Expanding the Value Horizon:

Stakeholders as Source of Competitive Advantage

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Stakeholder value – based on the economic, environmental, and social impacts a company has on its diverse constituents – is a rapidly growing source of business advantage, fuelled by rising societal expectations and the swelling ranks of social change agents newly empowered by information and communication technologies. Taking advantage of this source, however, requires a change in the mindset of leadership and a disciplined approach to integrating stakeholder value throughout the business. This article describes the rise of stakeholder value as a key component of business success. It offers a practical approach to building enduring advantage through simultaneously creating shareholder and stakeholder value.

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Stakeholder value, based on a company's economic, environmental, and social performance, is a new and largely untapped source of competitive advantage that is likely to grow in the years ahead. Declining traditional sources of advantage[1] and rising societal expectations of business are creating new strategic opportunities. Although much has been written about stakeholders[2], we propose to re-frame the subject in terms of competitive advantage using an approach that systematically integrates stakeholder considerations into business strategy and operations. Such an approach can assist companies to reduce costs, differentiate products and services, develop new markets that serve unmet societal needs, and influence industry "rules of the game." Success in capturing these opportunities requires a new leadership vision and the courage to understand and engage a diverse set of constituencies.

Part I of this article defines stakeholders and traces their rise as a factor of business advantage. Part II describes a framework for measuring business performance. In this framework the value created by a company is sustainable only when it is positive for shareholders *and* stakeholders. Part III outlines a disciplined process for managing stakeholder value – the "how to" of sustainable value creation.

Part I: The New Societal Context for Business

Until recently, when stakeholders were taken into consideration, it was usually with regard to the company's moral principles or values. Companies such as Procter & Gamble in the US, Philips in Europe, Tata Industries in India, and *zaibatsu* companies such as Matsushita in Japan considered stakeholders central to their business mission over fifty years ago, but the cultural context in that era was very different and corporate paternalism often played a key role.

In recent decades, massive changes in the competitive landscape have increased stakeholder power in nearly every industry, driven by information and communications technology, low cost transportation, globalization, and a tighter interface between business and civil society. Consumers, employees, investor groups, and non-governmental organizations (NGOs,) to name just a few stakeholders, are now able to instantly access data about a company and make informed choices about its products, services, shares or employment opportunities. A committed cadre of these stakeholders is willing to act against companies who fail to meet new societal expectations and reward those who do. As a result, the need to take a systematic approach to managing stakeholder impacts has become an important business challenge in addition to a moral one.

Who are stakeholders?

Anyone who risks something of value (such as capital, health, welfare, or happiness) in interacting with a company can be said to have a *stake* in it[3]. From a business perspective, a stakeholder can be considered to be a person or group who can help or hurt the company. Stakeholders who wield sufficient power to materially affect business performance either favorably or unfavorably are important to the company's future; they are *key* stakeholders.

A stakeholder is anyone with value at risk from interaction with your company

In Figure 1, we distinguish between economic and societal stakeholders. Economic stakeholders participate directly in the value chain by adding economic value to the company's final product or service. Societal stakeholders are external to the value chain, but they can nevertheless exert significant influence on a company's value add, as is often the case with governments and NGOs.

Figure 1. Stakeholders

The power of economic stakeholders is well documented in the case of customers, employees, and suppliers; they are often important strategic partners for companies increasingly dependent on collaboration and networking to create and sustain competitive advantage[4].

Societal stakeholders have entered the business equation much more recently and with greater resistance on the part of the business community.

Local communities and NGOs have only recently become broadly recognized as important to corporate success on issues such as governance, environmental protection, human health and quality of life[5].

The rise of stakeholder power

During much of the twentieth century, value destruction for stakeholders was considered to be an externality. It could take years and even decades to hold a company accountable for economic, environmental, or social harm. Companies could generate negative consequences to society because these consequences were perceived to be external to the business or because the perceived benefits outweighed the costs. Examples of products and services that caused societal damage over decades before being either banned or controlled include leaded interior decorative paint and asbestos (both of which were sold in the US for over 50 years) and tobacco. Similarly, worker safety and human rights problems in companies such as Rio Tinto plc were allowed to persist for decades.

Advances in technology have increased stakeholders' ability to organize, communicate, and act

With advances in information and communications technology, the cycle time for identifying and internalizing negative stakeholder impacts has been shortened. A company's impact on a stakeholder group in any part of the world is often instantly communicated across the globe, with direct consequences for its ability to conduct business. A signal moment occurred in 1995 during the controversy over the disposal of Shell's Brent Spar oil-platform, when TV images of young women activists being doused by water canons were shown on prime time networks. The impact of the Brent Spar incident on Shell's reputation was compounded by the environmental and human rights issues surrounding its activities in Nigeria. In an effort to restore its reputation as a century-old industry leader, Shell created a set of General Business Principles leading to its well known corporate responsibility policies known as "People, Planet and Profits." Unfortunately, its recent oil-spills in the communities of the Ngoni people in the Niger Delta and its admission that it had grossly overstated its reserves have continued to tarnish the company's reputation. On the day Shell announced it had materially overstated its reserves (January 9, 2004) its share price fell by 7.5% and the credibility of its management was severely shaken.

