

# **Integrating Sustainability Impacts into Management Decisions: Paradox, Challenges, and Solutions**

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# The Leadership Challenge

Corporations have competing pressures:

- to produce profits
- to be good corporate citizens

Managers increasingly understand that these are linked. (e.g. waste reduction, product design)

# The Business Environment

- Organizations are facing
  - increased risks
  - from more sources
  - with greater impacts
- This increases as organizations:
  - achieve more global reach
  - increase use of internet
  - increase use of new technologies, financial instruments, and networks.

and the companies are typically both surprised and unprepared

both large and small companies need to better anticipate social consequences

Some social impacts turn into crises – but most do not.

How can companies predict which ones will, better manage the risks, and be better prepared?

And, how can they minimize the negative externalities?

How can companies convert risks into opportunities for growth?

# Key Questions

- How can companies
  - Measure
  - Manage
  - Report these risks?
- How can managers integrate these impacts, opportunities, and risks into management decisions including operational and capital investment decisions?

# Social and Political Risks Are Among

- The most challenging risks to integrate into management decisions
- The fastest increasing
- The most devastating
- High cost, low probability events – and are not typically considered or managed well.

Companies must decide whether to accept, avoid, or mitigate (share, transfer, reduce) these risks

# Social and Political Issues

- Child labor and poor working conditions
- Environmental emissions
- Nationalization of industries
- Joint venture partner risk
- Unstable or corrupt governments
- Potentially dangerous products
- Nutrition and obesity
- Interrupted supply

# Sources of Social Risk and Opportunity



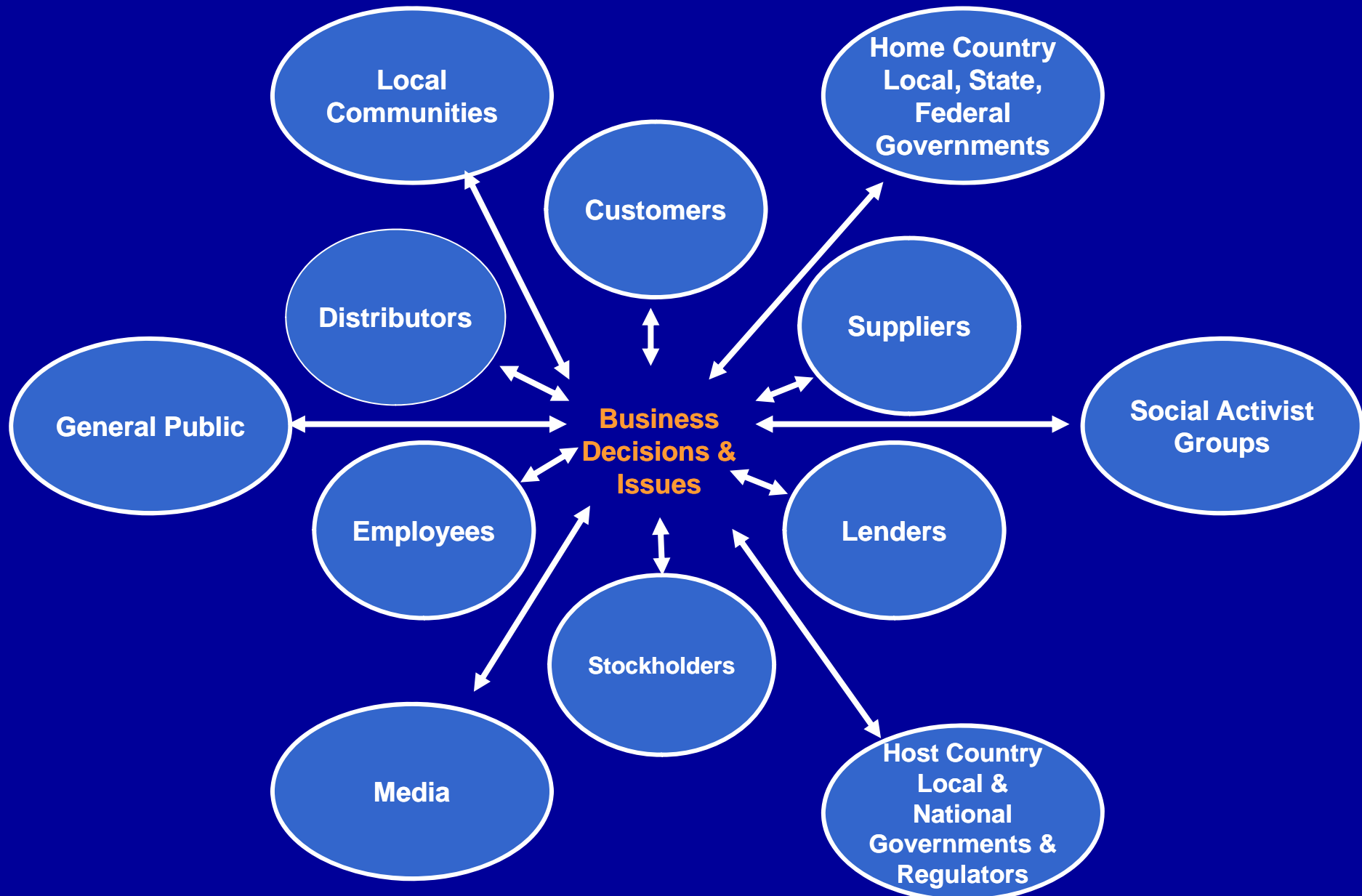
# Social Risk/Opportunity Integration Model



