# 1 Business Strategy and Value Preservation

The superior man, when resting in safety, does not forget that danger may come.*

**Confucius**

## 1.1 CORPORATE STRATEGY IN AN ERA SEEKING SUSTAINABLE SUCCESS

So far the twenty-first century has already seen a litany of corporate failures and financial scandals that have had a significant impact on the reputation of the corporate world, and perhaps more tellingly on broader society. The early part of this century highlighted the dangers of excessive optimism with the boom and bust of the dotcom bubble, and it also identified continued weaknesses and deficiencies in corporate behavior resulting in the demise of corporate giants such as WorldCom, Enron, and Arthur Anderson. At the time such events were heralded as valuable lessons and served as warnings for future generations. Less than a decade later, the dangers of excessive optimism were again highlighted, this time by the occurrence of what is now commonly referred to as the great financial crisis that affected the planet on a global scale and its impact is still being felt in many geographic regions (UNCTAD 2010).

These events have clearly shaped how society, in general, now views the corporate world and indeed how it views the working of capitalism and the capitalist system. As a consequence, stakeholders all over the world are now placing increased pressure on organizations to focus on their stakeholder obligations, with a view to delivering sustainable value to stakeholders in the long term. This has resulted in more and more organizations recognizing their obligations in this regard, and

* Per *The Best Confucius Quotes*, April 2015, James Alexander, Crombie Jardine Publishing Ltd, Bath, UK.

many are now duly focusing their attention on the concept of sustainability and the delivery of long-term stakeholder value.

There now appears to be an increasing recognition that any such long-term obligation can only be delivered once the concept of sustainability in its broadest sense has been successfully incorporated into how the organization does its business. This means that long-term sustainability must be embedded into the organization's vision and become a common feature of consideration at strategic, tactical, and operational levels within the organization itself. It means addressing it within the corporate strategy.

Traditionally, the concept of corporate strategy was considered to be concerned with helping to ensure that the organization was capable of providing sustainable above average industry performance, thereby allowing it to perpetually deliver superior returns and help create wealth for its shareholders. The global financial crisis however clearly exposed systemic weaknesses in the prevailing corporate strategy on an international scale. The subsequent fallout from this seismic event has resulted in the reputation of the corporate world being severely tarnished in the eyes of many stakeholders. The resulting negative impact has been felt not only by shareholders but also by management, staff, clients, business partners, suppliers, regulators, local communities, and indeed society in general, who all have eventually suffered as a consequence of flawed corporate strategies.

The corporate world now faces multiple pressures to reform the manner in which business is conducted and how individual organizations are managed. Stakeholders are now demanding higher standards of corporate citizenship in terms of integrity, ethics, and accountability. They are also demanding an improved strategic direction in order to provide them with greater protection and assurance going forward. Increasing pressure in the form of proxy advisor demands and pressure from stakeholder activist groups have prompted a rigorous search for an improved approach to corporate strategy, one that is aimed at helping organizations to foster an age of long-term sustainability.

### 1.1.1 Corporate Strategy: A High-Level Perspective

Corporate strategy is typically concerned with the overall scope and direction of an organization's strategic activities. It is concerned with the *big picture*, the complete strategic scope of the enterprise, and how its various business activities operate together in order to help achieve particular strategic goals and objectives. Corporate strategy is commonly used to help develop a long-term plan for a company's success, the main purpose being to help ensure that the business can outlast the competition over the long term, regardless of the type of internal or external conditions that may present themselves. It is regarded as the roadmap to be followed by the organization and can also impact on its culture and be a driver of corporate behavior.

#### 1.1.1.1 The Strategic Agenda

Corporate strategy will be dictated by the organization's strategic agenda. Typically, the board of directors set an organization's strategic agenda after giving due consideration to the relevant organizational conditions. The strategic agenda should be set to address the organization's aspirations in relation to issues such as growth, performance, and change. The board, in association with the executive management, should provide the vision and leadership required to determine the appropriate path that they consider will best deliver on the organization's aspirations over time.

An organization's aspirations should represent a reflection of its culture and the expectations of the organization as a whole. Corporate culture is commonly referred to as *the smell of the place* or *how things are done around here*. An organization's culture reflects the common shared values and ideals that are embedded within the organization. Values include the beliefs that are shared throughout the organization. They drive culture and strongly influence the behaviors, actions, and decisions of the board, management, and staff. The organization's aspirations are reflected in its sense of *raison d'être*, its aim, its reason for being. Its aspirations reflect the purpose of the organization, its ambitions, and the planned journey ahead. This journey ahead is best understood and described in the organization's vision and mission statements.

#### 1.1.1.2 Vision and Mission Statement

The requirement for a vision and mission statement is aptly described in the following words by the late Warren Bennis, an influential authority on leadership, when he said: "To choose a direction, an executive must have developed a mental image of the possible and desirable future state of the organization. This image, which we call a vision, may be as vague as a dream or as precise as a goal or a mission statement" (Hindle 2008).

*The vision*: Ideally the corporate vision should help to immediately visualize the *big picture* by providing a description of the organization's desired future state. It represents a broad, forward-thinking image that the organization should have for its purpose and intentions before it sets out to achieve its goals and objectives. Typically a corporate vision should be short and succinct, and represent an inspiring image of its mindset and aspirations. It should describe where the organization wishes to go and what it is trying to create and develop. Ultimately it should describe what it intends to achieve in the future and should represent a source of motivation for the workforce.

