The Role of Finance in Environmental Sustainability Efforts

A report prepared by CFO Research Services in collaboration with Jones Lang LaSalle
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At CFO Research Services, Bill Birchard conducted the interviews and wrote the report. Celina Rogers directed the research and managed the project.

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Introduction

Environmental sustainability has moved in recent years from the margins to the center of many corporate agendas. As just one sign of the issue’s new prominence, Michigan-based furniture maker Herman Miller reports that 95 percent of its customers’ requests for proposal now ask about the $1.9 billion company’s environmental record and the sustainability of its approach to its products. Moreover, environmental issues are the deciding factor in 5 percent of its customers’ purchase decisions.

Managing sustainably, defined in this report as managing environmental impacts to meet the needs of both present and future generations, can affect the very core of a business. It influences processes and systems of all kinds, from product design and marketing, to corporate governance and facilities management. A variety of pressures have elevated sustainability’s prominence in recent years: competition, globalization, regulation, energy costs, climate change, and other factors. These pressures promise to change the role and responsibilities of all senior executives.

To see how finance executives in particular have responded, we executed a survey in the first quarter of 2008 to gain insight into finance’s views on sustainable business practices. How important are these practices today? How have they changed corporate strategy, and how might they cause companies to change their strategies in the future? What role does finance play in these sustainability initiatives? Do finance executives have the tools and frameworks they need to support decisions that take environmental sustainability into account? To what extent do finance executives recognize the business benefits of environmentally sustainable practices?

Our assessment from the responses of executives to our survey: Incorporating sustainability into the finance function is a work in progress. Even so, finance departments at many companies have advanced their work to a very high level.

Experts corroborate this view. Marc Epstein, management professor at Rice University and author of Making Sustainability Work (Berrett-Koehler, 2008), says that finance executives no longer question whether or why to undertake sustainability efforts. What they question is how, and how far, to pursue these efforts.

Companies at the forefront, Epstein says, are those taking a rigorous business approach. They ask, he says, “How much money can I make? What impact does this have on the bottom line?” There are two sides to that equation, he adds: minimizing risks, and maximizing opportunities and growth.

To see how this is playing out in greater detail, we talked with executives at Herman Miller, Dow Chemical, Bank of America, Weyerhaeuser, and American Electric Power. At each of these companies, executives have melded the work of finance with their company’s commitment to environmental responsibility. The issue of sustainability is not a foreign influence intruding on the financial domain at these companies; rather, the executives we spoke with have embraced their companies’ environmentally sustainable business practices, and have adapted their thinking accordingly.

At Herman Miller, CFO Curt Pullen says the issue has become part of the company’s DNA. Ultimately, he maintains, any sustainability initiative has to be viewed from multiple standpoints: “Is it good business? Does it help us in our reach to customers? Does it make a positive impact on the environment? And does it help us attract capital?”
Although our research suggests that the finance function remains relatively passive when it comes to sustainability, change is afoot across industries. Here are some of the key findings from our research:

• The importance of sustainable business practices has risen sharply in the last five years. Four out of five finance executives say they expect pressure to adopt such practices will rise even more in the next five years.

• The finance function plays its most prominent role in companies’ sustainability through decision support. Only rarely do the finance executives we surveyed say they play a leading role in management of environmental performance or risks.

• Finance executives cite a number of barriers to increased involvement in sustainability, including a lack of decision-making frameworks that take environmental factors into account and an inability to document a link between sustainability initiatives and shareholder value.

• A substantial number of executives say their companies would allocate resources to a sustainability initiative even if it didn’t meet customary investment hurdles.

• Sustainability goals are generally not integrated into management and control systems. Moreover, the finance function rarely takes the lead in sustainability reporting.

• Finance executives say they believe companies will realize a variety of benefits from sustainability efforts—in particular, increased brand value and enhanced reputations.

About this report

In February 2008, CFO Research Services (a unit of CFO Publishing Corp.) conducted a survey among senior finance executives in North America to examine the role of executives in their companies’ environmental sustainability efforts. The survey asked about the priority of activities related to sustainability, the integration of finance with sustainability activities, the barriers to improvement, and the benefits of sustainability.

We gathered a total of 175 responses from senior finance executives from a broad range of company segments, as follows:

**Annual revenue**

<table>
<thead>
<tr>
<th>Revenue Range</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than $100 million</td>
<td>2%</td>
</tr>
<tr>
<td>$100 million-$250 million</td>
<td>1%</td>
</tr>
<tr>
<td>$250 million-$500 million</td>
<td>2%</td>
</tr>
<tr>
<td>$500 million-$1 billion</td>
<td>23%</td>
</tr>
<tr>
<td>$1 billion-$5 billion</td>
<td>41%</td>
</tr>
<tr>
<td>$5 billion+</td>
<td>30%</td>
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</tbody>
</table>

**Titles**

<table>
<thead>
<tr>
<th>Title</th>
<th>%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chief financial officer</td>
<td>21%</td>
</tr>
<tr>
<td>EVP or SVP of finance</td>
<td>8%</td>
</tr>
<tr>
<td>VP of finance</td>
<td>18%</td>
</tr>
<tr>
<td>Treasurer</td>
<td>4%</td>
</tr>
<tr>
<td>Controller</td>
<td>15%</td>
</tr>
<tr>
<td>Director of finance</td>
<td>24%</td>
</tr>
<tr>
<td>Other (including CEO, president, or managing director)</td>
<td>10%</td>
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</tbody>
</table>

Respondents work for companies in nearly every industry. The financial services, business services, manufacturing, and food/beverages/consumer packaged goods are particularly well represented.
Focus increases on environmental sustainability

We asked finance executives to tell us about their perception of the importance of sustainability to a variety of company stakeholders. More than half of respondents say that environmentally sustainable business practices are more important to senior management, employees, investors, boards of directors, customers, and people in the finance function than they were five years ago. Almost no one says that any stakeholder group considered sustainability less important today, compared with five years ago.

