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Business with impact

UBS Chief Investment Office
Wealth Management white paper

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From Corporate Social Responsibility

To Corporate Societal Returns

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Foreword

Dear reader,

Running a business sustainably has never been more important nor more difficult. In a world with increasingly constrained resources and perpetually rising costs, business owners face a tremendous amount of pressure to operate efficiently and deliver value to investors, shareholders, and customers. At the same time, as the pace of globalization accelerates and socioeconomic disparity widens, corporations are being called on to assume greater responsibility for mitigating negative environmental and social impacts.

This new paradigm means that historically reliable strategies for managing social and environmental risks are no longer sufficient for modern companies. Firms are under increasing pressure not only to minimize their potentially negative impacts, but also to proactively boost their positive impact on society while also growing their commercial returns. Yet businesses cite a number of obstacles that prevent them from putting financial profits and positive societal returns generation on an equal footing.

This white paper from UBS Wealth Management's Chief Investment Office explores a new business approach that is an evolution of traditional corporate social responsibility. A so-called "business with impact" strategy aims to maximize positive social and environmental outcomes alongside financial returns over the long term. This approach meets the demands of new client and customer groups that view societal factors not as risks to be managed, but as opportunities to be seized. It allows businesses to align their objectives with those of broader society, and even unlock unrealized commercial opportunities whose benefits can accrue to the bottom line.

Using a combination of academic research, our insights as the world's leading wealth manager, and case studies from real-life initiatives, this paper offers corporations a practical guide on how to amplify their positive financial and societal impact. In particular the paper emphasizes the importance of businesses working together. Collaborative firms – both large and small – have a great opportunity to improve social and environmental conditions in less developed regions and nations, paving the way for new markets, suppliers, and customers – and a new way of doing business.

Thank you for taking the time to read about this critical topic.

Yours sincerely,

Jürg Zeltner
President Wealth Management

Jürg

Tom Naratil
President Wealth Management Americas and President UBS Americas

Tom Naratil

Executive summary

Part 1

Definitions of business sustainability are evolving

- Businesses have long run their operations with sustainability in mind. Traditional corporate social responsibility programs aimed to address social and environmental risks, provide philanthropy to local communities, and enhance companies' reputations.
- However, this approach historically managed social and environmental risks principally to protect commercial returns. Positive outcomes for the environment and society were secondary considerations.
- Today the idea of business sustainability is evolving, as firms are increasingly empowered to adopt an approach that embeds simultaneous financial and social return generation as core objectives of their operations.
- In this new "business with impact" approach, firms regard social and environmental factors as opportunities to deliver commercial returns while proactively generating positive outcomes for society.

Part 2

Businesses are under pressure to make money and benefit society at the same time…but they can face blocks in doing so

- Both demand and supply-side factors are driving firms toward intentionally targeting measurable financial profits *and* positive environmental or social returns that complement one another.
- Businesses may struggle to become more impactful in the long term if they face pressures from external stakeholders to generate short-term profits. Many "business with impact" strategies, while they may have attractive rates of return, can take time.
- Mismatched incentive structures across different stakeholders can mean that business leaders adopt short-term business strategies that aim to maximize near-term profits by cutting corners, but do not maximize social or environmental returns over the long run.
- Businesses, especially small- and mid-sized enterprises, can also face internal constraints of resources, communication, and insufficient knowledge that prevent them from performing social good while generating financial profits.

Part 3

Businesses can build on sustainability programs to develop impactful strategies that make financial sense, and also generate positive outcomes for society

- Firms should collaborate internally and with other businesses to overcome internal resource constraints, open up new profit opportunities, and generate measurable and scalable social benefits to whole communities.
- Businesses can resist short-term pressures and become more impactful by learning from their clients, customers, and private investors that have long-term investment timeframes. Corporations can generate potentially higher long-term financial returns and generate positive social outcomes from intentional, sustainable projects than from solely short-term profit-maximizing ones.
- Businesses can harness the power of networks to draw on external expertise, adopt the impact investment industry's best practices, and solve the challenges that have prevented impact investing from becoming a more mainstream investment approach.

Part 1

The definition

Definitions of business sustainability are evolving

- **Businesses have long run their operations with sustainability in mind.** Traditional corporate social responsibility programs aimed to address social and environmental risks, provide philanthropy to local communities, and enhance companies' reputations.

- However, this approach historically managed social and environmental risks principally to protect commercial returns. **Positive outcomes for the environment and society were secondary considerations.**

- **Today the idea of business sustainability is evolving,** as firms are increasingly empowered to adopt an approach that embeds simultaneous financial and social return generation as core objectives of their operations.

- In this new "business with impact" approach, **firms regard social and environmental factors as opportunities** to deliver commercial returns while proactively generating positive outcomes for society.

The origins of corporate social responsibility

The era is over when most businesses' sole objective is to maximize near-term profits. In today's world, businesses and other institutions are increasingly adopting corporate targets that include sustainability measures, such as reporting on environmental, social, and corporate governance standards.

A conventional definition of sustainability, used in the UN World Commission on Environment and Development in its 1987 report *Our Common Future*, is:

> "…development that meets the needs of the present without compromising the ability of future generations to meet their own needs."

The below, stylized case study aims to give some practical examples of how a company can implement a "business with impact" approach. Look out for these signposts throughout the white paper.

Hi, I'm Jenny, CEO and founder of MokShatin. My Hong-Kong based company produces functional, stylish gym wear.

As we've expanded our sales footprint to six countries across Asia and the US, my business has had to reconsider how we can continue to generate profits in a sustainable way.

From the outset MokShatin has thought carefully about how we manage our business in a way that is environmentally-friendly and a great work place for colleagues.

But the bigger we get, the more the costs of sustainable behavior rise. How can I still do good for society - without sacrificing my business's profit, and without damaging my wealth?

Let's explore an example of a traditional corporate social responsibility approach. The global garment and textile industry has responded to social challenges in Southeast Asia's manufacturing hubs. Compliance mechanisms to tackle safety issues followed in response to the Rana Plaza factory disaster in Bangladesh in 2013 – examples include stricter adherence to fire safety regulations. A second wave of strategic environmental and social sustainability measures followed, such as textile waste reduction and programs to improve human resource management that principally mitigated operational risks but generated secondary favorable outcomes to wider society.

Investors have long embedded sustainability considerations in their strategies. They initially used simple exclusionary screens to avoid companies that were either unsustainable or operated in industries that were perceived to generate negative consequences for society or the environment. In the second wave of business sustainability when firms began to include environmental, social, and corporate governance (ESG factors) explicitly into their operations, investors responded by adopting investment strategies that select securities not just according to financial metrics but also take into account a business's performance along ESG criteria.

But in today's world, leading firms are moving beyond traditional corporate social responsibility (CSR) to focus on a "business with impact" approach that seeks to deliver impact in all parts of an enterprise's activities. In this paradigm, businesses shift their emphasis to generating corporate societal returns. They intentionally target measurable positive social and/or environmental returns alongside positive financial returns and try to maximise both.

Hi, Jenny here again from MokShatin.

Working in the clothing industry, I've always been a strong advocate that businesses should encourage strong environmental and social standards from their supply chains.

Two years ago we discovered that one of the textile processing firms we use in Vietnam was wasting up to 35% of processed cotton inputs. We worked closely with them to reduce this environmental risk.

Instead of wasting 35%, a combination of new technology and enhanced training provided by our supply chain team in Hong Kong means we now produce 45 gym kits for the same material that once made 41 outfits.

Even when factoring in the costs of providing the training and technology, these measures saved my firm USD 360,000 over the last two years.

What is “business with impact?"

“Business with impact” builds on traditional corporate sustainability programs in that it focuses less on philanthropy and managing risks, and more on seeking opportunities for positive impact. A "business with impact" approach's main goals are intentional, measurable financial and social return maximization for all core corporate operations. This approach is neither an exclusive response to regulatory pressures nor a public-relations boosting exercise. It is one where firms embed sustainable and impactful business practices into their operating model, with a view to generating financial as well as social and environmental returns.

How does a “business with impact” approach differ to traditional corporate social responsibility? If traditional sustainability initiatives were focused exclusively on risk management, efficiency, local philanthropy, and generating social returns as a by-product, a “business with impact” approach focuses on creating intentional and measurable financial and sustainability returns, with a clear mission to deliver on both objectives.

What does a “business with impact” approach look like? Using the above example drawn from the global textile industry, “business with impact” practices came to life as firms realized that projects that generate positive social returns could complement and augment financial returns (and vice versa). Examples of a more impactful approach included corporations working with pharmaceutical companies and non-governmental organizations in developing markets to deliver comprehensive healthcare programs for workers and their families. By raising healthcare and nutrition standards, communities can benefit from improved standards of living (a measurable social return), while firms can benefit from increased worker productivity and reduced absenteeism costs (a measurable financial return).

The investment community is taking this shift in the definition of sustainability in stride. Traditional norms-based exclusion strategies that avoid sectors that face social or environmental risks are morphing into strategies that seek to leverage sustainability trends to try to generate market-beating returns. While many investors still consider environmental, social, and corporate governance (ESG) factors alongside traditional financial analysis, this ESG approach typically still places greater importance on financial returns over social or environmental ones. These approaches are still relevant for public market investing (though shareholder engagement is an emerging impact-focused public equities strategy).

Investors are also empowering firms to adopt a "business with impact" approach, by increasingly committing capital to "impact investment" strategies. These more holistic investment approaches explicitly aim to maximize both long-term financial and societal returns at the same time. They also emphasize the robust measurement of both, and depend on a closer alignment of different stakeholder demands than traditional corporate social responsibility-driven investment methods.

A practical guide to the “business with impact” approach

In part 2 of this white paper, we explore why businesses are being compelled to target corporate societal and environmental return generation at the same time as financial profits. We take a look at some of the perceived obstacles to adopting a “business with impact” approach, and propose practice solutions that businesses can use to do well for society as well as make money for their stakeholders.

