CREATING VALUE FOR STAKEHOLDERS

A good strategist must learn how to think carefully about the creation of value for customers, suppliers, employees, communities, and shareholders. This expansive view is at the heart of our idea about value creation. You can use this idea to assess and integrate what you have learned in other courses and disciplines.

While every disciplinary perspective is about some piece of the value creation process in the more holistic sense, each pays special attention to a specific part of the process. One of the tasks of the strategy curriculum is to help you put these pieces together (Figure 1).

Figure 1. Role of each discipline in strategic creation of value for shareholders.

<table>
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<th>Discipline</th>
<th>Focuses on:</th>
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<td>Marketing</td>
<td>Value creation for customers</td>
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<td>Leading organizations</td>
<td>Value creation for employees</td>
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<tr>
<td>Accounting and finance</td>
<td>Value creation for financiers (shareholders, bondholders, etc.)</td>
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<td>Global economics &amp; markets</td>
<td>The global economic context of value creation</td>
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<td>Operations</td>
<td>Value added to products and services by suppliers and manufacturers</td>
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<td>Decision analysis</td>
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<td>Ethics</td>
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In the section that follows, we give a brief description of one way to understand “creating value for stakeholders” in the broader sense.
The importance of considering all stakeholders and the centrality of value creation has emerged over the past 30 years from a group of scholars in a diverse set of disciplines, from finance to philosophy. The basic idea is that businesses, and the managers and executives who manage them, actually do and should create value for customers, suppliers, employees, communities, and financiers. We need to pay careful attention to how these relationships are managed and how value gets created for these stakeholders.

The basic idea of “creating value for stakeholders” is quite simple. Business can be understood as a set of relationships among different groups, which have a stake in the activities that make up the business. Business is about how customers, suppliers, employees, financiers (stockholders, bondholders, banks, etc.), communities, and managers interact and create value. To understand a business is to know how these relationships work. The job of the manager or entrepreneur is to manage and shape these relationships.

Figure 2 depicts the relationships among stakeholders, here shown surrounding the focal organization. It is important to note that the stakeholder idea is perfectly general. Corporations are not the center of the universe, and there are many possible alternative configurations of this figure. One might put customers in the center to signal that a company makes customers the key priority. Another might put employees in the center, and then link them to customers and shareholders.

Stakeholders and Stakes

Financiers clearly have a financial stake in the business in the form of stocks, bonds, and so on, and they expect some kind of financial return from them. Of course, the stakes of financiers will differ by type of owner, preferences for money, moral preferences, and so on, as well as by type of firm. Google shareholders may support Google’s articulated purpose to Do No Evil, but they very likely want returns as well.

One way to think about the employee relationship is in terms of contracts. Employees have their jobs and usually their livelihood at stake; they often have specialized skills for which there is usually no perfectly elastic or frictionless labor market. So in return for their labor, they expect security, wages, benefits, and meaningful work. Often, employees are expected to participate in the decision making of the organization, and if the employees are management or

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1 The following paragraphs, including Figure 2, are adapted from R. Edward Freeman, Jeffrey Harrison, and Andrew Wicks, Managing for Stakeholders (New Haven: Yale University Press), 2007; and R. Edward Freeman, “Managing for Stakeholders” in T. Beauchamp, N. Bowie, D. Arnold, Ethical Theory and Business, 8th edition (Englewood Cliffs, NJ: Pearson Publishing), 2008. We are grateful to the authors and editors for permission to use this material here.
senior executives, they shoulder a great deal of responsibility for the conduct of the organization as a whole. Many companies have stock ownership plans, so loyal employees who believe in the future of their companies often invest voluntarily and thus may be considered financiers as well.

Figure 2. Organizational stakeholders.

