
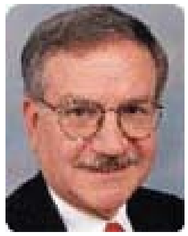

Ask the Experts

by Steve Rice & Richard MacLean
October 2000

Funding Criteria ... Sustainable Flight ... Outsourcing ...

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.

Q: Last month's question on the lack of venture capital investment in environmental technology and businesses raises a broader question -- why aren't such technology and ideas being funded?

SR: This really goes to the heart of the matter. First of all, the inherent characteristics of environmental investments (small markets, low barriers to entry, more commodity than proprietary and subject to unexpected regulatory change) generally run counter to venture investors' criteria for funding. As such, these opportunities are "out of favor" with most investment groups. Hydrogen- and methanol-based alternative energy opportunities appear to attract the most investor interest lately.

Secondly, most of the people behind the technology and business ideas whom I have met have great technical expertise yet have not approached the opportunity from a *business* perspective. Funders want to know three things:

1. What are the **business prospects**?
2. Who is the **management team** behind the effort?
3. What **personal effort and equity** have the existing principals put into the effort?

"The environment" typically is only a small, incremental investment matter of concern to them.

Third, the recent track record is something next to horrendous. Many venture firms still have memories of Molten Metal and have seen similar substantial losses recently with Kafus and Verde.com. Until there are some substantive successes they will not venture too closely to this sector, even though there will not be many successes until there is substantive investment. So, what's a startup to do?

This is a much more extensive issue, but one key element is to approach only those funds, groups and individuals that have a focused interest in these types of opportunities. Unfortunately, their investment range is small, usually regional, and usually focused on later-stage firms -- those that have at least some revenues and market response data.

Sealtech LLC recently received an infusion of $5.5 million, so it can be done.

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Q: We are planning to hold a conference and would like to recommend two or three airlines for our conference attendees' use, based on airlines' sustainability performance. Where can we find this type of selection guide or rating?

SR: While one of my colleagues and I have information on the topic in our files, we are not aware of any group that has published such an industry-specific ratings guide. If one does exist that can be shared, we invite the readers of this column to notify us and we'll share it in next month's column. In general, the European airline industry is doing most of the work in sustainability reporting.

In addition, any type of rating will represent the respective rating organization's value judgments. While the core data may be the same, an organization that places a higher relative value on air emissions will come up with a different set of ratings than an organization that places a high relative value on either waste management practices or social responsibility activities.

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Q: I've heard that Honeywell is shifting further away from the chemicals and plastics industries and focusing more of its time and attention to electronics, aerospace, and other technology-based segments. What effect will this have on Honeywell's participation in Evergreen, the nylon carpet recycling venture with DSM?

SR: That interpretation of Honeywell CEO Michael R. Bonsignore's statement may be a bit narrower than the actual statement. I've read that Bonsignore is losing patience with the financial returns of various business units, with no specific mention of their chemicals and polymers units.

Chemical Week reports:

> *Bonsignore expressed frustration with the company's polyester and nylon fiber units, signaling that some operations will be cut loose. "These are businesses where there is no ability to improve pricing, despite a near tripling of feedstock costs," he says. "We have to ask ourselves, do we want to have those kind of businesses in our portfolio?" He adds, "The answer is probably not."* [Chemical Week, July 19, 2000; page 9.]

Mike Costello, Evergreen's operations manager, told me that he concurs -- the statement was more general and that did not specifically mention any particular business units. Costello told me, "The price of oil and raw materials have had a substantial impact on the polymer business unit's returns; recently changes to the business have been made and the prospects are favorable."

I think Costello is right on track. That said, however, it is not difficult to surmise that Bonsignore was referring to a few select business units, including Honeywell's chemical and polymers units, of which Evergreen is a portion.

While I can't predict Honeywell's business moves, the company has been moving steadily away from nylon fiber and toward the higher margin nylon plastic materials, particularly for the automotive sector. If -- and that is a highly speculative if -- Honeywell quits the fiber business, there doesn't appear to be much reason to maintain its interest in Evergreen. If that's the case, look for either DSM to take sole ownership of the unit or for BASF to express an interest in the unit, though perhaps more for its output of recovered caprolactam (the key raw material of nylon 6) than as an unit to process nylon carpet yarn from its 6ix Again carpet recycling program.

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Q: Where can I find more information about the impact of good environmental performance on shareholder value?

RM: The view of "shareholder value" has shifted in a very positive direction. In the mid 1990s, environmental, health and safety (EHS) departments were under siege. Business managers were responding to competitive pressures and EHS managers were facing severe cutbacks. Many responded by attempting to prove to business executives that their staffs and programs were worth keeping, as opposed to outsourcing or eliminating.

Consultants responded to the increased anxiety (and market opportunity) by providing tools and techniques to provide cost/benefit assessments. Unfortunately, everyone got bogged down in minutia and lost sight of the big picture. Overly focused on cost cutting and budget-related issues, responses centered on demonstrating value for the money spent on EHS services and capital investments.

