Gone are the days when investors and lenders judged companies on financial performance alone. Nowadays safeguarding share price and access to capital means managing the Triple Bottom Line. So what can you do to keep ahead of the curve?

Being a good investment

By Alan Banks

A decade after Rio, the 'Big Idea' of the trickle down effect of global capitalism has had little noticeable effect on the economic and social welfare of developing countries. In fact all the indicators of poverty, sanitation, clean water, health, education and environment have worsened dramatically. So companies are under growing pressure to work proactively with the societies in which they operate to promote social and environmental improvement. The carrot is better-regarded products, more productive workforces, a lower cost of capital and long-term share price out performance against their peers. The stick being that if they don't embrace sustainable development they will lose market share, destroy expensively created brand values and suffer long-term declines in profitability.

All this means the most significant new issue for CEO's over the next decade will be sustainable development. It is no longer enough to create shareholder value, employ people, and pay taxes. The almost universal mantra emanating from corporate boardrooms is the 'Triple Bottom Line' combining economic prosperity with environmental stewardship and corporate social responsibility (CSR).

What have you got to loose?

All the evidence points to good sustainable development performance = good financial performance. Whether it is a direct effect or a manifestation of better management doesn't matter – the two have become intimately linked in the minds of asset managers. To be included in their core investment list your company needs to pass both rigorous financial and non-financial tests.

Today's institutional investors are looking for those companies who are positioning themselves to benefit from long-term changes in consumer behaviour and emerging technologies. They want to avoid companies where shareholder value is destroyed as a result of adverse publicity surrounding unethical behaviour. A company whose factories employ child slave labour, or pollute the environment, suffers a double whammy: consumers stop buying the product and investors sell the shares. In short, investors are looking for companies where corporate activity is aligned with, and supportive of, the brand values of the company's products and where the risk profile is low.

Arthur D. Little estimates that around 70% of the market value of public quoted companies is made up of non-financial items, such as brand value and goodwill. A potent combination of Internet-fuelled consumer awareness, NGO pressure, financial regulation, threatened legislation and class actions are making companies aware of the fragility of their brands and the many non-financial parameters that affect their cost of capital.

What do you stand to gain?

However, it is not all negatives and defensive positioning. On the plus side good sustainable development performance can open up a whole raft of benefits and opportunities such as:

- First mover advantage from anticipating increasingly ethically minded consumer preferences. Ethical purchases of goods and financial services are outgrowing non-ethical purchases 6 to 1
- New revenue sources from tradable energy, greenhouse gas and waste certificates
- Improved access to global capital pools. Ethically screened investment portfolios account for 10%+ of all portfolios but are growing 50% faster and often carry voting mandates in excess of their actual holdings
- Lower insurance and debt funding costs through lowering the business risk profile
- The very significant, long-term positive corporate benefits of having productive, well trained workforces and supportive stakeholder groups
- Wide product acceptance.

The support of employees and stakeholder groups and wide product acceptance are seen as critical by many CEO's to the long-term success of their business. Consumer confidence in a company's products is generated through brand building but, without exception, brand values have to be carried through into corporate values. If not, the truth gets out very quickly these days. Investor confidence is dependent on disciplined management, stable operating environments, satisfied, productive workforces, innovative well-received products and an absence of bad news. No investor or capital provider wants to risk collateral reputation damage.

Managing the triple bottom line
These points together create the triple bottom line against which investors now judge companies:

- Economic prosperity
- Environmental stewardship
- Corporate Social Responsibility, defined as:
    - Impact of products on society
    - Impact of company on its employees (pay and rights)
    - Human rights
    - Impact on local communities

Understand your impacts
In a time of increasing stakeholder and shareholder activism, what can the CEO do to better manage the triple bottom line? The most critical issues are transparency and communication. However, before rushing into new forms of reporting, you need to define the high impact areas for your company. By all means take into account the various United Nations, Global Reporting Initiative and World Bank reporting standards. However, the most important task is to define your company's external impacts and set your own principles. Providing these are fair and reasonable, clearly articulated and communicated, and consistently applied and verified, you will get rave reviews.

Know your stakeholders
Start by defining your stakeholder communities. Typically these include:

- Customers
- Shareholders
- Direct employees and those employed through the supply chain
- Local communities in which you operate

Next define the issues that are most important to each stakeholder group. For customers you will probably have defined ‘economic’ criteria such as price, performance, delivery, and support. Now add in the environmental impact of products, both during the manufacturing process and throughout the lifecycle, including packaging materials. For shareholders you will have earnings, dividends, growth rate and ROC. Equally important are corporate governance issues such as management discipline, elimination of bribery and corruption, exception reporting, and risk reduction. For employees issues such as pay and pensions, health and welfare will top the list. But training is just as important for long-term success and staff motivation, particularly at the non-managerial levels. For local communities you will need to consider a broad range of ‘stakeholders’, particularly indigenous peoples and the family economic unit including child workers.

Set and apply your principles
Build a matrix of these issues and use them to develop an overall statement of principles that covers your products, manufacturing processes, employees, and communities. Make sure these principles are explained in the annual report and in corporate literature. Communicate your values strongly both internally and externally.

Make a member of the Board responsible for turning these principles into actions and targets at all levels of the company and across all its main activities. Then ensure there is ongoing monitoring of performance against those targets. Communicate performance against targets regularly to your stakeholders, perhaps through environmental and social impact reports

Look at product design and manufacturing to ensure that your environmental and social principles are rigorously applied. Particularly take into account natural resource utilisation, water pollution including runoff, atmospheric pollution, and production and disposal of waste. These topics are often highest in the mind of local government and regulators, and you’ll do well to be ahead of the curve. Consider carefully how to recycle your products, and where possible redirect the R&D process to design environmentally friendly alternatives.

Ensure that corporate values are applied within the key parts of the supply chain. Insist your suppliers sign up to a code of conduct, and audit compliance on a regular basis. Global companies are judged very harshly if they are not aware of, or turn a blind eye to, major ethical and environmental issues with their suppliers.

Put something back
Where your products have an unavoidable environmental or social impact that cannot be designed out, commit to putting something back. If you can’t use managed woodland, then plant more trees than you cut down and pay to relocate indigenous species. Consider carefully the full economics of biodiversity rather than just exploiting a single natural resource to the detriment of others. Develop local stakeholder partnerships to agree what contribution your company can make to the local community – be it schools, healthcare, clean water, power, sanitation, or telecommunications. In many cases the infrastructure you have to put in place for your own company operations can be easily and cheaply extended to benefit the local community. Develop a series of public reports, reviewed by community advisory panels, to monitor and report on this local activity.

Summing up
This may seem to be a very big list of actions but they can be boiled down to a few key points:

- There is a proven link between sustainable development and shareholder value
- Many leading asset managers use non-financial screening in selecting stocks; banks and insurance companies use the same information in pricing risks – so it does affect your access to, and the cost of, capital
- Read the different international standards, but define your own principles to deal with your own high impact areas
- Use your own core competencies for the benefit of local communities
- Ensure you do well on the big issues:
    - Corporate governance, especially bribery and corruption
    - The environmental impact of your products and manufacturing processes
    - Local community partnerships for poverty reduction through employment, education and infrastructure
    - Responsible supply chain management
- Report clearly and regularly on how you are performing on these issues, and be prepared to audit and verify your actions
- Don't greenwash – we don't believe you!

Alan Banks, is Chief Executive Officer, at Global Risk Management Services

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