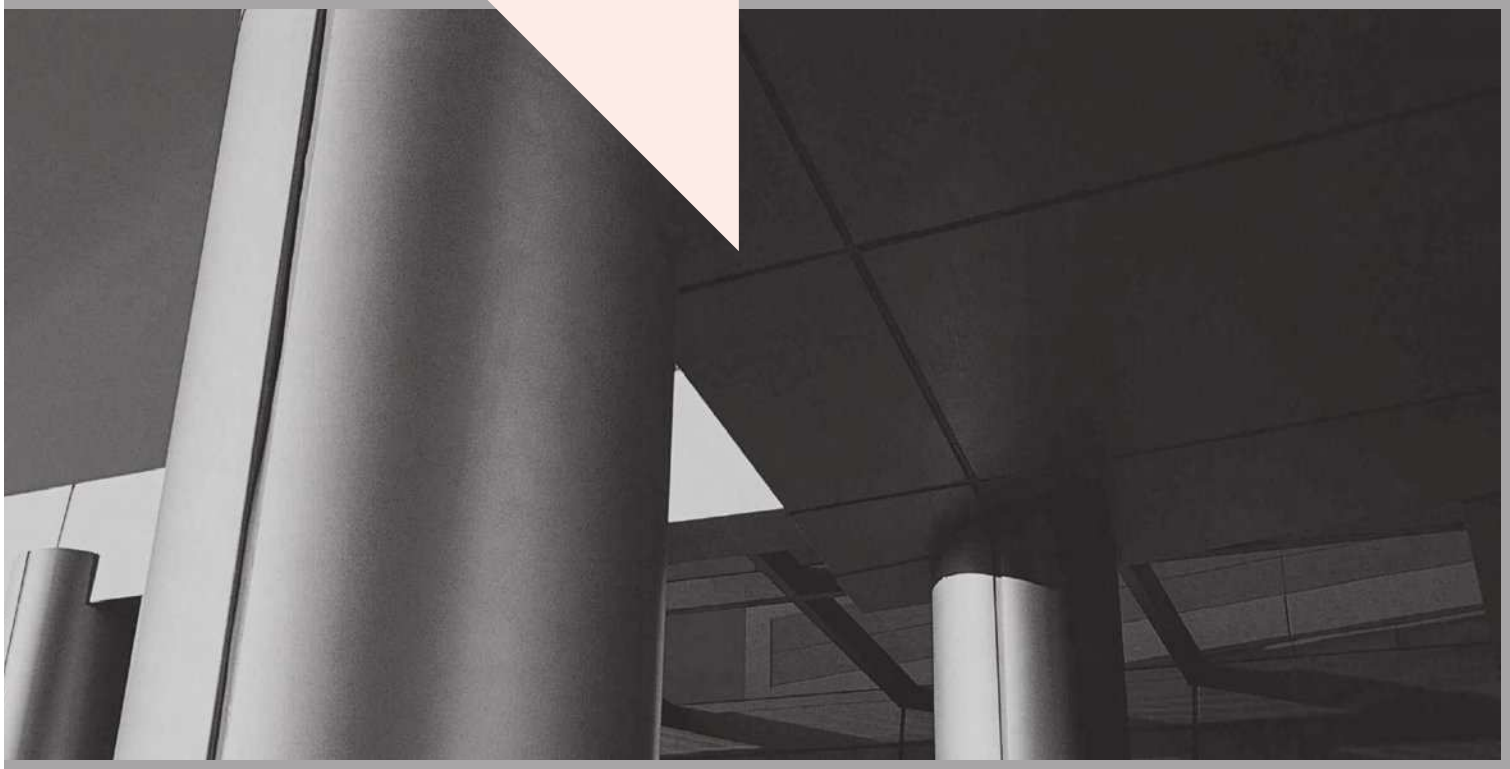
ENVIRONMENTAL MANAGEMENT REPORT

Focus on Sustainability and its implications for CSR

Adrian Henriques & Peter Lærke-Engelschmidt



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Introduction

What this book is for

For many, the world of business is becoming less fun and harder to negotiate. There are pressures on all commercial organizations from an ever-widening number of sources – the media, pressure groups, governments and many more are all increasingly concerned about corporate regulation. The result is a proliferation of regulations, standards, principles, initiatives and codes of conduct.

At first sight, the increasing popularity of 'sustainability' looks like another in a series of fashionable business trends, especially among large multinational organizations. There are more and more environmental reports and social reports to sit beside the annual reporting of financial performance. Now it seems, sustainability reporting is also on the rise. Companies as diverse as Unilever, Shell, BT and General Motors are all part of this move. But is it really clear what they are trying to do or whether any of this activity is making a difference?

Before any judgement can be made about this, we need a common understanding of the issues and the approaches to them. The first purpose of this book, then, is to explore what sustainability is all about – what it means, and especially what it means for business. As we will see, while it may not be very clear what a fully sustainable world looks like, it is fairly clear what it means for a company to become more sustainable. It will also become clear that this is a goal worth pursuing – from many points of view.

The next issue is how can you, as a manager, help your organization become more sustainable? There are numerous tools, techniques, standards, methodologies and so on, all claiming to be the main thing lacking in an unsustainable world. How do you discover which is the most appropriate for you and your organization? The second purpose of this book is thus to provide a map of the various means (tools, approaches, methods, etc.) that may be useful for moving a company towards sustainability.

However, from the inside, companies may seem to be already stifled by numerous tools, codes and methodologies. For many, another initiative looks more like the final straw than the final solution – ready to break the back of the already overburdened manager. What are the cost implications? Where is the business case? Even if it were cost-free, why should anyone divert their time to it? And even if it could make money, would it not look to the shareholders like the company is going soft? The final purpose of this book, therefore, is to support the preparation of a business case for moving towards sustainability. On reaching the end, readers should be better able to articulate their own thoughts on the way forward for their organization.

Who this book is for

Given the purposes of this book, its prime audience is those who can make things happen within companies. This means that, although it is written for managers, it also recognizes that action can be initiated from several different levels at once within an organization. This is a practical book, supporting those who are attempting to make companies more sustainable; but there is 'practical' and 'practical'. There are, after all, many books that provide checklists of things to do, and promise fundamental, if not magical, change as a result. This book is not like that – it is aimed at those who need to develop a mental framework for thinking about the issues facing everyone, including those in business, and to take action in the light of their understanding.

Who might such people be? One answer is prefaced by 'managers and executives with responsibility for …'. However, the structures within companies change so rapidly, that it would be hazardous to try to complete such an answer. On the other hand, the sentence could have a variety of endings such as:

- corporate responsibility;
- environmental management;
- compliance;
- quality;
- public affairs;
- communications;
- public relations;
- corporate social responsibility.

All these areas, and others, have in fact comprised the lead in the sustainability debate within different companies. Any of these areas can become the worthwhile champion of efforts to make companies more sustainable.

Finally, this book is not for experts. The aim is not to try to develop a new approach to sustainability. Rather, the aim is to clarify and communicate what has been worked through elsewhere.

How to use this book

There are three different ways to use this book, depending on the reader's current level of exposure to the idea of sustainability:

- read Part I: The big picture – this part can be read as background, providing perspectives to help convince people that sustainability is a real problem facing us all and that companies can be part of the solution;
- read Part II: Getting it done only – this part can be used as a source of ideas, material and approaches that could be useful in trying to determine what steps to take next.
- read both parts – this will allow any proposed actions in your organization to be put into an overall context.

PART I

The big picture

Business trends and drivers 1

It is not an accident that there is a huge interest in sustainability at this time. Sustainability is intimately connected to the key business trends with which all companies are working. Sustainability, which was originally introduced as a term and a principle in the Brundtland Report (World Commission on Environment and Development 1987), remains a core concept, and the language and the conceptualization around it has taken many shapes, such as corporate responsibility (CR), corporate social responsibility (CSR) and corporate citizenship.

This chapter sets out three key trends confronting companies: globalization, technology and the blurring of sector boundaries. It looks at the influence these trends can have on business operations and suggests how this might in turn affect the kind of impact that a company can have on the economy, on the environment and on society. It also outlines three of the fundamental business responses that have emerged with increasing strength over the same period: the nature of faith in economic growth, ethical positioning and accountability. These responses are each key elements of the sustainability of a company.

Trend 1: globalization

While it is very often cited as a key issue, it is not always clear what is meant by 'globalization' and, if the meaning is clear, whether or not it is a good thing. Globalization concerns the increasing interconnectedness of the modern world. It has several aspects, of which the most important is probably the economic dimension. Economically, globalization is a way of describing the trend towards the ever increasing size of product markets. Where once a comany's market might have been seen as the local region – a space perhaps 100 miles across – now it may be global. In the late 1990s, the total amount of foreign assets held by the 100 largest multinational organizations was about US $1,800,000,000,000 and the total foreign sales of the same companies was about US $2,100,000,000,000 (United Nations Conference on Trade and Development 1999) Together with this, the size of companies has grown. Whereas in the past anticompetition authorities thought about the size of a

companyin relation to its country of origin and home market, the consideration is now at least continent-wide: is the company too big for Europe? As a result, companies may now outrank countries when comparing turnover to gross domestic product (GDP) (Held et al 1999). This increasing size of companies and their operations creates a situation where social, ecological and economic welfare becomes more dependent on companies. At the same time, the dynamics of globalization create a difficult situation for regulating authorities.

Globalization, as the apparent abolition of national borders, also applies in the environmental and social domains. Pollution does not respect national borders. Acid rain produced in the UK is affecting Scandinavia. Similarly, overuse of water in one country directly affects the ability to use water in other countries. Socially, the geographical reach of economic and environmental activities is affecting all of us. Global markets tend to mean global supply chains; and global supply chains mean that the peoples of the world are increasingly dependent on each other for their survival. As a result, national economies and social structures are more vulnerable than before. National and cultural differences appear because, while globalization means the abolition of borders and differences, these differences then become visible and move closer to each other. When supported by new communication patterns, including the Internet, these differences can turn into conflicts. A recent example of this is the case of the Danish cartoons, which created a crisis between western ideals of freedom of speech and Islaamic religious beliefs.

As product markets expand ever further, the variety of cultural forms and biological species (and, of course, products) diminishes. Environmentally, socially and economically, diversity is reduced; this, in turn, reduces the ability to respond adequately to challenges. Why is this happening? The simplest answer is that we want it to! Globalization, in so far as it is driven by economic growth, is a 'choice' that the western world has made in order to sustain that growth. Sometimes globalization is presented as if it is inevitable. Yet there is clearly no natural law requiring it to happen. Through institutions such as the World Trade Organization, most of the countries of the west are trying to ensure that globalization happens as fast as possible.

However, the 'we' that wants globalization is largely synonymous with certain interests in the West. Not everyone wants globalization, as illustrated by the demonstrations and campaigns against the apparatus of globalization such as the Multilateral Agreement on Investment, the World Trade Organization, the World Bank, and large corporate projects such as genetically modified organisms. From the USA to Poland and the UK, from Turkey

to India and the turmoil in the Middle East, there is widespread unease about and active resistance to globalization.

For companies interested in sustainability, even at the simplest level of survival, it is no longer possible to assume that a good product idea will make good money. The concerns of the societies of the world, for themselves and for the environment, are factors that have to be taken into account.

Trend 2: science, technology and communications

A second key trend is technology or technological development. The development of new technologies on the back of new fundamental science is a central factor in economic development. It enables production techniques to be refined or replaced and entirely new products to appear. Fifty years ago, there were no mobile phones, genetically modified organisms or heart transplants (Figure 1.1). Today, not only is the rate of technological change far more rapid, but the time to widespread acceptance of it has also dropped dramatically. For companies, this means huge opportunities in terms of new products and new production processes. For people in capacities other than company representatives, it is not clear what the net impact is, apart from the need to cope with an ever-increasing rate of change.

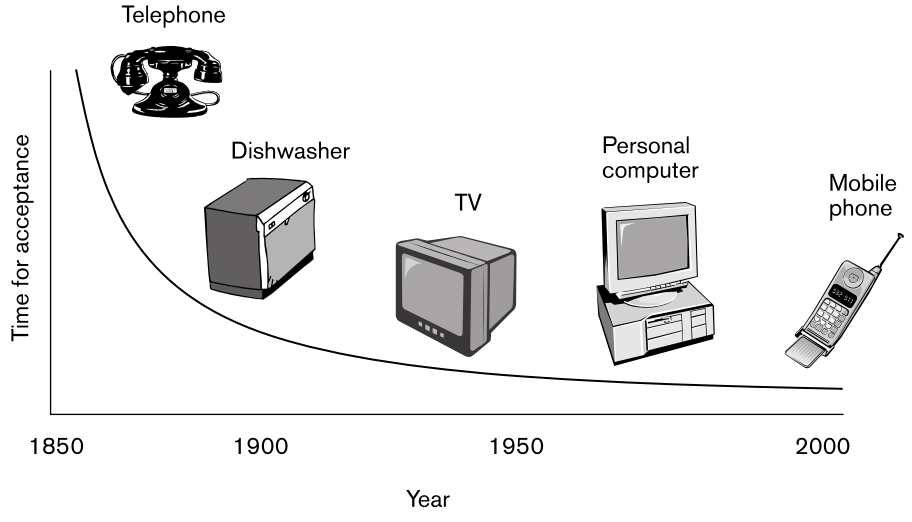


Figure 1.1: *Technological change since 1850*

One area in which the pace of change seems extremely rapid is that of communications. Driven by technological changes, new communications – from mobile phones to the Internet – are reaching into most people's lives in the West. For companies, this can mean easier reach into their employee's lives, so that people feel they must be available 24 hours a day. However, conversely this also means that, due to the internet and the omnipresence of television, the activities of companies can be broadcast instantly to a global audience. Instead of living in the shadow of 'big brother', we are all living under the watchful eye of everybody else.

How should companies relate to scientific and technological advances? Scientific and technological change have been one of the main driving forces of the world economy since the Industrial Revolution. New technologies make new products possible, and this opens up the possibility for new and larger markets. Government policy in the west has recognized this, and has funded basic science and tried to support the adoption of new technologies. This approach worked until perhaps the Second World War, after which radically new science and technologies (nuclear power, information technology and bioscience) became much more widely applied.

One of the core positions of some advocates of sustainability has been the 'precautionary principle'. Simply stated, this suggests that until you know what you are doing and what risks are being run, it is better to avoid making use of a new technology. Such a position was adopted by the European Union (EU) over genetically modified foods, as illustrated by the case study in Box 1.1. From that point on, the issues are about evidence and risk; and both governments and business have made life difficult for themselves. Some European governments, for example, have appealed to 'scientific evidence' as the basis and justification of policy. The argument runs: where the science is sound and there is no evidence of any risk, then why not? There are two problems with this approach. The first is that scientific evidence is evidence for or against some scientific hypothesis, not government policy. Secondly, people may simply not want whatever is on offer, regardless of any evidence – it may be a matter of values, not science.

For businesses this is a key issue. If the public does not want a product, for whatever reason, then it is risky to pursue it. Quite apart from the issue of environmental impacts, there is a business question as to the wisdom of pursuing markets that are rejected by society.

Genetically modified organisms (GMOs) are new life forms that have been developed through the new biosciences. Based on existing species, GMOs are engineered to have specific properties, such as resistance to weedkillers, different colours, extra nutritional value, infertility, and so on. Seeing new markets, the agrochemical industry has invested billions of dollars in the development of GMOs. The market has been estimated to be worth US $3 billion annually currently, and perhaps US $25 billion annually by 2010. One industry spokesperson has said that, for the agrochemical industry, the greatest challenge is the marketing of GMOs. The aid industry claims that GMOs can help feed the world. The World Bank, for example, has claimed that it is 'inconceivable' to feed the world without GMOs.

However, the industry faces formidable obstacles from consumers, governments, campaigners and smaller producers. Consumers in Europe, and increasingly in the USA, are scared of so-called 'Frankenstein foods'. Fuelled by an increasing number of food and health scares, there is not only little demand for GMOs, but there is antipathy towards them. As a result, many supermarkets have declared themselves GMO free. Producers of traditional crops, from Brazil to India, see a threat to their livelihoods, as the owners of GMOs buy into the agricultural supply chains.

In response, governments have introduced new legislation. Japan and China have introduced stricter labelling laws identifying GMOs. In the UK, a testing period has been introduced. Thailand has decided not to test genetically modified rice. Tasmania may use quarantine laws to control the use of GMOs. The European Union introduced a moratorium on testing; although this has now been slightly relaxed there are currently strict regulations on the labelling of GMO products.

Throughout the world, many non-governmental organisations (NGOs) have mobilized to campaign through direct action, lobbying and public communications. As a result, fewer genetically modified crops have been planted (the acreage devoted to GMOs has been constant), and a potential new market has been made far more difficult to exploit.

The challenge for GMO companies is to work with their stakeholders, to see if there are new products that will actually be welcomed.

Box 1.1: *Genetically modified organisms – a precautionary tale*

Trend 3: blurred sector boundaries

As suggested above, globalization is an overarching trend influencing all aspects of society (culture, politics, regulation, etc.). The last couple of decades have also shown that sector borders, which were formerly well defined, are collapsing or at least becoming blurred (Figure 1.2). Non-governmental organizations (NGOs) are becoming professional, public authorities take up corporate management models, and corporations take over activities that traditionally have been the preserve of public authorities or NGOs.

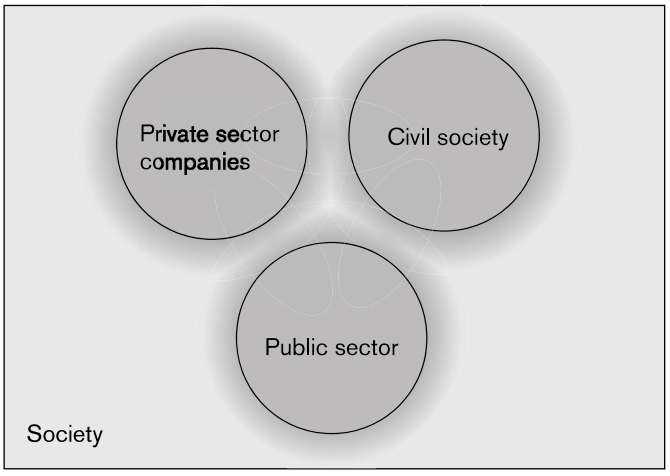


Figure 1.2: *The blurring of sector borders*

This in itself creates new business opportunities, because corporations have larger markets to address. It is illustrated by the way in which values and attitudes are communicated and built into the corporate branding of a lot of organizations. In this way corporations may be said to 'colonize' new territories, imprinting their message in the minds of employees and consumers. However, businesses entering the territory once occupied by public institutions comes at the price of new public expectations of business behaviour. This change in the traditional division of labour between sectors has changed patterns of governance. With the interesting exception of reporting, traditional centralized governance, expressed by directive legislation, is giving ground to more indirect forms governance.

Sustainability issues and the acknowledgement of these by corporate responsibility (CR) practitioners reflects this shift in regulation. The CR agenda is moving towards more self-regulation, and the role of public organizations is taking the form of encouragement and recommendations. CR initiatives remain largely voluntary. Even though accounting law in EU member countries has been revised as a consequence of the EU Accounts Modernisation Directive, mandatory rules are still few regarding information on non-financial issues. In the UK, the government has recently abandoned plans on mandatory rules on forward-looking information (which would also include information on environmental impact and community activities).

A number of EU initiatives seem to be moving in this direction. The EU Multi-stakeholder Forum had as one of its purposes to examine the potential for future regulation. While this was an area of very active debate, it seems that the EU is abandoning the idea of regulation in the area of CSR in favour of voluntary recommendations. Overall, the role of

government seems to be taking the form of merely encouraging voluntary initiatives and providing tools and guidelines on how to turn sustainability into good business. The EU and national states have been focusing on mainstreaming CSR – i.e. spreading the CSR message to a bigger population of companies, including small and medium sized enterprises (SMEs). It is perhaps too simple to refer to this development as deregulation; it may, however, be seen as a shift towards regulatory experiments with mechanisms of self-regulation (Power 2001).

The UN Global Compact (Gjølberg and Ruud 2005) and its 10 voluntary principles for sustainable development is gaining increasing attention from companies; corporate sustainability reports are appearing that contain reporting according to these principles. All these activities serve to focus attention on sustainability, both at the operational level as well as at the policy level. However, the impact on the level of sustainability performance actually achieved by these voluntary initiatives should not be overestimated. Nevertheless, the growing autonomy of companies makes it clear that sustainability must be a part of CR. Companies are, after all, very close to many of the most pressing sustainability issues.

Having abandoned regulation through minimum standards, the regulatory discourse focuses on the business case for sustainability. As will be argued below, this creates the expectation in companies that the business case can be documented and forecasted up front. Unfortunately, this seems far from the experienced reality within a lot of companies, who see CSR as a learning process and the business case as something that emerges over time.

Response 1: attitudes to growth

When confronted with the adverse consequences of industrial society, one of the arguments often advanced is that economic growth will make everything better. This is the received wisdom almost everywhere – of governments, international institutions and businesses, and many consumers the world over. Part of the reasoning is the 'trickle down' theory, which suggests that the increased wealth of one economic participant, say a company, will improve the lot of at least some other participants. Taken as a whole, economic factors are like boats floating on the sea, and the tide of economic growth will raise them all together.

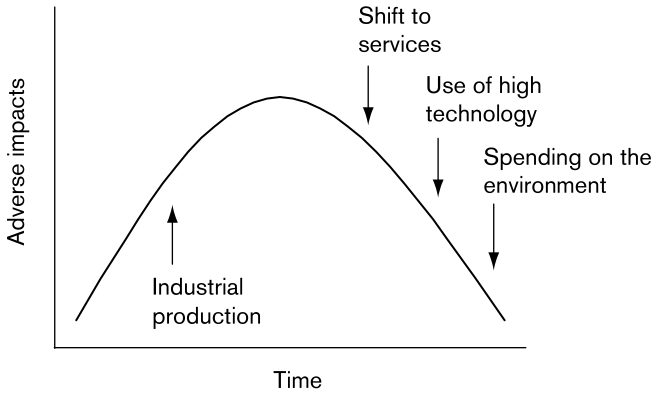


Figure 1.3: *The forces behind the Kuznets curve*

Another part of the argument, especially in relation to adverse environmental impacts, is that there is evidence that increasing wealth, by some mechanism, eventually reduces adverse environmental impacts. So, while environmental problems, for example, may be regrettable in the short term, in the long term things will get better. The evidence for such a view comes from a number of technical economic studies that suggest that income inequalities and key environmental pollutants increase in the early stages of economic growth and decline later on. That is they follow a Kuznets curve, the evidence for which is challenged in Appendix 1.

The reasons cited by the various studies as to why there might be a Kuznets curve for various pollutants are that, although economic growth tends to produce pollution, there are several factors arising from economic growth that tend to reduce it (Figure 1.3). The difference in timing between the pollution-causing and pollution-abating factors is what gives rise to the Kuznets curve.

The factors that tend to reduce pollution are that advanced economies:

- tend to rely increasingly on *services*, rather than more pollution-intensive primary industries;
- tend to make use of increasingly *advanced technologies*, which are less pollution intensive;
- are more prosperous, and so there is *more money to be spent on a cleaner environment*.

These assumptions about economies are offered as plausible reasons for the empirical findings. In the context of the Kuznets curve debate, however, perhaps the most important point is when the turning point levels of income are likely to be achieved in most of the world. In India, for example, GDP per capita stood at about US $1,260 in 1990, but the level

of GDP at which cadmium pollution is expected to start declining is US $11,600. More pessimistically, if such affluence does not come, then neither can an abatement of pollution.

Then again, are the three abating factors actually occurring? The shift towards services, for example, is clearly under way in some countries. However, although the share of services is rising in advanced economies, the absolute quantity of industrial production worldwide continues to increase. One of the reasons why the relative domestic share of industrial pollution has declined is that the corresponding manufacturing, for domestically consumed industrial goods, has taken place in less developed economies. In other words, pollution is being 'exported'. The less developed economies, which have imported the pollution, will not necessarily themselves be able to export their industrial production in due course – there may be nowhere that is less developed to export it to.

Secondly, while high-technology industries can be less polluting, it could be that their particular environmental impacts are not yet clear. Genetic engineering, for instance, produces virtually no sulphur dioxide, particulates or any of the traditional measures of pollution. However, could it produce rogue DNA at some point? Currently there is no obvious measure of such pollution. Similarly, the levels of 'safe' radioactivity from the nuclear industry are being constantly revised downwards.

Thirdly, the idea that richer nations can afford to deal with pollution assumes that the people in such nations will want to do so. There is no causal relationship between a higher income and a wish to protect the environment. In practice, such moves as there have been towards a cleaner environment have come from entirely voluntary protest at unclean industrial practices.

The main lesson from this debate is that economic growth can be used to reduce adverse social and environmental impacts, but that it does not happen automatically. In other words, it is necessary to manage social, environmental and economic impacts to the desired end. One of the key actors in that management process are companies.

Response 2: ethics and values

One of the business responses to the difficult trends identified above – and others – is to emphasize a commitment to ethics and values in their business operations. 'Ethics' and

Box 1.2: *Living our values: an extract from the Camelot Social Report 2005*

Our vision is 'To serve the nation's dreams through The National Lottery'. In pursuit of this vision, our overriding goal is 'To build a growing and respected National Lottery'.

This goal clearly combines our commercial ambitions and our commitment to the highest standards of business practice and social responsibility.

We want government, shareholders and players to have confidence in the integrity and trustworthiness of the lottery.

Our values

Our company values are fundamental to the way we do business and to building that confidence:

We believe in **fair play** for our people	We behave with **integrity**	We can be **trusted** to deliver	We see **excellence** in everything we do	We discharge our **responsibilities**

The Camelot way of doing things

We believe that every employee has a right to understand how he or she can contribute directly to achieving our goal. So we asked our staff to help define the behaviours that would embed these values in our day-to-day operations. This is what they said:

- we are **passionate** about what we do
- we seek **creative** solutions
- we are **empowered** to give of our best
- we make **progress** through partnership
- we take **ownership** of the issues

'values' are terms much used in relation to sustainability. Many companies want to be seen as ethical, principled or value-driven organizations, despite the fact that it is not always at all clear:

- what ethics and values are about;
- how they relate to sustainability;
- how ethical conflicts can be dealt with.

First of all, values (or sometimes 'principles') may be thought of as a statement of 'what is important'. Values work at an abstract, inspirational level. Thus a company statement of values should reveal what the company is prepared to say is important. Often, however, statements of values are hung on the wall, rather than lived (which might suggest that they

Our credo

We believe our first responsibility is to the doctors, nurses and patients, to mothers and fathers and all others who use our products and services. In meeting their needs everything we do must be of high quality. We must constantly strive to reduce our costs in order to maintain reasonable prices. Customers' orders must be serviced promptly and accurately. Our suppliers and distributors must have an opportunity to make a fair profit.

We are responsible to our employees, the men and women who work with us throughout the world. Everyone must be considered as an individual. We must respect their dignity and recognize their merit. They must have a sense of security in their jobs. Compensation must be fair and adequate, and working conditions clean, orderly and safe. We must be mindful of ways to help our employees fulfil their family responsibilities. Employees must feel free to make suggestions and complaints. There must be equal opportunity for employment, development and advancement for those qualified. We must provide competent management, and their actions must be just and ethical.

We are responsible to the communities in which we live and work and to the world community as well. We must be good citizens – support good works and charities and bear our fair share of taxes. We must encourage civic improvements and better health and education. We must maintain in good order the property we are privileged to use, protecting the environment and natural resources.

Our final responsibility is to our stockholders. Business must make a sound profit. We must experiment with new ideas. Research must be carried on, innovative programs developed and mistakes paid for. New equipment must be purchased, new facilities provided and new products launched. Reserves must be created to provide for adverse times. When we operate according to these principles, the stockholders should realize a fair return.

Johnson & Johnson

Box 1.3: *Values as 'what is important': Johnson & Johnson*

cannot be that important after all). Without further evidence that the values are required to affect behaviour, they may almost be counterproductive, provoking cynicism among staff. Such evidence may arise from incorporating the values into day-to-day management or publicly reporting on how they have been realized.

Secondly, many statements of values seem scarcely to touch on substantive issues. Statements of values tend not to talk about the value attached to money or profitability. For the great majority of companies, making money is a central value. If that is the case, it should not be omitted from a statement of values. It is interesting to compare the values statement from Camelot (Box 1.2) with that from Johnson & Johnson (Box 1.3).

The ideas of 'ethics' and of 'values' can easily be confused, and the terms are sometimes used interchangeably. While closely related to values, the concept of ethics tends to be more practical, translating (at least some) values into more day-to-day realities. Ethics are more directly about what individual behaviour is expected. A statement of ethical principles should spell out, in a clear set of rules, just what is expected of staff and management and how difficult decisions should be made:

> "*Ethics is … not merely a matter of result or impact, but turns out to have much to do with intention and choice.*"
>
> Zadek et al (1997)

Statements of ethics are typically found in professional associations, which may need to prove they are worthy of self-regulation, and are intended to govern the behaviour of members in a way that will enhance the reputation of the profession as a whole. In a corporate context, ethical statements may focus particularly on issues such as corruption and bribery in business dealings and also how to behave with integrity in other cultures.

How does all this relate to sustainability? The most important factor is that having acceptable values and behaving ethically are seen as important elements of positive social performance in its own right. They are part of what we would expect from companies in a sustainable world. That such an approach may also be a key indicator of financial sustainability is perhaps the key message of *Built to Last* (Collins and Porras 1995). In fact, many people believe that a companies should pay greater attention to social and environmental performance in particular. The emphasis is on the moral element, not on the benefit to business.

A second relationship is that in order to improve financial business performance it is helpful to have staff who are inspired by their company's approach and who can be managed through having clear rules for behaviour (Box 1.4). The key difficulty in working with values and ethics is the issue of whose values and whose ethics. Since not everyone shares the same values, the choice of values and ethical systems is problematic. While the values of the company may overlap with those of many of its stakeholders, there may still be many stakeholders whose values are radically different from those of the company – and they may be very much affected by what the company does. In addition, companies increasingly operate within a wide range of other countries with values quite beyond those of the society where they are based. The situation is illustrated in Figure 1.4.

Q: You have said, Harry, that corporate ethics and sustainable development are critical enablers of successful business performance. Can you explain what you mean?

PEARCE [GM's vice chairman Harry Pearce]: Well, the great strength of any company is people. There isn't a more important resource. In my judgement, the way you truly turn people on is to do the right thing whether it's legally, ethically, socially or environmentally. If you have ethical standards or environmental principles or social standards by which you hold yourself accountable, you energize and motivate your people. They're turned on about being an employee and nothing produces greater productivity, more creativity, more innovation than that.

Source: *GreenBiz News*, January 2001

Box 1.4: *General Motors' view of ethics and sustainability*

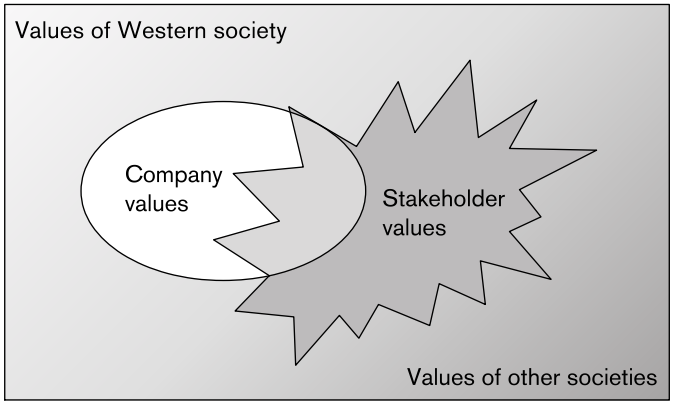


Figure 1.4: *Whose values?*

Just as environmental sustainability requires respecting biodiversity, so social sustainability requires respect for a diversity of values. Yet this requirement raises a host of ethical problems. Even though United Nations and International Labour Organization conventions provide some level of consensus on ethical behaviour, real-life situations can seem extraordinarily difficult. An example of such a dilemma is illustrated in Box 1.5.

Response 3: accountability

In one sense of the term, 'accountability' is about the ability to give an account of something to somebody with an interest in it. In another sense, 'corporate accountability' refers to the ability, supported by legislation, to hold companies to account through criminal or

Box 1.5: *The dilemma of child labour*

Child labour provides a good example of value conflicts. Although only outlawed from 1830 onwards in the West (the 'developed world'), child labour is now viewed with abhorrence. Some of the sharpest campaigns against multinational companies centre on child labour. Nike, for example, has been the subject of continuing campaigns calling attention to violations of its own code of practice concerning child labour in the manufacture of garments. The key question is: What should you do when child labour is discovered?

The pressure of development in many countries in the South (the 'less developed world') is such that families may feel they have no choice but to put their children to work. In these circumstances, to dismiss any children working seems right in the West, but unfair in the South.

How can such dilemmas be resolved? One of the most practical ways out is to work in partnership with local organizations in the southern country and with international NGOs to find a creative solution. In the case of child labour, current best practice is to pay for the education of the child until he or she is old enough to work, and then provide a job. This approach is advocated by Oxfam.

civil legal action. Historically, accountability has been concerned with the duty on a company to report to its shareholders. In this sense, traditional corporate reporting is an important part of corporate accountability. Accountability compensates for the 'agency problem' – the fact that the owners of a large company, who have a clear interest in it but are not usually directly involved in its management, need to understand how their company is being managed and how it is performing financially. This part of accountability has been much developed and regulated for many years, even though some will claim that it needs to be taken further (Box 1.6).

The idea of 'transparency' is often mentioned in connection with accountability. Transparency tends to have two separate but related meanings. It can either be used synonymously with accountability, or it can refer to the ethical dimension of business dealings. In the latter sense, transparency implies an absence of bribery and corruption in business affairs.

In relation to sustainability, accountability takes on a broader, although related, meaning. The greater breadth comes from including all stakeholders, in addition to shareholders, as part of those to whom an account is due. The related element of meaning is that all such stakeholders should be regarded as entitled to some kind of account of company activities. Currently there is very limited support in law for such a wide accountability in most national jurisdictions. Nevertheless, in an attempt to respond to some of the pressures set

Box 1.6: *Changes to Company Law*

Over the last few years the UK Government has initiated a fundamental review of Company Law. One of the main purposes of the review was to assess how far the basic structure of companies should reflect the variety of interests from different stakeholders.

The review will form the basis of new legislation, the Companies Act 2006. The main regulations for public companies are that:

- company directors ought to be clear that they were entitled and required to consider the interests of stakeholders and the environment in forming a view as to what was in the best interest of the company
- companies should prepare a business review requiring a narrative of their performance against a range of financial and non-financial risks.

In the USA, the Sarbanes–Oxley Act (2002) makes very clear that the board and officers of a company must take full responsibility for the financial accounts.

out earlier, an increasing number of companies are reporting to their stakeholders, in various ways, in order to be more accountable.

At first glance, accountability seems like a social phenomenon. It is clearly true that accountability is about the relationship of a company to its stakeholders – which is how part of the social element of corporate sustainability can be defined. But while some stakeholders (e.g. the local community) may be primarily concerned with social issues, others (e.g. some pressure groups) may be concerned with environmental issues. Others, such as shareholders and government, may be primarily interested in economic issues. Confining an understanding of accountability to the social dimension simply will not meet the needs of all stakeholders.

So, in relation to the nature of corporate activity, accountability is an integral part of the process of implementing all aspects of sustainability. It is also true that the way in which accountability may be discharged is similar, whatever the sphere of accountability. Despite this, accountability does seem to have a particularly social quality to it. This is because not only does it concern the way in which an organization relates to its various stakeholders, but also because how and whether it does this is itself intrinsically of social concern. In other words accountability is itself a social value. A rather complex picture therefore emerges, in which accountability relates to all aspects of sustainability, but also has a privileged place in relation to the social dimension. This situation is illustrated in Figure 1.5. Later chapters will identify some of the practical measures that can be taken to improve accountability.

