Institute for
Family Business

FBN international
THE FAMILY BUSINESS NETWORK

Sustainable Value Creation

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EXECUTIVE SUMMARY

This report explores how thinking about value creation has changed over the past few years in the light of the debate on sustainability, and provides practical advice on how to create long-term value in a company. We also examine the challenges and opportunities for family business in delivering sustainable value creation.

Sustainability deals with long-term issues that often have no financial counterpart, but which can have a material impact on the ability of an organisation to create long-term value. Companies that focus exclusively on financial metrics could miss the longer-term issues wrapped up in the sustainability agenda.

Keeping the sustainability dimensions in view, we define **sustainable value creation** as:

> *The behaviours and actions of an organisation across multiple financial and non-financial dimensions in order to manage the risks and opportunities associated with economic, environmental and social developments.*[1]

Businesses are not always used to managing across multiple dimensions, especially when this includes non-financial ones. This report identifies a "four keys" framework that, if introduced into the management of an organisation, can give it a structure for creating and sustaining long-term value.

Key 1: Operating efficiency is a sustainability virtue

An innovation that has been introduced in a number of progressive companies is evaluating operating efficiency through different lenses, rather than just in terms of financial or physical assets. One such lens is resource efficiency, relating to the organisation's use of natural capital.

As companies deal with depletion of resources, environmental impacts and materials security, they seek new and improved ways of operating. The consequence of this is improved performance inside the business, via efficiency gains and progress on long-term environmental and social issues.

Key 2: Sustainability attracts and retains the best people

Sustainability can be a powerful differentiator for family businesses in attracting and retaining the right employees. In fact, increasingly, it is the company's employees that are one of the main drivers for businesses wanting to do better when it comes to sustainability. This is because the employees understand how a business is really operating, and look to their employer to uphold good credentials as a corporate citizen. The best employees want to work for companies that they can believe in.

Key 3: Public forums and government actions are driving sustainability

For many businesses, engaging in public initiatives, or with government, may feel quite foreign. Yet, businesses are learning to make these changes to the way they work. Equally, the current lack of inter-governmental progress being made in international forums such as Copenhagen and Rio+20 might mean that companies have to be more aggressive than they might have planned, in order to meet their sustainability targets. Companies are increasingly working together in cross-industry bodies that further the cause of responsible business and promote the sustainability agenda.

Key 4: Sustainability requires balancing short- and long-term objectives

The best organisations have the ability to drive performance in the short term, balanced with a clear sense of vision for the organisation, where it is going and what it seeks to achieve. How does this perspective change seen through the lens of sustainability? It has brought the need for balancing long-term objectives with short-term performance into even sharper focus. Now, the long-term objectives of a company might be modified by long-term objectives for society at large in a way that was not seen before.

For family businesses, who have a natural affinity towards balancing long and short-term perspectives, this could be an area to seek advantage.

The metrics of sustainable value creation

You cannot manage what you do not measure. In many companies, good intentions are not translated into ways in which the business can understand its own performance and find ways to improve it. The prevailing business model is designed to maximise short-term financial results. As a consequence, most of the metrics that a company seeks to track and manage end up being financial ones. But what sort of metrics can a company use to manage its non-financial challenges?

This report uses the various types of capital defined by the International Integrated Reporting Council (IIRC) as a starting point from which companies can create metrics and key performance indicators (KPIs) that stretch beyond financial measures, and enable them to manage their journey towards sustainable value creation.

The four keys framework for sustainable value creation provides a useful and practical perspective on how companies can explore the sustainability agenda. However, the best laid plans and hopes on their own will not drive extraordinary performance. Companies have to find ways to make sustainability real in the context of their strategies, their operations and their relationships. Only then will they have the tools in place to create and sustain long-term value.

INTRODUCTION

In an FBN International member survey 72% of respondents indicated that they had a corporate strategy relating to environmental, social and governance (ESG) issues, confirming that sustainability is firmly on the agenda within progressive family firms. Family firms, particularly larger multi-generational businesses, are not new to this issue, sometimes sitting in the vanguard with other successful non-family businesses, learning step by step how to embed sustainable value practices into their operations.[2]

A chorus of bodies from the United Nations Global Compact[3] passing through many industry grouping initiatives such as Business in the Community (BITC) and Business for Social Responsibility (BSR) have raised the debate on sustainability to levels that have made it an issue very hard for business to ignore. In October 2011 FBN International called publicly on the family business sector to embrace the principles of responsible business through its *Sustainability Pledge* that was announced in Singapore at the 22nd FBN International Summit. In the pledge, family firms are exhorted to pass on their values and long-term aspirations to future generations.

This project has been designed to promote a debate within the FBN network and its national chapters that will encourage owners and their boards to take a fresh look both at the risks they face but more importantly to uncover opportunities available when the firm sets itself on a path towards sustainable value creation. The IFB Research Foundation, in partnership with FBN International, commissioned M Institute, a think tank specialising in medium-sized businesses, to produce this report, which draws on examples from cases, including fresh insights from family businesses who agreed to be interviewed.

The report is offered as a study that we intend to build on as and when more evidence comes forward. In the next stage we will publish a practical toolkit to help implement the principles set out in this report. Readers are invited to ask what practical steps they can take to embrace the four keys framework for sustainable value creation described in the report – and to consider what related actions they can implement.

Grant Gordon
IFB Research Foundation
October 2012

FBN INTERNATIONAL SUSTAINABILITY PLEDGE

A Sustainable Future

Without a sustainable approach our future is at risk. Not just the future of our businesses but, we also risk the lives and livelihoods of generations yet to come. This is why we, The International Board of the Family Business Network, are reaffirming our promise to promote a business model that will sustain not only our own generation, but all those that follow us.

The benefits of a sustainable approach are apparent to us all: the responsible use of capital is a powerful force for good and with corporate stewardship comes corporate advantage. Businesses that achieve great things deliver greater financial results, but these issues we face are more pressing than immediate financial return.

To provide future generations with more than we have received ourselves is a deep-seated human ambition. It is found in all walks of life, but it is in family owned businesses that inter-generational thinking is intrinsic. We believe that our inherent understanding and appreciation of legacy brings an obligation to support and promote a sustainable future in all that we do. As custodians of tomorrow, we believe that it is our duty to act now by making these pledges:

For our people:

We pledge to do all that we can to create and nurture workplaces and working cultures where our people flourish.

For our communities:

We pledge to be responsible global citizens making positive contributions to the communities that we work and live in.

For the environment:

We pledge to constantly search for ways to reduce the ecological impact that we create and safeguard the environment that we all share.

For future generations:

We pledge to pass on our values and long-term aspirations to future generations.

We know that these are bold promises and we do not make them lightly. But in order to protect all that we have done and create a sustainable future, where our work lives on, they are vital. We call on all family owned businesses, worldwide, to take responsibility for the future of our children and our children's children.

Please join us in our pledge.

Thierry Lombard	Arun Bharat Ram	Karl-Erivan Haub	Thilo Wersborg
Frederick Chavalit Tsao	Maurizio Sella	Andrew Wates	Patrice Gaidzinski
Sophie Lammerant Velge	Ingrid Faber	Alfonso Libano Daurella	Luc Darbonne

FBN international
THE FAMILY BUSINESS NETWORK

PART 1

EXPLORING SUSTAINABLE VALUE CREATION

When the Family Business Network introduced its *Sustainability Pledge* in 2011, it was tapping into the natural advantage that family-owned structures arguably have in delivering long-term value creation. Yet many family businesses fail to exploit this advantage to their benefit. This report explores how thinking about value creation has changed over the past few years, and provides practical advice on how to create and sustain long-term value in a company.

The report focuses on family businesses, but its content is drawn from both family and non-family structures, and the "four keys" framework presented here can benefit any organisation that seeks to create and deliver long-term value.

The context for creating value

Following years of a sustained upswing in growth, the 2008 financial crisis introduced a less comfortable, more spartan setting for global business.

The leading Western nations still face big challenges restarting their economies, and the BRIC countries for all their strength are not able to sustain growth on their own. Unemployment is rising to dangerous levels all over the world. Governments, businesses and consumers in the West are awash in debt and living standards are under pressure. A record one billion humans in the developing world face hunger and starvation. Globalisation has spurred the relentless competition that today's industries and firms have to deal with. On top of this, climate change from fossil fuel-based industrial activity looms on the horizon.

This may be an unnecessarily pessimistic view of the global business environment today but it does point to the significant challenges that companies face in building long-term value, and the broader risks that our planet faces. This is not just a business challenge. It draws each of us in.

Businesses of all types and size are on the lookout for new ways to cope with the rush of competition. Managers need to generate better margins, but mere savings no longer suffice: economies generated can easily be lost in competition and captured by customers. In managing businesses under such pressure, executives can end up systematically destroying economic value for their shareholders and sacrificing the jobs of their employees.

Family businesses are not immune from these challenges. In fact, they have to face these challenges with a business model that some observers view as being handicapped. Family businesses, according to a section of the academic and business community, often suffer from a lack of scale, they risk being culturally backward and can struggle to conserve capital. Further they can be prone to misplaced altruism, short-sighted coddling of the kids and nepotism – all factors (and more) that may prevent them from competing against their non-family peers.

