

ISSUE 1: APRIL 2010

The TRIALOGUE
SUSTAINABILITY
REVIEW

*The quarterly review of SUSTAINABILITY
in South African business*

SECTOR SPOTLIGHT
**Financial sector
sustainability**

SPECIAL FEATURE
**KING III:
All hail the King!**

LEADER

What drives
sustainable business
today?



CONTENTS & INTRODUCTION

From the editor

Welcome to the first edition of *The Trialogue Sustainability Review*, carried in the *Financial Mail*.

Sustainability has become part of our everyday business lexicon, yet the concept is often poorly understood. Some fling sustainability platitudes about with gay abandon, though their deeds don't match their words. Others are sidetracked by issues not relevant to their business. And many ignore sustainability, remaining mired in the mindset 'profits at any cost'.

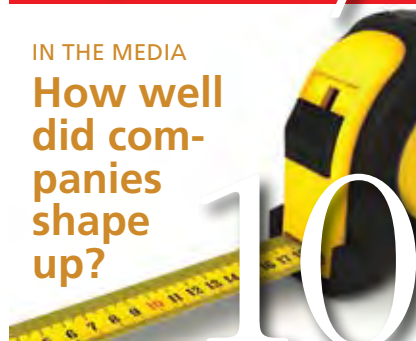
Simply put, corporate sustainability advocates pursuing profits in a way that is more responsible by taking into account broader stakeholder interests. The premise is that responsible business is good for society and less harmful to the environment, thereby ensuring business success over the long haul. Yet on the back of this comes a plethora of codes and standards that can distract management from their core purpose.

In addressing this emerging imperative, business has a choice. It can opt for the knee-jerk approach by drawing up a 'laundry list' of responses – from BEE and CSI to switching off lights and recycling paper – and set up a team to tick all the 'right' boxes. Or it can integrate sustainable business thinking with strategy, stakeholder relations and risk management. We believe this is the smarter choice. It views sustainability as a set of opportunities and a route to competitive differentiation, in this way serving the long-term interests of both shareholders and society.

Compiled each quarter, *The Trialogue Sustainability Review* brings different perspectives on this captivating topic to *Financial Mail* readers. In this edition, we examine the business case for sustainability. Our Quarterly Review looks at developments that are shaping business practice. We consider the implications of the King III Report, which is moving sustainability into corporate boardrooms. Our review of media reportage shows how sustainability coverage promotes or damages company reputation. And we put the spotlight on the financial sector, examining the inter-relationship between good financial business and societal benefit.

We hope it will provide some pointers along your pathway to responsible, sustainable business.

Andy Freemantle
Editor



Editorial

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What drives sustainable business today?



You don't have to look far to recognise that humankind is currently on a **TRAJECTORY TO COMPROMISE** our children's future.

Every day, respected scientists warn of the impending dangers of climate change, of the many ways we are degrading our natural environment, and of growing competition for scarce natural resources. Every day, the media trumpets the injustices of human inequality and massive global poverty. Yet we don't seem to recognise the incipient danger of it all, and are hell-bent on continuing as we are. In so doing, we shift the burden of responsibility for finding solutions onto future generations.

The crux of the challenge

The juxtaposition of environmental and social components of the problem leaves us with an intractable challenge: how do we meet the justifiable socio-economic expectations of billions of poor people for a more prosperous life, and how do we continue growing our economies, but in a way that does not continue to denude our planet and destroy the earth's remaining natural capital.

The challenge we all face is to ensure that our activities become more:

- Environmentally sustainable, meaning that we exploit resources and products only to the extent that ecosystems can regenerate; that we reduce, re-use and recycle wherever possible; and that we discharge by-products in a way that is safe for the environment and people.

- Socially responsible, meaning that we consider affected stakeholders in everything we do; deliver benefit to these stakeholders and do not harm them; and accept accountability for our actions.

Why should companies respond?

All commercial activity is ultimately reliant on natural resources and social capital. But the reality is that our economic and trade systems and our lengthy corporate supply chains have created a disconnect between us – as producers and consumers of products and services – and the earth and society. Consequently, the corporate sector is clearly complicit in the sustainable development dilemma. The pressures on companies to respond – and to be an integral part of the solution – are mounting steadily.

Growing resource scarcity will require businesses to find alternatives and to brace themselves for increasing resource costs and the possibility of future human conflict over scarce resources. The climate change debate means that businesses need to prepare for a policy environment increasingly hostile towards carbon emissions, and must plan for the costs of adaptation. Stakeholder expectations about the role businesses should play in society – from governments, consumers, investors, employees, labour unions and civil society – have changed markedly. And digital communication has reduced the time it takes to build and destroy corporate reputations.

