



Shiloh Estate LLC

RWA STRATMAN KNOWLEDGE BASE SERIES

www.shilohestate.com

Stakeholder Value

by
Reese C. Wilson
April 2001

Coordination Draft
Comments Welcome

Enterprise Success

Success, like beauty, is in the eye of the beholder—and, like a diamond, has many facets. The success of a business enterprise is defined differently by customers, employees, investors, and others that are directly or indirectly affected by its products and services. Individuals or groups that benefit from the success of a business have a stake in the overall enterprise—they are called stakeholders.

Enterprises that succeed over time satisfy stakeholder expectations. They deliver value to stakeholders—today and tomorrow. A strategically managed winery, for example, would articulate values such as those listed in the box; and would strive to operate in consonance with these values. Enterprise success would equate to delivering value to multiple stakeholders.

Beyond Tradition

Delivering value to stakeholders requires: (a) new approaches to organization design and development that go well beyond traditional hierarchies and (b) new measures of success that go well beyond financial measures such as return on equity and capital gains to shareholders.

A more innovative and comprehensive approach is required.

Importantly, a business enterprise that delivers value to stakeholders must have—and put into practice—values itself.

Reese C. Wilson engages in home winegrowing and winemaking within the Napa Valley, and accepts occasional RWA strategic management consulting assignments. He holds M.S. degrees from Stanford and Syracuse Universities, a B.S.E.E. degree from the University of Southern California, and is currently active in the Viticulture and Winery Technology Program at Napa Valley College.

Value Statement

1. Grow, make, and market an extraordinary wine.
2. Create and serve satisfied customers.
3. Recognize that our employees are our most valuable asset.
4. Respect and sustain the environment through thoughtful winegrowing and winemaking practices.
5. Serve as active members of the communities in which we operate.
6. Generate the profits needed to sustain the enterprise and provide value to stakeholders.

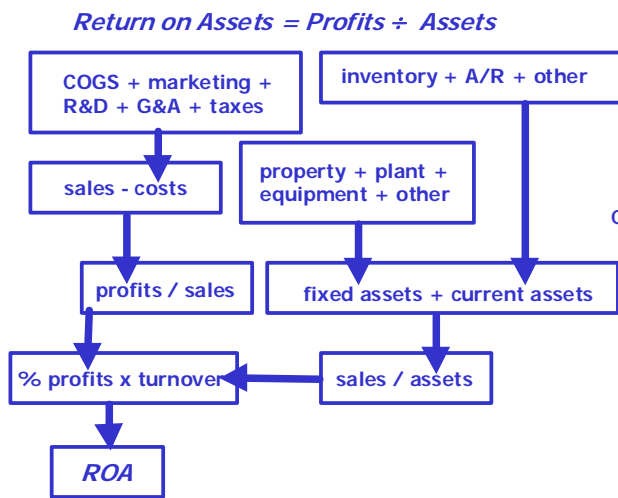
Values

Enterprises that enjoy economic, operational and strategic viability year after year usually have clearly stated values such as those listed above.

Values typically embrace the product mix, customers, employees, the environment, the community, and profits. Even small winegrowing or winemaking operations can posit and practice these and other values deemed important.

An enterprise that recognizes important values is in a much better position to deliver values to stakeholders than one that does not.

In what follows, I will review three increasingly comprehensive approaches to enterprise success: return on equity, creating shareholder value, and delivering value to stakeholders.



Return on Assets

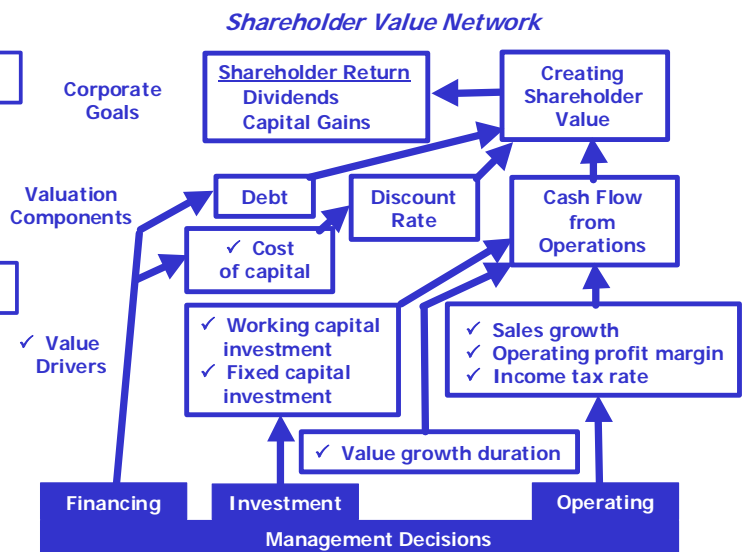
ROA (or return on investment) is based on financial measures derived from a firm's profit and loss statement and balance sheet:ⁱ

