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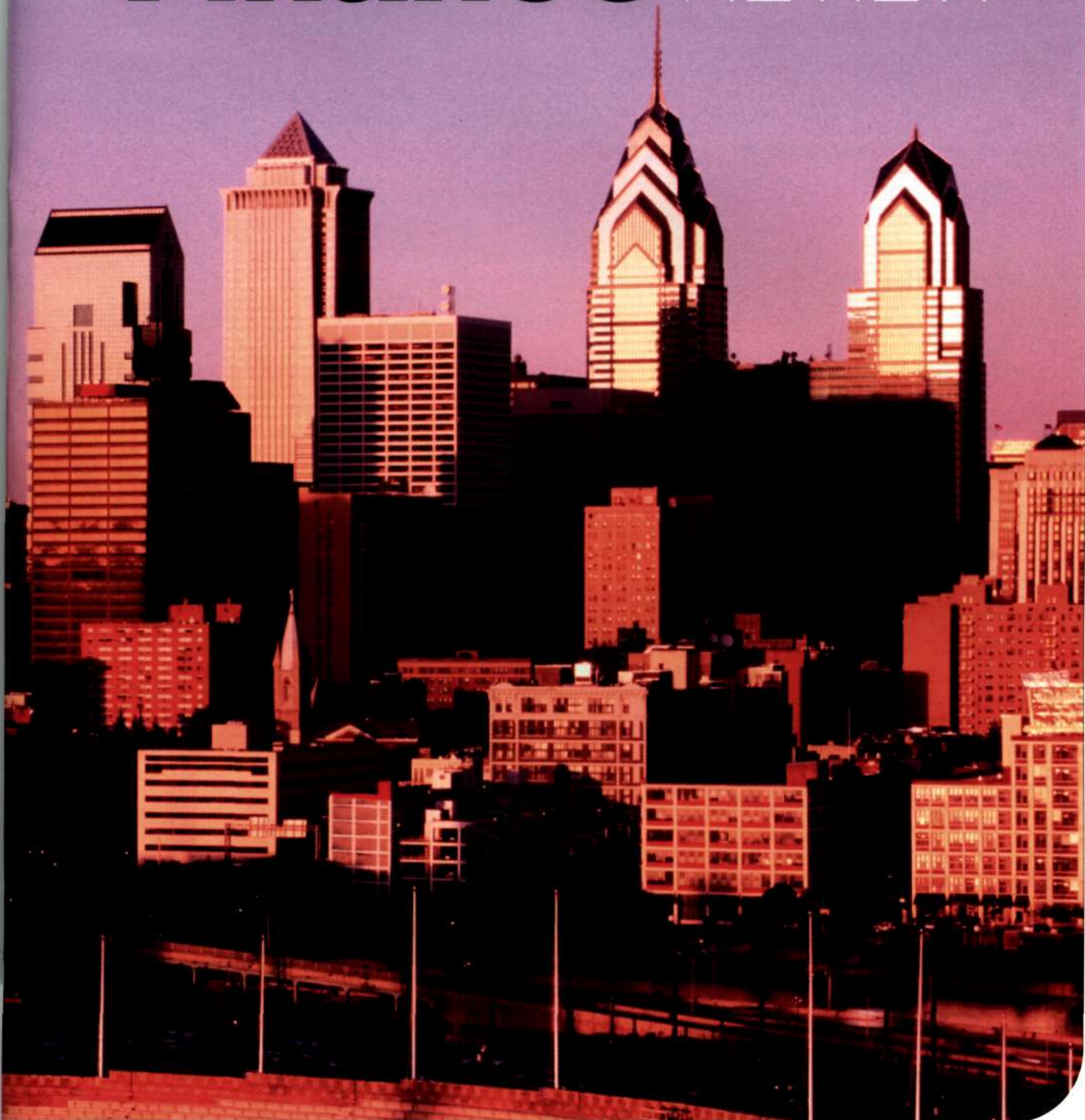

Staggered Boards
And the Informativeness of Accounting Earnings

The Greening of Public Corporations

Demand and Supply

CORPORATE Finance REVIEW

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HANK BOERNER

THE GREENING OF PUBLIC CORPORATIONS

Greening is everywhere in the corporate world, and seemingly epidemic among corporate managers at all levels. Board members are looking for ways that their enterprise can be more green. Is this a passing fad (remember the corporate embrace of "Zero Defects," "zero-sum budgeting," and others)? Or is the greening of the corporation a longer-lasting trend?

The answers may be found in investor sentiment: More mainstream institutions and their money managers are focusing on sustainability, which is at the heart of "greening," to pick market winners and losers, if not short term then for the long term. There are higher stakeholder and investor expectations today for companies to "be green" and "do green": decreasing pollution, lowering the carbon footprint, producing eco-friendly goods, reducing energy use, exploring alternative energy sources, and creating processes that augur for a long-term sustainable enterprise.

