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CREATING VALUE – FROM CORPORATE GOVERNANCE TO TOTAL SHAREHOLDERS RETURN. AN OVERVIEW

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Abstract:

The term "value" can be interpreted in a subjective way, depending about what we refer at. Usually the firm`s value is related to the financial performance: profitability, cash flow, liquidity, solvability, etc. A corporation can create and in some cases reduce value for its stakeholders. Also, a corporation can create value for the stakeholders by simply creating jobs, paying taxes and help the population to improve their financial situation. The aim of the paper is to describe the process of value creation starting with corporate governance, continuing with stakeholders' expectations and finishing with shareholders requests.

Key words: *value creation, corporate governance, stakeholders, total shareholders return*

1. Introduction

The process of value creation is very complex. The complexity of the process is based and influenced by the interrelations between stakeholders, the interests of shareholders, and the synergistic use of resources. Value "is a particularly helpful measure of performance because it takes into account the long-term interests of all the stakeholders in a company, not just the shareholders… and according to a growing body of research, companies that maximize value for their shareholders in the long term also create more employment, treat their current and former employees better, give their customers more satisfaction, and shoulder a greater burden of corporate responsibility than more shortsighted rivals" (Koller, Goedhart and Wessels, 2010).

Nowadays, the concept of value need to include all dimensions of the triple bottom line – economic, social and environmental (Hubbard, 2009, Henriques and Richardson, 2013). According to the World Economic Forum (2015), there are two concepts of value: corporate/financial value and societal value. The managers have to integrate both corporate and societal value into the decision making process in order to achieve sustainable value (on the long term). More than that, Jo and Harjoto (2011) argue: ”the impact of corporate social responsibility and corporate governance on firm value has become a great interest for shareholders, practitioners, and government regulators”.

2. Value creators: factors and determinants

2.1. Corporate governance and shareholders value

But, first of all companies will create value for their owners. At the second level they will consider the stakeholders. That is why corporate governance is about the separation between management and finance; it deals with the agency problem (Schleifer and Vishny, 1997).

Also, OECD (2004) defines corporate governance as a concept that *“involves a set of relationships between a company’s management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined. Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and its shareholders and should facilitate effective monitoring.*”

In this context, Michael J. Mauboussin and Alfred Rappaport (2016), consider that “today there are two camps that aim to define the idea of governing objective, but neither is effective: (1) The first believes the company’s goal is to maximize shareholder value; (2) The second advocates that the company balance the interests of all stakeholders”. For example, some companies, in order to maximize the shareholders’ value and balance the interest with one important part of the stakeholders – the employees, started to use ESOP’s or *employee stock ownership plans*. Under an ESOP, “employees are given the opportunity to purchase stock in their company, sometimes at a discount to the market value of the stock. The company may also contribute to a certain proportion of the purchase price. By making employees stockholders, ESOP’s tend to increase the already strong emphasis on maximizing returns to shareholders” (Hill and Jones, 2009).

Kanter (2011) emphasizes that great companies think differently: ”instead of being mere money-generating machines, they combine financial and social logic to build enduring success”.

But still, shareholders have a unique role in the company, they are the suppliers of the venture capital, they are assuming the risk, so by maximizing their value, the company creates value. Considering that, return on invested capital (ROIC) and revenue growth are efficient indicators which show the performance of managers in their strive for creating value for its shareholders.

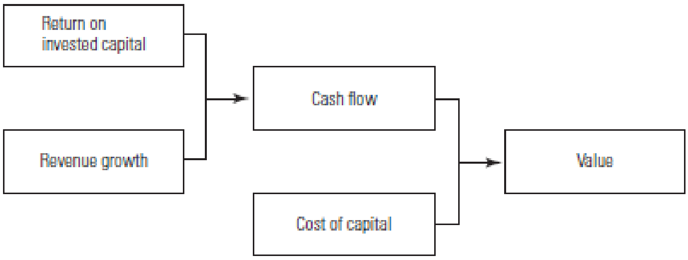


Figure 1. Growth and ROIC drive value
(Source: Koller, Goedhart and Wessels, 2010)

Managers can increase shareholder value by: acquire businesses, compete for share in a stable market, increase share in a growing market, expand an existing market, or more by introduce new products to market.

