



Sustainability measures that count

By **Josh Dowse**, Director, Dowse CSP

- *A realistic approach to integrating CSR measures into your organisation*
- *How to add sustainability thinking into existing business processes*
- *Tools to assist managers to measure CSR*

- if the standard measures represent the goals of sustainability, then we have some joining-the-dots to do for line managers, so that they appreciate the significance and importance of those measures
- while many standard measures need to be reported, the performance on some will motivate and interest its people and stakeholders more than on others. Companies need a way to determine which these are, and concentrate on them
- there may be some non-standard measures the pursuit of which would equally support sustainability, but would be aligned with the company's business objectives in a way that is immediately apparent to both employees and external stakeholders. These again should be reported and pursued.

Total sum of taxes of all types paid broken down by country.¹

Total materials used other than water, by type.²

Evidence of consideration of human rights impacts as part of investment and procurement decisions.³

These are three of the 40 core indicators from the Global Reporting Initiative (GRI) (the only globally regarded set of corporate social responsibility (CSR) measures) and tall orders for any company to calculate and report. When business people, not sustainability advocates, are faced with the full list, it leaves them cold. They rank with panel tender documents as the most onerous and tedious of corporate assignments. 'Are these remotely relevant?' they ask. 'How will knowing this make a difference to anyone?' 'Surely totals are meaningless when our output varies?' And I struggle to answer them convincingly. The fact is that most of the standard measures cut down management's early interest in sustainability.

Most companies will eventually report on sustainability metrics as and when required by law. But most will remain superficial partners in sustainability — unless and until their line managers see the connection of their work with sustainability and until their performance is measured in those terms. For this to happen, three things need to fall into place:

In other words, let's not put the cart before the horse. Your company will want an effective strategy for its sustainability efforts. You should select and report measures that reflect that strategy. Rather than simply follow the ratings agency or reporting standards lists, the aim is to align the external reporting expectations with the things that your people actually find relevant.

Avoid the CSR 'add-on'

One effective way to do this, as with many other change approaches, is to build on what people are already doing in their business — that is, add sustainability thinking into existing, well-known business processes. This is evolution rather than revolution, but it does mean that the sustainability strategy is embedded in what the company does, and not just tacked on as something run by the corporate centre. Starting with a company's 'CSR values' and securing a board-approved strategy for bringing them to life may well excite the person responsible for CSR. It may even animate those with related corporate responsibilities: compliance, HR, risk and brand. But general managers who don't feel they have the financial liberty to pursue such distractions may be less cheerful about them.

This article suggests ways to integrate sustainability into the company's core strategic and performance management processes. Financial valuation looms high in the minds of those conducting those processes, and so sustainability needs to find a place there.

This, of course, sounds like a sop to business interests over sustainability. Though this critical debate is outside the scope of this article, society needs business to be both profitable and sustainable. There's an 'and' there that should not be overlooked. So the challenge is to insist on every sustainability initiative being a win-win, within an acceptable timeframe for investment. Each sustainability investment needs to be fully aligned with the corporate or business strategy. If it is not, then the initiative will be pulled whenever a manager loses interest or changes job, money is tight, or relationship priorities change. And that only fails the social issue and the partners you're engaging with.

First, though, we need to review where the potential sustainability metrics may come from.

Scan for sustainability metrics

The GRI is the starting point for identifying metrics for sustainability reporting, especially since the launch of its third generation 3G guidelines. But GRI, even with its sector supplements, is not the finishing point. Other fruitful sources include a review of published reports, reputable ratings agencies such as Innovest or SAM, dialogue with stakeholders on what matters most to them, current operational metrics of corporate culture or brand acceptance, industry standards on environmental, employment and social issues, and metrics that indicate the long-term economic value of the company.

Brainstorming further, one might also discover possibilities that matter more to your company and its stakeholders than they might to the outside world. One leading Australian resort operator, for example, is the dominant business in the world heritage areas in which it operates. It shares those privileged environments with indigenous aboriginal communities that have levels of health, education and employment that are unacceptable in anyone's terms. Can these luxury resorts sit cheek-by-jowl with such poverty indefinitely? The company doesn't believe so, so has included in its own sustainability reports both metrics on the health of its neighbour communities, and metrics on how it is helping to improve them. Nobody is going to expect such a metric as a general standard, but it is a tangible reminder to the resort staff of the challenges that they have a role in meeting. Why just report the money and effort spent on a problem, without reporting on the progress, or not, being made?

