Stakeholders and Their Influence on Corporate Governance

Every organisation has stakeholders. A stakeholder has been defined (by Freeman 1984) as: 'any group or individual who can affect or [be] affected by the achievement of an organisation's objectives. An important part of this definition is that a stakeholder may:

- be affected by what the organisation does
- affect what the organisation does, or
- both be affected by and affect what the organisation does.

Companies have stakeholders. A stakeholder in a company is someone who has a 'stake' in the company and an interest in what the company does. A company must offer something to all its stakeholders. If a company does not give its stakeholders something of what they want, the stakeholders might cease to have an interest in it. All stakeholders in a company have some expectations from the company. If a company wishes to remain associated with its stakeholders, it must do something to satisfy these expectations.

The expectations of different groups of stakeholders are not the same, and they are often inconsistent with each other. One of the objectives of corporate governance should be to provide enough satisfaction for each stakeholder group.

Stakeholder groups in a company include:

1. **The shareholders of the company**: shareholders expect a reasonable return on their investment in the company. They may be able to influence what the company does by exercising their right to vote at general meetings of the company.
2. **The company's employees**: employees expect a fair wage or salary, and often expect job security or career prospects. They can affect what the company does either positively (for example by being well-motivated and efficient) or negatively (for example, by going on strike, or demanding higher pay).
3. **The directors and management of a company**, who need to satisfy the expectations of both shareholders (for high profits and dividends) and employees (for high salaries). In addition, they have their own self-interests, for example in high remuneration and status.
4. **Customers of the company**
5. **Suppliers of the company**
6. **Trade unions**
7. **Communities in which the company operates**
8. **The government**
9. **Pressure groups and activist groups, such as environmentalists**

CLAIMS OF STAKEHOLDERS

Each stakeholder or stakeholder group in a company makes demands of the company and want the company to do something to satisfy these demands. These demands are known as '**claims'**. Shareholders want dividends and a higher share price, employees may want job security and higher pay, customers may want better quality goods at lower prices, and so on.

It is not always possible to identify the claims of a particular group of stakeholders. Certain groups of stakeholders may not know that they have a claim against an organisation; others may know that they have a claim but do not know what it is and do not express it openly. This gives rise to a distinction between direct and indirect stakeholder claims.

Direct Stakeholder Claims: these are claims made by stakeholders directly, with their 'own voice'. For example, employees may make a direct claim for higher pay. Shareholders, customers, suppliers and (sometimes) local communities may express direct claims to the company.

Indirect Stakeholder Claims: these are claims that are not made directly by a stakeholder or stakeholder group, but are made indirectly on their behalf by someone else. For example: Future generations have a claim on what a company does today, for example if the company's operations are capable of preserving or destroying the environment, future generations will be affected. They are not yet alive and able to express their claims directly, and someone else has to think about their interests for them. A problem with indirect stakeholder claims is that it is not always possible to be sure that the stakeholders are being properly represented and their claims correctly expressed. After all, how can we be sure what future generations will want, or whether a terrorist group really does speak in the interests of a wider community?

Stakeholder Influence

A feature of corporate governance or strategic analysis in any company is the balance of power between the stakeholder groups and the relative power and influence of each group. The **Mendelow Framework** can be used to understand the influence that each stakeholder group has over a company's strategies and actions. The framework identifies two factors that make up the strength of a stakeholder's influence over a company's strategy, actions or decisions:

i. The power the stakeholder is capable of exercising, and
ii. The interest that the stakeholder has in the particular issue, and how much the stakeholder cares about it.

Influence over a strategy or action comes from a combination of power and influence:

Influence = Power x Interest

The Mendelow framework can be presented as a 2 by 2 matrix. Each stakeholder group can be placed in one section of the matrix, and the company's strategy for dealing with each particular group will depend on where it is positioned in the matrix.

Interest

		Low	High
Power	Low	Minimal Effort	Keep Informed
	High	Keep Satisfied	Key Players

Fig. 1 *The Mendelow framework*

- If stakeholders have little power and a low interest in a matter, a company can largely **ignore them**. (However the Mendelow framework does not consider ethical issues and whether it would be ethically appropriate to ignore the stakeholder group).
- Stakeholders with high interest but low power may try to increase their power by entering into a coalition with one or more other stakeholders. However as long as the group remains in the 'high interest, low power' section of the matrix a company can limit its treatment of the group to **keeping it informed** about what is happening, but the company's decision making will not be affected by the group's objectives.
- Stakeholders with a lot of power but only limited interest in a matter should be **'kept satisfied'** so that they do not exercise their power to affect the company's strategic decision-making. For a large company, the government may be such a stakeholder.
- Stakeholders with the highest amount of power and interest are the **key players**, whose influence will be of some significance in making strategic decisions. If there is just one stakeholder group in this section of the matrix – for example the company's senior management – there should be no problem. Difficulties can arise when there are two or more stakeholder groups in this section and they have differing interests and objectives.

