

THE VALUE DRIVER MODEL:

A TOOL FOR COMMUNICATING THE BUSINESS VALUE OF SUSTAINABILITY

A PRI-UN Global Compact LEAD
collaboration on creating long-term value

The Value Driver Model

A tool for communicating the business value of sustainability

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This report is part of a toolkit which includes presentation slides and fully developed case examples. The toolkit is available for those interested in learning more about the Value Driver Model and how companies can utilise it for communicating with their shareholders and potential shareholders. For more information, please visit the UN Global Compact website.

The work presented here is part of the [ESG Investor Briefing Project](#), a collaboration between Global Compact LEAD and the UN-supported Principles for Responsible Investment (PRI). Using the model of a quarterly financial call, the ESG Investor Briefing Project aims to:

- Provide a baseline model for companies to enhance their communication on how environmental, social and governance (ESG) strategies and performance translate into financial value.
- Help overcome the silos that often exist regarding sustainability within companies and financial institutions, as well as between the various actors along the investment value chain.

Not all companies featured participate in LEAD. However, their examples serve as illustrative cases for all companies. Utilising the Value Driver Model as a tool, companies are invited to join the ESG Investor Briefing Project and create a tailored method for communicating their own ESG value drivers, internally and with investors.

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About Global Compact LEAD

Launched in January 2011 to drive innovation and quality among participants of the UN Global Compact, Global Compact LEAD recognises the critical need for supporting UN Global Compact participants to achieve higher levels of corporate sustainability performance – as outlined in the Global Compact’s Blueprint for Corporate Sustainability Leadership. LEAD Participants share a commitment to implement the Blueprint and a willingness to lead the Global Compact with strong engagement at local and global levels. LEAD currently has 56 participants representing all regions of the world.

About the Principles for Responsible Investment

The United Nations-supported Principles for Responsible Investment (PRI) Initiative is a network of international investors working together to put the six Principles for Responsible Investment into practice. The Principles were devised by the investment community and reflect the view that ESG issues can affect the performance of investment portfolios and therefore must be given appropriate consideration by investors if they are to fulfil their fiduciary (or equivalent) duty. In implementing the Principles, signatories contribute to the development of a more sustainable global financial system. Launched in 2006 by UNEP Finance Initiative and the UN Global Compact, the Principles provide a voluntary framework by which all investors can incorporate ESG issues into their decision-making and ownership practices and so better align their objectives with those of society at large.

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Introduction

Background

Investors and companies have long sought an approach to assess the business value of sustainability.¹ A variety of methods have been employed, from analyses correlating ESG data with financial² performance, to methodologies aimed at calculating previously externalised social and environmental costs and benefits to get a clearer picture of value. Several new comprehensive frameworks are in development.

The Value Driver Model provides a simple and direct approach that companies can use to assess and communicate the financial impact of their sustainable business strategies. While the reported financial and market performance of any firm is a product of a complex array of internal and external factors, the goal of the Value Driver Model is to provide a few key metrics that illustrate how a sustainable business strategy contributes to overall performance. For many companies whose sustainable business strategies are already yielding tangible financial benefits, employing the Value Driver Model could represent a good first step on the path toward deepening investor interest in sustainability as a source of business value. For firms seeking to increase the positive financial impact from their sustainable business strategies, the Value Driver Model can be a useful tool to align and motivate the organisation.

While sustainability issues are only one of the multiple drivers influencing corporate financial performance, companies' sustainable business strategies are integral and therefore have an important role to play in assessing overall financial performance. Accordingly, the Value Driver Model described in this report directly demonstrates how sustainability impacts on reported financial results in the short and long term.

Business as usual is changing. While once companies saw sustainability issues as risks to be managed, many now also see sustainability as a source of innovation that drives growth and profitability. Demand is growing for products and services that meet long-standing needs in new ways that save energy and natural resources, and are less damaging to our physical and social environments. Companies are pursuing significant opportunities that result from the new needs of a fast growing global population for safe and reliable access to energy, food, water, housing, transportation healthcare and more.

Many companies are also changing the ways they operate by becoming more effective in executing strategies that promote more efficient use of human and natural resources and thereby improve operating results.

The intent of the Value Drive Model is to make the financial impacts of responding to these new sustainability imperatives more visible at the company level. It is a "back to basics" approach for assessing the business impacts of sustainability by measuring three

key factors:

- *Sustainability-advantaged growth (S/G)*
Measuring a company's revenue volume and growth rate from products they define as sustainability-advantaged in comparison to their predecessors and/or competitors.
- *Sustainability-driven productivity (S/P)*
Measuring the aggregate financial impact on a company's cost structure as reported by the company from all sustainability-related initiatives in a given time period.
- *Sustainability-related risk management (S/R)*
Measuring performance over time on the critical metrics that a company (often in consultation with stakeholders) believes pose meaningful risk to revenue and reputation.

