

# EXC3505 – STRATEGY

## Week 4

## Stakeholders & Culture

# Projects

- Two firms so far; detailed info is on ItsLearning
- Start your project asap
  - Internal & external environments
- Submit your group info in google sheet
  - <https://docs.google.com/spreadsheets/d/1suRQ8BWaJHQawKZRlcrXGW6He7-fGrO6-sYGXAOLzd8/edit?usp=sharing>
  - Group member; company and question you work on
  - Deadline: Feb 3
  - Contact me if you still need help

# Communications

- My goal: reply to all emails within 48 hours
- If you do not hear from me within 3 days
  - Check your spam box
  - Send another email using your another email account
  - Talk to me in person
- Expect delayed response if you send message via ItsLearning

# Recap from last two weeks

- Firms' external and internal environments are crucial in explaining their performance
- Firms' strategies are affected by both external and internal environments

# This week

- **Stakeholders**

- Who are stakeholders
- How do stakeholders affect firms' strategies
- Which stakeholders are more important given a ownership model
- How do stakeholders use governance structure to protect their interests
- How are stakeholders affected by culture
  - Dangers of cultural drift

# Stakeholders

Individuals or groups that depend on an organization to fulfil their own goals and on whom, in turn, the organization depends



# Stakeholders

- Firm relies on managers to operate; managers relies on the firm to realize self-achievement
- Govt relies on firm to create job or innovation; firm relies on govt to provide a good business environment
- Customers rely on firm to provide goods; firm relies on customers to survive and prosper
- ...

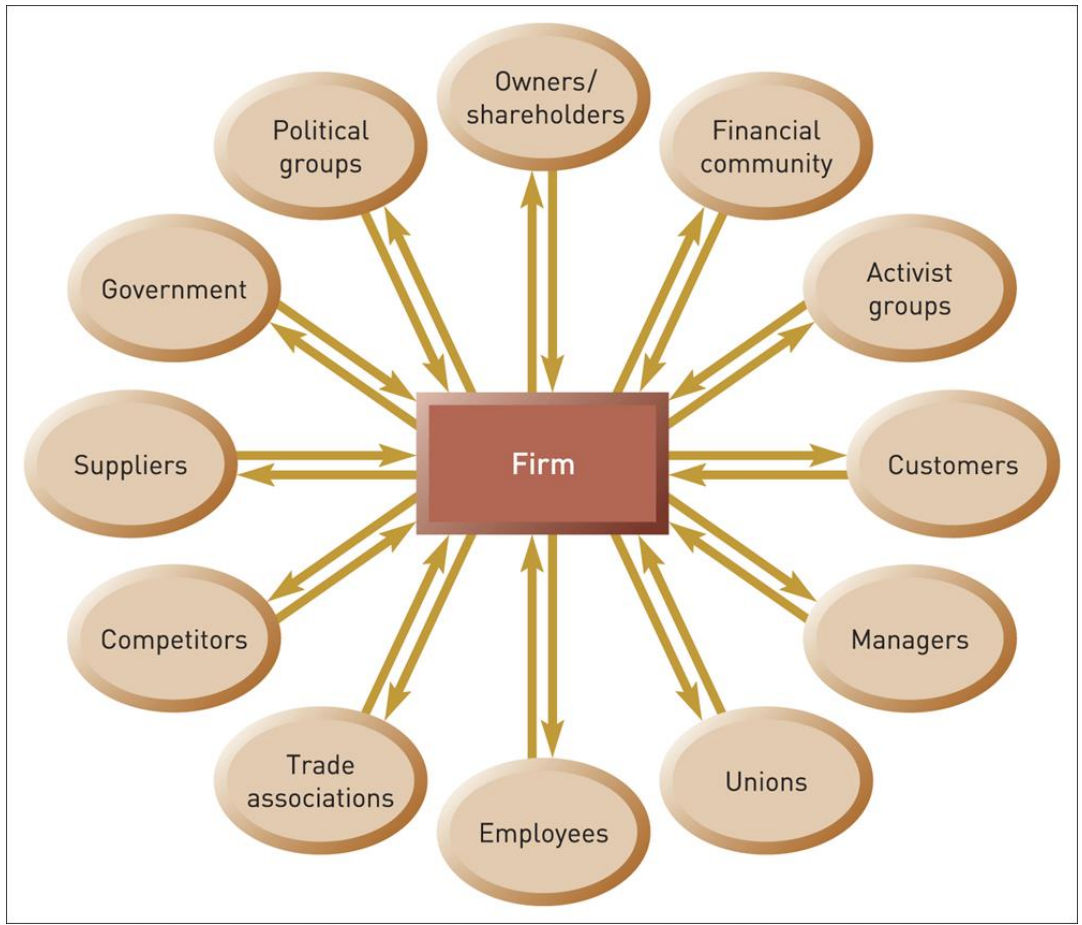


# Stakeholders

- Stakeholders usually can exert strong influence on firms
- But they tend to have conflictive interests

## Discussion:

- Firm A wants to relocate to areas with cheaper production cost
- What are the likely reactions from different stakeholders?



