Why Companies with a Greater Purpose Will Thrive in the New Social Era

Collaboration between Barbara Gray, CFA and BrightHouse, LLC

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BrightHouse, a first-of-its-kind creative consultancy that is recognized as the source and resource for helping organizations to excavate, articulate, and activate their unique purpose, has partnered with Barbara Gray, a celebrated and innovative Chartered Financial Analyst (CFA), to offer this perspective on why companies with an authentic and high-order sense of purpose will thrive in this highly connected and transparent era. Drawing from BrightHouse's decades of experience working with purpose-driven firms and Barbara Gray's experience analyzing and valuing companies as a sell-side equity analyst, we propose a new framework for valuing companies, one that reflects the risks and opportunities of Social Capital, not just financial capital.

Social Media is Creating a Revolutionary Force of Highly Connected and Empowered Stakeholders

Unlike previous eras, consumers today have access to larger amounts of knowledge and greater ease of connecting to like-minded partners to spread their individual message on a more massive scale. Social media exchanges are acting as catalysts to accelerate the formation of weak and strong ties, leading to the formation of bonding, bridging, and linking capital between and among a company and its various stakeholder constituencies. **Social media is turning the silent majority into a revolutionary force of highly connected consumers, employees, and suppliers** and empowering them to:

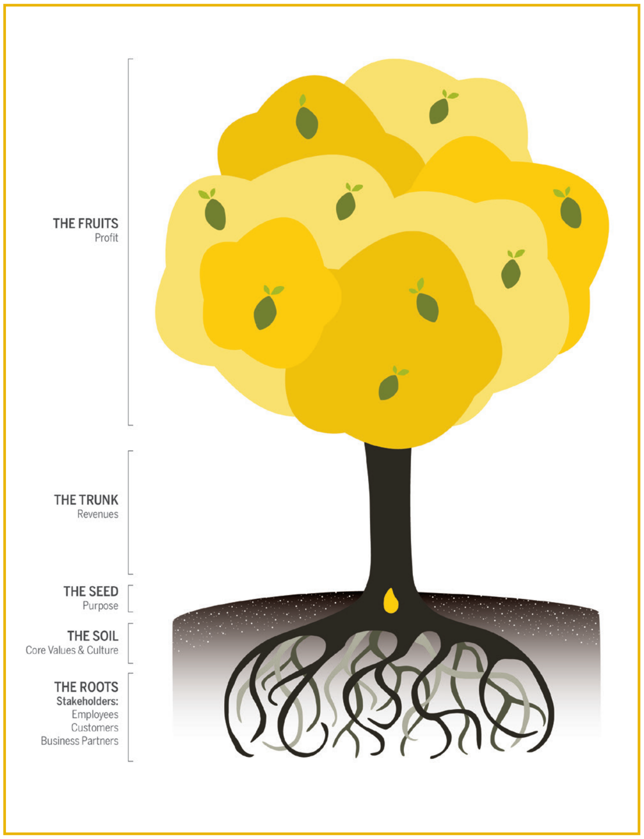
- **Influence, expose, and disseminate** their views (both positive and negative) on a company's products and/or services, how a company treats them or other stakeholders, and how a company's business activities impact society and the environment
- **Self-organize and join forces** on a common cause to gain support from others and lobby for social and regulatory reform and change
- **Create new communities** to enable learning, collaboration, and co-creation

This is leading to the creation of a new form of equity called Social Capital. And as the number of individual and corporate users of Facebook, Twitter, and LinkedIn increase, new social exchanges such as Google+ and Pinterest emerge, and the density of connections within and between the different social networks increases, we expect Social Capital to continue to appreciate in value.