Globalization and instantaneous communication of information, exploited by a cadre of highly committed and effective NGOs[6], have contributed to the heightened risk of negative publicity associated with a single event. Rising societal expectations for corporate responsibility have created a new class of socially-responsible investors, customers, and employees and, more generally, a broader public awareness of human health and ecological risks. For a demonstration of how activist stakeholders are generating public pressure on companies they target, try conducting a Google search of the company names Nike, Esso, Wal-Mart and Home Depot. In the top ten results are websites for "Boycott Nike," "Stop Esso," "Wal-Mart Watch" and "Home Depot sucks for sourcing and selling old growth lumber." These sites, over 5 years old in the Nike case, contain specific complaints and demands for change, and they offer visitors easy ways to get involved.

The rise of complex and amorphous NGO alliances, such as the grouping of over one hundred NGOs that targeted COSTCO in 2003 for its mega-store project on a historic site in Mexico[7], serves as an emerging indicator of a global business environment that is on the cusp of fundamental change. Increasingly, previously marginal actors create opportunities to realize their collective potential as networked actors in ways unimagined in the past.

Expectations of corporate social responsibility are not likely to diminish. Environmental concerns such as industry-induced climate change and water scarcity will grow in importance, as will fears about carcinogenic and mutagenic substances found in a broad range of today's manufactured materials and products. The social exclusion of billions of people from global markets and the economic conditions that contribute to instability and terrorism are becoming central preoccupations for a business world that depends on orderly markets.

Stakeholder partnerships represent an opportunity for value creation

The rise of stakeholder power presents companies with new opportunities to dialogue with and learn from key stakeholders. Partnering with economic stakeholders is not new; examples include the success of Wal-Mart and its key suppliers in streamlining the supply chain, and Taiwan Semiconductor Manufacturing's success in inventing a new industry (the virtual fab) in partnership with its semiconductor design and marketing customers.

What is new is the real value that savvy companies are getting from partnering with societal stakeholders. This includes partnerships with government, international and local NGOs, community groups and universities. One example of such partnership is Dow Chemical's Corporate Environmental Advisory Council, which provides Dow executives with a valuable outside-in perspective on key issues as input into critical decisions. Another example is the partnership between FedEx and Environmental Defense to develop a new generation of pick up and delivery trucks. The FedEx-Environmental Defense partnership reduces fleet emissions by 90% and increases fuel efficiency by 50%. As the sophistication of societal stakeholders increases, companies are realizing the value of teaming effectively with them as strategic partners.

The need for a new approach

A stakeholder value approach requires managers to think "outside-in" about how their companies create and sustain competitive advantage. Outside-in thinking, which sees the world from the perspective of stakeholders, is a powerful new lens through which managers can discover new business opportunities and risks. Leaders who engage stakeholders and proactively address stakeholder issues can better anticipate changes in the business environment, discover new sources of value, and avoid being surprised by emerging societal expectations that can put shareholder value at risk.

Examples of stakeholder value success – and failure

Outside-in product design: the Toyota Prius

The Toyota Prius is an example of successful product design that effectively integrates stakeholder considerations. Toyota, the world's most profitable and second largest automobile manufacturer[8], has its sights set on a global growth strategy driven in part by superior environmental and social performance. Well known and admired for its production system, Toyota also has a remarkable vision of the future of the automobile.

By some measures Toyota's environmental performance has worsened in recent years. For example, its sales of gas-guzzling SUVs have risen as a percentage of its total vehicle sales. Carbon emissions for its fleet grew 72% in 2002 compared to 33% for the industry as a whole. Yet according to some insiders[9], selling more SUVs and trucks is a pragmatic response to a market opportunity in the short term that also provides a means to fund its longer term growth strategy of moving into environmentally responsible technologies: hybrids, hydrogen-powered internal combustion engines, and fuel cell vehicles. According to the company, the Prius, its first foray into new clean technologies, is now profitable in 2004, after seven years and 150,000 units sold worldwide. The Prius hybrid drivetrain increases gas mileage and reduces emissions. At the same time, it reduces operating costs for the owner (especially at today's record gas prices), while sacrificing nothing in performance or styling. The car has also created a small but growing cadre of passionately supportive customers, and added an environmental and innovative cachet to the Toyota brand's aura of superior quality. If gasoline prices continue to rise, Toyota will have a real advantage in the market as it extends hybrid drivetrains to a broad range of vehicle types. If global climate change creates increased pressure for reduced use of fossil fuel, Toyota's advantage will increase further. And, in addition to creating a competitive advantage in hybrid technology (which Toyota is already licensing to other car makers), the knowledge and experience Toyota has gained positions it to be a leader in fuel cell vehicles as that technology matures.

