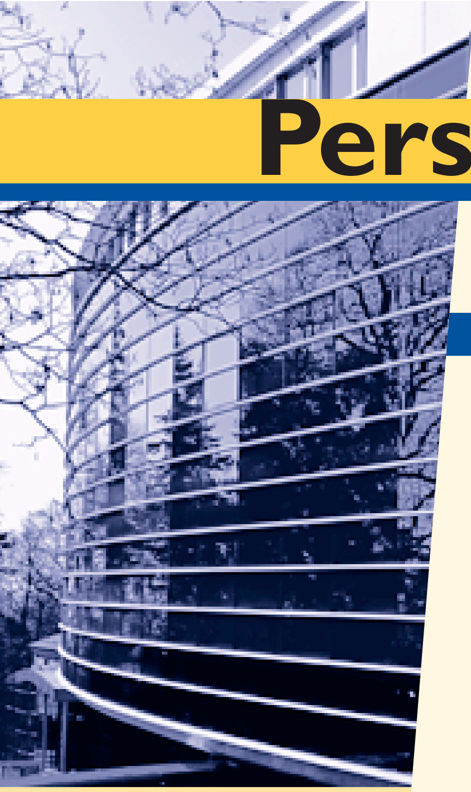

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What is the Business Case for Corporate Sustainability?

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The Forum for Corporate Sustainability Management (CSM) at IMD has conducted an extensive research project on the industry-specific business case for sustainability. This research indicated, firstly, that companies cannot always quantify the important influences that affect value drivers either directly or indirectly, and they often attribute them to "license to operate" or brand value and reputation. So it is difficult to express the business case in the traditional corporate language of financial numbers.

Secondly, companies are content enough to work on the dual assumption: that their sustainability-activities are "the right thing to do", and the extra costs they imply are in any case marginal.

Thirdly, companies hesitate to cite self-interested business reasons for the good things they are doing. But one result is clear: contrary to some rhetoric, nearly all companies prefer a cautious, step-by-step approach, with more focus on increase in operational efficiency than on technological breakthrough or untested business models. In other words, common-sense prevails, given that these ongoing efforts will undoubtedly be more run-of-the mill, but nevertheless have sustainable impacts, even after the hype has disappeared.

Hangovers from bubble excesses always provide fertile ground for "business ethics" and other corporate "do-gooding". The buzzword of the year is "corporate sustainability", the new "Holy Trinity" for win-win-win solutions, integrating economic, social and environmental criteria into corporate decisions. Nearly everybody is jumping on the bandwagon and very little escapes the eagle eye of activists and other stakeholders, from nuclear power to chemically intense farming. Few companies can ignore them. It takes the self-confidence (some say arrogance), financial success and security of its own home turf in Texas to prompt Exxon to swim against the tide and virtually ban the words "sustainable development" from its corporate vocabulary.

But, please, hold the applause before getting overexcited about the new slogan "doing – well – by – doing – good". After all, since medieval times, when religious, economic and state power were concentrated, social institutions have taken on differing roles within society, with good reason. The "license to operate" for companies is not to promote the "common good", but rather to meet the objective of serving market needs while making a profit along the way, as an indicator that they have added more value than the resources they used (at least, this is what economists believe since Adam Smith's era).

Does this imply that companies should leave everything beside markets to governments or pluralistic non-governmental institutions (NGOs)? Not necessarily, as the concept of externalities, in existence since 1923, shows. In addition to market-valued costs, companies create positive and negative externalities through their activities. For example, pollution is at the forefront of the negative externality debate - but positive externalities are also significant, with examples ranging from the income multiplier of local investment to the synergies of agglomeration.

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Companies can minimize negative or maximize positive external effects by using three main levers: technological innovation, new management concepts and influencing customers. But only under one overriding condition – often neglected in the public debate – that whatever they do does not impinge upon their economic interest. Any scheme that does not fit into the economic imperative of corporations tends to be rhetoric, not action.