In part 3, we establish a framework for establishing a “business with impact” operating model, and highlight best-practice examples of firms that have already adopted this more holistic approach. In one case study, we outline how one firm adopted a “business with impact” approach, raised worker pay by 15%...and managed to boost productivity by a fifth.

We examine the lessons that businesses can learn from various stakeholders on how to maximize financial and non-financial returns. And we conclude by providing recommendations on how to support mainstream adoption of a “business with impact” operating model.

Part 2

The pressure

Businesses are under pressure to make money and benefit society at the same time…but they can face blocks in doing so

- **Both demand and supply-side factors** are driving firms toward intentionally targeting measurable financial profits and positive environmental or social returns that complement one another.

- Businesses may struggle to become more impactful if they face **pressures from external stakeholders to generate short-term profits.** Many "business with impact" strategies, while they may have attractive rates of return, can take time.

- **Mismatched incentive structures across different stakeholders** can mean that business leaders adopt short-term business strategies that aim to maximize near-term profits through cutting corners but do not maximize financial, social, or environmental returns over the long run.

- Businesses, especially small- and mid-sized enterprises, can also face **internal constraints of resources, communication, and insufficient knowledge** that prevent them from performing social good while generating financial profits.

Today, the concept of corporate sustainability is in a state of evolution.

The idea of corporate sustainability has moved on from its early beginnings as a side-shoot of the core business that focused on philanthropy, enhancing the firm's reputation, and mitigating risk by avoiding activities that have a negative impact upon wider society. It is no longer sufficient for firms to regard social and environmental factors as risks to be managed. And firms cannot just hope that effective management of social or environmental factors generates a secondary financial return on investment, through adding to intangible assets such as reputation or staff satisfaction.

Why do firms need to rethink their sustainability strategies?

Three principal factors are driving leading businesses to build on their traditional corporate sustainability practices and move toward a "business with impact" approach that delivers financial and societal returns intentionally and simultaneously. Pressures on firms are coming from both the demand and supply side.

Investors, consumers, and stakeholders demand more impactful firms

Investor interest in sustainable business practices has grown significantly over recent years, and has been accelerated by the launch and widespread support for the UN Sustainable Development Goals (SDGs). According to the 2016 *Global Sustainable Investment Review* from the Global Sustainable Investment Alliance, assets managed with responsible investment criteria grew from USD 18.3trn in 2014 to USD 22.9trn in 2016.

The report outlines how the bulk of investment funds are still following traditional approaches. These include: the exclusion of certain corporate sectors or firms that employ unsustainable practices (comprising USD 15trn of assets); and investment methodologies that integrate ESG assessments alongside financial analysis (accounting for USD 10.4trn of assets).

A growing number of people and institutions want impactful businesses and investments (beyond a simple exclusionary investment approach) that deliver financial and social or environmental returns simultaneously, with millennial and female investors leading a wider wave of demand across society. Investors are ever more prepared to engage businesses and use their power as shareholders, if necessary, to force change.

Broader awareness of social and environmental issues, fuelled by leaps in technological progress and in smartphone-enabled connectivity, allows the collection of higher-quality data and the emergence of new frameworks, goals, standards, and methodologies to assess impact. Among the most important of these are the UN Sustainable Development Goals (SDGs), a set of

17 ambitious targets launched in September 2015. These help investors and society work together to promote both more equitable economic growth across the world, and to measure businesses' individual efforts to generate non-financial, societal returns.

Consumers also say that they care about whether corporations adopt the SDGs and would prefer to do business with those that build these aims into their business model. Of around 2,000 citizens surveyed by PwC in its 2015 *SDG Engagement Survey*, 90% of participants responded that it was important for businesses to sign up to the SDGs. At a country level, enthusiasm for making SDGs part of a company's core strategy and operations was highest in Malaysia and the UK (just under 70% of people surveyed in each). Above half responded that the SDGs should be integral business policy in emerging markets such as China and Brazil, compared to just 30% in the US and 25% in Japan.

New generations of stakeholders also expect businesses not just to deliver financial profits, but also to further the public good. These new stakeholders include the millennial generation that already expects firms in which it invests to deliver positive returns to wider society and is unwilling to invest (or willing to divest) if a business does not deliver for society while generating profits.

Female investors are also increasingly interested in using their wealth for social and environmental good. According to Spectrum Millionaire's Corner data cited in the World Economic Forum USA's 2014 report *Impact Investing: A Primer for Family Offices*, about half of affluent women and a third of men are interested in opportunities that generate potentially positive social or environmental outcomes.

A) Operational risks can be business liabilities…or opportunities

Increasingly international firms are realizing that social and environmental consequences of doing business can have rising material impacts upon their international and local operations.

Shareholders are punishing listed firms' stocks more harshly for environmental damage. According to two academic studies cited in UBS Asset Management's 2015 report *(A revolution in equity investing: A deeper dive into nonfinancial data)*, the average abnormal equity return in the two days after a firm issued negative environmental news was -0.4% in the 1980s. These average underperformance figures worsened to -0.7% in the 1990s, and -1.1% in the period 2000-2009.

Operational risk management is an important driver of operational efficiency. A growing body of academic and industry analysis suggests that firms that exhibit superior sustainability criteria can overcome operational risks and lower capital costs. The average cost of debt is 7-18 basis points (0.07-0.18 percentage points) lower for firms with no investor concerns about social responsibility compared to unsustainable businesses, according to a 2011 Journal of Banking & Finance study by Goss and Roberts of nearly 4,000 bank loans to US firms. In a study of more than 2,300 US listed companies conducted between 2003 and 2010, Caijas, Fuerst, and Bienert (2012) found that firms that continuously invested in good social and environmental business practices reduced their estimated cost of capital relative to the wider market by 0.07-0.13 percentage points.

By contrast, firms are realizing that long-term business success depends on more than operational risk management. It depends on finding operational opportunities to generate higher financial and social profits at the same time, by aligning business objectives with those of customers, employees, and other stakeholders.

Jenny here, CEO at MokShatin. The firm has suffered a major setback.

We had a workers' strike at one of our newest supplier factories in Cambodia. The production line stopped in protest at new production targets that mean employees have to work a 16-hour day. Lunch breaks fell to just 15 minutes too, and lower overtime pay led 30% of the workforce to resign as they can't afford to eat or feed their families.

We really needed our 15,000 unit order to be delivered in five weeks for a new store opening in LA – but there was no chance of delivery.

We had to switch supplier really quickly to another trusted factory in Vietnam, adding additional costs of around USD 80,000.

Our buying team is looking at how this risk was overlooked. And our PR agency is managing the fallout of our firm being linked to an "exploitative factory."

What could we have done differently?

Let's consider an example of how to manage the operational risks and opportunities afforded by employing a global workforce. The International Labour Organization (ILO) estimates that the number of global supply-chain related jobs rose by 53 per cent between 1995 and 2013, to a total of 453 million.

However, the complexity of these supply chains, across industries and jurisdictions, means that operational risks can easily arise in firms if downstream labor practices do not comply with law or minimum acceptable practices. For example, a 2015 UN Conference on Trade And Development (UNCTAD) report that analysed 100 export processing zones (EPZs) reported that 80% of them paid workers at rates below the local national minimum.

In a "business with impact" approach, firms do not just manage operational risks but also look for opportunities to change operational practices in ways that intentionally generate financial profits and positive returns to society. One example of such an approach to managing global labor supply chains is the ILO's Sustaining Competitive and Responsible Enterprises (SCORE) initiative.

The SCORE initiative worked on improving labor conditions among a group of Shanghainese suppliers, through training and in-factory consulting. In a 2017 ILO study, SCORE Training in International Supply Chains, the results showed a measurable improvement in social conditions – 92 per cent of surveyed workers and managers reported that the initiative had improved relations between executives and shop-floor labor, and that trust across ranks had increased. The authors also noted enhanced financial returns at the same time through increased employee productivity and reductions in waste. The extent of these gains was such that suppliers could end leases on surplus storage space, saving around USD 30,000 per month in the process.

This "business with impact" approach reduced operational risks like absenteeism, increased financial returns through greater operational efficiency, and generated a positive, measurable improvement in employees' well-being.

B) External (regulatory) requirement pose risks…and offer opportunities to boost reputation too

The need for sustainable business behavior is increasingly enshrined in law. Regulatory burdens differ across jurisdictions, but businesses today generally face tighter legal requirements concerning the management of environmental, social, and corporate governance risks.

Non-compliance can have a significant negative impact upon businesses' financial operations, as evidenced by the high-profile censuring of firms that fail sustainability standards. In 2016, the US Department of Justice (DOJ) and the Securities Exchange Commission (SEC) collected a record USD 2.43bn of fines against firms that breached the Foreign Corrupt Practices Act (FCPA). This sum totaled nearly four times the average amount of fines collected annually between 2011 and 2015, according to data from the SEC and law firm Jones Day.

China is also clamping down more heavily on water polluters. Between January and May 2017, the Chinese Ministry of Environmental Protection investigated 13,478 cases of water pollution law violations, more than three times the number of inquiries made in the comparable period of 2016. In June 2017 the ministry announced that it would amend the Water Pollution Prevention and Control Laws to make local officials directly responsible for managing local water quality while raising fines for offending businesses to CNY 1m.

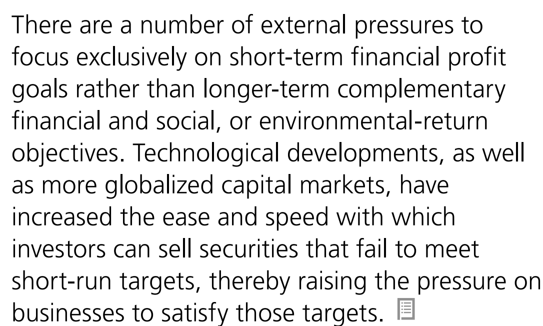
While these issues are core to traditional corporate sustainability strategies, the culture that is built via a "business with impact" model takes it a step further, and may even involve working with regulators on positive regulation to level the playing field and ensure sustainable practices are rewarded by the market. By taking a "business with impact" approach and targeting higher-than-minimum standards that pre-empt regulatory change, businesses can adapt to new operating environments more quickly, gain a competitive edge, and boost financial returns alongside social ones.

