THE VALUE DRIVER MODEL:

A TOOL FOR COMMUNICATING
THE BUSINESS VALUE OF
SUSTAINABILITY

A PRI-UN Global Compact LEAD collaboration on creating long-term value
The work presented here is part of the ESG Investor Briefing Project, a collaboration between Global Compact LEAD and the UN-supported Principles for Responsible Investment (PRI) to support companies in enhancing their communication of how ESG strategies and performance translate into financial value. The content for this communication is based on a Value Driver Model, which encourages companies to communicate the financial impact of their sustainability strategies. These presentation slides are part of a toolkit that includes a report and a series case examples. The toolkit draws primarily upon publicly available information.

Not all companies featured participate in LEAD. However, their examples serve as illustrative cases for all companies. Utilising the Value Driver Model as a tool, companies are invited to join the ESG Investor Briefing Project and create a tailored method for communicating their own ESG value drivers, internally and with investors.
These presentation slides are part of a larger toolkit, which includes a report and case examples.

• The purpose of the report is to advance the Value Driver Model as a useful starting point for companies to enhance their communication of the financial value of their sustainable business strategies.

• The cases provide examples of companies that apply and report key aspects of the Value Driver Model to their shareholders and other interested parties.
Objectives

1. **Inform** your firm on how companies with sustainable business strategies are communicating business value to investors and stakeholders

2. **Demonstrate** a model for capturing and communicating the business value of sustainability to investors and analysts

3. **Determine** if your firm is positioned to gain advantage from improved communication of the business value of sustainability

4. **Assess** your firm’s capacity to plan, execute and report on sustainability as a value driver

5. **Move forward** in enhancing investor communication regarding the business value of sustainability
Agenda

1. Inform
   - Perspectives
   - Closing the gap between companies and investors

2. Demonstrate

3. Determine

4. Assess

5. Move forward
Key Findings from 2013 UN Global Compact/Accenture CEO Survey

1. 49% of CEOs said potential for revenue/growth and cost-savings were among their top three drivers for taking action on sustainability
2. 47% of CEOs said customer demand drove them (up from 39% in 2010)
3. Only 38% said they could quantify business value
4. 69% thought investor interest would be increasingly important
5. Only 12% reported investor interest today
6. 93% thought sustainability would be important or very important to the future success of their business

Source: The UN Global Compact-Accenture CEO Study on Sustainability © 2013
What is Sustainability?
One Existing Investor Perspective

Obligation or Compliance = > Costs

Good risk management, but no clear connection to upside opportunity

Opportunity = Big Growth & Productivity

Earnings Premium

Earnings Drag
What is Sustainability?
Emerging Corporate Consensus

Obligation or Compliance = > Costs

Sustainability drives innovation, which drives results

Opportunity = Big Growth & Productivity

Earnings Drag

Earnings Premium
From the Corporate Perspective, the Balance has Shifted

• 2013 UN Global Compact/Accenture CEO Survey Reports that 80%+ of respondents
  – Pursue sustainability as a source of revenue growth and innovation
  – Expect to derive competitive advantage from sustainability strategies

• Findings supported by studies from McKinsey, Boston Consulting Group, IBM, PwC and others
  – Companies are differentiating themselves via sustainability as a value driver for their businesses
  – Studies suggest that 10-20% of publicly held firms are now harvesting meaningful financial gains from sustainability

As sustainability has evolved, the gap with some investors has grown
The Disconnect on Sustainability

- **Problematic** because sometimes lack of perceived investor interest limits management’s willingness to commit – according the 2013 Accenture-GLOBAL Compact survey only 12% of CEOs report pressure from investors as a factor in taking on sustainability issues.

- **Understandable** because the current models for sustainability reporting were not intended to highlight financial upside and do not easily align with analysts’ financial models.

- **Addressable** because what is required from companies is simplicity in communicating the value already being realized.

Source: The UN Global Compact-Accenture CEO Study on Sustainability © 2013.
Who Benefits from Closing the Gap?

- Companies
- Investors
- Workforce
- Society
**Agenda**

1. Inform

2. Demonstrate
   - Introducing the Value Driver Model
   - Operationalizing the Value Driver Model
   - Sustainability/Growth-Productivity-Risk (S/GPR)
   - Case studies: Pirelli and DuPont

3. Determine

4. Assess

5. Move forward
The Value Driver Model: A Tool for Establishing the Relevance of Sustainability to Existing Key Business Metrics

Return on Capital Employed (or equity, shareholder value, economic value added)

Growth
- New Markets & Geographies
- New Customers & Market Share
- Product & Services Innovation
- Long-term Strategy

Productivity
- Operational Efficiency
- Human Capital Management
- Reputation Pricing Power