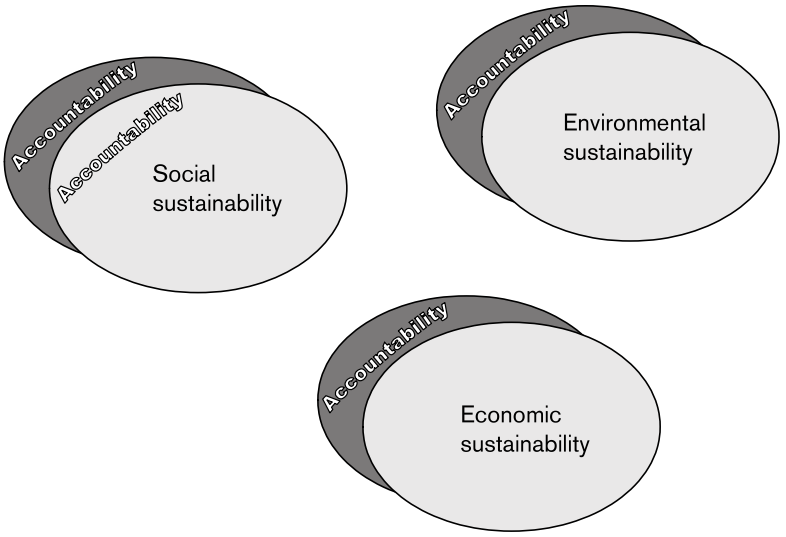


Figure 1.5: *Sustainability and accountability*

Recent developments

Sustainability is more prominent

Over the last five years sustainability has become an increasingly prominent global issue. The 2002 World Summit for Sustainable Development (WSSD) established the Millennium Development Goals covering economic, social and environmental performance. The WSSD also proposed that the public and private sectors should work in partnership in the pursuit of sustainability. The sustainable development approach has therefore come to acknowledge that all organizations from the public, private and voluntary sectors should address the problems of sustainability.

For companies this has manifested largely as a concern for CSR. In practice, it is not possible to separate sustainability from CSR. Despite the ostensible meaning of CSR, it is not confined only to social issues, but encompasses environmental, social and economic matters. One indicator of this trend is the growth in CSR and sustainability reports. The number of such reports has grown from less than 50 in 1992 to about 1,900 in 2005 (CorporateRegister 2006).

Furthermore, an increasing number of these reports have been influenced to some extent by the Global Reporting Initiative (GRI). The GRI aims to raise sustainability reporting to the same level of rigour as financial reporting. It lays out principles that reporters should follow in preparing their reports, together with indicators for each aspect of sustainability.

It also encourages organizations to develop appropriate indictors based on stakeholder consultation. Finally, the GRI has developed a number of sector supplements to provide for the different requirements of different sectors, such as finance and automobile production.

Legislation

Over the last 10 years an increasing number of countries have introduced legislation to require companies to report on their sustainability impacts. This has operated in two ways: one is to require direct reporting of a company's impacts; and the other is to require pensions funds, which own the majority of shares in listed companies in many countries, to report on their approach to sustainability issues.

Denmark, The Netherlands, Sweden, Norway, Belgium and Australia have passed laws requiring (usually public) companies to include sustainability information in their regular reporting or as part of a report to a separate agency. This has usually included only environmental impacts. France, however, in 2002 passed the New Economic Regulations, which require companies to report on each aspect of their triple bottom line (i.e. including social information as well as environmental impacts).

Following the UK legislation in 1995, in 2001 both Australia and Germany passed laws requiring the disclosure by pensions or investor providers to disclose their policies on social and environmental matters.

In the USA, following a number of high-profile corporate failures, the Sarbanes–Oxley Act was passed in 2002, which tightened the regulatory regimen for large companies. It concentrated on the management and disclosure of financial information. This particularly includes financial reporting, but also requires systematic assessment and disclosure of risk in all its aspects.

Labour, outsourcing and the supply chain

The industrial revolution in Europe led not only the modern company form but also to the development of organized labour. Long before CSR, driven by the terrible conditions often suffered by workers, the union movement has worked to protect workers' rights and ensure that companies pay attention to their responsibilities to their staff.

As globalization, through foreign direct investment, brings industrialization to more parts of the world, to some extent this history is repeating itself. As a result of pressure to reduce costs, western companies have increasingly redefined their core business to focus on customer and brand relationships. In consequence it has become possible to contract out other functions to suppliers based in the developing world. While enabling Western companies to take advantage of cheaper labour supplies in the developing world, the price has often been very poor and exploitative labour conditions, which can include excessive hours, unsafe working conditions, pay set below a reasonable living wage and the use of child or prison labour. The public realization in the developed world that goods sold in western countries had been produced under such conditions has often led to serious adverse publicity for the companies involved. Given the extensive global supply chains of the large number of goods needed by all kinds of organizations, the responsibility to avoid the use of such practices can be a problem faced by any sector, whether private, public or voluntary.

It has not always been possible to rely on the local national governments to address these problems. In consequence, in addition to the development of organized labour, a number of voluntary codes involving companies and NGOs have been developed to address them. SA8000 (www.sa-intl.org) was one of the first examples of this approach to CR.

Health

Historically, ill-health, including both acute and chronic conditions, can be linked to poverty. This continues to be the case. The production processes used in manufacturing illustrate one aspect of this. While companies in developed countries may move to safer production processes, those in the developing world may not always be able to do so. Asbestos-related disease, for example, the leading cause of work-related death worldwide, is rising in the developing world, while declining elsewhere.

As new technological and industrial methods of production and modern lifestyles have developed, new health conditions have emerged. One example of this is obesity. While, in one sense, obesity may be the result of individual choices, it must also be acknowledged that it results from the lack of exercise inherent in modern life together with the abundant availability of high-sugar, high-fat foods. The respective responsibilities of individuals, companies and the public sector are currently a matter of active debate.

Other diseases, while they may not result from industrial practices, are so severe in their impact, that all sectors of society are called to address them. Tuberculosis and HIV/AIDS affect the developing world disproportionately. One reason for this is that the available treatments may be too expensive; this is a matter to be addressed principally by pharmaceutical companies and the public sector. In addition, it is now increasingly seen as the responsibility of all companies and other organizations to ensure that they have in place effective HIV policies for the support of their employees. The obvious advantages of such an approach include a healthier and more able workforce.

Meanwhile in the USA, tobacco has become an issue. While still a perfectly legal product, groups of consumers have brought class action suits against the cigarette manufacturers for harm to their health. State authorities have also begun legal actions to recover the costs they have borne due to members of the public harmed by smoking.

Socially responsible investment

Recent years have seen a rise in the quantity of money held in socially responsible investment (SRI) funds. In the French market in 2003, for example, the total assets under management by SRI funds grew from €2.5 billion to €4.4 billion in just one year. In Australia, over the years 2001–2005, SRI managed portfolios grew from AU $305 million to AU $7.67 billion. This has brought additional pressure on companies to review their responsibilities.

A number of stock exchanges around the world have also launched a variety of indices to track the performance of 'ethical' companies. The FTSE group launched the FTSE4Good Index, based on the FTSE Global Equity Index Series. This requires companies to demonstrate that they are working towards environmental sustainability, developing a positive relationship with stakeholders and upholding universal human rights; it also excludes tobacco producers, arms manufacturers and nuclear power.

The Johannesburg Stock Exchange in South Africa launched the JSE SRI Index in 2004, following the second King Report on corporate governance. The JSE SRI encourages companies to take triple bottom line reporting seriously and to balance it with the need for shareholder returns. In December 2005 the São Paolo stock exchange launched a 28-member Corporate Sustainability Index.

Standards development

The number of voluntary standards has also been increasing. Other than the GRI, one of the most prominent of these is the Global Compact, launched by the UN Secretary General in 1999. The Global Compact now has nearly 3,000 participants, including over 2,500 businesses operating in 90 countries around the world. The significance of the Global Compact is that it is active in the developing world (Brazil has 162 participants, for example) and is often the first introduction to sustainability issues for many companies.

Another standard, currently under development is ISO 26000. In June 2004 the first ISO conference to develop a guidance standard for organizational responsibility was convened in Sweden; it is due to be launched in 2008. The standards development process has engaged more than 350 participants from over 60 countries, both developing and developed. The participants include standards bodies and also international organizations such as the WHO and other UN bodies. Given the ISO's status in the corporate world, it is likely to be influential.

The GRI, the Global Compact, and very likely the ISO 26000 standard, will serve to cement the position of key international conventions. These cover human rights and labour standards, in addition to environmental agreements.

Consumer demand

According to the Ethical Consumerism Report 2005 (CoOp 2006) ethical consumption in the UK has grown for the sixth consecutive year to reach £25 billion, with an annual growth rate of 15 per cent from 2003 to 2004 (the latest year for which figures are available). This trend, which is likely to be repeated throughout the developed world, is important as consumer demand is an unanswerable argument for businesses.

What counts as ethical consumption is also important. It can range from organic and Fair Trade products to purchases from charity shops. The largest single item was ethical food, followed by climate offsets, which totalled £3.4 billion in 2004. However, the range is extending continually. One important factor is that consumers are able to distinguish what is 'ethical' in some sense from products that are not. The key to this is labelling. From organic certification, to the Marine and Forest Stewardship Councils' certifications, the importance of such labelling schemes looks set to grow.

Why companies should develop sustainability business strategies

2

How do all the issues of sustainability affect companies and their day-to-day decisions? This chapter explores how sustainability is linked to the corporate agenda. Of course, one possible view is that the market will take care of whatever needs to happen. Markets, however, are made up of the activities of people and companies. So this chapter looks at what sustainability is and how responsible market-oriented business strategies can be developed. It asks 'What is wrong with unsustainability?' and, if it is a problem, 'What has it got to do with companies?'

An important starting point to understanding sustainability is to look at the lack of it as expressed in the environmental, social and economic problems that we face. While this will provide a good perspective, there are problems with this approach. One of these is that the issues can seem so large and overwhelming that it is easy to respond with a fatalistic attitude or become depressed. It is important to challenge this reaction; while essentially individual and psychological in nature, it can directly affect the responses of a company's board or management to the challenge. The values a company adopts can be helpful in this regard.

At the same time, somewhat paradoxically, an alternative reaction can occur. It can seem that, although these problems are real, they are not sufficiently immediate in their impact; action does not seem to be called for now – perhaps we just need further research at the moment.

Although both these reactions are understandable, they lead to the opposite of what needs to happen. If the lack of sustainability is to be addressed, then the response needs to be energetic action, not lethargy. And if we are to take advantage of the fact that the worst has not yet happened, then we need to take action now.

The next few sections set out a few of the main environmental, social and economic challenges we face. The picture painted is not meant to be a systematic or definitive one. In each case, only a few issues have been described. Nevertheless, the issues selected are certainly very significant ones for sustainability.

Following the snapshot in this chapter of 'unsustainability', it is important for companies to ask 'What is my responsibility?' Later sections address the practical issues of how to define clearly what responsibilities companies can and do take, and the pressures on them to do so.

Environmental issues

The scope and scale of environmental issues is vast. Important environmental issues include:

- degradation of land and climate, making it less amenable to agriculture and habitation;
- forest and habitat loss, leading to lower biodiversity;
- pressures from human population growth;
- pollution to water, land and air, including waste disposal, land contamination, degradation of marine and freshwater resources, and air pollution.

Pollution, as a result of man's activities, is a key issue affecting the land, sea and air (useful reference material on this issue may be obtained from the United Nations Environment Programme, www.unep.org). Air pollution is now experienced on most continents of the world. However, it is currently considered the priority environmental issue in eastern Europe. The effects of air pollution include:

- impacts on human health of poor air – in some major cities, such as Tokyo, traffic police are routinely issued with oxygen masks; air pollution has been linked with a rise in the number of cases of asthma cases in children and the accelerated decay of ancient monuments (e.g. in Greece);
- acid rain, affecting wildlife over a wide area;
- damage to the ozone layer – the ozone layer is a part of the atmosphere, existing at high altitude, which screens out some of the sun's ultraviolet radiation. When this layer is damaged, ultraviolet light is not filtered out and this results in damage to wildlife and increased numbers of cancers in humans.
- smell.

A great variety of chemicals in the air are responsible for air pollution. They include oxides of nitrogen and sulphur, and particulates from the burning of fossil fuels, including from

car use. These chemicals are produced from the burning of fossil fuels for heating, lighting, power generation and transport.

Global warming, which appears to be the result of carbon dioxide production and certain forms of air pollution, is perhaps the most significant single environmental issue (useful reference material on this issue may be obtained from the US Environmental Protection Agency, www.epa.org). The Intergovernmental Panel on Climate Change (IPPC), a large, international group of scientists, has overwhelmingly accepted that global warming is a reality and that human activities have had a major role in producing it. What is at issue is how fast the warming will occur and what the impacts will be. One common estimate is that the average global temperature will rise by an average of 0.02°C each year, although recently the estimates of the future rate of temperature change have been revised sharply upwards.

Global warming is caused by changes to the properties of the atmosphere. In turn these are caused by the release into the atmosphere of 'greenhouse gases' (i.e. gases that cause global warming). These include a range of compounds including those that can be used to manufacture refrigerators. However, the most important, by virtue of the volume in which it is produced, is carbon dioxide. Carbon dioxide is produced by almost all living things and also by burning carbon-based matter, including coal and oil. Perhaps 80 per cent of carbon dioxide is produced by the industrialized countries. At current rates of production, carbon dioxide is being produced far faster than the Earth's systems can absorb it. Global warming is probably the central problem for industrial society, particularly since its removal requires dramatically changing the fundamental way in which energy is generated and used.

The impact of global warming is likely to include:

- greater volatility of weather patterns – there is evidence that the Gulf Stream, which has stabilized the temperature of north-western Europe, including the UK, is under threat;
- changes in wildlife and viable crop plants, for a given location;
- rising sea levels.

The likelihood of rising sea levels appears to be confirmed by phenomena including the disintegration of the sea ice shelves off Antarctica, the melting of the Arctic ice cap and the shrinkage of Himalayan and Alpine glaciers. Rising sea levels are likely to submerge

large parts of East Anglia, the wharves of Manhattan and whole island states in the Pacific (Vernon 2001).

Social issues

Social issues are as varied and widespread as environmental issues. And just as environmental issues are particularly affected by location, social issues are very sensitive to culture and social circumstances. Social issues include:

- poverty and inequality;
- systematic abuses of power, including corruption and prejudice against people on account of race, age, sex, religion or other factors;
- denial of human rights, including exploitation of children, slavery and forced labour;
- the breakdown of basic social structures, such as the family in Asia, South America, the USA and Europe.

Inequality is huge on almost any measure (useful reference material on this issue may be obtained from the United Nations Development Programme, www.undp.org). Here are a few facts:

- the richest 20% of the world accounted for 86% of global gross domestic product (GDP) in 1997;
- the richest 20% of the world enjoyed 68% of foreign direct investment in 1997;
- the top three richest people in the world have the same amount of wealth as the poorest 600 million.

Furthermore, the problem is growing; the 200 richest people in the world doubled their wealth between 1995 and 1998. While many people have to manage on a dollar a day all year round, some receive a Christmas bonus of £24 million.

The problem of inequality is not only a moral one. It also engenders social instability and unrest. When the overall picture includes not only increasing inequality between nations but also within them, as is the case across the world from the USA to China, then the prospects for social stability seem bleak.

Perhaps the most extreme form of inequality is slavery. Slavery occurs where traditional social structures have been destroyed and people can be forced into work, often to supply

western companies with food or clothing. It has been claimed that there are now more slaves in the world than at any time in history (Bales 1999).

Economic issues

Over the last 50 years, the global economy has grown by a factor of six, as measured by GDP alone. Each day over US $1.5 trillion is traded on the world's currency markets, and about 20% of all goods produced are sold abroad. Yet while the world economy is now characterized by globalization, new technologies and far greater interconnectedness of national economies, it has not produced a climate within which it is any easier for companies to work. The combination of all these factors has led above all to unpredictability in business life and volatility in individual markets.

As the scale of markets grows and the ease with which capital can flow increases, the consequences of marginal change in the market become more critical for individuals and nations. For a market of global scale, a change that is minor at a global level, perhaps a fall in the price of wheat, can be catastrophic at a local level (i.e. the level at which people live).

The collapse of the Thai currency in 1996–1997 caused the collapse of the economies in much of south-east Asia. Within a year the net inflow of capital to the region of US $93 billion had changed to a net outflow of US $12 billion. Over 13 million people lost their jobs.

More recently, new technology stocks have rocked the world's stock markets. First these rose precipitously, and then dropped just as dramatically. Investment and company management in these conditions is fraught with danger. Pressures on more traditional (or just out of fashion) companies and sectors can become arbitrarily harder as capital follows the fashionable stocks.

Accompanying globalization, there has been an increase in the concentration of wealth. This is an economic issue, as well as one of the manifestations of social inequality, discussed earlier. The growing concentration of wealth has meant that small retailers, producers and farmers are being driven out of business as larger companies increase their market share and monopolize town centres. This is an important aspect of a continuing change in the structure of the world's economies, which can make national economies more vulnerable to fluctuations in the global economy.

What of the future?

This chapter has so far presented a snapshot of current trends. It is the forecaster's favourite occupation to suppose that if current trends continue then all sorts of absurd consequences will follow, such as that every adult in the world will have 10 mobile phones by a particular date. For all sorts of practical reasons, we cannot simply extrapolate the types of trend set out so far. Each trend depends on its own specific and complex set of circumstances, and each one is dependent on at least some of the others. It is therefore usually wrong to predict that the future will just be more of the same, or an exacerbation of current conditions.

So what can we realistically expect? What can be useful when dealing with such complexities is to imagine scenarios that are perspectives coherent within themselves and which are at least consistent with an analysis of current trends. Here are three (for others see the World Business Council for Sustainable Development (www.wbcsd.org) and the DTI (www.foresight.gov.uk)):

- *The optimist's scenario* – 'Look, I know things have not been going too well, but surely the rate at which things are getting worse is going down. It has been proved that the industrialized countries produce less pollution than those which are climbing the development curve. Surely what we have to do is help them develop economically as fast as possible?'
- *The pessimist's scenario* – 'We are all about to fall off a cliff. Our ecosystems, that support our life, are on the point of failing. The most urgent possible action is necessary if we are to survive *at all*, and for human beings, never mind furry animals!'
- *The depressive's scenario* – 'The lures of business as usual will always be too compelling, and the slope of the pessimist's cliff will never seem too steep to venture down. We are in for gradual decay and degradation of all aspects of the quality of our life. A picture of life in 50 years time might seem frightful. But tomorrow will always be just about bearable.'

Which scenario is right? It is not possible to know. If the optimist's scenario is right, then this book may seem redundant. However, as set out in later chapters, those who run their businesses according to that scenario are likely to lose out on the opportunities that moving to a more sustainable future can afford. However, the action from companies demanded in the last two is similar, and this too is set out in the rest of this book.

What is clear is that, as a whole, the corporate sector has tremendous, and growing, power and responsibility. It remains the responsibility of individual companies to use that power wisely. This means not only pursuing the sort of management approach outlined in later chapters, but also using their influence at national and international levels to ensure that sustainability is addressed as vigorously as possible. Any overall judgement as to the sustainability of a company's activities must rely in part on the extent to which it is using its influence to ensure that government policy or international conventions move in the right direction.

What is sustainability? 3

Defining sustainability

This chapter looks at the opposite side of the equation, i.e. at sustainability itself. Trying to define sustainability may appear rather theoretical, yet 'What is sustainability?' is a question often asked by those who are themselves being asked to invest money in the idea.

The most often quoted definition is that given in the Brundtland Report:

> "*sustainable development … meets the needs of the present, without compromising the ability of future generations to meet theirs.*"
>
> World Commission on Environment and Development (1987)

This is a very good definition. It has been acknowledged by many companies, such as Carillion (2000). It is also one with which it is hard to disagree. However, it is just as difficult to understand what it might mean in practice. While the definition sets out a vision, it offers no guide to the realization of that vision. Since 1987 there have been hundreds of redefinitions of sustainability, and there is still no agreed definition. This is because it is both a highly valued and a hotly contested term. A great deal hangs on the definition: not only the well-being of the world's people and the environment in the long term, but also the daily activities of a great many businesses in the shorter term. It is therefore worth taking some care over what sustainability means, if only to reassure ourselves that whatever actions companies take to move towards sustainability have a firm and justifiable foundation.

First of all, it is useful to point out that sustainability does not mean the same thing as 'sustainable development'. Sustainable development was a term originally directed at the viability of developed country aid programmes for the less developed countries. Concern about sustainable development arose, at least in part, from disastrous development programmes, in which inappropriate economic infrastructure development projects for less industrialized (southern) countries were tied to western aid. Large projects such as dams were, and still are, built regardless of their impact on the environment, people's

livelihoods or their communities. Such concerns are still obviously a critical aspect of sustainability.

Sustainability, as well as being used to mean 'being sustainable', has also been applied particularly to activity in developed countries. Some suggest that the origin of the term sustainability was the Brundtland definition; if so, then clearly sustainable development came first historically. In any case, concern about sustainability in the West probably has its origins in the pollution experienced in the developed (western) world, as first pointed out in Rachel Carson's book *Silent Spring* (Carson 1991). This alerted the world in a dramatic fashion to the devastating consequences of the use of pesticides and other chemicals.

However, as the pace of change in the developed world increases to match that which development programmes tried to impose on the developing world, it is increasingly recognized that sustainable development is as much an issue for the West as sustainability is for the South.

What further links both ideas, is the time dimension – the idea implicit in the Brundtland definition that unsustainable activities 'cannot go on', from either a practical or a moral point of view. Now, a 'sustainability perspective' is being extended to almost every human activity – from companies and countries to lifestyles, food production and technologies. As a result, sustainability has become the subject of intense and confusing debate at many levels of society in many countries, and the definitions of sustainability are correspondingly many and varied. Two examples are given below.

> "*Sustainability is the capability of an organization (or society) to continue its activities indefinitely, having taken due account of its impact on economic, social and environmental capitals.*"
>
> Association of Chartered Certified Accountants (1997)

> "*Sustainability is a dynamic process which enables all people to realize their potential and to improve their quality of life in ways which simultaneously protect and enhance the Earth's life support systems.*"
>
> Forum for the Future

Another insight is given by the very intuitive idea of the 'triple bottom line', which was suggested originally by John Elkington of Sustainability Ltd (Elkington 1997, Henriques 2004). This works by establishing the three dimensions – social, environmental and

financial – as of comparable status in their own right, and crucially also as legitimate aspects of management attention for companies in working towards sustainability.

Part of the confusion results from the fact that different people have different problems in mind when developing their definition. For some, the problem is to define sustainability in the abstract. This is a key question, but one which for companies needs also to be answered in very practical terms. For others it is the nature of a sustainable world that is at issue. From this perspective questions of a political nature arise, which require continuing debate, such as:

- the approach to developing new technologies and the applicability of the precautionary principle, which suggests that new technologies should be proved safe before use, rather than discontinued after being proved unsafe;
- the extent to which localization should balance globalization;
- the kinds of consumer lifestyle that are possible in a sustainable world.

Another source of confusion over what sustainability is arises from answering these practical questions about a sustainable world in different ways. This is a direct reflection of the diversity implicit in the Brundtland definition, which talks about 'meeting needs'. So, what can be drawn from these interesting and overlapping but, in the end, different views? One implication is that there are not just different views of sustainability, but that, in an important sense, while strictly speaking sustainability is a property of the world as a whole,there are different sustainabilities for different groups or organizations. In other words, sustainability is one thing for a consumer and a different thing for a non-governmental organization (NGO). Again, sustainability for a multinational is different to sustainability for a small business. So the vision of each organization as to how it will become and maintain its sustainability may be different to that of any other. While there may be a single sustainability for the world system as a whole, perhaps diversity can be celebrated at the level of organizations themselves. The role of a particular company in relation to sustainability can be quite specific.

The question for a specific company, then becomes 'What is my sustainability?' As a result, companies are developing what is, in effect, their own vision for their sustainability. Of course this does not mean that a company should decide what its sustainability means in isolation. The development of a vision of sustainability is a task that requires a rich involvement of its stakeholders.

Again, what this does not mean is that, say, carbon dioxide production is not important for a small business, but vital to a large one – clearly global warming is sensitive to the total

quantity of carbon dioxide in the atmosphere, but indifferent to its source. There is still a real need to account for impact – and there is still much debate as to how this can best be done. Measuring impacts must go hand in hand with developing a vision.

Despite this complexity, a number of themes emerge from among the various definitions:

- recognition of the environmental, social and economic dimensions of human activities – these three dimensions are a way to understand what 'need', as articulated in the Brundtland definition, can mean;
- the importance of the *viability*, or *continuity over time* of human activities (i.e. the ability to continue the activities on an indefinite basis) – time may, in this sense, be regarded as the fourth dimension of sustainability.

Part II of this book therefore works particularly with a four-dimensional concept of relative sustainability, focusing on the systems, tools, indicators and techniques useful to companies in ensuring continual improvement and achieving long-term survival, as well as what to consider in constructing the business case. The most basic requirement is that in the end it is possible to recognize practical activity by companies that move them in the direction of greater sustainability. The remainder of this chapter looks at the first three dimensions critically, exploring particularly how they are related to each other. We will see that each dimension blends into the others.

However, such an approach has one important drawback. A great deal depends on the rate at which a company is moving towards sustainability. If carbon dioxide levels are increasing at twice the rate that companies and other organizations are reducing their output, then their effort will be in vain. For this reason, it is always dangerous to be complacent about the extent of corporate sustainability that has been achieved. It is still important to know what is sustainable in some 'absolute' sense. At the end of this chapter, therefore, two approaches to describing absolute sustainability are explored.

The environmental dimension

What is 'the environment'? Interestingly, the term 'environmental' itself is very difficult to define. It often appears that the concept of sustainability is essentially environmental, and

for many, the term seems intuitively obvious, yet in other languages, such as German, there is no simple equivalent of the term in English.

The term 'environment' includes the living and non-living world, and environmental issues range from biodiversity to natural resource availability. It excludes what might have been termed the 'social environment' and the 'economic environment'. In terms of corporate impact, the key elements are often taken to be:

- energy use;
- materials use;
- water use;
- pollution and waste;
- product impacts;
- impact on land.

It is not uncommon today for 'environmental evaluations' to include the impact on scenery, archaeological sites and local communities, as well as pollution and resource use. For example, in a report prepared in the UK for the Environment Agency (1997), the Countryside Commission, English Nature and English Heritage, there are some surprising elements of the environment. Alongside the more obvious features, such as animal and plant habitats and the quality of the air, waters and land, the list of features provided as a guide also includes:

- archaeological remains;
- vernacular buildings;
- historic villages;
- listed buildings;
- townscapes.

Clearly buildings are social constructions as well as physical ones. Yet, in addition to that, for some environmental groups there is an acknowledgement that sustainability has irreducible social elements. The most common way in which the social is linked to the environmental is as a condition for achieving environmental improvements; for example, because in the absence of social equity environmental concerns will be ignored in the struggle for social justice. This perspective is now one shared by Friends of the Earth:

> "*inequitable distribution of control over resources can be a driving force for local and wider environmental degradation.*"
>
> McLaren et al (1998)

The social dimension

What is the social dimension of sustainability? The social may be defined in terms of society, which in general, is the system of interrelationships connecting people together. From the perspective of an individual organization, society may most practically be thought of as the totality of its relations with its stakeholders. A stakeholder, in turn, may be defined as an organization, individual or set of people which either affects, or is affected by, the company. Almost all companies have the following stakeholders in common:

- shareholders;
- customers;
- staff;
- suppliers;
- local communities.

Stakeholders typically include pressure groups concerned with social or environmental issues. Beyond this generic list, companies may have additional stakeholders of two types: (i) subsets of the stakeholders identified in the generic list, and (ii) additional stakeholders not contained in the generic list. For example, the stakeholders of one company might include other companies within the same group, business partners, overseas suppliers and local suppliers as distinct categories within the overall supplier stakeholder group. The issues for each sub-stakeholder may be very different. Another company may, in addition to the list above, have to count the media as a key stakeholder.

To define the main elements of social impact for a given stakeholder is even more challenging than to define environmental impact. This is because what matters is what matters to stakeholders – and, more broadly, what matters is what is significant for a particular society. Fashions taken for granted in the west, for example, can be regarded as blasphemous in Islamic cultures.

At a very high level, there is some consensus over the key aspects of social impact in some areas embodied in United Nations (UN) conventions. These can be thought of as a global baseline, although very much focused on labour conditions and child welfare. Bearing this in mind, the key elements, relating to the workforce include:

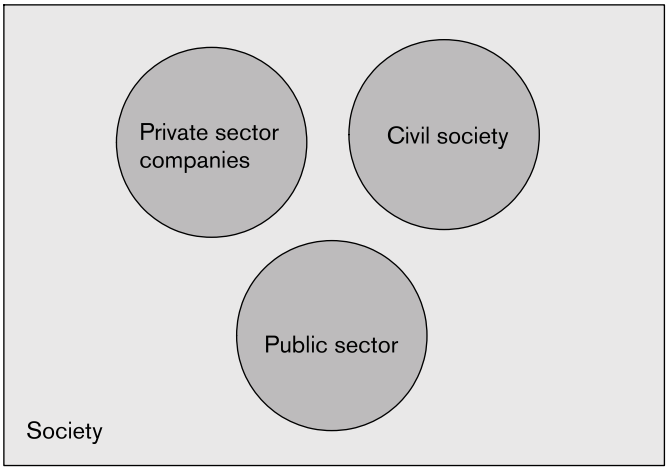


Figure 3.1: *Civil society in relation to society as a whole*

- health and safety conditions;
- discrimination;
- forced and child labour;
- freedom of association;
- community rights.

In the context of sustainability, the term 'civil society' is very often used. Civil society does not have a fixed meaning. One usage is to equate it with NGOs. However, NGO is itself a term with a very varied use. It was originally used by the UN to mean any non-governmental organization (e.g. companies, aid organizations and international agencies). More recently it has come to mean voluntary and campaigning organizations.

Currently perhaps the most common usage of the term 'civil society' is to understand it to include informal groups and movements and voluntary organizations of all kinds (Henriques 2001). Thus NGOs, unions, spontaneous movements, religious organizations, local clubs and associations are all part of civil society. In this sense, then, civil society is often presented in relation to society as a whole as one of three key groupings, as illustrated in Figure 3.1.

The economic dimension

The usual definition of 'economics' is that it is the study of how to use scarce resources efficiently. The resources in question are usually capital (goods, such as machinery and

money), land and labour. The basic measure of such efficiency is usually expressed in financial terms. Thus, in practice, the term 'economic' is used both to mean 'cost-effective' in the financial sense and also to refer to impacts on the wider domains of land, labour and capital.

However, the view that the economy is simply the way in which we organize to produce social and environmental effects (British Telecommunications 2000), while technically true, does not fully capture the way the economy interacts with the social and environmental dimensions. Economic impacts (i.e. impacts on the economy) can be described in their own right and have direct consequences for sustainability. For example, the length of supply chains is an important aspect of economic structure that will have a direct bearing on the vulnerability of the economies in which the bulk of the chain lies. If a poor country relies for its employment on the manufacture of fashion articles for North America, then when the fashion changes, their economies can be damaged.

So it seems that the economic dimension of sustainability is not well understood. This is strange because both financial accounting and economic analysis have a lengthy history, and, as we have seen, the idea that the financial is a component of the triple bottom line has ensured that sustainability in business terms is taken to mean, amongst other things, the continued financial viability of a company.

Of course, the financial results of a company are an important part of its economic impact. But they are far from all of it. A company's impacts include:

- how its goods and services are used in other economic activities;
- the consequences of its investment, both in terms of consequent spending effects and also the development of new technologies and products;
- purchasing impacts;
- employment effects, both in terms of spending and also the development of skills.

In trying to measure economic impacts, it is useful to bear in mind that some indicators are lagging (in the sense that they measure historical impact) and others are leading (in that they point to future impact), while others still are more current in their effects (Figure 3.2).

What about the question of growth? For some, economic growth is the whole point of economic activity; for others it is the root cause of the lack of sustainability. Today it is very difficult to question the need for growth, since growth has been the objective of

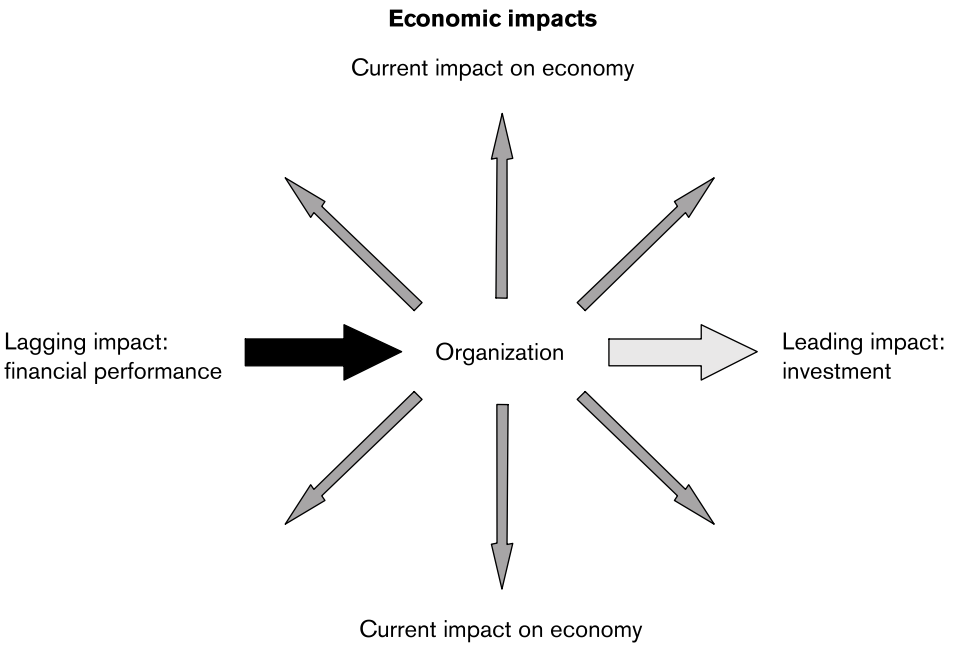


Figure 3.2: *Lagging and leading indicators of economic impacts*

government policy for perhaps a century, and it is now built into the fabric of regulation, legislation and the economic structure generally. Nevertheless, it has occasionally been questioned, and alternative models proposed (Douthwaite 1992). However, this issue takes us squarely into a realm beyond individual companies and organizations. At the moment, it is a given for a company that survival requires growth. What can still be questioned is the nature of that growth, and what the result for sustainability will be.

Real life is in three dimensions

Real human activity extends in all three dimensions of sustainability. Just as it is impossible to find an object in the real world that exists in only one or two dimensions of space, it is hard to think of an activity that does not have some kind of environmental *and* social *and* economic impact. How then do the three dimensions relate to one another?

The three dimensions of sustainability are often pictured as three circles that interlock with one another (Figure 3.3). In this image, sustainability is represented as the centre towards which the forces of sustainability management are pushing. One way to understand what this can mean in practice is to look at the interfaces between the three dimensions in order to bring to the surface issues of sustainability.

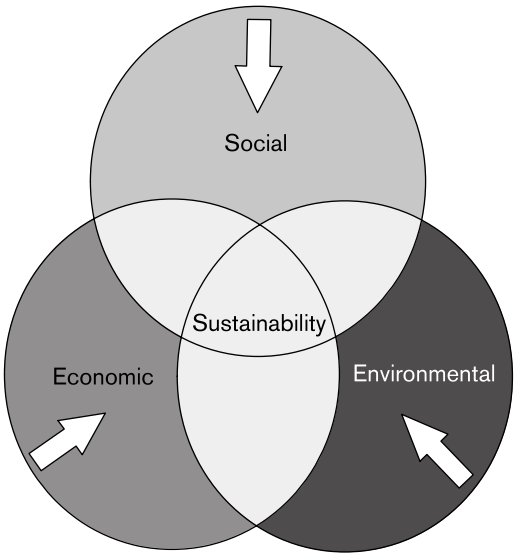


Figure 3.3: *The three interlocking dimensions of sustainability*

The interaction of the environmental and economic dimensions can be questioned from two perspectives. From the economic side, the issue is about the efficiency with which environmental resources are being used. Often summarized as 'eco-efficiency', this approach has been championed by the World Business Council for Sustainable Development. It is clear that there are significant business benefits to reducing resource use and the consequent cost reductions.

However, from the environmental side there are further questions. For example, are there markets that are inherently unsustainable? How can the extractive industries, including oil and metal mining, however efficient, ever be sustainable? How can environmental impacts and liabilities be properly accounted for?

