

# **Third Generation Quality Management**

## **The role of stakeholders in integrating business into society.**

David Foster  
Associate Professor  
Faculty of Business, RMIT University  
PO Box 2476V Melbourne, Australia 3001  
(email) [david.foster@rmit.edu.au](mailto:david.foster@rmit.edu.au)

and

Jan Jonker  
SOM Research Fellow,  
Nijmegen School of Management, University of Nijmegen  
PO BOX 9108, 6500 HK Nijmegen – Holland  
(email) [janjonker@wxs.nl](mailto:janjonker@wxs.nl)

### **ABSTRACT**

*This contribution outlines the development of quality theory through various stages to the point where it now recognises the impact of external groups and individuals on the output of quality products and services. In particular, it articulates how the developments in stakeholder theory has coincided with the development of a theoretical framework for quality management and how stakeholder involvement relates to the output of the organisation. It examines some of the implications of this re-orientation and aims to describe tomorrow's emerging stakeholder model of quality. Finally, it argues that the new conceptualisation represents a generational change as it has fundamental ramifications for the nature of organisations and the way they maintain and evaluate quality. The differences between the generations are characterised and examined to demonstrate their potential significance.*

**Keywords :** stakeholders; quality; management; corporate social responsibility

## **1. Introduction**

The notion of quality, which has been around for more than a century, seems to be moving into a new phase. Having commenced as an object-oriented measurement and control device, it has passed through a number of phases where the emphasis was on expansion and integration of all aspects of organizational management. While the origins of quality theory were firmly embedded in the quality of the output (of either a product or service), in the last few decades it has become much more concerned about the overall management of the organisation. The significance of these changes suggests that the quality movement has passed through what can be loosely described as its first and second generations.

It is argued here that we are now entering a third generation where notions of accountability and responsibility are blending into the quality framework. Recent research has begun to analyse the effect of relations with external groups and individuals on the way the focal organisation is managed. At first, this investigated bilateral relationships between groups/individuals and the organisation. Very recently, that has been extended to include an analysis of the multi-lateral relationships that exist between the focal organisation and the external world. This has been called the stakeholder view of quality theory. What might appear at first sight to be yet another add-on, may really represent the start of a fundamental (re)orientation of the meaning of quality.

This paper outlines the way the management of quality has evolved over the years and the nature and implications of those changes. Its main contribution is to demonstrate how substantially different the 'Third Generation Quality Management' is to those that preceded it and to raise awareness of its implications.

## 2. Changes to Quality Management

The concept of quality has played a prominent role in the business management literature since work began on it in Japan in the 1950's (Deming 1986; Juran 1988). The key message of the so-called 'quality movement' has been that management must focus on improving organisational outputs to provide superior customer value (Clarke and Clegg 1998).

However, the concepts and ideas coming under the broad umbrella of quality have evolved over the last few decades from a focus on inspection of the finished output (product) to consideration of the whole management system and how this affects the nature of the output (product). Integral to this evolution has been the shift in focus from viewing quality as inherent in the product itself to one which focuses on quality as a characteristic of the management system which is responsible for producing the finished product (Hardjono, ten Have et al. n.d.). The other major change that has occurred has been the move away from an almost total emphasis on manufacturing and products to the application of quality concepts and ideas to services (Haskett, Sassar et al. 1990; Lovelock 1992).

Total Quality Management is often described as a philosophy of management that strives to make the best use of available resources and opportunities by constant improvement. Given the acknowledged diversity of definitions (Oakland and Sohal, 1996), and the desire of organisations to assess their progress in implementing the many ideas and techniques, there has been a search for a standard or framework against which organisations may be assessed or compare themselves. This has resulted in a range of such frameworks which include the US Baldrige Award, the UK Quality Award, the European Excellence Model and the Australian Quality Awards (Evans and Lindsay 1995). Although developed independently, and often reflecting the needs and particular circumstances of the country in which it operates, they all have a lot in common. These include a focus on the organisation's processes, quality management system, human resource management, results and customer satisfaction (Oakland and Sohal 1996 : 97).