*Mission statement*: A mission statement should typically be more detailed than the corporate vision and represent a statement of rationale regarding the fundamental purpose of the organization. It should help guide the decisions and actions of the organization and it is therefore important that it is stated clearly so that it is understood by all, and can serve as a constant reminder to its stakeholders of the purpose of the organization's existence. It can be used as a reference point to evaluate the current activities or to help resolve trade-offs or disputes between different stakeholders. The mission statement should broadly outline the aims of the organization and what unique contribution the organization provides to its stakeholders. The lack of a clear mission statement diminishes the organization's ability to verify that it is progressing on its intended course.

The vision and mission statements help provide a background to the organization's strategic objectives for the future, without specifying the measures that need to be taken to help achieve the desired goals. In this way, they help to provide a context within which the organization's strategy can be formulated.

#### 1.1.1.3 Managing Corporate Strategy

The clearer the organization's vision and mission statement, the easier it is for the strategic management of the organization to clearly oversee the setting and implementation of its corporate strategy. The corporate strategy represents a statement of strategic intent for the organization by way of strategic objectives. The strategy itself should be based on the principal findings of the strategic assessment conducted by the organization's strategic management. It should clearly outline the strategic choices that have been made and the rationale supporting these choices. Corporate strategy refers to the highest business strategy of the organization. It should address the mix of markets the organization intends to compete in and the way in which the strategic network should be coordinated and integrated.

The board of directors and the executive management team are expected to bring considerable professional experience and diversified business insight to their contribution on the organization's corporate strategy. Their sound judgment, specialist knowledge, and leadership qualities will be of particular benefit when deciding on which services, products, and markets to compete, and in which geographic regions to operate. Management of the corporate strategy process typically involves a number of basic phases.

*Strategy formulation*: The corporate strategy is in effect the path that has been chosen in order to arrive at the end vision. It therefore represents the roadmap by which the organization intends to complete its mission. A clear formulation of the corporate strategy should help the board and executive management to connect the ideas, assumptions, and decisions that are driving the organization's strategic agenda. It should help to provide a definite plan of

action going forward to achieve this end. In determining corporate strategy, due consideration should be given to matching the organization's strategic activities to the organization's environment, its available resources (e.g., people, processes, and technology), and the extent of its capabilities. Due consideration should also be given to the values the organization wishes to espouse and the expectations to be set for its various stakeholders. The strategy formulation process should help set the organization's strategic objectives and help to identify and select an appropriate business model. It should clearly state the organization's strategic goals and outline the strategic measures and initiatives required to achieve these objectives. These strategic goals should be tangible and achievable in order to be helpful in guiding all of the organization's business activities going forward.

*Strategic planning*: Corporate strategy is typically implemented via a strategic plan; however, there are many examples of organizations whose failure was attributed to its inability to successfully execute its strategy in practice. Successful strategy implementation requires a carefully planned approach, a very high level of discipline, and involves the effective implementation of critical business activities in order to make it work. It is unreasonable to expect the attainment of strategic goals without the adherence to a carefully planned approach and the implementation of the required tasks. The strategic planning process should consider the corporate culture, the resources available to the organization, and the projected timescales required to achieve the stated strategic objectives. The strategic plan should guide and direct the subsequent tactical and operational planning exercises, in order to help ensure that these plans are in alignment with the organization's strategic objectives. The resulting plans should identify tasks that are specific and measureable and will noticeably contribute toward the achievement of the strategic objectives. Many strategies fail due to poor or inadequate planning, and the quality of the final plans is generally a reflection of the quality of the planning process.

*Strategy execution*: Once a clear strategic plan has been formulated, the executive management is then responsible for ensuring the effective and efficient implementation of that corporate plan. Execution of the corporate strategy via implementation of the strategic plan is critical to success and should never be underestimated as it is never guaranteed. Indeed, many strategic commentators suggest that execution is the key to competitive success, as making the plan work can be an even bigger challenge than formulating strategy, or creating a strategic plan. There are many factors that can hinder successful execution, including internal politics, resistance to change, and the occurrence of hazard events. Execution involves putting the plan into action by translating planned tasks and activities into the completion of verifiable actions. It involves the effective performance of the necessary tasks outlined in the plans and this requires considerable organization, and employing resource management and change management practices. This is perhaps best achieved using a top-down approach that incorporates the full chain of command so that the required action steps are performed at strategic, tactical, and operational levels. The executive management team needs to collaborate with the line management to help ensure timely, effective, and efficient performance of the required tasks.

*Strategy review*: Once a strategy is executed according to the plan, there is a reasonable expectation that it will prove to be successful; however, a successful outcome can never be assumed or taken for granted as there is *many a slip between the cup and lip*. The strategy needs to be a living breathing concept that needs to be continuously monitored and assessed. The success or failure of a corporate strategy cannot be adequately assessed without a process to review how well the strategy is performing in practice. This should involve comparing the actual results against the benchmark of intended milestones and outcomes. A strategy review process represents an evaluation of the corporate strategy and substrategies, and an appraisal of the execution of the strategic plan. The process of strategy review is equally as important as the processes of strategy formulation, strategy planning, and strategy execution as it evaluates the logic and rationale of the original strategy and appraises the effectiveness

> and efficiency of the implementation of this strategy. It enables the organization to focus on the appropriateness of the current strategy and to question the soundness of previous assumptions, which may no longer stand up to scrutiny due to changing circumstances and the dynamic environment of the twenty-first century. It allows an organization to re-evaluate the validity of the previous strategic choices and the extent to which ongoing performance has helped achieve the desired results. It also allows an organization to measure the variance that exists between the original desired results and the organization's actual results.

In certain cases, a strategy may prove to be successful from the very beginning, and the organization may be prepared to ratify it and endorse it going forward. In other cases, it may be determined that there is a considerable room for improvement and that the existing strategy needs to be modified or adjusted accordingly. The extent of this modification will need to be considered on the back of the results of the strategy review. In certain scenarios, the results may indicate that a serious corrective action is required. In such cases, the existing strategy may be rejected as a failure, and it may be determined that a new strategy is required and needs to be formulated.

