PART III

The Value Creation Tool Kit
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How can business unit heads, chief financial officers (CFOs), board members, EH&S managers, and other business professionals help to create value for shareholders and stakeholders? Part III outlines a process and a set of tools that managers can use to pursue the financial bottom line while effectively addressing social and environmental issues that are important to the company’s future. The process and tools are designed to build agreement among such diverse constituencies as business unit heads and EH&S managers and thus enable companies to create business value in ways that are more robust than those used in traditional shareholder strategies.
Chapter Ten

Introduction to the Tool Kit

This chapter introduces a tool kit to help business managers implement strategies for creating sustainable value. It covers the following key points:

- The concept of sustainable value
- Reframing business value to include stakeholders
- Rethinking stakeholders and their relationship to business
- The organization of the tool kit

The Concept of Sustainable Value

The core concept behind the frameworks and tools is that the financial value created by a business is always associated with a stakeholder value that can be either positive or negative. Positive stakeholder value is created when a business adds to the capital or well being of the individuals and constituencies it impacts. Negative stakeholder value is created when a business reduces their capital or undermines their well being.¹

We can illustrate the difference between creating negative stakeholder value and creating positive stakeholder value by using the example of an aggregates company operating in a relatively dirty extractive industry:

- The negative stakeholder value case: The aggregates company operates stone quarries in ways that negatively affect the local community
and ecologies through dust and noise pollution and poorly restored spent quarry lands. It does only what is required by law. There is little or no communication or coordination with the local community and NGOs.

- **The positive stakeholder value case:** The company operates stone quarries with standards for dust and noise control that are beyond compliance levels. It restores and rehabilitates spent quarry lands through reforesting and through reintroducing plant and animal species according to a plan codesigned with the local community.

In the positive stakeholder value case, the aggregates company benefits from more favorable permitting terms (faster permit approvals for extensions, permits of longer duration), reduced risk of community opposition to quarrying activities, and higher land values once the spent quarry site is sold. All these benefits translate directly into bottom-line profitability.

In every industry and sector, for every product or service, a range of stakeholders is impacted by a business’s activities at multiple points along the value chain and thereby contributes to the company’s profit opportunities or threats. Consider, for example, a company that makes industrial business-to-business products such as chemical dyes sold to the textile industry. In this company’s production process, wastewater and auxiliary chemical residues are an economic and an environmental cost. Various stakeholder groups are impacted differently by environmental performance improvements to the process, but all are affected. The textile producer who purchases the dye values lower environmental clean-up costs and higher efficiency in the dye application process. The end customer values improved color uniformity; local communities value cleaner site operations; employees value a less toxic work environment; and investors and NGOs may value a smaller environmental footprint.

Stakeholder value may be a more obvious factor for companies such as Patagonia or The Body Shop, whose business-to-consumer products have a clear social or environmental dimension. Outdoors people and consumers of natural skin and hair products may be predisposed to pay
more for positive social and environmental attributes in the products they buy.

Yet stakeholder value as a business proposition applies equally to business-to-consumer products that are by nature socially and environmentally damaging. Consider the automobile in its gas-guzzling sport-utility vehicle (SUV) embodiment compared to hybrid gas-electric or fuel-cell cars. Hybrid vehicles still create a negative impact on the environment, but compared to existing automotive technology they offer significant environmental and social benefits. These benefits—natural resource conservation, less air and noise pollution, and improved safety—are valued by a range of stakeholders at multiple points along the value chain. Such benefits then translate into business value for the industry leaders. (For anyone who doubts the imminent arrival of hybrid cars into the automotive mainstream, consider that in late 2002, GM announced it would offer hybrid power in five models by 2007, and Toyota announced that a broad range of its vehicles would be based on the hybrid platform by 2012.2)

Finally, stakeholder value as a business proposition is increasingly important in services such as retail banking (see Chapter 8) and insurance companies (for example, AVIVA plc). In many cases, customers have recently demonstrated increased willingness to pay more for social and environmental performance.

**Reframing Business Value to Include Stakeholders**

In a wide range of industries, stakeholders are proving to be key drivers of business value. Traditionally, business has overlooked stakeholders in this role, preferring to rely heavily on ownership rights and access to resources as key determinants of its wealth-generating capacity. The problem of value creation now requires reframing in a way that goes beyond issues of access to capital, labor, technology, and location.

In 1980, Michael Porter’s *Competitive Strategy: Techniques for Analyzing Industries and Competitors* helped shift the meaning of business value away from ownership rights and resource access and toward industry structure. Value creation (or destruction) came to be seen in terms of the
threat of new entrants and substitute products, negotiating power with buyers and suppliers, and industry rivalry. Now the need is to expand the value-creating universe further to include an even broader array of stakeholders who contribute to the wealth-creating capabilities of a company. The concept of sustainable value expands the value-creating universe to include all key stakeholders.