Yet, it may be possible that some of the challenges in building long-term value in a company today are such that family businesses are coming into their own. The best family businesses, according to researchers Miller and Le Breton-Miller, have inspiring values, prefer the substantive over the pecuniary, and foster a culture of mutual loyalty, parsimony and patience.[4] If anything, their long-term perspective offers them tremendous opportunities to succeed where many short-termist, lean, "re-engineered", widely owned organisations have run into unforeseen difficulties. A new chorus has emerged since the financial crisis categorising the best companies as those that balance short-term and long-term horizons. First-class family businesses have an in-built natural tendency to approaching corporate stewardship in ways that ensure their pursuit of short-term performance does not compromise their long-term objectives, and vice versa.

Analysts and consultants call on businesses to create more value through innovation, but most of our companies, family businesses included, arguably have been engineered to produce efficiency, not innovation. However, there are companies that are innovating in ways that allow them to reconceive their sources of strategic advantage and master new mechanisms to build lasting or sustainable strength.

It is these innovations and mechanisms that this report is interested in, and in particular the lessons we can learn from the experiences of companies (family and non-family) that are seizing opportunities to build sustainable value. No company has yet fully mastered all the elements needed to deal with today's hyper-competitive business environment, but those that are creating longer-term, sustainable value display some common threads.

It is these common threads that we focus on. William Gibson, the science fiction writer, observed that "the future is already here, it is just unevenly distributed." We wish to learn from the companies that are at the leading edge of the business world today, so that the ways through which they create sustainable value can become part and parcel of how business is conducted today and into the future. For the well-run family businesses, this is good news indeed.

Defining sustainable value creation

Even while enduring a global financial crisis, caused in significant part by short-termism and unsustainable strategies pursued by companies and their investors, we are still living beyond our means. Short-termist perspectives with the influence of instant opinion polls, tweets and sound-bites continue to drive our investment decisions.

As Herman Daly, a US ecological economist has argued a short-termist approach has also largely broken down the trust that society holds in business. In fact, it has placed the future of capitalism itself in question.

> **"We are driving our economies and our planet into liquidation."**
>
> Herman Daly, University of Maryland

But what would a longer-term form of capitalism look like? There is some agreement that long-term economic value creation would explicitly integrate environmental, social and governance (ESG) factors into strategy as well as the assessment of risks and opportunities. ESG issues have emerged as the three main areas of concern that are central in measuring the non-financial impact of a company on its stakeholders, and their management within a company is often bundled together under the banner of sustainability.

Examples of ESG issues include:

- Environmental factors, such as climate change impacts, water, waste, air quality and air pollution.
- Social factors, such as human rights, child labour, diversity, freedom of association and consumer protection.
- Governance factors, such as employee relations, executive compensation, and board and management structures.

So how is sustainability related to sustainable value creation? Some subscribe to a narrow definition of sustainability, built around the ESG factors listed above. However, sustainability is really wider than that in its scope and impact. In 2008, a definition of corporate sustainability was developed by consultant PwC and asset manager SAM as follows: "A business approach that creates long-term shareholder value by embracing the opportunities and managing the risks associated with economic, environmental and social developments."

In this sense, sustainability deals with long-term issues that often have no financial counterpart, but which can have a material impact on the ability of an organisation to create long-term value. It follows that companies that focus exclusively on financial metrics could miss the longer-term issues wrapped up in the sustainability agenda.

Unless a business entity creates value for its customers, it would struggle to sell its products and services. Furthermore, unless it creates value for its shareholders it will probably compromise its ability to raise capital in the future with the support of a committed group of owners. Consequently, keeping the sustainability dimensions in view, we can define **sustainable value creation** as:

> *The behaviours and actions of an organisation across multiple financial and non-financial dimensions in order to manage the risks and opportunities associated with economic, environmental and social developments.*

Businesses are not always used to managing across multiple dimensions, especially when this includes non-financial ones. What this report does is identify a "four keys" framework that, if introduced into the management behaviour of an organisation, gives it a good opportunity for creating and sustaining long-term value. Let's explore what the keys to sustainable value creation look like.

Traditionally, value was created when a business earned revenue that exceeded its expenses, or had a higher return on capital than the costs of raising that capital. The lesson of the past few years is that such a limited view of value ignores the contribution of intangible drivers like people, brands and ideas. If we try and understand the sources and drivers of value creation within an industry or a company, we might add numerous categories of intangible assets – such as technology, innovation, intellectual property, natural capital usage, alliances, management capability, employee resources, community relations and brand equity – to the more pervasive financial ones.

Do we still need to pay attention to ESG?

Although sustainable value creation is deeper and wider than a narrow ESG (environmental, social and governance) definition, we find that ESG factors are an important component of the business strategy of a modern company. In fact, ESG, often dubbed “sustainability”, commands a lot of attention among business leaders today. If a CEO’s pronouncements were all the evidence we needed that a business was doing something, then sustainability would be top of the strategy charts.

Over half of the McKinsey Global Survey 2010 participants consider sustainability “important” or “extremely important” to their businesses. An even more optimistic Accenture study of 766 CEOs found 81% claiming that sustainability is part of the strategy and operations of their businesses, and 96% want it embedded into the core of the business.[5]

But in practice, for most companies, word and deed diverge. The same McKinsey study reports that most companies are not actively managing sustainability, or seeking opportunities for investment or making it part of their business practice. Yet, the best sustainability performers comfortably beat their competitors on pure economic grounds.

Accenture’s study of 275 global Fortune 1000 companies analysing business and sustainability performance metrics shows that the top 50 companies ranked on sustainability outperform the bottom 50 by 16% when it comes to shareholder returns over a three-year period.

Over five years, the results are even more skewed in favour of the best sustainability performers: the top 50 outperform the bottom 50 and middle 50 peers by 38% and 21%, respectively.

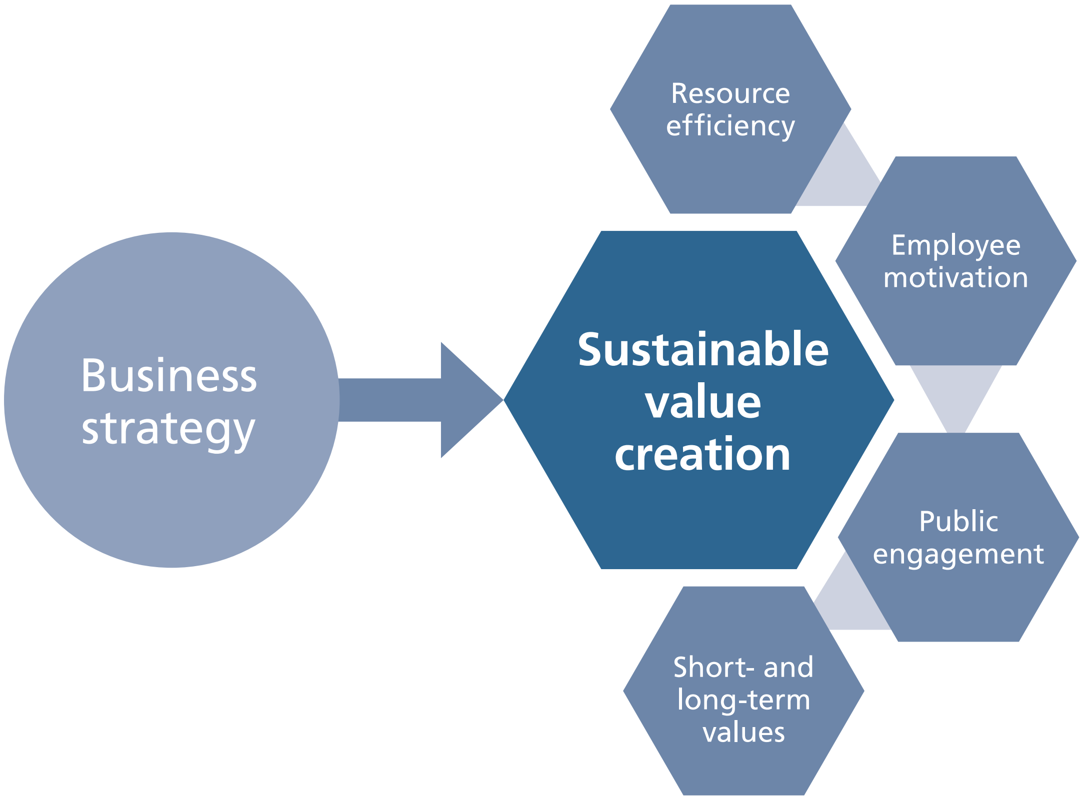
So the best sustainability performers make more money. Whatever the cause and effect here, it’s still a great reason to get involved in sustainability, even in its narrower ESG derivative.

The link between these assets and long-term value creation is the strategy of the business. The thesis of this study is that there are **four keys to sustainable value creation** that every business needs to consider and apply to its own situation. These keys are drawn from the experiences of companies that are operating at or near the edges of business performance in long-term value creation, including both family and non-family businesses:

- Resource efficiency, including utilisation of natural capital and other resources.
- Employee relations and the development of people capital.
- Engagement with public forums and governments on sustainability issues.
- The interplay between long-term objectives and short-term performance.

The rest of this report lays out how the four keys framework can be introduced into the modern family business and monitored, through the use of business tools such as metrics and diagnostics.