What is stopping firms from adopting a “business with impact” approach?
Given the compelling evidence, why is the "business with impact" approach not more widespread? Why do investors place so much emphasis on quarterly earnings data, and so little on quarterly social impact data?

Apart from being a relatively new agenda, the principal reason why such an approach remains a niche one is that businesses encounter obstacles to becoming more impactful.

C) External pressures

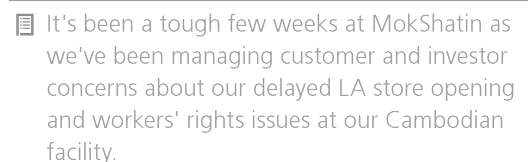
In a survey of 615 large- and mid-sized US publicly listed companies, McKinsey Global Institute explored the trend of near-sighted corporate behavior in its 2017 paper Measuring the Economic Impact of Short-Termism. Its data indicates that 87% of executives and directors feel under pressure to deliver strong financial performance within two years or less. Almost two-thirds reported that short-term pressures had risen over the past half-decade.



There are a number of external pressures to focus exclusively on short-term financial profit goals rather than longer-term complementary financial and social, or environmental-return objectives. Technological developments, as well as more globalized capital markets, have increased the ease and speed with which investors can sell securities that fail to meet short-run targets, thereby raising the pressure on businesses to satisfy those targets.

Misaligned incentive structures may explicitly link executive pay to short-term financial profit objectives, but not to positive long-term social or environmental objectives. This can mean that business leaders are rewarded for talking about maximizing long-run societal returns from business but targeting short-run risk-adjusted financial returns. One example of this behavior is that senior managers apply high average discount rates to future expected cash flow that are well in excess of shareholders' and bondholders' average rates of return, as outlined in Poterba and Summer's 1995 article for The Sloan Management Review. In other words, firms could be using unreasonable financial assumptions to focus on near-term profits, at the expense of longer-term investments that would have potentially generated higher financial and social returns for stakeholders.

For privately-listed firms, the pressure arising from quarterly financial earnings updates may be somewhat less acute, but can still arise if investors look to sell their investments. These external pressures may occur even if the firm is meeting or exceeding longer-run financial targets and generating positive returns to the environment and society.



It's been a tough few weeks at MokShatin as we've been managing customer and investor concerns about our delayed LA store opening and workers' rights issues at our Cambodian facility.

Our third largest investor is demanding change. They say that we need to think about sustainability not as a side-shoot of the business, but as a core part of everything we do.

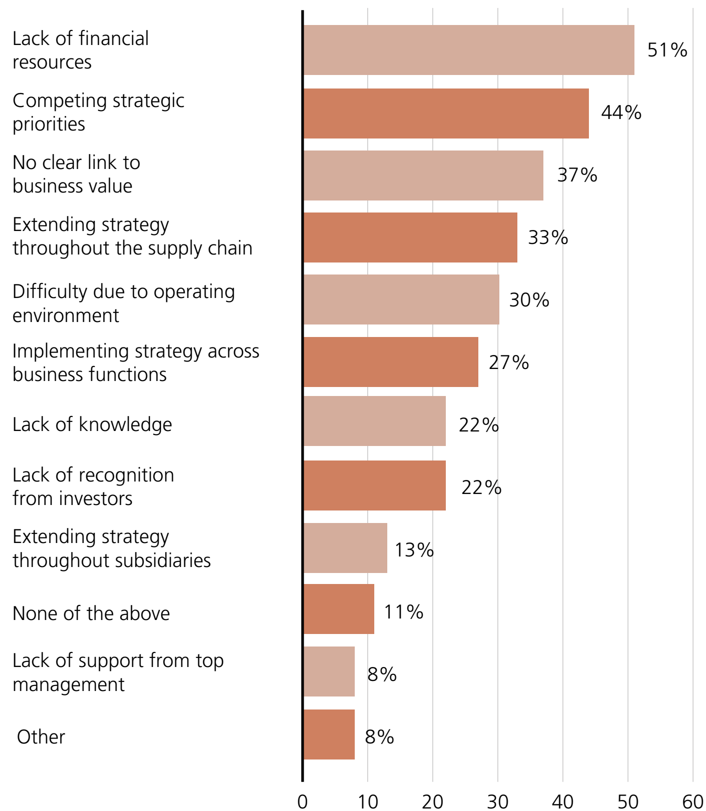
In three months' time they want a clear plan of action as to how we will improve our social and environmental returns to society - or they'll pull their USD 15m of equity capital that we need for our three new store openings in Europe and our new marketing campaign.

D) Internal pressures

The 2013 edition of the Accenture/UN Global Compact CEO Study found that business leaders were subject to a number of internal pressures that hindered their firms from maximizing financial and non-financial returns concurrently.

CEOs identify the lack of financial resources, competing priorities, and the lack of a link to business value as critical barriers

Which barriers keep you, as a CEO, from implementing an integrated and strategic company-wide approach to environmental, social, and corporate governance issues? Respondents identifying each factor among their top three choices.



Source: UNGC-Accenture CEO Study (2013), UBS.

MokShatin's largest investor is demanding we boost our quarterly earnings growth rate from 7% to 10% by year-end.

Where will I find the resources and tools to make us more sustainable, and make more money?

In particular 51% cited a lack of financial resources as reason not to embed environmental, social, and corporate governance in a strategic and integrated fashion. Even for larger firms, 27% said that implementing such a strategy across business functions was difficult, most likely due to operational complexity, silo mentalities across different units, and a lack of awareness around which parts of the business were best placed to embed behaviors that benefit wider society. Twenty-two per cent also cited knowledge gaps as a barrier to conducting business more sustainably.

Survey data shows that sustainable business behavior seems to be less important for small- and medium-sized enterprises (SMEs) than it is for larger ones.

For example, Epsom and Quocirca surveyed 500 IT and line-of-business managers in SMEs and large enterprises in 2016 from across the UK, France, Germany, Spain, and Italy. Seventy-four per cent of larger firms described sustainability as being very important to their business, more than double the 33% response rate from SMEs.

One explanation for this could be resourcing levels dedicated to sustainability initiatives. Seventy-four per cent of SMEs said that they had no resourcing allocated to sustainability, or that they planned to fill this gap; the corresponding percentage for large enterprises was 18%. In turn, SMEs lag their larger peers in adopting policies that can boost both financial and social returns. Just 42% of small and mid-sized firms had policies in place to increase workplace energy efficiency (versus 77% of large firms) and reduce their carbon footprint (compared to 76% of bigger enterprises).

SMEs are estimated to account for around 90% of world businesses, contribute up to 45% of total employment, and as much as a third of emerging markets' gross domestic product, according to World Bank data. Yet SMEs accounted for just 10% of the total number of sustainability reports included in the Global Reporting Initiative's Sustainability Disclosure Database in 2016, highlighting a considerable gap in capturing the full business value of social and environmental return potential alongside financial profits.

Part 3

The plan

Businesses can build on sustainability programs to develop impactful strategies that make financial sense, and also generate positive outcomes for society

- **Firms should collaborate internally and with other businesses** to overcome internal resource constraints, open up new profit opportunities, and generate measurable and scalable social benefits to whole communities.
- Businesses can resist short-term pressures and become more impactful by **learning from their clients, customers, and private investors that have long-term investment timeframes.** Corporations can generate potentially higher long-term financial returns and generate positive social outcomes from intentional, sustainable projects than from solely short-term profit-maximizing ones.
- **Businesses can harness the power of networks** to draw on external expertise, adopt the impact investment industry's best practices, and solve the challenges that have prevented impact investing from becoming a more mainstream investment approach.

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Part 2 of this white paper outlines the principal reasons why businesses are increasingly empowered to operate more sustainably and to generate positive societal outcomes alongside profits. However, we also flagged a number of obstacles that prevent businesses from doing social good at the same time as making money.

We would argue that many of these hindrances are easier to overcome if firms cooperate, collaborate, and focus their efforts on a common cause.

In the sections that follow, we outline how firms can build up their existing sustainability strategies to adopt a "business with impact" approach that generates commercial returns and does well for wider society.

A) How to become a “business with impact" through collaboration

Collaborate internally and work with other businesses to test impactful business strategies, meet client demands, and overcome internal constraints

For businesses to have positive financial and social impacts, a key first step is to identify opportunities and define purposeful objectives.

The ultimate objective of an impactful business strategy depends on the size, industry, and resources of each firm. A common approach for a large global firm’s impact strategy is to focus on economic opportunities in developing markets, either through working closely with supply chains or directly operating in these markets. For many large corporations that are well established in developed economies, emerging and frontier countries may offer interesting potential for selling goods and services. Corporations can adopt a business with "impact" approach within their existing operations. They can increase operational efficiency by reducing procurement risk, while having a positive social and environmental impact on the workers and communities across the supply chain. Privately-owned clothing manufacturer C&A offers an example of this collaborative approach via its funding of "The Sustainable Supplier Programme" through its strategically-aligned C&A Foundation.

It's Jenny from MokShatin.

We needed to make some radical changes in order to make sure that what our business does aligns with what society wants.

To make sure our supply chains are more sustainable, we needed help. We reached out to a supply chain management specialist.

This firm is working with us to design and implement a new education and monitoring program across all our factories and supply chain intermediaries. We've drawn up a Code of Conduct that explains the minimum working standards we expect from all our suppliers. It includes working hours, nutrition, healthcare, and longer holiday provisions.

Our analysis suggests that by spending USD 2m on education and data measurement across all factories, we can potentially improve productivity by 10% and raise worker welfare by 15%. That should deliver a financial return of up 12% while benefiting workers.

