Redefining Value: The New Metrics of Sustainable Business

Forthcoming Opportunities and Reflections on Recent Lessons

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Climate change, water and food scarcity, overpopulation and the inequitable distribution of wealth and opportunity are among the many challenges we face – in business, government and society -- as we march ahead into the 21st century. But our challenges are not only in recognizing the value of ecological, social and human capital and how it drives financial value. Perhaps more importantly, we are challenged by our constrained mental models or frequently limited worldviews, from how we translate the information coming our way each day to how we design our institutions, strategies, business models, and financial systems.

Innovation and thought leader Stewart Brand, who for many years advised Royal Dutch Shell, once observed that it wasn't the pursuit of profits that the company's senior management clung to most fervently. It was their mental models, as past success reinforced the connection to what worked previously, rather than what needs to be designed for the future.[1]

This theme is pervasive in capital markets as well. While financial firms advise "past performance is not indicative of future results," the "short-term-ism" of our capital market systems is driven by mental models commonly held in our society that no longer align with the needs of our time. We must transform these legacy worldviews, and this requires a commitment to new mental models – and hence new ways for business, government and non-profits to serve society's needs.

Fortunately, there is mounting evidence that a shift is already taking place within some of us, in some of the mental models we hold about the nature of our world, our individual roles in it, the role of business, and our collective role as consumers in shifting the world toward a sustainable future.

The things to which we ascribe value are beginning to change, creating both new opportunity and a new imperative for business to investigate. **Sustainable Brands and its Issues in Focus series on New Metrics**[2] hosted both online at sustainablebrands.com and in face to face meetings at the Wharton School of the University of Pennsylvania in 2011 and 2012 (and again this fall in 2013, at the University of Pennsylvania[3]) are highlighting this shift in values and new forms of value creation.

[1] Black, J. Stewart, and Hal B. Gregersen. *It Starts with One: Changing Individuals Changes Organizations*. Upper Saddle River, NJ: Wharton School Publication. 2008. Print.
[2] http://www.sustainablebrands.com/news_and_views/new_metrics
[3] http://www.sustainablebrands.com/events/issuesinfocus/businessmetrics

The Important Role of Metrics in Business, and in our Future

In business, and in our economic and social systems more generally, **what gets measured gets managed**. Metrics are both valuable and, at the same time, imperfect. In business, metrics create a shared language against which shared values are agreed upon. Metrics form the basis for helping us understand and communicate how we are progressing toward our goals. Furthermore, metrics are also potentially transformative. Metrics are not just management tools and measuring rods; they're also **change agents**.

We are seeing rapid change in the degree to which citizens trust business or brands; the degree to which they care if any individual brand persists, or doesn't; the degree to which they are beginning to hold business accountable for addressing many of the social and environmental challenges we face. If for no other reason than to respond to these shifts (never mind the parallel set of metrics tied to increased risks to be expected from climate change, supply chain disruption or commodity price increases tied to impending shortages), for businesses to persist successfully into this unfolding century of great change, the metrics by which they define and measure the value they are delivering must change as well. Nothing can drive faster organizational response to a changing business environment - or facilitate realignment between corporate functions or within value networks - than a shift in the metrics used to track success.

In 2011, Sustainable Brands launched a series of conversations on this topic, both online and via the New Metrics of Sustainable Business conference, convened again in 2012, and again in the fall of 2013 at the University of Pennsylvania in Philadelphia to address these important shifts. The objective has been to bring together thought leaders from business, non-profits and academia to realize three objectives:

1. Understand the rapidly evolving progress towards developing and implementing New Metrics globally
2. Advance the state of the art through focused discussions based on case studies
3. Nurture the emergence of new mental models to deliver and benefit from new forms of value

The New Metrics of Sustainable Business Conference '12

This paper summarizes key findings from the 2012 gathering. You can refer to the full program, as well as links to slides from all sessions, at this address: http://www.sustainablebrands.com/sites/default/files/docs/sbnm-learning-leaders.pdf.

Further in-depth dives into New Metrics case studies and additional innovations from the Sustainable Brands community can be found on SB's #NewMetrics channel here: http://www.sustainablebrands.com/news_and_views/new_metrics.

Each name is hyperlinked to the respective speaker profile, where you can read more about the speaker biography and find links to social media accounts. All sources are from the New Metrics of Sustainable Business Conference Sept. 27 and 28 at the University of Pennsylvania, unless otherwise stated.

Each footnote is hyperlinked to the audio and/or slides from the referenced session.

2. The Opportunity to Reduce Risk and Enhance Upside

Why are **New Metrics** required for business success? Sustainability represents the single biggest profit and innovation opportunity of the 21st Century.

The purpose of business is to solve problems. The problems of this century are overwhelmingly driven by 7 billion citizens seeking a higher quality of life while living on 1 planet that has limited resources and regenerative capacity. Efficiently using existing resources while solving for these human needs in a productive manner is essential to the survival of business, but more importantly, of humanity itself. Whether the challenges are environmental or social, attractive payoffs await the companies that create broadly applicable solutions. The greater the problem, the greater the profit opportunity — and our sustainability-related problems are enormous.

Furthermore, comprehensive systems thinking inspired by sustainability is a lens that allows smart companies to see products and services, along the entire life cycle, in large planetary and societal contexts. It's thus a tool for innovation, a way to identify possible cost savings and new business opportunities. For example, a few years ago Interface invested heavily in bringing biomimicry training to its designers. The initiative visibly led to increased creativity and innovation; management was impressed with the results.

In his keynote presentation, *Sacred Economics* book author Charles Eisenstein outlined four ways that sustainability delivers benefits:

1. Creating goodwill and building brand reputation
2. Helping foster a culture of accountability and attention to detail
3. Building morale, increasing employee retention and aiding in employee recruitment
4. Encouraging anticipatory thinking, which can deliver early-mover advantages[4]

Ultimately, sustainability consciousness has the powerful potential to drive radical shifts in our dominant mental models.

[4] Eisenstein, Charles. "Beyond the Science to the Art of Economics."

Dr. Steve Lydenberg, Partner of Strategic Vision at Domini Social Investments, pointed out in his presentation three main dimensions of designing solutions with a sustainability mindset:

1. Complex systems
2. Uncertain outcomes
3. Long-term effects[5]

When we problem-solve using these as our main guides, we see things more holistically and come up with solutions quite different from the ones that conventional business metrics dictate.

We're not suggesting that a dramatic, near-term change in consciousness is impending. The vast majority of companies that have made a commitment to sustainability are doing so through a traditional linear lens. The sustainability template that Lydenberg identified may be the acorn that becomes the oak of business planning.

Sustainability is the Wave of the Future

- It opens the door to an entire universe of **opportunities** for business **innovation** and leadership.
- It is a tool for **creating value in all corporate functions**, ranging from cost-cutting to increasing employee productivity to more effective communications.
- It has the potential to transform our approach to **problem solving in the 21st century**.

