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Stakeholder orientation and financial performance: evidence from Indonesia

Abstract

This paper presents the findings of a study that examines corporate stakeholder relationship models, determining whether stakeholder orientation motivates firm strategic decision making. The study adopts the instrumental and normative realms in evaluating the stakeholder roles in a business organization. Results indicate a strong motive of stakeholder management towards the achievement of economic return, but no support for intrinsic value and moral concern, implying that the motives and observed behaviors of managers toward their stakeholders are mainly inspired by profit maximization. Sample data were collected from 101 Indonesia manufacturing companies, using questionnaires that capture firms' responses on stakeholder issues.

Keywords: stakeholder orientation, stakeholder typologies, firm strategies, financial performance.
JEL Classification: D2, G3, J13.

Introduction

In the development of organizational strategies, firms take into account the numerous internal and external stakeholders who affect the achievement of organizational goals in different ways. Each stakeholder group has a different set of expectations regarding the firm's objectives. Some stakeholder groups hold power in influencing firm resources (Jawahar et al., 2001) while others deliver perceived strength to influence firm's success (Wood & Jones, 1995). Still others are treated by managers because of moral obligations. A corporation, according to Wood (1994), is an intersection of relationships of dependency and expectation of various parties. Stakeholder orientation by corporations is a key determinant in strategic decision making processes, and consequently has been the subject of theoretical and empirical research in strategic management theory (Berman et al., 1999).

The above views suggest two propositions. Firstly, stakeholder management model is an economic strategy expected to pay off in increased profits (Friedman, 1970). By its nature, this strategy basically addresses the fiduciary obligation of the managers to the shareowners, reflected by firm policies aimed at creating shareholder value (Clarkson, 1995). Secondly, stakeholder management integrates economic strategy and social perspectives (Wartick & Cochran, 1985). However, even though social issues do present themselves in corporate life, in practice not all stakeholder relationships are equally important to managers (Mitchell et al., 1997). Phillips (2003) for example, divides the stakeholder groups into normative stakeholders to whom the organization has a moral obligation, and derivative stakeholders whose actions and claims must be accounted for by managers. Clarkson (1995) separates these groups from those who have a clear stake in the success or failure of the firm.

Studies show a strong relationship between the ambitions of company's goals and the stakeholder power in the process of organization learning (Roome and Wijen, 2001). Porter and Kramer (2003) argue that charitable efforts to community can improve the competitive context. Sundaram & Inkpen (2004) exhibit two principles of stakeholder management: first, to inspire the stakeholders, and to create communities that provide a strategic advantage in which every one aspires to do their best to deliver value; and second, to encourage moral and ethical responsibility in dealing with the stakeholders.

Two compelling questions then emerge. (How) does the stakeholder orientation help a firm strategically in achieving its objectives? And does profit maximization primarily determine managers' motives to treat their stakeholders? Adopting prior empirical works to examine both instrumental and normative stakeholder theories (Berman et al., 1999; Jones & Wick, 1999), this study attempts to attest whether the stakeholder orientation is strategic and embraces the moral motives. Employing models offered by Berman et al. (1999), this study examines integrated propositions of the stakeholder typologies of Donaldson and Preston (1995) and the Freeman's (1984) definition of stakeholder.

1. Literature review

1.1. Stakeholders and their impact on firm performance. Sundaram et al. (2004) argue that although managers' orientation in general is for shareholder value maximization, the implicit objective is to enhance the outcomes for all stakeholders. Berman et al. (1999) conversely argue that stakeholder management is a means to an end, which has nothing to do with the welfare of stakeholders in general but the advancement of the interests of only one stakeholder group – its shareholders. Clarkson (1995) states that companies manage specific stakeholder relationships as a way of engaging their social responsibilities. His research provides insight into why specific policies, practices, and outcomes toward stakeholders in the same industry differ, and why companies make trade-offs among stakeholder groups in trying to achieve their goals. Bendheim et al. (1998) provide assessment of best practice performances on an industry basis by stakeholder categories, demonstrating that wide differences exist among industries in dealing with five primary stakeholders. Stakeholder theory explores the concept and the purpose of a corporation as the intersection of a range of interests (Clarkson, 1995); as a node in a complex web of dependency relationships between, and expectations of various constituencies (Wood, 1994); or as an aggregation of constituencies attempting to advance their self interests while respecting the interests of others (Wartick, 1988). The impact of management decisions on different groups or on affected actors helps firms to achieve their traditional goals (Reed, 2000). Post et al. (2002) identified stakeholder orientation as the means existence through which organizations create wealth (Post et al., 2002).

Three typologies of stakeholder theory are used in research studies to explain the purpose of corporate stakeholder management (Donaldson & Preston, 1995). The descriptive realm describes the way managers think about managing stakeholders and dealing with the interests of corporate constituencies. The instrumental realm concerns the connection of stakeholder management to the achievement of corporate objectives. The normative realm addresses moral and philosophical guidance for operating and managing stakeholders. Donaldson and Preston (1995) argue that firms manage their stakeholders for both instrumental and normative reasons. In previous researches these typologies have been used for empirically assessing why managers proactively address stakeholder interests (Berman et al., 1999).

There are several definitions of stakeholder groups. Carroll (1996) focuses on the '*stake*' notion; Freeman (1984) on '*the affect or is affected by*' approach; Starik (1994) stresses *'claims'* or '*rights*'; and Post et al. (2002) *'desire'* to create wealth. Because of the concern with firm performance, this study employs the definition of Freeman (1984). Stakeholder of an organization, according to Freeman (1984), is any group or individual who can affect or is affected by the achievement of organization's objectives. According to Berman et al. (1999), this definition suggests two-way relationships between firm (management) and stakeholders. The first direction is the word '*affect*" on firm's objectives. This implies that the firm's decisions, and hence its performance may be affected by the present activities of its stakeholders. This understanding suggests that firm is seeking to manage those stakeholders for economic benefit. The second direction is the word '*is affected by'* firm's objectives. This implies that firm's decisions will affect the well-being of its stakeholders (Berman et al., 1999). Here, managers may feel that they have a fundamental moral obligation to the stakeholders that grounds their managerial approach. These two implications of Freeman's (1984) definition are used as basic empirical models to test the motives of stakeholder management. To capture the broader aspect of strategic management, this study building on Berman et al.'s (1999) models employs strategy to link the effect of stakeholder orientation on performance perspective.

