

STAKEHOLDERS DRIVE STOCK VALUES

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Here is a bold statement:
Building cooperative relationships
with external stakeholders can double
the value of your company's assets

That is a proposition not usually put in such stark financial terms, but understanding the real value of such efforts has become an increasingly central goal for company executives and shareholders.

The question I've sought to address through research is whether it is possible to go beyond broad statements such as, "It is in my company's interest to foster a good relationship with local stakeholders," and to be able to say something more definitive, such as, "Failure to engage effectively with stakeholders could wipe \$100m off my company's stock market value."

After extensive, long-range academic work with colleagues (Sinziانا Dorobantu, of Wharton, and Lite Nartey, a former Wharton doctoral student now on the faculty at the University of South Carolina), we have been able to get a clearer understanding of both how to quantify the value of good (and bad) relationships with external stakeholders, and how specific company practices lead to value-enhancing cooperation (or value-destroying conflict).

Our first paper, *Spinning Gold: The Financial Returns to External Stakeholder Engagement*, studied data between 1993 and 2008 from 26 gold mines owned by 19 companies listed on the Toronto Stock Exchange. We concluded that there was a powerful business case for making

the effort to win the hearts and minds of external stakeholders. Indeed, we estimated that the value of cooperative relationships with external shareholders was worth twice as much as the actual market value of the companies' gold.

A cooperation premium

How did the study work? We had two substantial challenges. First, we needed to be able to measure the opinions of a wide array of external stakeholders, including local and national politicians, community leaders, priests, warlords, paramilitary groups, NGOs, and multilateral bodies like the World Bank. Second, we needed to be able to measure the objective value of each company to shareholders (that is, the net present value before taking account of these stakeholder opinions) as well as its market capitalization.

To measure external stakeholder opinion, we systematically hand-coded more than 50,000 "stakeholder events" found in media reports, developing an index of the degree of stakeholder cooperation or conflict for these mines. The term "stakeholder event" included reports from these groups that indicated cooperation or conflict with the mine owners.

At one extreme, for example, would be militia attacks on mines in the Congo; at the other extreme would be groups ↗



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organizing to defend a mine from such an attack. Less extreme events might include peaceful protests by community leaders, demonstrations by environmental NGOs such as Greenpeace, or pledges of additional financial support from multilateral lenders.

We then linked this data to audited information provided to the Toronto Stock Exchange on the quantity of gold reserves, the cost of extraction, and the forecast price of gold. Using this data, we estimated what the value of each mine's gold – thus the market valuation of the parent company – should be, assuming the company can extract the gold with optimal efficiency. When we compared these estimated values to the actual market value it turned out that the companies traded, on average, at a 72 per cent discount.

Next, we examined whether companies that scored higher on the index were expected to have fewer delays and disruptions and therefore had lower discounts. Indeed, the data revealed that by incorporating the cooperation scale into the financial valuation calculation, we could reduce this discount from 72 per cent to as low as 13 per cent.

Disruption discount

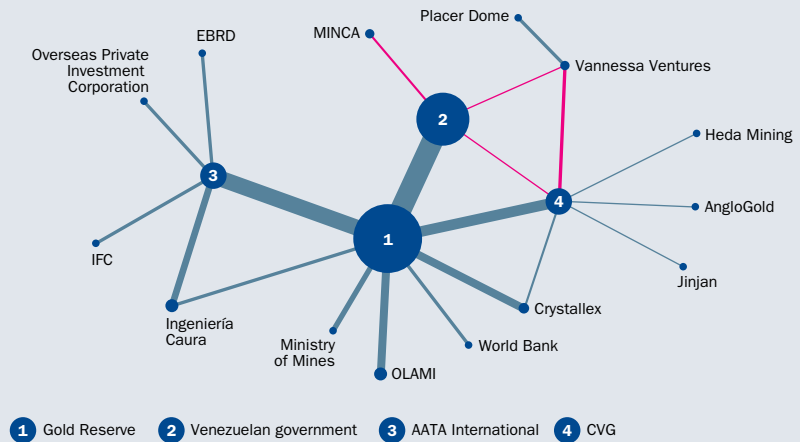
A case study included in our research that clearly illustrated the link between market valuation and stakeholder relations was that of Gabriel Resources. In the late 1990s, this small Canadian mining company began lobbying relevant authorities for permits to develop an open-pit gold mine at Rosia Montana, in the heart of Transylvania, Romania. The project was to be the largest of its kind in Europe and as long as it looked set to go forward, the company's market valuation rose steadily, to more than \$260m on the Toronto exchange.

