Natural capital accounting

The next big thing in sustainability?

Businesses all over the world are waking up to the importance of accounting for the environmental assets they use and own – but why, and why now? World Watch spoke to Alan McGill and Will Evison to find out.

Maybe it makes sense for us to start by defining what we're talking about – what do you mean by 'natural capital'?

Alan McGill: Well 'natural capital' describes any aspect of the natural environment that provides some kind of value to humans – it can be divided into categories like air, water, land and so forth, or characterised by the specific natural assets it consists of, like stocks of fish, stands of trees and so on.

And where does the accounting part come in?

Will Evison: It starts with putting a monetary value on the environment. But there are different ways of doing this – and there's an important difference between valuation and pricing. We *all* value the environment to some extent – because we enjoy walking in it, or looking out of the window, or breathing clean air – and monetary valuation simply expresses these different values that we all hold, in common units.

Pricing is a whole different ball game. That implies equilibrium of supply and demand in some form of market. Pricing– can be hugely useful – for example, in identifying the areas of environmental change most in need of our attention.

So it's useful – but is it essential? Or is it more something that only the environmentally-minded businesses are going to be looking at?

Alan: Natural capital accounting is going to become big for *all* businesses. Few companies have a lot of natural capital under their direct control. Extractives and forestry are the big primary industries that do. But virtually all companies have significant indirect influence over natural capital – in their supply chains. And in a world of dwindling natural resources – resources you need to run your business – understanding the impact of your company and managing these consequences is going to become business critical. There's obviously a big risk component here too: you have to understand what resources are strategically important to your business in the short and long term – and I think every CEO would agree with that!

Just picking up on that final point – is there a market consensus on valuing the environment?

Will: That's a good question – you need a pretty broad consensus for natural capital accounting to be effective. Bearing in mind the equilibrium and market points we were discussing earlier, it doesn't help if you're using natural resources that are business critical and another business is denying that they even need that same thing to function! We were at the World Forum on Natural Capital in November, and that was the first time I'd seen a large majority in agreement that valuing the environment in monetary terms is a good idea. When we asked the question, about 90% of the audience had their hands up in support of the idea.

So would it be fair to say that business is on board?

Will: I think people are waking up to the idea that it's important, but I would say that it's less clear whether major corporations have fully grasped the concept of natural capital. Some high-level analysis we did, examined whether Britain's biggest listed companies reported on natural capital, biodiversity or ecosystems in their annual and sustainability reports. It turns out that only two of the FTSE 100 – which contributes an esitmated $4.5 trillion to the global economy annually – mention 'natural capital' in annual reports, and only six of 95 do the same in their sustainability reports.

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> **Will Evison, PwC**

Encouragingly, biodiversity came off better – but it's been in the reporting and sustainability lexicon for longer. Almost half of the FTSE 100 mentioned it. I think we'll see natural capital thinking permeating through company management and reporting over the next few years though – especially because it has a much more immediate resonance in the corporate context than biodiversity or ecosystem themes.

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> **Alan McGill, PwC**

Alan: Part of the problem is that our ability to account for these environmental assets and their rate of depletion is variable. In a limited number of areas, like fossil fuels, we've got pretty good at putting numbers on resources. But we're failing to account for many more environmental services such as the clean air provided by forests, flood protection courtesy of wetlands and crop pollination by insects. It's important that we understand the range and depth of these assets – and at a national level, because that will inform policy decisions. It's no longer just about individual CEOs saying, "well, what's the risk to *my* business?" It's about understanding whether our actions are truly sustainable and underpin business performance and good growth.

And were you encouraged by the reactions at the World Forum in November?

Will: Well there does seem to be increasing agreement that properly valuing environmental assets and impacts is useful, and there was a palpable buzz around the natural capital accounting sessions. I am encouraged!

Alan: The Forum was a great opportunity for businesses and sustainability leaders to come together and discuss how these natural assets can be factored into decision-making and systems of national accounting. To me, it's clear that over time we'll see companies make radical changes to their environmental accounting for resource use along their entire value chain.

The Forum was packed and the debate was varied – and at times, pretty robust – but the overall consensus was encouraging: natural capital is important and business has a role in safeguarding it.