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A Practitioner Critique of a Conceptual Paper on Measuring Value and Performance

Andrew C. Wicks
University of Virginia

Jeffrey S. Harrison
University of Richmond, harrison@richmond.edu

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ANDREW C. WICKS
Ruffin Professor of Business Administration
University of Virginia
The Darden School of Business
P.O. Box 6550
Charlottesville, VA 22906-6550
Tel: (434) 343-8739
Email: wicksa@darden.virginia.edu

JEFFREY S. HARRISON
W. David Robbins Chair in Strategic Management
University of Richmond
The Robins School of Management
1 Gateway Road
University of Richmond, VA 23173
Tel: (804) 287-1920
Fax: (804) 289-8878
Email: harrison@richmond.edu

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ABSTRACT

Much of the business literature suggests that firm performance should be measured in financial terms, based on the notion that the primary obligation of a corporation is to provide high shareholder returns. An alternative literature is emerging in which scholars identify the many weaknesses associated with shareholder primacy, and offer alternative performance measures that are focused on a broader set of stakeholders. One such publication was provided to high-level executives in large companies. The executives were then given the opportunity to critique the paper and to discuss the extent to which their firms are engaging in the types of performance measurement activities contained therein. This paper is a direct response to the need to engage practitioners in useful dialogues about stakeholder theory within the academic community.

MOTIVATION

> "What we said is we're going to bet the farm on an idea that doing good, positively impacting the lives of our associates, customers, and communities, is the best path to doing well, making money… We are betting the farm on stakeholder theory, betting the farm on it." Mark Fernandes, Leadership Officer, Luck Companies

What does it mean for a company to create value, what kinds of value should be measured, and how do we know a great company when we see one? Luck Companies, a large aggregates manufacturer, measures its performance across multiple stakeholders. In contrast, a widely held belief is that the primary measure of performance should be financial – specifically making profits or maximizing shareholder returns (Berle & Means, 1932; Rappaport, 1986; Jensen, 2001; Sundaram & Inkpen, 2004). The popularity of this perspective was confirmed in a study of law and business curricula by Darrell West (2011), director of Governance Studies and a senior fellow at Brookings. He found that in classes that deal with the purpose of the corporation, the focus is typically on maximizing shareholder value. He also found that graduates consider shareholder value as the most important objective of the corporation.

In spite of the popularity of the shareholder primacy perspective, some scholars have argued that while profits are vital and an important part of firm performance, we need a broader conception of value – one that recognizes the importance of stakeholder participation to make firms sustainable, and to help managers appreciate the value stakeholders seek (Atkinson, Waterhouse & Wells, 1997; Chakravarthy, 1986; Kaplan and Norton, 1996; Mendelow, 1983; Stout, 2012). Harrison and Wicks (2013) write about a variety of types of "value" stakeholders seek, both to draw attention to the ways firms do good things, but also as a way for firms and managers to appreciate the variety of ways they can get and sustain support from groups like customers, employees, financiers, suppliers, and the local community. While these groups may want financial returns and/or products and services, they tend to seek other things as well, such as voice, fair treatment, respect, affiliation, and in the case of employees, secure employment, promotion and development opportunities (Harrison, Bosse & Phillips, 2010).

While the Harrison and Wicks (2013) paper was addressed primarily to academics and drew largely from the academic literature, it was also designed to engage the manager and the marketplace. Although their claims may have had sufficient conceptual support to allow acceptance in a well-known academic journal, sometimes such efforts are just that – academic. If their ideas are reasonable, or at least headed in the right direction, and given the groundswell of interest among corporations and society in sustainability and social responsibility, then one might expect to find in business organizations some non-traditional approaches to measuring performance – approaches that give value creation for stakeholders a high priority. This does not imply a "one-size-fits-all" set of practices, particularly since various stakeholders may seek different things, and firms provide different kinds of value. Part of what is interesting in this conversation is the variety in value and how firms can create more of it by making value-creation, broadly defined, a salient and intentional focus.

Business academics frequently discuss the need to engage practitioners in their discussions and activities, but to date there has been limited engagement. Our purpose for engaging in this research was to present high level executives in large companies with an academic article on measuring performance more broadly, seek their honest reactions to the article, and surmise the extent to which their firms are engaging in the types of measurement activities contained therein. An investigation of this sort can help guide research in the area of performance measurement, to the extent that scholars are willing to listen. We believe this kind of research will also stimulate further interest in stakeholder theory as a useful tool in moving organizations towards the creation of more value, broadly defined.

