Strategic Management: A Stakeholder-Based Approach

1. Introduction and Problem Outline: The Need for and the Difficulties Involved in Strategic Management and Performance Evaluation in NPOs

Over the last decade many nonprofit organizations (NPOs) have felt increasing pressure to become more performance oriented (Gray et al., 1998). A number of reasons, including the increased competition for funds, financial constraints, and more demanding stakeholders, have forced NPOs to think about evaluating their existing programs and developing new strategic orientations. That is the main purpose of strategic management. It deals with clarifying the mission of an organization, with setting clear long-term objectives, and with formulating steps to achieve them (Harrison et al., 1995). It seems to be obvious that NPOs should use the tools developed for business organizations to improve and evaluate their performance, but there are a number of difficulties in simply transferring management instruments from the for-profit sector to the nonprofit sector.

Nevertheless, conspicuously few authors\(^1\) have discussed the issue of strategy development and performance evaluation of NPOs – a fact that is probably attributable to the specific problems involved in this issue. The next section, therefore, discusses characteristics specific to NPOs concerning strategy development and performance evaluation. The following section introduces three models of strategy building that serve as the basis and point of reference for a model developed by the authors, which is presented in the subsequent section. The final section discusses the advantages of this model and challenges faced in applying it.

\(^1\) Exceptions are, e.g., Matul/Scharitzer (2002); Moss Kanter/Summers (1987: 155); Murray/Tassie (1994).
2. Specific Features of NPOs Concerning Strategy Development and Performance Evaluation

Nonprofit organizational strategy and effectiveness are always multidimensional and will never be reducible to a single measure (Herman & Renz, 1999). This is partly because NPOs normally do not have a primary objective such as maximizing profits or a dominant stakeholder such as the owner, as do for-profit organizations. Often NPOs have multiple goals to fulfill (Oster, 1995). Additionally their goals are frequently intangible (Shoichet, 1998).

Many nonprofit organizations experience trouble implementing strategic management because of the lack of operational goals (Horak et al., 2002: 4). Strategic planning can generally be seen as a process to produce fundamental decisions about general questions such as what business an organization is in, how it wants to achieve its main goals, and what values and beliefs can be seen as central to the organization. These decisions typically concern the mission, mandates, management, products, cost, financing, and design of an organization (Herman, 1994: 5). Therefore, one part of strategic management has to be the definition of goals and evaluation criteria. For that reason in particular, nonprofit organizations should not neglect the process of formulating goals and implementing a strategic planning process (Horak et al., 2002: 4).

Furthermore, NPOs are typically subject to the – often widely divergent – demands and expectations of different groups of stakeholders. Commercial enterprises are also influenced by a number of stakeholders, but the owner is without doubt the most important stakeholder. Therefore conflicts like the ones occurring in NPOs are normally resolved in favor of the owner. The NPO, however, has to survive amid diverse pressures from multiple stakeholders who want to support or threaten the organization. They want to see it continue, diverge, grow, shrink, or even vanish (Shoichet, 1998). This conclusion has been drawn by authors writing about specific types of NPOs such as welfare associations (e.g., Olk, 1995: 10; Pankoke, 1995: 12), voluntary organizations (Harris, 1998: 13), and social change organizations (Brown, 1988; Covey/Brown, 1985), but also in studies about NPOs more generally (Horak et al., 2002: 4; Horch, 1995: 16; Herman/Renz, 1997; Moss Kanter, 1987: 17; Simsa, 1999: 18; Simsa, 2001; von Eckardstein, 1999: 19; Zauner, 2002: 153; Feehery, 1997: 21). Thus there is not a single objective measure of organizational effectiveness independent of the judgments of the various stakeholders (Herman/Renz, 1997).

All these factors are problematic with regard to strategy development. Concerning performance evaluation, another problem arising for NPOs is
the fact that in some cases the beneficiary cannot place a value on the results of a certain service, because he or she is physically or psychologically unable to do so (Marik, 1997). In the for-profit sector the price realized at the market is the ultimate yardstick for performance measurement and reflects at least to a certain degree the preferences of the customer. Therefore qualitative aspects come only second, whereas in the nonprofit sector – since the outcome is often not purchased on the marketplace - the qualitative aspect of performance measurement tends to be the dominant one. Furthermore, the usefulness of financial data as central performance indicators is very limited for nonprofit organizations. In the for-profit world, however, financial results are important and widely recognized as the criteria for measuring an organization’s performance. NPOs, while by necessity concerned about financial effectiveness, often have a much stronger orientation towards non-financial results due to their mission. Various authors (Murray, 1994: 5; Hermann, 1997: 50; Gray, 1998: 389) report that NPOs often measure inputs rather than outcomes to assess performance. Outcome-based evaluation is believed to be important, but it is uncharted territory for most NPOs (Gray et al., 1998).