Building new markets by building trust: Cemex's Patrimonio Hoy

In the world of construction materials Cemex, the third largest cement company in the world, is discovering a new and profitable segment while creating societal value in its home market. Its *Patrimonio Hoy* program supports home building among Mexico's poor by extending micro-credit to small groups of customers who commit jointly to repay the debt. The program has enabled 75,000 families to build houses one room at a time in a third of the time at a third less cost. According to the program's general manager, *Patrimonio Hoy* is generating positive cash flow from operations of one million pesos per month as of April 2003[10].

The perils of underestimating societal concerns: Monsanto

Monsanto, the global leader in genetically modified seeds with over 90% of the market in 2002, built its value proposition on providing specific benefits to farmers when its seeds are used in conjunction with its Roundup herbicide, but ran into concerted opposition that ultimately limited its ability to carry out its business strategy.

In its earlier transformation to a life-sciences company, Monsanto seemed to successfully link pharmaceuticals, nutrition and agriculture on a biotechnology platform. Under CEO Robert Shapiro, Monsanto became a darling of both Wall Street and a select circle of sustainability champions. The company's promise was huge shareholder returns while restoring the natural environment and solving the world's food and nutrition problems. By 1998, total returns to shareholders had increased 285 percent over a five-year period. Yet as the decade came to a close, Monsanto faced a depressed stock price and growing opposition to its controversial genetically modified products (also know as Genetically Modified Organisms or GMOs.) In December 1999, it agreed to merge with the U.S.-Swedish drug group Pharmacia & Upjohn, Inc., ending speculation that it would split off its agribusiness or be acquired by a larger company. Opposition to its agribusiness continued to grow, particularly in Europe, and in October 2002, Pharmacia spun off this business under the Monsanto name.

Monsanto's failure to sustain its original promise was largely due to a single factor: its inability to conduct meaningful dialogue with civil society. It saw opposition to GMOs as arising from consumer ignorance that could be overcome with better advertising and government lobbying. It did not acknowledge consumer fears related to health risks from the contamination of food crops, particularly in Europe. It brushed aside NGO campaigns against genetic manipulation and reduced diversity. As a result, the company underestimated the magnitude of the backlash from stakeholders concerned about the unintended consequences of its strategy.

The new Monsanto continues to face investor criticism[11], stock price volatility, the risk of market rejection and possible forced product buy-back programs[12]. In May 2004, the *Washington Post* reported that Monsanto announced it was scrapping its plans to commercialize Roundup Ready wheat, after meeting resistance from US and Canadian farmers concerned that a GMO crop destined primarily for human consumption would cost them key markets in Europe and Asia[13].

The cost of ignoring stakeholder value: ABP

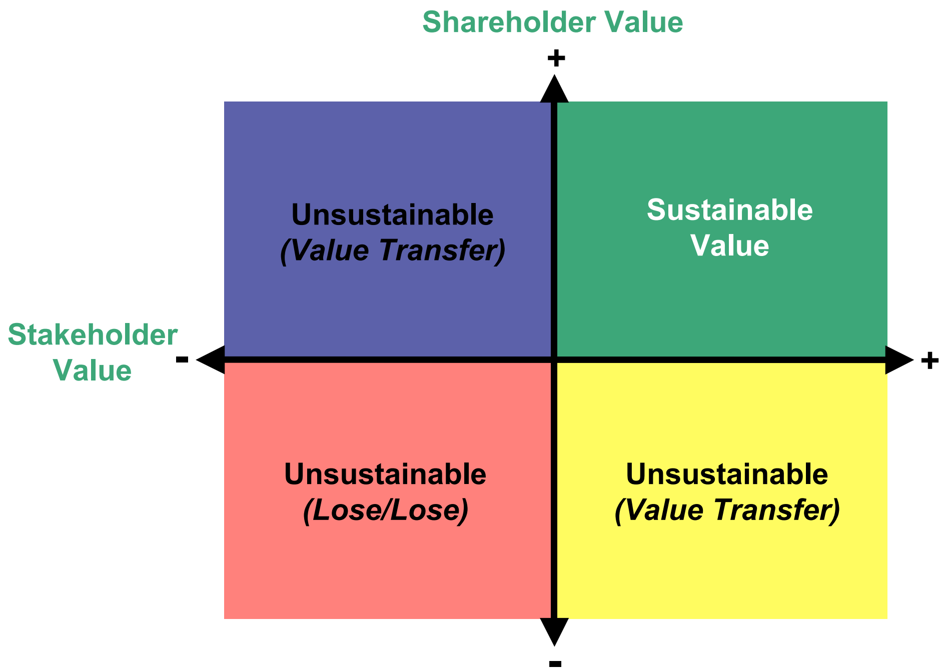
Another example of the downside associated with negative stakeholder impacts is that of Associated British Ports (ABP), Britain's largest ports operator. In April 2004, ABP experienced a one-day 10% decrease in share price as a direct result of environmental issues facing the company. Local environmental campaigners had waged a fierce, and ultimately successful, campaign to block the company's plans for a new container terminal at a site in the south of England, claiming that the terminal would wreck essential wildlife habitats. ABP is being forced to write off substantially all of the estimated $80 million of capitalized costs associated with the failed terminal's approval process[14].

