Five Reasons why Board Directors must Prioritise Sustainability and how **it's Relevant to Business Strategy**

(Part I)

There are a number of strong social and economic forces in play that will determine the corporate winners and losers of the next few decades. Boards ignoring these forces for change do so at their own risk. The evolving concept of corporate sustainability involves a diverse set of issues and ideas that have advanced well beyond traditional thinking on community investment, philanthropy and office paper reduction, and tie directly to companies' core strategies and competitive positioning. Business performance is becoming ever more intertwined with social and environmental performance and business has never faced higher expectations in this respect from stakeholders. But those that view this as opportunity to engage through sustainable business strategies will win.

2015 was a year of extraordinary vision and hope with the ratification of the 17 Sustainable Development Goals at the United Nations on the 27th of September and with the successful outcome of COP21 in Paris in December. For corporations the two most powerful emerging drivers of economic transformation are likely to be de-carbonization and digitalization balanced with a need for more inclusive growth and a more responsible approach to social and environmental governance (ESG).

By contrast, 2016 has been a year marked by less optimism and with the expression of widespread social frustrations leading to BREXIT, political upheaval in both advanced and developing countries, challenges to the idea of mainstream liberal democracy, emerging strongmen politics in Asia and increased protectionist thinking and anti-globalization attitudes. Indeed at the recent G20 meeting leaders called for "civilized capitalism" to respond to these building social tensions which are threatening to transform the established political and corporate norms.

How companies choose to react to these drivers of change will have a profound impact on their multiple stakeholders from employees to investors and customers. Leading companies are thinking hard about their underlying social purpose in conjunction with the profit motive and some are beginning to differentiate their brands through conscious leadership in the area of sustainability and social purpose. These are all areas where boards need to engage in healthy debate and challenge.

In this two part paper I wish to share some observations and ideas on the following five core themes:

1. De-carbonization will impact your corporate balance sheets
2. Brand differentiation through social purpose and sustainability leadership
3. Get ahead of the challenge of addressing climate resilience and adaptation
4. Increased attention on Environmental Social Governance (ESG) reporting
5. Private sector supply chains must take responsibility to help solve modern slavery and commit to ensuring human rights are protected

In this Part 1 I will address themes 1 and 2.

1. De-carbonization will impact your corporate balance sheets.

Many energy and resources companies are facing mounting pressures from diverse stakeholders over their commitment to fossil fuels and their response to the outcomes from the Paris Accord on Climate Change (COP21). Some are unloading their most contentious assets and reserves often at a loss or are simply suspending investment decisions as we saw with BP recently in the Trans-Tasman Sea. Banks, sovereign wealth funds and insurance companies are looking to reduce their exposures to coal in order to reduce risk and salvage tarnished reputations and governments are looking for ways to honor their COP21 commitments by curtailing fossil fuel exploration and exploitation plans.

For example the insurance group AXA has recently divested and is halting investment in mining companies deriving over 50% of their turnover from coal mining and even electric utilities deriving over 50% of their energy from thermal coal plants. The Norwegian Government Pension Fund has divested from 22 companies that are involved in oil sands production, coal mining, cement production and coal-fired power generation and from 1 January 2016 are divesting from and freezing new investments in companies that base 30% or more of their activities on coal. A background paper entitled “Divestment and Stranded Assets in the Low-carbon Transition” by the OECD provide some further interesting insights on this topic.

The concept of stranded assets is a new accounting force for board directors to be aware of. Stranded assets are “assets that have suffered from unanticipated or premature write-downs, devaluations or conversion to liabilities” and are often associated with reserves of coal or oil factored in a company’s net worth that are destined to never being realized and therefore “left in the ground”.

On the other side of the equation opportunities are emerging from new technologies associated with wind, solar and digital solutions driving efficiencies. Boards need to rapidly embrace these developments and seek out ideas to drive innovation and embrace opportunity inherent in the de-carbonization the economy. However Banks continue to struggle to understand the risks and commit their balance sheet to this shift. As a result private equity remains a dominant source of funding for the emerging renewable sector. That said this is an area of huge dynamism and opportunity.

According to the Solar Foundation (www.the-solarfoundation.org) the U.S. solar industry grew dramatically in 2015, and is expected to continue to do so in 2016. The industry employed over 200,000 workers in 2015 after adding over 35,000 jobs year on year. By the end of 2016, its ranks should reach 240,000 workers. They report that the solar sector employs 77% more workers than the 70,000 presently employed by the U.S. coal mining industry. Last year, the solar sector added workers at a rate that was almost 12 times faster than the overall US economy, says the report. How the various corporate players choose to take tough decisions, prepare to cannibalize past winning strategies and to embrace the new will determine the winners and losers in the next few decades.

2. Brand differentiation through social purpose and sustainability leadership

Companies who have developed genuine long term business strategies grounded in sustainable business practices and with a corporate philosophy built on a clear sense of social purpose are seeing evidence of financial and non-financial returns for their efforts. So what exactly is the concept of social purpose? The social purpose of a business is based on the belief that social change is good for business and business is good for social change. The social purpose of a business should embody the declared purpose of its leadership. You see this in the way Paul Polman has changed the way Unilever is managed and focused. Most importantly the social purpose of a company is integrated making it impossible to separate from everything the business does to make money.

Social purpose led companies are building brand value and attracting and retaining talent. Research is showing that “Millennials” are making decisions about which firms they will work for or indeed remain with based on their understanding of the company’s commitment to doing good. Research groups like Edelman are showing that customers are also differentiating brands and making buying decisions based on perceptions of social purpose; both good and bad.

So the obvious question must be is whether it is indeed good for business. The good news is that there is increasing evidence that managing with a clear sense of social purpose is better for business performance. Based on 10 years of empirical research involving 50,000 brands, Jim Stengel developed a list of the world’s 50 fastest growing brands which built the deepest relationships with customers through a clear integrated social purpose. The study, establishes a cause and effect relationship between a brand’s ability to serve a higher purpose and its financial performance. Notably, investment in these companies – the Stengel 50 – over the past decade would have been 400% more profitable than an investment in the S&P 500.

In the second and final part of this paper we will be addressing:

3. Get ahead of the challenge of addressing climate resilience and adaptation

4. Increased attention on Environmental Social Governance (ESG) reporting

5. Private sector supply chains must take responsibility to help solve modern slavery and commit to ensuring human rights are protected.

To be continue in next issue

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