Many finance executives also say their companies have changed their business strategies to respond to outside pressures. (See Figure 1.) Respondents cite consumers most frequently as a force behind change, but they say their companies have changed strategy due to pressure from outside stakeholders of all kinds. Next to consumers, the second-most-common group driving change, say executives, is government leaders and policymakers.

Among enterprise-level environmental objectives, finance executives most often cite compliance with environmental regulations, improving energy efficiency and reducing carbon footprint, and reducing the environmental impact of operations as high priorities. (See Figure 2.)

Finance executives who participated in the interview program describe sustainability initiatives at their companies that, in many cases, closely mirror the priorities identified by survey respondents. At Herman Miller, for example, the company’s sustainability efforts include the design and retrofit of facilities to reduce energy use. The company has committed to bringing all facilities up to so-called LEED certification, the green-building standard.
of the U.S. Green Building Council, which the company co-founded with others in 1994. Over a dozen of Herman Miller’s owned and leased facilities, including the company’s headquarters and a manufacturing plant, are already LEED certified, while 27 percent of the company’s energy usage in 2007 was generated from renewable sources.

But we learned through interviews that companies are vigorously pursuing a wide range of sustainability initiatives, including some that survey respondents are less likely to rate as urgent. Although only one in three survey respondents, for example, say that developing or redesigning products to address environmental needs is a high priority, several participants in the interview program discuss their companies’ high-profile efforts to develop new products and revamp production processes to serve environmental needs. At Michigan-based Dow Chemical, CFO Geoffrey Merszei points to the $53.5 billion company’s new initiative to use sugar cane to make polyethylene plastic, one of the most widely used plastics in the world.

Dow typically derives polyethylene from oil and natural gas—both non-renewable feedstocks. In Brazil, the company has partnered with a leading sugar cane-to-

Figure 2. After environmental compliance, improving energy efficiency and reducing carbon emissions is most often cited as a high priority among sustainability objectives.

How high of a priority are the following enterprise-level environmental sustainability objectives at your company?

<table>
<thead>
<tr>
<th>Objective</th>
<th>Percentage of Respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Complying with environmental regulations in all jurisdictions where your company does business</td>
<td>61% 26% 5% 9%</td>
</tr>
<tr>
<td>Improving energy efficiency/Reducing carbon footprint</td>
<td>47% 32% 15% 6%</td>
</tr>
<tr>
<td>Reducing the environmental impact of operations</td>
<td>45% 36% 11% 7%</td>
</tr>
<tr>
<td>Encouraging sustainable work practices among staff members</td>
<td>43% 40% 15% 2%</td>
</tr>
<tr>
<td>Managing environmental risks</td>
<td>37% 34% 17% 13%</td>
</tr>
<tr>
<td>Reducing the environmental impact of products and/or services</td>
<td>36% 36% 21% 7%</td>
</tr>
<tr>
<td>Introducing environmental improvements to the supply chain</td>
<td>35% 34% 25% 6%</td>
</tr>
<tr>
<td>Developing/redesigning products to address environmental needs</td>
<td>35% 27% 22% 15%</td>
</tr>
<tr>
<td>Incorporating environmental factors into investment/resource-allocation decisions</td>
<td>30% 34% 29% 7%</td>
</tr>
<tr>
<td>Reporting environmental performance/improvements to investors, analysts, and others</td>
<td>29% 32% 30% 9%</td>
</tr>
<tr>
<td>Integrating environmental factors into corporate performance measurement and incentive systems</td>
<td>22% 31% 39% 7%</td>
</tr>
</tbody>
</table>

Note: Percentages may not total 100 percent, due to rounding.
ethanol converter to test the feasibility of a large-scale plant to convert ethanol to ethylene, and from ethylene to polyethylene. The result will be a plastic derived from a renewable feedstock. Finance played an important role in the initiative, notes Merszei, because it analyzed the long-term economics of the project.

When Dow Chemical makes decisions that take environmental factors into account, “these efforts must stand up to the rigors of our decision-making processes, which include thorough financial vetting and analysis,” according to the company’s CFO.

Although relatively few survey respondents cite reporting on environmental performance as a high priority, our conversations with finance executives make it clear that environmental reporting is on the rise. Indeed, a substantial number (37 percent) of survey respondents say in a separate question that they expect finance will make more of a contribution to environmental reporting efforts in the future.

At Dow, the company has tried different approaches to reporting. In 2005, it made a decision to drop its environmental report. The company now issues an annual report, largely its SEC Form 10-K, and a “corporate report” containing a summary of financial, environmental, and social results. In an unusual move, the company sends this “triple bottom line” report to all 450,000 shareholders along with the proxy statement.

