

THE FUTURE IN PRACTICE
THE STATE OF SUSTAINABILITY LEADERSHIP



Keeping nature's balance sheet in balance

José Lopez



The River was shot in 2010 by
Brenndan McGuire, as he journeyed
down the Amazon with a team of
artists and scientists.



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Sustainable development – providing sufficient material and spiritual well-being to enable a good life for all of humankind, within the limits imposed by our one planet – is by definition a concept with global reach. This has significant implications for policymakers and the private sector alike, which influence each other.

Yet global negotiations on climate change, and many regional challenges around increasingly limited water resources, are characterised by a dilemma: almost everyone acknowledges that the world would be better off through co-operation, but as countries and regions don't trust each other enough, each player tends to favour their own, short-sighted advantage. Governments and businesses approach the challenge as though it were just another round of the famous ethical conundrum 'The Prisoner's Dilemma', creating the result that everyone may get caught out by environmental collapse – just like the two prisoners who betray each other in the false hope of a more lenient verdict.

To escape from the prisoner's dilemma in the area of climate change an international

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policy mechanism has been put in place, the UN Framework Convention on Climate Change – however imperfect this may be. But climate change is only one aspect of the much

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broader concept of 'natural capital': the sum of all mineral, hydrological, fossil and biological resources, and the ecosystem services they provide as an essential input for human activities – clean drinking water, food, timber, climate regulation, recreation, and many more.

Let's look at this idea of natural capital through the lens of a business leader. Assessing the health of our own companies, we typically use three main financial tools: cash flows, income statements and the balance sheet. Looking at any of these in isolation doesn't tell you the full story.

Now imagine you're appointed CEO of Earth Ltd. You would have some kind of cash flow and income statement at your disposal: global GDP, which currently stands at some US\$65 trillion. An impressive success story! But what about the balance sheet? There is simply no equivalent accounting mechanism in place that could give you a sense of the natural capital available to run your company. In fact, a standing forest is worth literally nothing in national accounting terms, while a forest that is cut down contributes to GDP. The lost forest is not accounted for as a liability on the Earth's balance sheet, in the same way as the standing forest was not counted as an asset. Both are externalities that are not reflected in today's prices. But someone will have to pay the bill, probably sooner rather than later.

Estimates of the economic value society derives from the living environment are of an order of magnitude similar to global GDP itself. But until recently, these services were simply taken for granted. Only now, as we draw down nature's capital, we realise that the diminishing asset base begins to yield diminishing returns.

As the world's largest food company, Nestlé turns nearly one per cent of the world's agricultural output into food and beverages. Responding to the nutritional needs of our consumers, we depend probably more than most other businesses on functioning ecosystems and a sound environment. And as a whole, the agro-food sector faces the considerable challenge of producing food that is not only safe, nutritious, and affordable for all, but that is also produced in a way that keeps nature's balance sheet in balance.

Yet, as long as the real costs of natural capital are not internalised – ie not borne by businesses, and ultimately by consumers – according to a fair, equitable and global level playing field, markets do not receive the right price signals and financial capital continues to flow in directions that do not always help to preserve natural capital. In other words, companies are often caught in the same prisoner's dilemma as countries and politicians: nobody dares to make the first move. The politician does not dare to act because he fears the verdict of the voter, and the business leader because he fears the verdict of the customer or shareholder, as a full internalisation of costs would lead to potentially significant price increases.

Like many other leading companies, at Nestlé we are trying to build the necessary trust to overcome the dilemma in three main ways.

Leading by example in our own operations and areas of influence

For many decades we have focused our activities on making our own manufacturing sites more eco-efficient. Since 2001 we have reduced water withdrawal by 28 per cent

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and greenhouse gases by 17 per cent, while increasing production volume by 73 per cent. We apply high environmental standards wherever we operate, including in areas where regulatory expectations were much lower than our own.

Here, too, we have faced a dilemma, for example when building wastewater treatment plants in countries where none was required by law. Our local management would, quite rightly, argue that similar investments were not being made by local competitors, and so for us to pursue them increased our production costs and might eventually price our products out of the market. This is a typical example of what we mean when we say we don't compromise our long-term development for short-term gains. What may indeed have been a certain cost disadvantage in the short term turned out to make our business more sustainable in the longer term: often we set expectations that led to stricter regulations over time, requiring local competitors to upgrade their operations too.

Beyond our own 461 factories in 83 countries, we have many other opportunities to improve the management of natural capital through our complex value chains. Most importantly, this involves helping farmers through our network of 1,000 agronomists to make agricultural production more efficient, while preserving the natural capital that delivers the ecosystem services we all rely on. Nestlé was the first company to commit to eliminating deforestation from its supply chain. We extended our traceability program beyond palm oil, and pulp and paper, to 10 further areas and main commodities. We have also partnered with The Forest Trust and other groups to map our supply chains and to assess

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our suppliers' compliance with our responsible sourcing guidelines, while providing technical support to those committed to achieving sustainability.

We are convinced that the only way to feed an increasingly urbanised global population is by leveraging modern technologies responsibly and by reducing waste and inefficiencies all along the value chain. The economies of scale provided by today's agricultural and food system has made more food more affordable for more people than was thought possible only a few decades ago.