One of the key characteristics of this second generation of Quality Management has been the emphasis on the holistic nature of management. This is reflected in the use of 'total' in the TQM literature and the holistic nature of the quality awards. However, the way this has been implemented makes quality management look like a loosely coupled set of mini-theories, tools and techniques in which coherence is difficult to discern. Foley, *et. al.* (1987) argue that while the basic philosophy, principles and techniques of quality are sound, problems arise due to "the lack of explicit statement (theory) of enterprise behaviour based on quality. ." (1987 : 2). They argue that such a theory of management based on quality would have its roots in economics, science, metrology and statistics and would help to overarch and link other theories of management. This should ensure that quality is viewed systemically and be understood as more than the sum of its parts. Unfortunately they were not able to articulate such a theory based on quality as it is currently conceived.

However, at least one aspect was clarified. Much of the quality management literature assumes implicitly that the objective of the enterprise is the continuous pursuit of improving quality. However, Foley, *et. al.* (1987) argue that :

"Continuous improvement of quality of service and/or product cannot be the end to which competitive business is directed. Whilst every business wants to remain viable . . . continuous improvement and customer satisfaction can only be a means to an end and not an end in itself. There may be times in the life of an enterprise where, to satisfy its survival (profit) criterion, it will be necessary to discontinue or slow down the rate of quality improvement activity, however clear it might be that those activities would increase quality of product and/or service and customer satisfaction" (1987 : 3).

In other words, none of the principles or techniques of quality are ends in themselves but should be seen as potential contributors to the goal of maximizing long-term value. As a descriptive theory it suggests that firms who undertake quality improvements do so in order to improve the long-term value of the firm. Foley (1987) therefore proposes the following theory of quality management :

“Maximization of quality in the short term (subject to the condition that a certain level is achieved) will maximize the long term value of the firm” (1987 : 62).

Interestingly the ‘theory’ uses the term ‘enterprise value’ rather than profit. Profit is regarded as too restrictive and suggests that the only beneficiaries of an enterprise are its shareholders. This, as will be seen below, leaves the door open for the extension to a stakeholder theory of quality.

### **3. A Stakeholder Model of Quality**

Following the seminal work by Freeman (1984), the importance of stakeholders has been emphasised by many scholars (Evan and Freeman 1988; Preston and Sapienza 1990) and promoted in many reports (eg. Royal Society for the Encouragement of Arts 1995). This has been associated with a corresponding attempt to re-conceptualise the nature of the business enterprise to one that has been called the stakeholder theory of the firm (Wheeler and Sillanpaa 1997; Clarke and Clegg 1998). Implicit in this is the idea that survival depends on the firm’s relationships with the external world.

Building on this, Foley, *et. al.* (1997) suggest that quality management should have an explicit focus on shareholders, suppliers, customers and staff and not simply on internal operations. They therefore developed the foundations of a stakeholder model of quality even though this did not include the external groups envisaged by Freeman (1984).

The idea of looking beyond the internal operations of the organisation is not new to the quality movement. The Quality Awards in most nations have alluded to this fact in several of their criteria. For example, in the Baldrige Award this area is considered under leadership and is titled ‘Corporate Responsibility and Corporate Citizenship’. Under this criteria an applicant must “describe how the company includes its responsibilities to the public in its quality policies and improvement practices” and also how the company “leads as a corporate citizen in its key communities” (Brown 1993). This takes a very broad view of corporate responsibilities including such things as “environmental protection, charity, support for the arts, support for education and help of (*sic*) the community” (Brown 1993 : 113). The Australian Quality Awards also acknowledges the importance of this under its leadership category and is titled ‘Leadership in the Community’.

