

Sustainability: Living off Interest, not Capital

Sustainability management goes beyond pure risk management – it adopts environmental and social performance in order to realise competitive advantage.

Authors*:

Oliver Schmid-Schönbein
Daniel Rufer
Arthur Braunschweig

With the collaboration of

Simon Furter
Gaby Oetterli

English translation of the article:

“Nachhaltigkeitsmanagement: Von den Zinsen statt vom Kapital leben” published in the magazine: “IO new management”, edition 05 / 2004, page 16-23

Overview: The four corporate sustainability dimensions – market, financial, social and environmental – enable companies to reduce risks, to increase efficiency, to differentiate, to innovate and to enhance their reputation. In order to achieve this, all four dimensions must be incorporated within the formulation of corporate strategy and its implementation. Sustainability management thereby contributes to the long-term success of the company. It is the responsibility of top management to recognise these opportunities and to apply them within the strategic, structural and cultural development of the company.

“We are striving for sustainable success!” Every manager and entrepreneur would sign up to this goal. However, what does it exactly mean for corporate practice? For many, sustainable success means long-term financial success, or even just the long-term survival of the company. However, an increasing number of companies see sustainability as the systematic integration of environmental and social performance. Is there an overlap between both views of sustainable success? The following introduction into sustainability management shows how an integrated approach can lead to corporate credibility, acceptance and long-term success.

The term sustainability originates from within the forestry industry. Sustainable forestry was defined as clearing fewer trees than can grow back within the same period of time. In economic terms: live off interest, not capital.

In 1987, the World Commission of Environment and Development was initiated by the United Nations General Assembly. The Commission, chaired by the Norwegian Prime Minister Gro Harlem Brundtland, defined the term sustainable development within its report “Our Common Future” (World Commission

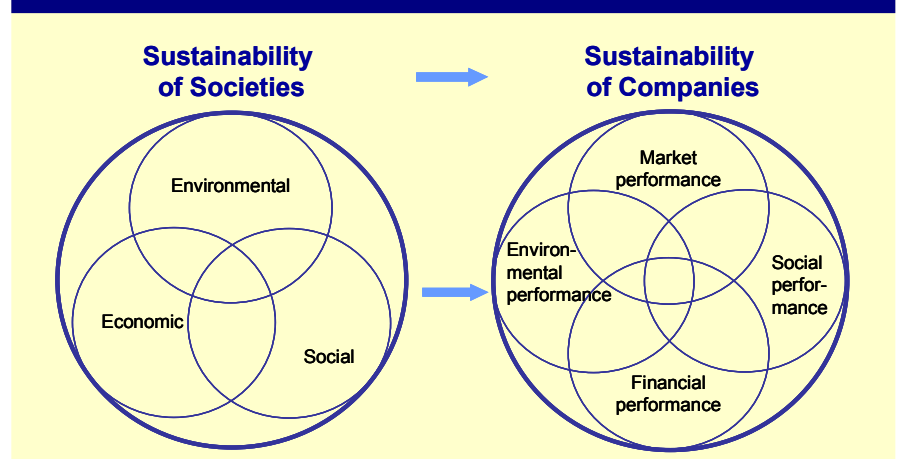
1987) as: “Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs.”

This report launched public discussion regarding sustainable development, which were strengthened during the environmental conference in Rio 1992. Since then, the integrated and interrelated optimisation of **economic, environmental and social performance** is understood by the term sustainability (see figure 1, left-hand side).

Harmonisation of Long-Term Goals

The results of the Rio conference and the debate on globalisation have influenced discussions on corporate responsibility since the nineties. In addition, investors began assessing companies also based on environmental and social criteria. With the collapse of the stock market bubble in 2001, corporate responsibility was considered in a new light under the catchword ‘corporate governance’. The effects of short-term and unsustainable corporate strategies with misleading incentive structures for top management resulted in a crisis of confidence amongst investors and the public.