# Stages to Measuring Social Risk/Opportunity

1. Calculate Benefit of Each Issue
2. Calculate Potential Costs and Benefits, Including Reputation
3. Estimate Probability
4. Calculate Expected Value of Each Risk/Opportunity
5. Calculate NPV of Each Risk/Opportunity
6. Aggregate NPVs of Social Risks/Opportunities
7. Calculate Expected Value ROI

# Potential Stakeholders



# Integrating Social and Political Risk Costs in ROI Calculations

1

**CALCULATE THE MONETARY BENEFITS OF THE PROJECT**

Output	Revenues	Value
New product	Added revenue stream	\$.....
	Labor cost savings	\$.....
	New customer base	\$.....
<b>Total Benefits</b>		\$.....

**2****CALCULATE THE TOTAL COSTS OF THE PROJECT****Costs****Value**

<b>Shipping</b>	<b>Transport rates, import duty, transporting goods from port to factory</b>	<b>\$.....</b>
<b>Raw materials</b>		<b>\$.....</b>
<b>Labor</b>		<b>\$.....</b>
<b>Total Social Risk costs</b>	<b>See schedule A</b>	<b>\$.....</b>
<b>Total Political Risk costs</b>	<b>See schedule B</b>	<b>\$.....</b>
<b>Total Costs</b>		<b>\$.....</b>

**3****CALCULATE THE PROJECT ROI**

$$\text{ROI} = \frac{\text{Total Benefits} - \text{Total Costs}}{\text{Capital Costs (Investment)}} * 100$$

## SCHEDULE A

## COSTS OF SOCIAL RISKS

Risk	Benefits	Cost types	Costs	Likelihood	Expected Value
<b>Civil unrest surrounding site</b>	\$.....	<ul style="list-style-type: none"> <li>▪ <b>Extra security personnel</b></li> <li>▪ <b>Hiring community relations manager</b></li> <li>▪ <b>Managing activist NGO relations</b></li> </ul>	\$..... \$..... \$.....	..... %	\$.....
<b>Prostitution near site</b>	\$.....	<ul style="list-style-type: none"> <li>▪ <b>Implementing health education for workers to teach about sexually transmitted diseases (in order to avoid costs related to HIV infection)</b></li> </ul>	\$.....	..... %	\$.....

<b>Child Labor</b>	\$.....	<ul style="list-style-type: none"> <li>▪ Reputation damage</li> <li>▪ Managing boycotts from activist consumers</li> <li>▪ NGO-relations manager</li> </ul>	\$..... \$..... \$.....	..... %	\$.....
<b>Infringement of indigenous lands</b>	\$.....	<ul style="list-style-type: none"> <li>▪ Litigation in international courts</li> <li>▪ Remunerating population</li> <li>▪ Work stoppages due to local strike or community protests</li> <li>▪ Hiring community relations manager</li> <li>▪ Managing activist NGO relations</li> </ul>	\$..... \$..... \$..... \$..... \$.....	..... %	\$.....
<b>Reputation Costs (including lost sales and profits)</b>					\$.....
<b>NPV</b>					\$.....

