To Whose Profit?

Building a Business Case for Sustainability

Cui bono: To whose profit?

Marcus Tullius Cicero (106-43 BC)

The Oxford Dictionary of Quotations

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Published by WWF-UK, Panda House, Weyside Park, Godalming, Surrey GU7 1XR

WWF-UK registered charity number 1081247
A company limited by guarantee number 4016725
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A catalogue record for this booklet is available from The British Library

ISBN 1 85850 190 3

Designed by Studio Repro
Printed by Fencourt Printers on Greencoat Velvet (60% post consumer waste, 20% converted fibre and 20% virgin fibre). Greencoat is a totally chlorine free stock.

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Introducing
the Project Partners

WWF-UK is committed to working with business innovators to create a better understanding of sustainability. Through such partnerships, we aim to identify best practice and to promote the business case for sustainability through the use of concrete examples. To support our work in these areas, WWF's Business Education Unit commissioned Loop Environmental Networks Ltd and URS to carry out an extensive review of current research, focusing on the evidence for a link between sustainability issues and business performance. The research findings were then developed and refined into a publication, which includes guidance on how senior managers might start the process of developing a business case for their own companies. By publishing our findings, WWF aims to encourage more companies to start working towards the integration of sustainability issues into business practice.

Within WWF-UK, project development and management has been handled by Alasdair Stark, Business and Industry Training Manager, and Joss Tantram, Business Education Manager.

Cable and Wireless plc is a global communications company that aims to be a leading supplier of Internet Protocol (IP) and data services to business customers across the world. We work within a complex system of cultures and environments and recognise that global business success requires good corporate citizenship. In addition to supporting initiatives across the world, we are committed to developing our thinking in these areas by participating in relevant research. We were therefore delighted to lend our support to WWF and to share the information and resources needed to turn a great idea into an important research project. We shall continue to work with WWF to develop our thinking in this area.

From its inception, this project has relied on the collaboration of experts from a variety of backgrounds to develop ideas, share information and to prepare the various project outputs. We were delighted to call upon the company experience of Loop Environmental Networks Ltd, URS and Riverside Management Consultants to support the various iterations of the project. In particular, we wish to thank the following individuals:

The author: Vicky Kemp, Loop Environmental Networks Ltd.

Contributors: Andy Hughes and Jim Walker, URS.

Project research team: Andy Hughes, Jim Walker, Emily Farnworth and Rob Evans, URS; Hugh O'Neill, Cable and Wireless.

Project review team: Alasdair Stark and Joss Tantram, WWF-UK; Christine Slight, Cable & Wireless; Katherine Howard, Riverside Management Consultants; Craig MacKenzie, Friends Ivory & Sime plc; Toby Belsom, F M Morley plc.

Publishing & Marketing team: Cherry Duggan, Karen Gates, Laura Dyer and Lorraine Lacey, WWF-UK.

Editorial: Roger Cowe, freelance journalist; John Kemp, Loop Environmental Networks.

About the Author

Vicky Kemp

Vicky Kemp is a Director with Loop Environmental Networks Ltd. She has over eleven years' experience in corporate environmental management, project management and consultancy and has taken a lead role in developing new approaches to environmental management that deliver tangible business benefits. The main focus of her work is to help companies understand and obtain benefits from improved environmental performance, beyond matters of strict compliance.

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Executive Summary

Several events during 2001 have emphasised that sustainability issues are beginning to emerge as key concerns for business, carrying important strategic threats and opportunities:

- The determination of most governments in the industrialised world to push through the Kyoto Protocol on climate change highlighted the potential for carbon-saving technologies and the markets for more sustainable products and services.

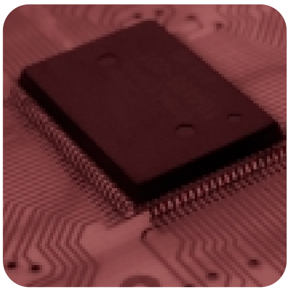
- The patent protection case brought by the pharmaceutical industry in South Africa demonstrated the need for strategies that take account of developing countries and issues of poverty. Some of the world's leading drug companies attempted to enforce patents on Aids drugs in the South African courts. They were concerned about imports of low-price, generic copies. But their action provoked uproar as it was seen as denying life-saving drugs to impoverished Aids sufferers. The case was eventually abandoned.

- The furore over alleged slave labour in the cocoa plantations of the Cote d'Ivoire emphasised that responsible supply chain strategies are needed by all companies – not just those in the textile and sports goods industries which have hit the headlines in the past. A Channel 4 TV documentary, *Secret History*, claimed child slavery was widespread on plantations in the Ivory Coast, which accounts for 40 per cent of the world's cocoa crop. Although Cadbury, Mars and Nestlé insisted that they had seen no evidence of slavery, they responded by setting up emergency investigations into these claims.

Many companies have addressed specific environmental or supply chain issues. Many have made great strides in reducing the environmental impact of their plants. But the emphasis has typically been at an operational level, focusing mainly on internal company issues. In most cases it has been difficult to broaden the approach to embrace wider issues of sustainability; to raise the level at which these issues are addressed within companies so that they are incorporated in board-level strategies; and to seek opportunities as well as identifying threats.