Primary stakeholders are characterized as the key stakeholders, in Freeman's (1984) view. These groups have formal, official, and contractual relationships enabling them to exert a direct influence on corporate objectives. Phillips (2003) pointed out that stakeholders are groups from whom the organization has voluntarily accepted benefits, and to whom the organization has therefore incurred obligations of fairness. It includes *owners* with a clear stake (claim) in the success or failure of the firm, '*employees'* who have invested time, energy, and intellectual capital in the firm, *'customers'* with whom there is a trust that products or service will have fundamental quality, integrity, and usefulness, '*communities'* that have invested in local infrastructure and employment opportunities, and '*suppliers'*. The focus of this study on primary stakeholder groups is due to their high level of interdependence with the achievement of organization performance.

Shareholders hold the most legitimate power to firm management (Friedman, 1970). They own a firm by virtue of owning equity shares. This argument supports the view that managers' fiduciary is to maximize shareholder wealth because shareowners or investors provide capital (Post et al., 2002), thereby bearing more risk than other stakeholders. From a moral ethic perspective, Phillips (2003) argues that there should be fairness of obligation to all stakeholders.

Post et al. (2002) note that employees develop specific human capital as a source of comparative advantage. Committed employees support the achievement of organization goals. Prusak and Cohen (2001, in Post et al., 2002) observe that employee communication is a unique asset that in the form of social capital benefits the firm and enhances its reputation. Skilled managers and talented workers co-determine the work quality that expresses the competitive advantages of the organization.

Favorable customer relations are instrumental in product and service design, attracting new customers to the firm and enhancing loyalty. Research indicates the impact of firm-customer relationships on financial performance. The negative impact of irresponsible firm activities (Frooman, 1997) and product recall (Davidson & Worrell, 1992) exemplify the importance of customer relations and product quality and safety (Hunt, 1999).

Partnership with suppliers is a critical activity for many firms to strengthen their competitive position. Research shows that effective supplier relationships positively affect performance (Soehadi, 2003). Productive supplier relationships build network and value chain efficiency for the firm success (Post et al 2002). Stuart and Mueller (1994) found that supplier partnering activities positively affect productivity and quality of service. Kalwani and Narayadas (1995) note that long-term relationships enable firms to improve their profitability level. From studies across Europe and United States, it has been shown that companies with stable supplier relationships achieve benefits across their business (Boitoult, 1997).

The effects of community relation on financial performance are less clear (Berman et al., 1999). Porter (1980) holds that the community relation is felt as no greater benefits by firm whereas activities of social responsibilities as core of community relation are mostly done unfocused and as piecemeal work. Most available research is limited to examination of corporate philanthropy (Wood & Jones, 1995). In some studies, local community is considered to have an impact due to its potential to prevent conflicts. According to Post et al. (2002), communities open up '*licenses to operate*'.

1.2. Stakeholders and strategies. Strategy deals with social trends, industry structures, and the environment in order to achieve goals like superior financial performance (Wheelen & Hunger, 2002) or sustainable growth (Dentchev, 2004). The issue of sustainability relates to non-financial performance and behavioral characteristics of the firm (e.g., good citizenship), normally included in the domain of corporate social responsibility (CSR). CSR is explicitly associated with the analysis of the organization's relations with its stakeholders (Clarkson, 1995). Moneva (2007) argues that stakeholder orientation should be integrated into strategic management. By generating value for different stakeholders, the value is also generated for the shareholder. Stakeholder orientation and firm strategy are in that sense as antecedents to firm performance. His research indicates that firms with strong CSR and stakeholder orientation simultaneously increase shareholder's value and comply with commitments toward society. Likewise, a weak stakeholder orientation will have a negative effect on firm performance and thus, on the shareholder value (Frooman, 1997). Reversely, involvement of stakeholders in decision making processes is considered if those stakeholders offer strategic value to the firm (Berman et al., 1999).

This study employs Porter's (1980) generic strategies, because they adopt both internal and external strategic orientation (Kumar et al., 2000). The use of generic strategies is based on a strong and widely accepted theoretical foundation, and serves as the dominant paradigm in literature (Miller and Dess, 1983). Cost leadership orientation assesses cost aspects of producing products to reach production efficiency, and producing asset per unit of output is few. Differentiation strategy relates to the degree to which a product and its enhancements are perceived as unique and building perception of consumer of a product special. It broadly captures a firm's attempt to differentiate itself from its rivals using variety of marketing-related activities (Hambrick, 1983). Like Hill (1988), this study recognizes that differentiation and low-cost aspects can be integrated into one company's strategy, based on the concept that differentiation can be instrumental in achieving a low cost position. The use of combined differentiation and cost leadership strategy has been widely accepted in research works (Hambrick, 1993, Berman et al., 1999). The option to add focus as a dimension to the two generic strategies has not been used, as several authors have offered a strong eudence that it just acts as a subset of cost leadership and differentiation (Lynch et al., 2001).

2. The development of models and hypotheses

2.1. Overview. Models in this study are conceptualized from two interrelated theses: the stakeholder definition (Freeman, 1984), and the stakeholder typologies (Donaldson & Preston, 1995) as summarized in Table 1. First, stakeholders affect the firm's objectives (profit), thus the purpose of managing the group(s) would become part of firm strategic decisions of seeking profit maximization (instrumental realm). Second, stakeholder(s) is (are) affected by firm objectives, thus the firm decisions will influence the well-being of stakeholders. In this case, strategic decisions of managers embrace moral and ethical aspects (normative realm), which in turn affect the firm objectives.

