
Responsible Excellence Pays!*

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Over 1,400 companies have signed the United Nations Global Compact to date. The business benefits of adopting the principles set out by the Compact have already been put forward. But do financial performance indicators vindicate this argument? In collaboration with SAM Sustainable Asset Management it was asked if the group of Global Compact signatories in the DJSI database was doing anything differently from the non-signatories. The question followed: How would a fund, solely based on Global Compact signatories, reward its investors compared to a fund of non-signatories? In SAM's corporate sustainability assessment, 76 of the Global Compact signatories made it to the DJSI World Index. It was found that, in a declining market, this group of 76 outperformed the mainstream MSCI by 3.7% over the three-year period between June 2001 and June 2004. It is suggested that the reason for this above-average performance on the stock market is not simply the fact that the companies are associated with the Global Compact; rather the commitment to the Compact and the appeal of the companies to traders are symptoms of the same characteristic: responsible excellence. In the first instance, Global Compact engagement is an effect of existing managerial dedication to responsible excellence with all the potential to then become one of its key enhancers through the means of strategic integration.

- Global Compact
- Responsible excellence
- SAM Sustainable Asset Management
- DJSI
- MSCI
- Performance indicators
- Stock portfolios
- Triple bottom line

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SHOULD BE COUNTED AS A 'COMPACTOPHILE' OF THE FIRST ORDER. IN MY VIEW, the universal principles of the United Nations (UN) Global Compact provide the shared reference to all corporate citizenship initiatives. In the early discussions around corporate social responsibility we had quickly come to the conclusion that 'one size cannot fit all'. Company size, market sector, geography and culture make a difference. But we must also accept that it is not 'do as you please'. We need a set of robust co-ordinates to stimulate alignment toward a shared purpose of progress. The ten principles presented in the Global Compact are precisely this non-negotiable underpinning to any corporate citizenship approach.

But, of the 1,400 and more companies that have now signed up, how many have yet to rethink their business model in the context of this commitment? After four years of campaigning, the Global Compact, as a project, faces a test of performance. Is it like a comet, with all the energy concentrated in a few, deeply engaged, companies at the head, while the larger number drags in the tail? In expectation of this test of performance, the Global Compact has initiated a dialogue around integrity measures and a model for implementation that aims to change the comet into a plain but growing snowball. This dialogue among early adopters and other experts resulted in the design of a **performance model** closely aligned to the practice of total quality and business excellence in order to start from a discipline familiar to well-managed companies. The Global Compact performance model is now available as a practical handbook (Fussler *et al.* 2004). It proposes a suite of tools and examples of practices that can link what managers must do 'on Monday morning' with what the Global Compact and society also expect them to deliver.

While I was working on the 'how to' and the performance model, the question of 'why' or of the 'business case' kept raising its head. Much has been written in the last few years about this business case. The list of business benefits is, for example, well summarised in a SustainAbility and UNEP (UN Environment Programme) study (2001). Their value matrix highlights the following main factors:

- ▶ **Human capital.** It is easier to attract and retain talented people—motivation, creativity and focus run high in the company that is serious about corporate citizenship.
- ▶ **Risk management and licence to operate.** By going beyond the obvious risks and setting radical improvement goals, the business disruptions are reduced—frequent information and consultation with stakeholders avoid delays in building and operation permits.
- ▶ **Cost savings and productivity.** Eco-efficiency programmes and process control reduce the consumption of energy, water and raw materials, and save waste and emissions costs.
- ▶ **Revenue growth and market access.** Product and service innovation—a new-ventures approach to the huge potential of basic needs creates new growth in markets of low purchasing power.
- ▶ **Brand value and reputation.** A proactive social responsibility and sustainability strategy opens many doors—public authorities and procurement, green consumers and the press.
- ▶ **Access to capital.** A convincing risk management and a high brand reputation attract investors and reassure bankers.

