the organization.

If well executed, the strategic management process can help an organization develop one or more competitive advantages, which may in turn lead to the fulfillment of organizational goals and the satisfaction of key stakeholders. However, the ability of a competitive advantage to lead to these worthwhile objectives depends, in large part, on whether the advantage is sustainable over the long term. The next section provides additional insights on how organizations can develop competitive advantages that last.

STRATEGIC APPLICATION 1.1

IDENTIFYING THE STRATEGIC MANAGEMENT PROCESS

Think of the largest organization with which you are familiar. Can you bring to mind any evidence that the organization engages in any of these strategic management activities?

Environmental Analysis

Does the organization make any efforts to assess the needs or desires of its key stakeholders through surveys, interviews, or direct contacts?

How does the organization use information about key stakeholders?

Is the organization systematically engaged in collecting information about social trends, financial trends, or advances in technology?

Mission and Goals

Does the organization have a formal statement of mission? How is it communicated to employees and other stakeholders?

Have managers established organizational goals?

Strategy Formulation

Does the organization apply a consistent approach to the way products and services are produced and marketed? How would you describe this approach?

Does the organization stress low cost and efficiency, customer satisfaction, high quality, innovation, or flexibility?

Does the organization seem to focus on one particular type of customer or client?

Strategy Implementation

Is there a formal reporting structure or line of communication in the organization?

Does top management devote any energy to creating an internal environment (i.e., culture) that supports quality, efficiency, integrity, customer service, or some other factor?

How do each of the functional areas (i.e., finance, marketing, manufacturing, etc.) contribute to the overall organization?

Strategic Control

Does the organization hold groups and individuals accountable for their performance?

What are the reporting mechanisms used to measure performance?

Note: These activities are also found in smaller firms. However, typically the larger a firm becomes, the more formalized and recognizable these activities become.

Developing a Sustainable Competitive Advantage

Resource-based View of the Firm
View that an organization is made up of resources (human talent and skills, proprietary knowledge, physical assets, organizational reputation, financial resources, management techniques, products, services, contacts, and contracts) that need to be managed in a way that best achieves the organization's goals

Sustainable Competitive Advantage
An advantage that is difficult to imitate by competitors, leading to higher-than-average organizational performance over a long time period

Distinctive Competence
Aspect or activity an organization does better than any other organization

According to a theoretical perspective called the **resource-based view of the firm**, an organization is made up of resources, which include human talents and skills, proprietary knowledge, physical assets, organizational reputation, financial resources, management techniques, products, services, contacts, and contracts.[14] Proponents of the resource-based view of the firm argue that one of the most important roles of strategic managers is to manage resources so as to produce a **sustainable competitive advantage**.[15] A sustainable competitive advantage is an advantage that is difficult to imitate by competitors and thus leads to higher-than-average organizational performance over a long time period. It exists even after competitors have done everything they can to imitate it.[16] The two essential elements of a sustainable competitive advantage are (1) perceived customer value and (2) uniqueness.[17] There is some evidence that aligning the skills and other resources of the internal organization with the needs and demands of the external environment can itself be a source of competitive advantage.[18]

Closely related to the concept of sustainable competitive advantage is the idea of developing a **distinctive competence**.[19] A distinctive competence is something that one organization does better than other organizations. If the distinctive competence is difficult or impossible to fully imitate, it can lead to a sustainable competitive advantage. For example, Wal-Mart has a distinctive competence in the efficient distribution of products to its stores that allows Wal-Mart to offer lower prices leading to higher customer satisfaction.

The success of Marriott is largely attributable to two distinctive competencies. The first is financial controls. Marriott can determine and anticipate construction and operating costs with nearly exact precision. Second, Marriott has developed a distinctive competence in customer service, or "becoming the provider of choice." Looking to the future, Marriott is actively engaged in creating a third organizational capability as the "employer of choice." Marriott executives reason that with fewer people entering the labor force in the 18- to 25-year age group, good workers will become increasingly difficult to attract. Also, good workers are especially important in a service business like hotels because they interact directly with customers.[20] Many strategy scholars believe that developing a distinctive competence that produces a sustainable competitive advantage is the most important factor in organizational success. The importance of creating good working relationships with stakeholders is further demonstrated in Strategic Insight 1.2.

As the Marriott example and Strategic Insight 1.2 demonstrate, stakeholder analysis and management can help an organization develop a distinctive competence or sustainable competitive advantage. In fact, external and internal stakeholder analysis has implications for all of the activities in the strategic management process, as the next major section will demonstrate.