Table 1. Interrelated perspectives in stakeholder orientation model

Stakeholder Definition	Stakeholder model		Remarks
	Instrumental approach	Normative approach	
Stakeholders affect firm's objectives	Direct effect model		Stakeholder management is presumably concerned to influence directly firm's performance.
	Moderating effect model		Stakeholder management moderates the influence of firm's strategic decisions on firm performance.
Stakeholders are affected by firm's objectives		Mediating effect model	Moral and ethical motive of stakeholder management will drive firm strategic decisions which eventually affect firm performance.

2.2. The direct effect model. A fundamental assumption of the instrumental approach is that the ultimate objective of corporate decisions is economic success. Any decision involving stakeholder commitment should contribute to the financial performance. Firms view stakeholders as part of the environment that should be managed in order to maximize profitability. Stakeholder management thus, links "means" and "end" (shareholder value). This complies with Donaldson & Preston's (1995) instrumental realm that establishes a framework for examining the connection between the practice of stakeholder management and the achievement of corporate objectives. There are two models in this instrumental approach: the direct effect model and the moderation effect model.

Stakeholder orientation in the direct effect model asserts that the relationship built between management and its stakeholder group can bring effect on firm performance as depicted in Figure 1. In their research, Hillman and Keim (2001) argue that developing long-term relationships with primary stakeholders expands the set of value creating exchanges with these groups. Barney and Hansen (1994) argue that in an institutional context, repeated dealings with stakeholders generate reputation and trust.

It is hypothesized that:

H1: Stakeholder relationship variables which address managers' intention to generate economic value, separately and simultaneously with strategy variables, have a direct effect on firm performance variables.

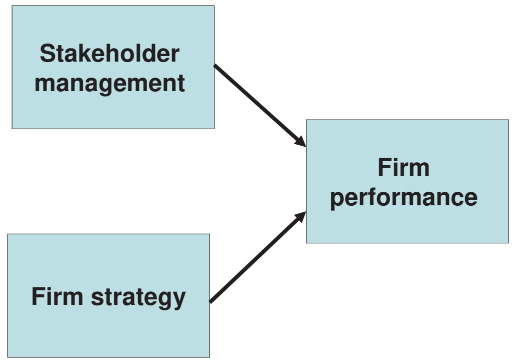

Fig. 1. Direct effect model of stakeholder orientation

2.3 The moderation effect model. In the moderating effect model, stakeholder orientation toward profit maximization is achieved indirectly through moderating the effect of strategic decisions (strategy) on financial performance (see Figure 2). The concerns of stakeholders enter a firm's decision-making processes only if they offer strategic value to the firm. Stakeholder relationship that increases the firm's wealth creating capacity will in turn supports strategy toward profit maximization (Post et al., 2002). Stakeholder and resource allocation decisions are inseparable, because the way in which managers allocate resources inevitably has implications for the strength of stakeholder relationships, and their variables interact to affect firm financial performance (Berman et al., 1999). Managers who do not consider key stakeholders will be at a competitive disadvantage.

It is hypothesized that:

H2: The effect of firm strategy variables on performance variables will be moderated by stakeholder relationship variables which involve the intention of managers to generate economic value.

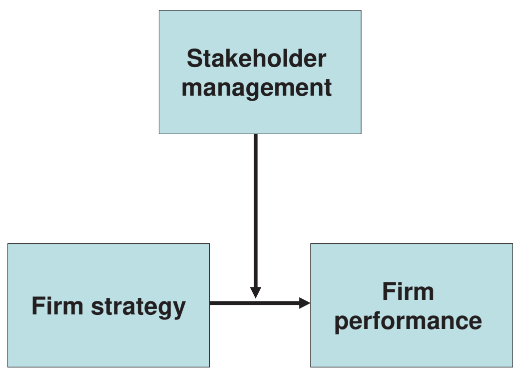

Fig. 2. The moderating effect model of stakeholder orientation

2.4. Mediating effects model. Donaldson & Preston's (1995) normative approach holds that relationships built with stakeholders are based on normative, moral commitments rather than on the desire to maximize profit. In other words, a firm establishes certain fundamental moral principles that guide how it does business – particularly with respect to how it treats stakeholders – and uses those principles to drive decision making (Berman et al., 1999). The model that acknowledges the influence of stakeholder management on strategy decision, and indirectly on firm performance, is displayed in Figure 3. Firm strategies which accommodate stakeholder interests as moral concerns will result in better performance.

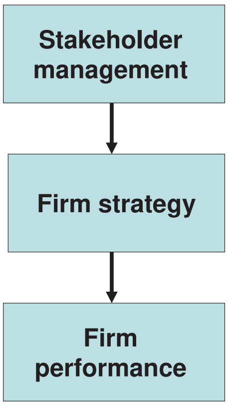

Fig. 3. Intervening effect model of stakeholder orientation

It is hypothesized that:

H3: Stakeholder management variables that embrace moral concerns of managers will influence strategic decisions of the firm, which in turn affects firm performance variables.

3. Methodology

3.1. Data. Empirical data for this cross-sectional study were collected from manufacturing firms within the district of Jakarta. The sample list of medium and large manufacturing firms was taken from the data base of Central Bureau of Statistics Indonesia, 2005, and cross-checked with the Indonesian Yellow Pages: the Industrial Guide, 2005. General information on the sample firms including information of product category, stakeholder information, strategy and performance were obtained from primary (questionnaire) and secondary (annual report) sources. Data of the stakeholder groups were collected through questionnaires based on the qualified information received from the sample firms. A total of 570 medium size enterprises (employing between 100 and 1200 workers) in wide category of manufacturing industry were invited to participate in the survey. At the end, a total of 109 companies respond to the questionnaire packages. Among those firms, 101 were decided to be eligible for further analysis showing a response rate of 17.7 percent. The rest is either they do not respond to the questionnaire, give incomplete data, or incorrectly fill it in. The questionnaires were developed using seven-point Likert scales (1 = none/nothing; 2 = very less/poor; 3 = less/not good; 4 = fair; 5 = quite good; 6 = good; 7 = very good/great) for all variable items as shown in appendices A and B.

