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Shared value
Realising the potential of business and communities

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What is shared value?

Many organisations in Australia have to date pursued a ‘corporate social responsibility’ or ‘sustainability’ agenda, focused on objectives such as:

1. **Risk prevention:** ensuring that the business is not contributing to unacceptable levels of environmental and social harm that have the potential to disrupt its operations and license to operate.
2. **Corporate reputation management:** developing a reputation as a responsible corporate citizen that appeals to customers, regulators, investors as well as future and existing employees.
3. **Resource efficiency:** reducing consumption of scarce resources such as energy, water and materials and in doing so also reduce cost.

Whilst sustainability professionals often highlight the importance of ‘embedding sustainability’ within the core corporate strategy, **activities based on a social responsibility agenda have often remained on the periphery of business strategy.**

However more and more examples are emerging of companies taking a new ‘shared value’ approach which puts consideration of societal value at the heart of the business, and involves the development of strategies which have the potential to create real long term value.

The term ‘shared value’, as first coined by Michael Porter and Mark Kramer in an article for the Harvard Business Review, essentially means **creating business value in a way that also creates value for society by addressing its needs and challenges**.

It involves a change in the way that a business thinks about value creation, from a narrow sense focused on short term financial performance, to a broader sense which recognises the potential that external issues have to impact on long term value.

A recognition of the importance of shared value has led to ‘reinvention’ by a number of major corporations such as GE, Unilever and Nestle, as well as an explosion in the number of smaller and more nimble social enterprises recognising that business models can exist which deliver a return to shareholders through targeting societal issues.

Why adopt a strategy built off shared value principles?

1. *Improve your customer experience*
2. *Improve your employee value proposition*
3. *Innovate in response to changes in your external environment*
4. *Position your business for the short, medium and long-term*
5. *Derive a return from being responsible*
6. *Leave a legacy and make a difference in the community*

Perspectives of value

Shareholder value

The term “Shareholder Value” implies that the ultimate measure of a company’s success is to maximise its value. A company’s value is often determined by taking its expected future free cash flows (FCF) and discounting them by its weighted average cost of capital (WACC).

Every company has its own key drivers of FCFs and WACC, which can be placed into one of 6 value drivers categories. These 6 value drivers can, in turn, be enhanced by strategies intended to create Shared Value – essentially win-win strategies that simultaneously create both Shareholder Value and Stakeholder Value.

Shareholder value

FCF
Cash is king. The greater the free cash flows that a company is expected to generate, the higher its expected returns on invested capital. This will result in a greater rate of reinvestment and/or higher dividends to shareholders –both of which increase its business value

Revenue Growth

Expected growth drives value. Similarly, any reduction in the expected rate of decline in revenues will enhance value

Cost and Profit Margin

Reduced operating costs and higher productivity result in higher operating margins and therefore higher free cash flows and higher value

Tax Rate

A lower effective tax rate results in higher free cash flows and higher value

Investments

Investments in capital expenditure and working capital have a negative short term impact upon free cash flows. Provided the expected returns from the investments are sufficient, they will have a positive overall effect upon value

WACC
A company that manages its risks and capital better than its peers will be rewarded with having to pay lower risk premiums on capital raised. This leads to a lower WACC – and therefore a higher business value

Capital Structure

Debt funding is cheaper than equity funding. Optimising the mix between debt and equity funding will reduce the weighted average cost of capital

Risk

Risk is reflected in the volatility of cash flows. Activities that de-risk future cash flows will have a positive impact upon value

Societal value

A business creates value for society by delivering 'outputs' which lead to societal 'outcomes'.

Where these outcomes are not 'priced in' to a transaction or process, they are referred to as 'externalities'.

In recent years, initiatives to measure societal value have become increasingly common and a range of methodologies have been developed in order to assist organisations in this regard.

Underpinning all of these methodologies and central to the measurement of societal value is an application of economic principles which consider:

1. What are the outputs of your business, both positive and negative (for example products, employment, environmental pollution)?
2. What are the outcomes of these outputs (intended and unintended)?
3. Which stakeholders have been impacted by these outcomes?
4. By how much have these outcomes changed for stakeholders as a result of your organisation's activities, relative to what otherwise would have happened?
5. Can a financial value be placed on a unit of this change?