Many companies have also found ways to incorporate environmental issues into investment decisions using traditional analytic tools and decision-making frameworks. At the companies we spoke with, finance executives often rely on familiar tools and financial models, such as economic value added (EVA), to make decisions that take environmental factors into account. Dow’s Merszei strikes a common refrain, stressing that Dow uses a traditional, disciplined approach to decision making in this area: “These efforts must stand up to the rigors of our decision-making processes, which include thorough financial vetting and analysis. All projects must stand on their own merit and show they...generate long-term shareholder value.”
Finance offers analytical support for decisions involving environmental sustainability

Merszei’s comments underline finance’s apparent forte in the corporate sustainability effort: decision support. When we asked finance executives to tell us about finance’s role in sustainability efforts, survey respondents were most likely to say finance plays at least a supporting role in decision making and in the oversight of business support functions. (See Figure 3.)

The survey shows that respondents believe finance plays a “supporting” or “substantial” role—if not a “leading” role—in many sustainability areas. This is particularly true for three activities traditionally performed by finance, in addition to decision support: reporting, risk management, and performance management. Only a small number of finance departments play a leading role in any of these activities.

These results may indicate that many companies treat environmental management as a discrete activity, holding it apart from financial reporting, and from the management of business risk and financial and operating performance. But these results may also indicate that many companies are just beginning to take a broad approach to environmental management. While all companies work toward compliance with mandatory environmental regulations, only leading-edge companies in the sustainability area are likely to have incorporated environmental sustainability in financial and operating performance management, risk management, and reporting. If conducting business sustainably moves up the larger enterprise’s list of business priorities, finance may find itself playing a larger role in these efforts as well.

### Figure 3. Finance plays at least some role—if not a leading role—in many activities related to environmental sustainability.

What role does the finance function play at your company in the following sustainability areas?

<table>
<thead>
<tr>
<th>Activity</th>
<th>Percentage of Respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Decision making</td>
<td>14% 33% 42% 11%</td>
</tr>
<tr>
<td>Oversight of business support functions</td>
<td>14% 31% 35% 19%</td>
</tr>
<tr>
<td>Compliance with environmental regulations</td>
<td>10% 18% 37% 34%</td>
</tr>
<tr>
<td>Management of risks to performance due to environmental factors</td>
<td>9% 22% 49% 21%</td>
</tr>
<tr>
<td>Environmental reporting</td>
<td>9% 20% 37% 34%</td>
</tr>
<tr>
<td>Management of environmental performance</td>
<td>8% 17% 41% 35%</td>
</tr>
</tbody>
</table>

Note: Percentages may not total 100 percent, due to rounding.
The Role of Finance in Environmental Sustainability Efforts

Typical of companies that have long dealt with capital investment and resource planning issues is American Electric Power (AEP), where finance provides the analytical muscle to vet every investment aimed at sustainability. The Columbus, Ohio-based utility, with revenues of $12.6 billion, 80 generating plants, and operations in 11 states, has made mammoth investments in such projects for decades.

Rich Munczinski, senior vice president of corporate planning and budgeting, explains that AEP has to justify capital expenditures not only to company management, but also to public utility commissions. Unless the company’s investment decisions meet standards for “prudence,” Munczinski explains, they won’t gain regulatory approval. Furthermore, Munczinski notes that AEP’s investment decisions must represent the “least reasonable cost” to ratepayers. “If we’re presented with five or six possible actions, we’ll measure them and pick the one that yields the least cost to the ratepayer, which is usually the least cost for the company. This doesn’t restrain us, but it does bring a lot of discipline, and also provides us some protection under the laws,” he says. The level of rigor and discipline that the company must bring to its decisions under this regulatory framework leads Munczinski and his team to rely on rigorous financial models to translate every new strategic or tactical move—including the company’s environmental initiatives—into numbers people will trust.

The shifting landscape of state and federal environmental regulations also presents challenges to the company. AEP continuously tracks legislation governing greenhouse gas emissions, Munczinski says. Every time the U.S. Congress introduces a bill to control global warming, internal company stakeholders—including AEP’s environmental policy organization—assess the options, calculate incremental cost scenarios to AEP, and supply the numbers to finance, which incorporates them into its overall strategic planning profile for senior management. The cost of environmental compliance is substantial, because AEP is one of the biggest users of coal in the United States. Most of this legislation involves cap-and-trade schemes, and each new piece of legislation requires a different schedule of investments in plants and equipment to comply with the law.

Interviews with finance executives reveal that AEP also plays a substantial role in the environmentally conscious investment of company assets. No better example is provided than that of Bank of America, which recently launched a new unit specifically to invest in environmentally sustainable businesses. The unit, led by Richard Cohen, managing director of Strategic Environmental Investments, is based in San Francisco (see “Investing in Sustainability at Bank of America,” page 9). Although Bank of America is pursuing a wide range of sustainability efforts—from pricing carbon emissions into its lending decisions to addressing the environmental efficiency of its own facilities and infrastructure—the Strategic Environmental Investments unit focuses on developing equity investments. “The driver here is business opportunity for the bank,” says Cohen. “It’s to solve issues our customers are facing.”