The Foundation partnered with two external institutions, the Gesellschaft für Internationale Zusammenarbeit (GIZ, a governmental development agency) and TBM Consulting Group. It began to sponsor a program in 2011 to improve worker conditions and productivity simultaneously in 18 clothing factories, employing over 22,000 employees, across five countries in Asia. The initiative intended to reduce absenteeism and overtime while raising production quality, productivity and wages. The inputs to the program were investments in worker-manager relations via the inception of Continuous Improvement Teams; the laying out of clearer career development paths for employees; and the training of workers in lean manufacturing techniques.

Embodying a "business with impact" approach that measures and assesses returns and project outcomes in a quantifiable way, the C&A Foundation partnered with Giving Evidence in 2014 to assess critically the two-year pilot initiative.

> Positive results included reported average increases in sewing efficiency and total take home pay (excluding overtime) of 20% and 15% respectively, while worker turnover fell an average 24%.

C&A generated financial returns in terms of cost savings in the order of around EUR 450,000 per factory and an independent assessment by Solutions Matrix computed a return on investment of 118% with a payback period of less than one year (accounting for both the factories and C&A Foundation's investments).

This case study also revealed challenges that a "business with impact" approach can encounter. For example, the program generated significant variation in results between factories – worker turnover changes ranged from -71% to +64% depending on location. This variation was attributed to change implementers placing differing levels of emphasis on improving social conditions and improving financial performance. A key lesson to learn is that firms should agree on a common set of measurable financial and social targets before undertaking a new investment or project (with equal priority put on the fulfillment of these targets).

Costs of execution and measurement per factory were comparatively high given the low numbers of participants and difficulties in scaling the operation. Part of the reason for this was that factories were asked to share payment for the program, reducing the number of suppliers that joined the program and leaving a smaller number of participants to bear the costs. Businesses looking to become more impactful can learn from this lesson and spend time educating suppliers and other external partners on the potential costs and benefits of targeting simultaneous financial and social returns. Businesses should also be prepared with statistics and case studies as examples of how intentional targeting financial and societal return generation can have widespread benefits and should not be dismissed immediately as pure costs.

Another obstacle to impactful business in this instance was a lack of strategic alignment between C&A's business, foundation, and stakeholders. Inconsistency between partners meant that engagement with supply chain partners and monitoring of implementers was challenging and costly.

A key message here is that it may make sense for firms to trial a "business with impact" approach in a small number of markets, preferably where resources can be shared and marginal costs reduced. Successes and failings from this "proof of concept" can then be measured, evaluated, and presented to all business stakeholders. After consensual agreement on which initiatives should be rolled out more widely given proven financial and social returns, employees and external stakeholders can then decide on a clear path for scalable future expansion of impactful activities, with agreed and measurable objectives. This pilot approach may work particularly well for smaller firms, as it may be difficult to overcome resource constraints and find the resources to identify new markets and trial new business models across all markets at the same time.

Jenny here again.

The first results of our supply chain education and measurement program are in. The findings have been mixed.

Twenty-seven out of the 30 suppliers we use signed up to the Code of Conduct. We helped run 244 training sessions so far, and implemented a comprehensive nutrition and healthcare program across one factory.

Costs so far are above target – USD 2.3m. Although we boosted productivity in the trial factory by 8%, productivity went up 5% in the other factories too. Staff turnover hasn't fallen yet. And even though all workers in the trial now have access to three meals a day, absenteeism has risen slightly.

We need more data to make this program a success. And we need to find ways to scale this program to the other two factories at lower cost.

Key lessons for businesses to learn from this case study are:

- Firms can generate positive social returns in emerging markets by investing in projects that benefit the local environment or local workers; improving developing market conditions can also develop new commercial opportunities and unlock new avenues of financial profit;

- It is critical that firms align financial business objectives and societal objectives, particularly when deploying capital, to bring about successful and impactful corporate investment outcomes;

- Businesses need to invest time and resources early on to test small-scale impact pilots and learn important lessons on how to scale projects successfully.

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Interview with Tan Sri Dr. Lim Wee Chai

Executive Chairman of Top Glove Corporation Bhd

How did you first identify that generating social returns by improving your employees' health and wellbeing was a key driver of firm productivity and profits?

I have always regarded health as one's greatest wealth. Good health is also a core part of our business – rubber gloves are an essential item in the healthcare sector, whose demand for our products makes up 80% of our total market.

Fifteen years ago we began to recognise the explicit link between employee health and wellbeing, and our company's performance. We identified that throat infection was one of the biggest causes of sick days. So, we gave everyone two toothbrushes: one for the office, another for home. This initiative improved oral health, the number of sick days fell, and our productivity increased.

We must all be fit, both mentally and physically, if we want to maintain a competitive edge in our personal and professional lives. Hence, I have made it my personal mission to create awareness of the importance of good health and wellbeing amongst all my employees, business associates and friends. Healthy practices are firmly embedded in our company culture and I believe have been instrumental in our company's success.

What initiatives has Top Glove put in place to improve employee wellbeing

All our initiatives form part of a company-wide, health-focused corporate culture. Food, nutrition, and seven hours' sleep can boost physical health. Good mental health comes from ensuring a corporate culture where honesty, transparency, and integrity are standard practice. In fact, we encourage our employees to look after themselves and their families through one of our Business Rules - "Do not lose your health."

We invest in giving out complimentary dental kits (toothbrushes, toothpaste, tongue cleaners, and floss) to all staff on a yearly basis as a way to encourage them to brush three times a day and maintain good oral and overall health. Our team of five nutritionists work closely with top management to design programs that foster good food habits like three good meals a day among all staff. We provide free fruit to all staff in our Malaysian and Thai offices once a month to promote healthy eating. And we have recently started a joint venture with Global Doctors to provide a health service, not just to employees in our corporate headquarters, but also to the wider community.

Education is also a critical part of our corporate strategy. Health talks on topics ranging from lower back pain management, cardiovascular problems, and non-communicable diseases empower our employees to look after their own wellbeing and reduce preventable illness. We encourage all our employees to make use of programs at our free in-house gym, or participate in the firm-wide sports activities we organize. We encourage everyone to do 30 minutes of exercise a day, at least five days a week. And we have created a Healthy Food Guide for our in-house canteens to teach healthier cooking methods and raise awareness of nutritious foods. Monthly healthy food competitions help turn theory into practice in a fun way too!

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Finally, we have put in place measures to monitor employee health and learn how to improve our employees' wellbeing through data collection. Each member of staff has a quarterly check of their Body Mass Index (BMI) to make sure they maintain a healthy score below 25. If they score above 25, our nutritionists help staff to find ways to lower their score through healthier eating. We then regularly meet these staff to track progress and offer further help and guidance if they need it.

We want our employees to know that being healthy can and should be the norm, if the right preventative steps against ill-health are in place. This approach will be particularly important for the 300-400 new graduates that join us every year, if they are to maintain healthy, happy, and productive careers over three to four decades.

How do you measure the financial and social returns of your employee wellbeing program?

We look at a variety of financial and social metrics to assess how our initiatives are benefiting society and our company.

Our data shows that Top Glove's employees are healthier than the national average when it comes to levels of obesity. The percentage of people with a BMI over 30 in our company is just 17%, less than half the 45% rate recorded for the overall Malaysian population.

At the firm financial level, we monitor medical expenses per employee – these fell to MYR 213.60 in 2017, a 0.6% fall from MYR 214.90 in 2016. We also track employee-days lost due to ill health and compare this to our competitors. Top Glove loses 0.7% of employee days to sickness in a year – that's around a quarter of the 2.8% industry level.

How have you used data to refine and improve the program?

We collect and analyse a lot of internal data. Employees help us here – many voluntarily share their fitness and teeth cleaning habits with us, so we can make our health program more impactful and more effective.

We gather cost and benefit data for our initiatives as we test them on a small scale. If the measurable benefits outweigh the costs, we then roll out a health initiative more widely. For example, the financial and social advantages of our three-times-a-day teeth cleaning program more than outweigh the USD 100,000 cost of providing oral hygiene products to our employees.

We also actively participate in externally-run, research-based studies to identify gaps in our health strategies and find ways to constantly improve our program. These include working with the Malaysian Ministry of Health, University Malaya, USCI University, and AIA Vitality.

Did your business colleagues, stakeholders, and customers all react in the same way to this employee initiative?

Given that we're the world's largest rubber glove manufacturer and our product is a basic necessity in the healthcare industry, our stakeholders generally bought into health being an integral focus area for the business. They generally recognized that our focus on health aligns well with the company's mission and vision to enrich and protect human lives.

Over 90% of our shareholders understand that healthier employees contribute more to our company and therefore support the investments we're making in workers' health and wellbeing. The employee responses to our health-centric culture have been positive. We have made extra efforts to promote early worker uptake of new initiatives such as teeth brushing and making a

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gym visit a regular part of daily routine. Although there were some who felt a bit uncomfortable as it was outside their usual routine, constant encouragement and emphasis on its benefits has helped our employees to accept and embrace our healthy living culture.

What are the top three things that Top Glove has learned from investing in its employee health and wellbeing?

We have seen very positive results from investing in our health initiatives, with the biggest benefits coming in three key areas:

i) Increased productivity, as employees are far more productive when they are physically healthier, showing extended concentration and producing higher quality output;

ii) Positive corporate image, thanks to a health-centric approach at the core of our business, and the higher quality products that healthier employees produce;

iii) Good employee engagement, as employees realize that schemes such as free gym use don't just boost their short-run productivity but can have favorable long-run effects like fewer sick days and lower medical costs.

What advice would you give to other businesses that want to become more sustainable, but feel they don't have the resources to do so?

> I would advise them to start on a small scale and gradually increase their investment in the most productive areas for social and financial returns.

Investing in employee well-being is a long-term investment and one which must receive priority as there are both tangible and intangible benefits in doing so.

In fact, I believe it is the wisest investment a business owner can make. Employees are the foundation of a company and continuous investment in their wellbeing is crucial to ensure sustainable corporate success. When you take care of your employees' health, they will take care of your business's health.