But where is the "smart zone", the zone within which companies can improve their economic, social and environmental performance at the same time, thus killing three birds with one stone? This question is suspiciously absent from the debate. Governments have no interest in answering this, because often they are happy to hide their incompetence in problem solving behind the public's increasing expectations of corporations for social and environmental performance. The visionaries of the "next big thing" do not wish to be bothered by details and managers pragmatically focus on "how" to manage, followed willingly by academics who go on developing ever more sophisticated tools for ever more irrelevant management questions.

At the Forum for Corporate Sustainability Management (CSM), 20-plus global corporations from IMD's *Learning Network*, working in collaboration with WWF International, believe that the question of the economic logic of corporate sustainability is vital. Why? Three reasons: firstly, so that companies do not create unrealistic expectations (as did Monsanto, ending in fiasco). Secondly, to help them focus on how they can contribute to sustainable development. And thirdly, for the public to understand the contributions of different players (governments, businesses, consumers).

In June 2002, CSM launched a comprehensive empirical investigation, in cooperation with WWF, covering nine industry sectors, ranging from the "usual suspects" such as energy (oil & gas and utilities), chemical, car manufacturing and aviation, through conventional industries such as technology and food & beverage, to more "hyped" industries such as financial services and pharmaceuticals.

Our basic premise was that the "smart zone", representing the business case for corporate sustainability within corporations, is at least sector-specific and more probably company-specific, and that there is a need for a simple tool to help companies identify their individual business case. After about 450 interviews in 16 developed countries and a survey of over 1000 respondents, the bottom line is still not easy to draw. All the more so since the content and context of corporate sustainability differ widely among the industries researched.

First and foremost: companies have to build their business case for corporate sustainability – they will not simply "find" it.

Even in "best-practice" companies, the business case is neither well developed nor formulated by sustainability officers in such a way that other managers understand it. Sustainability officers are programmed to concentrate more on "how" to manage the ongoing challenges with which they are confronted. For example, it was not uncommon for our researchers to find that their interviews actually triggered some managers' first in-depth reflections on the economic logic to corporate sustainability.

But the good news is: you can, if you want to. In all of the more than 130 companies we looked at in detail, there were sound economic reasons to invest in corporate sustainability.

Secondly: sustainability issues are extremely fragmented, uncertain, controversial and difficult to quantify.

Sustainability is certainly not the "next big thing" for companies, which is probably good news because it is not about to be forgotten soon. Rather, it is definitively here to stay. For most corporations, sustainability is considered to be an issue of "second tier" importance, but one that nevertheless still requires the requisite careful handling and professional management. If not, things can easily flare up and get out of control – and while markets may not always reward sustainability pioneers, they are very likely to punish laggards.

What makes life most difficult in this area is the fact that the relevant issues are numerous, differ from industry to industry, are highly uncertain and their business relevance is often either unclear or discussed in a confusing cloud of controversy (for example - what does the potential climatic impact of stratospheric water vapor imply for an airline?). This makes it difficult to quantify the whole business impact of sustainability for a company and close to impossible to put financial figures on it (other than for specific projects, such as establishing the financial impact of more accelerated licensing of an investment, when proactive, well-reputed companies get through the process more rapidly than other more controversial ones).

The fact is that more progressive companies do not regard the "soft" qualitative nature of the business case as a problem, but laggards certainly do.

Stakeholders: the uncertain trumpet.

Companies generally get rather mixed reactions to their sustainability efforts from stakeholders:

- Capital markets are relatively indifferent, except for a small niche dedicated to "sustainable investment funds";
- Customers simply ask: "what's in it for me?" and do not want to be bothered with the details, especially if they are negative;
- Employees like to work for "ethical" companies, but their actual personal engagement is limited;
- Regulators have not given up the "heavy-handed" approach, thus fuelling industry resistance, and
- NGOs range from being skeptical to outright hostile, but nevertheless realize that at the end of the day, they have to work with companies to get results.

Therefore, companies often have to rely on their own strategic judgment about how far they should drive corporate sustainability, since their stakeholders are rarely "in the driving seat".