Customers and suppliers exchange resources for the products and services of the firm and, in return, receive the benefits of the products and services. As with financiers and employees, the customer and supplier relationships are enmeshed in ethics. Companies make promises to customers via their advertising, and when products or services don’t deliver on these promises, then management has a responsibility to rectify the situation. It is also important to have suppliers who are committed to making a company better. If suppliers find a better, faster, and cheaper way of making critical parts or services, then both supplier and company can win. Of course, some suppliers simply compete on price, but even so, there is a moral element of fairness and transparency to the supplier relationship.

Finally, the local community grants the firm the right to build facilities and, in turn, it benefits from the tax base and economic and social contributions of the firm. Companies have a substantial impact on communities, and being located in a welcoming community helps a company create value for its other stakeholders. In return for the provision of local services, a
company is expected to be a good citizen, as is any individual person. The firm should not expose the community to unreasonable hazards in the form of pollution, toxic waste, and so on. It should keep whatever commitments it makes to the community and operate in a transparent manner as far as possible. Of course, companies do not have perfect knowledge, but when management discovers some danger or runs afoul of new competition, it is expected to inform and work with local communities to mitigate any negative effects, as far as possible.

Almost every business is concerned at some level with relationships among financiers, customers, suppliers, employees, and communities. We might call these groups primary or definitional. But it should be noted that as a business starts up, sometimes one particular stakeholder is more important than another; there may be no suppliers, for example, and it may be justified to devote attention to one or two key customers or a sponsoring venture capitalist.

A somewhat broader conception of a stakeholder would be any group or individual who can either affect a business—and so whom managers must consider when strategizing about value creation—or affect or be affected by the realization of the firm’s purpose. At a minimum, some groups can affect primary stakeholders, and we might see these as stakeholders in the outer ring of Figure 2 and call them secondary or instrumental stakeholders.

The Role of the Executive

Executives play a special role in the activity of the business enterprise. On one hand, they have as much at stake as every other employee in terms of an actual or implied employment contract, a stake linked to those of financiers, customers, suppliers, communities, and other employees. On the other hand, executives also are expected to look after the health of the overall enterprise to keep the various stakeholders in harmonious balance.

In the process of value creation, no stakeholder stands alone; each is multifaceted and connected with the others. How could a bondholder recognize any returns without management paying attention to the stakes of customers or employees? How could customers get the products and services they need without effective employees and suppliers? How could employees have a decent place to live without communities? Many models of business and capitalism pit the needs of multiple stakeholders against one another and thus present prioritization as the primary challenge of value creation. We see this as a false choice.

First and foremost, stakeholder interests must be considered as inextricably joined. Accommodating and retaining such a unified vision of shared interests can be challenging, and it may seem easier to trade one for another. Why not delay spending on new products for customers to keep earnings a bit higher? Why not cut employee medical benefits to invest in a new inventory control system?

Managing for stakeholders suggests that executives try to reframe the questions. How can we invest in new products and create higher earnings? How can we be sure our employees are
healthy and happy and are able to work creatively so that we can capture the benefits of new inventory control systems? In a recent book reflecting on his experience as CEO of Medtronic, Bill George summarized the managing-for-stakeholders mindset:

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.²

The primary responsibility of the executive is to create as much value as possible for stakeholders. Where stakeholder interests conflict, the executive must find a way to rethink the problems so that these interests can go together, so that even more value can be created for each. If tradeoffs have to be made, as often happens in the real world, then the executive must figure out how to make the tradeoffs and immediately begin improving the tradeoffs for all sides. Creating value for stakeholders is about maximizing that value while avoiding tradeoffs and, when tradeoffs have to be made, improving those tradeoffs.

Strategic management involves asking the key questions about how to create value for multiple stakeholders simultaneously. We apply many of the tools in the strategist’s toolkit—analyzing the industry, understanding capabilities, and so on—to improve the strategic choices a firm makes. When making these choices, however, one must understand and engage with the interests of each of the firm’s stakeholders. This requires broad thinking; societal considerations, far from being externalities, are by definition as strategic as any other type of consideration. Indeed, one stakeholder’s externality may be another’s key priority.