Such a list always creates the impression that there are no limits and no downside to this business case. Every business should have been on board for some time now. What is still holding so many up? Two things: first, implementation requires a will to change and a wilful co-ordination of practices and resources to enable that change. The majority

of people prefer to ride waves, only changing under pressure or great inspiration. Second, there are a number of discouraging market conditions and institutional failures that raise the uncertainty of success; they demand an even higher courage and creativity to take the necessary step and 'lean out of the window'.

However, on balance, the advantage is convincing when one analyses the performance of those who have mustered this courage, took the step, declared their commitment to the Global Compact, and now allow the public to track their progress on social responsibility and sustainability.

To get the facts, we turned to the research team at SAM Sustainable Asset Management.¹ From its Zürich base, SAM produces the Dow Jones Sustainability Index (DJSI) which enables many financial institutions to create equity funds on the basis of a sustainability filter. To this end, it maintains a comprehensive database of performance indicators for many companies. In collaboration with SAM, we asked ourselves if the group of Global Compact supporters in the database was doing anything differently from the non-supporters. We found a striking difference, reported in detail in this paper. It was so clear that we could not help but ask the other question: 'How would a fund, solely based on Global Compact supporters, reward its investors compared to a fund of non-supporters?' We were apprehensive that it could turn out to be worse; it would be out of character to cover up the evidence, but certainly awkward to explain in a text written to show companies how to implement the Global Compact! Fortunately, the analysis shows rather robust advantages.

SAM evaluates companies with a comprehensive set of sustainability criteria. Based on a 'best-in-class' hypothesis and methodology, the proprietary process selects a group of sustainability leaders that is tracked for share-price performance in the form of an index. The founders of SAM started their work in 1995 as asset managers at the early stage of the socially responsible investment wave before it grew to the current US\$2,000 billion business worldwide. Their methodology to screen and select a distinct portfolio of companies proved successful and robust. They could demonstrate that this selection consistently outperformed the benchmark of the Morgan Stanley Capital Index (MSCI) which tracks a similar but much larger group of stocks. The selected stocks presented a positive risk-value profile.

This was one of the first research findings into the objective correlation between shareholder value and a sustainability strategy. At last the advocates of the business case were vindicated by this clear divergence between the peaks and troughs of two stock market charts. In 1999 the SAM selection was adopted into the Dow Jones family as the DJSI. It is now the basis for a number of specific variations and facilitates the design and delivery of customised financial products based on equities screened for sustainability.

Every year SAM takes the largest 2,500 companies (by market capitalisation) from the Dow Jones Global Index. In order to avoid comparing a mining company with a bank or a food producer, it sorts the companies into market groups by their respective major activity. While all companies are invited for the evaluation, 487 responded directly to a detailed questionnaire in 2003 while another 284 were evaluated from public data. The direct response requires a company commitment. It competes for time with more and more questionnaires from other ratings agencies and research groups. Invariably, such questionnaires land on the desk of the same person who may already be grappling with the internal process of the company's own sustainability report. This is not likely to change. There are ever more specialised analysts looking for insights on the social responsibility side. Mainstream analysts are also looking for additional indicators of a company's management quality. Companies usually have more staff to cultivate the traditional financial analysts through yearly group briefings, monthly conference calls,

¹ www.sam-group.com

special interviews and continuous news lines. It may be time to think about the opportunity for their investor relations staff to master the communication of sustainability issues.

The SAM questionnaire is tailored for each market sector. It probes for key performance elements in the environmental, social and economic domains to assess how risks and opportunities are managed. It is practically a version of a yearly performance report, as comprehensive as the Global Reporting Initiative² guidelines in several aspects, but more focused on elements that have a material impact on the financial bottom line. SAM selects the top 10% of companies on a sector basis, and may add a few more to reach at least 20% of the market capitalisation of that sector. It scores each element of the questionnaire for each company in each market sector. It also assesses information from other sources for complementary evidence of performance. This results in a league table of companies ranked by total sustainability score.