# Responding to Social Issues

Identify threats to organization and industry

Identify potential responses

Identify opportunities for growth

Unlock and capture opportunities

# Gas drilling in Wyoming

What are the social, environmental, and economic impacts? (identification)

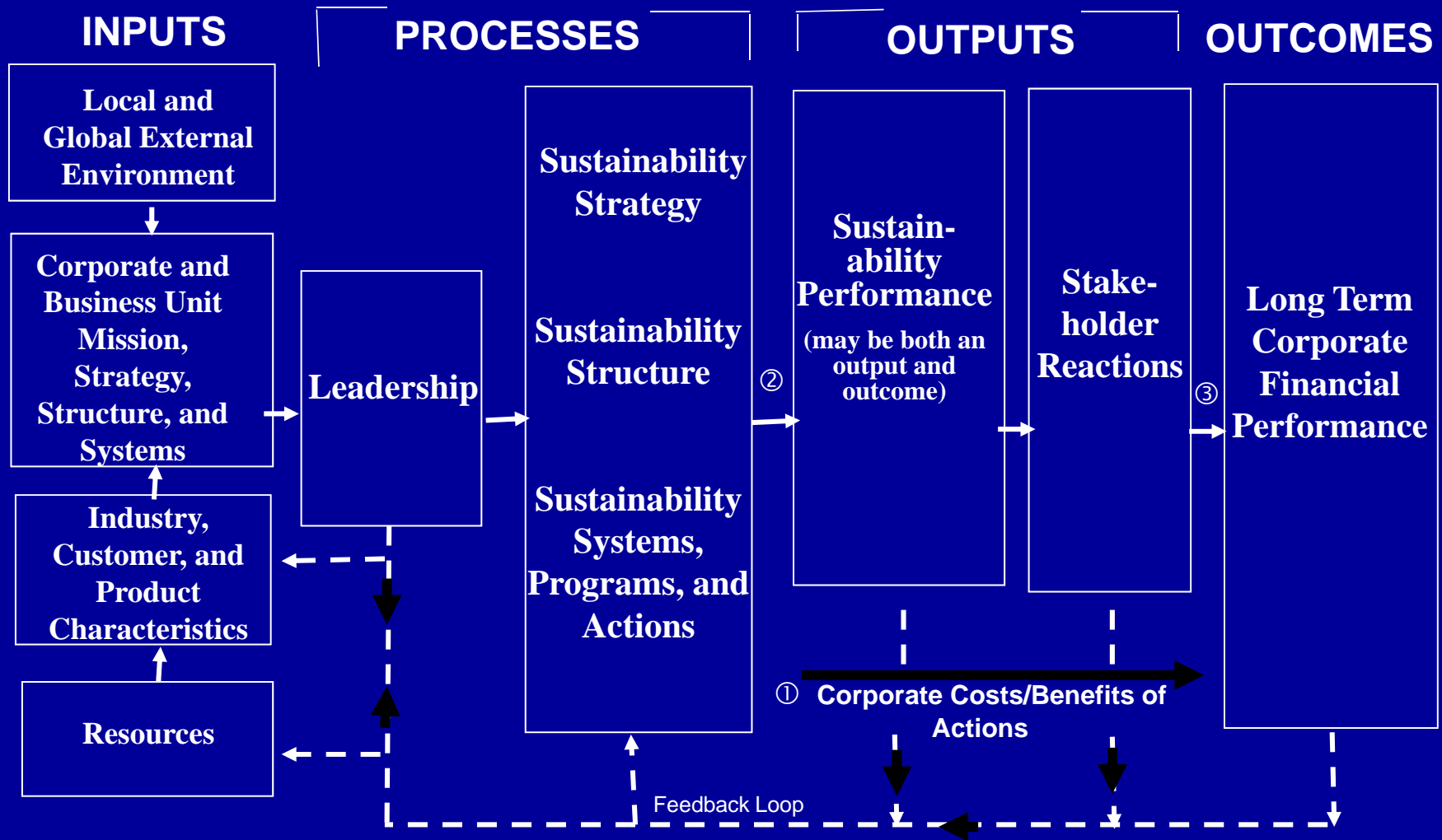
What do we know about the impacts and how do we measure them? (information and measurement)

How to make appropriate decisions and how to make the tradeoffs for each of the stakeholders? (decision models)

# The Management Challenge

Corporations are looking for workable models for responding to environment, social, and governance issues. Many mainstream companies want to be more socially responsible but do not know how increased social responsibility and accountability relates to shareholder value.

# Sustainability Contribution Model



adapted from Epstein and Roy (2001)

Measures have been developed for the inputs, processes, outputs, and outcomes and used in both company analysis and academic research.

