

The Value of Sustainability

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Two Perspectives
on Shareholder Value and Sustainability

- “It pays to be green.”

- It doesn’t.

How Might Sustainability Deliver Shareholder Value?

- It might increase customers' willingness to pay
- It might reduce costs of inputs:
 - Purchased raw materials and energy
 - Capital
 - Labor
- It might improve management of business risk

Increasing Willingness to Pay: *Environmental Product Differentiation*

- Idea:
 - raise costs, but recapture from customers
- Evidence:
 - differentiation has been tried
(with mixed success) in:
 - industrial goods markets
 - consumer goods markets
 - markets where prices are set by government

Increasing Willingness to Pay: *Environment and Strategy*

- Idea:
 - firm raises its own costs
 - firm forces rivals to raise their costs further (due to technological asymmetries)
- Evidence:
 - anecdotally successful
 - apparently requires unusual industry economics

Reducing Private Costs:
The “Porter Hypothesis”
and its Descendants

- Idea: reexamination of design, production, and delivery systems will reveal private cost savings (for raw materials and energy) as well as social cost savings
- Evidence: some impressive cost savings; dispute about whether these are one-shot gains or the beginnings of long sequences of learning-based improvements
- New idea: savings in the capital and labor markets may be even more significant
- Evidence: so far anecdotal

The Management of Environmental Business Risk

- Ideas:
 - reduce expected value of environmental costs
 - reduce variance of environmental costs
- Evidence:
 - Most firms have opportunities to:
 - reduce probability of bad events
 - reduce total costs of bad events if they occur
 - transfer risk to other parties
 - obtain better information about these opportunities
 - Superior risk management can be a long-run competitive advantage, but
 - Overinvestment in risk management is possible

“The Business Case for Sustainability”: *A Misnomer?*

- Firm-level statistical studies have been disappointing
 - Measurement of interesting variables is difficult
 - The possibility of diminishing returns worsens this problem
 - Causality is hard to disentangle
 - Firm-level data aggregate many, possibly competing, effects
- Analysis of particular investments or projects is necessary
- The value of an investment may depend on complementary assets owned by the firm or others

Some Further Reading

- Neil Gunningham, Robert A. Kagan, and Dorothy Thornton, *Shades of Green: Business, Regulation, and Environment* (Stanford University Press, 2003)
- Forest Reinhardt, *Down to Earth: Applying Business Principles to Environmental Management* (Harvard Business School Press, 2000)
- Robert Stavins, Richard Vietor, and Bruce Hay, eds., *Environmental Protection and the Social Responsibility of Firms* (forthcoming)