STAKEHOLDER ANALYSIS

Stakeholder Analysis
An identification and prioritization of key stakeholders, assessing their needs, collecting ideas from them, and integrating this knowledge into strategic management processes

Stakeholder Management
The communication, negotiation, management of relationships, and motivation of stakeholders so these stakeholders behave in ways beneficial to the organization

Before proceeding, it may be helpful to draw a distinction between stakeholder analysis and stakeholder management (see Table 1.3). **Stakeholder analysis** involves identifying and prioritizing key stakeholders, assessing their needs, collecting ideas from them, and integrating this knowledge into strategic management processes such as the establishment of missions and goals and the formulation and implementation of strategies (refer to the arrows pointing down from stakeholder analysis in Figure 1.1). **Stakeholder management,** on the other hand, includes communicating with stakeholders, negotiating and contracting with stakeholders, managing relationships with stakeholders, and motivating them to behave in ways that are beneficial to the organization and its other stakeholders. Although stakeholder management is primarily an implementation or control activity, the processes associated with stakeholder analysis and management overlap. Stakeholder analysis will be introduced in this section.

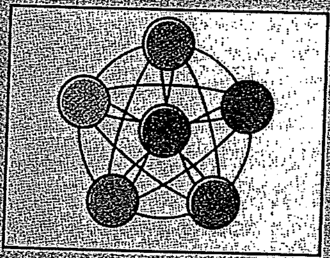
Identification of Stakeholders

The first step in the assessment of stakeholders involves the identification of stakeholders that are of primary importance to the organization. While Figure 1.2 can serve as a useful guide in identifying key stakeholders, it should not serve to limit the number or types of stakeholders identified, since it is not comprehensive or specific to any particular firm. Unlike Figure 1.2, actual company, group, or individual names should be included where possible. Thus, the major competitors of Wal-Mart might be identified as K-Mart, Target, and so forth.

Identification of stakeholders is even more complicated when organizations are significantly involved in countries other than the home country. There are several ways to respond to this situation. First, an organization can conduct an analysis of all stakeholders in all countries simultaneously. The resulting

STRATEGIC INSIGHT 1.2

STONYFIELD FARM SAVED FROM DEMISE THROUGH INNOVATIVE USE OF STAKEHOLDERS



In 1987, the Londonderry yogurt manufacturer named Stonyfield Farm, Inc. (Londonderry, New Hampshire) still did not have a plant of its own. In October of that year, the company which manufactured under contract for Stonyfield declared bankruptcy, leaving Stonyfield with no ability to continue production. Faced with this loss, the company developed and implemented an innovative recovery plan that involved several key stakeholders, including employees, suppliers, a government agency, a new bank, stockholders, managers, and customers.

First, the company turned its product development plant into a full-scale operation until a permanent facility could be built. Because the prototype plant was so small, a seven-day, three-shift schedule was implemented to maintain volume. This required the support and patience of employees, which management fostered through weekly meetings. Financial resources were strained throughout the entire recovery period due to the cost of the new manufacturing facility, and employees were asked to accept lower pay for future bonuses. Low-wage hourly workers were scarce in the region because of an abundance of high-paying, high-tech jobs. To attract and retain workers, the company instituted flexible time scheduling, an improved benefits program, increased training, and participative decision making. In spite of the stress, employee relations were excellent.

Due to its weakened financial condition, Stonyfield established creative partnerships with several suppliers and engineers, who agreed to provide up-front service and products without pay for exclusive supply and service agreements. Stonyfield also obtained the assistance of a government agency, the Small Business Administration, in the form of a loan guarantee. An emergency meeting of stockholders yielded commitments for bridge loans which would help the company meet its financial obligations while long-term financing was being arranged. Finally, the company secured construction financing from a major lender.

The company was eventually able to create a permanent manufacturing facility, which opened in 1989, and along with it a management structure to prevent the crisis from recurring. The next task was to bring the company to the position of operating stability. This involved a series of management changes that strengthened the company, including a three-tiered management structure. Still faced with a tiny marketing budget, the company developed some creative ways to reach its customers. They created a "Moo Patrol" program, complete with a "Moos from the Farm" newsletter and an "Adopt-a-Cow" program, in which children received a picture of their adopted cow and periodic letters indicating how many calves they had or how much milk they were producing.

Now squarely on its feet, Stonyfield has watched sales grow to $6.6 million, with an annual growth rate of over 60 percent in several of the region's largest chains. The company also opened several major national product lines. In 1990, it was one of only three companies to receive the Ethics in Business Award from *Business Ethics Magazine*.

Source: Adapted from "Stonyfield Farm, Inc.," *Strengthening America's Competitiveness: The Blue Chip Enterprise Initiative* (Warner Books on behalf of Connecticut Mutual Life Insurance Company and the U.S. Chamber of Commerce, 1991), pp. 56–57.

