Hans MÜHLBACHER – Oliver KOLL

STAKEHOLDER RESPONSIVENESS AND BUSINESS PERFORMANCE

Scanning both the academic and popular business literature of the last 40 years in a search for indications of how to be most successful in business must leave any reader in a puzzled state of mind. "Being close to the customer", efficient consumer response, Total Quality Management, shareholder value maximization, lean management, focusing on core competencies, management reward systems or employee involvement programs, are but a few of the slogans and buzz-words introduced as means to reach top performance. The reason for this wide array of sometimes opposing ideas stems from different assumptions about the purpose of organizations, from different understandings about the concept of effectiveness and from opposing opinions which means are superior in attaining a given end. So far, little effort has been made to assess the various suggestions in an orderly manner. To do so, some framework is required to compare the various approaches that can be found. One possibility would be a classification of suggestions depending on the importance they attach to different constituencies in the firm´s environment.

Most of the marketing literature proposes customers as primary stakeholders deserving the company´s main attention. In the last decade, the creation of satisfied customers has frequently been declared the predominant goal of businesses. Customer orientation has become a major buzz word in management circles. At the same time, other authors have claimed that maximizing shareholder value is the major key to business success. The basic idea behind this orientation is again a simple one: As owners of the company shareholders do have the right to demand maximization of their wealth which equals the maximization of the net present value of all future free cash-flows. Increasing shareholder value has become a major driver for many mergers and acquisitions in the last decade. Still other literature sources line out the importance of employees for a business to achieve top level performance. Again, the basis for this claim seems logical: Only satisfied staff can guarantee a high level of service and provide valuable input into continuous improvement processes as well as innovation needed for top performance. Therefore, following this management orientation staff is key to the success of a company.

During the 1980s stakeholder orientation gained prominence in the management literature. The basic idea is simple: Every business is embedded in an environment consisting of a set of stakeholders. These are defined as any group or individual that influences or is being influenced by the achievement of the organization´s purpose. Each stakeholder supplies the firm with critical resources and expects satisfaction of its own interests in return. If some of these interests are not satisfied, the respective stakeholder will cease to supply resources and harm the performance or even endanger the very existence of the company. Therefore, a company has to maintain mutually satisfying relationships with all of its stakeholders to achieve best performance. No one group is a priori considered most relevant.

Methodology

In order to compare the impact of different orientations concerning the responsiveness to stakeholders on the success of business organizations an empirical study was conducted. It might be preferable to learn about the variety of organizational behavior towards stakeholders through observation and in-depth interviews with the parties involved. However, such a research approach seems unrealistic given the requirements for the number of observations and number of time periods to be studied. Therefore, in this study the behavior of organizations towards key stakeholders was analyzed on the basis of data coming from their financial system.

The study employed data from the COMPUSTAT database, a secondary source widely used in strategy research. The COMPUSTAT database contains full historic financial information for over 10,300 corporations and provides 20 years of annual data, 12 years of quarterly data plus business and geographic segment data. While organizations have a great deal of latitude regarding their reporting practices, COMPUSTAT claims to remove any reporting variability through standardized collection techniques and to so ensure accurate comparison across companies.

Due to the limitation to financial variables the firms´ responsiveness to organizational constituencies was captured by the data shown in Table 1. Organizations providing customers with goods and services offering better benefits than competition should be able to enjoy growth in sales and comparatively higher margins as their offerings provide greater value to customers. However, these indicators for customer orientation may be interrelated. Therefore, they were only used in conjunction with each other. An organization scoring high on gross profit margin and sales change can be assumed to be more responsive to its customers than a comparable organization scoring low on one or both indicators.

Table 1

Indicators for Stakeholder Responsiveness available in COMPUSTAT

Stakeholder	Indicator
Customer	Percentage Change in Sales Gross Profit Margin
Shareholders	Total Financial Return
Staff	Labor and Related Expenses/Person Pension Expenses/Person

Shareholders will mostly be interested in the financial return offered by an investment in a company. Therefore, the annual percentage return (generated by an increase in share price and dividend pay-outs) was used as indicator for the responsiveness to shareholders.