In 2004, 317 companies qualified for the DJSI World Index. The top-scoring company is identified in each of the 18 market sectors (see Table 1). Some have maintained their lead in recent years; some have lost or gained it in a remarkable new race to the top.

Sector	Year		
	2001	2002	2003
<i>Automobiles</i>	Volkswagen	Volkswagen	Toyota
<i>Banks</i>	UBS	Westpac	Westpac
<i>Basic resources</i>	Dofasco	Dofasco	Dofasco
<i>Chemicals</i>	Dow Chemical	DuPont	DuPont
<i>Construction</i>	Skanska	Lafarge	CRH
<i>Cyclical goods and services</i>	Sony	Teijin	Philips Electronics
<i>Energy</i>	Shell	Shell	BP
<i>Financial services</i>	ING	Land Lease	British Land
<i>Food and beverage</i>	Unilever	Unilever	Unilever
<i>Healthcare</i>	Bristol-Myers Squibb	Novozymes	Novozymes
<i>Industrial goods and services</i>	3M	3M	3M
<i>Insurance</i>	Swiss Re	Swiss Re	Swiss Re
<i>Media</i>	Granada Media	Pearson	Pearson
<i>Non-cyclical goods and services</i>	Procter & Gamble	Procter & Gamble	Procter & Gamble
<i>Retail</i>	Ito Yokado	Marks & Spencer	Marks & Spencer
<i>Technology</i>	Intel	Intel	Intel
<i>Telecommunications</i>	British Telecom	British Telecom	British Telecom
<i>Utilities</i>	Severn Trent	Severn Trent	Severn Trent

Table 1 DOW JONES SUSTAINABILITY INDEX LEADERS, BY MARKET SECTOR

The yearly SAM corporate sustainability assessment includes a good number of Global Compact supporters. There were 99 in the 2003 assessment and 76 made it to the index. This is a good sample but only represents large market capitalisation companies that are included in the Dow Jones and STOXX markets. Small companies, privately held or state companies are, of course, not included. With this limitation in mind, we found

2 www.globalreporting.org

that, in a declining market, the group of 76 signatories (GCS76) outperformed the mainstream MSCI by 3.7% over the three-year period between June 2001 and June 2004, analysed in US dollar terms (see Fig. 1)