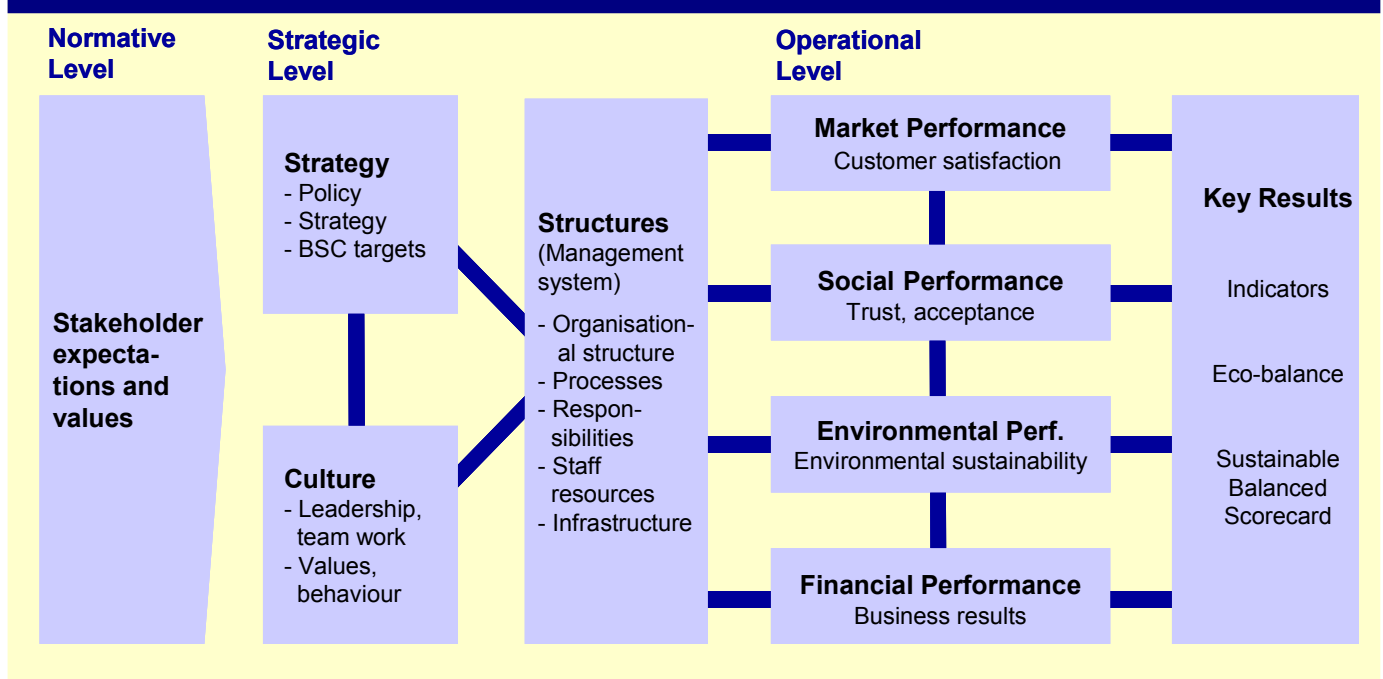
Figure 1: Sustainability on Society and Company Levels



The business perspective requires a differentiation of the economic performance.

* The authors are managing partners of E2 Management Consulting Inc. (Zürich), a consultancy firm specialised in sustainable corporate strategies.

Figure 2: Sustainability Management Model



The sustainability management model is aligned to the logic of the EFQM model.

The three-dimensional sustainability concept is a societal or, also, an economic concept. From a business point-of-view, further differentiation of the economic dimension makes sense (Ruffer; Huber 2001): Companies that deal economically aim for the highest possible benefits for their customers through their market performance. At the same time they strive for the highest possible rate of return (financial performance) of the capital invested (see figure 1, right-hand side). Whether consciously or not, companies therefore perform in all four sustainability dimensions (see also table 1).

The term sustainable success means long-term success. This is understood also by more traditional management. However, what characterises a sustainable company and what is the role of environmental and social performance in this context?

An important characteristic is harmony between the corporate goals. Long-term success, which is not oriented towards the next quarterly results, is the key focus. In a sustainable company the strategic and operative goals of capital providers and management are in line and

the company can build credibility and the trust of staff, customers and the public. In order to align the company with the principles of sustainability, management needs certain degrees of freedom to manage the company continuously, to avoid crisis situations or react adequately during them. Elements for the necessary degree of freedom are:

- **management capacity and ability** to react in time during crisis situations
- a healthy **financial structure** with regard to profitability and balance sheet structure, so that the company does not have to be oriented towards short-term financial goals
- the **trust of stakeholders**, which is based on transparency and communication with them.

If these degrees of freedom are missing, this leads to a non-sustainable development as soon as external problems hinder the company on its strategic path. At that point, oversteering becomes almost inevitable – e.g. the halt of investments or the short-term reduction of business areas and staff – and often leads to an enormous loss of value created. In crisis situations, reactions tend

to be unpremeditated.