Growth, productivity and risk are common components for most investor models. However, today it is difficult to determine how big a role, if any, sustainability plays in a company's performance. In addition, sustainability issues can be so integrated and embedded in a company's overall operations that it is not always practical to separate them. Nevertheless, some companies have generated and identified real gains, such as a significant shift in the proportion of their revenue coming from sustainable solutions. Some of those firms are making these results more visible to investors.

For example, while it is useful to know that DuPont reported 9.8 per cent revenue growth from 2007 to 2011, it is also important to understand that growth from the firm's portfolio of sustainability-advantaged products grew at 5.5x that rate and now makes up 30 per cent of total revenue. (See page 9 for further details.)

Numerous studies have examined the impact of ESG issues on financial performance, with reports such as UNEP-FI and Mercer's "Demystifying Responsible Investment Performance"³ and Deutsche Bank's "Sustainable Investing: Establishing Long-Term Value and Performance"⁴ examining and summarising the key findings of over 100 studies. Though the results show impressive links between broad-based sustainability measures and financial performance, it remains challenging for investors to see the specific ties between the execution of sustainable business strategies and revenue and/or earnings growth.

Recent studies from leading consultancies, including Accenture⁵, BCG⁶ and McKinsey⁷ attempt to describe the emergence of this growing group of companies that claim that their sustainability strategies are producing innovations in products, services and operations that directly tie to improvements in revenues and margins. Boston Consulting Group labels them "harvesters" and "embracers", McKinsey calls them

“leaders” and Accenture describes a “two speed world” in which “transformational leaders” are moving quickly to generate significant business value from sustainability, while others move at a much slower pace.

The Value Driver Model attempts to quantify these direct impacts of sustainable business strategies. Most often the contributions to business upside can be traced to revenue growth and positive cost-structure impacts. The intent of the model is to offer a means of simplifying and highlighting such key impacts and to make it easier for a wide spectrum of observers to evaluate sustainability as a noteworthy source of value creation. Companies, such as those described in the research, are not only generating significant value from their sustainability strategies but are also giving investors a window into the financial value of sustainability by reporting how those strategies impact revenues, margins and related risks.

Purpose

The purpose of this report is to advance the Value Driver Model as a useful starting point for companies to enhance their communication of the business value of their own sustainability. It does not replace other current or planned sources of sustainability performance data and should be continually enhanced as both companies and investors learn about how best to improve communications.

The Value Driver Model does not represent an exhaustive or comprehensive taxonomy of all sustainability-related impacts, but rather a descriptive model intended to show how companies are implementing sustainable business strategies as an evolving business imperative. By focusing on sustainable business strategies as a source of financial upside and protection from downside risks, it is expected that investors will be better able to assess the value of sustainability.

The report recommends that companies begin their efforts to communicate business value with simple metrics that reflect how a sustainable business strategy bears directly on three key concerns of investors: 1) current and future revenue growth, 2) the organisation’s overall productivity and operating margin and 3) the firm’s exposure to risk.

In preparing the report, companies were examined across industries and geographies that showed evidence of sustainable business strategies that are currently delivering significant benefits. In the case studies developed in tandem with this report and referenced herein, the research finds numerous examples of companies that are using an approach to communicate the value of sustainability to shareholders and stakeholders that closely parallel the growth, productivity and risk-drivers of the Value Driver Model (or elements of it). Many of these companies have also chosen to complement these simple business-oriented metrics by disclosing more comprehensively to a wider stakeholder base via broadly accepted reporting

frameworks such as the UN Global Compact Communication on Progress (COP) and Global Reporting Initiative. Yet, it should be noted that without specific efforts by these firms to classify, measure and aggregate total impacts on revenues and costs, it would remain very difficult to quantify financial benefits from existing comprehensive reports.

The experience and results of these companies offer insight to other companies and investors on how to express the value of sustainable business strategies. The report offers a path forward for companies wishing to enhance their ability to communicate the materiality of their sustainable business strategies in measurable terms.

PART I

The Value Driver Model: An Overview

The UN-supported Principles of Responsible Investment (PRI) and the UN Global Compact have been working to encourage the adoption of the Value Driver Model, as shown below, as an approach for communicating the business value of sustainability issues to investors and other interested parties. The Value Driver Model was derived from previous efforts, including the work of Kaplan and Norton⁸, Porter and C. van der Linde⁹, Esty and Winston¹⁰, and Lubin and Esty,¹¹ among others. Each of these observers makes the argument that all strategies can be decomposed into core elements that drive business growth, productivity gains and risk mitigation – hence the origin of the value drivers concept.

The Value Driver Model is an open model that provides a structure for companies to describe and measure how their sustainable business strategies can drive financial results. Its direct tie to core business strategy and outcomes is the differentiator. The model places social and governance value drivers on equal footing with environmental drivers, though it acknowledges that in some cases they may be harder to link directly to financial results.

The model assists firms in constructing their own metrics to describe the connection between their top financial objectives (e.g. return on capital or return on equity) and the following:

- Revenue growth from sustainability-advantaged products, services and/or strategies (S/G).
- Total annual cost savings (and cost avoidance) from sustainability-driven productivity initiatives (S/P).
- Reduced sustainability-related risk exposure that could materially impair a company's performance (S/R).

