COVER STORY

A STRONG BUSINESS CASE FOR BEING GOOD

BY CHUA SUE-ANN

A convergence of factors and stakeholder demands has culminated in greater awareness and push for companies to operate more sustainably. The triple bottom line of people, planet and profit has become the new benchmark for businesses.

There are no mock cheque presentations. No grand gestures. No posing for the cameras. None of these are required. Responsible business practices are increasingly a part of the day-to-day operations. And it is serious business indeed.

Globally, there has been a convergence of factors and stakeholder demands that has culminated in greater awareness and push for companies to operate more sustainably. What this means in practical terms is a shift from purely pursuing profit to the "triple bottom line" of people, planet and profit.

In recent years, efforts to push sustainability have translated into several global initiatives and emerging trends. On a higher level and broader scale, 193 United Nations member states have adopted the Sustainable Development Goals (SDGs) launched in September, which expands on the earlier Millennium Development Goals (2001 to 2015).

The SDGs comprise 17 major aspirational goals and 169 specific initiatives to achieve the global goals by 2030, which is a short 14 years away.

Time is of the essence. The effects of climate change are being felt all over the world. The world's seven billion population — and growing — is clearly stretching the earth's resources and well-being.

We are at a crossroads. The global context for business is changing. Business as usual is simply not good enough to address the many urgent challenges that humanity and the planet face.

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PUSHBACK AGAINST SHORT-TERMISM

The last decade in particular has seen a pushback against what has been called "short-termism" in the way companies are expected to operate and perform.

Numerous studies have shown that businesses will be more successful at growing value if its managers take a longer-term view, as opposed to a short-term perspective, which tends to negatively impact strategic leadership, innovation, human capital development and financial prudence.

This is aptly articulated by Generation Investment Management, a private investment management firm with offices in London and New York, whose investment philosophy is based on that very conviction.

"We believe the interest of shareholders, over time, will be best served by companies that maximise their financial returns by strategically managing their economic, social and environmental performance."

Andrew Chan, who leads PwC's sustainability and climate change practice for Southeast Asia, sees tensions between the financial system and the broader shared values held by stakeholders. Financial investors, he notes, tend to exert pressure on companies to perform on a quarterly basis, thus preventing them from taking a longer-term view that allows for more sustainable ways of operating.

"The majority of financial investors might say they want quicker returns instead of longer-term returns. You may get similar, if not better, returns in the longer term, but they want it now," he says.

Chan cites Sultan Nazrin Muizzudin Shah's speech at the Khazanah Megatrends Forum 2014. The Sultan of Perak spoke about the paradigm shift from profit maximisation to value maximisation.

"This is the broader concept of value: value to the environment, society and company and shareholders. Michael Porter's concept of creating shared value is to benefit everyone instead of only concentrating on traditional performance measures," he adds. (Porter is an American academic and author known for his views on economics, business strategy and social values).

It does not necessarily have to be a zero-sum game. Companies do not need to destroy the environment in their pursuit of profitability, nor do they need to endure higher costs and sub-par returns in order to operate responsibly.

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Datuk Seri Tajuddin Atan, CEO of Bursa Malaysia Bhd, one of the institutions at the forefront of promoting good business practices, says businesses can and should consider referencing the SDGs in business strategy to achieve both financial returns and results for the greater good.

Invariably, there will be trade-offs and difficult decisions to be made given competing stakeholder interests. Take climate change, where the seeming-

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ly "logical" solution would be to minimise global greenhouse gas emissions by reducing fossil fuel consumption and increasing the use of renewable energy.

"If this is the case, oil and gas and coal mining companies would have to cease operations for the 'greater good' of society. But in reality, this is not possible immediately as it is a difficult trade-off," says Tajuddin.

"Therefore, to achieve a coherent outcome, governments, businesses, non-governmental organisations and civil society will have to make commitments and, if necessary, policy changes."

Tajuddin is among those who see that more investors are becoming concerned about sustainability issues. They are beginning to appreciate the positive correlation between environmental, social and governance (ESG) factors and the financial performance of corporations.

"Capital markets are evolving. Investors are placing more emphasis on non-financial information, meaning they no longer solely look at revenue and profit," he says.