TABLE 1.3 Stakeholder Analysis and Management Processes

Stakeholder Analysis
- Identifying Stakeholders
  - External Stakeholders
  - Internal Stakeholders
- Classifying Stakeholders into Meaningful Groups
  - Type of Influence
  - Type of Stake
  - Dependence
  - Potential for Cooperation
  - Potential for Threat
- Prioritizing Stakeholders
  - Importance to Organization
- Assessing Needs and Collecting Ideas
  - Transactions
  - Meetings
  - Surveys
  - Research
  - Direct Involvement
- Integrating Knowledge into Strategic Management Processes
  - Mission and Goals
  - Strategies
  - Implementation Plans

Stakeholder Management
- Communicating with Stakeholders
  - Printed Media
  - Speeches
  - Meetings
  - Transactions
  - Surveys
- Negotiating and Contracting with Stakeholders
  - Contracts
  - Joint Ventures and Other Alliances
- Managing Relationships with Stakeholders
  - Trust and Fairness
  - Mutual Satisfaction of Needs
- Motivating Stakeholders to Behave in Ways Beneficial to the Organization and Its Other Stakeholders
  - Financial Motivation
  - Legal/Political Motivation
  - Cultural Motivation
  - Persuasion

combined influences provide the organization with a global picture, which helps managers craft missions, goals, strategies, and implementation plans that are applicable in a broad global setting. On the other hand, managers can deliberately segment organizational stakeholders by global region to assist in the creation of custom-tailored approaches to missions, goals, strategies, and implementation plans.

A combined approach is also available in which organizations develop their missions and long-range goals based on an analysis of stakeholders in their home country, but conduct globally segmented stakeholder analyses to assist in the formulation of custom-tailored strategies and implementation plans for particular regions. The choice of approach depends on the global orientation of the organization, a topic that will be covered in detail in Chapter 4.

Classification of Stakeholders

Once specific stakeholders are identified, they should be classified into meaningful groups. For example, groups might be formed on the basis of their stakes in the organization and the type of influence they have over firm behavior (see Figure 1.3). This type of classification can help managers understand both the needs and the potential power of their key stakeholders. In Figure 1.3, groups and individuals can have an ownership stake, an economic stake, or a social stake. An ownership stake means that the value of the organization has a direct impact on their own wealth.

Stakeholders can also be economically dependent without ownership. For example, employees receive a salary, debt holders receive interest payments, governments collect tax revenues, and suppliers receive payments for goods and services provided to the organization. Also, customers at other stages of the industry supply chain may depend on the products and services of an organization to produce their own products or services, as in the case of an auto manufacturer depending on a sheet steel manufacturer. Competitors are economically dependent on each other since actions taken by one competitor can dramatically influence the economic well-being of other competitors. Finally, global governments often depend on foreign organizations, especially firms from highly industrialized nations, to bring new investment capital or goods and services into their countries.

The final type of stake is social, which means that stakeholders are not directly linked to the organization but are interested in assuring that the organization behaves in a socially responsible manner. These are the "watchdogs" of our modern social order.

On the influence side, groups and individuals may enjoy formal power, economic power, or political power. Formal power means stakeholders have a legal or contractual right to make decisions for some part of the organization. Regulatory agencies and the Internal Revenue Service also fall into this category; they have formal power given to them by the government to cause organizations to pursue certain courses of action or pay fees and taxes. Joint venture partners—organizations that jointly pursue business opportunities—typically have formal power or decision-making authority in the joint ventures that are created.

Economic power, on the other hand, is derived from the ability to withhold services, products, capital, revenues, or business transactions valued by the organization. Finally, political power comes from the ability to persuade lawmakers, society, or regulatory agencies to influence the behavior of organizations.

Notice that some stakeholders have more than one source of power. For example, creditors sometimes have both economic and formal influence because they have formal contracts and may also have a seat on the board of directors. Also, competitors can impact a rival organization economically through their competitive strategies and also politically by lobbying for legislation that will give them a comparative advantage. In a very real sense, *any* of the stakeholder groups can have political influence. For example, disgruntled stockholders or employees may organize a group to influence government officials or the financial community. However, in an organization that is maintaining good working relationships with its stakeholders, the classifications found in Figure 1.3 are a fairly realistic picture of stakeholder roles.

