

Keys to optimize stakeholder investments

Invest in stakeholders? Absolutely. But how much and when? Research exploring stakeholder investments and outcomes finds that sometimes, less is best.



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Nike did it. Back in 1998, facing public outrage over "slave wages, forced overtime and arbitrary abuse," Nike committed to investing more in its employees and suppliers. Not only was that the right thing to do ethically, but instrumental stakeholder theory posits that investing in stakeholders is actually good for corporate performance.

And it was for Nike. The footwear maker's financial returns soared in the nearly two decades since. Not only did Nike's employees and suppliers benefit from increased investment, but

shareholders and customers did, too.

But is there a limit to how much companies should invest in their stakeholders? Is there a point when costs run too high and returns diminish?

Research by [Roberto García-Castro](#) and Claude Francoeur says yes, there is. [Published in the *Strategic Management Journal*](#), this research explores the complex interplay of stakeholder investments' "complementarities, costs and contingencies" to conclude that more is not always better. In fact, under certain boundary conditions, less works best.

According to the article, a minimum investment level in a company's primary stakeholder groups is required for a company to perform optimally. When a minimum investment level is surpassed, the co-authors explore where a point of overinvestment might begin. In this, they show that the relationship between stakeholder investments and returns is far from linear. They also find that simultaneous investments in stakeholder groups is especially effective.

When more is not better

With theoretical and empirical tests, García-Castro and Francoeur posit that there are lower and upper bounds for firm investments in shareholders, employees, customers and suppliers — i.e., the primary stakeholders.

Empirical tests use data compiled by Sustainalytics — an independent consulting firm tracking social, environmental and governance performance for more than 2,000 publicly traded international companies — along with public financial figures. In order to analyze "complex configurations and multiple interaction effects" for more than a thousand firms' investments in stakeholders, taking other factors (such as strategy and industry) into account, the co-authors utilize "set-theoretical methods (STM)," which allow the use of *fuzzy sets* (whose elements have incomplete or degrees of membership) and sophisticated statistical tests.

In addition to lower and upper bounds, the co-authors identify some contingencies, costs and complementarities that matter.

Specifically, looking at strategy, industry and more, they find:

- Within industries where firms have a low degree of differentiation (e.g., car parts or commodities), "the cumulative effect of firms' investments in employees, suppliers and customers can give firms a competitive edge."

- "Similarly, firms suffering from low innovation levels can alternatively leverage their sets of stakeholder relationships to build a competitive advantage in the marketplace."
- "Contrary to conventional wisdom, one salient and bad act by a company will not necessarily damage its financial performance, or an enduring reputation will not overshadow all acts good or bad."
- "According to the results provided in this article, stakeholder investments are more effective when done simultaneously across all the relevant stakeholder groups, when there are no disproportionately high investments in isolated stakeholder groups beyond some upper bound and when strategy, industry and legal/national conditions are taken into account."

In sum, instrumental stakeholder theory states that investing in stakeholders is good not just for that particular stakeholder group — be they shareholders, employees, suppliers or customers — but also good for creating more economic value overall. While that is true in a general sense, the relationship is not linear — i.e., more is not always better. Invest simultaneously across stakeholder groups for better results.

Methodology, very briefly

"In this article we rely on set-theoretic methods and a large international dataset of 1,060 multinational companies to explore theoretically and empirically some of the complementarities, costs and contingencies likely to arise in stakeholder management," they summarize.

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