In traditional management, social and environmental performance are not at the forefront. However, it is clear that the systematic negligence of these dimensions leads to crisis situations, or even to a company's ruin. In the case of Arthur Andersen, the misconduct of a few individuals and the resulting loss of confidence from key stakeholders led to the demise of a decade-long successful global company within a matter of weeks.

A comprehensive sustainability strategy goes beyond pure risk management. It involves active environmental and social performance in order to develop competitive advantages. The contribution to the sustainable development of society and the protection of the natural environment should simultaneously lead to long-term business success. Examples of this are the co-operation between Unilever and WWF to secure fish stocks or the social commitment of the textile trading house, Switcher, within the Indian cotton producing regions.

In the Anglo-Saxon world the terms **corporate social responsibility (CSR)**

and, more recently, corporate responsibility have been established and stand for a sustainability strategy. The content remains the same, however the emphasis is sometimes different: issues such as “community involvement” or “ethnic diversity” culturally have different weighting in these countries. However, corporate social responsibility as a concept is also increasingly being picked up in continental Europe.

Not only Risk Management

As a model for further discussion we propose a sustainable business management model based on the «European Foundation for Quality Management »(EFQM 1991) logic (see figure 2).

A sustainable corporate strategy distinguishes itself in that:

- **stakeholder expectations** are actively considered during the formulation of corporate strategy,
- the **four sustainability dimensions** - market, financial, environmental and social - are systematically incorporated within strategic management and appropriately integrated within all relevant corporate processes,

- possible **conflicts of goals between the sustainability dimensions** are allowed and clarified without bias.

Sustainability deals with a broader perspective: It does not only cover the time perspective, it covers the entire value chain. This includes the supply chain and the influence of products on customers. Based on this, initial issues for a sustainable corporate strategy can be defined (see table 1).

Through a comprehensive understanding of sustainability and a strategic procedure, many **additional benefits** can be realised (see Hamschmidt/Dyllick 1999 or Reinhardt 2000).

The **reduction of risks** is the initial issue for many companies. Financial risks, such as liability risks of products and contaminated sites or operational and reputation risks through suppliers’ social grievances or the case of Brent Spar for Shell, can result in operational crises.

As a result of a systematic sustainability management, many companies can significantly **increase their efficiency**. As a result of environmental and quality

management, Canon (Switzerland) was able to reduce fuel costs of their vehicle fleet by 30%.

Companies that are sustainability-oriented can, in addition, strengthen their employee **motivation**.

Following the motto “do good and talk about it”, there is the additional advantage of **improving image, reputation and credibility**. This deals with actively striving for a positive image amongst key stakeholder groups through environmental and social performance.