These pressures have brought to the corporate sector a range of new laws, regulations, standards and 'licence to operate' conditions with which businesses must comply. They have

increased the risks of doing business and the challenges of managing corporate reputation. And they have raised the bar for attracting quality employees. At the same time, new perspectives on traditional approaches to business are creating opportunities for companies to build their reputation, improve market penetration, grow new revenue streams, develop new products, improve productivity, generate operating efficiencies and reduce costs.

How to respond?

How should your company respond in a way that makes sense to your business? By engaging your stakeholders and analysing all your risks, your company must identify which sustainability issues are material to the business and develop integrated response strategies. The sustainability actions that companies must embrace will differ according to industry sector and from company to company. The list of possible actions is long, and it requires you to review your operations across the spectrum of sustainability dimensions summarised in the diagram below. Some companies make the mistake of using this as a list of 'tick-box' items. Rather, you need to interrogate this list in the context of your business, to focus on those items that are relevant, and to come up with deep, meaningful actions and solutions that make sense to your business.

So, for example, mining companies like Anglo Platinum tend to focus on actions that make their operations more environmentally sustainable (in terms of land rehabilitation, water stewardship and effluent management), more socially sustainable (in terms of employee health, safety and skills development) and to make society more sustainable (through local economic development around their operations). From time to time, new mining operations may require communities to relocate. How the mine deals with such a social issue is highly relevant to the business. Failure to reach acceptable and mutually beneficial arrangements not only impacts on corporate reputation, but can lead to expensive and damaging litigation and stalled mining operations.

Industrial operations, like Sasol, need to pay particular attention to environmental issues ranging from energy consumption and emissions to water stewardship and waste and effluent management. They must also focus on workplace practices, occupational health and safety. A scan of the Sasol sustainability report provides evidence of just how much the company does to ameliorate its negative impacts. But failure in just one sphere of sustainability, namely a breach of ethics in the form of anti-competitive behaviour, can do considerable damage.

Retailer Woolworths concentrates its efforts on the 'Good Business Journey'. This entails reducing the environmental and social impact of the products it sells through careful product sourcing and more efficient packaging; and it requires co-dependent relationships with Woolworths' extensive supply chain. By influencing the environmental practices of its suppliers – be that to encourage organic cotton growing or drip irrigation for growers – Woolworths is able to walk the talk of its Good Business Journey. This gives the business strategic differentiation for an increasingly discerning consumer market segment.

Financial services companies tend to focus on transformation and skills development and on social development through CSI and enterprise development. But they also face a range of specific issues that are outlined in our article on pages 12-13.

Making business sense

One of the shortcomings of the sustainability agenda, to date, has been its focus on 'corporate responsibility', which implies that sustainability actions are 'the right thing to do'. And many standards and guidelines have suggested a checklist of sustainability-related actions that companies should take. But the result is that many companies regard sustainability issues as peripheral to business as usual, as an unnecessary

The spectrum of sustainability issues

Responsible, sustainable business


Make operations environmentally sustainable	Make operations socially sustainable	Sell products responsibly	Make society sustainable	Influence suppliers
<ul style="list-style-type: none"> • Energy consumption • Emissions and climate change • Water consumption and stewardship • Waste and effluent management • Environmental stewardship and rehabilitation 	<ul style="list-style-type: none"> • BEE ownership and management • Employment equity and skills development • Occupational health and safety • Workplace conditions and practices 	<ul style="list-style-type: none"> • Responsible marketing and advertising • Competitive product pricing • Universal access to products and services • Responsible packaging • Downstream impact of products and services 	<ul style="list-style-type: none"> • Enterprise development • Corporate social investment • Social impact of operations 	<ul style="list-style-type: none"> • Preferential procurement • Sustainability practices in supply chains • Product sourcing and traceability

burden, and as an additional cost of doing business.

On the contrary, you should only embrace sustainability actions based on their potential to improve shareholder value and the long-term profitability of your business. The private sector is, after all, not in the business of ‘doing the right thing’. Businesses are unashamedly self-interested profit-seeking entities, and their every action is driven by the profit motive. There is no fat in the system for feel-good tree-hugging or social sops.

