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

Sustainability

Competitive position, business models, intangibles

Strategy
### Competitive positions

#### Generic competitive strategies (Porter, 1985)
- Cost leadership
- Differentiation
- Focus

#### Attributes of strategic assets (Lev, 2017)
- Valuable
- Rare
- Difficult to imitate
Sources of competitive advantage:

- Resources
- Knowledge
- Human capital
- Networks
Business models

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

- Customer value proposition
- Profit formula
- Key resources & processes

= Business model
Business models

Business model canvas (Osterwalder & Pigneur, 2010):

- Key partners
- Key activities
- Value propositions
- Key activities
- Customer segments
- Key activities
- Key activities
- Cost structure
- Revenue streams
Intangibles

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

Source: Ocean Tomo
Intangibles

Intangible resources

Intangible assets
Materiality

- Accounting materiality
- Market materiality
- Business materiality
Materiality mix

Figure 5.6: Novozymes’ materiality matrix

- **Importance to stakeholders**
  - High
  - Medium
  - Low

- **Impact on Novozymes**
  - High
  - Medium
  - Low

- **Material issues with targets/flagship initiatives**
  - Sales
  - Compliance
  - Innovation
  - Partnerships
  - Climate change & energy

- **Other material issues**
  - Corporate governance & ethics
  - Bioethics & gene technology
  - Customer relationship management
  - Responsible sourcing
  - Responsible sourcing
  - Waste
  - Water
  - Occupational health & safety
  - Product safety & stewardship
  - Labor practices & human rights

- **Medium**

- **High**

- *Material issues with a targets/flagship initiatives*

- *Other material issues*
Strategy

Strategy = The plan to achieve a desired future state

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

- Arenas
- Vehicles
- Staging
- Differentiators
- Economic logic
Typical material sustainability issues

- Environmental
- Social
- Governance
- Other
# Stakeholder impact maps

<table>
<thead>
<tr>
<th></th>
<th>Stakeholder 1</th>
<th>Stakeholder 2</th>
<th>Stakeholder 3</th>
<th>Stakeholder n</th>
</tr>
</thead>
<tbody>
<tr>
<td>Positive impact</td>
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<tr>
<td>Negative impact</td>
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<td>Short term goals</td>
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<td>Long term goals</td>
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</tbody>
</table>
Preparing for transformational change

Systemic change

Business sustainability typology (Dylick & Muff, 2016):

<table>
<thead>
<tr>
<th>Business Sustainability Typology</th>
<th>Concerns (What?)</th>
<th>Values created (What for?)</th>
<th>Organisational perspective (How?)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Business-as-usual</td>
<td>Economic concerns</td>
<td>Shareholder value</td>
<td>Inside-out</td>
</tr>
<tr>
<td>Business Sustainability 1.0</td>
<td>Three-dimensional concerns</td>
<td>Refined shareholder value</td>
<td>Inside-out</td>
</tr>
<tr>
<td>Business Sustainability 2.0</td>
<td>Three-dimensional concerns</td>
<td>Triple bottom line</td>
<td>Inside-out</td>
</tr>
<tr>
<td>Business Sustainability 3.0</td>
<td>Starting with sustainability challenges</td>
<td>Creating value for the common good</td>
<td>Outside-in</td>
</tr>
</tbody>
</table>

Key shifts involved

- 1st shift: broadening the business concern
- 2nd shift: expanding the value created
- 3rd 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):

- **Pre-use**
  - Extraction
  - Manufacturing
  - Assembly
  - Retail

- **Use**
  - User
  - Add value
  - Retain value

- **Post-use**
  - Repair/maintain
  - Reuse/redistribute
  - Refurbish
  - Remanufacture
  - Recycle
Company purpose

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

Maximise profitability
= shareholder model
(Friedman, 1970)
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

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

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

The full NPV of the desalination plant: 
-$2.2bn + $9.6bn = $7.4bn
Conclusions

- Sustainability
- Competitive position, business models, intangibles
- Strategy