ENTERPRISE VALUE CREATION AND VALUE SHARING BASED ON SUSTAINABLE GROWTH

BO ZHANG¹, ZHUQUAN WANG²

¹Business School
Wenzhou University
Wen Zhou, 325035, China
z-b514@163.com

²School of Management
Ocean University of China
Qing Dao, 266071, China
zhuquanw@yahoo.com.cn

ABSTRACT. With the transformation of economic form from industrial economy into economy based on knowledge and the transformation of enterprise’s nature from “economic man” into “social-ecological-economic man”, enterprise’s sustainable growth becomes a more complex task. The objectives of the company should be derived by balancing the conflicting claims of the various ‘stakeholders’ in the firm, and maximizing the profit of stakeholders. In this paper, we analyze on how to rationally and effectively create value and share from the levels of enterprise, value chain and value network for stakeholders, and eventually realize the sustainable development of enterprises through implementation of business strategy.

Keywords: Sustainable Growth; Stakeholders; Value Creation; Value Sharing

1. Introduction. With the transformation of economic form from industrial economy into economy based on knowledge and the transformation of enterprise’s nature from “economic man” into “social-ecological-economic man”, corporate sustainable growth becomes a more complex task. A sustainable organization is one that while pursuing profit, enlightened companies should take care to protect the environment and uphold the rights of workers and other stakeholders as well. Maximization of shareholders’ value is not necessarily the right objective. The theoretical justification for this objective was derived from the “nexus of contracts” view of the firm. According to Fama and Jensen (1983), each party belonging to the nexus has contractual claims on the surplus with pre-determined payoffs. Stout (2002) forcefully argues that: “the residual claimants argument for shareholder primacy is a naked assertion, and an empirically incorrect one at that”. The objectives of the company should be derived by balancing the conflicting claims of the various ‘stakeholders’ in the firm, managers, workers, stockholders, suppliers, vendors (Ansoff, 1965). “Companies that set profits as their No 1 goal are actually less profitable in the long run than people-centered companies (Waterman, 1994).”

The “new” business organization is becoming increasingly networked. The boundaries of the organization are becoming more blurry, permeable, and interactions with stakeholders
become more thoroughly knit into the fabric of firms. Which stakeholders are internal and which are external to the organization is becoming an increasingly importance. Zingales (2000) defined modern enterprise as a kind of net of specialized investments from stakeholders and the stakeholders relation net develops into a value creation system of open enterprises network. Max Clarkson (1994) offered the following definition, “The firm is a system of stakeholders operating within the larger system of the host society that provides the necessary legal and market infrastructure for the firms’ activities. The purpose of the firm is to create wealth or value for its stakeholders by converting their stakes into goods and services.” Generalizing stakeholders commonly create enterprise’s value, and have the rights of sharing the enterprise’s equity. Therefore, it is necessary that should research enterprise’s sustainable development issues from angle of stakeholders’ value creation and sharing.

The rest of this paper is organized as follows. Section 2 provides a brief discussion of the meaning of stakeholders’ value. Description and analysis of value creation are given in Section 3. Section 4 presents measures and methods of value sharing. Section 5 concludes the paper.

2. Stakeholders and Stakeholder Value.

2.1. Categories of Stakeholder. A stakeholder perspective indicates that it is no longer tenable to regard the shareholders as the only residual claimants, where residual claimants are defined as persons or collectives whose relationship to the firm gives rise to a significant residual interest in the firms’ success or failure. Stout (2002) points out that the argument that shareholders are the sole residual claimants in corporations not only does not hold as a practical matter, but also as a matter of law. The idea that the law views shareholders as the sole residual claimants is a common misconception among many economists. Such a view is not legally accurate. There is widespread agreement that the stakeholder framework has proved useful in the analysis of the strategic and normative challenges organizations face, and that good stakeholder relationships are key to organizational viability and business success (Freeman, 1984; Donaldson, 1995; Wheeler, 1997; Svendsen, 1998; Post et al., 2002). Madu (1996) pointed out that “being environmentally correct is not only a business strategy that stands to yield huge profits for companies, but also a social responsibility function for companies”. At the broadest definitions sustainability is concerned with the effect which action taken in the present has upon the options available in the future.

