This article first appeared in *Reporting*: ey.com/reporting.

People, planet *and profits*

Businesses that want to survive in the long term understand the imperative of measuring and valuing their natural, social and human capital today. *Sally Percy* reports on initiatives that can help them do so.

With increased social unrest around the world and growing concerns about the impact of human activity on the environment, businesses today are under pressure to prove that their profits do not come at the expense of people and the planet.

"There's a lot of urgency to act," says Gretchen Daily, Bing Professor of Environmental Science at Stanford University in the US. "There's nothing wrong with capitalism, but we haven't got the capital bit right. We need to instill the values of natural capital into policy, finance and management before the losses are devastating. We know how – and we have many promising demonstrations to build on."

Indeed, the business community is starting to recognize its responsibilities with regard to sustainable development. Business leaders from around the world are actively seeking out ways to collaborate with each other, and with governments, scientists, standard setters and charities, through initiatives such as the United Nations Sustainable Development Goals and the One Planet Summit that took place in Paris in December 2017.

A major focus area for businesses when it comes to sustainability is how to put a value on natural capital and, increasingly, on social and human capital as well. This is because the process of measuring and valuing various forms of capital provides businesses with a better understanding of their key dependencies and their risks, giving them the ability to make informed decisions that will underpin long-term success.

More than 1,500 businesses worldwide now use the International Integrated Reporting Framework developed by the International Integrated Reporting Council (IIRC) – a global coalition of regulators, investors, companies, standard setters, accountancy bodies and non-governmental organizations (NGOs). The IIRC's framework gives businesses a method for communicating with investors and other interested stakeholders about how they measure their natural, social and human capital, as well as three other forms of capital: financial, intellectual and manufactured.

The IIRC defines natural capital as "all renewable and non-renewable environmental resources and processes that provide goods or services that support the past, current or future prosperity of an organization." Social and relationship capital consists of "the institutions and the relationships within and between communities, groups of stakeholders and other networks, and the ability to share information to enhance individual and collective wellbeing." And human capital consists of "the individual's capabilities, and the knowledge, skills and experience of the company's employees and managers, as they are relevant to the task at hand, as well as the capacity to add to this reservoir of knowledge, skills and experience through individual learning."

NATURAL CAPITAL

The Natural Capital Coalition was set up in November 2012 to raise awareness within the corporate world of how businesses both affect their environment and depend on it. "We're not a body, we're a space in between people who are doing lots of brilliant things," is how Executive Director Mark Gough describes the Coalition's activities. "We're the link that allows them to collaborate."

Around 270 organizations make up the core coalition and they represent seven distinct groups known as "worlds." These worlds are:

- Businesses (which make up around 50% of the membership)
- Governments and policy-makers
- NGOs and conservation bodies
- Professional associations, including accountancy bodies and the World Business Council for Sustainable Development (WBCSD)
- The finance community
- Science and academia
- Standard setters, including the Global Reporting Initiative (GRI) and the IIRC

> "Measuring and valuing various forms of capital provides a better understanding of the key dependencies and the risks."

The Coalition is supported by a secretariat that facilitates collaboration and outreach and coordinates expert input into different projects.

Case study: The Dow Chemical Company

Over the past decade, The Dow Chemical Company, based in Michigan in the US, has become increasingly attuned to the business risks posed by the loss of healthy ecosystems and declining biodiversity. In particular, it relies on a plentiful supply of clean water for its manufacturing operations, and on clean air to create a healthy environment for its workers and their communities.

"As we started thinking more about the impacts and the dependencies we have on ecosystem services, such as clean water and pollination, we realized that we needed to value them more comprehensively in our decision-making models," says Mark Weick, Lead Director, Sustainability and Enterprise Risk Management at Dow (pictured above). "We knew we needed to value nature differently when we were evaluating capital projects or new production facilities, developing new products or business models, or even making real estate decisions."

In 2015, Dow launched seven 2025 sustainability goals, one of which is to value nature. "It's a decade-long goal to gain US$1b in business value by doing projects that are good for business and better for nature," explains Weick. To meet this goal, the company looks at the decisions that it might have made had it not valued natural capital and ecosystem services; compares those with the decisions that it made when it did value them; and works out the difference in the value. "We've already collected US$160m in value toward that US$1b in the last couple of years," Weick reveals.

A member of the Natural Capital Coalition, Dow reports on its sustainability performance using GRI standards. "We consider those to be the gold standard for sustainability reporting," Weick says. "They meet our stakeholder needs very comprehensively. We find that the investor community is looking for shorter and shorter reporting, while a lot of our external stakeholder audiences, including NGOs, are looking for more and more information in a format that hasn't lent itself yet to what I would call an integrated report."

Case study: Philips

Dutch healthtech company Philips has been scrutinizing its environmental and social impact for decades; it started measuring the carbon footprint of its factories in the 1990s. Its focus has expanded to the environmental impact of its products during their entire life cycle, as well as the sustainability of its suppliers. That includes whether they hold appropriate licenses, source raw materials in a responsible manner and meet acceptable labor standards.