Categories Of Stakeholders

Various writers have identified different ways of categorising stakeholders.

i. **Narrow and wide stakeholders**: Evans and Freeman made a distinction between narrow and wide stakeholders. Narrow stakeholders are those that are the most affected by the actions and decisions of the organisation. Narrow stakeholder groups for a company usually include shareholders, directors, other management, employees, suppliers and those customers who depend on the goods produced by the company. Wide stakeholders are those groups that are less dependent on the organisation. Wide stakeholders for a company may include customers who are not particularly dependent on the company's goods or services, the government and the wider community (as distinct from local communities in which the company operates, which may be narrow stakeholders).

Evans and Freeman suggested that a company has much more responsibility and accountability to narrow stakeholders than to wide stakeholders.

ii. **Primary and secondary stakeholders**: Clarkson made a distinction between primary and secondary stakeholders. A primary stakeholder group for a company is a group that is essential for the continuation of the company as a going concern. Customers, suppliers and employees may be primary stakeholders. Secondary stakeholders are those that the organisation does not directly rely on for its continued survival, at least in the short term. According to Clarkson, primary stakeholders have strong influence over a company's decisions and actions.

iii. **Active and passive stakeholders**: Mahoney (1994) made a distinction between active and passive stakeholders. Active stakeholders are those that seek to get involved in the company's activities and decisions. These stakeholders may be a part of the company's normal decision-making and operating processes, such as management and employees. Other active stakeholders who are external to the company may include, for example government regulators or environmental pressure groups.

Passive stakeholders are those stakeholders who do not usually try to get involved with a company's policy-making. They may have a strong interest in what the company does, but they do not want to get actively involved in the decision-making. The government and local communities may be examples of passive stakeholders.

iv. **Voluntary and involuntary stakeholders**: A distinction can also be made between voluntary and involuntary stakeholders. A voluntary stakeholder is someone who becomes a stakeholder voluntarily. They include employees (who could move to a job with a different employer), customers (who could buy goods from another company) and shareholders (who could sell their shares). Involuntary stakeholders are those who do not choose to be stakeholders but have no choice. These include local communities, stakeholders who suffer from the effect of the company's operations on the environment, and future generations. Most competitors are also involuntary stakeholders.

v. **Legitimate and illegitimate stakeholders**: Another distinction is between legitimate and illegitimate stakeholders. Legitimate stakeholders are those with a 'right' to make a claim on the company (a 'legitimate' claim). Illegitimate stakeholders are those that do not have such a 'right'. Deciding whether stakeholders have legitimate or illegitimate claims on a company may depend on a person's viewpoint and the distinction is therefore to some extent a matter of judgement. Examples of illegitimate stakeholders may be certain lobby groups or pressure groups (for example, animal rights activists) or charity organisations. In some countries, rebel groups or terrorists may be illegitimate stakeholders with considerable influence over a company's activities. The main issue with this categorisation is whether a company should acknowledge the claims of a stakeholder group (if it is legitimate') or whether it should ignore them or oppose them (if the group is illegitimate).

vi. **Known and unknown stakeholders**: A distinction can also be made between known and unknown stakeholders. Known stakeholders are those that the company knows about. Unknown stakeholders are those whose existence the company is not aware of. This distinction may be relevant when a company has operations that affect the environment, or is planning new activities that will have an environmental impact. The company will not necessarily be aware of all the stakeholders that will be affected by its activities – for example animals, insects, sea creatures. It may be argued that before implementing any new business strategy a company should carry out a thorough investigation in order to identify unknown stakeholders and consider the impact of its strategy on them.

vii. **Internal and external stakeholders**: A widely-used distinction is between internal and external stakeholders. Internal stakeholders of a company are inside the company and a part of it. External stakeholders are outside the company and are not a part of it. Two insider stakeholder groups in a company are the equity shareholders and the directors.

SHAREHOLDERS AND DIRECTORS

The main stakeholder groups in a company are usually the shareholders and the directors of the company. The shareholders own the company and the directors are its leaders.

The Shareholders: The influence of shareholders over their company varies with circumstances. In a small company the shareholders and directors might be the same individuals. In some companies, there may be a majority shareholder (controlling shareholder). A majority shareholder should be able to influence the decisions of the board of directors, because he has the power to remove directors who disagree with him.

In quoted companies (stock market companies) the interests of shareholders are likely to be focused on the value of their shares and the size of dividends. However, the shareholders might have little influence over the decisions of the board of directors.

The Directors: The board of directors is a significant stakeholder group in a company because they have the power to direct the company. Directors act as agents for the company and represent the interests of the company.