However, when members of the local community learned about possible disruptions to local settlements and ancient landmarks, they reached out to Stephanie Roth, a well-known Anglo-Swiss environmental activist (already known in the country for her successful opposition to a Dracula theme park), to mount a campaign against the mine on their behalf. ➡

MAPPING SUCCESS: EVOLUTION OF STAKEHOLDER NETWORK FOR GOLD RESERVE'S BRISAS MINE IN VENEZUELA

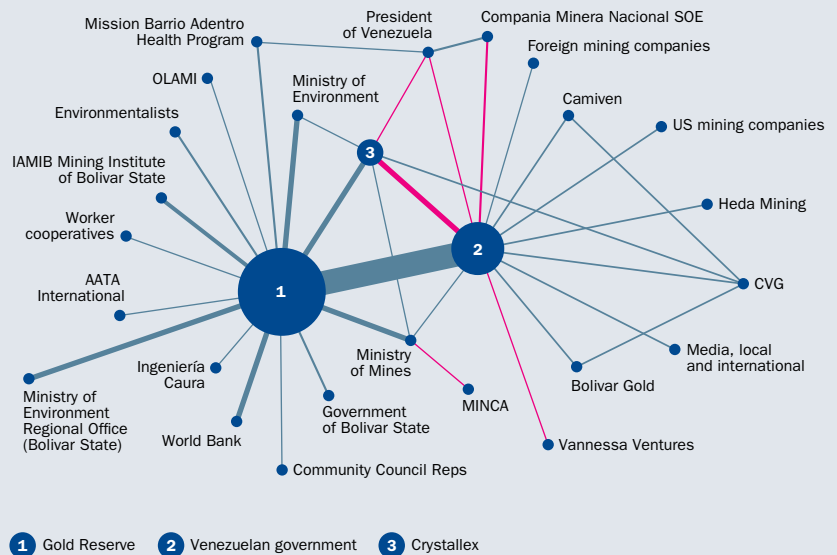
2004

A stakeholder map of Gold Reserve's Brisas mine depicting the strength of influence of the organization (small versus large circles), cooperative or conflictual relations (blue versus pink ties) and the frequency of interaction (wide versus narrow ties). The key issue dominating this period is the Venezuelan government granting approval to Gold Reserve to develop the Brisas mine.