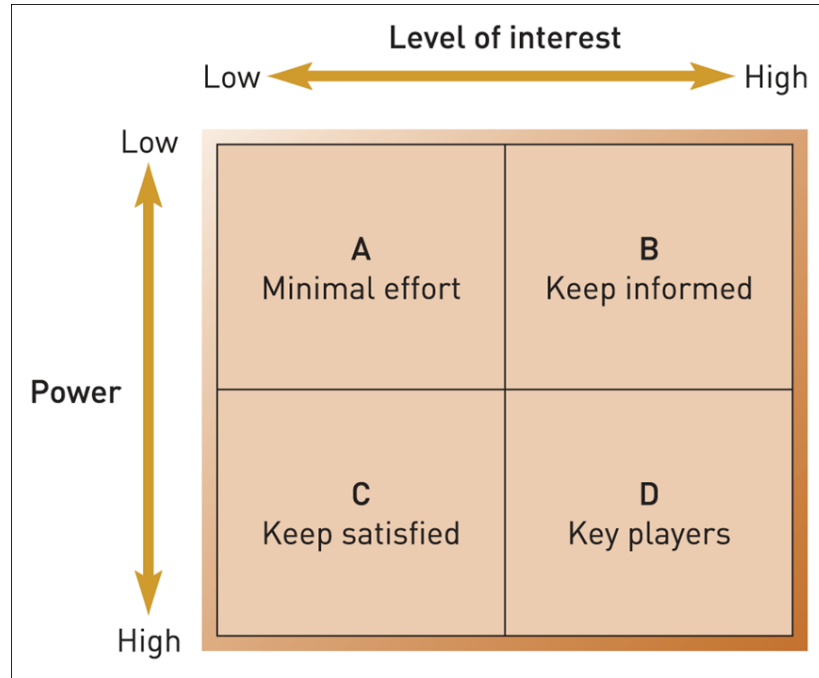


# Stakeholders

- Firm A wants to relocate to areas with cheaper production cost
  - Local managers and employees resist for fear of losing jobs
  - Local govt welcomes the proposal as it wants to upgrade industry
  - Activists resist out of environmental and labor exploitation concerns
  - Shareholders and customers are happy as they might enjoy benefits
  - ...
- The firm's job is to resolve the conflicts

