

Creating value from corporate responsibility

Does your reported data get the respect it deserves?

February 2011

At a glance

Today, there's more emphasis than ever on companies' environmental and social performance—in addition to traditional financial results.

Companies are disclosing unprecedented amounts of information, promoting their corporate responsibility goals and commitments.

More enterprise value can be generated by those efforts with stronger operational discipline.



Stakeholders are looking for investment-grade information on corporate responsibility. Like financial reporting, it takes discipline to track outcomes, analyze data, and make decisions related to company goals.

“Local communities, national governments, non-governmental organizations—they have all articulated a higher standard for corporate behavior,” according to Gregory Page, chairman and CEO of Cargill. “Similarly, most of our customers have made it eminently clear to us that our reputation impacts their reputations,” he says. And his company is not alone.

But do stakeholders give your company full credit for its corporate responsibility efforts? Or do they shrug? The gap between awareness and effort can be frustrating—especially when sustainability and corporate responsibility are important parts of a company’s strategies behind brand building, market expansion, cost containment, or customer acquisition.

Before diagnosing this as a communication problem, consider whether your corporate responsibility reporting is as rigorous and credible as your financial reporting is. Sophisticated analysts, investors, regulators, and customers tend to overlook anything that is not measurable and reliable.

More than one-third of U.S. corporate directors say issues related to corporate responsibility should be a focus of a board’s time.¹ And as a result, companies are giving the public a wider and deeper view into their inner workings by using metrics that are linked to business success—for example, having a good safety record, controlling greenhouse

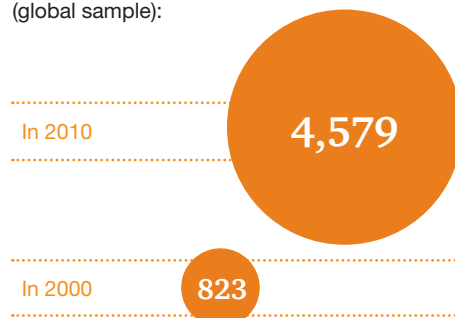
gas emissions, or making major contributions within the communities in which they operate. Companies are also publishing more information on corporate websites and responding to dozens of detailed requests from investors, NGOs, and customers every year.

Simply by disclosing relevant information, companies imply that it is investment grade. But many companies use rudimentary systems in the way they track results, analyze data, and make decisions related to their corporate environmental and social efforts. So, efforts tend to get watered down at the reporting stage.

Just as a culture of discipline pervades the realm of finance and operations, bringing similar skills and approaches to corporate responsibility efforts can enhance a company’s credibility. It also can build a foundation for cost containment, improved risk management, revenue creation, enhanced employee satisfaction, and stronger relationships with stakeholder groups that lead to stronger brands.

Figure A: Rise in reporting

Number of corporate responsibility or sustainability reports issued (global sample):



Source: CorporateRegister.com (copyright 2011)

Why are more companies promoting their corporate responsibility efforts?

The goals are to increase long-term shareholder and social value while mitigating the negative environmental and social impacts of company activities.

What sustainability challenges are companies dealing with today?

Economic, social, and environmental factors are challenging business as usual, causing companies to evaluate risk along several axes. In doing this, they are considering how:

- the pervasive use of digital communications requires closer monitoring of corporate reputations
- global financial markets and business networks are linked to each other, often in unexpected ways
- population growth and economic development may open new markets and strain natural resources
- national and local concerns about climate change, energy independence, and natural-resource use influence business operations and planning

What are sustainability performance goals?

These include a company's goals for generating revenues, increasing profitability, and gaining competitive advantage in response to trends related to sustainability challenges. They have specific and measurable outcomes tied to them.

What are examples of these goals?

A company selects its own goals based on its assessment of risk and opportunities. Objectives commonly include:

- reduction of water use, waste, or greenhouse gas emissions throughout the company and its supply chain
- dedication of R&D funds to products and services that address environmental or social problems
- setting revenue goals for products that have environmentally friendly attributes
- saving costs by improving energy efficiency
- educating the talent pool

Why should we bother with more-rigorous tracking?

The benefits of rigorous data collection, calculation, and validation include:

- better assessment of risks and opportunities at all levels of the business
- the ability to allocate resources and set appropriate performance goals
- confidence that baseline measurements are accurate
- the ability to enhance trust and promote value with key stakeholders
- improvements in delivering information in timely and consistent ways
- fewer errors and restatements
- less opportunity for manipulation

Simply by disclosing relevant information companies imply that it is investment grade.

More interest, greater scrutiny

CEOs tell us that regulatory concerns related to sustainability challenges—ranging from food production, to rare minerals, to greenhouse gas emissions—represent only part of the reason to anticipate greater public scrutiny of corporate activity.

