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KAREN GRIGORYAN/SHUTTERSTOCK

Accounting for change: the drive to put a dollar figure on nature

Natural capital has entered the mainstream for business. Angeli Mehta **reports on efforts to now take it to the heart of decision-making**

This month, many companies will report on their end of year finances, and we'll be able to see clearly who made a loss or a profit. Alongside those accounts, companies might also disclose their carbon emissions, how much energy they saved, and whether they're using less, or more, water.

But in their financials very few of those companies will have taken any account of the natural capital that enables their business to prosper. Natural capital is everything nature provides for life: air, water, and land. We derive essential services from renewable resources such as forests, which sequester carbon, prevent soil erosion and minimise flooding. Likewise, we benefit from non-renewable stocks such as oil and gas.

The latest attempt to put a value on global ecosystem services was made by Australian and European researchers: $125trn a year in 2011. It's sobering to realise that in the same year global GDP was $75.2trn. The authors estimate that due to changes in land use between 1997 (when they made their first calculations), and 2011, global loss of ecosystem services was somewhere between $4.3trn and $20.2trn a year.

'The idea of natural capital now is mainstream. What is required is the win-win for business to become more apparent'

"We need to move from CSR," says Mark Reed, professor of socio-technical innovation at Newcastle University. "The idea of natural capital now is mainstream. Companies appreciate that there are benefits for business, but what is required is the magnitude of the win-win for business to become more apparent." Reed is leading a major UK project to try to do just that, with food giant Nestlé. (see Nestlé helps to build a business case for natural capital)

30 SECOND READ

- We derive essential services from resources such as forests, which sequester carbon, prevent soil erosion and minimise flooding.
- The value of global ecosystem services was an estimated $125trn a year in 2011. In the same year global GDP was $75.2trn.
- Work is evolving around how to measure natural capital, but innovation is needed to manage natural capital so that it's at the heart of every decision made.
- The Natural Capital Protocol is a standardised framework to help companies take account of natural capital in their decision-making.
- The UK's 25-year environment plan mentions "natural capital" more than 100 times. It says government intends to use natural capital as a tool to "help us make key choices and long-term decisions" but is short on the detail of how.
- Natural Capital Coalition will next month launch a guide to help financial institutions take natural capital impacts into their lending, investment and insurance practices.
- Kepler Cheuvreux looked at 700 European companies and found that their use of resources and their polluting emissions affect more than 2,500 species each year.

Measuring natural capital

At last November's World Forum on Natural Capital, held in Edinburgh, the word "data" was on everyone's lips: where to find the data; its quality; and how to interpret it. That is because without measurement, good decisions often can't be made.

Jessica Fries, executive chairman of Accounting for Sustainability (A4S), points out that work is evolving around how to measure natural capital, but "innovation is needed to improve measurement and manage natural capital so that it's at the heart of every decision made".

Luxury fashion house Kering pioneered environmental profit and loss accounting, and has made its methodology open source (see Kering gets to the bottom of its supply chain). Michaël Beutler, director of sustainability operations at the French company, suggests: "We need a level playing field in terms of data ... a forum where [players] can compare data to stimulate action."

One tool to help companies is the Natural Capital Protocol. Launched 18 months ago, it was piloted by more than 30 companies. The protocol is designed to provide a standardised framework to help companies take account of natural capital in their decision-making.

"Companies were coming at it from different directions ... we needed a generally accepted logical process to make it less intimidating and more accessible," explains Hannah Pitts, relationships director at the National Capital Coalition. "The primary objective was for internal decision-making, to make a business case for more sustainable choices on raw materials and processes etc."

The protocol is designed to be applicable to any business sector, and complementary to approaches that companies might already be using to examine their impacts.

From its ongoing work in the private sector, the coalition found that a lack of ready access to robust data for decision-making was proving to be a barrier for businesses.

It's working to develop a data kit that will provide a catalogue of existing data sets, and their limitations; a "lexicon" to help achieve standard definitions; and examples of how decisions can be made despite data gaps and uncertainty.

'If I'm an investor, I want to know what will your business look like in a two-degree world?'

Challenge for governments

Valuing natural capital is a challenge for governments, too. A report for the multi-stakeholder Green Economy Coalition says that natural capital should be reflected in national wealth accounts, as it is a better guide to economic progress than gross domestic product.