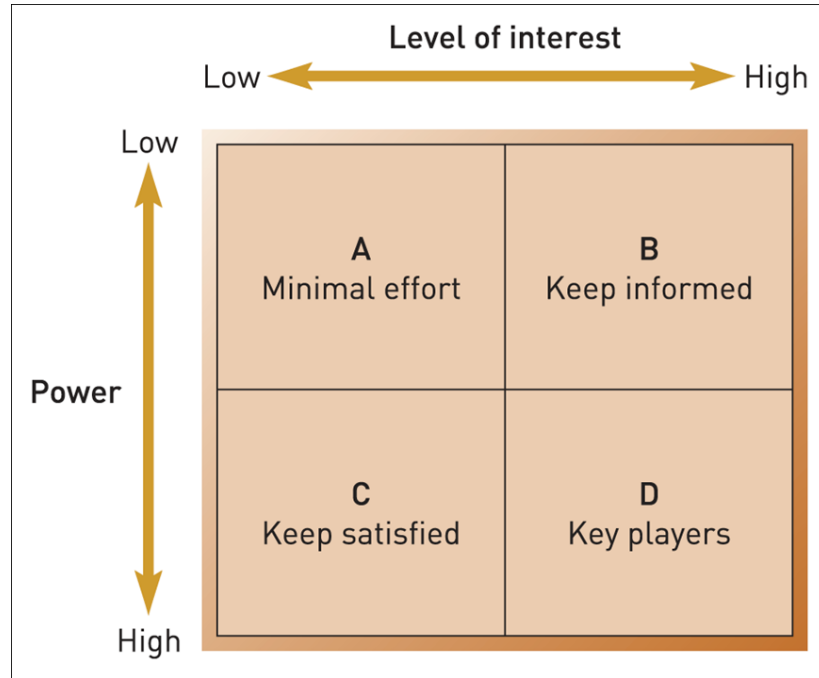


# Stakeholder Mapping



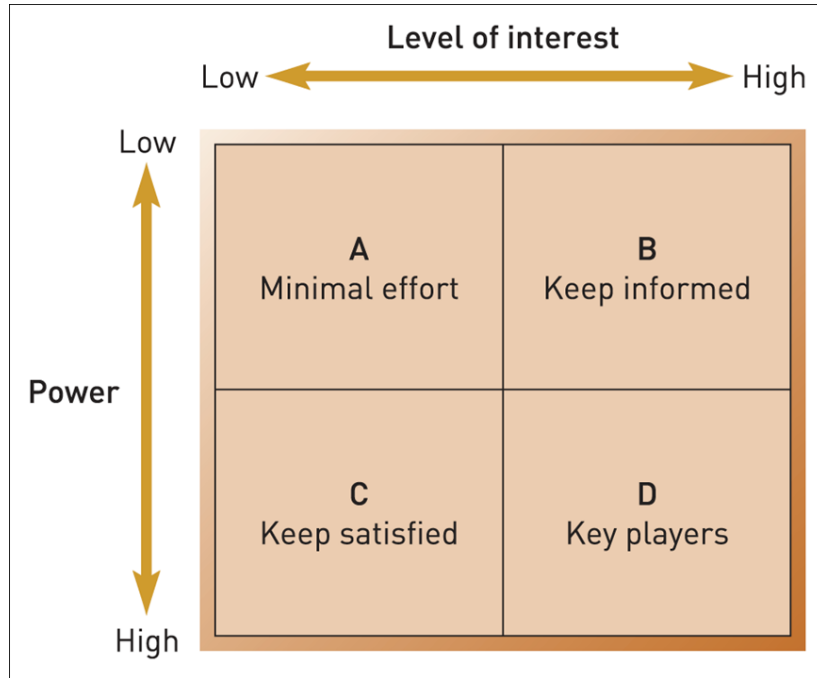
- Blockers vs. Facilitators
  - Local managers, employees, activists are blockers
  - Local govt, shareholders, customers are facilitators

# Stakeholder Mapping



- Blockers vs. Facilitators
- Can they be repositioned?
  - How to make managers, employees, and activists agree with your plan?
  - When govt, shareholders, customers might resist your proposal?

# Stakeholder Mapping



- Blockers vs. Facilitators
- Can they be repositioned?
- How to maintain interest?
  - Keep happy ones happy
  - Don't make those neutral parties and facilitators change minds against you (e.g., local communities seem to be neutral now)

# Stakeholders

Different orgs have different  
\*important\* stakeholders



# Stakeholders

- Chefs are very important for a good restaurant
- Professors have limited influence on universities
- UAW had huge influence on auto companies
- ....
- Which stakeholders are more important  
Depends on ownership models



**CAR TALK**

## How the Unions Killed Detroit

Updated 04.25.17 3:18PM ET / Published 04.20.09 2:26AM ET



AP Photo

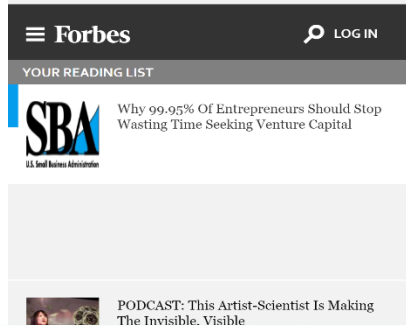
What's actually to blame for the deep debt plaguing Detroit? Peter S. Boyer writes in this week's New Yorker that it was the long-held arrangements with unions and workers, which began in 1937, when the U.A.W. became the sole bargaining agent for the nation's autoworkers. While foreign car manufacturers might not have matched General Motors, Chrysler, and Ford in wages in the early 1980s, they played it smarter

# Ownership models

- **Entrepreneurial businesses**
- **Public companies**
- **Family businesses**
- **State-owned enterprises**

# Entrepreneurial businesses

- **Businesses owned by entrepreneurs**
- **Entrepreneurship**
  - The process of starting a new business
  - A word with halo, but reality is not
    - Most of the entrepreneurs are not ambitious
    - Even ambitious entrepreneurs rarely succeed



Since because they are not in the preferred industries, have not displayed the potential or the proof of potential, have not been referred by the right person, or any one of many reasons.

The reality is that most ventures do not qualify for venture capital and never will. According to the Small Business Administration, about 600,000 new businesses are started in the U.S. each year, and the number of startups funded by VCs was about 300. This means that the probability of an average new business getting VC is about 0.0005 (300/600,000), and it also means that 99.95 percent of entrepreneurs will not get VC at startup.