"We want to improve the lives of three billion people a year by 2025," explains Simon Braaksma, Senior Director of Group Sustainability at Philips (pictured above). "If our vision is to make the world healthier and more sustainable, then we won't be credible if we don't address those topics within our own company."

Philips is committed to being carbon neutral by 2020. Its US factories already leave a zero carbon footprint, since they run on 100% wind energy. Frans van Houten, Philips' CEO, also wants the company to do more to apply the principles of the circular economy by reusing materials, refurbishing equipment and moving away from selling equipment in favor of long-term strategic partnerships with different ownership models.

Philips has published annual reports that integrate financial and nonfinancial performance since 2008, using the IIRC's framework. It also applies the principles of the Natural Capital Protocol and plans to adopt the Social & Human Capital Protocol.

Its 2017 annual report includes an Environmental Profit & Loss account that highlights the hidden environmental costs associated with the company's activities and products. It reveals that, in 2017, Philips had an environmental impact of €7.2b, of which €200m (3%) was directly caused by its own operations – mainly energy consumption at its factories. Meanwhile, the company earned 60% of its income from green revenues (products and services that meet specific environmental criteria, such as energy efficiency) and recycled 80% of its operational waste.

The biggest audience for Philips' sustainability information is its own employees, although customers, suppliers and financial analysts take a keen interest as well. And investors, Braaksma says, "are often of the opinion that a company with good sustainability performance has a better chance of long-term success than a company that doesn't pay any attention to sustainability."

Its first project was to create the Natural Capital Protocol, a framework for identifying, measuring and valuing impacts and dependencies on natural capital. This evolved out of the 40 or so different private sector approaches that were in use prior to the Coalition's foundation. Within the first 18 months of the Protocol being launched in July 2016, around 35,000 copies of it were circulating. Daily says of the Coalition's work to date: "They've done a great job of bringing along a broad community."

> "Measurement is great because it gives you numbers, but to apply those numbers you need to understand value."
>
> **Mark Gough, Natural Capital Coalition**

Gough says the Protocol is important because it is a tool for embedding natural capital in decision-making processes. "Most of the things we've done within the sustainability movement are around measurement," he explains. "Measurement is great because it gives you numbers, but to actually apply those numbers, you need to understand value. Value is the relative importance and worth of something to you. When people see that their business is dependent, for example, on clean air, water, or a certain type of workforce, they realize that they need to invest in these areas to make sure the business runs."

SOCIAL AND HUMAN CAPITAL

The momentum behind natural capital has been building, and social and human capital are set to follow suit. During 2018, the WBCSD will found the Social & Human Capital Coalition as part of its Redefining Value program, which aims to ensure that sustainable companies are better recognized in the market, better rewarded, and therefore more successful overall. The WBCSD will play a key role, but the Social & Human Capital Coalition will be open to all stakeholders and will be overseen by an independent board of experts, rather than remaining a WBCSD-led initiative. Access to resources, and input into decision-making, will therefore be available to all interested parties.

The new Coalition will build on the existing Social & Human Capital Protocol, which the WBCSD developed alongside the Natural Capital Protocol on behalf of the Natural Capital Coalition. Both protocols have a similar framework and apply similar logic. As with natural capital, the aim is

This article first appeared in *Reporting*: ey.com/reporting.

Demonstrators at a People's Climate March in New York

to bring together existing methodologies and to raise awareness of companies' social and human capital impacts and dependencies. The members of the Coalition will include academics, accounting bodies, business people, economists, health and safety experts, human resources professionals and investors.

"The Protocol is broad in its scope," explains Matthew Watkins, an Associate on the WBCSD's Redefining Value program. "We include human capital – for example, skills, knowledge and wellbeing – and also social capital – for example, relationships, shared values and institutions. Social capital is typified by the level of trust between a company and its customers, and how the value of that trust can help the business."

Eva Zabey, Director of the program, points out that it is possible to value something "without it having a market price or having to pay for it." She cites the example of social media platform LinkedIn: "It is a free resource, but if you lost all your connections, you would realize that you have lost something that has a value to you," she says. "There are numerous valuation techniques that can be applied to understand how important, or useful, different social and human impacts are. Values from these exercises can then be used to make better decisions, even if they won't feature in the financial bottom line."

Zabey reveals that, while the WBCSD did consider creating an integrated coalition for natural, social and human capital, "the risk would be that the social and human capital communities would not have the time or the space to be able to convene and converge, because it would immediately be linked with other communities." Nevertheless, the long-term plan is that there will be integrated performance management and reporting for both protocols.

Viewpoint

Measuring the intangible

Prof. dr. Nancy Kamp-Roelands, Executive Director, Ernst & Young Accountants LLP

In the past, natural, social and human capital were often left "unmeasured." And what is not measured is not managed. As a consequence, trust in businesses, financial institutions and society as a whole is low. If we want to make progress, we have to address the issues behind these problems.