### 1.1.2 Short-, Medium-, and Long-Term Orientations

An old Chinese proverb states that *a journey of a thousand miles begins with a single step* and so it is with corporate strategy. When considering the topic of corporate strategy, it is important to bear in mind that although an organization's vision may reside in the distant future, the corporate strategy should present a roadmap that will guide the organization toward the achievement of this long-term vision. This involves not only clearly identifying the organization's long-term strategic objectives, but also setting achievable strategic goals in the medium and short terms. Ideally short- and medium-term goals should be aligned to long-term strategic objectives so that the achievement of short- and medium-term goals act as stepping stones to the accomplishment of the longer-term strategic objectives, and in the process, fulfilling the organization's mission statement and ultimately realizing its corporate vision.

#### 1.1.2.1 Short- or Long-Term View: A Sprint or a Marathon?

Although the adoption of a long-term focus in order to realize the corporate vision is indeed a worthy ambition, in the modern world it has to be acknowledged that a short-term focus is necessary in order to ensure immediate day-to-day survival. Short-term gains are required in order to achieve a long-term growth; however, excessive short-terms gains can sometimes lead to the detriment of the long-term growth and stability. It must, however, be accepted that to be successful in the long term, an organization also needs to have a certain degree of short-term success.

In the wake of the great financial crisis, many economic commentators are of the opinion that the world's financial markets are somewhat addicted to the short-term view, which in turn leads to an unhealthy obsession with the achievement of monthly revenue targets and quarterly earnings. In this light, short-sighted remuneration and compensation structures also often intensify this obsession. In fact, there is a prevailing notion that during the build-up to the global financial crisis, the business world in general became preoccupied with the pursuit of short-term gains and lost sight of the long-term bigger picture. This resulted in the development of what are often referred to as *strategic blind spots* that were later to negatively impact on wider society, both economically and socially.

#### 1.1.2.2 The Way Forward

What is required is a balanced view whereby the organization has a clear understanding that there is no disconnect between an organization's present and future, so that they are intrinsically connected and do not exist in a vacuum. First, however, there needs to be an acknowledgment that short-term gains can indeed result in a long-term gain; however, excessive short-term gains can in fact result in a long-term pain. It must also be acknowledged that, in some cases, short-term pain is required in

order to achieve a long-term gain; however, excessive short-term pain can in and of itself also lead to a long-term pain.

This acknowledgment can help an organization appreciate that what is required is a blended approach, where one eye is focused on the medium to long-term horizon and the other eye is focused on addressing short-term issues that need to be handled in the present. Although sustainability is generally associated with the long term, its achievement requires focusing on the short-, medium-, and long-term horizons, and an appreciation that there are times when short-term instant gratification is required to be sacrificed in order to help ensure longer-term gratification.

## 1.2 CORPORATE STRATEGY AND VALUE CREATION

Although one organization's vision and mission statement may differ considerably from that of another, generally speaking, the vision and mission statements are concerned with contributing value to the organization's primary stakeholders. Corporate strategy is subsequently concerned with actually delivering this value to these stakeholders over the short, medium, and long terms.

### 1.2.1 The Value Concept in Corporate Strategy

The concept of value is an inherent aspect of the twenty-first century capitalism. The promise of value is therefore an integral part of any corporate strategy, and addressing this value proposition is an essential element of corporate strategy. Developing a value proposition is based on a review and analysis of the benefits that can be delivered by the organization to its stakeholders, less the associated costs. The residual balance represents the value proposition to its stakeholders. In order to address the value proposition, it is important to clearly understand the concept of value.

It is said that value is like beauty, as it is *in the eye of the beholder*, and it is often equated with a sense of worth that in turn can act as an incentive to take a desired action. The notion of value is increasingly being measured in both quantitative and qualitative terms in order to reflect both its tangible and intangible nature. Value may have different meanings in different contexts and to different stakeholders in terms of intrinsic as well as extrinsic value. In the final analysis, an organization's understanding of stakeholder value is best determined through engagement with its stakeholders.

#### 1.2.1.1 Business Value as a Strategic Concept

In the realms of strategic management, the term business value is perhaps a somewhat informal concept, without any agreed consensus. The term is generally used to include various forms of value that can help determine the corporate health of an organization. More recently, the term business value is being expanded beyond the traditional, financial, and economic value to also encompass numerous other forms of perceived value. Although historically the notion of value was predominantly associated with monetary contribution, not all forms of value are directly measured in pure monetary terms and a broader notion is now emerging.

As well as value that may be quantified in financial terms, value may also manifest itself in what is described as utility value. Utility value represents the qualitative aspect of value, and it reflects value as perceived in the minds of stakeholders such as consumers and users through its capacity to meet individual human needs. Utility value is therefore recognizable by its demand and in business it is realized through its consumption.

Value in the broader sense is therefore increasingly based on its worth to the stakeholder and the stakeholder's assessment of its worth. Stakeholder value may not necessarily be assessed from a single source such as its monetary benefit, but may also be assessed in terms of what it can provide to the stakeholder and how it can help the stakeholder to achieve their various objectives. Value may therefore be measured in terms of physical, emotional, and intellectual stimulation. Consequently, the value of a product or service and the price of a product or service are not necessarily one and the same thing. In the famous words of Warren Buffett, "Price is what you pay. Value is what you get."

Business value therefore can embrace both tangible and intangible assets such as the organization's balance sheet value and the value associated with its business model and other intellectual capital. Indeed, the concept of business value can also embrace the theory that an organization's value can best be viewed as a network of relationships with stakeholders who are both internal and external to the organization itself. In this context, business value is concerned with the value embedded in these relationships over time.