While a number of soft factors, which are not captured in the COMPUSTAT database, will influence the satisfaction members of staff derive from their work, financial benefits will play a prominent role in determining employee satisfaction. Expenses for labor and pensions related to the number of staff and compared to an industry average or an industry maximum will affect the assessment of staff how much their company values their input.

Choice of a suitable performance measure may be the most critical question in any organizational effectiveness study. In this study two variables were employed. Return on assets is one of the most widely used criteria of organizational effectiveness. Additionally, the z-score measure of bankruptcy was used, which assesses the potential of an organization to survive.

Responsiveness towards each of the constituencies and performance were measured in comparison to the relevant set of competitors that is within the respective industry, for every single period. For every period the relevant measures were ranked for each of the three industries. Missing values were substituted by assuming a linear development for each measure and each organization. If there were two indicators for one stakeholder group – as for customers and staff – the two ranks were multiplied and the results ranked again. The higher the rank the more responsive the organization was considered towards the respective stakeholder group.

Comparing responsiveness to stakeholders only makes sense within single industries, as the impact of different constituencies on organizational behavior is likely to differ between industries. One may argue that the borders between industries are less clear-cut than they used to be due to increased cooperation between firms coming from different industries. Especially organizations, which show a high degree of diversification, cannot easily be allocated to a single industry and caution is warranted when their responsiveness to stakeholders is compared to an industry standard. Therefore, in this study only three industries were selected which show a rather low level of diversification: oil (SIC code 2911), utilities (SIC code 4911) and airlines (SIC code 4512). Within these industries firms were included only if at least one indicator per constituency group was available for every year of data analysis resulting in 17, 35, and 17 organizations in the final samples respectively.

A ten-year period including data from 1988 to 1997 was selected for analysis. Two reasons support analysis for multiple periods. First, the value of findings increases once certain associations can be established for more than a single period. In addition, some part of organizational behavior may not immediately translate into some measure of organizational effectiveness calling for an evaluation of time lags between behavior and result of such behavior.

For every year the organizations were allocated to one of three groups on each orientation. The first group was made up of the 20% top responsive organizations, the second group of the 60% of medium responsive ones, and the third group of the remaining 20% of least responsive firms. The cut-off level may look somewhat arbitrary but it may be argued that performance has to differ substantially from industry standards before likely affecting performance. In a three-way table, each organization was then assigned membership to one of 27 groups depending on the responsiveness levels for each of the three constituencies.

Table 2

Frequency of Observed Stakeholder Responsiveness Combinations

Group				Airline		Oil		Utility		Overall	
	CUST	EMP	SHA	EXP	OBS	EXP	OBS	EXP	OBS	EXP	OBS
1	L	L	L	2,2	2	**2,2**	7	**2,8**	**9**	7,2	**18**
2	L	L	M	**5**	**0**	**5**	**12**	8,4	5	18,4	17
3	L	L	H	**2,2**	**0**	2,2	2	2,8	4	7,2	6
4	L	M	L	**5**	**12**	5	3	8,4	16	18,4	31
5	L	M	M	11,2	10	**11,2**	**4**	25,2	22	47,6	36
6	L	M	H	**5**	**2**	5	3	8,4	5	18,4	10
7	L	H	L	2,2	4	2,2	2	2,8	5	7,2	11
8	L	H	M	5	6	5	5	**8,4**	**2**	18,4	13
9	L	H	H	2,2	4	**2,2**	**1**	2,8	2	7,2	7
10	M	L	L	**5**	**1**	5	3	8,4	10	18,4	14
11	M	L	M	11,2	12	11,2	7	25,2	25	47,6	44
12	M	L	H	**5**	**2**	**5**	**2**	8,4	9	18,4	13
13	M	M	L	11,2	7	11,2	8	25,2	15	47,6	30
14	M	M	M	25,3	34	25,3	31	75,6	76	125,6	141
15	M	M	H	11,2	9	11,2	15	25,2	26	47,6	50
16	M	H	L	5	7	5	9	8,4	6	18,4	22
17	M	H	M	11,2	12	11,2	12	25,2	34	47,6	58
18	M	H	H	5	6	5	5	8,4	9	18,4	20
19	H	L	L	2,2	4	**2,2**	**1**	**2,8**	**1**	7,2	6
20	H	L	M	5	9	5	4	8,4	7	18,4	20
21	H	L	H	**2,2**	**9**	2,2	2	**2,8**	0	7,2	11
22	H	M	L	5	2	5	7	8,4	7	18,4	16
23	H	M	M	11,2	7	11,2	13	25,2	30	47,6	50
24	H	M	H	5	8	5	6	8,4	12	18,4	26
25	H	H	L	**2,2**	**1**	**2,2**	**0**	**2,8**	**1**	**7,2**	**2**
26	H	H	M	**5**	**0**	5	4	8,4	10	18,4	14
27	H	H	H	**2,2**	**0**	2,2	2	2,8	2	7,2	4

