

Sustainable Profit

Reconciling Sustainability and Corporate Profitability

Dr. Frank Figge

Sustainability Research Institute, School of Earth & Environment, University of Leeds, UK

frank@env.leeds.ac.uk

Dr. Tobias Hahn

Institute for Futures Studies and Technology Assessment (IZT), Berlin, Germany

t.hahn@izt.de

Abstract

This paper introduces the concept of Sustainable Profit that reconciles sustainability and corporate profitability. It is argued that on the one hand the conventional notion of profitability is too shortsighted as it is exclusively related to economic capital and turns a blind eye on the fact that corporate profits depend on the use of a whole bundle of different economic, natural, and social forms of capital. On the other hand the prevailing approaches to corporate sustainability are misconceived as they are either burden-oriented or instrumentally subordinate sustainability issues to profit goals. Sustainable Profit adopts a broad view that includes all forms of economic, environmental and social capital used in companies. It reconceptualizes the notion of corporate profitability by integrating corporate contributions to sustainability and the strive for profits.

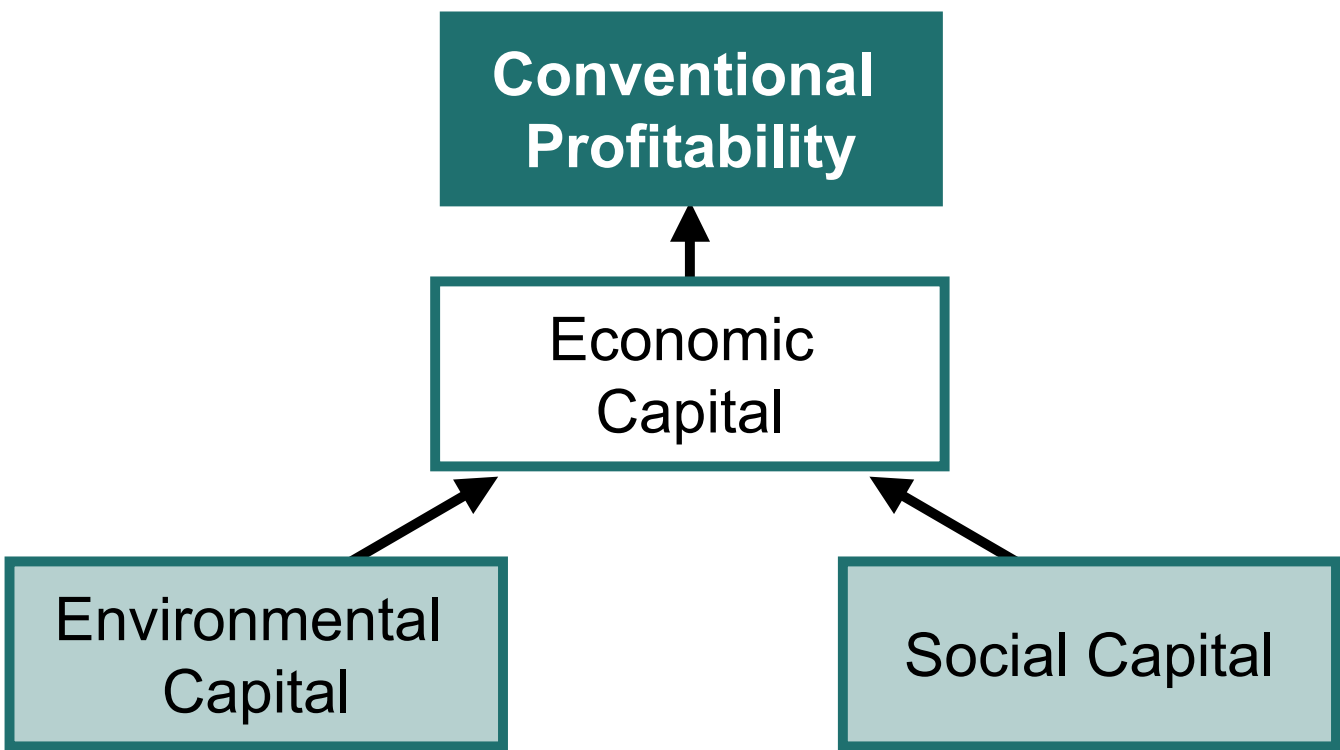
The Conventional Notion of Profitability

In the traditional view the ultimate goal of companies is to efficiently allocate and use resources in order to **maximize risk-adjusted returns** (e.g. Berle & Means, 1932; Jensen & Meckling, 1976). From this perspective all corporate activities are thus oriented towards maximizing profitability.