At Dow Chemical, the company’s venture capital program—charged with pursuing investments that offer the potential both for financial returns and strategic value for the company—has found that an increasing number of its venture capital opportunities have involved environmentally sustainable businesses in recent years.

In 2006, the company’s venture capital group, under CFO Merszei, invested in WaterHealth International, a small California firm offering a water-treatment system that brings clean and affordable water to people in remote villages in the developing world. In late 2007, Dow provisionally agreed to give WaterHealth loan guarantees to help it build its business to support 2,000 water treatment units, serving 11 million people in rural India. Dow will likely pursue more such investments in the future, driven in part by its commitment to meet the “2015 Sustainability Goals” it set two years ago: to create at least three breakthroughs solving the world’s problems of food, housing, water, and health.
Investing in Sustainability at Bank of America

In March 2007, Bank of America CEO Kenneth Lewis announced that his company would commit $20 billion to address global climate change. Every part of the bank, from lending to investments to philanthropy, would pitch in to reduce carbon emissions. Bank of America pledged to lower its own greenhouse gas emissions 9 percent by the end of 2009 (compared to 2004), and it pledged to lower the emissions stemming from its financing of utilities 7 percent by the end of 2008.

Executives heading up the various business lines at the bank each took responsibility for part of the $20 billion challenge. The private equity group, under CFO Joe Price, made a commitment to provide capital to companies at all stages of the business cycle who promised to reduce emissions. One of the early deals under this commitment was $65 million in financing to allow California’s Redwood Forest Foundation to buy 50,000 acres of coastal redwood timberland. Cash flow to service the debt will come from sustainable timber harvest.

In 2008, CEO Lewis made a formal commitment to a dedicated Strategic Environmental Investments unit, run by Richard Cohen, a managing director spearheading deals already in the works in the private equity group. Broad changes in business conditions—including a sudden spike in interest in greenhouse gas reduction and the prospect of a more environmentally active presidential administration—were presenting opportunities for the bank to put its own money to work in global warming-related projects.

Cohen says the bank now sees adequate risk-adjusted returns in financing and investments that it wouldn’t have even considered a couple of years ago. He cites deals in renewable energy, energy efficiency, carbon sequestration, emission credits and offsets, and environmental infrastructure. “We’re really kind of pushing the envelope,” he says. Among the first projects to come under the group’s consideration was an investment in a software and analytics company developing new tools to monitor heating and air-conditioning use. Under the deal, which remains under consideration, capital provided by the bank would help the company build its product set and bring it to market. To start off, the bank would help the company pilot its new tools in the bank’s 3,200 branches, potentially saving the bank money, reducing its carbon footprint from facility energy use, and earning attention for its environmental commitment.

Another investment the bank is strongly considering is the development of large-scale capacity to supply solar power at the consumer level. Most homeowners cannot afford the up-front costs of home-based solar units. Cohen and his group are working with people in the bank’s consumer lending, tax leasing, and other groups to figure out how to finance and transform that marketplace. “There are obviously tremendous environmental benefits in taking people away from carbon-based electricity,” says Cohen. “That’s why we’re putting all the effort into it.”

Perhaps more quickly than in other businesses, the greenhouse gas issue has catapulted Bank of America’s finance function in new directions. Finance professionals across the bank have taken on entirely new roles. “The whole sense of urgency and sense of priority around a lot of these issues has changed dramatically,” says Cohen. “We don’t think it’s going to go back.”
Finance executives are challenged to document the link to financial performance

As companies push their sustainability programs forward, finance executives identify a range of barriers that hamper the integration of environmental factors into financial decision making. The barrier they cite most frequently is an inability to measure or document the effects of decisions on either financial performance or shareholder value. (See Figure 4.) Other factors that hinder more integrated decision making include a lack of standardized frameworks to make decisions that take environmental issues into account.

When we asked in a separate question whether finance executives believe they have the tools, frameworks, and knowledge they need to support decisions that include environmental considerations, a slight majority

Figure 4. Trouble linking environmental to financial performance hampers finance’s ability to contribute to decision making.

In your opinion, what are the greatest barriers to incorporating environmental sustainability factors in financial decision making?

- Inability to measure the effect of sustainability initiatives on shareholder value/investor returns: 46%
- Inability to document the effect of environmental factors on financial performance: 37%
- Lack of standardized decision-making frameworks that take environmental factors into account: 36%
- Inability to make a traditional business case for sustainable practices: 28%
- Lack of tools and systems to accurately account for sustainable business practices: 26%
- Lack of investor interest in the environmental impact of decisions: 25%
- Inability to extract useful, relevant information from IT systems to support decision making: 22%
- Difficulty in coordinating work/gathering information across disparate business functions: 22%
- Organizational resistance to incorporating sustainability factors in decision making: 20%

Note: Respondents were asked to select up to three answer choices.
(51 percent) say they do. But that leaves a substantial number of finance executives who feel they don’t have the tools, frameworks, and knowledge they need to support these decisions. These perceived deficiencies may well prevent finance executives from contributing as fully to sustainability-related decision making as they do to other day-to-day business decisions. As one survey respondent observes in response to an open-ended question, “As more efficient measuring tools are created and utilized, finance’s role in sustainability efforts will be greatly enhanced.”