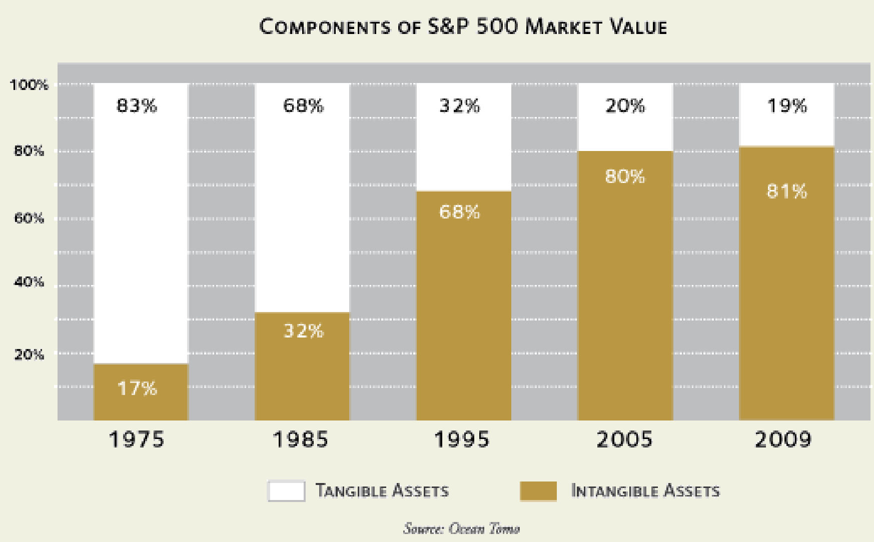
[5] Lydenberg, Steve. "Impact Investing and Its Future Impact on Business Priorities."

3. The Inadequate State of Conventional Metrics

Among knowledgeable sustainability advocates, there is virtually unanimous agreement that conventional corporate metrics badly need an overhaul. The main complaint is that the standard metrics for capturing and evaluating data are now too narrow and too shallow – they do not accurately identify and track the root opportunity for value creation.

Conventional business metrics, for example, generally ignore the essential fact that 80% of market value is not officially represented as a tangible asset on the balance sheet but comes in the form of some intangible such as 'good will' or 'brand equity.' This 80% of untracked value (as calculated by Ocean Tomo Advisors) represents ignored but knowable risks – as well as realizable but untracked opportunities for driving greater competitive advantage and financial value. New metrics provide a broader lens for business to understand the physical and societal "world" in which it operates and the impacts, both positive and negative, it generates. By expanding the way we think about and measure value, or the capital we use or create through business operations, we can expand beyond the single-minded focus we currently have on financial value. We can define additional opportunities for value creation, which, in turn, pave new paths to profit.[6]

Today, 80% of corporate value is intangible



[6] Ocean Tomo 300® Patent Index, Ocean Tomo Advisors, http://www.oceantomo.com/ot300.html.

In fact, we see six types of capital that drive the success (or failure) of a business – and all are measureable:

1. Financial
2. Physical
3. Social
4. Intellectual
5. Human
6. Natural

Yet only the first two — financial and physical capital — are typically factored into a company's internal and external financial statements.

An Incomplete Picture

You wouldn't drive a car with a windshield 80% covered with fog or ice, yet that's how we drive our companies and investment portfolios by ignoring New Metrics.

This unnatural filter produces narrow and often irrational thinking. Jennifer Driscoll, VP of Investor Relations at Campbell Soup Company, saw issues when the company decided to shut down one of its plants. Even as executives were agonizing internally over how to soften the blow for the people they were letting go, Wall Street analysts were "calling with high-fives," congratulating Driscoll and her colleagues for their cost cutting move. Yet no one was asking, "was it the *right* plant to shut down? What are your plans for the human capital and expertise you invested in already?"[7]

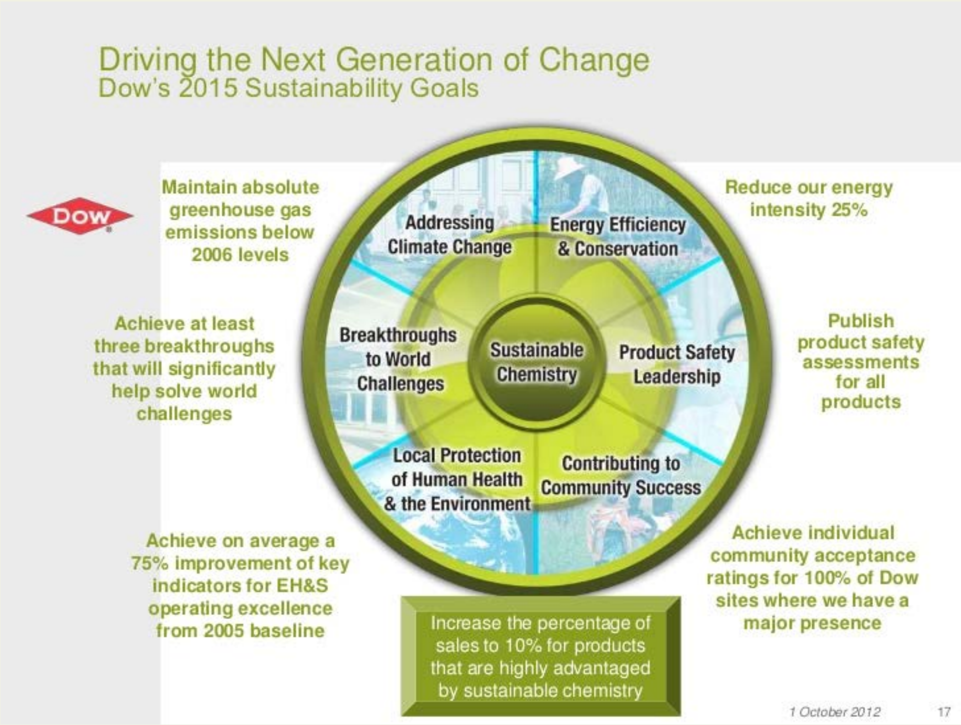
The emotional disconnect wasn't the story's only take-away. "Wall Street analysts were assuming that the move was good for business for one reason only — because they were focusing on the short term," noted consultant Andrew Winston. "They weren't looking at whether it made sense for the long term. The fact that businesses need to thrive beyond the next quarter wasn't part of their mental model."[8]

To further complicate the matter, today's rules of engagement are applied rather inconsistently. Some corporate activities need to show excellent ROI grades while others don't get close scrutiny. "Companies often invest enormous amounts of money without a prior ROI," noted Winston. "Unilever produced a Super Bowl ad with Eminem that cost millions of dollars. They made this investment without feeling the need to quantify the payback in advance. In mission-critical areas such as marketing and R&D, there's an a priori assumption that there'll be a healthy ROI. Sustainability champions, by contrast, have to demonstrate a favorable ROI to get their projects green-lighted. ***Sustainability is guilty until proven innocent."*** This simply must stop if we are to ensure a flourishing landscape for both business and society to prosper into the future.