The environmental/social interface again has two perspectives. From the social side, the distribution of the benefits and costs associated with environmental impacts may be questioned. Despite articulate concern about environmental issues in the developed countries, it is clear that the major impact of environmental destruction often falls on countries in the South. For example, as noted above, the effects of global warming will destroy some island nations in the Pacific Ocean. Yet perhaps the key question here is about intergenerational equity: What kind of environment will be left to future generations?

From the environmental side, there are questions about how the nature of our society affects the environment. It is clear that many traditional, low-technology societies had no net impact on the environment. Yet western society appears to be keen to retain lifestyles,

such as tourism, which have clear negative impacts on the environment, for example through air travel and the destruction of natural habitats to build resorts.

The economic/social interface also has two perspectives. The economic contribution to society is one with which most businesses feel comfortable. Business generates wealth, provides employment and produces goods and services that, to a degree, people do need. To the extent that business now provides social services directly, as is increasingly the case with social welfare provision, business disciplines can ensure that they are provided efficiently.

From the social side, while the principle of business contribution may be accepted, there are questions about the detail: Who benefits from the generation of wealth? How exactly is it distributed? There are also wider questions concerning the ethics of business practice: How ethically is business conducted? How fair are the terms of trade?

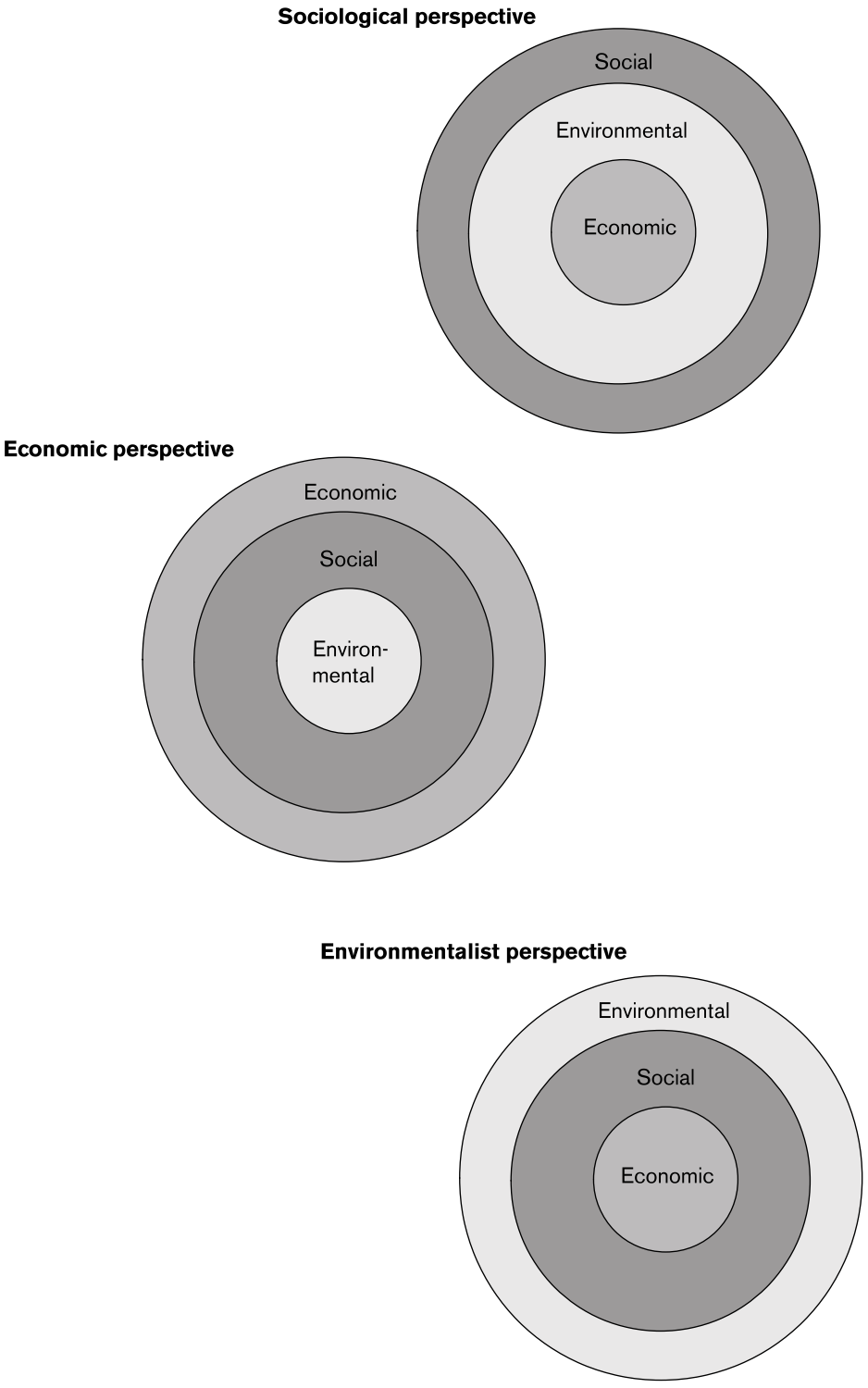
Bringing it all together

Beyond being a fertile source of issues about sustainability, how can we make sense of such complicated interactions? It would be helpful if it were possible to show that the three dimensions are all aspects of one thing – preferably one of the dimensions. The difficulty with this view is that, although the three dimensions are not actually as distinct as they are sometimes portrayed, neither are they reducible to a single underlying theme.

Yet the temptation is there, so it is not surprising to find that, in some accounts, the three dimensions of sustainability are seen as nested inside each other. It is as if the social were simply part of the economic or the economic just part of the environment, and so on. In this view, a number of different possibilities emerge, which tend not only to explain one dimension in terms of another, but also to prioritize them in the same way. With a certain amount of licence, it is possible to characterize three main perspectives in this way, as illustrated in Figure 3.4. (There are clearly three further variations beyond the ones pictured. However, the nature of the outermost, most fundamental dimension is the most important characteristic.)

From the environmental perspective, the environment is regarded as the most fundamental dimension. It sustains us and is the matrix out of which society emerges and on which

Figure 3.4: *The three dimensions of sustainability nested within one another: the three main perspectives*



we depend. Similarly, the economic system we have created is a social phenomenon, and so it too is ultimately dependent on the environment:

> "*if the environment doesn't work, nothing else – not the schools, not the health care system, not the economy – can work … restoring the environment cannot be done through compromise.*"
>
> Donella Meadows, *The Guardian*, August 2000

From the sociological perspective, society is the primary factor. The economy is clearly a sociological construction, as for the environmental view, but so is (at least our view of) the environment. How we perceive the environment and the importance we attach to it are sociologically determined. The regard that Native American Indians held for their environment, for example, was part of their culture.

The economist's perspective suggests that the economy determines our social relationships. It also argues that the economy affects key aspects of the environment. It is generally accepted that if economic transactions bore the full cost of all their impacts (i.e. all 'externalities' were internalized) then the market alone might be much nearer to ensuring that all economic activity were sustainable. From this perspective, working with social and environmental impacts, in particular, is an attempt to substitute non-financial measures for impacts that have no readily determined price.

In some ways this is the most radical perspective, as it takes the logic of the marketplace to its conclusion. Paradoxically, as noted above, it also seems the hardest to realize, since the changes required of the current market system are obviously so vast. Nevertheless, the idea of carbon trading, which is about capturing some of the cost of carbon emissions, is now being pioneered by companies such as BP Amoco, the UK government and the European Union. In a much weaker sense, this perspective underlies the many attempts so far to manage sustainability more systematically (see Part II: Getting it done).

A matter of balance

Assuming that the social and economic dimensions are a part of sustainability alongside environmental considerations, what is the relative importance of each of them? And does it vary from issue to issue? Clearly this is not (only) meant to raise philosophical questions, but is also important in trying to find the correct way to make a decision that will have impacts in all three dimensions. For example, in building a bridge, how can cost

considerations be balanced against the environmental impacts of different construction materials? Box 3.1 shows how BT has thought about the trade-offs involved in the increasing acceptance of telecommunications.

Box 3.1: *Trade-offs involved in the increasing acceptance of telecommunications (British Telecommunications plc)*

Positive

Environmental

- Teleconferencing enables meetings without travel
- E-commerce can eliminate shopping journeys
- Flexible working negates the need for commuter travel
- IT and telecommunications enables transactions and information transference without paperwork
- De-materialization of some equipment by IT

Economic

- Flexible working can provide financial savings in rent and business rates
- Flexible workers are generally more productive
- Opportunities for small businesses to sell goods and services globally
- Tele-medicine should mean that health authorities spend less money on administration and more on healthcare

Social

- Home working provides more work opportunities for people living in remote communities, for parents with young children and for those with disabilities
- Tele-medicine should provide opportunities for faster consultation and diagnosis
- The Internet provides access to a limitless library for learning and opportunities for collaboration between different schools and institutions
- Telecommunications can bring new opportunities to our democracies and make governments more open and accountable
- Community networks can re-energize local communities
- Tele-care should enable some elderly people to be looked after in their own home so they can retain their independence but get help when required

Negative

Environmental

- Teleconferencing could also inspire travel
- Flexible workers may undertake more social journeys to counter feelings of isolation
- Printing-off of e-mails and Internet pages. Increased use of computers counteracting energy savings
- Problem of disposal of some IT equipment at the end of its life

Economic

- Initial capital investment in equipment
- Difficulty for small enterprises to continuously update software to keep up with technology
- Significant investment required, particularly for NHS-wide applications

Social

- Difficulties in separating work and social life
- Loss of doctor–patient relationship
- Children may be able to access material of a sexually explicit or controversial nature
- Inequality of access would lead to the information rich and the information poor
- Individuals could suffer a loss of personal liberties as information on them is built up and stored
- IT may mean that people do not relate to their local neighbourhood as much
- People may feel as if they are being 'watched'

In one sense, much of human activity is a trade-off between one dimension of sustainability and another. Mining metals out of the ground will deplete natural reserves, but enable people to build bridges. The labour of planting a forest may increase the potential for recreation and enhance the environment. Going to work has social costs (and benefits), but it pays the bills.

This raises the important question of how far sustainability may be achieved in one dimension alone. Is it possible to be environmentally sustainable, while being a social disaster? Is it possible to be economically sustainable, while bringing about an environmental catastrophe? And is it possible to be socially sustainable while being economically incompetent or environmentally impoverished? In the complex debate about sustainability, there have probably been advocates of all these positions, as well as other possibilities.

However, there are several reasons for doubting that you can be sustainable in one dimension alone. First, it seems intuitively unlikely that:

- economic stability is possible in the face of social unrest or environmental failure;
- social stability is possible in the face of economic or environmental failure;
- environmental stability is possible, given social or economic volatility.

Secondly, and more importantly, the various dimensions of sustainability are not independent of one another, as noted above. This is not only because affluence may change attitudes to the environment or good natural amenities may increase a sense of well-being, but also because the dimensions are merely different aspects of the same activities. BP Amoco might think of itself as a *chemical* engineering company. However, it is also a *social* engineering company – e.g. in its handling of staff and in its impact on local communities.

This brings us back to the original question about trade-offs. The key issues are:

- How much trading off is acceptable to maintain sustainability?
- Who decides whether it is acceptable?

One answer to the second question is that the market will decide via the price mechanism. This is the position of traditional economists. The problem with it is that, until recently, the price mechanism *has* been the chief means to make such decisions, and we are not nearer sustainability as a result. As we have seen, the market mechanism might be left to decide such things if there were no externalities unaccounted for (i.e. if the full cost of

ozone depletion and all other environmental and social effects were taken into account). As this is never the case, other means must be found.

In practice it is unlikely to be possible to find a general answer to the question – unless it is the 'hard sustainability' position, which is that no compromise of one dimension for another is permitted at all. Yet while this may be theoretically elegant, it is difficult to see how it could be put into practice: given we start from a place in which much economic activity is environmentally damaging, in the short term it will be necessary to look for activities that are better than current ones, even if not 'perfect'.

If there is no general answer, then practical decisions must be made continually. Clearly one decision that is easy to make is to pursue a course that benefits, say, both the environment and society as well as making money. This is a win–win situation (or, more correctly, a win–win–win situation). However, these decisions will not be found everywhere. Where there is a choice to be made, the most robust way in which to find an answer is to work with the stakeholders. This does not mean that the stakeholders will always agree with each other, or never change their minds, but it does mean that all parties are as aware as possible of the implications of such decisions. This is a key element of corporate accountability.

Absolute sustainability

So far, much of this chapter has worked with a concept of relative sustainability – i.e. it is important to know what is more sustainable and what is less so, and to manage environmental, social and economic impacts accordingly. However, there are problems with this approach, as it is difficult to know whether a given company is being sustainable *enough*:

- it requires national and international coordination to ensure that the total activity of all organizations is sustainable – this is currently weak at the national level and weaker still at an international level;
- it embodies no sense of the limits of natural or social systems, and therefore critical limits (e.g. for the maintenance of biodiversity) may be breached without any warning.

It also suggests that losses in one dimension may be set off against gains in another. For example, some net environmental damage may be acceptable for social gain. This is known as 'weak sustainability', in contrast to 'strong sustainability', which will allow no such trade-offs.

The problem with the weak/strong analysis is that it assumes that the dimensions of sustainability are independent of each other. As we have seen they are not. Therefore, a loss in one dimension is likely also to be a loss in the others. This may be seen perhaps where workers are made redundant to save costs during an economic downturn. In this case perhaps the workers' skills may degrade, and this may lead to more difficult recruitment when the upturn comes. And, of course, the reverse is also true. A social or environmental gain should also be an economic one.

In this sense there is no escaping from the consequences of our actions. The problem becomes one of how to discover all the business benefits, and costs, of action for sustainability, while working with a rigorous test of what it actually means, even if it is not possible to identify every consequence of company action. The remainder of this chapter looks at two approaches to absolute sustainability: capital and system conditions.

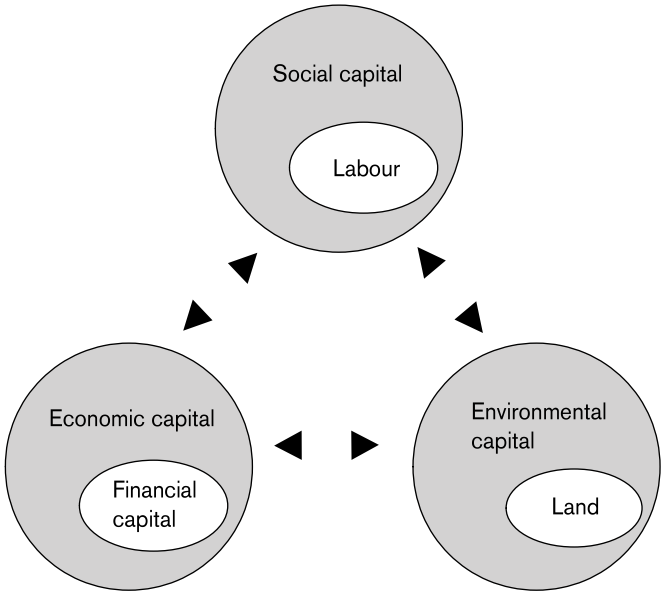
Working with capital

The word 'capital' encourages thinking about investment. This is no less true for environmental and social capital than it is for financial capital. Hawken and Lovins (1999) have made the concept of natural capital, and the advantage of investing in it, well known. Before that, Ekins (1992) had developed the ideas of eco-capital, human capital and organizational capital. Similarly, the idea of social capital is receiving new attention. How does the concept of capital help with sustainability?

The first thing to realize is that, in fact, the concepts of environmental and social capitals are nothing new. Classical economics developed the idea that there are three factors of production – land, labour and capital (as ordinarily understood). Classical economics has focused very much on 'capital' in the manufactured and financial senses. While it has not entirely ignored land or labour, it has not taken full account of the scarcity of these resources and the factors in their production. In essence sustainability simply recognizes that land, understood broadly to include the natural environment and labour, again understood more broadly to include all of society, are scarce resources. It follows that they are valuable and, theoretically, can be priced into the market.

It is important also to recognize that, from an organizational point of view, capital is something that does not belong to the organization, but is under its stewardship. This is as true of environmental or social capital as it is of shareholder capital (Figure 3.5). While the

Figure 3.5: *Sustainability and economics*



concept of 'ownership' of environmental or social capital is clearly not often legally supported, it is clear that not only is there at least a moral case to husband environmental and social resources properly, but there is also a duty to account for that stewardship.

This approach suggests that there could be a significant restructuring of the balance sheet for companies, to recognize and account for environmental and social, as well as economic capital. While far from fully developed, some companies have explored this idea by expanding their financial balance sheets to take into account impacts on natural capital, although there is as yet no agreed way to prepare such accounts. Nevertheless, it is interesting to reflect that proven oil reserves, for example, would normally be represented as assets in financial accounts. However, while the rights to the land in question may be treated as assets, the actual land itself, including its oil, is environmental capital, and therefore a potential liability. If a company is using that capital, what assets could represent it in the environmental accounts? And as the oil is depleted, what environmental improvement is set against it?

Quite apart from accounting, to think in terms of capital points to a number of opportunities for business. As the scarcity of environmental and social capital is realized, there will be direct financial returns to those who can make good use of them. This can be seen from looking at the way social capital has been written about.

Social capital has been written about in a number of rather different ways (MacGillivray and Walker 2000). Social capital is here taken to include all of the following:

- human capital;
- community or social capital;
- intellectual capital.

Human capital is usually taken to mean the skills and capacities of individuals. In relation to companies, it corresponds quite directly to the value of staff to the company. In industries such as IT, for example, it is particularly important that staff knowledge is kept up to date. This intellectual, or human, capital is important for the company to maintain, even though the knowledge of its staff does not 'belong' to the company.

Similarly, the network of relationships with suppliers, shareholders, staff and local communities upon which companies depend forms part of the social capital with which it is working. The value of such capital can be seen from the reaction to companies that are seen to abuse this trust. The campaigning effort against the clothing manufacturer The Gap, based on concern for labour standards in its supply chain, for example, shows what happens when the network of social relationships starts to unravel.

In the context of sustainability, the concept of economic capital has not been well articulated. Economic capital is, of course, more than financial and manufactured capital, which are both very familiar to companies. Economic capital needs to be understood more broadly to include also those economic resources upon which companies depend to trade – other than environmental and social capital. There has been much work on the structure of the broader economy, but less on the way in which individual companies may understand their interaction with it in this sense. One such key resource is clearly the structure and stability of the economy itself. Examples include:

- the regulatory regime that may apply to a company;
- the technological sophistication of the economy;
- the infrastructure available to a company;
- the extent to which supply chains and demand chains extend beyond the local economy.

In summary, the definition and measurement of sustainability in terms of capital is not well understood. It is, however, an emerging area that is likely to continue to grow in importance over time.

System conditions for sustainability

It would be useful to know what tests can be applied to activity to know whether or not it is sustainable, without measuring the full impact. This is possible thanks to the work of the natural step – at least in relation to environmental sustainability. The natural step is a framework for thinking about environmental sustainability based on a scientific analysis of material and energy flows within the environment. It has been developed as a tool for companies to work towards sustainability. The natural step method has defined a number of 'system conditions' for sustainability; it is suggested that these conditions must hold for any environmental system. The system conditions are:

- substances from the Earth's crust must not systematically increase in nature;
- substances produced by society must not systematically increase in nature;
- the physical basis for the productivity and diversity of nature must not be systematically diminished.

There is a fourth system condition: 'We must be fair and efficient in meeting human needs', in the natural step method, which, while valid, is evidently of a different order from the first three. It introduces social and economic aspects, but does not cover them with the same rigour as the environmental aspects.

However, beyond the natural step, it is possible to define the social conditions for sustainability further as follows (the social conditions for sustainability set out here have been incorporated in the Sigma project):

- organizations practise stakeholder dialogue and accountability – recognizing the needs and values of stakeholders;
- acceptable social, economic and environmental impacts are stakeholder defined and equitable.

Finally the economic conditions for sustainability may be defined as follows:

- scarce resources are used efficiently;
- levels of economic activity are stable;
- scarce resources are effectively used at all scales – from local to global.

It follows that an activity that is held to be sustainable must satisfy all eight of these conditions. If it does not, there remains the problem of measuring how far short of sustainability it falls.

Summary

Part I has identified some of the key business trends, such as the drive towards globalization and the increasing use of technology, and shown how they lead to increasing pressure for sustainability and accountability.

It has also shown that there is overwhelming evidence that the world is becoming less stable – environmentally, in social terms and economically. Companies must play their part in changing course, even if only to survive. Just as the management of the financial consequences of company activity (including profit) is becoming ever more intense, so must be the management of corporate impacts on the environment, on society and on the economy.

Finally, it has been shown that, although sustainability is hard to define, moving towards sustainability is necessary. Part II reviews the practicalities of how this may be done.

PART II

Getting it done

From sustainability to corporate responsibility

4

In Part I, macro-level issues were considered in association with sustainability pressures. This chapter considers the move from the sustainability agenda to the way in which sustainability principles are adopted by companies. We can speak of this shift as a shift from an issues-based sustainability focus to corporate responsibility. Sustainability can be said to define the underlying issues, whether determined by authorities, voluntary organizations or grassroots campaigning groups. The responsibility agenda has been developed through active corporate participation.

As argued in Part I, there are a lot of reasons for companies to develop responsible strategies based on sustainability principles. However, the last few years have seen a shift. This shift in business conditions has influenced various mainstream business disciplines: risk management, investment, marketing, communication, governance and human resources management. It can also be seen in the education programmes established in major business schools featuring subjects such as ethics, corporate governance and community issues. To the extent that Company Law features new principles of stakeholder commitment, it is even more reasonable to state that sustainability principles will be part of reforming capitalism and its institutions. A new form of capitalism may arise – it is perhaps no longer a question of if it is going to happen, but of when, how and from which direction (Porritt 2005).

Corporate responsibility: ethical imperative or response to new business conditions?

Corporate responsibility (CR), which is confusingly often referred to as CSR (corporate social responsibility), can be seen from three perspectives. It may be:

- *an ethical imperative*, which business must sign up to for the simple reason that it is the only way forward if we want a future for our planet and people;

- *a response to new business conditions,* in response to the trends and drivers described above;
- *a new way of business thinking*, which contains models and tools to benefit the financial bottom line.

These three perspectives are connected, and the future and efficiency of the CR agenda depend on how they are brought into balance. Applying the ethical imperative view necessitates starting from a position from which persuasion and regulation is the way to make business work with responsible strategies. Using ethical arguments you may face a whole army of sceptics arguing that business is about making money, in a free market, where the only rules are determined by statutory law. We have already seen that regulation is only rather slowly entering the CR field; corporate lobbying has been actively deployed against regulatory initiatives.

If you adopt the second view, a way towards efficient CR practices could be to consider how CR strategies can be built into the mainstream policies, tools and strategies appropriate for responding to the challenge of new business conditions. This model should work with a long-term business case for CR.

The third view is to focus on short-term cause and effect links between CR and business performance. One example could be how employee activities influence employee turnover and/or recruiting costs, or how environmental management accounting can optimize use of water and electricity supplies.

However, all three of these perspectives are important and necessary. If the second view is overdeveloped it might become dominant to the extent that tools are applied in an unreflective manner to legitimize any corporate behaviour. This will benefit neither business nor society. If only the first view is applied, you will most likely face traditional defensive mechanisms, and the CR agenda will never find its way to the heart of the corporate thinking.

The third view will support the integration of CR practices into the heart of mainstream business, making the return on CR investments traceable. However, this agenda still needs elements of the big picture contained in the first two views if it is not to lose its overall purpose.

This book is based on these three principles, thus stressing the importance of sustainability as a core principle alongside the necessity of considering the reality of the capitalist economy.

What is the responsibility of companies?

Is the collective voluntary response of the corporate sector adequate to the challenge of sustainability? In the UK a lot of CSR reports are now called 'Responsibility Reports', indicating that companies consider various environmental and social issues as a natural part of their commitments and responsibility. Sustainability, once an agenda pursued by government agencies and non-governmental organizations (NGOs), is becoming mainstream. Increasingly, corporations are integrating sustainability or responsibility information in their annual reports, and 2005 was an encouraging year for the sustainability investment market. Increasing investor demand for sustainability is evident (from both retail and institutional asset owners) all over the globe (Sustainable Asset Management and PricewaterhouseCoopers 2006) as investors are becoming more aware: of the risks associated with irresponsible company behaviour; that consumers are sensitive to company behaviour; that customers demand more information about the products and services that they purchase; and that employees are sensitive to company values and attitudes. In this sense the arguments surrounding sustainability and CR are becoming still more complex.

If you look at the language and structure of the arguments, it appears that the CSR or sustainability initiative has moved away from convincing companies of their share of the blame to exploring how and why they can be part of a more business-oriented approach built on voluntary commitment and responsibility. Yet it is difficult to say whether this shift has also led to increased sustainability or if this development is just another attempt by companies to legitimize more economic growth. For example, one problem with the development of 'mainstream CSR' is that companies may address CR issues guided only by what they think 'could give them the quickest direct benefits through, perhaps, enhanced reputation.

Clearly, companies *should* engage in CR because the issues they address are a long-term commitment and integrated with their business strategy, perhaps even the basic condition for corporate accountability. Yet companies should also do what they do best – produce products and services. Consequently, their CR commitment should be closely attached to

their core mission; however, as argued above companies must define their mission under very blurred and confusing conditions.

The increased CR activity by companies in the past few years makes it relevant to consider whether companies are moving in a direction that benefits society in the most efficient way. In the absence of appropriate regulation one must suspect that companies will simply choose the CR strategy that will provide the quickest business gains. However, one positive trend is that a lot of business leaders claim that they work with CR and sustainability because it is the right thing to do. Furthermore, still more company boards are getting involved, and reporting is becoming a mainstream part of strategy and corporate communication. A few companies even take on the responsibility of inspiring others. Smaller companies are also being drawn into these issues under pressure from bigger companies, and their CSR programmes.

In general there is no blueprint for working with CR and most companies must experiment and create their own way to build their CR practice. The move towards CR has pushed the discussion about the business case for CR into the foreground. A lot of companies and other actors in the consultancy and government field argue that in general there is a long-term business case for CR. This is hardly true for all companies, as evidence shows that the business case must be developed through experiment and learning processes. Accordingly, the business case cannot often be established in advance.

Of course companies do not stand still. Some companies that have been criticized for unethical behaviour have changed their attitude, and may gradually learn how CR can be part of good business. It is possible, in general, to talk of five generic stages that companies go through (Zadek 2004):

- *defensive*: 'It's not our fault';
- *compliant*: 'We'll do only what we have to do';
- *managerial*: 'It's the business';
- *strategic*: 'It gives us a competitive edge';
- *civil*: 'We need to make sure everybody does it'.

While the analysis above suggests that there is a clear moral case for action, it is not necessarily clear exactly who should take it. There is clearly a job for companies to do, but action might be taken by at least three parties:

- individuals;
- companies;
- governments – both national and international.

How is responsibility to be distributed between individuals, companies and governments? For individuals, on a personal level, there is a role for all to make personal choices (e.g. what they buy or how much to use a car) that reduce adverse impacts. There is growing public awareness and interest in these issues.

It is also obvious that action cannot be confined to individuals (and companies) alone. Governments and NGOs are also actors on the sustainability stage. Sustainability must, in the end, be considered as a property of the sum total of all human activity. Company A may be a net producer of carbon dioxide, for example. But company B may possibly be a net absorber of carbon dioxide. Their overall impact is the sum of the two.

So it is obvious that there is a role for government – both nationally and internationally – to ensure that the sum of activities of all actors is sustainable. The negotiations over the Kyoto protocol for carbon dioxide production show, perhaps, that there is a growing awareness at international levels of these issues. It also shows the immense difficulties involved.

How such issues may best be managed is critical, but is outside the scope of this book. Nevertheless, clarity over boundaries needs to borne in mind when choosing which tools a company should make use of in managing its impacts. Some of the tools and measures of sustainability are particularly appropriate at national or international levels. For example, measures of environmental limits, such as carrying capacity or environmental space, are particularly relevant at the national level, rather than at the level of an individual company. However, data from individual companies will be crucial in determining how nearly such limits are being approached. It is therefore part of the task of business to ensure that a clear account of company impacts is available to government.

There are many practical problems in doing this, not only in collecting the data but also in knowing how to present it. Let us take the company A/company B scenario a little further. What if company A owns 10 per cent of company B? While this figure may, under some accounting regimes, mean that the financial assets of company B are outside the balance sheet of company A, does this mean that the (in this case, beneficial) environmental impacts should also be excluded? To some extent this is 'simply' a matter of boundaries.

Providing company B reports on its impacts, company A need not report on company B's impacts. What matters above all is that the boundary of responsibility that a company acknowledges is clear to see.

While accepting that sustainability is an issue, it is still quite possible for companies to argue that, although there are huge problems with the state of the world, companies are simply here to make money. Surely this in itself makes a positive social and economic contribution, particularly by creating jobs. In this view, the relevant part of sustainability for companies is their financial sustainability, or their long-term viability. Yet in a world in which sustainability is an established issue, what counts towards financial viability may change radically. An oil company, for example, may have to transform its core business in order to survive. If, through global warming, oil reserves come to be seen as a liability rather than an asset, the financial viability of the company will be ravaged. The beginning of serious investment in non-oil energy sources by oil companies is perhaps some recognition of this. Similarly, pharmaceutical companies are currently built on the premise of high mark-ups on products with very large research costs, making these products inaccessible to some of those most in need of them. To match their business model to the disease burden of the world will require very significant change.

However, there are significant and increasing pressures on companies to take a deeper than financial interest in sustainability. For some, the 'bargain' is between shareholders who receive limited liability in return for a 'licence to operate' (Royal Society of Arts 1995). For others, the bargain is simply that companies have a moral duty to manage their impacts responsibly. However, in many cases there is also a business case for acting responsibly.

In any case, those who move too slowly may be pushed. Pressures on companies to expand their responsibilities and to improve performance come from a number of sources:

- public opinion;
- civil society groups;
- the law.

Public opinion is volatile, but surveys have consistently shown that there is a high expectation that companies should be 'responsible' (Box 4.1).

Three-quarters of the public (73%) feel that industry and commerce does not pay enough attention to its responsibilities. There is also a rising trend in the influence of corporate responsibility on purchasing behaviour. Compared with five years ago, the proportion saying corporate responsibility is very important in their purchasing has almost doubled, from a quarter (24%) in 1997 to more than two in five (44%) this year.

Box 4.1: *The results of a MORI Poll (2002) on attitudes towards corporate responsibility*

Much has been written about the increasing power of civil society groups. The history of Shell in relation to the Brent Spar incident is often quoted. The incident centred on the issue of how to dispose of an oil platform. Shell wished to dispose of it at sea, Greenpeace, a major environmental campaigning group, opposed this with dramatic direct action and much media coverage. The result was not only that Shell changed its plans for disposal, but that it embarked on a much more energetic change programme to encompass sustainability within its approach to business. More recently, NGOs have challenged governments and the World Trade Organization at Seattle and the World Bank at Prague. Other NGOs are engaging with companies in less confrontational ways to achieve change (Heap 2000). The lesson from all this is that the pressure from NGOs and civil society on companies to take more responsibility is increasing.

Laws and regulations are also changing. In the UK there have been changes to the Combined Stock Exchange Code, by which all major UK listed companies have to abide. The areas in which change is occurring include directors' remuneration and the management of risk, including social and environmental impacts. In addition, there have been changes to pensions law, requiring pension schemes to state what their policy is on social and environmental issues in relation to their investments, or whether they have one at all. Clearly this will feed through to companies, so that all major companies will have to pay greater attention to these issues.

In other countries also, there is pressure for legal change. Bills have been introduced in legislatures from California to Canberra. The courts are also interpreting existing legislation more stringently. For example, in the USA, in 1999 Montana's Supreme Court ruled that the state cannot allow activities to continue that have the potential to poison the environment. Also in 1999, a Brazilian federal court ordered the government in to compensate a remote Indian community after it ruled that a road built through tribal territory had caused the death of most of its members.

Boundaries of responsibility in practice

In practice, then, for which issues should a company take responsibility? Companies have tremendous power to do things, if not always to take decisions differently. So how much responsibility can companies take for globalization, new technologies and the other major trends of the economic world? While there is obvious truth in the view that companies are not evil villains masterminding the destruction of the world, it is also true that major trends are not imposed in the abstract as a *fait accompli*, but result from innumerable practical decisions, many made by companies. The manner and speed with which major trends are realized is therefore amenable to influence. For companies, there is almost always a margin of freedom at their disposal, within which they can make a difference.

This is a vital point because there is a huge temptation for companies to:

- sell all the possible benefits of a new product or approach;
- ignore the disadvantages;
- deny responsibility should the benefits not materialize.

For example:

- Large multinational companies like globalization. This is often supported by suggesting that globalization will lead to economic development. But if the jobs implied by this picture fail to appear, who takes responsibility?
- New technologies, such as human gene mapping, are sold on the premise that they will enable new cures for disease to be found. But what if the new cures are only available to a very few or lead to discrimination in insurance? The responsibility for these outcomes is rarely claimed.

The remainder of this chapter sets out the steps involved in a 'responsibility analysis' for a company. The first step is to identify company stakeholders (and amplify the idea of stakeholders) and their issues. There is no mechanical way to do this – stakeholders vary from company to company. However, it may be convenient to include the environment and the economy within the 'stakeholder', to ensure that no critical issues are missed. To kick start the process, it is helpful to think of those groups that the company:

- affects most;
- is most affected by;

- deals with most often;
- deals with occasionally;
- would like to have as a stakeholder;
- fears it may have as a stakeholder.

As an example, Box 4.2 shows the stakeholders acknowledged by UDV Poland, a subsidiary of Diageo, the major drinks company. This information was taken from the website for Diageo and illustrates some of the stakeholders in Diageo's Polish operation and some of their issues.

Having identified stakeholders and issues, one practical way to begin to define the boundary of CR is to draw a line around it. Stakeholders and their issues may be placed on a stakeholder map, with the company at the centre. A line can be drawn to indicate whether the issues of concern to a particular stakeholder group in relation to the company are within or without the sphere of responsibility of a company. This is illustrated in Figure 4.1.

However, this approach needs refinement to recognize that, while there are some impacts that are within the practical control of a company, there are others that a company can influence but not determine. There are, therefore, two zones of responsibility that a company can acknowledge (Figure 4.2).

In practice different companies position themselves differently in relation to the responsibility they take. It may be thought that the minimum responsibility a company can take is simply to accept legal responsibility for its direct actions. However, even this boundary is shifting as the interpretation of laws is influenced by prevailing social values. Cape plc, for example, did not accept responsibility for its subsidiaries over the asbestosis caused by the South African subsidiary's operations until legal action was completed. Many companies are very active in lobbying, which may be a means to try to influence what its socially acknowledged responsibilities are.

On environmental matters, many companies have begun to take responsibility not only for their impacts, but also for those of their suppliers. It is now accepted good practice to propagate good environmental performance and management along the supply chain. British Telecommunications plc, for example, has a policy of encouraging its suppliers to improve their environmental performance:

Box 4.2: *Diageo and its stakeholders*

1. Brand consumers
UDV Poland's commitment to brand consumers is reported under a number of topics: value and price; quality and safety; advertising and promotion; labelling and packaging; complaints and compliance. It includes reference to market surveys on the two lead brands: Smirnoff and Johnnie Walker Red Label.

2. Employment creation and people development
The performance is externally reported under: job creation; employee training and education; training of business partners; diversity, particularly local recruitment and gender ratio; comparative wage rates and the impact of the merger on employees. The company has been particularly concerned to monitor its performance with regard to looking after employees affected by the merger.

3. Government
UDV Poland contributes a very high level of taxation to government. A key indicator of the high level of taxation of the drinks industry in Poland is the total tax contribution as a percentage of gross turnover.

4. Business partners
UDV sources a significant proportion of its sales volume from local producers and measures this when possible against other comparable foreign companies.

5. Technology transfer
UDV invests in the upgrading of technology, particularly bottling and water demineralization processes. A key indicator of this would be the introduction of world class distillation technology, the unique charcoal filtration system used by Smirnoff, to UDV's production partner.

6. The community
UDV Poland measures and assesses its involvement in a number of community projects including taking a lead in the promotion of corporate social responsibility amongst Polish business leaders.