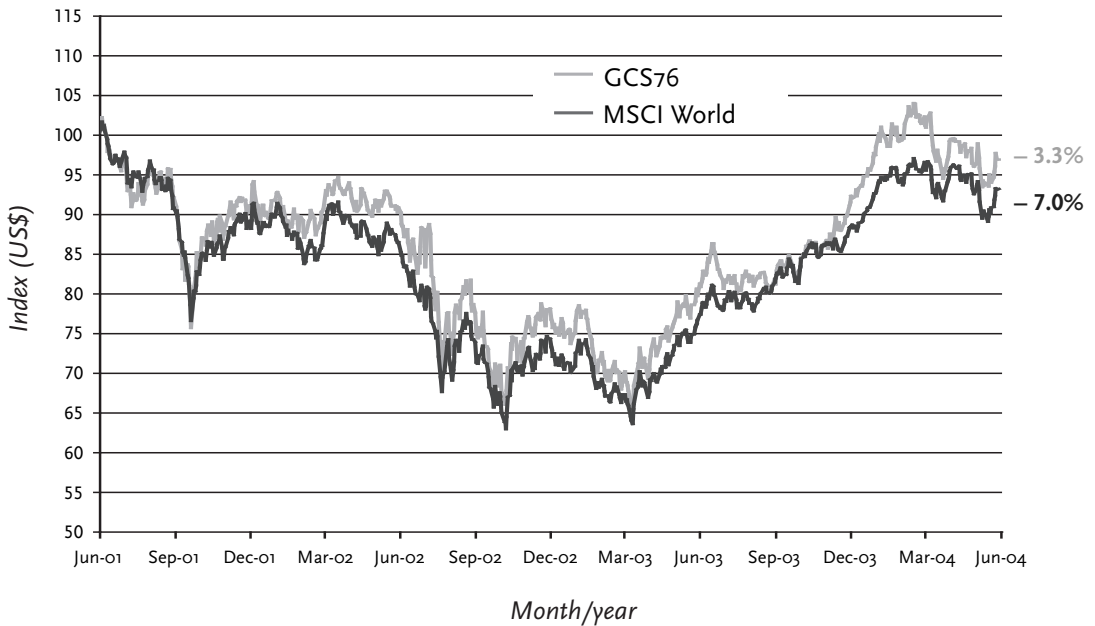


Figure 1 THREE-YEAR PERFORMANCE OF 76 GLOBAL COMPACT SIGNATORIES (GC76) COMPARED TO THE MORGAN STANLEY CAPITAL INDEX (MSCI)

The DJSI also regularly outperforms the mainstream market, as measured by the MSCI in US dollars.³ Colin le Duc, former Head of Research at SAM, points out that:

The risk—the degree of uncertainty of return on an asset, in this case the equity of the Global Compact signatory companies—was 26.43% for the GCS76 compared to 20.99% for the MSCI. This is an extremely interesting risk profile for an investor. Excess return is achieved at relatively low risk, even though only 76 companies are part of the GCS76, compared to approximately 1,500 companies in the MSCI. One would usually expect a much higher risk for such a small selection of companies. Thus, a broad conclusion is that Global Compact signatories and members of the DJSI create premium shareholder value at acceptable risk levels. They definitely do not carry a handicap for shareholders relative to the mainstream market.

In theory, an investor takes more risk in reducing investment options to a portfolio that only covers a small fraction of the market opportunities—one out of every 20 in this case. However, the experience shows that a sustainability criterion is an efficient method to pick investments; it produces rewards that outweigh the risk. It is not the only method to pick a winning group of stocks. Warren Buffet's focused Berkshire Hathaway portfolio is a resounding example (Hagstrom 1999). Nor is the sustainability portfolio failsafe. In 2000, the sharp simultaneous fall of Dell, Intel, AOL and Lucent stock values was such that it caused the whole DJSI to under-perform the market average for several months before rebounding to the lead. The sustainability premium only goes so far.

³ www.sustainability-index.com

Can we really speak of a Global Compact market premium?

If I had only invested in the 76 shares of the GCS76 in June 2001, I would be 3.4% better off at the start of June 2004 than someone who had invested the same amount of money in the 1,500 shares of the larger MSCI group (in the context of a declining market). As a group, the Global Compact signatories created more value. We have yet to understand why. Over that period, there were more bidders than sellers for their shares and the bidders were prepared to offer a premium so that sellers let go of their shares. This is why share prices move up—the bulls outnumber the bears. Why did the bidders behave like this? Obviously, they felt that this purchase was a safe use of their money and they speculated that, even at a price premium, it would return more than inflation, treasury bonds or whatever else they could use it for. They expected the companies in that group to do better in the future. One always buys shares for future returns, short or long term.

What did the Global Compact bring to this speculative move? Is it a magic wand that boosts stock appeal? Surely not—of all investors trading in and out of those equities none is likely to trade purely on the basis of a Global Compact criterion, or even to have heard about it. A few, the socially responsible investors, definitely select shares on the basis of principles that include human rights, corruption, labour standards and environmental responsibility. They have leverage, but not to the extent of pushing this kind of premium in the highly traded, large market capitalisation stocks of the GCS76.