The report focuses on these three value driver metrics (referred to as S/GPR) as a place to begin, though many other potential value drivers exist. It suggests that by first employing metrics to describe the direct impacts of sustainable business strategy on revenue, productivity (cost) and risk – before trying to measure more subtle, indirect effects – a company increases its chances of engaging a broader audience. Therefore, the model begins with an effort to measure these direct factors.



Figure 1: The Value Driver Model

Moving Toward the Tipping Point

One of the greatest challenges to effective integration of sustainability across markets is that investor engagement on sustainability has yet to reach its tipping point. While evidence suggests that leading companies are realising direct financial gains from sustainable business strategies, many of those same company executives report little progress communicating with their investors and analysts on sustainability strategies and impacts on the bottom line.

It is not surprising that investors and analysts have difficulty assessing how sustainability performance contributes to financial results. Reporting on sustainability factors can be inconsistent, incomplete and at times even inaccurate, since there are no universally accepted sustainability reporting or auditing standards as there are for financial data. Improving the comparability, normalisation and sector specialisation of today's sustainability reports is desirable. But that alone will not suffice. The problem of currently perceived relevance of the data to business strategy and outcomes must also be overcome. Investors must be able to see a clear link between sustainability business strategy and financial results.

Over time, it is possible that maintaining competitiveness in cost structures and products will require meeting a much higher sustainability performance threshold. Sustainability's impact on business may well become inescapable. Consequently, sustainability will be more fully integrated into both conventional business and investment logic. However, as observed in previous quality and technology trends, the greatest opportunity for investors to gain advantage is in the expansion phase of business innovation. This is the point in the cycle when a growing number of companies are able to differentiate from competitors and successfully scale-up innovations that yield competitive advantage and the resulting business benefits. This often occurs years before high performance becomes ubiquitous in the marketplace.

We are again at a unique moment in time. A growing number of firms, such as those showcased in tandem with this report, are differentiating from their competitors and are generating significant financial value from their sustainable business strategies. If investors are able to more easily identify such firms through simple metrics, they may help move the market to a broader appreciation of sustainability.

As noted in research by the UN Global Compact and Accenture, financial markets have the potential to play an accelerating role in moving companies forward on sustainability.¹² According to a 2010 UN Global Compact/Accenture survey of 788 senior executives, CEOs recognized that the "power of the financial markets, if harnessed, could perhaps be the strongest driver towards companies around the world integrating sustainability into core business".

On the investor side, signatories to the PRI now represent more than USD 34 trillion of assets under management, which corresponds to over 20 per cent of the world's investable assets. While this is significant, a 2011 analysis comparing the internal active assets of PRI signatories with the wider global market found that around seven per cent of all global capital is now subject to ESG integration (by PRI signatories), up from six per cent in 2010 and four per cent in 2008, indicating that a tipping point has by no means been reached.¹³

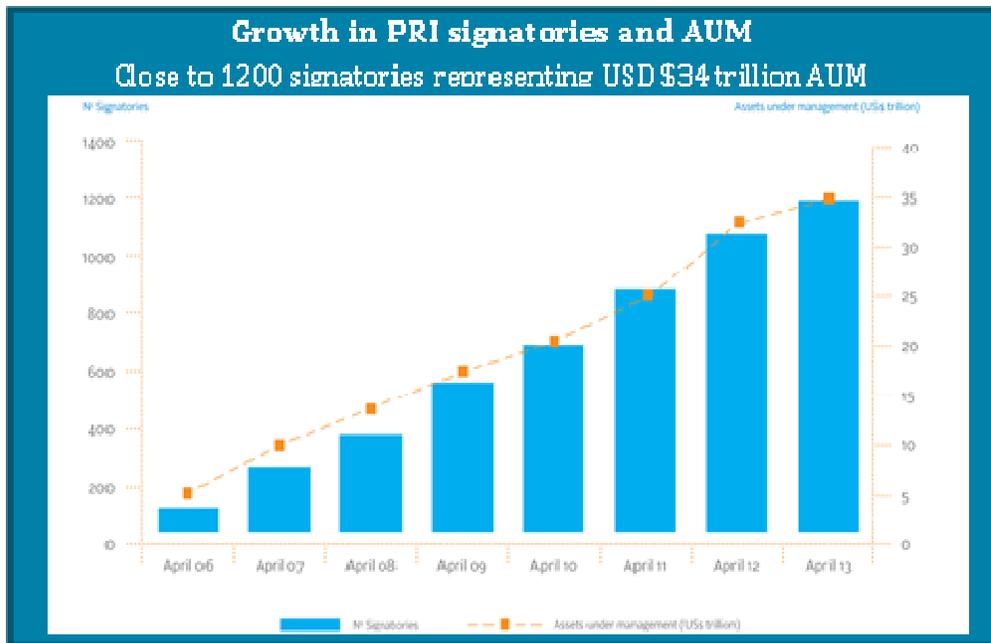


Figure 2: PRI

The data indicates that gaining maximum advantage from the financial market's role as an accelerator of positive change will likely require companies to establish the relevance of sustainability to the successful execution of their business strategies and adequately communicate it to shareholders and potential shareholders. Getting this positive dynamic working requires companies to send, and investors to receive, clear signals about the ability to drive top and bottom line performance advantage from sustainable business strategies.