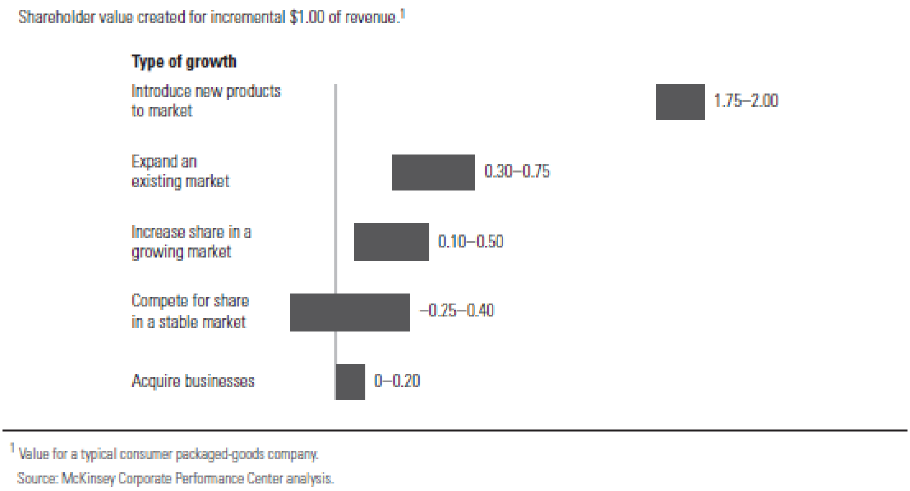


Figure 2. Value creation by type of growth
(Source: Koller, Goedhart and Wessels, 2010)

2.2. Create value through companies brand

Companies seek to use and optimize all assets (tangible and/or intangible) in order to achieve maximum value creation for shareholders. From this perspective, company's brand is a very important asset able to create value by himself. Many authors including Peterson and Jeong (2010) consider that "brand value can be defined as the dollar-based marketing effects or outcomes that accrue to a product or service due to its brand name, as compared with the effects or outcomes that would accrue if the product or service did not have that brand name". More than that, brand value is directly related to shareholders value. Even if, according to Kerin and

Sethuraman (1998), “at a conceptual level, managers should consider that the incremental benefits of company-wide brand value building have a threshold beyond which further accumulated brand value growth may not yield a corresponding increase in shareholder value”, at a practical level, according to the same authors, “nonlinearity in the *brand value-shareholder value* relationship suggests that managers should be knowledgeable of existing company brand values before embarking on brand value (equity) growth initiatives for the purpose of improving shareholder value”.

A brand is a part from the intangible assets and in its contribution to the value of a company differs from industry to industry. Nowadays building a strong brand represents an investment in a financial future success. So, in measurable terms, the value of a brand is equal to the financial returns that the brand will generate over its useful life.

According to Annual Report made by MillwardBrown, called BrandZ™ Top 100 Most Valuable Global Brands 2016, *brand strength leads to superior shareholder returns*. The research made by MillwardBrown shows that “if you'd invested $100 in the stock market (the MSCI world index) in 2006, your return in 2015 would be $30. However, if you'd picked your portfolio from the BrandZ Top 100, the return would be $103 – three times greater. Brand building also brings resilience in challenging times. While the share price of all brands dropped during the economic downturn, it took strong brands just six months to recover versus three years for average brands”.