Whatever your chosen sustainability focus areas, the emphasis must be on demonstrating how your company can be more competitive by being sustainability-driven; where and how you can avoid risks, control costs, take opportunities, and be pioneering across the spectrum of relevant sustainability challenges. Ultimately, each sustainability action you take should be able to demonstrate one or more of the following:

- Improve pricing power – through product differentiation and better brand reputation,
- Reduce costs – by securing operating efficiencies and resource efficiencies, using new technologies or by reducing taxes,
- Increase productivity – through better production methods and improved staff satisfaction and retention,
- Grow current market share – by attracting new customers, increasing customer loyalty and/or lowering customer churn,
- Increase revenues – by differentiating products, innovating new ‘green’ products or building brand reputation,
- Lower business risk – by facilitating those important relationships and meeting ‘licence to operate’ conditions that enable one to continue business in a stable and conducive environment,
- Reduce corporate risk premiums – by lowering business, market or supply chain risk, reducing cost of capital or improving access to finance.

Interestingly, you will probably find that most of the sustainability actions you contemplate can be justified on one of these grounds. But if a sustainability action can’t be shown to achieve one or more of these profitability drivers, it doesn’t belong in your business! 

fast **FACT**

Sustainability-related codes and standards

Aspirational principles & compacts	<ul style="list-style-type: none"> • Universal Declaration of Human Rights • UN Global Compact • CERES Principles • Rio Declaration on Environment & Development • Agenda 21 • Millennium Development Goals • Johannesburg Plan of Implementation • New Partnership for Africa’s Development (NEPAD)
Multi-national codes of conduct	<ul style="list-style-type: none"> • OECD Guidelines for Multinationals • International Labour Organisation standards • Caux Round Table Principles for Business • Global Sullivan Principles for Business • Kyoto Protocol
Management guidelines	<ul style="list-style-type: none"> • AA1000 Series • Sigma Guidelines • ISO 9000 • ISO 14001 • ISO 26000 • OHSAS 18000 • NOSA grading • UNEP FI • King III Report on Governance • dti Codes of Good Practice • Industry Transformation Charters
Reporting & assurance standards	<ul style="list-style-type: none"> • Global Reporting Initiative (GRI) • AA1000 Assurance Standard • SA8000
Fair trade initiatives	<ul style="list-style-type: none"> • Ethical Trading Initiative • Fairtrade Labelling Organisation • Agricultural Ethical Trade Initiative of South Africa
Investment screening	<ul style="list-style-type: none"> • Equator Principles • UN Principles for Responsible Investment • World Bank Group’s EHS Guidelines • Carbon Disclosure Project • Dow Jones Sustainability Indexes • FTSE4Good Index • JSE Socially Responsible Investment Index • Socially responsible investment funds

Sustainability On a roll

In this quarterly review, we examine some recent events, actions and highlights that are helping to shape sustainable business practice.



Copenhagen frustrates

At the global climate change negotiations in Copenhagen in December 2009, no legally-enforceable agreement was reached on greenhouse gas emissions reduction targets. Instead, the conference ended with a non-binding political Accord signed by 28 countries, including South Africa, but this did not commit any nation to greenhouse gas emission cuts after 2012. However, the negotiating schedule has been intensified in the run-up to the next global UN Climate Change Conference, to be held in Mexico in December 2010.

It is still likely that a legally-binding global agreement could be reached in the coming years, with profound implications for corporate South Africa. Government is likely to introduce a range of legislative, policy and fiscal measures, impose possible emissions reduction targets, and prescribe other onerous conditions, costs and incentives for business.

Government turns up the heat

Government pledged, at Copenhagen, to cut South Africa's carbon emissions to 34% below its business-as-usual emissions trajectory by 2020 and 42% by 2025. It isn't clear how government envisages meeting these goals, although the pledge assumes 100MW of concentrated solar power; 200MW of wind power; introduction of independent power producers; roll-out of solar water heaters; and energy efficiency savings of 35% by 2015. Business will have to play its part in the reductions, which government will enforce through a number of expected measures.

During the first quarter of 2010, government announced that it will issue a Green Paper on Climate Change in April/May 2010, which should provide more clarity about what the targeted reductions might mean for corporate South Africa. Current speculation is that it could include measures such as:

- Mandatory carbon inventory calculations for companies (probably

for those with an electricity bill greater than a specified size).

- A tax on carbon emissions effective from 2012 (National Treasury plans to release a Carbon Tax Discussion Document by mid-2010).
- Mandatory carbon emission cuts on commercial buildings by 2015.

In its February 2010 Budget proposals, government announced a sliding-scale CO₂ tax on vehicles based on their certified carbon emissions, effective from September 2010. According to Treasury, the aim is to "influence the composition of South Africa's vehicle fleet to become more energy efficient and environmentally friendly".

