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# CORPORATE SUSTAINABILITY MANAGEMENT



THE ART AND SCIENCE  
OF MANAGING  
NON-FINANCIAL PERFORMANCE

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### **About the Cover**

The cover illustration is taken from *Sylvicultura Oeconomica* (Carlowitz, 1713), the first book ever written on sustainability management. Carlowitz's focus was on sustainable forestry, and the illustration shows the proper way to cut down a tree that has been allowed to grow too long. Because the lower trunk is too hard to cut with saws or axes, workers are forced to cut into the tree at a higher and softer level.

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By Mark W. McElroy and Jo M.L. van Engelen

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# Introduction

## Setting the Context

This is a book about the advent of a new management discipline; its origins; the trouble it's in; and how to save it. The management discipline we speak of, of course, is corporate sustainability management, or CSM; and the trouble it's in involves nothing less than its own credibility and prospects for survival. Indeed, as we will show on the pages that follow, CSM has thus far failed to accomplish the one thing it was intended to do, which is make it possible for organizations to measure, manage and report their sustainability performance in a rigorous way. In fact, CSM in its present form does nothing of the kind – literally – despite common representations to the contrary. On the pages that follow, we will explain exactly how it is that CSM fails to do so, and what can be done about it.

CSM, of course, in its modern form is not an entirely new field, and is at least twenty-some years old – not including its *pre*-modern form, that is, which goes back at least three hundred years (see, in particular, Carlowitz, 1713). We know this because at least one company – Ben & Jerry's in Vermont, where one of us lives – has been issuing corporate social responsibility, or sustainability, reports since the late 'eighties. Others may have been doing so as well, but it is also the case that common frameworks for how to even think about the subject (e.g., the so-called triple bottom line; Elkington, 1997) and standards for reporting, such as the Global Reporting Initiative, or GRI (first deployed in 2000) are much more recent in their appearance.

Earlier theoretical and academic treatments of the subject can certainly be found (see, for example, Friedman, 1970 and Davis and Blomstrom, 1975), but reporting and standards for reporting, *per se*, are not that old. Nonetheless, given the modern intellectual history of the subject – at least forty years old – and the fact that corporate sustainability management functions have been in place in some companies for at least twenty years, one would have thought the discipline would be much further along than it is in terms of having acknowledged its shortcomings and taken steps to resolve them. In fact, it has not.

What, then, is the trouble we speak of? The trouble we speak of is that mainstream sustainability reports – which are supposed to report on the sustainability performance of organizations – rarely if ever actually do so, and in the process reveal a serious conceptual flaw in CSM as a whole; or at least a willingness to put up with it (we're not sure which is worse). The flaw we are talking about is the absence of what in sustainability theory and practice is known as *context* – or *sustainability context*, as GRI puts it.

Context in sustainability, or in CSM, has a particular meaning, not to be confused with broader or looser interpretations of the term. In so many words, what it refers to is the background state of vital social and environmental resources in the world, and what an organization's impacts on them ought to be (or not be) in order to be sustainable. If a vitally important water resource, for example, is already over-taxed and nearly depleted, knowledge of that is important to include when measuring and reporting the sustainability of an organization's use of it. Indeed, the same level of use might be sustainable on the one hand or not sustainable on the other, depending on what the status of the resource is to begin with.

Thus, the status of social and environmental conditions in the world matters, insofar as an organization's efforts to measure, manage and report its sustainability performance is concerned. Context, that is, is fundamental to CSM, so much so that CSM can't be done without it. Why, then, is it so regularly and conspicuously missing from contemporary practice? And how can we take CSM seriously as long as it is?

Imagine, by analogy, a management discipline for measuring and reporting the financial (or profitability) performance of organizations that systematically failed to take costs into account. Profitability measurement and reporting under such a system would be solely a function of revenues (as if costs didn't exist, when in fact they do), and would be reported on *income statements*, accordingly.

