



# Thought Leadership Workshop Two

## The economics of sustainability



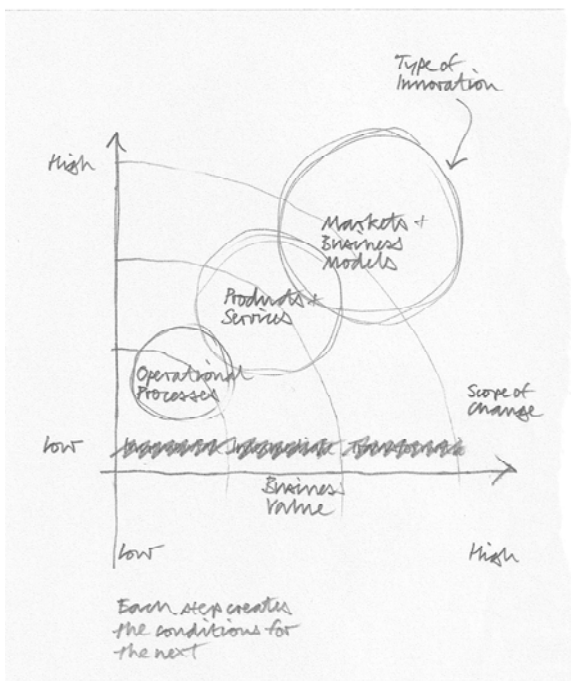
The second workshop in the Sustainability Thought Leadership series focused on *The economics of sustainability*. Held in London in December 2008, the session was facilitated by Dr. Mark Wade, with a keynote address from **Mark Lee**, CEO SustainAbility. Less than three months after the collapse of Lehman Brothers bank, and at the height of the financial crisis, the workshop was a timely opportunity to address whether, and why, it makes sense to address sustainability regardless of the economic environment and what the risks of inaction can mean for international competitiveness. With a background in financial services and sustainability reporting, Mark was well placed to encourage reflection on what sustainability means for companies' bottom line, for innovation and ultimately for business models that allow for leadership and sustained competitiveness.

Dr. Mark Wade briefly provided the contemporary context for the workshop, noting particularly **the twin challenges of the financial situation and the climate change and energy efficiency imperative**. Taken together, these emphasise both our global interconnectedness, as well as the finite nature of our resources – both financially and environmentally. The Stern Report (2006) was the first very public connection of these two challenges, and a report that succeeded in demonstrating the economic impact of dealing with climate change, as well as the understanding that the longer it is left, the greater the cost is likely to be. Dr. Wade reminded us that business is inextricably linked to the collision of these two factors: **business is affected by the health of the society in which it operates** because it is unable to operate in isolation, or to prosper in a financially, environmentally, or socially 'unhealthy' society. Put simply, from a business perspective, gradual degradation of the environment jeopardises the future viability of our businesses. With this vested interest, a sustainable development approach to business provides a single lens for addressing these issues. But is sustainability just a luxury for the good times? Or does it provide strategic insight that enables long term success?

To begin addressing these questions, Mark Lee started by suggesting that moments of crises can be defining moments of great opportunity to learn how to do things better. Sustainability, he argued, is a vehicle through which many of the other core challenges facing business can be addressed. During periods of massive economic expansion, it is often difficult to convince people of the possibility of a very different reality if environmental, ethical and social issues are ignored. However, in a situation where questions are being asked about where economic systems have gone wrong on a structural scale, a great opportunity emerges to deeply

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embed change. Mark noted that over the past three to four years there has been a **big shift in the nature of the sustainability debate – from the 'what' to the 'how'**. Where a decade ago, CFOs or executive level staff would meet discussions around sustainability with strong resistance, this is no longer the case. "This is a government issue now, and once that's the case, the conversation turns quickly – as it has done – to a business issue and how much, at what pace and what scale investment in the issue should be."



Mark's first slide, illustrates this relationship between sustainability and innovation, with the type or degree of innovation on the vertical axis, plotted against business value.



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He suggested, to simplify, three main stages of innovation on sustainability that companies and markets as a whole go through. These range from operational processes, through an evolved product and service offering, to whole new business models and market transformation.

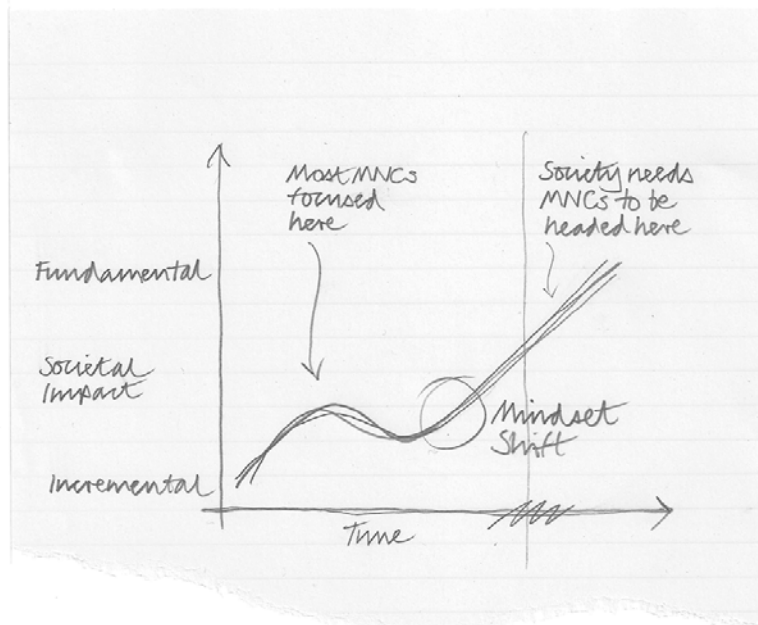
To illustrate this, Mark related this progression to the example of the auto industry. In the operational phase, this would involve more efficient factories – using less energy, less water or fewer

material inputs to produce the same cars. This involves more efficient processes, but the same output. Moving to the product and service base, this could be characterised by the production of hybrid cars, for example. This business is still based on a single passenger, or single family vehicle model, but one that is fundamentally better. A technology shift has occurred, and a certain level of innovation and re-thinking has been required.

