P r o g r e s s

Improving performances in the boardroom

Former UN Secretary General, Kofi Annan, launches the Principles for Responsible Investment (PRI), an initiative of UNEP Finance Initiative and the UN Global Compact, at the New York Stock Exchange. NY Stock Exchange

True to global research, companies that value their intangible assets and pay regard to the social, environmental and community issues that ultimately matter to stakeholders are now registering above-average financial performance. This is being reflected by Socially Responsible Investment Funds in Australia outperforming the ASX200.

Often ‘sustainability’ is referred to using terms such as ‘corporate social responsibility’ and ‘triple bottom line reporting’. Ultimately, all of these terms refer to the same pressure to perform to a wider set of criteria than traditional financial ones.

International strategic investment firm Innovest’s 2004 report, Corporate environmental governance: a study into the influence of environmental governance and financial performance, found that, ‘In 51 of the 60 studies reviewed, a positive correlation was found between environmental governance and financial performance … Results from fund, sector and company analysts are all generally positive.’

Research by AMP Capital Investors suggests similar defining trends are emerging in Australia.[1] A number of studies by the firm regarding the performance of Socially Responsible Investment (SRI) managers in Australia show that the median SRI fund outperforms the ASX200 over the medium term.[2] Of the top five performing funds in Australia last year, three of them were SRI funds.[3]

Their more recent research[4] confirms the value of focusing on performance in these areas known as ‘intangible assets’. Twenty years ago, company valuation was mostly about tangible assets – buildings, equipment and investments. AMP[5] shows that over 75 per cent of the value of a typical Australian company is made up of unseen or intangible assets. These include a company’s corporate reputation; the way it attracts and retains its employees; its occupational, health and safety practices; and its environmental performance.

In *The Human Equation: Building Profits by Putting People First*, Stanford University Professor Jeffrey Pfeffer carefully reviewed the research evidence on the characteristics of high performing organisations.[6] He concluded that the most critical factor was human resource practices. This is perhaps intuitive: global studies indicate that better employers have higher revenue, higher profit growth and higher investment returns.[7] Westpac Australia, for instance, has found that 50 per cent of graduates chose it over other Australian banks for employment, explicitly because of its proactive Corporate Social Responsibility (CSR) approach.

The Hayes Best Employer Survey (2006) shows that nearly 75 per cent of 20-year-olds will not apply for a job if they’re uncomfortable with the company values.[8]

CSR gives competitive advantage

Company boards are realising they can improve their organisations’ competitive advantage through a sustainability strategy that both focuses on reducing operational costs through efficiency and delivers higher quality, ‘greener’ products that command premium prices (see Table 1).

But Harvard Business School’s Professor Michael Porter and colleague Mark Kramer wrote recently that, ‘Many companies have already done much to improve the social and environmental consequences of their activities, yet these efforts have not been anywhere nearly as productive as they could have been … The fact is, the prevailing approaches to CSR are so fragmented and so disconnected from business and strategy as to obscure many of the greatest opportunities for companies to benefit society. If instead, corporations were to analyse their prospects for social responsibility using the same frameworks that guide their core business choices, they would discover that CSR can be a source of opportunity, innovation and competitive advantage.’[9]

This is being increasingly understood. Martin Jones, General Manager for Government Relations at CSR Ltd, reported to us that, ‘In 2007 there has been a much stronger recognition by the management

1 AMP Capital Investors (2002). SRI performance and style review (includes an extensive review of other literature). Available at: http://www.ampcapital.com.au/corporatecentre/research/sriresearch.asp (Accessed May 2007)
2 Medium term refers to one, two, three and five years to 31 March 2006.
3 Taken from a total of 66 active managed funds.
4 Anderson M and Dennis A (2006). SRI managers continue to beat the benchmark. AMP Capital Investors. http://www.ampcapital.com.au/_pdf/corporatecentre/sri/researchpapers/SRIResearchPaper20060608.pdf?DIRECT (Accessed May 2007)
5 Anderson M (2007). Investing in an intangible world. AMP Capital Investors. http://www.ampcapital.com.au/K2DOCS/site_corporate/33BA7F0E-09FB-4BAD-BCFD-EE64F2B77168/InsightsSustainabilityPaper20070418.pdf?DIRECT (Accessed May 2007) .
6 Pfeffer J (1998). *The Human Equation: Building Profits by Putting People First.* Harvard Business School Press, Boston.
7 Hewitt Associates (2004). Summary of findings report, ‘Hewitt Best Employers in Australia and New Zealand Study’. http://was7.hewitt.com/bestemployers/anz/pdfs/studyhight2004.pdf (Accessed May 2007)
8 Hayes Best Employer Survey (2006). http://www.careerone.com.au/jobs/job-search/job-market-insider/pid/1588 (Accessed May 2007)
9 Porter M and Kramer M (2006). Strategy and society: the link between competitive advantage and corporate social responsibility. *Harvard Business Review* December: 1–14. http://harvardbusinessonline.hbsp.harvard.edu/email/pdfs/Porter_Dec_2006.pdf (Accessed May 2007)

