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THE NEWS CORP. ISSUE

Reputation: The golden thread of stakeholder capital

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As the international press' focus shifts away from Rupert Murdoch to US debt, we take the opportunity to ask what have we learnt, and how can investors avoid similar reputational crises battering their investments in the future.

The stark severity of the reputational damage suffered by News Corp. is reflected in the company's market capitalization dropping by \$10 billion, not to mention the lost jobs and market position. News of the World lost the basic permission that society gives to a corporation to conduct its activities, its "social license to operate". Once revoked, Murdoch was forced to shutter News of the World, pull out of his bid for BSkyB and accept the resignation of News International Chief Executive Rebekah Brooks.

The repercussions have also hit News Corp.'s credit worthiness, with Standard & Poor's placing their credit rating on a negative watch, citing the company's reputation and business activities are at risk from the hacking investigations.

An organization is essentially a nexus of relationships. The ability to have beneficial relationships with key stakeholders is a foundational component of the value of an organization. Value creation in corporations is increasingly dependent on non-financial factors, such as stakeholder capital. Stakeholder capital is the quantity and quality of a firm's relationships. It is built on trust, confidence and ultimately the reputation of the corporation. Reputation is critical for the ability of an organization to attract and retain relationships with its different internal and external stakeholders. The nature of reputation and its intangible effects, make it very difficult for a company to measure, manage and protect this valuable strategic resource.

Reputations provide a window into the fundamental character of companies, helping to explain strategic behavior and provide investors with confidence that managers will act in ways aligned with their interests. Without a reputation from which you can leverage a brand that resonates with stakeholders, the other intangibles, management quality, intellectual capital and brand equity become much less valuable than they could be. A CEO's ability to address multiple stakeholder concerns is pivotal in using relationship management as the lever from which value from intangibles

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PERSPECTIVE

Assessing the culture of an organization

The real question for investors from the News Corp. saga is how can the culture of an organization be assessed? How can we assess a company's reputation and make investment decisions based on that assessment in order to avoid future capital losses?

IPCM's five factor proprietary model specifically examines a company's human and organizational capital.

Factors that we analyze include a company's recruitment capabilities, board level diversity which includes capabilities, experience and culture. The importance of retention and high performance workplace strategies as well as whether a company has developed knowledge and organizational learning structures provides us with insight into the culture of the company.

Drilling into a company's labour rights strategies and performance as well as stakeholder relations with regulators and local communities provides us with an understanding of how a company manages its external environment – an important factor in determining whether the company can deliver value on a long term sustainable basis. Using our proprietary model, News Corp. has consistently been rated in the bottom decile in the media sector on organizational capital and indeed for its overall performance on our five factors.

It is worth pointing out that IPCM's investment process, by including factors such as a business's capacity to innovate, its commitment to knowledge and learning and its stakeholder relations generates a more comprehensive analysis of a company's sustainability than analysis based only on analyzing environmental, social and governance factors. While in the short term a company may be able to grow without focusing on its culture, in the end it is only if a company has developed a culture that encourages factors such as innovation, sustainability and knowledge can it hope to deliver long-term returns to investors. <

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is optimized. Increasingly corporations recognize the importance of stakeholder capital management, but there are many who still choose to ignore it until an issue arises that threatens the bottom line.

Phone hacking allegations against News Corp. first surfaced five years ago. However, in early July 2011 it was revealed that News of the World hacked into a murdered teenager's voicemail messages, catapulting News Corp.'s business practices into the spotlight. Now, risks that have been lurking in the recesses of this organization have surfaced, but should there be any surprise?

The idea initially insisted upon by News Corp. that the phone hacking was an isolated incident perpetrated by a single rogue operator never held water. Senior management's denial that they knew anything about it was compounded by the lack of investigation and a glacial recognition of the political ramifications of the charges. Murdoch's defense strategy so far has been one of plausible deniability. However, given Murdoch's hands-on approach in the management of his holdings, it is difficult to fathom, according to Murdoch that, "management was misled by very bad people at a very low level in the organization." However as former editor Bruce Guthrie at one of News Corp.'s papers was quoted as saying, "The culture that exists at his newspapers is a culture he has developed."

A corporation's culture develops from a set of shared values, which shape an organization's reputation and its behaviors, providing the guiding compass that determines what employees are willing to do in the pursuit of profit.

Murdoch believes however, that the damage to the company is "nothing that will not be recovered," and that he is just the man to clean up the mess. Investors have long turned a blind eye to News Corp.'s culture, but increasingly believe that a "Murdoch discount" is embedded in the share price, with Bloomberg reporting that News Corp. would be worth 50 percent more without him.

As investors nurse their losses, they will be left wondering why they didn't shine a light into the darkness earlier. With the FBI probing whether News Corp. employees bribed police officers to obtain information about victims of the 9/11 terrorist attacks, the company is at risk of a similar backlash in the US, where News Corp.'s US franchise accounts for nearly 60 percent of News Corp.'s revenue and an even higher proportion of the company's earnings. With the threat of further reputational repercussions, News Corp. is at risk of losing the support of more stakeholders, including advertisers.

While News Corp.'s ability to bounce back from this continuing crisis will depend on whether it can genuinely tackle its culture, from our analysis we know that the company is not the only one with issues.

For investors there are now two examples in the last year – BP and News Corp. – where corporate culture has in the end severely impacted on the company's value. News Corp. is just another example that demonstrates that sustainability alpha has yet to be factored in by most investors, providing an opportunity for those that do. <

ABOUT US

Inflection Point Capital Management

is a new, sustainability-driven asset management boutique. A research-driven organization, IPCM builds on the knowledge base and networks of its predecessor company, Innovest Strategic Value Advisors. Innovest was ranked by the Thomson Extel survey of institutional investors as the #1 research firm in the world in the sustainability space. IPCM has offices in London, New York, Toronto, and Melbourne.

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