Likewise, some of the early conceptual literature on quality made reference to aspects of quality that extend beyond the operations of the firm. For example, Hoyle (1994) differentiated between three dimensions of quality : product quality, business quality and organisational quality. Most of the research to that time had focused on product quality with its emphasis on the extent to which products and services meet the needs of specific customers. Organisational quality refers to the extent to which the organisation maximizes its efficiency and effectiveness through minimizing waste, good human relations, etc. This has been the focus of much of the TQM work in the 1990s. Business quality, on the other hand, is about “the extent to which the business services the needs of society” (Hoyle 1994 : 11). This latter dimension extends the focus beyond the internal operations to suggest that long term enterprise development must recognise the significance of its relationship to the broader society.

Quality management has therefore begun to adapt to the stakeholder view of the firm and include consideration of external influences and groups. Foley (1999) attempts to make this external focus explicit while at the same time reconciling it with the traditional view of business as a profit-maximizing organisation (Friedman, 1962). He develops a stakeholder model of quality management that seeks to incorporate the external stakeholder who can influence what happens in the organisation and the nature of their issues or concerns.

Foley (1999) begins by looking at the way the community regards business. He suggests that despite assertions to the contrary, there is evidence that business does not want to be seen as simply self-serving and is very conscious of being a ‘good corporate citizen’. Business enterprises often express concern about the interests of other stakeholders besides its shareholders such as employees, customers, the local community, etc. (Charkham 1994). Despite this, (Foley 1999) asks the rhetorical question whether being

sensitive to community, environmental and other issues is really part of the aim of business? In other words, do businesses have a duty to do more than make profits? His answer is no. “The business enterprise exists to provide goods and services in order to make profits; if it is not making profits, its *raison d’être* is violated” (Foley 1999 :91). He does go on to point out, however, that :

“this is only another way of saying that in seeking to provide the conditions for profit making, the business enterprise will ignore staff, suppliers, customers, the environment and the community interest at its peril. *It is not the purpose or aim of business to provide personal fulfilment, spiritual development, a clean environment or full employment; business enterprise is concerned with the development of its staff and the interests of its other stakeholders only to the extent that they contribute to the aim of business*, which is to create sufficient profit to satisfy the needs and expectations of shareholders . . . . Viewed in this way, the social ‘responsibility’ of business is not the business aim but a *business strategy*; a way of determining direction and creating and maintaining relationships and structures which enhance performance” [Foley, 1999 : 92; emphasis in original].

Based on this conceptualization, Foley (1999) develops a ‘Stakeholder Model of Quality’ that is useful in considering organisational effectiveness or “health”. As the name implies, the model suggests that effectiveness is concerned with meeting the needs of stakeholders. Foley (1999) believes that *inter alia* business enterprises should be developing ways to identify and meet the needs of stakeholders and the ways to present information on actions taken to meet those needs. However, given the aim of business, this occurs only in so far as it contributes to the long-term survival of the firm.

Stakeholder Issues/ Outputs	Customers	Management	Staff	Suppliers	Shareholder	Conservation Groups	Wider Community
Financial Probity							
Risk							
Quality							
Health & Safety							
Owner Value/Profit							
Environment							
Knowledge							
Ethics							
Innovation							
Strategy/Plans/Planning							
Data Integrity							

Figure 1 : Foley’s Stakeholder Model of the Business Enterprise

(Foley 1999) suggests that for stakeholders to be satisfied they must have sufficient information about the “state of the enterprise and plans for future actions (in terms relevant to each *and providing confidence in the integrity of that information*) to ensure that they will not take action detrimental to the enterprise” [Foley, 1999 :107 ; emphasis in original].

The Stakeholder Model is presented as a matrix with one axis representing the stakeholders and the other representing the various issues or outputs of concern to stakeholders (see Figure 1). The latter are the determinants of stakeholder behaviour (*ie.* “the issues or outputs on which they base their behaviour in relation to that business” (1999 : 104)). These issues become “the strategic imperatives of the enterprise”. In other words, the stakeholder model of quality focuses on the whole operation of the organisation, and this focus is in terms of those issues which are of relevance to stakeholders. Effectiveness (or quality of management) is judged by the organisation’s ability to adapt to changing circumstances (or new initiatives) in a manner acceptable to stakeholders. This will ensure survival.