The dti released the second version of its Industrial Policy Action Plan (Ipap2), which aims to promote green and energy-efficient industries, goods and services. Key 'green' priority areas covered in Ipap2 include solar water heating, concentrating solar thermal power, industrial energy and water efficiency, energy efficient vehicles, and industries that support the development of these areas.

fast FACT

Companies leading the way

The JSE's Socially Responsible Investment (SRI) Index analyses the environmental, social and economic sustainability practices and corporate governance of listed companies. The results for 2009 were as follows:

- 67 of 109 companies reviewed became Index constituents,
- The Index comprised 34 Top-40 companies, 30 mid-caps, and three small-cap companies,
- 11 companies made it onto the Index for the first time,
- 30 companies were identified as best performers.

Government also announced that its Economic Sectors and Employment cluster intends finalising a 'Green Economy Plan' for presentation to Cabinet by July 2010. It expects 'green' jobs to grow in the transport, energy, building, manufacturing, agriculture and forestry sectors – particularly for products and services relating to wind turbines, insulation materials, recycling, photovoltaic cells, batteries and green building materials.

King III promotes the agenda

On 1 March 2010, the King Report on Governance for South Africa - 2009 (King III) superseded the 2002 version (King II). The concept of sustainability threads through almost every section of King III, with specific principles relating to responsible corporate citizenship, ethics, sustainability leadership and integration, stakeholder engagement, and integrated reporting and assurance. Read more about the implications of King III in our Special Feature on pages 7-9.

The GEPP steps boldly in

The SA Government Employees' Pension Fund (GEPP) – the custodian of about R850 billion in government workers' pension assets – first gave notice of its intention to begin factoring environmental, social and governance (ESG) issues into its investment decisions when it signed the UN Principles for Responsible Investment (UNPRI) four years ago. In March 2010, it stated its intentions even more unequivocally, releasing a policy on responsible investment that gives the GEPP an official mandate to integrate ESG issues into its investment decisions.

Although the UNPRI and the GEPP policy are 'aspirational', the GEPP's move is highly significant for corporates. It means the GEPP is likely to engage senior management of investee companies found not complying with certain material ESG issues. Where they fail to comply, the GEPP is likely to modify its portfolios to give greater weight to other companies that do have responsible ESG practices.

The move is also likely to influence investment policy in the broader asset management industry, since private sector asset managers are always looking for a slice of GEPP business. A number of local investment houses had already signed up to the UNPRI in recent years –


as at March 2010, two South African asset owners and 18 local investment managers were UNPRI signatories. The GEPP's latest move is likely to consolidate the trend and to encourage investment houses to pay more than lip service to responsible investment.

Corporate actions making headlines

Some of the sustainability-related corporate actions that attracted attention in recent months included the following:

- Standard Bank is setting up the Africa Carbon Asset Development (ACAD) facility in partnership with the United Nations Environment Programme (UNEP). The aim of the unit is to stimulate growth in Africa's carbon market through investor outreach and seed capital.
- Absa was the latest financial institution to sign the Equator Principles, which bind signatories to minimise the social and environmental impact of their project-lending decisions for projects valued at more than \$10 million. Nedbank, FirstRand, Standard Bank and Absa have all become signatories.
- Mining giant Exxaro announced progress on its feasibility study to erect a 100MW wind farm at its Namakwa Sands operation on South Africa's west coast. This follows its involvement in the 40MW Tsitsikamma Community Wind Farm, currently in feasibility phase. Exxaro previously indicated that it plans to generate 5,000MW of renewable energy in the next eight years.
- Short-term insurer Santam confirmed during March 2010 that its residential clients would be able to replace burst electrical geysers with solar water heaters during the claims process, through a partnership with Eskom.
- Santam also indicated that the risk profile of parts of South Africa could change based on the projected effects of climate change, and that it might have to consider re-rating the risks associated with insuring property and business owners in certain areas (particularly regions vulnerable to flooding and sea-level rise).
- Retailer Shoprite announced that it is testing a nitrogen-powered transport refrigeration system, ecoFridge, before rolling it out to its fleet of

fresh-produce vehicles. Relative to conventional diesel-driven systems, these units do not release any carbon, HFCs or HCFCs, thereby substantially reducing the emissions footprint of each vehicle.

