



# Economic Sustainability The business of staying in business

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March 2001

## Acknowledgements

The authors thank Mark Watson, Mark Bartell, Sara Murphy and Mike Pierce, Linda Bishop, Paul Monaghan, Mike Barry, Jayn Harding, James Farrar, and all SIGMA project partners on both the research and corporate sides, plus attendees at various workshops, and colleagues and former colleagues at NEF. Also thanks to Alison Reed, Mike Crompton and the other finance people who gave us their time even though they really were not sure what this was all about. All errors are our own, though.



## Executive Summary

Although sustainability is now generally understood to be a combination of environmental, social and economic performance, this report finds that economic sustainability is the most elusive component of the triple bottom line approach. There is not even universal consensus that businesses should be economically sustainable, though most concur that sustainability is desirable to prevent the devastating and inefficient impacts of corporate premature death.

Finding out how businesses actually stay in business is a different and altogether more difficult matter. It is the obvious case that most businesses most of the time manage their economic performance pretty effectively – so why ask how they do it. Despite the excrescence of management handbooks purporting to share the secrets of highly effective business people, it is also the fact that few successful business strategists are willing to share their techniques – for obvious reasons.

There are surprisingly few tried, tested, accepted, available and affordable management tools and systems for use by the evolving 'economic sustainability manager'. Furthermore, there is evidence that this role spread between varied functions, such as finance teams, investor relations, strategy units, brand managers, corporate communications, risk assessment, the board, human resources (HR), and information technology (IT). This mixture of roles and their fragmented application to sustainable development creates the impression of being haphazard.

Innovative concepts such as intellectual capital, as well as interesting techniques including brand valuation, are beginning to make some inroads into this confusing terrain. Managing 'sustainability' – whether the starting point is economic, social or environmental – can help many organisations escape from what they themselves consider as a highly constrained approach based on short-term aims, growth, sales and profits. The alternative is a more strategic environment that enables steady organic growth, a planned accumulation and distribution of increasingly intangible assets, and prudent management of risks and opportunities.

The key findings are:

- Σ Most existing 'sustainability' management tools and systems are mainly written by environmentalists and social scientists. Some do refer to economic sustainability but are so sketchy that they would be inadequate for actually managing a real business.
- Σ Fortunately, though, they are not really aimed at economic sustainability managers (ESMs), who instead have a relatively well-known (if limited and creaky) set of financial indicators to rely on. These are historical and focus mainly on turnover, profit, and for PLCs, market capitalisation and earnings per share.
- Σ Unfortunately, in a harsh climate where corporate actions and investor expectations are at an all-time high, companies that manage financial performance using only these narrow indicators risk premature death.
- Σ No amount of excellent social and environmental performance will prolong the life of a company that is economically unsustainable, nor are green and community values necessarily good gauges for longevity.
- Σ A broader perspective on how to manage economic performance is emerging, based around brand, intangible assets, reputation, full cost accounting, ability to add value and the management of knowledge.
- Σ It is still early days for the developers and promoters of workable management techniques, with technical, commercial confidentiality and political obstacles to overcome.
- Σ Most approaches are still considered to be dark arts, not hard science, and surprisingly few companies even value their brand.
- Σ The strategic import of environmental and social sustainability activities are rarely adequately explained to economic decision-makers or the City.
- Σ Nor is it always easy for sustainability managers to influence the full strategic commercial realities in which they are operating.
- Σ Probably as a result of this, there is quite a lot of enthusiasm for more guidelines on economic sustainability, almost as much as there is scepticism about whether that will be possible.

To assist in the development of useful guidelines, the following tentative recommendations can be offered for what the guidelines could cover:

- Σ Enabling ESMs to address the need for broader financial and economic measures beyond the profit and loss accounts as well as balance sheet, and the interdependence of the organisation with its local, national and global economies.
- Σ Ensuring that organisational design actively promotes cross-learning and joint-working among various sustainability teams.
- Σ Encouraging ESMs to be the first to attempt, crudely if necessary, at measuring intangible assets, full-cost accounting or even an economic sustainability index.
- Σ Encourage ESMs to bring these issues - as well as a broader approach to assets - to the attention of all decision-makers in the organisation.
- Σ Identifying ways to manage all significant factors affecting the performance of the management measure(s).

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# 1.0

## Introduction and Background



## 1.1

### Introduction

Economics is a tricky science as well as a dismal one. For every theory about economics, there is another theory that counters it. Although economics is largely about how we allocate resources to meet human welfare needs, economists rarely agree with one another regarding how to achieve the most optimal use of scarce resources. Many contribute to the practice of ensuring economics remains a complicated science - making things somewhat obscure for the average person, from the use of language and jargon to complicated econometrics modelling.

Yet still, with many great minds applied to the science, we have yet to arrive at a full understanding of how to tackle global poverty and ensure growth at the same time. To further complicate the matter, we are now trying to achieve economic growth while protecting the environment at the same time. In recent years, there has been a convergence of opinion around the globe within business and government circles that the market is the best way to manage economies whereby financial success (narrowly defined as profit), continues to be the single most important motivator.

This paper is partially about understanding how businesses can reconcile the need to be environmentally and socially sustainable with the demands of a market-based system, whose key measurements of success are growth and profit. The patron saint of economics, Adam Smith, once asked the question: "how does a market society prevent self-interested, profit-hungry individuals from holding up their fellow citizens for ransom?" Smith's theory assumed that perfect balance would arrive between supply and demand, and that the pressures of the marketplace would inexorably direct the selfish activities of individuals by an "invisible hand", resulting in producing only those goods that society needs. Simple? If only.

Smith was writing some three hundred years ago, and he had no idea of the challenges that were to come. The natural system that Smith would have assumed as infinite would become severely at risk. Smith's perfect market society would now be holding the environment and our social systems for ransom.

Unfortunately, in spite of the change of context, we still more or less manage the economy as he had foreseen. And the problem with sustainability, it seems, is that it turns the traditional idea of economics on its head. Why? Because preserving the environment in a sustainable way does not necessarily square with the profit incentives that the market has to offer. Consequently, many companies succeed by doing nothing at all to manage their environment or social activities; others even survive by doing harm.

There are some moves to try and prove otherwise: this effort is centred on developing the "business case" to sustainability. Many argue that good environmental management will save money; that managing stakeholder accountability will ensure you're more in tune with your business; and that implementing positive social programs, from community development activities to better labour standards for workers mean that your company will see benefits to the bottom line. But is this assumption accurate? In fact, the jury is still out. Some of the pressures of short-term survival, demanded by the City (and even from Grant-making institutions or public funders for other sectors) may mean that all the good from sustainability programmes never even come to fruition.

## 1.1

Sustainability is about long-term survival; environmentally, socially and economically. Sustainability managers need to understand more thoroughly what makes business survive; what finance directors need to know and what other things they need to consider so that when a company sees things falling, sustainability programmes do not fall by the wayside.

This paper looks at the economic sustainability of organisations in the context of sustainability management. It aims to put forward an understanding of how business ticks and what business contributes to the wider economy, if challenged to do so. Sustainability, for the time being, is only one option for most organisations – it is not imperative for short-term organisational survival. But it may just be the key to long-term staying power. Those organisations that opt for the sustainability route may in fact be the ones that are best positioned to survive, both for their own benefit, and for the well-being of society as a whole.

# 1.2

## Background and objectives

The SIGMA Project aims are "to build the capacity of organisations to meet their business and other institutional objectives by more effectively addressing social, environmental and economic dilemmas, threats and opportunities." The project hopes to achieve this by developing integrated guidelines for managing this 'triple bottom line' or indeed 'sustainability'.

Phase I of the SIGMA project was completed in Spring 2000 and identified six themes for further research in a second phase. These themes were identified as: 1) linkages and integration; 2) economic sustainability; 3) environmental sustainability; 4) social sustainability; 5) supply chain management and evaluation; and 6) innovation, learning and culture change. Phase II aimed to undertake practical research into each of these components, as the basis for developing a fully integrated system to help organisations understand and manage sustainability.

The New Economics Foundation was commissioned by the SIGMA project to address theme two – economic sustainability. The aim of the research was:

*"to explore the economic aspects of sustainability, to come to a more thorough understanding of its implications for sustainability as a whole, and to identify ways to capture these within a management system framework."*

2.0

Methodology



## 2.1

### Methodology

The research involved the following activities, completed between Autumn and Winter 2000/2001:

- Σ literature review of existing approaches to economic sustainability;
- Σ survey of SIGMA organisational partners;
- Σ interviews with organisational partners;
- Σ R&D workshops with other research teams and organisational partners;
- Σ analysis of the findings and recommendations;
- Σ peer review process.

## 2.2

### Assumptions

Some assumptions have been made as part of the research project:

- Σ Economic sustainability is best considered in the wider context of environmental or social sustainability, but it means something in its own right and can be defined.
- Σ Most companies are concerned not only with their immediate financial performance, but with their ability to continue long into the future being a player able to make positive contributions to their local community, broader society and planet as a whole.
- Σ It is desirable for individual companies – on the whole - to live out their natural lives in a dynamic but stable environment, so that their planned social, economic and environmental activities can reach fruition.
- Σ Despite the enormity of some of the challenges (eg global warming), it is actually easier to demarcate, understand and start to manage the environmental component of sustainability than it is to work in the grey area that is social and economic sustainability.