#### 1.2.1.2 Value Delivery and Realization

In business, value needs to be considered in terms of the value delivered to the various stakeholders of the organization. Value delivery refers to how the organization provides benefits to its stakeholders in the short, medium, and long terms. Organizations are concerned with questions such as *what benefits are we providing, how are we providing these benefits, and who are we providing these benefits to?* Follow-on questions may include *how can we improve on our delivery of value?* Value delivery can therefore be considered to be a source of potential competitive advantage.

Value realization on the other hand can refer to the organization's own return on its investment (financial or otherwise). Value realization involves putting in place the appropriate set of activities that are required to help ensure the expected delivery of value. The objective is to ensure that the full projected value is attained within the expected timescales. Hence the realization of value is a critical element of any successful corporate strategy. For example, once value realization starts to occur in the form of increases in cash flows, profitability, net worth, and so on, additional strategic options may begin to present themselves. Such options can include the opportunity of further growth through acquisitions, newfound interests from potential capital partners, additional strategic alliance opportunities, and enhanced exit strategies. Each organization must clearly establish its own value realization metrics in order to monitor the process effectively.

From a shareholder perspective, value may be realized through annual dividend income, or via an attractive sale or other liquidity event that provides the opportunity to transform equity into cash or other valuable liquid assets. This may involve taking-up options, or the sale of stock or other assets in the organization, whether in whole or in part, at a value that is determined by the market, which may be in excess of the shareholders' initial investment, and thereby yielding a healthy return on that investment. Other stakeholders may realize value in nonfinancial ways such as through corporate social responsibility and environmental initiatives. Over time, the organization's capacity to realize sustainable value for its stakeholders is a function of the organization's ability to create and preserve value on an ongoing basis.

### 1.2.2 The Value Creation Focus

What does the term value creation mean? The International Integrated Reporting Council (IIRC) describes the value creation process as follows: "Value is created through an organization's business model, which takes inputs from the capitals and transforms them through business activities and interactions to produce outputs and outcomes that, over the short, medium and long term, create or destroy value for the organization, its stakeholders, society and the environment" (IIRC 2013a). An organization can therefore create value over time through conducting a wide range of business activities that in turn produce outputs. These activities can occur within the many different environments in which the organization operates, both internal and external to the organization itself. This involves developing and managing relationships with its key stakeholders[*] with whom it interacts, and on whom it depends for its survival. Value can be maximized by fulfilling the needs of these key stakeholders while also considering the interests of society in general and the impact on the environment. The extent to which these needs and interests are addressed will determine the type of value that is created.

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[*] The nature of the stakeholder relationship is addressed in Chapter 3, Section 3.3.3.

#### 1.2.2.1 The Business Model

An organization's business model describes how the organization intends to go about creating value for its stakeholders. The business model lies at the core of an organization, and its long-term success will be determined by the resilience of its business model over time. An organization's chosen business model represents its business approach and the fundamentals of its business processes and key business activities. It reflects its system of inputs and outputs that in turn lead to outcomes that create value and help the organization to achieve its goals and objectives, and help to fulfill its mission statement in the longer term.

Organizations that operate in a number of different market segments may employ more than one business model; however, due consideration needs to be applied to appreciating the level of interconnectivity that exists between these business models and their business activities. The business model typically includes addressing a number of issues.

*Key business activities*: The business model should clearly identify and outline the key business activities that the organization intends to operate. Generally an organization's key business activities involve the processes by which the organization intends to convert its inputs to outputs. These outputs generally take the form of either products or services that can provide value to the organization's key stakeholders. When considering its business model, the organization should clarify how it intends to differentiate itself in the marketplace in terms of such issues as its unique selling point (USP) (e.g., product differentiation, market segmentation, supply chain, and distribution channels) to be used to deliver its products or services to its stakeholders. It should focus on how the organization intends to convey its message to its key stakeholders and how it intends to communicate with them on an ongoing basis.

*The inputs*: The essence of the business model is the conversion of inputs into outputs in order to create value. The business model should clearly identify and outline the key inputs required by the organization, which when applied through the business process will convert into value-added outputs. These key inputs represent those ingredients that the organization depends on in order to deliver value. The performance of its business activities provides the organization with its source of differentiation by converting its key inputs from raw materials into its finished end product. Key inputs are derived from various types of capital whereby business activities draw on many types of capital in one form or another as inputs into the value creation process. The key inputs and how they relate to the various capitals from which they are derived represent a critical aspect of the organization's business model. How the corporate strategy links key inputs to capitals, opportunities, risk, and financial performance is critical to the success of the strategy.

*The capitals*: The business model should clearly identify and outline the types of capitals the organization depends on for its success. Organizations typically depend on different types of capital whether they are considered tangible or intangible capitals. There is no currently universal agreement on the different types of capitals, and they may be classified in different ways by different organizations. One example is the six types of capitals identified by the IIRC as follows: *financial capital, manufactured capital, intellectual capital, human capital, social and relationship capital, and natural capital* (IIRC 2013b). These capitals represent stores of values in various forms that become inputs into the organization's business model. Such capitals can be used to release value in the form of producing outputs and outcomes when they interact and are combined, transformed, and leveraged through an organization's business process. Value is therefore created by the resulting increase, decrease, or transformation of the capitals.

The overall stock of the value stores, which is provided by the capitals, is not fixed over time, but rather they are in a continuous state of flux as they are increased, decreased, or transformed through the activities and outputs of the organization. Consequently such

interactions can in fact enhance, modify, or otherwise affect the overall capital stock. Although in theory the organization's aim is to create value in its capitals, in practice this may also involve the depletion or destruction of the value stored in some capitals while at the same time increasing it in others. In general, this can result in an overall net increase or decrease in the overall stock of the capitals.

