MAKING THE CASE FOR LOCAL SUSTAINABLE DEVELOPMENT

Introduction

Business often sees sustainable development as a payment to society for improving people’s lives and the environment in exchange for the license to operate. It views regulatory compliance with environment, health, safety and many social issues as preventing risks that could also threaten the company’s right to operate. At the same time, sustainable development offers an opportunity for increased revenues at the top-line and increased profits at the bottom-line. Smart businesses respond much better to opportunities than threats. Organizations that voluntarily show environmental, social and economic leadership enhance their reputations, build trust and meaningful connections with their key stakeholders and tend to prosper in the long term.

However, business leaders need proof that sustainable development projects will lead to quantifiable financial benefits in the short-term as well as the long-term. After all, money is the language of business and its most important metric. By integrating environment, social and economic responsibilities, it should be possible to demonstrate these financial benefits. However, most sustainable development professionals know less about accounting than accounts know about sustainable development. Corporate officials or customers are quick to impose sustainable development programs and requirements on local facilities with little to no guidance on helping them make the business case to their local leaders. It is well known that no business benefits, no program momentum. Some of the top-down mandated programs never really get out of the starting blocks. Saving the world is a daunting agenda for a local facility. It is challenging enough to find local initiatives that reduce costs, improve profits, and increase shareholder value. All business is hustling for market share in a very competitive market. Going out of business to save the world would be a tough strategy to propose in a boardroom. They are so fixed on this week’s, this month’s and this quarter’s financial results! The business case needs to be expressed in business language.

All the modules leading up to this one were focused on what it would take to get a local business to get on the path to sustainable development and to make continuous improvement towards this important objective. The nexus with local government and the key stakeholders (including employees and neighbors) was covered as well. This module will summarize what we need to know about “making the case” for this journey to start and continue.

No other question thwarts companies from pursuing corporate sustainability strategies more than, “What’s the business case?” Corporate leaders rightly want to know how
corporate sustainability will affect shareholders. Most previous attempts to address the question have focused on anecdotes, generic arguments, or academic studies, which have failed to persuade all but a few early adopters that corporate sustainability adds value for shareholders.

There are many approaches that have been proposed to help organizations make the business case for sustainable development. A number of these approaches will be presented here in this module. It is up to the organization to review this and other information in order to make the best business case for sustainable development that is consistent with the financial sophistication of their management.

Since the Baldrige model helps companies make the case for business excellence, it will also be briefly presented in a section below to show how it supports the making of the business case.

**Some Business Case Approaches**

Author Chris Laszlo\(^1\) started out by having the organization create “value creation initiatives” in his *Discipline #4*. This is very similar to the project approach used in this course and covered last week. (see *Tactic #5* below to learn how to associate EHS initiatives with value drivers in an organization). Laszlo focuses on six value drivers:

- Profitability
- Capital efficiency
- Cost of capital
- Growth
- Real options
- Market confidence.

In *Discipline #5*, he addresses the development of the business case. Just as proposed last week, he argues that each of the project’s costs and benefits must be determined with a monetary value, to the extent possible for each project. He also advocates the use of real options to value the intangible benefits of the projects (see *Tactic 4* in the bullet below for a description on how to use real options for valuing intangibles of sustainable development projects). Laszlo presents a list of challenges for using this discipline and a second list of critical success factors.

Laszlo’s *Discipline #6* describes his approach to capturing the values. He states that this discipline requires stakeholder management and engagement as part of the normal course of business. He then talks about validating results, capturing learning, and building sustainable value capacity in Disciplines #7 and #8.

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Ulrich Steger presents a paper on making the case. He states that organizations cannot always quantify the important influences that affect value creation, either directly or indirectly and they often attribute the drivers for sustainability to a “license to operate” or brand value and reputation. This makes it difficult to express the business case in traditional financial terms. Some organizations are content to feel that their sustainability efforts are “the right thing to do” and that the extra costs in doing them are marginal. Finally, organizations hesitate to cite self-interested financial reasons for the good things they are doing. He states that companies prefer a cautious, step-by-step approach to sustainable development with a focus on operational efficiency.

