

# **PRINCIPLES OF SUSTAINABLE FINANCE**

## **Chapter 5: Strategy & intangibles**

# Overview of the book

## **Part I: What is sustainability and why does it matter?**

1. Sustainability and the transition challenge

## **Part II: Sustainability's challenges to corporates**

2. Externalities - internalisation
3. Governance and behaviour
4. Coalitions for sustainable finance
5. **Strategy and intangibles – changing business models**
6. Integrated reporting - metrics and data

## **Part III: Financing sustainability**

7. Investing for long-term value creation
8. Equity – investing with an ownership stake
9. Bonds – investing without voting power
10. Banks – new forms of lending
11. Insurance – managing long-term risk

## **Part IV: Epilogue**

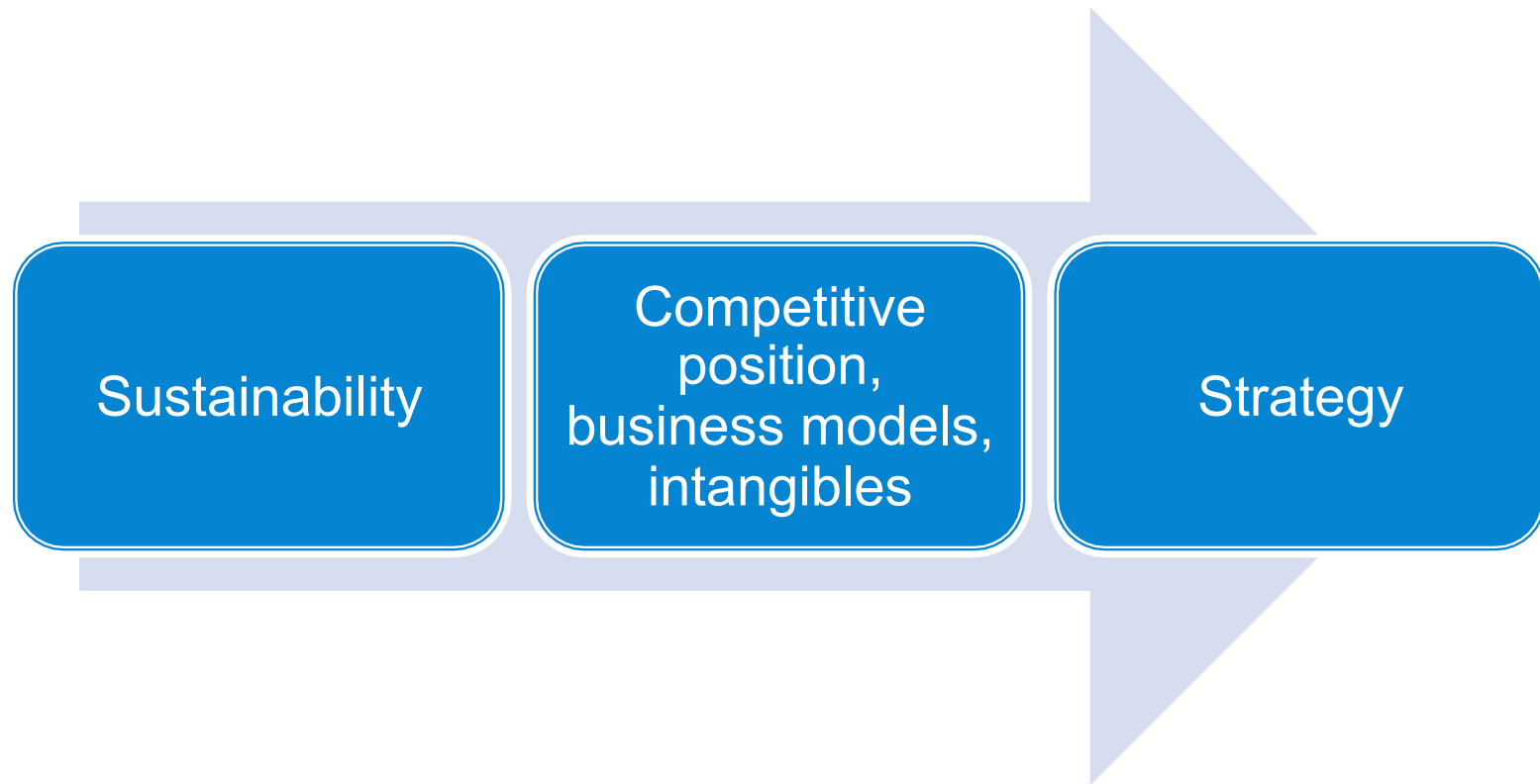
12. Transition management and integrated thinking

# Learning objectives – chapter 5

- ▶ explain why and how companies should connect sustainability to their competitive position, business model, intangible assets and strategy;
- ▶ loosely connect corporate sustainability performance with corporate financial performance;
- ▶ identify the materiality of sustainability issues;
- ▶ explain how companies can prepare for the transition to a sustainable economy.

