

A new era of sustainability

The world is being shaped by an unprecedented confluence of global megatrends. From population growth to emerging markets to climate change, these global trends are pushing us to the limits of our ecological system and in the process also changing the competitive landscape in which businesses operate. Looking ahead, the ability for companies to manage environmental and social issues is likely to become increasingly vital to their long-term competitiveness and financial performance – and perhaps even to their survival.

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The modern concept of sustainability arrived on the global corporate agenda in 1983. At the time, the UN World Commission on Environment and Development sought to address the growing concern about “the accelerating deterioration of the human environment and natural resources, and the consequences of that deterioration for economic and social development.” It was also in this context that the popular term “sustainable development” was first introduced, later famously defined in the Brundtland Report as development that “meets the needs of the present without compromising the ability of future generations to meet their own needs”.

The unsustainable legacy of the Industrial Revolution

Many of our modern business practices have their roots in the Industrial Revolution. Perhaps the most transformative megatrend in human history, the Industrial Revolution saw the European manufacturing process rapidly develop in the early 19th century from small-scale production by hand to large-scale production by machine. And while this shift would lay the foundation for the developed world’s economic prosperity, it also introduced many business practices that today are no longer acceptable – practices such as pouring waste into water and smoke into the sky because natural resources were thought to be limitless.

The Industrial Revolution was centered around the production of goods and services for consumption. This focus on production is also reflected in our current system of national accounting, which relies on gross domestic product (GDP), and measures the value of goods and services produced in a country. And while GDP is precise in its ability to account for capital goods, it is less imprecise in its ability to account for natural and human resources because it assumes them to be both limitless and free. In fact, many environmentalists even charge that GDP treats damage to ecosystems as a plus in the context of higher economic output rather than a minus on account of the forests destroyed or water or air that is polluted.

The inability of GDP to fully account for the integrity of the environment or other factors that may affect quality of life may also suggest why our current model of economic development is geared to externalize many social and environmental costs to society. Externalities are costs produced by industry but paid for by society. For example, pollution is an externality which is sometimes taxed by government in order to push the entity responsible for the pollution to “internalize” the full costs of production.

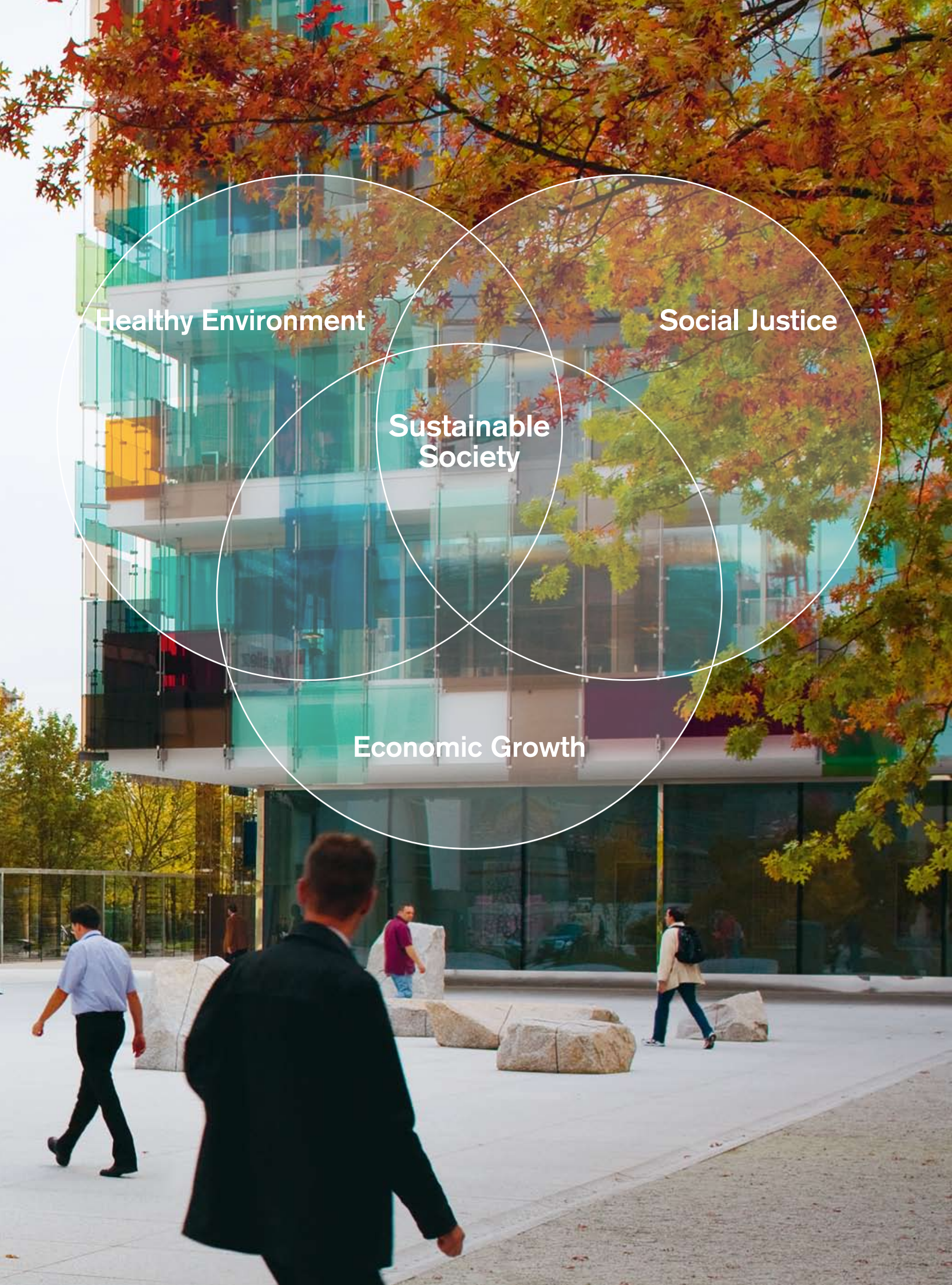
But before the “polluter pays” principle was first introduced in Sweden in 1975, companies around the world were implicitly being rewarded financially for maximizing externalities in efforts to minimize their cost bas-