Conventional performance assessment and management approaches **only consider the return on one form of capital** which is economic capital. All other forms of capital used, i.e. different forms of environmental and social capital, are instrumental to maximizing the return on economic capital. From the viewpoint of sustainability this is insufficient and detrimental. However, the conventional approach is well-established in corporate practice.

- Standard management theory has largely turned **a blind eye on environmental and social dependencies** of corporate activities.
- Standard management theory has “tacitly encouraged organizations to behave in ways that ultimately destroy their natural and social life-support systems” (Gladwin, et al., 1995a: 896).

Instrumentality of Environmental and Social Capital



In current approaches that try to integrate sustainability and profitability **sustainability issues are instrumental to economic performance** and conventional profitability goals. Instrumental subordination of sustainability issues to conventional profitability does not measure up to the notion of sustainability.

Conventional Measurement of Corporate Profitability

	Company	Industry Average
Return on economic capital	3.78%	3.02%
Value Spread	0.76%	
Capital employed	58,064,000,000 €	
Value created	441,286,400 €	

Profitability is assessed as an excess return on capital compared to a benchmark. Value is created whenever the return on capital of an investment exceeds the opportunity cost of the investment. The opportunity cost is determined by the return of an alternative investment, e.g. by the market or industry average return on capital.

Real World Application and Conclusion

Conventional performance analysis only looks at the return on economic capital. It lends no fundamental value to all other forms of capital that are used in companies. These are instrumental at best. The conventional notion of profitability and all approaches to assess whether it pays to be green stop here.

Sustainable Profit puts the instrumental bias straight and widens the scope of profitability considerations. It applies the well established **notion of opportunity cost** to integrate the use of different forms of capital in companies. There is no instrumental subordination of environmental and social concerns under narrow conventional profitability goals.

As a result Sustainable Profit expresses the profitability of the use of economic, natural, and social capital in companies in absolute monetary terms. The table on the right hand side shows the Sustainable Profit of a major European company from the manufacturing sector. It is evident that the conventional notion of profitability does not measure up to the notion of corporate sustainability.

Form of Capital Considered	Profit contribution
Capital employed	441,300,000 €
CO ₂ -Emissions	1,598,800,000 €
NO _x -Emissions	891,500,000 €
SO _x -Emissions	-155,700,000 €
VOC-Emissions	-1,924,500,000 €
Waste generated	597,000,000 €
Water use	-119,000,000 €
Work accidents	743,700,000 €
Number of employees	-1,609,600,000 €
Sustainable Profit	51,500,000 €