**Why does sustainability matter to  
competitive positions,  
business models,  
intangibles  
and strategy?**

# Linking sustainability and strategy



# Competitive positions

## Generic competitive strategies (Porter, 1985)

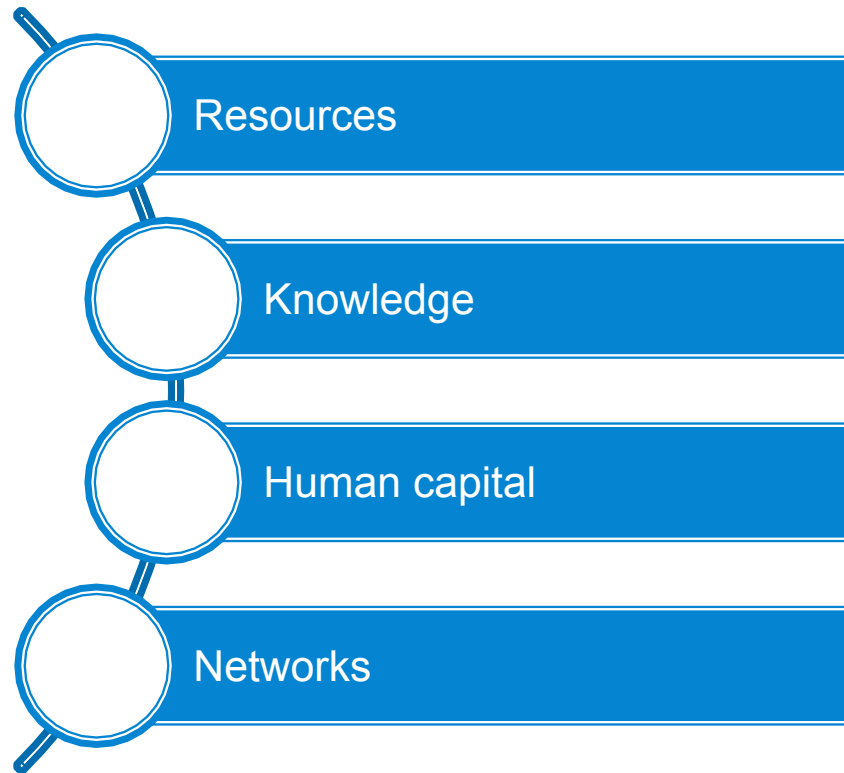
- Cost leadership
- Differentiation
- Focus

## Attributes of strategic assets (Lev, 2017)

- Valuable
- Rare
- Difficult to imitate

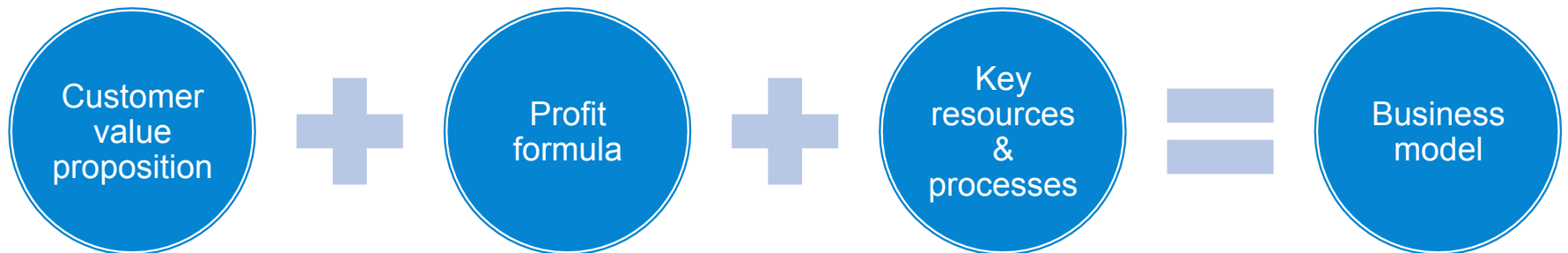
# Competitive positions

Sources of competitive advantage:



# Business models

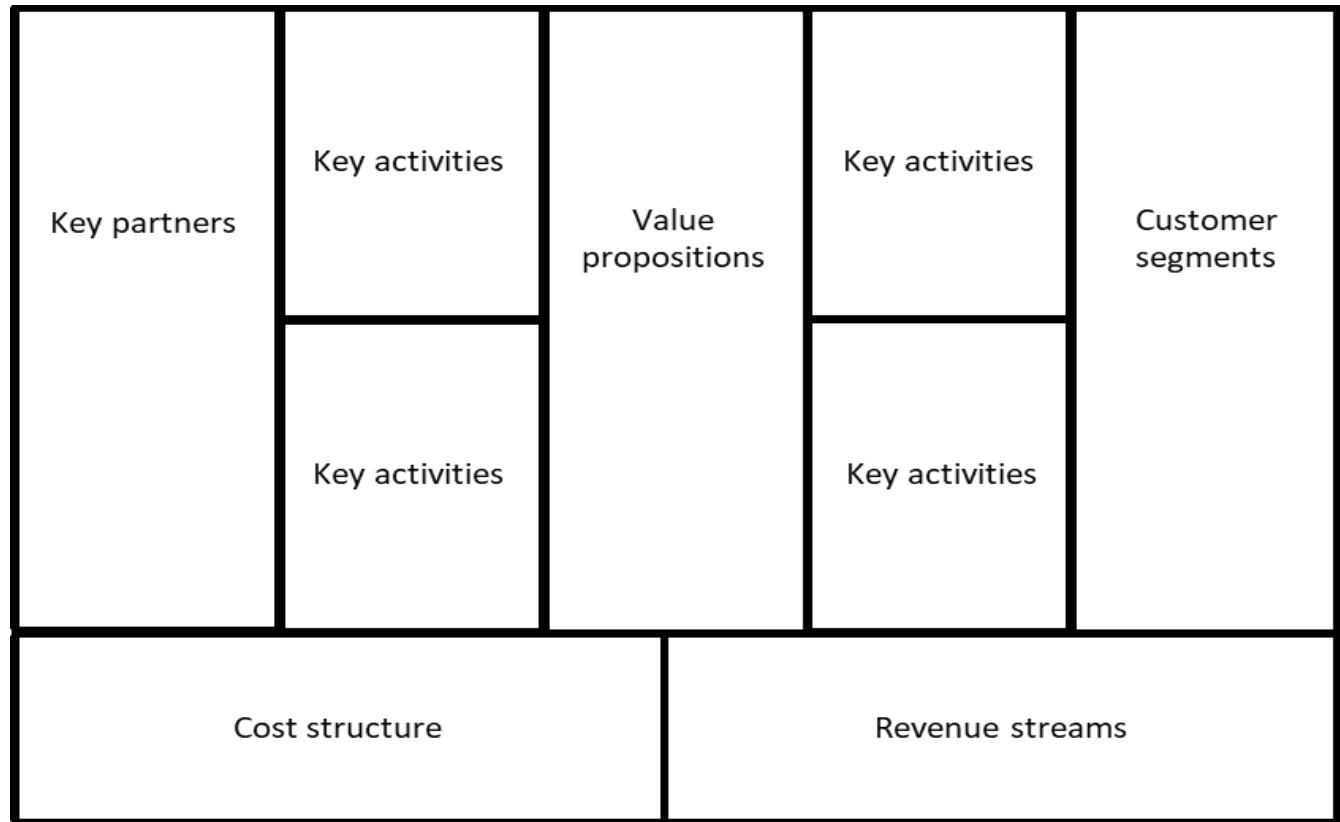
Three components of a business model (Johnson, 2008):