Findings

The extent to which organizations can attend to their respective stakeholders is limited by two factors: First, the amount of time and attention capacity is limited. Second, some constituencies may perceive high levels of responsiveness to another group as negatively affecting the responsiveness they experience. Therefore, data analysis first focused on the frequency of the various combinations of responsiveness.

Table 2 shows the 27 groups of different levels (Low = L, medium = M, or high = H) of responsiveness to customers (CUST), shareholders (SHA) and staff (ST). If the number of group members more than doubles the statistically expected observations or only reaches half of the expected observations the respective numbers are shown in bold. If three times as many observations are found than would be expected or only one third, the figures in the cells are shown in bold and the cells are shaded.

A number of considerable deviations from what could be expected if a random process determined group membership can be identified. Group 1 consisting of organizations with comparatively low responsiveness to all three constituencies contains substantially more members than would be expected. In contrast, group 27 consisting of firms with comparatively high responsiveness to all three constituencies contains substantially less while the expected number of observations would be equal. One may conclude that it is more difficult to be highly responsive to all three constituency groups than it is to be comparatively less responsive to all of them. The other outstanding deviation from randomness concerns the combination of above average responsiveness to staff and customers with low responsiveness to shareholders. Attending disproportionately to the former two groups at the cost of the latter may be a difficult road to take since one would expect shareholders to penalize such behavior by reallocating their funds.

The expected number of group members with at least two responsiveness scores being high or at least two being low is 84, whereas the actual numbers are 84 and 103 respectively. This finding supports the idea that it is difficult to be highly responsive to more than one constituency.

Table 3

Summary of Success Measures

Measure	Airline (n=170)	Oil (n=170)	Utilities (n=350)
Average ROA	2.01	4.08	2.99
Std.Dev. of ROA	11.6	3.14	2.67
Average z-score	2.06	2.52	1.17
Std. Dev. of z-score	1.47	0.61	0.35

Organizational effectiveness was measured in terms of return on assets and the z-score measure of bankruptcy. *Table 3* provides an overview of the measures in the three industries.

It is interesting to note that the threshold for the z-score measure was originally set at 3; i.e. scores below 3 were taken as a sign of financial distress. Both a higher degree of leverage during the time of this analysis as well as a lower level of retained earnings and a fairly high asset intensity in the three industries studied may have caused this value to be significantly below 3.

Tables 4, 5 and 6 focus on the relationship between different levels of responsiveness to customers (CUST), staff (ST) and shareholders (SHA) and average effectiveness, both in terms of ROA and the bankruptcy measure.

Table 4

Effect of Customer Responsiveness on Performance

	Airline		Oil		Utilities	
	ROA	z-score	ROA	z-score	ROA	z-score
Low CUST	-6.96%	0.89	2.79%	2.3	1.72%	1.04
Medium CUST	2.60%	1.94	4.62%	2.63	3.32%	1.22
High CUST	9.64%	3.48	4.08%	2.46	3.26%	1.17
F-Value	27.168	49.165	4.889	4.427	10.359	6.755
Sign.	0.000	0.000	0.009	0.013	0.000	0.001

Low levels of customer responsiveness seem to be detrimental for success in all three industries. The differences between groups of responsiveness are significant for all industries. But being highly customer responsive may not pay off for the oil and utility industry where medium levels show the highest success rates.