Ultimately whether the net effect is perceived as either an increase or decrease may well depend on the perspective of the stakeholder concerned. In many instances, returns in financial capital may be dependent on interrelationships among other forms of capital in which stakeholders have different interests, for example, society and the environment. Also, not all of the capitals required by the organization are necessarily owned by that organization. Certain capitals may be the property of the organization, whereas certain others may be owned, belong to, or be an entitlement of various other stakeholder groups who in turn share in both the value created and their associated costs.

As noted earlier, there are different types of capital that organizations typically depend on for their success; however, not all organizations are equally dependent on the same capitals; therefore, different capitals will have different relevance to different organizations. Although it is likely that most organizations will interact with all of the capitals mentioned earlier, to a certain degree, some of these interactions may be considered immaterial in terms of the organization's business model.

Whether certain capitals are increasing or decreasing can affect the availability, quality, and affordability of those capitals. This is a particular issue of concern for capitals of which there is a limited supply, and capitals that are not possible to be renewed. It is important to bear in mind that the availability and supply of certain capitals can be seriously impacted by the extent to which organizations, both collectively and individually, interact with these capitals. Ultimately, such issues can in turn have a serious impact on the long-term viability of an organization's business model.

*Innovation*: The business model should clearly identify and outline the organization's USP over that of its competition. An organization's long-term success or failure may well be determined by how the organization addresses the age-old requirement to be innovative. The business model should clearly address the organization's attitude to innovation and its approach to responding to change. The flexibility of its strategy, the agility of the business model, and the organization's capacity and capability in adapting to change can have a profound impact on the organization's long-term viability. This may be of particular relevance when faced with sourcing inputs and capitals, and adapting business activities. Logically, the key to a long-term success lies in the extent to which the organization can foster an innovative mindset throughout the enterprise so that it becomes embedded in the corporate culture and is continually present in day-to-day activities.

#### 1.2.2.2 The Value Creation Process

The concept of value creation lies at the very heart of corporate strategy and the business model. The value creation process itself involves initially taking the business inputs and putting them through the business model in order to eventually produce desired benefits in the form of business outputs and outcomes at the other end of the process. This process can involve applying the organization's business processes in order to combine or transform the organization's capitals, thus producing both positive and negative effects on these capitals with the intended result of the creation of value for the organization and its key stakeholders. The nature of those effects will determine the extent of the value created and the outcomes for the different stakeholder groups.

Generally speaking, value can be created over short-, medium-, and long-term time horizons, and it can be created through the use of different capitals and created for different stakeholder groups. Creating value will often involve a trade-off between the effect on different capitals, some positive

and some negative. Such a trade-off should consider the effects both individually and collectively. Assessing the nature of the value created involves considering the nature of the interdependences that exist between the capitals and their relationships with the various stakeholder groups. It is doubtful that long-term sustainable value can be created by solely focusing on increasing one individual capital at the expense of all of the other capitals. The value creation process is typically concerned with a number of issues.

*Value drivers*: The value creation process is concerned with determining the organization's value drivers. Typically it is the organization's value drivers that distinguish it from its competitors as they have a critical role to play in the organization's ability to create value over the short, medium, and long terms. Value drivers can vary by types of business; they can be generic, industry specific, or organizational specific and their range can vary from one organization to another. They reflect certain key elements, characteristics, or attributes that make an organization attractive to its stakeholders. Such elements consist of those unique activities, capabilities, and core competencies that enable an organization to provide a perceived competitive advantage in the perception of its stakeholders.

Value drivers may be tangible or intangible as both can contribute to the creation of value by an organization. They may reflect tangible assets owned by the organization or intangible assets that help to increase the overall desirability of the organization in the eyes of its stakeholders. In the twenty-first century, intangible assets are now increasingly being perceived as primary value drivers. Value drivers reflect those factors that are identified as having the most significant impact on the future value of the organization and those factors that can be most effectively managed and controlled. Therefore identifying and managing value drivers can help an organization to focus its attention on the key activities that are most likely to help in achieving its short-, medium-, and long-term goals and objectives.

*Outputs and outcomes*: The value creation process is concerned with determining the organization's required outputs and preferred outcomes. From a value creation perspective, there is a subtle but important distinction between an *output* and an *outcome*. The organization's business model represents a series of processes and activities that convert inputs to outputs. As outputs tend to be process driven, they therefore refer to planned deliverables whereby the end product typically tends to be tangible in nature and therefore can be accurately anticipated in advance, and precisely and objectively measured in quantitative terms on completion.

Outcomes, on the other hand, refer to the impact that the outputs may have on the stakeholders, both internal and external. Stakeholder reaction is typically reflected by its impact on the organization's capitals. Outcomes therefore relate to the ultimate payoff, the value added to the stakeholder as a direct or indirect result of the outputs. Therefore outputs have an impact on outcomes, but it is important to appreciate that they are not the same thing. As outcomes tend to be reaction driven, they are by their very nature less predictable than outputs and hence more difficult to anticipate as they can take place over multiple time frames.

Although an outcome may be less predictable, it is still measureable in terms of its impact (financial and nonfinancial) on the organization's capitals. This measurement may be more subjective and qualitative when dealing with nonfinancial capitals. Although outcomes can result in the anticipated, planned, or intended consequence of an output, it must also be understood that it can also result in an unanticipated, unplanned, or unintended consequence. As an outcome represents the occurrence of a change in circumstance for a stakeholder, which is a result of targeted outputs, it is important to understand that such a change can have either positive or negative consequences, which means that an outcome can present either a potential upside or a potential downside for the stakeholder and in turn the organization itself.