# Entrepreneurial businesses

- **Entrepreneurs have immense power**
  - Positively correlated with their knowledge of the business

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In a VC office on Sand Hill Road, a start-up with 3 founders came to pitch their business idea. All of the 3 founders are around 50 years old, and have lots of experiences working as top level managers at Fortune 500 companies.

Their business idea is to set up a software that allows hotels to provide better customer service, e.g., sight seeing suggestions, making restaurant reservations, booking tickets etc.

As none of the 3 founders know code writings, they hired a company to write the codes, which are expected to be delivered by the end of this year. They have also discussed with several hotels, including Hilton and Marriot, about collaboration. All 3 founders thought these hotels showed great interest.

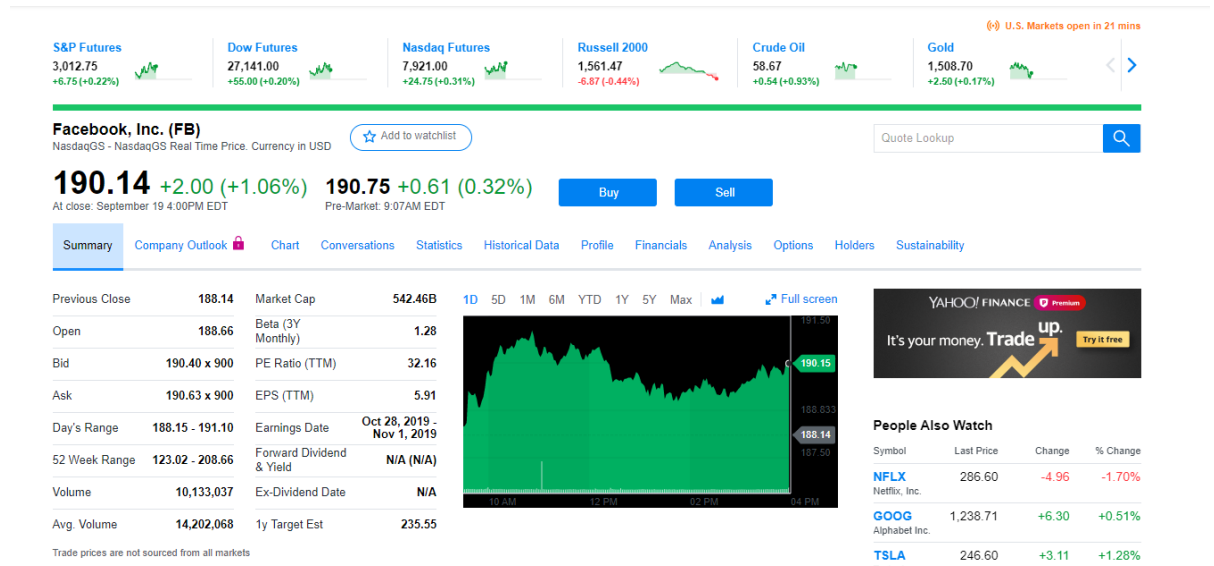
# Public companies

- One of two major exit events for entrepreneurial businesses
  - IPO and M&A
- Equity shares are publicly traded in stock exchanges



# Public companies

- Equity shares are publicly traded in stock exchanges



# Public companies

- **Lots of delegations to professional managers**
- **Shareholders have lots of power**
  - Institutional and individual investors
  - Share price too low leads to merger or market exit
  - Balance short vs. long run profitability

# Family businesses

- Family members heavily involve
- Usually small to medium in size
- Big ones eventually become public firms
- May not necessarily be rational



CULTURE VIDEO **INDY/LIFE** HAPPY LIST INDYBEST LONG READS INDY100 VOUCHERS PREMIUM

News > World > Americas

## Family businesses: Ford: The end of a dynasty

When William Clay Ford Jr stepped down as chairman of the company founded by his great-grandfather this week, it brought nearly 100 years of family leadership to an end. Stephen Foley reports