Given the growing attention being paid to climate change, global warming, carbon emissions, greenhouse gases, diminishing natural resources, and other issues of concern to citizens and public officials in many countries, the financial stakes for managers and boards are real, even if a number of greening issues appear to be intangible, nonfinancial, and not easily measurable.

The focus on the intangible and nonfinancial performance metrics of the enterprise can in fact be very misleading; in the end, don't these performance metrics factor into the tangible? Don't these factors affect the valuation of the enterprise by the capital markets? We shared with you earlier that Goldman Sachs research had found that environmental, social, and governance (ESG) leaders in certain sectors had outperformed key global indices by 25% in recent years.[1] These findings began transitioning ESG factors to the tangible and financial for many companies, most often beginning in the EU.[2]

So is this also what the "greening" trend for companies is all about? In many ways, yes.

At a conference presented in New York City in spring 2008 — "Everyone's Going Green: A Corporate Leader's Challenge in the 21st Century" — institutional investors, investment bankers, financial analysts, and professional money managers joined with academics, bankers, energy experts, economists, and other capital markets players to look closely at the greening of American companies and capital markets. The conference was one in the series of workshops presented by The Robert Zicklin Center for Corporate Integrity at Baruch College/City University of New York.[3]

Green helps build revenues—and a wider moat

One bold assertion of a number of the conference's speakers was that companies were enthusiastically going green to (1) reduce dramatically their operating costs; (2) develop new know-how, processes,

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and innovative systems that they can apply to their services and products to generate "greener" revenues; and (3) capture new markets for their products, both domestically and internationally. These approaches in turn are providing a wider moat between innovative companies and their competitors.

Ignoring the greening of corporations and capital markets could cost corporate laggards money, leadership position, and even signal long-term unsustainability to investors as global energy costs escalate, energy shortages develop, natural resources become more scare (and more costly), and global competition for these resources increases.

You may or may not be regularly tuning in to, or yet involved in the "green revolution" arising in the capital markets and within a growing number of corporate suites. But as more institutional investors embrace green investing strategies, this is something that every corporate finance professional will want to know more about—especially because of the competitive threat of early adopters.

The warnings of Thomas Malthus—still with us?

Michael Mandel, chief economist *of BusinessWeek,* opened the discussion at the "Everyone's Going Green" conference by reminding participants of the observations of oft-quoted English political economist Thomas Malthus in the 1800s: observing the escalating population of the world, he cautioned industrial countries about reaching the limits of growth. As populations grew, Malthus feared that food production would not keep pace with the increase in people. The good news is that so far Mr. Malthus's famous musings have been proven wrong.

Because of the global Industrial Revolution— featuring such advances as the internal combustion engine and abundant power sources including electricity— many societies were able to figure out how to increase food supply through greater crop yield, clean up the water supply (and vastly improve public health), transport necessities over very long distances, preserve foods for transport and storage for later use, and more. But, cautioned economist Mandel, we may be once again reaching certain limits in Malthusian terms, in the form (this time around) of demand outstripping the world's energy supplies and the unintended consequences of the Industrial Revolution— related especially to climate change.

IGNORING THE GREENING OF CORPORATIONS AND CAPITAL MARKETS COULD COST CORPORATE LAGGARDS MONEY AND LEADERSHIP POSITION, AND ALSO SIGNAL LONG-TERM UNSUSTAINABILITY.

Mr. Mandel held that we are now seeing lower corporate profits, slower economic growth, escalating energy demand and the increasing release of "greenhouse gases," and with all of this combining with the overhang of huge public and private debt, we may be approaching some unpleasant dead-ends in society's ability to deal with important issues. He cited the challenge of dealing with the earth's rising temperatures, dramatically escalating energy costs (with potential shortages as a result as India and China and other emerging industrial nations continue to increase demand for energy), and other concerns for the leaders of industrial nations.

At the same time, Chief Economist Mandel of *BusinessWeek* saw opportunities for American companies to innovate, develop new technologies, and not only address critical issues facing US business but also develop the means of creating new revenues and profits by helping non-US companies in the global marketplace address and resolve the same issues. This brings us to the key points for corporate finance professionals to consider, as presented by corporate managers and professional money managers on the "greening front lines."

Green investment—it is paying off

Zachary Karabell, executive vice president and chief economist at Alger—a money management firm with $10 billion in assets under management—addressed the issue of "green investment," which is at the critical tipping point of going mainstream. While environmental activists and capital markets players were usually at odds on philosophies and attitudes on financial and business issues in the 1970s and 1980s, we have

now reached an historical inflection point with large public companies thinking seriously about change and the need to engage with sustainable investment players.

At the same time, Wall Street views are changing. Formerly, the easiest way to get started in socially responsible investing, he pointed out, was to "screen out" those companies that the "social" or "ethical" investor looked on with disfavor. Today, there is more "screening in," with more mainstream institutional investors and their advisors looking favorably toward companies with clearly improving green track records.

SUSTAINABILITY AND GREEN ACTIVISM ARE THE KEY TERMS OF THE DAY NOW.