## 2.0

### Outputs

This report encompasses the two key outputs for the research stream:

- Σ a summary report with an overview of findings from the desk research, literature review and inputs from those interviewed; and
- Σ recommendations for SIGMA guidelines, including ways of identifying, measuring and communicating the economic benefits of sustainability;
- Σ how to incorporate these into an overall management system framework, and;
- Σ how to manage economic risk as it relates to sustainability management.

## 3.0

### Understanding Economic Sustainability

This research paper is concerned with economic sustainability – which at its simplest can be interpreted as how companies stay in business. It is clearly important to situate this within the general framework for sustainability, though. Sustainability refers to the notion that anything that can go on being done on an indefinite basis is sustainable; anything that cannot is unsustainable. By common consensus, sustainability is thought to have an economic, a social and an environmental component. All three overlap, and they interact.

This paper assumes that economic sustainability is integrally linked to the environmental and social outcomes an organisation achieves. And while good financial and broader economic performance might mean that companies survive in the short-term, it does not necessarily secure a long-term economic future, nor does it guarantee positive environmental or social outcomes. If the predictions about sustainable development are accurate, neglecting the environment and social issues may be a barrier to long-term survival at both the micro or macro level. Consequently, those companies that can effectively manage their environment and the social will also help make themselves economically sustainable.

The working definition for the SIGMA project sees "sustainable development as a dynamic process that enables all people to realise their potential and to improve their quality of life in ways that simultaneously protect and enhance the Earth's life support systems." This definition is underpinned by several principles outlined in the Natural Step, whereby:

In a sustainable society nature is not subject to systematically increasing:

- ∑ concentrations of substances extracted from the earth's crust;
- ∑ concentrations of substances produced by society;
- ∑ degradation by physical means, and that;
- ∑ in society, human needs are met world-wide.

## 3.0

The social conditions for sustainability are:

- Σ organisations practice stakeholder dialogue and accountability, recognising the needs and values of stakeholders, and
- Σ acceptable social, economic and environmental impacts are stakeholder defined and equitable.

However, economics is traditionally about how we allocate scarce resources. Economic sustainability, then, might be better described as the process of allocating and protecting scarce resources, while ensuring positive social and environmental outcomes.

The remainder of this report expands on the understanding of what economic sustainability means, why it is important and how it should be considered as part of an overall management system tool for sustainability.

## 3.1

### What is Economic Sustainability?

#### BOX 1 : DEFINITIONS OF ECONOMIC SUSTAINABILITY

*"Tomorrow's Company uses its stated purpose and values, and its understanding of the importance of each relationship, to generate its own success model from which it can generate a meaningful framework of performance measurement"*

RSA Inquiry Tomorrow's Company

*"The business of business is business"*

Milton Friedman

*"Economic growth can and should occur without damaging the social fabric of a community or harming the environment".<sup>2</sup>*

US President's Council on Sustainable Development

*"The criteria by how a pound of profit is made is a building block in the creation of a just capitalism; progressive profitability must replace simple financial profitability as the sole yardstick of business success".*

Will Hutton, Putting Back the P in PLC, January 2001

*"A brand is sustainable when your customers are going to increase in number or spend more."*

Food retailing company, February 2001

*"Economic systems support sustainable social and environmental outcomes, where economics is the process through which humans create social and environmental outcomes."<sup>6</sup>*

Adding Values, Chris Tuppen and Simon Zadek, 2001

*"Optimum utilisation of tangible and intangible assets"*

Transportation company, SIGMA workshop participant, January 2001

*"Maintaining high and stable levels of economic growth is one of the key objectives of sustainable development. Abandoning economic growth is not an option. But sustainable development is more than just economic growth. The quality of growth matters as well as the quantity."*

UK Government Annual Report 2000, January 2001

*"The value you add to the society you work in"*

Financial services company, SIGMA workshop participant, January 2001

*[Socio-economic development is] "the degree to which a company actively and constructively uses its resources to support the social and economic development of communities, through direct investments of cash, in-kind support or staff time, or through company policies that generate community capital, such as local sourcing, hiring, partnerships and education"*

Buried Treasure, SustainAbility, 2001

## 3.1

Research into environmental and social sustainability is somewhat further along than research on economic sustainability. A literature review revealed few direct discussions on economic sustainability within the context of sustainable development, as highlighted above by the many definitions it is possible to glean.

In fact economic sustainability is the paradoxical golden child of sustainability: if organisations or countries understood perfectly well what it meant to be economically sustainable, there would be full employment, less poverty and no bankruptcies. Unfortunately, that is not the case: economic sustainability is a complex picture, the nature of which cannot be fully understood without looking at both the internal and external environment in which organisations are operating.

The UK Government's stated sustainability policy is "high and stable levels of economic growth", with a target measured by GDP growth of 2.25-2.5%<sup>4</sup> a year. But beyond this headline indicator, a sustainable economy is better understood through a wide range of well-known indicators, such as investment, interest rates, productivity, housing starts, mortgage lending activity and labour market and employment statistics.

The interactions between these are supposed to tell us how well things are going and point to whether or not current levels of economic activity are "sustainable". If the economy heats up too much, a government or central bank might increase interest rates; or do just the opposite to kick-start something that is slow moving. The generally accepted premise is that there is a careful balance of actions that must be taken in order to manage the economy: from adjusting interest rates or monitoring expenditure on social programs to changing rates of taxation. Precisely what that balance is, on the other hand, is fiercely contested.

At the organisational level, things can also look pretty straightforward. A major industrial company with a turnover of £100 billion a year might say the City demands that it grow sales at 5% a year (twice the speed on the UK economy). If its main market is fairly static, it might be looking for half a dozen new business ideas each capable of delivering £1 billion in sales. If it can do this profitably year on year, it can stay in business - and so is sustaining itself.

In practice, there are numerous other measures that point to a successful organisation. Investors look not only at the bottom line, but at the management systems, risk profile, intellectual property or future potential as a way to measure and value corporate performance. The financial bottom line is the obvious indicator: the others are not quite as clear or refined. "The economic and financial are simply not equivalent", say Chris Tuppen and Simon Zadek. "The financial concerns the market valuation of transactions that pass through a company's books. The economic, on the other hand, extends beyond the boundaries of the single organisation and takes into account activities in, and outcomes for, societies at large".<sup>5</sup>

## 3.1

In the literature, there are two ways to approach economic sustainability. The first starts with how organisations stay in business and approaches the issue from the inside. The second looks first at the economic impacts an organisation has on society – the outside or stakeholder view.

Economic sustainability forces us to look on the internal and external implications of sustainability management. This means that managing economic sustainability must consider:

- Σ the financial performance of a company;
- Σ how the company manages intangible assets;
- Σ its influence on the wider economy; and
- Σ how it influences and manages social and environmental impacts.

The next section explores, in greater depth, the two approaches. The inside view looks at the issues of corporate turnover and brand reputation and considers these to be at the heart of economic sustainability. It does not necessarily tell the whole story – but it does tell an important part of it – an issue now lacking in most sustainability management tools. Later we deal with the wider economic impacts a company has on society and how that, too, is important for a company to remain in business and for managing sustainability as a whole.

## 3.2

### Here today, gone tomorrow: the sustainable company seen from the inside

Why is economic sustainability important? For social and environmental purists, the only companies worth having around are the "goodies" - those who manage the environment responsibly and those that provide positive socio-economic benefits to the communities in which they're operating. In a sustainable economy, only the best should and will survive. They're the companies who put social and environmental sustainability at the centre, while still remaining profitable. The others can go to the wall for all the 'deep green' movement cares, especially if they are a much-demonised multinational.

At the same time, the modern corporate form is also coming under harsh criticism from radical business writers like Ralph Nader and David Korten in the US, and Will Hutton and Roger Cowe in the UK<sup>6</sup>, calling for stakeholding by regulation and dissatisfied with the modest scope and speed of the Company Law Reform and its equivalents. Such writers are responding to a public which seemingly cannot get enough stories of blundering mismanagement, super-normal profits, so-called 'fat cats' and branch-closing callousness.

In fact, the business case for excelling in social and environmental performance is still not compelling enough for many businesses, and companies as we currently know them will be around for some time yet, as major employers and economic mainstays. Sustainability is about managing a company in such a way as to ensure it stays around for future generations with social and environmental programs firmly in tact.

An understanding of what makes companies survive will help sustainability managers embed their programmes more effectively. If they are not concerned with whether or not their company can stay in business, all the good green and community work could disappear at the whim of the market.

