The Business Case for Sustainability

International Finance Corporation
World Bank Group

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Whether managing downside risk, creating business value by incorporating sustainable solutions, or identifying innovative ways to finance sustainability, the private sector is becoming the engine of competitive solutions to sustainability and can help finance and address sustainability challenges in the years ahead.

BUSINESSES FACE SUSTAINABILITY CHALLENGES—THE GLOBAL CONTEXT

Globally, sustainability challenges are becoming even more material, reaching thresholds of importance to companies' long-term strategies, to their customers, and external stakeholders. From increasing demand for natural resources to economic disparity to climate change, companies are facing a more complex array of trade offs and risks across their value chains.

Population growth, a rising middle class, rapid urbanization, and economic growth are all fueling an increasing demand for food, water, energy, land, and other resources. In the last decade, emerging markets saw an 80 percent increase in per capita income, which in turn is resulting in an increase in consumption. By 2030, another three billion middle class consumers are expected to drive up demand even further. Early projections show an 80 percent increase in energy use and 60 percent increase in water use.[1]

Climate change matters to business success. Understanding climate risks and adaptation is critical to supporting clients. The long-term impact of climate change will be felt by many businesses as changes in temperature, rainfall patterns, sea level, and storm conditions require new adaptation strategies. There is also public pressure for companies to decrease their greenhouse gas emissions, which rose by 6 percent in 2010—one of the highest rates in recorded history. Many companies are developing climate change strategies, assessing their internal and supply chain emissions and examining their approach to climate change throughout their operations and value chain.

Volatility and uncertainty impact both consumers and private sector. In many countries, the rising price of food has already pushed millions of people into poverty, disproportionately affecting the vulnerable. Moreover, the high price of resources, including food, energy, and water, can fuel civil unrest in emerging markets. Volatility of resource prices causes uncertainty for the private sector, creating risks associated with productivity investments and potentially distorting supply chain efficiency.

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[1] McKinsey Study 2011. Resource Revolution: Meeting the World's energy, materials, food and water needs.

THESE COMPLEX CHALLENGES CAN CREATE VALUE FOR BUSINESS

Sustainability has become an important factor in business strategies. Large multinationals and mid-sized companies are increasingly taking a long-term view toward managing environmental and social risks. Many companies recognize that by addressing environmental and social issues they can achieve better growth and cost savings, improve their brand and reputation, strengthen stakeholder relations, and boost their bottom line. Strategic integration of sustainability prepares companies to better anticipate and understand long-term trends and the effect of resource use, and to address stakeholder expectations. According to a 2011 McKinsey Survey, 76 percent of CEOs consider that strong sustainability performance contributes positively to their businesses in the long term.[2]

Companies are capitalizing on local conditions and shaping their business strategies to accommodate constraints on natural resources in a way that allows them to develop innovative new products, services, and business models. This also provides opportunities to bolster their growth, profitability, and add societal value.

[2] McKinsey Global Survey results 2011. The business of sustainability.

The business case for sustainability is also connected to improved reputation and brand value. The global survey of senior executives from around the world conducted by the Economist in 2011 found that 76 percent of respondents think that embedding sustainability into the company's business leads to enhanced reputation and increased brand value. The more a company proves to stakeholders that its business is driven by strong sustainability policies, the lower the risks associated with that company. In contrast, weak environmental, social, and governance (ESG) performance can negatively impact a firm's reputation, which in many cases can be costly. British Petroleum (BP) is a good example of how a company's brand value can be affected by poor sustainability policies.

PROTECTING BRAND VALUE

Due to the Gulf of Mexico oil spill, BP has lost more than $32 million a day in brand value. BP's market value has dropped from $184 billion to $96.5 billion, roughly 48 percent in a period of two months. Developing a good environmental and social reputation can contribute to a willingness among customers and investors to pay a price premium, which directly affects the company's bottom line.

CREATING INNOVATIVE SOLUTIONS

Jain Irrigation is an example of a company that created innovative social solutions and feeds those innovations back into communities. The IFC client, based in Jalgaon, India, pioneered a system of contract farming in which the company buys farmers' crops at a guaranteed price, thereby enabling farmers to plan and obtain loans for irrigation products, such as an affordable drip irrigation system that reduces water consumption. Jain Irrigation has worked closely with its rural customers to promote precision farming, which increases output by optimizing the balance between fertilizers, pesticides, water, and energy. This approach has given Jain Irrigation a competitive edge: its close relationship with smallholder farmers and the fact that its products are customized to local conditions make it easier to win business from large agricultural suppliers.

Investment in resource efficiency is important for small and large companies. It helps them strengthen their competitive advantage. Studies have shown that improvements in resource efficiency in energy and water have lead to significant cost savings and lower environmental impact. DuPont, for example, has cut costs by $2 billion in the last 10 years by investing in energy efficiency equipments while reducing greenhouse gas emissions by 75 percent. Another good example in reducing operational costs and environmental impact is the IFC client Kuybyhev Azot in Russia. Companies are working with suppliers to become more resource efficient and environmentally sustainable. For example, Wal-Mart is aiming to save $3.4 billion from reducing supplier packaging by 5 percent by 2013.