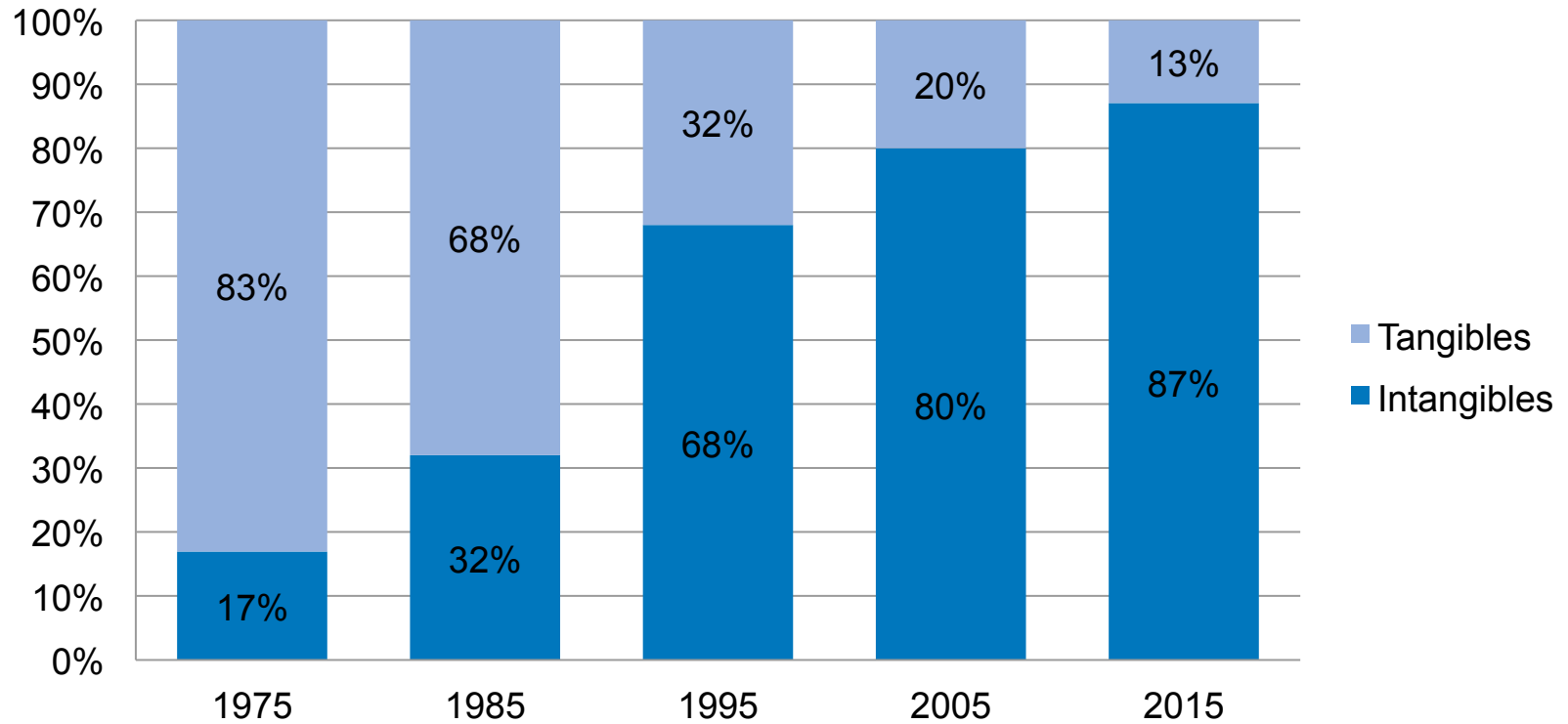


# Business models

Business model canvas (Osterwalder & Pigneur, 2010):