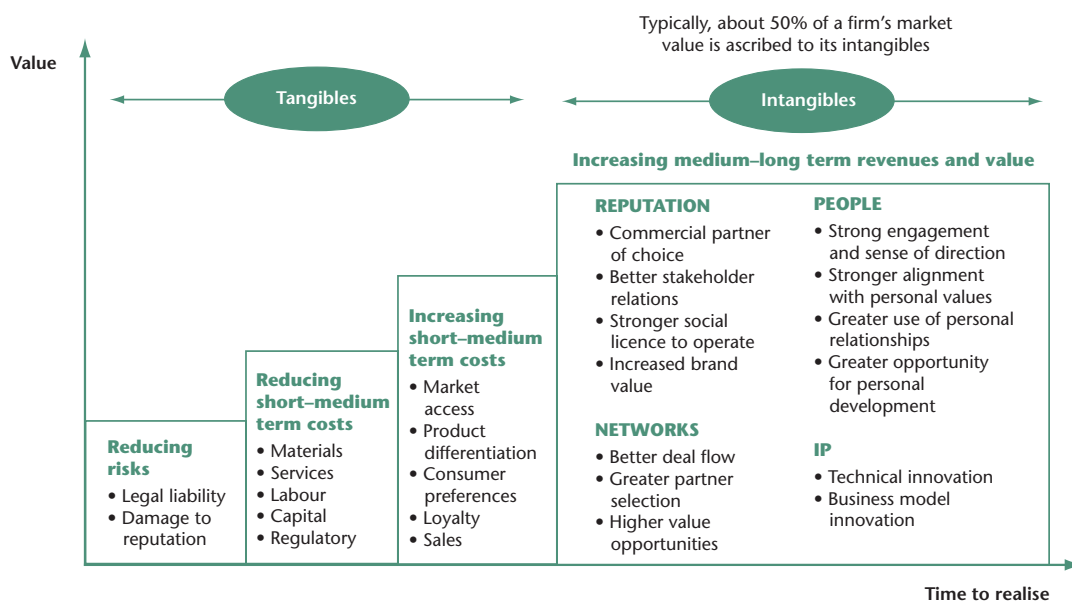
You say 'sustainable', I say 'responsible' ...

Would you like the company you work for to be 'sustainable' or 'responsible' or both? With all good intent, advocates of 'corporate social responsibility' (CSR) and 'corporate sustainability' have done a remarkably poor job in defining what they mean by these terms. As a result, the terms are now interchangeable in the board room. But they do have different 'roots' and so hold different meanings for many people.

'Responsibility' flows from long-held debates on corporate ethics: the idea that companies should do more than just comply with the law, but should behave ethically. That, of course, begs the question of what is ethical or responsible. For most, it is a negative definition: that is, for companies *not* to act *irresponsibly*. Doing so implies that companies consider others, and the environment they depend on.

'Corporate sustainability' originally flowed from the language of 'sustainable development': the idea that we should meet our needs 'without compromising the ability of future generations to meet their own needs'. ('Sustainability' itself only hit the Macquarie Dictionary in the late 1990s as a derivation of 'sustainable development'.) So 'sustainable companies' are those that take their place in a sustainable economy by engaging with the threats to future generations, and seeking solutions to them. Companies may even do this strategically, so that in seeking these solutions, they strengthen their reputation, their innovation and their relationships. A sustainability strategy might ask 'what can we do that we're not doing now that would be good for a particular social and environmental issue, and good for us.'

However, 'sustainable' has another well-established meaning: able to last. Since the special meanings of 'sustainable' and 'responsible' have been poorly defined, this is the meaning that is winning over in the board room. If our companies say they want to be sustainable, they now mean they want to be here for the long term — it is the company's sustainability they are talking about, not the planet's. So Michael Hawker, Managing Director and CEO of IAG, may say on the company's website: ' "Sustainability" is a word often used but its definition is rarely agreed upon. At IAG, we see sustainability in a straightforward way — it's about managing our business to ensure success for the long term'. Many boards would have claimed just such a role, long before 'sustainability' was coined.

Chart 1: The potential value of sustainability

Yet the idea is not to report or measure all of these possibilities, but to filter them down to those feasible measures that matter most to the organisation and its stakeholders.

Filter out possible metrics

Most readers will appreciate the criteria for selecting the most appropriate measures to track and report. They include stakeholder expectations (including reporting norms), the cost of obtaining data, the availability of reliable data, whether there are other operational reasons for tracking the proposed metric, and whether there are alternative metrics that serve the same purpose in a better way.