3. Models of Strategic Management for the For-Profit Sector as a Base

The concepts of strategic management in for-profit organizations cannot be used in nonprofit organizations without adaptation (Gmüür, 2000: 3).

- Financing: NPOs are dependent on several donors with different interests. Therefore the NPO has to legitimize its programs with respect to different funders. This is one reason stakeholder management is central to the strategic management process.
- Variety and ambiguity of goals: It is not possible to reduce the goals of NPOs to a simple criterion of economic success. Goals concerning the financial dimension are therefore only sub-goals to the primary mission.
- The value of tradition: Tradition is very important for nonprofit organizations because it is a main source of trust in and identification with the organization. This leads to less flexibility compared with firms.

For these reasons, the political dimension of strategy development and performance measurement is of particular importance. This means paying special attention to the interests of NPO stakeholders and to the process
whereby performance measurement is developed and implemented. In recent years, international business administration researchers and practitioners have developed several models that can be usefully applied to performance measurement and monitoring of NPOs from a political perspective, provided that they are appropriately modified for this purpose.

**The Balanced Scorecard According to Kaplan and Norton**

Kaplan and Norton (1996) offer an instrument that was developed for business enterprises. Their intention is not so much to grasp aspects of the political process in the formulation of objectives and their realization; rather, their goal is to look at more than only the financial performance of a corporation for its shareholders, but to draw attention also to its foundations and sources by which financial performance is controlled. In this sense, they propose to consider not only financial results, but also processes within the corporation, i.e., corporate learning and growth. In addition to the owners who are the dominant stakeholders, they introduce also the customers as a second class of stakeholders who are a source of corporate success. In the context of measuring and controlling the performance of NPOs, the Balanced Scorecard approach means that performance must be regarded as a complex phenomenon involving different stakeholder groups. Another important factor is that internal processes and organizational learning are seen as an expression of the ability to achieve change and improvement. They are also instrumentalized for the medium- and long-term success of the shareholders. The authors propose to define operationalized objectives with respect to these criteria. The Balanced Scorecard approach thus provides a comprehensive management model that enables a rough differentiation by stakeholder, albeit not as its primary objective.

**The Excellence Model of the European Foundation for Quality Management**

The European Foundation for Quality Management (EFQM) model is based on the quality management approach (Krzal, 1999). Its goal is to provide a matrix of criteria for the measurement and promotion of the quality of enterprises. It can be used for organizational development through measuring and developing quality. Since it differs from the Balanced Scorecard approach insofar as it includes additional stakeholders such as employees and society in general, it might be useful for adaptation in NPOs.

In addition to the stakeholder categories, two other dimensions of quality are included: the *results dimension* and the dimension of the so-called *enablers*, i.e., the factors that generate quality. The differentiation here is
between quality results with respect to the expectations of different stakeholder groups, and the factors that should enable an organization to achieve results. Within the enabler criteria, processes and leadership are of central importance. The addition of further stakeholder groups is worth noting; however, the predetermined weighting of the two quality dimensions (results and enablers) is based on plausibility considerations and conventions for which no further explanation is given, so that in the final analysis it must be termed arbitrary (v. Eckardstein, 1999: 429).

*Figure 1: Balanced Scorecard*


One advantage of the EFQM model is that it provides a matrix with a rather well differentiated range of performance criteria. The uniform weighting helps to draw comparisons between several organizations. Within the scope of each performance criterion, there is a high degree of autonomy in deciding how to define and measure specific performance and quality criteria. The EFQM model can work in principle as a framework for assessing the performance of NPOs in a political perspective, provided that the predetermined weighting of the individual criteria is disregarded and, if necessary, additional stakeholders are introduced.
Figure 2: The Excellence Model of the European Foundation for Quality Management


The Accountability Scorecard Model

Nickols (1998) proposes an Accountability Scorecard, which he developed directly for application by NPOs. Its fundamental concept is that key stakeholder groups should be integrated into performance management. In his example, the key stakeholders are clientele, staff, suppliers, management and society at large; the societal dimension is operationalized as a positive impact on the general level of education. Nickols asks what stakeholders contribute to the organization, and, conversely, which inducements the organization offers to its stakeholders in return for their contributions. It calls for a balance between inducements and contributions. Nickols calls for a dialogue between the organization and the various stakeholders to enable them to reach an understanding on the trade-offs of inducements and contributions. However, the question of how the organization can deal with the contradictory expectations of different stakeholders remains open. Compared to the other two models described above, the Accountability Scorecard approach focuses most prominently on the multiple stakeholder perspective and thus on political aspects. Each stakeholder group is awarded an autonomous position.
4. Integrated Model of Stakeholder-Oriented Strategy Development for NPOs

The authors of this chapter propose a model of stakeholder-oriented strategy development and performance measurement. It integrates ideas of the models described above but does not establish the owner as the most relevant stakeholder nor fix the number of stakeholders that should be included and the weight of their expectations. Therefore, it is more open for the special situation of a given NPO.