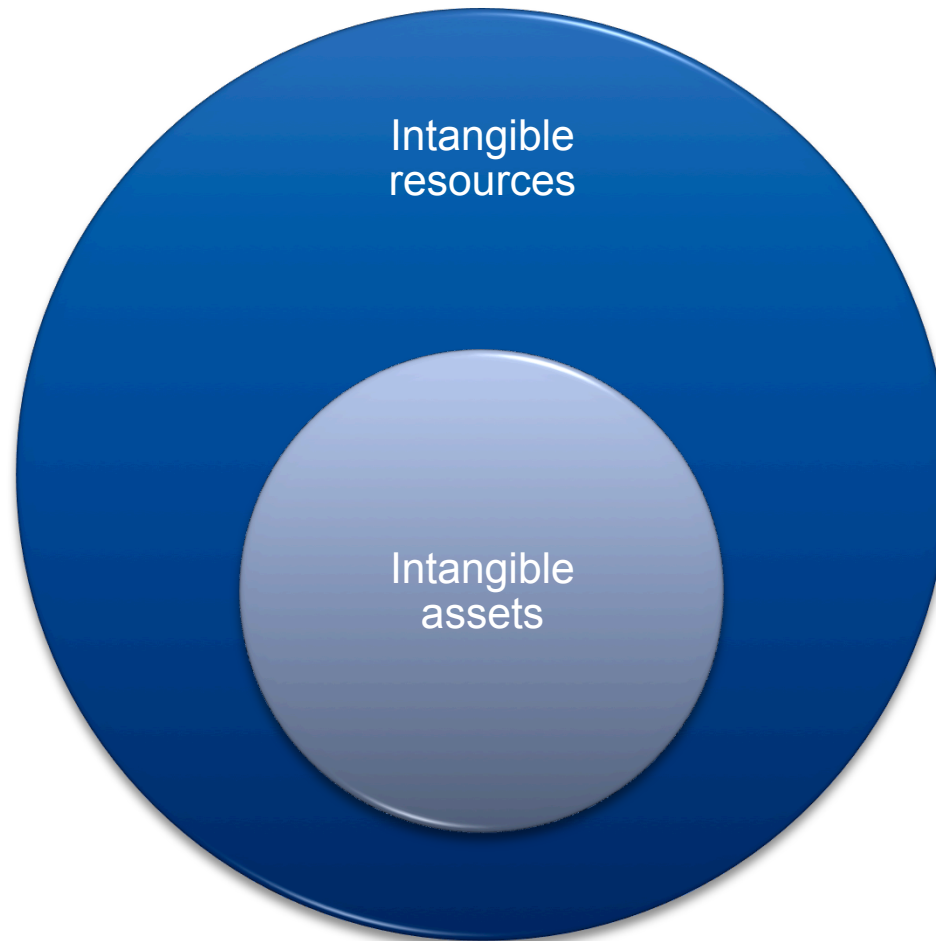
# Intangibles



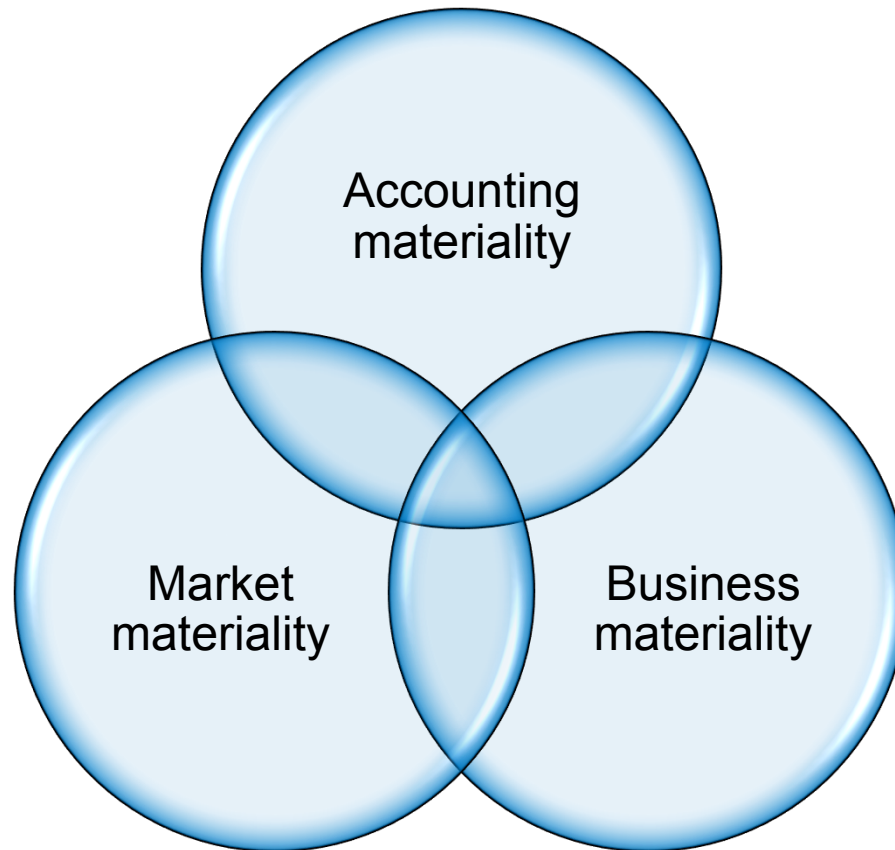
Note: all measured as a percentage of the market value of S&P 500 companies