In October 2013, the PRI launched a new Reporting Framework that will require all signatories that manage assets to disclose publicly how they are incorporating ESG factors into their investment decision making processes and ownership practices. It allows investors to communicate how the sustainability information disclosed by companies is used to inform investment decision, and the responses provided by signatories will provide useful insights for companies seeking to understand how investors use company-reported data to make risk-reducing, value-enhancing investment decisions.

Achieving this objective should create a window of opportunity for companies and investors.

Therefore, an improved approach is needed.

Enhancing Communication with Investors

This report begins by directly tying sustainability performance to what investors have already broadly agreed they need to know about companies – how they are positioned

to grow revenues, what strategies they are executing to boost productivity and thereby improve profitability, and how they are tracking and managing risks that could meaningfully impact their business results. Establishing the relevance of sustainability may be more easily accomplished with a few, critical data points, especially if those key metrics already appear as central to an analysis of business fundamentals.

While the performance data examined through the case studies released in tandem with this report may not be perfectly or directly translatable into exact earnings per share or earnings before interest and tax, the relevance of the data cited to key business outcomes is compelling.

Through this “back to basics” approach focused on sustainability-driven revenue growth, productivity and risk, companies, investors and analysts should be able to more clearly see the elements of financial value and competitive differentiation that can result from a well-executed sustainable business strategy. This would allow investors to better make sustainability an integral part of investment analysis.

This report seeks to evolve and operationalise the Value Driver Model as an approach to engaging all investors based on the following assertions:

- If investors do not perceive the potential business impact of sustainability – both opportunity and risk – they are unlikely to undertake efforts to integrate sustainability data into their existing investment processes.
- The absence of broad based investor engagement can undermine corporate progress in advancing sustainability.
- Investors are more likely to value and integrate sustainability data if results are framed in financial language (potential for revenue growth, ability to drive productivity gains that improve earnings, and capacity to track and manage key risks), provided the impacts are significant.
- If positive financial impacts linked to sustainability are significant and easily understood, then there is likely to be greater interest by investors in considering sustainability as a business performance driver, and greater interest by companies in advancing and featuring their sustainable business strategies.
- Leading companies are already experimenting with more direct attempts to communicate the business value of sustainability in common sense terms, and others can learn much from their efforts.

PART II

Operationalising the Value Driver Model

The figure below takes a closer look at the Value Driver Model and how it can be, and has been, operationalised by other firms enabling them to more clearly report the business value of sustainability.



Figure 3: Operationalising the Value Driver Model

Figure 3 describes the model's three sustainability value drivers – growth, productivity and risk – and their subcomponents. The following sections look closer at each and how the concepts have been operationalised.

The Value Driver Model is intended to provide a means for companies to describe (and measure, when appropriate) the enablers of sustainability-driven growth, productivity and risk mitigation. This is accomplished via any and all relevant channels, including routine quarterly and/or other regular announcements and presentations, roadshows and reports. The model seeks to provide companies and investors with the best possible guidance on how sustainable business strategy contributes to measurable gains along the three primary dimensions. An initial example of operationalising the model through creation of each of the S/GPR metrics is also presented. The report examines how the featured firms use variations of these measures in an effort to communicate the business value of sustainability.

Growth

Sustainability-advantaged revenue growth depends upon variations of the following four key sub-components:

- Expanding market share based on enhanced demand for sustainability-advantaged products.
- Gaining sales to new customers and geographies based on brand and reputation for sustainability product leadership, especially where those attributes are differentiators.
- Developing innovative sustainability-advantaged products and services that better meet customer needs while minimising unwanted social or environmental consequences and/or enhancing desirable social and environmental outcomes.
- Implementing a long-term strategy and plan, along with the required investments, to deliver sustainability-advantaged growth.

Measuring sustainability-advantaged revenue growth

Most investors want to know at least two essential facts about a firm's sustainability-advantaged revenue growth. Firstly, what is the current sustainability quality of revenue or the absolute percentage of total sales accounted for by products or services designated as sustainability-advantaged either by the company itself or a reliable third party? In the cases profiled in tandem with this report, the absolute percentage of sustainability-advantaged revenue ranged from seven to over 40 per cent and in all cases represented a meaningful component of the product mix.