[7] Driscoll, Jennifer. "Impact Investing and Its Future Impact on Business Priorities."
[8] Winston, Andrew. "Opening Remarks."

Mark Weick, Director of Sustainability for Dow Chemical Company

"I dream of having a specific measure of ecosystem value in the same way we value crude oil or labor. Accountants accept these numbers even though they're wrong. Why can't I have the same for water or pollination?"[9]



All in all, the current mainstream approaches to measuring business value undermine the dominant narrative about business hyper-rationality by discouraging consistency. The metrics themselves are inadequately narrow, they invite myopic and skewed analyses, and they are applied largely based on 20th-century assumptions that don't necessarily hold anymore.

What does this world of New Metrics look like? What might it look like going forward if we are to design and build a flourishing future? This is the big question behind the New Metrics conversation.

[9] Weick, Mark. "Updates in the Valuation of Ecosystem Services."

4. Innovations in Creating New Value

What does this world of New Metrics look like?

Innovators inside corporations and evaluators of business and investments are actively developing new measures and standards for determining which businesses are being managed best for both the near and long term, and some are already being implemented. Bahar Gidwani, Co-Founder and CEO of CSRHub, called this a "marketplace of ideas".[10]

As these initiatives take shape, one key point of philosophical divergence revolves around whether it is ultimately more strategic to focus on changing the foundational corporate value system or to concentrate on opening the right apertures to success as traditionally measured. Do you focus on redefining corporate purpose — or on redefining the inputs into traditional value creation as conventionally understood, i.e., profitability?

Each camp has its proponents. The social enterprise movement is focused on redefining organizational purpose, with Benefit Corporations and Certified B Corps gaining legal ground in multiple states.

In another camp are thought leaders such as Deloitte's Eric Hespenheide, who approvingly cited a tongue-in-cheek bon mot by Peter Bakker, president of the World Business Council for Sustainable Development: "Accountants will save the world." In other words, tweak the numbers while working inside the current mission and purpose approach.[11]

A related question is: How radical do you have to be to achieve the requisite progress? "I'd like us to get more non-violently radical," notes Andrew Winston. "This position is often painted as naïve, but in my view it's the only practical course." In a similar vein, Charles Eisenstein points out, "There comes a time when the hopelessly radical starts being common sense." Radical can backfire, though, especially if meaningful headway is possible without it.

What is the "true cost," and therefore net profit, of business today, and how might business deliver new forms of value that contribute to the 21st century? These are the central questions behind the "New Metrics" discussion.

[10] Gidwani, Bahar. "The Evolution of Sustainability Standards."
[11] Hespenheide, Eric. "New Horizons in Measuring the ROI of Sustainability."

The New Metrics community tests the philosophical tension between the “value” and “values” camps. There has been a proliferation of standards and frameworks around new environmental and social metrics for products, processes and company performance — over 300 at last count just in eco-labeling for products and supply chains.

Managers and corporate innovators are trying to transform the companies they work for, while forward-thinking advisers, consultants and investment managers are working at the broader ecosystem level. One way they are doing that, for instance, is by developing frameworks for measuring progress toward sustainability or by working to change the metrics by which institutional investors, everyday investors, and Wall Street analysts measure risk and corporate performance.

The line between the two levels can get blurry. When a company the size of Walmart becomes sustainability-friendly, the entire surrounding ecosystem shifts in that direction. Suppliers hasten to toe the line. Competitors race to keep up with the Waltons. Change at the corporate level thus affects the supportive ecosystem and vice-versa — and of course this only increases the generalized sense of crosswinds stirring up dust in all directions.

Metrics can be complicated - the territory is rich with unanswered questions

- How does one reliably measure social impacts and give them a dollar value?
- How does one assess the true value of the price of land, air, and other ecosystem services?
- What is the best metric for valuing human capital?
- How does one aggregate a broad suite of metrics into a tidier set of simple, easily comprehensible metrics – or even one single metric?
- How does one accurately compare performance across these factors as they can differ among companies and industries?

These are just a few of the issues the new metrics community is grappling with. Given the inevitable micro-focus of the vast majority of participants, it’s easy to get lost in the weeds. Gil Friend, President and CEO of the strategy consultancy Natural Logic, provides important framing: “If the goal of the sustainability movement is to transform the economy of our entire planet in one generation, and if it’s hard to manage what you don’t measure, this brings us to two key questions. What do you measure? And how good is good enough?”[12] These questions make an excellent compass for the New Metrics movement as it charts its course going forward.

[12] Friend, Gil. "New Horizons in Measuring the ROI of Sustainability.”

5. Clear Forward Momentum

"What do you measure? And how good is good enough?"[13]

With respect to values transformation, social enterprise — the term that has emerged for organizations with a double (or triple) bottom line — is catching on swiftly. 2007 estimates placed the number of people employed globally by the social enterprise sector at around 40 million people, with 200 million volunteers.[14] Many of the leading business schools in the US offer programs or electives in social enterprise. With over 400 members, the Social Enterprise Club has become one of the largest clubs at Harvard Business School, while the proportion of MBA applicants to the hugely successful social enterprise Teach for America tripled from 2007 to 2010.[15] David Cameron, the United Kingdom's Prime Minister, has called social enterprise "the great social innovation of our time."[16]

Social enterprise has even made its way into the often-impenetrable corridors of political power. Statutes granting legal protection to managers and board members of companies registering with an explicit balance of social and financial goals have been passed in 18 states, with more statutes on the docket in other states. Social enterprise has also been welcomed with open arms by U.S. President Obama's administration, which in 2009 established an Office of Social Innovation and Civic Participation that includes among its mandates the support of social enterprise.

On the value-creation side, forward progress is occurring. In North America alone, almost 500 companies filed Global Reporting Initiative (GRI) sustainability reports, an increase of about 50% over two years ago.

Impact investing comes on strong

According to the Responsible Investment Annual Report published by CAER in 2011, "Nearly one out of every eight dollars under professional management in the United States is invested in ways that use at least [one] socially responsible investing (SRI) strategies. This represents more than 12% of all investment assets under professional management in the US, or US$3.07 trillion out of US$25.2 trillion."[1] These funds are subjected to New Metrics, including environmental, social, and governance criteria as drivers of risk, return, and overall value.[17]