FIGURE 1.3 Typical Roles of Various Stakeholders

STAKE	Formal (Contractual or Regulatory)	Economic	Political
Ownership	Managers Who Own Stock in Organization Directors Who Own Stock in Organization Stockholders in General Sole Proprietors	Other Companies That Own Stock in the Organization	
Economic Dependence	All Paid Managers and Directors of For-Profit and Nonprofit Firms Joint Venture Partners Creditors Internal Revenue Service	Employees Customers Suppliers Creditors Competitors	Competitors Foreign Governments Local Communities
Social	Regulatory Agencies (i.e., EPA, OSHA, and SEC) Unpaid Trustees or Managers of Nonprofit Organizations	Financial Community at Large (i.e., large brokerage houses, fund managers, and analysts)	Activist Groups (i.e., Nader's Raiders) Government Leaders The Media

INFLUENCE ON BEHAVIOR

Source: Adapted from R. E. Freeman, *Strategic Management: A Stakeholder Approach* (Boston: Pittman, 1984), p. 63. Reprinted with permission of the author.

A simpler approach to classifying stakeholders is to determine the extent to which an organization is dependent on them for prosperity and survival. For example, a privately held company with low debt and a conservative mission has little or no dependence on creditors. However, if that same organization should adjust its mission to support rapid growth because of a change in the values of its owners, then creditors and the financial community in general could become very important.

Both of the influence and the dependency approaches to stakeholder classification are more descriptive than prescriptive, since they really don't tell an organization what to do. On the other hand, Strategic Application 1.2 contains a classification scheme that provides ideas concerning how various stakeholder groups might be effectively managed.

STRATEGIC APPLICATION 1.2

STRATEGIES FOR MANAGING STAKEHOLDERS

Stakeholders are divided into groups based on their potential for threat and their potential for cooperation. In general, stakeholders with a high potential for threat exhibit one or more of the following characteristics: (1) they are more powerful than the organization, based on size (market power), political ties, or some other factor; (2) they are likely to take actions that are nonsupportive of the organization; or (3) they are likely to form a coalition with other stakeholders that may damage the competitiveness of the organization. On the other hand, stakeholders that have a high potential for cooperation tend to exhibit the following traits: (1) they are less powerful than the organization; (2) they are likely to take actions that are supportive of the organization; or (3) they are likely to form a coalition with the organization.

These classifications are combined to form Mixed Blessing (high cooperation/high threat), Supportive (high cooperation/low threat), Nonsupportive (low cooperation/high threat) and Marginal (low cooperation/low threat) stakeholder groups. In general, organizations should attempt to collaborate with Mixed Blessing stakeholders, involve Supportive stakeholders, defend against Nonsupportive stakeholders, and monitor Marginal stakeholders so that they do not become Nonsupportive.

Source: G. T. Savage, T. W. Nix, C. J. Whitehead, and J. D. Blair, "Strategies for Assessing and Managing Organizational Stakeholders," *Academy of Management Executive* (May, 1991), p. 65. Used with permission.

STAKEHOLDER'S POTENTIAL FOR COOPERATION WITH ORGANIZATION			
	High	**Mixed Blessing** Clients or Customers Employees in Short Supply *Strategy: Collaborate*	**Supportive** Board of Directors/Trustees Managers *Strategy: Involve*
	Low	**Nonsupportive** Competitors Unions *Strategy: Defend*	**Marginal** Activist Groups Stockholders *Strategy: Monitor*
		High	Low

STAKEHOLDER'S POTENTIAL FOR THREAT TO ORGANIZATION

Prioritization of Stakeholders

Regardless of the analytical tool used, once stakeholders are classified, they should be prioritized. Stakeholders that are considered particularly important to the organization should be given ample attention during strategy formulation and implementation. In for-profit organizations, the most important stakeholders typically include customers, employees, and shareholders or owners.[21] For example, according to Tony Anderson, chief executive officer of H. B. Fuller Co., a *Fortune* 500 company that makes glue, "Customers are first, employees second, shareholders third, and the community fourth."[22] At Fuller, satisfaction of customers is the key to satisfying other stakeholders.

In nonprofit organizations, there are no shareholders. Consequently, donors, customers (i.e., clients or beneficiaries of services), employees, and sometimes regulatory bodies are typically given highest priority.

Assessment of Needs and Collection of Ideas

Information about stakeholders can come from a variety of sources. For example, regular transactions such as sales, purchases, meetings, and government inspections can provide a wealth of information. Most larger organizations systematically assemble information on sales patterns for use in determining marketing strategy. In addition, purchasing patterns are studied for ways to increase efficiency and quality.