In this model stakeholder expectations are at the center of strategy development and performance assessment. Stakeholders are individuals, groups and organizations (and in some cases, society at large) that, from the perspective of the organization, have legitimate or enforceable expectations vis-à-vis the organization. These expectations must be compared with and
related to the organization’s interests and scope for action. Since the political perspective provides the background for the model, power relationships between the NPO and its diverse stakeholders are a significant factor to be considered.

**Process of Strategy Development**

The description focuses on two aspects: one of them is what has to be done, i.e., which steps have to be taken as factual issues; the other political perspective focuses on the question of managing the political processes within the organization and between the organization and its stakeholders, i.e., the management task of how to design and manage the process.

*Figure 4: Steps and participation in the process of strategy development*

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<thead>
<tr>
<th>What To Do</th>
<th>How To Do It</th>
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<tbody>
<tr>
<td>1. Analysis of the present situation</td>
<td>Decision on the degree of participation;</td>
</tr>
<tr>
<td>2. Surveying the expectations of relevant</td>
<td>Which stakeholders and members of the NPO</td>
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<td>stakeholders</td>
<td>are to be included in which step in which way?</td>
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<td>3. Internal processing of stakeholder</td>
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<tr>
<td>expectations</td>
<td></td>
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<td>4. Transposition of the response strategy into</td>
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</tr>
<tr>
<td>operational objectives and performance</td>
<td></td>
</tr>
<tr>
<td>criteria</td>
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<td>5. Evaluation, reflection and external</td>
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Source: Own Figure

Apart from useful methods regarding process structuring and management, every step requires decisions on participation, i.e., which members of the organization should be included, and how they should be included. Fact-finding and decision-making may be tasks exclusively for the top management, or they may be organized as a collective, internally negotiated process. Still, the judgment of the organization’s leaders will eventually be decisive in these choices. With a view to the creation of internal transparency and, as far as possible, common perspectives, it is advisable to include at least representatives of the various organizational units in the assessment process. Usually, a more participatory approach improves acceptance and thus the willingness of staff to implement decisions. Moreover, there will be many cases in which top management will have to rely on the expert knowledge of members or units. However, “top-down” decisions, which can reduce stress and produce welcome clarity, may also function as a useful expression of leadership, especially in NPOs whose scope for action is
restricted by an excessive orientation toward its staff (see also v.Eckardstein/Simsa, 2002).

Frame of Reference for the Model

The central point of reference for any strategy development and performance measurement is an organization’s mission, i.e., its self-defined, overarching task. Measuring and controlling performance always refers to achievement or failure relative to the mission goals. Operationally, the situation in which the organization acts is determined by three sets of factors: the constituent factors of the organization, relevant stakeholders, and external factors. Constituent factors of an NPO include (a) the resources of the NPO, i.e., “tangible” features, such as its size, financial resources, and composition, number and qualification of staff; (b) reality concepts of the organization, i.e., relevant ideologies and patterns of explanation; (c) products, i.e., tangible and intangible benefits that the organization provides for its stakeholders; and (d) processes, i.e., the modes by which the organization performs.

Another relevant aspect of an organization’s situation is those stakeholders who currently receive some kind of product or service from the NPO or, conversely, provide products or services to an NPO. Usually, there are far more relevant stakeholders in the case of NPOs than are taken into consideration in business administration models.

External factors are the conditions under which NPOs operate, but on which they have no or only indirect influence. A general rule cannot be formulated regarding which external factors should be included in the analysis. For example, national social policy strategies and the resulting changes in social legislation or government spending may be extremely important for NPOs who engage in social work. Another example is the development of the new media, which may impact the conditions under which many NPOs work.

Steps in the Process of Strategy Development

First Step: Analysis of the Present Situation

The first step in stakeholder-oriented performance measurement and control is to assess the present situation on the basis of the following questions:

- What are at present the constituent factors of the organization?
- Who are the stakeholders for whom the organization performs services, and what are the services in each case? Conversely, what
does the NPO need from which stakeholders? How can the stakeholders be weighted in accordance with their importance for the NPO?
- What are the external factors that influence the organization at present?