CEOs also are monitoring other stakeholders, including investors, customers, employees, competitors, and other market actors closely—either non-profit groups advocating for change or companies in other industries that are making big bets on where the market is headed. Last year, some eye-catching activities emerged.

First, investors are using disclosures to engage companies on the issues. In the 2010 proxy season, activist shareholders targeted more than 80 U.S. companies in various industries with resolutions for better disclosure on how they are managing potential business impacts related to sustainability risks and opportunities.ⁱⁱ

Second, an unprecedented level of business transparency is allowing companies to compete for investor attention by using non-financial indicators that may have implications for business value. Progressive companies are aiming to differentiate themselves through their inclusion in popular sustainability indexes that synthesize vast amounts of information for investors interested in both financial returns and corporate responsibility practices.

In an effort to make environmental, social, and governance information more assessable to investors, Bloomberg now broadcasts to investment analysts—over the same terminals that receive financial data—more than a hundred metrics such as carbon-dioxide-equivalent intensity as a function of EBITDA or water intensity per sales. In a separate effort, Google Finance pumps out public companies' carbon disclosure ratings from the Carbon Disclosure Project (CDP). The CDP gives these ratings to companies by request of more than 500 global institutional investors with \$64 trillion in assets under management.ⁱⁱⁱ

Other voluntary initiatives—such as the United Nations' Principles for Responsible Investment, which represents \$22

trillion in assets—advocate mainstream adoption of more-responsible investment practices, an effort that could ultimately change how capital is allocated.^{iv} Roughly 12% of the \$25 trillion in total assets under management in the United States is dedicated to some form of socially responsible and sustainable investing thesis, a category that continues to grow.^v

Third, more companies have been swept into sustainability supply-chain initiatives initiated by large customers. Kaiser Permanente, Pacific Gas and Electric (PG&E), Procter & Gamble, Walmart, and others have introduced supplier sustainability programs over the past year. So has the federal General Services Administration (GSA), which purchases up to \$500 billion a year in goods and services.^{vi} The objective of these programs is to reduce both risk and cost in the supply chain, with a particular focus on energy use, greenhouse gas emissions, waste, and recycling.

Finally, a proliferation of sustainability and corporate responsibility ratings, awards, and certifications has fed the demand for making sense of performance. SustainAbility, a consultancy, reports that of the 108 ratings initiatives in 2010, only 21 existed in 2000.^{vii}

Recent initiatives in the United States reflect a growing response to sustainability challenges.

Figure B: Key U.S. sustainability initiatives influencing business^{viii}



New watch word: rigor

Most companies are still building the capabilities they need to operate effectively in response to stakeholder concerns over environmental and social issues. They use basic spreadsheets, e-mail, or do-it-yourself reporting systems to gather data and calculate metrics. The systems, processes, and internal controls long established in financial and operating areas of the business tend to be lacking for many of the metrics reported to stakeholders under the umbrella of sustainability.

requests. Drawing on perspectives from the finance and information technology (IT) functions and from external benchmarks, this company is exploring how to reduce inefficiencies and human error as well as how to automate some of the data collection and calculation processes needed to produce more-timely information. The company is also identifying where employees follow different processes to collect similar data—with a view to ways these processes can be standardized and verified internally.

Performance targets should emphasize data quality, because errors can compound year over year, making it impossible to be sure the company is reaching its goal.

Overlooking these fundamentals can leave valuable information unused, can introduce error, and can diminish the efforts of management to make effective decisions. The following examples show some of the common signs that reporting programs are not working as well as they could be.

- ***Data is old or unavailable when needed.*** Historical data can be useful, but what happened last year doesn't always indicate what's happening today. For example, one large financial services company takes most of a year to collect data and produce its view of the company's sustainability metrics. This leaves stakeholders with a one-year lag on key metrics and greatly limits the company's flexibility in managing information

- ***Data for key metrics get restated from one year to the next.***

Restatements are common when companies first learn how to report, but they shouldn't persist. Performance targets should emphasize data quality, because errors can compound year over year, making it impossible to be sure the company is reaching its goal. At one large IT services company, a 2009 assessment found that large amounts of electricity, natural gas, and diesel fuel had not been included in the company's original estimates for greenhouse gas emissions. While this company was able to self-correct, it nonetheless had to restate prior-year greenhouse gas emissions by 8% and revise public statements on progress toward the emissions reduction goal.

- **Data reliability does not get evaluated.** Based on responses to the 2010 Carbon Disclosure Project, half of almost 800 companies in a range of industries can report greenhouse gas emissions within a 5% certainty range and can support that claim with documentation, yet nearly one-quarter of respondents either do not disclose any information about how

they evaluate uncertainty ranges of reported data or do not evaluate uncertainty at all.