- Price fixing remained in the news. In January the Competition Tribunal slapped a R195.7 million fine on Pioneer Foods for participating in a bread-baking price-fixing cartel. The Competition Tribunal announced in March that Pioneer, along with Tiger Brands, Foodcorp and Premier Foods, would come before the Tribunal again for a ruling on alleged price fixing in their flour milling divisions. In January, the Competition Commission announced that it is investigating alleged collusion on prices and pricing strategies between local airlines BA/Comair, SAA, Ittime, SA Airlink, Mango and SA Express. 

fast FACT

Declaring their carbon footprints

Through the annual Carbon Disclosure Project (CDP), global investors with assets of \$55 trillion ask companies to measure and report their carbon emissions. Of the 99 companies that were asked to participate in the 2009 South African CDP, 67 answered the questionnaire, 15 declined to participate, and 16 did not respond at all. This 68% response rate (59% in 2008) was the fifth highest internationally. The analysis found that:

- Electricity use dominates most local companies' carbon emissions,
- There is growing awareness of climate change risks and opportunities,
- A growing number of companies have GHG emissions and/or energy reduction targets,
- Local companies focus on mitigation strategies but pay insufficient attention to adaptation,
- Companies target energy efficiency measures, but investment in renewables remains limited,
- Climate change issues are increasingly being integrated into company governance.

Act today. Change tomorrow.

Pick n Pay has, since its inception over 40 years ago, placed great priority on environmental issues and sustainable practices and has continually sought ways to promote awareness and opportunities for positive action.

With a five-year sustainability vision launched in 2007, Pick n Pay's approach to sustainability is focused around four priority areas – economic sustainability, transformation, social development and environmental responsibility.

Having been nominated in 2009 as the company that most actively promotes sustainable living, we will continue to ensure that our performance continues to meet and exceed the expectations of all our stakeholders.

The ability to offer products and services that meet sustainability and ethical criteria is becoming a differentiator in the mass retail market. In the early 90s Pick n Pay led the way with a range of 'green products', and we continue to raise the bar with an expanded, enhanced portfolio of green and ethical products.

Our PnP Green Range of household, kitchen, bathroom and personal care products is 100% recyclable and contains natural biodegradable ingredients. In addition to this, a percentage of the profit from our Green Range supports the Indalo Yethu Environmental Campaign.

Limited edition eco-friendly designer bags, created by Fair Trade supplier, Township, were launched last year and these, as well as our regular Green Bags, give customers an increasing range of alternatives to plastic bags.

In addition to continuing public awareness of recycling, it is our pledge to manage our own waste and reduce packaging, while still maintaining product integrity, safety and quality. Our national biodiesel rollout is underway and will see the conversion of used cooking oil in our stores to biodiesel for re-use in our delivery trucks.

Recycling is made easy with our new in-store recycling bins, in which used batteries, CFLs, ink cartridges and plastic can be deposited. Consumers can dispose of waste on entering the store and place any unwanted packaging in the bins on their way out.

Further examples of how Pick n Pay is taking practical steps towards change, is the replacement of outdated ozone-damaging refrigeration with energy-efficient refrigeration technology; as well as the

implementation of sustainability initiatives at our Pick n Pay Express Stores. Easy-to-use recycling drop-offs are located on the forecourts; and only environmentally friendly paint is used in the stores. The bathrooms are fitted with water-saving devices, as well as green toilet paper and hand towels, and even the lighting design is based on reflective technology to maximise output without increasing energy use.

There is a strong drive within the organisation to establish a more strategic enterprise development initiative. We believe enterprise development must seek to quantify social and environmental value created across the supply chain, and that this approach should ultimately inform the broader business model for Pick n Pay.

Our efforts in recent years have focused on assisting small-scale entrepreneurs to become sustainable suppliers to the retail industry, and have sought primarily to address the inequalities of the past by focusing on BBBEE. This hub of entrepreneurship is now increasingly becoming a pipeline of new and enterprising products reaching our shelves, and a lever to drive our product innovation.

Our achievements to date show us we are no longer laying foundations – we are actively promoting and integrating sustainable business practices at the core of our activities, while focusing on innovation and fresh thinking to continue building a resilient business with heart.



Pick n Pay
Inspired by you



All hail the King^(III)

On 1 March 2010, corporate directors and managers across South Africa could be forgiven if they felt a NOOSE TIGHTENING around their necks with the launch of the King III Report.

Until now, the King Report on Governance for South Africa - 2009 (King III) has been much discussed, but having now come into effect the day-to-day impacts on business have moved from theory to practice. The transition from King II represents a step change, rather than a sea change, but the greater emphasis King III places on a number of corporate governance functions adds a new layer of complexity to directing and managing corporate operations.