For example, Global Environmental Management Initiative in 1998 developed a pamphlet, Environment: Value to Business (EVTB), which acts as a guide to measuring and communicating the business value of environmental activities. Around the same time, Arthur Anderson developed and marketed Return On Health and Safety Investments (ROHSI). Activity Based Costing (ABC) was in vogue.

The really "big ticket" EHS issues and opportunities are associated with major risk, branding, market strategy, competitive product strategies, and long-term liability issues. Long-term liability issues or product concerns can erupt overnight if your particular issues become the focus of environmentalists' ire. While the consultants and published literature addressed these issues and opportunities to some degree, the tools to carry them forward were never fully developed. Additionally, environmental professionals, historically focused on compliance/regulatory issues, have been woefully inadequate in communicating these issues to business executives.

Recently, we've seen a new breed of business-savvy attempts to put a more executive-oriented focus on what all this may mean. The first of these articles appeared in 1995 and attempted to draw a correlation between share price and environmental performance. Recent, thoughtful research has come out of Europe by such organizations as the University of Basel and Bank Sarasin & Company, Basel, Switzerland. This area is emerging; I highly recommend you keep abreast of developments.

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Q: What resources are there to better understand the global environmental issues that environmentalists are concerned about?

RM: Think globally, but act locally. Most corporate environmental folks have paid attention to the local/regional/national scene, but still remain largely unaware of global implications to their business. For example, you may ask yourself, "What does decreasing water resources in India have to do with *my* business?" In actuality, the potential impact could be sizeable, even disastrous, if your marketing department anticipates tremendous sales growth in these countries. Revolution brought on by starvation may increase arms sales dramatically, but may very well hurt *your* business, which focuses on widget sales.

Nine Indian states are running major water deficits. In aggregate, they total just less than 100 billion cubic meters a year. Similar issues affect China, North Africa, and Saudi Arabia. The rate of loss of water supply due to natural habitat degradation is significant. And, significant as it may be, it rarely is reported in the news media, other than as occasional sound bites that executive business managers promptly forget amid all the other noise. In today's global marketplace, this information does matter, just as the advance knowledge of riots underway in Newark, New Jersey, would have alerted companies in the 1960s to an imminent decrease in sales. Forewarned is forearmed.

It is difficult to sort out the rhetoric from reality when it comes to global environmental issues. My favorite source is the Worldwatch Institute. There are several starter books to give you an overview of emerging global environmental issues. I recommend State of the World 2000 by

Lester Brown, et al. al. or Vital Signs 2000: The Environmental Trends That Are Shaping Our Future, by Janet Abramovitz, et. al., both of which are published by the Worldwatch Institute. For a global analysis by major region, read the United Nations Environment Programme's Global Environment Outlook: Overview GEO 2000, Editor: Robin Clarke, 1999. These publications may have a decidedly eco-slant, but examine the hard data and the sources quoted.

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Q: Is the trend to outsource and consolidate environmental staffs into shared service groups continuing?

RM: Outsourcing and shared services were all the rage starting in the mid 1990s. Even today, business management often considers environmental functions as service-type activities. This is not surprising, as many aspects involve regulatory issues (legal), reporting (information systems), health (employee relations), and risk management (engineering). It is no wonder that environmental departments have been caught up in the same frenzy to cut staff overhead.

Recent surveys by Competitive Environment have found that the trend has leveled off somewhat, in part because so many companies have already gone in this direction. Much of the "fat" in environmental staffs, which was built up to respond to new regulatory pressures in the late 1980s, has been trimmed. What we see today is a gradual maturing in the way that companies go about outsourcing or consolidating resources. Some companies are bringing back in-house activities that they only recently outsourced because of quality issues leading to compliance issues.

One major West Coast-based oil company felt it really was just not worth the risk to outsource certain activities. Another major East Coast-based chemical company reported that sites that eagerly sought to "get rid of overpriced internal shared service staff resources" found out later that the external consultants grossly underestimated what was required. Thus, they underbid the internal shared service staff, were awarded the work, but were subsequently faced with unhappy clients who expected much more.

The first example illustrates **Rule No. 1:** Environmental services are not the same as routine services, such as issuing employee paychecks. There needs to be a careful evaluation of the risks associated with outsourcing. The second illustrates **Rule No. 2:** No amount of contractual language will define exactly what the client expects. In the second example, the client expected X and always got X from internal staff because they understood what the needs were, including subtleties such as company cultural necessities. The consulting firm was unaware of these nuances and unknowingly underbid.

We also note a gradual relaxing of the rigid service level agreements between internal shared service staffs and their customers. In effect, both parties -- customer and internal service provider -- are more comfortable in delivering and receiving value-added services. How is this manifested? By moving from hourly cost tracking to six-month or annual allocation. A handshake is replacing rigorous service level agreements.

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