Secondly, investors want to know the growth rate of sustainable products compared to the firm's overall growth rate (termed S/G). In the case we examined, S/G values ranged from 2x to more than 25x the growth rate of the company overall, making sustainability-advantaged growth a critical component of the overall business momentum and the growth strategy of the firm. As the proportion of total revenue categorised as sustainability-advantaged climbs, the comparative growth rate (S/G) falls. However, even in the Pirelli and DuPont cases cited above, where sustainability-advantaged revenues are above 30 per cent of total revenue, S/G scores of 2.2x and 5.5x overall revenue suggests that recent and likely future growth is highly related to the success of these products.

Defining the specific profit contribution of sustainability-advantaged products goes beyond what is needed to establish investor interest and the scope of this report. Providing a clear picture of how a company's revenue composition is significantly changing is sufficient to demonstrate the importance of this dynamic for investors.

Example: Siemens (S/G)¹⁴

Engineering company Siemens has committed to revenue growth from sustainability. The company's fiscal year 2012 revenue saw 42 per cent, or over EUR 33 billion, come

from its environmental portfolio for an estimated S/G calculation of 2.2x. As a result, the company reports it is on track to achieve its target of EUR 40 billion in revenue from its environmental portfolio by 2014. As of its most recent reporting, the company's environmental portfolio comprised contributions of 70 per cent from energy efficiency solutions, 22 per cent from renewable energy and 8 per cent from environmental technologies, such as those related to air pollution control.

Productivity

Like revenue growth, sustainability-driven productivity gains ultimately flow through to the top metrics that the firm uses to measure financial results. Sustainability-driven productivity gains may come from three key primary sources:

- Operational efficiencies, resulting in cost savings and/or cost avoidance from better use of natural resources, reduced wastes and/or finding better alternative materials with lower costs and impacts.
- Human capital management, reducing the cost of attracting and retaining top talent to the firm as a result of the firm's commitment to sustainability and the employees' perceived value of that commitment, as well as increased worker productivity due to skills and safety training, and inclusive and equitable work environments.¹⁵
- Margin improvement, potentially increasing price and volumes from customer perception of enhanced value from sustainability-advantaged products.

Measuring sustainability-driven productivity gains

Investors want to know the aggregate cost savings and/or cost avoidance, along with any other directly attributable benefits from the implementation of the company's sustainable business strategy. It is no doubt of interest to read in a sustainability report that a new factory or facility has reduced its energy use or employee turnover by a certain percentage. However, investors need to know how sustainable business strategy impacts the overall cost structure of the business in total dollars and ratios (cost per unit produced, or cost per worker hour or per dollar of capital) for a given reporting period and how those gains trend over time.

It is up to investors to determine what they believe to be the thresholds for assessing the significance of such savings. In the cases developed in tandem with this report, examples typically ranged from one to 15 per cent savings on total costs. Cost structure improvements in these ranges could be highly material. However, the results need to be interpreted in the context of the overall business performance. What is of particular interest is that the companies examined for this report, which have disclosed data that has been translated into an S/P rating, have moved to systematic reporting of how their

total operating margins are impacted by sustainability-driven operational improvements; thereby making it easier for investors to evaluate the scale and significance of sustainable business strategies on the bottom line.

Example: Unilever (S/P)¹⁶

Unilever's Sustainable Living Plan aims to double growth while halving the company's greenhouse gas, water and waste footprint across the entire lifecycle of its products. Over the past four years, the company's productivity savings have reached almost USD 400 million as it prepares for this plan. Unilever estimates its eco-efficiency programmes have saved about USD 130 million in energy costs, USD 240 million in materials expenses, USD 22 million in water expenditure and USD 13 million in waste disposal.

Risk

Like sustainability-advantaged growth and sustainability-driven productivity, sustainability-related risk management (S/R) provides investors with a few critical, measurable data points that reflect management's best assessment of exposure to risks that could imperil key business objectives. Many firms disclose a wealth of risk metrics through their existing corporate responsibility reporting model. However, connecting with investors requires firms to define their critical metrics that investors can track over time, observing progress in risk factors such as:

- Operational and regulatory risk management: decreasing levels of environmentally critical and/or constrained resource use; limiting business interruptions and risk of losing the license to operate; reducing emissions of key pollutants or toxins; and other areas that could expose the firm to regulatory actions or penalties, as well as increasing adherence to established sustainability-related operating standards, including results of related audits and certifications.
- Supply chain risk: increasing assurance via assessments, audits and/or certifications that the firm's suppliers are providing reliable, responsibly produced products and services in accordance with the firm's policies, industry codes and international standards.¹⁷
- Reputational risks: decreasing exposure to reputational risks arising from a variety of actions including, fines, negative legal judgments, boycotts, public protests and/or negative media attention through implementation of proactive policy and procedures that limit the risk of social and environmental harm.