So, why is there a premium? The more realistic influence on this premium lies finally in the overall quality of each company in this group. It reflects credibility in management excellence and responsibility, the portent of future returns, that draws investors to these companies. This same **responsible excellence** opens and moves the leadership of those companies to support the Global Compact, so acting as a trigger and focus for further improvements. In the first instance, the Global Compact engagement is an effect of existing managerial dedication to responsible excellence with all the potential to then become one of its key enhancers through the means of strategic integration.

I need to temper these conclusions with a reminder of the uncertainties, or risk profile, of such a comparison. Besides the assumed value of the sustainability commitment of the GCS76, there are a number of other biases in its comparison to the MSCI, such as geography, currency, or market mix: they could well be a cause for the value differential, or an additional handicap, it is difficult to judge on the evidence of a small difference over a few years. But I lean toward the sustainability explanation for two reasons. One is the growing body of research in this area, particularly a recent study by Claudia Volk and Hendrik Graz (2003). In *More Gain Than Pain* they clearly establish the value of a sustainability investment style with a detailed discussion of its risk profile and statistical confidence in each of the main traditional investment categories. The second reason is that, when it comes to a large number of managerial practices that are driving business excellence, the group of Global Compact signatories demonstrates a clear difference with non-signatories. This was actually the first objective of the inquiry reported here. It is only after I found such a clear difference in practices that I thought that readers would also wonder about a stock value correlation, which is a simple way to check the business case and catch the attention of business readers.

Back to the main issue: I looked in the SAM database for tangible practices that underpin the elements of business excellence in the area of corporate citizenship. A number of indicators enabled a reliable comparison between two groups of companies—those 99 companies (see Table 2) that signed the Global Compact, and the 436 that did not. It must be noted that 90% of this Global Compact sample have headquarters in Europe. We could also include in the comparison the 308 companies that made it on to the 2004 DJSI. This index is a sort of middle-ground sample as it actually includes 76 of the Global

Global Compact signatories in the DJSI 2004 (the GCS76)

- | | | |
|-------------------------------------|-----------------------------------|--|
| ● ABB Ltd | ● Dexia | ● Novo Nordisk A/S |
| ● Accor | ● Diageo plc | ● Novozymes A/S |
| ● AGF | ● DuPont De Nemours & Co. | ● Pearson plc |
| ● Allianz AG | ● Electrolux AB | ● Pfizer Inc. |
| ● Asahi Breweries Ltd | ● Endesa SA | ● Reed Elsevier plc |
| ● Aventis | ● Groupe Danone | ● Ricoh Co. |
| ● Aviva plc | ● Groupe Société Générale | ● Rio Tinto plc |
| ● Banca Monte Dei Paschi Di Siena | ● Grupo Ferrovial SA | ● Royal Dutch/Shell Group of Companies |
| ● Banco Bilbao Vizcaya Argentaria | ● Grupo Iberdrola | ● Saint-Gobain |
| ● Banco Itaú Holding Financeira SA | ● Grupo Santander Central Hispano | ● SAP AG Pfd |
| ● BASF AG | ● Henkel KGaA | ● Schneider Electric SA |
| ● Bayer AG | ● Hennes & Mauritz AB | ● Serono |
| ● Bayerische Motoren Werke AG (BMW) | ● Hewlett-Packard Co. | ● STMicroelectronics |
| ● BHP Billiton Ltd | ● Holcim | ● Statoil ASA |
| ● Bnp Paribas | ● HSBC Holdings plc | ● Stora Enso Oyi |
| ● BP plc | ● Inditex SA | ● Storebrand ASA |
| ● BT Group plc | ● ISS A/S | ● Suez |
| ● Carrefour | ● L.M. Ericsson | ● Technip-Coflexip |
| ● Coloplast | ● Lafarge | ● Telenor ASA |
| ● Credit Suisse Group | ● Li & Fung Ltd | ● UBS Group |
| ● Danisco A/S | ● Nestlé SA | ● Unilever |
| ● Deutsche Bank AG | ● Nexen Inc. | ● UPM-Kymmene Oy |
| ● Deutsche Lufthansa AG | ● Nike Inc. | ● Veolia Environnement |
| ● Deutsche Telekom AG | ● Nokia Corp. | ● Volkswagen AG |
| | ● Norsk Hydro ASA | ● Volvo AB |
| | ● Novartis AG | ● Westpac Banking Corporation |