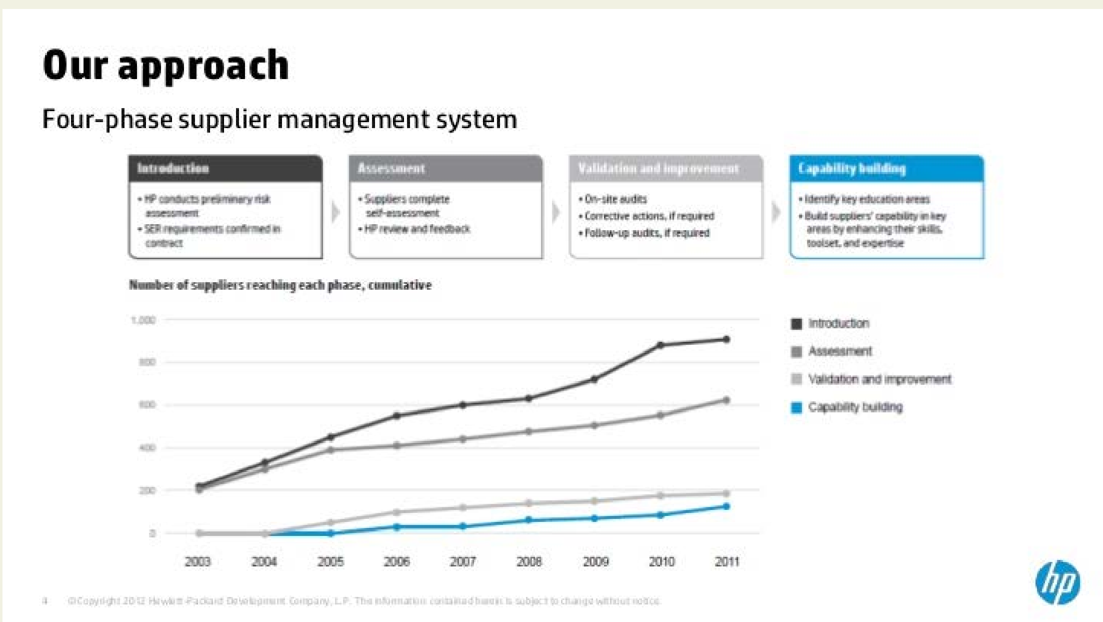
[13] Gil Friend, The New Metrics of Sustainable Business.
[14] *Mainstreaming of the Mavericks*, Charles Leadbetter, The Guardian. 24 Mar. 2007. http://www.guardian.co.uk/society/2007/mar/25/voluntarysector.business
[15] *Real Change Requires Politics*, Anandas Giridharadas, The New York Times. 15 July 2011. http://www.nytimes.com/2011/07/16/us/16iht-currents16.html
[16] Cameron, David. "Social Investment Can Be a Great Force for Social Change." UK Presidency of G8 2013. 15 July 2013.
[17] CAER. Responsible Investment Annual 2011 Report. Page 15.

More anecdotally, two transformative mental models appear to be gaining more traction. More professionals are accepting the premises that (1) widening the metrics apertures can **increase corporate profitability**, and (2) sustainability metrics can **fuel innovation** and deliver competitive advantage.

Other mental models are evolving in important ways, too. Traditional notions about competition and collaboration are shifting as boundaries become more porous. It is increasingly becoming the mainstream view that companies are responsible for the social and environmental impacts of their entire value chain, not just their own organization. Also, longtime competitors are increasingly joining forces to develop certification programs and share information and best sustainability practices.

Hewlett Packard takes a leap to transparency

When Ellen Jackowski, Global Programs Manager for Sustainability and Social Innovation at Hewlett Packard, joined HP, the company was debating whether to release its supplier list. The internal Global Citizenship Council was in favor while the rest of the company was opposed. There was concern the company would be giving away important competitive information. To help resolve the question, management brought in Nike, which had released its supplier list the year before. It turned out that there had also been a lot of fear at Nike before they took the step, but there were no negative repercussions when they released the list. Thus reassured, Hewlett Packard released its supplier list, boosted transparency and experienced no meaningful downside.[18]



Judy Wicks, founder of Philadelphia's iconic White Dog Café and co-founder of the Business Alliance for Local Living Economies, had a self-described "transformational moment" when

[18] Jackowski, Ellen. "Creating Shared Value and Measuring Impact in the Supply Chain."

she decided “that rather than viewing information about my local suppliers as a competitive advantage requiring protection, I would share it with my competitors.” The result? “My energy shifted to one of sharing and cooperation, and this attracted people to what I was doing.”[19]

Yet another important emergent reality is the increasing willingness on the part of some executives to adopt a more non-linear, system-oriented mental model as the basis for corporate sustainability strategy. Robert Boller, former Vice President of Sustainability and Production at Jackson Family Wines, achieved impressive results when he took a non-linear approach to embedding sustainability consciousness into the company.[20]

Judy Wicks, Founder, White Dog Café

While at the White Dog Café, Judy Wicks took this notion to its logical conclusion, albeit at the small-business level: “Our focus was about maximizing relationships, not profits.” She focused on supporting the local food system while assuming profits would increase — and they did.

[19] Wicks, Judy. “Updating the Meaning and Measure of Value for the 21st Century.”
[20] Boller, Robert. “Two Case Studies on Measuring ROI.”

6. Five Principles of New Metrics

As noted above, these are uncertain but exciting times for New Metrics advocates. In the following pages, we group highlights from the 2012 New Metrics of Sustainable Business Conference into five categories based on characteristics we consider crucial for New Metrics to become universally adopted.

Relevant

Let's start with what may be the most important question of all: Are corporate sustainability efforts actually reversing our problematic environmental and social trajectories? Are they, at a deep level, relevant?

Most corporate sustainability efforts focus on reducing negative environmental and social impacts. This is certainly better than nothing, but also less than ideal. It is the rare company that publicly seeks to have a net positive impact.

Becker Underwood, a manufacturer of biological products now part of BASF, is a trailblazer in this regard. The company's goal, in the words of Global Sustainability Lead Daniel Krohn, is to "have more positive than negative impacts," using the NETpositive framework he developed in collaboration with the Stockholm Environment Institute (SEI) and ESD Consulting.[21]

In discussions about corporate sustainability, relevance is often linked to **materiality**, a word that originated from the legal and regulatory tradition, where it means significant enough to trigger certain legal rights or requirements.

Corporate sustainability communications with legal materiality requirements are typically aimed at investors. The SEC has long required publicly listed companies to disclose material issues — those that "reasonable" investors need as part of the "total mix of information" for their investment decision-making (a stance reinforced by the Supreme Court in 1976.) More recently, the SEC has clarified how materiality applies to environmental and social issues, specifically in a 2010 guidance that requires companies to disclose how climate change may materially impact their operations.[22] Additional guidance is emerging from the Sustainability Accounting Standards Board (SASB), which aims to create minimum standards for reporting of key material sustainability impacts by industry, to appear in public companies' Forms 10-K or 10-Q or 13-F. In other words, SASB's ambition is to understand and quantify the most material environmental and social issues in each of 89 industries. It will examine and eventually encourage the SEC to adopt respective formal reporting requirements.[23]

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[21] Krohn, Daniel. . "Two Case Studies on Measuring ROI."
[22] U.S.A. Securities and Exchange Commission. *Commission Guidance Regarding Disclosure Related to Climate Change*. 8 Feb. 2010.
[23] "Materiality: Why Is It Important?" Sustainability Accounting Standards Board.