The next section provides a vivid illustration of expanding value for the automotive industry. According to a 1999 report by the Union of Concerned Scientists, the use of personal vehicles is one of the most environmentally damaging activities in the world. It is only natural that companies offering a way to reduce the automobile’s negative impacts on society and the environment, in an economical way, should find financial rewards. Although the transition to “clean and green” personal transportation is still in its early stages, the business case for it is instructive.

Creating Sustainable Value: Fuel-Cell Vehicles

A company’s sustainable value depends on its ability to meet its customers’ needs profitably while satisfying social expectations. For any of the leading companies in the car and truck industry today, senior managers in charge of running the business might reasonably conclude that they are doing a good job on both fronts: their products move their customers and their families, haul materials, and provide other personal mobility solutions safely and efficiently, thereby greatly benefiting society. Although not everyone would agree, a large majority of people in the world might support this view. Indeed, the record is impressive, whether measured in terms of improvements in fuel efficiency and safety, in comfort and road performance, or in percentage of junked automotive parts that can be recycled.

But when those same managers look 20 years into the future, a different picture emerges. Stakeholder impacts loom darkly on the horizon, and the promise of incremental improvements in technology does nothing to dispel the managers’ worry. Consider what we know about how internal combustion engine (ICE) cars and trucks impact society and the environment—and then project 20 years forward, to a time
when an expected 300 million additional vehicles are expected to be on the world’s roads, reaching as many as 1.1 billion vehicles in total.

Negative stakeholder impacts begin with the relatively low energy efficiency (about 25 percent) of the ICE itself. Additional negative impacts are the result of a chassis design that combines the ICE with predominantly mechanical systems for steering, braking, and throttling. Cars typically weighing 3,000 to 4,000 pounds are designed to move four persons or fewer, contributing to energy inefficiency as well as to safety risks, noise, and urban congestion.³

For the industry as a whole, the manufacture and use of its products translates into the following environmental and social impacts:

• Degradation of ecosystems resulting from ozone-depleting releases; emissions of global warming gases such as carbon dioxide, carbon monoxide, and nitrogen oxides; and other chemical releases to the air.
• Solid waste and water contamination generated in the manufacture of steel, batteries, paints, plastics, lubricants, and other materials.
• Safety risks and noise emissions from heavy, mechanically complex vehicle designs.
• Degradation of public health and quality of life.
• Unsustainable resource use. The automotive sector is a significant contributor to the depletion of fossil fuels, consuming between one-third and one-half of the world’s oil when the manufacturing process is included.

By contrast, hydrogen fuel-cell cars and trucks are twice as energy efficient as their ICE counterparts and emit nothing worse than water vapor. Although it takes energy to extract hydrogen from sources such as oil or natural gas, the fuel cell’s high efficiency more than compensates for the energy required to accomplish the extraction. And eventually, the energy required to produce the hydrogen for fuel cells could come from renewable sources such as biomass, hydroelectricity, solar, wind, or geothermal energy.

When integrated with drive-by-wire technology, cars and trucks can be designed to be much lighter. The design has fewer constraints
because a mechanical drivetrain is no longer needed. The space and weight freed up contribute to a potentially safer, more comfortable, more personalized, less expensive vehicle. In the GM conception, drive-by-wire fuel-cell vehicles (called Hy-wire, for hydrogen-by-wire) consist of an integrated skateboardlike chassis containing the fuel cell, electric drive motor, hydrogen storage tanks, electronic controls, heat exchangers, and braking and steering systems. The vehicle’s body sits on top of the chassis, fitted together much like plug-and-play computer components. A simple visit to the dealer could enable the owner to pop up the existing body—say, a sports sedan—and replace it with another body such as a minivan, while keeping the same chassis. From the consumer’s perspective, it’s somewhat analogous to being able to switch the bezels on a Swatch: you get several possible models with one base unit.

The potential impact of fuel cell and drive-by-wire technological innovations on shareholder and stakeholder value is shown in Figure 10-1. Business value includes stakeholder value as a factor of performance. A conventional ICE-based product creates relatively moderate shareholder value while eroding stakeholder value for the reasons just discussed. The fuel-cell product has a clear positive impact on stakeholder value and has the potential to raise shareholder value—although, as GM CEO Rick Wagoner has said, the economics of fuel-cell vehicles are still unclear. The added benefits of drive-by-wire designs could further improve both stakeholder and shareholder value.