Meetings with shareholders, employees, customers, union representatives, suppliers, and other stakeholders can also be used to collect valuable information. Stakeholders are typically willing to express their opinions openly because of their stakes in the organization. Representatives of the organization need only ask for their opinions. However, an organization must also develop systems to record this information and transmit it to the appropriate decision makers. This is a much greater challenge. Suggestion boxes, which work especially well in Japanese firms, are a way to tap into the ideas and feelings of employees. Customer comment cards apply a similar principle to an external stakeholder group. Most effective CEOs maintain close personal contacts with their key suppliers, customers, government officials, union officials, joint venture partners, and sometimes even competitors.

Occasionally, organizations conduct formal surveys of various stakeholder groups to determine their needs and desires and tap into their ideas concerning the organization. For example, universities often conduct surveys of their alumni for suggestions on how to improve their programs. In addition to these formal surveys, organizations should stay abreast of recent research developments, the actions of competitors, potential threats from activist groups, changes in government policies and regulations, labor movements, and social trends as they apply to the organization. A lot of this information is available in business periodicals, such as the *Wall Street Journal* and a variety of trade and industry publications, in the United States and abroad. Large organizations often employ full-time researchers to collect this type of information, especially when an organization is involved in several countries. In smaller organizations, this information is generally collected informally by managers and executives.

A final means of collecting information is through direct involvement. One form of direct involvement, which is increasing in popularity, is inviting representatives from internal and external stakeholder groups to sit on the board of directors or board of trustees. A more traditional means of direct involvement is through employee participation in decision making. These options and many others will be explored in detail in Chapters 2 and 3.

Communication with stakeholders should be a two-way process. No organization should reveal everything it is doing or planning to do to all stakeholders. However, an organization that is responsive to its stakeholders can afford to be more open than competing firms that do not share a similar philosophy. In fact, effective stakeholder management requires that a firm provide information to its stakeholders on how the organization is responding to their ideas, needs, and desires. The trust, loyalty, and respect created by this approach can be another source of competitive advantage.

Integration of Knowledge into Strategic Management Processes

Organizations can use the information they collect from stakeholders to develop and modify their mission statements, goals, strategies, and implementation plans. Specific examples of how to use information from stakeholders in strategy formulation and implementation are provided in each of the individual chapters on these topics. Organizations can also use information from stakeholders to predict their responses to planned actions, at home and abroad. In addition, a well-informed organization may be better able to forecast trends in its environment, which can lead to a competitive advantage. Chapter 2 describes the use of business intelligence systems in forecasting.

In conclusion, internal and external stakeholder analysis is central to all activities in the strategic management process. Since organizational ethics guide the way an organization deals with its stakeholders, the final section of this chapter is devoted to a discussion of organizational ethics as they relate to the strategic management process.

STRATEGIC MANAGEMENT AND ETHICS

Ethics is an important topic in business today. It becomes an important topic of discussion in a society when it is undergoing fundamental changes in the way people perceive it and when the basic agreements that govern it become subject to question.[23] The monumental changes in the world over the past few years have created just such an environment.[24] The breakup of the Soviet Union, war in the Middle East, human-induced crises like the oil spill off of the Shetland Islands, and an increase in reports of corruption among political officials in industrialized nations have led many people to question basic values and institutions. In this politically sensitive environment, an organization that has an ethics edge may also be able to gain a competitive edge. Many of the examples contained in this book concern these types of organizations.

What are organizational ethics? Where do they come from? The next two sections deal with these two important questions, followed by a segment on the special ethical problems faced by global organizations, another section with arguments concerning the desirability of taking a proactive ethical stance, and a final section dealing with contracts.

Ethics and Social Responsibility

Ethics
A personal value system used in determining what is right or good

Organizational Ethics
A value system widely adopted by members of an organization

As they relate to an individual, **ethics** are a personal value system that help determine what is right or good. These values are typically associated with a system of beliefs that supports a particular moral code or view.[25] **Organizational ethics** are a value system that has been widely adopted by members of an organization. For example, Wal-Mart's values emphasize the worth of customers and employees, while Motorola has values that focus on participation and patriotism. To determine what the ethics of an organization are, a student can simply study the pattern of decisions in the organization to discover what or who is given priority.[26] Sometimes the stated ethics of an organization differ from the actual values that guide organizational decisions.

For example, an organization may publish an affirmative action statement that condemns prejudice in hiring and promotion decisions on the basis of sex or race. However, that same organization may not have a single minority member or female in its top management team. Thus, studying the pattern of promotion decisions over a few years can determine whether the stated ethical position differs from the actual behavior of the organization. This approach to ethics is consistent with the stakeholder model developed in this book, since stakeholders will naturally make these types of judgments when determining how well the organization is satisfying their needs and desires.

Virtually all strategic decisions contain ethical dimensions because they are directly linked to the way the organization interacts with its stakeholders.[27]