3.2. Measures. Appendices A and B present the details of items used to measure the various constructs of interest in this study. The operationalization of the construct variables has been adopted from previous researches, and modified to the situation of the sample firms.

The variables for stakeholder relations were measured employing Clarkson's (1995) stakeholder issues model that delineates the expectations of primary stakeholder groups to firm's stakeholder commitments. These issues have been cross-checked with Davenport's (2000) principles of corporate citizenship, Berman et al.'s (1999) application of the KLD (2004) data base, and Moore's (2001) raw social performance indicators, and modified to suit the industry environment. This study develops five items of customer relation, seven items of employee relation, five items of supplier relation, five items of shareholder relation, and five items of community relation (Appendix A).

Porter's generic strategies of cost leadership and differentiation have been operationalized to capture the firm's strategic decisions. Both strategies are used to reveal the important aspects of firm's strategic resource allocation utilized to achieve competitive advantage (Hambrick, 1983; Hill, 1988), as they may be simultaneously directed to attain long-term profit. Strategies were measured using modified scales of Lynch et al. (2000) and Kumar et al. (2000) which originally were adopted from Dess and Davis (1984). This study develops five items of differentiation strategy, and four items of low cost position strategy (Appendix B).

In measuring financial performance, the subjective or indirect method is used as data collected are based on perceptions of top management relative to the target of the average industry (Venkatraman & Ramanujam, 1986). These measures, due to the unavailability of quantitative (secondary) data, employ perceptional scales averaged during the period of 2002-2005. The financial measures use profit growth and return on asset growth that traditionally linked to cost leadership strategy, and revenue growth that links to growth in market share, market expansion, and sales volumes (mainly linked to market oriented differentiation strategies; cf. Hill, 1988). These performance categories are employed to indicate the presence of competitive advantage.

3.3. Model specifications. Several specifications are employed to estimate our models. Firstly, the application of multiple regression model for the direct effect of the independent variables (stakeholder relations and strategy) on the dependent variable (financial performance) as shown in equations 1.1 and 1.2 (Hair et al., 1998). Secondly, the estimation of interaction effects model among the independent variables (stakeholder and strategy) on financial performance as represented by regression equations of 2.1 to 2.3 (Baron & Kenny, 1986). Thirdly, the interaction effect of the mediating variables (strategy) and the independent variables (stakeholder relations) on the dependent variables (performance) as shown in Figure 3. Equations 2.3 and 2.4 represent model specifications of this interaction effect. Here we use two-step regression model; firstly, from independent variables (stakeholder relation) to the mediating variables (strategy) and secondly, from the strategy (mediating) variables to the performance (dependent) variables. All the above processes are run by SPSS 13.0 (2005).

Direct effect model

$$\text{Performance (FP)} = \beta_0 + \beta_1 SHR + \beta_2 CSR + \beta_3 EMR + \beta_4 SPR + \beta_5 CMR + \beta_6 DF + \beta_7 CL + \varepsilon \quad (1.1)$$

$$\text{T-test} = \beta_i / S_{\beta i} \; (i = 1,2,3,4,5,6,7) \quad (1.2)$$

where β_0 = intercept; β_1 - β_7 = Coefficients of independent variables (stakeholder and strategy variables); ε = error; $S_{\beta i}$ = variance of parameters.

Moderating effect model

$$\text{Performance} = \beta_0 + \beta_1 SHR + \beta_2 CSR + \beta_3 EMR + \beta_4 SPR + \beta_5 CMR + \beta_6 DF + \beta_7 CL + \beta_i (SR_j \, x \, FS_k) + \varepsilon, \quad (2.1)$$

where β_0 = intercept; β_1 - β_7 = Coefficients of independent variables (stakeholder and strategy variables); β_i = coefficients of interaction terms (i = 8,9,10,...); SR_j = Stakeholder Management Variables (j = SHR, CSR, EMR, SPR, and CMR); FS_k = Firm Strategy Variables (k = DF and CL); ε = error

Mediation effect model

$$\text{Performance (FP)} = \beta_0 + \beta_1 DF + \beta_2 CL + \beta_i (SR_j \, x \, FS_k) + \varepsilon, \quad (2.2)$$

where β_0 = intercept; β_1, β_2 = coefficients of independent variables (strategy variables); β_i = coefficients of interaction terms (i = 3, 4, 5,...); SR_j = stakeholder management variables (j = SHR, CSR, EMR, SPR, and CMR); FS_k = firm strategy variables (k = DF and CL); ε = error

$$\text{Indirect effect coefficient } (\theta_1) = \gamma_1 * \beta, \quad (2.3)$$

Where γ_1 is a regression coefficient of stakeholder variable on performance variable; and β_1 is a regression coefficient of strategy variable on performance variable.

$$\text{Standard error of } \theta_1 \text{: } s_{\theta 1} = \sqrt{(\gamma_1^2 S\gamma_1^2 + \beta_1^2 S\beta_1^2 + S\gamma_1^2 S\beta_1^2)}, \quad (2.4)$$

where $S\gamma_1$ is standard error of γ_1; and $S\beta_1$ is standard error of β_1

$$\text{T-value} = \theta_1 / S_{\theta 1} \quad (2.5)$$

4. Data analysis and results

Firstly, we check the goodness of data applying validity and reliability tests. Reliability test is to ensure the consistency of the instrument developed, while validity is to indicate how well the instrument developed measures accurately the concept (Hair et al., 1998). In addition, multicollinearity in the data set is examined using variance inflation factors (VIF) assessment. In order to test the research hypotheses, the regression models have been specified and estimated.

