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The Financial Value of Sustainability and ESG

Submitted by:	Christopher Gleadle
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As I reflect back on my journey in business and finance that has brought me to where I am today, the overriding constant in conducting business is, it is results, outcomes and accountability that have always carried weight. Serving customers well and adding value – making them more efficient, more effective, helping them grow. And, with sustainability, what began as a niche approach, today is flourishing into a strategic imperative, and must have a result-focused orientation.

Yet, within the mainstream of the sustainability movement it is common for organizations and many of their advisors to focus on how to execute process rather than how to deliver results. In part, I believe this since companies are not focused on the outcomes and sustainability's relevance to the overall goals of the firm – let alone give tangible, financial expression. Indeed, it is not uncommon to find organisations with as many as ten different sustainability focus topics; some have more than 30 (2/3rds of S&P 500 survey)! And, if the senior executives or business owners do not understand, and prioritize, but merely see sustainability as a box ticking exercise, then the result is disconnection from the firms purpose. This seriously hinders the ability for the firm to reduce conspiring environmental and social cost and risk, and further shackles the firm's ability to meet its primary objective of increasingly being able to capture, create and deliver more economic value.

And, while sustainability is rising in the corporate lexicon, and words are powerful tools in shaping perceptions, the hallmark of an authentic sustainability policy remains with a firm's ability to communicate in a material and contextual manner from understanding how sustainability connects across the entire organisation, its value and investment chain. The business demonstrates how systems thinking for Sustainable Viability, allows them to create fresh opportunities by uncovering the largely hidden risk and cost. They understand how to analyze and synthesize effectively with tangible, material metrics to achieve more with less – to make efficiency effective - to be more innovative and know how to leverage their newfound information and report in a manner that is integrated, material, and in context to engage individual stakeholder groups who have a material interest in the success of the business – to demonstrate their provenance. This allows them to break free of me-too competitors with a value-advantaged position – to serve their customers better by capturing, creating and delivering more value.

How do we know? What evidence is there that this is indeed the case? To answer these simple questions, let us look at finance, investment, risk and how sustainability and ESG (Environmental, Social and Governance) has material impact on the financial value of a business: potentially your business.

"Poor performance on ESG factors are used as a lever to reduce the value of a business by as much as ten percent".

In a recent PwC survey for the Principles of Responsible Investment (PRI), entitled The Integration of ESG & Governance Issues in M&A (Mergers & Acquisitions) Transaction, Trade Buyers Survey Results, it is shown how poor performance on ESG factors are used as a lever to reduce the value of a business by as much as ten percent. It being assumed excellent ESG is accounted for in the selling price. Moreover, once the demand for ten percent is exceeded, the willingness to continue with the deal may well be removed altogether. This would suggest that for the sale price of US$200M, a company could be affected by US$20M for poor ESG Sustainability performance – if the deal goes ahead at all. I suggest US$20M is a great cost not to have taken sustainability seriously and furthermore, does not demonstrate the opportunities to capture, create and deliver more value that have been missed on the journey to this point. Indeed, it must be further noted, according to the PwC / PRI survey it is 80% of deals that have shown a reduced valuation, or the deal has not gone ahead on poor ESG factors.

Therefore, for CEOs and CFOs, timely, accurate, validated ESG Sustainability information is vital. It must be delivered to them in a comparable language, as sustainability is proving to be increasingly affecting their ability to drive financial value inside their organizations, and in turn, as they seek cost effective funds. In fact, an area of complaint from boards is the lack of ability for sustainability personnel to communicate their work at a business and finance level. This suggests the earlier argument to be true that there is a lack of systems thinking and too much fragmentation of sustainability, further suggesting there is a need for greater involvement at the senior executive level. Additionally, there is an education and knowledge gap to deliver the quality of reporting - integrated, material and in context – that is increasingly needed to be a value driver, giving access to investment, and the removal of a price reduction lever.

However, to ease this shift, according to the Deloitte 2012 Sustainability Study, 61% of CFOs expect their involvement to increase over the next two years, underpinning internal collaboration, internal knowledge transfer and fostering the removal of the silo mentality. And to leverage sustainability for economic profit, robust ESG Sustainability factors are going to add a dominant perspective, showing ESG Sustainability efforts are at the nexus of financial materiality.

Ultimately, ESG Sustainability performance of an organisation, integrated with discipline, and reported with relevance and materiality, is becoming inextricably linked to due diligence and financial value. And, in the pursuit of a more sustainable, more regenerative and just world, it is the translation of that vision, delivered in appropriate language to the appropriate stakeholders where business winners of growth are, and will increasingly be found.

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