On the left, above, profits are sales less costs where costs are the typical cost of goods sold (COGS) plus costs for marketing and sales, research and development (R&D), general and administrative (G&A), and so on. Profits divided by sales yields the profit margin.

Typical balance sheet entries are shown on the right-hand side culminating with sales divided by assets, a ratio that represents turnover. Turnover—the sales to assets ratio—reflects the effectiveness with which investment is converted into productive capacity and sales. ROA is the profit margin on sales times turnover.

The ROA approach explicitly measures various financial indicators and ignores non-financial aspects that implicitly drive the financials. Members of the enterprise, of course, must achieve results in the marketplace in order to generate an adequate ROA. To sustain satisfactory returns over an extended time period, financial and non-financial decisions, actions, and results must be both effective and efficient.

Any approach that focuses on financial measures to the exclusion of other concerns is short sighted and gets a company into trouble more often than not. So ROA, quarterly income statements, and earnings per share must be consciously complemented by non-financial measures of performance—customer satisfaction, for example.



Creating Shareholder Value

The shareholder value approach, depicted by the network diagrammed above, links the corporate goal to create shareholder value with basic valuation parameters or *value drivers*.ⁱⁱ

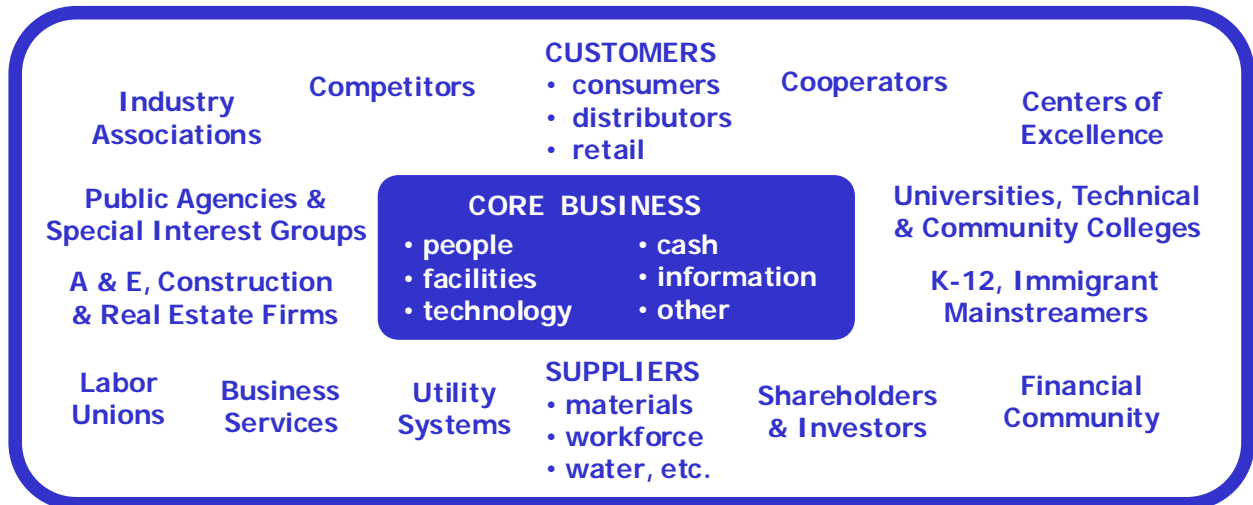
Here the emphasis is on management decisions that have a positive impact on the firm's financial, investment, and operating parameters that, in turn, drive value to shareholders up.

Operating decisions—*e.g.*, product mix, promotional mix, distribution, and customer service—affect sales growth rate, operating profit margin, and income tax rate. Investment decisions—*e.g.*, increasing capacity or inventory—affect working capital and fixed capital investment. Financing decisions—*e.g.*, cost of capital—affect debt and equity.