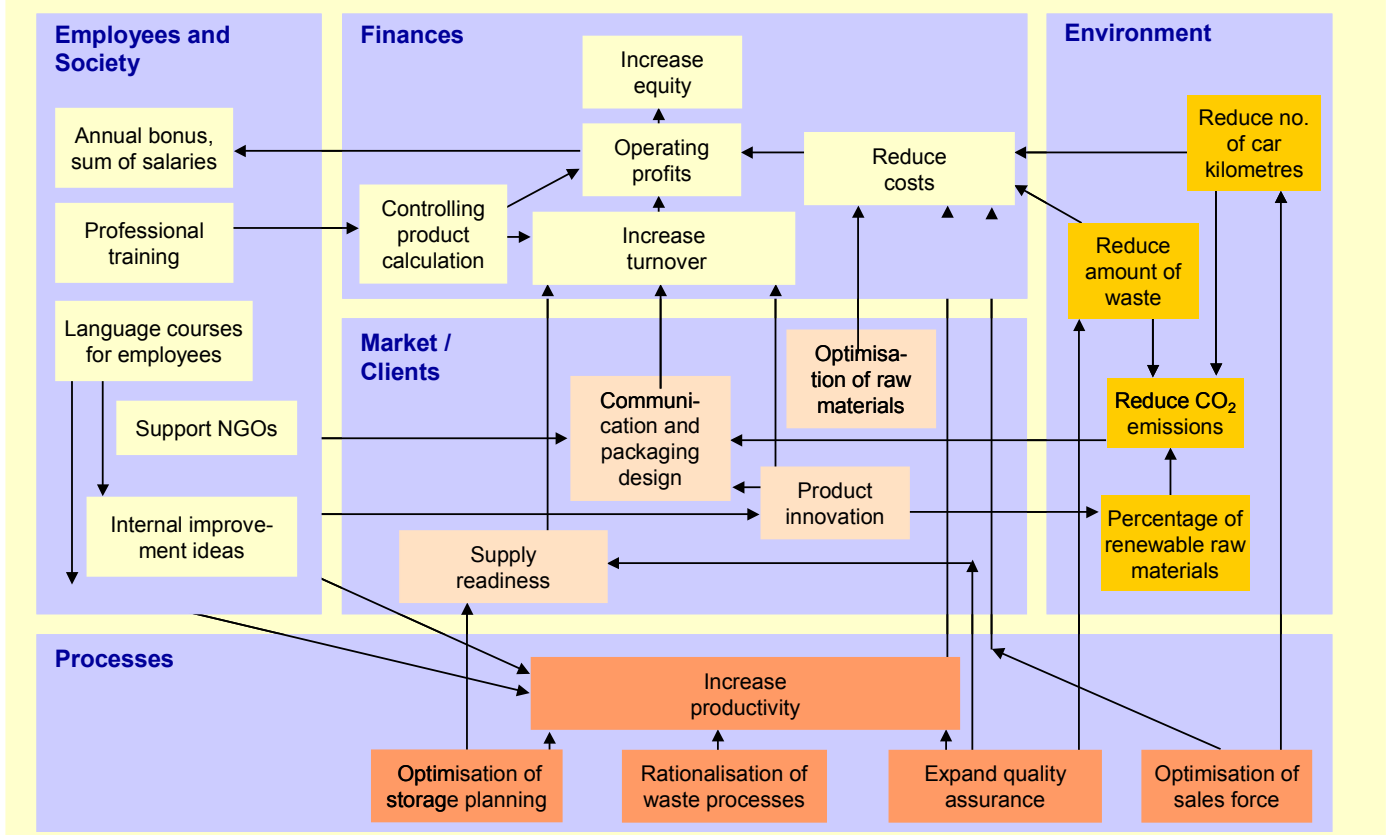
Within a **differentiation strategy**, market success can be achieved if products and services are in line with the sustainability principle. The COOP Group applies this: In 2002, their key environmental and social labels had a turnover of ca. 1.2 billion CHF, which already corresponded to 13% of the turnover of similar product categories. The growth of turnover for these products was 16% in 2002 and substantially contributed to the growth of market share of the Group.

Lastly, **new markets** can be launched through sustainable innovations. For example, car-sharing is a completely new solution to mobility needs.

Table 1: Aspects of Corporate Sustainability Performance

	Suppliers	Internal Processes	Clients / Products	Society / Nature
Environmental Dimension	<ul style="list-style-type: none"> • Environmental criteria in procurement 	<ul style="list-style-type: none"> • Conserve resources: <ul style="list-style-type: none"> - energy - materials - waste - transport • Avoidance of emissions and risks 	<ul style="list-style-type: none"> • Avoidance of negative env. impacts during product use (risk reduction) • Environmentally oriented products & services (market opportunities) 	<ul style="list-style-type: none"> • Realisation of environmentally-friendly solutions and technologies
Social Dimension	<ul style="list-style-type: none"> • Social criteria in purchasing • Social performance towards suppliers 	<ul style="list-style-type: none"> • Human resources: <ul style="list-style-type: none"> - Fair employment contract - Work-life balance - Non-discrimination 	<ul style="list-style-type: none"> • Avoidance of negative social impacts (social exclusion, product risks) • Products with high social benefit (market opportunities) 	<ul style="list-style-type: none"> • Value added for society • Contributions • Build-up know-how • Reputation and credibility
Financial	<ul style="list-style-type: none"> • Procurement costs / financing 	<ul style="list-style-type: none"> • Process costs / financing 	<ul style="list-style-type: none"> • Price / returns 	<ul style="list-style-type: none"> • Profit
Market	<ul style="list-style-type: none"> • Quality / innovation 	<ul style="list-style-type: none"> • Quality / innovation 	<ul style="list-style-type: none"> • Benefit to client 	<ul style="list-style-type: none"> • Legitimacy

Figure 3: Example of a Sustainability Balanced Scorecard



A sustainability balanced scorecard allows companies to manage all dimensions of sustainability.