It has been found that even in the leading companies, the business case is neither well-developed nor formulated by sustainability officers in such a way that other managers understand it. The directors of the sustainability efforts concentrate more on “how” to manage the ongoing movement down the path even though there are sound economic reasons to invest in sustainability.

For most organizations, sustainability is a secondary issue, but one that nevertheless still requires the careful handling and professional management. There is a fear that things will get out of control if this is not handled properly. They feel that markets may not always reward sustainability, but they are very likely to punish those that lag. There is also a great difficulty in quantifying many of the poorly defined issues (e.g., specific impacts of global warming and their impact to the organization).

There is a feeling that how a company engages relevant stakeholders and addresses its particular corporate sustainability issues can have a direct bearing on its access to markets and capital, its ability to attract and retain a quality workforce, the efficiency of its operations, and its reputation and brand value. However to be successful, the sustainability effort needs to be a part of value creation. What is needed is a concept that integrates, not separates into a separate silo of environmental and social interests. The article states that the question is not – “Is there a value case for sustainability?” Instead the questions posed should be – “Where is the value for this particular company and how can that value be captured?”

Another issue addressed is that traditional corporate financial performance metrics haven’t changed much and are increasingly less useful as a measure of corporate value and future prospects. More and more it is the intangibles that are making the difference (i.e., human capital, intellectual capital, social capital, natural capital and structural capital). The value is coming from four areas: Improved margins, risk management (including brand and reputation), increased growth, and capital efficiency.

The SIGMA Project (see the bullet below the narrative on the course web site) has issued a guidance document that is designed to help an organization make the business case for sustainable development.

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Stalking the Elusive Business Case for Corporate Sustainability (see the bullet below the narrative on the course web site) takes a much different approach applying both conventional and emerging techniques of financial analysis to address the question of specific strategies at specific companies. This reveals new options for embedding an applied understanding of value creation through corporate sustainability in everyday business decisions.

Corporate leaders working to make their companies more sustainable and to demonstrate the value to financial stakeholders can use Stalking as a guide to build measuring the financial consequences into their efforts. Investors can use Stalking to stretch their thinking about how to extend their analysis to capture a source of value that others do not yet understand.

The business case is not a “one-size fits all.” Instead, organizations need to take into account specific circumstances of their organizations and how these circumstances can drive the sustainability effort. Moving down the path to sustainable development sounds like a good business idea and the preponderance of evidence confirms it.

The authors point out that there are four likely approaches to making the business case:

- Story telling
- Risk avoidance
- Overall excellence
- Analytical.

Next, the authors present information on understanding valuation. There are the concepts of ‘relative valuation,’ ‘discounted cash flows,’ and a variety of emerging valuation methods. These methods include: risk analysis, valuing intangible assets, and real options (i.e., covered in the economic responsibility module). The financial dimension of the case for sustainability strategies has long eluded those who have sought it. Many of the ‘answers’ given in the literature can be safely rejected. The financial case is neither obvious, nor impossible.

Investors will not be the ones to break the code to understanding the value of sustainability strategies because investors do not lead the creation of value – instead they follow it. It is up to the organizations that believe they are creating value through sustainability to clearly articulate that value to investors and financial analysts. The emerging techniques of competitive advantage and real options analysis are capable of helping stakeholders understand the value of intangibles such as reputation, knowledge, and the social license to operate.

The internal financial officer must first become comfortable with the case for using sustainable strategies. These people also need to be more familiar with how leading organizations are managing risks and realizing opportunities through their quest for sustainability with particular attention to the financial results they point to in their analysis.
The authors of “Beyond the Business Case” argue that an organization also needs to consider the ‘natural case’ and the ‘societal case’ in addition to the business case. However for the business case, they turn to the concept of eco-efficiency (i.e., efficient use of natural capital) as the most broadly accepted criterion for sustainability. However, in line with their concern for the triple bottom line, they make a plea for a measure of socio-efficiency (i.e., the relation between an organization’s value added and its social impact). It is felt that there are many positive social impacts that can balance the negative environmental impacts.

Business Case Literature Review provides a road map to making the business case (See Attachment 1).

Appendix 2 provides some information on what the business case might look like.

**Baldrige and the Business Case**

When you visit the Baldrige web site, you learn that companies that use the Baldrige model outperform financially the companies that do not use this performance excellence model. It carefully links criteria that define true performance with the results of a performance excellence program (i.e., Criterion 7).