Particularly significant is King III's emphasis on sustainability, which threads through almost every section of the report and promises to have a major impact on any entity that needs to apply its principles. Indeed, it is safe to say that few in the corporate world yet appreciate how fundamental the impact will be on running a business.

More than glossy reporting

Since King II in 2002, many larger South African companies have gone through the motions of producing sustainability reports – but in more than a few instances it has been a cynical game with millions spent on reports that are not much more than glossy marketing brochures dressed up in hemp. While reporting standards have generally improved, only a few managers, or the exceptionally thick-skinned, can accurately claim that sustainability is truly integrated into their business.

The King committee wants to change this. By advocating integrated reporting, King III aims to force sustainability and financial reporting onto the same footing. So, instead of sustainability being an afterthought to tick on a corporate governance checklist, integrated reports will need to show how sustainability issues permeate the business, their implications for the business, and how the business is responding. It will be much harder to roll out the PR offensive when nothing substantive has changed in the organisation. The tail wags the dog and business changes.

Sustainability is the bottom line

Sustainability sceptics may say that financial sustainability and shareholder returns are all that matter. The error they make lies in their assumption that sustainability is only a cost to the business and cannot contribute to profitability. On the contrary, the sustainability agenda is all about continued company profitability in the long run.

To this end King III aims to move the focus away from the short-term mindset inherent in what currently gets reported to the investment community twice a year. Instead, it advocates a number of governance procedures, strategies and reporting requirements that focus on the longer term and are, therefore, likely to generate long-term prosperity for the organisation.

SPECIAL FEATURE

“The board should appreciate that strategy, risk, performance and sustainability are inseparable.”

Principle 2.2, King III Report

King III also emphasises the fundamental premise of the sustainability movement, namely that organisations don't operate in a vacuum. Rather, they shape, and are shaped by, the communities and environment in which they function. Consequently, long-term corporate strategy must take input from a broader range of stakeholders, and must consider a number of important issues in the social and environmental realms.

If this is obvious – and it seems like it should be – then it makes no sense, for example, for construction companies to

trumpet their profits and project pipelines on the front page of their annual reports while squirrelling away worker injury and fatality statistics in a dense table 30 pages further into the report. Likewise, mines should consider showing their worker safety stats alongside figures relating to their ounces of production – thereby showing at what human cost their production was achieved. Those who still imagine that the two are not related are in for a rude shock – worker strikes and DME-enforced mine closures for unsafe working conditions definitely have a measurable financial effect. Suddenly, shareholders become interested in the social angle.

In the same way, industrial companies that ignore the effects that their waste or safety policies have on the environment need to read the old Union Carbide case studies. Quite apart from compliance with tightening environmental laws, there is a human impact that has long-lasting reputational, and also financial, effects.

In a world of more immediate information, many consumers are also becoming more focused on making green purchase choices and avoiding goods that harm the environment. Companies that tap into this trend are seeing a measurable impact on their top line.

If King III can make businesses think more deeply on these links and take a longer-term view, it makes sense to engage workers, legislators, communities, customers and other relevant stakeholders, and to ensure that their legitimate interests and expectations are taken into account when formulating business strategies.

Embedding sustainability

Once the board sees sustainability issues as real and relevant risks to the company, then strategy, risk, sustainability, stakeholder relations and long-term performance become inseparable and the company takes its place as a good corporate citizen. Once sustainability becomes integrated into business risk management, it permeates into internal control processes, IT strategy, and internal and external communications. And as profit targets and incentives become linked to specific sustainability targets, so management will feel the pressure to respond.

Organisations are going to be challenged to improve their skills and understanding around sustainability

fast FACT

Some important King III principles that relate to sustainability

Principle	
1.1	The board should provide effective leadership based on an ethical foundation
1.2	The board should ensure that the company is and is seen to be a responsible corporate citizen
1.3	The board should ensure that the company's ethics are managed effectively
2.2	The board should appreciate that strategy, risk, performance and sustainability are inseparable
3.4	The audit committee should oversee integrated reporting
3.5	The audit committee should ensure that a combined assurance model is applied to provide a co-ordinated approach to all assurance activities
5.2	Information Technology should be aligned with the performance and sustainability objectives of the company
8.1	The board should appreciate that stakeholders' perceptions affect a company's reputation
8.2	The board should delegate to management to proactively deal with stakeholder relationships
8.3	The board should strive to achieve the appropriate balance between its various stakeholder groupings, in the best interests of the company
8.5	Transparent and effective communication with stakeholders is essential for building and maintaining their trust and confidence
9.1	The board should ensure the integrity of the company's integrated report
9.2	Sustainability reporting and disclosure should be integrated with the company's financial reporting
9.3	Sustainability reporting and disclosure should be independently assured


at all levels. Directors will need the knowledge and skills to oversee the integration of a number of disparate facets of sustainability within the organisation. Those managers responsible for formulating strategy, managing risk, implementing appropriate actions and monitoring performance will require relevant information and training. Staff training will also be required in order to equip everyone in the organisation to understand the reasons for, and consequences of, embedded sustainability.