The other 23 not in the DJSI 2004

- | | | |
|----------------------|-------------------------------|-------------------------|
| ● Air France | ● L'Oreal | ● Skanska AB |
| ● Aracruz Celulose | ● LVMH Moët Hennessy | ● Sodexo Alliance SA |
| ● AXA | ● Norske Skogsindustrier Free | ● Telecom Italia Mobile |
| ● Cisco Systems Inc. | ● Rabobank | ● Telecom Italia SPA |
| ● DaimlerChrysler AG | ● Renault | ● Telefonica SA |
| ● EPCOS AG | ● San Paolo-IMI | ● Titan Cement Co. |
| ● France Telecom | ● Sanofi-Synthelabo | ● TotalFinaElf |
| ● ICI | ● Sasol | |

Table 2 SAM CORPORATE SUSTAINABILITY ASSESSMENT™ OF GLOBAL COMPACT SIGNATORIES ANALYSED

Compact signatories. The other 23 signatories had still some way to go to move into the index—a proof, if needed, that the Compact is not a magic wand to performance but the start of an interesting journey. But all three groups are already remarkable for the fact that they qualified for the SAM corporate sustainability assessment. The differences, therefore, become clear signs of leadership and excellence. They provide further evidence that it is possible to live up to responsible excellence without an economic penalty but, on the contrary, with a market value premium.

For instance, the leaders take a stand on the boundaries and their scope of responsibility; they clearly influence the behaviour of their suppliers and contractors, and they show a stronger customer orientation. Their engagement with stakeholders has moved beyond communication and dialogue to partnerships on projects (two out of three companies). Their investment in employee skills, knowledge and satisfaction is deeper—as a result, more than one in three could measure progress in employee satis-

Global Compact signatories			99
Components of the Dow Jones Sustainability Index 2004		308	
Non-signatories of the Global Compact	436		
Have guidelines for suppliers on:	%	%	%
<i>Human rights</i>	28	43	65
<i>Environment</i>	68	82	90
<i>Labour practices</i>	46	58	68
<i>Occupational health and safety</i>	53	63	73
Audit suppliers' performance	36	40	39
Corporate environmental policy covers impacts of:			
<i>Products and services</i>	77	84	95
<i>Suppliers and service providers</i>	66	75	83
<i>Other business partners</i>	23	28	26
Measure customers' satisfaction	28	33	37
Engagement with external stakeholders:			
<i>Engage with shared projects</i>	36	50	64
<i>Key stakeholders are prioritised</i>	51	55	67
<i>Seek feedback from stakeholders</i>	52	56	58
<i>Provide regular briefings</i>	75	81	75
<i>Spend more than 1% of EBIT for social investments and philanthropy</i>	23	29	31
Employee survey shows a trend for:			
<i>Higher satisfaction</i>	20	28	38
<i>Constant satisfaction</i>	26	24	20
<i>Lower satisfaction</i>	3	3	1
Specific job training covers 90–100% of employees	23	28	35
Over 80% of employees covered by knowledge management system	38	43	44
Long-term success of human resources policies is measured	84	86	95
Performance indicators are used and published for:			
<i>Diversity</i>	25	38	54
<i>Environment, health and safety</i>	40	49	66
<i>Layoffs</i>	9	14	24
<i>Discrimination</i>	11	16	25
<i>Freedom of association</i>	6	9	17
<i>Forced labour</i>	10	11	8
<i>Child labour</i>	12	13	9

EBIT = earnings before interest and tax

Table 3 SELECTED PARAMETERS FOR GLOBAL COMPACT SIGNATORIES, NON-SIGNATORIES AND COMPONENTS OF THE DJSI 2004 (continued opposite)