Figure 5: Constituent factors and stakeholders as determinants of the NPO’s strategy

Finding answers to these questions is not a uniformly easy or difficult task. While it is comparatively easy to identify the organization’s resources, it may be much more difficult to confirm consensus on its mission. Is the original founding idea still valid? An analysis of these questions may even lead to a tentative answer to the question, “How do we know if we are successful?”.

Experience has shown that the assessment of significant environmental conditions and the identification of the relevant internal and external stakeholders and their relative importance for an NPO tend to be exercises with some potential for conflict. This makes clear that the first step in the process is not only an assessment in a technical sense, but also a political process in which values and interests play a role. Thus, the best approach at this stage is to involve as many staff members as possible.

A well-tested and relatively simple method is to visualize results. In an initial brainstorming session, all persons, groups and institutions that (may) have claims on the organization are listed. Then their relative importance from the organization’s perspective is assessed.
Second Step: Surveying the Expectations of Stakeholders with Regard to the Organization

The second step is to identify the expectations of the stakeholders that have been identified as relevant. Often there are assumptions and conjectures regarding the expectations of the various stakeholder groups, which are only rarely put to the test.

This analysis of stakeholder expectations should not be misinterpreted as a merely mechanical process that produces an objective guidance for actions by the NPO management. Various methods can be used. The methodology of empirical social research provides a broad range of survey instruments. The selection of survey techniques depends on the available resources and on the nature of the relevant stakeholder groups. Examples of methods to identify stakeholder expectations are customer surveys (e.g., by telephone, questionnaire, interviews), staff surveys, interviews with selected stakeholders, or discussions and focus groups. In the case of stakeholders that cannot express their views, such as “society at large” but also individuals who can hardly articulate their views (e.g., mentally handicapped patients), the NPO has to act as their representative in defining expectations.

Third Step: Internal Processing of Stakeholder Expectations

Surveying stakeholder expectations is an interim step. It provides the raw material, which then needs to be processed by the NPO. This is necessary for a variety of reasons. The expectations of different stakeholders are often conflicting: many expectations are too high and cannot be reconciled with the NPO’s resources; in some cases, they may also be opposed to the objectives of the NPO. In a subsequent step, the organization therefore has to develop strategies for responding to expectations, i.e., it must decide how and to what extent expectations of the various stakeholders will be fulfilled. This decision has to be based on the analysis of the organization’s scope for action. The question to be answered is: To what extent is the fulfillment of stakeholder expectations compatible with the NPO’s objectives, financial resources, physical capital resources (Barney, 1991), and existing processes? These questions refer to the resource-based view of strategy development. Particular attention must be paid to the prior weighting of the importance of different stakeholders. Possible response strategies may be categorized as follows:

- **Negotiation**: Here the expectations of individual stakeholders are set against the scope of action and goals of the organization and modified in a bargaining process. A typical example for this is the negotiation of service contracts with government authorities.
providing public funds. The organization’s knowledge regarding the needs of clients, as well as information about contradictory expectations, may be used as a solid basis for arguments against the expectations of public authorities so that modified contracts can be negotiated.

- **Acquiescence:** If stakeholders are in a highly influential position, it may be necessary to meet their expectations without the organization’s having any say in the matter. One example may be the expectations of a dictatorial regime that permits activities by humanitarian organizations only on condition that they refrain from organizing protests against human rights violations. Less extreme examples include dealing with major donors, but frequently also key members of the organization whose interests are unconditionally accepted within the organization. The only questions are what the NPO can get in exchange for its acquiescence, and from where and how it can secure such an exchange.

- **Ignoring:** Many expectations cannot be met. This may be due to limited resources, but expectations may also conflict with the objectives, strategies or ideologies of the organization. Clear-cut decisions in this respect have a stress-relieving effect. For example, the expectations of public funding authorities are often met where financial administration is concerned, whereas they are ignored with respect to policy content.

- **Reframing:** In this case, certain demands are re-interpreted. This may mean that needs of stakeholders which are “hidden behind” overt expectations may be fulfilled in a way that differs from what is explicitly demanded. For example, the explicit expectation may be the provision of care in nursing homes; reframing may mean providing support for relatives, neighbors or others to make the provision of care possible in the patient’s own home.

The process of internal decision-making may again be structured in different ways, i.e., with different degrees of participation of the organization’s staff. Because of the decision’s central strategic significance, however, management is ultimately responsible for it.

Fourth Step: Transposition of the Response Strategy into Operational Objectives and Performance Criteria

After decisions have been taken about how to respond to stakeholder expectations, the next step is to operationalize objectives and set performance criteria. The fundamental question is how to determine whether expectations
have been fulfilled as agreed.