Measuring sustainability-related risk management

For investors, the most important risk metrics are those that pose material business risks to revenue and reputation, that clearly tie to the business model and that are increasing or declining along with the trajectory of the business. While absolute increases and decreases in sustainability-related risk factors like GHG emissions are important, many investors want to understand the relative changes in risk intensity as reflected in dimensions such as:

- **Water and stressed water intensity of revenue**
The use of the amount of water (and water in resource constrained geographies) consumed per dollar of revenue.
- **GHG (or other key emissions) intensity of revenue**
The firm's capacity to manage risks (and potential cost which may be internalized in the future) per dollar of revenue.
- **Energy intensity**
The firm's exposure to potential availability and cost volatility per dollar of revenue.
- **Waste recovery**
The firm's capacity to limit exposure to factors such as raw materials price volatility and escalating waste disposal costs and risks by measuring the proportion of total waste produced that is recovered for reuse.
- **Accidents**
Frequency and intensity (cost) of accidents per dollar of revenue.
- **Sustainability-related product risk intensity**
Total company costs arising from social and environmental damages due to use or manufacture of company products as a percentage of revenue. This could include specifically quantified loss of revenue from social problems in a company's supply chain. A growing number of companies are carefully monitoring the social performance of their supply chain for this reason.
- **Uncovered supplier risk**
The percentage of total dollars paid to suppliers not covered by company approved sustainability-related risk assessment, including ESG factors
- **Human rights risk**
The Guiding Principles on Business and Human Rights provide that companies should conduct human rights due diligence and remediate adverse human rights impacts that they cause or contribute to. As a result, companies are beginning to carefully monitor their direct impacts on human rights as well as those linked to their products and services through business relationships. Having an

operational-level grievance mechanism, through which complaints and company responses are tracked, is a key human rights risk mitigation tool.¹⁸

- Manufacturing and operational process risk certification
The percentage of company processes not certified as meeting or exceeding independent sustainability-related standards.

These represent the types of sustainability risk measurement most relevant to investors. The specific metrics can only be defined in the context of a company's operations and business eco-system.

*Example: The Coca-Cola Company (S/R)*¹⁹

To create their product, beverage companies such as The Coca-Cola Company require access to fresh water, which can be scarce in areas of the developing world, and not addressing this resource constraint poses a significant potential risk to revenue and profitability. As a result, Coca-Cola has focused on water management as a business-critical aspect of its sustainability efforts. The company implemented locally-relevant water resource protection sustainability programmes in 2012 and is currently performing hundreds of source water vulnerability assessments. Coca-Cola has achieved 20 per cent gains in water efficiency from 2004 to 2011, and the company and its more-than 250 bottling partners in over 200 countries have committed to achieve an additional 25 per cent in water efficiency gains by 2020. Furthermore, Coca-Cola has a water neutrality goal of returning to communities the equivalent water volume that it uses in finished products and production by 2020. In terms of results, Coca-Cola measures water use efficiency, or litres (L) of water used per litre of product produced. This performance metric has been improving annually, with the company reporting 2.12L of water per litre of product produced in 2012, down from 2.70L in 2004 – an improvement of 21.4 per cent over the previous nine years. Coca-Cola's compliance with internal wastewater standards has also improved with time, increasing from 85 to 98 per cent. In addition, its percentage of water replenished is 52 per cent, up from 35 per cent in 2011, achieved through community water projects, such as watershed protection, community water access, rainwater harvesting, reforestation and agricultural water use efficiency. These calculations allow Coca-Cola to demonstrate its sustainability progress and strategic management of risks.

Direct versus Indirect Value Drivers

The Value Driver Model is composed of two types of drivers: direct and indirect. Direct drivers are those with links to top or bottom line results that require no intervening variables to have a measurable effect. For example, with respect to revenue growth, sales of sustainability-advantaged products is considered a direct driver and R&D spending an indirect driver because the former translates into revenue and the latter presumes the company has some intervening process for effectively converting R&D into revenue. Similarly, productivity improvements can result from direct drivers, such as reduced material or energy costs, reduced employee absenteeism and turnover, or process changes. This is distinct from indirect gains related to brand and reputational benefits of community engagement, for example, which may indirectly translate to being an attractive employer, and therefore reduce recruitment costs, or to increased customer loyalty, which may increase customer base and reduce marketing costs. This initial effort to identify value driver innovators has focused on direct drivers of revenue growth, productivity gains and risk mitigation. This is not to say that indirect value drivers are not important factors for companies to measure and report. It is believed that if investors are better able to see the direct links first, then increased attention and interest may follow on the various indirect sources of value.

Example Company Profiles

This report is part of a larger toolkit for companies, which includes presentation slides and fully developed case examples. The cases provide examples of companies that, like DuPont and Pirelli highlighted below, report key aspects of the Value Driver Model to their shareholders and other interested parties. On the UN Global Compact website²⁰, detailed case studies are available for the Dow Chemical Company, DuPont, Pirelli, Phillips, Swiss Re, as well as Boeing, Praxair, Reckitt Benckiser and Schneider Electric. The website also includes snapshots of companies that quantify gains on one or more dimensions of the Value Driver Model. Some of those featured include Alcoa, BASF, BT, The Coca-Cola Company, General Electric, Fujitsu, Kimberly-Clark, NEC, Office Depot, Siemens, Toshiba and Unilever.

