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#TURNINGPOINT

STAKEHOLDER CAPITALISM

HOW TO MANAGE A COMPANY'S STRATEGIC RELATIONS TO ADDRESS THE POST-CORONAVIRUS RECOVERY

Madrid, July 2, 2020

LLORENTE Y CUENCA

We have been plunged into a healthcare turmoil with major economic and social impacts. Any company that aims to emerge stronger from this needs to consider how it manages its relations with its key stakeholders, and how it manages its forms of capital from day to day. A focus on underpinning alignment with consumers, clients, employees, suppliers, shareholders and others will help companies to pick themselves up from the current situation and be better prepared to lay claim to the future.

Successful organizations in this second turbulent decade of the century not only recognize the **VUCA ecosystem** *(Volatile, Uncertain, Complex and Ambiguous)* in which they operate, but have the skills to handle it. They therefore understand that leading this context through a culture of collaboration, continuous improvement and constant transformation to which we are prey.

They are also aware of the need to define **what their organization exists** for and what its inner purpose is; they know how to explain **why, who for** and **how** they want to do things; and they are clear about **what** they aim to obtain as an outcome before they begin to act.

This might at first glance seem a straightforward task, but anyone with responsibility for leading an organization knows that it is not. It is now more complex than ever, but not impossible. All that is needed is a change of perspective: without overlooking economic capital, we need to pay greater heed to relational capital. We need to move beyond the primacy of the shareholder to the balanced management of the expectations of all those with a stake in the future of the business.

From the Business Roundtable to the World Economic Forum, there is a consensus that stakeholder capitalism is here to stay. How did we get here, and what can we do to make the most of it?

(UN)LEARN TO MANAGE CAPITAL

The **creation of value shared with stakeholders** took giant strides at the start of this century as a business management theory, in an apparently obvious response through the incorporation of ethics and a corporate purpose focused on the common good for all stakeholders as a fundamental management focus.

To understand what this entails, it is vital to dissect the challenges for the **boards of directors and chief executives** of companies in responding to the need to create value for and with all key stakeholders, and above all to understand that value is based on the range of forms of capital that an enterprise needs in order to operate.

We are gradually realizing that accountability requirements are constantly on the increase, **to the bewilderment of companies' financial areas.** As the stakeholder map extends to those whose expectations we must aim to fulfill, the tangible and intangible aspects required in accountability grow exponentially.

Traditional reports are no longer enough, and with the transposition of the European Non-Financial Reporting Directive, few managed to understand what this minor leap forward is for, and why it has happened. The regulations adapt and incorporate new issues on which companies will have to report as to their level of compliance, and if they do not comply, they will have to explain their lack of performance.

In order properly to understand this, **we have to unlearn**, which is one of the most complex and challenging activities for most people. We have to unlearn the dynamic according to which management and reporting were focused only on shareholders. From now on, we also have to report and manage the value created for consumers, clients, employees, suppliers, citizens, etc.

And we likewise have to unlearn the idea that the only capital we need to manage is economic and financial. Intangibles are becoming increasingly important on company balance sheets, while other non-economic tangibles are beginning to appear on management dashboards.

