

1 *Challenges for a new paradigm in strategic management*

The future of business in society: social and economic changes

During the last decades, both business and the society have undergone enormous changes. A few key examples may illustrate this: technological and scientific progress, changes in social structures and mindsets, globalization, development of new players in the world economy such as Brazil, China and India, and the downturn of Communism. This has opened new horizons for firms but also for customers, suppliers, citizens, and for many other kinds of stakeholder groups.

However, there have also been fundamental challenges and negative effects caused by these changes that also impact the firm and its stakeholders. The rising defaults on subprime mortgages in the United States illustrate such a fundamental challenge, as these defaults triggered a global crisis in the financial system. As a result, leading investment banks collapsed and the US government carried out massive bail-outs. Similar observations can be made for Europe and Asia. Even national economies have encountered serious difficulties. Greece and Ireland, for example, have had to be bailed out by the European Union and the International Monetary Fund (IMF).

For economic theory, these incidents turn out to be empirical tests in the worst sense, as Barbera claimed shortly after investment banks collapsed worldwide: “But for the majority of economists, those who use theory to try to make sense of the world, shouldn’t we all agree that the new classical framework failed in spectacular fashion last year?”¹ Not only was the economy greatly affected but also the whole of society, as Stiglitz emphasized: “The financial sector has imposed huge externalities on the rest of society. America’s financial industry polluted the world with toxic mortgages.”² Due to the global crisis in the financial system the confidence in corporations has waned and led to a crisis which has had a strong impact on society as a whole. All

Cambridge University Press

978-0-521-19639-0 - Stakeholders Matter: A New Paradigm for Strategy in Society

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Excerpt

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these developments have become an economic and a social challenge at the same time.³

In the interplay between business and society today, areas of conflict need to be overcome and the focus needs to be shifted away from the one-sided dominance of the economic sector, as Reich emphasizes: “Something I call supercapitalism was born. In this transformation, we in our capacities as consumers and investors have done significantly better. In our capacities as citizens seeking the common good, however, we have lost ground.”⁴ Already a decade earlier Habermas blamed the dominance of the economic sector, when he recognized a structural transformation that “restricts the latitude of national governments, their remaining options no longer allowing them to ‘cushion’ undesirable social and political consequences of transnational economic transactions.”⁵ The roles of the nation state and of the economy are challenged, as market mechanisms have gained weight excessively in relation to other social and political processes. Giddens concludes, “A good society can be defined as one in which there is an effective balance between a competitive marketplace, a robust third sector or civil society and the democratic state.”⁶

The dominance of the economic sector has been questioned by a wide range of people. This can be illustrated by a worldwide BBC poll in twenty-seven countries, including over 29,000 people. It showed that people are highly dissatisfied with free-market capitalism; only 11 percent said that the free market was working well, and the majority thought that the capitalist system was in need of regulation and reform.⁷

The economic and social changes also impact individual firms and their stakeholders. They are confronted with new expectations and growing complexities and dynamics in the context in which they operate, and this leads to new or changing and more demanding stakeholder interactions. Until recently, most corporations concentrated on one or very few stakeholders who are directly related to the firm’s value creation process. Freeman *et al.* describe the concentration on one stakeholder by using different narratives of capitalism: “These narratives do not simply ignore other stakeholders. Rather, each narrative presumes that by focusing on the interests and rights of their dominant group, all other stakeholders will benefit.”⁸ But more and more firms realize that this narrow business model no longer fulfills the expectations of their strategically relevant stakeholders, including

shareholders. The need to shift to a new paradigm in strategic management is evident and has to be understood in the larger context of economic and social development.

Requirements for a new paradigm in strategic management

Historic nature of paradigms

The challenge of change is not only prevalent in reality but also in the sciences, and can be the kick-off for a paradigm shift. At any given period of time, scientific ideas are closely related to the dominant worldview. Worldview is defined by Habermas as the basic construct with which we interpret the world.⁹ Science is a social construct, as it is conceived by human beings. Like other social realities, it is subject to different systems of interpretation, and therefore different scientific worldviews have existed over time (see also the Appendix in this volume). Since the seminal work of Kuhn's *Structure of Scientific Revolutions*, there is a general understanding that there are no timeless and universal concepts of science or scientific methods that would satisfy all claims.¹⁰ Insights such as new scientific findings evolve, or conditions undergo extreme transformations when findings or changes cause anomalies in previous scientific explanations.