B1) Learn how to invest on a long-term basis from sustainability-focused clients and investors

Businesses can draw upon a wealth of expertise from their clients, investors, and other stakeholders in their efforts to move their business models from managing sustainability risks to adopting a "business with impact" approach.

Collaboration with clients and investors can help firms not only to address internal resource constraints, but also to overcome commercial pressures that benefit short-term financial returns over long-term financial and societal gains.

For example, a growing body of evidence suggests that female and millennial clients and customers are likely to spur increased demand for (and supply of) impactful corporate investment over the coming years.

Female customers, clients, and investors increasingly assess their investments on the basis of positive societal effects and non-financial criteria. Sixty-five per cent of women judge an investment's success based upon its social, political, or environmental outcomes – the proportion of men that do the same is 42%, according to 2013 research from US Trust cited in the same report.

Women's financial power is growing, and so too is their influence on corporate behavior.

In the US women already control nearly half of all estates worth more than USD 5m, according to Fara Warner's 2006 book *The Power of the Purse: How Smart Businesses are Adapting to the World's Most Important Consumer – Women.* And women are expected to inherit 70% of the estimated USD 41trn in intergenerational wealth transfers over the next forty years, according to a 2003 report by the Boston College Social Welfare Research Unit. The millennial generation – whose members will likely be the future clients, investors, and stakeholders of businesses around the world – are also well-placed to bring their skills and values to bear in helping firms generate both financial and societal returns.

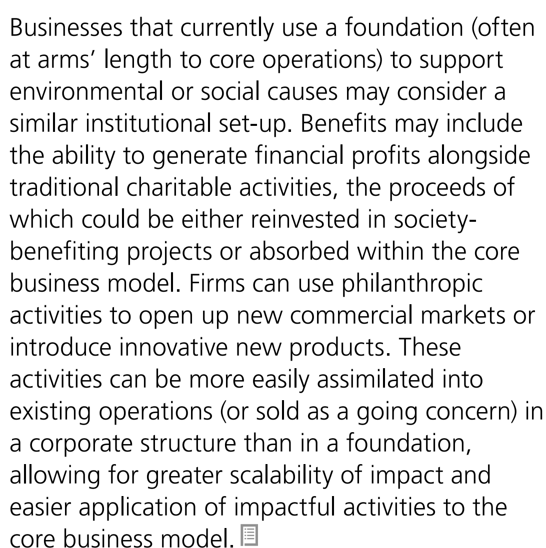
Under-35s are twice as likely as other age groups to sell an investment if the issuing company is perceived to be unsustainable, according to a 2015 study from Morgan Stanley. The millennial generation is expected to inherit a greater share of global private wealth over the coming years and to account for three-quarters of the global workforce by 2025, as outlined in UBS's recent white paper, *Millennials – the global guardians of capital.* This generation looks set to require even greater accountability and sustainability from business as its economic power expands and as a growing number of millennials become business managers and likely place greater emphasis on generating intentional social returns.

The millennial generation is already leading by example and offering corporations examples of how to achieve positive financial and social returns through their operations.

One example of a millennial-created firm that aims to achieve a "dual bottom line" is EdAid. The UK-based peer-to-peer lending firm uses a crowdfunding model to allow UK-based university students to fund their studies at lower interest rates than available through traditional commercial channels. As well as having a purposeful goal of increasing educational levels and broadening access to less-privileged students, the company intends to generate financial returns by offering a matching service between graduates and employers.

High-profile millennial entrepreneurs have already chosen to embrace alternative models in lieu of traditional foundations for their philanthropic and impactful giving. Mark Zuckerberg and Priscilla Chan committed 99% of their wealth to their limited liability company, the Chan Zuckerberg Initiative. By selecting a limited liability company model over a foundation, the entrepreneurs have joined other philanthropists that want the flexibility to engage in purposeful "for-profit" activities that can generate financial as well as positive returns to wider society.

Businesses that currently use a foundation (often at arms' length to core operations) to support environmental or social causes may consider a similar institutional set-up. Benefits may include the ability to generate financial profits alongside traditional charitable activities, the proceeds of which could be either reinvested in society-benefiting projects or absorbed within the core business model. Firms can use philanthropic activities to open up new commercial markets or introduce innovative new products. These activities can be more easily assimilated into existing operations (or sold as a going concern) in a corporate structure than in a foundation, allowing for greater scalability of impact and easier application of impactful activities to the core business model.



Aside from philanthropy, companies can learn lessons on how to embed an impactful, corporate societal returns approach by listening and responding to their investors.

Firms are already responding to increasing client demands for firms to generate commercial returns that do well for society (and vice versa). Fifty-eight per cent of more than 1,000 CEOs surveyed in *The UN Global Compact - Accenture Strategy CEO Study (2016)* that their company not only runs sustainability initiatives but can accurately measure the business value of such activities. This figure is more than twenty percentage points higher than the 2013 responses. Four-fifths of respondents identify a

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Learn more about this article at:
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positive social purpose as a key differentiator to competitor firms, while nearly 90% recognize that a commitment to sustainability is having positive social impact across the entire industry in which they operate.

Shareholders of listed companies are using their power to push firms toward more purposeful targeting and measurement of social and environmental returns alongside financial ones. Private and institutional investors are increasingly using shareholder engagement and active ownership to encourage business change through their voting rights.

Investors have typically engaged with companies around corporate social responsibility and ESG issues, particularly pushing the laggards to improve. Examples include dialogue around climate mitigation strategies, supply chain risk, transparency around political donations, non-discrimination, and more traditional corporate governance issues such as separation of Chair and CEO roles.

However, investors are increasingly interested in encouraging firms to deliver corporate societal returns by aligning their long-term business objectives with wider aims for society. An example could include using shareholder influence to encourage firms to take action on the UN Sustainable Development Goals (SDGs). Engagement through shareholder activism and active voting can support projects that generate environmental and social returns while creating long-run shareholder value through greater operational efficiencies or fewer wasted resources.

In conclusion, firms that target both financial and social returns look more likely to attract capital from new generations of millennial and female investors that want to make money and do well for society. We therefore recommend that businesses consider the following recommendations:

- Millennial and female clients are already using impact investment techniques to identify intentional and measurable financial and social returns – businesses should draw on these groups' management and investment expertise and embed these insights into their day-to-day operations;
- Businesses should reconsider the corporate foundation model and assess whether other operating models, such as a limited liability company, would give them greater flexibility to target simultaneous financial and social returns on philanthropic and for-profit investments;
- Firms should foster greater cooperation between core business units and philanthropic or charitable activities – firms that generate potential revenue – and profit-generating opportunities through impactful investment could consider incorporating their foundation expertise into the main businesses, allowing them to scale their impact investment activities and increase both financial and social or environmental returns.

B2) Draw on private businesses and family offices to incorporate social and environmental returns into operations in a scalable way

Family offices frequently have long-term, multi-business-cycle investment horizons. This contrasts with some of the short-run profit-maximization pressures that businesses cite as reasons against adopting a "business with impact" operating model.

Businesses can therefore learn from family offices' and family-run businesses' long-run investment time horizons and financial objectives that align company goals with those of wider society.

The inclination of family-run businesses to seek a positive social impact through for-profit philanthropy is already relatively high. Surveying the owners of 525 of the largest family businesses across 21 counties, a 2016 study conducted by EY and the Center for Family Business at the University of St Gallen *(Family business philanthropy: Creating lasting impact through values and legacy)* found that 47% of entrepreneurs running firms with 501 to 5000+ employees were highly engaged in impact investing, as were 35% of owners of small firms with up to 500 employees. Family firms often cite for-profit impact investing as a way to boost a business legacy and to engage future generations of the family.

Hello, Jenny here from MokShatin.

The collaboration with our foundation partner turned out to be a real success. We rolled out the scheme to all three of our factories. Employee absenteeism due to ill health has fallen by a third, while worker engagement and productivity are up 18% and 24% respectively.

We shared our findings with the supply chain management firm with whom we're working, and introduced them to the foundation's primary donor. He manages his family wealth through a family office, and aims for all his investments to do good for society and generate profits too.

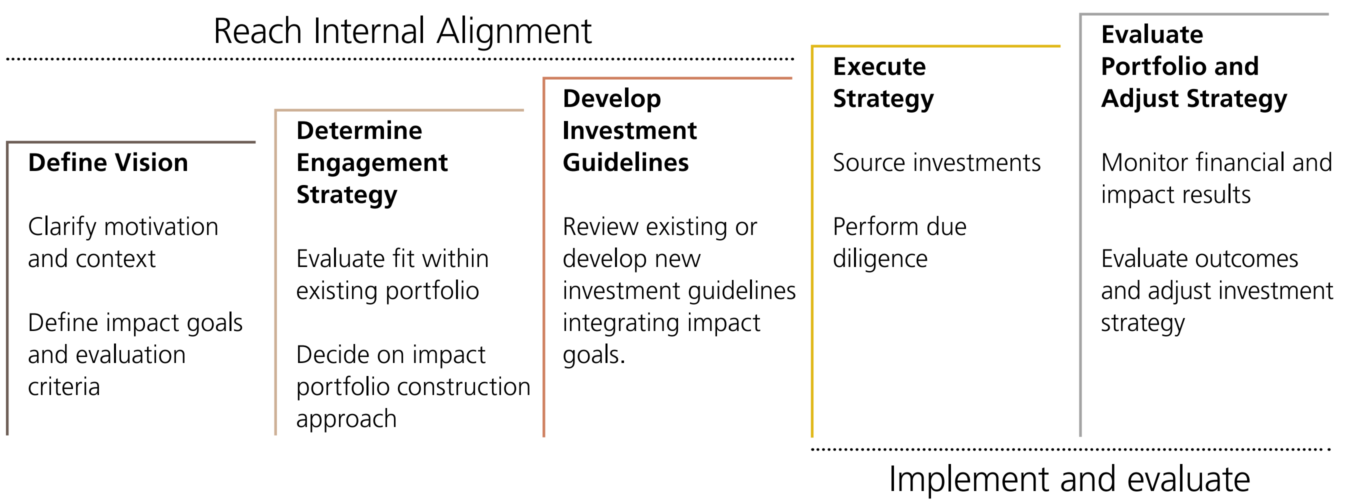
So we're using the "impact" framework that his family office employs as a framework for MokShatin. We're defining our vision for how we'll generate social and financial profits with each and every piece of gym wear we make. We're working on how to scale the successful farming project with the foundation across our whole supply chain.