Nearly half (49 percent) of respondents say their companies would allocate resources to a sustainability initiative, even if it failed to meet their customary investment hurdles.

Finance executives at the companies we spoke with tend to use familiar valuation and measurement tools such as EVA to evaluate sustainability-related decisions. But such tools and measurements are only one piece of sound decision making, executives point out. “I don’t know that we would rule out a new [financial] tool if it became available, but I don’t see a need to change what EVA and other financial models tell us,” says Herman Miller’s Pullen. “A financial model provides one reference point out of several that we consider for any investment decision. I describe the process as a navigation problem: You take points of reference from several places—and financials are certainly important ones—but you’ll also think about some other things.” Citing sustainable energy sourcing as an example, Pullen advises companies to think broadly about environmentally conscious decision making. “The unit cost of green energy might be higher than energy from conventional sources, but through conservation efforts and other methods, could we not increase energy savings—and then take some of those savings and invest in greener energy to improve our carbon footprint?” he asks.

At AEP, senior vice president Munczinski says that finance evaluates supply- and demand-side resource options using net present value models—always with an eye to the company’s regulatory mandate to provide energy at the least cost to ratepayers. AEP applies its financial models not just to coal-fired plants but to renewable energy projects, including power generation from wind and biomass. Munczinski’s group compares the cost of renewables against the alternative, a clean coal or natural gas plant. With energy prices rising, Munczinski says AEP has now been able to identify opportunities for such non-traditional least-cost alternatives. This is especially true when the company takes into account the likelihood that carbon emissions will soon start costing money, a possibility under several new bills pending in Congress. “We’ll do scenario analysis, and we’ll do a Monte Carlo risk profile...loading up all of the possible ranges of a carbon bill,” he says. “It wouldn’t be prudent for us not to do that at this point in time.”

Finance executives responding to our survey appear to recognize the need to take additional factors into account when evaluating sustainability initiatives; nearly half (49 percent) of respondents say their companies would allocate resources to a sustainability initiative, even if it failed to meet their customary investment hurdles. Moving beyond customary decision making and evaluation frameworks can be challenging, however, and it often means taking both a longer and a broader view of investment returns.

Consider the $16 billion global forest products firm Weyerhaeuser, based in Federal Way, Washington. When the company built a plywood plant in Tacuarembó, Uruguay, in 2007, it installed an electrostatic precipitator to scrub plant air emissions. The $1 million piece of equipment wasn’t required by local regulations, but it better removes chemicals from adhesives used in making plywood. Making investments in equipment and facilities that exceed current requirements has helped the company stay ahead of the regulatory curve and prepare itself for the future. “We don’t treat it any differently than if this equipment, plant, or workers were in the U.S.,” says Kathy McAuley, vice president of investor relations. “Our standards [abroad] are high, and they’re the same as in North America.”
Although our research shows that many companies are willing to look beyond short-term financial gains to make more environmentally sustainable business decisions, the finance executives who participated in this study also agree that the process must remain disciplined. As one respondent observes in response to an open-ended survey question, “There still needs to be a cost/benefit relationship that makes some sense even if ROI is less than a normal project.” While decision-making tools and frameworks remain a work in progress, companies are increasingly turning their attention to the need to conduct business sustainably. With its analytical skill, decision-making experience, and broad organizational scope, finance is well positioned to make an important contribution to sustainability efforts by bringing discipline to these decisions.

While decision-making tools and frameworks remain a work in progress, companies are increasingly turning their attention to the need to conduct business sustainably.
Greenhouse gas constraints emerge across industries

The challenge that currently dwarfs all other environmental challenges is greenhouse gas production. It seems clear that few companies will escape the rising tide of legislation aimed at reducing greenhouse gas emissions, in the United States and abroad. The issue’s importance may be partly reflected in the number of respondents who cited “improving energy efficiency/reducing carbon footprint” as a high priority among an array of environmental objectives. Only complying with environmental regulations is more often cited as a high priority (see Figure 2, page 5).

We can say with certainty that finance executives interviewed for this report take this challenge seriously. In 2007, Herman Miller tallied and reported its greenhouse gas emissions publicly for the first time. Meanwhile, the company has been reducing energy use, increasing its use of renewable energy, decreasing its transportation intensity, and designing products for energy efficiency. These efforts all aim to shrink its carbon footprint and move the company toward “carbon-neutral” status. The company has acted aggressively toward this end, even though it cannot yet calculate the total financial impact of reducing its carbon footprint.

Dow Chemical has similarly made sweeping commitments to reduction in greenhouse gas production. It has set a corporate 2015 goal to reduce greenhouse-gas intensity (emissions per pound of product) by 2.5 percent per year. Few companies have bigger commitments to hydrocarbon feedstocks than Dow. In 2007, its feedstock and energy expenses were $25 billion—three times more than its 2002 feedstock expenses. The company’s Brazil ethanol-to-plastic plant and other biofeedstocks projects will contribute to lower fossil-fuel use.