When people apply for the Baldrige Award, the applications are scored by trained examiners. They train with cases. A training case example (i.e., GeoOrb Polymers) is provided in the bullets below this narrative on the course web page. It will provide you with an example of how a small company would approach the six performance criteria and the results criterion.

Some of the wording in the opening sections and in the financial results sections will help you see how it speaks to making the business case for the program. If you plan to go into the sustainable development field, it will be very important that you learn to express a program in business terms with a strong financial case.

**Concluding Remarks**

This brief module and the bullets that appear with it on the class web page provide a broad look at making the business case for sustainable development. If the company is publicly traded, the business case must be much more sophisticated than if the company is a smaller private company. We have focused on local businesses. Most companies that are actively involved in sustainable development make the business case generally at the corporate level, not at each local facility. However, it is in these facilities where the “front line” of sustainable development lies. The local manager must weigh the various

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corporate initiatives against the local business reality and deliver the revenues and profits to the corporate financial coffers. So the business case must be made at each and every facility that is involved in sustainable development to be effective.

The Systems Approach to process improvement makes the business case by tracking the cost and benefit of every project in the sustainable development program. This is similar (yet more detailed) to what is proposed by Chris Laszlow. Gwendolyn Hallsmith made a big point (as does the Baldrige model performance criteria) on having action plans to move forward down the path to sustainable development. The Systems Approach helps employees derive such action plans and get them approved by management prior to the implementation of each project.

Sustainable development experts keep trying to get companies to change their traditional accounting system to better accommodate the types of benefits that come from this programs. By using the employee projects, this is much more like good project management which always carefully tracks costs and benefits. The accountants are used to this and usually support these projects and the program with no problems.
## Attachment 1. Road Map to Making the Case

The route map was designed to "guide senior managers as they work towards building their own business case". It comprises the following steps and tools, also stressing the need for involving equity market managers.

<table>
<thead>
<tr>
<th>Step</th>
<th>Tool</th>
<th>Outcome</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Identifying significant impact</td>
<td>Impact Assessment/Appraisal (e.g. AA 1000)</td>
<td>Register of company-level impacts</td>
</tr>
</tbody>
</table>
| 2. Identifying key issues | - Issues/Stakeholder Matrix  
- Stakeholder dialogue (e.g. WBCSD criteria: legitimacy, contribution/influence and outcome) | Customized register of present or future key issues (from an external perspective) |
| 3. Establishing sources of potential threats and opportunities | Threat and Opportunity Analysis | Customized register classified by threat and opportunity |
| 4. Identifying and prioritizing proposed actions | - Porter's Five Forces Model (adapted): list of key issues prioritized according to their potential to create and conserve value  
- Correct strategic choice: test strategic fit  
- Rappaport's key drivers of shareholder value (adapted): assess potential of proposed action for creating additional value  
- cost-benefit analysis | Short-list of issues and proposed actions |
| 5. Highlighting actions with strategic implications | Strategic assessment (Macmillan and Tampoe) | Short-list of issues and proposed actions, highlighting those of strategic business concern |
| 6. Determining preferred actions for inclusion in a business case | Financial measures to test anticipated pay-off:  
- Return on capital employed (ROCE) impact  
- Economic value added  
- Discounted cash flow | Optimal list of issues and preferred action for inclusion in a business case |
Several other tools and web sites are presented for those seeking to find a way to make the case.

Appendix 2. What’s A Business Case?

A high-level overview of the business case landscape. Topics include:

- The nature of the case
- The central problem: Which costs and which benefits?
- A worst-case scenario: The double-list business case
  - Costs and benefits depend on case design
  - Every case needs a time line
  - The case must have self-evident validity
- A best-case scenario (the view from 39,000 feet)
- Business case check list
  - Are subject, purpose, and scope up front and clear?
  - Are cash flow projections organized along a time line?
  - Does the case describe its assumptions and methods?
  - Does the case include all important benefits?
  - Does the case discuss critical success factors?
  - Does the case identify and measure risks?
- What's the difference? Business case vs. business plan

The Main Points

Explain the relationship between case structure and case-building, through an intermediate-level overview of key points.