A Greater Purpose Leads to a Stronger Stakeholder Ecosystem

"When you rediscover your organization's true identity – what it stood for, then you will gain fresh

Figure 1: Root Stakeholder Ecosystem of Company



insight into the reasons for its existence, its essence, its why – its very soul. It doesn't change over time. Yet, too many lose sight of it and don't know how to get it back. Too many companies, in America, become lost souls. So many brands stand for nothing. They have lost their purpose and meaning. ***To discover what will make your company or brand truly great in the years to come is to discover its history – its WHY – and rebuild from there."*** – Joey Reiman, BrightHouse Founder & CEO, "The Fruits are in the Roots"

As the shift from material want to meaning want progresses, people will be looking for companies that offer more than just a utility (i.e. functional / financial) or emotional value proposition. They will be looking for companies that stand for something – companies with a greater purpose. As shown in Figure 1, we visualize the stakeholder ecosystem of a company like the root system of a tree, comprised of the seed, the soil, and the roots.

The root analogy explains how a greater purpose leads to a stronger stakeholder ecosystem:

THE SEED – the seed represents the ethos of the company and its purpose, or reason for existence. Companies with a greater purpose are unique as the founder planted the seeds for the movement inspired by a motive other than profit and conceived the company through passion.

THE SOIL – the soil represents the company's core values and culture. This is where the seed of the company is cultivated. The greater purpose of a company leads to a more authentic set of core values and culture that speaks to the interests of all its stakeholders and serves to guide daily behaviors and decision-making to ensure alignment.

THE ROOTS – the roots represent the community of the company's customers, employees, and business partners, which reside in the soil and sprout from the seed to form the stakeholder ecosystem of the company. The greater purpose and authentic core values and culture attract a cult-like following from people that believe in the movement's greater purpose and are seeking to align their values with those they buy from, work for, and do business with. Beyond having an emotional connection to the brand, these stakeholders actually form a deep psychological attachment to the company's greater purpose.

The companies that will thrive in the new Social Era of stakeholder connectedness and empowerment are those with a greater purpose that have evolved from being soulless machine-like entities to being more human-like and transparent, authentic, and engaging in terms of their core values, culture, and community. These companies create positive Social Capital by displaying the following characteristics towards their stakeholders:

- **Level of Trust** – High trust vs Low trust
- **Mindset** – Optimizing for long-term relationship-building vs Maximizing for short-term individual gain
- **Treatment of Stakeholders** – Cooperation vs Exploitation
- **Impact on Society & Environment** – Reciprocity and Corporate Social Opportunity vs Regulatory compliance and Corporate Social Responsibility

As stated by John Mackey, co-CEO of Whole Foods, in 2007 in his paper titled "Conscious Capitalism: Creating a New Paradigm for Business", *"Having a deeper, more transcendent purpose is highly energizing for all of the various interdependent stakeholders, including the customers, employees, investors, suppliers, and the larger communities in which the business participates."*

A Greater Purpose Leads to New Value Creation Opportunities

"Maybe there are better kinds of companies, which can return more than just profit through better approaches to production and consumption, that can yield more meaningful, durable benefits by trading and exchanging hardier, more enduring, more fruitful kinds of capital…. They're demanding organizations that don't just make money, but can begin seeding, nurturing, and harvesting higher order wealth in them, with them, and for them. It is up to those organizations that power, advantage, trust, and returns are already inexorably flowing." - Umair Haque – "Betterness: Economics for Humans"

The stakeholder root ecosystem visually portrays how a company's consumers, employees, and partners are starting to use social media to intermingle and intertwine and form relationships amongst and between themselves. This is resulting in the growth of new secondary root systems as new relationship domains of consumers-to-employees, employees-to-partners, and consumers-to-partners emerge. This ultimately is leading to the creation/ destruction of a firm's Social Capital.

In the new Social Era, companies will no longer be able to derive their competitive advantage by exploiting their customers, employees, and partners or by pursuing activities that generate negative societal and environmental externalities. Traditional economic moats such as being a low-cost producer, possessing intangible assets, creating high switching costs, and benefiting from closed network effects will start to erode as stakeholders use social media to criticize, protest against, and defect from companies that profit at their expense.