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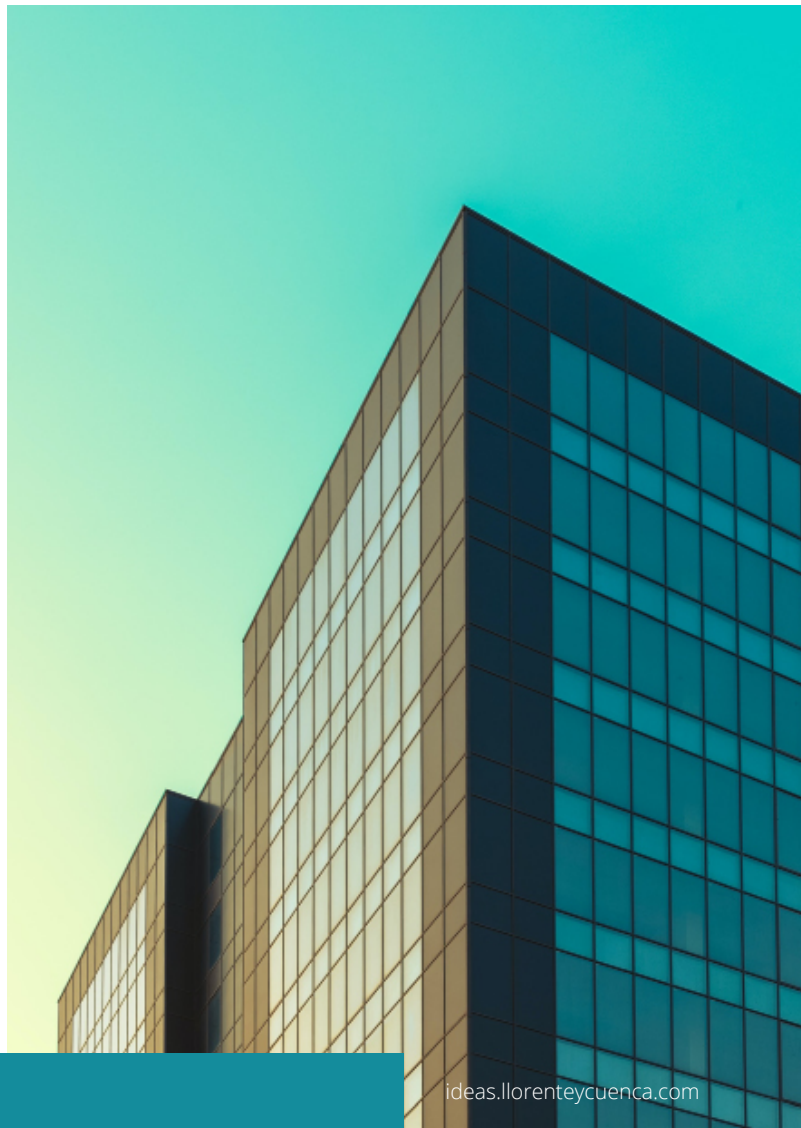
Companies obtain resources from their ecosystem so that they can operate, and obviously incorporate **economic capital** to generate the assets needed so as to function, and the working capital needed to keep the flow moving. We are very highly educated and sophisticated when it comes to this specific capital, to the extent that many citizens have come to the conclusion that companies themselves believe only in this kind of capital, and overlook all others. Our aim here is to show that this is not the case.

The second capital that organizations need to operate is **talent capital**, the human capital that allows the organization to function. This means turning to the employment market in an attempt to attract talented individuals aligned with our operations, “leasing” a substantial part of their time from them in order for them to help us fulfill the company’s purpose and its action plans. Beyond the economic management performed by some personnel or human resources executives, as an expenditure entry on the income statement, there is a concealed capital to be managed: talent. Could we really be accountable to our organization’s stakeholders as to the results we have obtained in talent management at our organization? This is the right question for boards of directors to be asking their chief executive. Talent management policies help to create value beyond personnel policies intended to manage labor costs. We have a great deal to unlearn so as to focus people management on their development, but it is vital to do so.



The third key capital we need to manage is very closely connected with talent, but goes a little further: **knowledge capital**. Knowing what we know, what we do not know and what we need to learn is vital if a board and a CEO are to be capable of foreseeing the investments needed if the organization's value proposition is to remain competitive, cutting-edge, and sustainable. The areas of management systems, continuous improvement, talent, research, development and innovation take on particular significance in this operational strand.

One new form of capital which is taking on ever-increasing importance at organizations is **relational capital**. Do we properly understand the map of clients, employees, suppliers, citizens and shareholders that we need to relate to? Do we have a relational management system at the organization allowing us to ascertain at the end of the year whether we have developed and improved? Do we know the value this gives us, and the lost profits we are missing out on by not managing it properly? Any company keeps going simply by fulfilling the key needs of its stakeholders to a sufficient degree. If it aims to be sustainable in the future, it should be dedicating time and money to understanding the megatrends which will be bringing about changes here, and responding to the challenge of constantly adapting the value proposition in accordance with new challenges.