And I'm looking at ways to apply these "impact" principles to the way I communicate with my investors...and the way I manage my own money.

The report also shows interesting regional variations in how much emphasis family firms attach to generating a financial return from philanthropic endeavors, information that may help corporations to tailor the balance of societal and profit objectives depending on where they operate and who their stakeholders are. For example, family business owners in Japan, South Korea, and France place the most emphasis on generating monetary profits from philanthropy, whereas financial incentives are least important in Italy, China, and Switzerland.

Businesses could also consider drawing upon the insights of family offices to design impactful and purposeful corporate investment programs that deliver financial and non-financial returns.

The five-stage approach that the World Economic Forum advocates for family offices in its 2014 report *Impact Investing: A Primer for Family Offices* may work well as a starting point for businesses to build upon their existing sustainability strategies and develop a "business with impact" approach.



Source: World Economic Forum (2014) Impact Investing: A Primer for Family Offices, UBS, as of December 2014.

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Corporations could consider modifying the above process flow in the following ways:

1 & 2. Define vision and determine engagement strategy.
Depending on whether the business is privately or publicly owned, businesses should liaise with owners and stakeholders internally and externally to ensure that the firm's wider social mission is clearly defined. Activist shareholders or institutional investors may prefer that a firm engage in a thematic investment approach, for example, that aligns goals and motivations, and evaluation criteria with the business's main operating sector.

In particular, businesses could embed sustainability into their corporate governance framework, ranging from board level oversight and compensation to internal business policies and external public policy relations. Organizations like sustainability advocate, Ceres, outline the detail of how to embed such criteria into a firm's DNA in documents such as *The 21st Century Corporation: The Ceres Roadmap for Sustainability.*

3. Develop investment guidelines
Businesses should set out a clear vision on how their core operating strategy and profit-generating activities align with wider social and environmental goals. When investment plans are created, firms should give due consideration not just to the expected returns on financial investment, but also to the expected social or environmental returns. Corporations must also account for the "impact" risk that they are willing to bear alongside the financial risks before committing to a new investment project.

4 & 5. Execute strategy, evaluate portfolio, and adjust strategy
The family office community frequently evaluates the social or environmental returns of its impact investments using external resources with expertise in designing social return on investment metrics or key performance indicators. Many corporations may have sufficient in-house resources to assess and audit the financial performance of its operations and investments. However, firms looking to run their businesses in a way that generates greater social impact may have either to invest in internal assessment capabilities or find external partners to undertake due diligence, measure impact, and use their evaluative powers to refine impact investment strategies.

In conclusion, corporations and investors can learn valuable lessons from one another on how to embed social and environmental return generation in measurable, scalable, and commercially attractive ways. We recommend that businesses adopt some key characteristics of family office and institutional investors' to implement a "business with impact" model:

- Businesses can replicate family office and ultra-high-net-worth investors' longer investment time horizons, focusing more on projects that generate sustained financial and social returns rather than prioritizing short-sighted financial objectives alone;

- Firms can adapt family offices' five-stage approach to impact investing and replace existing project management models so that each and every business decision is assessed according to the measurable financial and non-financial returns it generates for the company's stakeholders and for wider society.

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Interview with Paul Polman

Chair of World Business Council for Sustainable Development (WBCSD) and CEO of Unilever

Do you think there is evidence that 'doing good for society' can be seen as a profitable activity or will businesses always believe they have to sacrifice financial returns to generate positive social or environmental outcomes?

There's a long way to go but momentum is building. Increasingly the data shows that businesses will have to respond to challenges arising from increasing inequality, poverty, and escalating climate change.

There is a clear economic case for taking action:

- McKinsey research demonstrates that companies with a long-term strategy and high investment have stronger fundamentals, including nearly 50% higher and less volatile turnover growth, and 36% higher earnings growth over the last decade.
- The Business & Sustainable Development Commission's report "Better Business, Better World" highlights opportunities for sustainable business activity that could be worth USD 12 trillion by 2030.
- Mounting proof-points demonstrate that an environmental, social and corporate governance (ESG) focus yields better results. For example:
  - The Carbon Disclosure Project demonstrates that businesses that take the issue of climate into account enjoy 18% higher returns on investment.
  - McKinsey research shows that empowering women and allowing them to participate in the economy equally to men could boost the world economy by USD 28 trillion by 2025
  - In our sector, in the US we see 68% of the market growth is coming from purpose-driven brands and our research shows over 50% of people now want to buy brands that are more sustainable.

Investors are increasingly starting to ask questions. A recent study by BCG and MIT found:

- Seventy-five percent of senior executives in investment firms said they considered a company's sustainability performance as materially important to investment decisions;
- Eighty-one percent of investors now say "companies' increased potential for long-term value creation" is the main reason for their interest in sustainability initiatives.

As is often the case, once policy-makers come under pressure to respond and once the financial markets start to catch-on, we begin to see tipping points.

Nowhere is this more evident perhaps than on climate change. Action is being taken, driven by the welcome introduction of bodies like the Financial Stability Board's Task Force on Climate-Related Financial Disclosures. For example:

- According to the Climate Bonds Initiative, climate-aligned bonds now stand at USD 694 billion – up 15% from just a year ago.
- According to BCG, more than 400 institutions and 2,000 individual investors in 43 countries have committed to divesting EUR 2 trillion in assets from fossil fuel companies.

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Where do you see the real opportunities for business to demonstrate that more sustainable and responsible business models can lead to better returns?

Business leaders are increasingly realizing that the more opportunities they harness for society, the more successful they – and ultimately shareholders – will be. There is a clear economic case to do so.

The Business & Sustainable Development Commission's research estimates that businesses aligned to the sustainability agenda could create upwards of 380 million new jobs and open up USD 12 trillion of market opportunities in just four economic areas – food and agriculture, cities, energy, and health and well-being. That is worth over 10% of today's global GDP.

Take energy for example, 1.5 billion people are expected to join the higher energy-consuming income brackets by 2030. With depleting natural resources, we are rightly turning to renewable energy options to provide the world with power. These sustainable solutions are estimated to be worth up to USD 4.3 trillion.

Other trends are also opening up opportunities for business. For example, by 2030, the majority of people will be living in cities. This will require more investment to address housing and urban infrastructure challenges. It has been estimated by the Global Commission on the Economy and Climate that over the next 15 years the world needs to invest USD 90 trillion in infrastructure.

In the area of health and well-being, we are already tapping into this market at Unilever. Through our soap brand Lifebuoy, we are aiming to change the hygiene behaviour of 1 billion of our consumers, via our handwashing programmes, providing good sanitation and reducing child mortality. Lifebuoy shows how it is possible to achieve social good while growing the business: Lifebuoy soap has been one of our fastest-growing brands.

> There is no doubt about it; the business case for sustainable development is strong. It opens up new opportunities and big efficiency gains; it drives innovation and it enhances corporate reputation.

This enables companies to attract and retain talent, enhance consumer loyalty, strengthen their relationships with business-to-business (B2B) customers and investors, and secure their licence to operate. That's why sustainable companies around the globe are thriving and already deliver attractive returns to shareholders.

What do you see as some of the roadblocks in moving to a more sustainable approach, and how can these obstacles be overcome?

We need a new way to define, measure and communicate value.

The global operating model is increasingly short-term, and short-sighted. Businesses are facing unprecedented short-term pressures – from executive compensation tied to share price performance, to activist investors seeking immediate returns, to analyst and media focus on quarterly earnings. Until we can demonstrate more holistically the opportunity of managing for the long-term we will not be able to drive system change.

Research by McKinsey has shown that more than 50% of a typical company's value is created by activities that will take place three or more years in the future and yet 78% of executives would take actions to improve quarterly earnings at the expense of long-term value creation.

There are three key challenges to overcome: materiality, measurability and comparability.

The first barrier is a common agreement on the issues that really matter. The second challenge is that many of the key impacts are hard to measure. The whole field of non-financial

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metrics is relatively under-developed and we need to develop new metrics and new ways to collect the data.

And finally we need this information to be comparable across companies so that we are better able to judge relative change.

The solution is far from easy. Reassuringly though, it's abundantly clear there is appetite to change with many movements already beginning to form be it:

- Focusing Capital on the Long Term (FCLT) which is focused on shifting the financial markets to the longer term by changing behaviors in investment and business decision making.
- Or The Embankment Project for Inclusive Capitalism which is focused on how businesses measure and communicate the value they create for all stakeholders.
- Or the World Business Council for Sustainable Development and Aviva recommending the creation of a global goals league table to measure and compare the performance of companies against the Sustainable Development Goals.

What are the risks for business and shareholders alike of not moving in this direction?

There is a clear risk for any who fail to heed that the cost of inaction is now steadily exceeding the cost of taking action. We see this particularly in the area of climate change. Since the 1980s, for example, the number of registered weather-related loss events has tripled. As Mark Carney has pointed to in his role as Chairman of the Financial Stability Board, inflation-adjusted insurance losses from these events have increased fivefold since the 1980s to some USD 50 billion over the last decade alone.

Already the total cost to the global economy from climate change, according the IMF, is put at over USD 5 trillion a year.

If the consumer goods industry doesn't move to more sustainable models, then most of its profits could be wiped out within 30-50 years, according to a KPMG study (Expect the Unexpected), and even earlier in the case of Foods.
So there is a real risk of failing to take action to mitigate these costs. But equally there is a risk for businesses and investors who fail to seize the opportunities. When public policy, consumer demand and technological innovation are all driving a rapid shift to a local carbon economy, surely it makes sense to invest in the business models of the future, not the past?