- A board of directors consists of both executive and non-executive directors. Executive directors have executive responsibilities as managers in the company, in addition to their role as director. They are usually fulltime employees of the company. Non-executives are not involved in executive management and are very much 'part time' and in many countries (for example the UK and US) they are not company employees. Since executive directors combine their role as director with their full-time job as company employee, their interests are likely to differ from those of the non-executive directors.

- On the board of directors, some individuals might have considerably more influence than others. Typically, the most influential members of the board are the company chairman (board chairman) and the managing director (often called the chief executive officer or CEO).

The board of directors take many decisions as a group, but they also have individual interests in the company. Directors are therefore stakeholders in their company both as a unit and as separate individuals.

Other Internal Stakeholders

Employees can be an important internal stakeholder group. It might be possible to divide employees into sub-groups, each with a different set of interests and expectations, and each with a different amount of influence over the actions of the company.

- It might be appropriate to separate senior management and other employees into two separate stakeholder groups. Senior management might have a bigger interest in the profits and share price of the company because they belong to a share incentive scheme or share option scheme, or because they receive annual bonus payments based on the company's profitability. Other employees who do not have such incentives will have much less interest in the financial performance of the company or its share price.
- Some employees might be able to demand large rewards from the company or might exercise strong influence because of their value to the company. For example, in the UK some individual investment bankers have a strong influence within their bank because of the specialist skills they possess and the income they are able to earn or the bank.

In some companies, there might be a strong trade union influence. The ability of a company to alter its working practices, for example, may depend on obtaining the co-operation and support of the trade unions.

External Stakeholders:

The External stakeholders are individuals or groups who do not work for the company but who nevertheless have an interest in what the company does and who might be able to influence the way in which the company is governed.

i. **Lenders** have an interest in a company to which they lend money. They expect to be paid what they are owed. Usually a lender will not be closely involved in the governance or management of a company, but they will monitor its financial performance and financial position. Lenders will also become significant stakeholders if the company gets into financial difficulties and is faced with the risk of insolvency.

ii. **Suppliers** have an interest in companies who are their major customers, although their influence over its governance might be small.

iii. **Regulators** have an interest in companies whose activities they are required to regulate. Some aspects of regulation have a major impact on the way in which a company is governed. For example, quoted companies must comply with the rules set by the securities regulator (such as the Securities Exchange Commission in Nigeria, the US and the Financial Conduct Authority in the UK).

iv. **Government** has a stake in companies. Companies are a source of tax revenue and also collect tax (income taxes and sales taxes) for the government from employees and customers. For some companies, such as companies that manufacture defence equipment, the government might have an influence as a major customer for the goods that the company produces.

v. **Customers**, the general public or special interest groups might have a significant influence over a company, especially a company that relies for success on the high reputation of its products or services.

vi. **Stock exchanges** have an influence over the governance of quoted companies, because companies must comply with the rules of the stock exchange on which their shares are traded.

vii. A company's **auditors** should also have some influence over the governance of a company, by making sure that the board of directors presents financial statements to the shareholders that present a true and fair view of the company's financial position and performance.

viii. **Investors** are a major influence over companies whose shares are traded on a stock exchange. Investors decide what the market price of a company's shares should be. A company needs to satisfy the expectations not only of its shareholders, but of the investing community in general, if it wishes to sustain or increase the share price (and so the total value of the company).

Institutional Investors

Institutional investors are entities that specialise in investing, mainly in shares and bonds. There are several types of institutional investor.

i. **Pension funds**: These institutions hold funds that will be used to provide pensions to individuals after their retirement. Pension funds may be sponsored by an employer, or may be private pension schemes of individuals. Until the money is needed to pay a pension, it is invested to earn a return.

ii. **Insurance companies**: The funds of insurance companies come from insurance policy premiums and life assurance premiums. Until the money is needed for payment to the insurance policy holders, it is invested.

iii. **Mutual funds**: Mutual funds are funds of many individual investors, who invest relatively small amounts of money in the fund. The investments of the many different individuals are combined and invested collectively. In the UK for example, the main types of mutual funds are unit trusts and Open-Ended Investment Companies or OEICs.

Institutional investors are significant stakeholders on companies, in any country where they invest large funds. They are particularly influential in the US and UK.

- Individually, an institutional investor might hold only a small proportion of the shares in a large public company. However, by joining together and speaking collectively, a group of institutional investors might be able to have some influence over the decisions of a company's board of directors.
- Most institutional investors belong to a 'trade association'. In the UK, for example, most pension funds are members of the National Association of Pension Funds (NAPF) and most insurance companies are members of the Association of British Insurers (ABI). Each of these trade associations give information and advice to their members about corporate governance matters, and might recommend how they should vote on certain issues at the general meetings of companies. Collectively, bodies such as the NAPF and ABI (and their members) can have a major influence on companies because of the significance of their members as investors and shareholders.

In the UK for example, the influence of the institutional investors has been significance in persuading listed companies to adopt (most of) the provisions of the UK Corporate Governance Code.