In determining the reliability of the multi-item scale, Cronbach's alpha was calculated as shown in Appendices A and B. Reliability for all items ranges from 0.75 to 0.96, exceeding the threshold value of 0.6; all scales can be considered moderate to (very) good (cf. Hair et al., 1998). Factor analysis is applied to indicate scores of MSA (measure of sampling adequacy) to test the validity. Results show that all MSA scores of the construct variables reach between 0.671 and 0.946; these are above the necessary threshold of sampling adequacy of 0.5 (Hair et al., 1998).

Table 2 provides the descriptive statistics and correlations among the dependent and independent variables. Further test of variance inflation factor (VIP) statistics show that no multicollinearity problems in the data set as the observed scores of these factors are less than the critical limit of 10.0 (cf. Hair et al., 2002).

Table 2. Means, standard deviations, and correlations

Variables	Mean	Std dev.	VIF	1	2	3	4	5	6	7
1. Performance	4.941	0.845		1.000						
2. Differentiation	5.174	0.823	1.185	0.402	1.000					
3. Cost leadership	4.755	0.791	1.161	0.162	-0.242	1.000				
4. Employee relation	5.001	0.756	1.069	0.319	0.101	0.223	1.000			
5. Community relation	4.845	0.727	1.099	0.241	0.195	0.138	0.557	1.000		
6. Customer relation	5.110	0.746	1.034	0.354	0.287	-0.163	0.322	0.165	1.000	
7. Supplier relation	5.301	0.642	1.095	0.219	0.307	0.040	0.268	0.381	0.388	1.000
8. Shareholder relation	5.305	0.630	1.050	0.420	0.147	0.196	0.307	0.237	0.097	0.280

Next, we estimate relationships between two constructs of independent variables, i.e. stakeholder relationships and strategy and financial performance as dependent variable. Here, we use four regression models to approach the direct effect model. Models 1 and 2 represent restricted models where stakeholder relationship and strategy variables are examined separately as independent variables of firm performance. In Model 3 a full model is examined in which all independent variables are estimated simultaneously as the dependent variable (Kotha & Nair, 1995). However, the results show that model 3 does not represent a significant improvement over models 1 and 2; therefore model 4 is performed as a parsimonious model to improve the results of model 3 (indicated by the scores of R-square, F-stat, and df). In sum, the results show that three stakeholder relationships: employees, customers, and shareholders significantly affect firm performance with confidence level $p < 0.10$ or better. In addition, we found that both strategies also positively and significantly relate to firm financial performance. Hence, our results support Hypothesis 1.

Table 4 presents results of regression test of moderating-effect model of stakeholder relations variables on strategy-financial performance relationship. Here, we use two-step approach. Firstly, we examine full model (model 5) to estimate the regression coefficients of stakeholder relations and strategy variables respectively on performance. Secondly, we estimate coefficients and t-values of the interaction effects of both independent variables on performance as shown in model 6. The outcomes denote that majority of stakeholder relationship variables moderate the strategy-performance relationship. Statistical tests indicate that interactions of employee relation and differentiation strategy; supplier relation and differentiation strategy; employee relation and cost-leadership strategy; customer relation and cost-leadership strategy, as well as shareholder-relation and cost-leadership strategy, show significant results. These indications interpret that except for the community, all four stakeholder-relation variables moderate relationship between strategy variables and performance variables. These findings support the prior work of Berman et al. (1999) confirming the principle of instrumental approach of stakeholder theory that postulates *means* and *ends* interrelatedness. Hence, H2 is supported.

Table 3. Regression results on performance – direct effect model

Variables	Dependent variable: financial performance			
	Model 1 (Strategy)	Model 2 (Stakeholder)	Model 3 (Full model)	Model 4 (Parsimonious)
Intercept	0.0000 (0.088)	0.0000 (0.086)	0.0000 (0.080)	0.0000 (0.0000)
Stakeholder relationship				
Employees		0.208 *** (0.087)	0.153**** (0.083)	0.152 **** (1.853)
Communities		0.123 (0.087)	0.060 (0.081)	
Customers		0.299 * (0.087)	0.264 ** (0.084)	0.264 ** (0.083)
Suppliers		0.083 (0.087)	-0.019 (0.084)	
Shareholders		0.363 * (0.087)	0.295 * (0.082)	0.294 (0.081)*
Strategy				
Differentiation	0.425* (0.089)		0.327 * (0.087)	0.331 * (0.082)

Table 3 (cont.). Regression results on performance – direct effect model

Cost leadership	0.222**** (0.089)		0.182 *** (0.086)	0.186 *** (0.085)
Model statistics				
R-Square	0.230	0.286	0.403	0.499
F-stat	14.625 *	7.604 *	8.962 *	12.605 *
df	2	5	7	5

Note: N=101. Unstandardized regression coefficients are shown with standard errors in parantheses *p < 0.001; **p < 0.01; ***; p < 0.05; ****p < 0.1

Table 4. Regressions on performance – moderation effect model

Variables	Model 5 (Full model)	Model 6 (Moderation model)
Intercept	0.0000 (0.080)	0.094 (0.086)
Stakeholder relationship		
Employees	0.153 **** (0.083)	0.162 **** (0.082)
Communities	0.060 (0.081)	0.053 (0.087)
Customers	0.264 ** (0.084)	0.200 *** (0.087)
Suppliers	-0.019 (0.084)	-0.029 (0.083)
Shareholders	0.295 * (0.082)	0.272 ** (0.089)
Strategy		
Differentiation	0.327 * (0.182)	0.370 ** (0.088)
Cost leadership	0.182*** (0.086)	0.298 ** (0.091)
Interactions:		
Differentiation * employee		-0.203 **** (0.121)
Differentiation * communities		0.039 (0.105)
Differentiation * customers		-0.133 (0.113)
Differentiation * suppliers		0.140 **** (0.076)
Differentiation * shareholders		0.003 (0.072)
Cost leader * employee		-0.173 **** (0.097)
Cost leader * communities		-0.009 (0.106)
Cost leader * customers		0.131 **** (0.076)
Cost leader * suppliers		0.123 (0.086)
Cost leader * shareholders		-0.258 ** (0.083)
Model statistics:		
R-Square	0.403	0.522
F-Stat	8.962 *	5.340 *
df	7	17

Note: N=101. Unstandardized regression coefficients are shown with standard errors in parantheses, p < 0.00*1; **p < 0.01; ***p < 0.05; ****p < 0.1; N = 101.

