



The Business Case for Sustainability

Assurance and Advisory



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"From a business perspective, sustainable development is now a mainstream management issue for any company that believes it has a future in the 21st century. Sound environmental and community performance is part of doing good business."
Paul Anderson, BHP Managing Director and Chief Executive Officer

The world's corporations are at a behavioural crossroad. The community at large is showing a distrust of corporations and requesting that industry demonstrate to the public that it can be trusted by earning a new 'social licence to operate.' The protests in Seattle, Melbourne, Prague and other places may be perceived to be the work of a radical fringe, but they have touched a nerve that is present across the broader community.

As a result, success can no longer simply be measured in terms of bottom line profitability, but must include a range of factors such as reporting on non-financial indicators and becoming the investment and employer of choice. Consumers, shareholders and other stakeholders are demanding good corporate governance practices, in particular managing an organisation's reputational risk and ensuring transparent processes. It is a powerful trend and by all judgements, a trend

that will continue to play an increasingly influential part of global corporate life in the years ahead.

The Business Community Responds

Already, this change in community and consumer expectations has given rise to Socially Responsible Investment (SRI), where investors take into consideration a corporation's commitment to issues such as environmental protection, abolition of child labour and human rights entitlements when making investment choices. Short-term financial returns are now only one indicator of good business. Corporations that fail to expand their indicators of success to include non-financial accountability are at risk of failing to win the support of discerning investors, trading partners, employees and regulatory bodies.

Many major global organisations have embraced this new business philosophy of sustainable development and implemented new measurement and reporting mechanisms, in addition to social and environmental policies. They understand that this approach makes good business sense and are leading by example. Tools such as the Global Reporting Initiative (GRI) and AccountAbility 1000 (accounting standard for social and ethical

accounting, auditing and reporting) have been developed to assist in this process. The rise of organisations such as the World Business Council of Sustainable Development (WBCSD), the Council for Environmentally Responsible Economies (CERES) and the United Nations Global Compact reflect major corporations' support for a move to a management philosophy of sustainable business development as the appropriate business response to new societal values and expectations.

"It is important to understand that we are not doing this (BP's work with local communities in Columbia) from any sense of philanthropy but as a proper part of doing business."
Sir David Simon, Chairman BP

Sustainability: Why do it?

The World Commission on Environment and Development (The Brundtland Commission) popularised the concept of sustainable development in 1987, defining it as "development that meets the needs of the present without compromising the ability of future generations to meet their own needs."

The rise of a new economic philosophy championed by several leading global corporations advocates sustainable

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business development and active corporate citizenship programs as part of the new strategic management domain, and redefines the role of the corporation in society. It is not just a move from shareholder focus to one of stakeholder focus and accountability. Instead, the new philosophy recognises and accepts that corporate leaders have a choice in how they conduct their business operations, that they can actively choose to protect the environment and enhance civil society without sacrificing profitability.

Advocates of sustainability seek to promote a greater understanding of the interdependence of economic viability, environmental soundness and social responsibility in delivering sustainable business success. Increasingly these advocates include peak corporate, government, not-for-profit and investment groups, which have identified the link between sustained growth and management of non-financial performance. These advocates have 'raised the bar' in terms of business accountability, particularly as it applies to global corporations. It is now no longer a question of whether to address sustainability but how.

Shifting Societal Values

Social and environmental protection issues are now established as basic rights in the western world's public consciousness and for many the idea that economic growth is the main instrument of social progress no longer holds. Increasingly, civil society is demanding that it be consulted by the corporate world. Organisations are increasingly being asked to articulate their values as well as their balance sheet or market values.

Despite the economic benefits delivered to many of its citizens, three quarters of Americans believe big business is too powerful.² This has led in many quarters to a powerful backlash with renewed demands for government intervention and regulation. Community outrages such as the World Trade Organisation protests in Seattle and the S11 Protest Group against the World Economic Forum in Melbourne, are indications of the depth of this public backlash against corporate institutions that fail to consult with stakeholders.

Furthermore, the development of indicators to systematically measure economic, environmental and social trends, such as the Calvert Henderson Quality of Life Indicators³, show that

the community wants to engage in discussions about the quality of life and what constitutes a liveable community.

This shift in societal values has meant that there has also been a corresponding shift in the balance of power in organisations. The centre of power has shifted from inside to outside the organisation. Today, external stakeholders have more say than ever in how managers run their enterprises. Different industry sectors are exquisitely sensitive to public opinion in a world where attitudes are communicated globally and instantly. Business now operates in a 'CNN World' where information about global events can be transmitted instantaneously, enabling interested parties to monitor corporate activities in any corner of the globe and to take immediate action if corporations are found to be wanting.