Public policy and action-oriented dialogue to address the natural capital 'overdraft'

However, business action alone will not be sufficient as long as most policy frameworks favour the short term over the longer term and provide the wrong incentives. We therefore engage in policy dialogue at local, regional and global level with two clear messages. We are against misguided subsidies, in particular those that are detrimental to natural capital, as is the case with subsidising the conversion of food to fuel. The massive use of food for fuels has become a major driver for food price increases, with the worst consequences for those least able to afford higher prices. Furthermore, most scientists now agree that agrofuels are worse for the environment than fossil fuels, if all externalities such as water withdrawal, pollution and the knock-on effects of land-use changes are taken into account.



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We also advocate that everyone should pay at least for the cost of the water used in the products they consume. Water is subsidised by the taxpayer in many parts of the world (usually, in fact, through public debts inherited by tomorrow's taxpayer), with the consequence

that there is little incentive to conserve this most precious of natural resources. Obviously, any reform of the water market has to be done in a socially just and responsible way, guaranteeing the human right to water and providing for the vital needs of those who are unable to pay for it.

While being against misguided subsidies, we are equally strongly for an international policy framework to leverage market forces to internalise those costs that are currently not even accounted for, and that draw down

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natural capital. We realise that this is a probably one of the most complex challenges facing mankind in the 21st century and we don't believe there will be a quick fix. This is why we support the Cambridge Programme for Sustainability Leadership and its Natural Capital Leaders Platform, which brings together leading thinkers and practitioners in the search for pragmatic and practical solutions.¹

Another example of a successful policy dialogue is the 2030 Water Resources Group initiated at the World Economic Forum, which involves the International Finance Corporation of the World Bank Group, McKinsey & Company, and a consortium of business partners. Under the leadership of Nestlé Chairman Peter Brabeck-Letmathe, the Water Resources Group seeks new insights into water scarcity, explores the opportunities and costs of possible solutions, and fosters results-based stakeholder dialogue. It has established and successfully tested a new methodology, the water cost curve, which guides policymakers in making the best possible choices to balance demand and supply in any given watershed. What started essentially as a private sector initiative is now being adopted by a growing number of regional bodies, with a multi-stakeholder approach as one of its key features.

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¹The Natural Capital Leaders Platform is a major business-led programme focusing on practical action and policy influence. Influential companies with a global reach are working to address the impacts of ecosystem and natural capital loss and degradation on business, their customers and wider society by: triggering significant changes in the business response to sustaining ecosystems and natural capital globally; demonstrating business support for progressive government policy and action; and stimulating new ways of thinking, so that the future direction taken by business and government addresses risks and grasps opportunities in relation to natural capital.

Leveraging growing consumer awareness for competitive differentiation

While responsible supply chain management and policy dialogue require a high degree of often complex collaborations with countless stakeholders, the third element that nudges actors towards more sustainable choices is based more on competition than on collaboration. Competition for better solutions has been the major driving force behind economic and indeed social development. I believe it is a sign of maturity that sustainable development over the past few years has entered the competitive landscape, and that sustainability has become a driver for competitive differentiation.

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The challenge here is to engage with consumers in a way that is honest, fact-based, and looks at the sustainability performance of the entire lifecycle of a product rather than exaggerating individual aspects, which will sooner or later be exposed as 'greenwashing'. What is required is fair competition, based on a level playing field established through collaboration between all stakeholders. We



actively support several initiatives around the world that establish scientifically reliable and uniform environmental assessment methodologies and communication tools, such as the European Food Sustainable Consumption and Production Round Table.

Conclusions

Sharing the benefits of our planet's limited natural capital equitably among today's societies, and preserving them for future generations, requires both collaboration and fair competition, based on mutual trust and understanding between all three major constituencies: businesses, policymakers and

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citizen-consumers. To overcome the prisoner's dilemma we need to put a value on natural capital and identify the most appropriate levers to drive progress. These levers will probably include pricing, but also incentives, taxes, and other forms of regulation, as well as voluntary approaches.

The challenges of keeping nature's balance sheet in balance represent an overwhelming agenda for any company. At Nestlé we have decided to focus our contribution in particular on two areas that are core to our business strategy and vital to the welfare of society: water, the most precious of natural resources, and rural development. Together with nutrition, these form the pillars of what we call Creating Shared Value, the basic way we do business, founded on the belief that in order to create long-term value for shareholders, we have to create value for society.

The State of Sustainability Leadership is CPSL's annual thought leadership report, delivering insight and challenge from our world-wide network of business leaders, policymakers and academic experts. This year's edition, to be published in full in December 2012, is focused on the theme of business and the long-term – what leaders can do to understand and shape the future. CPSL is an institution within the University of Cambridge's School of Technology. www.cpsl.cam.ac.uk



In 2010, Cape Farewell embarked on its ninth art and science voyage, not to the Arctic but to another hotspot of climate change: the Peruvian Amazon. Brenndan McGuire captured through video and sound recordings his path into this hostile and yet vibrant, rich, and sensitive environment. His footage inevitably mirrors his own "feelings and the sense of nostalgia when journeying down the river" (Brenndan McGuire). CPSL is proud to be collaborating with Cape Farewell, which works with artists and scientists on a cultural response to climate change. www.capefarewell.com