Source: Ocean Tomo

# Intangibles

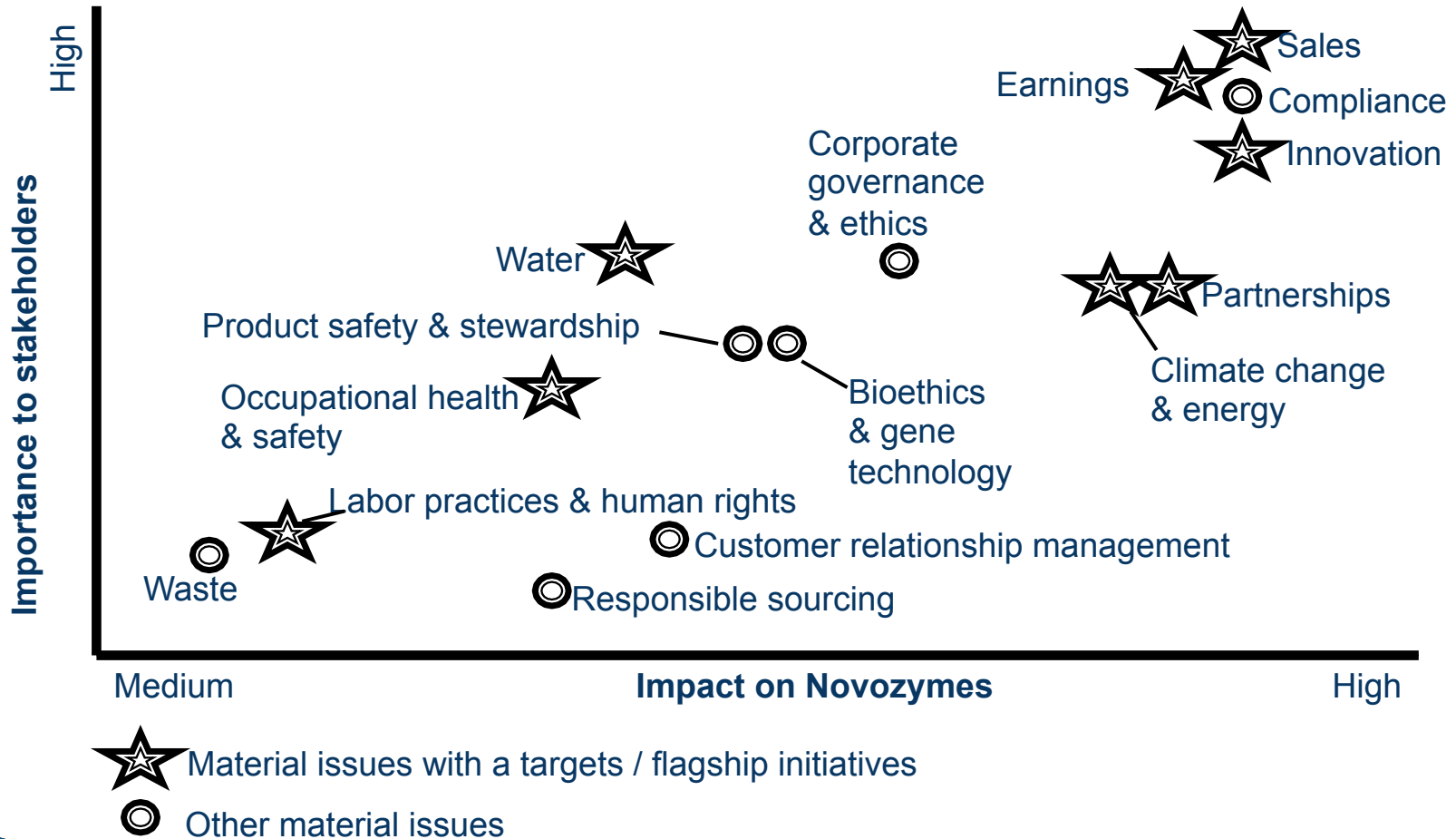


# Materiality



# Materiality mix

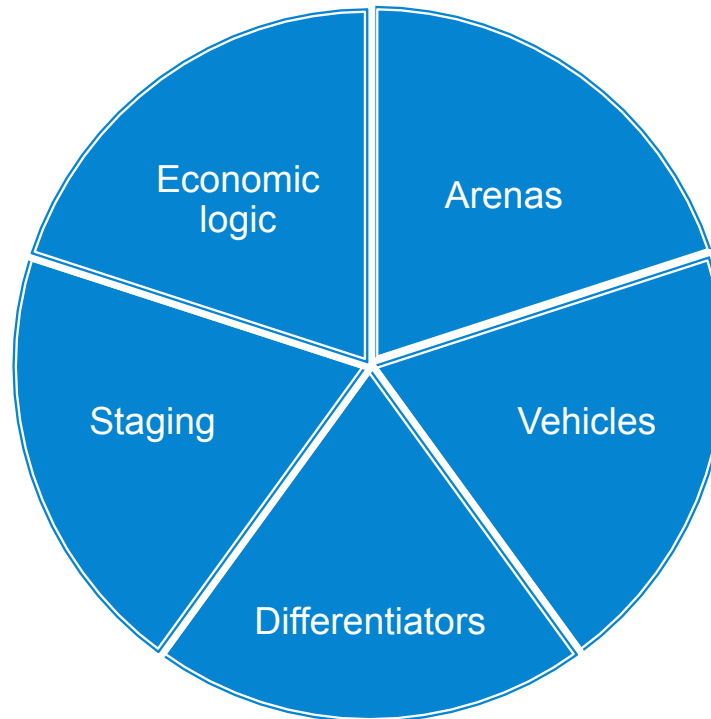
Figure 5.6: Novozymes' materiality matrix



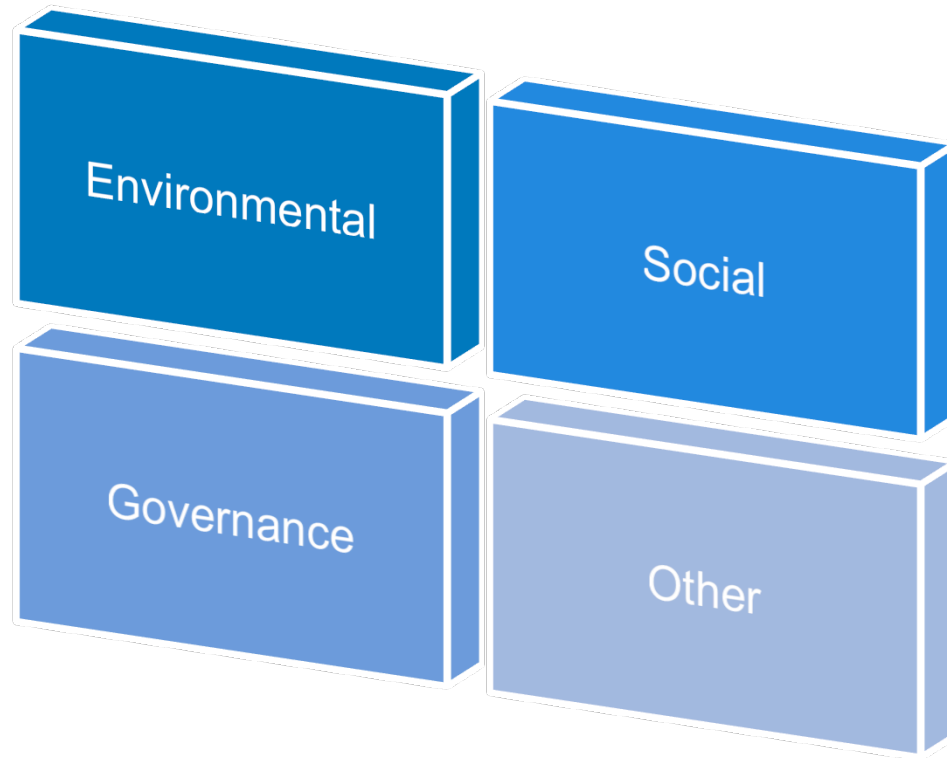
# Strategy

Strategy = The plan to achieve a desired future state

Five parts to a strategy (Hambrick & Fredrickson, 2001):



