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Environmental performance & Economic Value Creation

By
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Growth is the only way to create value in the long-term.

A company that does not grow by more than 7.5% per year (i.e., a doubling of revenue every 10 years) loses its attractiveness and independence in the long term.

It's difficult to grow economically without CO_2 emissions, especially in product production and distribution industries. The environment is becoming a critical issue for companies.

Why and how can we reconcile growth and the creation of economic value while reducing our environmental footprint?

Why reduce our environmental footprint?

There is now a consensus on the impact of economic growth on certain environmental dysfunctions, notably climate change.

The most emblematic is the impact of CO_2 emissions on global warming. Over the past 50 years, the concentration of CO_2 in the atmosphere has risen from 320 parts per million to over 400 parts per million, marking an increase of almost 30%. This has led to a 1.5°C rise in global temperatures.

There is therefore an urgent need to reduce this environmental footprint, particularly CO_2 emissions, to limit the temperature rise. This is the ambition of the Paris Agreement (COP 21) signed in 2015. This awareness has gained momentum recently, driven by a strong societal movement from younger generations.

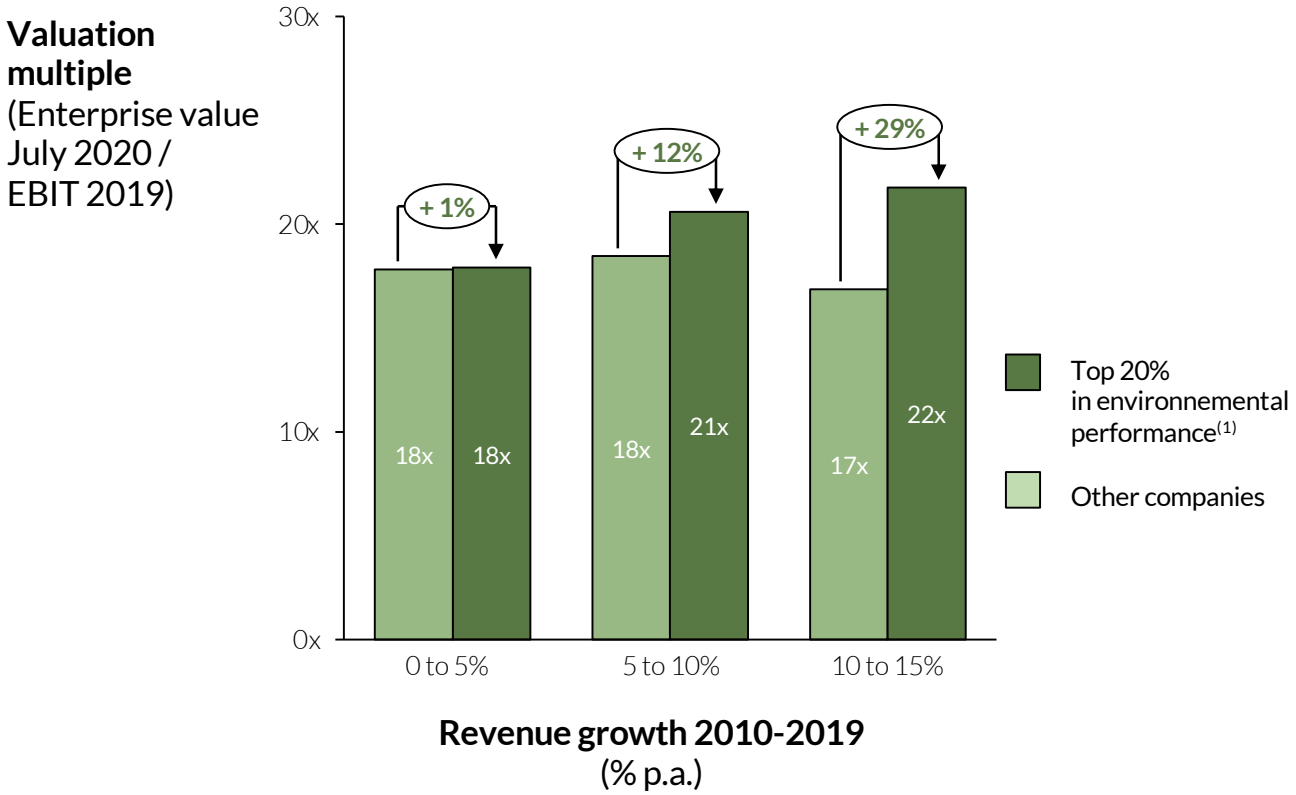
Beyond civic reasons, there are three main economic reasons for companies to reduce their environmental footprint.

Firstly, there is an increased value for customers. In both BtoC and BtoB businesses, customers are becoming more environmentally conscious. They are beginning to make their own consumption choices by avoiding products and companies that are not committed to environmental transition. They are willing to pay more for eco-designed products that minimize their environmental impact. This shift is recent, still emerging, and notably varies greatly across product categories, geographies, and price ranges. The luxury industry is experiencing this evolution as well. All stakeholders have undertaken significant environmental initiatives, often funded by price increases. This value is expected to grow in the coming years while remaining highly differentiated across segment.

