indian management

The Journal of AIMA
ALL INDIA MANAGEMENT ASSOCIATION

JANUARY 2020 VOLUME 59 ISSUE 1 PAGES 92 ₹60

A SPENTA MULTIMEDIA PUBLICATION

VALUE IN A STAKEHOLDER WORLD
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BEYOND THE TANGIBLE
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PURSUIT OF VALUE

Not just a profit-driven journey

Value in a stakeholder world

Deciding on stakeholder focus and measuring tradeoffs between the various groups are among the most challenging tasks in the value creation journey.

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For decades, much of the corporate world has focused on maximising value for a relatively small group of shareholders. Increasingly, this focus has expanded to the welfare of a broader group of stakeholders, including employees, customers, suppliers, and society at large.

In response, managers must consider how to go beyond merely maximising share prices. They must increasingly concern themselves with employment levels, wages, customer satisfaction, and broad societal benefits like environmental protection and a sense of social purpose.

Although all companies can improve on these types of goals, many successful management teams have already realised that companies that take care of their employees and consumers tend to deliver better results for shareholders too. We demonstrated this in research published earlier this year, in an article titled 'Companies that Do Well Also Do Good'[1], on CFO.com.

We studied the total shareholder return (TSR), including stock appreciation and dividends, of companies in *Fortune*'s Most Admired Company ranking, which includes 50 global 'all-stars' determined by a survey of executives, directors, and securities analysts. The criteria used were social responsibility, quality of products and management, investment value, and the ability to attract talent. We similarly studied the *Forbes*' Just 100, which recognises companies that pay workers fairly; treat customers well and protect their privacy; produce quality products; minimise their environmental impact; give back to the community; commit to ethical and diverse leadership; and create abundant job opportunities.

Over five years, the companies on the Forbes list delivered median TSR that was 12.6 per cent above the median for the S&P 500 index. And the companies on the *Fortune* list did even better, at 26.4 per cent. For the 23 companies that made both lists, the median cumulative TSR was fully 41.5 per cent higher than the median of the index.

These results show a positive relationship between shareholder value and the social benefits a company provides, though, of course, they do not infer causality. Is there evidence that companies that deliver good for society do better for shareholders because of it, or in other words, that investing in employee and customer satisfaction can pay off over time?

Some soft evidence for this argument may be found by looking at Nordic and Scandinavian markets, where stakeholder-friendly capitalism has been practised for decades. A recent article in *The New York Times* notes that Nordic equities over the last 50 years have outpaced American ones over the same period.[2] This comparison suggests that we might see this socially responsible strategy

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as a potential working model of stakeholder-based capitalism, in which stakeholder value may be seen as a strategy for driving shareholder value over time. In fact, many would argue that shareholder and stakeholder interest actually align over a suitably long time horizon.

To add to these findings, environmental, social, and governance (ESG) research has shown that, in some industries, ESG initiatives may indeed lead to better performance, relative to peers. A recent study, for example, showed that banks that outperform peers on sustainability metrics outperform their peers financially as well.[3]

While these findings provide more support for the notion that social good leads to strong shareholder value creation, there remains the possibility that financially successful companies can simply afford to be better to stakeholders.

Size of the pie, size of the slice

The principles behind stakeholder primacy are commendable, but putting them into practice inside a company can be difficult. Shareholder value has the advantage of being a single goal that can be the foundation for making tradeoffs. But the multiple goals involved in managing stakeholder value make optimisation far less straightforward.

For example, what if we can put $10 in the pockets of shareholders by taking $8 away from employees, perhaps by offshoring some jobs? We need to be able to go beyond the size of the pie, and include information on the different slices.

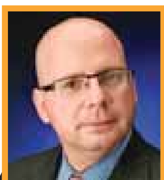
How can we measure value created for employees? We could look at the growth in the number of employees. Taking this further, how about the average pay gap between our employees and those in similar jobs in the local community? Or, maybe companies should measure the total dollars of excess salary over market, so that they consider the number of employees 'and' any pay premiums or discounts. But does this mean adding a job that pays a market wage is not worth anything? It is a complex issue, to be sure.

Measuring the value created for customers also requires an objective framework. Consider a pure commodity like cardboard or bulk chemicals, and assume you have developed unique manufacturing processes that allow you to profitably price your product below market. The difference between the value of the product, as perceived by the customer, and the price paid is referred to by economists as the consumer surplus. So, the value created for customers is simply the number of units multiplied by this surplus.

By analysing demand curves that indicate the average or median value consumers ascribe to their products, companies could potentially work out the size of this consumer surplus and measure tradeoffs. But it can become overly complex, for example, if instead of providing the same product for less, we supply a better product for the same price.

Further, measuring tradeoffs 'between' stakeholders is likely the most challenging aspect to consider. Walmart provides 'everyday low pricing', which is an enormous benefit for low-income customers. But, to achieve this, they have historically paid relatively low wages, to the detriment of employee stakeholders. If they raised wages and then had to raise product prices, can we say stakeholder value has increased despite customers losing their surplus?

This is likely to remain the biggest question mark around stakeholder value creation. In the end, companies will likely have to decide internally which stakeholders they want to prioritise, and how to measure value created for these groups. But in the absence of absolute facts, and standardised measures



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to gauge social impact, here are some guidelines for companies to consider when trying to establish a focus on stakeholders.

Guidelines for instilling a stakeholder focus

- The most important business objective is to create value, and doing so requires some form of differentiation—either through delivering a superior product or service, or by delivering it more efficiently than competitors.
- Consider the social purpose of your company—how and why the organisation creates value for stakeholders. Companies should take actions to communicate their stated purpose and the benefits they provide to stakeholders and society at large.
- Identify key stakeholders and the benefits the company seeks to provide to them. Companies that are serious about stakeholder primacy should establish internal metrics to track their progress and the impact on key stakeholders. These results can be communicated to both investors and other stakeholders in order to align the company's investor base with its social mission.
- Whenever one stakeholder group can benefit at little to no cost to other stakeholder groups, take on such initiatives, as they will 'always' be good for the company.
- Be careful of tradeoffs that may seem good in the short run, but could have negative long-term consequences. Investments in R&D and brand-building advertising, for example, should be preserved as well as staff training and other less obvious investments.
- Consider performance and value creation over a suitably long time horizon to ensure alignment of stakeholder and shareholder interests. Top-tier value creation in the short term means little, if this involves eroding the long-term trust and admiration of consumers, employees, the community a company operates in, and society at large.

By following these guidelines, companies can refocus their efforts on stakeholder interests, which tend to result in more shareholder value creation over the long term. IM

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Michael Chew is an associate, Fortuna Advisors, and edited the forthcoming book, *Curing Corporate Short-Termism*.

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