7. Social aspects of alcohol
UDV has taken a lead role in establishing an industry organization to promote sensible and responsible drinking, and reports on UDV Poland's performance in establishing a social aspects organization (SAO) for Poland. One objective of the SAO is to take steps to reduce the incidence of abuse of alcohol products.

8. The environment
The study also highlighted some of the trade-offs in balancing economic, social and environmental considerations. For instance, with regard to the environment, bottles currently used for Smirnoff are not collected for reuse as it is felt that the company could be exposed to increased counterfeiting risk. One of the performance indicators reflected the potential problems arising from the disposal of used bottles and the need to find ways to improve performance in bottle recycling.

9. Shareholders
UDV Poland's ultimate holding company is Diageo plc. The external report referenced the group's governing objective regarding shareholder return and UDV's contribution to this, but detailed performance was not externally disclosed in accordance with group financial reporting codes.

10. Code of ethics
In terms of ethical performance the report confirmed that UDV Poland conducts its business within the law of the country and with respect to the values of Polish society, and that it operates within a global framework of ethics and values established by UDV and its parent company Diageo.

Towards the future – continuous improvement
As part of the external report, UDV Poland is committed to continue to monitor and evaluate its economic and social impact and has set targets for future performance, including the development and implementation of stakeholder surveys. These will be incorporated in the company's strategic planning for 2000.

Source: Diageo's social report, 1999

Box 4.2: *Contd*

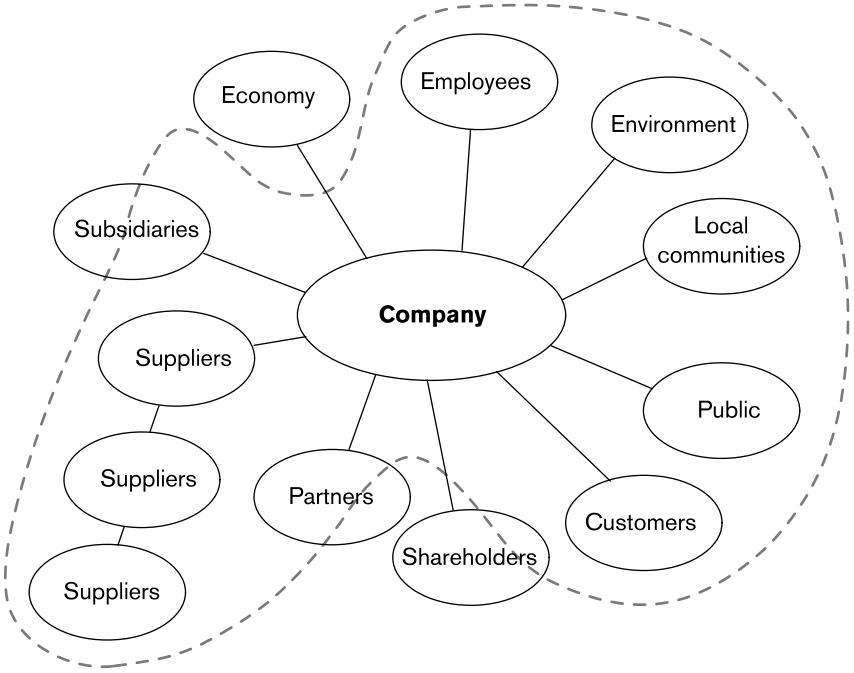
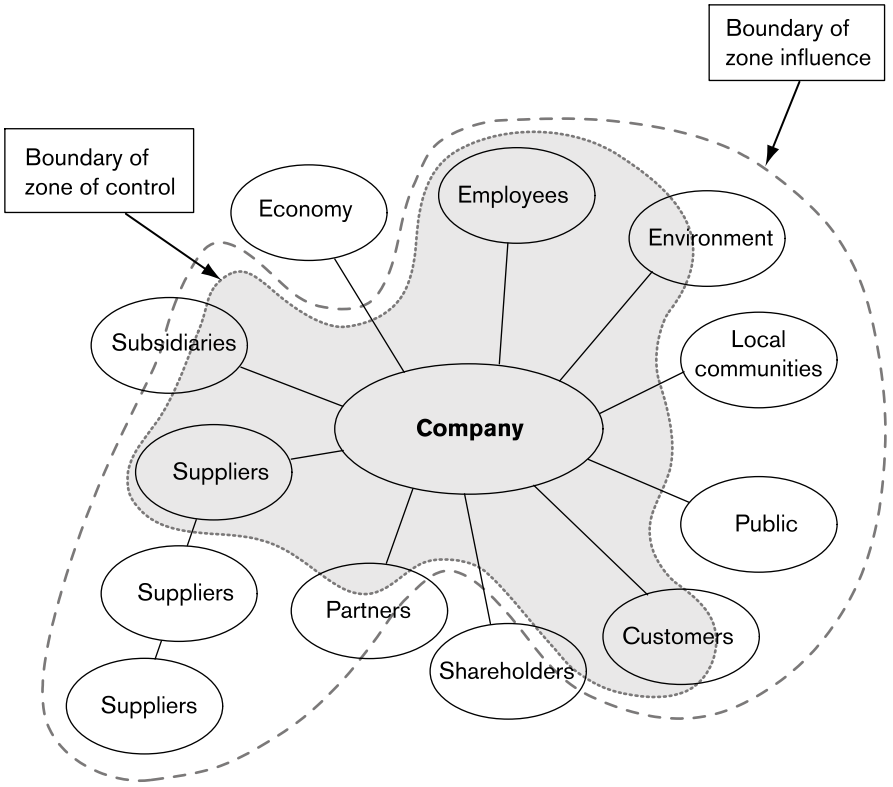


Figure 4.1: *What is the boundary of company responsibility?*

Figure 4.2: *Zones of responsibility?*



> "*We need to be reassured that our suppliers have looked at their own supply chains and operations. If they have credible environmental, health and safety policies, they will find themselves in a strong competitive position within our supply chain.*"
>
> British Telecommunications (2000)

At the other end of the scale, companies in the apparel and footwear sector, such as Nike and Adidas, have been forced by events to take quite extensive responsibility for their supply chains, implementing significant management programmes to monitor and improve their suppliers' social and environmental impacts.

De Beers, the world's largest diamond company, has been developing a certification scheme by means of which dealers, who purchase from them, right through to consumers, will be able to know that a diamond has not originated in a conflict zone and so has not been used to fund a local conflict. This is effectively a scheme to manage ethically the 'demand chain' for its products.

Of course, however important a starting point, to take responsibility is not the same thing as to achieve good performance. The actual performance of a company will have to be

judged by what actually happens as a result of the stance taken in terms of responsibility. Companies may be challenged on:

- where they have drawn the boundaries of responsibility – whether in terms of influence or action;
- the actual level of performance they have achieved within the boundaries of responsibility.

Corporate governance and corporate responsibility

5

Does good governance matter to corporate responsibility (CR)? Investors seem to think so:

- A report by the United Nations Environment Programme (UNEP) (2006) shows evidence from different analysts and investors that the impact of CR on share price can be valued and quantified.
- In a worldwide survey, 73 per cent of 192 investment managers stated that CR indicators would be mainstream by 2015 (Mercer Human Resource Consulting and Mercer Investment Consulting 2005).
- Of the world's leading financial institutions, 31 have signed up to the Equator Principles (*http://www.equator-principles.com*) for screening their financing of global projects according to social and environmental criteria.
- International investors, who manage €364 billion, have formed the Enhanced Analytics Initiative (EIA), urging analysts to focus on CR issues.
- The best performers on corporate governance of the FTSE 350 perform 32 per cent better than the lowest performers measured on stock value (Grant 2005).

This chapter shows how the involvement of the board of directors is a necessary condition for true CR. The most progressive approach for corporations is to abandon the defensive notion of CR as a necessary evil (i.e. as a response to external demands from society). Rather, corporations should see CR as the best approach to find new strategies in a world where business conditions demand self-reflection and consideration of the entire social and ecological system. (Another definition of what is termed responsible corporate governance (RCG) is: 'RCG is a stakeholder-oriented policy approach allocating responsibilities to societal actors, who will drive corporate accountability' (Kuhndt et al 2004).)

A company's board of directors and executive management have a key role to play in setting the tone for effective delivery of responsible corporate behaviour. Basically, it is important for the company to acknowledge the fact that long-term value creation is not only about shareholder value. The Combined Code on Corporate Governance (Financial

Reporting Council 2006) states clearly that CR is important and must be considered. It says that 'directors should set the values and standards of the company and ensure that it meets its obligations to shareholders and others'. However, the code gives little guidance on how this should be achieved. In the same way, the UK Companies Act 2006 links CR to the duties of directors. Here it is stipulated that directors should listen to and act on the interests and points of view of other stakeholders when considering the value creation of their companies. This 'enlightened shareholder value' argument suggests that directors have a duty to behave responsibly and respect the interests of others. However, as is the case with the Combined Code, the new UK legislation lacks formal guidance as to how directors should go about this task in practice.

Nevertheless, if companies actively seek *rewards* for their responsible business activities, boards should get involved and integrate CR concerns in their day-to-day routines. This would include: the formulation of corporate values; the recurring approval of strategy; reviewing risk appetite and risk management systems; managing incentive systems and overseeing the functioning of internal controls. The following sections describe a number of ways in which this might be done. See Chapter 6 for detailed description of the link between CR and the management of business risks.

Values and standards

First the board must establish a point of reference for the CR work throughout the company. It is important that the choices made in this regard reflect the long-term priorities of the company. The choices made as to standards (in this section 'standards' refers to expected, moral standards of behaviour) and values should establish the frame of reference for board decisions, as well as the behaviour of executive management and staff.

The boards of 73 FTSE 100 companies have approved a public statement of business principles expressing the standards and values they expect the company to adhere to. Boards should ensure the standards they set are clear, comprehensive and consistent.

The role of boards is different in important respects from that of executive managers. Their primary role is to govern and set tone, pace and direction – not to manage. The board should, therefore, establish boundaries and controls, recruiting and motivating appropriately so as to fulfil its obligations to all stakeholders. The board also has a

fundamental role to play in mapping out areas of risk, including those everyday pressures and temptations that can lead to irresponsible behaviour on the part of management and staff.

Of course differences in companies' cultures and business activities mean that their standards and values will vary, but certain widely accepted and legally mandated CR principles will be relevant to every company. Stakeholder consultation is an important part of defining which standards to apply. Some important areas that should be considered when developing a comprehensive and consistent set of values and standards include:

- honouring contracts;
- bribery;
- human rights;
- non-discrimination;
- true and fair communication;
- fair competition;
- employee health and safety;
- responsible marketing;
- community investment;
- product safety;
- environmental protection.

One of the most common ways to demonstrate CR commitment is through a statement of business principles and a code of conduct. A board's statement of business principles helps to communicate internally and externally the boundaries of commitment, which should guide company operations. It can provide a firm foundation for the wide set of policies and practices necessary, both informally within the corporate culture, and formally through internal control and disciplinary procedures. This creates a basis on which the board can formulate the role and the expected behaviour of both executives and staff – as well as its own effectiveness.

Principles and codes of conduct provide a frame of reference that managers can use in their decisions. This helps with decisions on aspects such as relations with stakeholders, conflicts of interest, gifts, equal employment issues, incidents of public criticism, harassment, fraud, insider information and trading, etc.

Box 5.1: *How BP works with the code of conduct to raise awareness of its content and implications*

We believe that compliance with laws, regulations and our own standards is central to our sustainability as a group

In 2005 we acted to strengthen compliance by launching the BP code of conduct overseen by our Group Compliance & Ethics function. The code of conduct enshrines BP's commitment to integrity, defining what is expected of BP employees in one universal framework. It sets out how BP people should behave when faced with choices about their behaviour at work, ranging from how to raise a concern about safety to whether to accept a gift from a supplier. On detailed issues, it refers readers to other standards and principles.

In 2005 we rolled out the code across the company, using multi-lingual resources such as books, posters, websites, videos and e-Learning. Interactive training sessions to introduce the code were held throughout BP; these were led by team leaders to explore the legal and ethical issues that were most relevant to each team's area of work. The extensive roll out programme has resulted in a high level of employee awareness of the code of conduct: an internal communications survey showed that 99% of respondents had heard of the code, with 96% having access to a copy.

To help implement the code throughout the organisation, a network of 135 senior level compliance and ethics leaders (CELs) was appointed throughout the group covering each business, function and region.

Source: BP web-reporting (*http://www.bp.com*).

When the company has defined its position on responsible business it may provide employees and customers and other stakeholders with a written pledge. This might cover:

- corporate values;
- the definition of what is right, fair and good, and the expected actions and consequences of non-compliance;
- a guarantee that all employees (at every level) of this organization will treat each other and stakeholders accordingly.

This communication of values and principles is the starting point for training of employees in their responsibilities and how they can translate the values and principles into specific actions that support the company's position.

Box 5.1 describes how BP works with the code of conduct to raise awareness of its content and implications throughout the organization. The code of conduct covers five areas: health, safety and environment, employees, business partners, governments and communities, company assets and financial integrity.

Managing incentives

Corporate responsibility principles and values are important and necessary, but are not enough to ensure that a company behaves responsibly. Principles and values must be built into incentive systems and address the pressures to breach them, which will inevitably be an everyday challenge facing management and staff. Consequently, effective board action on CR must manage the incentives that cause unwanted temptations.

Incentives are not only financial, but will include other factors such as recognition, status, career progression – and participating in a corporate culture that is dedicated to doing the right thing. If management and staff see that responsibility is rewarded, they are likely to act accordingly. On the other hand, temptations to act unethically will continue to exist if compliance with company values is not rewarded or, even worse, is tolerated as part of the organizational culture. But this is ultimately self-defeating, as former President Alan Greenspan of the US Federal Reserve Bank has noted. With corporate scandals such as Enron in mind, he strongly criticized perverse non-transparent arrangements such as incentive structures narrowly aimed at maintaining high share prices rather than 'sound and ethical business', arguing that these have created a state of mistrust. He concluded: 'When trust and reputation disappear so does value'.

Pressures for management and staff to act unethically can be caused by both internal and external factors. Bribery, for example, can come from market failure outside the corporation, whereas other problems can be caused by internal factors such as corporate culture, remuneration schemes and performance management. The board of directors therefore holds an important position in stimulating and rewarding good behaviour through the design of the right incentive mechanisms. The board should analyse risk areas affecting CR principles and design internal incentives accordingly.

However, according to a global survey by the American Management Association and the Human Resource Institute (2006), pressure from management or the board to meet unrealistic business objectives and deadlines is the leading factor most likely to cause unethical corporate behaviour. The desire to further one's career and to protect one's livelihood are ranked second and third, respectively, as leading factors in unethical behaviour. The survey of 1,121 managers and human resources experts around the world found unethical behaviour flourished in environments where there was cynicism or diminished morale, and improper training on the ethics of actions.

Simple ignorance that some acts are unethical was another common leading factor of unethical behaviour, as was a lack of consequences when employees were caught. The 'only following orders' excuse was another reason often cited, along with peer pressure or the desire to be a team player, a desire to steal from or harm the organization and, paradoxically, wanting to help the organization survive.

According to the survey, organizations should establish policies and processes for ensuring an ethical culture. These include: leadership support and modelling of ethical behaviour, consistent communications from all leaders, integrating ethics into goals, processes and strategies and making ethics a part of both performance management systems and recruitment and employee selection processes.

The survey also found that the single most important ethical leadership behaviour was keeping promises, followed by encouraging open communication, keeping employees informed and supporting employees who upheld ethical standards. If an organization had leaders who simply did not 'walk the talk' when it came to ethics, there was little hope of maintaining a strong ethical culture, it suggested.

As for specific programmes and practices, a corporate code of conduct was viewed as being most important. One way to demonstrate the priority of company standards is to report on the consequences of breaching them. BP publishes an annual report which includes an overview of its allowed discharges and instances of non-compliance with regulations or company policies (Box 5.2). This measure is underlining the priority of these issues both externally and internally.

Alignment of corporate responsibility with performance management

Companies may achieve short-term gains from behaving irresponsibly. The benefits are often financial, through increased revenues and lower costs; however, the cost of short-termism may be intangible, such as the erosion of customer loyalty, employee commitment and reputation. If boards evaluate strategy in purely financial terms, the intangible costs of irresponsible behaviour cannot receive enough weight. In the worst case, be they aware or unaware, boards may end up approving strategies that are both irresponsible and value destroying.

Everyone who works for BP has a responsibility to uphold our business policies: any breaches, whether the result of deliberate actions or carelessness, are treated as a very serious matter.

We expect all our employees to adhere to high standards of legal and ethical conduct, wherever in the world they operate. Our new code of conduct will set out these standards along with universal, company-wide rules. It will be every employee's personal responsibility to adhere to the standards contained in the code of conduct and to consult it for guidance when acting on behalf of BP.

We use the annual certification process to help us identify policy breaches within the company: businesses report any breach or potential breach in law, regulations or company policy they have identified during the year. In 2004, the certification process reported no occurrences of child or forced labour within BP. In the future, the Certification process will require BP's businesses to attest that their staff have complied with the rules and policies of the code of conduct in addition to legal and regulatory standards, irrespective of location or business.

Despite our best efforts, policy breaches still occur. In 2004, 252 people were dismissed for non-compliance or unethical behaviour (this figure excludes retail site dismissals), compared to 165 dismissals in 2003. The main reasons for dismissals in 2004 were theft, misuse of company assets, HSE violations and fraud.

In 2004, 41 contracts with third party organisations were either terminated or not renewed due to infringement of BP policy, laws or regulations compared to 29 contracts in 2003. Reasons for terminating or not renewing these third party contracts included non-compliance with HSE regulations and breaches of BP company policy.

Box 5.2: *BP Sustainability Report 2004*

Short-termism and problems in giving sufficient weight to intangible factors are particularly relevant to performance management. If too much focus is given to short-term performance and financial gain, people will not care much about the long-term consequences of their actions. There is no doubt that too much attention to financial results can steal focus from the role of non-financial value-drivers. Value-drivers like customer satisfaction, employee morale and reputation are essential for the long-term creation of shareholder value. The board should create incentives that increase shareholder value through emphasis on intangible value creation (reputation, organizational culture, stakeholder relations, etc.), and accepted standards of responsibility. This of course presupposes performance metrics that integrate both tangible and intangible value creation. A lot of companies acknowledge this and experiment with new management tools like balanced score cards and knowledge accounts.

It is perhaps old fashioned to think that people are only motivated by financial benefits. People are also motivated by power, status, approval and recognition, and overall job satisfaction. In addition, employees and managers often act from a misconceived loyalty to the company because company values and standards have not been built into all levels of the business.

Overall, the performance management system is a very important driver for change of corporate behaviour. Boards and, specifically, the remuneration committee of the board, control the rewards for the chief executive officer (CEO) and executive management team through performance-based incentive schemes. The responsibility for applying the values and policies of the company should therefore be built into these systems in order to create incentives for responsible behaviour throughout the organization.

Building a culture of integrity

It is impossible entirely to eliminate temptations to violate company values and standards. Situations will always occur where short-term personal gains are chosen instead of loyalty to the company. Therefore, boards should not only focus on removing temptations, but also on encouraging people to resist them when they do arise. An efficient tool in this regard is business culture.

The board should promote the development of an integrity culture. Organizational culture can be very efficient in regulating the behaviour of management and staff. An integrity culture should be based on the values and standards defined by the board. These principles should be communicated through all internal channels, such as programme announcements, new employee orientation, training programmes, posters, annual reports and CR reports, speeches and meetings (Box 5.3). Building an integrity culture is a long-term project, but can potentially be more efficient than controls – or at least justify less emphasis on controls.

Communication is important, as are examples of good and bad behaviour, which will be rewarded or punished. Fundamental to this process are trust and openness – both between management and staff, and between executive management and the board. It is important that employees, when in doubt about a certain incident, can have an open dialogue with the management on how to interpret the CR principles. Learning from practical examples is very important to developing an efficient integrity management system.

Box 5.3: *Communicating an integrity culture through a training programme*

Some companies, such as Citigroup, Lockheed Martin and Boeing, use ethics games in their training, with the aim of creating openness and developing management commitment.

Participants are divided into small groups and given a problem involving an ethical dilemma. The group is asked to decide between four or five different solutions and to justify their choice. Each answer has predetermined value points. Senior management participate as an 'appeals board' in cases where the teams dispute the correctness of answers or their predetermined point values.

Source: US Department of Commerce (2004)

To ensure an organization-wide awareness and understanding of the ethical values and principles, training programmes should be developed. The programme should involve everyone from new employees to the CEO, and even members of the board. At the end of the training participants should be certified to train others in these areas. The goal should be to promote the idea that peers should be helping one another maintain an ethical work environment.

Parts of the training programme could be standardized, and others customized for the different positions within the organization. The idea is to ensure that employees clearly understand their specific roles and responsibilities in relation to the company values and the code of conduct.

The importance of ethics can be reinforced through a number of cultural supports:

- During the recruitment process, staffing professionals should ensure that they hire people who seem to share the company's values and passions.
- During the induction process, new employees should be schooled not only in the fundamental principles such as trust and transparency, but also in core value issues such as integrity, accountability, mutual respect and corporate citizenship. New employees should sign the code of conduct.
- Formal team meetings should include a section during which CR values and ethics are reinforced.
- The human resources function and management in general should work to foster an emotional commitment with each employee: the stronger that commitment, the stronger the bond between the employee and the company's culture.

- There should be a certification of the accountability programme that all employees are required to participate in once a year.
- Regular surveys and audits will help solve ethics problems and detect their origin as a product of work processes, or isolated individual actions. This knowledge can be fed into training and the design of work processes.

Managers and staff should not only adhere to the company's CR principles but they should also be expected to enforce the principles and report breaches. Staff and managers who turn a blind eye to unethical conduct should themselves be sanctioned. The existence of anonymous helplines and strong and well-understood protections for whistle-blowers will further encourage reporting of breaches.

There is evidence that many people, because of their personal values, will behave responsibly, even in the face of financial incentives to the contrary. Boards can reinforce and develop this by fostering a culture in which responsible behaviour is expected and lapses are noticed, criticized and punished with appropriate sanctions (see Box 5.2).

Some people are more willing to do the right thing than are others. The results of the global survey by the American Management Association (2006) of factors that are likely to lead to unethical behaviour (for a full discussion see p. 73) underline the importance of communication and training and of the board to stating explicit CR principles to remove any potential for confusion.

Structure and responsibility

The board should, in general, ensure that its structures properly support the governance of CR. Strategic decisions and the responsibility profile of the entire company can only be decided by the whole board. However, a lot of CR decisions fit within the general job description of standard board committees.

The text in Box 5.4 was taken from the BP Sustainability Report 2005. It gives a good explanation of the BP governance framework. BP has established a special committee dealing with CR issues, which oversees the responses of executive management to specific incidents such as the Texas incident, in which 15 people died and many more were injured.

Box 5.4: *BP's corporate governance framework*

BP's shareholders delegate authority for the direction and oversight of the business to the board. As at December 2005, the board consisted of 17 directors, 11 of whom did not hold executive office, including the chairman and deputy chairman.

The board's governance role is distinct from that of management. The role of the board is to focus on tasks that are unique to it as the representative of shareholders and are necessary to promote their interest effectively. This necessarily requires input to and oversight of the strategic direction of the business as well as on-going scrutiny of business activity.

BP's goals are set by the board, which is accountable to shareholders. The board makes broad policy and delegates management of the business to the group chief executive (GCE), who is in turn accountable to the board.

Non-executives comprise a majority of the board. Board committees, which monitor the group's activity and performance, are comprised solely of independent non-executive directors, so that they are free from any conflict of interest that might arise from having a management role.

The ethics and environment assurance committee (EEAC) monitors the non-financial aspects of management activity, such as ethical conduct, environmental matters and health and safety. This committee therefore has a key role in respect of those issues covered in this report.

During 2005, topics discussed by the EEAC included safety, employee health, GHG emissions, oil spills and plant integrity. The committee met specially to consider the incident at the Texas City refinery and continues to monitor the executive management's response and the strengthening of its safety and operational capability. The EEAC also considered the success of measures taken to promote driving safety across BP's operations. Following its practice of examining risks that require management at regional or country level, risk reviews were undertaken for Africa, the Middle East and Alaska.

Other committees include:

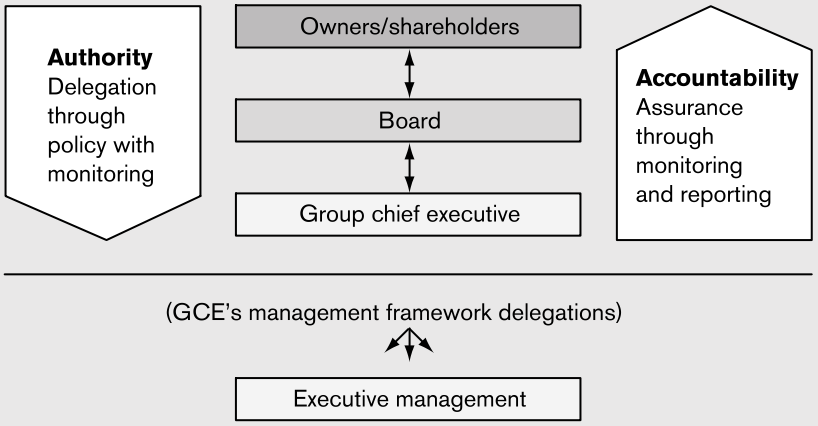
- The chairman's committee, which comprises all non-executive directors and considers broad governance issues, including the overall effectiveness of the chairman and group chief executive.
- The audit committee, which monitors reporting, accounting, control and financial aspects of executive management activity.
- The remuneration committee, which determines the remuneration of the group chief executive and other executive directors.
- The nomination committee, which considers the appointment and reappointment of directors and other matters affecting the board's composition and succession planning.

The board delegates all executive management authority to the group chief executive. It prescribes the way in which that authority may be exercised through its executive limitations policy, which defines the boundaries within which the group chief executive and his management delegates can operate. The executive limitations require, for example, the group chief executive to take into account the health, safety and

Box 5.4: *Contd*

environmental consequences of any action. A comprehensive system of internal control is also required for the operation of the group. In managing the risks of the group, the executive limitations require that no one substitutes their own risk preferences for those of the shareholders as a whole. As a result, risk identification and management are important elements of the formal group planning process. More information is available on pages 158–163 of *BP Annual Report and Accounts 2005*.

GOVERNANCE FRAMEWORK



Source: BP Sustainability Report 2005

Another important task for the remuneration committee is to ensure that the remuneration policy is not creating undesirable incentives. Pay-schemes should not conflict with CR goals and strategies but actively support their implementation.

In recommending candidates for board directorships, it is the nominations committee's role to ensure the right character and integrity of candidates, and that this is reflected in the specification for the role and in briefings to executive search consultants.

It is the audit committee's role to review the company's internal controls to ensure that it adequately identifies and manages CR-related risks. The audit committee has the main responsibility for ensuring that the company's internal audit procedures are effective in monitoring CR.

Often it is appropriate to delegate responsibility for specific CR issues to a special board committee. Such delegation is valuable because CR issues are complicated and often expert opinion is needed. However, special-purpose committees have their limits and the most important aspects of CR must be considered by the board as a whole.

Risk, HR and marketing

6

The purpose of this chapter is to describe and exemplify how different business disciplines can adopt and integrate corporate responsibility (CR). It describes CR concepts and practices associated with risk management, marketing and human resources management. However, it is important to keep in mind that this chapter is not a blueprint for how to adopt and implement CR the right way, but rather is intended as a source of inspiration – bearing in mind that CR is a highly individual learning process. There has been much interest in the strategic business perspectives of CR and how they can be integrated into mainstream business disciplines. Business schools provide special programmes on the issue (e.g. Harvard Business School has an MBA programme called Strategies for Creating Business and Social Value), which is itself a sign of CR becoming mainstream.

Risk management

Risk management is, as indicated previously, a part of the responsibility of the board and, as such, a part of corporate governance. The risk-mitigating measures associated with the general establishment of governance and CR compliance systems – the internal infrastructure – were discussed in Chapter 5. The specific management of different business risks, including specific CR risks, should be built on top of these systems. These risks originate from external factors to which a company must respond.

In this section, the way in which CR and the management of different business risks can be matched to establish a valuable business-oriented system is described and examples given.

First it is important to establish what a business risk is. It can be defined as follows:

> A business risk is the threat that an event or action will adversely affect an organization's ability to achieve its business objectives. Business risk arises as much from the possibility that opportunities will not be realized as it does from the possibility that threats will materialize.

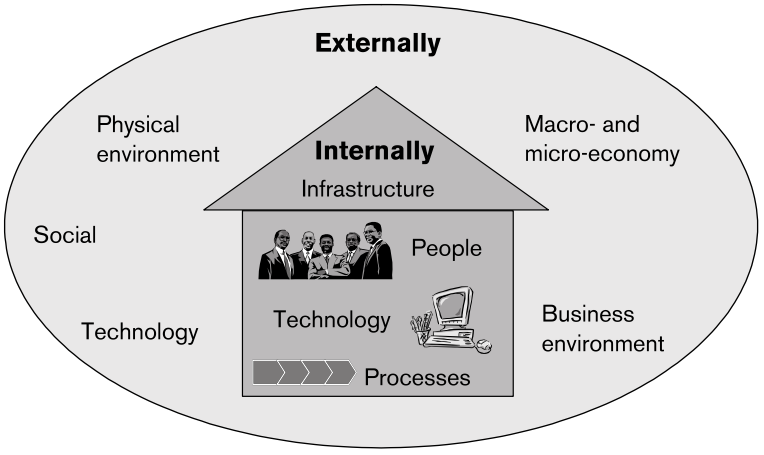


Figure 6.1: *The dependence of efficient risk management on internal infrastructure and external factors*

Accordingly, business risk management is a process focusing on optimizing opportunities while minimizing threats. However, change in business environments and increasing organizational differentiation and complexity has created a need for a more holistic and coordinated approach to risk management. This has given rise to concepts such as enterprise risk management (ERM) and functions such as the corporate risk officer. The pressure for a more coordinated and holistic risk management framework has been driven by:

- corporate scandals and public pressure for more corporate regulation and accountability;
- a general focus on corporate governance;
- globalization (differentiated regulation, integrity in supply chain, financial risks);
- the 'knowledge society', with a consequent increased complexity of the business environment;
- increased demands for self-justice and ethical behaviour.

Figure 6.1 illustrates how efficient risk management depends, on one side, on the establishment of a suitable infrastructure (see Chapter 5) and also on external responsiveness. Both these issues should be considered when the board addresses strategic risks. In general, the corporation faces progressively more complex sets of risks, which must be handled through a systematic and holistic approach.

This approach is often referred to as ERM. After the Enron, WorldCom and Sarbanes–Oxley debacles there has been a great focus on risk management – and especially the lack of

it (Lam 2003). Risk management has traditionally been a fragmented function dealing with isolated risk areas such as financial risks or insurance issues linked to certain operational risks. A more holistic approach to risk management takes a cross-organizational and cross-functional approach, involving disciplines such as communication, branding and human resources.

The Committee of Sponsoring Organizations of the Treadway Commission (COSO) (2004) has developed a framework that uses this approach. Their report describes the following benefits to the management of ERM:

- an awareness of what risks exist;
- information on risk interrelationships and impacts;
- more complete and precise information about risks;
- the ability to identify and seize opportunities inherent in potential future events;
- the ability to manage risk within and across business units;
- an established common risk language, facilitating communication;
- and, ultimately, an enhanced ability to create, preserve and realize value.

The eight components of the COSO framework are:

- internal environment;
- objective setting;
- event identification;
- risk assessment;
- risk response;
- control activities;
- information and communication;
- monitoring.

Following the Turnbull Report (The Institute of Chartered Accountants in England and Wales 1999) and the development of the ERM-COSO framework, many boards have developed a more systematic approach to risk management, and many companies explicitly incorporate strategic CR risks as part of the process. In 2001, the Association of British Insurers – a large association of UK institutional investors – gave further impetus to this development by issuing guidelines for disclosure by companies of significant risks associated with CR.

Integrating risk management with corporate responsibility

Corporate responsibility can, from the perspective of risk management, be considered as actions that reduce the negative impact of an organization on the environment and people and society in general. For example, retailers monitoring their employment policies to ensure they are adhered to throughout their supply chain may avoid scandals concerning abuse of human rights or potential litigation over working standards. In the last few years many issues in this category have hit the newspaper headlines, which has made risk management and CR a hot issue. Examples include the ethics of arms and defence deals, 'fat cat' director salaries and shareholder activism, illegal workers and supply chain issues, the financial scandal of Parmalat, and the famous collapses of Enron and WorldCom, which involved false accounting.

The same retailers would also be concerned about how products are marketed and how the products affect the environment or the people buying them. Nike has been exposed to a lot of criticism for exploiting the workforce in third world countries. Today, ethics and integrity management is high on the corporate agenda:

> "*Corporate responsibility challenges us to take a good, hard look at our business model, and understand our impact on the world around us.*"
>
> Nike Responsibility Report 2004

On the other hand manufacturers will look for opportunities to use CR in their brand building and product development – active risk management focuses on opportunities and not merely on threats.

The first step towards building an efficient risk management system is the mapping of risk areas internally and externally. Externally, the focus should be on issues associated with market conditions in general, regulation, business partners, the press, non-governmental organizations (NGOs), etc. Internally, the maturity of systems and corporate culture should be in focus (see Chapter 5). The risks associated with the business strategy should be considered, including the risks of breaching CR standards.

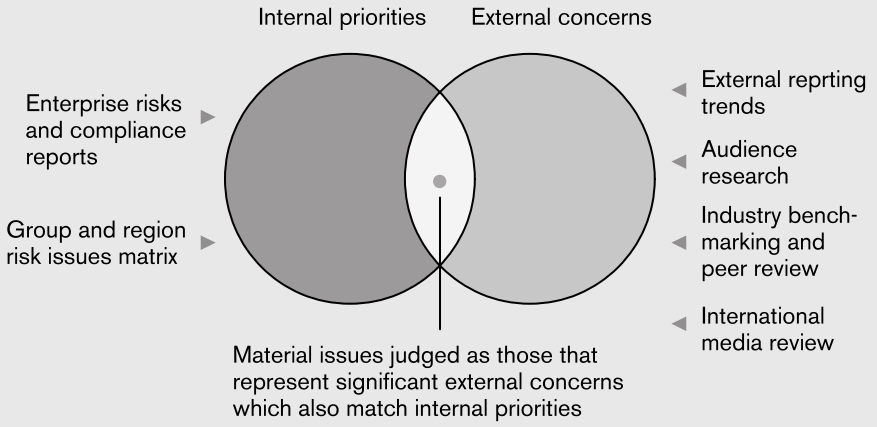
The example in Box 6.1 shows the different considerations associated with the external reporting of risks. BP has analysed the external concerns of their stakeholders and

Material issues

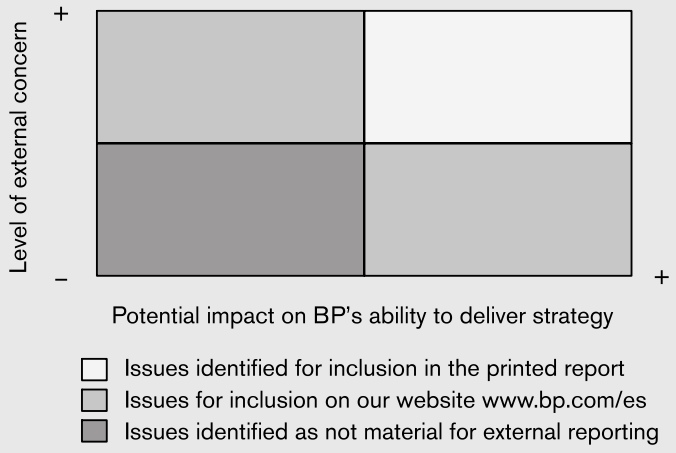
As our reporting has evolved we've developed more robust processes for identifying the most material issues – those that could affect our business – for inclusion in our group reports. We try to combine an 'inside-out' view of key issues and risks (as defined by our strategic priorities and internal risk management processes at group and regional levels), with the 'outside-in' of external observers.

We've developed processes to make us more responsive to external concerns, including a process of capturing concerns represented in international media coverage, dialogue and engagement processes, and peer review. During 2004, the sustainability reporting working group assessed the most material issues and produced a reporting materiality matrix. This was reviewed at senior management level before review by the ethics and environment assurance committee (EEAC) in January 2005.