Sustainability within Strategic Management

Environmental or sustainability strategies are often considered as independent strategies, which focus on environmental and/or social aspects. This may be sufficient as an introduction into this topic, however, it is not suitable as a long-term option. The activities resulting from such strategies are in danger of becoming isolated solutions and may be completely abolished during times of crises.

A sustainable corporate strategy actively and complementarily applies the four dimensions of corporate performance. The difference between the corporate and the sustainability strategy no longer exists, there is only one strategy: all dimensions of sustainability are considered in the corporate strategy.

The formulation of objectives and monitoring progress belong within the process of strategic management. In this context, instruments such as the Bal-

anced Scorecard (BSC, Kaplan/Norton 1996) or the EFQM model have been applied since the mid 90s. Their benefits result from a balance between financial goals and their non-financial drivers. From a sustainability management point-of-view, these concepts merely need to be enhanced by adequately considering environmental and social goals. For example, the four BSC dimensions of “finances”, “market/clients”, “processes” and “learning/development” are extended: “environment” is added as a

separate dimension, and the dimension “learning/ development” is extended to “employees/society”. Such a **Sustainability Balanced Scorecard (SBSC)** for a medium-sized industrial enterprise is displayed in figure 3.

The strategic goals anchored within an SBSC then have to be operationalised. Goals need to be given appropriate measurement units, concrete measures and projects as well as deadlines and responsibilities.

Table 2: Examples of Indicators to Measure Social Performance

	Suppliers	Company	Product	Society
Management Indicators	<ul style="list-style-type: none"> % of suppliers monitored on their social performance Number of supplier audits 	<ul style="list-style-type: none"> CSR policies Training hours Number of internal audits 	<ul style="list-style-type: none"> Development costs for products with social benefits Customer complaint handling 	<ul style="list-style-type: none"> Expenditure on communication with stakeholders
Social Dimension	<ul style="list-style-type: none"> Number of suppliers with minimum social standards at the workplace Suppliers satisfaction 	<ul style="list-style-type: none"> Top management remuneration Minimum salary paid Gender profile per management level 	<ul style="list-style-type: none"> Share of turnover from products with social benefits 	<ul style="list-style-type: none"> Value added Number of workplaces Community contributions

Standards also for the Social and Environmental Dimension

Based on corporate strategy, the four sustainability dimensions then have to be embedded within the management system. Again, stand alone solutions are not the right path. The addition, or integration, of environmental and social aspects within the existing management system should be followed. Standards for quality management systems are well-known and widespread, but also environmental and social standards exist today.

Certifiable standards are ISO 9001 for quality management and ISO 14001 for environmental management, as well as SA8000 for social management (SA = Social Accountability). OHSAS 18001 (Occupational Health and Safety Assessment Series) is a new standard for the management of e.g. occupational safety and health protection. EFQM is a comprehensive Total Quality Management model. In addition there are a number of more general sustainability management system approaches in Anglo-Saxon regions (e.g. AA1000, 1999 or SIGMA, 2003).

The quality, environmental and social standards mentioned above should be integrated within the existing management, business and support processes, whereby a sector-specific procedure makes sense. Many companies strive for integrated management system consisting of ISO 9001 and 14001. For

companies purchasing at a global level, the SA 8000 standard is of particular interest since it deals with supplier issues (such as child and forced labour).

The principle of continuous improvement underlies most of these management standards. They include conformance to certain minimum standards according to the sustainability dimension (e.g. environmental legal compliance, prohibition of child labour), plus a management cycle leading to the continuous improvement of corporate performance needs to be installed. Aligning management systems to such standards does not necessarily require certification. Initially, the coverage of topics such as securing minimum requirements and the establishment of continuous improvement processes is important. Striving for short term certification is rather counterproductive. The certification should deliver concrete benefits: systematisation of the procedure, increased credibility amongst internal and external stakeholders or the willingness to undergo a learning process through carrying out external audits.

What gets measured gets done

For focussed implementation, **corporate performance measurement** should include all four dimensions of corporate sustainability. For the measurement of the market and the financial performance, comprehensive sets of performance indicators already exist. Specific instruments and indicator sets to measure environmental and social performance, however, are also required.

An environmental performance evaluation records the material and energy flows of a company or a product.