Another part of our motivation for this paper was to note, and attempt to get beyond, the existing clash between stakeholder theorists and shareholder theorists (Argenti, 1999; Campbell, 1999; Freeman, et al., 2010; Smith, 2003). Debates about why firms exist and who they serve is important, but that conversation has largely been driven by academics. We wanted to get past the focus on the academic disputes and see what real firms and real managers are doing, particularly related to creating value and measuring it.

THE PAPER

The Harrison and Wicks (2013) paper is called "Stakeholder Theory, Value and Firm Performance." The abstract of the paper is as follows:

> This paper argues that the notion of value has been overly simplified and narrowed to focus on economic returns. Stakeholder theory provides an appropriate lens for considering a more complex perspective of the value that stakeholders seek as well as new ways to measure it. We develop a four-factor perspective for defining value that includes, but extends beyond, the economic value stakeholders seek. To highlight its distinctiveness, we compare this perspective to three other popular performance perspectives. Recommendations are made regarding performance measurement for both academic researchers and practitioners. The stakeholder perspective on value offered in this paper draws attention to those factors that are most closely associated with building more value for stakeholders, and in so doing, allows academics to better measure it and enhances managerial ability to create it.

The four factors Harrison and Wicks associate with the utility (value) stakeholders receive from their interactions with firms are: 1) the tangible benefits created for stakeholders associated with the products and services of the firm, 2) the intangible benefits stakeholders enjoy based on just and fair treatment, and 3) the benefits of affiliating with particular organizations and, embedded within each of these other three factors, 4) the notion of opportunity costs. As they explained in the paper, utility is based on perception, and perception is influenced by whether stakeholders believe they are getting a good deal from the organization compared with what they might expect to receive through interactions with other firms that serve similar purposes. As the abstract suggests, the four-factor model was compared to other perspectives on firm performance, including shareholder primacy, the Balanced Scorecard, the Triple Bottom Line, and corporate social performance in general. Harrison and Wicks also proposed that much of the value a firm creates might be measured, at least in part, by the happiness of the firm's key stakeholders, individually and collectively (Blanchflower & Oswald, 2011). They provided a table with numerous examples of happiness-based performance measures, as well as potential proxies for these measures that might be useful to researchers.

THE EXECUTIVES AND COMPANIES

We asked executives from six major companies from a variety of industries to read and then respond to the article. We started with a list of questions (which size limitations do not allow us to provide in this proposal), but then we also asked follow-up questions and allowed executives to expand on topics in which they were particularly interested.

The full interviews are found at http://tinyurl.com/wicksharrison (they are listed along the right column). The participating companies and the executives we interviewed are as follows:

Unum Group, an Employee benefits insurance company with over 10,000 employees and over $10 billion in sales in the U.S. and Europe; part of the S&P 500. Executives were Tom Watjen, President and CEO, with responsibility for all aspects of the company and working with the board, and Joe Foley, Senior Vice President of Marketing and Public Relations, with responsibility for brand advertising, image, public relations, and corporate strategy.

The Home Depot, Inc., The world's largest home improvement specialty retailer, with more than 2,200 retail stores in the U.S., Puerto Rico, the Virgin Islands, Guam, Canada, and Mexico. The executive was Hal Laughton, Senior Vice President of Merchandising, with profit and loss responsibility for $23 billion in sales covering tools, hardware, outdoor living, outdoor garden, and cleaning businesses.

Luck Companies, the leading mid-Atlantic (USA) supplier of high quality crushed stone, sand, gravel, architectural stone, clay tennis courts, and high-end real estate construction. The executive was Mark Fernandes, Chief Leadership Officer, with responsibility for strategic direction for the enterprise mission. He is also a thought leader for development of Luck's Values Based Leadership (VBL) ideology and model.

McKinsey & Company, LLC, a global management consulting firm. The executive was Elie Maalouf, Senior Advisor. Formerly he was President and CEO of HMSHost Corporation, with approximately $3 billion in sales and 34,000 employees in 14 countries.

