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Better performance through understanding risks and impacts

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Viewing business success differently

The business environment is changing

Nearly 200 UN countries came together twice in 2015 to agree two unprecedented global commitments around sustainable development and climate change – and to achieve them by 2030. The Sustainable Development Goals (SDGs) and the Paris Agreement on climate change put difficult challenges under the spotlight and signal a switch from short to long-term strategies to deliver change.

Significant investment will be required to tackle these major world issues and business will be the critical player in their success. In this year's PwC Annual Global CEO Survey CEOs admit they are feeling the pressure to address wider stakeholder needs but, perhaps surprisingly, also stating that it's a profitable approach. This is where business is often seen at its best, when it brings scalable and profitable solutions to market that benefit society and business performance simultaneously.

All the signs point to business embedding sustainable development thinking, with the result that it's becoming a mainstream approach to business-as-usual. This shouldn't be surprising as it is common sense that business gives priority to its own longevity and reputation, risk management and resilience, in effect the cornerstones of sustainable development.

***86%** of CEOs say they are changing how they measure success and what they hold themselves accountable for*

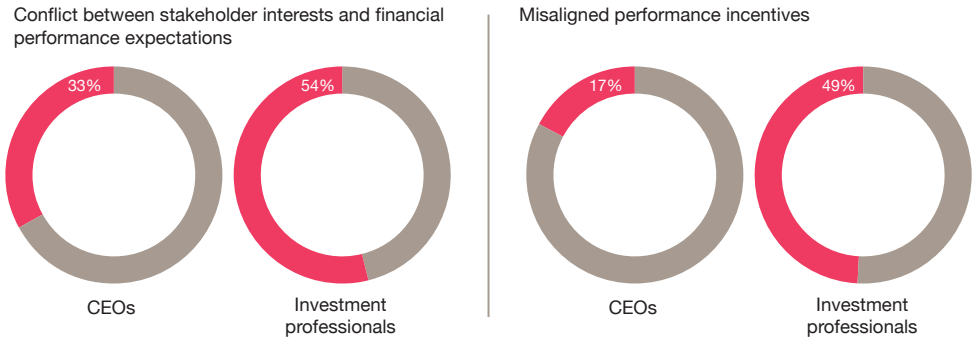
***84%** of CEOs said that they are expected to address wider stakeholder needs*

Investors' point of view

The PwC 2016 Global Investor Survey highlighted some interesting points of view, particularly over the strength of the investment community's interest in drivers of long-term business performance beyond those covered in traditional financial statements.

Issues of trust, company purpose and values are on some investment professionals' radar. For some investment professionals, metrics related to environmental impacts now appear fundamental to their assessment of a company's future value-creation potential, as well as their assessment of risks. Investment professionals want CEOs to 'walk the walk', not just 'talk the talk', when it comes to running long-term sustainable businesses. Although CEOs may see a case for a long-term focus, it seems that many also see barriers to its implementation.

For example, many CEOs seem to think that markets will punish companies if they incur additional short-term costs by adopting new practices that take account of wider stakeholder interests, even if they believe they could enhance future performance. Based on our research, we encourage CEOs to think again – they may find a more receptive audience than they think.



What does this mean for business?

Optimum value creation requires a robust understanding of business outcomes

Value creation over time is no longer limited to the traditional measures of financial performance, e.g. profit or earnings per share. It manifests in changes to all inputs that are used and affected by the organization's business activities, and its outputs (which are defined by the Integrated Reporting Council (IRC) as the organization's products and services and any by-products and waste). Importantly, it also includes value created for the organization and for others in the form of outcomes (which are defined by the IRC as effects of an organisation's activities), whether these are internal to the organization or external, positive or negative, intended or unintended, stated in monetary terms or not.

Outcomes create feedback loops affecting the resources available to an organization in the future and the efficacy of the business model, which impact the long-term value creation ability of the organization. The consideration of the outcomes over time by the organization's leadership is essential to integrated thinking in decision-making and operations. A key point made by the IRC, is that more effort is required by organizations to improve the articulation and disclosure of their effects on the external environment resulting from their value creation process.