The management of **reputational capital** is crucial in order to maintain a good relationship with stakeholders. The perception we have generated in their minds is what will prompt them to change their attitudes towards us, to change how they act with regard to us and buy the company's products, services or shares. It is what will induce them to work with us, offer us finance, give us a license to operate or simply deliver their products or services to us for inclusion in our value chain. Reputation creates value, and so we need to manage it as a key intangible.

An enterprise is worth more simply by measuring its intangible capitals and adding them to its tangibles, but that is not enough. Boards of directors are including within their focus the role of upholding the interests of stakeholders as a whole, and taking on responsibility for value creation. The challenge is to shift from one single focus on the shareholder and economic capital, to an overall vision of stakeholders and all the different forms of capital.

STAKEHOLDER MANAGEMENT, OR HOW TO MANAGE STRATEGIC RELATIONS WITH YOUR STAKEHOLDERS

For some considerable time now companies have been forced to interact more closely with the context within which they operate. Although the suggestion of the need for dialogue and relationship with stakeholders may seem to be one of the key foundations of Corporate Responsibility, the fact is that we moved beyond this concept some time ago, and companies are increasingly aware that all their stakeholders impact on their bottom line in one way or another.

It was in 1983 that analyses of the relationship with different stakeholders began from a strategic perspective, viewed as a vital to the success of a company's strategy. **R. Edward Freeman**, mathematician, philosopher, and academic director of the *Business Roundtable and the Institute for Corporate Ethics, The Darden School, University of Virginia*, is viewed as the originator of this vision and the father of the theory of stakeholders. His article entitled **"Strategic Management: A Stakeholder Approach"** for the first time gave these relationships a strategic framework serving to extend the corporate focus, which had previously addressed only the owners, or shareholders, of the organization, subsequently including all those groups affected by or having a potential effect on the course of the organization's operations.

In turn, crises arising both at companies and in the financial markets because of managerial malpractice force both governments and companies themselves to establish an ethical and regulatory framework in business practice capable of generating trust among stakeholders as a whole.

In the era of information, misinformation and information overload, any stakeholder has the capacity to have a more or less intense impact on the course of business operations. We have also seen the emergence of the paradigm of multiple personality, as the dividing line between consumer and employee, citizen and investor, is an increasingly fine one. Hence the importance of developing mechanisms for communication with all the company's interlocutors, and the need to maintain a consistent line throughout the whole conversation.

The conversation with stakeholders needs to provide information about the company's performance, what is to be expected, what the operational and financial or reputational risks are, and this must serve to focus a strategic plan allowing the organization to succeed from any viewpoint.

"Incorporating stakeholder management within the strategic plan and the monitoring system applied to it makes it easier for boards to track these aspects, and can generate a competitive advantage for the company"

Stakeholder architecture, prioritization and dialogue must therefore be modeled as part of the strategic plan itself. If we address the need to provide the company with ethical, efficient, profitable management and strict regulatory compliance, then we must inevitably turn to the most senior managerial bodies. It is the board of directors which is responsible for defining and approving the strategic plans drawn up by management committees. And they bear ultimate responsibility for the existence of the channels and the tools that are needed to facilitate corporate accountability in accordance with the criteria that have been set. In the final instance, their committees also need to oversee the evolution of the company's risks, standards of ethical management and transparent accountability.

Incorporating stakeholder management within the strategic plan and the monitoring system applied to it makes it easier for boards to track these aspects, and can generate a competitive advantage for the company, which will be better able to anticipate both future market opportunities, and the management of potential crises. In short, this underpins a different, integrating, responsible and forward-looking leadership model.