MeadWestvaco, a global leader in packaging and packaging solutions; the company also has businesses in specialty chemicals, community development and land management. Executive was Mark Watkins, Senior Vice-President of Technology and Forestry. Responsibilities include manufacturing technology, forestry operations and research, corporate engineering, safety, health, environment, and sustainability.

SunTrust Banks, Inc. operates as the holding company for SunTrust Bank and various other subsidiaries that provide various financial services in the United States. The company operates in three major segments: Consumer Banking and Private Wealth Management, Wholesale Banking, and Mortgage Banking. The executive was Rilla Delorier, Executive Vice President, Chief Marketing and Client Experience Officer.

Below you will find some of the many interesting responses to questions we asked, and various approaches to how their own firms think about – and measure – value creation for stakeholders. We edited the interviews somewhat to correct minor linguistic errors, provide clarifications, and eliminate material unrelated to the topic. The executives were also allowed to edit their answers for the purpose of clarity.

OVERALL REACTIONS TO THE PAPER

Unum Group: "…I think we very much support the concept of multiple stakeholders and the growing importance of those stakeholders and, frankly, it defines the brand of this company."

Home Depot: "we've never gone through a process of saying, hey, let's really in a very analytical way, let's go though and do a stakeholder theory assessment and a set of actions against those and that sort of thing. It's really more – a lot of the things that are in here make a ton of sense and we do them just as a matter of course every single day. It's more embedded in our culture. We're a 35-year-old business, one CEO removed from our founders, and so much of the culture they created is very much pervasive in the business."

McKenzie: "I have, maybe, a slightly different view in the sense that I do believe that putting shareholders first is necessary in for-profit organizations. If you're a not-for-profit or governmental organization, that's a different game altogether. I do believe it's necessary and unavoidable. You may try not to, but it will get you eventually. The capital markets have changed. Ownership structures have changed significantly over the last 20 years; unless there's a family that owns 50.1%, sooner or later the capital markets, through activists, hedge funds, and others, will bring the pressure to put the shareholders first. But there are different ways to put shareholders first, and I could still agree with most of your argument that taking care of other constituents is part of putting shareholders first because long-term, it enables you to survive and succeed in your industry and to create more shareholder value."

Luck Companies: "We're a company that has lived by the principle of reciprocity for years. Ninety years ago Charlie's (Luck) granddad bought his first quarry. It had six people… He started the company on the philosophy - now remember, this is back during the era of the great man theory of leadership, command and control... Well, his idea was - listen to what he said – "If I do right by my people they'll do right by me."

SunTrust: "We agree that value creation for a firm extends beyond the traditional focus on shareholder return determined by quarterly financial results. It is important for companies to take a wider view of the stakeholders that they serve in order to predict the longer-term health of the company and its ability to deliver sustained value."

Luck Companies: "What we said is we're going to bet the farm on an idea that doing good, positively impacting the lives of our associates, customers, and communities, is the best path to doing well, making money… We are betting the farm on stakeholder theory, betting the farm on it."

STRENGTHS OF THE PAPER

Unum Group: "The theory and what you've laid out in a very academic fashion is obviously very close to what we're trying to execute in a non-academic way in the business world. The parallels are pretty impressive."

SunTrust: "The paper delves into the value that is created through the activities that firms pursue. SunTrust's purpose-driven strategy probably relates most to the categories discussed in the paper of stakeholder utility associated with organizational justice and stakeholder utility from affiliation."

MeadWestvaco: “I haven’t seen anybody write about the dimension of happiness in business. I think it’s a rare concept in business thinking but one that I find interesting to explore.”

Home Depot: “…our actions certainly reinforce the belief that if you engage with and build relationships with community stakeholders, suppliers, customers, and do those in an emotional investing-like way, that it will pay dividends for you in sales and profit over the long run. We don’t do a kind of a calculated return on investment because we do it each and every day.”

WEAKNESSES OF THE PAPER

Home Depot: “I do think that folks do it with the expectation that there’s a payback on the investment and that they really want to measure it and I think that it has a tendency to come off fake to the stakeholders. I think it’s very important for a business to execute in a way that’s real.”

Unum Group: “The way we would look at these issues in our business under our circumstances would be very different from how a manufacturing company might look at them. Some of the issues are the same, but when you start to think about our stakeholders, for example, we’re in a very regulated business so that actually adds a different dimension. The manufacturing sector doesn’t have quite the same degree of regulatory involvement in their business.”