But increasingly, the notion of materiality is becoming a central organizing principle for companies as they take on the challenging internal task of establishing their social and environmental priorities. Determination of materiality, based on analysis of the most tangible negative impacts resulting from the operations of a business from cradle to grave, as well as of stakeholder perception of these impacts serves as a conceptual filter, a mechanism for sorting out what to focus on and what to let fall by the wayside.

Materiality as a conceptual filter has received significant institutional support. It's been a first-order principle in the Global Reporting Initiative (GRI) guidelines since the organization's founding in 1997. It is also being adopted by the International Integrated Reporting Council's (IIRC) still-in-development standard for integrative reporting. According to Aleksandra Dobkowski-Joy, a Principal at the sustainability consultancy Framework LLC, "Materiality is a way to make your job easier. You don't have to be reporting on every single thing. You can focus on the more important, the 'material issues.'"[25]

"Sustainability is about living within our means."

Unlike materiality, sustainability context measures sustainability activities strictly against the harsh reality of our global and local, scientifically established, environmental limits. According to Mark McElroy, Founder and Executive Director of the Center for Sustainable Organizations, "Sustainability is about living within our means. There are **ecological thresholds** that should not be crossed. We need to ensure social systems that support human well-being. If we look at mainstream metric models, the **ecological and social limits** in question seem to be conspicuously missing." In short, corporate sustainability management cannot be effective unless companies discover, measure and manage a more stable path of total environmental and social impacts, given the context and thresholds of total resource availability and other users of those resources."[24]

Sustainability context isn't a new concept. As the ecological footprint, it's been around since the early 1990s. But as McElroy noted, it's "rarely applied at the organizational level." At the same time, it hasn't been totally disregarded, either. GRI coined the term and encourages companies to report on "the performance of the organization in the context of the limits and demands placed on environmental or social resources at the sectoral, local, regional or global level." However, "GRI has not yet provided sufficient guidance on how to implement sustainability context, leaving the elegant principle underutilized."[26]

McElroy has been partnering closely with Cabot Creamery Cooperative, a New England and New York State dairy farm cooperative, to operationalize sustainability using context-based sustainability metrics. The program was launched about five years ago. "Management chose

[24] McElroy, Mark. "Standardizing Sustainability Context."
[25] Dobkowski-Joy, Aleksandra. "Identifying Materiality in Corporate Sustainability."
[26] Baue, Bill. "Standardizing Sustainability Context."

to take this pioneering path," reports McElroy. "They felt the approach was more intellectually honest. While the need to develop metrics from scratch may have slowed things down a bit, the benefits received were well worth the wait." For McElroy, 2012 has been an "inflection point" with respect to context-based sustainability metrics. "The conversation has broadened significantly," he reports. "The general level of attention being devoted to this key issue has grown dramatically."[27]

Holistic

The current standard apertures for filtering data are too narrow. They tend to exclude information that merits inclusion for three main reasons: The information in question is considered external and therefore someone else's responsibility, it is treated as irrelevant, or it is deemed too difficult to quantify and analyze side by side with conventional metrics. A more accurate approach to sustainability metrics, then, would do a better job of accounting for intangibles such as the value of human capital and the effects of industrial externalities on ecosystem services.

A considerable body of evidence has established the role of intangibles in creating value:

- From 2006-2012, Ocean Tomo designed and managed an investment index that tracked public companies with a high intellectual property and intangible ratings. During this period, the index rose 7% even as the S&P 500 index declined.[28]
- Wharton School professor Alex Edmans compared the 1998-2010 financial performance of the S&P 500 index to companies in *Fortune* magazine's annual list of Best 100 Companies to Work For. He found that if you had invested in the S&P index, you would have averaged an annual 4% return. If you had bought and held the 1998 list of Best 100 Companies, your average annual return would have exceeded 6%, and if you'd bought and sold that same *Fortune* list each year, your average annual return would have been about 11%.[29]
- The Parnassus Workplace Fund invests in companies with good workplaces. Since its inception in 2005, its performance has roughly been double that of the S&P 500.[30]
- The socially responsible investment company HIP Investor has conducted research across a range of data, including women on the Board, ISO 9000 certification, and environmental performance. HIP's overall finding: The more new metrics are measured and managed, the stronger and more resilient performance you can achieve – lower risk, enhanced return potential and competitive advantage.[31]

[27] McElroy, Mark. "Standardizing Sustainability Context." View McElroy's slides.
[28] Ocean Tomo 300® Patent Index, Ocean Tomo Advisors, http://www.oceantomo.com/ot300.html.
[29] Edmans, Alex. "Does the Stock Market Fully Value Intangibles? Employee Satisfaction and Equity Prices." Journal of Financial Economics 101(3), 621-640, September 2011.
[30] Historical Parnassus Funds Reports, http://www.parnassus.com/forms-and-documents/reports/.
[31] Herman, Paul. HIP Investor.

As HIP Investor founder and CEO Paul Herman notes, probably the most overlooked intangible asset of all is human capital. Unlike other types of capital, people can walk out the door and start working for the competition – which is a large risk for companies dependent on service and innovation as a strategy. Employees build a company's products, drive its innovation and create its esprit de corps. Yet until very recently, only a handful of firms treated human capital as an asset to be measured. While CEOs state "people are our most valuable asset," the financial statements treat people as an expense on the income statement and a liability on the balance sheet. This under-measures the true value of meaningful capital. Examples can be found in India, with Infosys measuring "human resource valuation" publicly since its IPO in 1998.

Herman has made it his personal mission to change this state of affairs. At Sustainable Brands' annual conference in June 2011, he made a public invitation for a major company to start valuing human capital. Interface, which has been breaking new ground in its commitment to sustainability for nearly two decades, is pursuing this goal now.

Interface and the value of human capital

On being one of the world's first corporations to publicly commit to becoming a net restorative company, Interface's Vice President of Sustainability, Erin Meezan, says, "We make serious strategic investments in our people, and it's an investment that's paid off. What we're looking for," continued Meezan, "is a value we can use both externally and internally. Externally, we want to be able to communicate how our investments in our employees have helped both our people and performance. Internally, this number can become a driver: It will challenge us to come up with ways to increase the value of this asset and make us a stronger company."

As for the technical task of valuing human capital, there isn't much in the way of precedent to lean on. Interface has decided to use the net present value of employees' future earnings for now. Meezan cited two reasons for this choice: "We can use that number to compare performance over time, and it also happens to be an approach similar to what Infosys is using."

At the time of Meezan's presentation at the New Metrics conference, Interface's human capital initiative was barely eight weeks old. She was clear that many questions remained to be answered, including how exactly the metric will be developed to its final shape and then deployed. But this is a great example of how the creative process works and there've already been clear successes: "We've gotten buy-in and persuaded people internally that this approach has value," reported Meezan.[32]

A separate "accuracy" challenge involves measuring externalities' impacts on the availability and quality — and therefore value — of ecosystem services and biodiversity. There is increasing recognition in the corporate community that this needs to be addressed sooner rather than later. At the United Nations' recent Rio+20 summit, The Nature Conservancy and 24 leading corporations with a total of $500 billion in annual revenue issued a report stating that investments in natural capital can reduce risks and costs, fuel growth, and build brand.

