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Six reasons why sustainability matters to business

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Jyoti Banerjee and Chris Tuppen, partners at Fronesys, check out the business case for sustainability.

The business case for sustaina-bility

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If a CEO's pronouncements were all the evidence we needed that a business was doing something, then sustainability would be top of the strategy charts.

Over half of the McKinsey Global Survey 2010 participants consider sustainability – the management of environmental, social and governance issues "important" or "extremely important" to their businesses. An even more optimistic Accenture study of 766 CEOs found 81% claiming that sustainability is part of the strategy and operations of their businesses.

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The same McKinsey study reports that most companies are not actively managing sustainability, or seeking opportunities for investment or making it part of their business practice. Yet, the best sustainability performers comfortably beat their competitors on sheer economic grounds.

So how do companies get their deeds to match their words? And why should they bother? Here are six reasons why companies have to get their sustainability actions to speak at least as loudly as their words.

1. The best sustainability performers are the best performers. Period.

Accenture's study of 275 global Fortune 1000 companies analysing business and sustainability performance metrics shows that the top 50 companies ranked on sustainability outperform the bottom 50 by 16% when it comes to shareholder returns over a three year period.

Over five years, the results are even more skewed in favor of the best sustainability performers: the top 50 outperform the bottom 50 and middle 50 peers by 38% and 21%, respectively.

Investors are now using this information as ammunition in their investment strategies. A London-based hedge fund uses environmental performance metrics to pick out top decile performers in around 30 sectors. The historical simulated performance delivers around 5% outperformance compared to its index, but this sustainability-driven fund comes in over 9% per annum.

So the best sustainability performers make more money, therefore, attracting more investors. Whatever the cause and effect here, it's still a great reason to get involved in sustainability.

2. Operating efficiency is a sustainability virtue.

One important factor driving economic performance is resource efficiency. As companies deal with depletion of resources, environmental impacts, and materials security, they seek new and improved ways of doing what they do. The consequence of this is improved performance inside the business, and improved ability on the part of the company to transition into the low-carbon world that is already being shaped into place.

Resource efficiency is also an area where it's very important to be forward looking. According to World Wildlife Fund, the world economy took as much as the planet can offer (in terms of natural resources and as a sink for our waste, including global warming gases) in 1988. Since then, we have been borrowing from future generations and, as economies continue to grow, so does our deficit with nature. Many are predicting a crunch in the natural world as devastating as the financial credit crunch experienced in 2008. It's unlikely to happen as quickly as the financial crises, but businesses should be building it into their long term-cost forecasts.

In many ways, the recent price hikes in energy, commodities and food are all linked to long-term sustainabilityrelated trends, and are an early indication of the internalization of many externalised costs which are currently unaccounted for.

3. Keeping out of regulatory trouble is a sustainability driver

Let's face it: the world's economies have done a poor job of preserving the planet's natural resource amenities, such as air fresh water, and carbon. As a result, most Organization for Economic Co-operation and Development (OECD)-based businesses have to pay for some of the pollution they cause.

Historically, in the US and most OECD countries, polluters have paid around 2 to 2.5% of GDP to clean up their worst pollution. However, United Nations Environmental Program (UNEP) estimates that the annual environmental cost from global human activity was 11% of global gross domestic product (GDP) in 2008, and the number will rise to more than 17% by 2050. So we are not paying for anywhere near all the costs we incur.

Why is this relevant?

Because the day is coming closer that businesses will have to pay for the environmental damage they cause. UNEP and Trucost, the environmental data provider, together estimated that over $2 trillion of environmental damage in 2008 was caused by the world's 3000 top public companies. If these businesses actually had to pay for these damages, then around a third of them would no longer be profitable. Of course in reality prices to the end customer would rise to reflect the increased operating costs and cleaner technologies would become commercially preferable.

Puma, the German apparel manufacturer, has recently responded to this challenge by integrating its environmental damage costs into its financial reporting. Over the past 20 years a number of organisations have experimented with so called 'full cost' accounting. The Puma report, with input from consultancy PwC and Trucost, has received a lot of interest so maybe this time the approach will go mainstream.

Externalised costs are good at foretelling probable areas of new regulation that will ultimately drive all businesses toward sustainability, with measures such as the Carbon Reduction Commitment, Greenhouse Gas Emissions Allowance Trading Scheme and the Environmental Liability Directive all being relatively recent examples of the way governments are seeking to get responsible behavior from their corporate citizens.

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4. Reputation? What reputation?

While paying attention to the law, don't forget there can be an even higher court that holds businesses to account, the court of the consumer. Even if a business is meeting the letter of the law, but is violating its supposed social contract in some way, it can attract consumer boycotts and loss of revenue.

Of course many businesses are hidden away in the supply chains of big brands. But this can still make the big brand vulnerable, as many have found to their cost when it comes to working conditions in their supply chain. On the environmental front, the common accusation is that companies are only interested in "greenwash",not a genuine performance in the area of sustainability. As a result many large businesses are increasingly building sustainability issues into their procurement standards.

