TOMORROW'S CHALLENGES

MAKING THE SUSTAINABLE DECISION

COMPANIES NEED TO FORGO SHORT-TERM PROFITABILITY TO MAKE SUSTAINABLE CHOICES

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Companies increasingly talk about sustainability, but what exactly do they mean? Although many people would define sustainable practices as those that improve society, corporate sustainability is frequently reduced to minimizing harm to the environment. Firms have therefore taken measures such as reducing energy usage, minimizing materials, and using recycled goods.

Changing practices to become more socially responsible has not been too difficult for firms. Reducing the amount of energy and materials that they use in making a product generates significant cost savings. As a result, the vast majority of companies have altered their supply and operations chain to take advantage of this "low-hanging fruit."

General Electric's "ecomagination" initiative is a good example of how a firm can make itself and its consumers more sustainable while driving economic growth. Such innovations include natural gas engines, sodium batteries, and carbon capture systems, which all minimize impacts on the environment while increasing efficiency.

Another example is Aquafina's "Eco-Fina" plastic water bottle, which is made from 50% less plastic and consequently weighs half as much. Aquafina realized savings not only in material costs but also in transportation costs, thereby further curbing CO2 emissions.

Sustainability goes beyond profitability

Firms take the profitability of sustainable practices for granted and have begun to view sustainability as synonymous with profitability. But what happens when they need to reach a little higher? Will they be willing when necessary to make the difficult, and more costly, decisions that improve society? The signs are not promising, if J.P. Morgan Chase & Co's recent decision to exit the U.S. student loan market is any indicator.

Earlier this year, a FICO report highlighted the increasing number of loans and rising default rates in the U.S. student loan market. According to Andrew Jennings, FICO's chief analytics officer and head of FICO labs, "this situation is simply unsustainable." While this statement may not be striking at first, it represents a growing trend in corporate messaging to equate sustainability with profitability. If something that is critical to improving society, such as financing education, stops being profitable, does that mean the private sector should just abandon it?

Thasunda Duckett, the chief executive for student loans at J.P Morgan Chase, said the largest U.S. bank is getting out of the U.S. student loan sector because "we just don't see this as a market that we can significantly grow." While the market itself is growing, as the latest FICO report highlights, its profitability is decreasing. Similarly, US Bancorp stopped accepting student loan applications in March of this year while smaller American banks are also getting out of the market.

The rise in student loans can be attributed to the state of the U.S. economy and increasing tuition costs. But with federal Stafford loans capped at $31,000 and tuition costs rising with increased demand, where will students get additional loans to cover their education needs if not from private banks? As lower-income families face a harder time financing their homes and now their children's education, is getting out of these markets the "sustainable" choice for banks, or merely the more profitable one? And over what time horizon is profitability being assessed?

Taking the longer view

Some companies, and industries as a whole, are forced to expand their time horizons for profitability. The pharmaceutical sector is a good example. Its products require a significant upfront cost and face high risks of failure, but result in solutions that significantly improve society. Although the drug industry has its critics, it does offer insights on how short-term gains can be sacrificed for long-term profitability in order to promote sustainability.

The notion of "patient capital" is prominent in the field of international development, where investments are made with a 10-, 20- or even 50-year outlook, and in the emerging field of sustainable banking. These banks, which emerged from the microfinance and socially responsible investing movements, focus on investing in companies and organizations that aim to improve society. Netherlands-based Triodos Bank only invests in sustainable initiatives, assessing how they will improve society before determining their financial viability. The bank has also abolished bonuses to ensure that employees (or “co-workers” as they are called at Triodos) are not financially incentivized to make unsustainable decisions.

From profit first to society first

The shift from a profit-first perspective to a society-first one requires longer time horizons, as well as innovation in companies’ products and business models. Companies are quick to innovate if this increases short-term profitability, as we saw with the development of mortgage bonds and derivatives that led to the global financial crisis. But now firms need to start focusing on innovations that actually improve society. By extending the timeframe for returns on investment and prioritizing sustainability over profitability, firms can help promote a flourishing future for themselves and the societies around them.

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