All of the indicators except *value growth duration* are traditional financial measures. Rappaport defines value growth duration as "management's best estimate of the number of years that investments can be expected to yield rates of return greater than the cost of capital." This explicitly recognizes the importance an extended planning horizon—taking the longer view.

Given good management decisions, cash flow from operations adds to—and debt subtracts from—shareholder value. This is important.

Yet, many other useful measures of performance are missing—employee turnover, for example.



Delivering Value to Stakeholders

Any core business needs to have mutually beneficial relationships with major stakeholders. As indicated by the partial portrayal above, they are plentiful. Even competitors—many that would like to eat your lunch—become cooperators sharing common goals through associations.

The value statement emphasized several stakeholder groups:

Product-Market Matchmaking—The first two values focus on excellent products and satisfied customers.



Winegrowers, winemakers, and winemarketers often score high in this category. Yet a marketplace that is increasingly global, competitive, and turbulent demands new and innovative approaches.

Most Valuable Asset—The third value focuses on employees as a vital asset. This is not always explicitly recognized by many in the industry. I recently listened to a panel of four experts at a winery industry symposium discuss "Competing for People" without mention of field hands, cellar workers, or tasting room employees.

This represents an area where non-traditional organizational approaches can pay dividends as discussed on the next page.

Environment—The next value listed extends enterprise success boundaries to embrace practices such as sustainable agriculture and biodynamics. The industry is making great strides here, although in some areas such as Napa Valley, environmentalists are taking steps to restrict hillside development, water usage, and other growth activities thought to have a negative impact.

Community—Some members of the industry strive to establish themselves as productive members of the community; others do not.

Because climates conducive to wine grape production can also serve as strong magnets for population growth, there can be tension between wine industry and other land uses—this is true in some places such as Napa Valley. This in spite of active community leadership and generosity on the part of some local industry leaders.

Profits—The final value statement addresses profits as an essential ingredient for success, for delivering value to stakeholders. Customers within target markets exchange cash for products and services they value. Customer satisfaction translates into return on equity, increased shareholder value, jobs, and so on.

Some of the potentially valuable relationships suggested by the stakeholder model are not always adequately recognized by core business leaders and by others. For example, improved collaboration—communication, cooperation, and coordination—between the wine industry and the workforce education and training community could prove beneficial to all.

Toward Enterprise Excellence

Movement toward non-traditional organization and work designs is usually necessary to deliver value to stakeholders over an extended planning horizon. This approach is based on a number of the non-traditional organization and work design ideas as suggested to the right.ⁱⁱⁱ Within the wine industry, although many do a good job in product-market matchmaking as well as for other value categories, the future should never be confused with the past. Survival with grace requires innovative approaches.

Motivating *Raison D'être*—The business purpose shifts from shareholders to stakeholders. This is often easier said than done, especially for public corporations where Wall Street has influence.

Organization Design—Hierarchical approaches give way to network approaches that integrate winegrowing, winemaking, and winemarketing teams internal and external to the core business unit. Rewards are based on merit.

Power Flows—The core business relies increasingly on bottom-up implementation of action programs within a top-down strategic management framework based on shared values, goals, and agendas.

Organizational Scope—The scope of the core business expands to include external business partners as an integral part of the enterprise vital to success in the marketplace.

Work Design—To transition from the traditional to the non-traditional, a core business will have fewer but better employees. This is also true of the core business of partners. Employees will possess multiple skills, will work on multiple tasks, and will therefore be able to provide the team and individual flexibility needed to effectively and efficiently respond to changing conditions demanded by markets, the economy, technology, and Mother Nature.

Workplace Philosophies—Clearly, innovative approaches, based on the employee as *the*—or at least *a*—most important asset within the total enterprise is being increasingly recognized by visionary business leaders.

Excellence among management and other workers is essential to delivering value to stakeholders (including themselves).



In conclusion, traditional organizational designs and measures such as ROA and capital gains are expanding.

Greater emphasis is being placed on human capital as well as mutually beneficial relationships with an array of individuals and groups that have a stake in the success of the enterprise.

ⁱ Robert H. Hayes, Steven C. Wheelwright, and Kim B. Clark, *Dynamic Manufacturing: Creating the Learning Organization*, The Free Press, New York (1988)

ⁱⁱ Alfred Rappaport, *Creating Shareholder Value: The New Standard for Business Performance*, The Free Press, New York (1986)

ⁱⁱⁱ Reese Wilson, "Enterprise & Workforce Excellence," Reese Wilson & Associates, Menlo Park (1992)