Part II: Stakeholder Value as a Measure of Business Value

Business leaders are familiar with managing financial value, whether in terms of economic value added (EVA) or other measures driving stock price performance. They are less knowledgeable about measuring and managing stakeholder value. Because a company's impacts on stakeholders are often unintentional, it faces hidden risks and opportunities that managers can no longer afford to ignore.

To succeed in a stakeholder-driven business environment, business leaders must think and operate in new ways, shaping strategies and actions with full awareness of their impacts and implications on key stakeholders. Figure 2 describes company performance along two axes: shareholder value *and* stakeholder value. Managing in two dimensions represents a fundamental shift in how managers must think about business performance. In this framework, companies that deliver value to shareholders while destroying value for other stakeholders (or exploiting externalities) have a fundamentally flawed business model. Those that create value for stakeholders are cultivating sources of extra value that can fuel competitive advantage for years to come. Sustainable value occurs only when a company creates value that is positive for its shareholders and its stakeholders.

Figure 2. The Sustainable Value Framework



Starting in the upper left of Figure 2 and moving counter-clockwise, consider the following four cases of value creation:

Value transfer from stakeholders to shareholders creates business risks

1. **Blue quadrant** (upper left): When value is transferred from stakeholders to shareholders, the stakeholders represent a risk to the future of the business. Leaded paint and asbestos are obvious examples; however a much broader range of products and services face this situation. One example is the family of chlorinated plastics, known to contain chemicals that present a variety a human health hazards even at low exposure levels, found in everything from children's toys to sneakers to plastic food wrap. Another example is retail giant Wal-Mart, which is accused of avoiding overtime pay, discriminating against women and exploiting immigrant labor through subcontractors[15]. Shareholder value in these cases is created "on the backs" of one or more stakeholder groups, thereby representing a value transfer rather than true value creation.

2. **Red quadrant** (bottom left): When value is destroyed for both shareholders and stakeholders, this represents a "lose/lose" situation of little interest to either. Monsanto and its European competitor Aventis

lost large sums of money by underestimating stakeholder resistance to their GMO crop products. Before Aventis sold its CropSciences division to Bayer in 2001, it is estimated to have lost $1 billion in buy-back programs and other costs associated with its genetically-modified corn StarLink. StarLink was approved only for use in animal feed but was found by NGOs to have contaminated a number of human food products.

3. **Yellow quadrant** (bottom right): When value is transferred from shareholders to stakeholders, the company incurs a fiduciary liability to its shareholders. Generating shareholder value below the risk-free rate threatens the company's existence and therefore its ability to create societal value over time. It is interesting to note that philanthropy, when it is unrelated to business interests and represents pure charity, is also located in this quadrant. Unfocused philanthropy is implicitly a decision to take financial value from the company's shareholders and to transfer it to one or more of its stakeholders[16].

Value is sustainable only when it is positive for shareholders and stakeholders

4. **Green quadrant** (upper right): When value is created for stakeholders as well as shareholders, stakeholders represent a potential source of hidden value. Sustainable value is created only in this case. Shaw Industries, the world's largest carpet manufacturer with over $4.6 billion in annual sales, found a way to create a new carpet backing that offers benefits to both shareholders and stakeholders. Rising concerns among stakeholders about the environmental and health risks associated with traditional PVC backing led Shaw to search for an alternative. Its solution was EcoWorx backing, in which a thermoplastic polyolefin compound reinforced by fiberglass provides the same functionality as PVC backing with half the weight, resulting in savings on shipping costs. Shaw has made a commitment to pick up any EcoWorx product at the end of its life, at no charge to the customer, and recycle it into more EcoWorx, enabling the company to use these materials in a perpetual loop. Receiving a call when the customer's product reaches end of life also presents the company with a selling opportunity for new products. Within 36 months of launch date, EcoWorx production exceeded 50% of Shaw's total tile backing production and the company publicly committed to ending all PVC backing by the end of 2004[17].