Figure 1: Sustainable value creation – the four keys



The best family businesses perform well on financial metrics, such as revenue growth, return on assets and total shareholder returns, while listed family firms deliver equity market outperformance and demonstrate superior operating performance according to Credit Suisse research.[6] Where family businesses often pull away from their non-family peers is in non-financial metrics such as investing in their employees including the provision of social benefits, and in supporting their communities. The best-run family businesses also outlast others by a factor of two.[7]

So there is potential for family businesses to benefit from the application of the lessons of sustainable value creation because they play to the strengths of this form of business. Unsurprisingly, there is a lot of interest in the subject, with companies, business organisations and governments all playing their parts. And this is happening internationally, with business organisations like BITC in the UK, BSR in the USA and Instituto Ethos in Brazil all placing sustainability issues squarely on the public agenda.

There are also multi-national initiatives that have been created to support sustainability principles, including the United Nations Global Compact (aimed at companies), the Global Reporting Initiative (developing reporting standards that companies can use in reporting their sustainability impacts) and the United Nations Principles of Responsible Investing (aimed at investors).

PART 2

SUSTAINABLE VALUE CREATION: THE FOUR KEYS

In this, the main section of the report, we detail the four keys framework that has been identified through this study as providing a pathway to creating and sustaining long-term value. Sustainable value creation is not something new – businesses have been doing it for centuries. What is new today is how we analyse the different types of capital that a company uses in creating value, and the methods by which it conserves and builds those resources. Before discussing the different types of capital, the report sets out an understanding of how value creation brings together financial and non-financial dimensions so that long-term objectives are not obscured by short-term horizons.

Key #1: Operating efficiency is a sustainability virtue

It is well understood that when reporting processes are not continuously focused on using capital efficiently, potential sources of value can remain hidden. As a result, traditional measures of performance, such as working capital and return on investment (ROI) are not only financially important, but they are also a reflection of efficiencies in the business.

The best family businesses have been characterised as viewing their assets as family silver, to be burnished and polished. They often go the extra mile in investing in the plant, machinery and processes that produce value.

Some progressive companies are evaluating operating efficiency through different lenses, rather than just through the lens of financial or physical assets. One such lens is resource efficiency, relating to the organisation's use of natural capital.

As companies deal with depletion of resources, environmental impacts and materials security, they seek new and improved ways of operating. The consequence of this is a boost to performance inside the business, and an improved ability on the part of the company to transition into the low-carbon world that is already taking shape.

> **"The results of the Puma environmental profit & loss report underpin the urgency for a paradigm shift in the way we all currently do business."**
>
> Jochen Zeitz, Executive Chairman, Puma

An excellent example of this kind of thinking comes from Puma, the sports goods company (see the case study on page 14). Puma chose to denominate its external environmental, social and economic impacts in monetary terms so that it could compare these impacts in a much more holistic way across the organisation. One of the early lessons the company gained from its analysis was that its biggest environmental impacts were among the tier-four suppliers in its supply chain – those who source raw materials from nature.

Case Study

Puma

Revenues: €3 billion in 2011
Employees: 11,000
Founded: 1948
Headquartered: Herzogenaurach, Germany
Industry: Footwear and apparel

Puma, the German sports goods company, is searching for alternative materials it can make its products from, shifting from its traditional use of virgin raw materials like leather and rubber. In doing this, it is one of many companies in its industry seeking to find more sustainable ways to source and sell its products. But the journey Puma has taken may well have given it an innovation advantage over its competitors.

The genesis of Puma's sustainability efforts came from the attacks sports goods companies were receiving from activists regarding their use of Asian sweatshops. The company's initial attempts to engage with its supply chain were based on industry practices, auditing its key suppliers and putting good practice standards in place. But Puma went further than its competition in one respect: it sought to create a single model by which all of the company's external social and environmental impacts can be compared.

Puma chose to denominate its external environmental, social and economic impacts in monetary terms. As a result, the business is able to make comparisons of these impacts in a holistic way across the organisation. Plus, it gained insights on how to make business decisions, as it was looking at a much wider set of data than it had before.

One of its early lessons from the analysis was that its biggest environmental impacts were in its tier-four suppliers – those who source raw materials from nature. For a company that makes its sports shoes from virgin leather and rubber, this was pretty bad news. Both its key raw materials were competing for scarce planetary resources on many different fronts: land use, water, the greenhouse gas emissions of cattle, deforestation in order to grow cultivated raw materials, food versus non-food cultivation and so on. The list is potentially endless.

Puma's first attempt at using alternative raw materials resulted in the re-tooling of one of the company's most iconic products, the "Suede" shoe dating back to the 1970s. What Puma did was to dump the virgin leather and rubber used in the original. Instead, the rubber came from recycled tyres and the shoe's uppers were made from rice husk, a waste product from rice processing. The result was the Puma "Re-Suede".

The lessons from the Re-Suede were extensive. Every part of the Puma shoe-making process was impacted. Designers had to learn to work with new materials, which had to be sourced from different suppliers to the ones that Puma usually works with. The rice husk uppers made for a lighter shoe, compared to a leather shoe. As a result, shipping costs were lower, which Puma emphasised with new lightweight packaging for the Re-Suede. Overall, Puma estimates a savings of 15 tonnes of carbon emissions for every 10,000 pairs shipped. And the consumer needed to be told a different marketing story. Thanks to the shoe's sustainability credentials, a shoe made from waste materials and which cost less to ship had a higher selling price than the traditional shoe, and consumers were happy to pay that because they were buying the overall story of how the shoe came about.

For a company that makes sports shoes out of virgin leather and rubber, this was pretty bad news. Puma's response was to create a new shoe using rubber from recycled tyres and shoe uppers made with rice husk, a waste product from rice processing. In effect, it had transformed its most deleterious environmental impacts into positive economic performance by using waste materials from other industries.

Another firm to view its operating performance through the sustainability lens is SAP, the German software company (see the case study on page 17). Five years ago SAP set itself the target of cutting its greenhouse gas (GHG) emissions back to year 2000 levels by 2020, while preserving its double digit growth rate. The actions taken have resulted in an 8% growth in GHG emissions by 2011 whereas SAP's software revenue increased by 25%.

The company was one of the first to employ carbon abatement curves to help link sustainability performance to financial performance. There is still much to do, as emissions are still growing, but the company is ahead of where it wanted to be by the end of 2011. Also, superior carbon performance has led to a cumulative cost saving of $249 million since 2008, in comparison to a business-as-usual (BAU) extrapolation based on 2007 performance.

Is it business first or sustainability first? At Wates, a British family company in the construction industry, it is not black and white but the issues are clearly related (see the case study on page 20). Today, 97% of the company's waste goes to recycling, compared with 47% seven years ago. The company uses a lot of timber but only uses certificated sources of renewable timber. It has a policy of reducing its carbon emissions, which it applies in different ways, including the choice of company cars available to its employees.

Adnams, the family brewer based in the east of England (see the case study on page 23), learned how to apply sustainable thinking to its product lines when it co-created East Green, a low-carbon beer, alongside retailer Tesco. A raft of efficiency changes were introduced by careful examination of carbon emissions in the company's supply chain. The result was a combination of initiatives including sourcing agricultural ingredients locally, using more recyclable packaging materials, saving energy in the production process and improving the carbon footprint of the Adnams' process buildings.

The learnings from East Green beer were deeply impactful on the working of Adnams. Today, every beer the company makes benefits from the lessons learned in creating a low-carbon beer. Plus, the company has a new-found confidence in what it can and cannot do. In 2009, 4% of its beer volume came from new products, while in 2012 new products contribute nearly a quarter of company volumes. In the context of a dynamic market where the consumer seeks out products that are new and different, Adnams has a new-found ability to offer innovative products that are differentiated from its core brands.

"We are a heritage brand but a modern company. We have a computer-controlled brewery. We fixed the roof when the sun was shining. It would be much more expensive to do it now."

Andy Wood, CEO, Adnams

Resource efficiency is also an area where it is very important to be forward looking. According to World Wildlife Fund, the world economy took as much as the planet can offer (in terms of natural resources and as a sink for our waste, including global warming gases) in 1988. Since then, we have been borrowing from future generations and, as economies continue to grow, so does our deficit with nature. Many are predicting a crunch in the natural world as devastating as the financial credit crunch experienced in 2008. It is unlikely to be as sudden a shock to the world economy as the recent financial crisis, but businesses should be building it into their long-term cost forecasts.

In many ways the recent price hikes in energy, commodities and food are all linked to long-term trends related to sustainability, and are an early indication of costs that have historically been unaccounted for. As these new cost pressures increase and are internalised by companies, they are causing many organisations to fundamentally re-evaluate their business model.

Key #2: Sustainability attracts and retains the best people

Great family businesses are almost always discerning employers. As exemplars, they put a lot of effort into attracting and retaining (sometimes for their entire careers) staff who believe in what the company does, and fit in comfortably with its culture and values. None of that has changed.

What is also true is that employers (family and non-family) perceive a significant challenge in finding the right people at all levels of the organisation. In a 2012 study of European companies, GE Capital reported that four of the top ten challenges holding back companies during the downturn were related to attracting employees with the right skills.[8] In addition, family businesses can be at a disadvantage in terms of people because there may be a lack of understanding of this type of company.