How to identify stakeholders

Simply identifying stakeholders is quite straightforward, since any party capable of dialogue with the company would seem to be a stakeholder, above all at a time when the capacity to express opinions or to spread information about an organization is practically unbounded. However, prioritizing these groups and integrating how they are managed within the complexity of a company demands a methodology helping to simplify processes, and above all to separate out direct stakeholders from others which have a notable influence and impact on them.

THE 6 PHASES OF STAKEHOLDER MANAGEMENT

1. 360º DIAGNOSIS

At LLYC we have developed a methodology to support stakeholder management applicable to any business sector, and based on a prior analysis of each company's reality. This analysis involves conducting a 360° diagnosis which reviews not only the company's communication flows and platforms, but also how the organization functions as a whole. This 360° diagnosis takes into account different realities and different types of company (SMEs, family firms, big business, etc.) and the regulatory management framework within which they exist, without ever losing sight of the company's core business. A sound analysis must never disregard such basic features of the company as its purpose or values, but nor must one neglect such fundamental aspects of management as ethical management, risk management or the implementation of regulatory compliance systems, because this will all in one way or another shape the relationship with stakeholders.

Both this phase and the subsequent stage demand the engagement not only of senior management but also the company's different departments.

"A sound analysis must never disregard such basic features of the company , but nor must one neglect such fundamental aspects of management"

2. THE BUSINESS ECOSYSTEM: SEGMENTATION AND PRIORITIZATION OF STAKEHOLDERS

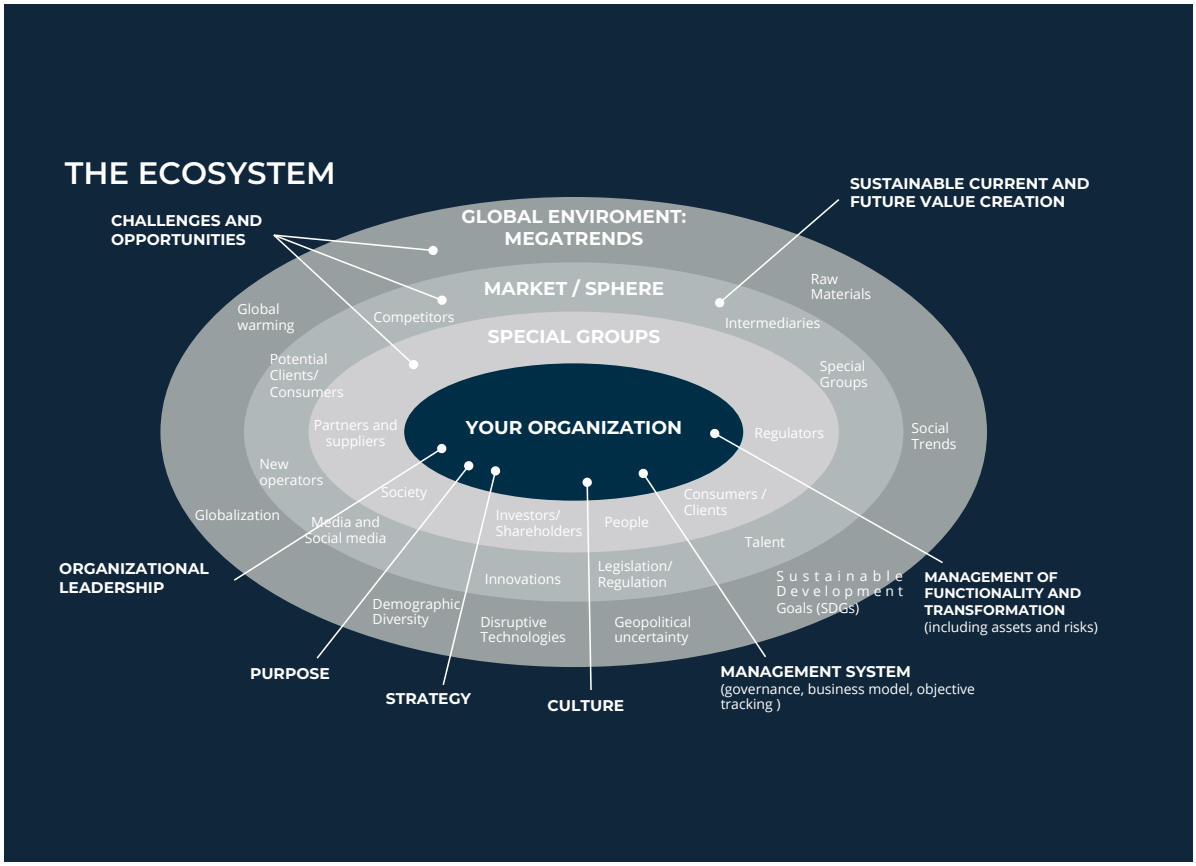
The analysis tells us the state of the company, but once we know its reality we must then proceed to categorize and prioritize the stakeholder groups, bearing in mind the whole ecosystem. The two traditional axioms take into account the influence of each stakeholder on creating value for the organization's balance sheet. This is in turn dictated by their capacity to impact on both daily activities and the company's bottom line. Hence the fact that some stakeholders are easily identifiable and typically of particular significance, such as shareholders, or clients/consumers. It would seem to be stating the obvious that the weight and influence of their decisions always have a major impact for a company. We must not, though, restrict ourselves to the obvious. Depending on the company's type of activity and its profile, there is a whole ecosystem around these stakeholders that may have a highly notable effect on its behavior. The company would define itself as an organization rooted in the society in which it operates or has to operate, based on certain parameters of cooperation or response and expectations of different social groups which will in any event influence its conduct.