*"Some companies, like the recently privatised utilities, the oil companies or those who value their reputation with consumers, will often find that behaving well proves to be a win/win outcome", writes Will Hutton. "But others will want the markets to rate their shares as highly as possible so they are the predators rather than the victims in the great game of take-over – and that means a relentless and unambiguous quest for shareholder value that social and environmental responsibility cannot be allowed to obstruct. For them exhortation and the new Operating and Financial Review (OFR) will be little more than good intentions to which they genuflect with little commitment; the real business remains as it was."*

## 3.2

### Survival of the fittest

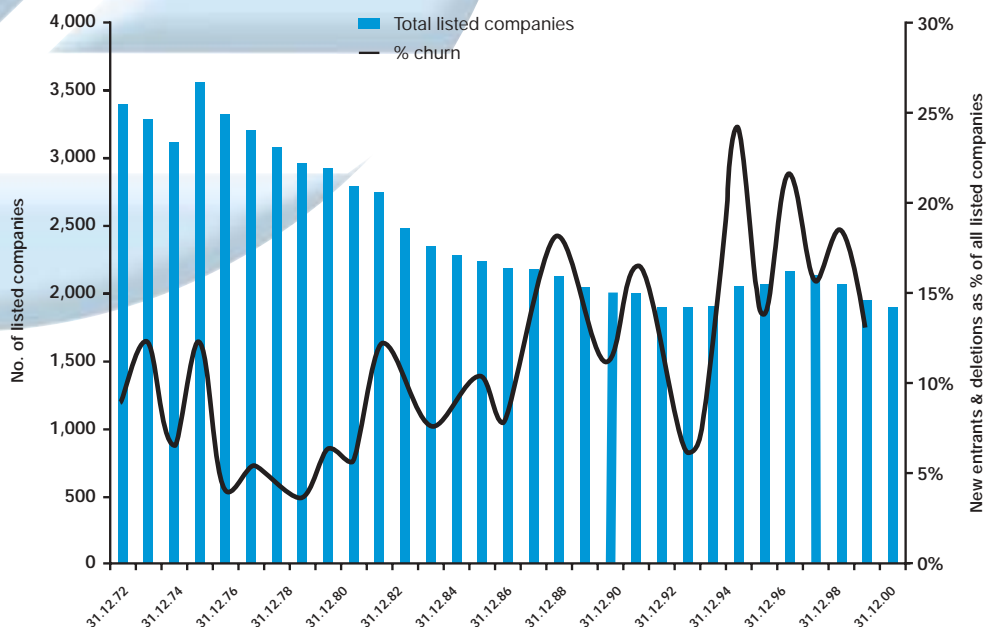
One of the government's key sustainability and quality of life indicators for the UK is average life expectancy. Allied to this is the concept of 'healthy life expectancy' – the number of years out of the total average life that are free from debilitating illness. In the UK, for both men and women, life expectancy is still increasing modestly after some dramatic increases over the last century. The next challenge is to increase the healthiness of that long life.

But what if any is the appropriate life expectancy for a company? Few business analysts these days are sentimental about the demise of companies established in the 19th century, and we have also become used to dotcoms crashing after just a few months of glory. So on the basis of the evidence, what can usefully be said about organisational sustainability?

Analysis of the London Stock Exchange over 30 years shows that the total number of listed companies has fallen steadily from 3,400 to under 2,000, and that 'churn' – the number of new entrants and deletions from the exchange - has risen steadily (see chart below). Running through the list of the original constituents of the FTSE 100 index, launched on 3 January 1984, suggests that only 30% of those companies are still trading in recognisable form in the top 100 today (see appendix). Of the 11 companies named as Britain's most profitable by Management Today between 1979 and 1990, four subsequently collapsed.<sup>7</sup>

Business life expectancy, like human life expectancy, may be partly cultural: German and Japanese stakeholders arguably prefer their corporations longer-lived, while the US may be even less sentimental than the UK. After mergers, acquisitions and bankruptcies, almost 40% of a selection of US companies dubbed "built to last" in a 1994 survey were not around five years later.<sup>8</sup> But there is a growing feeling in most countries that life expectancy is decreasing. The chart below shows that this feeling, in the UK at least, is accurate.

FIGURE 1: CONCENTRATION AND CHURN ON THE LONDON STOCK EXCHANGE



Source: NEF analysis of LSE statistics

## 3.2

This churn is driven by the rapid pace of company 'actions' (mergers, acquisitions, demergers, bankruptcies, delisting and share price collapses). And the pace seems to be accelerating. Mark Makepeace, chief executive at FTSE, confirms the view that things are getting tougher: "FTSE indices, including the FTSE 100, have seen an unprecedented number of constituent changes throughout 2000. This volatility is simply a reflection of the underlying market activity."<sup>9</sup>

There is nothing inherently unsustainable about 'churn'. On the contrary, low churn can be a clear indication of economic stagnation and the development of potential monopolies. But high levels of churn may indicate that companies are dying prematurely. The serious negative impacts on society of sudden mass lay-offs and overnight collapse of tangible and intangible assets are well-documented. Controversy has surrounded recent plant closures by Rover at Longbridge, Ford in Dagenham and Corus in South Wales. In general, it is hard to argue against the fact that reasonable longevity is desirable: very few organisations in private, public or charitable sectors voluntarily put themselves out of business.

"Competition creates turbulence", says business author David Korten, "Turbulence is embraced as opportunity by speculators, but for those who manage productive enterprises, the resulting uncertainty makes investment planning inherently difficult, disrupts the orderly function of the firm, and can result in serious economic inefficiency."<sup>10</sup> And not just economic inefficiency. Environmental and social innovations are sometimes the baby that gets thrown out with the bath water in a merger, as some observers of the NatWest/Royal Bank of Scotland action accused.<sup>11</sup> Even when no M&A activity is likely to take place, perceived shortcomings in financial performance can lead to inefficient knee-jerk retrenchments. "Short term business pressures," says Jayn Harding, J Sainsbury plc's environment manager, "can hugely dilute long term efforts."

This harsh environment explains why investors are sceptical about historical information in traditional annual reports and why managers insist on seeing a robust business case for any aspect of sustainability other than short-term survival. "When a business person is already over-stretched in meeting the challenges of the complex and highly competitive corporate environment", write John Weiser and Simon Zadek, "it is critical to demonstrate that corporate engagement improves their ability to meet existing objectives. The key is to show not only that it can generate black on the bottom line, but that it does so in strategically important areas of business performance".<sup>12</sup>

The media tends to focus on high-profile corporate actions among the 2,000 listed companies and especially the jockeying for position to get into and stay in the FTSE100. But premature death is also common among SMEs, where inability to access timely and affordable finance is one of the most common cause of death for the UK's 485,000 business failures each year (NEF, 1999). The early years are the most dangerous: government data show that the proportion of VAT registered businesses surviving for three years was 52% in 1994, rising modestly to 61% in 1998. This is a substantial mortality rate.

So what is the appropriate life expectancy for a mature business? 116 years, like Coca-Cola? 75 years, like European humans? 25 years, like Microsoft? There is probably no single 'ripe old age' for businesses, after which they can 'go peacefully in their sleep'. Nor is there likely to be an ideal level of corporate actions on the stock exchange. Even so, there is good evidence for the widespread complaint, even among successful businesses, that life expectancy has become, potentially at least, to quote Thomas Hobbes, "nasty, brutish and short".

### 3.2.3

## 3.2

This explains the attention given to radical ideas like 'A Corp': the US plan of tax breaks for outstanding social and ethical performance, and Roger Cowe's proposals for a mandatory stakeholder council for the FTSE 350.<sup>13</sup> Such councils could make hostile takeovers – one of the least pleasant forms of corporate premature death - extremely difficult. More far-reaching policy to extend corporate lifecycles will depend on companies themselves educating the public, shareholders and each other that full economic benefits can only be shared in a stable environment where planned long-term investments stand a chance of coming to maturity.

### **Short attention spans versus glacial change**

If there is some consensus that the hourly timescale of City investors is too short-term for business sustainability planning, there is much less agreement on the correct decision-making timescale in a business. Sustainability is a dialogue where the clocks of each stakeholder are seldom synchronised. "We used to look at fashions over a 4-6 month cycle," says Mike Barry of Marks and Spencer. "Now we are facing the issue of the loss of all fish stocks in 20 years".

The received wisdom is that The City has a very short attention span and that the company has a longer one. The reality is much more complex, as the table below suggests.

## 3.2

TABLE 1: ILLUSTRATIVE DECISION-MAKING TIMESCALES FOR BUSINESS

Stakeholder	Decision-making timescale	Factors
Shareholders	3 months – 3 years	Depends on portfolio & risk aversion. Many individuals content with ISAs, index trackers or annual whinge at AGM.  Only a quarter of private shareholders read annual report.
Investors/The City	1 hour-1 year	Ultra-rapid reactions to share price & general need to keep portfolio 'fresh' vs. institutional loyalties and innate conservatism of some investors such as pension funds. Venture capitalists can take longer term view, as may ethical pension funds.
Regulators/ watchdogs/	2 – 4 years	Focus on administrative & campaigners govt. cycles. Little in Whitehall happens in less than 2-3 years (eg Company Law Review). Regulators move on every 3-5 years. Campaigns typically last 2-3 years.
Investor relations / managers	1 day – 3 years	Daily contact with key investors. Takes brand years to build a brand, 50 seconds to lose it (eg a failed TV advert).
Finance department	Monthly – quarterly – annual	Part driven by regulatory reporting timescales & financial year. 3 years seen as absolute maximum acceptable investment pay-back time.
Sustainability managers	5 years – 15 years	Many projects cannot pay off inside 5-15 years. "If we went sustainable tomorrow, it would take 10-15 years to make money from it": sustainability manager of a major retailer. But managers have to justify their jobs & some quicker hits may be available (eg waste minimisation; Coop Bank's ethical brand).
Board	1 –10 years	Depends on average length of service. Typically 3-5 years.
Staff	2/3 – 10/15 years	Depends on career aspirations in sector. Average job duration for managers 2-3 years; with one company 3-5 years.
Other stakeholders	1 month to 15 years	Suppliers want payment within 30 days; community projects need funding over years; environmental projects can take 10 years or more to reach fruition.