Following is the evaluation of mediation effect model of strategy variables on stakeholder-performance relationship. Results of GLS regression in Table 5 reveal that there is not enough support for strategy variables to mediate the relationship between stakeholder-relation and firm financial performance (only three out of ten interactions or less than 50% show the significant scores). This result interprets that moral motive in stakeholder management is not used to drive strategic decisions of managers to pursue economic performance. Hence, H3 is not supported.

Table 5. Regression coefficients of mediation effect model

Variables	Model 7, Mediation effect model	
	Coefficient	Standard error
Intercept	0.121	0.092
Strategy:		
Differentiation	0.493 *	0.087
Cost leadership	0.349 **	0.110
Interactions:		
Differentiation * employees	-0.183	0.124
Differentiation * communities	0.082	0.108
Differentiation * customers	-0.317 **	0.110
Differentiation * suppliers	0.163 **	0.080
Differentiation * shareholders	-0.031	0.073
Cost leader * employees	-0.155	0.102
Cost leader * communities	-0.046	-0.448
Cost leader * customers	0.119	0.080
Cost leader * suppliers	0.080	0.088
Cost Leader * shareholders	-0.245 **	0.088
Model Statistics:		
R-Square	0.418	
F-Stat	5.267 *	
df	12	

Note: N=101, Unstandardized regression coefficients are shown, *p < 0.001; **p < 0.01; ***p < 0.05; ****p < 0.1: N = 101.

5. Discussion

The purpose of this study is to examine the motives of stakeholder orientation within firm strategic decisions using framework of instrumental and normative aspects of stakeholder theory. Here we use three assessment models of stakeholder orientation which are direct effect, moderating effect, and mediating effect models.

5.1. The instrumental approach. Instrumental approach deals with identification of connections between stakeholder management and the achievement of various corporate objectives (Donaldson & Preston, 1995). Fundamental assumption of this aspect is that the ultimate objective of corporate decisions is a market place success. Firms manage their stakeholders in order to assure revenues, profits, and ultimately shareholder value. This proposition can be explained by the results of hypotheses 1 and 2. Results of direct effect model in the hypothesis 1 for example, suggest that stakeholder management with economic motive significantly affects firm financial performance. This finding is supported further by the results of moderating effect model in the hypothesis 2 suggesting that the influence of strategic decisions on financial performance is moderated by stakeholder relation. In this study, strategic decisions refer to strategy perspective of strategic resource allocation (Berman et al., 1999). In the details of presented results, we found three variables of stakeholder relations (shareholders, customers, and employees) that contribute significant effects on financial performance, and four stakeholder variables (shareholder, customer, suppliers, and employees) that having significant interaction effect with strategy variables on financial performance. These results constitute our understanding of one side of Freeman's (1984) definition of stakeholder that the relationship with these groups is intended merely to pursue economic goals. We found the similar findings of prior works that emphasize how the productive relationships with employees and customers can significantly impact financial performance (Berman et al., 1999), or how the positive influence of treatment to customers, suppliers and employees affects firm performance (Waddock and Graves, 1997).

The interesting findings of the direct effect model emerged in two variables – supplier relation and community relation – which fail to exhibit significant effects on financial performance. This presumes that suppliers and communities are not considered by managers as the important groups to influence firm strategic decisions in maximizing profit. Compared to the findings of previous studies, our results suggest a contradictive estimate whereas these variables should create a significant influence on financial performance (Waddock and Graves, 1997; Lynch, 2001). As Berman et al.'s (1999) reasonable argument, the reason is that isolating these variables from other organizational attributes does not help them to affect financial performance directly. These two constructs should be performed with other functions in the organization to generate value. Lynch et al. (2001) for example, argue that a competitive advantage can be generated by integrating effort of effective supplier relationship with logistic capability. Jawahar and McLaughlin (2001) show how Digital Equipment involves their suppliers in its production planning teams, or Xerox shares its blueprints with its suppliers and involves them in designing parts. However, in spite of no direct effect of supplier relation on financial performance, the moderation effect model suggests that the interaction effect of supplier group and differentiation strategy positively and significantly affect financial performance, while interaction effect of supplier and cost leadership strategy positively although not significantly influence performance. Hence, the supplier group moderates the influence of strategy variables (resource allocation) on performance.

The failure of community group to show its influence on performance can be explained by taking Porter & Kramer's (2003) argument that most companies generally concern the community group only for social or philanthropic activities without linking them to company's strategic context. Post et al. (2002) added that in most practical cases, managers treat the communities or other social groups merely for humanitarian reason (Post et al., 2002). Therefore, community treatment is performed as a piecemeal task. In addition, the majority of companies in our survey list were mostly located in industrial estates where the interaction and communication with local communities are very limited or restricted. Therefore, it is to believe that the data collected from the respondents around the industrial estates contain a bias since the respondents may have a missing interpretation to value over a particular manufacturing firm.

The other reason of why these two groups do not support performance could be analyzed from the presence of contextual factors that are not examined in this study such as geographic location of a firm, or regulation that probably determine or influence the importance of the variable items.