es. Today, however, civil society is coming up with increasingly innovative ways to attach prices on emissions in efforts to reduce pollution. For instance, the concept of emissions trading – also known as cap-and-trade – has gained favor in recent years as a further innovative approach to reducing emissions. The program relies on providing economic incentives for achieving reductions by issuing tradeable “emission permits” that represent the right to emit a specific amount of carbon.

Social contract between society and business

Although modern society is vitally dependent on the significant contributions business brings to society – from productivity gains to driving innovation to creating jobs – businesses are also dependent on society in terms of the public legitimacy they receive (or not) from the societies in which they operate. This relationship forms the basis of an overarching social contract between business and society: businesses receive a license to operate from society, which is contingent upon companies providing an overall positive contribution to society. In this sense, companies that blatantly ignore public sentiment on environmental and social issues risk making themselves increasingly vulnerable to public sanction.

Examples abound of how broad public sentiment can influence corporate strategy. In the pharmaceutical sector, for instance, >



Healthy Environment

Social Justice

Sustainable Society

Economic Growth

public perceptions of excessive prices charged for HIV/AIDS drugs in developing countries have pushed global pharmaceutical firms to make these medications more accessible to the world's poor. Similarly, in the food sector, public concern on obesity (which afflicts 32% of Americans) is resulting in calls for further controls on the marketing of unhealthy foods. And the oil and tobacco (and potentially financial services) industries represent further examples of how changing public perceptions continue to reshape the ways companies do business.

Changing context of business

Indeed, today "license to operate" can no longer be taken for granted, as challenges such as climate change, water scarcity, food security and extreme poverty have reached a point at which civil society is demanding a response from business. At the same time, multinationals are often better positioned than governments to deal with some of the global challenges. In fact, of the world's 100 largest economic entities, 63 are corporations, not countries. This growing influence of business in society makes it even more important that profit-maximizing firms do not act against the interests of society. And society is increasingly turning to global businesses as the only institutions strong and large enough to meet the huge long-term challenges facing our global ecosystem.

Moreover, the proliferation of media technologies and the growing importance of Webenabled participatory media such as Twitter and Facebook have given NGOs and consumers new tools to encourage companies to integrate more sustainability into their strategic thinking. This is changing the context of business as consumer groups and non-governmental organizations gain broader and more immediate influence in scrutinizing the integrity of the social contract between society and a particular business.

Another factor that is changing the context of business is that today's economic value is increasingly being generated by intellectual capital and other intangible assets such as ideas, brands, reputation, customer service, motivation of personnel, the capacity to innovate, and the quality of relationships with key stakeholders (such as regulators, governments or non-governmental organizations). In fact, according to academic studies, it is estimated that today these intangible factors make up 80–85% of a company's true market value. What this means

for business is that the increasing value of intangible factors like a firm's reputation or its ability to attract top talent make its ability to respond to the demands of society crucial to creating long-term shareholder value.

Toward a new era in sustainable investment

Sustainable development is likely to be one of the most critical drivers of business over the next decade as companies realise that their survival hinges on how well they respond to environmental, social and governance (ESG) issues. In this context, the performance of companies on sustainability issues is becoming an increasingly powerful determinant of their future corporate competitiveness, profitability – and ultimately their share price performance. It therefore also comes as no surprise that investors are increasingly seeking to incorporate concepts like sustainability and responsible corporate behavior into their assessments of a company's long-term value.

At Credit Suisse, we view the sustainability investment process as a powerful tool – in additional to traditional financial criteria – in driving investment performance because it involves identifying hidden and potential risks and opportunities in companies. In this context, we believe the interests of shareholders, over time, will best be served by companies that maximize their financial performance by strategically managing their economic, social, environmental and ethical performance. So doing good and doing well may not be antithetical after all. <

Masthead

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