

Managing Stakeholders Well Pays Off - in the Long Run

In theory, stakeholder-friendly managers deliver better performance. In practice, managers appear to neglect stakeholders. Why? In the short term, stakeholder-friendly policies seem to affect performance negatively. Yet, good stakeholder management, although challenging, ultimately boosts shareholder value in the long run.



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Maximizing shareholder value contributes to the welfare of other stakeholders, or so the theory goes. Yet there is not always a positive correlation between financial performance and the welfare of certain stakeholders. Public skepticism over the idea of the firm acting in the interests of the wider community has grown, particularly in the wake of the global financial crisis.

In their article, [*Over the Long Run? Short-Run Impact and Long-Run Consequences of Stakeholder Management*](#), Roberto Garcia-Castro and Miguel Ariño of IESE and Miguel Canela of Barcelona University explore more fully the topical question of stakeholder orientation and firm performance.

Their study differs from previous research, both in its methodology and findings. Using regression analysis on two models based on 658 U.S.-based firms, the authors use a longer time horizon of seven years, from 1999 to 2005. This allows them to study the impact of stakeholder management (SM) on value creation in both the long and short term.

To measure SM, the authors construct their own unique index, using the established KLD Index ratings for five categories of stakeholder management: employee relations, customer/product issues, community relations, diversity issues and environmental issues.

Another difference is that the professors focus on shareholder value creation as measured by Market Value Added (MVA) instead of operational, accounting-based measures of performance such as Return on Assets (ROA) or Return on Equity (ROE), which are more open to manipulation.

Short-Term Pain, Long-Term Gain

Because implicit costs and long-term effects are more difficult to evaluate, MVA reflects the evaluation of a company's explicit costs. In adopting an enlightened employee relations policy, for example, some explicit costs for the company would include cash-sharing policies, above-average wages and so on. These costly policies are shown to have a negative impact on performance in the first years after investing in SM policies compared with companies that have no such commitments. In this regard, stakeholder-oriented management does, in fact, destroy value in the short term.

However, in the long term (later years after applying SM policies), there is a significantly positive relationship between SM and MVA. The commitments and trust-based relationships

created as a result of consistent stakeholder-oriented policies seem to reduce the explicit costs for those stakeholder-oriented firms. As a result, they create higher shareholder value compared with other companies that only put their shareholders first. Stakeholder-friendly management, therefore, does create shareholder value longer term.

It should be noted that the negative impacts occurred against a backdrop of general economic malaise around the time that the dot-com bubble burst, and the positive impacts coincided with the economic upturn of subsequent years. Furthermore, the effects were exaggerated, so that firms with SM in place performed significantly worse or better during the corresponding economic times, compared with firms with little or no SM.

The negative short-term impact ? particularly if SM firms perform commensurately worse ? may partly explain why most firms do not adopt stakeholder-friendly policies to manage their activities and relations with stakeholders as often as is presumed. But one must not forget the flip side: that firms are significantly better off in the longer term.

Implications for Decision Making

As good as the flip side is, one must not dismiss the very real challenges that an SM stance creates for managers. In seeking to honor all the various commitments they have to different stakeholders, including employees, suppliers and the community at large, managers will invariably find themselves constrained. Making decisions will require making some tricky trade-offs among competing stakeholder interests: For example, should a manager increase wages or freeze them to maintain or increase current stock profitability? There are no easy answers. Shareholder-oriented firms, meanwhile, have fewer constraints like this, and so they can more easily adapt their strategies and spending patterns to fit their environment accordingly.

The difficulty of measuring and anticipating long-term firm performance means that managers must find a credible, alternative rationale for justifying acting in their stakeholders' interests. The authors propose a different model for managers to build a case and argue for stakeholder interest, based on the common good, social contracts and a sense of fairness.

If stakeholders are to come first, managers must find effective ways to deal with the short-term trade-offs. They must learn how to choose among stakeholders' different and diverging claims. The management task is always to be aware that their short-term decisions are going to have a long-term economic and moral impact on all their stakeholders.

More research is needed to explore the relationship between SM, value creation and the economic cycle, to determine if firms that establish quality relationships with their stakeholders would be better protected from external shocks than average firms.

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