# Selected Sustainability Metrics

Drivers	Performance Measures
<b>Inputs</b>	<ul style="list-style-type: none"><li>○ Alignment of corporate strategy to sustainability</li><li>○ Number and diversity of business units</li><li>○ Geographic diversity of production and sales</li><li>○ Sustainability impact of processes, industry, and product</li><li>○ Corporate financial position</li><li>○ Industry competitive position</li><li>○ Sustainability component in managerial performance evaluation</li><li>○ Resources available for sustainability</li></ul>

## Processes

- Number of plant visits
- Commitment of corporate and sustainability leadership
- Access of sustainability management to top management
- Resources devoted to sustainability
- Adoption of codes and standards for sustainability improvement
- Number and level of staff devoted to sustainability
- Hours of ethics training per employee
- Number of suppliers certified for sustainability

## Outputs

- Volume of hazardous waste
- Philanthropy and cause-related marketing contributions
- Number of spills, accidents, discharges
- Number of human rights and labor violations
- Results of ethics audit
- Rate of defective products
- Number of consumer protests
- Number of employee grievances
- Number of fines
- Number of social funds including company
- Number of awards received

## Outcomes

- Revenue from recycled waste
- Revenue from cause-related marketing
- Increased sales from improved reputation
- Reduced cost of materials due to reduced waste
- Revenue growth
- Reduced cost of environmental clean-up
- ROI
- Profits

To make lasting changes in corporations, the consideration of impacts must be integrated into day to day management decisions in addition to disclosures to internal and external stakeholders.

These are high cost, low probability events – and are not typically managed well.

CEO's increasingly recognize the importance of sustainability for

- fulfilling responsibilities to communities
- increasing shareholder value
- improving both social and financial performance

# Sustainability Success

No longer a discussion of why, what, or whether to focus on sustainability – but how.

But, neither academic research nor managerial practice have been effective in describing how to simultaneously achieve excellence in sustainability and financial performance.

So, if CEO's recognize the importance of sustainability, why is sustainability implementation so challenging and so often fails?

Because, implementing sustainability is fundamentally different.

For operating goals, the direct link to profit is usually clear.

For innovation, though long term and difficult to predict and measure, the intermediate goal is new products and the ultimate goal is increased profit.

Companies set missions and strategies and develop aligned systems, structures, culture, performance measures, and rewards.

For sustainability, the goal is to simultaneously achieve excellence in both social and financial performance.

Measuring and managing this paradox creates more challenges.

It is often unclear how to make the tradeoffs.

It is often unclear how stakeholders will respond to managerial actions.

The incentives are typically poorly aligned.

And, both corporate and societal priorities often change.

And, the costs of implementing sustainability constantly changes.

So – the standard successful implementation approaches often fail.

# Sustainability Success

## Primary Research Question

How do companies and their managers effectively manage social and financial goals and performance simultaneously?

# Research Sites

- (1) Nike
- (2) Procter & Gamble
- (3) Nissan
- (4) Home Depot

# Research Findings

Heavy reliance on distributed leadership and learning

Heavy reliance on culture and leadership

Less on formal systems

Many organizations see capitalism and citizenship as competing paradigms

These leading companies don't see the conflict and can manage both simultaneously because they are using the tension to drive more innovation and creativity rather than as impediments to decision making

# Success Factors in Managing Social, Environmental, and Financial Performance Simultaneously

SUCCESS FACTORS	EVIDENCE FROM NIKE, P&G, THE HOME DEPOT, AND NISSAN
<p>Balance Financial and Sustainability Goals</p>	<ul style="list-style-type: none"> <li>• Trade-offs between the social, environmental, and financial goals and performance are not seen as difficult – usually seen as win-win</li> <li>• Sustainability tensions are solved by using new ideas, creativity, and innovation</li> </ul>
<p>Make Sustainability the Business Case</p>	<ul style="list-style-type: none"> <li>• Keen awareness of anticipated stakeholder reactions to sustainability that ultimately have a financial impact</li> <li>• Stakeholder impacts are implicitly included in strategic and operational decision-making</li> </ul>

Leadership	<ul style="list-style-type: none"><li>• Consistent CEO and senior leadership support of sustainability and sustainability manager has authority across the company</li><li>• Clear communication of sustainability strategy, policies, and goals</li></ul>
Strong culture	<ul style="list-style-type: none"><li>• Innovation, creativity, entrepreneurship, and volunteerism are the building blocks</li><li>• Openness, autonomy, and initiative are the norms supporting a strong, innovative culture</li><li>• Broad sharing of culture through communication</li></ul>

# Summary

Corporate social impacts and risks have increased dramatically.

Critical to develop process to more effectively:

- identify, measure, manage, monitor, and report corporate social impacts
- integrate into operational, strategic, and resource allocation decisions
- assist colleagues in managing the paradox of simultaneously improving social and financial performance
- recognize that strategy, leadership, culture, and implementation tools are all essential components