Luck Companies: "You've got to help us figure out how to measure it (stakeholder performance) even more."

McKenzie: "I'd go back to say that I maintain that shareholders need to come first and then there are building blocks towards that. I think that organizations that lose that focus are really miscommunicating to the other constituents – the employees, the customers, the suppliers, the communities. They may actually believe what you're saying – hey, we're all on equal footing here – and start to demand and require a different outcome, a different share of the pie, as you call it, because they see themselves on equal footing. That's not sustainable, and the system will just collapse. The market won't support that position, and then you're not taking care of anybody in the end."

ARE FIRMS MOVING IN THE DIRECTION THE PAPER DESCRIBES?

McKenzie: "No, I think it's moving in the opposite direction."

Home Depot: "…I'd say they're doing it where they have to, probably more so than before."

MeadWestvaco: "…I would say that the general trend over the last 10 years has been that more firms paying attention to these issues."

SunTrust: "We do observe that firms in general are starting to look more holistically at the stakeholders they serve and their impact on society."

Unum Group: “I think the stakeholder perspective actually may have been increased by the financial crisis and some of the things that certain segments have been through, where they’ve been under the spotlight obviously for concerns about how they managed the business for the long term, or how they managed their relationships with customers and consumers and regulators. So I think this period we’ve been through has helped raise the visibility of this perspective.”

Luck Companies: “A small number but it’s growing. But, I'll tell you what - they are really interested. That's why I'm really optimistic. We have a leadership crisis right now everywhere. Everyone knows it.”

IS YOUR FIRM MEASURING PERFORMANCE MORE BROADLY?

Luck Companies: “We have now identified five competencies with 15 attributes that we say make up a good values based leader…Every year we have a 360 assessment that all officers do. We get about 14 people…to say, ‘How am I walking against the competencies? How am I doing? Am I showing up in alignment?’ …We have many more nonfinancial measures than we do financial… We track our clout score. We track our community….”

Home Depot: “We have a saying inside the company that you get what you measure… There are ways people can manipulate the system and so I think we do things to try to ensure that we’re just doing the right thing without trying to drive system manipulation.”

Unum Group: "Five or six years ago, we began this process of re-establishing the way we think about the brand and how we want be viewed by all of our key stakeholders. If you were to look at our balanced business scorecard, you'd see the usual stuff with sales and profits and returns and customer retention. But you'd also see measurements around corporate governance, average learning hours per employee, volunteerism, work environment, talent retention, and I could go on. The point is there's a whole series of measurements that are embedded in our balanced business scorecard that puts some clarity on what kind of things we value."

SunTrust: "We currently track performance in four areas: 1) Deepest client relationships, measured by client loyalty surveys and the number of needs we meet for each of our clients; 2) most productive teammates, measured by teammate engagement and revenue per teammate; 3) top financial performance, measured by net income and efficiency ratio; and 4) leading a movement for financial well-being, measured through client surveys, teammate volunteer hours, and foundation activities."

Home Depot: "We do an employee survey. We measure participation in that as well as the actual raw metrics across a number of questions and then look at that in a longitudinal way over time and then look at variances across different parts of the country, different types of associates, tenure levels, that kind of thing. We also have a voice of customer survey that we do each and every day and look at that longitudinally as well as in various other formats, such as geography, etc. From time-to-time we will do a survey of our suppliers and get feedback and get scores. We don't really have anything that we measure per se that I'm aware of on shareholders, except our returns – ROI, EPS, PE, that kind of stuff."

MeadWestvaco: "Yes we are. We're exploring how we want to measure employee satisfaction and organizational effectiveness. We're doing some work on that right now."

MacKenzie: "I think they spend a tremendous amount of time measuring the progress and success and quality of their employees, which are their key resource. They have very close relationships with their customers and make sure that they're delivering value to their customers. [McKinsey] really doesn't have suppliers. Their suppliers are their employees."

HOW WOULD YOU HAVE WRITTEN THE ARTICLE DIFFERENTLY?

Luck Companies: "We're talking about stakeholder theory, and what I'm interested in is does stakeholder theory actually validate or give corporate responsibility teeth or actually help it matter versus it just being a sustainability report that I do every year?"