A systematic approach to materiality



Identifying material issues



Source: BP Sustainability Report 2004

Box 6.1: *An example of prioritizing the reporting of risks as set out by BP*

considered the different reporting requirements. These concerns are matched with their internal priorities. The issues included in the printed external report are those that have a high level of external concern *and* a high potential impact on BP's ability to deliver strategy. Issues that either have a high potential impact on strategy *or* a high level of external concern are reported on the BP website (*http://www.bp.com*).

The following risk areas are the most important to address in relation to CR:

- *Supply chain* – the risks in this area can be addressed by developing a code of conduct on issues such as human rights abuses, or company-specific risks such as pollution. In addition, a system can be built to ensure compliance with the code of conduct: Box 6.2 contains a description of the Nike compliance programme, and shows the different stages in their approval of new contract factories. Nike is gradually developing their compliance management programme based on the different experiences from their ongoing audit and compliance management work.
- *Operational risks* – this covers compliance with regulation, employee satisfaction/work climate and dangerous operations.
- *Products* – this concerns the use of hazardous raw materials, waste and pollution during production, and health and safety issues.
- *Societal expectations and corporate reputation* – the risks in this area arise from any additional expectations (other than from regulation) that a company may face, which if met could help protect its reputation and operational stability. An organization's reputation is built on its relationship with staff, customers, suppliers, investors and the community they operate within. Of course, these stakeholders are the very same ones that CR activities seek to involve. This is why CR can help maintain and enhance reputation. A change in reputation can lead to a number of negative impacts, such as a drop in share value of the business, a decrease in profitability as customer and staff loyalty drops, a decrease in business opportunities (as potential partners question trust and integrity), a decrease in new investment as the business is seen as a greater risk and even increased insurance premiums.

In Box 6.3 Nike explains its criteria for the selection of issues for their CR work. Nike has been exposed to a lot of criticism in the past because of the working conditions in some of their factories throughout the world. Considering the criticism to which Nike has been exposed, their practices demonstrate responsiveness and transparency; this is an important way to protect brand value and 'licence to operate'.

Box 6.2: The Nike compliance management programme

One way to understand our compliance programs for contract factories is to use the analogy of a life cycle.

At the beginning stage, we follow a six-step New Source Approval Process to select factories. Once a factory is approved and begins active production for Nike, the compliance team focuses on monitoring and assisting factory remediation of compliance issues that inevitably arise. Factories with whom we have longer-term relations also may benefit from Nike-supported training and other forms of capacity building to help the factory develop its own compliance management capabilities.

When business circumstances change, and we end our orders with a factory, we also may apply a factory exit process. Like the New Source Approval Process, the exit process has a series of defined steps, although it is usually applied only when our exit from a factory could create significant dislocations for the workforce.

It is within the context of this life cycle that our strategy, focused on business integration and multi-stakeholder initiatives, is implemented.

Stage One: New Source Approval Process (NSAP)

A multi-step process is required when a Nike business unit seeks to add a new factory to the source base.

The steps include:

- Factory profile
- Inspections for quality
- Environment, health and safety and labor inspection (SHAPE)
- Third-party labor audit
- A review of the need for a new factory
- Approval by the compliance department

The process is intended to weed out unnecessary additions to the supply chain, or contract factories that do not have compliance performance at a sufficient level. In fiscal year 2004, 57 percent of factories that had the basic inspections performed were approved for production. The disapproval rate of 43 percent, and the fact that almost every factory required significant remediation before approval, underscores the fundamental challenges of working conditions in the industry.

Since the New Source Approval Process was instituted, factories with which Nike places orders directly should receive an initial environment, health and safety and labor inspection audit (SHAPE) and a third-party labor audit, at a minimum. As noted above, there are times when a factory is not authorized, but nonetheless manufactures product for Nike. As a result, unauthorized factories may not have been audited. We know from anecdotal experience that approximately five percent of our audited factories in FY04 were found to use contractors that had not been formally approved. Unauthorized subcontracting is prohibited by our Code of Conduct.

Box 6.2: *Contd*

Stage Two: Monitoring and Factory Remediation

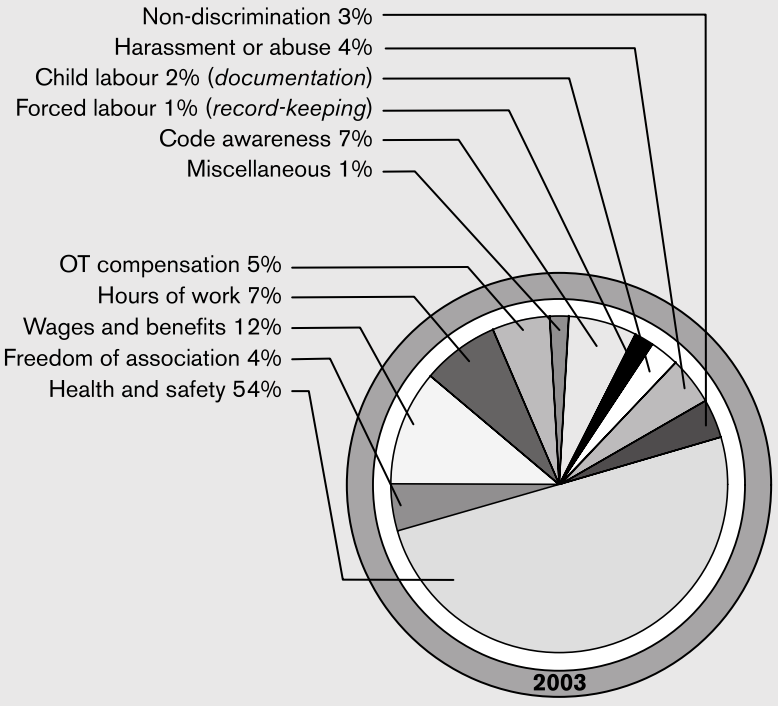
Monitoring:

We have three levels of monitoring, each of which is described in a separate section:

- Basic monitoring (SHAPE)
- In-depth (M-Audit)
- Independent external monitoring through the FLA

Source: *http://www.nike.com/nikebiz/nikebiz.jhtml?page=25&cat=monitoring*

FLA audit findings for 40 Nike contract factories (issue percentage as percentage of all issues found)



Source: FLA Calendar Year 2003 Public Report

FLA Independent External Monitoring Findings

The figure above displays the percentage breakdown by Code Provision of the total non-compliance issues reported by FLA independent monitors in Nike applicable facilities, which Nike addressed through remediation in Year Two. Non-compliance findings relating to Health and Safety were the most frequently reported issues, making up 54 percent of the total non-compliance issues identified. The most commonly reported and remediated Health and Safety issues related to inadequate postings and evacuation procedures, and personal protective and safety equipment.

Issues related to Hours and Wages were also common, with a total of 24 percent of all findings relating to Wages and Benefits (12 percent), Hours of Work (seven percent) and Overtime Compensation (five percent). The top Hours and Wages issues that were reported by FLA monitors and taken up by Nike through corrective action plans were related to overtime limitations, overtime compensation and worker awareness of their wages and benefits.

There were no findings of underage workers in facilities producing for Nike. Issues categorized under the Child Labor provision (two percent of all non-compliance reported) mainly related to factories having inadequate documentation for workers' ages in factory records, as required by the FLA.

There were no findings of forced or bonded labor in these facilities. Most non-compliance issues categorized under the Forced Labor provision (one percent of all non-compliance reported) related to factories keeping inadequate records to demonstrate compliance with all FLA benchmarks for this provision.

Source: *http://www.fairlabor.org*

Text in italics has been added by Nike for clarification purposes

Box 6.2: *Contd*

Materiality

Recognizing that some issues are more relevant than others, we developed the following checklist to guide us in determining what topics to cover in this report.

- Major impacts and issues: Based on internal life cycle an impact analyses.
- Policies and commitments: GRI Guidelines, Nike Code of Conduct.
- Peer benchmark: CR reports of industry peers.
- Internal business processes: Information used to manage CR internally.
- Stakeholder input: Priority issues as communicated by our stakeholders through our Report Review Committee and 2004 Stakeholder Forum.

Inevitably, we may have missed topics important to select individuals; it was our intention to prioritize issues raised most frequently by our stakeholders. We intend to continue to use this materiality framework as a guide for reporting in future years.

Approach to reporting

Our transparency efforts and our commitment to reporting are not limited to this document. We see value in different methods of reporting and communicating.

Disclosure

This report can be viewed as disclosure of our corporate responsibility impacts. Our intent is to share information in a systematic and standardized way on issues that are most relevant to our internal and external stakeholders. We have used the GRI as a guide for our reporting and we have tried to identify key indicators and clarify what the numbers mean. Ultimately, this format may allow for greater ease in gauging year-over-year progress. Our intended audiences for this report include members of the socially responsible investment

Box 6.3: *Nike's criteria for selecting issues for their CR work*

Box 6.3: *Contd*

(SRI) community, employees, academics, NGO and advocacy organization leaders, and individuals with an in-depth knowledge of corporate responsibility.

One of the major challenges that we faced in preparing this report was bridging the gap between different stakeholder groups. Much of the information we are reporting is used to help us manage our corporate responsibility impacts and drive improvements throughout our operations. We struggled with ways to present this information in a format that would be accessible to external stakeholders, comparable to the type of disclosure undertaken by our peers, and reflective of how the information is used to manage change within our business. This tension remains, and we hope to address it through our participation in the GRI sector supplement working group and through direct stakeholder engagement around the future of reporting.

Source: Nike Corporate Responsibility Report 2004

Human resource management

The competition to attract talent is a theme coming to the top of the corporate agenda. In the industrialized world jobs are becoming increasingly specialized and, consequently, hiring and firing is becoming ever more expensive. Loyal employees are valuable – and one way for firms to create loyalty and to develop the right competences is to focus on corporate values, work climate, training, health and safety, etc. According to a survey done in the USA by Care2 (2006), 48 per cent of employees (of a total of 1600 respondents) say they would work for less pay, if they could work for a socially responsible company, and 40 per cent of employees would be willing to work longer hours for a job at a socially responsible company. Furthermore, 73 per cent of workers said it was 'very important' to work for a company they believe is 'socially responsible'.

This in itself should be reason enough for companies to make corporate social responsibility (CSR) an active part of their human resources strategy and policies. (The company branding strategy will be discussed below, and employee loyalty concerns should be considered in this regard.) It is especially important to focus on how company values and CSR initiatives are communicated. Below we focus on material issues dedicated to employees.

Employee involvement

Human resources management has a crucial role in the development and implementation of CSR within an organization. Without the active participation of employees in both

defining and living out company values, CSR could become a potential threat to a company's reputation. Employees are possibly the most important ambassadors that the company has. Employee involvement can be achieved in a number of ways: through workshops, employee surveys, intranet, informal lunch meetings, etc. Employee involvement is especially important in relation to the following issues:

- definition of corporate values;
- feedback on risk areas in relation to corporate policies;
- review of company policy and procedures to ensure values are consistent across procurement, recruitment, training, appraisals and exit interviews;
- general CR activities (community involvement, environment, etc.);
- specific human-resources related activities (career development, health, safety and well-being).

We are committed to creating an environment where employees at all levels feel that they can speak honestly about the company and issues of importance to them. An international employee opinion survey, *Your Voice*, is run by ISR (International Survey Research), a leading global employee research organisation, to gather detailed feedback from employees to enable local action planning. The findings are compared with ISR's 2005 Global High Performance (GHP) norm, comprising data from a range of organisations globally that are considered high performers in financial performance (above sector average, typically on return investment measures) and in general levels of employee satisfaction.

Previously, *ViewPoint*, an annual international sample survey, was run capturing the opinions of a small but representative sample of employees. As it could only highlight top-line themes, *ViewPoint* was replace din 2005 by *Your Voice*, a full census survey, which provides more comprehensive and actionable data.

Your Voice was conducted in October 2005 in 34 languages in 98 countries, covering most Group employees. 44,326 questionnaires were distributed and 35,428 were returned, an 80% response rate. It covered over 100 questions across 16 categories, for 15 of which there is ISR GHP data.

The results by region, function and against the GHP benchmarks were discussed by our Management Board and priorities for action were agreed, together with opportunities for learning and sharing best practice identified in participating countries and functions. Local management teams have analysed their local findings, prioritised core issues to address and have communicated results to all employees. All participating companies are now expected to work with employees on addressing any areas of concern, supported by our Human Resources function in reviewing findings, identifying underlying drivers through follow-up focus groups and developing local action plans.

Source: British American Tobacco, Social Report 2006

Box 6.4: *British American Tobacco: employee opinion research 2005*

Most employees appreciate being invited to participate in these activities – and expect that their participation will make a visible difference in company decision-making. Consequently, it is important for companies to give feedback on how they use employee involvement in decision-making, whether it be an adjustment of compliance systems, in a definition of corporate values, CR activities, etc. An example of employee involvement is given in Box 6.4.

Training and career

As jobs become ever more specialized and companies demand a flexible and responsive workforce, employees increasingly value companies that take care of developing their skills. Having a good reputation with regard to training and career development is very important in recruiting and retaining personnel. Training and career development increase the employability and market value of each employee, and have a positive effect on the individual, the company and society.

Diversity and opportunity

Globalization is becoming an unavoidable condition, and this creates a demand for corporations to be global in the way they deal with their workforce. At the same time there is an expectation that companies actively support non-discrimination and aim for a diverse workforce across the dimensions of race, culture and sex. It is widely accepted that diversity and equal opportunities lead to innovation, a better reputation and better global opportunities. Companies are developing a variety of programmes in this regard, and often disclose the numbers of women in senior management positions. However, diversity and opportunity are very much also about creating a culture of openness, acceptance of difference, innovation and experimentation. These factors are difficult to measure and report on, but should nevertheless be articulated, programmed and managed in order to make a real difference.

Workplace health, safety and well-being

Health and safety issues are gaining increasing attention as health and lifestyle problems and stress-related diseases are acknowledged as very serious concerns. Employers have realized that their responsibility extends beyond the physical work environment and the

related safety issues. Issues related to the general health of their employees are receiving increasing attention. A lot of companies have smoking policies and exercise programmes, while others are getting involved in healthy diet programmes and stress coaching. This tendency of companies to become engaged in issues formerly the private affair of employees may be criticized for discriminating against employees who will not participate. Consequently, companies should proceed with caution, while acknowledging that they have a potentially important role to play, when it comes to influencing the health of their employees.

Investment in health in the workplace will pay in the end; the results should be seen in increased productivity, less absence, better work climate, lower employee turnover and, very importantly, happier employees. As with other intangible value drivers, payback on health- and work-climate investments can be difficult to track in order to make the right investment decisions. It is necessary to approach the issue in a systematic way. Box 6.5 gives an overview of how this might be done through establishing the right projects, reporting and making links to financial performance.

Marketing

Consumers are often faced with too many choices when they buy something. This abundance of choices makes life complex, and consumers look for ways to cut through and cope with the 'noise'. They therefore look for ways to make a quick choice, and resort to price (rationality) or reputation (emotion) to make a decision.

Price elasticity has gone up twofold between 1980 and 2000, so demand is now much more likely to shift with price, if no other value is perceived. Thus attention has shifted to improving reputation by means of word of mouth recommendation, public relations, referrals, CSR and relationship management. Collectively these areas are taking up far more company time and resources than ever before. Choice is not going to go away – it is a fundamental of capitalism, the result of oversupply and a greater diversity of need.

Corporate responsibility can be seen as a useful tool that can be applied by companies in order to differentiate themselves in an overcrowded marketplace. In this way CR can be

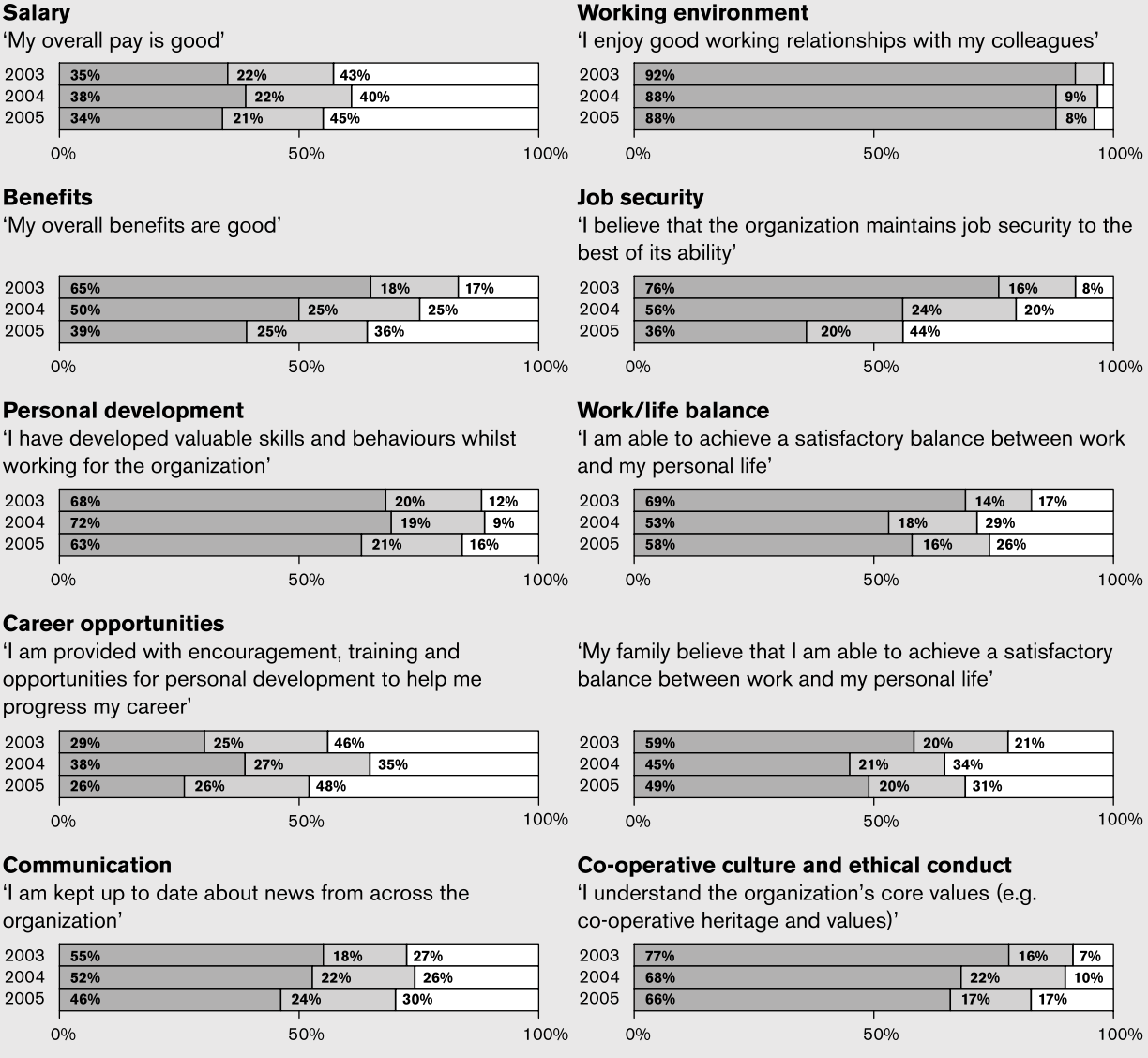
Box 6.5: *Linking investment in workplace health with financial performance: an extract from the Cooperative Financial Services Sustainability Report 2004*

Salary

Percentage of staff in each basic salary band

Basic salary bands	**Bank** (4,147 staff)	**CIS** (6,039 staff)
Up to £10,000	0.8%	2.8%
£10,001 to £15,000	51.0%	32.1%
£15,001 to £20,000	17.2%	23.9%
£20,001 to £30,000	16.9%	25.2%
£30,001 to £40,000	7.3%	10.8%
£40,000 and over	6.8%	5.2%

Data excludes 2,752 CIS Financial Advisers, who receive the majority of remuneration on the basis of sales commission.



Source: HI Europe Staff Survey 2005

another way to capture the heart of consumers and create loyalty. As we will see, this strategy can be a double-edged sword if not managed in the right way.

We suggest four generic approaches/levels for integrating CR into marketing strategies:

- *Full integration*: the core product is fully integrated with CR policies and activities. The company uses CR actively in support of its corporate brand. An example of a company that has done this is The Body Shop (Box 6.6).
- *Innovation*: the company has developed its CR strategy in close connection with its core business, thus demonstrating how the capacity of the company is put to work in an innovative manner, establishing a position to deliver extra benefits to society. This can be done by:
  - screening existing products for their environmental and social consequences and modifying them accordingly;
  - integrating social and environmental considerations into all new products and services;
  - looking for opportunities to develop new products and services that address an environmental problem or which fill a social need.

  Companies which have done this include mmO2, Novo Nordic and Co-operative Financial Services.
- *Little integration*: the company chooses to get involved in CR activities that are not particularly connected to their core business. Examples include companies working with cause-related marketing, charities and donations.
- *Bottom of the pyramid strategies*: this approach is associated with full integration. It has been mentioned as pointing to the future of CR. Companies working with these strategies focus on serving markets with low-income consumers, typically in Africa and South America. The specific consumer needs in these markets have often been historically neglected by companies. Supporters of this approach describe it as a viable way for both western companies as well as the countries themselves to benefit from foreign investment (Pralahad 2005).

A lot of different factors will determine which approach a company should use. The choice will depend on the market situation, history, experience, core product and technology among other factors. Whichever approach is pursued, consistency is important. The next section addresses how this can be achieved through corporate branding.

Box 6.6: *Fully integrating the core product with CR policies and activities: The Body Shop*

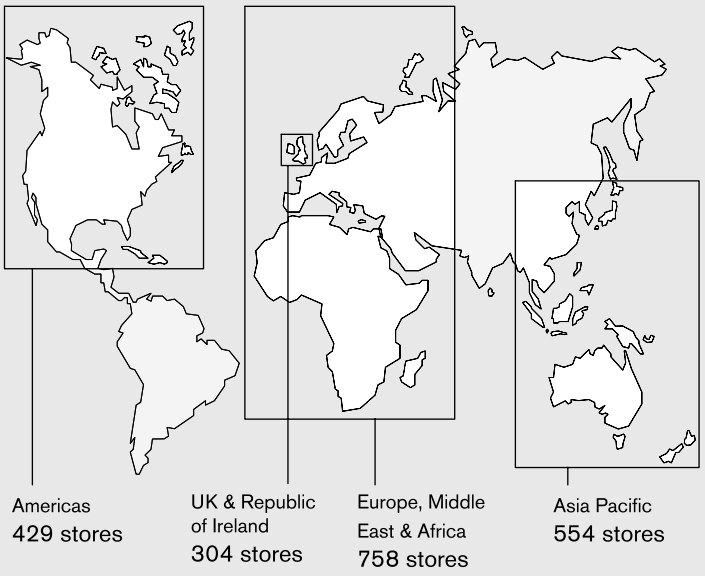
Who we are

The Body Shop International plc is a high quality skin and body care retailer operating in 52 markets with 2,045 stores, spanning 25 languages and 12 time zones. We have one of the most recognisable brands in the world and have an established reputation as a socially and environmentally responsible company.

The Body Shop is listed on the London Stock Exchange. Our total retail sales in 2004/2005 across all The Body Shop outlets amounted to £708.7 million (2003: £672.5 million). Group turnover was £419 million, up 10% from the previous year, and profit before tax increased by 21% to £34.5 [million].

How we operate

Our business consist of a combination of company-owned and franchised markets, and a developing multi-channel service with our direct selling organization – The Body Shop at Home and online retail in the US. We employ directly 6788 people, with approximately 14,000 additional employees working within our franchise network and as consultants in The Body Shop at Home and online retail in the US.



We source the majority of products and accessories from suppliers, who we screen under our Ethical Trade programme, and from our Community Trade suppliers. Our sole manufacturing operation is Soapworks, a 100-strong factory in Glasgow.

Source: The Body Shop Values Report 2005

The Cooperative Bank: Customer led, ethically guided

	Profitability contribution made by customers who state that ethics is **the most important** factor	Profitability contribution made by customers who state that ethics is **an important** factor
2001	14%	25%
2002	13%	24%
2003	17%	29%

Source: Cooperative Financial Services Sustainability Report 2004

Box 6.7: *The Cooperative Bank is marketed as an ethical brand. The bank produces annual analyses of how their ethical brand has supported the business*

Corporate branding

Corporate branding is a concept that has been gaining more and more ground over the last decade. Brands have traditionally been associated with products and services delivered by companies. Logos have been the visible sign helping consumers to make their choices – gradually building loyalty through the creation of emotional preferences. All kinds of commercials and marketing campaigns in combination with tailoring of the core product to customer needs build product brands. 'Superbrands' in this category include Coca Cola, Levis and Mercedes Benz. Whereas product branding relates to products and services, corporate branding includes the company itself and what it stands for. Corporate branding starts from the very core of a company – its values and its identity – and integrates business strategy.

Consumers are interested in what a company stands for and they are prepared to reward companies that demonstrate what they view as good corporate behaviour. Good behaviour is often identified as having a clear social/ethical profile. In this sense CR and a consistent approach to corporate branding go hand in hand (Box 6.7).

In a British survey (Consumer Watch 2004, *http://www.igd.com/consumerwatch2004.asp*), 85 per cent of the responding consumers said that companies have an environmental, social and ethical responsibility. 72 per cent wanted to know more about company activities in these areas and 42 per cent indicated that the information would affect their buying behaviour. In a US consumer survey (Cone 2004), 90 per cent of respondents said that they would boycott companies with a bad social/ethical profile. In another US survey (Cone 2002) 79 per cent indicated that companies should explain how they support social causes and 84 per cent thought that the social/ethical profile of a company should determine which companies should work in their local community.

As consumers become more critical – or political – in their consumption pattern, companies must be responsive. The companies that are able to keep a step ahead can even give themselves a competitive advantage on this account.

As corporate branding includes the company and its strategies as a whole, building the corporate brand demands a consistent and systematic approach (Duncan and Moriarty 1997). The benefit that a company can harvest from this includes trust and loyalty from its key stakeholders. Corporate branding ideally addresses all company stakeholders, including customers, investors, employees and the local community. However, a lack of consistency and failure to live up to the image created will backfire instantly. In this sense corporate branding is a double-edged sword. If a company works only with product brands it might succeed in hiding behind them, should a critical situation arise. The company might even avoid any negative consequences for other product brands arising from one in trouble. This result would not arise in relation to corporate branding – a crisis is most likely to affect all the company's business activities, and potentially damage all its stakeholder relations.

How to build a consistent corporate brand with corporate responsibility

Companies should engage with their stakeholders to find out what they expect from them in terms of running the business and in terms of information/documentation. Stakeholders are interested in the truth – what their actions effect as an investor, employee or customer.

One of the major brand consultancies put it this way:

> "*Truth means recognizing that consumers' interest in your product may well extend beyond what's in the pack to how it got there and what the environmental costs of that journey have been. It means making that information available right where the product is served. It means internalizing the demand for corporate social responsibility and delivering against it at every brand touch-point.*"
>
> Wolff Olins (2006)

All corporate brand manuals start out from defining the core: the *corporate identity*. Identity affects the who, what and how of the company – and the direction the company wants to go in. The fixed point of identity is corporate values, which will guide strategy, visions and all the systems built to implement the desired corporate actions (including reward

A natural part of daily business

Areas of priority

- The implementation of our code of conduct "The IKEA Way on Purchasing Home Furnishing Products" (IWAY). This states our minimum requirements for social, working, and environmental conditions and is primarily based on UN and ILO declarations and conventions. It also includes demands relating to forestry
- Offering safe and healthy products, including food served in IKEA restaurants.
- Reduction of emissions caused by transportation of IKEA products and people.
- Environmental work in IKEA units, with special focus on our stores and distribution centres.

Awareness, knowledge and responsibility

Training is an essential part of environmental and social work at IKEA. The goal is to create awareness, knowledge and a sense of responsibility. All co-workers receive basic training in these issues.

E-learning, a computer-based training method, offers a flexible approach to training and gives each co-worker an opportunity to take charge of his/her own development. Additionally, in depth and special training is given to local environmental co-ordinators and auditors in the supply chain.

Operational responsibility for social and environmental issues lies with the person responsible for each of the various IKEA countries and business units. This ensures that social and environmental issues are a natural part of daily business.

Valuable co-operation

IKEA co-operates with companies, trade unions, organisations and authorities throughout the world. We work closely together with Save the Children, UNICEF, and WWF, which enables us to achieve more than we could by working on our own with social and environmental issues.

IKEA puts special focus on the prevention of child labour and the promotion of responsible forest management in its supply chain. IKEA does not accept child labour at its suppliers or their sub-contractors. IKEA does not use timber, veneer, plywood, or layer-glued wood from intact natural forests or forests with a clearly defined high conservation value

Source: IKEA Social & Environmental Responsibility Report 2005

Box 6.8: *IKEA is an example of a global brand that has been consistently promoted through a focus on its corporate values. In their catalogue you encounter comprehensive information about what they do and do not do, and why. IKEA would even like you to return the (largely recycled) packaging of purchases to them, so that they can recycle it again. As a result, IKEA has become a sustainable, successful business worldwide.*

schemes, for example) (Box 6.8). A company would do well to use the following steps to protect their corporate brand:

- Involve stakeholders when defining what values to work with:
  - How do the values influence the company?
  - What strategic benefits are aspired to through the values?
  - Which stakeholders do the values primarily address?

- Choose to work with CR initiatives that link well with the core business. If they are too far-fetched they might be suspected as being an instance of 'greenwash' and create mistrust with stakeholders. From a societal point of view, it is beneficial for companies to put their skills, capacity and innovative skills to work in a creative manner to benefit broader social needs.
- Do not promise too much. Start with a few initiatives, and when you know that the right direction and systems are in place to secure the right implementation and follow-up, you can move to the next step. Keep in mind that investors only listen to visions once.
- Make sure that your stakeholders get the right information in the right way. Report on the basis of materiality and impact.

Managing for responsibility 7

Introduction

How does a company begin to become more sustainable? Over the last few years there has been an explosion of initiatives, codes, tools, standards, new organizations, systems, principles, labels and more – all designed to help companies with sustainability. Unfortunately, the very profusion of these tools is undermining itself. It is so hard to know where to start for many companies that they are simply waiting to see where the consensus emerges.

This chapter is therefore intended to meet a need by showing how some of the many standards, tools and so on fit together, and how to make a start. This chapter:

- Proposes some definitions. Although this should help in understanding this chapter, it should also be understood that there are no universally agreed terms in this area, indeed the same terms will be used differently elsewhere.
- Surveys the proliferation of codes to see what is emerging, and why, and then shows where they fit within the ways a company directs and manages its business, and so can become integrated into business operations where appropriate.
- Sets out a typical management cycle for managing impacts.
- Outlines one of the major pitfalls in getting started.

Definitions

Codes

The term 'code' has been used for ethical codes, which typically suggest processes for how decisions ought to be made, particularly when there is an issue around propriety, such as a conflict of interest. In the area of sustainability, the term code is used also to describe acceptable behaviours with respect to social impact and the environment. Codes are often devised in order to suggest the proper way of proceeding and dealing with sustainability

impacts. In this book the term 'code' is used to refer to all initiatives designed to help manage social, environmental and economic impacts other than the (formal) standards described below.

Indicators

Indicators are measurements designed to provide insight into an impact. Good indicators are able to communicate a message and lead to action. Indicators are discussed in more detail in Chapter 9.

Labels and labelling

Labels are marks on products that indicate their properties to purchasers. Environmental labels, such as the Soil Association mark, and social labels, such as a Fair Trade label, are intended to enable consumers to make purchasing decisions based on social or environmental considerations.

Principles

Principles are high-level, abstract statements concerning aspirational behaviour. Statements of principles are also called 'codes' and 'standards'.

Standards

Historically, the term 'standard' has meant an agreed and documented technical specification. The term has been applied to a huge variety of practices, from the construction of electrical components to management systems. Typically, standards emerge from prior practice, rather than the other way round. The term is also loosely used to describe what this book refers to as 'codes' – i.e. informal (although documented) specifications of practices. Standards-setting bodies such as the International Standards Organization and British Standards Institution have very well developed mechanisms for developing and agreeing standards. Standards may cover management and measurement processes as well as actual substantive performance.

Tools and techniques

There is no definitive distinction between tools and techniques. Both are concerned with practical application or achievement. The nature of the achievement may range from the

development of a strategy to the correct measurement of an indicator. Some of the more useful tools and techniques are be described in Chapter 8.

Codes

What kinds of codes have been emerging?

Along the social and ethical dimension of sustainable development, retailers are developing their own brands for Fair Trade products, tea and coffee possibly being the best known examples. Manufacturers of branded goods, such as Nike and Adidas, are also following suit, with attempts to adopt codes of practice that demonstrate their commitment to ethical behaviour in relation to employees and the employees of their suppliers. The diamond industry is establishing a certification system (the Kimberley Process) so that diamonds that have been sold to fund war do not reach the market. Codes such as Investors in People in the UK are setting expectations about how staff should be managed, and also producing evidence that is helpful to staff motivation and therefore financial returns.

Along the environmental dimension, organic foods and the Soil Association label are becoming increasingly well known and popular. Similarly, organic agriculture is one of the few growing areas in an otherwise globally depressed industry. International initiatives such as the Forest Stewardship Council and the Marine Stewardship Council have developed to attempt to conserve natural resources and ensure that they are harvested sustainably.

The economic dimension is rather less well served by codes. Nevertheless, there have been a number of attempts to improve the governance of companies in some countries, such that companies can be seen to behave responsibly in the way the pay of directors is set and risk is controlled. New codes have been developed within the UK and at European level.

There are two main causes of the ceaseless development of new codes. One is that regulation of markets has been unfashionable. As a result, governments are looking with favour upon initiatives to develop self-regulation – and are also increasingly active in producing 'guidance' for companies to follow towards sustainability. There are examples in the resolution of the European Parliament supporting the principle of monitoring and verification, and the principles prepared by the Organisation for Economic Co-operation and Development (OECD) for multinational companies.

The other cause of the development of so many codes is pressure from civil society. Civil society has been particularly active in the development of codes – indeed a number of organizations have been formed with the development of a code of conduct as their primary objective. Examples include the formation of the organization Ceres (www.ceres.org) in the USA, originally around the environmental principles raised by the *Exxon Valdez* oil spill in Alaska, and the development of SA8000 by Social Accountability International (originally the Council for Economic Priorities).

Corporate reaction to these pressures – other than a certain amount of confusion – has been an increasing tendency to report on social and environmental performance. Many large companies now report on their environmental performance, and an increasing number are reporting on their social performance also. In addition, while one of the original drivers of the explosion of codes was the desire of governments to deregulate, the tide may now be turning and there are initiatives exploring the development of legislation designed to support sustainability and provide a workable foundation for voluntary initiatives. The Company Law Review in the UK was perhaps an example of this.

Is it possible to spot the winning trends?

For the future it is possible to identify a number of winning trends. The first is that there will be a consolidation of codes. It is now recognized that the profusion of codes is counterproductive. One of the ways in which such consolidation is likely to occur is continuing clarification of the difference between substantive codes (which specify levels of impact) and process codes (which specify how impacts are managed). Both are necessary, but it is very helpful to be able to crystallize process elements, as they are far more easily capable of codification.

Another trend is the rise of partnership working, i.e. working on sustainability issues through collaboration between different organizations. The most promising partnerships tend to involve collaboration between companies and non-governmental organizations (NGOs) and other types of organization. A good example of such a partnership is the Global Reporting Initiative (www.globalreporting.org), which has set a standard for sustainability reporting. Codes resulting from such partnerships tend to be more robust due to the diversity of interests that give rise to them.

Partnerships are also an expression of a move towards more open organizations. This is itself perhaps a key sign of movement towards sustainability. Openness is a sign of

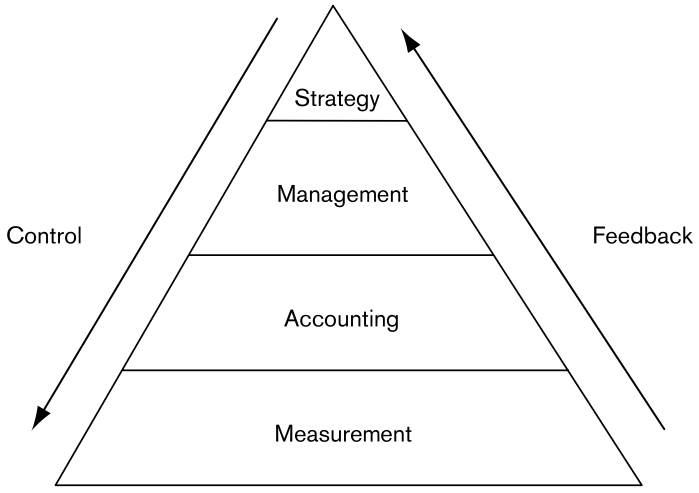


Figure 7.1: *An analytical framework for understanding standards*

willingness to learn and a desire to work with, rather than in spite of, stakeholder interests. The concrete expression of such openness will be a conscious effort to improve transparency through reporting and through the verification of the resulting reports.