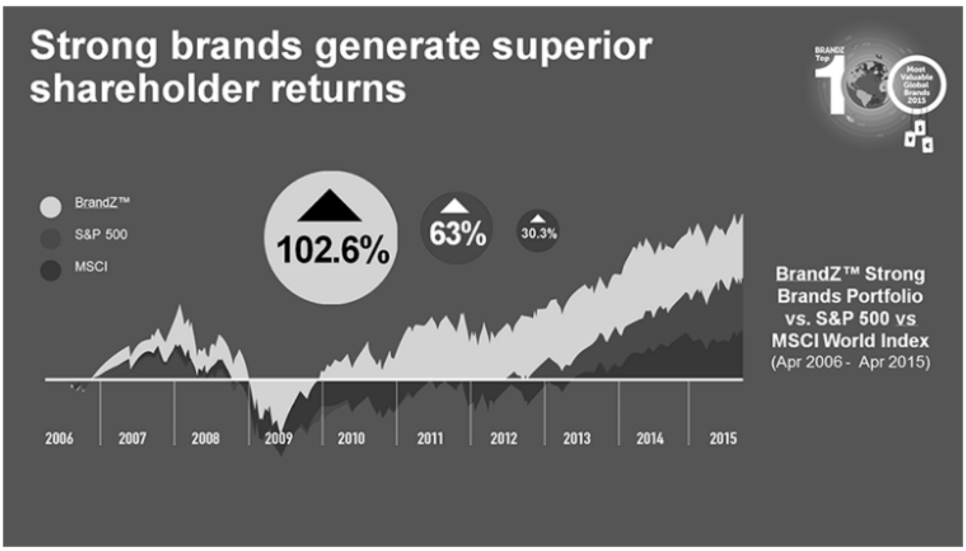


Figure 3. Brand Building: An investment in future financial success

(Source: Kantar, MillwardBrown, 2016)

Regarding the Top 10 Most Valuable Global Brands 2016, technology dominates the top with 5 companies (see table below).

Table 1. Top 10 Most Valuable Global Brands 2016

	Brand	Category	Brand Value 2016 $Mil.	Brand Contribution	Brand Value % Change 2016 vs. 2015	Rank Change
1	Google	**Technology**	229,198	4	32%	1
2		**Technology**	228,460	4	-8%	-1
3	Microsoft	**Technology**	121,824	3	5%	0
4	AT&T	**Telecom Providers**	107,387	3	20%	2
5	facebook	**Technology**	102,551	4	44%	7
6	VISA	**Payments**	100,800	4	10%	-1
7	amazon	**Retail**	98,988	3	59%	7
8	verizon	**Telecom Providers**	93,220	3	8%	-1
9	McDonald's	**Fast Food**	88,654	4	9%	0
10	IBM	**Technology**	86,206	4	-8%	-6

Source: MillwardBrown, BrandZ™ Top 100 Most Valuable Global Brands 2016, p. 14.

One of the best example for brand building value is the luxury industry, known as the industry with very high returns. The authors Kapferer and Bastien (2009) consider that in the case of luxury businesses, the brand stands at the extremity of the intangible ladder, translating this into financial evaluations of luxury brands. The luxury industry includes brands that design, craft and market high-end clothing, leather goods, fragrances, accessories and watches. In the table below we can see that in the case of luxury industry sector, the brand is a very important part in the process of value creation of the companies. First three companies are also ranked in Top 100 Most Valuable Global Brands 2016, such as: Louis Vuitton 30, Hermes 44 and Gucci 80.

Table 2. Luxury Top 10 Valuable Brands, 2016

Brand	Brand Value 2016 $ Million	Brand Contribution	Brand Value % Change 2016 vs. 2015
Louis Vuitton	28,508	4	4%
Hermes	19,821	5	5%
Gucci	12,592	5	-9%
Channel	10,316	5	15%
Rolex	8,153	4	-4%
Cartier	6,747	4	-11%
Burberry	4,594	4	-20%
Prada	4,405	4	-33%
Tiffany & Co.	2,468	3	-24
Christian Dior	2,066	3	N/A

Source: BrandZ™ / Millward Brown (including data from Bloomberg); Brand Contribution measures the influence of brand alone on earnings, on a scale of 1 (lowest) to 5 (highest), p. 77.

The luxury industry is no longer an industry dominated by the old image of family owned brands, independent jewelry houses, etc. Nowadays it is dominated by large groups, who started several years ago by aggressive acquisition strategy. The best example is LVMH (Louis Vuitton Moët Hennessy) who started this trend in the luxury industry, followed by Richemont and Kering. Based on the actions of this three large groups the luxury industry became dominated by them, by the principle “Big is Beautiful”. When a process of mergers and acquisitions is started this can end up in two simple ways, a success or a failure. In other industry there are several examples of failures in M&A, but in the case of luxury industry the three mentioned luxury groups managed to create synergy in order to be successful in their M&A strategy.

Luxury industry groups are considered special cases, because, in contrast with other groups, from other industries, the brand equity of luxury brands depends on their high symbolic power, on their capacity to generate corporate effect and to create value (Ijaouane and Kapferer, 2012). The main goal of groups from luxury industry is to create added value for company and shareholders, by using synergies between businesses, pooling resources for productive and supportive functions, and transferring know-how.