Companies can use the sustainable value framework to think in strategic terms about their existing portfolio of products and services. Most managers are able to assess the overall value created for a business or product in both shareholder and stakeholder terms. For example, an industrial paints producer identifies solvent-based industrial paints as positive for shareholders but negative to stakeholders due the presence of harmful volatile organic compounds (VOCs). By switching to water-based paints that are classified as non-VOC, it has the opportunity to create value for shareholders and stakeholders. By profitably recycling its water based paints, it has the opportunity to move its product portfolio even further up into the Green quadrant (upper right) of Figure 2.

Part III: A Disciplined Process for Managing Stakeholder Value

The opportunity for industry today is to understand its impact on stakeholders, anticipate changing societal expectations and use its capacity for innovation to create additional business value from superior social and environmental performance. Capitalizing on this opportunity will require companies to apply the same systematic discipline in managing social and environmental performance as they do in managing other aspects of business performance.

Why stakeholder value is poorly managed today

Stakeholder value is usually poorly managed. Several factors contribute to this. An incomplete awareness exists about the company's impacts on stakeholders and how these impacts might in turn affect future business value. Responsibility and knowledge of social and environmental issues are typically fragmented across the organization and often delegated to those outside the core management team. Practical tools are missing to measure and manage the business implications of social and environmental performance. Line managers are often focused on traditional drivers of shareholder value and view stakeholder-related issues as a distraction from their business objectives.

A new mindset is needed to manage stakeholder value effectively

The most critical barrier to managing stakeholder value is the dominant mental model. A new mindset is needed to capture the systemic interrelationships between a company and its societal context. In this mindset the goal is not only competing with industry rivals, but also understanding and managing the changing expectations of an ever growing and diverse set of stakeholders. It no longer makes sense to see nature and society as external and peripheral to the core of business. Indeed, in certain industries today it can be argued that the biosphere and its various life support systems (clean air, water, topsoil) that maintain life are essential stakeholders. "Instead of business operating as though it were separate from the ecological and biological systems on which it relies, business will [have to be seen as] as co-evolving interdependently with natural systems, even shaping those systems in unpredictable ways."[18]
The process described below is contingent upon leadership that is willing and able to alter the dominant mental models of the organization. It is not necessary that every single employee buy into a stakeholder view, but the

risk of failure is significantly raised if the CEO and key senior executives do not actively promote it.

Three key phases

A disciplined process to create sustainable value requires three phases:

Managing stakeholder value requires the same level of discipline as managing shareholder value

1. *Diagnosis*: Understand where and how the company is creating or destroying value for stakeholders. Anticipate future stakeholder expectations and identify key emerging issues. Assess the business risks and opportunities associated with the company's current stakeholder impacts.

2. *Value creation*: Choose specific actions that create shareholder and stakeholder value, or reduce stakeholder value destruction while increasing shareholder value. Build a compelling business case for action and obtain the needed resources.

3. *Value capture*: Determine the requirements for execution, including stakeholder alignment. Carry out the activities to implement the actions. Measure progress on shareholder value and stakeholder value, validate results, and capture learning.

The Diagnosis Phase

The diagnosis phase expands the organization's view of value to include stakeholder-related risks and opportunities. This requires a process of identifying and segmenting stakeholders, deciding which ones are important, and gaining a clear understanding of the issues that matter the most to each of them. The organization must develop a clear picture of where it is creating and destroying value for them. The company must also understand value flows *from* stakeholders (or coalitions of stakeholders) to the company. Where and how do stakeholders impact the organization, positively and negatively? The current state picture of value flows should be augmented by exploring how it might change in the future.

One of the biggest challenges in dealing with stakeholders is handling divergent views and conflicting positions. Actions that create value for one stakeholder segment can destroy value for another. Companies have to accept that in finding desirable solutions, some stakeholders may continue to perceive a loss of value. Some stakeholders may have legitimate issues that the company is not in a position to significantly alter. Other stakeholders may hold extreme positions that reflect a narrow slice of public opinion. In most cases, however, the tension that arises from divergent views can be a source of creativity and propel the company to develop innovative solutions that would not have been found in the normal course of business. For an example of the kind of creativity that comes from engaging divergent views, see Brown & Williamson Tobacco's Social and Environmental Report 2002/2003, which documents creative efforts defined through identification of common ground with anti-smoking groups[19].

Another challenge in diagnosing stakeholder value is that perceptions are often more important than scientific facts. For example, polyvinyl chloride (PVC) producers defend PVC on the basis of scientific arguments such as energy efficiency, low biomass accumulation, and product safety in normal use. Customers such as Nike, Sony and Shaw Industries that have committed to eliminating PVC in their products, as a precaution for their customers due to perceived health and environmental risks, are unlikely to change their perspective based on additional scientific facts provided by the chemical industry. As in the PVC case, suppliers in a range of industries are vulnerable to value loss due to their customers' customers' perceptions of environmental and health risks.