Thursday 7 September 2006 00:00 |



# State-owned companies

- Owned (mostly) by the govt
- Not very profit-driven



**中国工商银行**  
INDUSTRIAL AND COMMERCIAL BANK OF CHINA



# Corporate governance

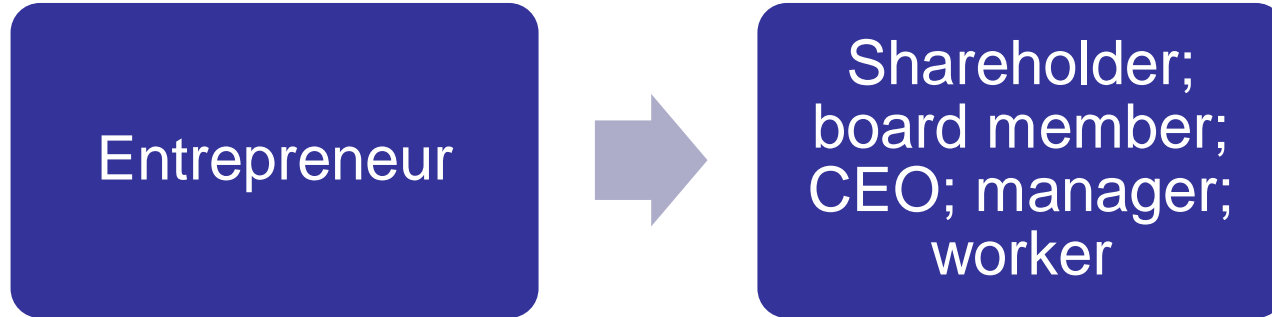
## How stakeholders protect their interests

- **Corportate governance** is structures and systems of control by which managers are held accountable to those who have a legitimate stake in an organisation (Johnson et al.)
- **Corporate governance** deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment (Shleifer and Vishny, 1997)



# Governance Chain

Can be long or short



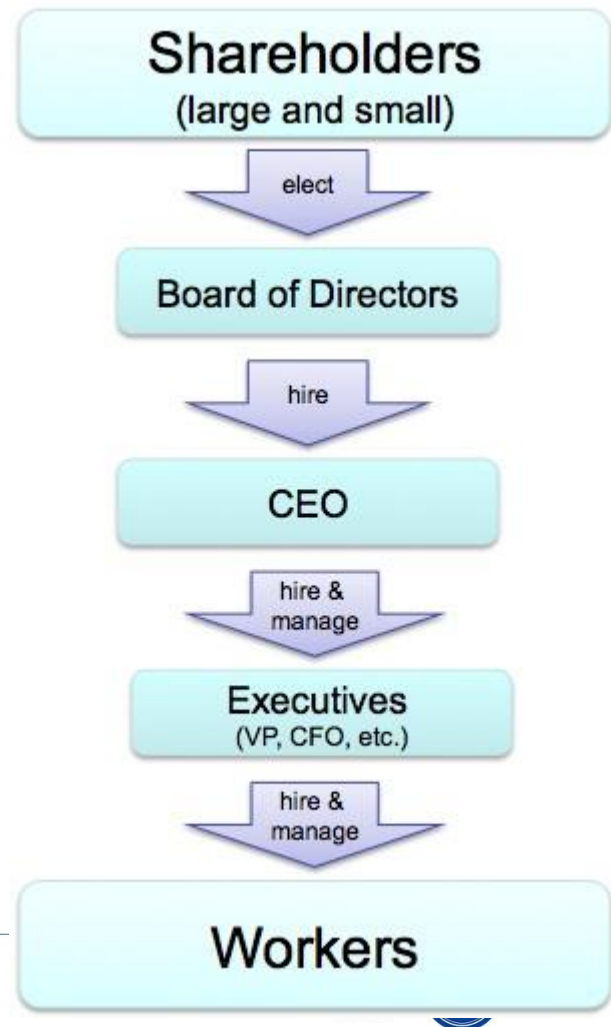


# Governance Chain

## Principals and agents

### Principal-agent problem:

- Agents don't act in principals' best interests
- **Example: two projects, A and B. The CEO knows that A offers more benefits for the company, but little private benefits for himself. B offers little benefits for the company, but huge private benefits to himself.**
  - If CEO chooses B, principal-agent problem