AEP has been calculating possible future carbon costs for years. Although utility regulators require the company to generate electricity at least cost to ratepayers, they also allow AEP to recapture costs for testing ideas that will comply with likely future carbon regulation. AEP has launched a variety of projects to test cleaner-burning plants and carbon sequestration (capture and storage). One is a project at its Mountaineer plant in West Virginia, where it will capture carbon dioxide via a chilled ammonia technology. It will then pump the gas underground for permanent storage in deep, saline sandstone formations. The process will capture as much as 90 percent of carbon emissions at the plant.

Senior vice president Munczinski stresses the importance of building a finance group with adequate expertise to perform the financial analysis of such environmental projects. “I have people in my group who are multidisciplined,” he says. “We have engineers, accountants, finance people. We offer our services to help [people] understand what’s needed, and then turn that into a financial answer.”

Since reporting its greenhouse gas emissions publicly for the first time in 2007, furniture-maker Herman Miller has taken efforts to shrink its carbon footprint and move the company toward “carbon-neutral” status.

In some ways, Munczinski may be a model for the type of finance executive needed to handle global warming and other complex environmental analysis challenges. He started as an engineer himself, moved to finance, moved to the regulatory group, and finally came back to finance. Munczinski says, “Everyone knows that you need to get the best information into these models, and then get the best information out of the models and get it shared with the functional groups... to help them understand how their actions are affecting the company’s bottom line.” Although his finance group offers analytical services to support others in the business, he says, a high level of expertise on technical, operational, and financial matters enables his group to be effective when delivering those services. “You don’t want to lose credibility when you’re talking to a Ph.D. from MIT about scrubbers... and environmental equipment [on] power plants,” he says.
Finance takes a supporting role in environmental reporting

We found through this research that finance makes a substantial contribution to supporting environmentally conscious decisions at many companies. To what extent does finance—the business function that is perhaps most skilled at gathering, organizing, and reporting large amounts of data according to complex regulatory requirements—contribute to environmental reporting?

When we asked respondents to tell us about the role various business functions play in environmental reporting, we found that responsibility for environmental reporting is distributed across several business functions at many companies. Survey respondents didn’t converge on any single group as the “leader” of environmental reporting efforts. (See Figure 5.) That said, it’s clear that finance, for all its reporting experience and skill, doesn’t often take a leading role in environmental reporting. Only about one-tenth of survey respondents say that finance is a leading contributor to these efforts at their companies. One-quarter of respondents say that finance contributes little, if anything, to environmental reporting.

Figure 5. Currently, finance is not a leading contributor to environmental reporting, say respondents.

At your company, to what extent does each of the following functions currently contribute to environmental reporting?

- Leading contributor
- Substantial contribution
- Some contribution
- Little or no contribution
- Don’t know/Does not apply

Percentage of respondents
Note: Percentages may not total 100 percent, due to rounding.
In our interviews with finance executives, we observed a distribution of environmental reporting responsibility across business functions that mirrors the distribution suggested by survey results. At Dow, finance takes the lead in the production of its “corporate report.” At Herman Miller, the environmental group takes the lead. In-between these two positions are companies like AEP, where the finance and sustainability groups work side-by-side on environmental reporting. While finance executives may be largely content with taking a supporting role in environmental reporting, there are some signs that their role may become more prominent: A third of those responding to our survey say they believe the finance function will contribute more to environmental reporting in the future. Only 2 percent say they believe finance will contribute less.

Although finance may not often take a leading role in environmental reporting, the support it contributes to reporting efforts is important. In many cases, finance lends support to environmental reporting by vetting and analyzing data produced by other business groups. Environmental reporting at some companies has reached a very high level of sophistication, and more companies may turn their attention to environmental reporting as they come under pressure from investors, customers, NGOs, and other groups to conduct business with more environmental transparency. The expertise in external and management reporting that resides in finance may well prove to be a valuable resource for those charged with preparing environmental reports in the years ahead.

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Twenty-eight percent of executives in our survey say their companies’ sustainability reports follow Global Reporting Initiative guidelines. GRI, the Amsterdam-based standards-setter for sustainability reporting globally, has promulgated rules for companies across industries to report in detail on environmental performance using hard data on goals and results. GRI also provides guidance for report auditing and verification.

At Weyerhaeuser, which produces a report according to GRI guidelines, the company devotes 17 pages to reviewing environmental performance, describing everything from forest management and plant pollution to greenhouse gas reductions. The controller’s group gathers much of the data for the report, which is routinely distributed to investors, says Kathy McAuley, the company’s vice president of investor relations. She admits that many investors don’t read the report, even though they request it: “The investors want to know it’s there, that you have it. If a company doesn’t provide it, they get suspicious.”
Finance executives expect sustainable business practices to yield broad benefits

When we asked finance executives about benefits they expect their companies to receive through sustainability efforts, we received a range of responses. (See Figure 6.) “Increased brand value/enhanced reputation” are the benefits respondents most often say their companies are “very likely” to realize, followed closely by “reduced risk associated with environmental factors.”

Although it appears that at least some finance executives remain skeptical about the business benefits of sustainability—particularly the potential for sustainability efforts to contribute to revenue—hard-core skeptics appear to be in the minority among survey respondents. About two-thirds of respondents say they believe their companies are at least “somewhat likely” to realize reduced operating costs, improved employee health and productivity, increased customer satisfaction/retention, or increased competitive advantage. About half say they are at least somewhat likely to realize increased revenue, improved employee recruitment/retention, or improved investor returns/shareholder value.