## 3.2

Working with differing timescales is a fact of life for the economic sustainability manager (ESM). The task is to manage diverse expectations of performance in periods ranging from an 1 hour (imagine a green protest at the AGM) to 10 years (justifying an investment in a new range of energy-efficient chiller units).

### Brand & reputation management

"Machines wear out. Cars rust. People die", said Hector Liang, former chairman of United Biscuits. "But what lives on are the brands".<sup>14</sup> Despite the importance of business-to-business (B2B) commerce, there is no doubting the overall economic importance of brands: the consultancy firm Interbrand estimate that a quarter of the world's financial wealth is tied up in brands, with the top 75 brands worth a combined US\$912 billion in 2000.<sup>15</sup>

Yet reputation – usually epitomised as a brand – is not inherently enduring. It needs careful management. "This takes many years to build up", says Chris Tuppen, Head of Sustainable Development and Corporate Accountability at BT, "but can be dramatically lost overnight".<sup>16</sup> There are many examples of this happening, Ratners being just the most dramatic.

Reputation assurance is sometimes said to be a synonym for spin, but its genuine importance is affirmed by Dr John Browne of PricewaterhouseCoopers. Research "consistently shows that corporate reputation occupies a central position on the strategy radar screens of senior management," according to Browne. "Our experience of working with company boards to meet the good practice guidelines of Turnbull is that boards are at least as concerned with those risks that can damage the business (or even their own personal) reputation as they are with risks that can cause immediate financial loss".<sup>17</sup>

Dr Craig Mackenzie, director of the ethics unit at asset management house Friends Ivory & Sime, emphasises the sensitivity of investors to the risks companies face: "After all, it is their capital that is at stake if things go wrong... At present, however, few companies or investors do much systematically to understand this kind of risk". Many big companies now have a risk manager, although one retailer we spoke to warned that it was not that easy for such a post to integrate itself into the existing decision-making apparatus.

"Conventional measurement, management and quality assurance tools are largely inadequate for assessing and managing risk associated with emerging social and environmental factors that can affect financial performance", says Dr Simon Zadek, chair of the Institute of Social and Ethical AccountAbility. This is why companies are actively "seeking new tools".<sup>18</sup>

These tools tend to be either dialogue based, or measurement based (or, more rarely, both). One type of tool, identified by Zadek, is based on effective stakeholder dialogue, and is covered in detail by the SIGMA research paper on social sustainability. Another type of tool begins with measurement and focuses on intangible assets (such as brand valuation, value enhanced by reputations, and intellectual capital.). It is the latter that is discussed in more detail in the sections below.

## 3.3

### Economic dynamo or bull in a china shop? The sustainable company seen from the outside

The second approach to economic sustainability involves looking at the external economic impacts an organisation has on society – and in turn, seeking to understand how these external impacts might affect the sustainability of the organisation itself.

Business remains the wealth-generating mainstay of developed economies. The question for this paper is: how do organisations individually contribute to a sustainable economy and what factors, signals and actions can help manage this process? Zadek and Tuppen's discussion paper *Adding Values* explores this idea. "The economic and financial are simply not equivalent. The financial concerns the market valuation of transactions that pass through a company's books. The economic, on the other hand, extends beyond the boundaries of the single organisation and takes into account activities in, and outcomes for, societies at large."

Economic impacts might include everything from employment and the obvious benefits that this provides to the payment and economic impacts of suppliers or even the production of certain types of goods and services which have an added 'public good' value: public transport for example. Most organisations are aware that these are benefits for organisations and society at large, but what is the added value in measuring or managing these? And furthermore, what is the contribution to sustainability?

Aside from any altruistic reasons, there are clearly some ways in which an organisation can see direct business benefits by considering its operations in the context of society as a whole. This might include ensuring that there is a sustainable skilled workforce; a continued supply of customers who have sufficient incomes (and trust); and a productive and healthy community in which to continue to do business. Most of these will produce long-term rather than immediate short-term benefits. Businesses who do not look at these issues will be less likely to sustain themselves into the future.

It also might help organisations understand contradictions inherent within current practices. For example, by reporting on public policy as part of economic sustainability management, obvious conflicts may arise. BP found this in the U.S. when it was part of the larger Global Climate Coalition whose sole intent was to stop any international regulation on climate change. So BP and others, such as Shell, quit the group.

## 3.3

TABLE 2: ADDING VALUES: AN APPROACH TO ECONOMIC SUSTAINABILITY

ECONOMIC IMPACT	INDICATORS		EXAMPLE: IMPACT ON WIDER ECONOMY/SOCIETY	
Profit	Levels of profit	Dividends paid	Geographical location and distribution of profit	Benefits the local economy; ensures companies stay in business
Human capital and knowledge (Intangible Assets)	Investment in training	Breakdown of intangible assets	Intellectual property rights and technology transfer business	Builds skilled-labour; benefits general region/community and
Investments	Fixed capital investment	Investment in knowledge	Acquisitions	Provides spin-off economic effects through longer-term investments
Employment (Labour Productivity)	The market value of people's productive capabilities (measured by # of employees, annual wage and salaries bill, etc.			Higher wages contributes to greater economic growth and overall wealth; More efficient use of people's skills produces more efficient outcomes
Community Development	Support for community economic regeneration	Partnerships with core company activities		Strong communities will be more likely to lead to stronger economic participation of its members: this benefits both the organisation and reduces long-term costs for reparative social services, such as welfare, crime, etc.
Outsourcing and procurement; (Suppliers) the way in	Financial spend on out sourcing and procurement			A companies' direct spend on its supply chain has a great influence on economic development and sustainability; which a company does this (i.e. respecting human rights or environment) can have even greater spin-off effects
Goods and Services (Products and Services) produce	Externalised economic effects	Contributions to the wider economy		Some goods and services are more sustainable than others and positive benefits: i.e. a public transportation service not only helps people with community, it contributes to reduced traffic congestion and, in turn, less environmental harm
Public Policy	Financial contributions to political parties	Methods of influencing		Ways in which organisations lobby public policy government can have positive or negative economic affects, for example through privatised utilities; or who bears the cost of climate change

Source: Tuppen & Zadek, 2000

## 3.3

Zadek and Tuppen's paper has gone down quite well as a constructive and semi-operational (the indicators are not fully worked up) attempt to map the confusing terrain. Their perspective on economic sustainability helps organisations understand their contribution to the wider economy and the impacts that business decisions have on it – even though some will dispute their judgement that some of the above areas are economic rather than social (a grey area as we have said, but not necessarily the priority to resolve).

Failure to consider these factors in business decision-making – whether they are considered economic or social - can lead to increases in risk to reputation, as Corus has found in South Wales; Vauxhall Motors at Luton; as M&S discovered in moving to overseas producers; and as several banks have found over large scale branch closures. Economic sustainability is integrally linked with decisions that go well beyond a traditional understanding of the financial bottom line.

In some ways, this is an extension of the Centre for Tomorrow's Company vision of a 'license to operate'. As their initial 1995 report says, "Tomorrow's Company recognises its interdependence with the community in which it operates ... furthermore] it recognises that its long-term future is enhanced by a supportive operating environment and acts, with others where necessary, to strengthen its licence to operate."

Despite the short-term approach the City is accused of taking, investors are more and more also looking at long-term 'shareholder value'. After a brief infatuation with dot.com mania, many investors are returning to stable 'blue-chip' companies - those seen to be there for the long run and which provide reliable added-value to the economy.

This approach, then, can complement the perspective gained by looking at the organisation from the inside. Building reputation and brand value is partially about how the customer or investor perceives you: if companies are seen to be good corporate citizens and contributing to the wider economy, if they remain competitive at the same time, they'll be more likely to be trusted and, as a result, to stay in business.

New Economics Foundation research for ACCA also shows that effective 'social capital' is made up of two equally important types of network: bonding networks within organisations, and bridging networks between organisations.<sup>19</sup> Too much internal bonding without enough external bridging means morale is high but can make a company insular and unresponsive – something the Post Office has been criticised for. Too little bonding but too much bridging – typical among airline pilots and in Silicon Valley - means that professional loyalties come before corporate ones and leads to high staff turnover.

### **Relevance to public sector, SMEs, and b2bs**

There will be a clear distinction between how public sector and private sector partners manage economic sustainability. Public sector partners, such as South-West Regional Development Agency (RDA), report that they had difficulty coming to grips with the standard approaches to economic sustainability: most indicators were either not completely relevant, especially profit or brand value, and needed almost to be turned on their head. For example, labour productivity or the number of employees in the RDA are far less relevant than the number of jobs created in the community directly through its activities. It should also be noted that the language of brand and reputation is confusing if not alienating to some public sector organisations, as well as small businesses and even large ones involved in business-to-business activities where there is no obvious consumer.