To succeed in a stakeholder-driven business environment, business must think and operate in new ways, shaping strategies and actions with full awareness of their impacts on and implications for stakeholders (Chris et al. 2007). Organizations and their leaders face the challenge of weaving a web of sustainable relationships, complex as it may be, navigating in it, and engaging a multitude of stakeholders in a dialog (across differences) to create resonance (Boyatzis and McKee, 2005), trust (Nootbooom, 2002), and ultimately stakeholder social capital.

However, enterprises have all forms of stakeholders, in order to serve the different types of stakeholders effectively; it must classify stakeholders reasonable. According to relevance
of corporate Interests, stakeholders can be divided into two types: one is internal stakeholders; Business activities have a direct impact on the interests of these type stakeholders, they are common interests and goals-makers of enterprise, and sought their cooperation to achieve this common interests and goals. The common interests and objectives of internal stakeholders is a reflection of the enterprise value, internal stakeholders share these enterprise value. The other is external stakeholders, Business activities have an indirect impact on the interests of stakeholders, and such stakeholders can be further divided into: value chain stakeholders and value network stakeholders. The former refers to enterprises of value chain; the latter refers to stakeholders of value network. Categories of stakeholder, type of value and key stakeholders are summarized in the following table 1.

<table>
<thead>
<tr>
<th>Categories</th>
<th>Type of value</th>
<th>Key stakeholders</th>
</tr>
</thead>
<tbody>
<tr>
<td>Internal stakeholder</td>
<td>Enterprise value</td>
<td>employees, shareholders, creditors, managers, etc.</td>
</tr>
<tr>
<td></td>
<td>Value of value chain</td>
<td>suppliers, distributors, the target enterprise</td>
</tr>
<tr>
<td></td>
<td>Society value</td>
<td>customers, community, pressure groups, environment</td>
</tr>
<tr>
<td>External stakeholder</td>
<td>Value of value chain</td>
<td>consumers, community, pressure groups, environment</td>
</tr>
</tbody>
</table>

2.2. Stakeholder Value. A major purpose of stakeholder theory is to help corporate understand their stakeholder environments and manage more effectively within the nexus of relationships that exists for their companies. However, a larger purpose of stakeholder theory is to help corporate improve the value of the outcomes of their actions, and minimize the harms to stakeholders. This article adopt the method of stakeholder value analysis proposed by Chris Laszlo et al. (2005), we build a sustainable value framework, which is shown in figure 1.
Figure 1 describes company performance along two axes: internal stakeholder and external stakeholder. In this framework, sustainable value occurs only when a company creates value that is positive for its internal stakeholders and its external stakeholders. Companies that deliver value to internal stakeholders while destroying value for external stakeholders have a fundamentally flawed business model.

Starting in the upper left of Figure 1 and moving anti-clockwise, consider the following four cases of value creation and destruction.

**2.2.1. Unsustainable (Value Transfer).** When value transferred from internal stakeholders to external stakeholders, the internal stakeholders represent a risk to the future of the business. External stakeholders’ value in those cases is created at the cost of one or more internal stakeholders, thereby representing a value transfer rather than true value creation.

**2.2.2. Unsustainable (Lose-Lose).** When value is destroyed for both internal stakeholders and external stakeholders, this represents a ‘lose-lose’ situation of little interest to either.

**2.2.3. Unsustainable (Value Transfer).** When value transferred from external stakeholders to internal stakeholders, the external stakeholders represent a risk to the future of the business. Internal stakeholders’ value in those cases is created ‘on the backs’ of one or more external stakeholders, thereby representing a value transfer rather than true value creation.

**2.2.4. Sustainable (Win-Win).** When value is created for both internal stakeholders and external stakeholders, this represents a ‘win-win’ situation of much interest to either.