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[32] Meezan, Erin. The Value of Human Capital. Vew Meezan's slides.

The report showcased a globally significant set of private sector-led initiatives to safeguard natural assets, including forests, freshwater and marine systems — systems upon which businesses and the global economy depend for sustained success.[33] Going one step further, a Phase 2 was announced that calls for similar commitments from companies totaling $1 trillion in revenue, to be announced at the World Economic Forum gathering in January 2014.[34]

Commitments like these make a strong case that the global corporate community is starting to value natural capital. When we write "starting to value natural capital," do we mean "has a regard for" or "quantifies?" The first usage is soft; the second is hard. It is in and around quantification that the truly hard work — in both senses of the term — must be done.

Despite the fact that nature's value is, by design, infinite to human beings, companies and NGOs alike are beginning to recognize that unless we thoroughly quantify the relative size, quality and importance of various ecosystem services, we run the danger of underestimating their full value contribution to the global economy. TruCost, one of the early developers and providers of data focused on understanding the economic consequences of natural capital dependency – and the key data engine behind *Newsweek*'s Green Rankings – identified that danger more than a decade ago.

Dow Chemical Partners with The Nature Conservancy

Dow Chemical is also doing important early-stage work in this area. According to Director of Sustainability Mark Weick, "In 2008, we recognized that we were missing key metrics around valuing nature. We were leaving implicit zeros in our net value calculations because we weren't valuing the ecosystem services that we were impacting and depending on in large measure. So we decided to look for help and joined forces with The Nature Conservancy."

In one pilot project, the company is seeking to accurately value the water the company takes from Texas's Brazos River. "Our Freeport is at the end of the river and there are a lot of people upstream with straws in that water. Cost and value aren't matching up, and eventually this will drive the price of water up. Demand on the water is increasing as Houston spreads out to the Brazos, and it's also anticipated that climate change and sea rise will create additional demand on the watershed. At what point will we want to start taking water out of the Gulf and desalinating it? To know the answer, we'll need to accurately value the water we're using."

Dow's second project involves putting a dollar value on nature's contribution to protecting the watershed against coastal storms. "With climate change, storms are expected to increase in frequency and severity," said Weick. "Should we build levees? To some extent, this depends on the extent to which nature provides protection. Right now, the models we're working with give zero value to this, but that's plainly not accurate. Should we be restoring and protecting marshlands instead of building levees? Here, too, we need to accurately value the services nature is providing in order to make sound business decisions."

[33] Tercek, Mark. "Rio+20: Leadership from New Directions." The Nature Conservancy Blog. 27 June, 2012.
[34] "The Power of 1 Trillion: Mobilizing global companies to value natural capital." Corporate EcoForum. 24 Sept. 2012.

Dow's work is bold and groundbreaking. At the end of the day, though, the company can't make headway on its own. "We'll have to move together on this," Weick said. "We can't be booking something our competitors aren't booking. Ecosystem services need to be in the entire industry's pricing models, otherwise Dow loses and BASF and DuPont win." [35]

Engaging

To maximize effectiveness, corporate sustainability initiatives need to secure the engagement and alignment of employees and suppliers.

SAP, the world leader in enterprise software and software-related services, has climbed an instructive learning curve with its 65,000 employees. "We're trying to get our employees to integrate sustainability into their daily lives," said Jim Sullivan, the company's Vice President for Sustainability Management and Strategy. To that end, the company is pursuing a four-pronged strategy:

1. **Awareness**: SAP has 15,000 corporate vehicles. The company set a goal of getting 10% of its employees to carpool. To encourage this behavior, SAP came up with a striking metaphor: Every day, company employees commute to the moon and back — twice. This image effectively communicated two important pieces of information: The company's travel footprint was sizable, and there was considerable room for reduction.
2. **Incentives**: "There are three ways to get things done," according to Sullivan. "Appeal to fear, greed or aspiration. We didn't want to appeal to fear or greed, so we were left with aspiration. We considered several possibilities, such as carpooling for a cause or offering preferred parking. In the end, what worked for us was the opportunity to connect with other people. Our pitch was, 'Meet cool new people. Hear the gossip around the office.'"
3. **Tools and processes**: SAP encourages its engineers to develop "fun projects" and show them at the company's annual Demo Jam. The 2011 winner was a carpooling app that made it easier for employees to connect and save money.
4. **Leadership and role models**: The program got a big boost when SAP's CEO committed to giving employees rides to work on a monthly basis. "People might not have given a thought to being picked up by their neighbor, but it was pretty impressive to be picked up by the CEO of a 65,000-person company," said Sullivan.

The carpooling program proved unexpectedly successful. One-third of the company's employees, or over three times the target number, are participating. "Sustainability needs to be incorporated into day-to-day operations," concluded Sullivan. "Employee engagement needs to extend to all employees, not just the sustainability folks."[36]

On the supplier side, Procter & Gamble has launched an initiative with valuable lessons for its peers. Several years ago, according to Woodrow Keown, P&G's Director of Global Sustainability, the company established a suite of sustainability goals, which they initially pursued by conducting a broad-scale life-cycle assessment. When they did this, Keown said, "A couple of things jumped out at us. We needed to get our customers to be more energy-

[35] Weick, Mark. "Updates in the Valuation of Ecosystem Services."
[36] Sullivan, Jim. "Incentivizing and Valuing Employee Engagement."

conscious, and we needed to improve the performance of our supply chain, which was also consuming lots of energy."

This got the company focusing on its supply chain. One of its first steps was to develop a scorecard, which it called the **Supply Chain and Sustainability Scorecard (SCSS)**. Keown took special pain to note that P&G did not simply go out and develop this scorecard on its own. Instead, "We brought in about 20 business partners to help us develop the tool," Keown stressed. "We wanted the tool to be flexible to apply across multiple issues and product lines, we wanted it to be user-friendly, and we wanted it to be developed collaboratively."

The scorecard, which was launched in 2010 and covers several core measures, gives suppliers the option of responding at the site, corporate, or P&G product level. About 80% of suppliers have responded, with roughly one-tenth of these respondents supplying product-specific information. The company hasn't attempted to put dollar numbers on the supplier data it's collected, in part because it's too early in the process, and also because the program isn't only about cost savings. "This is about dialogue that will lead to innovation in the products and packaging our suppliers deliver," said Keown.

Because the P&G program is so new, scorecard results or failure to file have not yet been used to penalize companies. This will change. In due course, said Keown, "the scorecard will be a key component in assessing the value of our business partners and who we choose to work with."[37]

Walmart has charged its merchandisers with tracking supplier performance, thereby reaching an important cohort of employees along with its suppliers. According to Senior Sustainability Manager Brittni Furrow, the decision to create a scorecard for suppliers emerged out of the realization that 80-90% of the company's social and environmental impacts came out of their supply chain and the products they were sourcing. "We wanted to raise the bar vis-à-vis the products that were being brought into the store," Furrow said. "This process needed to be built into how Walmart buyers were making purchase order decisions. Ultimately, this would also provide a mechanism for creating transparency for our customers."