The global mining company BHP Billiton (BHPB) has applied these filters. Much awarded as a sustainability reporter, BHPB reports in accordance with the GRI guidelines, and indeed is involved with the GRI Stakeholder Council to support GRI's further development. Nonetheless, BHPB has filtered out GRI indicators on the grounds of complexity (for tax information), negligible impact (on EC9 subsidies) or impracticality (EN2 — process inputs that are by-products of other processes; EN15 — proportion of products reclaimable and reclaimed at the end of their useful life). For GRI indicator LA9: Average Hours of Training per Year, BHPB sensibly reports that 'collating and reporting average training hours ... does not provide a meaningful measure of the quality of training and associated competencies provided by the Company'.

In other words, while all the standard measures need to be considered and many will be included in your report, some will be omitted. If the measure is not meaningful, internally and externally, and cannot be shown to be so to a company's line management, then cull it. Only a proportion will have management attention put on them as priority measures. What ones will they be?

Align sustainability with financial and strategic metrics

A thorough review of the social, environmental and economic (rather than financial) possibilities of your company will offer perhaps 40 to 50 measures to be tracked annually, and an equal number of qualitative issues to monitor. You may also want to set targets against these measures, list the initiatives to reach those targets, and report on some initiatives as case studies. Finally, you will want to set and pursue some basic parameters to managing initiatives for success. That's a lot of investment in sustainability and its monitoring. Like any business activity, you'll need to prioritise. How should you do that?

There is no one way. Working out how to prioritise your sustainability activity is akin to working out your sustainability strategy. You are looking for action that aligns with your corporate or business strategy, capitalises on your assets and capabilities, and taps into the interests of your people and partners. This article looks at just three of the many ways of pinpointing such actions:

- the value driver tree
- metrics of a company's financial 'health', and
- aligning with operational strategies.

For each, the starting point is the general business case of sustainability: that it generates and supports long-term value for the company, and does so in a number of ways. It is worth considering that about half the share-market value of a public company represents its current and known earnings, and half represents the intangible assets that will determine its future earnings (its people, its brand, its intellectual property, and its relationships). Looking at Chart 1 (opposite), it is not hard to see how sustainability measures will support those intangibles, not to mention many of the more immediate benefits.

I have omitted from these three prioritisation tools what is possibly the most common form of strategy: the brand-based strategy. The brand approach to sustainability calls for the company to clearly articulate for its people and its stakeholders what it stands for, and why it is distinctive. Its sustainability activities and priorities are set to support that brand positioning. Such strategies are the best known among CSR practitioners, so I have not pursued them explicitly here.

The value driver tree

The 'value driver tree' is a tool that is very simple in concept, but quite an art-form in its practice. While it looks like there is one single breakdown of the costs and revenues for a business, there are in fact many avenues to the same end equation. The

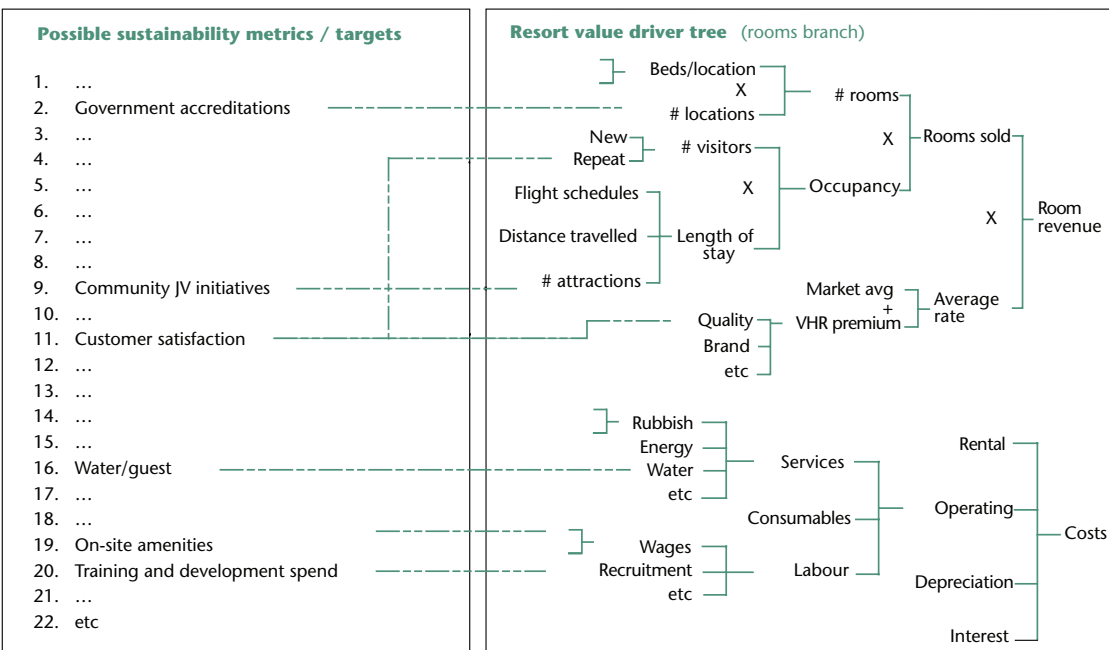
discussion of these possibilities can give a much richer understanding of the business drivers than the usual P&L presentations.

