CAPITAL THINKING

We all want to save the world, but where do we start? Peter Bartram outlines how the Natural Capital Coalition's protocols offer a blueprint for business to function sustainably

When Yorkshire Water had to take a disused water treatment plant out of commission, it faced a £26m bill to clean up and remove the soiled aggregate used to filter millions of gallons of water over the years.

It was the kind of cost no finance director likes - because it adds little value to the company. But Liz Barber, group director of finance and regulation at Yorkshire Water, didn't look at it that way. The company had been trialling a new protocol launched in July by the Natural Capital Coalition, which aims to help accountants and others look at the wider impact of their decisions on natural resources (see panel, overleaf).

At Yorkshire Water, the new thinking embodied in the protocol stimulated some creative lateral thinking. Instead of paying to have the aggregate cleaned and removed, Yorkshire approached some aggregate companies to cut a deal. The result: the material was sold to one of the firms for £3m.

The story is a pertinent reminder to senior finance professionals that the costs of taking into account broader environmental and natural resource concerns don't always fall on the debit side of the ledger. "By thinking in a more social economy fashion and using the underlying principles of the Natural Capital Protocol, we turned around the finances of the scheme," says Barber, who also co-chairs the Prince of Wales's Accounting for Sustainability project (A4S).

Her advice to other CFOs: "Don't be afraid of thinking along these lines because it can not only help the environment but also present a real commercial upside." Not only in the firm's bank balance, either. When high-profile companies are seen making positive moves such as this, it does no harm to their brand's image and reputation.

"One of the amazing things about the Natural Capital Coalition is that it is a real collaboration of organisations," explains Richard Spencer, head of sustainability at ICAEW. "It wasn't that a group of businesses got together and appointed a secretariat - 30 organisations from NGOs and industry bodies to firms including EY, KPMG and PwC have come together to create a public good (the IP is available to everyone for free under a creative commons licence).

"It is hard to think of other examples of this happening. ICAEW has been at the heart of it using our experience from the Finance Innovation Lab and Audit Futures to help make it work but the goodwill of all involved has been incredible. We expect that businesses will start to make very different decisions as a result of using the Natural Capital Protocol," he adds.

That is already clear at Yorkshire Water, where Barber and other executives are reconsidering the value they originally assigned to the company's 77,000 acres of land holdings.

"If you look at an acre of rough grazing, it would sell for about £1,000," Barber explains. "But when you apply the protocol, it begins to develop a greater value from issues such as carbon sequestration, flood mitigation and water quality."

For example, well-managed land delivers better water quality which needs less expensive treatment. Discoloured water is a problem that is costly to clean up. Yorkshire Water is currently spending £50m on a five-year investment programme of upgrading treatment plants to purify it. "So when you evaluate all of those factors, land that is conventionally valued at £1,000 an acre is worth a lot more," Barber says.

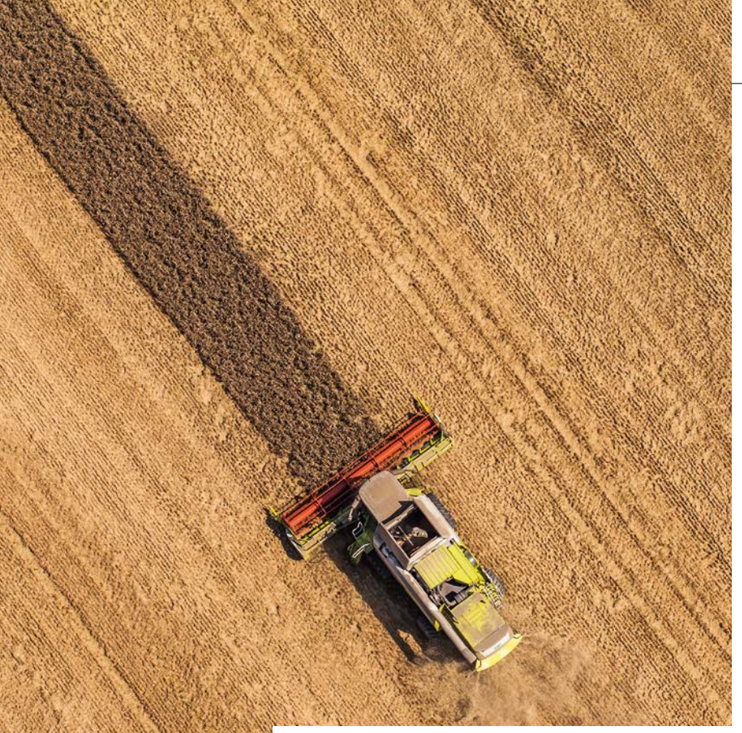
"The Natural Capital Protocol approach will fundamentally shift our view of the land, how it is used, and where we invest in it," she adds. "We will apply the protocol to all of our land holdings to make sure we are thinking very carefully not just about the pound note value but the natural capital value - be that surplus or deficit."