Walmart is pursuing a three-phase plan. It called the first one "**align and standardize**." The company identified key hotspot areas and developed metrics that could "help us understand what's going on in the supply chain and how we can improve performance." Pursuant to this goal, Walmart kick started The Sustainability Consortium, a multi-stakeholder organization with the mission to more accurately quantify and communicate environmental and social impacts of a long range of products. "We wanted to align with the industry and not reinvent the metrics wheel," said Furrow.

The company is now deep into the second phase, "**integrate and act**," rolling out a program to equip its buyers with tools for measuring supplier performance. Sustainability training is an important piece of this, along with appropriate incentives.

Walmart: Integrate and Act

It's not only suppliers who are being graded — Walmart buyers are, too. "Sustainability has made it onto the map for how buyers' performance is rated," said Furrow. "Every year, buyers are evaluated against a sustainability goal they set. It's a factor in their compensation."

Once suppliers file their data, they receive a report showing their category rank and how they can improve their sustainability performance over time.

The third phase, which hasn't been launched yet, is "**engage consumers**." In a very real sense, everything that's been done so far has been in preparation for this. "Consumers don't really know what they want," said Furrow. "It's up to us to help figure that out for them. We're working on behalf of our customers to have an impact on suppliers."[38]

Three features in particular stand out about Walmart's approach:

1. The first is how deliberate and methodical it's been. Throughout its sustainability journey, the company has proceeded fast enough to make demonstrable progress and slow enough to get it right.
2. Second is the extent to which the company is leveraging technology. ICIX, a collaborative commerce network that enables efficient sharing of large amounts of data related to supply chain relationships, is a key business partner: Its capabilities increase information exchange — and, ultimately, innovation — enormously.
3. Third, Walmart has placed a high priority on collaboration. It works closely with The Sustainability Consortium and is strongly encouraging input from both buyers and suppliers. The attitude is, 'We're all in this together.'

[38] Furrow, Brittni. "Incentivizing and Valuing Employee Engagement."

Persuasive

If your boss or a key customer asks you to do something, you'll probably do it. Generally speaking, in matters related to supply chains and employees, power is often used to shape relationships and sharpen incentives.

Not all stakeholders are subordinates in the chain of command, though. Some are superiors — C-suite executives, for instance — while others, such as financial analysts, aren't in the chain of command at all. These people won't jump simply because you say so — you have to persuade them. There's an art to this, especially when there's entrenched resistance, as happens to be the case with some types of sustainability metrics.

Over the years, three paths of persuasion have emerged in this context.

1. **Framing; Making It Familiar**

The first is around framing. When you're trying to get a superior in the corporate chain of command to approve sustainability initiatives, it's important to use the lens and language with which they are comfortable.

The Language of the CFO

"Chief financial officers have a distinct, precise language," said Lauralee Martin, CFO and COO of the global real estate services company Jones Lang LaSalle. "Terms like ROI, ROE and EPS make it possible for CFOs to speak comprehensibly with our peers across sectors. This is the language sustainability advocates need to use with us."

The rule: Make it familiar. Tee up the information so it's in your interlocutor's wheelhouse. "The worst communications mistake Al Gore made in trying to bring public attention to climate change was to focus on carbon," Martin said. "We don't understand carbon, and the more you talk about it, the more CFOs don't want to hear it."[39]

Robert Boller, who led a successful sustainability transformation at Jackson Family Wines, put it this way: "To get approval for anything in corporate America, you need to be able to demonstrate increased revenue or cost reduction."

2. **Evidence: Persuasion is not only about the form; it's also about the substance**

Evidence is paramount, which brings us to the second rule. Persuasion is not only about the form; it's also about the substance. Sustainability benefits need to be quantified with numbers that are credible and convincing. This can require a leap, not of logic but of the imagination.

[39] Martin, Lauralee. "The CFO Agenda: Enabling CFOs to See Sustainability as Central to Core Strategy."

“What’s the value of the license to operate? How does sustainability leadership increase that value? It’s relatively easy to quantify negatives like delays in permitting and bad press. It’s less easy to value the benefits of having negative events not happen,” Boller noted. Of course, much depends on the mindset of the person you’re trying to persuade. You’ll be fighting an uphill battle if they’re unwilling or unable to broaden their understanding of how value is created. [40]

Aggregated empirical evidence coming from highly reputable sources, in particular, can be very effective as shown by an ever-increasing body of academic research, making the case that a strong ESG record increases profitability and stock performance. For instance, when The Wharton School’s Witold Henisz analyzed the stock performance of 21 gold mining firms on the Toronto Stock Exchange, he found that stakeholder relations had more than twice as much impact on market capitalization as the net present value of the gold itself. His conclusion: **“The ROI on investing in stakeholder relations was better than any other capital investment the companies could make.”[41]**

Similar findings have come out of Harvard Business School. In a 2011 paper, professors Robert G. Eccles, Ioannis Ioannou and George Serafaim demonstrated that ‘high sustainability’ companies “*significantly outperform* their counterparts over the long term, both in terms of stock market and accounting performance.”[42]

For Witold Henisz, “We’re way past the threshold where net present value calculations argue for greater sustainability.” What’s required at this point is to get this compelling information into the hands of financial analysts and other potential change agents.

3. Recognition of Opportunity

The third key to effective persuasion is recognition of opportunity. In the view of Gregory Larkin, who works in innovation and new product development at Bloomberg, this is the best way to attract the attention of Wall Street analysts. “If you can show that your product is disruptive, this is something professional investors will get excited about,” he said. “If you can demonstrate that your ESG (environmental/social/governance) program is taking revenue from companies with a lesser commitment to sustainability, they’ll pay attention. You need to be able to show that what you’re doing will make everyone who’s come before you look antiquated quickly.” [43]

To that end, the power of metaphor comes in handy again. Just as a single compelling image (“employees travel to the moon and back twice daily”) helped secure heightened levels of employee engagement in SAP’s carpooling program, so smart wordsmithing can be leveraged by entrepreneurial souls to craft and present sustainability innovation as a disruptive, first-mover, competitive advantage. Painting a scenario that plausibly depicts an enormous payoff is a proven way to convert noise into a signal.

[40] Boller, Robert. “Two Case Studies on Measuring ROI.”
[41] Henisz, Witold. “New Horizons in Measuring the ROI of Sustainability.”
[42] *The Impact of a Corporate Culture of Sustainability on Corporate Behavior and Performance*, Robert G. Eccles, Ioannis Ioannua and George Serafaim, Harvard Business School Working Paper 12-035, November 25, 2011.
[43] Larkin, Gregory. “New Horizons in Measuring the ROI of Sustainability.”