# Typical material sustainability issues



# Stakeholder impact maps

	Stakeholder 1	Stakeholder 2	Stakeholder 3	Stakeholder n
Positive impact				
Negative impact				
Short term goals				
Long term goals				



# Preparing for transformational change

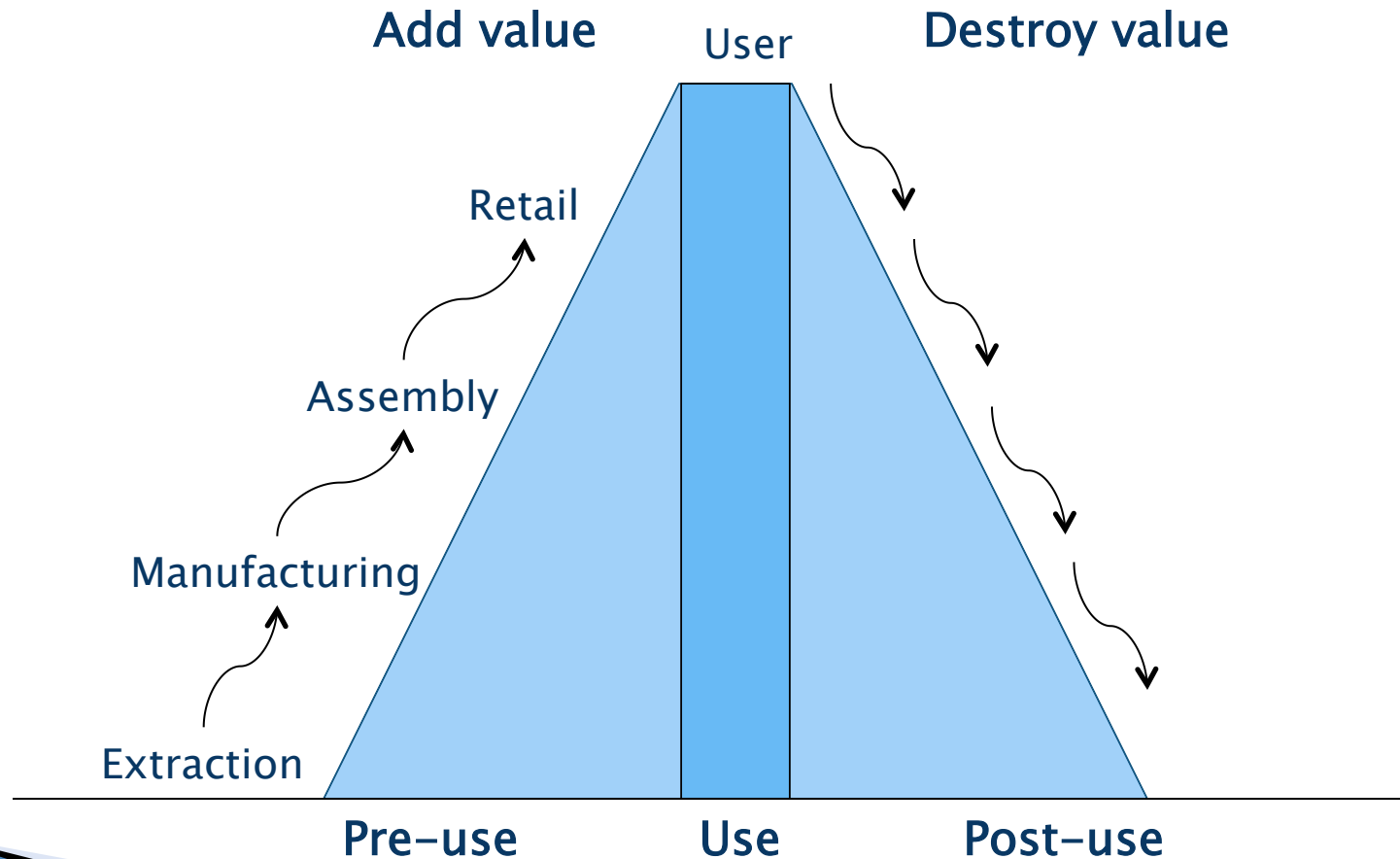
Systemic change

Business sustainability typology (Dylick & Muff, 2016):

Business Sustainability Typology	Concerns (What?)	Values created (What for?)	Organisational perspective (How?)
<b>Business-as-usual</b>	Economic concerns	Shareholder value	Inside-out
<b>Business Sustainability 1.0</b>	Three-dimensional concerns	Refined shareholder value	Inside-out
<b>Business Sustainability 2.0</b>	Three-dimensional concerns	Triple bottom line	Inside-out
<b>Business Sustainability 3.0</b>	Starting with sustainability challenges	Creating value for the common good	Outside-in
<b>Key shifts involved</b>	1 <sup>st</sup> shift: broadening the business concern	2 <sup>nd</sup> shift: expanding the value created	3 <sup>rd</sup> shift: changing the perspective