Audit departments beef up

As any internal auditor worth their salt will tell you, everything changed when King III became effective in March this year. King III puts the burden for overseeing sustainability squarely onto the audit committee and, by extension, on the internal audit department. This means that managers across organisations can expect increased scrutiny from

internal audit, which will now need to assess and report to management on organisational risk and internal sustainability controls. Internal audit will also need to satisfy itself as to the veracity and accuracy of the integrated annual report, including all sustainability-related information.

Sustainable business is good business, from every angle, and the changes required by King III are intended to clarify an organisation's vision for a long-term future. Indeed, King III requires that the concept of sustainability be embedded into corporate strategy, ethics, risk management, IT strategy, internal controls and communication.

Infusing sustainability into an organisation in this way ensures its continuing prosperity within prospering communities and a healthy environment. Perhaps the tightening sensation need not be a noose around the corporate neck after all but, rather, a set of reins to guide business in the right direction. 

“Current incremental changes towards sustainability are not sufficient – we need a fundamental shift in the way companies and directors act and organise themselves.”

King III Report

The greatest mark we can make is no mark at all.

Nedbank is the first large South African corporate to be going carbon neutral.

We aim to achieve net zero carbon emissions by reducing the size of our carbon footprint through changing the behaviour of our staff and the way we do business. We will offset the balance of the carbon emissions by buying carbon credits and funding climate change projects.

Not only does this enhance our strong environmental credentials and leadership in the industry, but we hope it will also encourage our clients, partners and peers to follow suit.

Some of our 2009 achievements.



- Saved enough electricity to provide power to more than 300 South African houses for a year.



- Saved enough water to sustain the almost 500 elephants of Addo Elephant Park for two years.



- Saved enough paper to cover more than 200 football pitches.



- Reduced air travel emissions equivalent to 9 000 economy flights between Johannesburg and Cape Town.
- Reduced car travel equivalent to driving 112 times around the world.

Of course, we've always been committed to the environment, as evidenced by our green credentials:

- Voted the company that does the most for the environment in the Ask Afrika Trust Barometer® Awards 2009.
- 20-year partnership with WWF-SA through the Nedbank Green Affinity Programme and The Green Trust.
- Formal pledge to reduce our impact on the environment in terms of energy, water, paper usage and carbon emissions.

We may be South Africa's only green bank, but green is not just a colour.

For more information visit www.nedbankgreen.co.za.



MAKE THINGS HAPPEN

NEDBANK

A Member of the  OLD MUTUAL Group

How well did companies shape up?



Dialogue, in partnership with Media Tenor, has developed the innovative Sustainability Coverage Monitor to assess CORPORATE REPUTATION based on sustainability reportage in the media.

Media has the ability to build or to destroy corporate reputations. Here is a channel that is quick, far-reaching and more objective than communication from a corporate origin. For instance, where companies have been exposed for transgressing laws, price collusion or pollution, the damage to their reputation and market base can take months or even years to repair. Tiger Brands and Pioneer Foods, for example, know all about reputational damage in the media following their price collusion, which eventually drove some management to resign. And no amount of corporate spin changes the way the public perceives Transnet or South African Airways, unless they get the 'thumbs up' from the media.

electronic media is a vital lens through which to assess corporate behaviour and its effects on corporate reputation. Together with our media analysis partners, Media Tenor, Dialogue sets out to do so by analysing the extent to which companies have received positive and negative media coverage on sustainability issues. The results are captured in our Sustainability Coverage Monitor (SCM), which analyses the coverage and tone of corporate sustainability reportage. The SCM considers the volume of coverage, the range of sustainability issues reported and the spread of media, as well as whether coverage was positive, negative or neutral.

On the other hand, positive media exposure on sustainability issues can give companies a competitive edge in a marketplace that is increasingly sensitive to environmental and social issues. And often, media coverage about the way companies proactively rectify previous concerns goes a long way towards restoring reputation.