5.2. The normative approach. Normative approach addresses perception that relationship of managers to their stakeholders is based on normative, moral commitments rather than on desire to use those stakeholders to maximize profits (Donaldson & Preston, 1995). Thus, firm establishes certain fundamental moral principles - the guide on how it does business - particularly with respect to the stakeholder treatment. In our model, these principles are examined within a strategic decision-making process framework which in turn impacts firm performance.

Our findings indicate a little support for this model summarizing that strategic decision doesn't function as a mediator to the influence of stakeholder management to firm financial performance. This is similar to the prior findings examined by Berman et al. (1999) using KLD data base for firms in the S&P 500. They didn't find support for what they call 'intrinsic stakeholder commitment model', the model that represents the normative approach of stakeholder orientation. From results shown by this moderating effect model, this study assumes that managers in manufacturing firms (as sample firms) do not view stakeholder management as a normative (moral) driver within their strategy formulation and implementation. This is in line with Clarkson's (1991) contending argument that the managers' act only occurs within the framework of fiduciary duties to achieve firm objectives. Managers are trained to understand the meaning of responsibility in the context of functional disciplines (such as finance, human resource, marketing, etc.), and they understand the meaning of accountability for the results of their decisions. Therefore, their obligations and responsibilities to customers, employees, supplier, and other important constituencies are executed together with the corresponding accountabilities to fulfill their fiduciary obligations to pursue the ultimate goal – the shareholder value.

Conclusions

Main conclusions. This study delivers two main conclusions. The first one is a view that confirms the instrumental proposition of stakeholder theory. The proposition expresses that stakeholder orientation is merely aimed to achieve shareholder return or profit maximization. The results under this proposition have been supported by strong evidences at previous studies such as of Turban & Greening (1996), Berman et al. (1999), and Post et al. (2002). In principle, they argue that managers who are in constant contact with key stakeholders are in better position to assess organizational goals, to take advantage of unforeseen but mutually advantageous opportunities (i.e. cost reductions throughout supply chain), and possibly to avert conflict before it reaches a critical stage (e.g., communication with dissatisfied employees or community activists). Stakeholder literature acknowledges that stakeholder management stresses on more corporate behavior than to argue for more moral position (Nasi et al., 1997). This clearly asserts the meaning of '*affect*' in the stakeholder definition of Freeman (1984). However, as Phillips (2004) recommends that yet managing stakeholders for economic benefits, managers should use moral and ethical manners (cf. socially responsible dimension, Wartick and Cochran, 1985). He argues that firm needs to build trust and goodwill in larger communities in which they sits uplifting view of their business. This links to the very earlier statement of Friedman (1970) who argued that the aim of social responsibility is to maximize firm profit.

The second one is a view that acknowledges the normative realm of stakeholder management. Here, we refer to the definition of a corporation as a node of networks of dependencies and expectations of various constituencies (Wood, 1994), thus contending an argument of integrating the economic and social objectives as stipulated by Carroll (1979) and Wartick & Cochran (1985), not merely for the economic purpose. They insist that there are stakeholders out there who expect the intrinsic values such as the communities and environments. These constituents depend on the existence of firms around them to encourage the sustainability of their well being and environment. Nevertheless, the findings show us that little evidence is found to support this view meaning that managers believe that stakeholder management which is oriented on moral and ethical aims will not drive strategic decisions to achieve firm performance. This view does not espouse assumption that managers really intend to improve the well-being of the stakeholders. According to the above scholars, social concerns should have been built outside business. Similarly to Freeman (1984) as saying that those externalities (involvement in social activities) will create social criticism and affect the decreasing productive capabilities. Therefore, managers should not be involved in the social life in principle.

In all, conclusion of the study reveals that the stakeholder orientation is acted based on the instrumental model, a desire to maximize economic return, and not on the intrinsic commitment (normative) model from which stakeholder relationships are executed under normative, moral commitments. The whole findings in this study have assumed their results following the characteristics of various manufacturing firms as a sample frame employed to examine the hypotheses. The results are thus many influenced by the mixed nature of wide-categoriacal industries (including light and heavy manufacturers) that offers complex characteristics such as industry control, the historical context, and the mixing varieties of stakeholders' power (Grave and Waddock, 1994). For further study, this model can be validated as well in more specific fields such as sensitive environmental related industry, service industry, or similar product-category industry as to offer more homogeneous characteristics. In similar vein, operationalization of dependent and independent variables is suggested to employ different proxies such as approaches to social orientation of stakeholder relations, and other performance measures that seem necessary to allow researchers to offer better understandings toward all possible links among variables of stakeholder orientation, strategy, and performance.

Sub conclusions. Several notions are derived from this study. First, regarding the issue management employed as measuring variables of stakeholder orientation. The low responses of firm on several issues of business environment indicate a legitimacy gap between the firm and the concerned stakeholder as source of the issues. The higher the legitimacy gaps, the harder the firm to maintain maximum discretionary control over its internal decision making and external dealings (Goodpaster, 1991, in Bendheim et al., 1998). This phenomenon explains why conflicts with a particular stakeholder group easily occur for a particular firm, while at the same time other firm can make use of the same stakeholder to create value through an effective relationship. Hunt and Morgan (1997) point this condition as a form of comparative advantage (by the latter firm) to win a market place competition.

Second, the results of the normative model has indicated us that actually most business firms are in nature not interested in being involved in social activities. According to Clarkson (1995), besides increasing cost, and sacrificing profit, involvement in social parties are perceived as not considered as strategic move that influences firm in driving profit. The intention of managers in dealing with social issues (if any) is based on humanitarian reasons. Therefore, Hunt and Morgan (1997) stress that manager who considers the social issues as non-strategic ones will leave their corporation to optimize its relational asset as part of strategic assets and lose an opportunity to create the comparative advantage.