More importantly, enlightened companies with a greater purpose will find themselves in an enviable position, as they will be able to start to build bonding, bridging, and linking capital with their stakeholders. This will enable them to form communities that will allow them to access the following new Social Capital value creation opportunities:

1. Advocate
2. Learn
3. Collaborate/Co-Create

1. Advocate

A company with strong and trustworthy relationships based on a shared sense of purpose is ideally positioned to benefit from the positive network effect resulting from word-of-mouth and interactions among and between its consumers, employees, and partners.

- **Consumer to Consumer –** Favorable user-generated reviews and positive comments on social media will attract new customers as well as increase existing customers' purchase frequency and average basket size, leading to increased revenue and reduced customer acquisition costs. These ambassadors can also assist a company with its grassroots marketing efforts to expand its market or to launch new concepts.
- **Consumer to Employee –** These advocates can help to reduce customer service costs by voluntarily helping other customers with any questions or problems. They can also assist a company with its grassroots recruiting efforts by sharing its job postings with their social and professional networks, which will decrease the company's employee acquisition costs and increase the potential quality of its talent pool. Advocate consumers are also often the most fertile ground for new product or service development ideas as they want to see the company and its portfolio of offerings succeed by evolving with them and their interests.
- **Consumer to Partner –** These supporters will voluntary come to the company's defense if it encounters a public relations issue, helping to minimize the negative impact on a company's reputation and goodwill. In addition, a large and powerful consumer support base will be an additional attractor for partners who want to work with the company.
- **Employee to Partner –** These corporate ambassadors can tap into their personal and

professional networks to help a company establish new partner relationships.

• **Employee to Consumer** – Associates who believe strongly in the company's purpose can act as missionaries who build trust with consumers in the brand purpose by illustrating that the people behind the brand live the corporate values and purpose daily.

• **Employee to Employee** – When associates connect to a company's purpose, they create a powerful culture that acts as a self-governing body that will foster strong connections with those who share the organization's values and purpose and weeds out those who do not.

• **Partner to Employee** – Partners who believe in the brand's purpose will be willing to work more collaboratively with the people behind that brand, oftentimes developing never-before-thought-of solutions to age-old challenges.

• **Partner to Consumer** – Consumers are increasingly aware of not only the employees within a firm and their beliefs but also the partners with whom a firm chooses to work. The stronger the set of shared beliefs and purpose are with partners, the stronger the bond with consumers as they will recognize a powerful ecosystem held together by shared values.

• **Partner to Partner** - Companies whose partners operate from a set of shared values and purpose vs. a strategic business need will be more willing to find additional partners through their existing partner networks. As everyone works in the interest of fulfilling a higher order purpose, notions of competition fade in favor of collaboration.

One example of a brand which has created powerful advocacy with their consumer, partner, and employee base is Secret antiperspirant and deodorant, part of The Procter & Gamble Company (P&G) portfolio of products. Through its work with BrightHouse, Secret discovered its purpose was to help women be fearless, not just in terms of the odor and wetness that comes with sweat, but to be fearless in their hearts and to explore pursuits they once thought were impossible. In activating their purpose, BrightHouse brought Secret the notion of partnering with a truly fearless woman, Diana Nyad, who at the age of 61 was planning to be the first person to swim the 103 miles from Cuba to Key West in shark infested open water. Through a powerful Facebook campaign, the brand became the second fastest growing Facebook page globally – garnering tremendous advocacy in record time. By connecting the sponsorship of Diana to Secret's Clinical Strength Waterproof Deodorant, the SKU, which had been in the marketplace for two years prior, experienced unprecedented double-digit growth, earning huge accolades within the P&G corporation.

2. Learn

A company can use social media platforms to dynamically and interactively reach out to its customers, employees, and partners to build learning communities focused around the passion for its greater purpose and the products and services it offers. This will create a unique experience and further deepen the level of psychological attachment its stakeholders have for the company.

One example of a brand that has used their social media platforms to build learning communities is the Graco brand, part of Newell Rubbermaid's portfolio of consumer products. BrightHouse worked with the brand to excavate, articulate, and activate their purpose, Cradle Those Who Cradle Them, expanding their business from focusing solely on juvenile products to be a baby and parenting essentials brand. Through this work, Graco created the Heart-to-Heart blog which allowed individual employees to connect directly with the mommy blogosphere. By humanizing the brand in this way, and connecting employees who were expectant moms with consumers who were parents or expectant moms, Graco was able to grow their business and consumer loyalty, even gathering key consumer insights that fuelled new product innovation such as SweetPeace, the first of its kind in the newly established soother category.