But there are also important internal barriers:

- Mindset of managers, lack of knowledge about sustainability leading to reluctance to get involved in corporate sustainability issues;
- Lack of organizational support;
- Resistance of key departments: finance and often sales & marketing (relative to support from R&D, human resources and corporate staff), with manufacturing seen both as a promoter and a resistor;
- The need to move with the whole business system (such as suppliers, partners, customers), because many problems cannot be solved within the "company fence".

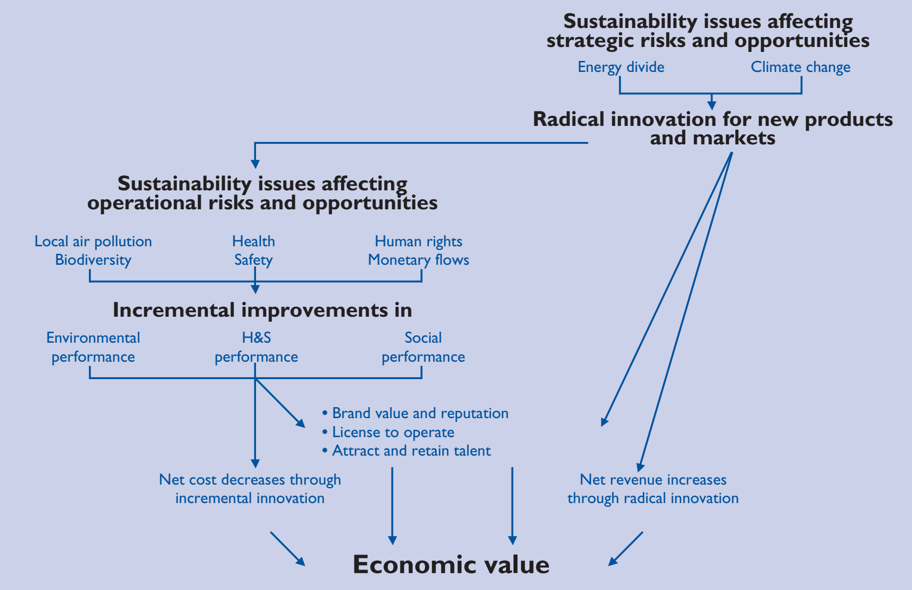
As a result, companies are moving very cautiously forward (despite the "revolutionary" change rhetoric linked to many aspects of corporate activity – not only corporate sustainability), hedging their bets, testing numerous technological options but applying them first as pilot projects in small niches and focusing primarily on operational efficiency gains (from waste management to HR policies).

Important: Value Drivers Support Corporate Sustainability.

After all this bad news, now for the good. Undoubtedly, value drivers support the assumption that there is a business case for corporate sustainability. At the end of the day, sustainability:

- Provides opportunities for cost reduction and process improvements on the operational level that have not yet been exhausted;
- Improves brand value and reputation - not to be neglected in most consumer driven

Systemization of sustainability issues, value drivers and the relevant corporate activities



businesses, or within either regulated industries (such as utilities), or businesses based on "trust" (for example, financial services);

- Lends itself to better risk management (particularly if an "early awareness system" is part of the corporate sustainability strategy);
- Helps to attract and retain talent and increase employee satisfaction;
- Is essential for the "license to operate" of companies (recent corporate governance scandals give an indication of just how quickly companies get regulated if they do not behave responsibly).

However, despite the need for managers to clarify their company's sustainability strategy and its relation to value drivers, the key question is not really about quantification or financial figures. Rather there is a need for a clear answer, to the following question: does the sustainability strategy support our core business strategy?

In this respect, work needs to be to done using a diagnostic tool, which can help managers discover the "smart zone" for a specific company and clarify the thinking between the value drivers influenced by the sustainability strategy, and the corporate strategy itself.

Companies that wish to look either at the empirical evidence in detail for specific sectors, or test the diagnostic toolsets we developed as a result of our empirical research, should go to www.imd.ch/research/projects/bcs

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