Nevertheless, the second key tells us that sustainability can be a powerful differentiator for family businesses in attracting and retaining the right employees. In fact, increasingly, it is the company's employees that are one of the main drivers for businesses of all stripes wanting to do better when it comes to sustainability. This is because employees understand how a business is really operating, and are looking to their employer to uphold good credentials as a corporate citizen. They see through greenwash and corporate propaganda. When a company's reputation takes a battering from external pressure groups, the workforce expect their employer to act and to be seen to do the right thing.

Starbucks, the coffee retailer, sends its employees on "Origin Tours" to Costa Rica, Sumatra and Tanzania so that they have a close-up view of the company's business practices. These employees see C.A.F.E. (Coffee and Farmer Equity) Practices in action, a Fairtrade initiative which ensures that farms in the Starbucks supply chain meet minimum standards in wages, agrochemical practices and environmental issues, while producing the best coffee.[9]

In the absence of seeing these positive impacts from their company for themselves, employees are less motivated to stay with a company, or to deliver their best. When Starbucks' employees return home from these visits they can confidently promote the company's ideals.

Bruntwood, a family company dealing in property across Britain's regional cities, has discovered that employing people who come from non-family companies can require a reset in their expectations about work (see the case study on page 25). Bruntwood found that a number of its competitors did

Case Study

SAP

Revenues: €11 billion in 2011
Employees: 55,000
Founded: 1972
Headquartered: Walldorff, Germany
Industry: Software and services

SAP's customers are responsible for over a third of this planet's emissions. Some 1.1 billion passengers fly on airlines using SAP software, and "72% of the world's beer, 70% of its chocolate and 86% of all athletic footwear come from our customers," claims Jim Hanemann Snabe, the company's co-CEO.

In 2007, the company decided to get its own greenhouse gas (GHG) emissions down to year 2000 levels by 2020. In most companies, emissions track with revenues, but SAP has no intention of slowing growth. Instead, it sought to improve its carbon efficiency, year on year, so that the company could grow its top line while taking down its emissions.

As a result, although SAP's software revenue increased by 25% in 2011, its emissions only grew 8%. Clearly, there is still much to do as emissions are still increasing, but the company is ahead of where it wanted to be by the end of 2011. The good news for SAP is that extracting superior carbon performance has an upside: last year alone the company saved $33 million through its energy and sustainability initiatives, building up to a cumulative cost avoidance of $249 million since 2008, in comparison to a business-as-usual extrapolation based on 2007 performance.

The company was one of the first to employ carbon abatement cost curves to help it join its sustainability performance to its financial performance. As a result of the cost abatement analysis, SAP focused on getting its employees out of company cars and into public transport, away from business flights and into video-conferencing suites, and saving energy across its buildings and data centres.

"Increasingly, companies ask us about our sustainability performance," says James Farrar, VP Sustainability at SAP. "They want to know why we include certain things in our reporting, or how they can change behaviour, or de-risk their supply chains. 15–20% of public tenders, especially in Europe, are just about sustainability."

not invest in training their staff, and responded by increasing its investment in people capital, making it a strategic priority. As a business that differentiates itself on service, Bruntwood has chosen to look after its people, on the basis that service only works if the staff feel cared for.

This attitude of care at Bruntwood carries through to the local community. Its employees are represented in 60 civic and charitable organisations in the cities where the company operates. Also, a quarter of the business is owned by the family's charitable trust which focuses its giving in the local community, strengthening the contribution that Bruntwood makes to society, and creating trust in the business.

A company's employees are generally representative of society as a whole and, given the low levels of public trust in business, many will be questioning the motivations of their owners and managers.

> **"We talk about creating places for business success. For our business to be successful, our customers, our local communities and our people have to be successful. If we work on each of the constituent parts, the others will follow."**
>
> Chris Oglesby, CEO, Bruntwood

Motivating employees by being seen to be doing the "right" thing, or even better involving them in these actions, builds employee commitment. And "happy" employees, as programmes like the Sunday Times Best Companies demonstrate, mean more productive employees and improved customer relations.

This focus on employees resonates with Soneva, a Maldives-based luxury hotel company (see the case study on page 32). Soneva seeks to deliver "barefoot luxury" to its customers, as captured by the acronym SLOW LIFE (Sustainable-local-organic-wellness Learning-inspiring-fun-experiences). The Soneva experience would be ruined if poor service intruded. As a result, the company has put in place a programme that trains its employees on the attitudes that make up the "Soneva Way", as well as buddy-guided job training that lays out the hotel's service sequence and key best practices.

From Soneva's perspective, companies are often too bottom-line driven. The magic, it seems, comes from the non-financial performance of the business – its people, the experiences, the physical attributes of its locations. These together are the company's product. It is not a surprise to discover that Soneva does not talk about employees, only hosts. These hosts are motivated by the culture of the company and its sense of purpose. The owners engage employees in establishing the strategy of the business, share regular updates on key metrics, and tie rewards to individual, team and (most importantly) company performance. Does this work? Soneva delivers 52% repeat customers in an industry that averages only half that score.

Increasingly, attracting and retaining talent is also influenced by the company's sustainability reputation, particularly when it comes to the recruitment of younger people – including Generation Y. Also, companies that fare better on sustainability hang on to their staff for longer. Wates finds that its employees want to work for a company that walks this path. As a result, its attrition rates are low. Adnams sees a virtuous circle in this regard: if you can make the company a great place to work, it is great for the customers, which also makes it a great place to invest in. Some 90% of Adnams' staff say they are proud or very proud to work for the company.

> **"When we talk about human capital, we are talking about a group of people that share common values."**
>
> Sonu Shivdasani, Chairman, Soneva

The GE Capital study referenced earlier found that, for many mid-sized businesses, recruitment is a challenge because it is harder to attract the best people to come to work in businesses when awareness of the company is low. However, Adnams' experience is that the trust and reputation it is building in the community through its sustainability-driven initiatives are reflected in its ability to attract good quality employees to the company.

Key #3: Public forums and government actions are driving sustainability

Companies engaged with the sustainability agenda are finding that public attitudes are changing with regard to sustainability. In Europe there is a significant shift in public focus towards sustainability issues, whereas the US is seeing polarisation, with its citizens moving to both ends of the sustainability spectrum. What we are seeing are companies doing more to keep in step with the widening regulatory framework that is being put in place.

One area where regulatory change is forcing companies to respond with appropriate internal management processes is in the area of reporting. National legislative frameworks are quite different in what they expect from companies. As more countries insist on greater visibility and transparency on sustainability, companies will have to respond with appropriate internal processes to monitor and manage issues that they might have ignored in the past.

Sustainability compliance issues around the world are changing company behaviour

- France and Sweden offer specific guidance to companies on sustainability issues they have to report on.
- India is headed towards becoming the first country to insist on mandatory sustainability reporting.
- South Africa has mandated integrated reporting (financial plus sustainability reporting) for its largest companies.
- The United States has no mandatory requirement for sustainability reporting but the Securities and Exchange Commission (SEC) does offer guidance that climate change-related data that is material to the company's performance needs to be reported.

We are seeing much more than just the hand of government at work here – there are other institutional stakeholders (national interest groups such as BITC or BSR, and global organisations like United Nations Global Compact) who are shaping the sustainability agenda and whom companies may choose to work with.

How should businesses view the role of governmental action or public agendas when it comes to sustainability? For organisations of all types of ownership and size, the regulatory environment is only going to get tougher with regard to sustainability issues as governments are pushed into taking action on the serious challenges facing the planet. The world's economies have done a poor job of preserving the planet's natural resource amenities, such as air, fresh water, and fossil fuels. Already, most Organisation for Economic Co-operation and Development (OECD)-based businesses have had to pay for some of the pollution they cause.

Historically, in the US and most OECD countries, polluters have paid around 2–2.5% of gross domestic product (GDP) to clean up their pollution. However, United Nations Environmental Program (UNEP) estimates that the annual environmental cost from global human activity was 11% of GDP in 2008, and

Case Study

Wates

Revenues: £1 billion in 2011
Employees: 2,500
Founded: 1897
Headquartered: Leatherhead, England
Industry: Construction

Given the industry it operates in, it is not surprising that Wates started its sustainability journey with a focus on waste and timber sourcing. Today, the company only uses certified sources of timber and 97% of its waste is recycled. The company's attention has widened to cover a number of other issues, such as energy and emissions. "Once you take the first steps, you keep seeing new ways of exploring how this works," explains Andrew Wates, Family Director on the company's board.

As a family business, Wates is different from many of its competitors in one significant way: "The next generation is sitting in the board room with you, and they are often way ahead of my generation on sustainability matters," points out Andrew. This is confirmed by Jonathan Wates, also a board director at Wates, and Andrew's son: "My father's thinking has constantly evolved. For example, his ideas on sustainability have really developed strongly in the last five years."

Both father and son agree that there is a value set embedded in the business which has enabled Wates to grow into a position of leadership on sustainability issues. "In Wates, we are phenomenally motivated by a desire to do well by people. It is enlightened self-interest, and I inherited this ethos," says Jonathan.