3. Collaborate/Co-Create

A company with a greater purpose is ideally positioned to encourage consumers, employees, and suppliers to work together towards a shared goal or vision. Social platforms create a new, open forum for participation, facilitating different forms of collaboration and co-creation ranging from user-generated content to idea generation to open-source to crowd-sourcing to mass customization. Through facilitating trust and allowing its stakeholders to build bridging capital, a company will be able to break down the barriers between professional disciplines, age groups, and geographies by allowing its stakeholders to find one another, learn from one another, and form heterogeneous groups. These creative collaborative efforts could result in the combination of concepts between multiple fields, generating intersectional ideas, increasing the quality and frequency of innovation. In the end, this will create a denser stakeholder network and tighter integration with the company.

One powerful example of collaboration is The Coca-Cola Company and their partnerships to address one of our nation's biggest problems – childhood obesity. By partnering with government, business (including their competitors), and consumers, Coca-Cola, in partnership with Dr. Pepper and Pepsi, removed high calorie beverages from schools, replacing them with juices, waters, and other low-calorie options. In addition, Coca-Cola recognized an opportunity to take veterans who are returning home in peak physical condition but to no jobs and use their skills to teach kids about physical fitness through their Troops for Fitness program. All of these efforts have and will continue to contribute to solving one of our nation's biggest problems, all based on their purpose.

Tremors in Stakeholder Ecosystem Will Shift Companies' Underlying Risk and Growth Profiles

As the world becomes more transparent and connected, the collective power of the individual will start to emerge from the depths of the earth. This will shake up the soil of the stakeholder root systems and cause massive tremors and shifts in the ecosystem of the corporate forest. Unlike a black swan event, which is unpredictable by nature, this revolutionary force of highly connected and empowered stakeholders will gradually start to disrupt the corporate world. As Nassim Taleb remarks in his new book "Antifragile: Things that Gain from Disorder", *"you can state with a lot more confidence that an object or a structure is more fragile than another should a certain event happen."*

The new Social Era will create a high level of fragility for companies who derive their competitive advantage through exploiting their stakeholders because, for the first time ever, the exploited have a voice and are empowered to join together and fight back. This will expose the fragile companies that have a shallow stakeholder root system and rip and tear at their thin, narrow, and fragmented roots, making them more vulnerable to external risks and stunting their future growth. But the companies that have deep, thick, wide, and highly intertwined stakeholder root systems are antifragile. Not only will they be able to withstand the tremors, but they will thrive as the shaking aerates the soil and enriches the nutrients, allowing their roots to grow even thicker and spread out further. This increases their immunity to external risks, accelerating their growth as they grow new branches and become more leafy and fruitful than anyone expected. And as the weak stakeholder companies quickly succumb to disease and natural disaster, the strong stakeholder companies will thrive even further. As the nutrients in the soil are enriched, they have more space to extend their roots, and they receive more sunlight.

Antifragile companies will be able to take advantage of the Social Capital value creation opportunities of advocacy, learning, and collaboration/co-creation. As shown in Figure 2, the creation of positive Social Capital will result in a decline in their individual risk factors, leading to a lower than expected risk profile.