The globalisation of business has spawned new expectations for multinational organisations, which now have to manage their company reputation in a number of arenas including online. The explosion of internet 'corporate watch sites' coupled with the instant global communications transfer, has rendered company reputations extraordinarily vulnerable

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to public perceptions. Because their range of influence is seen to extend across borders, corporate accountability and responsibility are seen to extend well beyond national laws and local regulatory compliance.

"We exercise good judgement by 'doing the right thing' instead of just 'doing things right.' We strive to understand the impact of our decisions and we accept responsibility for our actions."

HomeDepot

How to Manage Sustainability

The goal of sustainability management is to make operational the goals and values of the organisation in its social, environmental and economic spheres of influence. New management models enable directors, managers and employees to improve their performance and accountability in all three areas and in an integrated and strategic manner. The hallmark of commitment to sustainable business development is the move to 'triple bottom line' reporting. Here, organisations seek to monitor, measure, report and continuously improve their performance in three areas:

- Financial responsibility
- Environmental responsibility
- Corporate social responsibility.

By linking 'profits with principles', business leaders have recognised that, just as balance sheets may not communicate the full value of a company, financial indicators alone do not adequately reflect either their opportunities or their business risks. More strategic leaders recognise that financial indicators must be augmented by a variety of non-financial measurement techniques. By measuring, accounting for and reporting non-financial indicators as part of a performance measurement system, organisations safeguard their reputations, build trust among their stakeholders, retain investors' confidence, and ultimately, improve overall corporate performance.

A 'Sustainable Development Management and Reporting System' (an increasingly common baseline for many organisations) is a way of implementing a strategic framework that will integrate present and planned initiatives and programs for social, environmental and economic management. In doing so, it will guide a corporation towards improved sustainable business practices while demonstrating transparency with stakeholders, and increasing sustainable shareholder value.

"Reducing poverty and ensuring education for all are in everyone's interest. Poverty and inequality pose major threats to international stability and development. Instead of being marginalized, developing countries must be allowed to develop by promoting education and building up their resources of competence. The activities of international corporations are important in making this happen."
Jürgen Centerman, President and CEO, ABB

Managing reputation and brand value

Leading companies are investing in building stakeholder trust and simultaneously improving their business performance. In so doing, they are creating a new type of competitive advantage by linking value and values. This allows them to position themselves as 'companies of choice' among customers, investors, suppliers, business partners and local communities. These organisations accept that they must manage to retain the confidence of the general public by 'winning hearts and minds' as well as delivering on the bottom line. They are responding to a new set of societal values based around the evolving role of the corporation in society.

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Since most general business risks stem from non-financial factors, organisations have found that how they manage those business risks can influence their financial success. The experience of global organisations such as McDonalds, Nike, Coca Cola Amatil and BHP have demonstrated how protecting corporate reputations means not simply complying with the laws and regulations of the countries in which they operate. Instead, they must seek to move beyond the legal requirements and be seen to respond to societal expectations of, what are deemed to be, socially acceptable business standards. Such expectations are increasingly prompting organisations, in consultation with stakeholders, to define their global corporate responsibilities and to assess how effective they are in meeting them.

“Experience teaches that corporate responsibility best takes root and flourishes when founded in a widely recognised and broadly accepted set of values. . . . We believe that an organisation’s ability to achieve business success and at the same time affect positive change draws its strength from core values, both individual and institutional.”

Livio Desmone, Chairman & CEO 3M

There is a growing body of research to indicate that the number of these companies that measure and report on non-financial values, enhance shareholder value. The number of these companies is increasing.

A Harvard eleven-year study of corporations that emphasised stakeholder management (rather than just shareholder management) found these corporations had sales growth four times and employment growth eight times that of shareholder first companies.⁴ A follow-up study by Collins & Porras in 1995⁵ also found that those corporations that managed beyond their shareholder’s concerns outperformed by a factor of seventy-fold. Key benefits include:

- Enhanced reputation underpinning corporate position as the investment of choice with financial stakeholders; the supplier of choice with business partners; the neighbour of choice for overseas marketplace expansion; and the employer of choice as organisations seek to attract and retain knowledge workers.
- Corporate culture reform to deliver increased flexibility, innovation,

organisational responsiveness and learning.

- Enhanced risk management ability in the environmental, ethical, reputational and stakeholder arenas.
- Sustainable profits through strategic organisational performance and reduced operating costs.
- Improved stakeholder relationships through enhanced mutual understanding.
- A strong perception that the company was acting responsively at the local level as well as responding to global concerns.