Chart 2 gives an example value driver tree for one revenue stream of a resort operator (its room takings). Most branches of the tree, on the right-hand side of the chart, are straight financial calculations, with the numbers involved readily to hand in the management accounts. But at some point what determines those numbers becomes more fluid; more of a judgment call. At what point will a guest stay an extra day due to the number of attractions and activities at the resort? To know how much they will invest in new attractions, management needs to make a judgment call on that ratio.

Some branches in the value driver tree will directly link sustainability metrics and initiatives and their financial impact — for instance, the cost of water. Others will require relative assessments. For example, if federal government approval is needed to operate a resort in a world heritage area, what parameters does the government agency require to be met, and how much investment will be needed to meet those?

Such judgment calls are an extension of existing management skills and processes, rather than something entirely new. Some people support sustainability because they *believe* they should, and that it pays off. Others need convincing. Using a value driver tree helps show what initiatives and performance measures have a direct impact on the financial bottom line.

Chart 2: Prioritising metrics for resort operator



‘Corporate health’ metrics

Most business people are sceptical of sustainability practitioners who says that attention to triple bottom line issues and measures will create medium- and long-term value. But they may believe Tim Koller, co-author of the leading textbook *Valuation*.⁴ Koller and his colleagues propose a contestable way of setting measures that capture the financial health of a company, and so give a better prediction of its long-term performance.⁵ Surprisingly, or perhaps not so, most of the indicators of the medium- and long-term health of the company coincide with corporate sustainability issues and initiatives. These are the metrics that ‘can gauge a company’s ability to create economic value in the future and the risks that might prevent it from doing so’.⁶

The chain of metrics involved in the ‘corporate health’ approach is divided into short-, medium- and long-term health metrics (see Chart 3). Each metric has corresponding sustainability drivers. Even the short-term metrics such as sales productivity include the ability to charge a premium (a brand premium influenced by sustainability reputation) and the ability to open new outlets (government and social licence to operate; location and venue partnerships). But, as you would expect, the synergies are greatest in the medium- and longer-term metrics.

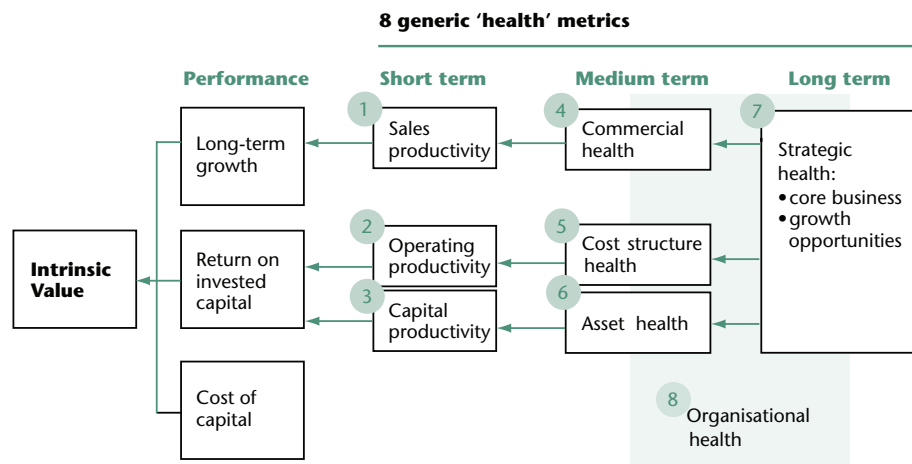
Commercial-health metrics include the product and innovation pipeline (R&D relationships, networks and investment), brand strength (positive recognition; word of mouth advocacy among suppliers and others; community

activity and impact), regulatory risk (environmental and employment compliance; governance of environmental or social risks) and customer satisfaction (repeat and referral purchases; survey responses and ratings). Cost-structure health metrics include the ability to manage costs in the future (awareness of economic and social trends; involvement with alternative cost solutions and providers). Asset health metrics include measures of how well the company is maintaining and developing its buildings and other capital assets (time between refurbishment; green building ratings; average length of tenancy).

Strategic health metrics include not only the ability to sustain its current activities, but ‘to identify and exploit new areas of growth’. As economic measures in a sustainability approach, then, companies may explore metrics such as investment in strategic modelling; new business investment; the number, size and progress of new portfolio businesses; and the number and geographic or industry reach of commercial partnerships.