Although the financial returns of mass-producing drive-by-wire fuel-cell vehicles remain unproved, we can discern the logic of increasing shareholder value from improved stakeholder value. Consumers who value the clean emissions, fuel efficiency, safety, comfort, and personalized designs of such vehicles will eventually pay more for them as the costs of air pollution and environmental degradation rise. The higher starting torque also provides a classic performance benefit: faster acceleration from a stop. Even though the full range of benefits is not yet available, early indicators of hybrid sales show faster than expected growth (see, for example, “Hybrid Cars Zip Off Lots,” a Reuters news-wire story by Timothy Gardner, August 19, 2001).

Vehicle manufacturers will also benefit from materials savings and
the lower capital intensity inherent in the greater design freedom afforded by the drive-by-wire and stackable fuel-cell technologies. Modular design could lower development costs through economies of scale of the base chassis models required to fit multiple body types. Having a smaller variety of components—such as can be achieved with fuel-cell stacks that can be scaled up or down—will further reduce costs.

Shareholder value will be created for those companies that succeed in shaping the automobile industry’s rules of the game in their favor or who are better prepared for a sudden shift in consumer or regulatory requirements. Should there be a rapid transition to ultra-low-emission vehicles (ULEVs) or hybrid or fuel-cell vehicles, car manufacturers that achieve a cost advantage in any of these technologies may find that they now have a significant new competitive advantage. One analyst talks about Toyota’s “raising the bar for the industry in the emerging environmental vehicle field.”

Raising the bar for the new technologies translates into competitive barriers to entry—an important traditional source of shareholder value.
Two of the industry leaders who are betting big on the win-win of the new technology are General Motors and Toyota. While other automobile companies are currently outsourcing fuel-cell technologies to companies such as Ballard or United Technology Corporation, these two companies already have their own proprietary fuel-cell technologies. GM’s concept, called AUTOnomy, made a debut at the Paris auto show in September 2002, using the skateboard-type chassis design. GM is also planning to offer hybrid power in various stages of development for selected light trucks and SUVs within a few years. A hybrid version of the Saturn VUE is expected as early as 2005—a much more mainstream vehicle than the current Honda Insight. Dennis Minano, former vice president of public policy and chief environmental officer at GM, told me in an early 2003 interview that, in his view, GM had learned a great deal about how to pioneer a new generation of vehicles. “There is an advantage to being first to market with a fuel-cell vehicle if it is also affordable and competitive in performance terms,” he said. “A fuel-cell vehicle that offers the broad range of features corresponding to how people make everyday decisions about personal mobility will create value for customers, shareholders, and society.”

Toyota has been in the hybrid market since 1997 with the Prius and is now prototyping fuel-cell vehicles based on the Highland platform. As reported in The Green Business Letter in its December 2002 issue, Toyota is now transitioning to a new phase, “sort of in between early adopter and mainstream,” according to Ed La Roque, Toyota’s manager of national advanced technology vehicles. With 36,000 hybrid vehicles already sold (at a profit on each vehicle), together with a public commitment to have its entire product range based on hybrid technology by 2012, Toyota is well positioned to create sustainable value for its shareholders and stakeholders in the new century.

There are still considerable barriers to realizing the vision of shareholder and stakeholder value presented here for the car and truck industry. The problems of storing hydrogen safely onboard the vehicle and reworking the infrastructure to supply energy to fuel-cell vehicles remain critical to mainstream success. However, the outlook is now much improved.
Rethinking Stakeholders and Their Relationship to Business

Companies know how to measure performance in terms of shareholder value. They are not used to measuring performance along the stakeholder dimension. Yet stakeholders increasingly represent a potential source of hidden value or risk to the future of the business.

The reframing of value creation does not focus on stakeholder issues as ends in themselves. The purpose is not to pursue social and environmental causes independent of economic payback. Such would be the case if the company operated only along the vertical axis in Figure 10-2, as it would with philanthropy. Instead, reframing value creation serves to implement an integrated approach to more significant and sustained benefits for the company, as shown by the diagonal arrow.

Al “Chainsaw” Dunlop notoriously repudiated the rights of stakeholders, adding, “You are not in business to be liked. . . . If you want a friend get a dog. I’m not taking chances; I have two dogs.” But in the minds of many business leaders, stakeholders have gone from having illegitimate claims on business value, to having a limited voice primarily focused on ensuring compliance, to being external actors that

Figure 10-2. A Sustainable Value Approach Integrates Multiple Dimensions
businesses must tightly control, to being value-creating partners with whom the company can collaborate for mutual benefit. Today’s mindset in business is hardly uniform, but it is changing. A review of the evolving perceptions of stakeholders helps give context to the tool kit and how it will be used.