Although the traditional corporate strategy and the setting of strategic objectives have been primarily concerned with focusing the potential upside and intended positive outcomes, an emerging

contemporary view focuses on an appreciation that corporate strategy must also include a sufficient focus on the potential downside and unintended negative outcomes. A balanced corporate strategy should therefore incorporate a degree of both value creation and value preservation.

## 1.3 DEFENSE OF THE REALM: THE VALUE PRESERVATION IMPERATIVE

In business as in many other aspects of life, the reality is that the nature of uncertainty means that an organization's activities can either have a positive or a negative impact on the value it delivers to its stakeholders. Over a prolonged period of time, this value experience may include numerous fluctuations as a result of both positive impacts and negative impacts. Successful organizations however depend on their ability to both create and sustain value over the short, medium, and long terms. Over the long term, value is compounded by both creating and preserving value.

Once an organization has succeeded in creating value, it then faces the dual challenge of continuing to create value on an ongoing basis while simultaneously ensuring that it can also preserve the value that is created. Therefore, a focus on value creation alone is not considered to be sufficient, it must be accompanied by a focus on value preservation. In any event, successful organizations learn to continuously monitor the dynamics between value creation and value preservation. Unfortunately in many unsuccessful organizations, although value creation quite rightly received due consideration in corporate strategy, there is far less evidence to suggest that value preservation received a similar consideration. In general, it would appear that the requirement to preserve value is much less appreciated and therefore is often neglected.

### 1.3.1 The Concept of Value Preservation

What precisely is meant by the concept of value preservation? If on the one hand value creation is primarily concerned with delivering a potential upside, then on the other hand value preservation is primarily concerned with protecting against a potential downside. Indeed, there are some who would argue that *a dollar of value preserved is indeed a dollar of value created*. Logically organizations that exhibit an ability to preserve the value they have created over an extended period of time tend to be successful, whereas organizations that are unable to preserve their value tend to fall by the wayside. An inability to successfully preserve value will inevitably result in a decline in, or destruction of, value. The value preservation concept therefore lies at the heart of lasting sustainability.

The value preservation imperative represents an organization's obligation to its stakeholders to take adequate steps to preserve value. It represents the measures (formal or otherwise) taken by an organization to defend itself and the interests of its stakeholders from a multitude of potential

hazards (i.e., risks, threats, and vulnerabilities), the occurrence of which could be detrimental to the achievement of the organization's objectives. To successfully deliver on this obligation, an organization requires an appropriate program for self-defense.

#### 1.3.1.1 The Threat of Value Reduction and Destruction

In business, organizations are constantly faced with the threat of value reduction, and often it is the extent of any value reduction that can determine the organization's ultimate fate. The existence of such a threat is simply the reality of doing business. The root cause of such threats can vary considerably, as can their timing and scale. Ultimately there are an unlimited number of events or series of events that can occur over the short, medium, and long term, which can result in the reduction or destruction of stakeholder value. Protecting and defending against the loss of stakeholder value is the kernel of the value preservation imperative. This includes an obligation to take adequate steps to anticipate, prevent, detect, and react to hazard events in order to avoid, mitigate, and manage any potential exposure in a timely manner. Although the extent to which an organization was expected to fulfill this obligation may once have been perceived as somewhat optional, this is no longer the case as it is now considered a business imperative whereby stakeholders expect and demand increasingly higher levels of due diligence in this regard.

#### 1.3.1.2 Value Erosion, Depletion, and Decline

Organizations need to be wary that value can decline in a number of ways, ranging from its sudden depletion as a result of an unexpected liability, its gradual erosion over time due to an outdated or inflexible business model, or its complete destruction due to flawed strategic assumptions. Without taking adequate steps to help preserve value, stakeholders of the organization may find their value being eroded and the organization may find its value declining year on year. Such a decline in value can be witnessed in many different ways, all of which can result in a negative impact for stakeholders either directly or indirectly. For example, it can be witnessed in decreasing market shares, decreasing revenues, increasing costs, decreasing assets, increasing liabilities, lower profits, higher losses, lower share prices, and lower market capitalization.

### 1.3.2 The Corporate Defense Necessity*

In order to help preserve value, organizations are now expected to take steps to protect stakeholder value, and the protection of stakeholder value is synonymous with corporate defense-related practices such as corporate governance, risk management, and compliance activities. Such practices are considered necessary to help defend stakeholder value against the vagaries of any potential threats that could result in value reduction or destruction. In the eyes of an increasing number of stakeholders, once value has been created, it then needs to be protected and defended.

The cost associated with defending stakeholder value was traditionally considered to be part of the inherent costs of doing business; however, more enlightened organizations are no longer regarding this as a cost but rather as an investment in the organization's own long-term sustainability. This suggests that corporate defense-related practices can also represent an opportunity for the organization to create a competitive advantage in the form of security over stakeholder value. It is anticipated by some that such stakeholder value security will in time attract a premium that will be factored into future stakeholder value calculations.

#### 1.3.2.1 Defending and Safeguarding Stakeholder Interests

The calculation of stakeholder value involves an assessment of the extent to which stakeholder value is being optimized, and this can include the extent to which stakeholder interests are being

* Failure by an organization to recognize this necessity will be seen by many stakeholders as representing a strategic "Red Flag".

safeguarded. In other words, there is an expectation that organizations are not only working toward adding to, or increasing stakeholder value, but also taking measures to protect the existing stakeholder value from decline. For example, shareholders expect the organization to take measures to help protect the organization's share price and its market capitalization.

In the twenty-first century, stakeholders are now demanding at least reasonable levels of due diligence in this regard and are increasingly prepared to hold the organization to account should they be considered negligent in their efforts. At a minimum, there is now an expectation that the organization will take all appropriate measures to ensure that it has adequate corporate defense initiatives in place. Organizations are expected to at least be able to provide reasonable comfort that stakeholder value will not be diminished.