- **Executives don't have sufficient confidence to put sustainability performance metrics in the annual report.** Executives at another Fortune 500 company expressed interest in providing stakeholders with a more integrated picture of financial

and non-financial performance. They wanted to add key metrics from the corporate responsibility report to the annual report along with standard financial results, but other executives raised valid objections: If integrated into the annual report, investors would expect the data to have the same level of quality as the financial data. Lacking that confidence, the initiative was placed on hold.

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—Jim Stanway, Walmart

What’s the outlook?

Nearly half of the chief executives who participated in PwC’s 14th Annual Global CEO Survey say they expect stakeholders to factor companies’ environmental and corporate responsibility practices into purchasing decisions in the years ahead (see Figure C). Within the next three years, CEOs expect to change strategies to meet this need.

External assessments, including third-party verification or assurance for sustainability information, can help companies plan for what’s to come. The CEO of one prominent consumer apparel company put it this way: “As

the Walmarts and Targets of the world become more powerful, they are demanding that they get what they ask for. They won’t accept our word, but need third-party verification.”^{ix} Indeed, as Jim Stanway of Walmart told us, in the context of his own company’s approach, “You have headaches later on, in my opinion, when you want to say something and people are wondering if what you’re saying is real.”

External rating organizations recognize that sustainability data should be verifiable. Both of the two most credible such organizations (as determined by sustainability professionals)—the Dow Jones Sustainability Index and the

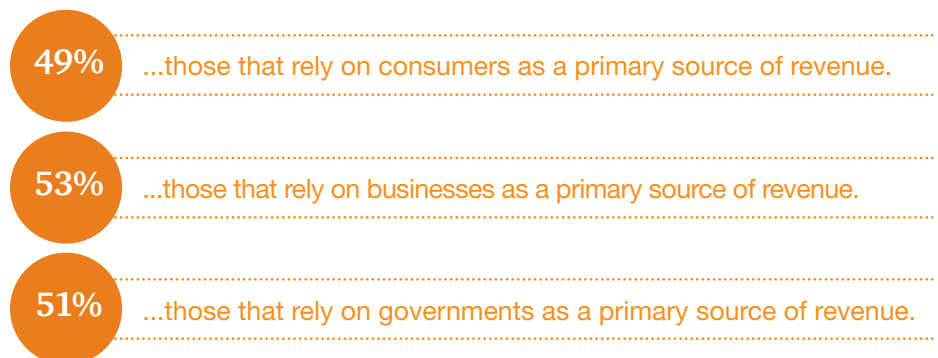
Carbon Disclosure Project—look for some level of independent verification, from any qualified third party, as part of their performance assessments.

U.S. auditors can issue opinions under standards that were created to produce information that stakeholders will trust. But before they seek an opinion, most companies will plan well in advance with a roadmap showing how to get ready for everything that assurance involves. Because they are newer disciplines, corporate responsibility reporting efforts and sustainability reporting efforts often don’t have in place the time-tested and rigorous processes that are ubiquitous in other areas of the business.

Figure C: CEOs plan to change strategies

CEOs planning to change strategies in the next three years because they expect stakeholders to factor companies’ environmental and corporate responsibility practices into purchasing decisions.

Respondents who stated “significant change” or “some change” in strategy



Source: PwC’s 14th Annual Global CEO Survey, PwC, 2011.

Q: To what extent will you change your strategy in the next three years to the following potential changes to purchasing behaviors? (Base: Consumers: 546, Businesses: 870, Governments: 176)

Considerations for management

When assembling corporate responsibility information, companies need to balance the need for discipline that produces reliable information with the need to be agile as the business needs change. The answers to several basic questions can help strike that balance:

- Do we demonstrate how corporate responsibility commitments and goals lead to enterprise value? Can we develop and report measures of return on those investments?
- Do our planning cycles for environmental and social initiatives make sense in light of our corporate objectives, expectations, and forecasts?
- Do decision makers feel they have the right metrics to manage performance?
- How well do we understand the challenges of getting information from disparate business units? from

our supply chain partners? How does this affect our planning for and timing of reporting?

- To what degree should we automate processes and calculations? Are technology options such as software as a service or cloud computing right for what we need to accomplish?
- Will we want third-party verification or assurance anytime in the future? How does that decision affect the design of our systems, processes, and internal controls?

Anticipating greater scrutiny of corporate responsibility information can be particularly fruitful in industries where regulation seems imminent or where key business relationships will come to rely on reported data. But in any industry, more discipline in measurement and reporting can help a company build trust with stakeholders and create business value.

Endnotes

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