		Fashion	Leather Goods	Timepieces	Jewelry	Fragrances & Cosmetics	Spirits	Overall
Pooling of Resources for Productive Functions	Manufacturing	◔	◑	◕	◔	◔	◑	◑
	Purchasing	◔	◑	◕	◔	◕	◕	◕
	Sourcing	◔	◑	◔	○	◔	◕	◔
	R&D	○	○	◔	○	●	◔	◔
Pooling of Resources for Support Functions	Logistics	◑	◑	◑	◑	◕	◕	◑
	Warehousing	◑	◑	●	◑	●	●	◕
	After-Sales Service	○	◔	●	◔	○	○	◔
	Human Resources	◑	◑	◑	◑	◕	●	◑
	IT and ERP	◕	◕	◕	◕	◕	●	◕
	Marketing	◔	◔	◔	◔	◔	◕	◔
	Media Buying	◑	◕	◕	◕	◕	◕	◕
	Real Estate	◔	◔	○	◔	○	○	◔
	Back Office	◑	◑	◕	◕	◕	●	◕
Transfer of Know-How	Best Practices	◔	◔	◕	◔	◑	◕	◑
Efficiency Synergies		◔	◑	◕	◔	◕	◕	

Figure 4. How Luxury Groups create added value
(Source: Ijaouane and Kapferer 2012).

In order to reveal, once more, both the link and the contribution of financial results/indicators (from income statement and balance sheet) and brand value to value creation it will be analyzed the first 10 companies from Top 100 Most Valuable Global Brands.

Table 3 . Financial results in 2015 (mil. USD)

Company	Revenues 2016	Revenues 2015	Operating Income	Net income	Total assets	Equity	Debt	Brand value
Alphabet	74,989.0	66,001.0	19,360.0	16,348.0	147,461.0	120,331.0	5,220.0	229,198.0
Apple	233,715.0	182,795.0	71,230.0	53,394.0	290,479.0	119,355.0	64,462.0	228,460.0
Microsoft	85,320.0	93,580.0	19,860.0	16,798.0	193,694.0	71,997.0	53,687.0	121,824.0
AT&T	146,801.0	132,447.0	24,785.0	13,345.0	402,672.0	122,671.0	126,151.0	107,387.0
Facebook	17,928.0	12,466.0	6,225.0	3,688.0	49,407.0	44,218.0	114.0	102,551.0
Visa	13,880.0	12,702.0	9,064.0	6,328.0	39,367.0	29,842.0	0.0	100,800.0
Amazon	107,006.0	88,988.0	2,233.0	596.0	64,747.0	13,384.0	8,227.0	98,988.0
Verizon	131,620.0	127,079.0	33,060.0	17,879.0	244,175.0	16,428.0	109,729.0	93,220.0
McDonald`s	25,413.0	27,441.3	7,145.5	4,529.0	37,938.0	7,087.0	24,122.1	88,654.0
IBM	81,741.0	92,793.0	15,262.0	13,190.0	110,495.0	14,262.0	39,889.0	86,206.0