- Design and process are everything
- The natural order of case design
- The core team: key to credibility
  - Provides cross-functional cross-organizational support
  - Spreads the sense of ownership
  - Communicates methods, rationale, and expectations
  - Turns damaging criticism into constructive criticism
- Take the long-term time line view
- Scenarios: the future in detail
- Business impacts: costs and benefits
  - Costs and the cost model
  - Benefits come from business objectives
- The financial model
  - The cash flow statement
  - The dynamic approach
- Uncertainties: the devil is in the assumptions
Case Description – Introduction

The case-building starts with case design. Some of the first design elements also appear early in the finished document. This section begins the detailed, practical explanation of the "what," "why," and—most important—the "how" of each business case element.

- First things first: The Introduction
- Recruiting the core team
- Gathering background information
- Planning case design
- Title and subtitle: the message starts here
- Authors and recipients: anonymous cases carry little weight
- Dates: more than a formality
- Executive summary: two purposes for two audiences
- The subject: what is the case about?
- The purpose: why does the case exist?
- Disclaimer: It's not always optional
- The situation: Objectives, needs, problems, and opportunities
- Bring in the core team
- What's the difference? Subject vs. Purpose

Case Description – Methods and Assumptions

A business case is like a scientific research report in one sense: it is not enough simply to present the results. Readers also need to know the methods behind the data and the analysis. Case elements in this chapter deserve careful development as well as clear presentation in the finished document.

- Who needs a "Methods" section?
- Scope and boundary definitions: what's in and what's out
- Financial metrics and other decision criteria
- Major Assumptions
  - To simplify
  - To predict
  - To clarify
- Data Sources
- Scenario design
- Data structure
Analyzing Results

Case readers may look immediately for the "bottom line," but a good case in fact shows several important results and projections. Readers may need to see all of these, and they should also understand the risks and uncertainties behind the results. This section explains methods for developing this information.

- The cost and benefit time line
- Cash flow categories
  - The business case vs. accounting statements
  - Before tax or after tax?
  - Structuring benefits and costs
  - Benefits categories
- Cash flow statement or Income statement?
- Estimating costs
  - Estimating costs: quick and simple
  - Estimating costs: spotlight on the core team
  - Estimating costs: all the assumptions
  - Estimating costs: activities as cost items
- Estimating benefits
  - Cost savings and avoided costs
  - Increased income
  - Contributions to other business objectives
  - Finding the target value
  - How much does this benefit contribute?
- Financial analysis: Putting it all together
  - Net and cumulative cash flow
  - Discounted cash flow
  - What's the difference? Precise vs. Vague understanding
Packaging, Presenting and Using the Case

Conclusions and recommendations may be obvious to those who propose and develop the case, but for the wider audience, they need to be developed—clearly and concretely. Credibility and acceptance can be enhanced throughout the case-building project, but they still need reinforcement in the final presentation. Here are some considerations designed to guide you through these issues, and then to use case results as a tool for continuing management and control.

- Making sense of the results
- A time for silence
- A single spreadsheet system
  - Spreadsheet skills and spreadsheet errors
  - The dynamic financial model
  - Spreadsheet implementation
  - Cost and benefit item worksheets
  - Cost item estimates
- Benefit estimates
- Cash flow statements
- Financial metrics: The primary results
  - Net cash flow
  - Cumulative net cash flow
  - Discounted cash flow / net present value (NPV)
  - Payback period
  - Internal rate of return (IRR)
  - Return on investment (ROI)
  - Cost analysis
  - "Cost per" metrics
- Graphs
- Sensitivity and risk analysis
- Simple sensitivity analysis
- Monte Carlo Simulation: The future played out thousands of times
  - An example for simulation
  - Setting up the simulation
  - Running the simulation
  - Assessing risks: How likely are these results? Other results?
  - Sensitivity analysis: What happens if assumptions change?
- Comparing financial and non financial benefits
- Learning from experience
- What's the Difference? Planning or Decision Support?
Appendices

Additional resources include:

- Appendix A: Sample business case
- Appendix B: Financial metrics
  - Cash flow, net cash flow, and cash flow stream
  - Payback period
  - Discounted cash flow (DCF) and net present value (NPV)
  - Return on investment (ROI)
  - Internal rate of return (IRR)
  - References and resources