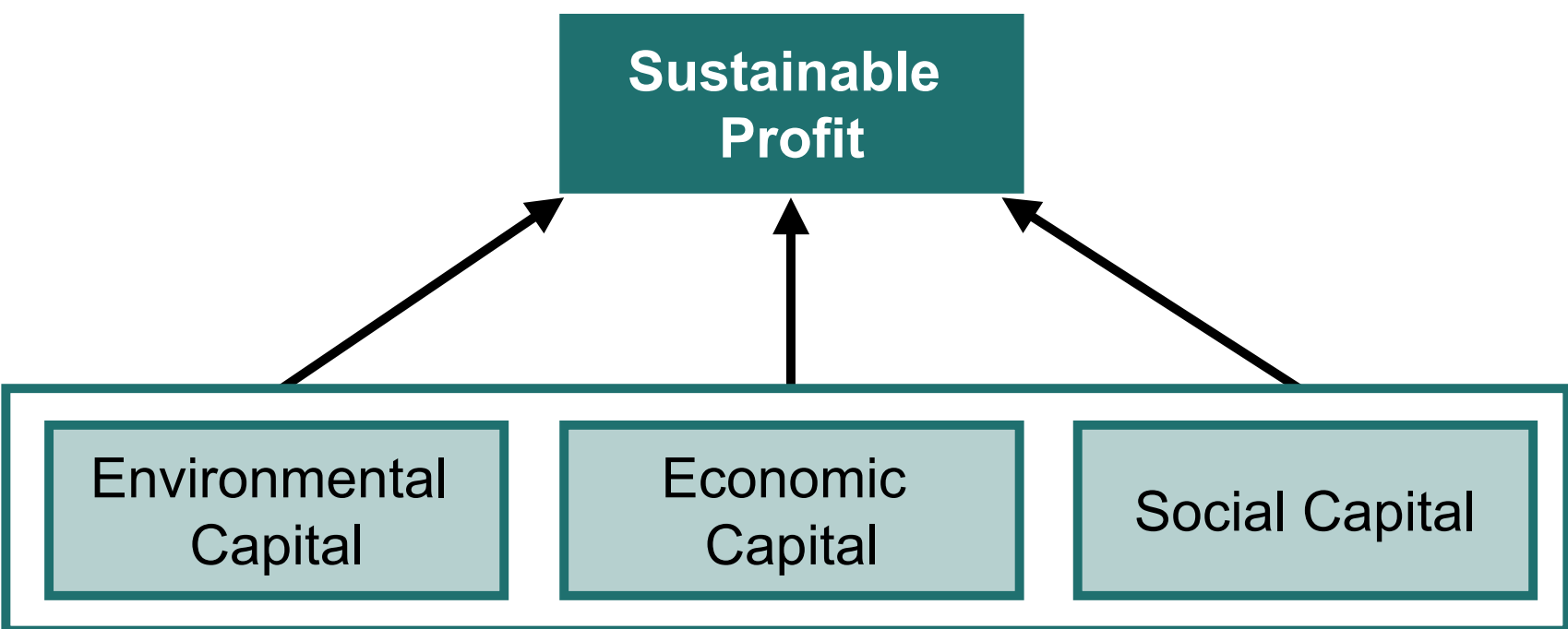
Sustainable Profit

Management theory and organizational science face the challenge of integrating environmental and social concerns. The development of meaningful and yet practical measures of corporate sustainable performance is crucial in this context. Shrivastava (1995: 954) calls for an integration of sustainability into the logic of corporations and a **rethinking of the basic concepts of organizations** like economic performance and profitability.

Many approaches in the field of environmental and sustainability management assess and aggregate environmental and social impacts according their harmfulness (burden-orientation). However, managers are neither used nor trained to assess natural and social resources based on their harmfulness. Managerial logic is thus value- rather than burden-oriented.

- There is a fundamental conceptual misunderstanding between the domains of management and sustainability that impedes integration.
- Consequently, there is a **need to reconcile sustainability and corporate profitability**.

Integration of Different Forms of Capital as Equals



Sustainable Profit is a **value-oriented concept** that assesses the use of environmental and social resources analogously to the way economic capital is accounted for. In contrast to the prevailing approaches it **does not subordinate environmental and social issues to financial goals**. Rather Sustainable Profit considers the use of economic, environmental, social resources on equal terms.

Measurement of Sustainable Profit

	Company	Industry Average
Water-efficiency [€/m³]	90.69	95.61
Value Spread [€/m³]	-4.92	
Water use [m³]	24,203,496	
Profit contribution [€]	-119,081,200	

Sustainable Profit assesses corporate profitability based on a value-oriented logic but widens the scope of the conventional stream of thought to include the use of natural and social capital similar to the way economic capital is valued. This procedure is carried through **for every economic, environmental, and social form of capital** considered. All forms of capital are thus integrated on the same level.

Sustainable Profit is a newly developed concept of sustainable corporate profitability. It reflects that any economic activity depends on the use of different forms of economic, natural, and social capital. Moreover, it helps to overcome some fundamental methodological shortcomings :

- Sustainable Profit does not turn a blind eye on resources other than economic capital but **integrates all different forms of capital**.
- Sustainable Profit is a value-oriented concept. It is thus **compatible with managerial thinking**.
- Sustainable Profit does not subordinate sustainability issues to conventional profitability goals. It reconceptualizes profitability to **integrate all forms of capital on an equal level**.

Sustainable Profit avoids the bold distortions and biases that occur if the narrowly defined standard notion of profitability is applied to sustainability aspects. Sustainability issues no longer depend on their instrumental relevance for traditional profit goals but represent an integrated element of an enhanced and yet sustainable profitability assessment.

