1 Corporate impacts: focusing on relationships and outcomes

All of us need to accept responsibility for the damage done to the free-market system …

You have to focus on all the stakeholders. It's a new thing for us. Long-term value is only achieved if growth benefits all stakeholders in a company, from owners to employees, communities and even governments.

Henry Kravis, CEO, KKR

If my bank is to get involved with its neighborhoods, what should it do? What can it do?

Senior banking executive

Corporations, the most powerful wealth-creation engines in the world, create value with their stakeholders on a daily basis (Freeman, 1984; Freeman et al., 2007) or—quite simply—they don't survive. Co-creating value delivers safe products and needed services for many stakeholders, encourages clients to come back time and again, creates jobs for employees in safe workplaces, and provides adequate returns to investors for mutual benefits (Wood, 1991). Positive impacts satisfy consumers and improve employees' welfare with spillover effects that increase the quality of life of communities through increased investments, sustained commerce, and tax receipts. In short, businesses co-create value with—and for—a multitude of stakeholders, including shareholders. A rising tide of thriving business districts builds a broader tax base, retains and attracts even more businesses, enhances a qualified workforce and contributes, in a virtuous cycle, to defraying the collective costs of community infrastructure.

Co-creating value seems like a simple concept: work with stakeholders, make a net positive difference for them and for you, improve lives, and repeat. Yet, if co-creating enduring value were simple to achieve, even more firms would match actions with intent. However, the daily news headlines suggest that co-creating value with multiple stakeholders simultaneously—however important—is neither straightforward nor easy to implement.

Implementing a process that mindfully co-creates value requires re-examining many, often implicit, aspects of the value-creation process. We start by focusing on the *interactions* of a firm's relationships with its stakeholders and with the not-so-startling observation that firms have both financial and non-financial impacts (Freeman, 1984; Baron, 1995). Financial and non-financial impacts are often intertwined and indistinguishable from one another, making assessing a firm's impacts messier than a simple accounting rubric such as share price. Purposely expanding impacts to include financial and non-financial impacts has a silver lining: more problems due to the sheer volume of impacts to consider also expands the possible solution sets available for figuring out how to continuously create value.

Lumping together all financial and non-financial impacts, however, suggests a false choice between financial and so-called 'difficult to measure' non-financial impacts that can't always be monetized. Yet, financial impacts frequently have non-financial, intangible dimensions such as reputation, trust, or ability to attract top talent that are equally difficult to monetize and are ignored at the business's peril. A one-size-fits-all rubric to assess all financial or non-financial impacts does not exist. Pride, loyalty, trustworthiness, safety, and effectiveness, for example, might be perceived, assessed, and measured in very different ways by employees, consumers, neighbors, and regulators. This book suggests a more nuanced perspective is needed based on the impacts that firms have with investors, employees, through the production chain, with consumers, as well as a broader set of thought leaders that are listening to, watching and influencing the firm. Influencing the influencers is increasingly an important aspect of managing corporate impacts to co-create value.

Effectively co-creating value that endures suggests, at a minimum, undertaking mutually beneficial activities while preventing bad things from happening. Mitigating harm by installing sprinkler systems and fire escapes in case of a factory fire that can kill employees is simply in the firm's best interests. When a fire occurs, the increased scrutiny of preventable deaths might irreparably harm a firm's reputation—better to prevent the fire in the first place. Creating an unfortunate legacy, these value-destroying events hamper growth and damage a firm's ability to expand. It's simply in the firm's best interests to consider its financial and non-financial impacts: businesses are in the business of creating mutual benefits that positively impact stakeholders and the firm.

Co-creating value often targets stakeholders directly impacted by a firm's actions. This book suggests that direct effects, as well as spillover and multiplier effects, of a firm's actions (or inactions) are where value is created or destroyed with stakeholders. When growing firms hire 100 new employees, for example, they often emphasize only the net positive benefits without a concomitant understanding of the spillover effects of hiring on the local neighborhood through traffic congestion or increased demand for local housing affecting local neighborhoods through increased property values or undue pressure on municipal services for trash, sewage, water, fire services, and police protection. Over time, a narrow, firm-centric understanding of the positive and negative spillover effects of growth can affect the firm's ability to continuously attract top talent in the future.