To understand such changes in scientific ideas, Kuhn uses the term "paradigm": "On the one hand, it stands for the entire constellation of beliefs, values, techniques, and so on shared by the members of a given community. On the other, it denotes one sort of element in that constellation, the concrete puzzle-solutions which, employed as models of examples, can replace explicit rules as a basis for the solution of the remaining puzzles of normal science."¹¹ This definition makes evident that each theory has underlying core values. Even though economic theory claims to be objective and not to rely on values, it is grounded in specific values.¹² Putnam calls such values epistemic.¹³ The epistemic values of a researcher impact why he selects a specific theory and which basic assumptions he presupposes. Putnam concludes with a historic overview of how researchers approach science: "Many who refer to values as purely 'subjective' and science as purely 'objective' continue to close their eyes to this same fact."¹⁴ In this realm he refers to Sen's book *On Ethics and Economics*,¹⁵ in which

Sen reflects on the basic assumption of self-interest of actors: “The idea that only self-interested values are rational is even harder to defend.”¹⁶

Origin of the economic paradigm

In the natural sciences in the last century, the confirmation and refutation of hypotheses were the ideal methodology, and objectivity was consequently in the foreground.¹⁷ It has also shaped the current understanding of the economic paradigm, which we will discuss in more detail in Chapter 2.

The understanding of the economic paradigm is originally rooted in the period of the Enlightenment. Adam Smith developed his famous concept of the invisible hand based on the liberal ideas of utilitarianism. It makes the assumption that the actions of individuals based on self-interest and market coordination lead to an increase in total welfare: “And he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention.”¹⁸ Adam Smith makes the moral assumption that human beings – and not the government – know best what makes them happy and under which circumstances. His theory is based on his observations of the political and economic developments in the eighteenth century.

In the course of development, the understanding of the economic paradigm with the basic assumptions of individual self-interest and the hypothesis of market efficiency still impacts the strategic management of firms today,¹⁹ the theory of the firm²⁰ and also shapes our current understanding of capitalism.²¹

Post-Enlightenment Capitalism

Until recently the underlying basic assumptions of the economic paradigm were accepted by many scholars and were seldom criticized with any effective results by powerful social movements. But this acceptance started to be questioned as stakeholders manifested dissatisfaction with economic developments (e.g. negative effects of globalization). Striking incidents of corporate scandal took place in 2003 (e.g. Enron) and later in 2008 in the financial crisis. The oil spill in the Gulf of Mexico caused by a drilling rig explosion in 2010 and the Fukushima disaster in Japan are further examples.

Since then discussions about a new understanding of strategic management, the theory of the firm and the capitalist system have taken place regularly, even at such prestigious events as the Academy of Management's annual meeting (see Chapter 2, p. 34) and at the conference of the European Academy for Business in Society (EABIS).²² In this context the responsibility of business schools is also being questioned, as most of them do not critically reflect on the dominance of the traditional economic paradigm.²³

Shortly after the wake-up calls mentioned above, scientists in the economic field began to discuss what the future of capitalism could or should be. Nobel Prize winner Stiglitz, for instance, claims that wrong basic assumptions are one of the main reasons for the financial crisis: "Conservative ideology, along with unrealistic economic models of perfect information, perfect competition, and perfect markets, fostered lax regulation, and campaign contribution helped the political process along."²⁴ In addition to these unrealistic models he questions the basic assumptions of self-interest of the actors: "Our rules and referees were shaped by special interests; ironically, it is not even clear whether those rules and referees served those special interests well. It is clear that they did not serve the national interests well."²⁵ He is quite clear about the boom of regulations taking place at the moment, and states that they are just of a cosmetic nature and not the solution for the real problems. Nobel Prize winner Phelps also questions the term "free market" and calls for more innovation in business: "Capitalism is not the 'free market' or laissez faire – a system of zero government 'plus the constable' ... If we still have our humanist values we will try to restructure these sectors to make capitalism work well again – to guard better against reckless disregard of uncertainty in the financial sector while reviving innovativeness in business. We will not close the door on systems that gave growing numbers rewarding lives."²⁶ There seems to be a growing agreement that traditional capitalism based on abstract models and basic assumptions such as self-interest and efficient market hypothesis is not the solution.²⁷

Mainstream thinking in strategic management, in the theory of the firm as well as in the understanding of capitalism, is challenged to move ahead to a modern way of thinking. Vidal calls this "Post-Enlightenment Capitalism": "If a Post-Enlightenment Capitalism emerges in response, it will require markets that function for the general interest as much as they do for the private interest, and

Cambridge University Press

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government, firms and civil society working on a scale of effectiveness the likes of which history has never before witnessed.”²⁸

