Is Sustainability Sustainable?

by Robert L. Burrus

Over the last decade, and especially in the last five years, more and more of America's largest companies have invested in Sustainability practices, usually as Corporate Social Responsibility programs.

They appear to be based on three premises:

1) Response to or anticipation of regulatory requirements;
2) Attention to certain shareholders who are very focused in this area; and
3) Recognizing opportunities for profit and to build brand loyalty.

"Sustainable development" was defined recently in a KMPG report as "achieving robust economic growth and vitality in a way that does not hinder future generations from realizing these same goals." Corporate social responsibility programs focus three factors: social, environmental and financial.

Nearly 80 percent of the world's largest companies now publish corporate social responsibility reports. Some embrace these programs view them as an "urgent aspiration."

This urgency reflects the growing concern as to the best ways to address climate change. CERES (Series) is an influential U.S. network of investors, environmentalists and other public interest groups. It calls climate change "the biggest, most pressing global sustainability challenge we face."

We don't fully understand the future impact of climate change, but there is a growing consensus among scientists, policy makers <u>and</u> business leaders that concerted action is needed to address greenhouse gas emissions.

KMPG reports that 44 percent of the 250 largest companies, especially those based in other countries, are concerned about long-term risks, including: extreme weather; changing agricultural patterns; flooding; and ecology and biodiversity change. Many global companies have started to focus on ways to mitigate the risks and increase opportunities in a carbon-constrained world.

Climate change is firmly on political, investor and consumer agendas. The potential legislation to combat climate change, especially now with a new Congress and new president, may be costly to implement – an incentive for companies to find solutions themselves.

In this time when many feel urgent action is needed, there is also opportunity. CERES predicts "The next 50 years will require a massive shift to cleaner energy sources and technologies to avoid unmanageable climate disruption…(making) climate change is the biggest economic opportunity of the 21st century."

Increasingly business leaders also are embracing the social investments of Corporate Social Responsibility programs. Some companies view these programs as risk management. Others as sophisticated public relations which enhance their brand. Examples abound.

In the aftermath of Hurricane Katrina, Wal-Mart reached out to help the hurricane victims, and in doing so, showed the retailer's extraordinary logistical ability to deliver products quickly to serve customers and communities.

You may recall that Nike received much negative publicity for the working conditions of its overseas factories. In 2005, it issued a corporate social responsibility report that included a first-in-the-industry disclosure on the names and locations of its 700-plus contract factories. It also outlined its programs for monitoring these factories to ensure they comply with worker protection, health, safety and environmental standards. Both industry watchdogs and investors responded positively -- saying Nike's transparency enhanced its reputation.

With the current recession underway, are companies going to continue investing in sustainable development? Should corporations continue to invest in energy-saving technologies and embrace social causes at a time when consumers are cutting back, credit markets are shrinking, and businesses of all sizes are viewing sustainability as weathering the economic storm to ***sustain themselves*** for the long-term? *Does investing in sustainable development make good business sense? Is sustainability sustainable?*

As a director and as a lawyer who advises many companies, (including some struggling to remain afloat in the current economic crisis), I firmly believe that if a corporate investment does not add to a company's long-term, sustainable value, the investment should be closely questioned by senior management. As Milton Friedman said three decades ago, "the social responsibility of business is to increase its profits."

Earlier this year, *The Economist* had a special report that looked at whether corporate social responsibility programs add value. One article pointed out that executives' jobs were to make money for shareholders – not to spend profits made on social causes.

Some shareholders agree with this view, and carry it further. They demand short-term results, and have little patience for investments where companies either don't see a return for many years…or, in the case of some social philanthropic programs, the return on investment cannot be measured easily.

But there is another type of activist shareholder, such as the investor members of CERES. These include state treasurers, state and city comptrollers, public pension funds, investment firms, religious groups, labor unions, and foundations. These investors are very focused on the environment, social and corporate governance issues that most corporate social responsibility reports detail.