# Governance Chain

Principle-agent problems arise from

- Knowledge imbalance
- Monitoring limits
- Misaligned incentives

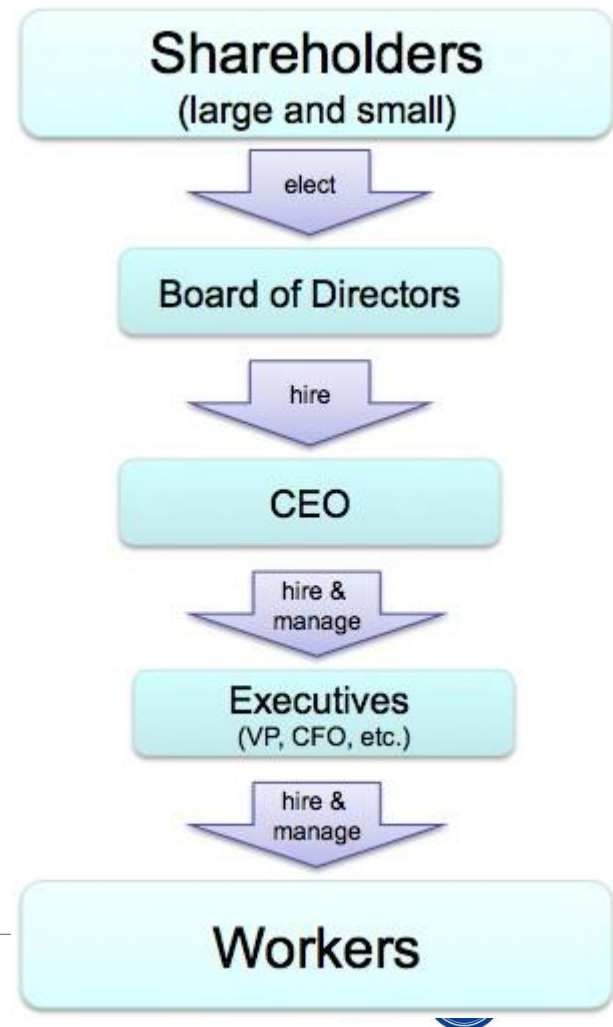
Any factors curb principal-agent problem?



# Governance Chain

Factors curbing principle-agent problems

- Employee loyalty
- Be fired
- Reputation concern
- Company failures
- M&A (maybe)
  - Poison pill
  - Parachute
- Management payment structure



# Governance Chain

## Board member nominations

- Shareholder model
- Stakeholder model
  - Loan provider (e.g., bank)
  - Local community
  - Employees
  - ...

**Differences in strategy making  
between two models?**



# Shareholder vs. Stakeholder model

	Shareholder model	Stakeholder model
<b>Advantages</b>	<ul style="list-style-type: none"><li>• Higher rates of return</li><li>• Reduced risk</li><li>• Increased innovation and entrepreneurship</li><li>• More objective decision making by managers</li></ul>	<ul style="list-style-type: none"><li>• Long term horizons</li><li>• Less reckless risk-taking</li><li>• Reduced pressure on management for short term results</li></ul>
<b>Disadvantages</b>	<ul style="list-style-type: none"><li>• Diluted monitoring</li><li>• Vulnerable minority shareholders</li><li>• Short termism</li></ul>	<ul style="list-style-type: none"><li>• Weaker decision-making</li><li>• Uneconomic investments</li><li>• Reduced innovation and entrepreneurship</li></ul>