And the risks and the costs get magnified further when firms act irresponsibly. The financial sector knows this well. Since the financial crisis of 2007-8, banks have paid over USD 320 billion in fines. But other sectors and industries are also finding that a combination of tighter regulation, greater transparency and less tolerant consumers can be a potent mix. The impact on corporate reputation can be as damaging as the threat to the bottom line. Indeed, the two are closely related. According to the World Economic Forum, more than 25% of a company's value is attributable to its corporate reputation.

How have you approached these challenges at Unilever, including ensuring that social and environmental goals are truly embedded in line with other objectives (the so-called 'business with impact' approach)?

The first thing we did was to make clear we weren't going to manage the business for the short-term. That's why we dropped short-term earnings guidance and quarterly profit reporting years ago. We don't run the business on 90-day cycles; our focus instead has been on consistent financial performance year-on-year, not each quarter.

Our shareholder base reflects this. Nine out of our top 10 investors are long-term by nature (a decade ago it was only five out of 10). More than 70% of our top 50 investors have held our shares consistently for more than seven years.

At the heart of our long-term compounding growth model is our Unilever Sustainable Living

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Plan (USLP), with its commitment to sustainable and equitable growth. Now into its eighth year, the USLP is demonstrating that there doesn’t need to be a trade-off between sustainability and profitable growth. Indeed, in many areas it is helping to create more value, including in the following ways:

- **Faster top-line growth:** We know that brands that firmly embed a social purpose see faster growth and higher profitability. In fact, those of our brands that meet our particularly high standards for social and environmental impact – ‘sustainable living brands’ as we call them – grew 50% faster than the rest of the portfolio last year and now account for 60% of our total growth.
- **Lower costs:** Being more efficient in the use of natural resources has helped us to achieve more than EUR 700m of cumulative savings.
- **Less risk:** particularly in our supply chain. We see this as essential to protect against future shortages of raw materials and the impact of new regulation. More than 50% of our agricultural materials are already sustainably sourced. And we have cut carbon dioxide emissions from energy by more than 60% over the last 10 years.
- **More trust:** This helps our relationships with consumers, customers and partners. And it also helps us attract and retain the best talent and drives employee engagement. The USLP is a big factor in 91% of Unilever employees being proud to work here, and us being the number one employer of choice in our sector across 34 countries.

Given this, it is perhaps not surprising that when surveyed, 80% of our investors said they saw the Unilever Sustainable Living Plan as a positive driver of value creation. None see it as a cost.

On reporting, at Unilever, we have three overarching long-term financial targets:

1) Growth ahead of our markets
2) Steady margin improvement
3) Strong cash flow

The three overarching Unilever Sustainable Living Plan goals have 50 targets in total. We report against all 50 targets every year. We are also transparent about where we are against our targets – sometimes it takes longer than we initially thought, sometimes we get there faster. We can reset our targets to more realistic ones, or to more challenging ones as required.

These are fully integrated into our external reporting and we explain how the USLP unlocks value as an integral part of our strategy.

B3) Learn from impact investors and their successes in overcoming operational constraints, and the challenges they face in scaling up their activities

Businesses looking to generate financial and social or environmental impact may lack the internal expertise to measure non-monetary returns with the same depth as they evaluate their profits. As outlined in part 2, firms may also lack the resources to create impactful operating strategies. They may also feel pressured to prioritize short-term financial returns over positive long-term social or environmental ones, given shareholder or stakeholder expectations, or misaligned incentive structures.

The impact investing industry, whose objective is to invest in businesses and securities to generate complementary financial and social impact returns, can potentially help business to do good for society without sacrificing financial profits. Equally, businesses can also help the impact industry. Examples of potentially productive collaboration could include filling gaps in data so that businesses and investors can identify where "impact" investment is most needed; tackling inconsistent methods of measuring social impact alongside financial returns; and using networks to increase the scale of impactful activities so that investing to generate financial and social or environmental returns concurrently becomes a more mainstream part of corporations' and investors' day-to-day operations.

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Data collection and evaluation

The first area of development where businesses and impact investment practitioners could work together is in the field of data collection and consistency.

Too often there are gaps in sustainability data not just at the corporate level, but also at the country level. According to a 2016 report from the UN Association – UK (Sustainable Development Goals 2016: The people's agenda) there was no available data on measurable poverty trends in 29 developing countries (and only one data point in a further 28 emerging nations) between 2002 and 2011.

Corporations similarly lack consistent and widespread data on social, environmental, and corporate governance opportunities across all the partners, contractors, and stakeholders with whom they work in day-to-day business. This is in sharp contrast to the financial reporting (where generally firms either conform to US Generally Accepted Accounting Principles or the benchmark metrics set by the International Financial Reporting Standards).

There are examples of firms that are collecting systematic and comprehensive data on social and environmental factors, both as risks and opportunities. One such company is Carbon Delta. The firm quantifies companies' climate change risks and calculates the potential valuation impact for holders of companies' capital securities (equities, bonds). This is presented as a "Climate Value at Risk" figure, analogous to the Value at Risk measure used in traditional accounting analysis for financial services firms. Firms can subsequently use this calculation to measure and manage climate risks to their operating model. Alternatively, investors armed with this data can lobby firms to make business changes to mitigate climate risks and comply with environmental regulations.

Tools, like Carbon Delta's Climate Value at Risk, not only bring greater availability and transparency to environmental issues. Such measurement techniques can also highlight the interconnectedness of social, environmental, and commercial returns; they can also engage company managers more closely on environmental risks and opportunities for their businesses; and they can empower investors and stakeholders to put pressure on corporate managers to measure environmental data and set strategic goals to improve environmental standards.

More broadly, corporations could accelerate the moves to create a consistent international set of standards.

This would help to meet stakeholder demands for common data on non-financial metrics. Firms could build upon the work undertaken by bodies such as the Global Reporting Initiative, International Integrated Reporting Council, Sustainability Accounting Standards Board, and Social Accountability International with its SA8000 Standard

Consistent and comprehensive impact measurement

While there is little disagreement or variation in how firms report financial profits, there is considerable debate and variety in the way that corporations, institutions, and individuals can measure social or environmental impact.

Following the Case Foundation's impact investing commitment spectrum laid out in its document A Short Guide to Impact Investing, operating models can begin with impact-motivated ones (where the main focus on financial return is complemented by a desire to have positive social impact). They may evolve into impact-committed models (from desire to intent to have positive social impact) where the firm agrees to measure its social impact performance against a set of benchmark indicators and commits to transparent reporting to stakeholders relative to these indicators.

The most comprehensive approach, an impact-certified one, devolves the setting of social return benchmarks and comparison with realized performance to independent third parties. The impact-certified approach may include a minimum performance threshold or "high watermark" against which firm-performance is evaluated. The business may also have codified a business change management policy to apply in cases where they fail to meet this minimum standard.

An important example of this certified approach is Certified B Corporation status, part of the wider Benefit Corporation movement. Its mission is to promote businesses in aligning their corporate goals to wider societal interests such as environmental protection and improved social standards. B Lab, the non-profit organization driving the movement, has developed tools such as B Impact Assessment and B Analytics to measure, evaluate, and improve their social impact with the same depth and granularity as data collection on financial performance.

To become a Certified B Corp, businesses have to take an assessment that scores their firm on matters such as governance, worker rights, community engagement, environmental record, and social impact. B Lab provides suggestions on how firms can boost their rating to the minimum threshold competency of 80 points out of 200. Firms that pass this first stage then undergo an Assessment Review with B Lab and send evidence to support their application, including a completed Disclosure Questionnaire that discloses any commercially-sensitive practices. The final stage consists of incorporating social and stakeholder purposes in a firm's constitution, making a formal commitment to generating social returns alongside financial ones. On completion a business can sign the B Corp Declaration of Independence and officially market itself as a member of the B Corp community. This is designed to provide a certification similar to Fairtrade Foundation or USDA Organic, which are increasingly valued by consumers and stakeholders.

How can businesses practically adopt a more impactful operating model?

Corporations can consider working together with impact investment consultants or funds to develop a "value chain" that holistically measures the financial, social, and environmental returns of a project. Instead of relying exclusively on internal resources to target financial and social returns simultaneously, firms can consider adopting a framework for evaluating an investment, operational process, or new business line using the "impact value chain" model (drawn in this instance from Hehenberger et al's 2013 paper for the European Venture Philanthropy Association called *A practical guide to measuring and managing impact).* Firms can add to this existing framework by including explicit financial return objectives or key performance indicators.

Jenny here again.

Good news to report! First, our third largest investor is happy with the progress we've made in managing our supply chain and aligning our business' objectives with societal needs. At the same time our largest investor is satisfied with the 9% profit growth we're generating, particularly given the costs we have laid out in our efforts to have a positive social impact.

We're still exploring how to scale our collaborative project with the supply chain management firm and our foundation partner.

We figured out that we needed some more help on how to measure social returns in more detail, and how to embed social return objectives into our formal corporate strategy.

So we partnered with an impact investment firm and consultant that aims to generate measurable financial and social returns from all their investments.

They have already taught my finance and operation teams some of the key basics around social return data collection and measurement. Impact Inc., our partners, and MokShatin are each sending three colleagues out to our South East Asian factories to collect data and install technologies that can deliver real-time information back to our finance, risk, and sustainability departments in Hong Kong.

Inputs	Activites	Outputs	Outcomes	Impact
Resources (physical, financial, human capital)	Concrete actions	The "real life" product or service generated by an activity	Changes resulting from the output	The combination of activities, outputs, and outcomes when adjusted for what would have happened without initial inputs, actions of others, and unintended consequences.
Measuring the financial costs	Building a new product; designing a new service; constructing a new building	Which corporate stakeholder(s) does this output serve? What is the expected financial return?	Measuring intentional financial benefit to the firm.	Evaluating financial return. Evaluating social returns.
Measuring the societal costs (environmental, social)		Does this output serve the public good? What is the expected social return?	Measuring the intentional social benefit to wider society.	Do financial and social benefits outweigh costs? Feedback loop to improve impact value chain for future projects.