The Value Creation Phase

In the value creation phase managers need to consider potential value from multiple levels of strategic focus. These are shown in Figure 3.

The stakeholder perspective can help create value at six levels

Figure 3. Levels of strategic focus

Levels of Focus	*Sources of Value*
Business Context	Changing the "rules of the game" so that sustainable strategies are both feasible and competitive
Reputation/ Brand	Gaining stakeholder preference and recognition as well as employee motivation
Market	Addressing new markets driven by customer and societal needs
Product	Using stakeholder pressure as a driver of product innovation. Creating product differentiation based on technical *and* environmental/social features
Process	Reducing energy, waste or other process costs and improving quality
Risk	Compliance –oriented management of risks and protecting license to operate

Often companies look only at the bottom two levels concerned primarily with eco-efficiencies from reducing energy or waste; avoidance of fines, penalties, and litigation due to regulatory non-compliance; and reducing risks related to license-to-operate.

The top four levels in Figure 3 represent opportunities that are significantly larger than those represented by eco-efficiencies. They are opportunities for innovation and top-line growth based on business solutions that integrate financial and societal performance.

The Equator Principles, adopted by Citigroup and other financial institutions to set a new environmental and social standard for project financing, is an example of creating value at the business context level. Patagonia's effort to "live its environmental values in everything it does" has led to a reputation and brand that attract customers, employees, and other stakeholders. Cemex's *Patrimonio Hoy* reaches a new previously unserved market of economically disadvantaged households. Toyota's Prius provides environmental and economic benefits from product use, while 3M's pollution prevention pays is a well known example of shareholder value created at the process level.

The Value Capture Phase

In the value capture phase, attention is focused on the conditions for successful implementation. A key consideration is how to use actions to change the dominant mindset and embed the stakeholder value perspective into the organization's management processes and operating model. In many cases this can be accomplished by expanding the frame of existing programs such as Six Sigma to include the full stakeholder perspective. The ability to measure in a credible way the impact of actions on stakeholder value is also critical.

Stakeholder-driven innovation

The "outside-in" view provided by stakeholders can help drive innovation

To understand how stakeholders can help companies create value at the top four levels depicted in Figure 3, it is necessary to consider the changing nature of innovation.

The notion of creating new market opportunities through value innovation has received much attention recently.[20] Value innovators go beyond the structure and dynamics of existing markets. For example, Clayton Christensen[21] describes low-end innovation disruptions that address over-served customers with a lower-cost business model. He also describes new-market disruptions that compete against non-consumption. A stakeholder value lens can help companies create new business models such as those identified by Christensen to address emerging societal needs, for example in serving the poor where price and technical features of existing products are out of reach of the customer base[22].

Figure 4. Key Questions by Phase

Diagnosis	Value Creation	Value Capture
• Who are your stakeholders? • What are their interests? • Where are you creating value or destroying value for them? • What potential future developments might change this stakeholder value picture? • What are the business risks and opportunities associated with this picture? • Which risks and opportunities warrant action?	• What actions will simultaneously create shareholder and stakeholder value? • At what level of strategic focus will they create value: risk, process, product, market, brand, business context? • What financial value will result: profitability, capital utilization, lower cost of capital, growth, intangibles, market confidence? • What are the critical success factors for the actions?	• What existing programs or systems could be adapted to include the stakeholder dimension? • What stakeholder alignment and support is required? • How will you engage line managers? • What financial and human resources are required? • How will you track progress, measure results, and share learning?

An example of innovation that meets new societal needs is food and agriculture giant ITC's approach to doing business with farmers in rural India. ITC has put personal computers in farming villages, with each PC serving about 600 farmers, reaching 2 million farmers in 2004. Often with the aid of literate women entrepreneurs, local farmers are able to use the PCs to access information about crop prices and weather conditions, and to enter "chat rooms" where they exchange information about soil testing services and other subjects. They electronically contract their crop sales with ITC and receive immediate payment over secured internet payment facilities. This system allows farmers to avoid middlemen, raise their incomes, lower input costs, and feel a greater sense of fair treatment and choice. It allows ITC to lower its farm costs, increase supply reliability, and develop a local market for its food products that is highly loyal to the ITC brand.

Changing the management mind-set: A hypothesis-first approach

A one-day workshop can open managers' minds to the business value stakeholders represent

Often the biggest barrier to success is changing the mindset of skeptical line management about the value potential of the stakeholder approach. This skepticism often makes it difficult to get line managers to invest the time required to understand and pursue sustainable value opportunities. A powerful technique for overcoming this barrier is a hypothesis-first workshop approach that minimizes the up-front time investment and builds the insight and commitment needed to free up additional resources. This approach can be quickly applied to any business area, product or investment using a cross-functional team that includes participants who understand the range of the business, technical and stakeholder considerations. In a one-day workshop, such a team can assess stakeholder impacts, identify business risks and opportunities, brainstorm and prioritize possible actions, and frame the business case. The results of such a workshop are often enough to convince line management that a follow-up effort to validate the hypotheses through a more rigorous, fact-based approach is worth the investment.