One of these issues is the emergence of new business models as we have shifted toward a knowledge economy. Within this new reality, intangible assets are becoming increasingly important to the corporate value creation process and represent a substantial proportion of market value.

So, if corporate reporting is to remain relevant, it needs to incorporate information about natural, social and human capital. However, even when companies do convey this information effectively, there is still the issue that investors and other stakeholders are not able to compare performance across companies.

To address this, some companies are making significant changes to the way in which they communicate and account for value. As standards such as the Natural Capital Protocol and the Social & Human Capital Protocol emerge, and new tools are developed to assist with data-gathering, companies increasingly have the means and instruments to measure and manage their nonfinancial capital.

Recently, we have seen leading companies integrate nonfinancial capital into their decision-making and their external disclosures. This new way of operating enables companies to design better solutions that address societal challenges, and to communicate about the way they create value. It helps them retain their license to operate, as well as their license to grow.

Delegates at the One Planet Summit, held in Paris in December 2017, where a range of initiatives to tackle climate change were agreed

"In the long run, we will need an integrated protocol," she explains. "To begin with, it will be voluntary, but if we want to achieve scale, it will need to be mandatory. Currently, the whole field of valuation is experimental, especially in business, so it's too early to establish mandatory methodology or guidelines. We need to make sure any guidance that is mandatory definitely leads to positive outcomes."

SUSTAINABILITY REPORTING

Companies that report on their natural, social and human capital impacts and dependencies can benefit from their disclosure in numerous ways. These include maintaining an operating license, being positioned as a supplier of choice, enjoying resilient supply chains, pleasing investors and retaining the loyalty of customers.

Yet the challenge for many businesses is deciding which sustainability reporting standards to adopt. Aside from the IIRC framework, there are the GRI sustainability reporting standards, the Climate Disclosure Standards Board disclosure system and the framework provided by the Task Force on Climate-related Financial Disclosures, to name just a few.

"Which is best?" ponders Gough. "I don't think I'm in a position to answer that. But from our perspective, the key thing is, what is the information being used for? How are people accessing it and how do you make sure they get the information they need in a timely fashion?" He believes that, while disclosure is important for driving transparency, it doesn't always lead to change, and he doesn't expect to see mandatory disclosures for natural capital introduced any time soon.

Yet it is encouraging that the importance of natural capital as a key dependency for business is increasingly being recognized through channels such as the Dow Jones Sustainability Index and the EU's Non-Financial Reporting Directive. Daily is also optimistic that the coming decade will bring a revolution in the way natural capital is reported on. "We'll get the ability to monitor natural capital in real time in lots of different ways," she says.

The Embankment Project for Inclusive Capitalism

In June 2017, the Coalition for Inclusive Capitalism (a not-for-profit organization dedicated to promoting the Inclusive Capitalism movement) and EY launched a project to develop a framework that would better reflect the full value that companies create through their deployment of human, physical, financial and intellectual capital. Known as the Embankment Project for Inclusive Capitalism, it brings together CEOs from more than 20 global companies. EY is developing the framework, which will be scrutinized, tested and refined by the project participants, with input from an advisory board comprised of leading academics, regulators, standard setters and other strategic advisers.

To find out more about the project, go to www.inc-cap.com/embankment-project

"I imagine we will see much more reporting across ecosystems, landscapes and production systems, and along coastlines and cities."

OVERCOMING BARRIERS

While some companies have begun to focus on sustainability, plenty are still lagging behind. So what is stopping them valuing their natural, social and human capital? There are many reasons, apparently. These include the perception that the process is complex and technical; the difficulty of finding consistent data inputs; and a fatigue with standards in general, which makes businesses unwilling to make additional voluntary disclosures. "One of the key barriers we face is a lack of understanding about potential benefits," explains Gough. "Also, we've been working with a lot of sustainability and risk teams, but we're aiming to engage more with CFOs."

To overcome these barriers, the Natural Capital Coalition is focused on addressing misunderstandings and creating an enabling environment that will allow the natural capital movement to really take off. "There's a big piece we can do to explain the benefits, challenges and where this fits in with what other people are doing," Gough explains. The Coalition is also producing a Finance Sector Supplement to provide guidance to the banking, insurance and investment sectors on how natural capital can inform investment decisions, and it is embarking on a data project to identify what information should be used as natural capital input data.

"The companies that survive are going to be the ones that move quickly in this area and build capacity."

Gretchen Daily, Stanford University

While businesses' awareness of their reliance on natural, social and human capital is growing, it is clear that they need to do more to measure and value their impacts and dependencies. "It's a matter of survival," says Daily. "The companies that survive are going to be the ones that move quickly in this area and build capacity. There's been an assumption over the past decade that what we see today will still be there in the future. That's not true any more." ■

May 2018

Building a better working world