What he presents is a model that has incorporated both (and distinguished between) the aim and the strategy of business. The aim is to deliver value to the shareholders. The strategy is to do this in a manner that ensures acceptance by the other stakeholders. The model acknowledges the existence of parties

(stakeholders) other than shareholders and their potential for affecting the achievement of performance measured as shareholder value.

#### 4. A Third Generation of Quality?

The stakeholder model of quality as presented attempts to incorporate the increasing necessity for management to respond to the needs and expectations of increasingly diverse groups while still delivering shareholder value. Many of the principles and techniques of quality management have been concerned with the needs and expectations of particular groups that have been acknowledged for a long time as part of the traditional managerial model (Freeman 1984). These include groups such as customers, employees and suppliers. The stakeholder model provides a theoretical justification and conceptual framework within which the quality aspects of relationships with other, more diverse, groups can be explicitly considered and addressed in a holistic manner.

The stakeholder model of quality can therefore be seen as fundamentally different from models that have come before. Indeed, it is so different that it can be seen to represent an emerging third generation of quality that will gradually replace those that came earlier. Its focus is still on quality but the way in which quality is addressed is different. Moreover, for the first time it is grounded in an explicit theoretical framework. A preliminary list of the characteristics of this so-called third generation, and the way it differs from the previous conceptualisations, are outlined in Figure 2. While each characteristic may be debated individually, when considered as a whole the difference between the ‘generations’ becomes apparent. As can be seen, the table provides for the addition of other characteristics to be added to the list. This will clarify the fundamental differences even further.

Generations	First Generation	Second Generation	Third Generation
<b>Characteristics</b>			
<b>Perspective on Quality</b>	Process	Holistic	Relational
<b>Focus</b>	Measurement	Assessment	Consensus
<b>Type of Action</b>	Reactive	Proactive	Engagement
<b>Criterion for success</b>	Reliability	Efficiency & Effectiveness	Accountability
<b>Orientation</b>	Production	Policy and Planning	Relationships
<b>Basic Assumptions</b>	Control	Manageability	Inter-connectedness
<b>Change</b>	Improvement	Transformation	Transaction
<b>Stakeholder Relationships</b>	Non-existent	Peripheral/Emerging	Embedded
<b>Others??</b>	?	?	?

Figure 2 :Characteristics of the Three Generations of Quality Management

The stakeholder model which characterises the third generation can be seen as being within the ‘quality family’ as its foundations rest squarely on business processes. However, rather than it simply introducing an additional set of processes to under-pin the relationship between the organisation and its stakeholders, the model requires fundamentally different types of processes that hitherto have not been part of normal business practice. These processes are not necessarily based on a commonality of interests or concerns or on an unequivocal outcome or objective. They are processes that must be capable of dealing with complex issues that are often ideologically based with problematic, indeterminate answers. These issues have been described as ‘wicked’ problems for which solutions are neither clear nor agreed.

However, it does more than this. Moving quality management beyond a strictly internal process orientation, the expanded concern for stakeholder’s needs and expectations raises the question of what

these external relationships mean for the *raison d'être* of the organisation itself. Processes are designed for specific purposes or to achieve particular ends. The fact that they now seek to meet the needs and expectations of a broader range of stakeholders implies some degree of responsibility to those groups or individuals. As noted above, Foley makes a distinction between business aim and business strategy with the former being identified as the longer-term survival of the firm. Further development of the model may need to revisit this to tease out exactly what this means. At present, it is an egoistic concept; further development may suggest that survival itself is characterised by a more inclusive ideal. As the film titled 'On the Beach' (filmed right here in Melbourne) demonstrated, what is the point of being the last survivor in a world that it utterly devastated?

There is increasing evidence that an enterprise does (and should) operate within a societal network of stakeholders that have the power to influence directly or indirectly the success of the enterprise (Zadeck, 2001). Operating in such a societal context requires a fundamental re-orientation regarding the role and position of business. In the very near future society's provision to business of a 'licence to operate' (Royal Society for the Encouragement of Arts 1995) will no longer be based on profit alone. Businesses will have to become part of the complex web of society and deal with a multiplicity of issues and concerns as expressed by stakeholders of varied backgrounds and interests. Consequently, the quality of management should be assessed in terms of the way in which it engages with this multiplicity of issues.