Another trend is towards more clearly defining the scope of codes. Where the scope of a code is restricted, the whole code can be more carefully defined and more rigorously implemented. However, in practice, there is a trade-off between the specificity of the code and the extent to which sustainability can be embraced. The scope of a code may be measured in a number of respects. One important aspect is the coverage of the different dimensions of sustainability. Another is the extent to which it is applicable across more than one industry sector. This may well matter even to an individual company, as many large companies are effectively operating in a variety of sectors.

Managing with codes and standards

In order to grasp the variety of standards with which companies are working, a selection of the more significant standards is analysed against an analytical framework. The analytical framework for understanding the function of different practical approaches set out in Figure 7.1 has four elements: strategy, management, accounting and measurement.

Strategy is about setting the overall direction of an organization and expressing its values. An organization without a strategy is lost. Strategy clearly includes questions about which market a business should be in; but it also includes asking whether the business can be sustainable. A strategy may be expressed in mission statements, value statements, policies, principles and other high-level statements, as well as in detailed strategy papers and business planning.

Management cycles and systems are about delivering strategic goals. An organization without some kind of management system will find it difficult to effect change. Management cycles are realized through systems and procedures which ensure that the direction and targets set by a strategy are being achieved. The next section in this chapter looks at management cycles in more detail.

Accounting is about knowing where you are in meeting a strategy. It is a key part of the management cycle. It may also be used in a broader sense in which it includes reporting and auditing. An organization without accounting is blind. Some of the main tools and techniques included within accounting in a broad sense are described in Chapter 8.

Finally, *measurement* is about being in touch with the world, and is one of the foundations of accounting. An organization without measures has no grip. Measurement requires knowing which indicators to use to provide a complete account of the organization's achievements – financial, economic, environmental or social. Indicators are discussed in further detail in Chapter 9.

A number of the more prominent codes and standards are described in Appendix 2, where each is mapped onto the strategy–management–accounting–measurement framework described above.

Management cycles

This section describes systems appropriate to the management of environmental, social and economic impacts. It describes how responsibility for environmental, social and economic impacts may be integrated with normal management processes, including the adoption of suitable codes and standards. First, a generic management cycle is described, and then the variations that apply to each of the dimensions of sustainability requires to the cycle are discussed.

Figure 7.2 illustrates a generic management system. Figures 7.3 to 7.5 illustrate the application of it. The generic management system is drawn as a cycle of activities, which suggests the order in which the activities take place. This is both useful and also misleading. It is misleading because most of the activities will take place continuously throughout the cycle. Nevertheless, the portrayal as a cycle brings out the logical relationships that each activity bears to the others, and is particularly helpful the first time round the cycle. The cycle shows the main activities, rather than the formal control procedures. Formal control procedures have been well documented in quality control systems and in some of the formal management systems appropriate to the dimensions of impact, which are discussed later.

Management cycles for sustainability

The way in which the generic management cycle may be implemented for each of the dimensions of sustainability is set out in Figures 7.3 to 7.5. The centre of each diagram identifies examples of that type of management system. Some of the main points of difference between the management cycles specific to each of the dimensions are then described.

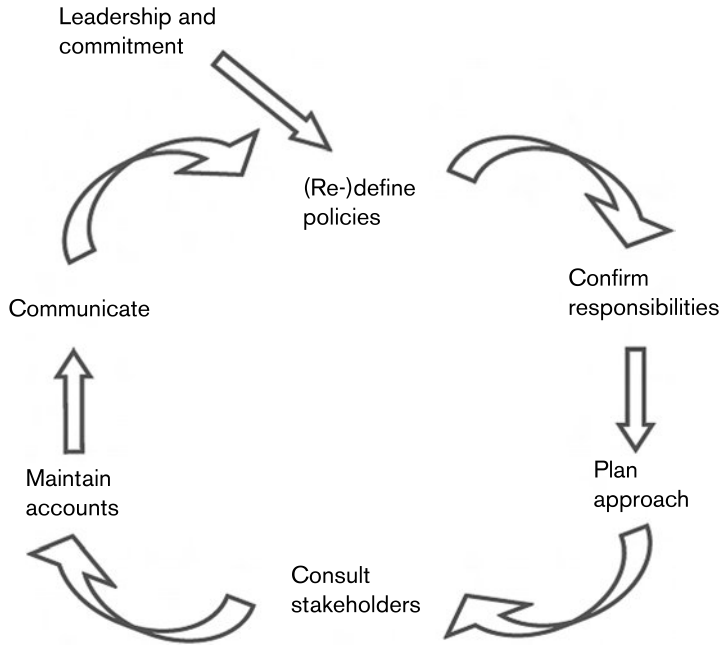


Figure 7.2: *The management cycle*

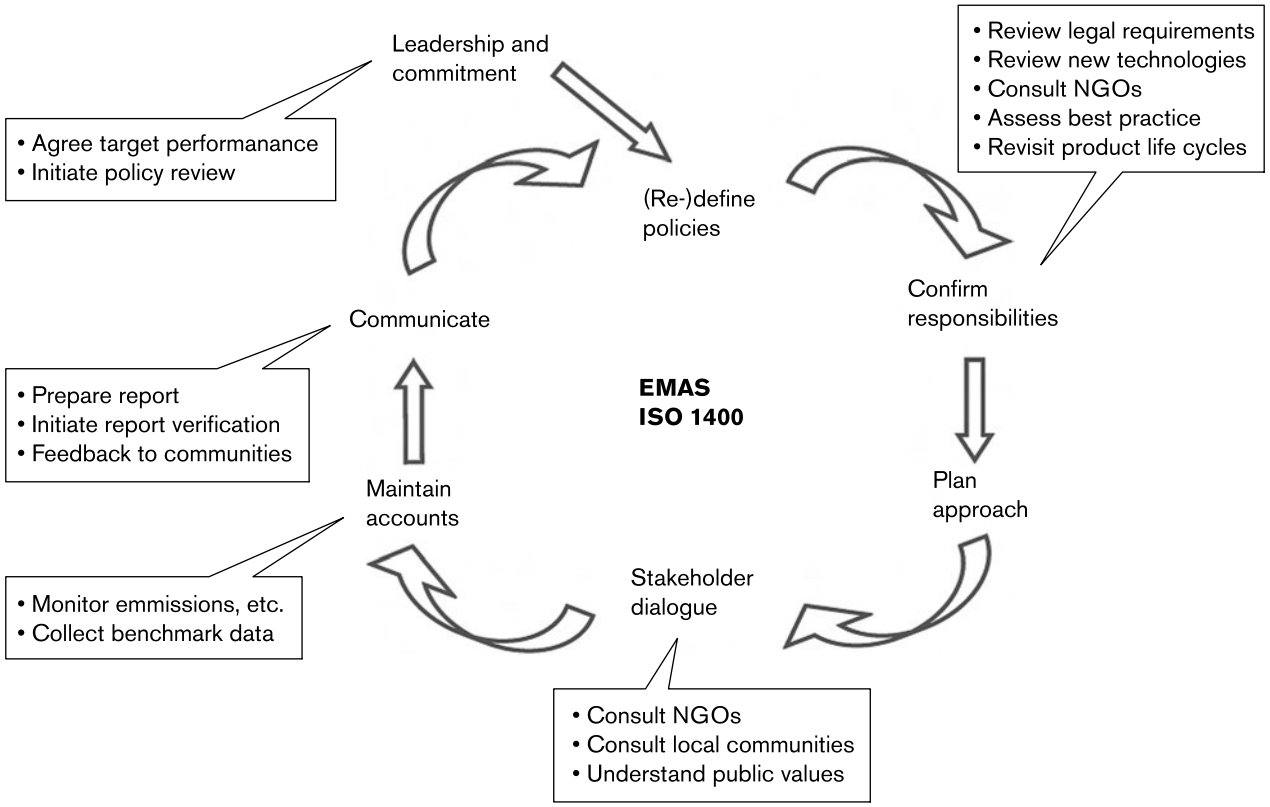


Figure 7.3: *The environmental management cycle*

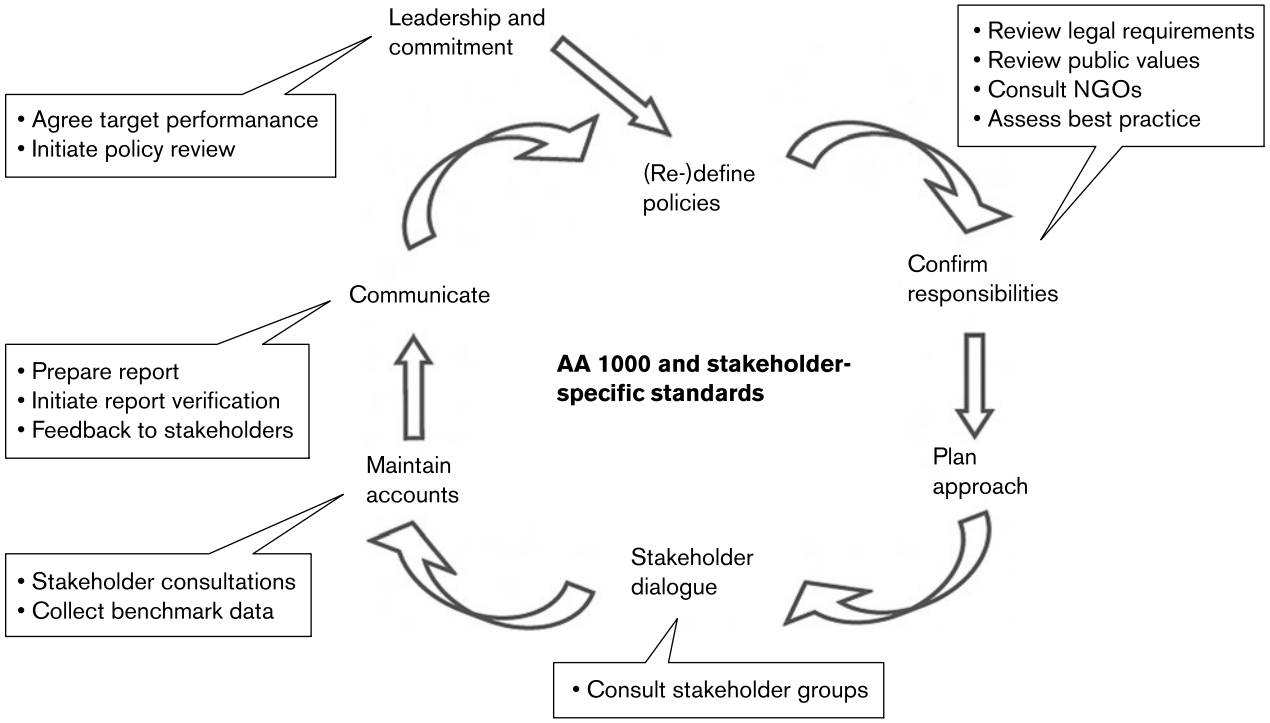


Figure 7.4: *The social management cycle*

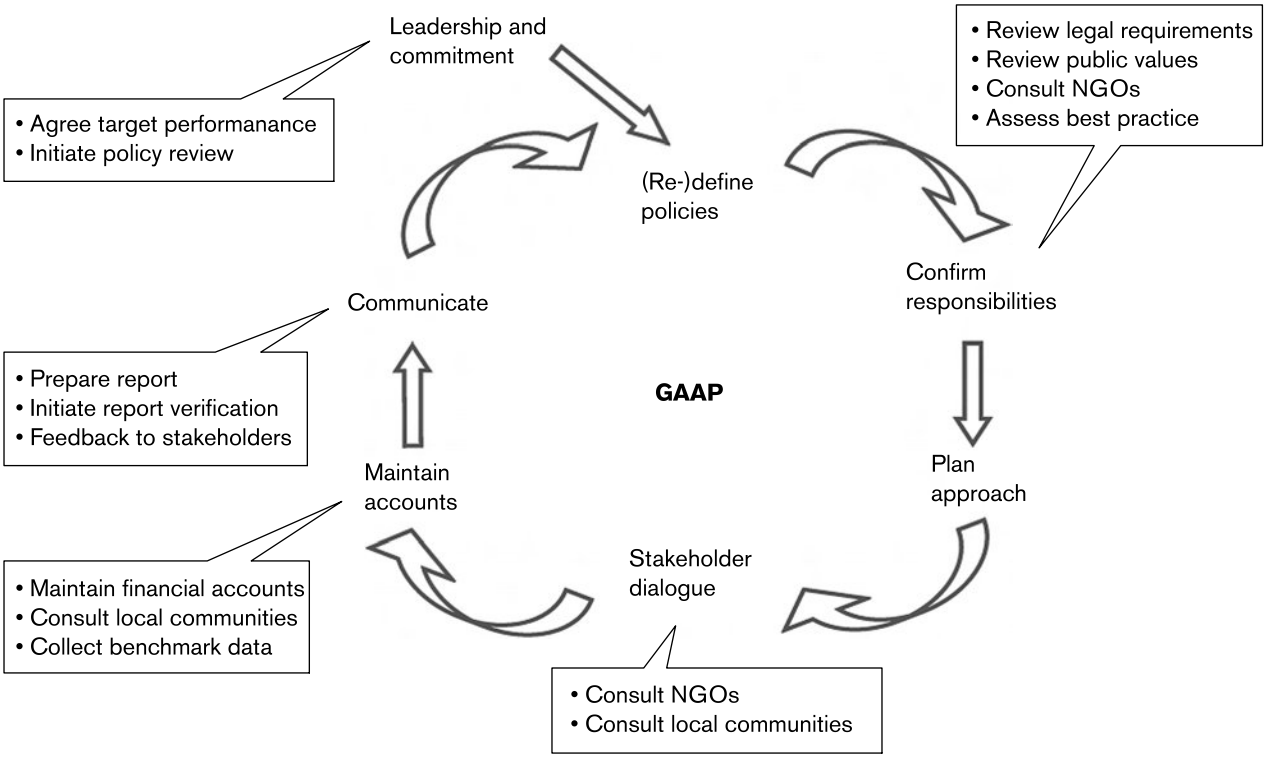


Figure 7.5: *The economic management cycle*

In general, the policies for each cycle will be issue based. So, for example, a company mining ore might be particularly concerned with the impact on local communities and need to demonstrate that it is not abusing human rights through its operations. A specific policy may be developed for this issue or the organization may decide to adopt a specific standard or code of practice. (A possible mapping of environmental, social and economic issues against industrial sector is given in Appendix 3.) Note, however, that the proper management of overall social performance will also require that significant impacts on all stakeholder issues be captured.

The planning activity will address not only the project management of the other activities, but may also be supplemented by the use of formal standards. Many of the appropriate codes and standards are based on the model of management control based on quality standards, such as ISO 9000:2005. Environmental standards include the ISO 14000:2005 series standards. Social codes include Assurance Standard AA1000:1999, which is a general code for stakeholder inclusion, and corporate governance codes, such as those that may be required for company listing. However, there may also be additional codes or standards for specific stakeholders. SA8000 is an example of a code with a specific application to staff

conditions within supply chains. There are currently few economic codes and standards beyond what is applicable to financial accounting, such as the US Federal Accounting Standards Advisory Board's Generally Accepted Accounting Principles (GAAP).

The verification of reports is similar for each dimension, except that stakeholder involvement requires additional consideration, within any of the dimensions. For verification to be credible, the stakeholder needs to have trust in the verifying party. Therefore, the choice of verifier is important, and if there are stakeholders with very different perspectives, a combination of organizations may be necessary. In addition, the verification of stakeholder dialogue requires that the dialogue itself be witnessed as part of the verification process. This means that it is not possible to involve a verifier only at the stage at which a report has been prepared. It is necessary for some involvement at critical stakeholder interactions.

Pitfalls of getting started

Implementing a serious sustainability project for the first time in a company will obviously require confronting all the typical issues facing any new project, including:

- gaining support and buy-in from senior management;
- obtaining resources, including staff time, to work on the project;
- obtaining cooperation from the operational areas of the company.

However, there is also a particular difficulty faced by sustainability projects. This is the difficulty of managing the tension between new aspirations and current actual behaviour. It is very difficult to maintain real commitment to sustainability, while being painfully aware of the actual behaviour of the company, which may be very different indeed. This creates tension in itself, but should the company become the object of the attentions of campaigning NGOs, the initiation of a sustainability project may seem dangerous.

While most NGOs are realistic enough to allow a company a period of grace to implement change, there may still be a psychological difficulty for staff. This can breed cynicism and undermine the project.

Some of the ways in which such tension may manifest include (Figure 7.6):

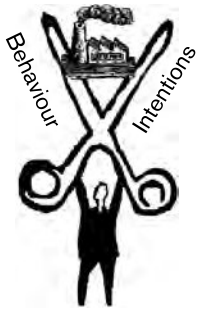


Figure 7.6: *Holding the tension*

- proclaiming a new statement of business principles, while day-to-day behaviour remains the same;
- committing to regular or systematic reporting and accounting, while the end of year reporting involves a chaotic process of gathering whatever data are to hand;
- committing to sustainability and the development of new businesses, while the core business remains manifestly unsustainable.

This tension can be managed. Provided, of course, that the brave new commitments are real, tension will be alleviated as actual change in the right direction occurs. In the meantime, it is very important to acknowledge what the situation is – how unsustainable, unethical impacts do occur – but also to demonstrate what plans are in hand to improve things.

Tools and techniques 8

This chapter describes a set of tools and techniques that may be helpful in assessing and managing environmental impact. None of the tools on its own will be sufficient to capture or manage the full range of sustainability impacts. Also, the tools function on very different levels – some are very precise but perhaps limited in scope, while others are very broad in scope but leave much work to be done on the practical application. Some require the application of others - and so on.

The tools are listed in alphabetical order and descriptions cover, where appropriate:

- the nature of the tool;
- uses;
- advantages and disadvantages.

The descriptions of the tools are not intended to be definitive accounts. However, they should be sufficient for the reader to know whether a particular tool may be suitable for an intended application.

Auditing

Auditing involves the review and assessment of systems, accounts or reports. It is most often encountered over the auditing of reports, which results in a formal statement (the verification statement) by a third party as to the truth and balance of the report of the accounts. It usually comprises a self-contained section within the report.

An audit report is necessary because the accounts and the report of the accounts will have been produced by the organization itself and approved by its management. Just as the role of the auditor in relation to financial reports is to provide assurance, as a trusted third party, to shareholders, the role of the auditor for sustainability reports is to provide assurance to the full range of stakeholders of the organization.

The work of auditing, the cost of which is borne by the organization preparing the report, involves:

- witnessing elements of stakeholder dialogue;
- reviewing the selection of issues and scope of the report;
- reviewing the accuracy of the statements within the report;
- preparing a verification statement commenting on the above, and including a description of the relationship of the auditor with the organization.

The qualities necessary for the auditor include technical and professional competency, but above all legitimacy and credibility with, and the trust of, the stakeholders. It may be difficult to find a single organization that possess all these qualities. Indeed, an organization that is credible to one stakeholder may have very little credibility for another.

Big meeting

The big meeting is a technique for stakeholder consultation. It involves a large number of representatives of different stakeholder groups meeting for half a day to a day. Up to 50 or more participants may attend. The meeting is professionally facilitated. The objective is usually to discover the issues of concern to stakeholder groups. The selection of participants should be undertaken with great care to ensure that a balance of views and interests will be represented.

Participants may include:

- company representatives;
- non-governmental organization (NGO) interest groups;
- relevant technical experts;
- facilitators;
- local community representatives.

The programme for such a meeting may include some or all of the following:

- a presentation about the company convening the meeting;
- a discussion about the agenda and what the company and the participants each expect to achieve;

- an open discussion or workshops to identify and prioritize issues;
- a discussion about what actions are reasonable.

Historically, the big meeting technique has been used particularly to deliver, and be seen to deliver, stakeholder consultation on environmental issues. It has been a popular method for the utilities sectors and for companies facing particularly severe criticism for their actions.

The advantages of the technique are that it can:

- allow different groups of stakeholders to exchange views with each other – it is perhaps as much a vehicle for such an exchange of views as for direct stakeholder consultation itself;
- make effective use of expert knowledge – this makes it particularly suitable for dealing with complex environmental issues;
- build consensus over appropriate actions.

The disadvantages are that:

- it may be used as a substitute for direct stakeholder consultation – big meetings do not necessarily treat each stakeholder group with equal attention;
- stakeholders may be inhibited in directly expressing their views because of the presence of other stakeholder groups and of company representatives;
- it relies on 'representative stakeholders' (i.e. NGOs or other 'leaders') – the views of the public, or customers, for example, cannot be systematically accessed by this method and therefore it should not be used as the sole technique of stakeholder dialogue.

Citizens' jury (citizens' panel)

The citizens' jury is a technique for stakeholder consultation. It involves the selection of a group of 'citizens' (i.e. members of the public) who then sit on a panel or jury in judgement over specific issues.

The technique requires:

- a process for selecting participants;
- the briefing of the jury;
- a degree of stage management, to maintain the juridical approach.

The citizens' jury has been used for two sorts of situation. One use is for arriving at views on policy matters. The second is to arrive at views on specific issues that have confronted an organization. Examples of the latter include customer complaints.

The advantages of a citizens' jury are:

- it results in a public view or judgement;
- the judgements should withstand tests of 'reasonableness'.

The disadvantages are:

- members of the jury may be self-selecting to some extent – simply by agreeing to take part;
- it cannot be used to gauge the views of a stakeholder group systematically;
- it can be seen as a public relations gimmick.

Cost–benefit analysis

Aspects of cost–benefit analysis are discussed in more depth in Chapter 10. This section gives only the key points of the cost–benefit analysis for comparison with other methods.

Cost–benefit analysis is a formal technique for comparing costs and benefits arising from an initiative. It formally compares the cash flows into and out of a company and produces a quantified result.

The technique requires:

- identification of the sources of cash flows;
- quantitation of the anticipated volumes of the cash flows over time;
- calculating critical values on the basis of the cash flows, which may be used to inform a decision about the initiative.

Cost–benefit analysis is very widely used to assess the financial wisdom of specific projects or investments. Its main use is outside the context of sustainability; however, it has served

as a framework for environmental and social impact assessments. It is also suitable for detailed analysis of the economic impacts of an organization (once they have been identified).

The advantages of cost–benefit analysis are:

- the methodology is well-established;
- the precision with which findings can be presented;
- the quantitative nature of the results.

The disadvantages are:

- the need to estimate the magnitude of cash flows;
- the tremendous difficulty of translating environmental and social impacts into financial quantities – there is a danger of treating impacts that cannot be readily be translated into financial quantities as of zero financial value, or of putting absurd values on them.

Economic accounting

See Financial accounting, p. 121.

Environmental accounting

Environmental accounting is a fundamental tool for sustainability. It involves keeping records of interactions with the environment. (See also: Environmental valuation, p. 120; Impact ssessment, p. 122; Life cycle analysis, p. 124.) There are two major types of environmental accounts, according to the units in which they are denominated. Some records may be denominated in units of currency, and can be considered an aspect of financial accounting; others may be denominated in the units in which the actual environmental impact is measured, and are known as 'native environmental accounts'. Both types of information are important for managing environmental impacts. The description of financial accounts as a tool for environmental management is considered under Financial accounting (see p. 121).

Native environmental accounts seek to record environmental impacts. Chapter 9 gives a schema for the major categories of environmental impact (see p. 138). This structure may be regarded as an environmental 'chart of accounts'. The task of maintaining environmental accounts, then, is the continuing collection of information on environmental impacts. It is crucial, however, to ensure that the actual indicators used for environmental accounting reflect the ways in which the organization actually affects the environment.

One of the issues for environmental accounting is how to deal with the various physical sites that may be the points of origin of waste or pollution, for example. The key environmental management systems are site oriented. It is important to preserve site-based information. However, it is also important to obtain a full picture of the overall impact of an organization. Therefore, the information must be consolidated in some way. This may give rise to problems as basic as ensuring that the same units of measurement are used.

Environmental footprint

Environmental footprinting is a technique used to calculate the area of land needed to supply all the environmental services used by a specified area. The ratio between the two is an intuitive indicator of environmental dependency. The population of a town, for example, will require a host of services, including land to grow food. If that were the only service utilized, the footprint would be the area of land required to grow the town's food, which alone is likely to be very much greater than that occupied by the town itself.

The technique has been applied to nations, towns, regions and states. It can also be applied to industrial sites. It works well where the dependent area is well defined. It does not work so well as an indicator for organizations that occupy multiple sites, although in principle it can be so used.

The key advantage of environmental footprinting is that it provides a very good indicator in terms of communication.

The main disadvantages with environmental footprinting include:

- the difficulty of calculating the services and the corresponding service area;
- finding a way to include services that are not directly related to land use, such as those related to the sea.

Environmental impact added statement

An environmental impact added statement is a way of structuring environmental accounts. It is a complete record of all material flows and energy flows into and out of an organization. 'Material flow' (or 'mass balance') is thus included in an environmental impact added statement. An environmental impact added statement should balance, with all matter and energy accounted for across the operations of an organization.

An alternative approach is to use 'loss-tracking', which focuses on those elements of matter or energy that are 'lost' in the sense that they are not part of the manufactured product. These quantities may be considered as signs of inefficiency and sources of pollution.

The environmental impact added statement is particularly appropriate for traditional manufacturing operations. For these it captures some of the major impacts and any movement towards dematerialization of the company's products. It is less suitable for, or rather it gives only an incomplete picture of, expressing the impacts of service-oriented companies.

The advantages of the environmental impact added statement approach are that it:

- allows consolidation (provided comparable methodologies are used at different sites);
- facilitates compliance with regulations such as the Toxic Release Inventory in the USA and the comparable European regulation;
- can be fairly readily analysed and related to the structure of company operations (e.g. by product or site).

The disadvantages of this method are that it does not:

- directly relate to the actual environmental impact of an organization;
- capture impacts on specific ecosystems.

Environmental impact assessment

See Impact assessment, p. 122.

Environmental valuation

Environmental valuation is a set of techniques designed to place a monetary value on environmental impacts. It may be used to support financial accounting or cost–benefit analyses.

The techniques include:

- identifying actual remedial expenditure as a lower limit for environmental damage (e.g. the cost of treating water to make it drinkable constitutes a lower limit for the environmental damage resulting from water pollution);
- determining actual reactive expenditure to limit environmental damage (e.g. extra insulation against noise);
- determining actual or potential preventive expenditure (e.g. end-of-pipe technology to limit air pollution at power stations);
- estimating the market price of goods gathered without payment (e.g. fish or firewood)
- using proxy markets to estimate demand curves (e.g. the market for tourism could be used to estimate the demand for protected areas);
- surveying stakeholders to estimate their willingness to pay for a given environmental good or the willingness to accept a payment in lieu of such a good.

The problems associated with valuation techniques include:

- the difficulty of getting data and the consequent limitation of such techniques to a relatively small subset of environmental impacts;
- the different results obtained from using different techniques (e.g. willingness to pay and willingness to accept can alone vary by a ratio of 10 to 1);

Valuation methods are at their strongest when used to value restitution of environmental damage, such as sequestration of carbon dioxide. They have fundamental problems where:

- they are applied to environmental goods resulting from 'commons' (e.g. biodiversity in rainforests or the sea);
- reference is made to existing markets, which typically do not include economic externalities.

Financial accounting

Traditional financial accounting, which is regulated in the interests of shareholders, is a critical part of economic accounting. The heart of financial accounting is a structured record-keeping to enable periodic descriptions to be made of how the business has affected shareholders' capital. There is currently no equivalent for the overall economic impact of an organization.

The way in which financial accounting standards deal with environmental issues is currently a matter of active debate. However, assuming that financial accounting captures the major financial impacts on a business, some of these will arise as a result of specifically environmental interactions. These financial–environmental accounts include environmentally induced expenditure and environmental liabilities (Schaltegger and Burritt 2000).

Environmentally induced expenditure may arise because of:

- fines for environmental damage or breach of regulations;
- costs of clean-up of pollution;
- legal costs actually paid;
- the costs of investing in environmental management and protection measures.

The question of when environmentally induced expenditure may be capitalized (i.e. treated as an investment) is currently an issue over which the various national financial standards bodies do not agree. Environmental liabilities may also arise when, for example, environmental damage is known to have occurred and the organization will have to make amends, but has not yet done so.

The financial accounting for social impacts is less well developed than that for environmental impacts. Nevertheless, in a number of European accounting regimes, information on social expenditure is required by law, or regularly volunteered by significant numbers of companies and included in their financial reports (Gray et al 1996). This information includes:

- political donations;
- community involvement;
- sponsorship and advertising;

- charitable donations;
- legal proceedings;
- investment policies.

The methodology of financial reporting on profit and loss and the balance sheet can be extended to include the financial implications of a much greater range of environmental and social issues. Where a company wishes to extend the range of issues for which it will take responsibility, the range of associated expenditures and provisions can also be extended. For environmental damage, for example, the costs of carbon emissions can be calculated in terms of the cost to remove or sequestrate each tonne of carbon. This cost can be included in the accounts to affect both the profit and loss statement and the balance sheet. This is a tool that brings home to senior management the actual costs of company impacts, and it can also lead to corresponding actual expenditure to correct any damage. This approach works well where:

- there are clear areas of adverse impact;
- the priority areas of impact are known;
- restitution costs are easy to calculate.

Impact assessment

'Impact assessment' is a term used to describe a portfolio of techniques that may be used to prioritize the environmental, social and economic impacts to which an organization will pay particular attention. The portfolio is particularly well developed for environmental impacts, but is applicable, at least in part, to social and economic impacts.

The various techniques are each addressed to a particular question or issue, which may be regarded as a defining one for a given organization or initiative. There is no consensus on the applicability of the various techniques, and each has its advantages and disadvantages.

Some of the most commonly used techniques include:

- Analysing impacts according to their contribution to particular problems. For example, if global warming is deemed to be an overriding issue, then measures and control of carbon dioxide emissions may be the priority.

- Volume-based targets. The 'Factor 4' and 'Factor 10' approach favours concentrating on the volume of resources required to produce each unit of output, and setting targets for their reduction by factors of 4 or 10.
- Space-based analysis. The environmental footprint method, described above, relates the total land area necessary to maintain a specified area, such as a town.
- Energy-based methods. These focus on the energy required for production.
- Regulation-based analysis. This favours concentrating on the targets or limits set by regulatory authorities or governments for carbon dioxide emissions, energy use, pollution or other impacts.
- Valuation methods. These suggest that impacts should be priced, in accordance with methods such as environmental valuation described above. The resultant pricing can be used to determine priorities.
- Stakeholder prioritization. This relies on stakeholders, via stakeholder consultation, to determine the appropriate priorities. Consequently, this method may in practice overlap with, or in the end require, one of the other methods in order to determine priorities. It has the advantage that it may be applied to social and economic impacts as well as environmental impacts.

All the above methods may be useful in particular circumstances. However, it would be dangerous to rely on a fixed method for prioritization, and particularly dangerous to confine accounting to the prioritized areas alone, as the accepted understanding of issues, regulation and other stakeholder pressures may well change over time. The management cycles described above provide for the regular review of such priorities.

Interviews

Interviews are one of the tools for stakeholder dialogue. They involve a structured and 'confidential' conversation between someone acting for the company and an individual stakeholder. The conversation is usually confidential in that the identity of the person may not be revealed, unless their consent is freely given.

Interviews are widely used for market research. Their advantages are:

- they enable a deeper understanding of the issues of concern to the interviewee through probing and follow-up questioning;

- they provide a rich source of anecdotal indicators.

The disadvantages are:

- both the selection process for interview and the actual guidelines for interviewers need to be carefully constructed to ensure that the interviewee is neither being led nor inhibited from expressing their concerns;
- they are suitable only for individuals for whom interviewing is 'natural' and thus they are inappropriate in some cultures and subcultures;
- they may not be suitable for stakeholders who are particularly vulnerable, or who fear for their jobs or lives if their true views are expressed.

Life cycle analysis

Life cycle analysis involves the analysis of the impact of a particular product or service over the whole of its life – from raw material extraction through to manufacture, transport, use and waste, reuse or recycling. Historically, only environmental impacts have been seriously considered. Life cycle analysis is theoretically applied once for each new product.

The elements of a life cycle analysis are:

- defining the goal and scope of the analysis;
- inventory analysis of the impacts over the life cycle;
- impact assessment (which is described above) of the impacts to identify the most significant;
- interpretation or improvement assessment, to identify the scope for improvement in the product.

Life cycle analysis has been well researched and there is now an international standard (ISO 14040:2006) covering the development of life cycle analyses. Life cycle analysis is also recommended or accepted by regulatory authorities in the USA and Europe.

This type of analysis is particularly suited to organizations responsible for the design and manufacture of physical products and where pollution or toxic impacts are an issue. It has rather less application, at least regarding environmental impacts, to service industries.

Its advantages are that it:

- represents an explicit extension of the boundary of responsibility that an organization accepts;
- encourages attention being paid to the design stage of products, at which improvements can be made most cost-effectively;
- can, in principle, be extended to include social and economic impacts.

Its principal disadvantages are that:

- It may be considered as a one-time solution. A one-time assessment of impacts is unlikely to predict accurately and aggregate successfully the impacts arising in different locations or as circumstances change. It may be better considered as a process that is repeated as necessary.
- It relies on impact assessments, which have their own significant problems.

Mass balance

See Environmental impact added statement, p. 119.

Materials flow analysis

See Environmental impact added statement, p. 119.

Qualitative market research

Qualitative market research involves the gathering of the views of a relatively small group of subjects. It is often used as a preliminary technique prior to quantitative market research. It typically involves either interviews or focus groups to solicit stakeholder views.

Focus groups involve a facilitated discussion between a group of up to 10 people.

For further comments, see Interviews, p. 123.

Quantitative market research

Quantitative market research involves the soliciting of the views of relatively large numbers of people through systematic techniques such as questionnaires. The questionnaires may be administered either in person or by post or e-mail.

Quantitative market research is one of the key techniques for market analysis. It is also widely used for social accounting, particularly for customers as a stakeholder group.

Its advantage is that it gives a quantifiable assessment of stakeholder views. Its disadvantages are that:

- it does not allow the in-depth pursuit of specific topics (the subject of the questionnaire has to be decided in advance);
- it is suitable only for individuals for whom questionnaires are 'natural' and who are literate (they may be inappropriate for people from very different cultures);
- they may not be suitable for stakeholders who are particularly vulnerable, or who fear for their jobs or lives if their true views are expressed.

Reporting

Reporting is one of the main techniques for achieving transparency and accountability. Sustainability reporting is also a key tool for stakeholder dialogue. Reporting presents many of the same issues whether the subject matter is environmental, social, economic, or all three, in nature. Although some stakeholders will require specifically tailored feedback, general public reporting involves the presentation of the environmental, social and economic accounts back to all stakeholders.

The UK Companies Act 2006 requires companies to provide shareholders with the information necessary to understand the company's strategy and prospects, making reference to risks, resources and relationships, and to social, employee and environmental issues, where relevant. Under the Act the board should report on corporate responsibility, to the extent necessary for shareholders to understand the company's strategy, risks, resources or relationships. It is worth noting that a report for shareholders about strategically relevant issues would not contain information that is not, in the board's view,

strategically relevant. Such issues should be contained elsewhere in the annual report – perhaps in the company's governance reporting – or in a separate corporate responsibility report. On the other hand, where corporate responsibility is strategically important, a clear account may enable investors to give more weight to the risks associated with irresponsibility and to the contribution of responsible behaviour to intangible assets and long-term success. This could, in turn, help to reward responsible companies with higher share prices, and reduce the pressures and temptations for improper behaviour.

Other than the financial component, there are few agreed codes or standards for sustainability reporting, although there are some very influential initiatives that have developed guidelines, such as the Global Reporting Initiative (GRI) (see Appendix 2).