Source: SAM Corporate Sustainability Assessment™

Global Compact signatories			99
Components of the Dow Jones Sustainability Index 2004			308
Non-signatories of the Global Compact			436
	%	%	%
Have a certified environmental management system for over 90% of business	22	24	20
Publish a certified sustainability report with strong social component	14	23	36
Publish corporate environmental targets	41	52	56
Have set a greenhouse gas reduction target	37	52	40
Have a greenhouse gas inventory for over 80% of operations ^a	66	80	72
Have a corporate governance policy	74	80	84
The code of conduct covers:			
<i>Environment, health and safety</i>	85	92	92
<i>Discrimination</i>	84	90	90
<i>Corruption and bribery</i>	84	89	83

^a GHG inventory and targets do not apply to all industries; industry mix varies for each sample.

Table 3 (from previous page)

faction. One in two firms has set public environmental targets and two out of five have greenhouse gas emission reduction objectives. One out of three has its sustainability report certified. The set of key performance indicators (see Table 3) tackles a number of Global Compact principles, but even child and forced labour are a little lower on their radar screen than for the non-signatories group. When it comes to codes of conducts all companies in the assessment score high. The differentiation is in implementation.

Some performance indicators for responsible excellence

Are such differences enough to create value? Not on their own, but they evolve from a broader base of value drivers. There is no simple equation or mathematical model that enables us to calculate the market value of the soft dimensions of performance such as a diversity target, the certification of a sustainability report or even the more tangible targets of waste and emissions reductions. A few logical chains, however, link social and environmental responsibility to financial value. It is easier to argue the links to the value of traded shares, but this should not leave out all those companies that are not publicly traded. At some point, state companies could be offered to public investors; private companies acquire, merge, pass to successors or secure credit lines—they too need to be concerned about value and how to enhance it in the long run.

Share value is a reflection of a company's worth through a complex prism—the economy at large, the news, the cash flows of investors, the situation of the company's sector and the investors' reading of the relative risks and opportunities of all the other choices in the market, to name but a few. The market is a real-time approximation of the company's worth and, as enough painful corrections have shown, its own nervous

dynamics can carry it away. The market actually does not create value like a product or service business. It creates value through arbitrage between investors who have different views and expectations about the value of the titles they are prepared to sell or buy. But what finally counts in the long run is the quality of earnings of the company behind the traded security.

What creates a premium is the expectation of excess returns compared to other options to invest money. These excess returns depend on the competitive advantage of the company and, particularly, the sustainability of its competitive advantage over time. Thousands of financial analysts continuously screen the universe of companies to assess their strategies and future earnings in relation to their current market value. Are they undervalued in relation to their business opportunities? Are they overvalued in relation to their business risks? Alois Flatz, current Head of Research at SAM, observes:⁴

Investors are once again looking for returns in excess of a general risk premium caused by exceptional costs that the economy must absorb. While throughout the 1990s the economy benefited from the peace dividends of the end of the Cold War, we had to cope in the few past years with the costs of ecological disasters of a new magnitude, anti-terrorism, pre-emptive wars, countries reconstruction, and major corporate failures. In many ways, the lack of sustainability raises the hurdle or risk premium that earnings must exceed to reward investors in absolute terms and create real financial value.

This financial value premium is based on strategy—hardly big news, but sometimes taken lightly in the more extreme moods of the stock market. And strategy is the effective and efficient combination of resources and business processes, employee creativity and empowerment, toward a shared vision, in ways that are difficult to imitate by competition.