Apart from the difference between financial and non-financial measurement and reporting, the analogy we have drawn here is quite literal. Mainstream practices and standards for measuring and reporting the sustainability performance of organizations, that is, quite literally fail to achieve the one thing they set out to do, which is make it possible to understand the true or actual sustainability performance of organizations who use them, thanks to their exclusion of the social and environmental equivalents of costs. Such factors may be non-monetary in form, but they are no less vital to the accounting task at hand.

If it is, in fact, the case – and we think it is – that the absence of context in the mainstream practice of CSM makes it impossible for organizations to measure and report, much less manage, the sustainability of their operations, then it is entirely possible, if not probable, that the vast majority of organizations on Earth have no real idea of whether or not their operations are sustainable. And given the extent to which organizations – businesses, in particular – are quite possibly the dominant human institution on Earth, with the greatest social and environmental impacts the world has ever seen, the fact that the most basic internal measurement system for monitoring and reporting the sustainability of their operations is fundamentally flawed should be of great concern to us all. Indeed, how can we possibly expect organizations to manage the social and environmental sustainability of their operations when their own internal dashboards, as it were, are deeply defective? And how, under these circumstances, can

we expect the conduct of human affairs, more broadly, to be sustainable given the prominent role that businesses and other organizations play in modern civilization? To be sure, we can't.

What this means, we're afraid, is that even as the number of organizations around the world actively involved in measuring, managing and reporting their sustainability performance is growing every year, their *actual* sustainability performance – despite claims to the contrary in their reports – may, in fact, be worsening, unbeknownst even to themselves; for without the inclusion of context in related accounting and management efforts, no one can possibly know what the true sustainability performance of an organization is, much less whether it is improving, worsening or what have you.

This, we believe, is an utterly untenable situation that should not be tolerated, especially given the plainly visible social and environmental stresses around us, many of which are attributable to commerce. In a very real sense, human well-being from this point forward hangs in the balance insofar as whether or not context is properly attended to in CSM, which at the present time it is not. In short, the need for context in CSM is urgent!

The good news is that (a) we are not the only ones who have identified the absence of context in CSM, although we may be the most vocal critics of it, and (b) principles, procedures and methods for injecting context into CSM where it belongs now exist, including in the book you are holding. We also take great comfort in knowing that the leading international standard for corporate sustainability measurement and reporting, GRI, strongly advocates for the inclusion of context in related efforts. That said, however, GRI also fails to provide sufficient guidance for how to do so, and regularly endorses superior ratings for GRI reporters (and their reports) who don't.

We will have a great deal more to say about this throughout the book, as well as about how to perform context-based CSM. That, of course, is the main purpose of the book: to provide a methodology for performing context-based CSM, or *context-based sustainability*, as we will refer to it from this point forward.

## **Project Background**

As co-authors of this book, the two of us first met at a symposium held in The Netherlands in June 2004, jointly held by The Dutch National Initiative for Sustainable Development (NIDO) and the Dutch Association of Inventors. Each of us, and our respective colleagues (see *Acknowledgements* section and the discussion below), had already for several years by then been focusing on the connections between knowledge, innovation and sustainability. In 2005, a core group of us consisting of ourselves (McElroy from the Center for Sustainable Organizations and van Engelen from the

University of Groningen), René Jorna (University of Groningen), Derk Jan Kiewiet (University of Groningen), Joseph Firestone (Center for the Open Enterprise), Steve Cavaleri (Central Connecticut State University), Benoit Cushman-Roisin (Dartmouth College) and Henk Hadders (University of Groningen) gathered in May, 2005 at Dartmouth College in New Hampshire to more or less begin the process of collaborating more closely on what we all felt was a promising new theory of sustainability that could have profound practice implications – which indeed it has.

Of central importance to our view was, and still is, that (a) effective action of any kind in life requires access to information about the world that is timely and accurate, and (b) such information has, in fact, been largely missing from the general practice of CSM in business, a serious shortcoming that must be addressed if sustainability, or CSM, is to have any chance of success.