In April of this year, CERES published "A Practical Toolkit for Investors" seeking to address climate risks and opportunities. In it, CERES urges investors to create a climate change statement, including references to climate science and climate risks and opportunities. CERES also suggests investors adopt a portfolio climate risk policy.

Environmental activist investors also are engaging more and more with companies directly, using dialogs with boards and executives to raise the awareness of climate risk issues, explain shareholder concerns and encourage improvements in corporate actions and disclosures.

If such dialogs are rejected or unsuccessful, some investors now file shareholder resolutions to address issues concerning climate governance, disclosure and other actions. Investors concerned about sustainability issues also are developing proxy voting policy statements and guidelines. In April 2008, investors filed a record 55 climate-related resolutions, up from 43 the previous year, and negotiated 24 withdrawals. Many of these resolutions called for companies to produce reports on what they are doing to assess the impact of climate change on the company or what actions they are taking to reduce environmentally harmful emissions.

These activist investors also are seeking to engage the SEC. In 2007, a coalition of state pension plans and institutional investors, who control one-point-five trillion dollars in assets, petitioned the SEC to publish a rule to force companies to disclose a great range of climate-related risks. Environmentally focused investors also are asking the SEC to protect shareholders' right-to-vote on resolutions related to climate change and to enforce existing rules requiring disclosure of material risks.

Environmentally focused investors also are lobbying lawmakers to enact legislation to slow the pollution which is linked to climate change. They lobbied Congress to make a mandatory policy to contain and reduce greenhouse gas emissions, with long-term cuts of 60-to-90 percent **BELOW** 1990 levels by 2050. They also asked for Congress to push the SEC into requiring climate risk disclosure.

Is all of the asked-for disclosure good for your company? Some studies have shown that companies recognized for good corporate governance don't necessarily have good stock performance. Analysts for Goldman Sachs are looking beyond just the numbers, and say, "There is no evidence that Environmental Social Governance or socially responsible investing add value," but Goldman Sachs determined that ESG analysis is a "good overall proxy for the management of companies relative to their peers," and therefore a good Environmental Social Governance program is indicative of a company's overall success.

My advice is that when making decisions regarding how your company invests in such programs and how much it wants to disclose about this activity, a key deciding factor must be to look at your company's long-term financial sustainability. In short, how are the steps you are considering going to add to your company's bottom line? Another consideration with the growing sustainability concerns is to ask if your company is positioned to realize new opportunities for profits?

Forward-looking investors are creating strategies that include investments in clean, climate-friendly technologies – such as energy efficiency and renewable energy. One example is CalPERS, which since early 2007, has committed $600 million to a portfolio of clean-technology investments.

Private equity investors also are investing in clean technology. In May, 2007, Citigroup committed to more than two billion dollars of private equity over the next ten years in areas such as renewable and alternative energy, clean technologies, energy efficiency, carbon credit markets, waste and water management and sustainable forestry. Several hedge funds are launching climate change funds as well.

A McKinsey Global Institute report released earlier this year speculates that major investments over the next decade in energy productivity may earn double-digit rates of return for investors, while cutting global energy demand growth by at least half, and achieving up to half of the reductions of greenhouse gas emissions that climate experts say are required to prevent the earth's mean temperature from increasing by more than two degrees.

Social Responsibility Investing also is on the rise. In 2005, it accounted for about more than two trillion dollars in assets in the U.S. One high-profile SRI investment firm is Generation Investment Management, started four years ago by Al Gore and former Goldman Sachs Asset Management CEO David Blood. Its investment approach is based on the idea that sustainability factors—economic, environmental, social and governance criteria—will drive a company's returns over the long term. In yesterday's *Wall Street Journal*, the former Vice President and Blood published an editorial, in which they blame the current financial crisis on "short-termism," citing, among other factors, the intense focus on quarterly earnings. They wrote that the current financial ills reinforced their view that "sustainable development will be the primary driver of economic and industrial change over the next 25 years."

Making sound decisions tied to sustainable development can benefit your company in many ways. I have been a director on the board of Smithfield Foods, the world's largest producer of processed meats, for twelve years. A decade ago Smithfield's waste practices generated one of the largest fines in EPA history. Both from a risk management view point and to protect its brand image, the company changed its practices, implementing several new programs to reduce pollution.