Source: Google Finance, 2016

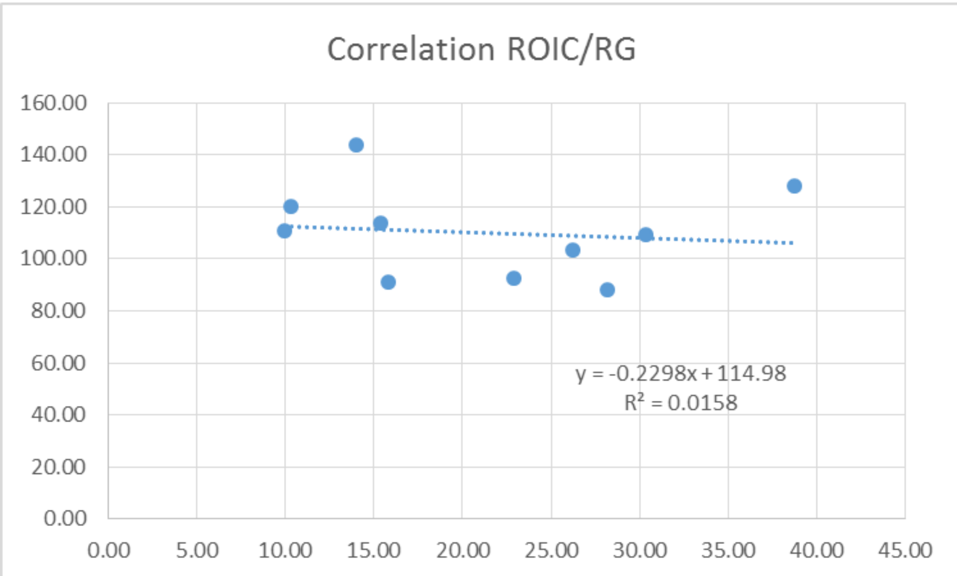
Table 4. Returns

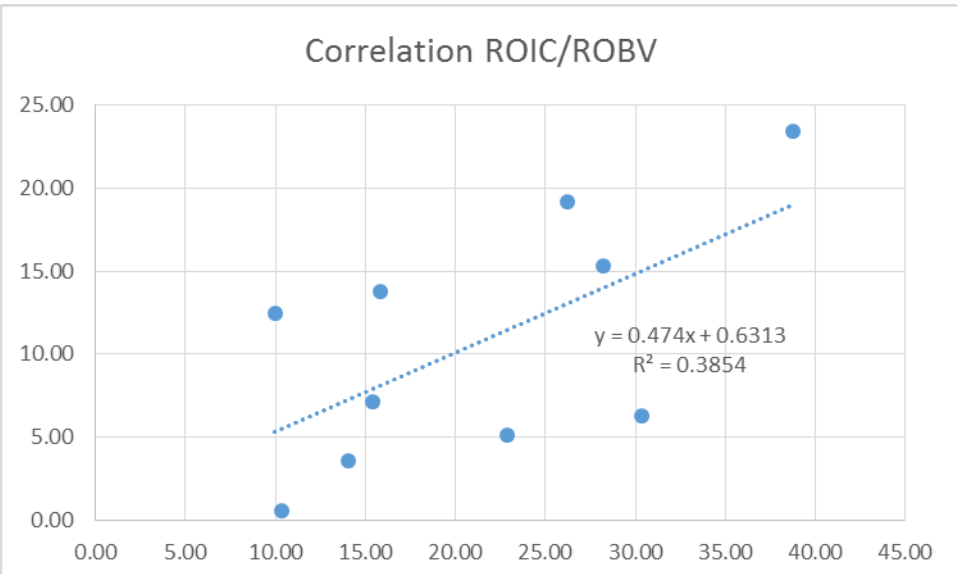
Company	ROA	ROS	ROE	ROIC	ROBV	RG
Alphabet	11.09	21.80	13.59	15.42	7.13	13.62
Apple	18.38	22.85	44.74	38.75	23.37	27.86
Microsoft	8.67	19.69	23.33	15.80	13.79	-8.83
AT&T	3.31	9.09	10.88	9.96	12.43	10.84
Facebook	7.46	20.57	8.34	14.04	3.60	43.82
Visa	16.07	45.59	21.21	30.37	6.28	9.27
Amazon	0.92	0.56	4.45	10.33	0.60	20.25
Verizon	7.32	13.58	108.83	26.21	19.18	3.57
McDonald`s	11.94	17.82	63.91	22.90	5.11	-7.39
IBM	11.94	16.14	92.48	28.18	15.30	-11.91

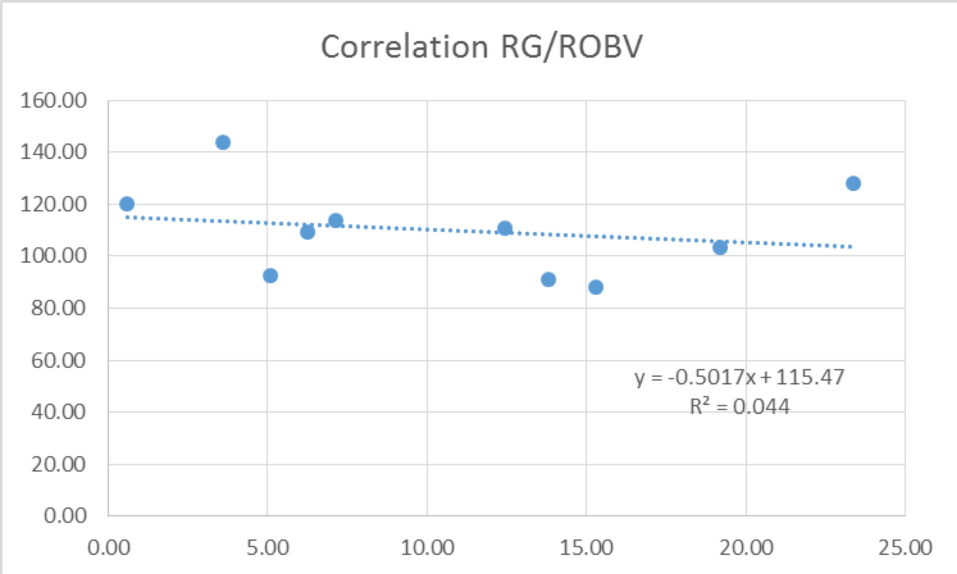
Legend: ROA – Return on Assets (Net income/Total Assets), ROS – Return on Sales (Net income/Revenues), ROE – Return on Equity (Net income/Shareholders equity), ROIC – Return on Invested Capital (Operating income/(Equity + Debt)), ROBV – Return on Brand Value (Net income/Brand value), RG – Revenues growth rate ($Revenues_{20016}/Revenues_{2015}$)