Table 5

Effect of Staff Responsiveness on Performance

	Airline		Oil		Utilities	
	ROA	z-score	ROA	z-score	ROA	z-score
Low ST	7.92%	3.56	2.92%	2.33	3.02%	1.23
Medium ST	0.76%	1.76	4.08%	2.52	2.84%	1.14
High ST	-0.92%	1.27	5.23%	2.69	3.40%	1.20
F-Value	7.39	40.86	5.702	3.542	1.185	1.721
Sign.	0.001	0.000	0.004	0.031	0.307	0.18

Table 6

Effect of Shareholder Responsiveness on Performance

	Airline		Oil		Utilities	
	ROA	z-score	ROA	z-score	ROA	z-score
Low SHA	-4.2%	1.3	2.52%	2.33	1.43%	0.96
Medium SHA	3.52%	2.17	4.43%	2.57	3.46%	1.23
High SHA	4.82%	2.57	4.84%	2.58	3.13%	3.13
F-Value	8.34	78.605	7.134	2.417	16.537	17.754
Sign.	0.000	0.000	0.001	0.092	0.000	0.000

The results for staff responsiveness are less clear-cut. Organizations in the utility industry do hardly differ in performance whether employee responsiveness is comparatively high, medium or low. The oil industry benefits from higher levels of staff responsiveness, whereas high levels of staff responsiveness are not rewarded in the airline industry. They result in negative return on assets.

Results for shareholders are comparable to results for customers with a generally positive effect of higher responsiveness on performance. Especially the differences between low and medium levels of responsiveness are significant with additional benefits resulting from high levels of shareholder responsiveness in the airline and oil industries and a small loss in the utility industry.

The basic pattern did not change neither when the firms were allocated to one of three groups depending on their performance level (low, medium, high) to avoid potentially biasing effects of outliers on the interpretation of results, nor when lagged performance levels were considered. In sum, the results for individual stakeholder relationships supported most arguments on the importance of single constituency groups found in the literature: Typically higher levels of responsiveness are related to higher levels of performance. Findings also support the basic hypothesis of the stakeholder approach, that there is a limit to what responsiveness to one single stakeholder group can do for organizational effectiveness: Most findings support the idea of both a minimum and (in most cases) a maximum level of responsiveness which is advisable. Faring both below and above this level causes either low performance or is not related to high performance.

To investigate the effects of combinations of responsiveness to customers, staff and shareholders on company performance groups of organizations were formed according to their levels of responsiveness. Groups categorized as "high" contained the top 80% of an industry in terms of responsiveness to staff, customers and shareholders. Groups classified as "low" contained the remaining 20% of organizations. Figure 1 summarizes the responsiveness findings and offers an overview how combinations of various levels of responsiveness relate to organizational performance. The area within the circles corresponds to presence of such a type of responsiveness whereas the area outside a circle corresponds to its absence. While the results differed between the three industries studied, some combinations of responsiveness were related to the same level of performance for all industries. For example, responsiveness towards staff without a minimum level of responsiveness to the other two stakeholder groups or low responsiveness to each of the groups always combines with a tendency to low performance. Even a lack of responsiveness for only customers and shareholders warrants low performance levels. In addition, strategies focussing on single constituencies and disregarding other ones usually lead to low performance or inconclusive results at best. While none of the three causes studied is sufficient for companies to perform above average, both customer and shareholder responsiveness are necessary conditions for above-average effectiveness. Responsiveness to all groups is often rewarded with above-average performance and hardly ever related to below-average performance.

Conclusions

Despite the obvious limitations of this study caused by measuring responsiveness to stakeholder groups only on the basis of publicly available financial data one may conclude from the results that the exclusive focus on a single constituency usually leads to low performance. A combination of customer and shareholder responsiveness has a higher probability of success. Aiming for a level of responsiveness to shareholders, customers and staff which goes beyond the lower 20% in an industry makes low performance very unlikely and is disproportionately related to high levels of performance. Therefore, stakeholder oriented management seems to dominate any other constituency orientation in terms of business performance.

Figure 1

Effective vs. Ineffective Combinations of Stakeholder Responsiveness