The following profiles of DuPont and Pirelli show how each has used elements of the Value Driver Model to communicate business value.

DuPont

Today, DuPont's business focuses on responding to three global challenges: 1) ensuring food security for a growing population, 2) discovering new solutions to meet energy needs and 3) working to insure the protection of life through cleaner and safer chemistry and materials. Its approach to meeting each of these objectives is driving financial value. Revenue from DuPont's products designated as sustainability-advantaged, now at over 30 per cent of total revenue (more than USD 10 billion), is

growing at a rate 5.5x faster than the company overall. In addition, internally-generated productivity gains from sustainability-related initiatives saved the company approximately 10 per cent, or USD 300 million, on their 2010 operating income of USD 3 billion. DuPont has also reported less exposure to key sustainability-related risks to its business via manufacturing process certifications and reductions of toxic emissions and water use, especially in geographic areas where water supplies are scarce or constrained.

Pirelli

Pirelli launched its Green Performance Strategy in 2009 and has since seen rapid growth in its sustainability-enhanced tyres. This class of newly designed products, meeting European Union standards, now accounts for 45 per cent of revenue and is growing at 2.2x the rate of Pirelli's overall sales. Advanced sustainability research has proved valuable, also. Pirelli has developed a process to use rice husk silica – a waste product from food processing – to provide a less costly, higher performing and more environmentally-friendly replacement for hazardous silica formerly required in the production process. With a 50 per cent future cost saving on this key raw material, the company believes that significant productivity gains will be realised as this technology is rolled out across the firm. In combination with an investment in sustainability-related risk management, Pirelli's sustainable business strategy aims to translate into significant and measurable benefits for shareholders.

These companies are providing a broad range of sustainability data to stakeholders and also represent examples of companies that have framed sustainability in mainstream value terms aligned with the Value Driver Model.

First Steps for Measuring and Communicating S/GPR

Focus on sustainability-advantaged growth

The challenge of measuring and communicating S/G is one of categorisation of revenue. General Electric internally developed rigorous criteria for its ecomagination product portfolio, which helps customers reduce their environmental impact,²¹ and a structured, verified process for inclusion and removal of products from the portfolio based on their sustainability performance relative to alternatives. Other firms have similarly categorised their revenues with a wide variety of internally and externally developed and/or validated models. The firms profiled as part of this broader project use a wide variety of categorisation methods that fall under the sustainability-advantaged revenue umbrella and each has been careful to describe how their categorisation models represent important distinctions.

Firms will need to invest time and energy to develop an appropriate categorisation model, implement an external system or even adopt another firm's approach in order

for investors to understand how their sustainable business strategies drive current and future revenues. In addition, they will need to assess the current and projected market demand for such products and analyse how their research and development expenditures are supporting sustainability-advantaged revenue growth.

The initial formulation of S/G is ideally suited for multi-line or multi-product firms that are making a transition to products designed to offer some enhanced sustainability value. Over time, the S/G metric gives us a view of the scale and pace of this transition. For firms that have a product or service portfolio that may be considered majority or 100 per cent sustainable (e.g. solar energy firms or pharmaceuticals), an S/G analysis could highlight other factors, such as the success of programmes developed or supported by the firm, to bring products to markets or populations not previously served. This success could be measured in terms of revenue percentages and might be an important part of an overall growth strategy.

Focus on sustainability-driven productivity

Calculating an S/P score requires aggregating data from disparate groups and functions across the enterprise. The challenge for most firms is going beyond anecdotal accounts of savings associated with a project. Investors cannot estimate the scale or scope of these gains and so do not pursue this aspect of the company's strategy as an important driver of cost structure improvement. The key challenge is understanding which cost savings to include and to capture them in a timely and consistent fashion in order to be relevant to investors analysing cost structure issues. Today, many companies, even those with substantial experience executing sustainability strategy, are unable to answer the question, "How much did we reduce our costs this year based on total gains from our sustainability-related initiatives?"

With modern enterprise resource planning (ERP) technologies and software, aggregating costs across the enterprise is a solvable problem, so long as management has the will to do it. The potential for material gains varies broadly across industries. While investors should be concerned with the level of resource efficiency in every firm, this factor may not materially affect all companies' bottom lines. For some, the costs savings and potential gains are more indirect, such as talent acquisition and retention, and computing solid estimates of impact is difficult. The case studies accompanying this report show how some firms have addressed these problems and, in many cases, now report material cost reductions based on sustainable business strategy. As is true in many areas of management, the discipline of systematic reporting often enhances management's ability to drive gains.

Focus on sustainability-related risk management

The challenge in measuring S/R is one of focus. For investors to value a firm's sustainability-related risk management, it must be seen in the context of potential

revenue, profitability and/or reputational risks that could ultimately impact the top and bottom line. While it is not possible to predict all material risks, it is necessary to reduce the very large risk portfolio to those critical few that are the focus for reporting and tracking progress. Less may be more, provided there is a clear connection between those deemed critical and the likelihood and potential significance of the risks they represent.