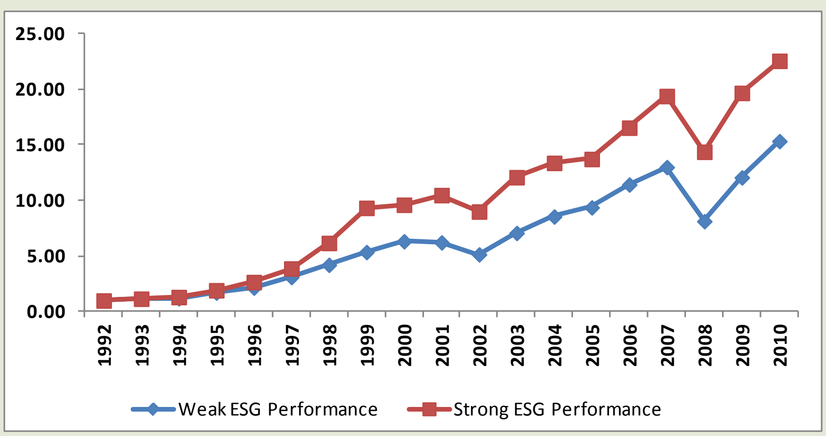
There is a correlation between good environmental and social performance and financial performance. According to a Harvard Business School study that tracked performance over the last 18 years, companies with strong ESG performance outperformed companies with weak ESG performance, as measured in accounting terms.[3] The study found that performance was stronger in sectors that were significant users of natural resources, where brand and human capital were particularly important and where the companies competed on a business-to-consumer basis.

[3] Eccles G.R., Ioannou I. Serafeim G. "The Impact of a Corporate Culture of Sustainability on Corporate Behavior and Performance," Harvard Business School, November, 2011.

Using Energy Efficiency to Decrease Costs

Kuybyhev Azot (KuAz) is a top chemical and fertilizer producer in Russia. IFC supported KuAz with a $20 million loan to finance a program to identify ways to use energy efficiency and cleaner production as routes to reduce costs, increase competitiveness, and improve environmental performance. Once completed, these measures will save the company about $9 million in energy costs a year. The resulting reduction in carbon emissions of over 115,000 tonnes of CO2 per year is estimated to be equal to taking 23,000 cars off the road.

Financial Performance of Companies with Weak vs. Strong ESG Performance



Source: Eccles G.R., Ioannou I. Serafeim G. "The Impact of a Corporate Culture of Sustainability on Corporate Behavior and Performance," Harvard Business School, November, 2011.

CUSTOMERS AND INVESTORS VALUE STRONG ESG PERFORMANCE

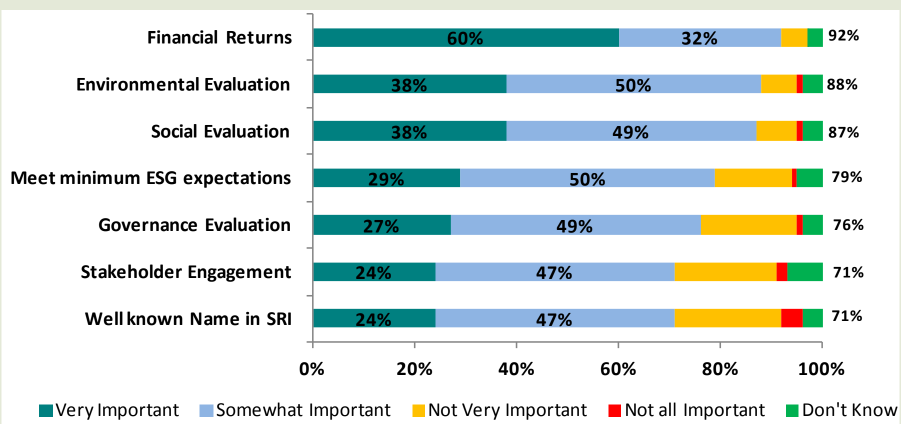
The growing demand by consumers and investors for sustainable products and services, coupled with increased scrutiny and reporting on corporate responsibility, are driving companies to pay greater attention to their ESG performance. According to McKinsey's global survey of 7,751 consumers, 87 percent are concerned about the environmental and social impacts of the products they buy and 54 percent are willing to pay a premium for products that are sustainably manufactured.

Increasingly, investors are considering environmental and social issues when selecting investments. According to Bloomberg, in 2010, 5,000 investors in 29 countries accessed more than 50 million ESG indicators in the Bloomberg platform—a 29 percent increase over the previous year. Different sustainability reporting frameworks such as the Global Reporting Initiative (GRI) and the Carbon Disclosure Project (CDP) have become important tools for investors in making informed investment decisions. The number of companies using GRI as a framework for sustainable reporting has increased by 73 percent in the last four years, with a dramatic increase from developing countries that are reporting on sustainability measures.