SunTrust: "The paper focuses more on tactical application versus the more qualitative question of "what is the value your company provides to the world, and what does it take to be able to deliver on this purpose?" Results come from more than measurement programs.   The purpose of the company (Why are you here?) needs to be aligned with the culture of a company or the guiding principles (How will you operate?), and the values of the company (What defines our people?). Once all of these elements are in place, the measurement system can be aligned to see if you are in fact winning in the game you have set out to play."

MeadWestvaco: "Regarding the presentation, perhaps try to make the writing a little more understandable for us non-academics."

Home Depot: "I think the only thing I would say is that businesses are under pretty extreme pressure right now for profitability and for growth and you've got a lower GDP growth rate".

Luck Companies: "I was wondering about the outside-the-work piece… I just don't think that you can ignore that. I think you're going to start seeing more about the need to allow people to bring home to work also. Because there are a lot of head and heart things that go on. They don't disappear. We're always worried about people bringing work home. Well, it's also they bring home to work."

A BRIEF COMMENTARY

We live in an era when many people are asking fundamental questions about capitalism and what it means to run a great company. As academics, we spend much of time in the world of ideas and books, thinking through the intellectual and historical foundations of business – a vital resource for understanding business and what it can become. There is ample reason in this literature to underscore value creation for stakeholders as a critical part of what capitalism is about and what makes it "work" over time. Indeed, many existing theories of business tend to obscure this basic insight and direct our attention away from it (Harrison and Wicks, 2013).

As we talked to executives about these ideas and heard what their businesses are doing, we found an array of views – some of which were emphatically supportive of creating value for stakeholders as a primary and dominant view, and others that were more reluctant or critical. All our interviewees saw the ideas as important and interesting. Some saw them as integral to how their business operates on a daily basis. Others saw them more as a luxury that was noble to try, but difficult to do and sustain given the "realities" of business.

Part of what was most compelling for us was not just these reactions to our paper, but to hearing more about what companies are actually doing – and how much is already going on in some firms. Without necessarily thinking about themselves as "stakeholder companies," some of the firms we included are undertaking a variety of innovative steps to capture, measure, and emphasize value creation for stakeholders on a variety of dimensions. Looking at the conversations, it is equally interesting to see why these managers and firms believe this measurement is important and how it fits with the larger priorities of the company. If we delight our customers or keep employees engaged, how exactly does this help us as a firm? What kinds of results create concern and lead us to take action to remedy it, even if it requires extensive resources to do so?

As academics, we believe we can learn a lot from managers and firms about this topic. Stakeholder theory is a "managerial theory" (Freeman, 1984), and therefore we should care about what the core ideas mean in practice, how they work, and what types of things are possible. Business is, in some sense, a laboratory for ideas that should help us understand what works and what doesn't – as well as why. And, if business isn't a static idea, but one tied to context, purpose, and human cooperation, then the ideas we start with may play a significant role in determining their fate. New ideas open up new possibilities. Looking at practice helps us see what is possible and allows us to get away from stale academic conversations.

At the same time, we hope this dialogue generates more interest from practitioners in the academic discourse. If the ideas proposed in Harrison and Wicks (2013) are valid, then managers and firms need to become more creative and more intentional about value creation for stakeholders. They need to better understand what stakeholders seek, how they can provide it, ways in which stakeholder interests overlap within the context of the firm, and how they can deliver more value over time. Traditional financial metrics matter, and stakeholder theory gives us additional reasons to see why – beyond survival, managers have a moral duty to stakeholders to generate profits – but that is only the beginning. Numerous sources tell us that what stakeholders seek is far more complex than just money and "stuff". They care about being treated fairly, living out their values, being associated with firms they respect, feeling like the work they do matters, and so forth. Many of these additional forms of value are hard to create and sustain, but at some level they are also almost "costless" (i.e. don't require specific expenditures of capital) and additive. Rather than taking value away from a given stakeholder to give it to another, value creation on these dimensions is additive and tends to make all stakeholders better off.

A great deal has been written about stakeholder theory. We hope the interest continues to grow and expand throughout the academy. However, we believe that for stakeholder theory to truly evolve and become a richer theory, we need more intentional connection to the manager and to real firms as part of the dialogue. This research provides a step in that direction. We hope future work builds on this step and finds other ways to enrich the discussion.

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