To build brand value and enhance stakeholder trust, leading organisations such as 3M, Bristol-Myers Squibb, Sony, Bayer, BMW Group, AstraZeneca, Credit Suisse and General Motors are moving to external verification of their reports. The Reputation Quotient (RQ)⁶ study of corporate reputations in the US, claims a direct link between market value, reputation and general corporate performance. Firms that increased their RQ from 1999 to 2000 experienced an average 8% increase in market value, while firms with declining RQ experienced a 28% decrease in market value.

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The Discounted Cash-flow Approach

As organisations consider how they can benefit from sustainable management philosophies, they are increasingly using a discounted cash-flow approach. That is, what levels of cash-flow can be expected in the future as a result of financial and non-financial stewardship and the interdependence of the two. Increasingly, it is being recognised that there are two currencies in organisations - bottom line performance and intangible contributions around brand and reputational value.

Corporate Governance

At the heart of the on-going corporate governance debate lies calls for companies and financial institutions to adopt a wider notion of corporate governance – a perspective that extends beyond board level structures and executive pay issues and embraces the full range of risks facing an enterprise. These risks arise from ‘non-conventional’ sources such as shifting societal values that place value on environmental, social and ethical accountabilities and use new global information highways to voice concerns and take action.

For instance, the 1999 Turnbull Report is the latest corporate governance review to advocate increased transparency and accountability in UK boardrooms. The span of internal control contemplated by Turnbull stretches wider than financial controls, to encompass social and environmental issues – matters that are increasingly identified as reputational risk areas. At the same time, market research is also establishing the business link between reputation and business performance.⁷

In the US and in the UK there are strong pressures now placed on institutional investors to use their influence and vote in favour of best practice in corporate governance reflecting the strengthening links between governance practices and business performance. The success of the US California Public Employees' Retirement System (CalPERS)⁸ and the UK's Hermes Funds⁹ in targeting corporate governance improvements as a way of adding real shareholder value, has helped build the business case for why boards should also embrace the new values of transparency and stakeholder accountability.

Managing Risks

To identify risks for an organisation, all areas of the business need to be strategically reviewed, and the universe of business impacts on all stakeholders identified. These include upstream processes (supply chain issues), downstream processes (product end-of-life issues), internal resources (corporate culture) and external areas (societal values). Risk areas that are being typically monitored by organisations keen to improve their sustainability performance include:

- Operational risks
- Product risks
- Supply chain risks
- Ethical risks.

How Success in Sustainable Management is Measured

Earlier this year, the fourth international Engaging Stakeholders Benchmark Survey, sponsored by the United Nations Environment Programme (UNEP) and the UK's SustainAbility, launched the first ever survey of corporate sustainability reporting and identified the top 50 global companies. The survey found that many reporting companies had started to use the language of the triple bottom line.

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Good corporate citizenship was seen to embrace a contribution to the economy, fair trade and ethical business practices, good staff treatment and environmental responsibility, as well as public affairs, community involvement and company giving. It also involved open communication with stakeholders and reporting against agreed benchmarks.

Case Study: Ethical Fund Companies

Ethical Investment or Socially Responsible Investment (SRI), is a well-established, major investment sector in the US, the UK and Europe and is expanding in Australia. In the US, one dollar in every eight dollars or 13% of the \$16.3 trillion in investment assets, is invested in socially responsible funds. The SRI sector in the US has grown at twice the growth rate of all assets under management in the US¹⁰, increasing 82% since the previous survey on the sector in 1997. In the UK the SRI industry is worth 2.8 billion pounds¹¹, and there are around 220 European SRI funds with over 11 million euros in total assets¹². In Australia, the size of the ethical investment market has increased significantly in the past twelve months.¹³ Currently the market is estimated at \$2 billion¹⁴ with a number of new funds to be introduced in 2001.

An ethical fund compares companies with a defined set of ethical and social criteria to determine their suitability for inclusion into a fund, and may engage with the companies they invest in to facilitate a company's movement towards environmental and social best practice. This trend towards shareholder activism at the institutional level is particularly prevalent in the US. In Australia, the ethical investment industry has grown out of the environmental movement, specifically concerned about native habitat protection, logging, woodchipping and uranium mining. These continue to be emotive issues for Australian ethical investors and dominate the ethical investment agenda in Australia.

The growth in demand for ethical and SRI investment options reflects the growing concern about environmental and social issues globally. Repercussions for companies that have been perceived by the public as transgressing acceptable environmental and social behaviours are brutal, as a number of companies have learnt to their financial detriment. Huntingdon Life Sciences, a pharmaceutical research company, provided a recent example of negative share price impact in 1998, when anti-vivisection activists, after a prolonged

campaign, secretly filmed pictures of animal mistreatment, which led to the suspension of shares in the company. Pressure from activists was partly responsible for fund manager, Phillips and Drew, selling its 11% stake, thereby reducing share values by half. Conversely, a positive gain was enjoyed by BP whose share price rose after they dropped out of the Global Climate Coalition, a group of oil companies campaigning against an effective agreement on greenhouse gas reductions.