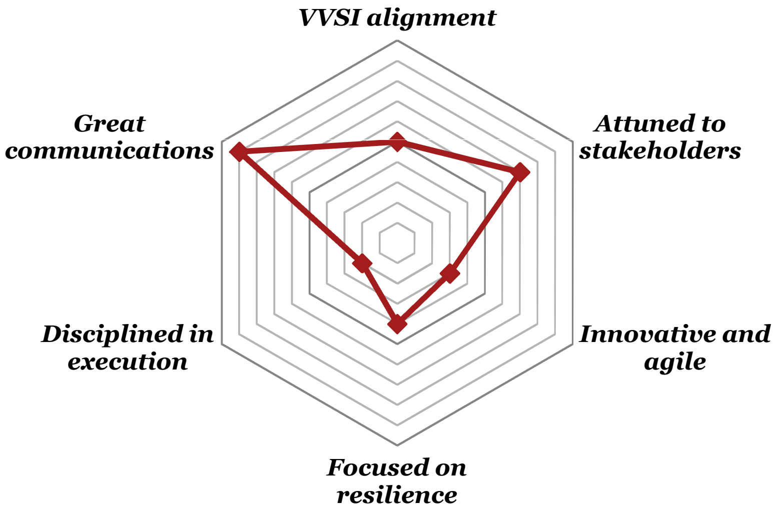
In some cases (for example, where a new product or service has created more employment), a direct financial value may be readily available. Where a financial value is not readily available (for example, improvements to health of the population, or a decrease in environmental pollution), then other methods can be used such as 'proxy values' from other similar studies, surveys or economic literature, 'willingness to pay' assessments, and stated or revealed preference techniques.

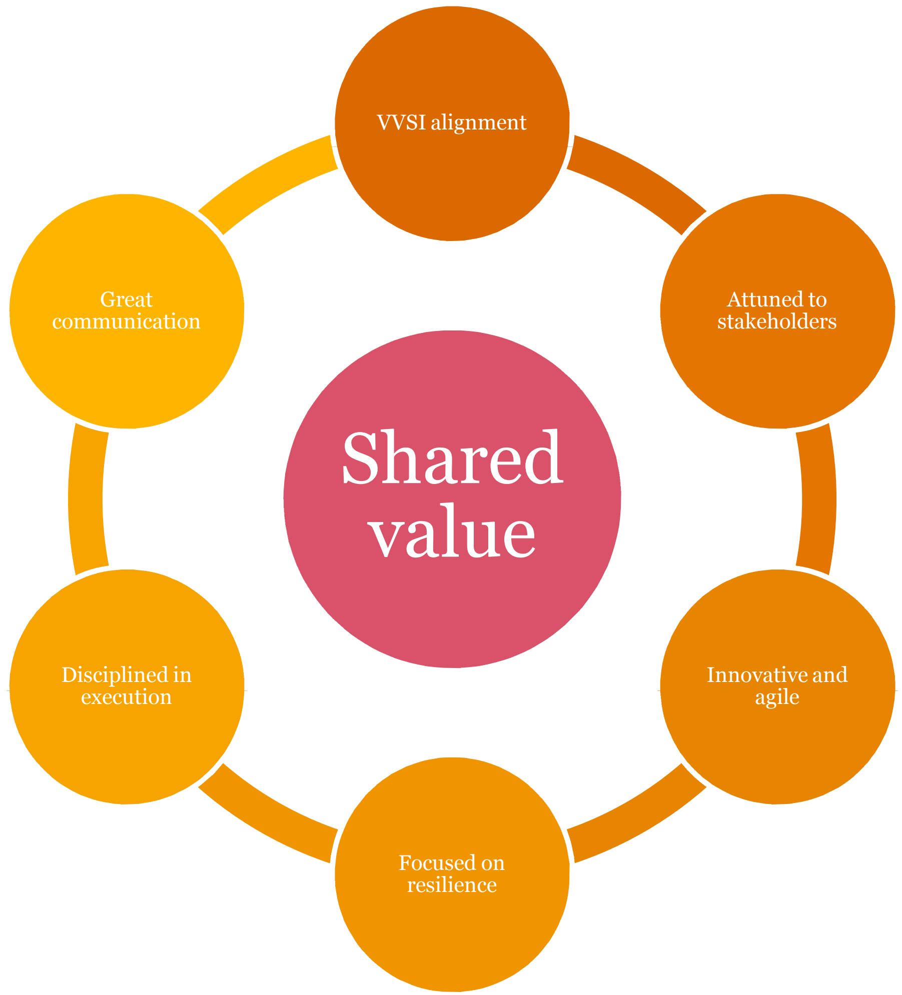
Are you realising the potential?