The purpose of this publication is to help managers achieve those objectives by putting sustainability on the Board agenda as a potential source of competitive advantage and increased shareholder value. The core of the publication (Chapter 5) presents a 'route map' guiding managers through the initial steps in this process – building a business case for sustainability.

The Strategic Imperative



The need for a strategic approach is highlighted by the examples above, and by several social, political and economic trends which make sustainability a core issue for most businesses (see Chapter 3).

The business world is increasingly expected to engage with issues, such as poverty and international development, which used to be regarded purely as issues for governments. Over the past two decades, governments throughout the world have stepped back from their traditional roles; privatisation programmes have seen the state withdraw from many sectors, and there is now a widespread reluctance to intervene in society as much as in the past. The corollary is higher expectations of the private sector.

At the same time, the accelerating pace of globalisation has created corporations whose power often seems greater than the governments of many countries in which they operate. Anti-globalisation protests have focused attention on this issue, and raised fears that corporate power may be used in ways that do not benefit society.

These two trends have led to much higher expectations of companies' environmental and social performance. It is no longer enough for companies to concentrate on financial issues. They are expected to take responsibility for their environmental and social impacts; to understand the interests and demands of all stakeholders, and to demonstrate through greater transparency that they are behaving responsibly.

Such raised expectations do not come only from the protesters demonstrating against globalisation. Customers, employees, and shareholders increasingly want companies to address these responsibilities (as explained in Section 3.6). There is also official backing for this view in the Company Law Review, which will be implemented in a new Companies Act, and in the UK Listing Authority's Combined Code, which includes requirements for addressing environmental and social risks based on the recommendations of the Turnbull Committee.

Competitive Advantage

A company that ignores ethical, environmental or social issues may *destroy* value through inadequate management of risks, but may also *limit* value through missing opportunities. The immediate response of most managers who do address these trends is to perceive the threats to operations and markets. But while focusing on the risks will protect existing business interests, and thus *conserve* value, such a purely defensive approach will not open up new opportunities to *create* value.

The table below identifies key strategic opportunities and threats in the environmental and social field (described in more detail in Chapter 3):

Opportunity	Threat
• Access to new pools of labour from education and training programmes and community involvement	• Labour shortages
• Higher productivity levels from better trained staff and higher standards	• Low productivity and quality due to poor labour practices and skill levels
• New markets through an improved understanding of consumer needs	• Missing new market opportunities, and the erosion of traditional markets
• New products and markets through the application of new technologies	• Product obsolescence through low levels of innovation and inappropriate technology
• First mover advantage by anticipating the impacts of social pressures	• Failure to anticipate new social and regulatory requirements
• Lower cost of capital because of greater investor confidence in company's ability to manage change	• Vulnerability due to low investor confidence
• Lower compliance costs by being ahead of regulations	• Higher cost levels from increased regulation of old technology
• Enhanced reputation leading to greater staff, customer and investor loyalty.	• Recruitment, customer retention problems through poor reputation.

Evidence (see Chapter 4)

Potential opportunities and benefits from sustainable strategies are not merely theoretical. There are specific cases where clear financial benefits have been identified. For example:

Sears, the US retail giant, tested the relationships between management quality, employee attitudes and financial performance. The research found that if employee satisfaction were to improve by five points, customer satisfaction would increase by 1.3 points, leading to 0.5% increase in revenue. For Sears, this would equate to additional sales in the order of $65 million per annum and increased market capitalisation of approximately $80 million.

The Co-operative Bank has gained 205,000 customers, and continues to grow, largely due to the explicit ethical policy launched in 1992. Its position is cited to be a powerful differentiator that creates tremendous levels of customer loyalty.

Volkswagen reports a link between high standards of environmental performance and overall business performance in several areas, including attractive conditions offered by banks and insurers. The company also emphasises that a well-functioning environmental management system minimises the financial risks resulting from environmental incidents, contamination problems and possible statutory fines. In addition, energy, water and waste disposal costs are reduced and an innovative approach to products and facilities is promoted.

Dow Chemicals's 'ValuePark' in Leipzig and Kalundborg Industrial Park in Denmark have been linked to create more effective systems. The waste from one business becomes the feedstock for another. Dow is investing $1 billion over ten years in 'ValuePark' and in the long-term anticipates a return on its investment of 30-40%, achieved through savings in raw materials, waste, labour and environmental costs.

Such case evidence is supported by a growing body of academic studies. For example, Graves and Waddock explored how high standards of social performance affect long-term business performance. Using the group of companies identified by Collins and Porras in their book *Built to Last (*BTL*)*, they compared five stakeholder-related measures with key financial and market performance measures. They found that in almost all years and for all of the measures of financial performance, the visionary companies outperformed their peers. On average, the BTL group's return on equity was nearly 10% higher than the comparison group; return on assets was 3.5% higher and return on sales was nearly 3% higher. They also found striking and consistent results when they applied share-based measures. For the ten-year relative total return, the BTL group outperformed the non-BTL group in all but one year, with an average advantage of 63.5%. The total shareholder return was more than 5% higher.