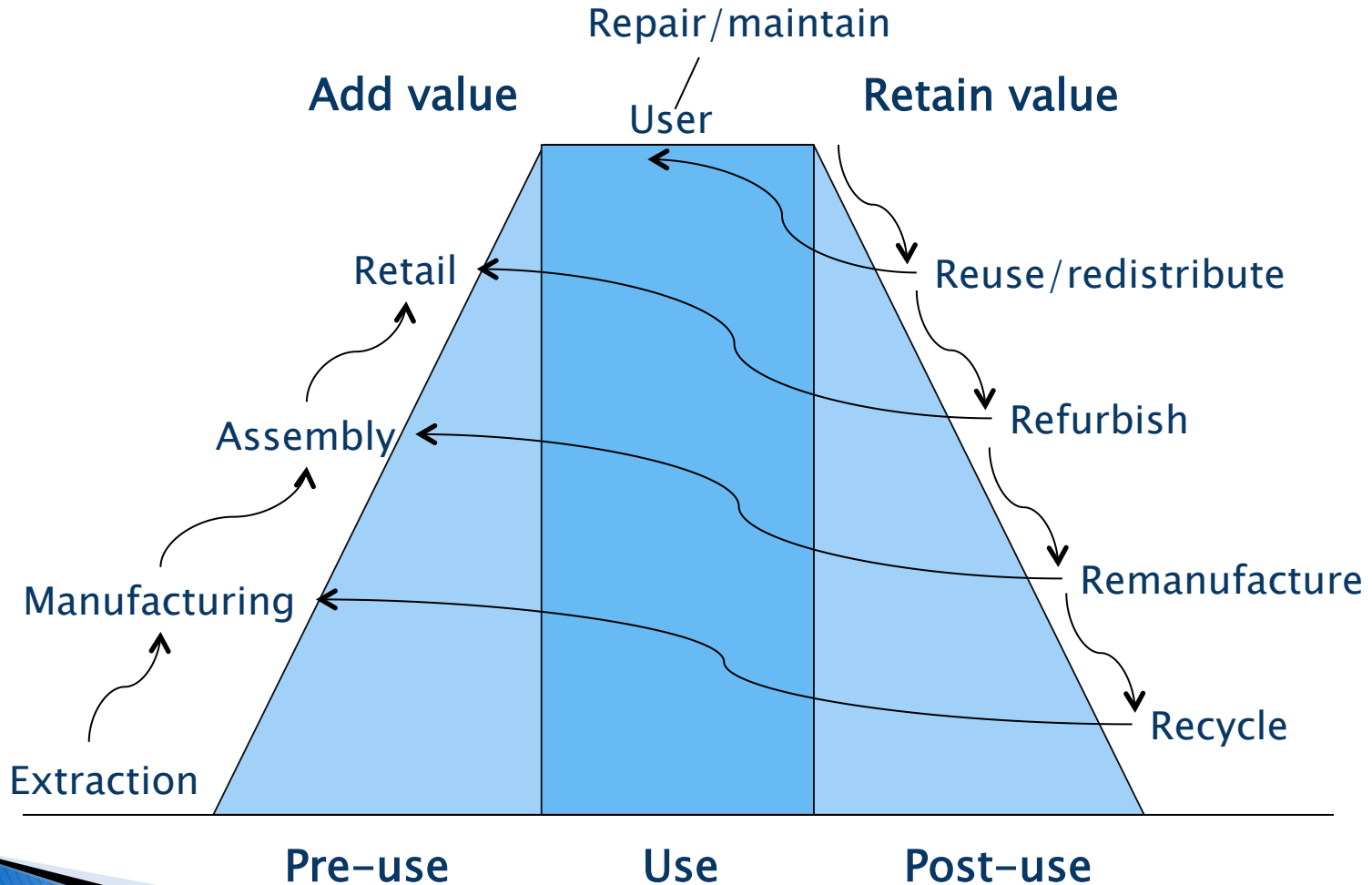
# Circular business models

The value hill in a **linear** economy (Circle Economy, 2016):



# Circular business models

The value hill in a **circular** economy (Circle Economy, 2016):



# Company purpose



**Maximise  
shareholder welfare**  
= stakeholder model  
(Hart & Zingales, 2017)



**Maximise  
profitability**  
= shareholder model  
(Friedman, 1970)

# LT value creation

Guidelines for a company pursuing long term value creation:

1) Make the company's purpose a key part of corporate strategy

2) Integrate sustainability and externalities in all functional business areas

3) Communicate LT goals clearly with all stakeholders

4) Deliver on what you promise

5) Build and maintain your key LT intangibles to achieve transformational change

6) Focus performance measurement on the LT and on meeting the purpose

7) Base incentives for management & employees on meeting LT objectives - get rid of ST variable pay

# LT capital budgeting

NPV of action

The naïve NPV of building a desalination plant:  
-\$2.2bn

-

NPV of inaction

The NPV of NOT building the desalination plant:  
-\$9.6bn

=

Full NPV

The full NPV of the desalination plant:  
 $-\$2.2\text{bn} + \$9.6\text{bn} = \$7.4\text{bn}$

# Conclusions