Very few businesses are. It's not easy and requires management focus and effort.

We believe that the following core elements should be addressed in order to realise the full potential of a shared value strategy.

PwC shared value maturity model

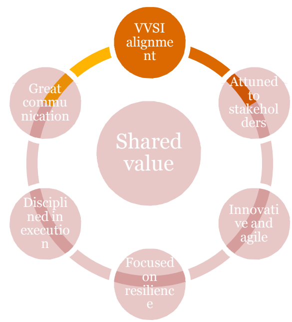




How do your company’s Vision, Values and Strategic Intent (VVSI) align to a focus on shared value?

For a shared value agenda to be successful there needs to be a common understanding of the concept at the highest level of the organisation, and commitment to a VVSI which recognises the needs of all stakeholders.

The VVSI needs to be well understood throughout the organisation, with senior management actions and behaviours aligned to the strategy in practice.



Case study: PwC Australia

Following an extensive consultation process with our partners, staff and clients we redefined our firm’s vision in 2012 to the following:

“To realise and discover the potential of…”

The “…” recognises the opportunity that we have to deliver shared value through making a difference to all of the firm’s stakeholders be they partners, staff, clients, communities, policy makers etc.

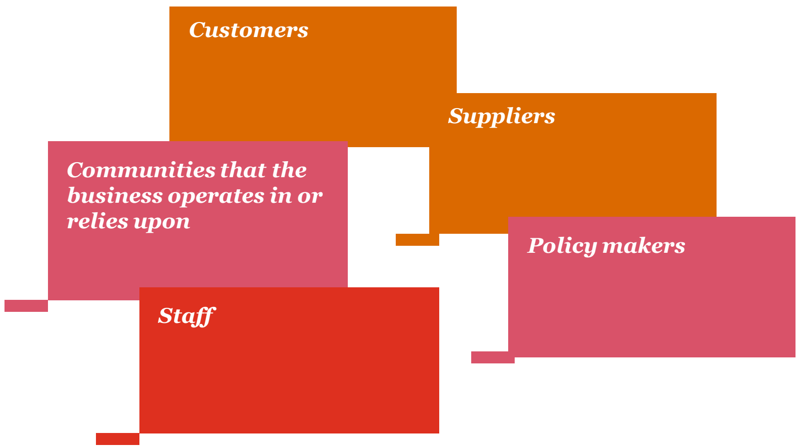
Case study: Nestle

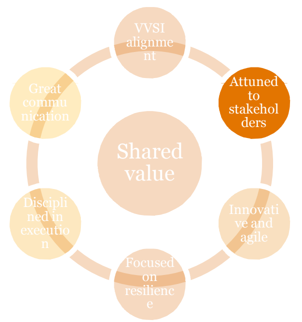
Nestle has an overarching objective ‘to be recognised as the world leader in Nutrition, Health and Wellness, trusted by all its stakeholders, and the industry reference for financial performance’. Their stated rationale for this is belief that ‘ it is only possible to create long- term sustainable value for our shareholders if our behaviour, strategies and operations are also creating value for the communities where we operate, for our business partners and, of course, for our consumers.’ Nestle has created a ‘4x4x4 roadmap’ to align its people behind its strategic priorities.

How well does the business understand the issues facing the communities and stakeholders that it relies upon?