Business through a new lens

There is a saying – "Business cannot succeed in a society that fails". This implies that business success is not possible if surrounding societies are not functioning. The science is clear: we are approaching, and in some cases surpassing, the limits of our planet's natural resources and carrying capacity. Many of the grand challenges that confront business - problems as diverse as climate change, the instability of markets, the availability of energy and resources, deterioration of biodiversity, increasing poverty and conflict -are the result of this interconnected web of cause and effect interplayed at the global, national and local scale.

Integrated thinking – the how

King IV advocates integrated thinking. Integrated thinking is about much more than eliminating silos within a business. It starts with the governing body making decisions in an integrated manner. Integrated thinking is then embedded through the integration of strategy, risk and opportunity, sustainable development, performance and outcomes. Businesses that adopt this approach evidence this through being an integral part of society, having standing as a corporate citizen, and being stakeholder-inclusive.

What should you do?

For business, the changing landscape and the search for 'good growth' present both opportunities and threats as stakeholders bring their growing influence to bear. These will affect diverse aspects of the business:

- **Re-look at your products and services:** opportunities come from rapid growth in the emerging economies but new sources of competition are potential threats;
- **Touch base with your customers:** changing customer needs in both existing and new markets offer scope for revenue growth, but revenue is at risk for those businesses which fail to keep in touch with their customers' shifting values;
- **Rethink your production processes:** businesses which use resources more efficiently stand to benefit, but those that ignore pressure on resources are at risk;
- **Refine your business model:** opportunities exist to develop new collaborative business models involving customers and/or suppliers to capitalise on the growth of the circular economy and collaborative consumption – established models which fail to adapt could be threatened; and
- **Communicate to enhance your reputation:** more open dialogue with stakeholders can improve business reputation (for example, by building trust and reinforcing the licence to operate) whereas "closed" businesses that fail to embrace new ways to communicate could be adversely affected (for example, if they are implicated in environmental damage or species extinction, tax avoidance or poor labour standards).

Some questions to ask:

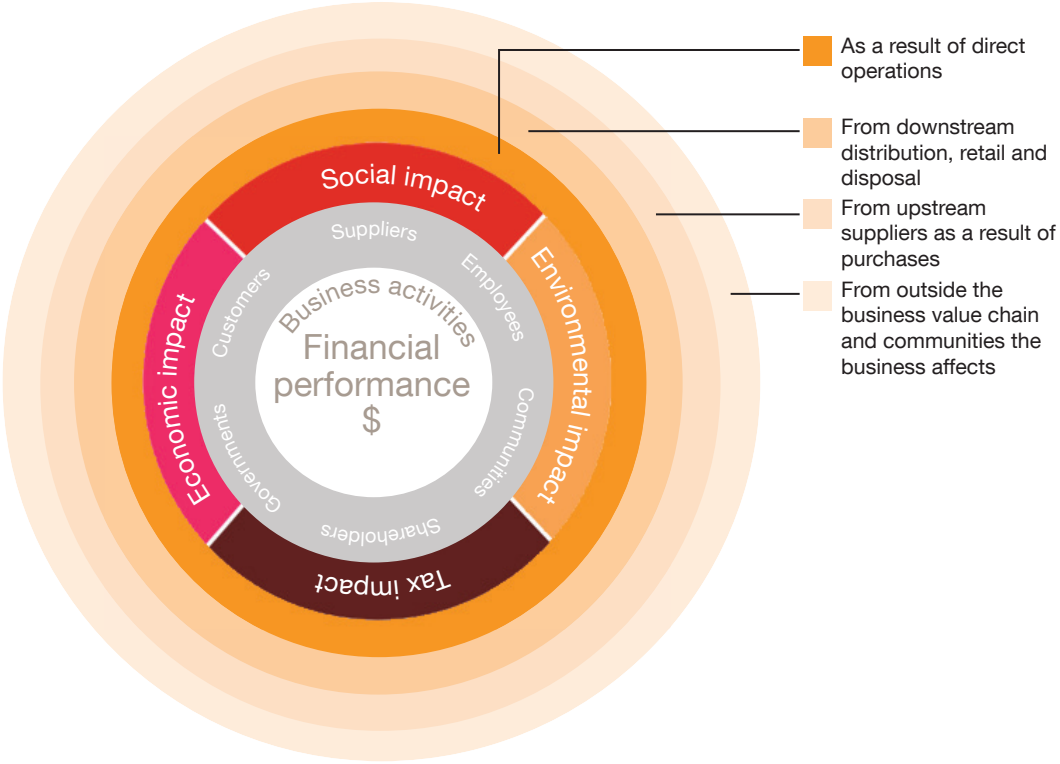
1. Can we articulate what sustainable growth means for our business?
2. Have we properly evaluated the impacts generated from business activities?
3. When it comes to important business decisions: Are we able to compare impacts to best inform new actions?
4. Do we really know how to improve our positive impacts and manage our negative impacts?
5. Can we effectively communicate with stakeholders on our outcomes and impacts?