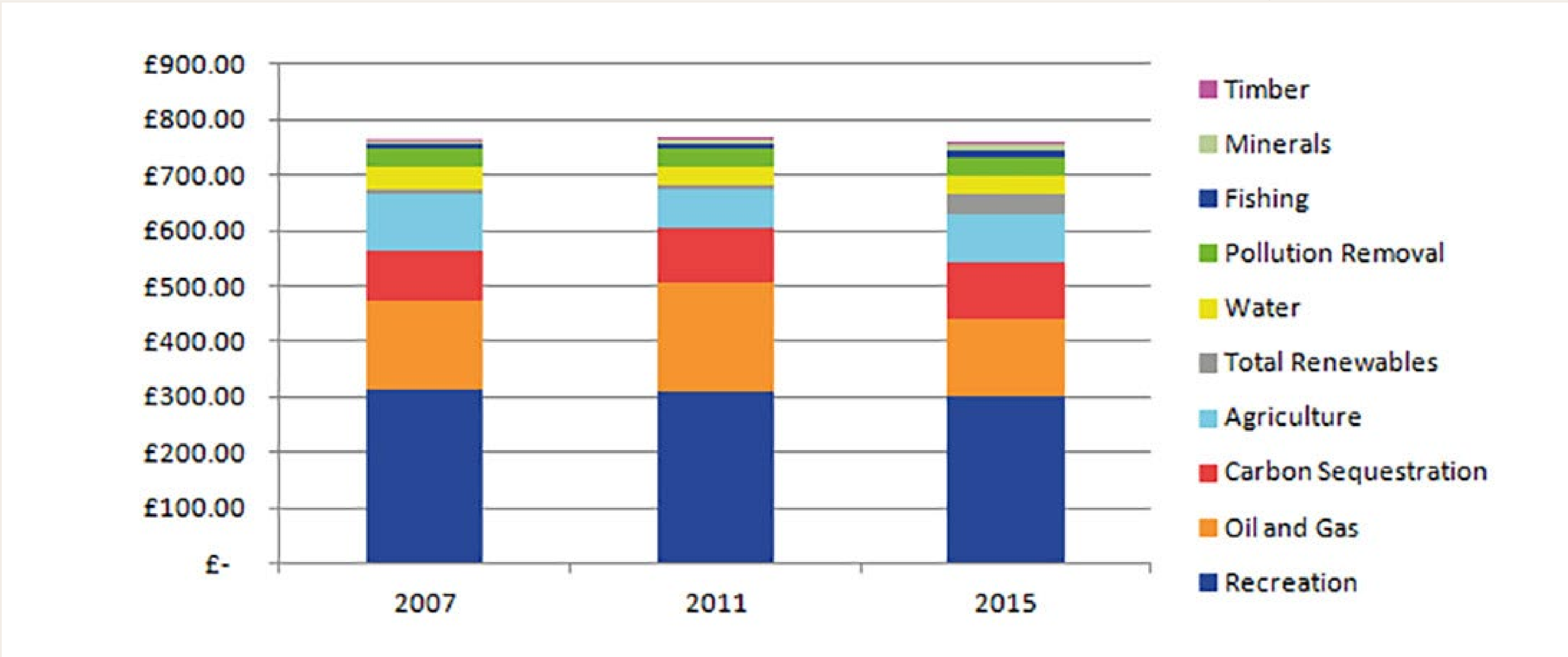
The report suggests that all natural capital, whether renewable or not, "could support greater prosperity if it were more appropriately valued and hence more efficiently used", and says governments and scientific institutions have important roles to play in data management and economic valuation.

AC RIDER/SHUTTERSTOCK

Investing in increasing forest cover can help avert flooding

The UK does publish estimates of the quantity and value of the country's natural assets. These are not complete because the underpinning methodologies are still being developed, and many ecosystem services have not yet been valued. (see graph)

The UK's 25-year environment plan, published in January, mentions "natural capital" more than 100 times. It says government intends to use a natural capital approach as a tool to "help us make key choices and long-term decisions" but is short on the detail of how, save to say it will use incentives and regulation where needed.



OFFICE FOR NATIONAL STATISTICS, MENE, AND NATURAL ENGLAND

Estimation of the value of UK natural capital in 2007, 2011 and 2015 (£ billion, 2015 prices)

Peter White, chief operating officer at the World Business Council for Sustainable Development (WBCSD) told the World Forum on Natural Capital that the UK government should align its policy on natural capital with the recommendations of the industry-led Task Force on Climate-related Financial Disclosures (TCFD). These call for organisations to publicly reveal how they manage climate risk, and who is responsible for the governance process of those disclosures.