Figure 2: Impact of Social Capital on a Company's Individual Risk Factors

RISK FACTOR	NEGATIVE SOCIAL CAPITAL	POSITIVE SOCIAL CAPITAL
Economic	Lose share of wallet	Gain greater share of wallet
Pricing	Low connection so reduces pricing power	Deepening connection increases pricing power
Commodity Price	Low loyalty—high price elasticity of demand	Increasing loyalty—low price elasticity of demand
Consumer Trend	Increases if don't listen to customers	Declines—2-way dynamic info flow creates dialogue
Innovation	Increases—not able to create communities	Declines—collaboration/co-creation opportunities
Labor	Strike/disruption—increase costs/reduce flexibility	Declines—sharing/learning/collaboration opportunities
Supplier	Supply chain disruption—slow down/stop production	Declines—opportunity for higher integration
Product Liability	Increased reputational risk	Mitigate goodwill/reputation risk
Environmental Liability	Increased compliance exp/capex, contract loss risk	Mitigate goodwill/reputation risk
	INCREASING RISK	DECREASING RISK

These companies will also be able to attract a high caliber of consumers, employees, and partners who believe in their greater purpose and are seeking to align their values with those who they buy from, work with, and do business with. They can now use social media to leverage these stakeholder relationships, positioning them to accelerate their low-risk, low-cost grassroots marketing efforts to grow comparable sales, expand their geographic footprint, and launch new concepts. This will result in a higher than expected growth profile.

Introducing a New Valuation Framework for the Social Era

"There is one and only one social responsibility of business – to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game…" – Milton Friedman, American economist

As we enter the new Social Era, Friedman's traditional view that companies should focus solely on maximizing value for shareholders is an increasingly risky proposition for companies as it fails to recognize the rise in connectedness and empowerment of the former silent majority of consumers, employees, and partners. As Paul Druckman, Chief Executive Officer, International Integrated Reporting Council, states in a recent Harvard Business Review article titled "Corporate Reporting Needs a Reboot", *"…today's model of capitalism overemphasizes short-term financial data and neglects information that gets at the true sources of sustainable value creation – things like innovation, brand equity, customer loyalty, and key stakeholder relationships."*

In this new Social Era, we have to realize that the Income Statement provides a limited view of a company, much like looking at a statue from only one angle. On its face, the Income Statement assumes a linear relationship between a company's inputs and its outputs with the underlying objective of the company being to maximize profit by maximizing revenue and minimizing costs. That doesn't really describe the complexities that underlie the interaction among all the stakeholders just as one cannot know the statue unless it is viewed from many sides. This simplistic mechanistic formula of maximizing revenue and minimizing cost is becoming increasingly outdated as companies will no longer be able to achieve profit maximization through exploiting their stakeholders and generating negative societal and environmental externalities. And more importantly, this myopic formula fails to recognize the potential value being built by companies that seek to create shared value for their stakeholders and are generating positive societal and environmental externalities.

The Balance Sheet is also limited as it does not speak to the intangibles that increasingly govern a business' value. On the Liability side, it does not account for the negative value of Social Capital of fragile companies that have weak and untrustworthy relationships with consumers, employees, and partners, nor the negative externalities these companies' business activities generate for society and the environment. And on the Asset side, the balance sheet does not account for the positive value of Social Capital created by virtue of a company's strong and trustworthy relationships with consumers, employees, or partners nor the positive contributions it makes to society and the environment. Although it does reflect the value of goodwill, this is only an accounting entry that represents the excess of purchase price over book value paid by a company when it does an acquisition.

The current valuation framework is highly misleading as it seduces investors into overpaying for fragile companies with negative Social Capital, while blinding investors to opportunities to establish stakes in antifragile companies with positive Social Capital. This new reality is not reflected in traditional valuation metrics such as profit-based ratios such as Price-to-Earnings (P/E), Enterprise Value-to-EBITDA (EV/EBITDA), and Price-to-Cash Flow (P/CF). These metrics are too myopic as they do not factor in how a company's stakeholder relationships will impact its future value creation/erosion prospects. Price-to-Book Value (P/BV) is even more limiting. Although it worked back in the Industrial Age, it does not reflect the fact that nearly 80% of companies' value is based on intangible assets, nor does it reflect the inherent liability of companies with negative Social Capital. And Dividend Yield (Dividend/Stock Price) is perhaps the most misleading as the sustainability of the business model of many cash-cow companies is questionable in the new Social Era.