Barber's conclusions are just what Mark Gough, executive director of the Natural Capital Coalition, wants to hear. Gough is thrilled that more than 500 companies - many of them big international names including Shell, Coca-Cola, Dow Chemicals, Nestlé and Hugo Boss - are already trialling the protocol and feeding back their findings.

"Making information about natural capital more available will inform decisions more clearly," Gough says. "Boards will be able to make informed decisions about the resources they have." He believes the protocol will help companies answer a question many still puzzle over, and which others haven't even asked: how do we measure the value of the natural capital that our business relies on?

James Robey, global head of corporate sustainability at Capgemini, a technology and outsourcing company, has been working with a team at Henley Business School to explore the factors that drive companies to take natural capital more seriously - and which factors enable some firms to reap more business benefit from sustainability than others.

Robey collected data from 177 companies with 10 million employees and a combined turnover of $2trn. Although his team is still crunching the data, he says that two trends have already emerged. "The first is that companies that are most successful at driving sustainability projects are best at making a business case for them," he says. "They use levers such as demand from customers, employees or NGOs. The stronger the business case is articulated, the stronger the outcomes.



"The second is that chief executive commitment is vital. The CEO drives the organisation's commitment to sustainability."

But although board support is important, so is backing from the top of the finance function. At The Crown Estate, which manages a huge UK property portfolio from the seabed around the British Isles to London's Regent Street, interim chief financial officer John Lelliott has led strategic oversight of a pilot programme to try out the Natural Capital Protocol. He sees it as a way of pushing sustainability issues up the organisation's agenda.

"Our advice is to focus on the profit and loss account rather than the balance sheet and look at the potential to to increase revenue and reduce costs – now and in the future"

Jane Baptist, The Crown Estate's deputy head of sustainability, who has been at the sharp end of the project, believes that a new approach to sustainability accounting has great potential for influencing decision-making. "But business buy-in is critical," she says. To try out the protocol, The Crown Estate team applied it to four buildings in its central London portfolio. It used the protocol to help it understand how to manage the strategic supply chain risks when buying materials used in the buildings' development.

"For example, risks may relate to the long-term ability to source a material or the effect on our reputation as a result of the environmental and social impacts associated with its production or supply," explains Baptist.

The Crown Estate team produced a "heat map" - which highlights data within a matrix in different colours - that showed where it relied most heavily on the use of particular materials. "From there, we could identify an action plan for each of the hotspots," says Baptist. "We also developed a process to ensure we maintain the risk database and continue to refer to it."

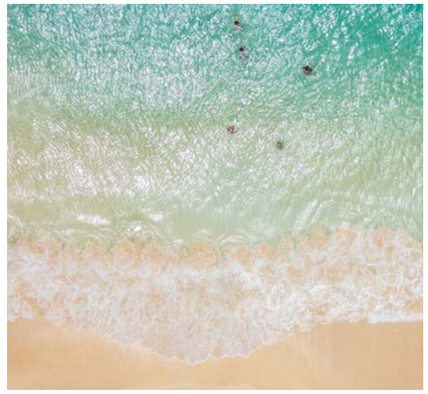
Baptist's verdict on the protocol: "It's important to be able to pick the bits that are going to help you in your business." She cautions against following it slavishly unless there is a sound reason to do so - such as calculating the respective environmental impact of developing two sites.

"When you've agreed that metrics are relevant to the business and you've understood and agreed on the basis for their calculation, those metrics can enable richer and better informed decisions that take account of factors beyond the purely commercial," she says.

But chartered accountant Mike Tuffrey, founding director of the consultancy Corporate Citizenship, believes there are different ways to approach sustainability accounting. He has advised Unilever for more than a decade. Its sustainability accounting focuses on four objectives: driving growth (such as opening new markets for safe drinking water); lowering cost (by cutting waste and saving energy); reducing risk (by ensuring long-term supply of key raw materials); and building trust (by strengthening relationships with all stakeholders). "Our advice is to focus on the profit and loss account rather than the balance sheet and look at the potential to increase revenue or reduce costs - now and in the future."

ICAEW's Spencer is convinced the Natural Capital Protocol - alongside industry sector guides, also being launched - will become key management information tools for thousands of businesses. "By using the tools, businesses will be able to deliver on their sustainable development goals," he argues. "They will be able to demonstrate they are serious about maintaining the planet we all depend on."