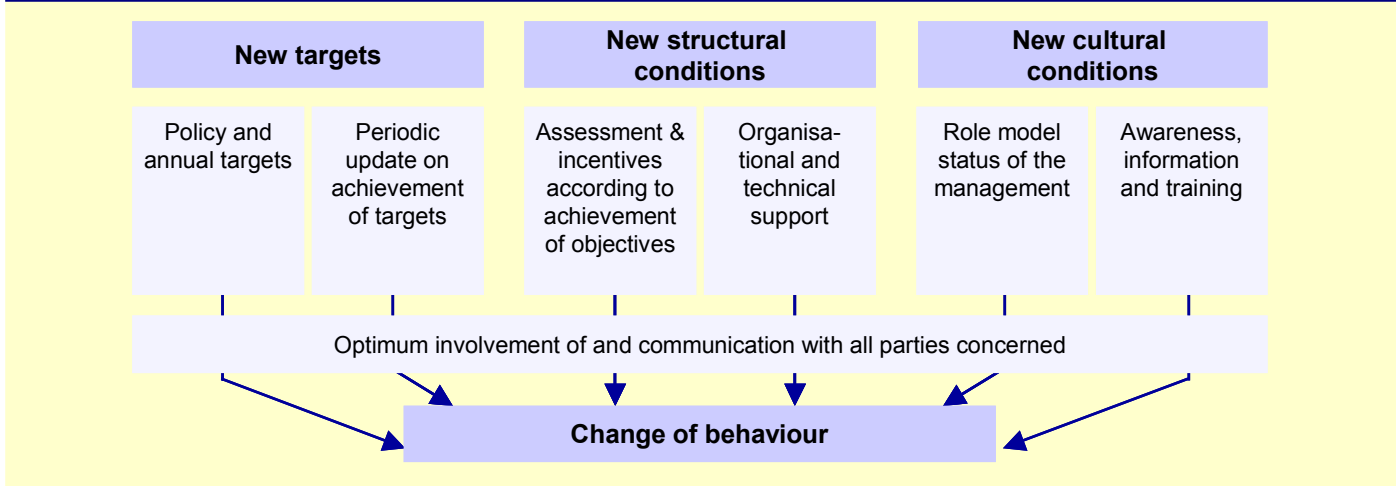
A **life-cycle assessment** (LCA) compares product alternatives taking into consideration environmental aspects and searches for innovative product designs. Based on the LCA, the environmental improvements of new products can be communicated within the market and direct recommendations can be made to clients when applying environmentally friendly products. The procedure to carry out an LCA is described in the ISO 14040 standard.

Corporate environmental performance evaluations (or eco-balances)

determine and analyse corporate environmental impacts. This allows the prioritisation, planning and monitoring of corporate environmental measures. The eco-balances also serve as the basis for the internal and external communication of environmental activities and successes.

LCAs and eco-balances have environmental and financial benefits: they allow existing processes and technical infrastructure to be viewed from a completely different perspective. They also correct the human inclination to overweight certain environmental impacts that can subjectively be observed (e.g. paper and waste) and to under-weight the non-perceptible environmental impacts (e.g. greenhouse gas emissions or heavy metals).

Figure 4: Key Elements for Change Management



Behavioural changes result from the parallel management of corporate targets, structure and culture

Indicators have also been developed to measure the performance of the **social dimension** since the end of the 90s. Sustainability oriented investors, who require measurable and comparable corporate data, have been an important driver in this. Initiatives to standardise reporting, such as the Global Reporting Initiative (GRI 2002), have also contributed to more transparency. Depending on sector, different issues are of importance (e.g. see SPI-Finance 2002 [Schmid-Schoenbein et al. 2002] for financial institutions). Table 2 displays indicators that are commonly applied for the social dimension.

Do Good and Talk about it

The greatest challenge for management possibly is the **integration of sustainability within the corporate culture**. New corporate strategies and structures can be developed relatively quickly in comparison. Sustainability can only really be realised when it is embedded within the corporate culture and within the every-day behaviour of the employees. In as much, the introduction of sustainability management is a Change Management Process, whereby learning processes need to be initialised and institutionalised (see figure 4).

Top management has a particular responsibility. Their role model status determines whether the change process towards sustainability is credible in the eyes of employees and stakeholders or not. Top management needs to actively address possible conflicts of interest between the four sustainability dimensions (e.g. payback periods for energy-saving investments). Through their decisions, they build up trust in the long-term validity of the changes. An important success factor is the gradual integration of environmental and social objectives within the individual employee objectives: environmental and social goals must also be related to incentives.