Did sustainability come first or was there a business driver? It seems there was, and is, a bit of both involved as "the two issues are deeply related," explains Andrew. "But we also benefit in indirect ways. As we live and breathe our own sustainability standards, we can support those of our customers, such as Marks & Spencer with its Plan A approach, who look for this thinking in the buildings we build for them."

Thanks to its commitment to sustainability, the Wates family is putting a lot of attention into renewable energy, a sector in which they have made a number of investments via Myriad, a company run by Jonathan Wates. The company was incubated outside the Wates business, but today the relationship between the two companies is growing closer as more of Wates' customers look for the sort of technologies that Myriad has to offer.

Another area that Wates has focused on is incorporating community-driven ideas into its building projects. "This is a model that really works well," explains Andrew. "Apart from the local community being an excellent source of ideas, we look for local social enterprises that we can buy our services from because this helps the local community stay on and make a success of our building project."

What Wates has learned is that none of this happens by chance: "You have to plan and make it part of the processes in the company," says Andrew. The company uses sustainability metrics in the reviews it carries out on its employees, though Jonathan points out that the use of such metrics has not reached incorporating them into bonus arrangements. "The current financial crisis is forcing businesses to think differently," he says. "We need to think carefully about what we do, and what needs to change. But we have never been clearer about our game plan and our priorities. The objective is to hand over the business to the next generation in a stronger form than it is now."

the number will rise to more than 17% by 2050. So we are not paying for anywhere near all the costs we incur.

Why is this relevant? Because the day is coming closer when businesses will have to pay for the environmental damage they cause. UNEP and Trucost, the environmental data provider, together have estimated that over $2 trillion of environmental damage in 2008 was caused by the world's 3,000 top listed companies. If these businesses actually had to pay for this damage, then around a third of them would no longer be profitable. In reality, of course, prices to the end-customer would rise to reflect the increased operating costs, and cleaner technologies would become commercially preferable.

Puma has recently responded to this challenge by integrating its environmental damage costs into its financial reporting. Over the past 20 years a number of organisations have experimented with so called 'full cost' accounting. The Puma report has received a lot of interest so maybe the approach will go mainstream.[10]

Externalised costs are good at foretelling probable areas of new regulation that will ultimately drive all businesses toward sustainability, with measures such as the Carbon Reduction Commitment, the Greenhouse Gas Emissions Allowance Trading Scheme and the Environmental Liability Directive all being relatively recent examples of the way governments are seeking to encourage responsible behaviour from their corporate citizens.

Donaldson Timber, a Scottish family company, knows all about the impact of regulation (see the case study on page 29). The timber industry has lots of different issues that governments seek to regulate, including greenhouse gas emissions, felling trees, illegal logging and replanting forests. All of this relates to the timber before it reaches the factory in Scotland. Once at the plant, there are a range of new regulations for Donaldson Timber to deal with, including waste packaging and control, the chemical treatment of timber and the by-products of this treatment, through to health and safety.

> **"We take decisions for the long term. If you build a house with a solid foundation, it will last. If it has shaky foundations, it will disappear."**
>
> Neil Donaldson, Chairman, Donaldson Timber

Donaldson Timber does not just pay lip service to these regulatory challenges. Instead, it sees a strong business driver to doing things properly. Over 50% of the UK's timber consumption is government linked, including social housing, schools, prisons and the Ministry of Defence. The government is driving improved standards at every step of the way in the timber industry so that it can legitimately say it is doing things properly. Donaldson Timber understands this and has invested to meet these requirements. It costs to know where the company's timber is sourced, and what has happened to it along the way, but Donaldson's view is that it would cost more not to do it, and companies that do not take a long-term view on these issues will be hurt.

In some areas, particularly related to the environment, the role of government can define the performance envelope available to a company. For example, Tesco, the international retailer, has an audacious goal to be a zero carbon business by 2050. Some 64% of Tesco's carbon footprint comes from its purchase of grid electricity. If the UK grid was to be decarbonised by 2050, and legislation forced transport to move to renewables, then Tesco's UK business could probably meet its carbon target without further investment. This demonstrates the key role that government policy plays in an area such as environmental management.

For many businesses, engaging in public initiatives, or with government, may feel quite foreign to them. Yet businesses are learning to make these changes to the way they work. Equally, the current lack of inter-governmental progress in international forums such as Copenhagen and Rio+20 might mean that companies will have to be more aggressive than they might have planned to be in order to meet sustainability targets they set for themselves. In fact companies are already working together in cross-industry linkages that further the cause of responsible business, and promote the sustainability agenda.

Business has often struggled to engage with government on regulatory issues and has sometimes even given up on such interactions. Now could well be the time to reverse this thinking as more governments engage on sustainability issues of deep importance to society, even if not at the speed or always in the direction that business may want.

Key #4: Sustainability requires balancing short- and long-term objectives

Myopic organisations are far too common. They focus on the near term, often keeping only financial matters in view. Their perspective is further obscured when you realise that financial metrics are often lagging indicators, looking backwards in time.

The best family businesses have the ability to drive performance in the short term, balanced with a clear sense of vision for the organisation – where it is going and what it seeks to achieve. Seeing this perspective through the lens of sustainability if anything brings the need to balance long-term objectives with short-term performance into even sharper focus. Now, the long-term objectives of a company might be modified by long-term objectives for society at large in a way that was not seen before.

> **"The answer to change is rooted in an ability to successfully blend long-term thinking with incredible performance in the short term."**
>
> Jonathan Wates, Family Director, Wates

But how has that changed a business's perspective on strategy? Over the past few years, one school of thought focused on understanding industry structures so that executives could target the most promising positions to occupy. Once the strategic positions were well understood, senior management could develop plans, typically with a one to five-year horizon, that laid out in detail a sequence of operating initiatives that a company would take to secure its strategic objectives.

An opposing school argued that industrial structures were being fundamentally changed on a regular basis. As a result, any strategic advantages could erode quickly. The recommendation was that executives should focus on near-term opportunities. In its most extreme form, such as the dot-com bubble, executives have been urged to dump strategy and focus on operational initiatives that can propel their businesses to profitability, staying one step ahead of copycats.

Case Study

Adnams

Revenues: £54 million in 2011

Employees: 402

Founded: 1872

Headquartered: Southwold, England

Industry: Brewing and retail

Adnams is a family business that has been brewing beer in the south-east of England for over 125 years. At the turn of the millennium, the company felt that the competitive landscape was shifting and it needed to change its approach. "We were a small, slow-moving, top-down autocracy," recalls Andy Wood, CEO at Adnams.

The review of the business environment pointed to some massive changes:

- There was a lot of consolidation taking place at the top end of the market, while the specialist end of the market was fragmenting.
- The big international brewers put their ale brands to one side and focused on lager, while a host of new micro-brewers came into the market, focusing on local production.
- Fossil fuels were going up in price. The company modelled a number of alternative scenarios pointing to an urgent need to re-engineer how it used energy in its operations.

While preparing for the long-term changes they could see coming, the company sought to introduce a cultural values programme. "We wanted our values to be real and tangible," explains Wood. "We challenged ourselves to move the business forward. We looked at how carbon pricing would impact our business model, the ways in which we managed people, the level of customer service we provide, and our brand positioning."

The outcome of the long-term thinking work continues to drive the business forward today. The company sought to improve its operational efficiency through focus on carbon emissions, which helped uncover inefficiencies, but also opportunities to do things in a new way. "We encouraged our architect firm to push sustainability ideas into the new distribution centre they were designing for us. The innovation in the new centre created a raft of interest for us in the market," Wood recalls.

The focus on energy has led to a new journey for the company regarding waste streams. The waste stream from brewing is ullage. It is nutrition-rich but "we used to throw it away paying for the cost of doing so," remembers Wood. Today, the company's waste stream feeds an anaerobic digester.

The company needed a way to tie together its various long-term programmes, and decided to define a brand that could tell the story of the company. As Wood points out, "We are a heritage brand but we are a modern company." The company's products reflect that. It has core products that have been in place for decades, while a host of new products reflect the changing trends in the market. "The consumer has become interested in the new and different. Our new and different products showcase what we can do. We are, undoubtedly, in the fashion business," says Wood.

Andy Wood is absolutely clear that the new-look Adnams fits the aspirations of its stakeholders: its customers, suppliers, staff, shareholders and local communities. As he points out, "Trust has been eroded greatly in business. People are very cynical about business. But they are not cynical about businesses where there is provenance and a story to match." The last point resonates with Adnams as a company today.

Both approaches have fallen short. On the one hand, strategic planning that is disconnected from the major challenges facing the organisation has proved inflexible, even irrelevant. Equally, operational initiatives that do not connect to long-term strategy can leave the company adrift of its moorings. Companies have discovered that pace alone is not sufficient; they also need a sense of direction. For family businesses, with their natural affinity to balance the long and the short term, this could be an area to seek advantage.

Bruntwood's competitors in the office space business have often been driven by short-term financial metrics. Sometimes they end up not investing when they need to, or even exiting from investments at the wrong time because their leveraged funding model runs out of runway when their backers want their money back in order to seek short-term opportunities elsewhere. Bruntwood has benefited from this in a number of instances, taking over after such about-turns by its competitors, resulting in significant growth for the company, with a business that now employs 450 people, up from 12 in the early 1990s.