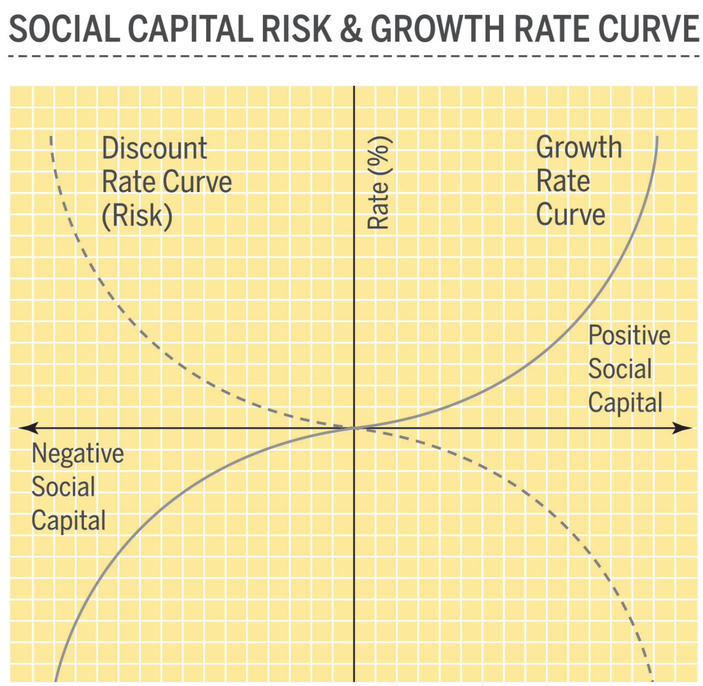
A better and longer-term valuation methodology is the Discounted Cash Flow (DCF) model, which calculates the Net Present Value (NPV) of a firm's projected free cash flow. As shown in the simplified NPV calculation in Figure 3, the two key variables to a DCF are its discount rate (k) and growth rate (g).

Figure 3: Net Present Value = Free Cash Flow / (k-g)

$$NPV = \left\{ \frac{\text{FREE CASH FLOW}}{\text{Discount Rate (k)} - \text{Growth Rate (g)}} \right\}$$

The problem is that most investors measure k as a function of beta, which is simply the mathematical measure of the volatility of its stock price. However, we believe a more accurate economic reflection of a company's discount rate is to measure it as a function of a company's level of Social Capital (either positive or negative). Although a company's Social Capital with its stakeholders is an intangible asset that, unlike goodwill, does not show up on a company's balance sheet, investors need to factor it into their analysis and valuation process as it will impact the company's implied discount rate and growth rate. As shown in Figure 4, we expect that the Social Era will result in a shift in companies' risk and growth curves based on a function of their Social Capital.

Figure 4: Social Capital Risk and Growth Curve Chart



To mathematically illustrate how changes in a company's assumed discount rate and growth rate impact its implied valuation, consider the following three scenarios for a mature company that is currently producing $1.00 in free cash flow:

- **Base Case Scenario** - assume a 10% discount rate & 2% growth rate: $1.00/(10%-2%) = $12.50
- **Company with Negative Social Capital –** assume a 12% discount rate & 0% growth rate: $1.00/(12%-0%) = $8.33
- **Company with Positive Social Capital –** assume a 8% discount rate & 4% growth rate: $1.00/(8%-4%) = $25.00

As shown in Figure 5, we calculate a company with Positive Social Capital would have triple the implied valuation of a company with Negative Social Capital ($25.00 versus $8.33 per share).

Figure 5: Simplified DCF Matrix

DISCOUNT RATE (k) \ GROWTH RATE (g)	0 %	2 %	4 %
8 %	$12.50	$16.67	$25.00
10 %	$10.00	$12.50	$16.67
12 %	$8.33	$10.00	$12.50

In summary, BrightHouse and Barbara Gray provide this perspective as a way to expand current thinking on how companies are valued, how they can be valued going forward to better capture the impact of Social Capital, and the power of a higher purpose.

Barbara Gray, CFA, is an Equity Analyst with Brady Capital Research (www.bradycap.com), and BrightHouse (www.thinkbrighthouse.com) is a creative consultancy with leading expertise on purpose.