The results of the calculated returns are very different even if it is about the same industry (technology or telecommunication). In order to identify the links between the results of the returns we will calculate the CORREL indicators.

	CORREL	R-Squared (R^2)
Correlation between ROIC and RG	***-0.1258***	***0,0158***
Correlation between ROIC and ROBV	***0.62083***	***0,3854***
Correlation between RG and ROBV	***-0.20968***	***0,044***







3. Measuring value: total shareholders return, financial performance and sustainable value

Total shareholders return is ”the sum of the percentage change in earnings plus the percentage change in market expectations—as measured by the price-earnings ratio (P/E)—plus the dividend yield.” (Deelder, Goedhart and Agrawal, 2008)

According to BCG, Total Shareholders Return (TSR) is the product of multiple factors (see figure 5). ”The model uses the combination of revenue (sales) growth and change in margins as an indicator of a company’s improvement in ***fundamental value***. It then uses the change in the company’s valuation multiple to determine the impact of ***investor expectations on TSR***…Finally, the model tracks the distribution of free cash flow to investors and debt holders in the form of dividends, share repurchases, and repayments of debt to determine the contribution of ***free-cash-flow payouts*** to a company’s TSR”.

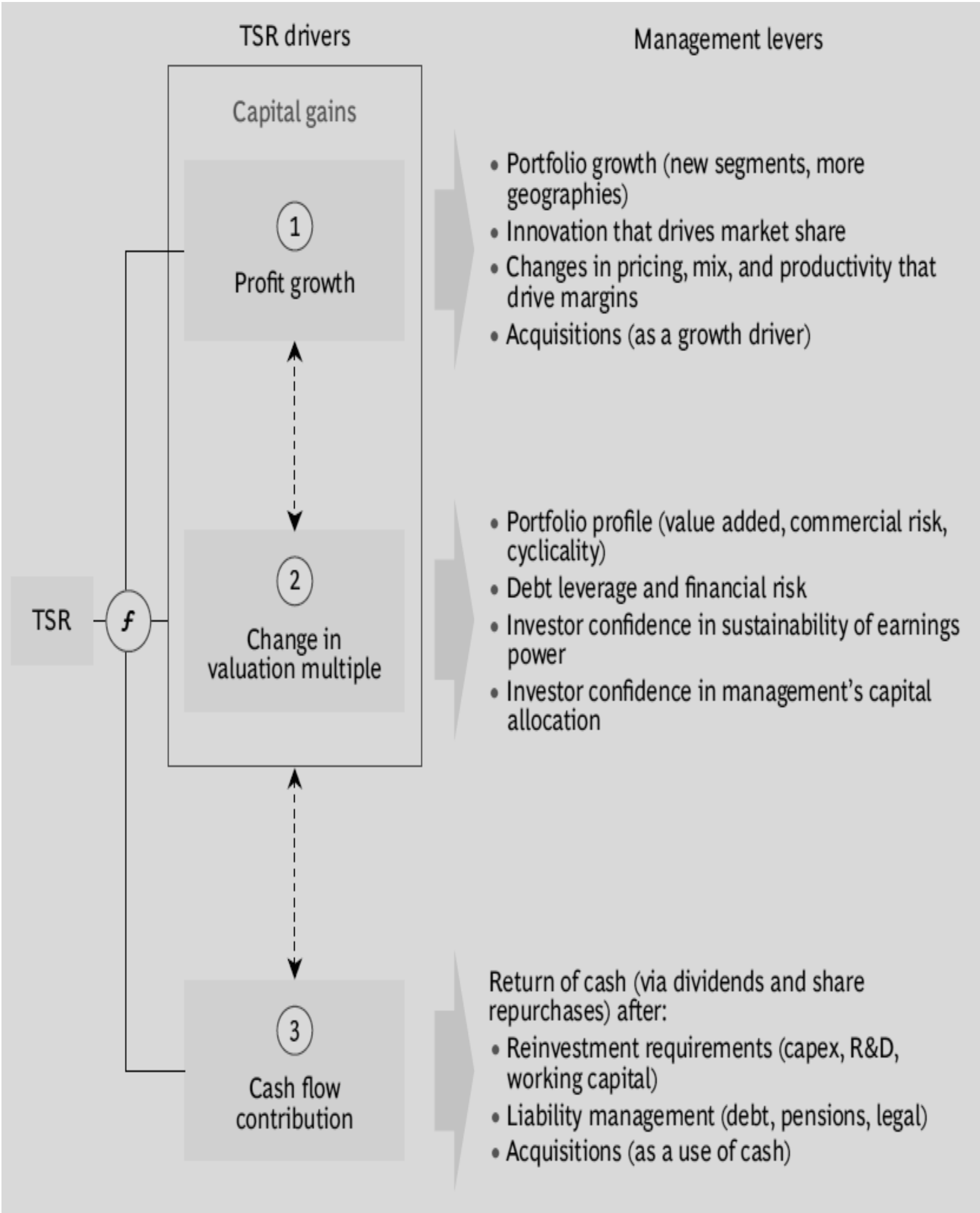


Figure 5. Total Shareholders Return drivers
(Source: BCG analysis; BCG The Value 2014 Creators Report: Turnaround Transforming Value Creation, p. 10.)