"If you recruit the right people who buy into the bigger picture of what you are doing, the success of the business works as a better motivator. The whole team is about selling then, not just the sales people."

Chris Oglesby, CEO, Bruntwood

The current austerity measures popular within many Western governments make the difference between those who win and lose through these policies all the more stark. Further, the short-term culture seen in the financial services industry has made fairness within business an issue for all companies to deal with. Social media has also upped the ante on visibility and scrutiny. For a company like Wates, this new landscape presents both opportunities and threats. Yet, it believes that some of the ingredients that enable it to be successful today are actually built into the DNA of the company: a clear objective to hand over the business to the next generation in a stronger form than it is now, a strongly held motivation to do well by people and finding ways to blend long-term thinking with short-term performance – all issues that Wates believes a family business is well-placed to deal with.

One guiding light for Wates in navigating these waters is its use of the FBN International *Sustainability Pledge* (see page 7). Among other issues, the pledge commits a family business to be responsible citizens in the communities they work in, and to pass on values and long-term aspirations to future generations. The Wates' partnership with local schools, and the "Creating a Sustainable Future" competency that it is building are indicative of the kind of thinking that enables the company to make such a long-term pledge.

The family's commitment to sustainability has also resulted in the creation of Myriad, a business (incubated outside Wates) focused on renewable energy. When the business idea was first mooted, it was not seen to be part of Wates' core business strategy. But now, as the markets served by Wates have moved towards renewables, Myriad and Wates are working closer together.

But is the long-term view compatible with the short-term performance agenda necessarily pursued by boards and management in family businesses? Donaldson Timber understands that family owners and

Case Study

Bruntwood

Employees: 431
Founded: 1977
Headquartered: Manchester, England
Industry: Property

Bruntwood was started in 1977 buying out old industrial property. In the 1990s it decided to move into the provision of office space. Chris Oglesby took over the running of the company from his father Michael who was the founder. Today, Bruntwood employs 450 people, up from 12 in the early 1990s, and has converted an initial investment of £50,000 in 1976 into a net worth of £330 million.

Over the company's life it has experienced growth of over 20% per annum. Typically, the funding for this has come from banks as private equity funders have been much more aggressive in their demands. However, there is a new stream of funding entering the market. As Chris Oglesby points out, "The main change in the market is that annuity funds are entering it and they are long-term lenders. The fact that we are a long-term family business gives us a good position in that market." As a result, Bruntwood has recently agreed a £130 million debt facility from a life fund.

"Family businesses, when they are good, are one of the best forms of ownership," says Oglesby. "However, finding equity finance that is matched and aligned to our family values is difficult."

What Chris and Michael Oglesby have built is a company that understands its position in the communities in which it operates. It has found a property model that works for regional cities in the UK, such as Manchester, Leeds, Liverpool and Birmingham. In each of these cities, it is a leading provider of office space.

But it is more than just understanding the market that serves Bruntwood. The values it brings to each regional community is important as well. "We participate in the Local Enterprise Partnership where we are based", explains Chris Oglesby. "Our people are involved with 60 external civic and charitable organisations in the cities we work in. I sleep very soundly knowing that the contribution the business is making to the broader community is very significant."

The company's growth was checked by the 2008 downturn, when its revenues dropped 20%. Although the business is back to pre-2008 levels, there were dark moments when Oglesby and his team thought about reining in the commitments the business had made to its local communities. "Each time we chose not to," says Oglesby. "The way we do business means that we have to be true to our values through the difficult times. If anything, this is even more important."

Oglesby likens the way the company works to a game: "The way you play it is important. We are in it for the long term. What the company stands for is important to us. The team is important to us." Which may be why Bruntwood does not offers bonuses to its staff, but allows all staff to share in an allocation of shares in the business. As Oglesby explains, "Research shows that bonuses do not support superior sales performance. If you recruit the right people who buy into the bigger picture of what you are doing, the success of the business works as a motivator."

professional managers can have different mindsets, but wants to benefit from the diversity of views from both groups. As a result, it promotes shareholdings among non-family members, with 15–20% of the business owned by employees. The objective is not just to provide a sense of ownership, but a sense of shared belonging. It also can make both sides more willing to understand the other's perspective.

Adnams was overt in taking the long view. It saw the global landscape for the brewing industry changing with a huge amount of consolidation, particularly in the mass market lager segment. At the same time, many locally focused micro-brewers have entered the market, resulting in fragmentation at the specialist end of the market. Adnams, which has been around since 1872, had to decide how it was going to set its own strategy.

It sought to play its heritage card in terms of branding, but also to modernise the business to sharpen performance in the context of the competitive environment it faced. One example of this was its approach to modelling the business based on carbon pricing. In its judgement, its business model was not tenable if the price of carbon kept going up and therefore it invested throughout the business to bring down its energy and environmental impacts.

Soneva is clear that its long-term values are what drive the business – something that many of its larger international competitors struggle with. When a business loses its purpose, it loses its drive and momentum. Like an oil tanker that can take miles to change course, a purposeless business can't easily alter direction. On the other hand, a business that is true to its values can make decisions that may even have a short-term negative impact but fit the overall direction of the business.

For example, water is a scarce resource in the Maldives, yet Soneva refuses to allow branded water on its property. Instead, it focuses on a combination of desalination, rainwater collection, aquifer water usage, purification and other water technologies as its way of matching its long-term goal of sustainability with its operational initiatives. Without the long-term objective, the idea of banning branded water might never have been conceived, nor might the follow-on activities have been researched and invested in.

PART 3

SUSTAINABLE VALUE CREATION: THE METRICS

For family businesses, the commitment they make to their stakeholders (shareholders, customers, suppliers, employees, the local community or society at large) often stretches out for decades and probably across generations. To underpin this approach, FBN International has codified that long-term commitment in a *Sustainability Pledge* (see page 7). While focused on family businesses, the pledge should be recognisable to non-family businesses that also seek to create and sustain long-term value.

The challenge for many businesses that seek to live by these ideas is that they often have difficulty in translating good intentions into practice. It is a truism that you cannot manage what you do not measure. In many companies, good intentions are not translated into ways in which the business can understand its own performance and help it to develop ways to improve it.

The prevailing business model is designed to maximise short-term financial results. As a consequence, most of the metrics that a company seeks to track and manage end up being financial ones. However, we have already seen that a company seeking to build sustainable value needs to respond to issues such as resource scarcity, environmental and social issues, and regulation around the world aimed at dealing with financial, governance and other crises. In addition to this, a company needs to consider, reflect on the impact of, and manage issues such as globalisation, population growth and heightened expectations of corporate transparency and accountability.

One approach in corporate reporting that is gaining ground is **Integrated Reporting**, through which an organisation can demonstrate the linkages between its strategy, governance and financial performance, and the social, environmental and economic context in which it operates. Although Integrated Reporting, as developing under the aegis of the International Integrated Reporting Council (IIRC), is focused on investors' corporate reporting requirements, every business can learn from analysis of the different types of resources that are in use in its business relationships.

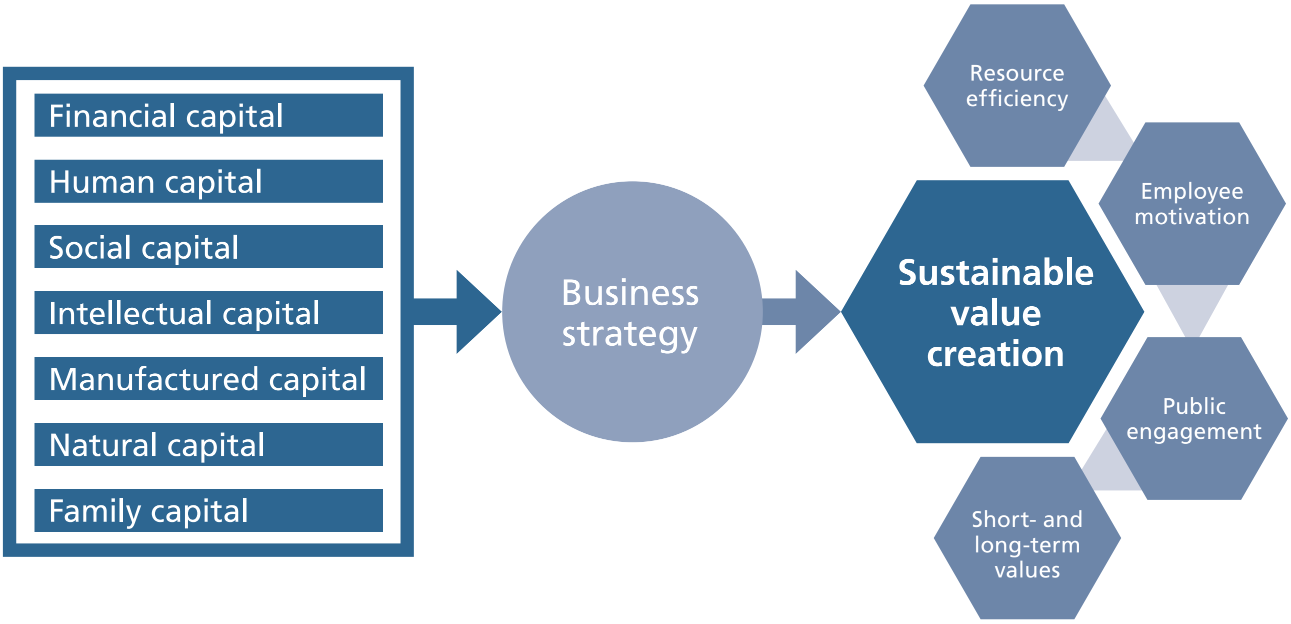
The IIRC distinguishes between the following categories of capital – the types of resources that are at the disposal of a company:

- **Financial capital:** the pool of funds available to the organisation for use in the production of goods, or the provision of services; usually obtained through financing or generated through operations or investments.
- **Human capital:** the skills and experiences of the employees in the business are used to innovate, communicate the organisation's strategies, lead and collaborate. It is particularly significant in the alignment and support of the organisation's governance framework and ethical values.
- **Social capital:** the institutions and relationships embedded within and between each community or group of stakeholders.
- **Intellectual capital:** the intangibles that provide competitive advantage, such as intellectual property, brand and reputation.