For example, in one recent workshop, executives from a multinational energy company were focusing on a natural gas development project. The company had been managing the project primarily from a technical perspective. It became clear that in a highly competitive context, time-to-market was the most important driver of business value. A stakeholder-centric approach revealed a variety of hidden risks and opportunities. Creatively managing the competing interests of regulators, local communities, property owners and NGOs had the potential for huge payback.

In another workshop, a team examined a new product currently in the alpha design phase in a high-tech manufacturing organization. A systematic assessment of stakeholder issues identified several key environmental and customer health and safety dimensions that they believed could help increase customer acceptance, reduce lifecycle costs, and differentiate the product in the marketplace. These issues were delivered to the product development team for further exploration and incorporation into the beta design.

In a third workshop, this time in a developing country, a hotel/hospitality leader looked at the immediate area surrounding one of its luxury hotel properties. The slums and polluted lake adjacent to the hotel, although an eye-sore, were considered part of the local context. By looking at the situation from a stakeholder perspective, the management team was able to identify the business value of restoring and rehabilitating the local area, including aerating, de-silting and biologically treating the lake. The business risks of not restoring and rehabilitating the area included health issues such as mosquitoes (and the risk of dengue fever,) unsanitary conditions for food deliveries, fines, reputation damage and lower room occupancy. The business opportunities included possible additional facilities such as a floating restaurant, and a potential source of clean water in an area where water scarcity was a major problem.

Conclusion

Integrating stakeholder value into strategy and operations is the next learning edge for business

Until the 1980s most companies believed higher quality meant higher costs. Japanese players demonstrated that it was possible to achieve higher quality and lower costs simultaneously. Today companies across a range of industries are finding that they can achieve high quality, fast speed to market, high customer service and low cost all at the same time. The leaders of tomorrow will demonstrate the same thing about stakeholder and shareholder value. They will find ways to create business value while delivering value to their key stakeholders. Integrating the full range of stakeholders into strategic and operational decision-making will become best practice. Today, courageous business leaders can already create competitive advantage by understanding their key stakeholders' interests, anticipating societal expectations and using the insight, skills and relationships developed through this process to design new products and services, shape new markets, develop new business models, and ultimately reshape the business context itself to one that supports the creation of truly sustainable value. The new leadership vision and a disciplined approach to creating stakeholder value are key success factors in tomorrow's marketplace.

End notes

[1] Lev Baruch argues that traditional investments in plant & equipment are no longer the main driver of stock price performance, as compared to intangibles such as leadership, reputation, and the skills involved in learning and collaboration. See *Intangibles: Management, Measurement and Reporting*, Lev Baruch, Brookings Institution Press, 2001.

[2] A partial selection of books on the topic of stakeholders includes 1. *Redefining The Corporation: Stakeholder Management and Organizational Wealth*, James E. Post, Lee E. Preston, Sybille Sachs, Stanford Business Books, 2002, (2) *The Stakeholder Corporation: The Body Shop Blueprint for Maximizing Stakeholder Value*, David Wheeler & Maria Silanpää, Pitman Publishing, 1997, (3) *The Stakeholder Strategy: Profiting from Collaborative Business Relationships*, Ann Svendsen, Berrett-Koehler Publishers, 1998, (4*) Stakeholder Power: A Winning Strategy for Building Stakeholder Commitment and Driving Corporate Growth*, Steven Walker, Jeffrey Marr, Perseus Publishing, 2001. Selected articles include 1. "A Stakeholder Approach to Strategic Management," R. Edward Freeman, John McVea, Darden Working Paper No. 01-02, 2. "A Stakeholder Theory of the Modern Corporation," R. Edward Freeman, 1994. In *Ethical Theory and Business*, T.L. Beauchamp and N.E. Bowie (eds.), Englewood Cliffs, NJ: Prentice-Hall, 2. "Sustainability Innovations," Kai Hockerts, PhD dissertation, University of St. Gallen, 3. "Beyond Greening: Strategies for a Sustainable World," Stu Hart, *Harvard Business Review*, January 1997, 4. "Beyond Built to Last… Stakeholder Relations in "Built-to-last" Companies," Samuel Graves and Sandra Waddock, *Business and Society Review*, Winter 2000, 5. "Responsibility: the New Business Imperative," Sandra Waddock et. al., *Academy of Management Executive*, May 2002, 6. "Focusing on Value: Reconciling Corporate Social Responsibility, Sustainability and a Stakeholder Approach in a Network World," David Wheeler, Barry Colbert, and R. Edward Freeman, *Journal of General Management*, Vol. 28, No. 3, Spring 2003, and 7. "Stakeholder Value Equilibration and the Entrepreneurial Process," S. Venkataraman, 2002, Ruffin Series No. 3, a publication of the Society for Business Ethics.