## References

- Brown, M. G. (1993). *Baldrige Award Winning Quality*. Milwaukee, ASQC Quality Press.
- Charkham, J. (1994). *Keeping Good Company : A Study of Corporate Governance in Five Countries*. Oxford, Clarendon Press.
- Clarke, T. and S. Clegg (1998). *Changing Paradigms : The Transformation of Management Knowledge for the 21<sup>st</sup> Century*. London, Harper Collins.
- Deming, W. E. (1986). *Out of Crisis*. Cambridge, Massachusetts, MIT.
- Evan, W. M. and R. E. Freeman (1988). A stakeholder theory of the modern corporation : Kantian capitalism. *Ethical Theory and Business*. T. Beauchamp and N. Bowie. Englewood Cliffs, New Jersey, Prentice Hall: 75-93.
- Evans, J. R. and W. M. Lindsay (1995). *The Management and Control of Quality*, West Publishing Company.
- Foley, K. J. (1987). *Report of the Committee of Review of Standards, Accreditation and Quality Control and Assurance*. Canberra, Department of Industry, Technology and Commerce.
- Foley, K., R. Barton, et al. (1997). *Quality, Productivity and Competitiveness. Strathfield., Standards Australia*.
- Foley, K. (1999). *What is Quality Management?*, Centre for Quality Management Research, RMIT University.
- Foley, K.J. (2001). From Quality Management to Organisation Excellence: Further Thoughts on the Contemporary Business Enterprise. *Proceedings 2<sup>nd</sup> MAAOE International Conference* (Versailles – Fr), pp. 197 – 214
- Freeman, R. E. (1984). *Strategic Management : A stakeholder approach*. Boston, Pitman.
- Freeman, R.E. (1999). Divergent Stakeholder Theory, *Academy of Management Review*, No. 24, pp. 233-236
- Friedman, M. (1962). *Capitalism and Freedom*. Chicago, University of Chicago Press.
- Hardjono, T., S. ten Have, et al. (n.d.). *The European Way of Excellence*. Belgium, European Commission.
- Haskett, J., Sassar, E., et al. (1990). *Service Breakthroughs*. New York, Free Press.
- Hoyle, D. (1994). *ISO9000 Quality Systems Handbook*. Bodenhams, England, Butterworth Technical Publishing.
- Heugens, P., F. van den Bosch and C. van Riel (2001), Stakeholderintegratie: Werken aan wederzijds verstrekkende relaties, *M&O*, No. 4, pp. 5 – 27
- Jonker, J. (2000), What has society got to do with it? Tracing the emerging third generation notion of quality, *Proceedings 6<sup>th</sup> ICIT Conference* (Ayer – Scotland), pp. 428-433
- Juran, J. M. (1988). *Juran on Planning for Quality*. New York, The Free Press.
- Lovelock, C. H. (1992). *Managing Services : Marketing, Operations and Human Resources*. Englewood Cliffs, Prentice Hall.
- Oakland, J. S. and A. S. Sohal (1996). *Total Quality Management : Text With Cases*. Melbourne, Butterworth-Heinemann.
- Prahalad, C.K. and G. Hamel (1999). The Core Competence of the Corporation, *Harvard Business Review*, May-June, pp. 79 – 91
- Preston, L. and H. Sapienza (1990). "Stakeholder management and corporate performance." *The Journal of Behavioural Economics* 19(4): 361-375.
- Royal Society for the Encouragement of Arts, M. a. C. (1995). *Tomorrow's Company*. London, RSA.
- Svendsen, A. (1998), *The Stakeholder Strategy: Profiting from Collaborative Business Relationships*, Berrett Koehler San Francisco
- Wheeler, D. and M. Sillanpaa (1997). *The Stakeholder Corporation*. London, Pitman..