- **Manufactured capital:** the physical objects that are manufactured and available to the organisation in the production of goods or the provision of services, including buildings, equipment and infrastructure.
- **Natural capital:** the organisation's use of and impacts on the resources provided by nature, including water, land, minerals, the air, forests, ecosystem health and so on.

To the IIRC's list of capitals may be added a seventh resource identified in the IFB *Family Business Stewardship* report – namely **Family capital**, which is the deep emotional attachment that a family has to its businesses, and the sense of obligation it carries to the past, present and the future, and which goes beyond the financial relationship.[11]

Figure 2: Sustainable value creation – capital resource drivers



Few companies today incorporate all these types of capital into their management metrics. This is an opportunity for businesses to perform better by intentionally tracking the diverse capitals they manage. By consciously managing all of these resources, an organisation has the opportunity to move beyond a business model that is focused purely on financial performance. Broadening the attention to manage all its forms of capital resource, the organisation is not simply trying to administer the "hard" financial metrics, many of which are lagging indicators, but can work on how to manage the "soft" issues that underpin organisational health and vitality. As a result, the organisation can become more forward focused, responsive to change and able to innovate.

Many leading companies are seeking to widen their business objectives along these lines, by adding soft metrics to the hard data they have traditionally tracked. SAP tracks key metrics in three main areas of impact, as set out in Table 1. These metrics are verified by an independent organisation and published for anybody to see how the company is faring on these counts.

Case Study

Donaldson Timber

Revenues: £105 million in 2012
Founded: 1860
Headquartered: Markinch, Scotland
Industry: Timber

Donaldson Timber started as a Scottish timber importer in 1860, and for about 100 years after that there was little differentiation in the business from those around it. When Chairman Neil Donaldson joined the business, he introduced new disciplines that "enabled us to think ahead about where we wanted to be and how we wanted to get there. That made it possible for us to engage with the stakeholders in the business: customers, suppliers, employees and shareholders."

"Being involved in a family business is one of the most amazing responsibilities you can have," explains Donaldson. "When you take over the running of the company and its employees, it is a huge responsibility for a family member like me. I was determined not to screw things up. I would take risks but not at the expense of selling the family silver. It's a totally different mindset from that of a hired gun."

Yet Donaldson Timber has its first non-family managing director now. "The trick in balancing the different mindsets is in letting non-family staff have ownership in the business," points out Donaldson. "This gives them the opportunity to create value. It's not just a sense of ownership but a sense of belonging."

The timber industry has to deal with issues impacting local communities, and which governments are beginning to act upon: greenhouse gases, chopping down forests, licences for timber logging, replanting forests and so on. To add to that, Donaldson Timber has to manage waste packaging and control, deal with the chemical by-products from its factories and comply with health and safety. In its industry, the UK government is driving improved standards and Donaldson Timber keeps up with doing things properly. "It costs money to do it, but it costs more not to," explains Donaldson.

This approach to not taking short-cuts is part of how Neil Donaldson works. He attempts to meet every employee at least twice a year so "we can talk about pensions or the soap in the washroom. We don't have a written description of our family values, but if you ask our employees what's important, they would talk about the sense of family values in the business. It's not about living for today, or taking what one can today. If you build a house with a solid foundation, it will last. If it has a shaky foundation, it will disappear."

Table 1: SAP's key management metrics

Area of impact	Example metrics
Social	Employee retention, women in management, business health culture index, employee engagement, technology for non-profits, employee volunteering and social investment
Environment	Greenhouse gas footprint, total energy consumed, renewable energy, data centre energy
Economic	Revenues, operating margins, customer satisfaction

Unilever, widely regarded as an international leader in sustainable value creation, tracks three key areas of non-financial performance, via its Sustainable Living Plan, with each area having detailed metrics in support (see Table 2).

Table 2: Unilever's key management metrics

Area of impact	Example metrics
Improving health and well-being	Help a billion people improve their health and well-being via proper hand washing, oral health, safe drinking water and improving self-esteem
Reducing environmental impact	Halve the company's environmental footprint, with a particular focus on greenhouse gases, water and waste
Enhancing livelihoods	Enhance the livelihoods of hundreds of thousands of people via sustainable sourcing and the provision of better livelihoods in Unilever's ecosystem

The SAP and Unilever examples illustrate that there is no single right way to measure an organisation's financial and sustainability performance. Each of these companies has evaluated the issues that they seek to manage, and has created metrics that reflect their performance in the chosen areas. Other companies when defining their own set of metrics would also need to think about those sustainability issues that are either intrinsic to their industry or specific to their organisation's own sustainability objectives.

Puma has pushed the management envelope in a different way, by monetising its non-financial impacts. In November 2011 the company announced that the environmental impact of Puma's operations and supply chain was valued at €145 million for 2010, covering key areas such as greenhouse gas emissions, water use, land use, air pollution and waste. Some 94% of its impacts were in its supply chain. By carrying out such an analysis, Puma is able to prioritise which areas it needs to deal with urgently, and how material those impacts are on the performance of the company in terms of business risk, cost savings and new ways of becoming more effective. It also enables the company to understand which of its suppliers it has to prioritise in its engagement with them, and which issues need the most attention.

Since the publication of its environmental reports, Puma has also announced profit and loss reports relating to its social and economic impacts.

The key performance indicators that a business uses for management purposes have to be relevant to the business and its strategy – a company cannot simply pick some other organisation's metrics and drop them into place. However, there are certain common practices that can be learned from others. By focusing on environmental metrics, companies such as Puma and SAP are gaining a perspective on their operations and efficiency in a way that was not available to them until they started applying the lens of sustainability.

But how does a company assess which of the sustainability issues it is facing are actually important? And, how can it compare these risks in terms of priority or importance? Fronesys, a sustainability advisory service,[12] proposes a materiality determination method (see box) for figuring out which sustainability metrics a company might want to track.

Also, it is interesting to see how businesses use metrics such as customer retention, customer satisfaction and employee satisfaction (as adopted by Adnams, Bruntwood and Soneva) because these are good at allowing the company to "take the temperature" in parts of the business that are impacted by other "four key" framework areas.

Fronesys materiality determination process for sustainability issues

- Collect a universe of potential sustainability risks and opportunities that the company faces.
- Choose an industry classification, such as SIC or NAICS, in order to create a list of peers you can compare yourself to. For example, what issues are they tracking that you could usefully track as well?
- Define a materiality test for this metric. Keeping dimensions such as financial, organisational efficiency, regulations and strategy in mind, how does this particular issue affect the performance of your company?
- Apply your materiality test to the sustainability issues faced by your industry.
- Rank the results – not all sustainability impacts are equally material.
- Compare the results with those of your peers.
- Create a custom list of key performance indicators that enable your organisation to track material issues.

Another interesting development is how companies are using non-financial metrics when considering how to compensate their employees. For example, Wates requires health and safety issues to be taken seriously in the business, and so rewards staff on their division's performance in this key area. Tying employee compensation to desired behaviour is a well-trodden path with many having bonus schemes linked to financial metrics. However, the incorporation of non-financial metrics into compensation packages is still relatively undeveloped.

Bruntwood offers a contrasting example. It has simply dispensed with bonuses altogether. It is a deliberate choice because it feels that bonuses do not deliver superior sales performance, though it does reward people with higher pay if they are working well.

Case Study

Soneva

Founded: 1995
Headquartered: Maldives
Industry: Hotels

Sonu and Eva Shivdasani first visited the Maldives on holiday. The hospitality standards were quite basic, as Sonu Shivdasani recalls: "The oil had been re-used and the fish was burnt." But they fell in love with the place and ended up creating Soneva, a family of hospitality properties and products offering holistic experiences in luxurious and inspiring environments.

"Today, the wealthy live in boxes in cities," explains Shivdasani. "They have a home box from which they travel to their office box in a car box. We offer what we call 'barefoot luxury' – a holiday without interruption from news or shoes."

But offering such an experience takes a huge amount of work. Soneva has created a "Sun Card" which lays out how a virtuous circle operates in the company: a unique corporate culture and hospitality experience is created; this generates enthusiasm and pride on the part of employees who are the hosts offering the experiences; the guests find that their expectations are exceeded, and they prove to be strongly loyal; the company benefits from a profitable and sustainable business model, with a feeling of self-fulfilment for the founders.