We could in this regard speak of other groupings that, without having a direct influence on the business since they have no real capacity to generate income or costs, or to add value to assets, do have the capacity to influence the other stakeholders. This category could include the media, activist groups or, in highly regulated sectors, public authorities themselves. Each case will be different, and on occasions the analysis of this ecosystem may prompt us to classify some of our influencers as stakeholders in accordance with the management demand they will entail for the company.

The snapshot prioritizing these groups is not static. A company's situation may change, as may the power and influence of each of its stakeholders. One clear example of this could be a family firm which is then floated on the stock exchange with a high level of liquidity. This could modify not only the snapshot of its stakeholders, but would also inevitably and unquestionably alter its ecosystem.

Above all, the whole set of company ecosystems is surrounded by existing trends or megatrends in the global environment which mark the path that sooner or later all companies will be required to follow. Monitoring and studying these trends necessarily shapes the envelope within which company management will involve.

ECOSYSTEM (BASED ON THE EFQM MODEL)



3. DESIGNING THE RELATIONSHIP MODEL

Designing the relationship model is an aspect that must be addressed from the very top of the company, as it will dictate its dialogue with all parties involved in how its operations progress.

This must in any event be aligned with the firm's purpose, vision, values, strategy and plan. Without overlooking the fact that when it is applied, it is vitally important to fulfill the principles established in the company's code of ethics.

In order to ensure a fluid relationship with different stakeholders, this must be based on transparency and mutual trust. Transparency lends security to relationships, and this is vital when the company's daily activities involve overlapping interests that, while all being legitimate, differ from one stakeholder to another. Trust is likewise fundamental in evening out these interests, in pursuit of the goal of balance and the fulfillment of the dictates of the strategic plan.

4. THE LEVEL OF RELATIONSHIP AND CHANNELS AND TOOLS FOR COMMUNICATION

As indicated previously, the importance of the stakeholders and their power over the company's operations is a variable that must be measured and so prioritized. Following prioritization of the stakeholders and definition of the fundamental or basic principles of the relationship model, the level of relationship with each of them must be addressed (interlocutors, closeness, frequency), with this exercise serving to define the channels and tools that will be used. A thorough understanding of channels and tools will already have been established during the analysis, and so this phase will define which channel would be useful or most appropriate, by segmenting the corresponding uses. The more standardized and procedural the use of each of the channels, and the clearer its links to each of the stakeholders, the more fluid and transparent relationship with each of them will be.