# Governance Chain

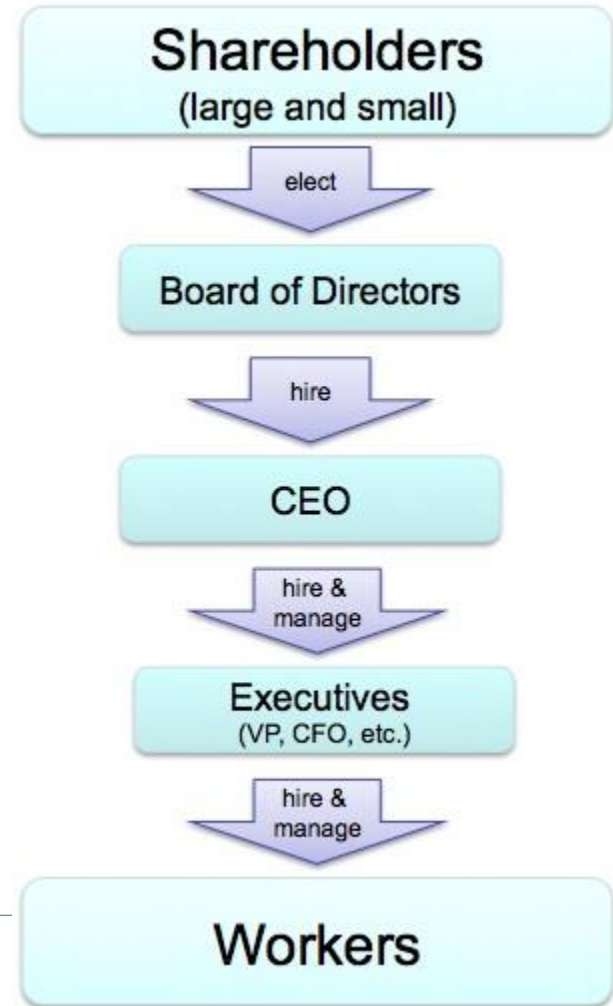
## Board member nominations

- Shareholder model
- Stakeholder model

## Board composition

- Insider director
- Outsider director

## Board interlock



# Growing importance of governance

- **Governance scandals**

**Enron's 2000 Reported Revenue vs. Similarly Sized Companies: Too good to be true?**

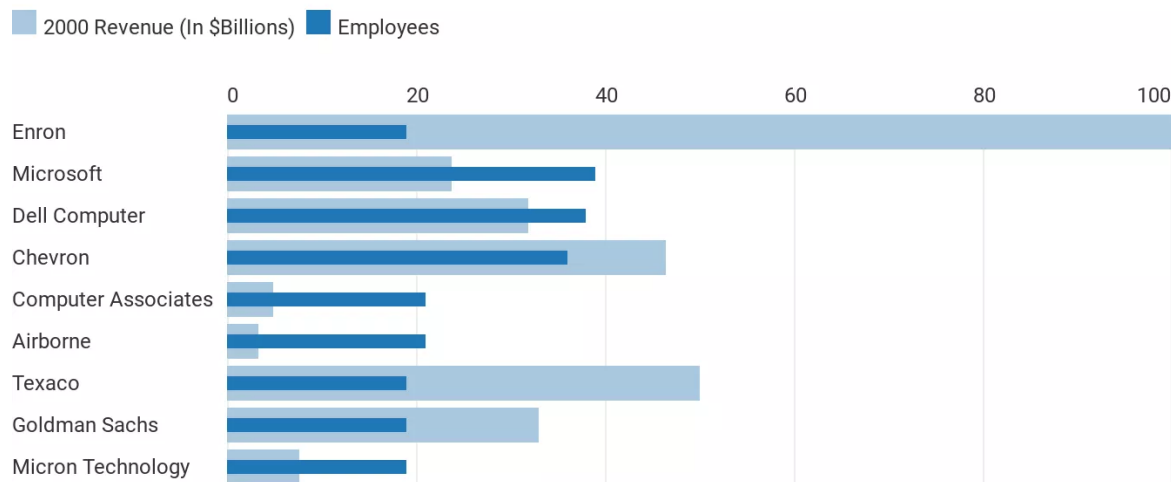


Chart: Investopedia • Source: Forbes • [Get the data](#) • Created with Datawrapper

# Growing importance of governance

- Governance scandals





# Growing importance of governance

- Governance scandals



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## GE falls the most in 11 years after Madoff whistleblower calls it a 'bigger fraud than Enron'

PUBLISHED THU, AUG 15 2019 • 7:40 AM EDT | UPDATED THU, AUG 15 2019 • 4:19 PM EDT



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SHARE



### KEY POINTS

- General Electric shares fall after Madoff whistleblower Harry Markopolos targets the conglomerate in a new report, calling it “a bigger fraud than Enron.”



NORWEGIAN  
BUSINESS SCHOOL



# Growing importance of governance

- **Governance scandals**
- **Stakeholders' increasing interests in corporate social responsibility (CSR)**
  - *Corporate social responsibility (CSR)* is the commitment by organisations to 'behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as the local community and society at large'

# Corporate social responsibility

- **Four views**
  - Laissez-faire view: firms are meant for profit-maximizing

# Corporate social responsibility

- **Four views**

- Laissez-faire view: firms are meant for profit-maximizing
- Enlightened self-interest: self-interest seeking guides firms' attention to CSR

# Corporate social responsibility

- **Four views**

- Laissez-faire view: firms are meant for profit-maximizing
- Enlightened self-interest: self-interest seeking guides firms' attention to CSR
- A forum for stakeholder interaction: include CSR as part of firm performance measurement

## FTSE4Good Index Series

The FTSE4Good Index Series is designed to measure the performance of companies demonstrating strong Environmental, Social and Governance (ESG) practices. Transparent management and clearly-defined ESG criteria make FTSE4Good indexes suitable tools to be used by a wide variety of market participants when creating or assessing sustainable investment products. FTSE4Good indexes can be used in four main ways:

# Corporate social responsibility

- **Four views**

- Laissez-faire view: firms are meant for profit-maximizing
- Enlightened self-interest: self-interest seeking guides firms' attention to CSR
- A forum for stakeholder interaction: include CSR as part of firm performance measurement
- Shapers of society: CSR is more important than profitability

# Corporate social responsibility

Martin Shkreli, CEO of Turing Pharmaceutical Inc., increased the price of Daraprim, a life-saving drug for HIV, from \$13.50 per pill, to \$750.