This model may seem simplistic to lay out on a piece of paper but is at the heart of how Soneva works. The key is the connection that the company makes with employees. Each employee, known as a "host", goes through an induction programme based on the "Soneva Way", an attitudinal training programme, followed up with training on a service sequence that captures key best practices. Each employee is guided through this by a buddy.

The motivation of the employees is supported by how consistent the company's products are with its values and ethos. "When the customers get what you promise them, the result is brand loyalty," explains Shivdasani. The outcome is that 52% of Soneva's customers return for another visit – a metric that is nearly double the average for the hotel industry.

Part of the Soneva proposition is the acronym SLOW LIFE (Sustainable-local-organic-wellness Learning-inspiring-fun-experiences). The sustainability component is critical in an island environment where natural resources have to be cared for. Energy is scarce and so the company uses solar panels to generate electricity. By eliminating waste and reducing greenhouse gas emissions, the company has saved 5% of its annual cost of sales.

Water conservation is practised in many ways, including rainwater collection and the use of desalination plants so that aquifer water can be used for the plants. Branded water is banned – that way water does not end up being transported across oceans or sitting in docks. Soneva donates 50% of the sales of its own water products to a water charity.

So what does top class performance look like for Soneva? "We want to hit great scores on our KPI matrix," says Shivdasani. "In particular, we want to increase repeat business, decarbonise our operations, build our brand, be a favourite employer and achieve 20% compound growth." A true cocktail of sustainable value, indeed.

PART 4

CONCLUSIONS AND NEXT STEPS

At the start of this report we defined sustainable value creation to be the behaviours and actions of an organisation across multiple financial and non-financial dimensions in order to manage the risks and opportunities associated with economic, environmental and social developments. However, just being able to define a concept is not enough to know how to achieve it in practice. The four keys framework provides a distinct set of lenses through which to observe the performance and behaviour of a company in terms of sustainability.

Resource efficiency takes forward the "lean" model popular among financially driven companies, and uses it to uncover inefficiencies that were not observable before. Companies with strong sustainability agendas benefit from excellent support from their employees who reward the companies with better attraction and retention of talent. Further, companies that seek to engage with sustainability issues that are in the public arena, whether government has legislated on them or not, find that they are ahead of those who are not reading the tea leaves.

The trend is to move away from a business model focused on the short term. But can a business succeed by simply looking at the long run? The answer is almost certainly going to be no. It seems there must be a laser focus on short-term performance, while keeping the company tiller pointed firmly in the direction of long-term objectives.

How does a company balance short-term and long-term perspectives in its work? How can an executive team seek sustainable value creation over the long run, without going bust in the short run? Earlier in the report we saw that companies are beginning to realise that pace alone is not sufficient to guarantee good performance. Direction too is needed. Companies lacking a clear sense of direction usually fall into reactive ways, pursuing too many options at once. In times of increasing uncertainty and fast-moving change, reactive ways of managing a business can present significant traps.

Instead, balancing pace and direction requires a different strategic approach for each of the two time horizons. A long-term horizon of five to ten years or even generations creates the backdrop for short-term decision making. Setting long-term objectives is not the job of some kind of strategic task force, and nor is it a long-winded process. Instead, the senior management team needs to agree on a view of the direction of its industry and chosen market, and this long-term perspective enables it to support its own strategic investment decisions. It also enables employees to understand the direction of the company.

Can every company be an industry shaper? Unlikely. Nor should everybody seek to be one. However, companies that are part of ecosystems led by others can still move more quickly, scale their initiatives faster, and adjust course more quickly when they have thought through where the industry is headed, and what their own role in it is going to be.

An interesting example of this sort of approach is the Adnams case study. By driving a long-term sustainable perspective through the company, Adnams has changed from being the small, slow-moving, top-down autocracy that it had been for a hundred years into a modern company where short-term initiatives are aligned with long-term value creation goals. Further, Adnams' business partners can make their own investment decisions, knowing that the company is sticking to its long-range plans.

In contrast, a company that is solely driven by short-term reactive strategies has a problem. It will find it difficult to get business partners and others in its ecosystem to make longer-term investments, because those partners will not see any evidence of a long-term strategic plan. In fact, it will be quite natural for the company to retreat from such opportunities itself, exacerbating the lack of long-term value creation opportunities.

Of course, while dealing with the long-term horizon, the senior executive team also needs to focus on the short-term picture: what can be done in the next six to twelve months that will help accelerate the company towards its chosen long-term objectives? In this regard, financial metrics may not be that helpful as they are often lagging indicators. It may be more helpful to explore the two or three operational initiatives that can deliver tangible short-term performance impact, and significantly move the company in the direction laid out in its long-term strategy.

> **"Once you start taking steps, you keep seeing new ways of exploring sustainability. It is enlightened self-interest."**
>
> Andrew Wates, Family Director, Wates

Overall, our four keys to sustainable value creation provide a useful and practical perspective on how companies can explore the sustainability agenda. However, the best laid plans and hopes on their own will not drive extraordinary performance. Companies have to find ways to make sustainability real in the context of their strategies, their operations and their relationships. Only then will they have the tools in place to create and sustain long-term value.

This is a journey where we have only mapped the initial steps. Each company has to discover its own destination and the milestones it wants to set along the way.

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The report was researched and written by Jyoti Banerjee of M Institute and was edited by Grant Gordon of the IFB Research Foundation. Professor Annelie Karlsson provided strategic input on behalf of FBN International. The case studies were researched by M Institute and we are most grateful to each of the participants for sharing their experiences and insights. We also value the contribution to the report of Paul Druckman of M Institute.

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Simon Perry acted as project copy editor and assisted in the production of the report with Nigel Woolcott of The Communication Solution.

IFB Research Foundation
London, October 2012

NOTES AND REFERENCES

1. This definition can be compared with the corporate sustainability definition drawn up by consultant PwC and asset manager SAM in 2008: "A business approach that creates long-term shareholder value by embracing the opportunities and managing the risks associated with economic, environmental and social developments."
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9. Starbucks initiated C.A.F.E. Practices to evaluate, recognise, and reward producers of high-quality sustainably grown coffee. C.A.F.E. Practices is a green coffee sourcing guideline which seeks to ensure that Starbucks sources sustainably grown and processed coffee by evaluating the economic, social and environmental aspects of coffee production against a defined set of criteria, as detailed in the *C.A.F.E. Practices Guidelines.* Starbucks defines sustainability as an economically viable model that addresses the social and environmental needs of all the participants in the supply chain, from farmer to consumer.
10. Puma's *Environmental Profit and Loss Report* was created with input from consultancies PwC and Trucost. The full report is available at: http://about.puma.com/wp-content/themes/aboutPUMA_theme/financial-report/pdf/EPL080212final.pdf
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ABOUT US

About the IFB Research Foundation

The IFB Research Foundation is dedicated to promoting a deeper understanding of family business, which makes a significant contribution to the economy and society. The knowledge fostered through the Foundation helps ensure the continued success and sustainability of the UK family business sector. The Foundation is a registered charity (no. 1134085) and its activities are divided into two principal areas:

Research – developing an enhanced understanding of best practice and seeking fresh insights into the sector for the benefit all stakeholders including owners, policy makers and the general public.

Dissemination – enabling the sharing of best practice through publications and other means.

The Foundation works closely with its sister organisation the Institute for Family Business, which is an independent, not-for-profit, politically neutral, membership association supporting the UK family-owned business sector through Education (IFB Forum) and Representation. The IFB is a member of FBN International, the global network for family businesses.

The IFB positioning is politically neutral and the organisation is uniquely equipped to contribute constructively and positively to policy debates on family business issues.

www.ifb.org.uk

About the Family Business Network (FBN)

The Family Business Network is the world's leading network of business owning families, promoting the success and sustainability of family business. The role of FBN is to articulate the positive role of family business and its contribution to the economy and society. FBN works to create opportunities for sharing best practice through national, regional and international programmes and events.

Founded in 1990 as a federation of family business associations, FBN has grown to 28 national associations. The Network is composed of 5,600 family business members (owners, leaders and next generation successors). Members come from medium- to large-sized companies in 56 countries across 5 continents. Every year FBN provides more than 100 programmes, educational opportunities and events.

The FBN "Vision for the Future": Without a sustainable approach our future is at risk – not just the future of our businesses but the lives and livelihoods of generations yet to come. That is why FBN International has reaffirmed its promise to promote a business model that will sustain future generations.

www.fbn-i.org

About M Institute

M Institute is a not-for-profit think tank, based in the UK, which has the objective of highlighting the opportunities and positioning of medium-sized businesses. Its work has been used by policy-makers and chief executives alike in order to drive a new understanding of the role that mid-sized businesses play in national economies, particularly in terms of job creation, value adding and innovation.

M Institute is led by its directors, Paul Druckman and Jyoti Banerjee, both of whom spent many years in the technology sector as entrepreneurs and business leaders.

Jyoti Banerjee, the author of *Sustainable Value Creation*, is a specialist in business strategy in technology companies. Increasingly, he has focused on sustainability as the only viable business strategy available to modern businesses. He is involved in a venture fund that invests in mid-sized businesses in emerging markets that are committed to ethical practice.

www.m-institute.org

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