Enterprise’s sustainable growth is to achieve a win-win situation of internal stakeholders and external stakeholders, to avoid value transfer value destruction. Furthermore, the realization of sustainable growth depends on two fundamental questions to a large extent: value creation and the distribution of this value (Schumpeter, 1954; Weintraub, 1977). These two persistently challenging questions are also or, arguably should be the two fundamental questions concerning the so-called “stakeholder theory”. Next, this article will focus on value creation and sharing from three different levels of enterprise, value chain and value network for stakeholders, and eventually realize the sustainable development of enterprises.

**3. Value Creating of Stakeholder.** Whatever approach to stakeholding is adopted by business the first question must be ‘who your stakeholders are and how to create value for them?’ The route to durable competitive success was by focusing less exclusively on internal stakeholders and financial measures of success, and including all stakeholder relationships within a broader range of measures, and in thinking and talking about business purpose, performance and actions. Accounting to a stakeholder agency theory, managers are seen as the agents for all stakeholders, not simply shareholders.

We defines success in terms of sustainable development, and arguing that outstanding businesses derive their strength from a distinctive structure of relationships with employees, customers and suppliers – which explains why continuity and stability in these relationships are essential for a flexible and co-operative response to change. In order to achieve the
sustainability of value creation, Enterprises need to implement stakeholder value management effectively form levels of enterprise, value chain and value network.

3.1. Creating Enterprise Value. The size of business value-added value depends on value-added of process as well as the size of value-added of activities that compose the processes. In order to improve value-added ability of processes and activities, it is necessary to implement business process management. Business process management is an important and effective enterprise management way, which is based on processes and process operations for control object, through streamlining, deleting, merging of processes or operations, it can such as measures to rationalize unreasonable business processes, delete non-value-added activities and optimize enterprise business processes, thereby creating greater value added.

The stakeholder view holds that firm performance is best measured by the value added. Computationally, the value-added amount can be determined by adding pre-tax profit to payroll costs plus interest charges. An alternate approach to computing value-added is to deduct “bought-in” costs from sales revenues, where “bought-in” costs represent all costs and expenses incurred in buying goods and services from other firms.

Functionally, the value-added statement may be conceived as a modified version of income statement. Consequently, it can be derived from the income statement, ie the value-added equation can be obtained by rearranging the profit equation (1) as follows:

\[ S - B - DP = W + I + DD + T + R \]

Where:
- \( S \) = Sales Revenues
- \( B \) = Bought-in materials and services
- \( DP \) = Depreciation
- \( W \) = Wages
- \( I \) = Interest
- \( DD \) = Dividends
- \( T \) = Taxes
- \( R \) = Changes in Retained earnings

Equation expresses the net value added method. In both cases, the left side of the equation shows the value added created by the groups involved in or impacting the managerial production team (the workers, the shareholders, the bondholders and the government); the right side illustrates the distribution of the wealth to the same members of the team. The right-hand side is also known as the additive method and the left-handed side the subtractive method.

3.2. Creating Value of Value Chain. Through the implementation of value chain management, it helps to improve relationship among enterprises of value chain, promote cooperation among enterprises of value chain, often allows every party to benefit. Therefore, it is possible to establish partnership based on common interest through implementation of enterprise value chain management, joint efforts to make “cake” bigger, that is, through joint efforts of enterprises of value chain to increase value of the entire value chain. Under normal circumstances, value-added of the entire value chain increases,
every enterprise of value chain is also likely to share more value of the value chain. Of course, the numbers of value-added of each enterprise of value chain can share are subject to the binding contract of value-added share, and value-added share is an important element of value chain management either.

Enterprises have to cooperate with other upstream and downstream enterprises to make the advantages complementary with each other so as to strengthen their competitiveness together, and therefore adapt to the competitive environment of the contemporary market. Enterprises have gradually abandoned the old management mode, in which they take charge of their own design, manufacture, and sales. While sparing no effort to gain the demands of end customers, they also pay attention to set up the cooperation relationship and firm the community interest with the suppliers and sellers, and create the efficient value chain.