# 3.4

## Eight hundred business cases

We have already referred to Weiser and Zadek's effort to provide a definitive answer to the question: is there a business case for sustainability, drawn primarily from the US data and giving cautious and patchy confirmation that the case can sometimes be very strong. UK consultancy SustainAbility has developed a complex and rather beautiful 'Sustainable Business Value Matrix'<sup>20</sup> in a colourful attempt to map ten measures of business success against ten financial drivers and performance measures, to see which have negative and positive impacts on each other. The maths is simple: there are 100 relationships, and for each, eight results are possible, from weak evidence of negative impacts to strong evidence of strong positive impacts. This means the research team's results take a while to penetrate.

The most conclusive business case was the benefits provided by sustainability activities to brand reputation and management; human and intellectual capital was a close second. All in all, the researchers conclude that "the jury is in – overall, corporate sustainable development performance has a positive impact on business success".

# 3.5

## Economic Sustainability: Systems, Methods & Approaches

### **Beyond profit, dividends and capital growth**

According to the Centre for Tomorrow's Company, shareholders concerned about risk management will increasingly demand evidence linking the quality of leadership with the creation of long-term shareholder value. They will want to know about the purpose, values and strategy of the organisation in order to form their judgement of the company's long-term potential (the so-called 'success jigsaw/recipe'). "They know the dividends and capital growth they have received in the past," says Mark Goyder. "What they need is information to guide a judgement on whether they should continue to hold the share in the future".<sup>21</sup> That kind of information is not usually found in the traditional annual report.

Research by consultants Pauffley found that although the report still remains an important tool for 85% of the investment community, there are acknowledged difficulties in using it as a gauge for telling whether a company is likely to survive and thrive. This mean that only half of US investors will now consider a poorly prepared report in order to raise questions about the company's financial position.

## 3.5

TABLE 3: STANDARD FINANCIAL MEASURES

Net Profit Margin	Net profit margin is calculated by net income/sales.
Return On Investment	The latest 12 months' net income divided by the total assets from the most recent quarter, more commonly, return on investment (ROI).
Return on Equity	The latest 12 months' net income divided by the most recent quarter common stock equity.
Pay-out Ratio	The pay-out ratio measures the proportion of earnings that is paid out as dividends.
Dividends	The cash dividends already paid out, or proposed to be paid out, of the current year's profit attributable to the shareholders.
Dividend Yield	The stock's dividend yield is simply the expected dividend as a proportion of the stock price.
Intangible Fixed Assets	The types of intangibles measured and reported most frequently, are: goodwill, patents, licenses, and trade marks, development expenditure, publishing rights and titles, and brands
Tangible Fixed Assets	Physical assets, which are held for long-term within the business including items such as land and buildings (both freehold and leasehold), plant and machinery, motor vehicles, fixtures and fittings.
Current Assets	Assets that are either cash or readily convertible into cash.
Current Liabilities	Include bank overdrafts, proposed dividends and taxation payable within one year, as well as amounts owed to suppliers.
Long-term Liabilities	Long-term liabilities are divided into (1) creditors (amounts falling due after more than one year), and (2) provisions for liabilities and charges.
Market Capitalisation	The number of shares in existence multiplied by the share price.
Book Value	A company's book value is its assets minus its liabilities.

Source: NEF, 2001

The financial indicators (Table 3) in most reports are predominantly retrospective, focussed on profits and dividends, with a tendency to conceal poor performance. Consequently less than half of UK investors say they expect to learn anything useful about assets, strategic direction, management capabilities or prospects for future direction from annual reports.<sup>22</sup> Many investors will admit, off-the-record, to setting no store at all by the mainstream financial indicators reported by companies. While finding them (usually) accurate, such indicators can be unenlightening, if not actually misleading.

According to Simon Zadek and Chris Tuppen, "there are no contemporary examples of companies adopting a systematic approach to accounting for, and reporting, their economic performance, let alone building it explicitly into transparent decision-making processes...".<sup>23</sup> However, there are many finance directors who believe they are doing just that.

### 3.5.2

## 3.5

One crucial paradox in the development of high quality management and measurement systems for economic sustainability is commercial confidentiality. Anyone who had developed an effective management system, it is argued, would sell it to the highest bidding company or, more likely, enter into partnership with a corporate raider.

Yet efforts in 'the public interest' to make any meaningful system mandatory across sectors or countries would immediately reveal the secrets of success of participating firms. This has led some opponents to argue that "the only good management system is a useless one".

### Do management systems cover economic sustainability?

Our research finds that sustainability management systems and codes (Table 4) are fairly weak on economic sustainability and most only pay a modest reference to the idea. Of the ones that do more, they only acknowledge the external impacts of how companies should do business in the communities in which they're operating; few if any pay any attention to the issues of trust and brand value.

The Global Sullivan Principles, for example, refers to two principles that relate explicitly to aspects of economic sustainability:

- Σ "We will compensate our employees and enable them to meet at least their basic needs and provide the opportunity to improve their skill and capability in order to raise their social and economic opportunities."
- Σ "We will work with governments and communities in which we do business to improve the quality of life in those communities – their educational, cultural, economic and social well-being – and seek to provide training and opportunities for workers from disadvantaged backgrounds."

The UN's Global Compact, while not explicitly referring to economic sustainability understands that business must operate in a manner that respects human rights, labour and the environment. The latter three components are outlined in the nine key principles, whereas financial sustainability is assumed as imperative.

**TABLE 4: EXISTING MANAGEMENT SYSTEMS/CODES & ECONOMIC SUSTAINABILITY**

Global Sullivan Principles	Broad set of principles referring to how government should conduct their business; two short references to livelihoods and economic impacts of business on the local community
Global Compact	High level principles generally referring to human rights and environmental standards. Vague link to economic sustainability.
Balanced Score Card	No explicit reference to sustainability, but focus on profitability of a company in relation to other corporate objectives.
The Natural Step	Economic sustainability is part of the fourth system condition. Places environment at the centre and economics as secondary.
Global Reporting Initiative	Set of indicators explicitly on economic sustainability. Similar to "Adding Values" approach, but focus specifically on reporting.

### 3.5.3

Other more detailed sustainability standards only touch on the matter of economic sustainability. The Natural Step, used as an environmental management tool does have a system condition referring to economics. The condition, "we must be fair and efficient in meeting human needs" defines economic conditions for sustainability as:

- ∑ scarce resources are used efficiently;
- ∑ levels of economic activity are stable;
- ∑ scarce resources are effectively used at all scales – from local to global

The Natural Step's approach places the understanding and management of economic sustainability as having an impact on the way we manage the environment, rather than the other way around, ignoring the fact that organisations still have to stay in business to survive.

#### **Managing value added: risk and opportunity**

At heart, these new economic management tools attempt to capture (elements of) potential future economic performance for shareholders and wider stakeholders, beyond the merely retrospective picture offered by profits and dividends. Broadly speaking, the tools tend to focus either on risk (following from Turnbull, using the language of liabilities and often the focus of questionnaires from 'green' investors), or on opportunity (the preserve of entrepreneurial pundits, brand and knowledge managers, using the language of value added and intellectual capital).<sup>24</sup>

According to accountants Philip Wright and Daniel Keegan, "While executives have always needed to forecast the company's future cash flows, this future-orientated information reflecting the financial management and investment policies of the company has not been subject to disclosure requirements, and most companies have chosen to keep such information internal ... In the 1990s a new view of shareholder value is taking root ... and a new type of reporting is emerging. We call it value reporting (VR). In essence VR focuses on long-term cash – i.e. cash that will come through the door at some future date – and other types of performance information that impact shareholder wealth, the company's prospects, and the financial markets' assessment of the company."<sup>25</sup>

But not all companies do have sophisticated and reliable management systems to manage economic performance, even for internal management. This does not just apply to SMEs. A manager from one major retailer described a typical 'long-term growth strategy' as "a four year line on a graph going up like this". Strategic planning departments were trendy in the 1970s but many were axed in the retrenchments of the 1980s and 90s.

Too many companies, according to a critical business press, lurch from crisis to crisis with no apparent strategy. And Simon Zadek and Chris Tuppen write in a recent discussion paper that "even leading edge companies which have publicly embraced the principle of 'triple bottom line' reporting have focused their economic reporting on an ad hoc bundle of performance measures covering profits and growth, dividends and shareholder return, tax, competition and investments." While these tools are no doubt important, say Zadek and Tuppen, they are incomplete, and "may at times even be misleading".

## 3.5

Mark Goyder is not despondent, however: "What every company can do now is to build on its existing operating and financial review to provide a clear picture of the components of the success jigsaw and to show more clearly, year by year, what are the predictive indicators – for example, market share, service levels, and product development. In time more sophisticated measures follow, like customer loyalty and training effectiveness." (Goyder, 1998).

### BOX 2: CENTRE FOR TOMORROW'S COMPANY REPORTING SCORECARD: SUCCESS MODEL AS A BASIS FOR MEASUREMENT

- Σ The report is simply a statement of financial results: there is no picture given of the components of the success jigsaw.
- Σ The report contains fragmentary references to the linkages between the ingredients of success and the financial results.
- Σ The report makes use of a clear model or recipe (whether based on the balanced business scorecard, or business excellence model or a model of its own) in demonstrating linkages between performance in each of its relationships and the financial results.
- Σ As above. Additionally the design of the whole report reflects the underlying success model (for example the four quadrants of the Balanced Business Scorecard).
- Σ As above. Additionally the report uses original and relevant new measures of success such as learning, knowledge management, supplier-relationship measurement and so on.