"If I'm an investor, I want to know the climate risk or opportunity of a company ... what will your business look like in a two-degree world?"

If government policy was aligned with the TCFD recommendations that would drive reporting and investment in natural capital, says White.

Everything is connected, so concentrating on one criteria, such as CO^2 emissions, may distort the bigger picture

Earlier this month, the EU said it would revise guidelines on non-financial disclosures to bring them more into line with the TCFD recommendations. Its strategy for sustainable financing also proposes to clarify the duty of asset managers and institutional investors to take sustainability into account in the investment process and enhance disclosure requirements.

Raising awareness

Next month the Natural Capital Coalition will launch a guide to raise awareness of natural capital and help financial institutions make decisions. It will provide guidance on taking account of natural capital impacts in their lending, investment and insurance practices.

Developed with the Natural Capital Finance Alliance and the Dutch Association of Investors for Sustainable Development (VDBO), it will build on the framework of the Natural Capital Protocol.

Independent financial services company Kepler Cheuvreux has shown that there is enough information out there for investors to get an overview of which sectors and companies they should be concerned about, and what liabilities they might incur in future. But it cautions that everything is interconnected, so concentrating on one criteria (eg CO^2 emissions), may distort the bigger picture and have unintended consequences elsewhere. For example, while companies might report water consumption, very few provide the context of water scarcity.

VINTAGE TONE

Lack of access to robust data on natural capital is a challenge

Kepler Cheuvreux's analysts looked across 700 European companies in a variety of sectors and found that their use of resources and their polluting emissions affect more than 2,500 species each year – much of the impact coming from the value chain. The companies are responsible for €2000bn of impacts.

Moreover, 45% of the companies (in sectors such as food, forestry and packaging) wouldn't be profitable if they had to pay for their use of the ecosystem services they depend upon.

There are caveats, but using company-level data can refine the results. Kepler Cheuvreux worked with UK-based natural capital accounting firm eftec to apply environmental accounting tools to publicly available information on a Swedish forest company, SCA.

Its analysis showed that while the company reported profits of €234m in 2016, the impact of its operations – through air pollution and water use, for example – caused a net deterioration in natural capital of €190m, which is not reflected in its financial balance sheet. However, its assets of forest (valued at €3.25bn) also provide benefits to society such as carbon sequestration and recreation, valued at €7.3bn. Again this value doesn't appear in its financial reports.

Pitts of the Natural Capital Coalition says that companies shouldn't be dissuaded from using natural capital in their decision-making just because the data on valuing it isn't perfect. "You can still make decisions on the basis of what you've got."

In the following pages we profile some of the companies that are leading the way. ■

Angeli Mehta is a former BBC current affairs producer, with a research PhD. She now writes about science, and has a particular interest in the environment and sustainability. @AngeliMehta

AKZONOBEL

How AkzoNobel put a price on its impact across four capitals

AkzoNobel has been trying to measure impacts in its value chain for some years. In the early 2000s it worked on lifecycle assessments, but this approach has limitations as it only includes the environmental aspect of sustainability, explains Emma Ringström, sustainability manager at its pulp and performance chemicals business,

In 2014, the company embarked on a pilot at its bleaching chemicals business in Brazil to investigate the entire impact of its business across financial, environmental, human and social dimensions. In collaboration with True Price and sustainability consultants GIST Advisory, it did full profit and loss accounting across these four capitals – what it calls 4D accounting. The exercise confirmed that its sustainability strategy did indeed cover the most important elements, says Ringström.

It led AkzoNobel to increase its use of renewable energy, and put greater focus on better resource use of both energy and raw materials. Looking at impacts on human capital brought more emphasis on training and developing capabilities; while social capital led to work improvements in health and safety, and rights at work.

Later, it piloted the Natural Capital Protocol for the production of chlorate, used for bleaching paper. "Using the monetisation element of the protocol, we got the possibility to identify the biggest impacts, and to scale up the positive and reduce the negative impacts ... We can see the hot spots here and there, which are most important to work on."

After the pilots, AkzoNobel applied the 4D approach across its entire pulp and performance chemicals business, followed in 2016 by environmental, social and economic profit and loss accounting across the entire business. It reported a monetary value for these three capitals, across its value chain.