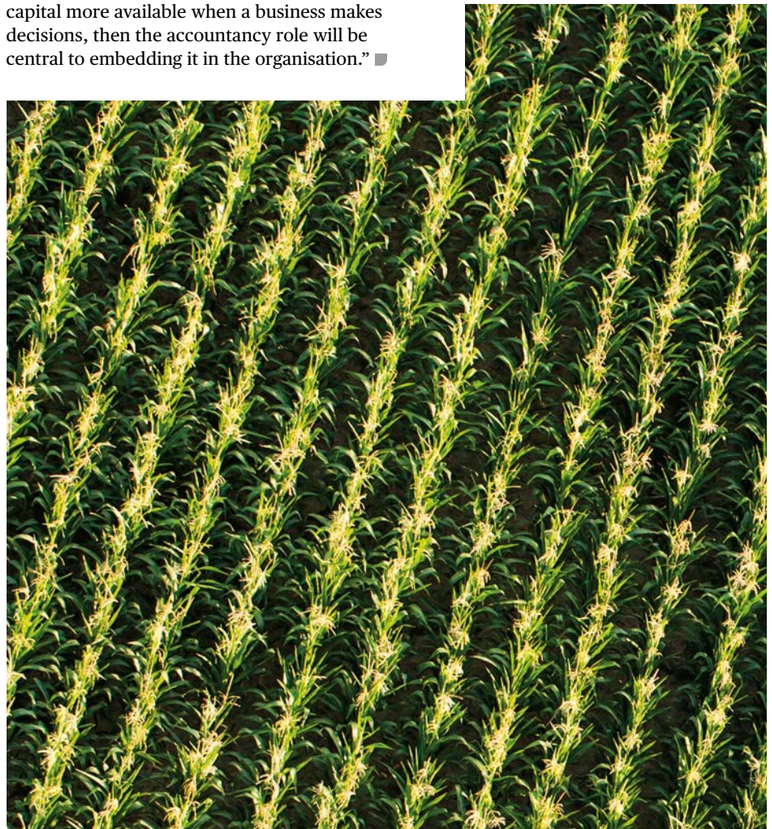
However companies choose to approach sustainability accounting, it is clear that finance professionals will play a key role. But to be most effective they will need to take a broader view, says Robey. They must think through new financial models which take a longer view and factor in the business value which comes from considering sustainability.



That approach is already delivering measureable financial benefit at Yorkshire Water. At the company, Barber and her finance team work with sustainability specialists. "The finance function is at the heart of business decisions, but the tools and techniques we traditionally use will miss all of the potential risks and opportunities - particularly around reputation - unless we take a broader approach," she says. "When sustainable accounting techniques are understood by finance teams and embedded in a business, thinking will become more resilient and long-term - and the business will take higher quality decisions."

Baptist points out that one of the obstacles to sustainability accounting is the lack of well-established and widely accepted methodologies and standards. "This means that different organisations account for environmental and social impacts in different ways," she says. Another obstacle is the lack of internal systems and processes to deal with sustainability accounting within businesses.

Gough hopes the Natural Capital Protocol will gain enough global traction fast enough to fill the gap that exists: "If we are going to make natural capital more available when a business makes decisions, then the accountancy role will be central to embedding it in the organisation."



HOW TO DO IT

To bring natural resources into your financial projections, how do you start – and where do you end?

That's where the NCC's Natural Capital Protocol comes into play. It's designed as a standard "framework" for firms to use as they measure the impact – direct and indirect – of natural capital on their future operations. But the protocol is deliberately not a set of prescriptive rules. It recognises that when it comes to measuring the impact of renewable or non-renewable natural resources every company will be different.

The term "valuation" is flexible to suit different circumstances. The protocol defines it as "the process of estimating the importance, worth or usefulness of natural capital" in a particular context.

So while some firms may want to put a monetary value to the capital, others may describe the impact of natural capital in non-financial numbers (such as the acreage of rainforest cut down) or with a "qualitative" description (such as the impact of a new quarry on the view of a beauty spot).

This is a challenge for finance professionals used to working with strict rules and standards. But there is clear logic in the nine steps of the protocol's process. Those nine steps are grouped into four stages.

First comes a "frame stage" where finance pros develop understanding of the concept of natural capital and the benefits of making it a factor in decision-making. Second is a "scope stage" where everyone firms up which natural capital issues to focus on.

The third "measure and value stage" guides users through the questions they need to answer before they take decisions on how to assess the costs and benefits of natural capital. And, finally, the fourth "apply stage" helps them embed their results in the company's decision-making process.

Underpinning every stage is a set of principles – relevance, rigour, replicability and consistency – designed to ensure the work is done at the kind of high standards finance professionals would expect to apply to a budget or set of accounts.