These steps, along with investments in areas of social benefits, helped Smithfield be recognized by *Fortune* magazine for the last six years as "One of America's Most Admired Companies." In recent years, Smithfield also has received the Governor's Excellence Award in Virginia, Wisconsin and Iowa. It received the Illinois Governor's Pollution Prevention Award. These awards enhance Smithfield's reputation, and Smithfield's focus on environmental protection makes good business sense.

From 2006 through this year, Smithfield has invested 27 million dollars in one-time capital expenses that generate environmental benefits. The annual savings of these investments is more than 30 million dollars. So, not only is there an immediate cost savings, over the next decade, that initial 27 million dollar investment will save Smithfield more than 300 million dollars.

Other companies have found similar economic benefits. In the late 1990s, FedEx Kinko's created an environmental mission statement after many of its stores on college campuses reported a demand for environmentally sustainable practices. Since then, about 30 percent of its stores use renewable energy…so when energy prices soared last year, FedEx Kinko's was much better positioned than it would have been a decade earlier to absorb the increase.

Companies may benefit through sustainability programs in other ways. In 2005, two Harvard researchers conducted an experiment on two sets of towels. One set had a label that explained they were "made under fair labor conditions, in a safe and healthy working environment." The other set had no such label. No matter which set of towels carried the special label, that towel's sales increased…even when the price was raised.

Believing that consumers want environmentally or socially friendly products is behind GE's "Ecomagination" line of products and services – which range from light bulbs to gas turbines to jet engines. By 2010, GE expects revenues from Ecomangination products to be at least 20 billion dollars. The demand for these products is high. GE is sold out of eco-certified products until 2009 and its wind turbine is sold out until 2010.

McDonald's is another large corporation that actively is differentiating itself from other fast-food chains by developing strong corporate social responsibility practices. Part of McDonald's focus has been to implement a Supplier Code of Conduct to ensure safe work environments, fair compensation and responsible work conditions for employees. It's telling its suppliers that they must adhere to a stringent set of expectations, as does Wal-Mart.

Bids from these industry giants now ask potential suppliers to detail the elements of their sustainability programs. In fact, more and more CSR programs are incorporating measurements into their supply chains.

It can pay off to develop a corporate responsibility program before your customers demand it. When McDonald's and Wal-Mart asked its suppliers to provide information on sustainability programs, Smithfield was able to provide its CSR report and other information on the company's environment, community affairs, animal welfare, employee safety and food safety practices. As a result of its efforts, Smithfield recently was recognized by McDonald's for having the best corporate social responsibility program of any of McDonald's suppliers.

In *The Economist's* report from January of this year on corporate social responsibility programs, they conclude there are a "handful of leaders in corporate responsibility programs, a large number of followers and many laggards."

The corporate leaders typically have a CEO who embraces the policy, a chief officer responsible for implementing the program, who reports to the CEO, and a cross-functional board committee to ensure that the sustainability strategy is coordinated throughout the company. Thoughtful companies choose from the wide array of corporate social responsibility activities on the horizon, and focus on those that help it keep or enhance its market position.

The followers may talk the talk and produce the glossy report, but they do not have the mechanisms in place to measure the effectiveness of their programs. These companies view corporate social responsibility as public relations and treat it as a second-tier activity.

The Economist calls companies that are ignoring corporate social responsibility as "laggards" and warns this attitude could be increasingly risky in the future.

It is interesting to note that this is a 180-degree turn for *The Economist,* since three years earlier, it considered corporate social responsibility as a fad that will not last. Today the magazine calls these programs "enlightened self interest."

Over time, well-designed corporate social responsibility programs should help sustain profits for shareholders. It involves taking care of a company's reputation, managing its risks, and gaining a competitive edge. In doing so, a company should never lose sight of using good business sense when making CSR decisions. A strong commitment to corporate social responsibility and strong commercial competence gives companies a good chance of success. In short, a good sustainability program makes a company sustainable in the long term.