Process: Reduced costs through eco-efficiency	Product: Reduced costs through eco-innovation
• material savings from better whole-system design • increases in process yields and less downtime • better design to ensure that by-products and waste can be converted into valuable forms • greater resource productivity of inputs, energy, water and raw materials to reduce costs • reduced material storage and handling costs through 'just in time' management • improved OH&S • improvements in the quality of product or service	• higher quality, more consistent products • lower product costs (for instance, from material substitution, new improved plant efficiencies) • lower packaging costs • more efficient resource by-products • safer products • lower net costs to customers of product disposal • higher product resale and scrap value • products that meet new consumer demands for environmental benefits

Table 1. Benefits of eco-efficiencies and eco-innovation to a firm's competitive advantage.
From M Porter and C van der Linde

of CSR Limited of the importance of sustainability and the role it can play in developing competitive advantage at the company. An initial focus will be on improved understanding of the company's carbon footprint, and the implications in terms of mitigation, business opportunities and customer requirements. We intend to build on the leadership from Professor Porter to understand how to leverage our internal skills for the greatest sustainability outcomes.'

Risk management

Sustainable business strategies can also assist companies to proactively address emerging risks, especially at a time when climate change liability related litigation has already begun. Managing these risks is becoming a key investment criterion, and this is placing significant pressure on firms to apply socially and environmentally responsible strategies and practices to their business operations. Over 180 investment firms, totalling US$8 trillion worth of investments, have now signed the UN Principles for Responsible Investment.[10] Three of the four largest fund management companies in Australia signed up in early 2007: BT Financial Group, AMP Capital Investors and Colonial First State Global Asset Management.

Addressing investor demands

Investment houses are increasingly demanding performance information from firms across social and environmental impacts in addition to their financials. This is reflected by the exponential increase in the number of companies using the Global Reporting Initiative (GRI) – fast becoming the world's pre-eminent sustainability reporting framework.[11] Of the top 250 companies in the world, 64 per cent published sustainability reports in 2005.[12] Companies are joining the GRI because they know that 'if you can't measure it, then you can't manage it.' Those that begin with a rigorous process to collect sustainability performance data and metrics are well placed to assess how best to strategically approach sustainable business practice and meet their CSR aims.

What then are the key steps for firms to develop strategies to improve their competitive advantage through a sustainability strategy? As Porter and Kramer write, 'To put these broad principles (of corporate social responsibility) into practice, a company must integrate a social perspective into the core frameworks that it already uses to understand competition and guide its business strategy.'[13]

However, as The Natural Edge Project (TNEP) associate Dan Atkins, Director of Sustainable Business Practices, cautions, 'Developing an appropriate strategy and articulating a vision that meets the relevant stakeholders' expectations is becoming a critical component of shareholder value. How that vision and strategy is integrated within the organisation is largely dependent on getting the frameworks in place and a culture to execute the strategy in a way which is aligned to the overall business objectives and values.'

Key operational steps to ensure this occurs, identified by TNEP and its partners, include the following: [14]

- Obtain board and senior management understanding and commitment. Assign overall responsibility for CSR to senior management to ensure alignment of core frameworks with the company sustainability strategy.
- Undertake a comprehensive audit of the company's performance across social, environmental and financial indicators and the interactions between them.
- Bring together quantitative data on social and environmental performance to better inform decision making.
- Map social and environmental risks and opportunities to better inform company strategy.
- Identify opportunities to improve operational efficiency and new 'greener' product differentiation.
- Re-assess HR policy to ensure attraction and retention of the best staff. Foster a culture of innovation and institute appropriate rewards. Build the skills capacity of all employees.
- Initiate whole-of-company engagement, incorporating sustainability objectives into individual work performance measures. Establish multi-disciplinary teams ensuring all areas of the business are engaged.
- Review marketing and communications processes.
- Engage with stakeholders on CSR and develop partnerships including both internal and external participants, suppliers, customers and financiers.
- Report qualitatively in the annual report on social and environmental performance.

There is now significant evidence from market successes that pursuing these sustainable business practices pays significant dividends. A sustainability strategy with CSR reporting reinforces a company's capacity to act responsibly and profitably, while creating new ways to improve both short- and long-term value for shareholders.

Karlson 'Charlie' Hargroves, **Michael H. Smith**, **Peter Stasinopoulos** and **Stacey Hargroves**, The Natural Edge Project (hosted by Griffith University). Based on research commissioned by CSR Limited.

10 UNEP FI Principles for Responsible Investment (2007). Principles for Responsible Investment hit $8 trillion mark on first year anniversary. http://www.unpri.org/media/PRI_media_release_29-04-07.php (Accessed May 2007)
11 Global Reporting Initiative (2007). GRI database sector search – construction and building material companies, GRI. Available at: www.globalreporting.org/home (Accessed May 2007)
12 Porter M and Kramer M (2006). Strategy and society: the link between competitive advantage and corporate social responsibility. *Harvard Business Review* December: 1–14. http://harvardbusinessonline.hbsp.harvard.edu/email/pdfs/Porter_Dec_2006.pdf (Accessed May 2007)
13 Ibid.
14 For more information see Section 2 of Hargroves K and Smith M (2005). *The Natural Advantage of Nations: Business Opportunities, Innovation and Governance in the 21st Century*. Earthscan, www.naturaledgeproject.net/naon.aspx. See also 'The Path to Competitive Advantage' by Sustainable Business Practices Pty Ltd, www.sbpractices.com.