5. DIALOGUE AND RELEVANT INFORMATION

The dialogue with each group must be an active, specialized dialogue capable of identifying expectations. The expectations analysis and the pursuit of collaboration help to create synergies leading to greater efficiency in the company's processes.

This will also help identify any possible mismatches between each stakeholder's perception of the company's operations, and how it believes it is performing. This ultimately offers a snapshot of the degree of stakeholder satisfaction. And this depiction is hugely important in identifying and managing present or future risks with each of the stakeholders (employment climate, talent attraction, evolution with suppliers, interest in investing in or divesting from the company, etc.). And so dialogue with stakeholders provides essential support in identifying and managing the company's risks.

It should ultimately be emphasized that interaction based on transparency and trust, that provides relevant information for our stakeholders in accordance with their legitimate interests and expectations, fosters relationships focused on value creation, with a positive effect on the organization's capacity to undertake new developments focused on markets, employees, products, etc.

6. ACTION PLANS, HOW THEY ARE MEASURED, AND ACCOUNTABILITY

If we aim to make appropriate use of all the information we are obtaining from different levels of relationship, and sustainably to manage the risks identified, it is essential to draw up action plans with clear objectives focused on improving the relationship with each group, in an integrated manner aligned with the strategic plan. But for this to be possible, it is advisable to implement a reliable measurement system that will provide accurate and comparable information about how each stakeholder evolves.

And this means drawing on an in-depth understanding of the business and international benchmarks or indices, to create a set of monitoring indicators with multidisciplinary working parties. An initial measurement allows decision-making as to the action plans to be implemented in the short, medium and long term.

As we have seen, accountability from the stakeholder management and capital management perspective has shifted from being an obligation with no real meaning, to an activity that allows us to maintain a relationship and active listening with key stakeholders. An activity allowing us to generate feedback in our knowledge system, while constantly updating our strategy with a focus on sustainable value creation in the future.

MANAGE TODAY TO WIN THE FUTURE

Organizations must be capable of creating and realizing **sustainable value propositions for their stakeholders**, above all for their clients, while also needing to take into account their duty to understand and care for the ecosystem within which they operate.

Creating value and improving results in the short term is necessary for any organization, but is no longer enough. We must take into account the conditions arising within the ecosystem and **incorporate all other forms of capital into the equation of shared value creation.**

Now more than ever, organizations have to address two challenges in parallel: **efficient management today** —the short-term vision so as not to stumble over obstacles along the way— and **effective change management** so as to be able to win the future —the long-term vision guiding us along the way. Successfully managing both challenges in equilibrium will help prepare organizations to face up to a tomorrow that has never been more unpredictable.

We need to develop a different **style of leadership** based on purpose, on the engagement of the individuals who give the enterprise model its function, and in which **authority and cooperation** hold greater sway than organizational structure and command.

Instilling frameworks for creativity, research and innovation organizations that **welcome disruption with open arms** is essential in order to increase their value and be in a better position to face up to the future. If we can do so, we will be able to identify and provide an agile, effective and efficient response to the opportunities and threats within the organization's ecosystem.

This means understanding that our organization does not evolve in isolation, but is immersed in an ecosystem the maintenance and growth of which are largely in lockstep with its own. Incorporating a **culture of cooperation** with other players in our own ecosystem so as to change the paradigm and impose a win-win approach is an organizational shift that must be incorporated within daily operations.

As we have seen, the changes on the horizon are numerous and far-reaching. The only way reliably to adapt to them is for **change management** to be seen as a core activity within an organization's strategies. An activity to which boards of directors and management committees need to dedicate enough time and resources.

It is our duty, as organizations, to be the driver of change; to seize the reins and conscientiously ready ourselves to act within a constantly evolving ecosystem. That is the only way to **win the future.**

"Creating value and improving results in the short term is necessary for any organization, but is no longer enough. We must take into account the conditions arising within the ecosystem and incorporate all other forms of capital into the equation of shared value creation"

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