In 2007, Lepak, Smith, Taylor have broadened many definitions of value creation and based on that they have conceptualized the process by capitalizing individuals, organizations, government, consumers, society, and clients.

Level of Analysis or Source of Value Creation	Academic Lens	Target or User of Value	Creation Process	Value Capture Process	Article
Society	• Sociologists • Economists • Ecologists	• Individuals • Organizations • Government	• Innovation and new firm creation • Competition • Capital investment • Incentives • Laws and regulations	• Factor conditions • Demand conditions • Supporting industry infrastructure • Firm strategy and rivalry	Lee, Peng, & Barney
Organizations	• Strategic management • Organization theory • Strategic HRM	• Consumer • Society	• Invention • Innovation • R&D • Knowledge creation • Structure and social conditions • Incentives, selection, and training	• Rare, inimitable, nonsubstitutable resources • Intangible resources	• Sirmon, Hitt, & Ireland • Kang, Morris, & Snell • Priem
Individuals	• Psychology • Organizational behavior • HRM	• Consumers • Client • Organization	• Knowledge creation • Search • Ability • Motivation • Training	• Network position • Unique experience • Tacit knowledge	Teppo & Hesterly

Note: Dashed arrow (⋯⋯→) indicates value slippage; solid arrow (——→) indicates value capture.

Figure 6. Dimensions of value creation
(Source: Lepak, Smith, Taylor (2007))

In 2009 Hagel, Brown and Davison have developed a model to measure the financial performance of a company, called Shift Index. The Shift Index consists of three indices that quantify the three waves of the Big Shift - Foundation Index, Flow Index and Impact Index - each measured by a set of indicators, as we can see in the figure 7.