Companies in some industries are more sensitive to reputation risk than others. In his blog, Jeff Swartz, Timberland's CEO, claims that his company, a boot maker, is held to a higher sustainability standard than the maker of iPads. Swartz's argues that his company could never get away with Apple's behaviour, where it "refuses to set targets for reducing carbon emissions," and "remains tight-lipped about its supply chain" even though Chinese workers are alleged to have fallen ill, through exposure to a toxic chemical, while making Apple products.

In the fashion industry, claiming commercial confidentiality has long ago been blown away as an excuse for maintaining corporate silence on supply chain matters for companies like Nike, Timberland and Adidas. How long then before others have to 'fess up to sustainability sins? Probably, when the sceptre of reputation risk becomes real, and causes damage to share prices and revenues.

"... employees can see through greenwash or corporate untruths..."

The key here is to understand why the business may be vulnerable to sustainability-related risks, prioritize and, if possible, monetize them, and then introduce mitigation strategies.

Meeting customer and other stakeholder expectations is about winning the licence to operate, while exceeding them is about building brand loyalty and enhancing customer 'stickiness'. The first step here is to understand what those expectations are and how addressing them delivers business value. The trouble with talking to stakeholders is that it always generates a long list of expectations. But be prepared to deal with dilemmas, as different stakeholder groups can pull the business in opposite directions!

5. Employees care about sustainability too.

Increasingly, it is the company's own employees that are the reason why businesses want to do better when it comes to sustainability. This is because the employee knows the most about how a business is really operating, and can often see through greenwash or corporate untruths. When a company's reputation takes a battering from external pressure groups, (Greenpeace, Shell and Brent Spar is the classic example of such external action on a company's brand), it is the employee workforce that often needs to be encouraged that their employer is doing the right thing.

Starbucks, the coffee retailer, sends scores of its employees from across Europe on "Origin Tours" to Costa Rica, Sumatra and Tanzania, so that these employees are encouraged by a close-up view of the business practices of their employer, and can then push the company's ideals when they return home. Of course, these employers see CAFE Practices in action, a Fairtrade initiative which ensures that farms in the Starbucks supply chain meet minimum standards in wages, agrochemical practices and environmental issues, while producing the best coffee.

Without seeing these positive impacts from their company for themselves, employees are less motivated to stay with a company, or deliver their best.

A company's employees are often a fairly representative cross section of society and, given the low levels of public trust in business, many will be questioning the motivations of their bosses. Finding ways of motivating employees by being seen to be doing the 'right' thing, or even better involving them in it, builds employee motivation. And 'happy' employees mean more productive employees, and improved customer relations.

Increasingly, attracting and retaining talent is also influenced by the company's sustainability reputation, particularly when it comes to graduate recruitment.

6. Business opportunities are rife in the New World.

Finally, but by no means least, new sustainable products are opening up major new markets and creating fabulous business opportunities. We are calling this the New World of business opportunity.

These opportunities span from clean technologies, such as renewable energy generation, to sustainable sourcing in the food and agriculture sectors, to innovative design that makes our businesses and homes more efficient.

Ideally, sustainability needs to be built into the heart of the capitalist economy in a profitable way. Often this requires political intervention to remove perverse subsidies, incentivise investment in new technologies and sometimes change behavior patterns. Ultimately this is the win-win scenario for building what strategy guru Michael Porter calls shared value. Some businesses (and, indeed, countries) recognise this, and are investing for the long term.

"... sustainability needs to be built into the heart of the capitalist economy in a profitable way..."

But is there really a New World of opportunity out there?

Let's take carbon as an example. Already, businesses have started transitioning to a low-carbon economy, whether driven by climate change regulation, high oil prices, energy security, or plain competitive pressures from peers that have already made such investments.

Whatever initiatives are currently in place, as a planet we have only made baby steps. It is widely expected that for global temperatures to rise by less than two degrees centigrade, global greenhouse gases should fall by 90% from today's levels by 2050. In 2000, it took 32 billion tons of carbon to produce $32 trillion of global GDP. Taking economic growth into account, McKinsey estimates that by 2050, we will need to use 5-10 billion tonnes of carbon to produce around $145 trillion of global GDP.

To put it another way, carbon productivity is going to have to rise by 5-7% a year till 2050, when in the previous fifty years (when carbon was not seen to be an issue) the historic rate is 1%.

Making these huge changes to the way we work today will create generations of new global winners, and some massive global losers. The New World has always been about opportunities, and a new New World is upon us. Sustainability will be the key strategic weapon in this world.

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Jyoti Banerjee and Chris Tuppen are partners at Fronesys Limited, a company that brings together a very experienced teamof leaders in the areas of sustainability, ICT and corporate reporting.

We help companies understand their environmental, social and governance impact, and tie that impact to the more typical techniques and metrics companies use to make business decisions.

For more information: **www.fronesys.com**