3.3. Social Value Creation. Changing societal expectations are placing new challenges before enterprise, and are shifting the nature of the business and society relationship. Business firms are placing increasing emphasis on their ongoing “sustainability,” which implies a simultaneous focus on economic, social, and environmental performance. This has vitalized a new generation of civil society groups, who, along with other business stakeholders—consumers, communities, employees, and governments—are reshaping the set of demands facing contemporary business. Contemporary business need to adopt new stakeholder view to create value for organization and broad global society and re-orient business growth by broadening conceptions of context and capabilities. Sustainable business should provide quality products to meet consumer demands, establish good contacts with local communities and control adverse impacts on environmental out of business activities etc, in order to better create value for society.

4. Value Sharing of Stakeholders. When enterprise Value-added is given, the economic interests of various stakeholders constraints mutually, so each stakeholder is bound to conflict with other stakeholders in the process of maximizing his own interests, in order to ensure stakeholders cooperation fairly and efficiently, it is necessary to establish a system to coordinate their contradictions and confliction of economic interests among stakeholders, the core of such a system is enterprise value share system. (Wang, 2006).

Content and the form of value sharing in enterprise, there is a growing trend of diversification. In general, internal stakeholders share business value, that is, the value-added of enterprises, and external stakeholders will share the value of the value chain and society value.

4.1. Value Sharing of Enterprise Value. Nowadays shareholders and creditors invest monetary capital in enterprises, managers and employees also invest intellectual capital. Moreover, the intellectual capital has gradually become the main source of competition. Such changes in the structure of property rights, it is bound to require innovate companies’ distribution system. Sharing of enterprise value consists of three parts: the first part distribute according to a fixed share; the second part, value-added is shared between the owners of monetary capital and the owners of intellectual capital, it can distribute according to contribution, satisfaction or combination of input and contribution and so on;
the third part is retained to meet the needs for enterprise accumulation and development. When enterprise is carrying out innovation of distribution, it should take full account of the input or contribute of internal stakeholders; so as to promote innovation of sharing smoothly.

4.2. Value Sharing of Value Chain. The formation of value chain is to enhance competitive advantage of business alliances through using complementary resources, in order to achieve win-(multi-) win purpose, and finally realize operation of value chain stably. First of all, sharing of value chain must abide by the principle of mutual benefits. Co-operation of the enterprises in value chain is based on the participating companies who share the fruits of cooperation, and should obtain more interests than it operate solely, and this is a win-win basic value orientation, otherwise, it would lose the material basis of survival and development. This principle also fully reflects demands of the stakeholder theory. Secondly, it must comply with the balance principle of risk, cost and benefits. This principle does mean operating in accordance with risk, cost and size of contribution of the participating enterprises in the allocation process, embody the idea of efficiency. In practice, it commonly use value chain analysis, extension of Kolomogoro’s complexity analysis and profit pools analysis to distribute value of value chain.

4.3. Value Sharing of Social Value. The sharing of enterprises’ social values is different from the sharing of enterprise value and the sharing of the value chain, it is not based on relationship of interests, more or moral obligation is legally binding. There are many forms of enterprises’ social values, for example, enterprise reduce product costs, increase customer value and better meet customer needs; enterprise concern about the production environment, reduce pollution, product safely and reduce social problems; enterprise active co-operation with the community, create a good environment for the development of the community and win recognition and so on.

5. Conclusions. Whether financial shareholder wealth approach or the strategic management stakeholder approach is justified depends on what theory of the firm we hold. Thus, the theory of enterprise value creation and value sharing based on sustainable growth has important consequences for the theory of economic valuation, which is one of the two fundamental questions of the strategic management discipline, and is of enormous relevance to financial management practice. The theory of sustainable growth has fundamental economic implications for understanding economic value creation and distribution. Forward thinking business leaders in sustainability-focused organizations can use the framework offered here to bring clarity to the strategic management in their companies, and can help build the alignment capacity to convert strategies into actions.

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REFERENCES