Did one or more of these questions raise a concern for your business? Have a look further for a possible way forward.

Total Impact Measurement and Management (TIMM) framework – supporting better business decision making and risk management

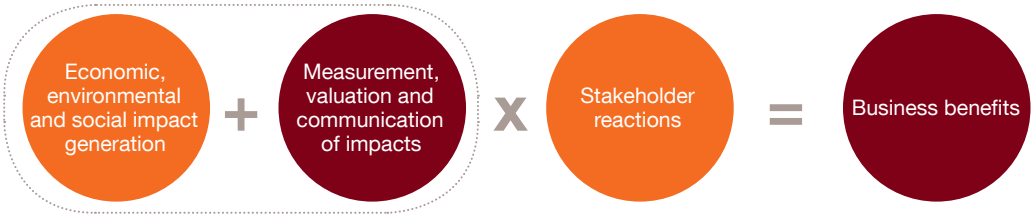
In addition to the returns they earn for their shareholders, all businesses have impacts on society, whether it's through their use of natural resources to generate products or provide services; the benefits they bring to the communities in which they operate; the employment opportunities they provide or their contribution to the public finances. Some of these impacts are positive and some negative.

Business decisions often fail to take all of these impacts into account because their significance is not fully understood and they're not measured by conventional techniques.



Emerging impact measurement techniques address these shortcomings by developing an understanding of the relationship between businesses' inputs and activities, their outputs and their longer term outcomes and associated impacts. This can extend to the valuation of impacts, which has the considerable advantage of allowing for more effective comparison and aggregation, something which other approaches are less able to do. It also has an impact on the organisation's ability to effectively identify and manage risks and opportunities pertaining to their activities.

The TIMM approach thus offers insight into total impact, across identified value creation focus areas. The process assists to quantify, evaluate and then communicate the effects of an organisation's activities and decisions.



The imapcts

Your business generates a wide range of positive and negative impacts (costs and benefits) – through the provions of financial services on consumers, suppliers and communities. You wish to account for and value these imapcts. We call this "Sustainability Accounting".

Support you require

This a complex task involving quantification and valuation of non-financial impacts and you are looking for a consultant with the right skills and experience to identify and develop the appropriate valuation techniques.

Creating full awareness

You want to be able to communicate the results of the accounting project to stakeholders to create full awareness of the relationship between costs and benefits. This work will allow you to engage with stakeholders in transparent dialogue. Therefore it is important that the analysis framework and valuation techniques help to bring results "to life" for those stakeholders.

Embedding Sustainability Accounting

This work will allow you to embed broader considerations into the way that make you strategic decisions (eg. better inform your planning and mitigation actions) and manage subsequent performance.

The external communication of the analysis will allow you to engage with stakeholders, manage reputational risk, and overall faciltate your "license to operate", demonstrating leadership.

This is a decision making model driven by an organisation's social, environmental, tax and economic impacts. In part, it's about helping companies recognise their overall contribution, to understand the balance between the positive and negative impacts generated across their infrastructure and supply chains. But, the real emphasis is what happens with that information. How it fits into the decision making process to shape the direction of future expansion, acquisition, growth, product development etc., and how corporate strategy and risk management can be modified to create a positive impact for all, including shareholders.

In summary

The world is changing. Are the business models of the past fit for the challenges of today? Will they generate the 'good growth' that governments and society as a whole are increasingly demanding? In this new business context, it is time to revisit the breadth of information used to make decisions and to judge long-term success.

Key Contacts

Jayne Mammatt

jayne.mammatt@pwc.com
+27 (011) 797 4128

Yvette Lange

yvette.lange@pwc.com
+27 (011) 797 4430

Chantal van der Watt

chantal.van.der.watt@pwc.com
+27 (011) 797 5541