Practical implications

The results of this study suggest several managerial implications. First, by understanding the stakeholder concerns, managers will consider the presence of strategic issues as representation of stakeholder expectations. Firms employing stakeholder orientation in their strategic decisions perceives benefit more than firms without challenging it although they use the same strategy. The effective and efficient relationships with strategic oriented stakeholders may offer a comparative advantage to pursue a strategic position in the market place as a component of competitive advantage because those stakeholders are source of expectations that constitute desirable and undesirable firm objectives (Wood & Jones, 1995). In several employee studies such as Roman and Blum (1987, in Wood and Jones, 1995), it was found that the managers with more socially responsible attitudes are more likely to have employee assistance programs that encourage benefits for the organization. Pinkston and Carroll (1993, in Wood and Jones, 1995) argue that managers consider their concerns on employee health and safety as the indicators as moral issues driven in employee loyalty. Post et al. (2002) called community acceptance as a firm license to operate.

Second, firms competing in highly competitive environments such as manufacturing industry are thus better-off to employ stakeholder oriented strategy as to protect themselves from possible conflicts occurred by the affected actors from which it may impair competitiveness. Although there is a little indication of the involvement of moral aspects to encourage profit, stakeholder treatment with ethical and moral standard has been beneficial for managers to create the social glue[1]. As source of expectations, stakeholders define the norms for corporate behavior because they experience the effects of corporate actions (Woods and Jones, 1995).

Third, the results of the hypotheses imply that different environmental characteristics of industries and locations may naturally cause different stakeholder influences and demands, so managers should prioritize their treatment based on characteristics of power, legitimacy, and perceived urgency of stakeholders within those industries (Carroll, 1979). Generally, the stakeholders evaluate how well firm can fulfill their expectations, and how good firm behaves to affect the groups in their business environment. Therefore, managers presumably need to perform better than the competitors with respect to treatment on key stakeholders as this effort creates a comparative advantage (Hunt and Morgan, 1997).

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[1] Vernon (2002) denotes that corporation is a social entity where all social interests of constituencies are pooled. Similar to an economic entity, a corporation possesses social capital to perform its social activities. Therefore, managers require social glue to fuel the dynamic needs of those social interests

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Appendix A

Variables and descriptive statistics of stakeholder management

Items variables	Code	Cronbach alpha	Mean	Std. Dev
STAKEHOLDER RELATIONS	CSR	0.868		
Customer Relations	*CSR*	*0.926*		
Overall customer satisfaction	CSR1	0.830	5.1552	0.95395
Showing response to customer complaints	CSR2	0.852	5.014	0.98331

Provide product information and safety	CSR3	0.835	5.0875	0.88832
Customer commitment & protection	CSR4	0.843	5.2608	0.88184
Provide follow-up service	CSR5	0.841	5.0314	0.90208
Employee Relations	*EMR*	*0.960*		
Equal opportunity	EMR1	0.952	5.1005	0.89474
Work insurance for workers	EMR2	0.953	5.0155	0.76907
Provide health and medical treatment	EMR3	0.957	5.0759	0.70197
Career planning system	EMR4	0.950	4.8364	0.91052
Training and development program	EMR5	0.949	4.9584	0.91362
Remuneration and incentive pay plan	EMR6	0.954	4.9436	0.809077
Solving the HR issues	EMR7	0.956	5.0793	0.79406
Supplier Relations	*SPR*	*0.856*		
Overall supplier satisfaction/supplier benefit	SPR1	0.826	5.4190	0.75844
Safety standard determined to the products supplied	SPR2	0.833	5.2326	0.74143
Offering solutions on suppliers' issues	SPR3	0.837	5.2870	0.88175
Supplier communication	SPR4	0.807	5.1368	0.84720
Commitment to fulfill Co. obligations	SPR5	0.829	5.4308	0.78365
Shareholder Relations	*SHR*	*0.806*		
Performance (profit) achievement	SHR1	0.784	5.3465	0.79606
Communication with Board of Commissionaires (BoC)	SHR2	0.756	5.2277	0.88183
Corporate response on environmental issues	SHR3	0.751	5.1782	0.86771
Relationships with local authorities and regulators	SHR4	0.782	5.4604	0.85347
Good governance practices	SHR5	0.770	5.3119	0.79010
Community Relations	*CMR*	*0.926*		
Support for social life of local community	CMR1	0.901	4.8925	0.78726
Involve in improving environmental condition	CMR2	0.899	4.0243	0.87478
Benefit of company's activities	CMR3	0.925	4.8574	0.84295
Response on social issues	CMR4	0.920	4.9774	0.78238
Philanthropic activities	CMR5	0.897	4.9446	0.84751

Source: Adopted and modified from Clarkson typical stakeholder issues (1995, pp.101-102).

Appendix B

Variables and their descriptive statistics: strategy and performance

Theoretical variables	Code	Cronbach's Alpha	Mean	Std. Dev.
STRATEGY				
Differentiation strategy	*DF*	*0.878*		
Provide new products or services	DF1	0.853	*5.2574*	*0.85619*
Offer unique products and/or services	DF2	0.851	5.0099	1.05352
Develop product or service for special needs	DF3	0.854	5.2475	1.00405
Offer a high degree of value in products and/or services	DF4	0.842	5.0792	1.06474
Offer highly differentiated products or services	DF5	0.866	5.2772	1.02097
Low-cost Strategy	*CL*	*0.840*		
Emphasize efficiency	CL1	0.792	4.5050	1.07353
Redesign product/service to reduce costs	CL2	0.769	4.5050	1.01611
Provide lower price of product or service than competitors	CL3	0.778	4.8515	0.93152
Invest in cost saving technology	CL4	0.840	5.1584	0.80911
PERFORMANCE				
Financial performance	FP	0.864		
Revenue growth	FP1	0.749	4.9505	1.00376
Profit growth	FP2	0.792	4.9109	0.90663
Return on asset (ROA) growth	FP3	0.842	4.9604	0.96873

Source: Lynch et al. (2000, p. 54).