The socially responsible investing (SRI) market enables investors to have a positive return on their investments while also bringing positive impacts to society. According to the Ethical Funds global survey of investors, 92 percent of respondents think that financial returns of SRIs play an important role in their decision to invest in SRIs. Similarly, environmental and social evaluation plays a crucial role in the investors' decision to allocate their capital to SRI funds.

The growth of SRIs has increased exponentially in the last 10 years. The SRI market has grown at an annual rate of 22 percent since 2003. By 2015, SRI assets under management will reach $26.5 trillion or 15 percent of the global total. In 2011, SRIs attracted about one dollar out of every nine invested. Investors are attracted by SRI markets due to their robust financial performance. The majority of SRI funds outperformed S&P 500 over a 10-year period by an average of 6.7 percent. Similarly, over a 5-year period the Dow Jones Groups Sustainability Index performed at an average of 36.1 percent better than did the traditional Dow Jones Group Index.

KEY DRIVERS FOR INVESTORS TO INVEST IN SRIS



Source: Ethical Funds Global Study 2011.

IMPROVEMENTS IN ESG PERFORMANCE CAN RESULT IN GREATER DEVELOPMENT IMPACT

The success of a company is inextricably linked to the success and sustainability of the communities in which they operate. The Coca-Cola Company and Newmont help illustrate how companies are integrating sustainable development objectives into their core business strategies, thereby benefiting the communities and local economies in which they operate.

The Coca-Cola Company played an important role in the sustainable development of communities in Zambia through the value of goods generated, jobs created, and its positive impact on the supply chain. Coca-Cola procures approximately 25 percent of inputs from local smallholder farmers. Remaining inputs are purchased from companies based regionally. Smallholder farmers play an important role in growing the sugar that is used in Coca-Cola products. In the case of Zambia, sugarcane workers are among the most vulnerable to labor violations due to the lack of formal contractual arrangements to protect their rights, and the low-paid/seasonal nature of their work. For this reason, Coca-Cola introduced an audit program to assess whether supplier and bottler workplaces uphold internationally recognized labor and environmental standards. Through its local partners, Coca-Cola introduced programs to support HIV/AIDS services for its employees and their dependents free of charge, including education and awareness-raising programs, voluntary testing and counseling, and free antiretroviral drugs.

Since Coca-Cola uses water as the primary ingredient in its beverages as well as in its manufacturing activities, the company's most significant impact is on water resources at the agricultural stage. Therefore, Coca-Cola required its suppliers to promote better management practices and design strategies that help Coca-Cola reduce the environmental impacts of its supply chain. By 2015, Coca-Cola's main supplier in Zambia will become 25 percent more water efficient. Through the Coca-Cola Foundation, the company invested about 1.3 million in community development programs that include sustainable management of water and watershed resources, installment of waste, and sanitation facilities.

Newmont Mining Corporation is a leading gold producer with operations in five continents. Newmont invested $588 million in the Ahafo Mine in Ghana to develop four mining areas, and build and operate related mine facilities. IFC supported the project with $125 million in loans or about 21 percent of total cost. Prior to investing in the Ahafo Mine, Newmont engaged with local communities to responsibly resettle and compensate roughly 1,700 households located in the mining area. Due to resettlement of communities, Newmont built new homes and schools and residents were granted legal title to the land, along with potable water and access to electricity. Additionally, Newmont launched a community development fund to contribute an estimated $500,000 annually to support community development programs such as the provision of water, sanitation, upgrading local clinics and training centers, HIV/AIDS programs for workers as well as a program on malaria prevention, and an information forum for women in the community. In addition to Newmont's community programs, IFC introduced linkages programs to increase local participation in the project and bring additional benefits to the surrounding communities.

IFC AND SUSTAINABILITY

A focus on sustainability is part of IFC's vision: sound economic growth, driven by private sector development, is crucial to poverty reduction. IFC is committed to ensuring that the benefits of economic development are shared with the poor and vulnerable, and that development takes place in an environmentally and socially sustainable manner. IFC's sustainability strategy is focused on transforming markets, driving innovation, and adding value to clients by helping them improve their business performance.

IFC's Sustainability Framework, originally adopted in 2006, reflects IFC's commitment to sound environmental management and social development. It is designed to address the concerns of people who are affected by IFC's projects and achieve greater development impact. IFC's Performance Standards on Environmental and Social Sustainability are an important aspect of the Sustainability Framework.

The Performance Standards have become globally recognized as a leading benchmark for environmental and social risk management in the private sector. They are often prerequisites for companies to raise funds, particularly from international markets. IFC's Performance Standards are reflected in the Equator Principles, now used by 72 financial institutions around the world. In addition, other financial institutions also reference IFC's Performance Standards in their policies—including 15 European Development Finance Institutions and 32 Export Credit Agencies from countries belonging to the Organisation for Economic Co-operation and Development.

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