Multi-paradigm concepts to reflect reality

To contribute to these diverse expectations, multi-paradigm concepts are being explored.²⁹ In this stream of thinking, scholars are trying to bring together aspects of different paradigms at a meta-level for a better grasp of reality. But if we are drawing on the bases and the assumptions of different paradigms we are confronted with incommensurability. Scherer and Dowling emphasize, “In modern times the problem of incommensurability has been recognized by all sciences especially since the term was introduced by Thomas Kuhn (1962, 1970) as a catchword for the assertion that one cannot reach a meta-level point of reference to decide objectively between competing theories from different paradigms.”³⁰

But Gioia and Pitre offer a solution to handle the issues of incommensurability: “The multiple-perspectives view implies a kind of meta *triangulation* not across methods *within* a single theory or paradigm, as is currently in vogue, but *across* theories and paradigms.”³¹ The authors emphasize that the methodological assumptions of subjective and objective are not clearly distinct notions but actually a continuum. To capture these blurred boundaries they label the parts of such continuums as “transition zones.” Our contribution to the stakeholder paradigm builds on Gioia and Pitre’s concept (see Chapter 5, p. 80).

Our contribution to the stakeholder paradigm

In our research we are motivated by the challenges mentioned above. We aim to contribute to the upcoming stakeholder paradigm for value creation based on a multiple-perspectives view.³² In today’s society, human beings are understood to combine their interest and purposes in different organizational forms from informal groups to highly professionalized organizations. Giddens deals with the origin and the development of such organizations in the course of history.³³ Every society has to address the issue of integration. In a simple, small society, social integration is made by face-to-face communication. In developed and increasingly large societies this kind of social

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integration is not possible anymore due to the complexity. Therefore, different kinds of organizations (e.g. firms, legal authorities, NGOs, specific stakeholder interest groups, etc.) are needed for mediation in large societies.³⁴ These different organizations are connected with each other through various interactions. Together they make up the whole of a society. Such organizations can develop the capability to be part of mutual value creation processes (see Chapter 4, p. 58). A vision for a strategy to achieve mutual value creation in society is required, and our aim is to contribute to it. This is the focus of this book.

Our theoretical and empirical journey of the last nine years has shown us that the Stakeholder View of Strategy, as described in the book *Redefining the Corporation*, to which we also contributed, was a development in the right direction.³⁵ But with respect to the changes and the challenges mentioned above it did not always go far enough. What we have experienced, primarily since 2002 when the book was published, is that if we want to advance the stakeholder paradigm, we not only have to consider stakeholders as potential risk or benefit providers for a given firm, but we have to think of the firm and the stakeholder interlinked in a network with each of them contributing to value creation. Stakeholders generally have to deal with issues that are similar to those of the corporations, or are involved in the development and use of innovative products or services. This fact emerged very impressively during our empirical investigations, where we talked with managers and stakeholders in semi-structured interviews in order to understand their perceptions of value creation. Managers increasingly acknowledge that stakeholder relations are a key element in their value creation process, and that it is not possible for the firm to fully control the complexly evolving stakeholder networks. Stakeholders not only provide potential benefits and risks to the firm, but very often they are highly qualified and experienced in the field they are active in. Others are impacted involuntarily by value creation processes. We also learned during the interviews with representatives of the firms and stakeholders that they are exploring new forms of interactions with each other when they engage in value creation.

We therefore have new material from our case research to present: as an example, pharmaceutical corporations, healthcare insurers and patient organizations have different and sometimes opposing perspectives on what is useful for advancing the health of patients. In the past,

the corporations and their stakeholders fought among themselves and lost sight of their common purpose of enhancing healthcare. Each of them tried to control the other's reaction to specific issues and thereby missed opportunities to advance healthcare for their patients. In the setting of our action research, they have started to realize that despite their different approaches, they also have similarities and common views. Building on these similarities has helped them to overcome the "old" management paradigm of controlling the other stakeholders, and has enhanced their ability to find new and innovative solutions together.³⁶

Path toward a new stakeholder paradigm

As discussed thus far, firms and their stakeholders are confronted not only with purely economic change but also with the growing complexities and dynamics of the social context in which they operate, as well as with more and increasingly differentiated expectations. The existing theories under the umbrella of the dominant economic paradigm are not sufficiently developed to tackle the economic and social changes as discussed above.

On the basis of these considerations, we propose a stakeholder paradigm for value creation that embraces how corporations and stakeholders can work together in networks, to create innovative products and service or innovative solutions for common issues. This suggests a new understanding about what stakeholders are, and the corporation's role in its stakeholder network.