Risk Management
- Operational & Regulatory Risk
- Reputational Risk
- Supply Chain Risk
- Leadership & Adaptability
Initial Approach to Operationalizing the Value Driver Model

Return on Equity or Capital

Growth
- New Markets & Geographies
- New Customers & Market Share
- Product & Services Innovation
- Long-term Strategy

Revenue Growth from Sustainability-Enhanced or Advantaged Products & Services
= S/G

Productivity
- Operational Efficiency
- Human Capital Management
- Reputation Pricing Power

Total Cost Saving + Avoidance from Sustainability-related Initiatives
= S/P

Risk Management
- Operational & Regulatory Risk
- Reputational Risk
- Supply Chain Risk
- Leadership & Adaptability

Measurable Reduction in Exposure to Sustainability-related Risks to Revenue and Reputation
= S/R
Other metrics may be appropriate to illustrate how your company’s sustainable business strategy contributes to the value equation; they can be developed.

However, a link to growth, productivity and risk assures relevance to investor interests.
**S/GPR: How to Operationalise the Value Drivers**

<table>
<thead>
<tr>
<th>S/Growth (S/G)</th>
<th>Key Challenge: Categorization</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td><em>Is it meaningful to categorize revenues in your company?</em></td>
</tr>
</tbody>
</table>

**Why measure this?** Companies are investing significantly in building new sustainability-advantaged products, but it can be difficult for investors to assess how these new products impact revenue growth or what percentage they are of total revenue.

- **Sustainability Quality of Revenue** = Sustainability-advantaged revenue as a % of total revenue in the period
- **Is it material to the business?** That is, are sustainability-advantaged revenues an important component of the business mix?
- **Relative Growth Rate of Sustainability-advantaged revenue to Overall Revenue** = Sustainability-advantaged Revenue Growth % / Total Revenue Growth %
- **Messaging regarding S/G**
  - **Is it currently a material or significant component of the revenue mix?**
  - **Is it strategic to the company’s future?** That is, are sustainability-advantaged revenues growing significantly faster than the business overall, thereby likely to grow in importance over time?
### S/GPR: How to Operationalise the Value Drivers

<table>
<thead>
<tr>
<th>S/Productivity (S/P)</th>
<th>Key Challenge: Aggregation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td><em>Is it possible to count the total dollars saved or cost avoided?</em></td>
</tr>
</tbody>
</table>

**Why measure this?** While some investors appreciate anecdotal evidence of meaningful gains from improved resource productivity, aggregating and communicating the total value of savings in the reporting period can help engage them on sustainability.

- Contribution to operating income from all sustainability-related initiatives in the period = Aggregated resource efficiencies (human and natural) as a percent of operating income (e.g., dollars saved / total operating income)

- Messaging regarding S/P
  - *Is it currently material/significant? That is, given the business segment and earnings history, do sustainability-related initiatives taken as a group produce meaningful cost savings?*
  - *Is it strategic? That is, in the context of business operations, is it anticipated that sustainability-related initiatives will drive cost structure advantages over time?*
**Why measure this?** It is sometimes difficult for investors to zero in on what the company, often in consultation with external advisors and stakeholders, regards as its key sustainability-related risks. Identifying and reporting on them over time gives investors insight into this potential source of revenue and earning volatility.

- Measureable reduction in potential risk to revenue and reputation from sustainability-related initiatives and procedures

  - *Is it material? That is, are the identified risks a potential source of meaningful revenue and/or earnings volatility?*
  - *Is it strategic? That is, does superior management of these risks position the company to reduce volatility?*
Pirelli’s Sustainable Business Strategy

2009 – Chairman Marco Tronchetti Provera Launches “Green Performance Strategy”

- EU mandates tire rating by 2013 (A-G)
  - Fuel Efficiency
  - Stopping Power
  - Environmental Impact

- Pirelli aims to lead the high-tech and superior performance segment
  - Growth opportunity
  - R&D Breakthrough – Efficiency and Safety
    - Rice husk silica replaces “dirty” materials
    - Savings of €1000/ton
Pirelli’s Sustainable Business Strategy

2009-12 Results: Sustainable business strategy drives value

1. Sales of “green performance tires” increased
   \[ S/G = \sim 3 \text{ times at } 45\% \text{ (€2.84B of €6.3B) of total revenue} \]

2. New green manufacturing process proven in Latin America, ready for global expansion
   \[ S/P = \text{Estimated } >3\% \text{ contribution to operating income. Significant upside as rice husk silica use expands.} \]

3. Sustainability-related risks declined
   \[ S/R = \text{Reduced by } >72\% \]
According to Pirelli Investor Relations, between 2009 and 2013:

- Number of sell-side analysts covering Pirelli increased from 12 to 25.
- % of shares held by international institutional investors increased from 33 to 74%.
- % of ownership by investors Pirelli classifies as growth–oriented increased from 37 to 71%.

