Columns

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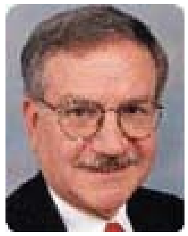

Ask the Experts

by Steve Rice & Richard MacLean
January 2001

Does Improved Eco Performance Pay Off? Maybe

Also this month:

- Issues for the coming decade
- Stakeholder perspectives
- Is corporate social responsibility a fad?
- The growth of non-compliance penalties
- **Got a question? Let us know**

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Q: I have been reading for years about how improved environmental performance is supposed to result in improved financial performance. How substantive is this assertion?

Steve: While I see more and more research showing such a correlation, I am not convinced improved environmental performance always causes improved financial performance. The research has not ascertained how much of the measured financial advantage is due to advanced environmental performance and how much is due to the multitude of other "good management" practices. Two recent reports have shed light on the matter:

The first report, "Green Dividends? The Relationship Between Firms' Environmental Performance and Financial Performance", was researched and prepared by the Environmental Capital Markets Committee of EPA's National Advisory Council for Environmental Policy and Technology. The committee examined several key questions, including, "Does existing research support the assertion that environmental performance has a material and positive effect on financial performance?" The report concludes in essence that there is strong empirical evidence that supports the correlation. It also concludes, however, that none of the studies conducted to date has been able to either prove or refute any underlying causation.

Generally, the report presents three theories that might account for the correlation. The strongest theory appeals to me: companies that are better managed achieve better performance -- both financial and environmental. As such, improved environmental performance may be more of the *result* of good management, rather than the *cause* of improved financial performance.

Mark Joyce, senior policy advisor at EPA and the leader of the project, told me, "Whatever the cause of the correlation, it is strong enough to lead smart analysts to conclude that a better understanding of a firm's environmental performance and environmental strategies can indeed be profitable."

The second report, "Pure Profit: The Financial Implications of Environmental Performance", evaluated the U.S. paper industry for differences in future value based on a variety of regulatory scenarios and probabilities. Prepared by the World Resources Institute, it showed that not all companies in that industry share the same value risks for the same sets of scenarios and probabilities. This study estimated that the value of the companies could change from about +3% to -11%.

This was a very important and insightful effort, though the approach that it used has two inherent investment-related shortcomings. First, the results are based on highly variable scenarios and probabilities. Small changes in the assumptions and probabilities changed the outcomes significantly. Second, the research and assessment took almost two years to complete; few investors can wait that long to make their investment decisions.

Thus, more work needs to be done before a substantive case can be made for the environmental-financial causation link. Several studies in the past few years have explored the causation links between financial performance and a variety of management factors such as company size, global presence and labor practices. Much of that work is summarized in the first few chapters of *The Human Equation* (Pfeffer; Harvard Business School Press; 1998).

Perhaps the rigorous methodologies used in those studies could be applied to determine if, and to what extent, improved environmental management yields improved financial performance.

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Q: Which major environmental issues do you think will drive change over the next decade?

Richard: I'll answer your question by referring to two excellent recent publications: one that examines domestic issues and another that takes a more global view.

The National Academy of Public Administrators released in November 2000 the report *environment.gov: Transforming Environmental Protection for the 21st Century*. Although the report focuses on U.S. environmental policy, it also contains an excellent evaluation of the underlying environmental stressors. This report is available at http://www.napawash.org/napa/index.html. I highly recommend it.

The blue-ribbon panel that prepared this report believes that the government should focus more of its attention on the major problems, rather than the minutia that consume regulatory agencies today. The top three issues are: reducing nutrients in watersheds; reducing smog; and reversing the accumulation of greenhouse gases. In part, these three were picked as worthy issues that could be used to demonstrate new approaches to better manage environmental issues.

They also described several other, interrelated, drivers for change:

1. **Increased wealth and demand for resources**, including a growing demand for energy services and for access to relatively unspoiled natural areas for recreation and housing.

2. **Increased pressures on ecosystems**, particularly from land-use changes caused by development, and from the spread of non-native plant and animal species.

3. **Increased costs for maintaining and replacing the nation's aging infrastructure** for safely delivering drinking water and treating wastewater.

Aside from the issues themselves, the bad news is that (taken from the very first line in the report), "The nation's current environmental protection system cannot deliver the healthy and sustaining world that Americans want." The good news is that there are policy solutions, as laid out in a 10-step action plan. However, this approach will take what report authors call "a precious commodity" in environmental management today: leadership. I wholeheartedly agree.

The second reference is *State of the World 2000*, by Lester Brown, et. al. of the WorldWatch Institute. Brown writes for GreenBiz.com and is one of the leading experts on global environmental trends. In this book, he focuses on seven significant trends: population growth, rising temperature, falling water tables, shrinking cropland per person, collapsing fisheries, declining forests, and the loss of plant and animal species.