In order to develop a strategy which delivers shared value, management and staff need to have a clear understanding of the external issues which are 'material' (relevant and significant) to the business and *its stakeholders* over the short, medium and long term. These will vary depending on the business sector and geography of operations but may include, for example, disadvantaged segments of communities, issues creating social tension or deterioration, or aspects of environmental degradation in the communities within which the company or supply chain operates.

In order to fully understand these issues the company should undertake ongoing monitoring of emerging issues relevant to stakeholders including:

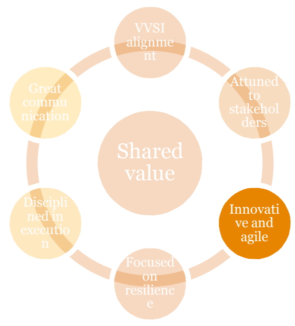




Case study: Unilever

Unilever, as part of its stakeholder engagement process set up a live online 'Lab' run for 24 hours, brought together a cross section of people from governments, NGOs and businesses to discuss the themes of sustainable sourcing, production and distribution, consumer behaviour change, and waste and recycling. It attracted over 2,200 registrants from 77 countries and almost 4,000 comments were posted, providing rich information on stakeholder concerns and facilitating the co-creation of solutions to address them.

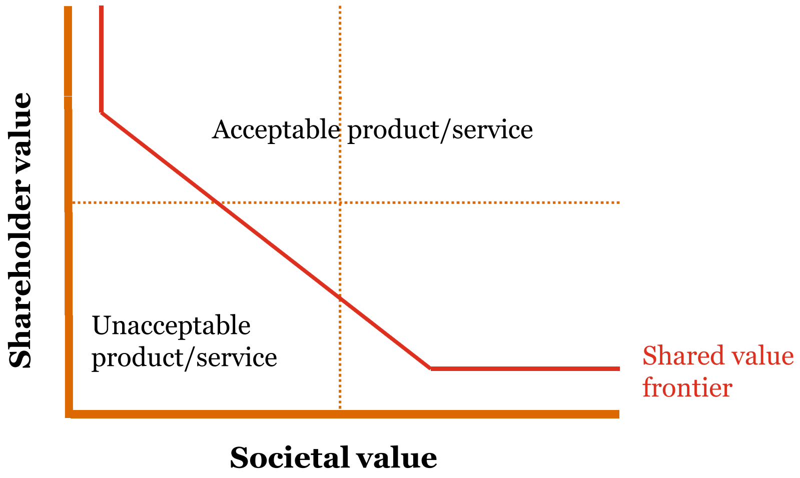
How innovative and agile are you to the factors that impact on your stakeholders?



Understanding the issues facing communities and stakeholders is one thing but converting that knowledge into the design and development of products and services is what sets the leaders apart from the pack.

Doing this continuously requires a commitment to and capability in product/service innovation. Agility in responding to the opportunities as they present themselves is also key.

There should be a clear framework for identifying and evaluating such opportunities and a common understanding of the optimal mix of societal and shareholder value (the "shared value frontier") for a range of competing shared value investment alternatives.



Case study: Grundfos

Grundfos is a global leader in advanced pump solutions and water technology. Its purpose is to 'contribute to global sustainability by pioneering technologies that improve quality of life for people and care for the planet.'

In 2009, Grundfos launched LIFELINK –water systems for small communities, market places, hospitals, orphanages and schools in rural areas in developing countries that have limited access to safe water, with a supply of safe drinking water at affordable prices. By pairing existing technologies with an innovative business model, Grundfos LIFELINK responsibly changes the way of operating and managing rural water supply.

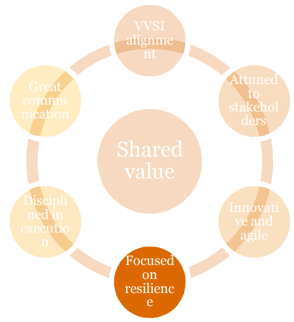
How resilient is your business to the factors that impact your stakeholders?

A recent PwC review of high impact, low likelihood risk events concluded that a common theme across events, was the failure of decision makers to understand the strategic trade-offs inherent in critical decisions and how to resolve them. Executives frequently work hard to communicate strategic priorities, but ignore strategic trade-offs in the mistaken belief that employees and other stakeholders can magically deliver against them all the time. In reality, most strategies will contain a number of potential dilemmas, where judgement needs to be exercised and trade-offs made.