Capitalism is under siege, in part, as the stakeholders impacted are not always accounted for; nor are a firm's impacts always positive, as value may be destroyed and lives irrevocably harmed. Nor are benefits to stakeholders proportional to their contributions or achieved simultaneously: poverty and disease endure and persist within a firm's sphere of influence (and those of business communities), while shareholder returns are near record highs. When the brunt of the burden is borne by stakeholders not reaping benefits, capitalism causes lopsided risks and tenuous rewards that may not endure over time. Lopsided equations of who contributes to value creation as well as who realizes the burdens when value is destroyed requires thinking beyond a firm's direct impacts to incorporate the value-creation process and potential for value destruction.

Value, easily destroyed, makes the headlines with extensive reviews of what happened, who is to blame, and often with outcries for new public policies to be put into place. Rather than an after-the-fact blame game, some businesses are getting ahead of the curve by understanding their direct and indirect impacts on stakeholders by managing for the positive and unintended negative impacts. Staunching value destruction is preferable to standing idly by. Yet managing the true impacts of a business can, in turn, improve competitiveness, making it better—and less costly—for a firm than doing nothing.

In short, firms co-create *and* destroy value with stakeholders. Firms impact, directly and indirectly, a series of stakeholders, including shareholders, having financial and non-financial affects. This book explores a corporation's multifaceted impacts expanding the conversation about mutual benefits by including the value created and destroyed by the firm. In doing so, we explore two questions about stakeholder engagement: *who* shares in the value-creation process (and is the firm's story about value creation inclusive of these stakeholders)? And in the process of creating value, *how* are benefits and risks borne through multiplier effects?

By focusing on four types of impact where value is created or destroyed, this book identifies managerial blind spots and opportunities for innovation. Examining financial impacts alongside employees, products, and information impacts suggests there is more to creating value than returns to investors. Confidence in leadership, trust, prestige, recognition, or loyal customers might be impacts valued more than returns. Focused on impacts, an inclusive stakeholder approach offers a holistic perspective of the value-creation process by: (a) examining material impacts, financial and non-financial, that might directly, or indirectly, affect a firm's relationships; (b) identifying spillover and multiplier effects; and (c) intertwining impacts to enhance competitiveness.

With an emphasis on impacts—the points of intersection between a business and its stakeholders through employment, finances, production, and information—this book explicitly includes employees, creditors, suppliers, and communities (e.g., thought leaders, the media, or government) in the value-creation process. At points of impact, where the firm and stakeholders intersect, opportunities exist for value to be created or destroyed. It is simply in a firm's best interest to choose to optimize its positive impacts while mitigating harmful impacts. If designing business interactions with stakeholders creates enduring value without destroying value, aren't we all better off?

Interestingly, in the tangle of firm–stakeholder impacts lies the 'sweet spot' of value being co-created, as well as the 'messy middle' of value being destroyed. Increasingly considered a messy middle, addressing corporate impacts is not going to get easier, yet they are exceedingly important. The sheer number and variety of impacts due to the volume of stakeholders impinging upon a business with opportunities to create (or destroy) value is accelerating. The interests of stakeholder groups expand and morph on a seemingly daily basis. Therein lies the opportunity to create, destroy, or dissipate value if myriad relationships are not understood in the light of their true impacts on the firm.

While corporate impacts can seem a bit like chasing a moving target, resulting in an explosion of relevant relationships, the key is tying the impacts to the process of creating enduring value.

Let's start by examining the direct and indirect stakeholders impacted by the 2010 BP oil spill in the Gulf of Mexico.

BP CASE STUDY: CORPORATE IMPACTS

On April 20, 2010, BP's *Deepwater Horizon* exploded and caught fire in the Gulf of Mexico, killing 11 workers and injuring 17 others (Hoffman and Jennings, 2011). Two days later the rig sank, causing the worst oil spill in US history. BP eventually capped the well on July 15, 2010 after almost five billion barrels of oil—19 times more than leakage from the 1989 *Exxon Valdez* oil spill—contaminated the Gulf (Fahrenthold and Kindy, 2010).