The principal requirement for reporting is the need to present a systematic description of the sustainability impacts of an organization. Reports may be tailored to specific stakeholders, issues, sites or countries. However, reports should contain:

- a description of the business of the organization and its vision for its sustainability;
- a statement of the scope of the report and the approach taken to reporting;
- an account of the boundary of responsibility that the organization acknowledges;
- a description of the way in which decisions affecting responsibility are made;
- an account of the policies for sustainability and how such issues are managed;
- a systematic presentation of the sustainability impacts of the organization.

One particular problem with reporting is the need to produce a structure that will be accessible to the various readers of the report. Reports may be structured in several ways, in particular by:

- the dimensions of sustainability (environment, social and economic);
- the stakeholders;
- issues;
- geographical presence.

Unfortunately, these structures are not mutually compatible. And to make things harder, there is no easy way to produce consolidated reports that summarize the various impacts across different countries. This is particularly a problem in the social dimension. However, the use of the Internet for web-based reporting may go some way to ease these

difficulties. It is possible to present the same material in a variety of different structures using the web.

Large companies face particular problems with the production of such reports, because it is difficult to reconcile the extensive range of their activities with an accessible report. This is a real problem, particularly when credibility is an issue. Web-based reporting, which is becoming increasingly popular, can, if well designed, allow each person to investigate the material in their own way. On the other hand, it may make it difficult for the reader to get a systematic overall view.

A further issue is how far to integrate the reporting of environmental, social and economic impacts. It is useful to make sure that each dimension of sustainability is fully understood, before trying to integrate it with the others. Whatever the theoretical desirability of such integration, it is more important to be able to account for and manage the impacts. It might, therefore, be appropriate to produce a report for only one dimension (most likely, environmental impact) first and to follow with others. Again, it may be easier to report on each dimension separately before trying to produce a combined report. Furthermore, when a combined report is a reality, there are further questions as to whether it merely contains a separate section for each of the dimensions or actually achieves real integration – and also whether such a report is separate from the annual report.

Social accounting

Social accounting is a fundamental tool for sustainability, supporting an organization's efforts to manage its accountability and social impacts. It involves keeping records of company interactions with society – excluding the environment for this purpose. As for environmental accounting, there are two major types of social accounts, according to the units in which they are denominated. Some records may be denominated in units of currency, and can be considered an aspect of financial accounting; others may be denominated in the units in which the actual social impact is measured (native social accounts). Both types of information are important for managing social impacts. The description of financial accounts as a tool for social management is considered under Financial accounting (see p. 121).

Native social accounts seek to record social impacts. Chapter 9 provides a schema for the major categories of social impact (see p. 139). This structure may be regarded as a social

'chart of accounts'. In general, a set of social accounts will be organized by stakeholder. The task of maintaining social accounts, then, is the continuing collection of information on social impacts. Of course most organizations already assemble considerable information on their stakeholder interactions, particularly for staff, and these can be used as the starting point for the social accounts.

It is crucial, however, to ensure that the actual indicators used for social accounting reflect the ways in which the organization actually affects its stakeholders, and central to this is an adequate identification of stakeholders and the elicitation of key stakeholder issues.

Social impact assessment

See Impact assessment, p. 122.

Indicators 9

Defining terms

Indicators are used to simplify, measure and communicate complex trends or events. A single indicator, however, will not usually give a comprehensive picture of a situation, and is therefore a part of, rather than a replacement for, more detailed analytical techniques. For businesses, indicators serve multiple purposes, they (SustainAbility Ltd 1999):

- provide enterprises with a management tool to enhance the quality of their operations through continual improvement;
- guide policies and decision-making at all levels of the organization;
- aid priority setting by providing early warning of adverse trends;
- strengthen public accountability by addressing the needs and expectations of external stakeholders.

An indicator is a variable that provides insight into an issue. The purpose of determining indicators is to manage the underlying issue. Although indicators are categorized as social, environmental or economic indicators, the reality is not as clear-cut. This is particularly the case with social indicators, as stakeholders are involved in determining them and stakeholder concerns are not only social in nature. Social indicators, therefore, may apply to environmental, economic as well as social aspects of performance. It follows that the relationship between an indicator and what it indicates may be quite subtle. For example, the wages of employees might be measured in pounds sterling. Yet, this particular indicator might be used to determine:

- the total wages received by an employee;
- the viability of the workforce;
- the quality of the human resource management.

A good indicator is one that:

- simplifies complex events or trends;
- is practical;

- is clearly defined and communicated well;
- is reproducible and can be monitored;
- is action-orientated.

Indicators may be:

- *quantitative* – e.g. tonnes of carbon dioxide emitted or the number of prosecutions brought under relevant equal opportunity law;
- *binary* – e.g. Was an equal opportunity policy in place? Did the company adhere to a particular code of conduct?
- *qualitative* – e.g. the number of staff familiar with the equal opportunity policy. Note that qualitative indicators can relate to perceptions and are expressed as the quantity of people who held a given view.
- *anecdotal* – e.g. 'I think our company policy towards ethnic minorities is excellent!' This type of indicator is, by definition, 'unrepresentative'. However, such indicators not only bring life to a report, they also may in fact be most directly related to what the indicator is trying to measure (i.e. outcomes), in this case perhaps company–staff relations.

Each of the above kinds of indicator may be useful. However, it is unlikely that one type alone can give a well-rounded picture. A set of indicators must be judged as a whole.

The diverse dimensions of sustainability bring with them the risk of information overload. For this reason it can be helpful to focus on the selection of a limited number of core indicators. Implicit within the selection of a core set of indicators are decisions over what is important. In reporting, the rationale behind such choices should always be made clear.

Involving stakeholders

It is not always straightforward for a company to determine the most appropriate indicators to use. Implicit within the selection of indicators is a view of what matters, and a model, or set of assumptions, as to why the indicator should work. At a fundamental level the indicators selected reflect values held and what the company is seeking to achieve. For example, conventional financial indicators – principally income and profitability – reflect progress towards these specific objectives. They do not necessarily reflect progress towards other goals.

Choosing indicators is not the same as determining satisfactory performance. Social performance, in particular, is not simply a technical issue of achieving specific goals, but is about culture and values. The only general rule is that stakeholders and their representatives or advocates need to play a key role, and need to be seen to play a key role, in designing and selecting indicators. Certainly the design of indicators cannot be completed except through stakeholder dialogue. Dialogue and indicators are intimately related, and build each other's quality and effectiveness.

Indicators are also, therefore, not chosen just once, but are subject to challenge and change as relationships change, and understanding deepens. Indicators need to reflect an evolving set of differences in views and priorities among those involved and affected. The history of environmental and financial indicators reflects this. Financial indicators and reporting are still actively evolving, some 300 years after the basic concepts were first articulated.

Indicators can measure company performance at three levels:

- *Company values, objectives and policies* – What is the company trying to achieve as part of its overall mission statement in relation to sustainability and also in relation to a given stakeholder? Answers to these questions will suggest indicators that naturally relate to some of the targets that a company should set for its performance.
- *Stakeholder values* – What is important to the stakeholders? How do they think it should be evaluated? These indicators may be identified during stakeholder dialogue processes.
- *Environmental, social and economic norms* – These are the 'benchmark' concerns established in the societies in which the organization is active. This includes market comparisons, which help the comparison of the company in question with others of its type.

Making these three levels and their indicators distinct and clear allows for a more systematic approach to all parts of the management cycle. It encourages a more global reach to reporting, not only across countries, but also, critically, across different parts of large companies operating in different countries. For example, for a large company, corporate aims may be identical across the group at management level. Yet, aims and expectations at the other levels may be very different. Where actual or apparent tensions exist between the values held at different levels, working across the three levels allows this to be transparent, which itself has enormous value. One example of this situation could be equal opportunity

as a corporate aim, while gender-based inequality is institutionalized in many countries of operation.

With regard to stakeholders, a good indicator is one that:

- has been developed in a participatory way with stakeholders;
- is meaningful to stakeholders – it should measure something believed to be important or significant in its own right;
- can be compared against the performance of other organizations, social norms and over time.

A target is a particular value of an indicator that the company is trying to achieve.

Process and substantive indicators

There are some complex issues connected with the distinction between 'process' and 'substantive' indicators. At its simplest, a substantive indicator is one that directly captures an impact, and a process element is one that describes how something is managed. A substantive environmental indicator, for example, could be the number of tonnes of carbon dioxide emitted by an organization. A corresponding process indicator might be the existence (or otherwise) of a management system to control the emission of carbon dioxide.

However, this distinction is rarely so neat in practice, particularly where social standards are concerned. The first issue concerns the level of detail at which an element is defined. If the substantive indicator 'tonnes of carbon dioxide' is replaced by a more abstract indicator, such as 'greenhouse gases', then process issues appear in the form of questions such as: How are greenhouse gases measured? The same is true for social elements. It appears that indicators and standards have fractal properties, in that, for almost any level of detail, it is possible to define both substantive (the 'what') and process (the 'how') aspects for a given element.

Social elements have an additional layer of complexity. This is that process elements, particularly in relation to accountability, are perceived as elements of substantive performance in their own right. In other words, if stakeholders care about an organization's performance, it matters to them how accountable those organizations are for that aspect of its performance. This again means, and in a different way, that the same element may be

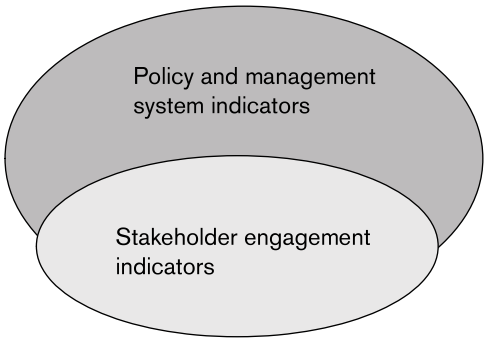


Figure 9.1: *The overlap of process and substantive indicators*

considered to be both substantive and process at the same time. For example, the level of pay for staff can be seen as a substantive matter. How pay levels are set (a process element) also matters in its own right, and can be a source of satisfaction or dissatisfaction in itself.

Therefore, in order to generate meaningful measures of performance, indicators need to cover both process (i.e. management) and substantive (i.e. achievement) aspects of performance. Good process performance should, indirectly, lead to good substantive performance, as it should generate good substantive indicators.

Process indicators are used to measure two main aspects of performance. First, given that stakeholders need to be involved in designing and selecting indicators, process indicators are needed to measure the quality of stakeholder engagement itself. Secondly, process indicators are also used to capture the existence and effectiveness of policies, objectives and management systems. In practice these two aspects overlap (Figure 9.1).

Process indicators relate to the process of management of particular issues. Process indicators therefore relate to the:

- existence and implementation of company mission and vision;
- existence and implementation of policies for each stakeholder;
- articulation of company and stakeholder values;
- implementation of dialogue with stakeholders;
- extent of inclusion of stakeholders in decision-making.

Process indicators are also closely linked to the question of governance. This is because process indicators can measure not only whether there is a management system in place

but also how decisions are made and how the indicators themselves are chosen. Process indicators would capture, for example:

- the existence of policies for stakeholder engagement;
- the existence of environmental, social and economic policies;
- how dialogue processes address the issue of power;
- the involvement of stakeholders in identifying indicators;
- the practice of setting targets for improving performance.

It is relatively straightforward to categorize substantive indictors as social, economic, environmental or a combination of these. This categorization is more difficult and less useful with process indicators. This is because process indicators may provide insight into company performance across *all three* dimensions of sustainability. For example, process indicators can be used to measure the existence and effectiveness of both an environmental policy and a social policy. Furthermore, process indicators are used to capture the quality of stakeholder engagement in relation to environmental, social or economic issues.

One of the advantages of working with process indicators is that they provide particular insight into the quality of management in relation to social performance. A further advantage is that it is often possible to be far more definitive about process indicators than it is about substantive indicators. Standards can therefore offer guidance on process indicators that can be relied on to generate good substantive indicators suited to particular organizations, stakeholders and contexts.

Substantive indicators measure specific levels of impact that have been attained. A further way in which they are commonly categorized is as *input*, *output* or *outcome* indicators. Input and output indicators can often be quantified and may refer to physical quantities and/or financial values. Outcomes, on the other hand, are often best approximated through perceptions, which can of course also be represented and analysed quantitatively. This classification of indicators is most directly applicable to clearly defined project-based work, such as contribution to the local community. Table 9.1 defines and compares these different types of indicator in that context.

It is not possible to make such universal recommendations about indicators for substantive performance as it is for process performance. This is because views on what constitutes good and bad performance will vary in different contexts and in the light of specific stakeholder interests.

	Input indicators	Output indicators	Outcome indicators
Definition	Resources (e.g. money, effort) used	Deliverables produced (e.g. number of buildings erected)	The reason why the project was undertaken (e.g. improve health or community well-being)
Advantages	Easy to measure Can be measured early in project life	Easy to measure	Most directly related to project objectives
Disadvantages	Less meaningful	Can usefully be measured later in project life	Hard to measure (often qualitative) May take years to materialize May be affected by a wide variety of factors

Table 9.1: *Categorization of substantive indicators as input, output or outcome*

Practical indicators

This following subsections provides lists of suggested aspects of environmental, social and economic impact that are suitable for substantive indicators. It should be borne in mind that, in general, all indicators of an organization's performance should be confirmed by the organization's stakeholders. This list is therefore intended as a starting point only. It is also important to bear in mind that it does not:

- repeat, for each indicator, what targets have been set;
- repeat, for each indicator, performance against industry, national, international or good practice benchmarks;
- repeat, for each indicator, the performance over time against that indicator;
- include any process indicators (as for substantive indicators, it is possible in relation to each process indicator to have targets, benchmarks and performance time series).

The list of substantive indicators that follows has been made by drawing on various sources and current good practice. The environmental indicators are drawn particularly from the Global Reporting Initiative Guidelines.

Environmental aspects

This section lists some of the major environmental aspects which are relevant to many organizations. Clearly, the nature of the business will have an important impact on the relevance of some of the aspects.

- Energy use:
  - total;
  - analysis by energy source;
  - analysis by key uses (e.g. vehicles).
- Material use:
  - total use;
  - analysis by recycling;
  - analysis of packaging;
  - analysis of hazardous materials;
  - analysis of wild animals and plants used.
- Water:
  - total use;
  - impact on water sources.
- Emissions, effluent and waste:
  - tonnes of greenhouse gas emitted in carbon dioxide equivalents (Kyoto Protocol);
  - ozone-depleting emissions (Montreal Protocol);
  - total waste (analysis of nature, destination and estimation method);
  - analysis of waste returned to market (including legal requirements);
  - analysis of waste to land, effluent to water and emissions to air (by type and recipient water bodies);
  - impacts on local communities.
- Product transport analysis.
- Product impacts:
  - life cycle analysis of product impacts.
- Land use:
  - analysis of land held by tenure type and ecosystem;
  - analysis of habitat changes as a result of land use;
  - impact on protected areas.
- Analysis of compliance with local, national and international laws and regulations.

Social aspects

This section lists substantive aspects that are relevant to the majority of direct stakeholders for many companies. Clearly, the nature of the business will have an important impact on the relevance of some of the aspects.

- Shareholders:
  - return on shares (analysis by dividend and capital growth);
  - compliance with legal requirements and good practice on corporate governance;
  - equality of treatment of shareholders (e.g. with respect to receipt of information and size of shareholding).
- Suppliers:
  - fair opportunity to tender;
  - clarity of specifications of supply;
  - fair contract terms in relation to payment schedules and price;
  - payment of invoices to schedule.
- Staff:
  - analysis of workforce in relation to equal opportunity for hiring, advancement and compensation, including training;
  - level of payment (regularity of payment, analysis of ratio of highest to lowest wages, and lowest to legal minima and local cost of living);
  - analysis of health and safety (including injury rates, lost days, absentee rates and investment per worker illness and injury prevention);
  - levels of child labour;
  - levels of forced labour;
  - freedom of association (analysis of staff associations, unions and legal actions concerning anti-union practices);
  - levels of required overtime;
  - analysis of disciplinary practices.
- Customers:
  - customer satisfaction;
  - analysis of product impacts on customers (including health and safety, environmental, social and economic aspects);
  - analysis of customer service provided (availability and use, response times);
  - analysis of customer feedback, including complaints.
- Local community:

  - level of use of security services, including their training and sourcing;
  - investment in local communities, including philanthropy;
  - analysis of impact of architecture, sites and buildings on local communities;
  - analysis of local volunteering schemes;
  - noise and smell impacts on local community.
- Competitors:
  - legal actions for anticompetitive behaviour.

Economic aspects

- Institutional financial performance:
  - share price;
  - profitability;
  - return on average capital employed;
  - earnings per share;
  - revenue;
  - productivity per worker, per natural resources.
- Investment:
  - analysis of investment in tangible assets;
  - analysis of intangible assets (including training, research, brand building);
  - analysis of acquisitions/divestments.
- Innovation:
  - inventions (including number of new patents per annum);
  - new products (including number of new products per annum);
  - partnerships sustained (analysis of partnerships with business (e.g. joint ventures), the public sector and civil society).
- Impact:
  - employment (levels and analysis by location);
  - taxes (location and level of payment; analysis of taxation at local, national and regional levels);
  - purchases (analysis of level of purchasing and location of purchasing);
  - local economy (percentage of suppliers from region/country of purchase);
  - structural changes (analysis of contribution to economic change, e.g. supply to/purchase from new sectors such as IT, communications, renewables and the social sector).

Other aspects

The list of stakeholders set out in the section of social aspects above is unlikely to be complete for any particular organization. The stakeholders listed represent those that most companies have in common. This section identifies some further stakeholders that many organizations will have, and which will therefore shape the performance measurement that is necessary. Rather than list further aspects, this section discusses the sort of issues, whether environmental, social or economic, that can arise in relating to them.

Regulators are stakeholders for many large industries in sectors such as the utilities and in any sector that is dominated nationally by only a few large companies. Relationships with regulators are, by their nature, formal. This makes it difficult to treat regulators as other stakeholders are treated or to be creative in ways to communicate with them.

The *supply chain* for a business includes its suppliers and extends to its suppliers' suppliers and their employees. Supply chain issues have been critical for companies in clothing, footwear and foods with a high visibility of their brand. The key issues have revolved around the discrepancy between standards expected by consumers in western markets and those that their suppliers' staff may be required to endure. As a result, a number of codes of conduct have developed, such as SA8000, which focus particularly on basic human rights and compliance with local laws, and also on environmental impacts. An especially important area is that of the management of supply chain issues, as the key to affecting performance indirectly. Note that it is still important to treat suppliers themselves as stakeholders in their own right.

The *demand chain* is a concept less well known, but with much of the significance of supply chains. The simplest demand chain consists simply of consumers. However, the organizations and individuals (whether wholesalers, agents or traders) that act as intermediaries may be included within the domain of responsibility of an organization. This is perhaps made most clear by the diamond industry, which is implementing a tracking system to ensure that all diamonds can be traced to their origin and thus diamonds originating from war zones can be identified.

Business partners are important in many different industries, from financial products to airlines. Business partnerships can vary form sales agencies to franchisees, joint venture partners and less formal alliances. This is an area that few companies have included in their social or environmental reporting. It is, however, one that looks as though it will be

increasingly important. Just as companies that have significant supply chains are being called upon to report on practices in the supply chain, so it is likely that business partnerships will need to be included.

The *media* are also key stakeholders for many organizations. However, like regulators, it is very difficult to engage them formally in stakeholder dialogue. While it is possible to gauge likely opinion, the nature of the media industries means that their interest in particular sectors is not sustained.

Pressure groups are also prominent stakeholders for many organizations. They may campaign on any of the full range of sustainability issues. One important issue is whether they should be treated as a separate stakeholder group, or within, say, the environmental area. There are instances of both types of approach to pressure groups. This raises a further question over the right which they have to speak for, or represent, the issue on which they focus. However, irrespective of the justification that they may have for taking the positions they do, they do in fact have a material impact upon organizations. They should therefore be included as significant stakeholders where appropriate.

Investment recipients are not often thought of as stakeholders for many organizations outside the financial sector, but the treasury operations of large companies or the constituents of holding companies can be immensely significant. Their significance is not only economic, but can extend also to social and environmental issues. A key issue is the extent to which social or environmental issues are taken into account in selecting and holding stocks.

Competitors are another stakeholder group with which it is often difficult to interact. Nevertheless, there is significant interaction with competitors over matters of mutual interest in industry or trade associations. Key issues can include the attitudes to new entrants and the way governments and other powerful groups are lobbied.

Governments are obviously also major stakeholders for all organizations. A key part of their function is to engage with companies about industry-wide issues. It is hard for them to engage with the specific issues of an individual company, unless that company is particularly large, or will have a particularly important impact. As with pressure groups, the issue of government accountability, and particularly their response to lobbying, may well be a prominent issue in its own right.

The business case 10

If corporate responsibility (CR) is how companies address sustainability, does this mean that from a business perspective it is simply about continuing forever? Although businesses do need continuity, and continuing positive cash flows are part of that, sustainability is also about continuing positive flows of wider economic, as well as social and environmental, impacts. Nevertheless, the task of justifying business decisions, in the traditional financial sense, will of course remain. It is relevant to argue that the business case should not be overemphasized, as a precondition for companies to work with CR. Strong corporate commitment to social responsibility does not necessarily involve concern for the financial bottom line. However, the corporate reality is that links to the financial bottom line must be considered, and a positive correlation between CR activities and financial performance will be important for market mechanisms to reward CR performance.

The business case: is good business good business?

Companies approach the task of justifying their decisions in many different ways. However, the preoccupation common to almost all methods is the need to be able to satisfy shareholders as to the wisdom of pursuing a particular line of business. Of course, shareholders are not the only audience, certainly not in the long term. The last few chapters should have made it clear that there are numerous other stakeholders, all of which need to be offered some kind of justification regarding the way a business is run. Nevertheless, shareholders are an absolutely vital stakeholder, and this chapter focuses on shareholder justification. It views the management of social and environmental impacts through the lens of financial impact.

There are two levels at which such an issue can be approached. The first is the empirical level – at which evidence is sought for the financial consequences of pursuing sustainability amongst the population of companies as a whole. This should be of interest to a

board. The second is the more pragmatic level of justifying specific proposals – which should of course also be of interest to a board.

> "*Corporate Sustainability leaders achieve their business goals by gearing their strategies and management to harness the market's potential for sustainability products and services while at the same time successfully reducing and avoiding sustainability costs and risks. It is this pursuit and management that creates long-term shareholder value.*"
>
> Dow Jones Sustainability Index

The first question anyone coming to the whole area of CR and sustainability will ask is: Is it good for business? A number of studies have addressed this question, but before looking at their findings it is important to understand the methodological difficulties faced in such studies.

To find an empirical correlation between financial performance and social or environmental performance, it is vital to be clear about the definitions of:

- financial performance;
- social performance;
- environmental performance.

From previous chapters it should be clear not only that social and environmental performance are not independent variables, but also that there are a great number of different measures of performance in the social and environmental dimensions. Any study that systematically addressed all of these would be enormous in scale – and in practice this has rarely been attempted. Most studies take one of two forms. They may take the form of a case study, which, however inspiring it may be, does not serve as a good basis for generalization. Alternatively, they may make use of some kind of proxy of social or environmental performance, such as a commitment to CR. This approach, while it allows generalization, does not indicate how improved performance needs to be achieved in practice.

The measurement of financial performance suffers from the opposite problem. There are a great many well-defined measures of financial performance, based on dividends, return on capital, share price, total shareholder return, market value added, etc. The problem here is choosing the most appropriate one to correlate with social or environmental performance. Depending on the indicator chosen, and the time perspective over which it is viewed, different findings may emerge.

There are two slightly more subtle methodological problems that should also be borne in mind before turning to what some of the studies have found. The first is how to think about any correlation between good environmental (or social) performance and financial performance. If the correlation is more than merely a statistical quirk, what is the nature of the causality? In other words, how does good environmental (or social) performance *cause* good financial performance? If that is not clear, then such studies may not inspire action.

The second is that the relationship between financial performance and environmental (or social) performance may not be susceptible to such empirical analysis. There may be so many variables influencing financial performance that it is impossible to isolate the influence of CR. For practical purposes, the relationship may therefore seem to be a chaotic one, in the formal sense that small changes in CR may have disproportionately large effects (good or bad) on financial performance. Of course this is precisely the sort of situation that statistical analyses should be able to clarify. Yet, until there is a sizeable population of companies that are clearly good social or environmental performers, it will not be possible to be definitive about the nature of a connection.

So, bearing all these issues in mind, what does the evidence look like? In summary:

- the hard evidence for a robust correlation between good social or financial performance has, in general, been considered weak (Zadek and Chapman 1998);
- the area of social performance that has been most strongly linked to good financial performance is related to reputation and employees;
- there is no evidence that good social or environmental performance leads to poor financial performance.

One way to gain a broad perspective on the financial impact of CR is the Dow Jones Sustainability Index (DJSI), which is prepared from a global base of companies. This is illustrated in Figure 10.1 against the performance of the general, all-company Morgan Stanley Capital International (MSCI). It is clear that the difference in the share price performance of the self-declared good sustainability performers is becoming more significant and favours sustainability. In interpreting the graph, it is instructive to bear in mind that a study conducted by Ernst & Young found that only 40% of company value can be directly related to financial performance.

Another study of top US companies by Verschoor (1999) found a good correlation between an explicit commitment to an ethical approach to business and market value

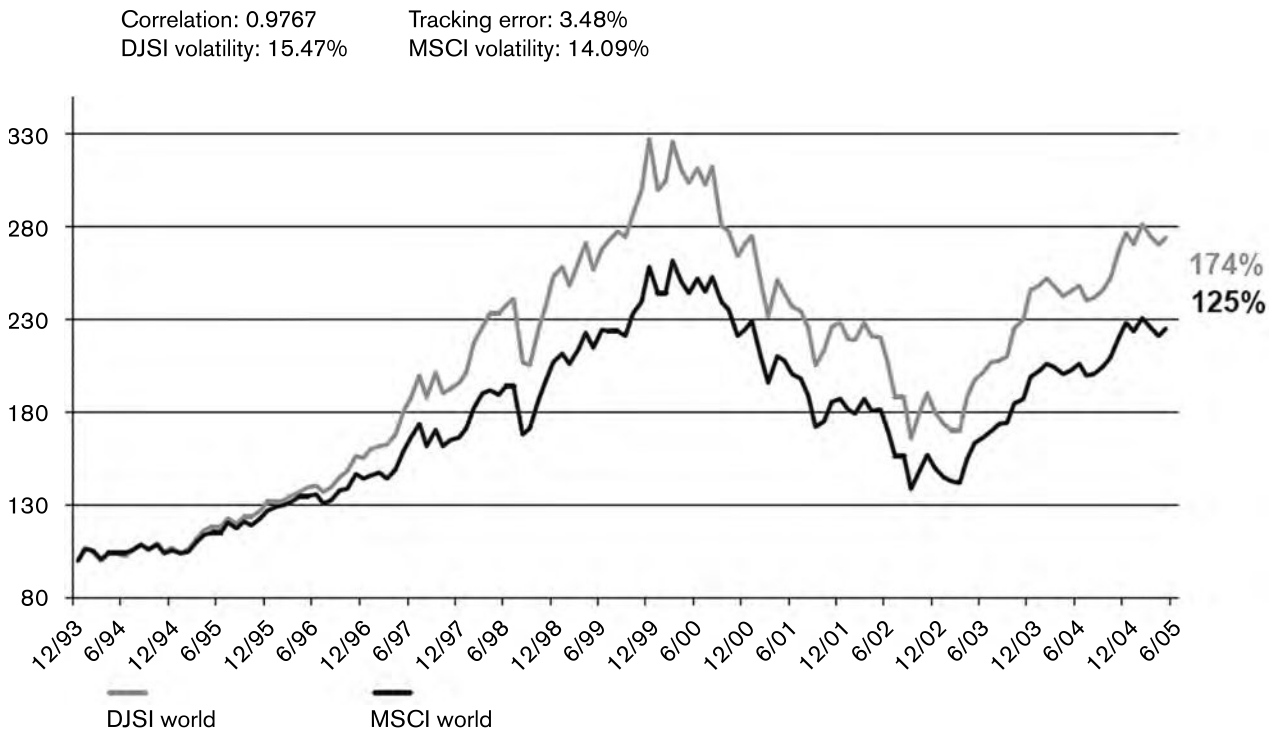


Figure 10.1: *The DJSI and MSCI world markets compared (US dollars, total return index)*

added. Of the 500 largest US companies, those with a code and a strong commitment to ethics had an average market value added three times that of those without any commitment. The same study also found that those companies where the ethics executive was a member of the professional Ethics Officer Association, had a *lower* correlation with good performance. The conclusion drawn from this is that the commitment matters far more than the code. In Verschoor's words:

> "*An emphasis on proper values deals with setting examples, interpreting ethical principles and structuring appropriate reward systems. Ethical culture spreads from clear and unequivocal goal setting at the top and openness throughout the organization. On the other hand, compliance has to do with rules, hierarchy and sanctions. Legalistic codes of conduct designed only to protect an organization from conflicts of interest or rogue managerial behaviors are unlikely to motivate loyal employee behavior and result in long-term retention of favorable relationships with suppliers, customers and other stakeholders.*"
>
> Verschoor (1999)

The most promising correlation is between good social performance in relation to staff and corporate performance. In the UK, the Investors in People initiative has claimed that

the return on capital employed is double the national average and the pre-tax profit margin is 50% higher where their staff management approach is followed (Royal Society of Arts 1995). The reasons for such a dramatic relationship revolve largely around greater staff motivation, resulting in (Tamkin et al 2000):

- reduced costs;
- increased invitations to tender;
- increased sales;
- improved customer/client retention;
- improved productivity;
- increased customer satisfaction;
- improved quality of service/product.

There are now a considerable number of such studies and also meta-analyses, which compare a number of underlying empirical studies. The general finding of these studies has been that there is a positive correlation between corporate social performance (CSP) and corporate financial performance (CFP). For example, Orlitzky et al (2003) suggests not only that good social performance leads to good financial performance, but also that good financial performance leads to good social performance (see also Roberts et al 2005). Furthermore, reputation seems to be an important mediator, and CSP (and to a lesser extent environmental performance) has a number of different positive outcomes.

Another key finding is that market forces generally do not penalize companies with good CSP, and therefore managers can 'afford' to be socially responsible. Ideally, if managers believe that CSP is an antecedent of CFP, they may end up pursuing CSP because they think the market will reward them for doing so.

These findings are supported by Sustainable Asset Management (SAM) (Gelfgren 2005), which surveyed investors' attitudes to companies' reporting of CR performance. His conclusion is that companies that lead their peers in terms of corporate social responsibility or sustainability reporting are more likely to generate better shareholder value than their peers. These companies can be expected to address the opportunities and risks associated with the trends and challenges of the globalized economy. Seizing opportunities leads to better return on invested capital (ROIC), which again increases free cash flow to the firm (FCFF). In turn, managing such risks efficiently leads to lower risk premia, which decreases financing costs, weighted average cost of capital (WACC). Higher FCFF and lower WACC leads to an increase in shareholder value (Figure 10.2).

There is arguably a general increase of interest among investors in CR and reporting. Certainly more companies are reporting and are listed in the DJSI, and investors are beginning to look at 'values' in the wider sense, as a possible source of return. However, there is room for improvement if this positive trend is to continue. Some problematic areas include:

- reporting is becoming still more generic;
- most corporations do not have a firm idea what investors want them to report on;
- most investors do not know how to use the reports published – they have difficulty trying to integrate non-financial information into their investment processes;
- it is often unclear what the impact of a CR strategy and its underlying intent might be;
- CR activities are too often driven by standards alone, rather than by opportunities;
- reporting usually omits links with business performance;
- there is too much focus on risk management rather than on business development;
- the links between CR and financial performance are rarely demonstrated.

The common features of successful companies in their approach to CR include:

- integration of CR with line-management functions;
- a pronounced strategic intent and clearly defined objectives;

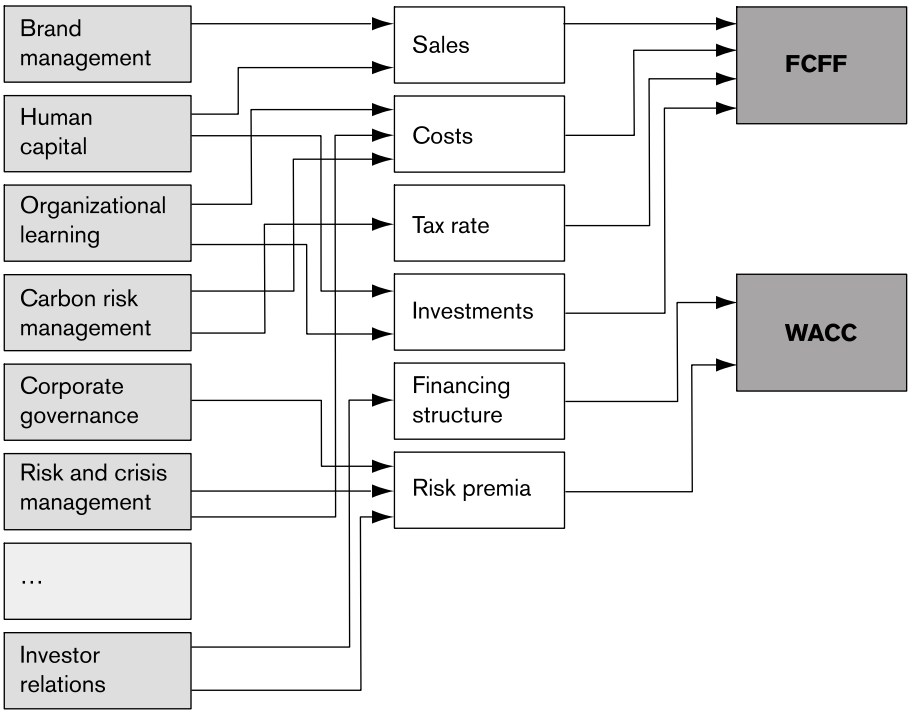


Figure 10.2: *Sustainability and shareholder value*

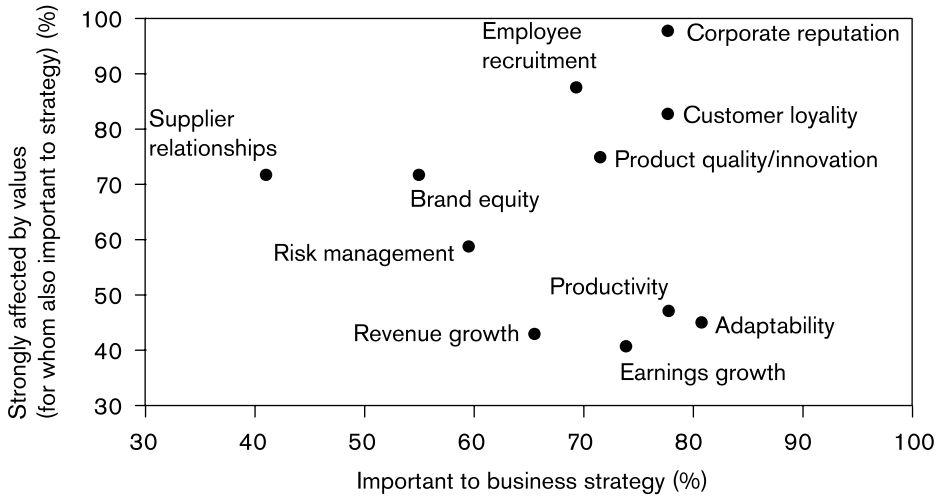


Figure 10.3: *Factors important to business strategy and strongly affected by values. (Source: The Aspen Institute and Booz Allen Hamilton Inc.)*

- action based on material business aspects, primarily focused on opportunities;
- articulation of the expected financial contribution of CR activities.

Overall the message is that it is important to define the strategic intent, whether it be to improve operational efficiency, increase growth opportunities or reduce operational risks. In this regard the underlying drivers of this intent should be explained, as should the way in which it is linked to developing business success, whether this is through conquering new markets, improving the competition for talent, reducing employee turnover, reducing litigation costs, improving general reputation and customer loyalty, or improving supply and distribution management.