Out of the collaboration cited above – including work performed both before and after the May, 2005 gathering at Dartmouth – came several works of great importance to the thinking set forth in this book (see, for example, McElroy, 1997; McElroy, 2000; McElroy, 2002; Firestone and McElroy, 2003; McElroy, 2003; Jorna et al, 2004; Cavaleri, 2005; Faber et al, 2005; Firestone and McElroy, 2005; Faber, 2006; Jorna, 2006; McElroy et al, 2006; McElroy et al, 2007; and Cavaleri et al, 2010).

Of particular relevance came the doctoral dissertation produced by one of us at the University of Groningen (McElroy, 2008), in which the concept of context-based sustainability as described and advocated in this book was formally developed, along with the *Social Footprint Method*, a context-based approach for measuring the social sustainability performance of organizations. Working closely with McElroy at the time were van Engelen, Jorna and Kiewiet, all from the University of Groningen.

This book, in turn, was motivated by a desire on the part of the authors to take what was otherwise a scholarly, academic and scientifically vetted concept over the years and express it in a more practical and business-friendly form, so as to make the significance and substance of context-based sustainability more accessible to CSM practitioners. Not only is it our hope and intent, then, that the methodology we are proposing here will be embraced by businesses and other organizations, we also hope that standards-setting bodies, such as GRI and others, will at least consider what we have said as a possible starting point – if not a ready-made solution – for establishing context-based guidelines of their own. Indeed, we would be very pleased if they did, and would happily support them.

## **Chapter Summaries**

In *Chapter 1*, we begin by providing a summary of the intellectual history of CSM, or of sustainability, the concept, more broadly. There our intent is to show that sustainability



is a not new idea, and that its appearance in the literature as a formal school of management practice goes back at least three hundred years to the writings of one Hanns Carl von Carlowitz (1713), a Saxon mining administrator who more or less singlehandedly invented the practice of sustainable forestry. On the basis of that case and many others that follow, we will show that the inclusion of context in sustainability theory and practice is not a new idea, just a sorely neglected one.

Next we will show in Chapter 1 that the modern form of CSM we have before us today is arguably the result of the convergence of two otherwise separate intellectual streams of thought that came together sometime in the mid- to late-twentieth century. One stream we will refer to as the *context* stream (i.e., utilized by sustainability theorists over the years, like Carlowitz, who all relied on the concept of context in their writings on sustainability to make their points), and the other is the *capital* stream. The capital stream mainly appears in the writings of economists, who eventually expanded application of the term from its narrow economic sense to encompass vital (capital) resources of all kinds, including natural capital, a term that has regularly appeared in the sustainability and environmental literatures for years now. Sustainability theory and practice in its modern form, then, is the product of the convergence of the context and capital streams, the implications of which for the practice of contemporary CSM are profoundly important.

In *Chapter 2*, having laid the intellectual foundations of context-based sustainability (CBS) in Chapter 1, we go on to apply our thinking to the treatment of several key issues of frequent debate and interest in CSM today. Here will we distinguish between issues involving (a) how CBS ties into, or interacts with, other mainstream management practices otherwise in use – strategy-related practices, in particular – and (b) how CBS relates to measurement and reporting as compared to other, more conventional CSM practices also in use today. The intent of this chapter, then, is to demonstrate the context-based approach in action, at least in terms of how it can be used to address several of today’s key issues in CSM. By so doing, it is our hope that the reader will develop a more intuitive understanding of CBS, and thereby better understand its significance and practice implications for CSM.

Of greatest importance, perhaps, in our discussion of key issues in CSM and how it relates to other established business practices, is the extent to which the context-based approach we are advocating here is, in a sense, nothing more than a new application of an old (and still predominant) management theory – long used in the financial domain – to the sustainability or non-financial domain. Here we will argue that just as conventional management involves the care and feeding of monetary capital on behalf of shareholders, so, too, does non-financial, or sustainability, management involve the care and feeding of (other) capitals on behalf of (other) stakeholders. After all, stakeholders include more than just shareholders, if only because the effects of an organization’s activities affect more than just the well-being of its shareholders. The

other capitals involved here are natural capital, human capital, social capital and constructed (or built) capital; and the stakeholders are whomever they might be (a criterion for which we provide in Chapter 3).