Source: Centre for Tomorrow's Company, 1998

The Balanced Score Card (BSC) is a measurement and feedback tool that enables organisations to measure business objectives across the whole company. Developed in the early 1990's by Drs. Robert Kaplan (Harvard Business School) and David Norton (Renaissance Solutions, Inc.) the balanced scorecard approach provides a clear prescription as to what companies should measure in order to 'balance' the financial perspective. "The balanced scorecard retains traditional financial measures. But financial measures tell the story of past events, an adequate story for industrial age companies for which investments in long-term capabilities and customer relationships were not critical for success. These financial measures are inadequate, however, for guiding and evaluating the journey that information age companies must make to create future value through investment in customers, suppliers, employees, processes, technology, and innovation."<sup>27</sup>

It does help organisations with priority setting and decision-making. Kevin Moxey of Vauxhall Motors says that the BSC helps organisations identify their impact on the company's objectives, from different levels in the organisation, and as a process it is extremely powerful. However, the primary weakness of the BSC is that it has not been designed around sustainability and only the most enlightened of organisations, with sustainable objectives in mind, will use the BSC for such outcomes.

The Global Reporting Initiative is probably the most thorough existing approach to economic sustainability. The October 2000 guidelines include a series of indicators specifically referring to these. Both the GRI and Tuppen and Zadek's Adding Values have similar approaches to what economic sustainability might be. The following table shows both of these approaches in comparison.

## 3.5

**TABLE 5: COMPARISON OF GLOBAL REPORTING INITIATIVE, & TUPPEN + ZADEK'S ADDING VALUES: APPROACHES TO ECONOMICAL SUSTAINABILITY.**

Factor	GRI Approach	"Adding Values" Zadek and Tuppen)
Profit	<ul style="list-style-type: none"> <li>Σ Net profit/earnings/income</li> <li>Σ Earnings before interest and tax</li> <li>Σ Gross margin</li> <li>Σ Return on average capital employed</li> <li>Σ Dividends</li> </ul>	<ul style="list-style-type: none"> <li>Σ Levels of profit</li> <li>Σ Dividends paid</li> <li>Σ Geographical location and distribution of profit</li> </ul>
Intangible Assets & Investments	<ul style="list-style-type: none"> <li>Σ Ratio of market capitalisation to "book value"</li> <li>Σ Human capital</li> <li>Σ Research and development</li> <li>Σ Other capital investment</li> <li>Σ Debt/equity ratio</li> </ul>	<ul style="list-style-type: none"> <li>Σ Investment in training</li> <li>Σ Breakdown of intangible assets</li> <li>Σ Intellectual property rights and technology transfer</li> <li>Σ Fixed capital investment</li> <li>Σ Investment in knowledge</li> <li>Σ Acquisitions</li> </ul>
Wages and Benefits	<ul style="list-style-type: none"> <li>Σ Total wage expense, by country</li> <li>Σ Total benefits expense, by country</li> </ul>	
Labour Productivity Or Employment	<ul style="list-style-type: none"> <li>Σ Labour productivity levels and changes, by job category</li> </ul>	<ul style="list-style-type: none"> <li>Σ The market value of people's productive capabilities</li> </ul>
Taxes	<ul style="list-style-type: none"> <li>Σ Taxes paid to all taxing authorities</li> </ul>	
Community Development	<ul style="list-style-type: none"> <li>Σ Jobs, by type and country, absolute and net change</li> <li>Σ Philanthropy, charitable donations</li> </ul>	<ul style="list-style-type: none"> <li>Σ Support for community economic regeneration</li> <li>Σ Partnerships with core company activities</li> </ul>
Suppliers	<ul style="list-style-type: none"> <li>Σ Performance of suppliers relative to economic components of programmes and procedures</li> </ul>	
	<ul style="list-style-type: none"> <li>Σ Number and type of incidences of non-compliance with national and int'l standards</li> <li>Σ Nature and location of outsourced operations</li> <li>Σ Value of goods and services outsourced</li> <li>Σ Performance of organisation in honouring contracts with suppliers</li> </ul>	<ul style="list-style-type: none"> <li>Σ Financial spend on out-sourcing and procurement</li> </ul>
Goods and Services	<ul style="list-style-type: none"> <li>Σ Major economic impacts associated with the use of principle products and services, including disposal</li> </ul>	<ul style="list-style-type: none"> <li>Σ Externalised economic effects</li> <li>Σ Contributions to the wider economy</li> </ul>
Public Policy		<ul style="list-style-type: none"> <li>Σ Financial contributions to political parties</li> <li>Σ Methods of influencing public policy</li> </ul>

### 3.5.6

## 3.5

As yet, no company has taken to reporting consistently on all of these areas; and some of the proposed indicators remain methodologically vague. One area where there has been considerable progress is in the treatment of intangible assets.

### Valuing intangible assets

The most widespread attempt to measure intangible assets is brand valuation. Though not yet that well established in UK business, brand valuation is becoming commonplace in the USA. Market leaders Interbrand have undertaken over 2,500 brand valuations in the 13 years since they developed their proprietary methodology. Interbrand starts with the economic profit generated by the brand to the underlying business, a similar concept to economic value added (EVA).

The valuation process examines three areas:

- ∑ the future economic earnings the branded business is expected to generate;
- ∑ the role of the brand in generating those earnings, and;
- ∑ the risk profile of the brand's expected earnings.

One limitation of this and similar external methodologies is that they require sufficient marketing and financial data publicly available in order to prepare a reasonable valuation.

As a result, brands owned by privately held businesses (e.g. Levis, Mars, and Lego) are excluded, as are brands whose businesses are consolidated with other business activities in a way that makes it impossible to separate meaningful brand specific financial information (e.g. CNN and TIME are consolidated with other operations of the TimeWarner Group).

Interbrand's method cannot handle non-profit or public sector brands as they do not generate economic profits in the traditional sense (eg VISA, Red Cross, BBC).

Finally, the method cannot work with brands in categories in which it is difficult to distinguish between brand and other intangibles without detailed inside information (e.g. airlines, pharmaceuticals, businesses with proprietary distribution).

But in a world where North American children can identify over a thousand brands from their logos (though not ten common plants), this still leaves a good number of brands to work on.

"It is clear that global brands are still the main creators of wealth", says Raymond Perrier, Interbrand Managing Director, "and they will continue to drive wealth creation in the foreseeable future. Technological advances, such as the growth of the Internet, will continue to accelerate this globalization trend."

These sorts of brand valuation are not without their critics, who claim that the process is basically inauditable.<sup>28</sup> But at the very least, Interbrand's work shows just how important – and how difficult - brand management actually is. In its eagerly-awaited annual league table, Coca-Cola, while still retaining top place over Microsoft, lost 13% of its estimated brand value last year (a hefty US\$11.3 billion loss).

### 3.5.7

## 3.5

Overall, 42 brands increased their value in 2000 (by an average of US\$2.7billion each), but 12 brands lost an average of US\$1.9 billion each. Only two out of 55 brands experienced stable growth in line with Western economies as a whole (BP and Heineken grew at 3% and 2% respectively). Only one company experienced absolutely no change in its brand value: Moët et Chandon.

Some analysts detect significant structural changes afoot that no one company can manage its way out of. According to brand expert Linda Bishop, older brands may be losing out to newer brands (will Microsoft overtake Coca Cola this year as the world's most valuable brand?). And FT journalist Richard Tomkins thinks consumers in saturated markets may be becoming less brand-conscious in their basic commodities (soft drinks, food), focusing their brand-consciousness instead on more luxury items (designer apparel, electronics). Some commentators note that advertising spending for top brands like McDonalds and Disney has now topped US\$1 billion apiece in the USA and may be levelling off in saturated markets (Klein, 2000).

"Until now, companies such as Coca-Cola, H.J. Heinz and Kellogg had been around so long that their brands looked indestructible", says Tomkins. "[They] seemed destined to command the top slots in the global league table for as long as anyone could foresee. It is still hard to imagine a day when these famous names will cease to dominate the supermarket shelves. But when a brand as powerful as Coca-Cola can lose 13 per cent of its value in just a year, it is possibly time to ask whether the lifespan of these brands is infinite, or something less."<sup>29</sup>

There are eight UK brands in the world top 75. As the table shows, three of these gained in brand value, while three lost an exactly equal amount (in percentage terms). This demonstrates the volatility of brand management.

**TABLE 6: INTERBRAND 2000 BRAND VALUATION: UK COMPANIES**

World Rank	Brand	Brand Value 2000 (\$m)	Brand Value 1999 (\$m)	% change
46	Reuters	4,877	..	..
58	BP	3,067	2,985	3%
60	Shell	2,786	2,681	4%
61	Burger King	2,702	2,806	-4%
62	Smirnoff	2,443	2,313	6%
67	Johnnie Walker	1,541	1,634	-6%
73	Guinness	1,225	1,262	-3%
74	FT	1,149	..	..

Source: www.interbrand.com

The last year has been a tough one for cherished brands like Homebase, Railtrack, Rover, Vauxhall, British Airways, Marks and Spencer, Iceland and a dozen other household names. But several of the companies we interviewed were not engaged in regular brand valuation, and our perception is that brand or reputation management is not yet being taken seriously in the UK.