Social impact assessment is in its infancy, but includes value related to the knowledge and skill development of employees and their future salary development.

SCANRAIL1

AkzoNobel makes coatings, including Dulux paints

The environmental assessment includes value through its products that help customers cut emissions. To put a monetary value on key impacts such as CO^2 emissions and use of fossil resources, it uses a science-based approach that takes a long-term view. Prices are, says its report, based on what would happen in 50 to 100 years if we keep on using resources as we do today.

AkzoNobel has a wealth of data from its businesses, and more is becoming available in its supply chain, so the actual measuring is getting easier, says Ringström. Valuation, however, is more difficult.

“We’d welcome more scientifically based methods that are transparent and publicly available,” Ringström adds. “It’s important that the methods are transparent, so we can judge if the values are representative for our case, as well as interpret the results in a correct way.”

As part of the Forest Solutions group at the World Business Council for Sustainable Development, AkzoNobel is piloting a forest sector guide, which will give the industry more specific guidance on measuring and valuing natural capital impacts. AkzoNobel is looking at the potential impact of changes in natural capital: for example, regional changes in water supply. The guide is expected later this year.

Angeli Mehta

JELLE VISSER/FLICKR

Kering gets to the bottom of its supply chain with EP&L

Kering, the French home of luxury brands like Gucci and Saint Laurent, pioneered environmental profit and loss (EP&L) accounting with its former sportswear brand, Puma, in 2010. The following year, the group chief executive decided to apply it in detail to all operations and brands in the stable, which generated €15.5bn in revenue in 2017. When development began on the Natural Capital Protocol, Kering contributed the work it had already done to build a methodology.

"It's not just a tool. It's also a mindset change. We engaged all our brands in developing the tool," explains Michaël Beutler, director of sustainability operations. The "EP&L is the key cornerstone of our targets to reduce [our] footprint."

Effectively the brands have a business intelligence and analytics platform that allows then to do "what if?" scenarios and calculate, on a product level, the impact of a new design. Raw materials sourcing is complex: Kering brands have an EP&L for 15 different kinds of wool, for example.

Having an EP&L has enabled Kering to work out where to focus its sustainability efforts. Almost 50% of the group's footprint is in raw materials, another 25% is converting those raw materials to products. "No one was looking deep in the supply chain before this," says Beutler.

Kering's impacts were valued at €857m in 2016, compared to €773m in 2013. Leather is the major driver. Its 2016 EP&L report points out that it is still expanding the scope of its analysis and that "leveraging changes across the supply chain is a long-term process, and in many cases will not yield immediate results". As the company is growing, Beutler says, "we look at our efficiency in terms of the materials we use to produce an equivalent amount of product". On that measure, the impact per kg or m2 of product has fallen from €74 per €1000 of revenue in 2013 to €69 in 2016, after it took currency fluctuations into account.

Kering's 2025 strategy is to drive a 40% reduction in EP&L, relative to its business growth. Half of that is intended to come from implementing best practices in its supply chain. The Kering standards, published earlier this year, cover sustainability certifications, traceability of raw materials and preferred sourcing countries for raw materials like fur and skins. The EP&L shows that organic cotton has up to 80% less environmental impact than conventional cotton, so it encourages suppliers to use as much certified organic cotton as possible. Thinking about where and how it sources raw materials may help create some benefits through more sustainable herding practices, and better management of pasture lands.

ABD. HALIM HADI/SHUTTERSTOCK

Almost 50% of Kering's footprint is in raw materials, such as leather

The other 20% cut in EP&L will come through the use of innovative new materials, like "lab-grown" leather, and regenerated cashmere, and re-using cuttings waste. Since 2015, it's also been exploring chemical recycling of cotton and polyester blends with UK start-up Worn Again.

Kering has developed an app that's very simple to use. "It's one of the easiest ways to understand natural capital," asserts Beutler. The aim is to raise awareness about the different impacts that material choices and agricultural (or mining) practices can have on end products, to help designers make more informed choices.

Designed with international universities, including Stanford in the US and China's Tsinghua, the current version has 4,000 data points from Kering's global data set. In the next version it will be closer to one million.

The app has been shared with competitors and at UK and EU government levels. Beutler stresses that the app is in its infancy, but one can't help but wonder if consumers could play a part: they now have some information at their fingertips to make more sustainable choices.

Angeli Mehta

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