Figure 6. Finance executives most often cite increased brand value and enhanced reputation as benefits their companies are likely to realize through environmental sustainability efforts.

In your opinion, how likely is your company to realize the following benefits through environmental sustainability efforts?

- Increased brand value/Enhanced reputation
- Reduced risk associated with environmental factors
- Increased competitive advantage
- Reduced operating costs
- Increased customer satisfaction/retention
- Improved employee health and productivity
- Improved employee recruitment/retention
- Improved investor returns/Increased shareholder value
- Increased revenue

Percentage of respondents

Note: Percentages may not total 100 percent, due to rounding.
Herman Miller is an illustration of a company that has enjoyed substantial brand and reputation enhancements as a result of sustainability efforts. For example, CFO Pullen says the company recently redesigned a product to improve it from an environmental perspective. The initial financial analysis of the redesign didn’t indicate that it would add value under the company’s EVA model. But he and his finance team—drawing on multiple reference points for decision making—believed that the product would open up a new market, and they advised the company to go ahead with the project.

“My counsel is not to overwork the specifics,” says Pullen. “The financial piece of this is important, [but] I believe we get to the ultimate financial answer when, in between, we think about the nonfinancial things that also matter.” He notes that finance had to heed the business opportunity, not just focus on the EVA number.

Although a dyed-in-the-wool practitioner of economic value added, Pullen believes in the 80/20 rule, in which EVA captures 80 percent of the answer. “Theoretically, EVA could capture all of the relevant variables and it would give you the right scientific answer,” he says. “Customer perception would be validated through their purchase of the product; therefore, the revenue number would be higher. My point is that I...want to get [EVA] to where it’s in the ballpark, and then I want to look at some other indicators...Then it’s going to come down to the judgment call.”

Herman Miller also illustrates another benefit of its sustainability efforts: as a means to attract capital. Today, the company receives a smattering of questionnaires from investors inquiring about the company’s environmental record. But Pullen sees sustainability in the future as a differentiator to attract a certain kind of investor. “I think it’s clearly going to grow in prominence relative to where it sits today,” he says, “and ultimately I think it will affect a company’s ability to attract capital at a reasonable rate.”

“Companies that don’t get it from the sustainability point of view could be subject to adverse market conditions. They could be subject to penalties levied on them because of their practices,” according to Weyerhaeuser’s vice president of investor relations. The global forest products firm aims to nip those risks in the bud and avoid the ire that has been directed at natural resource companies in the past by environmentalists and regulators.

Weyerhaeuser’s McAuley echoes Pullen’s view. Investors interested in sustainability pick up on stories about the company’s environmental innovations, she says. In the southern United States, for example, Weyerhaeuser plantations grow trees for lumber, spacing the trees 25 feet apart. Given the millions of acres of space between the trees, Weyerhaeuser and a partner—the energy giant, Chevron—are moving forward with “intercropping,” the practice of planting and harvesting the grass between the trees to feed an ethanol-based biofuels plant. The joint-venture partnership is a natural: Weyerhaeuser provides the land and feedstock, Chevron the fuel expertise and distribution network.

McAuley also cites the benefits of the company’s efforts to run sustainably as reducing risk in the eyes of investors: “Their job is...to look for problems on the horizon. Companies that don’t get it from the sustainability point of view could be subject to adverse market conditions. They could be subject to penalties levied on them because of their practices.” Weyerhaeuser aims to nip those risks in the bud and avoid the ire that has been directed at natural resource companies in the past by environmentalists and regulators.
How can finance executives contribute more to sustainability efforts?

The results of this research program show that finance executives would serve their companies well by bringing their expertise and analytical discipline to bear on sustainability efforts. As one respondent comments in an open-ended survey response, “Finance’s role in the sustainability movement will be powerful, yet today remains undefined. In the next few years, external pressure from customers and consumers will combine with internal employee pressure to force companies to review, alter as necessary, and more forcefully communicate their position. Finance should play a role in raising the awareness of this issue from a moral and business perspective.”

The pressure to do so is likely to become only greater in the coming years. Two-thirds of finance executives say that, in the eyes of senior managers, environmentally sustainable business practices are either “more important” or “much more important” today than they were five years ago. And the vast majority of finance executives say they expect the pressure on their companies to adopt environmentally sustainable business practices will increase over the next five years. (See Figure 7.)

There is plenty of room for finance executives to apply skills immediately that could benefit their organizations’ sustainability efforts. Reaching out to colleagues in other business functions may be one way to start. Says Herman Miller CFO Pullen, “I think finance has a critical role to play in this, and one of the roles they have is to help the organization know how valuable the nonfinancial piece of the equation is...I think finance has a role to lead the nonfinancial parts of the organization and say, ‘Hey, it’s okay. I need to hear your viewpoint, too.’”

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**Figure 7. Finance executives expect pressure to adopt environmentally sustainable business practices to increase over the next five years.**

Do you expect the pressure on your company to adopt environmentally sustainable business practices will increase, decrease, or stay the same over the next five years?