Pirelli’s Sustainable Business Strategy
DuPont’s Sustainable Business Strategy

CEO Ellen Kullman’s strategic vision is tied to addressing three key challenges:

• Food
• Energy Security
• Protection
DuPont: Sustainability’s Links to Results 2007-2011

• **S/G = 5.5x at 30% of Revenue**
  - Revenue from products that reduce greenhouse gas (GHG) emissions rose from USD 63 million in 2007 to USD 1.9 billion in 2011 or an increase of nearly 3100%
  - Revenue from products based on non depletable resources doubled from USD 5 to USD 10 billion on a revenue base of USD 33.6 billion in 2011 or an increase of 100%

• **S/P = 10% or ~ USD 300M of USD 3.3B 2010 operating income**
  - Using 10 year aggregate data – estimating annual $’s

• **S/R = Decrease by 38% using company data on:**
  - Stressed Water Revenue Intensity
  - Air Carcinogen Intensity of Revenue
  - Environmental Risk Intensity of Manufacturing Facilities
In 2012, DuPont’s Sustainability Strategy continued to add significantly to the company’s performance. Sales of sustainability-advantaged products reached approximately 30% of total revenue or USD 10B, and grew at a rate of 5.5x revenue overall. Savings and cost-avoidance from all sustainability-related initiatives were again in excess of USD 300M or nearly 10% of operating income. The company continued to make significant progress reducing exposure to sustainability-related environmental and health risks in accordance with its strategic plan.
Agenda

1. Inform
2. Demonstrate
3. Determine
   - Strengthen your value proposition
   - Analysis of S/GPR
4. Assess & Improve
5. Move forward
Determine if the Value Driver Model can strengthen your investor value proposition

- Is your company pursuing a value-oriented, sustainable business strategy?
- Does your sustainable business strategy drive revenue growth, productivity gains and risk management?
Determine – S/G

1. Does your company’s business strategy link clearly to sustainability-related factors, including products or services that:
   - Deliver the intended value to customer, but at significantly lower environmental or social impacts than other available solutions
   - Fall under the broad definition of sustainability-advantaged

2. Does your company seek enhanced brand value that impacts growth through strategies in sustainability-related areas (e.g. sourcing and human rights)?

3. Does your company measure or have an interest in measuring these factors as a component of overall growth?

If yes, the Value Driver Model may be useful to your company
Determine – S/P

• Does your company have initiatives to improve sustainability-related operating productivity, including:

  – Measureable and meaningful cost reductions from:
    • Human and natural resource efficiency gains
    • Reduced emissions or wastes, including toxics
    • Sustainability-related supply chain improvement
  – Measureable & meaningful improvements in operating margins from:
    • Pricing (or volume) improvements for sustainability-advantaged products

If yes, the Value Driver Model may be useful to your company
Determine – S/R

• Has your company developed a focused list of the key sustainability-related risks to revenue and reputation?

• Have you measured the performance of these key sustainability-related risks on some periodic basis to track progress?

If yes, the Value Driver Model may be useful to your company
Agenda

1. Inform
2. Demonstrate
3. Determine
4. Assess
   – Assessing Readiness
   – Analysis of S/GPR
5. Move forward
4. Assess

- Assess your company’s readiness to use the Value Driver Model to enhance investor communications

- Building on the results of your assessment, the Model can be used to improve your ability to describe your company’s sustainable business strategy and achieve results
Assess Your Organization’s Readiness to Employ the Value Driver Model

**Execution Capabilities**: Self-assess your company’s ability to translate sustainable business strategy and policy into business value through structured processes, tools and systems.
Example Value Driver Analysis: Assess What Drives S/G

Return on Equity or Capital

Growth
- New Markets & Geographies
- New Customers & Market Share
- Product & Services Innovation
- Long-term Strategy

= S/G

Productivity
- Operational Efficiency
- Human Capital Management
- Reputation Pricing Power

Total Cost Saving + Avoidance from Sustainability-related Initiatives
= S/P

Risk Management
- Operational & Regulatory Risk
- Reputational Risk
- Supply Chain Risk
- Leadership & Adaptability

Measurable Reduction in Exposure to Sustainability-Related Risks to Revenue and Reputation
= S/R

CONTINUED >>
Story Behind Each Driver: Example Analysis of S/G

Drivers

Direct

- Drive Premium Revenue Growth via Green Product Portfolio (GPP) Sales
- Increase Customer Engagement on Sustainability Value in Emerging Markets