The companies whose sustainability-related risk management reporting has been examined in this report and the accompanying case studies have focused on a mix of outcomes and process factors that describe both what they have done to reduce key risks such as GHG emissions, as well as how they are operating to reduce potential risk exposure, such as implementing audits and mandating standards within their own and their supply chain operations.

There are a number of considerations for companies when determining the materiality or relevance of a potential risk to their revenue or reputation. One common approach supported by the International Integrated Reporting Framework is that matters that have high likelihood of occurrence or larger magnitude of effect should be prioritised.²² On some issues, more specific guidance may be found. For example, with regard to human rights risk, the Guiding Principles on Business and Human Rights emphasise that the severity of adverse human rights impact is defined by its scale (gravity of impact), scope (number of individuals impacted) and irremediable nature.²³ For many companies, identifying and engaging with key stakeholders, including employees, communities, policy-makers and others is a critical first step to determining the most material risks to revenue and productivity.

A Look Ahead

Many companies, like those described in this report, already communicate material financial benefits like enhanced revenue growth, productivity gains and risk mitigation from their sustainable business strategies. If reported consistently, in a timely way and through the lens of financial modelling, more investors will likely pay closer attention to sustainability data. This report has highlighted a few of the firms that offer more direct signals of how sustainable business strategy drives business results. It is intended to connect to other work being done by colleagues around the world, including complementary points of reference, such as the UN Global Compact's COP, PRI's Reporting Framework, the Global Reporting Initiative's Sustainability Reporting Guidelines, the International Integrated Reporting Framework and ongoing work by the Sustainable Accounting Standards Board in the United States and the Delphi Project in the European Union.

Given the expected steady rise of climate change, regulatory pressure, changing consumer attitudes and buying behaviours, sustainable business strategy is expected to play an even greater role going forward. As companies become better able to

communicate to investors how they are gaining material business advantages from these trends, investors are likely to reward those leaders with a sustainability premium.

To capitalise on this opportunity, companies must systematically capture and report the sustainability-driven business impacts they are already seeing – and those they aim to generate – in terms that investors comprehend. Likewise, first movers in the investor community can take advantage of significant upsides before the rest of the field.

Beneficiaries are already starting to emerge. For example, Pirelli has reported a significant shift in ownership patterns since advancing their growth-oriented sustainable business strategy. Between 2009 and 2013, growth-oriented investor ownership, as defined by Pirelli, has climbed from 37 to 71 per cent. The number of analysts covering the company has risen from 12 to 25 and the average target price has doubled in four years. The Pirelli story is gaining attention and the company believes its sustainable business strategy is a key value driver for the business.

With many institutional investors and companies not yet focused on how sustainability is driving short- and long-term business results, there is an opportunity ahead for those who are ready to bridge this gap.

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¹ This report uses the UN Global Compact's definition of sustainability, which is “the delivery of long-term value in financial, social, environmental, and ethical terms”.

² Financial performance refers to any corporate security and not only specifically to equities

³ “Demystifying Responsible Investment Performance”. *UNEP-FI and Mercer*. (2007).

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⁵ “The UN Global Compact-Accenture. CEO Study on Sustainability 2013. Architects of a Better World”.

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- ¹² "A New Era of Sustainability – UN Global Compact-Accenture CEO Study 2010". September 2010.
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- ¹⁴ "Annual Report 2012." *Siemens*. 2013.
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<<http://www.siemens.com/sustainability/pool/en/current-reporting/siemens-sr2012.pdf>>.
- ¹⁵ See "Investing in Women's Employment: Good for Business, Good For Development, International Finance Corporation". October 2013.
<http://www.ifc.org/wps/wcm/connect/5f6e5580416bb016bfb1bf9e78015671/InvestinginWomensEmployment.pdf?MOD=AJPERES>
- ¹⁶ "Unilever Sustainable Living Plan, Progress Report 2012." *Unilever*. 2013.
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<<http://www.greenbiz.com/news/2013/04/18/unilever-sustainability-program-saves-395m>>.
- ¹⁷ For further resources on supply chain risk management, see here: <http://supply-chain.unglobalcompact.org/>; and "Supply Chain Sustainability: A Practical Guide for Continuous Improvement".
http://www.unglobalcompact.org/docs/issues_doc/supply_chain/SupplyChainRep_spread.pdf.
- ¹⁸ For further guidance on grievance mechanisms as a tool to track and prevent adverse human rights impact, see resources on the Global Compact's website here:
http://www.unglobalcompact.org/Issues/human_rights/guidance_material_continued.html#grievance
- ¹⁹ "Coca-Cola 2011/2012 Sustainability Report". *Coca-Cola*. November 2012.
<<http://www.coca-colacompany.com/sustainabilityreport/performance-highlights.html#section-activehealthyliving>>.
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- ²⁰ See http://www.unglobalcompact.org/Issues/financial_markets/esg_investor_briefings.html
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