## 3.5

It would be useful to watch over time how many UK companies are measuring, managing and reporting on intangible assets; as yet there is mixed practice. Technically, companies currently may only report on intangible assets which have been acquired. This leads to a situation where a knowledge economy firm such as KPMG UK reports intangible assets of just £0.9 million in its annual report (representing a sum of £809 per partner and staff member), as compared to tangible assets of £68.2m.<sup>30</sup> It is interesting to note that this is a company which has a joint venture with a consultancy called Intellectual Capital Assets.

For some of the most adventurous experiments in measuring assets, it is necessary to go to Scandinavia, where companies including Skandia and Celemi are pioneers in this field.<sup>31</sup> South African Breweries and a handful of US companies have also made some progress.

One reason for low take-up among the mass of companies is the proprietary nature of the vast majority of most techniques for measuring brand, reputation, intellectual capital and other key components of economic sustainability. The table below lists nine Anglo-Saxon valuation methods. The majority are proprietary. There is a wide variety and costs are high; to date, the uptake has been limited.

**TABLE 7: BRAND/REPUTATION MEASUREMENT SYSTEMS ARE MAINLY PROPRIETARY**

System	Proprietary: Y/N
CoreBrand Analysis*	Y
Corporate Equity Performance System	Y
Corporate Reputation Report	Y
Fortune Most Admired	~
GCI Corporate Brand Study	Y
Global Reporting Initiative	N
Intellectual Capital Services	Y
Interbrand Brand Valuation	Y
Reputation Quotient	N

Source: Weiser & Zadek, 2000; NEF, 2001

The absence of a single approach is also strongly indicated by the obvious fact that investors are usually far from unanimous in their views about any given company's sustainability. Finally, companies that are experimenting internally with techniques have been reluctant to leave their 'safe harbour' and disclose the results due to considerations of commercial or legal confidentiality.

However, it is possible that companies may be making a mistake if they await the perfect, unified decision-making framework of sustainability indicators. Kevin Thompson reports that it is possible and important to make a start with very modest, crude indicators like the so-called K-test for knowledge management introduced by one consultancy: the number of members of new staff and those about to retire as a percentage of the total workforce.<sup>32</sup> Such information is readily manageable.

## 3.5

What would happen if significant numbers of companies started reporting on such sensitive information? When the Accounting Standards Board promoted an operating and financial review that would go beyond platitudes, the Institute of Chartered Accountants of Scotland interviewed FTSE100 finance directors and found no evidence that the OFR was jeopardising commercial confidentiality. And the Global Reporting Initiative is not unique in putting non-mandatory indicators of economic sustainability into the public domain.

"There is considerable pressure building within the Financial Accounting Standards Board (FASB) to develop consistent and universally accepted methods for valuing intangibles, and to require that companies place the value of the intangibles on the balance sheets" (Weiser & Zadek, 2000). Weiser and Zadek also report that there is growing interest within the influential US-based Council of PR Firms for a "universally acceptable standard for valuing reputation".

In the UK, ICAEW's Centre for Business Performance has recently launched a programme on how to measure corporate reputation and other business intangibles. Director Anthony Carey reports "There does seem to be definite interest at a senior level in producing measurements that will not take them a whole year to get through but which will give them some help in assessing how their corporate reputation is affecting their value".<sup>33</sup>

So, despite a fiercely competitive, operating environment focused on short-term aims, and a lack of a universal management system, the progress towards better management tools for economic sustainability has been patchy. A number of observers believe that a practicable standardised approach is not just desirable but imminent. And it should be only a small step from measurement to management.

# 4.0

## Analysis and Commentary: Putting it all together: Insight from SIGMA partners

Companies would not be in business if they did not manage their economic sustainability at all. However, our research found that most companies currently manage it implicitly, rather than explicitly. And our analysis shows that an explicit approach might be the key to long-term survival: from understanding the economic impacts of an organisation on society, to recognising the sustainability links to brand value and reputation. Unfortunately, there is, as yet, no over-arching strategic approach to these factors within sustainability management systems or tools. But there are implicit methods: human resources systems, financial management systems or supply chain organisation. The key will be linking these systems to the bigger sustainability picture.

## 4.1

### First stop: reporting

An initial scan of a sample of SIGMA partners' annual reports shows a mixed approach to reporting on economic sustainability. In all cases, standard financial accounts, human capital investment and charitable donations were reported on. Some reported more widely on their economic contribution through taxation, while fewer reported on their public policy activities and only one included a set of green accounts within the annual reporting framework.

What does this tell us? Not only is there an ad hoc approach to reporting on economic sustainability, most organisations do not attach much importance to some of the wider factors. SIGMA partners generally accept that human capital, philanthropic donations and, of course, profit-based information, are relevant. But in sustainability reports, one rarely finds reference to brand value and intangible assets, let alone reporting on public policy interests.

**TABLE 8: HOW ECONOMIC SUSTAINABILITY FARES IN ANNUAL OR SUSTAINABILITY REPORT**

SIGMA partner	Economic factors reported in sustainability or annual report
Biffa	<ul style="list-style-type: none"> <li>∑ Annual accounts</li> <li>∑ Employee costs</li> <li>∑ Economic issues associated with operations/region</li> <li>∑ Taxes (including environmental tax burden)</li> <li>∑ Supplier non-compliance costs</li> <li>∑ Human capital investment (education &amp; training)</li> </ul>
Vauxhall	<ul style="list-style-type: none"> <li>∑ Annual accounts</li> <li>∑ Wages and benefits</li> <li>∑ Charitable donations</li> <li>∑ Human capital investment</li> <li>∑ Policy on political activity</li> </ul>
M&S	<ul style="list-style-type: none"> <li>∑ Annual accounts</li> <li>∑ Charitable contributions</li> <li>∑ Employment, wages &amp; benefits</li> <li>∑ Taxation</li> <li>∑ Fixed asset investment</li> </ul>
Wessex Water	<ul style="list-style-type: none"> <li>∑ Annual accounts (profits, losses, etc.)</li> <li>∑ Charitable donations</li> <li>∑ Capital investments</li> <li>∑ Human capital (training)</li> <li>∑ Employment, wages and benefits</li> <li>∑ Green accounts</li> </ul>
Rohm & Hass	<ul style="list-style-type: none"> <li>∑ Annual accounts</li> <li>∑ Employment, wages &amp; benefits</li> </ul>
∑	<ul style="list-style-type: none"> <li>Fixed asset investment</li> </ul>

## 4.1

Although not reporting does not necessarily indicate that organisations do not manage these issues, it's the first place where one might get a sense of whether or not there is a strategic approach to economic sustainability: and our first stop, reporting, would indicate otherwise.



## 4.2

### Second stop: Managing

A survey was sent to organisational partners which asked them which aspects of economic sustainability they managed and how. Most respondents argued that their companies did consider most of these issues, but that they weren't part of "sustainability management". The environment was considered by the left hand; financial performance, human resource management or others, with the right. They were just part of the overall day-to-day business of a company, often with 'sustainability' as an add-on.

**TABLE 9: WHO MANAGES WHAT? COMPARING ORGANISATIONAL APPROACHES**

Department	Profit	Intangible Assets	Wages & Benefits	Labour Productivity	Taxes	Community Development	Outsourcing & Procurement	Goods & Services	Public Policy
Finance	7	4	4	1	5		3	1	
Human Resources		4	4	2		2			
Public Affairs						1			2
Procurement							3		
Board									1
Managing Director									2
Environment						1			1
Operations	1		2	2		1	1	2	
Marketing		1				1		1	
Community Affairs						2			
Corporate Comms									1
Supply							1		
Legal		1					1		
R&D		1							
Strategy or Corporate Policy				1					1
Other		1		1		1			

NOTE: from SIGMA survey to organisational partners. Numbers in table refer to numbers of organisations who responded with the relevant department: for example, 7 partners reported that profit is managed by finance; while intangible assets were reported differently by a range of organisations

#### 4.2.1

## 4.2

The "silo-effect" could be one of the primary barriers to economic sustainability. Environment or sustainability departments were never charged with looking at any of the financial indicators; and not one organisation reported that they had a direct role in outsourcing and procurement. Public policy decisions were considered by no less than six different departments in eight organisations. And only one of these departments was charged with sustainability management. The finance department, on the other hand, was responsible for most of the key decisions and indicators on economic sustainability. They would seem to be, then, the heart of sustainability decision-making, but no SIGMA organisations considered them as such.

However, there were some exceptions to the rule. Organisations involved directly in providing goods and services that had obvious environmental impacts: waste management or water, for example, were more in tune with economic sustainability management. Biffa Waste Systems reported that they were always considering economics in their environmental sustainability system, from including the cost of carbon emissions on an invoice; to considering the potential value-added of their service to GDP. Wessex Water includes a set of Green Accounts and is aiming to embed sustainability management within each department in its organisation.

### BOX 3: ECONOMIC SUSTAINABILITY DECISION-MAKING: WOULD IT MAKE A DIFFERENCE?

M&S's decision to outsource a majority of its clothing line to the developing world must have been a difficult one. Obviously, the firm would have considered the financial costs of producing goods in the UK vs. abroad, presumably even taking transportation costs into consideration.

M&S would also have considered the negative impact of the economic losses it was inflicting on its domestic suppliers, although it would have been very difficult to cost these in to its decision-making.