Simple

Consumers thrive on simplicity. If you want to help them make a sustainability-friendly decision, the options need to be laid out in terms they can readily understand. Straightforward yes/no or better/worse choices requiring minimal mental processing usually work best. The product or company in question either gets a thumbs-up or it doesn't.

Forest Ethics: Report from the North Pole

The non-profit Forest Ethics applied this principle to positive effect when it produced eco-ratings of the catalog industry in a publication titled *Report from the North Pole*. In this example, which was provided by REI presenter Kirk Myers, a lump of coal meant failure, while in later iterations of the report a flying reindeer signified approval. Clear, compelling and entertaining: These appear to be the hallmarks of an effective consumer-facing certification program.[44]

Business executives thrive on simplicity, too. Although it's part of their job to manage complexity, it's also the case that too much complexity gums up analysis and produces flawed decisions. Physicist Ory Zik's business, EnergyPoints, is to clear out the clutter in sustainability metrics. His data-driven approach aggregates multiple inputs into a single, comprehensible measure, with each eponymously named "energy point" representing the amount of energy required to produce one gallon of gasoline.

Let's say a manager has to choose between multiple resource-conservation options. She could install a drip irrigation system, install solar panels or invest in a gas-hybrid transportation fleet. Her question is, which will provide the biggest return on the dollar? As Zik notes, it's a crucial question in this time of budget cuts and diminishing resources.

[44] Myers, Kirk. "Incentivizing and Valuing Employee Engagement."

This is where energy points come in. The approach makes possible a one-to-one normalization and comparison of resource consumption across all environmental domains, including water, electricity, transportation, gas, waste, and materials. More impressively still, it takes into account local factors such as emissions and water scarcity. Massive amounts of data-crunching on the back end produce a single, simple, straightforward metric for use in front of the curtain. “Energy Points brings to sustainability what Weight Watchers brought to nutrition: an intuitive yet accurate ‘points’ system,” says Zik.[45]

The energy points approach turns apples-to-oranges comparisons — or, more accurately, “fruit all over the floor” comparisons — into apples-to-apples ones. Our fictional manager is thus provided with a common denominator for comparing her widely divergent options.

Bahar Gidwani of CSRHub described the current state of sustainability standards as simply “a mess.” This is due to the seemingly endless proliferation of self-proclaimed sustainability metrics, standards, frameworks, and certification programs. This situation is a double-edged sword. On the one hand, competition improves quality; on the other, people have limited time and attention for the abundance of choices that require evaluation. If this problem is to be solved, it will be time and the natural flow of the winnowing process that does it.

But how much time do we have?

[45] Zik, Ory. “One Magic Number to Sum Up All Your Resource Inputs.”

7. Next Steps for Value Creation

All due speed, all hands on deck, change happens, and boldness matters.

Corporate sustainability advocates are racing against the clock. So are line managers whose job is to maximize quarterly earnings, but the two hourglasses are very different. Racing to ramp up quarterly earnings is based on a social agreement, while Mother Nature herself sets the sustainability clock.

In the professional sustainability community, this situation is widely known and accepted but not much discussed. Despite (or perhaps because of) its presence as a background reality, the temporal urgency of the sustainability crisis plays a major role in shaping our attitudes and approaches. This paper would be incomplete without a brief mention of the emerging collective wisdom about how best to manage this awareness, both emotionally and strategically.

All Due Speed. Sustainability advocates generally agree that accelerated progress is a must. In this regard, corporate advisor Gil Friend's declaration that we need to transform the global economy in a single generation is not atypical. Which brings us to this question: How can one possibly begin to undertake this without making the inevitable mistakes concomitant of trying to do too much too fast? The answer is to be found in a middle ground that marries a powerful sense of urgency with an equal commitment to due diligence, to "getting it right the first time." Walmart is a great example of a company whose sustainability program appears to be managing this difficult balance.

All Hands on Deck. As Margaret Mead famously noted, "Never doubt that a small group of thoughtful, committed citizens can change the world; indeed, it's the only thing that ever has." True enough — but a larger group can change it faster, and with time being of the essence here, we need all the help we can get. Employee and supply chain engagement aren't important only because they help companies reduce their environmental footprint or improve social conditions — building effective networks of like-minded stakeholders also accelerates our collective progress towards the tipping point of 'mainstreaming sustainability.'

Needless to say, other communities need to be on deck as well, including financial analysts whose assessments of current and projected performance continue to dominate investment decisions; and academics who do the hard, airtight sustainability research that eventually wins Wall Street over.

Change Happens. To some degree, the rate of progress is in the eye of the beholder. Since Walmart publicly embraced sustainability in 2005, the corporate community has come around much faster than most pioneers in the area would have projected. This is great news, and yet there is simply much more work to be done. Change typically happens very quickly and chaotically, but it absolutely can happen deliberately, too. It is for that reason that embedding sustainability and social entrepreneurship into higher education curricula is so important.

Change always has had, and will continue to have, a generational component. “You change the world,” said Witold Henisz, “by getting this information inside the MBA classroom.”[46]

Boldness Matters. Daring, entrepreneurial leadership will certainly accelerate progress. Unfortunately, corporate cultures tend to be bureaucracies where boldness gets much lip service but caution tends to rule ‘on the ground.’ Two decades ago, Interface CEO Ray Anderson set the corporate world on fire when he experienced his self-described “spear in the chest” about sustainability. More recently, Unilever’s Paul Polman made waves when he did away with quarterly reporting. These are bold and breakthrough steps that might reasonably have been expected to inspire a cascade of copycat behavior. Instead, as HIP Investor’s Paul Herman noted, “A vast stampede of one or two companies has followed Paul Polman.” Similarly, to date only one company — not surprisingly, Interface — has responded to Herman’s call for a company to start valuing human capital.

Despite all the positive change that’s occurring, the corporate sustainability community is currently running a deficit in bravery. We need more boldness to make the accelerated progress that’s required.

Get Involved

LEAD the Way – Share Your Lessons Learned – JOIN the SB New Metrics COMMUNITY

1. Share your own New Metrics in the Sustainable Brands community: Email us to submit a feature for publishing.
2. Join the New Metrics community online.
3. Attend the New Metrics conference at the University of Pennsylvania in Philadelphia in September.

[46] Henisz, Witold. “New Horizons in Measuring the ROI of Sustainability.” View Henisz slides.

About Sustainable Brands

Sustainable Brands® is the premier global community of brand innovators who are shaping the future of commerce worldwide. Since 2006, our mission has been to inspire, engage and equip today's business and brand leaders to prosper for the near and long term by leading the way to a better future. Digitally published news articles and issues-focused conversation topics, internationally known conferences and regional events, a robust e-learning library and peer-to-peer membership groups all facilitate community learning and engagement throughout the year. Sustainable Brands is hosted by Sustainable Brands Worldwide, a division of Sustainable Life Media headquartered in San Francisco, CA.