#### 1.3.2.2 The Necessity for Improved Corporate Defense Measures

In the build-up to the financial crisis, there were clear signs that stakeholder interests were not being adequately defended (Lyons 2006a), and the subsequent fallout from the related global economic recession has highlighted common weaknesses and deficiencies in relation to organizations' corporate defense activities. Ongoing events continually expose how so many organizations in various business sectors all over the world have failed to adequately defend the interests of their multiple stakeholders. This has resulted in the reputation of the corporate sector being severely tarnished in the eyes of many stakeholders.

Numerous national and international reviews have clearly highlighted the general failure to fully appreciate and consider the potential threat to stakeholder value as a core issue. Many of these reviews identified weaknesses and deficiencies in corporate defense-related activities as having a significant contribution to the occurrence of this economic downturn and have particularly identified areas such as failures in corporate governance and the management of risk and compliance as major contributory factors: "We conclude that dramatic failures of corporate governance and risk management at many systematically important financial institutions were a key cause of this crisis" (FCIC 2011). As a result, numerous stakeholder groups are now demanding improvements in the corporate defense-related measures employed by their organizations to defend their interests. These improvements need to start at a strategic level, beginning with looking at how the value preservation imperative is addressed when setting the corporate strategy.

### 1.3.3 Reimagining Corporate Strategy

Historically, when setting strategy, business organizations have tended to treat the critical issues of value creation and value preservation as separate issues. In retrospect, given the nature of their symbiotic relationship, this has proven to be both an artificial and dangerous segregation. Although, in general, corporate strategy does tend to formally address the issue of how the organization intends to create its value, the equally important issue of how the organization intends to preserve its value generally does not form part of corporate strategy. A similar observation very often applies to the foundations of the organization's business model. The result has been a clear distinction between the overall corporate strategy and a corporate defense substrategy, as generally speaking the strategic echelons of the organization tend to consider the issue of corporate defense as somewhat peripheral to corporate strategy and the business model. Consequently the board and executive management tend to approach corporate defense-related matters with extreme caution because they do not understand how corporate defense fits with corporate strategy. In fact, corporate defense matters can tend to become relegated so far down the strategic priority list that their relevance becomes difficult to establish. In extreme situations, those involved in corporate defense activities can feel as if they are regarded as almost like second-class citizens within the organization. In such circumstances, corporate defense practices can become disengaged from core business activities, and can very often exist in silo-type environments, whereby they operate as an afterthought to core business activities. This type of attitude simply cannot be allowed to continue;

things have to change, and going forward the corporate defense strategy needs to be considered as an essential element of the overall corporate strategy.

#### 1.3.3.1 Re-Examine the Way We Do Business

In many organizations, what is now required is a fundamental re-examination of how their business is conducted. This will involve a serious reframing of how they currently view the creation and preservation of value in the context of their corporate strategy and business model. They will need to redefine not only how their corporate strategy but also how the foundations of their business model address the corporate defense conundrum. Their business fundamentals need to formally incorporate the requirement for an adequate corporate defense strategy in order to help ensure value preservation and facilitate the build-up of business value over time.

Logically it is much more difficult to build-up significant business value over time if while creating new value, existing value is being depleted or destroyed at the same time. It is important that going forward when an organization addresses the challenge of defending stakeholder value within its corporate strategy and that this is clearly stated in terms of strategic objectives and clearly identified as a strategic activity within its business model. Indeed, prudence would suggest that a sustainable corporate strategy and business model should balance the organization's desire to increase its value over time, with the stakeholder desire to defend the value that has already been realized. Long-term sustainable success requires the two to go hand-in-hand, a concept that needs to be embedded throughout the organization, and across all of its business activities. An appreciation of how an organization needs to address defending its stakeholder value has far reaching implications at strategic, tactical, and operational levels and presents interesting challenges for the organization itself.

#### 1.3.3.2 Corporate Defense Is No Longer Considered Optional

To establish a sustainable strategy and business model, an organization needs to actively and systematically embed corporate defense-related practices at the strategic, tactical, and operational levels. Embedding the corporate defense concept into an organization's DNA requires a basic acknowledgment from the very top to the very bottom of the organization that good corporate defense represents a business imperative, rather than some sort of prerogative or optional add-on. Redefining strategy and the business model to incorporate the appropriate mix between the focus on increasing value and defending value will have significant implications for the organization and all of its stakeholders.

## 1.4 STRIKING A BALANCE BETWEEN OFFENSE AND DEFENSE

Military to civilian transition.

An old sporting aphorism states that *offense wins games, defense wins championships*. In business speak, offense refers to the focus on bringing the dollar in through the front door, whereas defense refers to the focus on preventing the dollar from leaving through the back door (Lyons 2014). In other words, in the corporate world, offensive activities are associated with the organization's focus on upside rewards, whereas defensive activities are associated with the organization's focus on the prevention of downside loss. What is essential is finding the correct balance between taking larger risks and reaping larger rewards. If organizations in the twenty-first century are to deliver long-term sustainable value, they must learn to achieve a healthy balance between their focus on offense and their focus on defense. Getting this balance right can help provide better opportunities for delivering long-term sustainable value.

A commonly held view of economic theory is that the Western capitalist model is primarily driven by the motivating factors of greed and fear. The former is the motivation to extend ourselves in search of even greater rewards, whereas the latter is the motivation to protect what has already been achieved lest it should be taken from us. Progress no doubt requires both, whereas prudence and common sense would suggest that long-term sustainability requires a healthy blending of the two.