Australian and international SRI funds have consistently returned more than the market average. The Domini 400 in the US has outperformed the Standard & Poors (S&P) 500 since inception, and the Dow Jones Sustainability Group Index returns above the benchmark MSCI World Index. Performance ratings of mutual funds in the US by Lipper and Morningstar have allocated ten of the fourteen US SRI funds with more than \$100 million in assets, top marks for performance. Social indexes have tended to outperform the wider investment universe as well, and these strong returns have fuelled interest from fund managers and retail investors.

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Consumer interest in SRI option, and in the social and environmental behaviour of companies is strong in Australia and internationally. The Australian public have registered strong interest in the opportunity to invest ethically. The Resnik-KPMG 'Money where Your Mouth Is' survey carried out in July 2000 found that 69% of a representative sample of Australians would consider investing their superannuation in an ethical option. It is consumer demand that underpins the development of ethical and SRI funds.

Similarly, a recent survey in the UK found 75% of the public want their pension scheme to operate an ethical policy as long as this does not reduce financial returns, and 37% want a small part of their pension fund invested in businesses that promote social or environmental causes even if this does result in lower returns.¹⁵ Likewise, a recent survey conducted by Market and Opinion Research International (MORI) found that 50% of British customers are paying attention to the social behaviour of companies and 30% have boycotted a product or company for ethical reasons in the past 12 months.¹⁶

The media has also facilitated raised awareness of SRI among the general public. The Ethical Investment Association's annual conference in 2000 received widespread coverage particularly in the Financial Review and The Sydney Morning Herald. In October 2000, The Sydney Morning Herald/The Age also published the Good Reputation Index, ranking Australia's top 100 companies across a range of sustainability criteria for the first time. This index intends to review companies and publish the results on an annual basis.

Inclusiveness: The New Formula for Success

In this new sustainable business model, companies are expected to explain what they stand for, communicate how they are responding to non-traditional business risks, and demonstrate how their performance objectives are linked with their financial goals and stakeholder accountability.

The strategic planners at Royal Dutch Shell articulated the shift in public perceptions of business as a move from a 'Trust Me' world of the 1950s, where civil society trusted that if business prospered so too would society, to a 'Show Me' world where following the perceived corporate greed of the 1980s,

civil society no longer trusted business to balance society's interests with profits. As the century closed, the new values of an 'Include Me' world have emerged where civil society has recognised commercial impacts beyond the bottom line and demands to be consulted in decisions that affect them.

The challenge for business in Australia, and increasingly Australian business competing in a global environment, is to not only keep pace with these rapid social developments but to leap ahead and embrace sustainability as a new paradigm for business. Compliance will no longer suffice as a demonstration of intent, instead embracing the principles of a social construct of business and demonstrating that we live in a society not an economy is the only way to ensure prosperity in the warm climate of global change.

"Every human act takes place in language. Every act in language brings forth a world created with others in the act of coexistence which gives rise to what is human. Thus every human act has an ethical meaning because it is an act of constitution of the human world. This linkage of human to human is, in the final analysis, the groundwork of all ethics as a reflection on the legitimacy of the presence of others."¹⁷

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Notes

¹ www.geneva-international.org

² Business Week, September 2000

³ www.calvertgroup.com

⁴ Kotter & Heskitt 1992 *Corporate Culture & Performance*, Simon & Schuster New York

⁵ Collins & Porras 1995 *Built to Last*, Random House, Australia

⁶ www.harrisinteractive.com & www.reputationinstitute.com

⁷ *Turnbull, internal control and wider aspects of risk*, produced by Association of Chartered Certified Accountants (UK) and the Institute of Social & Ethical Accountability

⁸ www.calpers-governance.org

⁹ www.hermes.co.uk

¹⁰ US SIF November 2000 figures

¹¹ UKSIF February 2000 figures

¹² Avanzi, www.avanzi.org

¹³ Knowles, Ross, *Ethical Investment*, 2nd Ed Choice Publications, Australia

¹⁴ Australian Investor magazine July 2000 and Australian Financial Review 14 February 2001

¹⁵ 'Groundswell of opinion favours pension ethics, ethical performance' in *Ethical performance* Vol 1 Issue 4, Aug 1999

¹⁶ www.mori.com

¹⁷ Maturana, Humberto R & Varela, Francisco J 1987, *The Tree of Knowledge*, New Science Library, Boston p 247

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