Indirect

- Build the GPP
- New Cradle-to-cradle Design
- Analyze New Market for GPP
- Develop /Select for New DfE* Skills
- Long-term Portfolio Planning
- Create Organizational Readiness

Value Driver Model

Financial

- Revenue Growth from Sustainability-Advantaged Products

Customer

- New Customers & Market Share

Process

- Product & Service Innovation

Enablers

- Long-term Sustainable Business Strategy & Plan

*DfE = design for the environment

CONTINUED >>
### Story Behind Each Driver: Example Analysis of S/G

**Bottom-up success gets results on top**

<table>
<thead>
<tr>
<th>Drivers</th>
<th>Sustainability Scorecard</th>
<th>Measure</th>
<th>Target</th>
</tr>
</thead>
<tbody>
<tr>
<td>Drive Premium Revenue Growth via GPP Sales</td>
<td>S/G</td>
<td>3 x</td>
<td></td>
</tr>
<tr>
<td>Increase Customer Engagement on Sustainability Value in Emerging Markets</td>
<td>Total Sustainability-advantaged Revenues</td>
<td>+20%</td>
<td></td>
</tr>
<tr>
<td>Build the GPP</td>
<td>Share of Sustainability Segment</td>
<td>25%</td>
<td></td>
</tr>
<tr>
<td>New Cradle-to-cradle Design</td>
<td>Customer Awareness of Sustainability Value Proposition</td>
<td>50%</td>
<td></td>
</tr>
<tr>
<td>Analyze New Market for GPP</td>
<td>Reputation as Sustainability Leader</td>
<td>90%</td>
<td></td>
</tr>
<tr>
<td>Develop /Select for New DIE Skills</td>
<td>GPP Win/Loss Ratio</td>
<td>2.5</td>
<td></td>
</tr>
<tr>
<td>Long-term Portfolio Planning</td>
<td>New Product Development Process for GPP</td>
<td>Ph 2</td>
<td></td>
</tr>
<tr>
<td>Create Organizational Readiness</td>
<td># Customer GPP Briefings</td>
<td>1hr/Q</td>
<td></td>
</tr>
<tr>
<td>Design of Environmental Readiness</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>GPP Leadership</td>
<td></td>
<td>100%</td>
<td></td>
</tr>
<tr>
<td>Long-term Sustainability Vision &amp; Goals</td>
<td></td>
<td>100%</td>
<td></td>
</tr>
</tbody>
</table>

Funding, responsibilities, & initiatives are linked to each element of the chain.
Ingersoll Rand: Example of Using the Value Driver Model to link sustainability to business results

<table>
<thead>
<tr>
<th>Financial</th>
<th>Customer/Society</th>
<th>Internal</th>
<th>Enablers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Premium Growth &amp; profitability thru GPP</td>
<td>Customer values GPP key attributes</td>
<td>Cradle to cradle design</td>
<td>Grow skills &amp; capability to design/build/market sustain solutions</td>
</tr>
<tr>
<td>Loss avoidance from Risk management</td>
<td>Customer values IR as s/leader</td>
<td>Co-create w/ Our Business Ecosystem</td>
<td>Leadership, Emp Eng &amp; Recognition for Sustainability Goals</td>
</tr>
<tr>
<td>Sustainability driven Productivity improvement</td>
<td>Shared value delivered by IR products</td>
<td>Incident Mgmt Process</td>
<td>Reporting, perf. Mgt, communication</td>
</tr>
<tr>
<td></td>
<td>Resilient &amp; reliable partner</td>
<td>Resource optimization process-manufacturing</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Minimize Life-Cycle Cost ©</td>
<td>Resource optimization process-TBD</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Minimize Life-Cycle Impacts (C&amp;S)</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Our Sustainability Strategy will support Ingersoll Rand Becoming a Premier Performing Company

By Driving Superior Revenue and Margin Contribution through **Customer-driven innovation and Emerging Markets Growth**......And contributing significantly to productivity gains and our **Operational Excellence** goals

Through development and roll out of new key business processes and methods internally and with our business partners that create sustainable solutions for a changing world

All built by highly skilled and engaged team members working in a **Progressive, Diverse and Inclusive Culture**
Agenda

1. Inform
2. Demonstrate
3. Determine
4. Assess
5. Move forward
5. **Move Forward** – Using the Value Driver Model

1. Adapt the Value Driver Model to your company context.

2. Integrate the metrics from your company’s Model into mainstream investor communications
   - e.g., host an ESG Investor Briefing

3. Track your efforts and investor reactions

*Share your progress and feedback with the Global Compact-PRI team.*
For more information please contact

Bostwick@unglobalcompact.org
Danielle.Chesebrough@unpri.org
lau@unglobalcompact.org