Although there is some overlap between issues examined in these two sources, the differences are troublesome. I fear that the United States will focus on "in your face" problems such as urban sprawl, while ignoring or not leading the solutions to the other, far more significant issues. Many of these issues are related to the price of resources, especially food. In a rich, developed country such as the United States, who cares if a loaf of bread costs two cents extra? The problem is that major disruptions in the flow of resources eventually affect global trade, which influences everyone. Wars are fought over resources; our borders no longer are effective barriers to the kinds of wars that will be fought.

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Q: Your recent column brought up the subject of sustainability performance metrics for the airline industry. What other stakeholder perspectives might be important for companies to consider?

Steve: One important perspective might be their employees' perspective. While many companies survey their employees for 'employee satisfaction,' I have found few that deal with the deeper issues of employees' perception regarding a) the amount of time and energy they spend performing their jobs and b) the quality of their company management.

In these days of instant-mix mergers and "hired gun" mindsets, more and more studies are showing that many employees have lost, or are losing, the feeling of purpose in their jobs and no longer trust their company management. Many recent studies have explored this aspect quite deeply and present convincing proof that proper employee management is perhaps the greatest common factor between companies that have achieved sustained success. After all, if one of the three legs of sustainability is societal, isn't a significant portion of a company's society its employees?

Metrics that reveal employees' perception to their company's commitment to sustainability and effective environmental, health and safety management would provide the organization with valuable feedback. Companies that measure, assess and respond to such measurements could prevent the unpleasant surprises that Monsanto, Interface and a few other companies have recently encountered, several years after initiating their sustainability efforts.

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Q: Do you think that the current corporate social responsibility movement will be another passing fad, only to disappear when the public loses interest?

Richard: Maybe, based on history. Maybe not, based on emerging technologies.

From a historical perspective, the corporate social responsibility movement is on at least its third cycle. I'm no historian; the cycle count may be even higher. The first may have been the labor movement at the turn of the last century. Upton Sinclair's writings brought on a wave of public awareness and new legislation over working conditions and employee safety. Child labor was another early social/industry issue both in the United States and elsewhere. The next major movement occurred around the time of the war in Vietnam, when environmental issues and the military/industrial complex were caught up in the activist movement of the time. Some of the better social responsibility evaluations were created during this time.

Little quantitative data exist to track the social responsibility movement, as accurately monitoring something this broad and loosely defined can be problematic. There is, however, considerable anecdotal evidence of its recent rapid growth on the corporate agenda.

For example, I have seen in the past year several of my clients appoint full time, senior professionals to track and manage this area. Probably the best indicator is the rapid growth in the number of community reports issued either separately or combined with environmental reports. The November 2000 meeting of the Global Reporting Initiative is another indicator: the attendance doubled from the previous year.

Clearly, this is a hot issue right now. But is there true commitment behind the words? A recent report, *Corporate Spin: The troubled teenager years of social reporting* by the New Economics Foundation claims that there are huge discrepancies between what some of the leading companies say compared to what they do. Another recent report, The Global Reporters by SustainAbility claims that companies are being more transparent but fail to address the major environmental and social impacts.

So, if the substance behind these reports is shaky, will the movement survive? How, for example, would a global recession affect the movement? Companies can afford to be good citizens when they are making money. But when about when they are cutting back?

I predict that poorly managed, shortsighted companies will cut back on these activities, akin to how companies immediately cut back R&D, travel, and training budgets at the slightest downturn in profits. The most successful companies weathering bad economic storms will, however, strengthen their activities and use their performance to competitive advantage.

This view may sound idealistic, but the deciding factor this time is rise of instantaneous communication through cheaper computers, environmental monitors, cameras, and, of course, the Web. Local problems can receive worldwide attention overnight. A continuous stream of irresponsible corporations being exposed in this new publishing media call the web will have a powerful influence on where the social responsibility movement is headed in the future. In effect, the genie of mass communication has been let out of the bottle and there is no way to get it back inside.

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Q: Several massive environmental non-compliance penalties have been announced recently. What's going on?

Steve: Certainly General Electric and Nucor are among the most notable announcements, though there have been many others. There seems to be two events going on simultaneously.

First, many of these compliance cases have been going on for years. The timing for the conclusion of the cases and subsequent announcements could be driven by agency issues such as a) wrapping up this year's compliance penalty assessment statistics, b) completing cases before the new administration assumes power and/or c) sending the public signals that the current administration has been "on the job."

Second, and perhaps more meaningfully, I have been visiting several companies and sites the past few weeks. One of the common characteristics I have witnessed across virtually all of them is the "backsliding" of companies' and sites' compliance efforts. Perhaps the persistent downsizing of EH&S staffs and companies' "1 + 1 = 1" merger math is starting to take its toll. People are under-experienced and over-worked. Audit ratings have slipped from "exceptional" to "significant non-compliance"; scrubbers and other control devices are even being installed and operated without air permits; annual monitoring reports are not being prepared.

Despite ISO14000, Responsible Care and various sustainable development and reporting initiatives, the next year or two might well be when many businesses find out the longer-term results of some of their recent short-term business decisions.

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Got A Question?

Send your question about environmental management issues to Editor@GreenBiz.com.

We can't guarantee that we'll answer every question, but we'll try.

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