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Sustainability Value Management: Stronger metrics to drive differentiation and growth

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Can a focus on sustainability also drive stronger business performance and tangible financial results? To an ever-increasing number of business leaders, the answer is "Yes." At the same time, skepticism exists among executives and investors alike as to how competitive advantage and growth are actually to be driven by stronger environmental and social performance of a business. This skepticism is largely a matter of measurement and valuation—demonstrating to society and investors in particular the link between sustainable business and corporate value.

The road to compelling sustainability metrics has been a rocky one. Now, new valuation approaches are being pioneered to help business executives identify and measure value to business and society, and to inform and steer portfolios of sustainable products and services. Applied consistently, they can foster better decision making and value generation.

Mind the gap

Are you on the same page with your investors when it comes to creating competitive advantage from sustainability?

In theory, you should be. After all, a report from the United Nations Global Compact found that 93 percent of participating CEOs believe sustainability is essential to their business strategy.[1] Investors are interested and committed, too. Another study found that 88 percent of investors see sustainability as a route to competitive advantage.[2]

Yet companies and their investors do not see eye to eye on the business value of sustainability. Why not?

A gap exists between companies and investors in terms of accurate valuation of sustainability initiatives from a business perspective. Investors are saying, "Show me the money." They don't think companies are effectively creating a business case for their sustainability efforts and then demonstrating how those efforts contribute to growth and competitiveness.

57 percent of CEOs say they are able to set out their strategy for seizing opportunities given by sustainability, but only 9 percent of investors share that view.[3]

Only 7 percent of investors agree that businesses can accurately quantify the value of their sustainability initiatives.[4]

Investors need to place clearer demands on business. At the same time, business needs to demonstrate clearer links between sustainability and corporate value.

Creating competitive advantage

Too many companies are overly focused on sustainability risks and their license to operate—that is, ensuring they comply with regulations and policies related to their permissions to do business. Likewise, corporate sustainability initiatives (Global Reporting Initiative, Carbon Disclosure Project) continue to be important in driving transparency and trust, but are insufficient by themselves to give companies a competitive edge and a license to grow.

Leaders in the area of sustainability instead shift the focus to create upside value for society and shareholders. They look to innovate based on sustainability trends, changing business requirements and new customer demands. These companies ask: "How can I differentiate my products and my portfolio?" "How can I transform my processes to drive growth?"

The Nestlé Nutritional Profiling System, for example, was developed to evaluate the nutritional value of food and beverage products. The company consistently optimizes the nutritional composition of products through product development with this system, and progressively applies it across the company's worldwide product portfolio.[5] Chinese company Tsinghua Solar Systems has developed solar energy products specifically for people "at the base of the pyramid" who are not on the electricity grid.[6] Intel and the city of San José, California are collaborating on a public-private partnership, known as Smart Cities USA, which is expected to help drive San José's economic growth, foster 25,000 clean-tech jobs and create environmental sustainability.[7]

Companies that innovate in this way can drive competitive differentiation, brand value and growth. Unilever has found that its sustainable living brands have grown at twice the rate of the rest of the business. In addition, the Unilever Sustainable Living Plan achieved over €200 million of savings through manufacturing, logistics, material efficiencies and research and development.[8] At BASF, the products with a substantial sustainability contribution along the value chain—called "Accelerators"—generated 23% of the company's sales and outgrow their markets by 2-10%, deliver margins >10% above the average and represent >60% of BASF's R&D pipeline.[9]

To close the "show me the money" gap, companies must now establish stronger metrics for sustainability success—not just backward-looking measurements, but also forward-looking indicators to drive decisions on strategy, portfolio mix and innovation. Management should track how their portfolio of sustainable products and services is driving differential growth and enhancing margins.

Stronger metrics for success

When it comes to metrics, companies cannot wait for standardization but need to take action now based on emerging approaches and techniques for valuing sustainable performance. Such approaches can quantify both value to business and value to society. The two perspectives can be measured separately or together.

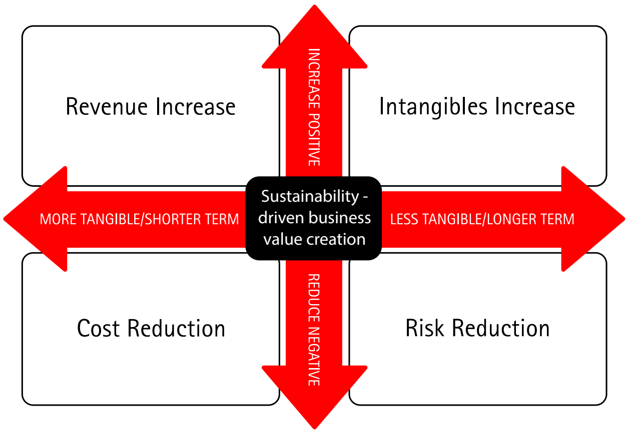
Value to business

The process of assessing the value of sustainability to business typically has three components:

1. Identifying sustainability drivers

Here, companies map value drivers and set targets that link to commercial value. It is important to define clear commercial goals for sustainable business—goals such as revenue growth, increase in value of intangibles such as trust and customer loyalty, reduced risks and lower costs.