## *Boeing 737 Max Safety System Was Vetoed, Engineer Says*

**Corporate social  
responsibility**





# Corporate social responsibility

## China's great leap forward as a natural CSR experiment

### An economic system, where

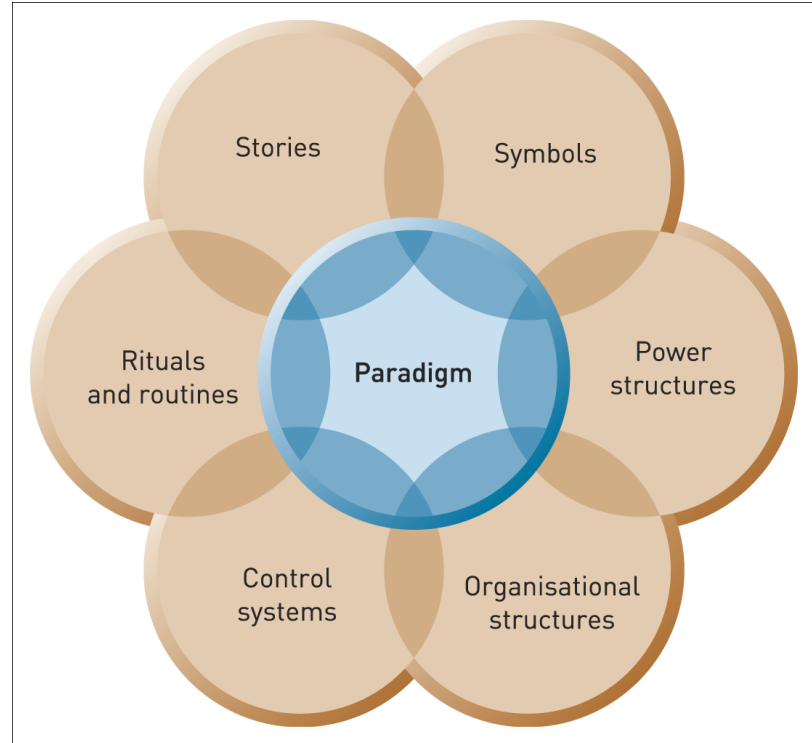
- Everyone receives the same salary
- How much work to do depends only on your assessment
  - Do more if you can
  - Do less or even nothing if you can't
- You work only to improve other's life quality and country prosperity

**What's your speculation of people's behavior?**



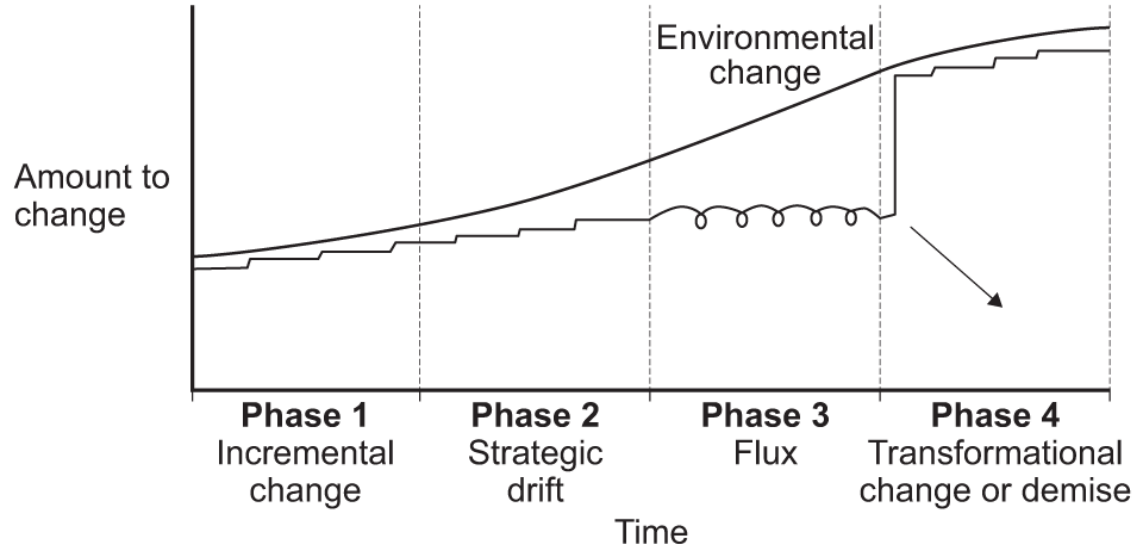
# Culture

- Culture: taken-for-granted assumptions and behaviors of organisations' members
- Should be part of your strategy analysis
- Strategic drift



# Culture

- Strategic drift



# Main Takeaways

- **The strategic purpose of the firm is influenced by both external and internal factors**
  - Ownership & governance, organizational culture
  - Stakeholders & social responsibility
- **The ways by which they do differs per firm**
  - Important to understand which factors are most salient for your firm!
- **Next time: Chapter 6-business strategy**