Support for the view that sustainability strategies generate business benefits also comes from ethical-rating and information organisations and from leading thinkers such as John Elkington and Simon Zadek. But there is not as yet a rock-solid case. The possibility remains that a company can still prosper despite ignoring its environmental and social responsibilities, although companies which do so – and their shareholders – need to be aware of the risks in such a strategy. Nevertheless, the evidence points to a positive relationship and the desirability of building a strategic case for sustainability.

A Route Map

Any strategic case needs to be built on a rigorous analysis of the broad business environment and the key influences which are likely to affect a company's markets and operations. A case can then be built for dealing with potential threats and capitalising on opportunities. To win the support of the Board and of investors, it will need to be communicated in standard business terms – identifying the size of market opportunities and the expected impact on financial performance and shareholder value.

The publication presents (in Chapter 5) a six-stage process for building such a business case, and suggests tools which can be used in each stage. The process, and suggested tools, are summarised overleaf:

Stage	Tool
• Understand the company's significant environmental and social impacts	• Impact assessment/appraisal
• Identify key issues for stakeholders	• Stakeholder analysis/dialogue
• Establish where threats and opportunities might come from	• Threat/Opportunity analysis
• Identify key actions to create and conserve value	• Porter's 'Five Forces' model
• Highlight actions with strategic implications	• Strategic assessment
• Test key actions for inclusion in a strategic business case.	• Economic Value Added.

It is important to base this process on a thorough understanding of the company's current position. This could be a substantial exercise for a business which has not previously undertaken impact assessments at a Corporate level, but it is crucial to the development of a strategy that will minimise adverse impacts and enhance the company's contributions to society.

Understanding the impacts a company has may be helped by engaging with stakeholder groups, including campaign groups. Dialogue with groups outside the company can also provide a different perspective on key issues and their associated threats and opportunities.

Once those issues have been identified, it will be possible to identify actions that can be taken to respond to them. These actions then need to be assessed and prioritised based on their potential to *create* and *conserve* value, and their compatibility with existing business strategy. In some instances, they may also highlight the need for a more fundamental review of existing business strategy.

The output from the process as a whole will be a series of actions to include in a business case based on viable options with desirable financial outcomes.

The Financial Imperative

No matter how important environmental and social considerations are, the business world understands money better than anything else. The financial implications of any strategy are therefore critical. This is particularly the case for quoted companies, which must maintain the support of shareholders, and especially institutional investors.

Equity analysts employed by institutions work predominantly with financial data. To win their understanding and support for a sustainability strategy, it is essential to be able to convey its potential benefits using standard business terms. Managers need to be able to talk about the impact of their chosen strategy on revenues, cost levels, investment needs, the cost of, and return on capital, or the economic value added.

But while money drives the City, investors have started to realise that a purely financial analysis can be misleading or short-sighted, and that a wider analysis is required. Attention is increasingly turning to the broader threats and opportunities facing companies, and their ability to manage them.

This broader approach begins by looking at *vision and leadership* from the top of the company, and how the Board operates compared to modern notions of membership, structure, practices and internal controls. This leads to assessment of corporate *strategies*, the quality of *management* which will have to implement them, the *structure and organisation* within which they work, and the *policies and procedures* which are in place.

Sustainability is important in this context, because it is concerned with longer-term competitiveness. Any sustainability strategy needs to meet the market's financial requirements, but it should also be used to highlight the broader imperatives that a company is trying to address.

Investors will back well-developed strategies that make sense in financial terms. The sustainability aspects of the strategy will be supported in this context, and will help equity analysts to understand the links between sustainable development and financial performance. But it is important that every company identifies the opportunities and potential benefits as well as the threats.

Sustainability can deliver business benefits. It is up to companies to demonstrate how that fits their corporate strategies.

Roger Cowe

To Whose Profit?

Building a Business Case for Sustainability

Companies today face increasing pressure to achieve higher standards, not only in terms of financial performance, but also in relation to ethical, environmental and social considerations. Additionally, a growing number of companies believe that sustainability issues will have an increasingly important bearing on the way in which economic activities are managed in the future.

Whatever their starting point, *To Whose Profit?* will help companies to examine how they might integrate sustainability principles with their business practice. It builds upon the premise that, while most companies already have systems and procedures in place for managing the operational risks and impacts, few have started to view sustainable development issues as a source of potential opportunity. It also builds on the premise that in determining what amounts to a strategic business benefit, financial stakeholders, and equity markets in particular, play an important stakeholder role.

Using standard business tools and an accessible, step-by-step format, the publication aims to:

- raise awareness of the key drivers for change in business sustainability and responsibility
- provide a means of helping to change common perceptions of sustainability issues from threat to opportunity
- encourage the treatment of sustainability issues as a strategic business concern
- identify a possible 'route map' for companies to follow when developing their own internal business cases for improved performance in these areas
- encourage companies and the equity market to apply common terminology and evaluation techniques to their understanding of sustainability and responsibility issues.

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