In order to develop our understanding of a stakeholder paradigm (see Figure 1.1 for an overview), we will begin in Chapter 2 to analyze and compare according to specific criteria the basic assumptions of the economic theory of the firm and the dominant theories of strategic management. In this way, we can recognize the important strength of these approaches, and can also work out where they fall short.³⁷ These approaches are contributing elements to our understanding of the stakeholder paradigm. In Chapter 3 we discuss those elements of the stakeholder theory, on which we build our own understanding of the stakeholder paradigm. Chapter 4 looks at approaches already discussed in the literature of a stakeholder paradigm in strategic management. Applying the same criteria in Chapter 2, the basic assumptions of the two approaches, the stakeholder theory of the firm and

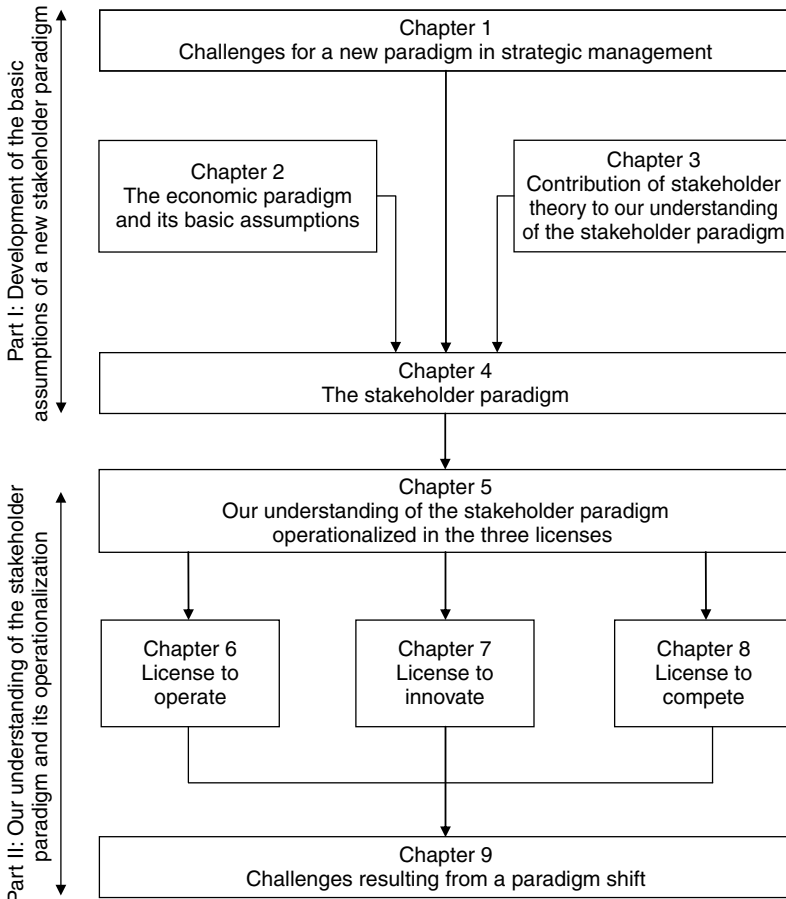


Figure 1.1 Structure of the current book

Stakeholder Capitalism, will be analyzed. Here the contributions to our understanding of the stakeholder paradigm will be identified, as will the further developments that we perceive as necessary.

The heart of the book is Chapter 5, in which we present our understanding of the stakeholder paradigm. Also, the differences in the basic assumptions from the economic paradigm will be pointed out. The operationalization of the stakeholder paradigm as we understand it will be developed by the three licenses: to operate, to innovate and to compete. These licenses are not exclusively the legal authorization

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for corporate activity, but rather a comprehensive entitlement for a mutual value creation process between firm and the stakeholders. The operationalization is supported by our empirical case research. In Chapters 6 to 8 we discuss how, in the perspective of the three licenses, the firms and the stakeholders engage in value creation with greater benefits and fewer risks for themselves and for each other. The basic assumption is that value creation based on mutuality in a network view is more valuable than satisfying pure self-interest in an unrelenting struggle for more individual profit. In the concluding Chapter 9, we address the question of how such a paradigm shift could come about, and what the resulting economic, cultural and legal/structural impacts might be.

This book seeks to stimulate a new approach to the understanding of value creation. In so doing, it places human beings and their quality of life at the center of the consideration. The paradigm change we propose is not a revolution, since it should build on, maintain and increase previous approaches to value creation. Rather, it is a fundamental evolution, in which the mutuality of value creation in networks is the primary concept.