Finally, organisational health metrics focus on the employee-related measures common in most sustainability reports, and which perhaps have the clearest alignment with business objectives. Here, though, measures that purport to indicate a positive like ‘flexible work arrangements’, such as the number of part-time workers, may disguise a reduction in employee commitment and capacities. Dobbs and Koller cite the case of the US retailer Home Depot. ‘When it took on lower-

Chart 3: Corporate ‘health’ metrics



Source: Dobbs and Koller ‘Measuring long-term performance’, *McKinsey Quarterly*, 2005 no. 1

cost part-time workers who often knew much less than its traditional store associates did, customers began to wonder what made the company special.⁷ Home Depot switched back to attracting more full-time associates. Metrics that might have predicted such an issue include the proportion of employees with skills ranked by external stakeholders as above average, or the average time needed for new employees to be completely familiar with the company's products, services and processes.

Aligning with operational strategies

Two of the most successful Australian companies have their business philosophy grounded firmly in the management of risk, yet apply that philosophy in very different ways to their sustainability strategy. While the emphasis here is on risk, the cases could be taken to be examples of any defining operational strategy of the company, and the way they guide the choice of metrics in reporting.

As an insurance company, risk is central to IAG's business. For its sustainability report, IAG filters potential indicators against what it calls its four operational 'pillars': cost management, claims management, pricing risk, and reducing risk in the community. For its customers, the risks are global (global warming) and local (traffic incidents and crime), while for the company the risks are to its people (health and safety). Accordingly, many of the sustainability initiatives taken by IAG are aimed at reducing these risks, and the data from these initiatives are reported. 'These examples show how working to reduce risk, and consequently the number of claims, makes good commercial and good common sense', states the CEO in the report.

BHP Billiton also holds risk management at its core. But BHPB keeps it there with a tight operational focus on eliminating risk that ensures that individual performance is improved by well-defined processes. It cascades its fundamental principles of risk management down from its formal charter, through its health, safety, environment and the community (HSEC) policy and management systems, key targets, GRI indicator selection, and ultimately to sustainability reporting. The metrics they manage by are almost all grounded in risk. Of the 23 priority targets in its HSEC scorecard, all but four are directed to risk management plans or hazard or harm reductions. Performance on this scorecard is included in management KPIs, and counts towards performance incentives equally with other corporate, area and personal project objectives.

Risk has always been at the core of the sustainability business case, as Chart 1 shows. As a result, risk-based sustainability strategies readily find corporate support, and fold well into existing governance processes. Since October 2004, the corporate ratings agency Standard & Poor's has

included sustainability indicators as part of their corporate risk assessment, and environment, social and governance (ESG) indices are now readily available to institutional investors.

Sound as they are, risk-based strategies are likely to capture less than the whole value of sustainability for many companies. When GE decided to invest US\$500 million annually in clean technologies in its 'ecomagination' initiative, it didn't imagine it would secure \$10 billion in annual revenues within five years. Having seen those returns, it has increased its annual investment to \$1.5 billion, expecting revenues to double to \$20 billion annually. Likewise, UNSW PhD graduate Shi Zhengrong didn't build US\$5 billion in personal wealth to become China's richest man by concentrating on risk. He saw the need in China for solar energy, and set about delivering it. For both, the defining questions were 'what are our strategic priorities, what are our defining assets and capabilities, what are our people and partners interested in — so what can we do?'

The corporate world is rapidly dividing into two camps: those corporate leaders who believe in sustainability and are putting it into action with integrity; and those who perhaps don't believe and either do nothing or adopt a passive or minimalist approach. Sustainability practitioners need to be able to engage the latter camp on their own turf. That means using the financial and strategic processes that they use, and promoting the relevance to those processes of sustainability metrics and moves. Long-term valuations, value driver trees and risk-based strategies are three tools that help connect the dots for line managers. There will be many more.

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Notes

- 1 Global Reporting Initiative (GRI) Sustainability Reporting Guidelines 2002, Economic Performance Indicator EC8. This indicator is likely to be replaced in the 3rd edition of the GRI guidelines, due to take effect in very late 2006
- 2 GRI Environmental Performance Indicator EN1
- 3 GRI Social Performance Indicator HR2
- 4 Koller, Goedhart & Wessels, *Valuation: Measuring and Managing the Value of Companies*, 4th edn, Wiley, 2005
- 5 The methodology is best captured in Dobbs and Koller, 'Measuring Long-Term Performance', *McKinsey Quarterly*, No. 1, 2005
- 6 *Ibid* p 18 ●