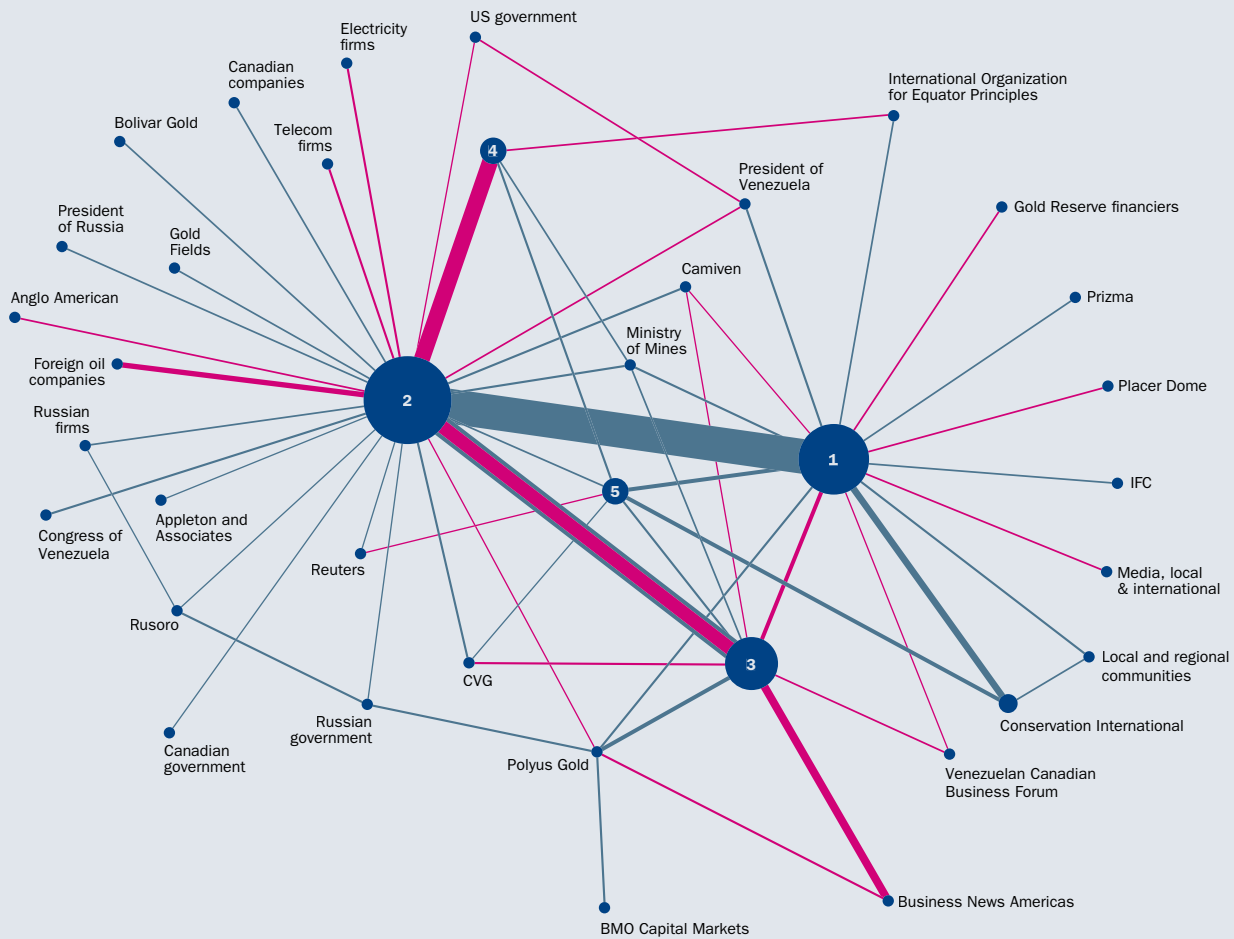
2006

Cooperative relations with Venezuelan authorities continue as Gold Reserve moves to complete its social and environmental impact assessment. The company also holds a public consultative meeting with nearby communities. Venezuelan authorities approve a new mining bill returning inactive mining properties to the State. Meanwhile, operators of the nearby Las Cristinas project (Crystallex and Vanessa Ventures) face possible contract revocation.



2008

Despite growing concern among foreign mining companies about the pending mining law, Gold Reserve obtains the environmental permit. However, Venezuelan authorities consider combining operations of both Brisas and Las Cristinas projects under a Russian operator. As 2008 ends, Venezuelan authorities refuse both Gold Reserve and Crystallex mining permits and despite cooperative overtures by Crystallex, the Las Cristinas mine is nationalized.



- 1 Gold Reserve
- 2 Venezuelan government
- 3 Crystallex
- 4 Foreign mining companies
- 5 Ministry of Environment

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“It is possible to engage stakeholders with the same degree of analytic precision that companies use to model customer retention or supply chain management”

Rising opposition ensued, from a broad spectrum that included the Romanian Orthodox church, the Romanian Academy, the Hungarian minority in Romania, the Hungarian government, Greenpeace, Friends of the Earth and various other environmental organizations. This concerted action translated into a steady decline in Gabriel Resources’ stock in the first half of the 2000s, with its market valuation falling to as low as \$181m.