DEMAND FOR SUSTAINABLE INVESTMENTS

All this has led to a steady demand for sustainable investments. For example, the global market for such investments grew 61% to US$21.4 trillion between 2011 and 2014. In Asia alone, responsible funds saw 32% growth over the same period. The United Nations' Principles for Responsible Investment (UNPRI) initiative recorded its highest number of investor signatories with more than US$60 trillion under management this year.

"This marks the mainstreaming of responsible investment in global capital markets," says Tajuddin, who has noticed growing investor demand for greater transparency in terms of company data and information and the sustainability performance of public-listed companies in Malaysia.

The sustainability focus can create differentiation and new revenue opportunities for businesses.

In Southeast Asia, the push towards sustainable business practices and investments has largely come from regulators. Malaysia, Vietnam and Singapore have made it mandatory for public-listed companies to make sustainability disclosures.

According to PwC's Chan, most companies tend to start their sustainability journey at the stage of compliance and risk management. This stage is typically the first of four key phases that most companies move along.

At this early stage, companies are complying with regulatory requirements, such as mandatory disclosures of sustainability policies to the stock exchange. Companies are also largely dealing with the environmental, social and governance risks that may arise to protect themselves from reputational damage.

The next step for companies involves operational efficiency enhancements by taking a broader cost-benefit analysis view.

"There are many initiatives related to sustainability that give a fairly quick payback, typically two to three years," says Chan. One example is purchasing energy-efficient machinery that might cost slightly more but offer longer-term energy cost savings or lower wastage.

In the work that PwC does with clients on sustainability, the team tries to move companies quickly towards the second stage because these efforts lead to demonstrable direct cost savings. What's more, this could in a big way demolish the perception that it is costly to respond to the sustainability agenda. "Companies that think of sustainability as compliance only will see it as a cost. Without a clear linkage to strategy, they will fail to link it to the third stage, which is revenue generation," says Chan.

NEW REVENUE STREAMS

There are many examples of existing businesses generating new revenue streams simply by leveraging their core capabilities to create new business segments with a sustainability focus.

Chan cites the example of Clorox, which noticed a demand for cleaning products that are kinder to the environment by a new generation of consumers. The result? A sub-brand called Green Works, which has captured new consumer segments for the established brand, is bringing in good growth.

The Boston Consulting Group (BCG), in a report, found that social responsibility is not just good corporate citizenship but can be a major source of growth. It notes that the global grocery industry has found a bright spot in the relatively stagnant segment.

"Responsible consumption" foods — or goods labelled as organic, natural, ecological or fair trade — have grown into a US$400 billion business. It is expected to grow another US$180 billion in the near future.

"Responsible consumption offerings are no longer niche products, but are capturing a disproportionate share of growth. In the US alone, sales of these products grew at about 9% annually in recent years — accounting for about 70% of the total US grocery sales growth between 2010 and 2013," says BCG.

Another example is General Electric, which made a commitment to solve global energy and environmental challenges. Since 2005, it has invested US$17 billion in R&D and realised US$232 billion in revenue from Ecomagination. It also cut greenhouse gas emissions and freshwater use by 12% and 17% respectively last year, from its 2011 baseline.

"The sustainability focus can create differentiation and new revenue opportunities for businesses. As you progress towards that, you will gain improved brand perception, which is the fourth impact you get from having more of a sustainability focus," says Chan.