Figure 1:
Assessing the value of sustainability to the business



By identifying clear targets and putting metrics in place, companies can better engage investors on the commercial potential of sustainability. They can sharpen stakeholder engagement with clearer links between commercial and non-financial goals, and also drive internal change by increasing clarity about the business case and key objectives.

In an initial phase of work, companies create a valuation model tailored to their drivers and goals. This model is then tested with selected products or services. It can also be tested in selected markets involving relevant stakeholders.

Novo Nordisk, for example, created a model that assessed the business and societal value of specific sustainability investments. The analysis considered both the upside benefits of future growth and the opportunities to minimize downside risks.[10]

A food and beverage company analyzed the links between the company's sustainability commitments and key commercial success drivers such as revenue, value chain integrity, intangibles, efficiencies and cost of capital. This analysis led to insights into the commercial value of the company's sustainability efforts and clear pathways for optimizing the commercial return on investments into sustainability.

2. Driving the product portfolio

With clear targets and metrics in place, it is important to steer and innovate the portfolio to increase profitability and sustainability of products or services. Companies can:

- Determine clear criteria for evaluating sustainability performance of products/services
- Support customer engagement on product/service benefits and reinforce brand messaging
- Engage stakeholders and investors on the revenue and growth contribution of sustainable products
- Inform future innovation, resource allocation and M&A strategies to target sustainable growth

One leading communications company, for example, analyzed sustainability trends and effects on more than 60 of its products, benchmarked competitors' portfolios, calculated sustainability benefits and created a business case for seven pilot products. An important outcome of this work was the ability to support growth by enabling the sales force to address the environmental and social needs of their customers.

Product categorization and segmentation is another important aspect of managing the portfolio. A consumer goods company defined a data-driven product categorization methodology to segment products by sustainability performance level. The company established a KPI framework combining financial and non-financial inputs to support internal management decisions.

3. Embedding metrics across the organization

An essential aspect of sustainability value management is institutionalizing it. This means embedding it into areas such as governance, workforce and executive behaviors, IT systems and business processes. Relevant and timely metrics can enable better decision making by management. By aligning data on the value of sustainable business, a single view of performance can be created.

Effective reporting is essential in operationalizing the valuation model. It is important to disseminate data to all key departments that can contribute to sustainable value. For example, a leading technology company investigated and analyzed its existing reporting procedures and data sources. This helped to define areas for improvement and to specify the requirements for an IT solution to support better performance management. The result was more efficient and effective sustainability data management and reporting. Better data and reporting, in turn, established the foundation for subsequent assessment of commercial impact. The company also improved its readiness for regulatory change and reduced the work load for multiple internal stakeholders.

Value to society

Calculating the value of sustainable business to society leverages a variety of approaches. For example, in its SMARTer 2030 report, the Global e-Sustainability Initiative (GeSI) modeled the potential of Information, Communications and Technology (ICT) products and services to enable environmental, social and economic development. The modeling identified several important outcomes. By 2030, ICT can:

- Maintain CO2 emissions at 2015 levels
- Connect 2.5 billion previously unconnected people to digital services, enabling the delivery of e-health services to 1.6 billion people and e-learning to half a billion people
- Drive $6 trillion in additional revenues and $5 trillion in cost savings[11]

Standardization efforts are also in progress. The Natural Capital Protocol (NCP),[12] for example, will enable companies to assess and better manage their direct and indirect interactions with natural capital. The protocol encompasses guidance on qualitative, quantitative and monetary valuation of natural capital impacts and dependencies and when to apply which level of assessment. It elaborates on business process integration and respective organizational considerations.

Developments similar to the NCP have been initiated, putting special emphasis on companies' positive and negative impacts and dependencies on people and society. For example, the Social Capital Protocol (SCP) is being developed as part of the "Redefining Value Program" of the World Business Council for Sustainable Development (WBCSD).[13]

The bottom line: Stronger metrics to drive differentiation and growth

Sustainability value management enables companies to link non-financial targets to financial metrics, better manage the product portfolio and embed metrics into performance management processes and incentive structures. Such valuation supports companies as they seek to use sustainability to drive benefits both for business and society.

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