Are, then, the Global Compact signatories better at strategy? I think so, at least insofar as they continue to be better than many others. The goals of sustainability, the challenges of social responsibility and the leadership's inspiration from principles higher than the sole profit motivation all foster business excellence. I like to call this responsible excellence, in the broadest sense of each word. The Global Compact brings an additional aspect—a voluntary public exposure. The majority of business leaders shy away from such an exposure because they hate to admit that they don't quite have their act together on all issues. An engagement for the Global Compact is, therefore, a strong indication by a company of its confidence in its own performance. It is an even bet that, for a certain number of issues, it is more interesting to get one's act together through public exposure and stakeholder dialogue, rather than behind closed doors with like-minded, or like-confused, colleagues. As Professor Gary Hamel has written (1999: 82):

If a company is interested in understanding the future, most of what it needs to learn about the future it is going to learn outside of its own industry.

Plain signs of this confidence to interact on sustainability issues can be read from Table 3: they are the high proportion of reporters, of verification, of public improvement targets and the depth of interaction with selected stakeholders.

Managing plantations, drilling platforms, extruders, clean rooms, warehouses, truck fleets, computers and bank accounts is one thing—and complex enough. If that were the only source of value, a good accountant would quickly establish their book value: end of story. Yet companies are valued at several multiples of their book value. The difference is 'goodwill' made of many layers of 'intangible' assets—intangible but essential to generate earnings, starting with the strategic savvy, the managerial competence and the know-how, creativity and motivation of the personnel. Goodwill is also the art of relationships, of building credibility, commitment and loyalty, not only

⁴ Personal communication. See also Flatz 2004: 5.

with commercial partners but also with public authorities, communities or new consumers, such as the poor, who have needs that no one has yet cared to satisfy adequately. We are back in the area of the Global Compact and sustainable development. And we are at a major source of the future cash flows and the excess returns investors are looking for. Brand strength and reputation are all about this art of relationships and vision.

Ivo Knoepfel, an investment research expert and founder of OnValues, has a view:⁵

Many of the Global Compact signatories are the ‘supertankers’ of their industries: they take (or are forced to take) a leadership role in their industries because of sheer size. These companies typically also take the lead in industry associations and push the agenda on standardisation, transparency and excellence in their industry. What comes first, the chicken or the egg, success or leadership, success or engagement for sustainability? Nobody really knows; these dimensions are probably intertwined.

In the long run, I believe that strategies and actions consistent with the principles of the Global Compact exercise and strengthen a number of intangible assets that drive value. While causality is hard to prove, it may be just as well to believe it and manage accordingly. Investors expect excess returns and it is up to managers to make them happen. This brings the management of intangible assets into focus and the necessity to understand how they drive value.

As society recognises the vital role of business in wealth creation and economic development, transparency and accountability have come to the forefront of the qualities expected from business management. A Global Compact performance model is part of the answer (Fussler *et al.* 2004). Those who embrace it beyond the declarations and token documentation, to effectively drive progress towards sustainable development, do not lose out. On the contrary, the evidence is building to demonstrate that they also do well on the financial scorecard.

The metaphor of the **triple bottom line** is now popular to describe how value is a composite of economic, social and environmental performance. Beware of the simplistic maths—it is not a sum; social and environmental progress will not offset an economic loss. Milton Friedman was justified in his claim that the primary social responsibility of business is to make profits; he should not have just stopped there. We need some higher maths to better encapsulate how responsible excellence drives value. An appropriate formula may be:⁶

$$P = me^i$$

The share’s market price P , hence the market capitalisation, is the multiple m of expected earnings per share e with the exponent i standing for an important cluster of **impacts** (social and environmental) and **innovation** or the **intangible** drivers of reputation discussed above . . . The power of i will enhance value when it is positive and growing, but, as algebra and business life has taught us, when it turns negative it slashes value with a vengeance. The power of i rises from vision, leadership and a wilful, creative coordination of the elements of responsible excellence.

5 Written comments to author during peer review of this paper’s draft; www.onvalues.ch.

6 Proposed by Claude Fussler in a keynote speech at the launch of the EDF Sustainability Chair of Ecole Polytechnique de Paris, February 2003.

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