Chapter 2 also includes an in-depth critique of GRI, or more narrowly, of the extent to which GRI advocates for the inclusion of context in CSM on the one hand, but fails to define and enforce it on the other. Here we will take the language currently contained in the GRI standard on the principle of *sustainability context* and critique it, line by line. Along the way, we will offer our own thoughts on what the text means, and also how, in principle, to act upon it from our own point of view. In general, we will take the position that the principle of *sustainability context* in GRI is laudable, if not vital; that it should be interpreted in terms of the context- and capital-based concepts we describe in Chapter 1; and that the methodology provided in this book is at least one viable way of operationalizing GRI's call for it (context) as a basic principle for sustainability measurement and reporting.

In *Chapter 3*, we lay out the methodology associated with context-based sustainability in great detail. The purpose of the chapter is, in fact, to provide CSM practitioners with a step-by-step procedure for performing CSM in a way that takes context fully and properly into account. Included is a comprehensive case study from a company in the U.S. – a dairy food producer known as Cabot Creamery Cooperative, or Agri-Mark, Inc. – in which the methodology we describe has been used, including a procedure we recommend for developing context-based metrics. All of this is discussed against the backdrop of an over-arching, 6-step methodology for CSM that we refer to as simply, the *CSM cycle*, a general methodology for CSM that can be used to understand, operationalize and perform CSM in an organization.

Chapter 3 also includes more discussion of the important role that stakeholders play in CBS. Indeed, the very substance and boundaries of a CSM program, we argue, are determined by – or *should* be determined by – an understanding of whom the organization's stakeholders are, and what its duties and obligations are to each of them to have non-financial impacts of one kind or another in order to ensure their well-being. As in the case of the intellectual streams of context and capital theory discussed in Chapter 1, here, too, we have found a kindred and well-established body of thought and literature that has a crucial role to play in CSM: *stakeholder theory*. Shareholders, we will claim, are not the only stakeholders to whom an organization owes a duty of performance, but instead are only a subset of a much broader range of constituents (stakeholders) whose needs and interest can and should inform and legitimize the design of a CSM program in any organization.

In *Chapter 4*, we provide a general summary of our thinking as otherwise put forward in Chapters 1 through 3, but also include some thoughts as to where CSM should go from here. Five areas of interest, in particular, are discussed: standards, accounting,

assurance, organizations and the capital markets. In each case, context as a principle is regrettably still missing from contemporary practice, although in some cases (e.g., the GRI standard), it is at least acknowledged.

Of most importance, though, to the continued development of CSM and to the context-based approach we are proposing, is the need for further development on the accounting front. Why? Because accounting, in principle, logically precedes everything else. Standards for measurement and reporting, for example, must be reflective of general principles for what needs to be measured, how it should be measured, and what it means when it is. Assurance practices, too, must be based on prior agreements for what measurement and reporting should consist of, and whether or not reports are true to accounting principles. And all of that, in turn, must be properly operationalized in organizational and capital market settings.

It is because of that that we wish to have our own thinking, as put forward in this book, viewed as a contribution to the management discipline of sustainability accounting, and not just CSM. Indeed, what we have tried to do here is explain what it means for an organization's activities to be sustainable or not, in a way that translates into a system of metrics and indicators for non-financial performance accounting. Context, it turns out, is indispensable in CSM, and without it there can be no truly meaningful sustainability accounting; no meaningful sustainability measurement; no meaningful sustainability management; no meaningful sustainability reporting; and no meaningful sustainability assurance. And without any of that, there can be no *sustainability* in the conduct of human affairs, for how can we expect ourselves to be sustainable in our own behaviors if we are blind to their effects? Context, we believe, provides us with just the light we need.