Source: UBS, based on Hehenberger et al (2013) and Rockefeller Foundation Double Bottom Line Project.

We recommend that businesses learn lessons from impact investors and:

- Collaborate with impact investors, corporations, and other institutions to collect comprehensive social and environmental return data;
- Measure social and environmental impact consistently so that firms can judge their social and environmental return performance against financial metrics, while investors can compare firms readily with one another;
- Implement an operating model that accounts for expected positive returns to society (and potential risks) at all stages of investment.

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Interview with Justin Finnegan

Director, Mountain Hazelnuts

How does Mountain Hazelnuts' business model account for social and environmental returns?

The whole business was built upon a "triple bottom line" approach from the very start. We believe that generating social, environmental, and commercial returns at the same time is critical to both our business mission and our firm's success.

Can you explain how your operating model works?

We're aiming to supply, without charge, 10 million hazelnut trees to smallholder farmers in the Kingdom of Bhutan. Our goal is for Bhutan to become one of the highest quality hazelnut producers in the world. Mountain Hazelnuts is looking to sell these hazelnut crops globally for commercial returns.

By providing trees to 15,000 farming households, we're aiming to improve the lives of a significant portion of Bhutan's rural population, diversifying the crops that they grow and giving them a supplementary source of income from cultivating hazelnuts. In this way we're hoping to play a large part in helping to alleviate rural poverty in Bhutan.

Meanwhile, the company invests significant resources in developing human capital, providing health and education awareness campaigns, and encouraging local entrepreneurs to build businesses that support the large hazelnut growing ecosystem. We've already seen several complementary businesses emerge that provide significant contributions to local communities.

The environmental benefits of our work are intentional and measurable too. Growing hazelnut trees on degraded mountain slopes slows erosion, reduces the build-up of silt in rivers, provides a sustainable source of firewood from prunings, and helps reduce the risk of landslides. Planting these productive forests throughout Bhutan's countryside also helps sequester significant amounts of carbon and lowers emissions.

So how do you manage to generate commercial returns while managing business risks?

Our business model looks to align our interests with farmers that want a sustainable income, investors that want commercial viability, and Bhutan's government that is looking to reduce rural poverty and mass rural-to-urban migration.

We have the scientific and logistical expertise to grow varieties of hazelnut trees that are well adapted to Bhutan's agro-climatic conditions and ecology. We provide farmers with the hazelnut saplings at no charge and teach them how to care for this productive asset. Farmers own the land and provide the labor to nurture and cultivate the trees, which helps align incentives.

We're able to use our scale and expertise to help the farmers maximize their chances of growing high-yielding, profitable trees. For example, we use our scale to procure large quantities of fertilizers for farmers to use if they choose. We tailor this fertilizer to specific soil types and orchard size and deliver it to farmers at cost with no transport charge. Previously, many farmers did not have access to all of these fertilizers at reasonable cost. So this development potentially benefits both our partner growers and the company.

Our promise to the farmers is that we guarantee to buy all of their hazelnut harvest. We bear the financial risk, as well as the costs of processing and shipping the nuts via India. We can then sell the nuts into international markets and generate commercial returns for our investors and stakeholders.

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How do you measure social and environmental returns with the same precision and depth as profits?

Thoughtful design of data systems from the very start has helped us collect good social and environmental information. We've been fortunate that Bhutan already had a great infrastructure to collect social data in existing Gross National Happiness household surveys. We have extended this to collect statistics related to our growers, and other social and environmental factors. Regular collection of data allows us to quantify the impact we're having in boosting local incomes, providing alternative sources of income that keep farmers in their local communities, and raising levels of social capital. And we have developed technology and data systems that provide fully auditable traceability of all of our fields, farmers, and trees. The eventual ambition is that a consumer can buy our product, scan the barcode, and see the provenance and growers of their product with full transparency.

And do you think financial and non-financial returns complement one another?

This non-financial data has already provided real commercial value in informing us where there may be growing concerns related to climate change or how to better optimize our community engagement. We expect this data's value to grow significantly in the future. It can help design more impactful programs that generate greater societal benefits, as well as have a commercial value as consumers continue to seek out and pay more for products that drive real social and environmental impact.

So many firms focus exclusively on financial profits and don't deliberately target social and environmental objectives or collect data on their wider societal impacts.

> This means they often miss really valuable opportunities to have positive social and environmental effects through their day-to-day business. But even more so, they ignore the commercial value that a strategic social and environmental focus can generate.

There is no need for profits to suffer from social and environmental investments.

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How did investors and stakeholders respond to your "business with impact" approach?

Our experience has been positive, helped by the fact that from the very start we aligned our corporate mission to the goals of our farmers and the objectives of the Bhutanese government. Our co-founders started the business with their own capital, which allowed the company to gain traction and allay concerns from sceptical capital providers that either didn't fully believe in our business philosophy or overestimated the political or other risks of doing business in a country like Bhutan where they had little experience.

Did you encounter any hurdles to adopting a "business with impact" approach?

One early challenge we faced was finding the right kind of "patient capital" that Mountain Hazelnut needed to be a sustainable, impactful firm. We were able to demonstrate clearly that prospective investors could make commercial returns, but growing nuts and realizing revenues takes time, so we turned down prospective backers whose investment time-frames did not match our longer-term outlook.

What advice would you give to businesses that are looking to have positive social and environmental impact but are reluctant to hurt their financial bottom line?

First of all, don't just think that making positive social or environmental returns is an added cost or drag on profits. There are many opportunities to tie this impact to stronger financial performance. Firms need to focus more on their societal impact…and positive social impact needs to be linked to being commercially viable. Without commercial viability, you will never have the chance to generate real impact. Shift your mind-set and you'll see the concepts are intertwined.

Second, companies investing in less developed markets and generating positive social and environmental returns could well open up new commercial opportunities that lower operating costs or provide fresh sources of revenue.

For example, our efforts to extend financial training to female farmers are not just having a positive impact in addressing gender inequalities and making sure more money is invested in local families. We also see scope for rising financial literacy rates to lead to increased bank account penetration rates among our farmers. That's good for society, as farmers could access better savings tools, and good for the company if we can pay for hazelnuts electronically and reduce considerable logistical and security costs of paying in cash. What's more, local financial institutions would likely look on farmers with a banking history as being more creditworthy.

If more farmers can take out loans at lower interest rates and more favorable costs to pay for their children's education, improve their houses or buy more land, this consumption and capital investment will have positive short- and long-run effects within communities and across Bhutan's economy as a whole.

C) Use networks to bring "business with impact" into the mainstream

As mentioned earlier in this white paper, many institutions, investors, and individual stakeholders are empowering firms to target both financial and social returns. Some of the constraints to adopting such a "business with impact" approach include insufficient internal resources, or insufficient cross-divisional communication within businesses.

Technology can empower businesses and other stakeholders to overcome internal constraints. Digital communication, connection and a "platform-company" approach (details of which are outlined in more detail in our white paper *Millennials – the global guardians of capital)* can help firms engage more readily with their internal "content" (human capital and expertise across business divisions) as well as connect more efficiently with external stakeholders.

Internal networks that foster collaboration between business divisions can help firms overcome operational constraints to impact practice and evaluation. Using a network to connect varied internal users with diverse content could increase the efficiency of this impact data collection and measurement, while allowing firms to send data more easily to external impact verification specialists, impact auditors, or external stakeholders.

It's Jenny here – this is my final update.

My business, MokShatin, has made some major changes to the way we do business. We've gone from managing risk by being sustainable to opening up new opportunities by targeting financial and social returns at the same time.

Using expertise from a host of partners, we now embed improving workers' nutrition and health as key objectives in our formal business plan.

All our financial and social return data is externally collected, verified, and monitored by our impact consultants.

We're now connected to a network of peer companies that aim to make money and have a positive impact on society at the same time. We're sharing our best practices with other firms (and learning fresh things too).

In short: what our business does is now fully aligned with what society and our stakeholders want.

Our profits are growing and our social returns are rising as we become more efficient in how we implement our nutrition and health programs. That's accounting for a higher cost base as we continue to invest in worker welfare.

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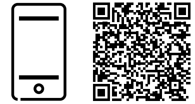

The benefits of networks, though, extend beyond single firms. For example, businesses that struggle to promote impactful supply chains due to quantity and complexity of suppliers could consider using a network to share information with a supply chain aggregator and validator. Such an external function could use technology to more readily assess the social and environmental impact of the links within a global supply chain, evaluate social returns, and recommend ways that firms can effect change to boost both financial and nonfinancial returns.

An example of such a supply chain aggregator is SourceMap, an MIT-developed product that uses blockchain technology to trace, monitor, and verify end-to-end sustainability risks and impact opportunities. This is particularly relevant to firms in today's world of extreme automation and connection, given that more than half of supply chain risk lies beyond first-chain suppliers.

Networks can help businesses to spread "business with impact" practices across industries and countries. The B Corporation and Certified B Corporation movements offer good examples of how businesses can use networks to share best practices on generating for-profit social and environmental returns. As of December 2016, there were around 4,000 Benefit Corporations and 2,000 Certified B Corporations across 130 industries and 50 countries according to a joint report from Yale's Center for Business and the Environment, and Patagonia. The report notes that CEOs of Certified B Corporations cite access to networks as one of the key benefits of the status, as it facilitates strategic business partnerships and knowledge sharing on how to do good for society while also making profits.

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Authors
Mark Haefele – mark.haefele@ubs.com
Simon Smiles – simon.smiles@ubs.com
Matthew Carter – matthew-za.carter@ubs.com

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Desktop
CIO Content Design

Design
Rodrigo Jiménez

Languages
English

Contact
ubs-cio-wm@ubs.com_

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