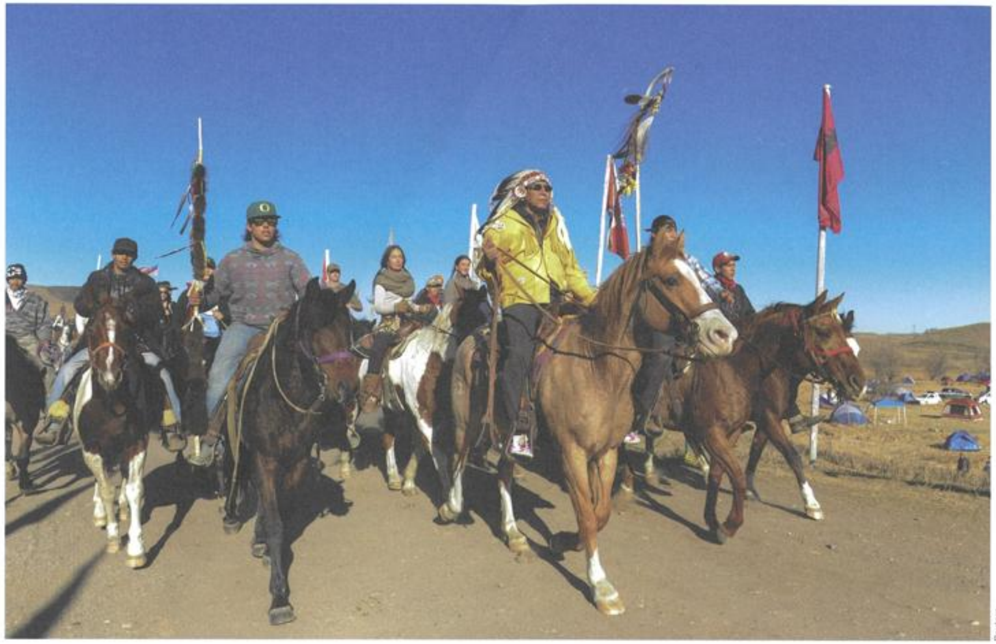
This fourth stage ties in with the aspiration that companies can indeed operate successfully by paying attention to the "triple bottom line" of people, planet and profit. Apart from regulators and governments, shifts in consumers' mindsets have also pushed companies to be good corporate citizens.

IMPORTANCE OF BRANDING

Global consumer survey firm Nielsen warns that consumer brands that have yet to embrace sustainability are at risk on multiple fronts.

"Consumers are starting to consider sustainable practices as a basic cost of entry rather than a market differentiator. Going forward, brands have to define a credible and relevant social purpose, deliver greater social value and communicate that value effectively to attract and retain consumers.

"By integrating sustainability into their business models and purpose — to whatever degree — companies can both help society and increase goodwill



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Native American riders protesting the Dakota Access pipeline near the Standing Rock Indian Reservation as it poses a threat to water supplies and sacred sites

towards their brands," it says in its October 2015 report titled The Sustainability Imperative: New Insights on Consumer Expectations.

Based on extensive surveys and analysis of more than 1,300 brands in 13 categories in 13 countries, Nielsen says consumer brands that have demonstrated commitment to sustainability have grown more than 4% compared with the paltry 1% of brands without commitments to sustainability.

From consumer surveys, it has found that 66% of consumers are willing to pay more for sustainable brands — a steady increase from 55% and 50% in 2014 and 2013 respectively. "Consumers are trying to be responsible citizens of the world and they expect the same from corporations. So, when it comes to purchasing, they are doing their homework," says Nielsen.

RAMIFICATIONS FOR NON-COMPLIANCE

There are heavy ramifications for companies that do not comply with regulations or have hurt the environment or society in the course of doing business. Companies that are caught are severely punished by regulators, investors and customers.

Last year, German automotive giant Volkswagen was caught cheating on emissions tests in the US after fitting its diesel engines with a "defeat device" that allows cars to adjust their performance when the software detects that they are being tested. This has hurt the brand as well as its bottom line.

The company set aside €6.7 billion to cover the cost of recalling millions of cars. It posted its first quarterly loss, of €2.5 billion, in 15 years in October last year. That's not all — the US Environmental Protection Agency can fine Volkswagen up to US$37,500 for each vehicle that breaches standards on emissions, with the estimated fine potentially totalling US$18 billion.

Then there is the New York-listed Lumber Liquidators, which was exposed by a news programme last year for selling China-imported laminate flooring that contained potentially carcinogenic formaldehyde that was over the regulatory limit in California. Sure, the company did not make the goods, but it failed to ensure that its supply chain was compliant with US standards.

After news broke, more than half its market capitalisation of US$3 billion was wiped out. The company has reported declining profit and same-store sales since.

The bottom line is this: Capitalism is in effect being turned on its head. What if businesses can be profitable without hurting the environment or society which they are a part of? Wonder no more. The age of sustainable business is here to stay. RB