As mentioned at the beginning of this article, stakeholder expectations and values provide impulses and are important indicators for sustainable corporate

strategies. Accordingly, **open communication with stakeholders** is also given a high value.

International accounting standards, such as ISA and FER exist for **financial reporting**. In the course of the stock market scandal, these standards were supplemented by Corporate Governance reporting standards, e.g. Sarbanes-Oxley (SEC 2002).

Sustainability reporting is continuously developing. Today, leading companies comprehensively cover their environmental and social performance within sustainability reports. Many companies are aligning themselves to the work of the Global Reporting Initiative, who periodically publish guidelines on sustainability reporting (www.globalreporting.org). Next to the generic "GRI 2002 Sustainability Reporting Guidelines", GRI is also developing sector-specific supplements. To date supplements exist for e.g. the automotive, tour operators or financial services industries.

Integrated Communication

Integration is also required in the future of sustainability communication. Instead of publishing a sustainability or environmental report in addition to the annual report, it makes sense to combine these publications. First examples of integrated annual reports (e.g. Zurich Cantonal Bank Annual Report, Zürcher Kantonalbank 2002) display how a company can comprehensively report on the performance of all its sustainability dimensions (market, financial, environmental, social).

References

- AA 1000** (1999): *Standard on Accountability, the Institute for Social and Ethical Accountability ISEA*, London, www.accountability.org.uk
- Coop** (2003): *Annual Report 2002*
- EFQM** (1991): *European Federation for Quality Management EFQM: EFQM Excellence Model*, www.efqm.org
- FER**: *Schweiz. Stiftung für Empfehlungen zur Rechnungslegung: Swiss GAAP FER - Fachempfehlungen zur Rechnungslegung*, Zürich, www.fer.ch

- Global Reporting Initiative (GRI)** *GRI 2002 Sustainability Reporting Guidelines*, www.globalreporting.org
- IAS**: *International Accounting Standards Board: International Accounting Standards*, London, www.iasc.org.uk
- ISO 9001:2000**: *International Organisation for Standardization ISO: Quality Management Systems - Requirements*. www.iso.ch
- ISO 14001**: *1996 Standard: Environmental Management Systems – Specifications with Guidance for Use*
- ISO 14040**: *1997 Environmental management – Life cycle assessment – Principles and framework (further details can be found in the ISO 14041 – 14043 standards)*.
- Hamschmidt, J. / Dyllick, T** (1999): *ISO 14001 in der Praxis Wirkungen von Umweltmanagement-Systemen in Schweizer Unternehmen, IWÖ-Schriftenreihe Nr. 75*
- Kaplan, R.S. & Norton, D.P.** (1996): *"Balanced Scorecard. Translating Strategy into Action."* Boston, MA: HBS Press
- OHSAS 18001**: *1999: Occupational Health and Safety Assessment Series, British Standards Institute*
- Reinhardt, F.L.** (2000): *Down to Earth: Applying Business Principles to Environmental Management*, Harvard Business School Press
- Rufer, D. / Huber, H.** (2001): *Von der rein wirtschaftlichen zur umfassenden Nachhaltigkeit im Unternehmen*, in: Wüthrich/Winter/Philipp (Hrsg): *Grenzen ökonomischen Denkens*, Gabler
- SA8000**: *Social Accountability International : Social Accountability 8000*, New York, 2001, www.cepaa.org
- Schaltegger, S. / Dyllick, T.** (Hrsg.) (2003): *Nachhaltig managen mit der Balanced Scorecard, Konzept und Fallstudien*, Gabler Verlag 2003
- Schmid-Schönbein O., Braunschweig, A., Oetlerli G.**: *SPI-Finance 2002: Social Performance Indicators for Financial Institutions*, www.spifinance.com
- SIGMA 2003**: *The Sigma Project (Ed.): The SIGMA Guidelines. Putting Sustainable Development into Practice – A Guide for Organisations*, www.projectsigma.com
- Swiss GAAP FER**: *Fachempfehlungen zur Rechnungslegung*
- The World Commission on Environment and Development** (1987): *„Our Common Future“*
- SEC 2002**: *U.S. Securities and Exchange Commission (SEC): Public Company Accounting Reform and Investor Protection Act (Sarbanes-Oxley)*
- World Commission** (1987). *Gro Harlem Brundtland (Ed.): : Our Common Future - The World Commission on Environment and Development*, Oxford University Press
- Zürcher Kantonalbank**: *Annual Report 2002*