Unfortunately the search for balance, or the middle path, is not a new concept and is one that goes back thousands of years. In the Western philosophy, especially that of the Greek philosopher Aristotle, the *golden mean* represented the desirable middle between two extremes, one of excess, the other of deficiency. Another famous Greek philosopher Socrates taught that man "must know how to choose the mean and avoid the extremes on either side, as far as possible." The search for balance continues to this day.

### 1.4.1 The Tao of Corporate Defense

In the Eastern philosophy, the Taoist tradition places great emphasis on the search for harmony between opposing extremes or forces. Taoism refers to the concept of the *yin* and *yang,* which is used to describe how seemingly opposing forces are inherently interconnected and interdependent in the natural world. Each of these forces is present within the other and in turn gives rise to the other. There are many examples of natural dualities such as dark and light, night and day, female and male, wet and dry, and action and inaction that are cast as yin and yang in the Taoist thought. In the corporate context, perhaps the duality of offense and defense can best be understood and appreciated when viewed in this context.

#### 1.4.1.1 Offense and Defense Viewed as Yin and Yang

Viewing offense and defense in terms of the Taoist duality can help provide a higher level of insight into this complex relationship. Offense (yin) and defense (yang) are considered to be antagonistic yet complementary principles that fit together seamlessly. They represent opposites that are bound together and intertwined, and are capable of working together in a perfect harmony. Offense and defense are considered to be the two halves within a greater whole and together they complete a unifying circle. Their relationship is not static as every aspect of business has both offense and defense aspects, and these continuously interact and never exist in a stationary state as the balance ebbs and flows. It is therefore impossible to talk about offense or defense without a reference to the opposite, as offense and defense are rooted together and one cannot survive without the other. It is therefore important that they are not separated or addressed in isolation.

In essence, offense and defense actually transform each another, as each contains a portion of the other within it. Offense contains within it the potential for defense, and defense contains within it the potential for offense. They are finely balanced in a dynamic equilibrium, whereby a deficiency in one can unbalance their relationship, and if one disappears the other is very likely to follow. In short, when either offensive or defensive activities become the subordinate, the whole is likely to suffer eventually.

Unfortunately, in the business world, this is rarely immediately apparent because offense elements are clear and obvious, whereas defense elements are more hidden and subtle. Therefore extremes in offense are far more regular than extremes in defense, although this can also occur. Ultimately, however, extremes in either offense or defense can result in the development of an organization that is putting its long-term sustainability in jeopardy.

### 1.4.2 The Current Strategic Imbalance

Unfortunately, the financial crisis and indeed more recent corporate scandals continue to clearly highlight the imbalance that currently exists between offense and defense in the corporate mind-set. Recent events indicate that short-termism tends to focus disproportionately on the former, often neglecting the latter. Such a mind-set has resulted in excessive risk taking in search of short-term rewards at the expense of longer-term sustainability.

There were many reasons for the financial crisis, and the following strategic, tactical, and operational issues have strongly contributed to the unhealthy imbalance referred to earlier (Lyons 2012a):

- An overly narrow focus on pure financial metrics while ignoring important nonfinancial issues
- A focus on short-term interests at the expense of broader, long-term stakeholder interests
- The lack of board-level appreciation of the necessity of having a formal, systematic *corporate defense program* in place within their organization to help ensure that their stakeholder interests are adequately safeguarded
- The lack of a seat at the C-suite table for a *defense champion* to challenge, scrutinize, and add a degree of balance to the formulation of corporate strategy and policies
- The resulting lack of transparency and responsibility for corporate defense where accountability is fragmented and diluted at the executive management level
- The lack of coherent coordination of defense-related activities at a functional level, leading to the development of silo-type structures that are not in alignment with one another but rather operate in isolation, resulting in both ineffectiveness and inefficiency

Although a great deal of work has been undertaken since the financial crisis to improve corporate behavior, there is sufficient evidence available to suggest that many of these issues still need to be addressed as weaknesses and deficiencies in corporate defense activities remain commonplace. Examples include the rogue trader Jerome Kerviel at Societe Generale, the cyber theft at SONY, the health and safety issues in the clothing industry in Bangladesh, and more recently the Volkswagen emissions scandal, to name but a few. This will require a notable correction to the current imbalance in order to create a natural harmony between offense and defense.

#### 1.4.2.1 Achieving a Healthy Balance

The challenge facing organizations is wide ranging; however, restoring a natural equilibrium between offense and defense in the corporate mind-set will go a long way toward improving the situation going forward. This requires joined-up thinking and perhaps can best be achieved by a degree of tweaking and joining of the existing dots, rather than by a complete overhaul of the entire system.

Correction of this current imbalance requires a broader stakeholder (shareholders, clients, staff, business partners, local communities, and society) focus and a more holistic view of how best to safeguard these stakeholder interests in the long term. Ensuring that there is a sufficient focus on long-term sustainability (i.e., survival) will require a subtle shift in corporate consciousness. Such a shift will necessitate a change of attitude in relation to the fundamentals of corporate health and a clear appreciation of corporate health requirements in the short, medium, and long terms. This will involve further educating the corporate world so that defensive behavior can be seen in a positive

light and as being necessary for the achievement of long-term sustainability, rather than being seen as a necessary evil. Corporate defense is not about business prevention; it is about doing the right business in the right way.

In far too many organizations there is a defense deficit. Corporate defense is more likely to be implied in corporate strategy rather than being considered a core element of business strategy, and more often than not there is an absence of any formal corporate defense strategy. Corporate strategy must therefore incorporate a balance between offense and defense in order to arrive at a natural equilibrium. This will require a subtle blending of these antagonistic yet complementary principles that are inherently intertwined and mutually interdependent within a dynamic system. In essence, the principles of offense and defense represent two sides of the same coin, and therefore cannot and should not be addressed in isolation from one another.

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