The BP oil spill directly affected a variety of stakeholders, including the neighborhoods and households living near the 16,000 miles of coastline composed of Alabama, Florida, Louisiana, Mississippi, and Texas (Mackey, 2010). Thousands of animal species were killed or injured in the six months following the spill. The spill also had far-reaching consequences for the industry, including stricter regulation for deep-sea drilling with the potential for more regulations in the future (Goldenberg, 2010a; Webb, 2010c).

BP faced massive financial consequences: 2010 was BP's first financial loss in 19 years, with $4.9 billion charged against earnings due to containing and cleaning up the oil spill in the Gulf (Webb and Bawden, 2011). BP's share price fell by more than 115 percent. Once Britain's most valuable company, by June 2010 BP's shares had fallen to less than half of their pre-spill value (Bryant, 2011). One day in early June 2010, BP shares plummeted by 13 percent, immediately wiping £12 billion off the company's value as news was released that oil well was not likely to be capped for two months or more. In 2015, five years after the oil spill, BP's share price still had not returned to the pre-spill value of more than $57. Pensioners dependent upon BP's dividend payout were acutely affected as the dividend was cut to 7 cents, less than half the level before the April 2010 Gulf of Mexico oil spill (Webb and Bawden, 2011). BP lost $103 billion in market value and says it faced more than $40 billion in spill related costs with civil charges and numerous lawsuits still pending (Larino, 2015).

BP's loss of $103 billion in market value is equivalent to wiping out (in 2010 dollars) Intel, McDonald's, Visa, or Disney. The loss in shareholder value was acutely felt by both the American and British governments as both wanted BP to survive, and not only for financial reasons (Webb, 2010a). BP accounted for more than 10 percent of dividends paid by UK companies, with numerous British pensioners relying on its dividend income. The company is headquartered in London and is a well-known British firm formerly known as British Petroleum; its privatization from state-ownership began in the late 1970s (Webb, 2010a). The United States government was concerned that if BP went bankrupt then it would not be able to pay the potentially billions of dollars in compensation to victims, leaving the US government footing the bill *and* being responsible for implementing the cleanup activities (Webb, 2010a).

BP's operations were directly affected, with production dropping to 10 percent less oil and gas being pumped compared with the year before (Webb, 2011). And presumably operating procedures, rig operations and oversight, and deep-sea drilling protocols, as well as the reporting relationships—including the very public sacking of BP chairman Tony Hayward in June 2010—were significantly changed, with BP taking on a laser-like focus towards safety after the oil spill. What is unknown to outsiders is the effect of the oil spill on employees. Did BP have to lay off employees due to the drop in production or were layoffs and loss of contracts outsourced, borne by suppliers of BP and their contract workers? Or did BP have to pay a premium to attract engineers or geologists to work for them? And were there negative spillover effects onto franchise owners that lost money or were unable to expand?

Expectations of future production were also lowered as BP sold assets worth $25 billion to create a cushion of cash to pay for spill-related costs (Webb, 2011) and BP dropped plans to drill in the Arctic owing to its tarnished reputation after the Gulf of Mexico spill (Macalaster, 2010). The reputation losses were only in part captured by the market value loss of $103 billion, as the company's brand value was also diminished due to the way BP had promoted its Beyond Petroleum program in the years before the spill, but failed to execute when a disaster arose (Healy and Griffin, 2004; Sweney, 2010). With a damaged reputation, BP may find it harder to enter new markets or bid for new contracts (Sweney, 2010).

Other spillover effects included a cut in BP's credit rating—after US politicians demanded the company deposit $20 billion in an escrow account to cover the cost of the *Deepwater Horizon* disaster, making it more expensive for BP to borrow money (Wearden, 2010). Within a week, Moody's, a credit rating company, followed with a cut to BP's credit rating (Gutierrez, 2010).