However, there is still room for more sustainable, improved business or market models. For example, this could involve the sale of mobility systems, rather than passenger vehicles, such as the electric car model that has been established by Better Place, a venture-backed company based in California. Better Place has created a market-based transportation infrastructure to support electric vehicles and which accelerates the transition to electric cars. With its first network in Israel, similar networks are due to open in Denmark, parts of Australia, Germany and the USA. In order to overcome the current barriers to widespread electric car use, as well as leveraging policies in some countries that create a tax differential between zero-emission vehicles and traditional cars, Better Place has developed an Electric Recharge Grid Operator (ERGO) model for transportation. The ERGO model overcomes the problem with electric car batteries not taking you far enough through the creation of a network of charging posts to allow greater ease of charging. For longer distances to be covered these charging posts are supplemented with battery changing stations, set up similarly to gas station car washes. Reducing the battery change time to under five minutes, Better Place effectively sell distance travelled, based on a rate per kilometre. The innovation around sustainability behind this new business model means it is not the engine or the gas tanks being sold. Rather ownership of that is retained and distance is sold. Terming this '**disruptive innovation**', Mark suggests that such **new business models create a virtuous circle and ensure sustainable wealth creation.**

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The scale of change that is both possible and necessary is reflected in Mark's second slide. Until recently, he maintained that corporate focus has remained on the first 'incline' – concerned with process improvement, rather than maximising economic returns while at the same time ensuring environmental sustainability. Looking at the whole system and the likelihood of a carbon-free economy in the West within the next three to four decades requires a **mindset shift**, which will ultimately maximise returns on investment. Mark noted that by the





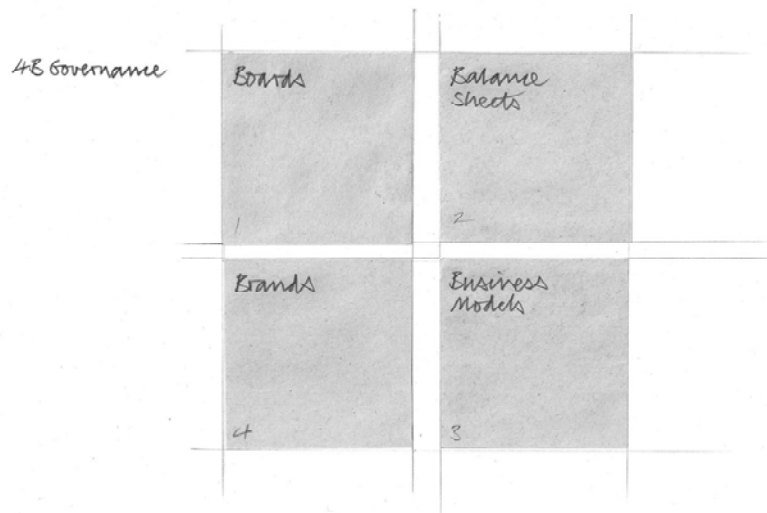
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time consumer trends or government policy is established, businesses are already operating in a crowded space, so leading companies are shaping market demand, rather than waiting for it to be identified and this is about discontinuity.

To illustrate this in relation to the credit crunch, Mark drew on the example of the interesting signals coming out of Japan. With mergers and acquisitions up five times over the preceding 12 months, Japanese firms are proving good at investing in downturns and taking the opportunity to move forward. Taking risks around new business models and strategic disruptions will allow their companies to lead out of the recession.

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In assessing a company's position and leadership potential on sustainability issues, Mark suggests a '4B' model that can be applied to a company of any scale. **Boards, balance sheets, business models and brands** all need to embrace sustainability for it to be fully embedded into a company and for the full benefits to be reaped. Here, Mark takes boards as a proxy for leadership, arguing this must come from the top. In terms of balance sheets, Mark argued that sustainability has traditionally been seen as a risk, but this is changing and consequently having significant impacts on business models. As soon as sustainability moves from the risk side of the balance sheet to the opportunity side, it alters fundamentally how it is dealt with and who deals with it inside a company. For example, moving from ownership by a compliance officer or an auditor, to the brand manager or designer and at the same time connecting these issues to the brand and presenting a whole new level of brand strength to the consumer. In this way it becomes clear how sustainability can be used as a proxy for good management.

Mark concluded with the challenge to New Zealand to leverage its current brand strength by backing this up with products that convey **transparency, traceability and simplicity**. As the financial crisis and the climate crisis collide, he argued that the definition of free and fair markets is increasingly converging to incorporate sustainability issues – free and fair has become **sustainable, free and fair**. Only clear, transparent and validated offerings will cut across emotive tendencies, such as support for local products. Going beyond compliance, if New Zealand companies are seen as exemplars, consumers will begin to see New Zealand products as synonymous with quality and sustainability, putting us in a leadership space.