[3] Thomas Kochan and Saul Rubenstein, "Toward a Stakeholder Theory of the Firm: The Saturn Partnership," 2000, Organizational Science 11(4): 373

[4] See James Heskett et. al., *The Value Profit Chain*, Free Press, 2003, and Gary Davis, *Corporate Reputation and Competitiveness*, Rutledge, 2003

[5] See Sandra Waddock, "Responsibility: The New business Imperative," *Academy of Management Executive*, May 2002

[6] *The San Francisco Chronicle* (January 21, 2003) reported that the number of international NGOs quadrupled in the last decade to over 50,000 organizations.

[7] See http://www.corpwatch.org/article.php?id=8070

[8] See Steven J. Spears, "Learning to Lead at Toyota," *Harvard Business Review*, May 2004

[9] Speech at the National Press Club by Jim Olson, former head of external affairs, Toyota North America, September 16, 2003. Hiroshi Okuda, former president and now head of the Toyota motor corporation, has said, "I do not believe environmental protection and economic growth are mutually exclusive. Economic growth that ignores environmental consequences is in my view reckless, but on the other hand, attempting to resolve global environmental issues without recognizing the need for economic growth is unrealistic. I believe our objective should be sustainable growth."

[10] For a University of Michigan case study on Cemex's *Patrimonio Hoy* program, see http://www.bus.umich.edu/BottomOfThePyramid/CEMEX.pdf

[11] In April 2003 Innovest Strategic Value Advisors published a special investor report, "Monsanto & Genetic Engineering: Risks for Investors," in which it warns that the company faces significant market and financial risks.

[12] Aventis, a European competitor of Monsanto in genetically modified seeds, was forced into product buy-backs related to its StarLink corn that cost it about 1 billion euros in the 1999 to 2001 period. Aventis sold its CropSciences unit to Bayer in 2001.

[13] "Monsanto Pulls Plan to Commercialize Gene-Altered Wheat," *The Washington Post*, May 11, 2004

[14] Innovest Strategic Advisors Issue Brief, "Associated British Ports" April 23, 2004

[15] According to a June 22, 2004 CNN news release, Wal-Mart's stock sank 2.1 percent on the day of a federal judge's ruling that a class-action lawsuit could proceed against the giant retailer. Brought by about 1.6 million women who have worked for Wal-Mart's US stores at any time since 12/26/98, the settlement could reach billions of dollars. See http://money.cnn.com/2004/06/22/news/fortune500/wal_mart.reut/index.htm?cnn=yes

[16] Michael Porter and Mark R. Kramer, "The Competitive Advantage of Corporate Philanthropy," *Harvard Business Review* OnPoint, 242x, 2002

[17] Shaw Industries, Inc. press release on June 14, 2004. "Shaw Ceases Production of Polyvinyl Chloride: Replacement Carpet Tile Backing Recognized by the EPA."

[18] Andrea Larson, "Reframing Global Environmental Issues through an Innovation and Entrepreneurship Lens," Darden University, Darden School Foundation, 2003

[19]Brown & Williamson Tobacco's Social & Environmental Report 2002/2003, page 28. http://www.brownandwilliamson.com/Index_sub2.cfm?ID=12

[20] "Value Innovation: The Strategic Logic of High Growth," W. Chan Kim and Renée Mauborgne, *Harvard Business Review*, January-February, 1997, p. 103-112

[21] *The Innovator's Solution: Creating and Sustaining Successful Growth*, Clayton M. Christensen and Michael E. Raynor, 2003, Harvard Business School Press

[22] There is growing appreciation for the potential to use emerging societal needs as a driver of innovation. Examples of approaches that include this perspective are Claude Fussler's "breakthrough discipline for innovation" (1996), Stuart Hart's "source of creative disruption" (1999), Bill McDonough and Michael Braungart's "next industrial revolution" (1999), Clayton Christensen's "great leap downward" (with Craig and Hart, 2001), Andrea Larson's "Schumpeterian departures from existing products, practices and markets" (2003), and C.K. Prahalad's "the world's poor as a source of innovation" (2004).

***Sustainable Value Partners* is a management consulting, research, and education firm based in the Washington DC area. Our mission is to help our clients create and sustain competitive advantage by focusing on shareholder and stakeholder value. We enable companies to reduce risks, drive cost out of the business, create new products, serve new markets, and position themselves to take advantage of industry change.**

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