Ann Svendsen, author of *The Stakeholder Strategy: Profiting from Collaborative Business Relationships* (1998), argues that 60 percent of corporate value is tied to such intangible assets as reputation, goodwill, employee know-how, and stakeholder trust. Cap Gemini Ernst & Young estimate that about 35 percent of investment portfolio decisions are driven by such intangibles as innovation, quality, customer relationships, leadership capability, alliances, brand reputation, and environmental performance. Whatever the exact number, there is consensus that intangibles are a growing part of market capitalization and longevity. According to Svendsen, “Research now shows that companies that treat their employees, customers, suppliers and communities well are twice as likely to be around in the long term.”

Svendsen makes a useful distinction between “stakeholder management” and “stakeholder collaboration.” In the former type of relationship—fragmented, ad hoc, linked to short-term business goals, and focused on controlling outcomes—companies appear more business-focused yet paradoxically create lower value from their stakeholder engagements. They manage stakeholders in a hierarchical control model in which relative power determines whether the company or its stakeholders achieve their respective aims—when one wins, the other typically loses. In this light, Monsanto’s attempt in the late 1990s to limit how (and when) farmers could use its genetically modified corn and Roundup Ready® soybean seeds could be seen as a failed attempt to manage consumer and environmental impacts by tightly controlling the outcomes. This is not the view of stakeholders or of their relationship to a company implied in the sustainable value model.

In the sustainable value model, the focus is on building relationships, creating opportunities, and generating mutual benefits linked to long-term business goals. In collaborative stakeholder relations, there is an explicit coherence among economic, social, and environmental objectives.
Stakeholders in the Sustainable Value Model

Stakeholders are the individuals and constituencies that contribute voluntarily or involuntarily to the company’s wealth-creating capacity; they are potential beneficiaries and/or risk bearers of the company’s activities; as the term implies, they have a stake in the business.

The criteria for identifying significant stakeholders of a company are threefold:

- They supply the resources that are critical to business success.
- They place something of value “at risk” (e.g., capital, their own welfare, their careers) that is directly affected by the fate of the business.
- They have sufficient power to affect the business performance either favorably or unfavorably.

It is the dynamic interaction and productive relationships with customers, employees, suppliers, investors, and other stakeholders that build a company’s capacity to create future wealth.

“The locus of value in stakeholder relationships shifts from contracts (such as in legal compliance) and transactions (such as in philanthropic donations) to trust and cooperation. Companies are beginning to realize that conflict models that assume that increases in stakeholder value are always offset by reductions in shareholder value will lead to conflict and a draining of resources. On the other hand, win-win models based on pooling resources and a mind-set of cooperation can lead to shareholder value creation even when the company and its stakeholders appear to be on opposite sides of the fence.

When a company and NGOs cooperate, the former may gain access to technical expertise or community goodwill that it may not possess in-house, while the NGOs learn to be more efficient and bottom-line oriented. Weyerhaeuser’s work to assess its forestry practices on the Tolt watershed in Washington State in the 1990s benefited from the

company’s relationship with representatives of the Tulalip Tribes, the Seattle Water Department, the Washington Environmental Council, and a number of other NGOs. The results were reported as “ground-breaking” in terms of fish savings, satisfying both Weyerhaeuser and some of its most outspoken critics. Lafarge’s cooperation with the WWF on climate change goals has helped it explore product mix alternatives, such as adding C-chemistry fly ash and slag to its traditional cement, at a faster rate than it might have done without the partnership, thus helping the company to reduce manufacturing costs and meet new greenhouse gas emission targets.

In today’s complex world, a stakeholder perspective adds significant value to conventional strategic perspectives that focus primarily on resources and industry dynamics. Figure 10-3 summarizes some of the sources of shareholder value from collaborative stakeholder relationships.

In effect, rethinking stakeholders as potential sources of shareholder value is leading to a redefinition of the corporate entity. James Post, Lee Preston, and Sybille Sachs offer the following view of the corporation based on the collaborative stakeholder model:

The corporation is an organization engaged in mobilizing resources for productive uses in order to create wealth and other benefits (and not to intentionally destroy wealth, increase risk, or cause harm) for its multiple constituents, or stakeholders.

The tool kit is designed with this integrated, multiple stakeholder definition in mind—with one important qualifier: the corporation’s primary responsibility is still seen as delivering sustainable value to its shareholders. To do so, however, companies are turning to stakeholders as a relatively untapped source of innovation and value creation—a key source of business advantage in the twenty-first century.

**The Organization of the Tool Kit**

Creating sustainable value through collaborative stakeholder relations requires specific financial, strategic, and measurement competencies
that help integrate stakeholder impacts into the value delivery capability of a company. Based on our experience in working with Global 1000 companies, these competencies fall into *eight disciplines*, described in the following chapter.

We have structured the tool kit to help companies excel at sustainable value creation. The eight disciplines can also easily be fitted to change-management processes designed to help companies deal with discontinuous change. Relevant change-management processes are discussed in Chapter 12.