- Increase dramatically: 26%
- Increase somewhat: 57%
- Stay about the same: 16%
- Decrease somewhat: 1%
- Decrease dramatically: 0%
Finance executives at many companies may well decide to take a more prominent role in sustainability efforts than they do today. To make that happen, Rice University’s Epstein says that finance executives need to integrate sustainability information into costing systems, capital investment decision making, performance management, and reward systems. He says, “When they do that—when the CFO’s office is partnering with the environmental and social responsibility folks to make better decisions, when they’re measuring the impact on brand value and reputation—that is, I think, the next step in best practice.”

“I think finance has a critical role to play in [sustainability efforts], and one of the roles they have is to help the organization know how valuable the nonfinancial piece of the equation is...I think finance has a role to lead the nonfinancial parts of the organization and say, ‘I need to hear your viewpoint, too,’” according to the CFO of Herman Miller.
The Business Case for Sustainability

Is there a business case for environmental sustainability? At Jones Lang LaSalle, we see very clearly that there is a strong business case to be made, and that companies in the near future will succeed or falter based on the extent to which they understand and take advantage of the competitive opportunities that sustainability offers. Finance executives have a central role to play in ensuring their companies’ strategic and financial focus extends beyond the superficial to the substantial, and in creating an investor message that articulates how sustainability creates value in the context of the company and its business.

The notion of being “green” historically has been seen as conflicting with primary business goals of revenue growth and profitability. In recent years, more and more companies have committed to creating more sustainable products and following sustainable practices; but this has sometimes been viewed as a marketing ploy or, at best, a reaction to a consumer trend primarily in the context of corporate social responsibility, rather than as a legitimate business driver.

In fact, sustainability presents a tremendous revenue growth opportunity for companies that incorporate the right practices and innovative thinking into their business models. Leaders in every field are searching the entire value chain for meaningful ways to become more sustainable, and in so doing to drive revenue growth and profitability. They are benefiting from the cost savings that come with operational efficiency, particularly in the area of energy management but also by reducing water usage and waste products. They are enhancing customer retention rates and generating new business more readily than competitors who fail to capture the value of these practices.

Study after study points to a correlation between companies focused on sustainability and higher investor yields over time. The tipping point of opportunity will now affirm this causal relationship. Companies that reduce waste, improve efficiency, mitigate risk, devise innovative ways to meet customer demand, and create a healthier work environment will come out ahead—and those that find the business and revenue growth related to sustainable practices will be the winners.

CFOs are naturally skeptical of these benefits. As professionals who deal in quantifiable data and established metrics, finance executives are understandably frustrated by the lack of standards and comparative data when it comes to sustainability. For example, “carbon footprint” data cannot readily be compared from one company to another because too many of the calculations are mere estimates, and because no two companies are really alike.

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The fact that sustainability is not easily measured is not a reason for CFOs to deny its value, however. As the survey responses in this report show, finance executives see that their customers want to do business with sustainable companies, and they see senior management taking action—yet their own role, they say, is limited. CFOs usually pride themselves on their ability to see the road ahead and help drive their companies to success; however, when it comes to sustainability, many CFOs seem to be using the rear-view mirror.

Admittedly, the path of revenue growth through sustainability is clearer for some companies than others. As a global real estate services company, Jones Lang LaSalle has several service offerings that produce substantial, and measurable, benefits to corporate clients. One increasingly popular service is strategic energy management, wherein we provide cost-benefit analyses of various levels of energy efficiency strategies, and then implement those strategies across a national or global portfolio and report progress as an extension of our normal performance measurement process.
In 2007, Jones Lang LaSalle helped clients reduce energy consumption by 210 million kilowatt hours, saving more than $38 million in energy costs and avoiding in excess of 133,000 tons of greenhouse gas emissions. In the majority of cases, these results have required little or no capital outlay, but are based on better facility management and procurement strategies. Now our corporate clients are expanding our energy management responsibilities to their entire global portfolios, and additional Fortune 500 companies have hired us to achieve similar results.

Another major growth area is developing or retrofitting buildings to conform to sustainable standards such as Leadership in Energy and Environmental Design (LEED) designations. LEED provides an objective standard for determining the level of environmental impact a building has, not only in terms of energy but also water, use of recyclable materials, proximity to mass transit, and many other relevant factors. Our firm today has more than 75 LEED accredited professionals and 40 LEED projects completed or under way, totaling more than 25 million square feet. We also manage 27 multi-tenant buildings that the EPA in February certified as Energy Star buildings, meaning they are 30 percent more energy-efficient on average than comparable buildings in their markets.

LEED and Energy Star are examples of how an industry can develop relevant data that companies can use to make a credible claim on the promise of sustainability. Jones Lang LaSalle is committing millions of dollars annually to hiring and training more LEED professionals and building the systems and tools to continue to be the industry leader. We are being rewarded with revenue growth, client retention, and industry recognition as a firm committed to promoting measurable financial benefits and metrics that justify corporate investment in sustainability.

Other industries are developing their own standards, and companies that lead the way in adopting them are being similarly rewarded. Thus, the business case is unique to every company, but one universal factor is the key role of CFOs in driving sustainability throughout the value chain and delivering the investor message.

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Jones Lang LaSalle wishes to thank CFO Research Services for providing a forum to make the business case for sustainability; and also to thank the reader for taking an interest in this important and timely topic.

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