Months after the largest oil spill in US history, speculation remained rampant in business news outlets that BP might become a takeover target, go bankrupt, or need to be significantly downsized and reorganized as the share price collapsed and was expected to drop even further (Webb and Pilkington, 2010; Tseng, 2010). What about BP's competitors? Are BP's rivals such as

ExxonMobil breathing a sigh of relief as the *Exxon Valdez* oil spill in Prince William Sound in 1989, previously the most notorious US oil spill, became yesterday's news with the BP oil spill (Hoffman, 1999; Hoffman and Ocasio, 2001; Hoffman and Jennings, 2011)?

Multiplier effects from the oil spill extended to the entire petrochemical industry, with new regulatory, political, and legal challenges. The Obama administration reversed an earlier decision and stopped offshore drilling until 2017, saying it had learned a lesson from the BP oil disaster. The cost and time delays in opening up new areas of the Gulf of Mexico to drilling affected the entire industry as more stringent safety measures were now required (Goldenberg, 2010a; Webb, 2011). Royal Dutch Shell, a competitor with an approved yet controversial drilling project in the Arctic, was required to upgrade its oil spill response plan, which delayed the planned start of the drilling until 2012 and then faced additional delays even after spending $4.5 billion on leases, equipment, and a campaign to persuade government officials (Broder, 2013). Shell initially refused to rule out pursuing damages against BP and other companies involved in the Gulf of Mexico disaster (Webb, 2010b).

The Obama administration sued BP and its partners in the *Deepwater Horizon* oil well disaster in the Gulf of Mexico, Trans-Ocean and Anadarko Petroleum. BP eventually settled with the Department of Justice in November 2012 for $4.5 billion in damages and pleaded guilty to 14 criminal charges while agreeing to pay fines to the Securities and Exchange Commission (Krauss and Schwartz, 2012). In later trials, BP was found grossly negligent, with the penalties and the appeal process still ongoing nearly five years after the oil spill (Larino, 2015; Stempel, 2014). BP faced hundreds of lawsuits filed by fishing interests, hotel chains, restaurateurs, even condo owners who say the spill ruined their holidays. The state of Alabama is also suing BP and other firms connected to the disaster (Goldenberg, 2010b; Larino, 2015).

In short, BP's financial loss of $103 billion in market value is only one aspect of the story regarding how BP co-created and destroyed value in the Gulf of Mexico oil spill. Only evaluating BP's financial impacts of the oil spill in the Gulf would miss the many financial and non-financial impacts on pensioners, financial analysts, partners, employees, suppliers, governmental contracts, local shrimp businesses and tourism companies, and neighborhoods, as well as consumers. Further, BP's prospects for co-creating value in the future are likely to be deeply intertwined with its responses to the 2010 *Deepwater Horizon* oil spill.

This book suggests it is simply in a business's best interest to understand how it impacts its stakeholders to enhance its value-creation process and mitigate risks that destroy value. We start by briefly identifying corporate impacts extending beyond financial impacts to include non-financial impacts, personnel and workplace, products/services, and information (Evan, 1965). Briefly discussing each of the four impacts (financial, personnel, products, and information) in isolation allows us to deeply dissect each type of impact in the next three chapters while alluding to how they work in combination with one another in Chapters 5 and 6. It's not that one specific impact is more important than the other, nor that they all must be evaluated in sequence, nor that all impacts must be accounted for; rather the intent of having a deep description of each impact allows for different narratives to emerge of how a business co-creates value *with its many stakeholders*.

Financial impacts

Financial impacts are often the most readily described and easily measured impact for publicly traded companies as share price and accounting returns are required to be published on a periodic basis. Financial impacts are most easily monetized, reflecting an accounting of risks, costs, and benefits to assess performance. Performance incorporates more than just financial metrics as it reflects past investments, new ideas that are generating sales, how efficient operations are producing goods and services, serendipity, and avoiding the crises affecting a firm's financial war chest. Various constituencies are directly affected by the financial value created by firms, including shareholders and financial investment industries created to assess, compare, and share information on a firm's financial prowess relative to rivals, industries, or most admired firms. Comparisons to rivals, contributions to national growth, and growth projections for investors assessing publicly traded companies deciding on whether to buy, hold, or sell company stock are commonplace. Often the shorthand for commercial success, financial impacts assess the impact on the owners, those providing capital, as access to financial capital is a requirement for all firms.