Another recent study (Kelly et al 2005) found that companies routinely identify values as a top agenda issue, and public companies that report superior financial results also report greater success in linking values to operations in areas that foster growth, such as innovation (Figure 10.3). The survey examined detailed responses by 365 senior executives from around the world, representing a broad range of industries. However, most corporate executives do not see a direct link to growth, and the study also concluded that most companies are not effectively linking their CR work with their business strategy.

This message of the lack of specificity and lack of linkage of CR issues with business drivers is echoed by the findings of a report by the Association of British Insurers (ABI) (2004). In their view, the CR 'movement' has tended to overgeneralize and overlook company-specific factors in its search for a general purpose 'business case'. On the other hand, the

financial world has been slow to take account of emerging technological, environmental and social risks, which can have a significant business impact.

All these observations suggest that companies should work with CR in their own way, and gradually develop their own position through a gradual learning process. Standards, benchmarks and generic indicators are important reference points, but should be applied thoughtfully.

Building the business case

Strategic considerations

Strategic decisions such as what mix of businesses to operate within the portfolio of a holding company or whether to enter a new market or outsource key parts of a business are the bread and butter of strategic consultancies. However, the really major strategic decisions thrown up by sustainability, such as whether to create a new kind of business or embark on a major consciousness shift within a company, are different.

Sustainability is very much about such major strategic decisions. This section looks at the kinds of advantages that strategic decisions to move towards greater sustainability can bring to businesses. A common joke is that such major strategic decisions are given less management time than the minutiae of business life. The problem arises partly because there are few formal ways to evaluate the consequences of such decisions. It also arises because, even if the projected consequences are clear, they may bring largely 'intangible' benefits to the business. 'Intangible' is often used to mean 'unreal', but should perhaps more fairly be used to mean 'hard to quantify financially'.

This section explores some of the connections between sustainability and the two principal justifications for major strategic change towards sustainability: innovation and reputation.

Innovation

Innovation – doing new things in new ways – is usually regarded as an unequivocally good thing. Investors regard innovation by a company as evidence of high-quality management. Innovation also tends to lead to new business opportunities and therefore higher

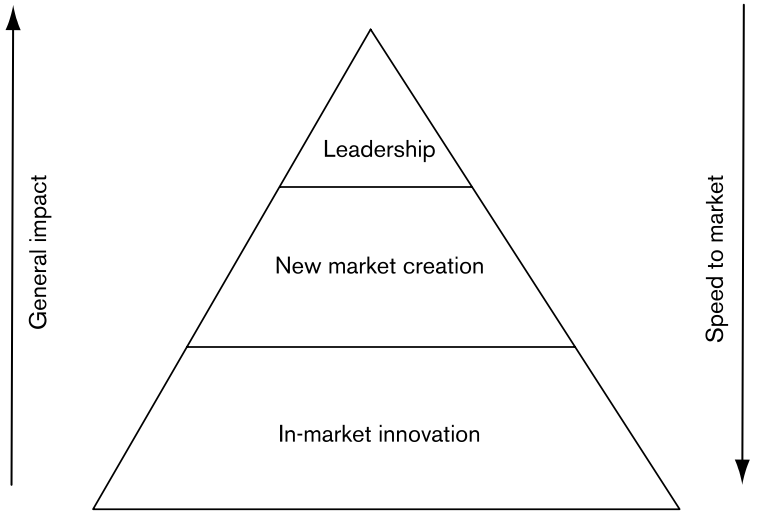


Figure 10.4: *The innovation challenge*

profits. Most governments attempt to encourage innovation, convinced that it is the only way to survive in the globalizing economy. But what does it have to do with sustainability?

As illustrated in Figure 10.4, there are several levels at which innovation may take place:

- in-market innovation, which is the least radical but the quickest to achieve;
- new market creation, which takes longer but may be far more rewarding;
- leadership, which has the longest lead times but achieves the most far-reaching effects.

Innovation 'in-market' is the most common type of innovation. It is commonly enabled by new technologies and the introduction of new products within existing markets. Websites devoted to new areas such as weddings, car repair or personal diaries could be examples.

Innovation that creates new markets is more powerful but, not surprisingly, less common. It depends on new ideas that enable companies or their customers to do new things (rather than find new ways to do the things they do already). Interface was originally a company selling carpet tiles, rather than carpets. This was a technical innovation that created a new product. However, as Interface realized it could sell something other than carpet tiles, namely 'flooring' as a service, it created a new type of market. (Although it might be tempting to think so, the creation of new markets through the privatisation of public activities does not really demonstrate innovation in this sense, since the 'market' and most of its activities existed prior to the privatization.)

The third level at which innovation can take place is through leadership that goes beyond a company to influence policies and the formation of markets itself. One way this happens is through lobbying. To use this word makes it clear that such leadership, and indeed all the levels of innovation identified, can be used either in the service of, or to counteract, sustainability. So what does innovation for sustainability look like?

If the conviction as to the importance of innovation is well founded, then innovation is critical to the economic sustainability of a company. Obviously, the survival of a company is very directly related to its financial sustainability. Yet the economic sustainability of a company depends on the range of (positive) economic effects that it may have. So innovation may be necessary to, but not sufficient for, economic sustainability.

Innovation in the service of sustainability can be recognized by its impacts. For example, at the level of in-market innovation, the development of a new method to manufacture faster cars, which also increased the rate of accidents, would be unsustainable innovation. On the other hand, the development of low-emission fuels would be innovation moving towards sustainability.

The development of a new market for ultra-heavy lorries, which hastened the destruction of the existing road infrastructure, would be working against sustainability. The development of hydrogen-based technologies, which could have zero-emissions, might be pro-sustainability.

At the level of leadership, working actively within a closed industry group to undermine efforts to reduce carbon dioxide emissions in order to maintain current markets would be working against sustainability. On the other hand, forming broad alliances and new types of partnership with a broad range of stakeholders to develop ways in which a more rapid migration to more sustainable transport might be achieved is working towards greater sustainability.

Reputation

> "*The reputation of a thousand years may be determined by the conduct of one hour.*"
>
> Japanese proverb

The fragility of reputation means that it has always itself had a bad reputation. However, that makes its management a vital task, particularly in a world, as we have seen, where a company's reputation may be ruined in minutes through the media or the Internet. And

Conventional public relations wisdom has it that companies should:

- stake out the middle
- acknowledge prior misbehaviour – repeatedly
- acknowledge current problems – repeatedly
- discuss achievements with humility
- let others certify your performance
- bring concerns to the surface

Source: adapted from Burton (1999)

Box 10.1: *Public relations approach to achieving a good reputation*

good reputation may be expressed in financial terms, through accounting conventions such as 'goodwill'.

Yet the management of reputation has also been treated with great suspicion by the public. Is it only about managing perceptions, or is it about communicating a changed behaviour? To its credit, the received wisdom in the public relations industry is that honesty is the most important factor in achieving a good reputation (Box 10.1). This is entirely consistent with the exercise of CR, as it was defined earlier in this book. As we have seen, the explicit definition of a boundary of responsibility is seen as vital to the exercise of real CR. The communication and negotiation about this boundary is the basis of a good reputation.

Yet honesty and clarity over responsibility is just the beginning. To actually achieve a good reputation, requires good performance. At one time, good financial performance alone might usually have guaranteed a good reputation, but this is no longer true. In the long run, it is likely that a good reputation will have to be built on good performance across all dimensions of sustainability – economic (including financial), social and environmental.

> "*We have to consider why trust is declining. I think that the roots of this mistrust lie in the fact that people increasingly fail to see the relationship between business success and their own quality of life … They are suspicious that business standards do not protect people and the environment … and don't understand how business can contribute to achieving a sustainable future.*"
>
> Chris Fay, Chairman, Shell UK (1996)

Justifying a project

One observation that is frequently made by those who do not work for companies is that 'companies have lots of money and lots of power', implying that it should be easy for a given project to be resourced adequately. This is rarely the view of those working inside a

business, where decisions seem to be highly constrained and budgets appear to be entirely rigid. Yet there is some truth to the view that, while an increase in budget is difficult, large sums of money are constantly being deployed. For the business as a whole, once the strategic positioning is clear, there are often adequate resources for investment that can be allocated accordingly, thus ultimately setting budgets for specific projects.

When it comes to an actual project, such as the development of a new product, joining an initiative, implementing a standard, or reporting on sustainability, there are different considerations. Amongst these the calculation of cash flows is central, and this is dealt with in this section. However, there are also additional considerations of risk, which are dealt with in the following section.

Cash flow

At the level of cash flow a typical business case involves calculating the costs of project investment, operation and wind-up over the life of the project, and sets these against the cash benefits deriving from the project. The decision as to whether to proceed with a project on the basis of cash flow is taken not simply by summing all the flows (i.e. inflow minus outflow) but on the 'present value' of the flows, possibly together with related features such as the break-even point or the return on capital. There are several ways in which a sustainability perspective can affect this approach:

- the selection of cost streams;
- the choice of discount rate or acceptable break-even points.

The normal approach to constructing a business case for a project, the success of which is desired, is to claim all possible benefits and exclude as many costs as possible. For example, the justification of nuclear power plants was based on the idea that the product would be 'too cheap to meter' and that decommissioning costs could be properly ignored, rather than deducted from profits. What is at issue here is a related, but different sort of, boundary of responsibility to that discussed earlier. From the economic perspective, only the inclusion of all externalities will guarantee sustainability. Examples from other industries of costs that were ignored but are now having to be acknowledged include asbestos damage and tobacco damage. Claims have even been made for the effects of violent films on behaviour.

Externalities can be positive as well as negative. So there may be unacknowledged benefits, accruing to particular stakeholder groups, which can be acknowledged as well. Often there

is no mechanism for translating these benefits into actual cash for the company. But they do suggest where it may be fruitful to look for stakeholder partnerships. Nevertheless, such externalities tend to be more widely acknowledged. Examples could include:

- the use of new technology for communications;
- a reduction in packaging;
- the dematerialization of a transition to service, rather than product-led business;
- the impact on employment in the local community.

Leadership, in this area, involves taking the widest view of all externalities. That is, the wider the set of externalities that is acknowledged and used in the project decision-making process, the more likely the project is to be sustainable. Since there are usually more costs externalized than benefits, this approach will, in general, tend to reduce the net present value of the project.

Yet there is another critical variable involved in the calculation – the discount rate. Often discount rates are set in relation to a view of interest rates over the lifetime of the project and there is little discretion permitted in project appraisal. The level of discount rate used, however, is a fundamental expression of the attitude to sustainability of an organization. When interest rates are low, much longer term projects can be justified. The high quality and sustainability or longevity of Victorian sewers and the approach of the Japanese to investment in infrastructure projects more recently, are a testaments to the prevailing rates of interest.

Conversely, high interest rates – and high discount rates – are testimony to short-termism. They imply that any benefits or costs are worth less in the future, or to future generations, than are current benefits or costs. The leadership to manage over time requires that discount rates are set at the lowest possible level. In practice, it will be very difficult to change discount rates significantly until appropriate policy changes have been implemented at the national level and investors are educated to be far more patient. However, there may be more leeway with changes to the acceptable break-even point, the time when a project has recouped its costs.

Benefits

Obviously the benefits arising from a particular project will be unique to that project. What this section tries to do is to identify the *kinds* of benefits that may be expected. First

Table 10.1: *Ways in which an increase in trust can result in financial benefits*

Stakeholder	Increase in trust measured by
Shareholders	Longer term outlook Lower cost of capital Increased propensity to hold shares More stable market price
Staff	Lower recruitment costs Increased staff retention Greater staff motivation and commitment
Suppliers	Lower legal costs Fewer disputes
Customers	Greater customer loyalty Constructive approach to problems
Local community	Greater cooperation with new projects Lower-cost consultations Swifter decisions by local authorities

the economic dimension is briefly examined, and then the environmental and social dimensions are considered.

As acknowledged above, the economic dimension has been less clearly elaborated than the other dimensions of sustainability. Nevertheless, the kinds of economic effect that a business project may produce include greater employment, stronger local economies and, possibly, further economic development. While the financial consequences of these effects for the business will be real, they can more easily be captured under the appropriate stakeholder headings, such as 'supplier relations'.

What kinds of financial benefits from environmental impacts can be expected? The most ardent support for such benefits can be found in the book *Natural Capitalism* (Hawken et al 1999). Benefits (and cost reductions) can include:

- eco-efficiency – lower-cost production;
- dematerialization – inherently lower fixed-cost businesses;
- development of new markets and new approaches to pricing, dependent on changes to consumer values and regulation, which reward the more sustainable business.

The financial benefits of social impacts can be summarized as deriving from stakeholder trust. In general, an increase in trust between an organization and its various stakeholders

will result in a lowering of the costs of doing business with them. Table 10.1 sets out some possible ways in which financial benefits can result from an increase in trust.

Costs

The costs of most projects are often already all too obvious. What can be added from the perspective of increasing sustainability are two points. The first is that, included as part of the direct costs of a project, an allowance should be made for communication of the motive and purposes of the project. While a cost, such activity will serve to enhance the social benefits already identified.

The second point relates particularly to projects aimed squarely at improving social performance, such as undertaking stakeholder dialogue or social reporting. This is that communication with stakeholders will result in stakeholder feedback, which will suggest ways in which the business can operate better (from the stakeholder point of view). It will be reasonable, and in the company's own best interest, to implement some of these. As a result there will be consequential costs that may arise from undertaking such projects. A full appraisal of project costs must take these into account.

Project risk

A discussion of project risk is a gloomy way to end this chapter on business cases. But that is where risk is normally put – at the bottom of the pile and something to be avoided. Typically, risk is analysed in terms of the assumptions underlying the business case. The assumptions – such as the price of a new product, or the level of demand – may be varied to see how the change would affect the returns and, therefore, which factors are most important to control or monitor. In addition, scenarios may be constructed showing how variations in a series of factors may work together to influence the financial outcome. In many cases financial risks, such as exchange rate variations, will be included within a business case routinely.

Now, clearly any responsible business has to minimize risk, but there is a more positive way to think about risk than simply as something to be avoided. It can be thought about as something from which to learn. At one level, the risks to a business from unsustainability are so catastrophic, and usually so far beyond the control of an individual company, that they are simply ignored. With the important exception of the insurance industry, very few

business cases take real account of the impact of global warming or of civil unrest, to take two issues.

Yet one lesson that can be drawn from global warming, and all that surrounds it, is how working to limit global warming can be hugely motivational to staff. The case of civil unrest may not seem so obvious, but companies such as McDonalds and The Gap have learnt that their brands may be a focal point for protest as much as a symbol of loyalty, as Klein (2000) has pointed out.

However, there may be far more specific risks relating to a company or its projects, which should be factored into decision-making. The significance of these is that they result from the impacts of the company itself and therefore should be an integral part of the assessment of a project. Economic risks of this sort can seem difficult to identify, yet are no less important. For example, the impact of supermarkets on town centres can be unpredictable, leading to a backlash that might affect reputation or staff morale.

Environmental risks may be easier to identify, but become challenging to acknowledge and manage. Environmental risk may be thought of as poor environmental performance, which a company is likely to be called upon to rectify. Historically, environmental impacts have been entirely externalized – i.e. no cost has been borne by the company. Today, it is far more common to think about the health and safety implications of new product development, such as a new manufacturing method for a shoe, during the development, rather than afterwards when workers are affected by fumes from a new solvent. Other risks may include new legislation, which in the developed countries has been constantly moving in the direction of greater stringency.

Social risk is a measure of the gap between the boundary of responsibility that an organization acknowledges and that perceived by its stakeholders. In other words, social risk arises from the mismatch between the values and expectations of the organization and those of its stakeholders and of society at large. It can result in impaired, low-trust stakeholder relationships, which directly or indirectly increase the costs of doing business. It can be reduced through careful management of stakeholder relationships and increased accountability. As one senior executive put it: "unfulfilled aspirations … that's the start of trouble".

The concept of social risk is perhaps less well understood than the concepts of economic or environmental risk. Figure 10.5 therefore sets out some of the diverse origins of social risk.

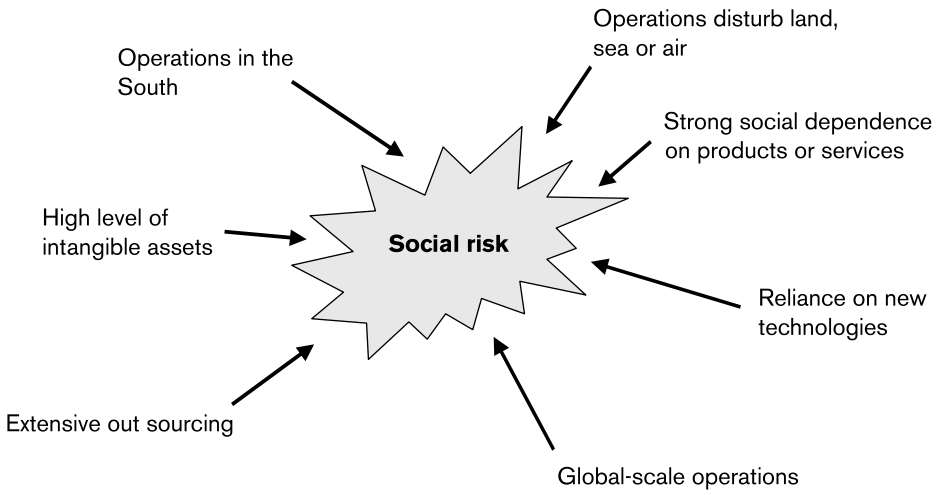


Figure 10.5: *The origins of social risk*

Conclusion

Making the business case for change and for greater sustainability requires careful analysis. It may seem that those companies that take the trouble to work for sustainability will be outflanked by competitors who ignore all environmental, social and economic damage in the search for the lowest price. But this is wrong for two reasons. First, it is very often possible to make gains at the margin in terms of sustainability impact, without significant cost implications. Secondly, and far more significantly, the three dimensions of sustainability are intertwined. Therefore, social and environmental action will *always* have economic and, very likely, financial implications. Social costs and environmental costs will therefore *always* have financial costs in the long run. Conversely, social opportunity and environmental opportunity are also always business opportunities.

This book has shown not only that there are real problems facing the world in terms of the environmental, social and economic consequences of what we do, but that there are also solutions. Companies need to be key actors in the changes that the current lack of sustainability will force upon us. It has also shown that not only are there management challenges, but there are also some practical tools, which each of us can grasp. It is possible to move each company towards sustainability.

Appendix 1: Evidence for the Kuznets curve

This appendix challenges the main evidence, put forward by Kuznets and others, that has been used to support the view that economic development will *automatically* result in improved environmental performance.

Simon Kuznets, who developed the first Kuznets curve, actually worked on the measurement of national incomes in developed countries. The original Kuznets curve expressed the proposition that inequalities in income will worsen in the early stages of economic growth and then improve. Others have applied the same ideas to environmental pollutants, such as sulphur dioxide, particulates, lead and cadmium (Figure A1.1) (WWF 1996).

The work on environmental Kuznets curves is based on trying to identify the turning points, expressed as gross domestic product (GDP) per capita, for various pollutants. For reference, current world GDP per capita is of the order of US $3,200 (all figures are quoted in 1985 US dollars). Key points about the evidence are:

- There are different turning points for different pollutants. In one study (Grossman and Krueger 1994) this ranges from US $1,900 for lead to US $11,600 for cadmium.
- Different studies find different turning points (and sometimes none) for the same pollutants. For example, while one study finds a turning point for suspended

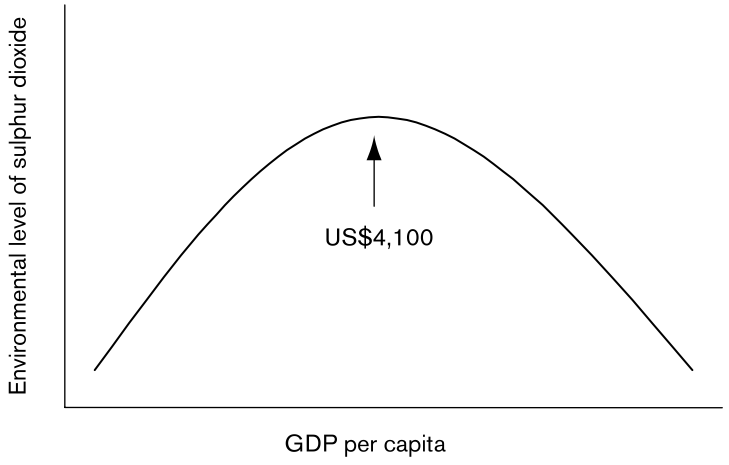


Figure A1.1: *A Kuznets curve for sulphur dioxide*

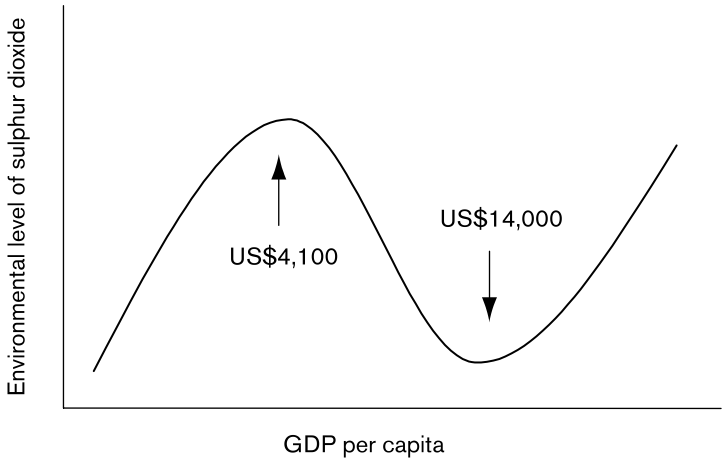


Figure A1.2: *Another Kuznets curve for sulphur dioxide*

particulate matter at less than US $5,000, others find it at over US $8,000 (Selden and Song 1994). Another study (Stern et al 1994) found that there was a turning point for energy consumption if United Nations data are used, but not if data from the World Bank are used.

- Some pollutants appear to have a second turning point after which the level of pollution rises again. In one study a turning point for sulphur dioxide appears at US $13,400 and a second turning point appears at US $24,000.
- Global projections for turning points for some key pollutants places their peak a long way in the future, and at levels much higher than now (Figure A1.2). One study suggests that sulphur dioxide emissions will peak at 354 per cent of the 1986 level in the year 2085.

A further, methodological, problem with some of the studies is that they look at the level of incomes and pollution within a single country. There are two difficulties with this as a way of capturing the relationship between the two factors:

- Pollution may not only be apparent in the source country. For example, about 40 per cent of the sulphur dioxide affecting France originates in France.
- Some countries (typically those with a higher per capita income) tend to replace the domestic manufacture of polluting goods with imports. The energy intensity of US imports, for example, has recently been increasing. Developed countries therefore tend to export their pollution, resulting lower domestic levels of pollution.

Thus only *global* evidence may reliably be used to generate confirmation of a Kuznets curve. Few studies have followed such an approach.

Appendix 2: Initiatives, standards and codes

This appendix collects together a number of the codes and standards referred to in the main part of the book. It also includes a number of additional references and a number of the initiatives and organizations that produce such tools and codes. It categorizes the corresponding codes, tools and standards against the analytical framework set out in the book. This appendix has drawn on the work of the Sigma Project (www.projectsigma.co.uk).

Name	Comments	Strategy	Management	Accounting	Measurement
AA1000 AA1000AS AA1000SES	AA1000 is produced by AccountAbility, a UK-based international organization that promotes social accountability. AA1000 is a standard for the management process of accountability; AA1000AS is a standard for assurance of sustainability reports; AA1000SES is a standard for stakeholder engagement. It centres on stakeholder dialogue and the accounting and auditing of social issues. It also provides for the training and professional accreditation of social auditors		✓	✓	
Balanced Business Scorecard Initiative	The Balanced Scorecard is a performance measurement tool for translating strategic objectives into indicators using four perspectives: financial, customer, internal business processes, learning and growth. It talks of a specific cause and effect relationship in the measures applied to a Balanced Scorecard process. It was introduced by Professor Robert Kaplan and Dr David Norton in 1992. To date, scorecards have been implemented at corporate, strategic business unit, shared service functions, and cascaded to team and individual levels in hundreds of organizations in both the private and public sectors worldwide			✓	✓

Name	Comments	Strategy	Management	Accounting	Measurement
BS 8900	BS 8900 was produced by the British Standards Institution (BSI). This standard offers guidance to organizations in approaching sustainability issues	✓			
Caux Round Table	The Caux Round Table is a network of senior business leaders advocating positions on economic, social and environmental issues. Their principles cover ethical business, support for trade and respect for stakeholders	✓			
Combined Code of Governance	The combined code embraces the work of the Cadbury, Greenbury and Hampel Committees. It has more recently been complemented by the Turnbull Report on internal audit procedures. It is a condition of listing for companies on the UK stock exchange. The Combined Code focuses on the governance of the organization at its highest level. It therefore focuses on those who govern the organization (the board, management) and how they govern it. The stakeholders covered are, therefore, the board, shareholders, and staff	✓	✓		
Ecumenical Council for Corporate Responsibility (ECCR) Principles	The ECCR, in the UK, is a faith-based organization that has produced a set of principles which draw together much of the content of numerous other declarations and principles. The principles are intended to provide guidance to civil society organizations (including churches) in relation to their investments. They cover a wide range of social and environmental issues. In the US, ECCR has a counterpart body, the Interfaith Centre on Corporate Responsibility (ICCR), and in Canada, the Taskforce on the Churches and Corporate Responsibility (TCCR)	✓			✓
European Chemical Industry Council (CEFIC)	CEFIC is an industry association. It has produced health, safety and environment reporting guidelines for its members' use				✓

Name	Comments	Strategy	Management	Accounting	Measurement
Eco-Management and Audit Scheme (EMAS)	EMAS is supported by the European Union. It is an environmental management and reporting standard designed for specific sites. It is closely related to ISO 14000		✓		✓
Extractive Industries Transparency Initiative (EITI)	The EITI is an initiative in which governments, companies and NGOs are involved to ensure that payments to governments for oil and other minerals are publicly declared			✓	✓
Ethical Trading Initiative (ETI)	The ETI is a partnership of companies, NGOs and the UK government. It is developing approaches to monitoring and verification appropriate to supermarkets, other retailers and some manufacturers with supply chains extending to the non-western world. It draws on substantive United Nations (UN) and International Labour Organization (ILO) conventions and allows for local laws		✓	✓	✓
European Code of Conduct	In 1999 the European Parliament adopted a resolution calling on the Council of Europe to adopt standards for European enterprises operating in developing countries with regard to human rights, labour standards and environmental standards. Also to establish the duties of these enterprises, particularly through a possible European Monitoring Platform and through trade agreements	✓	✓		
European Convention on Human Rights and Fundamental Freedoms	This convention implements the UN Universal Declaration of Human Rights (UNDHR) within Europe. It can be enforced by the European Court of Human Rights and is binding on members of the Council of Europe	✓			
Excellence Model (EFQM)	The EFQM Excellence Model was developed as a tool to develop a quality management system that enabled organizations to be successful. It is a general model for managing performance, but does have within it a focus on employees, customers and society as stakeholders. It makes reference to suppliers, and these would be incorporated in 'partnerships and resources'		✓	✓	

Name	Comments	Strategy	Management	Accounting	Measurement
Fair Labor Association (FLA)	The FLA is a partnership between companies and some NGOs. The FLA has been designed to provide a system for monitoring the practices of manufacturers of clothing and accessories. Typically, such companies have extensive supply chains in the non-western world. A key part of the FLA's work is overseeing the monitoring and verification of labour conditions in factories		✓	✓	✓
Greenhouse Gas Protocol Initiative	The Greenhouse Gas Protocol Initiative is a multistakeholder project to develop a detailed standard for reporting on greenhouse gas emissions				✓
Global Compact	The Global Compact is a partnership initiative launched by the Secretary General of the UN. It requires companies to declare their adherence to a set of principles covering environmental and labour issues. Companies are also asked to make regular statements as to how they are observing the principles	✓			
Global Sullivan Principles	The Reverend Leon H. Sullivan developed the Principles, the objectives of which are: to support economic, social and political justice by companies where they do business; to support human rights and to encourage equal opportunity at all levels of employment, including racial and gender diversity on decision-making committees and boards; to train and advance disadvantaged workers for technical, supervisory and management opportunities; and to assist with greater tolerance and understanding among peoples, thereby, helping to improve the quality of life for communities, workers and children with dignity and equality. Initially applied to South Africa during the 1970s, the Principles are now global and in 1999 were 'globalized' through the UN	✓			

Name	Comments	Strategy	Management	Accounting	Measurement
Global Reporting Initiative (GRI)	The GRI was developed by an American NGO and is now a project encompassing the UN Environment Programme (UNEP), companies, NGOs and accounting professionals. The GRI is intended to provide a standard for reporting on social, environmental and economic impacts of companies. The potential coverage of GRI reports includes strategy, management and accounting systems, as well as substantive impacts			✓	✓
Interfaith Centre on Corporate Responsibility (ICCR)	See Ecumenical Council for Corporate Responsibility				
International Labour Organization (ILO) Core Conventions	The core ILO Conventions were developed by the ILO. They cover equal remuneration, discrimination in employment, collective bargaining, forced labour and child labour. The ILO conventions are an important reference point for codes such as SA8000 and ETI				✓
International Chambers of Commerce (ICC) Business Charter	The ICC was founded in 1919. Today it groups thousands of member companies and associations from over 130 countries. National committees in the world's major capitals coordinate with their membership to address the concerns of the business community and to convey to their governments the business views formulated by ICC. The Business Charter has 16 principles covering environmental issues. The ICC has also developed principles for marketing and advertising	✓	✓		
ISO 9000	The International Organization for Standardization (ISO) is a worldwide federation of national standards bodies from 130 countries. ISO administers over 11,000 standards covering 97 categories (one of which covers management). ISO 9000 is a general standard for quality management. ISO 9000 refers to customers, staff and suppliers in the delivery of a 'quality' system in the delivery of service and product		✓	✓	

Name	Comments	Strategy	Management	Accounting	Measurement
ISO 14000	See also ISO 9000. ISO 14000 is a standard for environmental management and reporting. The 14000 series of standards includes guidelines for environmental management, auditing, labelling and life cycle analysis		✓		✓
London Benchmarking Group (LBG)	The LBG was formed in 1994 by a group of large companies based in London. It focuses on measuring the effectiveness of a company's community involvement work. In so doing, its stakeholder focus is communities, staff of the company, suppliers and customers. It is mainly a process standard, but it directs organizations towards specific ways to go about their community involvement		✓		✓
Model Business Principles	The Principles were developed by the US Departments of State and Commerce and the US NGO, Business for Social Responsibility in 1996. The principles encourage respect for staff, environmental responsibility and general corporate citizenship	✓			
Natural Step	The Natural Step was produced by an international group of scientists to define the nature of sustainability and how it might be approached. It is strongest on the conditions for environmental sustainability	✓			
OECD Corporate Governance Guidelines	The OECD is an organization of national governments devoted to economic and social policy issues. It has produced Guidelines on corporate governance, which include principles on ethical issues and sustainability	✓			
SA8000	SA8000 was developed by Social Accountability International, an American NGO. SA8000 focuses on employer labour practices and provides for site-level certification. It was designed for companies to ensure that their supply chains were following acceptable labour practices. It draws on substantive UN and ILO conventions and allows for local laws. It prescribes appropriate management processes and encourages verification		✓	✓	✓

Name	Comments	Strategy	Management	Accounting	Measurement
Sunshine Principles	Prepared by the Stakeholder Alliance based in the USA, the Sunshine Principles set out standards for corporate transparency on social and environmental issues			✓	
Taskforce on the Churches and Corporate Responsibility (TCCR)	See Ecumenical Council for Corporate Responsibility				
UN Universal Declaration on Human Rights (UNDHR)	The UNDHR is part of the International Bill of Human Rights. The UN has produced numerous agreements on issues related to human rights, of which some of the most important are grouped under the UNDHR. The scope of the UNDHR is wide and includes equality of all in terms of dignity, law, freedom of assembly, thought and conscience and refers to other UN conventions				✓
World Business Council for Sustainable Development (WBCSD)	The WBCSD is an international association of major companies working towards sustainability, particularly focusing on eco-efficiency indicators	✓			✓

Appendix 3: Issues by sector

This appendix suggests some of the main environmental, social and economic issues that may be faced by particular sectors. It is based on the experience of the authors. It does not claim to be exhaustive, and it should be recognized that issues may change, with the changing nature of business or technology. Nevertheless, the information here may form a useful starting point for considering which impacts should be considered for inclusion in sustainability accounts.

In the following tables, H indicates a high priority issue for a sector, M indicates medium priority and L indicates low priority.

Environmental issues

Sector	Issue									
	Energy use	Material use	Water use	Emissions to air	Emissions to water	Solid waste and pollution	Transport	Product impact	Land impact	Regulation
Agriculture, fishing, forestry	M	L	H	L	M	H	M	L	H	M
Energy, water supply	H	M	H	H	H	H	L	H	H	H
Minerals, metals, plastics, chemicals	H	H	H	H	H	H	H	H	H	H
Metal goods, engineering, vehicles	H	H	H	H	H	M	H	H	L	H
Food, drink	M	L	M	L	H	L	H	H	H	M
Pulp, paper	M	M	H	M	H	H	M	L	H	M
Other manufacturing	M	M	M	M	M	M	M	L	L	M
Construction	M	H	L	L	L	M	M	L	H	M
Distribution, transport	H	L	L	H	L	L	H	M	M	M
Communications, printing, publishing	L	M	L	M	M	M	M	L	L	L
Banking, finance, insurance	M	L	L	L	L	L	L	L	L	L

Sector	Issue									
	Energy use	Material use	Water use	Emissions to air	Emissions to water	Solid waste and pollution	Transport	Product impact	Land impact	Regulation
Retailing	M	M	L	L	L	M	M	M	M	M
Marketing, advertising	L	L	L	L	L	L	L	L	L	L
Other services	L	L	L	L	L	L	L	L	L	L

Social issues

Sector	Issue										
	Corporate governance	Public perception	Human rights (staff)	Local community	Supply chain	Demand chain[a]	Commercial practices[b]	Lobbying and leadership	Health	Safety	Regulation
Agriculture, fishing, forestry	M	M	M	M	L	L	L	H	H	H	M
Energy, water supply	M	H	L	H	L	L	L	L	M	H	H
Minerals, metals, plastics, chemicals	M	H	L	H	L	L	M	H	H	H	H
Metal goods, engineering, vehicles	M	M	M	M	L	L	H	L	M	M	L
Food, drink	M	H	L	L	H	H	M	H	H	L	M
Pulp, paper	M	M	M	H	L	L	L	L	M	M	M
Other manufacturing	M	M	L	M	L	L	L	L	L	L	M
Construction	M	H	M	H	H	L	H	H	L	H	M
Distribution, transport	H	H	M	M	L	L	H	M	M	L	L
Communications, printing, publishing	H	H	M	L	L	H	H	H	L	L	H
Banking, finance, insurance	H	H	L	M	L	M	H	H	L	L	H
Retailing	M	M	L	H	H	H	H	M	L	L	M
Marketing, advertising	M	H	M	L	L	H	M	H	L	L	M
Other services	L	L	L	L	L	M	M	L	L	L	L

[a] The demand chain includes issues such as the way demand is created

[b] Commercial practices includes relationships with suppliers and competitors

Economic issues

Sector	Issue							
	Financial performance	Intangible assets[a]	Innovation	Taxes	Local impact	Employment	Structural changes[b]	Regulation
Agriculture, fishing, forestry	H	L	L	L	H	M	M	M
Energy, water supply	H	L	L	L	M	L	L	H
Minerals, metals, plastics, chemicals	M	M	H	M	L	L	L	L
Metal goods, engineering, vehicles	M	L	L	M	M	M	L	L
Food, drink	M	M	H	M	L	L	L	L
Pulp, paper	M	L	M	L	M	L	L	L
Other manufacturing	M	M	L	L	L	L	L	L
Construction	M	L	L	L	H	M	L	L
Distribution, transport	H	L	L	L	H	M	L	H
Communications, printing, publishing	M	H	H	M	M	M	H	H
Banking, finance, insurance	M	M	H	H	H	M	M	H
Retailing	M	L	L	L	H	M	M	L
Marketing, advertising	L	H	M	L	L	L	M	L
Other services	M	M	M	M	L	M	L	L

[a] This indicates the typical level of intangible assets for the sector

[b] Structural changes indicates the changes that the activity of the sector produces – not those it may be undergoing itself

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