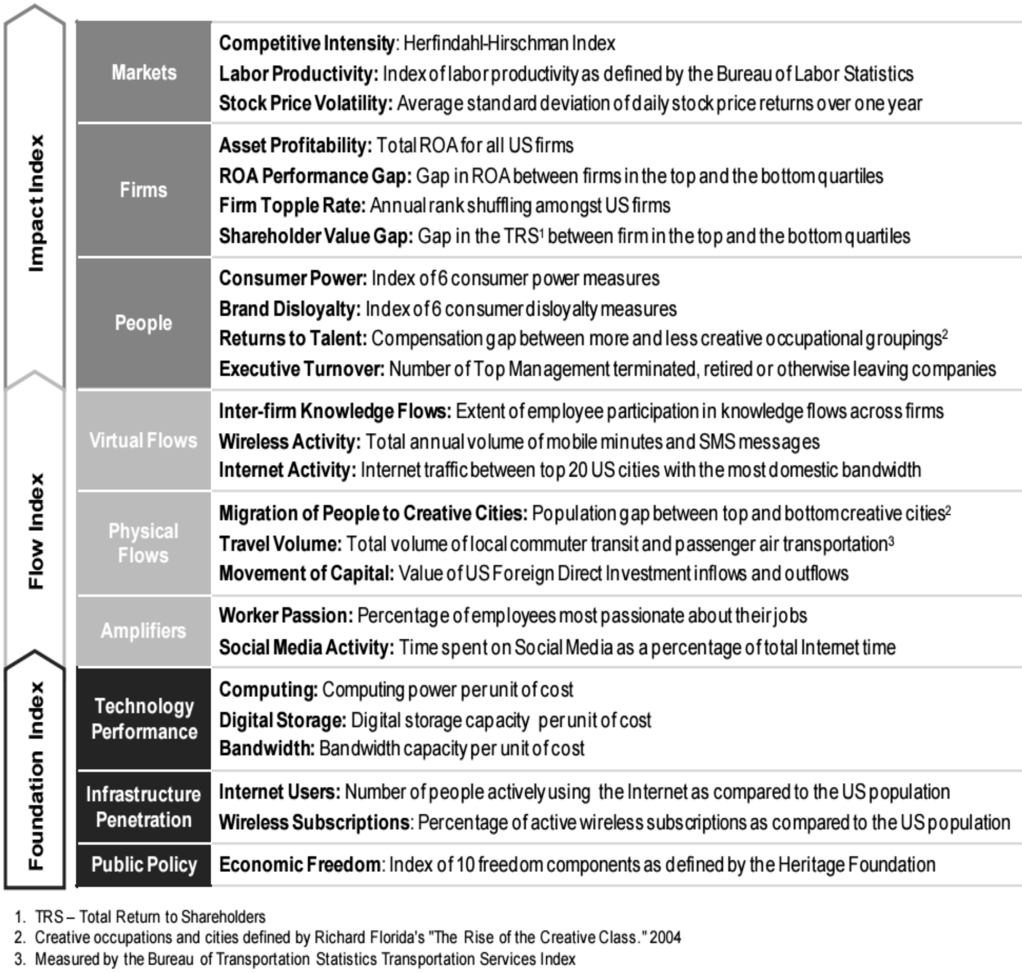


Figure 7. The Shift Index Model

(Source: Deloitte analysis; Hagel, Brown and Davison, The Shift Index: Uncovering the Emerging Logic of Deep Change, June 2009, p. 8.)

More and more shareholders, investors or stakeholders are interested in creating sustainable value. Hubbard (2009) have proposed a model in order to measure organizational performance by integrating the triple bottom line dimensions. Starting from this point, we consider that if all factors presented by Hubbard will be synergistically approach by managers, they will be able to create value for all stakeholders not only for the shareholders.

Financial	*Internal processes*
Sales growth Return on sales Return on assets Return on equity Gearing	Productivity Labour turnover Ave. unit production Working capital/sales Capacity utilization
Customers/market	***Learning and development***
Market share No. new customers Product return rate Defects Order cycle time	New products New markets entered R&D spend/sales Training spend/sales Invest./total assets
Social performance	***Environmental performance***
Employee satisfaction Social performance of suppliers Community relationships Philanthropic investment/revenue or profit Industry-specific factor: e.g., community open days	Key material use/unit Energy use/unit Water use/unit Emissions, effluent &waste/unit or as a % of total resources used Industry specific factors: e.g., GHG emission

Figure 8. Key factors for creating sustainable value
(Source: Hubbard, 2009)

It can be observed that the financial indicators alone are no longer able to measure the value of a company in sustainable terms. It is time for new model or new pattern to evaluate the company overall value.

4. Conclusions:

In the process of value create, companies have to capitalize all the resources in order achieve long-term value. It is very challenging to balance the interests of all stakeholders and to create value in the same time (it is hard to achieve value, but it is even harder to maintain the achieved value). By using an integrated approach based on the power of brand, the power of employees, the power of customers, the power of organization, the power of suppliers, companies will be able to face the challenges, to make the shift – from corporate value to societal value (sustainable value).

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