What other factors beyond basic cost might have influenced M&S's decision, if there had been a robust sustainability decision-making framework available? For example:

- Σ What might have been the potential loss of trust (social capital) of the UK consumer?
- Σ What was the risk to the M&S brand?
- Σ How much erosion of brand value would be acceptable, for how long?
- Σ What would be the economic losses, not only to domestic suppliers, but the loss of multiplier effect in those local communities?
- Σ What was the loss to UK government services in the form of tax revenue?
- Σ What were the long-term costs to the business from global warming resulting from freighting goods from the Far East?

In follow-up interviews SIGMA partners discussed how looking at these in a more systematic way could help them come to grips with a better understanding of the decisions that had to be made, and, indeed, the "balance sheet" for sustainability as a whole. Further research and application of this idea was recommended.

## 4.3

### Third Stop: getting buy-in

SIGMA organisational partners current approaches to managing their business provided substantial insight into how economic sustainability could be sold. From the language of sustainability to organisational management, a number of opportunities were identified.

The language of sustainability was the most commonly cited challenges in organisations. According to one major retailer, finance directors ask for things in "Jane and John language", but often get jargon instead. The sustainability message may not be getting through to the Board and senior managers, even in organisations where sustainability is considered core to the business. Management decisions were still made on a traditional financial basis, unless regulatory pressures prevailed. Some of the links to brand, as discussed earlier, or a sustainability approach to intangible assets, might go some way in helping overcome this barrier. On the other hand, a finance manager of one large financial services company said they were "flirting" with brand valuation but found the proprietary techniques too expensive.

But although some argued heavily in favour of managing environment as 'economic' opportunity rather than risk, the language of the city would seem to support the approach towards the language of risk in a sustainability management system. Can we move towards a more opportunistic approach? Does the broader understanding of economic sustainability result in better business decisions? The literature says yes, and so do our SIGMA partners. Future research might consider a survey of top FD's and City brokers to determine what an effective language of sustainability could and should be.

In the meantime, how do sustainability managers cope? How can they get the financial and economic decision-makers thinking about sustainability as a whole? Luck is a factor, and careful use of language and internal marketing, of course, are key, but there is also a role for tactical manoeuvres and even a little Machiavellian approach, as the three examples below make clear.

## 4.3

TABLE 10: POTENTIAL 'WAYS IN' FOR SUSTAINABILITY MANAGERS

Mechanism	Examples
Sermon-on-the-mount	The CEO or a senior leader in the organisation suddenly is converted to the case for sustainability, and then carries the organisation with them. Ray Anderson of Interface is probably the leading exponent: he literally had a revelation while reading <i>The Ecology of Commerce</i> on a long flight. At a more modest level this has also happened at companies as diverse as the Body Shop and Du Pont. Hard to arrange this sort of conversion! Also hard for competitors to respond.
Trojan Horse	Sustainability managers work effectively at getting modest sustainability activities going in the organisation, and then gradually introduce more far-reaching ones. At Wessex Water, a set of green accounts was 'slipped' into the annual sustainability report, placing it right at the core of economic thinking within the organisation. Once people saw it in print, they began to warm up to the idea. The environment team at J Sainsbury have benefited from the green commitment of individuals in the finance team. Risky tactic if key staff move on.
Good Cop/ Bad Cop	The sustainability manager can make a convincing case to break ranks with the rest of the sector – "so long as society demands it". They work closely with policy / campaigning groups so that those demands are heard loud and clear. BP and Greenpeace worked this kind of routine on solar energy. B&Q developed a strong relationship with WWF, and Alan Knight was allowed to get on with the job with the tacit blessing of the CEO. Unpredictable on competitors: where Shell is being forced to follow suit, Homebase folded.

Source: NEF from SIGMA workshop, January 2001

## 4.4

### In the 'Bleachers': Issues beyond organisational control

There was a concern expressed by organisations that some things which impacted on economic sustainability were out of the control of organisations themselves. Decisions had to be made at either the sector-wide level, or even the public policy level. And public policy decisions often had a negative impact on the economic sustainability of companies. Regulatory pressures, for example, reducing customer costs for certain types of public services, such as water or electricity, might limit organisations' abilities to invest in new technologies, unless this was done on a sector-wide basis. Similarly, consumer demand (or lack thereof) for environmental products might also impact on economic decisions an organisation might be able to make in favour of sustainability.

The implications for SIGMA are:

- Σ Understanding what factors organisations can manage vs. those that are managed elsewhere;
- Σ doing a thorough analysis of the wider environment, both on an industry-wide and public policy basis;
- Σ making decisions about these issues transparent in the reporting process;
- Σ ensuring that public policy and other activities are aligned with sustainability objectives.

# 5.0

## Conclusions & Recommendations

Business sustainability is generally accepted to be a combination of environmental, social and economic performance. This report finds that economic sustainability is the most elusive component of the "triple bottom line" approach. There is some consensus that sustainability is desirable for individual businesses to prevent the devastating and inefficient impacts of corporate premature death, and to enable and protect social and environmental initiatives, which tend to be the product of more mature businesses.

Understanding how businesses stay in business is a difficult business. Most companies, most of the time, manage their economic performance pretty effectively, perhaps without knowing quite how they do it. There are few if any successful business strategies available in the public domain. If there were, there would be less corporate 'churn'.

There are also very few tried, tested, accepted, available and affordable management tools and systems for use by economic sustainability managers (ESMs). Economic management is a set of activities spread between diverse functions. These include finance teams, investor relations, strategy units, brand managers, corporate communications, risk assessment, the board, HR and IT. This fragmentation can encourage 'silo' thinking and reduce synergy.

Innovative concepts like social, intellectual and emotional capital and interesting techniques like brand valuation are beginning to make some inroads into this confusing terrain. Managing 'sustainability' – whatever the starting point – can help organisations rise above an unwelcome focus on short-term financial performance, and into a more strategic environment that enables steady growth of economic value-added, a planned (and equitable?) accumulation and distribution of increasingly intangible assets, and prudent management of risks and opportunities. Our ten key conclusions are presented in the Table 11.

## 5.0

TABLE 11: KEY CONCLUSIONS

Finding	Plain language caricature
1 Most existing 'sustainability' management tools and systems seem to have been written by environmentalists and social scientists. Some refer to economic sustainability but are so patchy or vague that they would be inadequate for actually managing a real business	"Look, this system should be taken really seriously, okay? I've even put financial stuff in it, and everything"
2 Fortunately, though, most systems are not really aimed at economic sustainability managers (ESMs), who instead have a relatively well-known (if limited and creaky) set of financial indicators to rely on. These are historical and focus mainly on turnover, profit, and for PLCs, market capitalisation and earnings per share.	The annual report is accurate, alright, "but it's pretty misleading".
3 Unfortunately, in a harsh climate where corporate actions and investor expectations are at an all-time high, companies that manage financial performance using only these narrow indicators risk premature death.	"Help! Somehow we've got to show the City that we're really worth a lot more than that or there'll be a hostile take-over".
4 The business case is confusing and contradictory, but no amount of excellent social and environmental performance will prolong the life of a company that is economically unsustainable, nor are green and community values necessarily good gauges for longevity.	"The Sinclair C5 was a lean, green machine; it's so unfair."
5 A broader perspective on how to manage economic performance is emerging, based around brand, intangible assets, reputation, full cost accounting, ability to add value and manage knowledge.	"Taking brand seriously isn't just about giving ourselves a weird new name – though that might help too".
6 It is still early days for the developers and promoters of workable management techniques, with technical, commercial confidentiality and political obstacles to overcome before leading companies will leave their 'safe harbour' and share best practice.	"We could tell you how we do it, but then we'd have to kill you".
7 Most economic valuation approaches are still considered to be dark art not hard science, and surprisingly few companies even value their brand. Cost, complexity, and competing techniques are the key disincentives. But the issues are often also managed in a complex structure.	Forget the old adage "you can't manage what you can't measure". This is more "How could we ever manage to measure that?".
8 The strategic importance of environmental and social sustainability activities is sometimes not well enough explained to economic decision-makers or the City. But sometimes the 'numbers men' are right to be sceptical.	"You'll never get the finance director along - there's no business case".
9 Nor is it always easy for sustainability managers to influence the full strategic commercial realities in which they are operating. Business life can be 'nasty, brutish and short'.	"Gerald, can you just quickly sign off this new recycling policy before you talk to the press about quality?".
10 As a result of all this, there is quite a lot of enthusiasm for more guidelines on economic sustainability, but there is also plenty of scepticism about whether that will be possible.	"Sustainability management guidelines? Fat chance! But could I have a look at what you've got anyway?"

## 5.0

To assist in the development of useful guidelines, the following recommendations are offered:

- Σ Economic sustainability managers need to accept the need for broader financial and economic measures beyond the P&L and balance sheet, and the interdependence of the organisation with its local, national and global economies;
- Σ Senior managers must ensure that organisational design and structures actively promote cross-learning and joint-working among various sustainability teams, rather than a 'silo' or 'not-invented-here' mentality;
- Σ Managers should be encouraged to make a first attempt, crudely if necessary, at measuring intangible assets, full cost accounting or even an economic sustainability index.
- Σ Managers should be confident that they can use the findings of their work, getting information to the attention of decision-makers, both inside and out.
- Σ Over time, management goals can be set for all significant factors affecting the performance of economic sustainability.

## 6.0

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