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Investors place higher value on companies with strong environmental performance

Panel of 500 listed companies



(1) Top 20% environmental performance measured by Sustainanalitycs indicator

Secondly, there is an increased value for investors. Investors increasingly value companies that have initiated environmental transitions, either out of personal conviction—often because their stakeholders prioritize such investments—or for opportunistic reasons, or because they are convinced that fiscal mechanisms will be put in place quickly. The terms of green finance are more favorable than others. The valuation multiples of the greenest companies are 1 point higher than those of other companies (see Table). This trend is likely to continue.

Finally, there is an increase in taxation. There are already many taxes aimed at penalizing activities with a significant environmental impact. In France, the carbon tax is 45€ / tCO_2e, in force since 2014, which applies to the consumption of all fossil fuels, affecting in particular transport, industry, and construction. At the European level, the EU Emissions Trading Scheme (EU ETS) limits emissions from more than 11 000 energy-intensive facilities (such as power plants and industries) and airlines operating in 31 participating countries. Ursula von der Leyen aims to go further and introduce a broader carbon tax, which would put a carbon price on every product based on the CO_2 emissions off all its components. For example, an iPhone would be taxed at €3,75 and a Nike T-shirt at 40 c€ [1].

Companies must therefore combine their ambition to create economic value with a reducing in their environmental impact.

Two risks to be avoided

In this context, companies must avoid two risks.

Firstly, there is the risk of disregarding the environmental dimension in business operations. This dimension is growing, and it is necessary to establish a vision, a framework, an ambition, actions, and incentive mechanisms. Otherwise, we run the risk of suffering the consequences of a lack of vision with regard to customers, investors, and employees, especially the younger generation. The environment then becomes a never-ending well, where any progress is perceived as a constraint and insufficient to the issues at hand.

Secondly, there is the risk of conversion to the environmental cause with the announcement of highly ambitious targets without fully assessing the extent of these commitments. In this case, there is risk of losing credibility both internally and externally, because the company's ambitions do not match its financial resources and operational priorities.

[1] 75 kg of CO_2 emissions for an iPhone X (excluding product use and distribution); 7 kg of CO_2 emissions for a Nike garment (excluding product use and distribution)

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Companies must combine their ambition for economic value creation with a reduction of their environmental impact

KEY TAKEAWAYS

- Growth is the only way to create value in the long term..
- A company that does not grow by more than 7.5% per year (i.e., a doubling of revenue every 10 years) loses its attractiveness and independence in the long term
- It is difficult to achieve economic growth without CO_2 emissions.
- There is consensus on the impact of CO_2 emissions on global warming and the urgency of reducing them.
- Companies need to balance their ambitions to create economic value and reduce their environmental reduction.
- Doing so should enhance their competitiveness and improve their resilience, which is essential for long-term growth.
- This requires the implementation of an environmental strategy that is integrated into the company's value strategy and business model.

An environmental approach linked to the of economic value creation

The implementation of an environmental strategy must be linked to value creation and structured around 6 iterative steps:

1. Definition of strategic and operational ambition
2. Definition of actions to be implemented
3. Quantification of costs and benefits of these actions
4. Prioritization of actions, potential revision of objectives, and link with value creation
5. Establishment of funding mechanisms for actions
6. Implementation of incentive mechanisms and monitoring

The challenge is to define a coherent and integrated approach from upstream to downstream: a clear strategic vision that is articulated and aligned among shareholders, executives, and teams; the definition, quantification, and prioritization of priority actions, focusing on those that create sustainable competitive advantages such as eco-design, raw material supply chain management, recycling, etc.; incentive mechanisms to move from intention to execution, such as systematic engagement by operational units with trajectory definition, regular monitoring of this trajectory, ongoing involvement of financial directors, implementation of incentive systems linked to compensation, and integration of environmental dimensions into investment and spending decisions.

What to conclude?

The environmental transition is a fundamental structural movement for companies that will have a significant impact on their strategy, finance, organization and operations over the next 10 to 20 years. It will require investments, implementation costs, and consequently, a reduction in profitability.
Companies that have taken the measure of this challenge will be able to develop sustainable competitive advantages. Others will lag behind and will not benefit from the value of being a first mover (leader) or the resilience value of their operations.
As with any major change, it must be addressed in a structured way, linked to the economic value creation and at the highest corporate level.

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Strategia Partners *is an international strategy consulting firm based in Europe (Paris & Zurich), the United States (New York & Seattle), and China (Shanghai). It assists the top management of large European and North American companies in their growth strategy. Its approach integrates 3 perspectives: strategic and financial performance, environmental performance, and human performance.*

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