This step must relate to concrete products or actions; it is therefore useful to operationalize objectives as far as possible. If the objectives are very general, then as a minimum, indicators may be defined that permit conclusions to be drawn as to the degree to which the objectives have been realized. For example, media attention, measured by newspaper articles, may be defined as an indicator of the impact the organization is making on society.

Usually, criteria are set by top management. With regard to the criteria that are extremely difficult to measure, it is advisable to conduct an internal discussion at which the various staff groups have the opportunity to voice their opinions. The basis for decisions on participation is, on the one hand, information on the stakeholders’ criteria, and, on the other hand, the specific expertise of staff members or organizational units. The defined objectives and performance criteria have to be broken down and at the same time communicated internally. They serve as input for the process of Management by Objectives (MbO), which should follow the decision on relevant goals. Particular attention should be given to resource constraints and the consequences for the NPO’s financial situation. (MbO is a very common management tool which is characterised by the setting of goals for all departments of an organisation and for all its members or employees. The function of these goals is to serve as orientation and stimulus for organizational and individual performance and as an instrument for coordinating the activities of the organizational departments and members.)

Fifth Step: Evaluation, Reflection on the Underlying Criteria and External Communication of Organizational Performance

Organizational performance must be reviewed on the basis of the predefined objectives and criteria after a certain agreed-on period of time. Performance results should always be communicated to all members of the organization. On the basis of the insights gathered from the analysis of expectations, a decision may then be taken on how to communicate the organization’s performance to the different stakeholders. Private donors whose expectations focus mainly on success in the organization’s activities will probably have little interest in detailed documentation of the financial administration of the organization.

On the basis of the experience gathered in this process, the underlying criteria should be reconsidered. Useful questions to ask in this context include, among others: Did we forget important stakeholder groups? Do the selected criteria work in practice? Have we correctly assessed stakeholders’ responses? Has the situation changed since the first stage, and does the organization have to respond to such changes, and in which way?
5. Benefits and Challenges

One central benefit of this model of stakeholder-oriented strategy development is that it adapts the strategic controlling approach for use by NPOs. This makes it possible for an NPO to harmonize strategy development with performance measurement and to relate this to operational management tasks, thus achieving a closed NPO management model.

This management model is based on the (political) stakeholder approach. Compared to other models it is much more open as regards the type and number of stakeholders, as well as their relative weight and position, because it is not based on predetermined priorities, but rather makes these decisions an intrinsic part of the model. Moreover, the model enables NPOs to explicitly state their objectives. NPOs are often characterized by ambiguity and lack of clear goals and objectives. Defining objectives, by way of negotiation or otherwise, can contribute to improving the overall clarity of goals within the organization.

Furthermore, the model creates the basis for a clear documentation of objectives and performance, but the NPO does not have to communicate the documentation externally in its full complexity. If, how and to whom documentation is provided has to be decided on the basis of the known stakeholder expectations. Decisions on how to respond to the expectations of different stakeholders not only create clarity, but also have a stress-relieving effect. No organization is able to meet all expectations fully and equally, but ignoring demands is easily seen as an individual failure if there are no clear decisions in this respect.

Finally, performance is determined proactively, that is, the organization does not wait for an evaluation from outside, but sets performance criteria for itself in accordance with relevant environments. NPO performance is particularly difficult to evaluate by standardized criteria. Furthermore, the analysis of stakeholder interests may also be used in negotiations with stakeholders. For example, documented expectations or contradictions can be used in arguments to reject or modify demands.

The challenges involved in the effective application of the proposed model are twofold. Firstly, it may require considerable resources – for this reason, it will often be impossible to follow an ideal course of action. In certain stages, for example, a collective, organization-wide decision-making process may be judged useful, but may be too costly or time-consuming. Neither will it always be possible to analyze stakeholder interests in the theoretically most desirable way. Secondly, effective use of the model’s instruments requires high sensibility and qualification as regards process structuring. The management must decide, for example, when to involve

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3 See the chapter on evaluation in this volume.
which staff members or units of the organization in the process, and which instruments to apply for assessments, analyses and decision-making.

Suggested Readings

Horak, Ch. et al. (2002): Ziele und Strategien von NPOs. In: Badelt, Ch. (ed.): Handbuch der Non-Profit-Organisationen. 3rd ed. Stuttgart

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Horak, Ch. et al. (2002): Ziele und Strategien von NPOs. In: Badelt, Ch. (ed.): Handbuch der Non-Profit-Organisationen. 3. Aufl. Stuttgart


Strategic Management

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