Corporate green winners

While investors often look to new technologies and start-up companies for innovative products and services to market—think Google or Amazon, was the advice—Dr. Karabell suggested that long-established companies are also taking the lead in innovation.

Wal-Mart is a prime example. The giant retailer's top managers may get some things "wrong," but they are also taking major, dramatic steps towards becoming more green by creating more sustainable packaging and shipping methodologies, which will affect many other companies (all along the continuum of the vast Wal-Mart supply chain). These changes will have a widespread effect on corporate shipping practices and the practices and behaviors of other retailers and will shape new approaches in package manufacturing.

General Electric (GE) is another example the economist cited, with the company's "ecomagination" programs generating billions of dollars in new revenues as improvements inside GE are taken to the market as new offerings.

"We have to leave moral absolutes aside in these 'green' discussions," Dr. Karabell counseled the market and corporate professionals present at the conference. "Government action, pricing, pressure by NGOs, auction markets for energy credits — all of these will be part of the emerging financial mix for companies and capital markets."

GE's ecomagination success. General Electric's director of public relations Peter O'Toole provided conference participants with the broad strokes of the scope of the company's ecomagination operations. Initiated enterprise-wide when CEO Jeff Immelt assumed office February 2001, these initiatives now generate very tangible financial results:

- More than $25 billion in new annual revenues are being generated;
- Clean and green research and development activities have doubled, with company investment exceeding $1.5 billion;
- Greenhouse gas energy usage is down, saving GE billions of dollars more in operating costs;
- There is $70 billion stacked up in backorders for green technology services and products.

GE's "clean" locomotive production is sold out; so are wind turbines and compact light bulbs (and the leading retail seller of the latter product is Wal-Mart—see the synergies of greening?). The ecomagination revenues in the various business units are growing faster than GE's total revenues.

Citi's across-the-business sustainability efforts. Valerie Cook Smith, vice president of environmental affairs for Citigroup, detailed the new approaches to sustainability taken by Citigroup. With a small team, she provides critical advisory services across all of Citi's business units to help unit and corporate management address environmental and social risk issues, "which," she pointed out, "can become financial risks if not properly managed." She cited Citi's initiative in committing to stakeholder engagement and working partnerships to address issues.

The company has embraced the "Equator Principles," which is a global benchmarking system adopted by the financial services industry to address social and environmental issues in project financing. Citigroup has also helped to launch the "Carbon Principles" along with JPMorgan Chase, Morgan Stanley, and a number of leading US electric utilities companies to develop climate-change guidelines for advisors and lenders to

power-generating companies in the United States.

Citi has pledged $50 billion over ten years to address global climate change through investments, financing, and commercialization of alternative and clean energy along with the embrace of "green projects" within Citi's own operations. The company is aiming for broad-based Leadership in Energy and Environmental Design certification for many of its facilities.

Citi's stock is listed in the Dow Jones Sustainability Index and FTSE4Good Index. These inclusions acknowledge a company's leadership and commitment to sustainable growth and performance in key metrics relating to environmental protection, economic performance, and social programs.

Sustainability—inconvenience or new business paradigm?

Closing the discussion, keynoter Daniel Mahler, leader of the global sustainability practice at AT Kearney, a consulting organization, posed this key question for corporate leaders: Is all this about sustainability a costly inconvenience or a new business paradigm? For *Fortune 500s* and multinationals, he said, companies are clearly going green. Leadership is thinking strategically on these points and it is not a passing fad.

The primary challenges now facing corporate leaders and institutional investors, Mr. Mahler noted, are scarcity of resources, escalating prices, the potential cost of dealing with a multitude of real global threats, growing risks associated with corporate supply chains, and the concentration of some resources with unreliable players. He cited iron ore as an example: 70% of production is concentrated in the hands of just three global players. Many extractable resources are in the hands of unstable nations and leaders. Think beyond branding and reputation management here, he suggested: *Sustainability* and *green activism* are the key terms of the day now.

"When companies excel in these areas — in assuring sustainability and embracing green activism — Wall Street is increasingly rewarding them, with as much as a 25% share price premium. By becoming a 'sustainability champion,' the enterprise can deliver greater value over the long-term, vs. 'do-nothing' companies that over twenty years will likely see maximum value destruction." And beyond doing the right thing in terms of gaining the advantage in competitive sustainability, companies will also be maximizing opportunities and minimizing their own risks. These are strategic directions being taken by companies, not just PR or repackaging. •

NOTES

1. H. Boerner, "Your Company's ESG—Environmental, Social, and Governance Factors Are Mattering More Now to Institutional Investors," *Corporate Finance Review* (Vol. 12, No. 2, September/October 2007): 40-43.
2. H. Boerner, "Environmental, Social, and Governmental Concerns Converging on the Corporate World," *Corporate Finance Review* (Vol. 13, No. 1, July/August 2008): 30-34.
3. "Everyone's Going Green: A Corporate Leader's Challenge in the 21st Century," conference held on April 1, 2008 in New York City. For more information on the ongoing Zicklin Center series, see www.zicklin.baruch.cuny.edu.