An awareness of the trends influencing a business' stakeholders provides a context within which these trade-offs need to be made and informs decisions that can improve resilience.

Understanding, for example, the labour conditions of potential suppliers is important to a company considering off-shoring production of a key product. In weighing up the potential cost savings, the increased risk of disruption due to social unrest as well as the potential brand damage should be considered.

Conversely, well targeted community investment in the extractive industries is a proven method for building capacity in local communities in a way that supports the company's 'license to operate' within that community.



Case study: Nespresso

The *Nespresso* AAA Sustainable Quality™ Program was launched in 2003 to help protect supply of high quality coffee and secure the livelihoods of the farmers that grow them. The three 'A's within the *Nespresso* AAA Sustainable Quality™ Program represent :

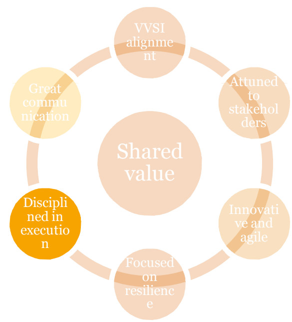
First A: Quality. Helping farmers adopt best practices in coffee cultivation to protect the supply of the highest quality coffee.
Second A: Sustainability. Supporting farmers to become more environmentally and socially responsible.
Third A: Productivity. Helping farmers to improve productivity and implement cost reduction initiatives to increase their net income.

How disciplined is your business in executing on the shared value opportunities and risks that it has identified?

As mentioned earlier in this paper, whilst sustainability professionals often highlight the importance of 'embedding sustainability' within the core corporate strategy, activities based on a social responsibility agenda have often remained on the periphery of business strategy. Where this occurs they commonly run the risk of being seen as 'discretionary expenditure' where limited management attention is focused on execution of the initiatives in a way that delivers benefits.

Shared value leaders bring structured program management disciplines in realising shared value opportunities. These include:

- Defined roles and responsibilities for oversight and execution
- Defined processes for assessing competing opportunities and allocating resources to initiatives
- Ongoing monitoring of benefits realised against those contained within the investment hypothesis
- Clear exit/handover strategies for initiatives



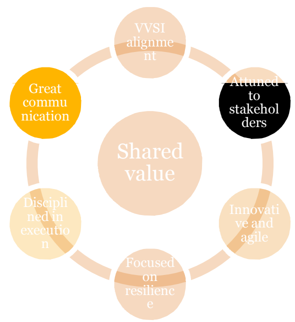
Case study: GE

GE's 'Ecomagination' program includes more than 140 environmentally sound products and solutions, generating more than $105 billion in revenue to date.

To qualify for the ecomagination portfolio, products and services must significantly and measurably improve customers' operating performance or value proposition and environmental performance.

The ecomagination Product Review (ePR) process ensures that offerings meet necessary criteria and that associated marketing claims are clear, compelling and substantiated.

How well do you communicate the shared value you have created to your stakeholders?



Effectively communicating the progress of your business in relation to its shared value priorities serves a number of important purposes:

- It reinforces accountability to deliver on commitments made
- It allows the Board and Management to understand the return on the investment of shareholders funds for shared value programs
- Through demonstrating outcomes, it strengthens the brand of the business in the eyes of its stakeholders.

Value is however, in the eye of the beholder, meaning that a business needs to design communication activities tailored to its stakeholders.

Most retail consumers, for example, are unlikely to read an extensive sustainability report. They might however digest an easy to read poster located at a point of sale machine. Conversely, policy makers are more likely to have an appetite for data on outcomes achieved

Case study: Vancity

On its website, Vancity Credit Union in Canada uses short case studies to tell the story of the impact that it is having in the eight community investment priorities it has. Within 3 clicks of landing on its website, Vancity also provides its members with an interactive map allowing them to drill down to the community investment projects that it has funded within their local area.

For those stakeholders with an appetite for more detail Vancity also provides a detailed range of audited performance data on its environmental, social and economic footprint in an 'Accountability Statements' report also located on its website.

Acknowledgements

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