During the latter half of the 2000s, the company’s shares seesawed in response to the ebb and flow of support. When new management took over in 2005 and embarked on a public relations campaign, shareholders welcomed these efforts by driving the company’s market value above \$1bn. When the Romanian government undermined Gabriel’s prospects by suspending an environmental impact study in 2007, the company’s market valuation slid back to \$344m. The arrival in 2009 of yet another management team, which focused more systematically on engaging stakeholders, propelled the company’s market valuation to as high as \$1.84bn.

The dynamics of conflict

In our more recent work, we have used the data from the same 15-year study to examine the evolution of each gold mine’s

stakeholder network over time, in order to see what specific company practices improve cooperation and minimize conflict.

We have created a strong visual tool to plot the “stakeholder landscape” over time. These dynamic stakeholder maps represent the more powerful organizations by larger bubbles and the strength of ties between organizations by the width of the lines linking them. Color represents the degree of cooperation and conflict. It is possible, by rapidly running a series of annual or quarterly figures through the tool, to form a sort of movie that captures the dynamics of the stakeholder network (see snapshots of the tool in action on the previous pages).

What does the analysis of these maps tell us about the sort of strategies that enhance cooperation and reduce conflict?

For one thing, it is important for companies to build slowly and to avoid short cuts, such as making initial connections to powerful but disliked actors (for example, political power brokers). Such ties may be beneficial at first but likely will lead to conflict. Similarly, making a large number of connections to local stakeholders pays off in the long run. Third, an attempt to make a connection that is not reciprocated is a wasted effort. Reaching out or providing resources to an external stakeholder does not necessarily signal a reduction in conflict or increase in cooperation. The initial action must be reciprocated and, ideally, deepened over time if it is to alter perceptions and, more importantly, behavior. And finally, undertaking activities jointly with stakeholders – such as gathering, monitoring, and evaluating information together – significantly increases cooperation over time.

Taking this work further, we are now exploring the influence of external dynamics – for example, to what extent do these recommendations vary with the degree of press freedom and democracy in a country, or in terms of the magnitude and timing of external shocks investors may be faced with.

The road less travelled

We studied mining companies first because the nature of their business required them

to enter some of the riskiest areas in the world. Industry leaders made every mistake possible and got completely burned – but then they learned. Now, ironically, some of these companies, which are often thought of as environmentally uncaring, are actually at the forefront of sustainability and stakeholder engagement. Other multinational companies could learn a great deal by studying what these mining companies are doing around the world.

Our research quantifies what many companies have realized through experience: that cooperation rather than conflict with external stakeholders improves the chances of delivering a business plan on time and on budget.

Furthermore, it shows that it is possible to engage stakeholders with the same degree of analytic precision that companies use to model customer retention or supply chain management. Such an approach requires thinking of corporate social responsibility and government affairs as central to enterprise risk management and strategic planning, rather than just a cost center. It also strongly supports the case that insufficient investment in political and social capital can turn revenue-generating assets like a mine into a costly liability.

Our results also provide an immediate retort to those who argue that pure profit maximization should be the only goal of a public company. It is a false dichotomy: to maximize profits *requires* a degree of stakeholder engagement. As the head of sustainability for a major mining company recently said, “If a modern mining company thinks its competitive advantage is in mining, they are sadly mistaken.”

The lessons are widely applicable. Any organization or individual with project-specific stakeholder, financial, and operational data can run the exercise. It can apply not only to companies extracting resources but also to those building hotels or retail outlets, or indeed to politicians running for office. Analyzing the data and pursuing a strategy designed to enhance cooperation and minimize conflict with stakeholders is not just socially responsible, our studies show, but is also enlightened self-interest. 🌱