Yet, a single-minded narrative of profit maximization is not serving the interests of the business community or its stakeholders (Stout, 2012). The ostensible pursuit of short-term profits at all costs, as we saw in the BP oil spill case, can stymie businesses' growth potential; multiplying risks and ignoring new opportunities. Attention to human health and safety, risk mitigation, forestalling lawsuits, sharing information, trust, and the ability to work with stakeholders may be valued more than current cash flows for BP, for example. With even more stakeholders asking 'what's in it for me?' a financial payoff may not be the best answer, nor in the best interests of the firm.

Further, different firms are targeting different types of investors—particularly those investors that are focused on the long term. CEOs from Microsoft and Facebook are defending long-term investment strategies that don't provide immediate returns by asking investors to either be patient or to find another firm for their investment portfolio (Goldman, 2015). These firms are looking beyond short-term financial impacts to invest in future business growth. Investments in R&D, for example, can immediately benefit employees while in turn benefitting customers and investors in the long term. Without an adequate response to questions about how business co-creates enduring value with its many stakeholders, naysayers will continually undermine the financial value created by businesses.

Employees in the workplace impacts

Corporations directly impact—and are impacted by—employees and through workplace facilities. How a company engages its employees, builds its internal feedback systems (hiring, firing, training, and development processes), and facilities in which employees work (safety, security) increasingly helps to tip the balance in the competition for top talent (Turban and Greening, 1997). Employees and contract workers are often the first stakeholders to see gaps between the policies of a company or aspirations of its leadership and the way in which people are actually treated. Employee pride, retention, diversity, and loyalty as well as programs appropriately tailored to education, volunteering based on building skills and expertise, matching contributions, or internal training and development can contribute to employee effectiveness (Mackey and Sisodia, 2013).

Workplace impacts can be numerically accounted for as: workplace safety (accidents or deaths of employees and contract workers); number of regulatory violations (e.g., child labor and human trafficking policies); number of lost workdays per year; carbon, water, or energy consumption; waste and efficiency; as well as LEED certification of facilities. These workplace impacts often spill over to contract workers, partners, and suppliers as we saw in the fallout from the BP oil spill.

Overall, personnel and workplace impacts are a combination of both actual and perceived value. Being perceived as a trusted employer, an employer of choice, or winning 'best place to work' awards, alongside appropriate consumption of water, carbon, and energy or LEED certification of offices are not substitutes for headline-raising issues such as child labor, human trafficking, or unsafe workplace conditions, yet can often help when workplace conditions make headline news. A steady paycheck at living wages, for example, may be valued differently than safe working conditions or policies on human trafficking by employees or non-governmental organizations (NGOs) specializing in human trafficking. Adopting a co-creating value mindset suggests that both types of value, actual and perceived, need to be satisfied as risks can threaten the survival of the company and its ability to continuously create value as it seeks to retain its employees or expand facilities into new markets.

Product-based impacts

A third way that firms directly impact and are impacted by stakeholders are through day-to-day production and procurement decisions. In short, how a product is sourced, produced and delivered. Decisions that encourage (discourage) the use (misuse) of goods and services impact many stakeholders along the value chain: suppliers, suppliers of suppliers, distribution networks, clients (product purchasers), and consumers (product users). Whether it is a local barbershop offering free haircuts or a multinational company with production facilities and kiosks in numerous communities around the world, every organization impacts stakeholders through sourcing and delivery of its products or services.

Assessing the economic aspects of product/service impacts are quite common as they can be readily measured through, for example: pricing; loyalty of consumers; carbon, water, and energy consumption per unit of product; recycling programs or lifecycle analysis; traceability