Top-5 coverage in Q1 2010

The table below lists the top-5 companies on the SCM, based on their coverage in the media over the period December 2009 to February 2010. This is traditionally the quietest media period and the SCM scores were, at times, influenced by favourable and widely reported coverage of just one or two issues. This top-5 rating therefore provides a sense of who, over the period, was well regarded in the media and why, but would not necessarily have a lasting impact on corporate reputation.

Reputation through the media lens

In this context, analysing the coverage and tone of corporate sustainability-related reportage in the print and

fast FACT

In order to analyse the media, we partner with The Media Tenor Institute of Media Analysis (Media Tenor), which scrutinises the news, opinion and business sections of leading South African print, broadcast and online media to provide a range of media intelligence to the corporate sector. The quarterly and cumulative calendar year results of our Sustainability Coverage Monitor (SCM) will be published in this Review each quarter. The data used for our SCM is based on Media Tenor's comprehensive day-by-day analysis of all relevant company-related articles appearing in 30 broad-based national daily and weekly newspapers and TV news broadcasts. For more information on the methodology and categorisation of this index, please visit www.mediatenor.co.za or www.trialogue.co.za.

Top-5 (Q1 2010)	Main issues driving positive reputation
1. Barclays	Top executives forgo a cash bonus for 2009
2. Standard Bank	Commitment to BEE codes; stated intention to keep South Africans in homes without fear of legal action or repossession
3. Old Mutual	Announced that it will sell its life unit and list its funds operation in the United States as part of a strategic overhaul and an attempt to reduce the complexity of its business
4. DRD Gold	Zimbabwe seriously considered for its growth prospects, despite political uncertainty
5. Air France	Air France launched the new A380, the most environmentally-friendly aircraft to date, which is capable of increasing capacity with no need for increased airport infrastructure

Top-10 coverage in 2009

Tracking results over an entire year is a more robust indicator of which companies have performed well in the media and why. The table below lists the top-10 over the period January to December 2009. SAB Miller, Woolworths and Standard Bank claimed the top three spots. What do these companies have in common? Despite various sector challenges resulting from the global economic crisis, they have managed to maintain good sustainability profiles in the media by actively seeking new growth opportunities and redefining their business strategies – and by talking about it. SAB Miller, for example, although experiencing its worst six-month trading period in a decade during 2009, sought new opportunities in emerging markets and invested heavily in Africa. The brewer's strategy on the continent also took into account the relative poverty of the population through the introduction of local crops, such as sorghum and cassava and, by so doing, reducing input costs and lowering prices. Similarly, Woolworths battled declining consumer figures by implementing a new retail strategy that included the reintroduction of Woolworths "basic" wares that have traditionally formed the cornerstone of the brand.

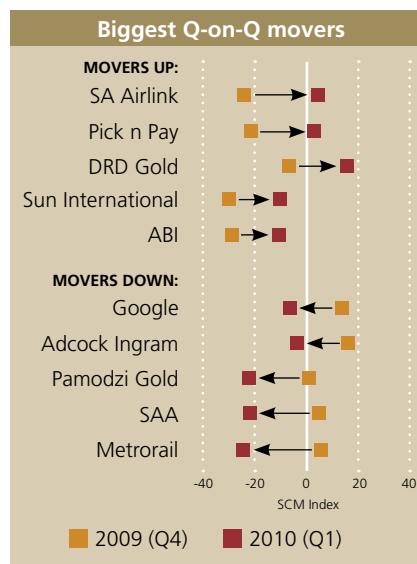
Top-10 (2009)	
1	SAB Miller
2	Woolworths
3	Standard Bank
4	MTN
5	Absa
6	Deloitte
7	First National Bank
8	Netcare
9	KPMG
10	ACSA

Regulation, particularly compliance with legislation, and the ramifications of the economic crisis emerged as the most critical sustainability issue facing the financial services industry. Banks such as Standard Bank, Absa and First National Bank adopted the strategy of driving 'softer' issues such as BEE/transformation and community relations while maintaining a core focus on expansion and business diversification. First National Bank, in particular, profiled its African operations, including the opening of more branches in Zambia.

Another highly visible issue for the same period was customer relations, including customer complaints, general levels of customer service and high-profile court cases with clients, such as Absa's legal battle with businessman Rico Bernert. Considering that the economic crisis proved the fallibility of financial institutions, non-fiscal sustainability-related issues will remain critical to help restore trust in the sector.

Biggest Q-on-Q movers

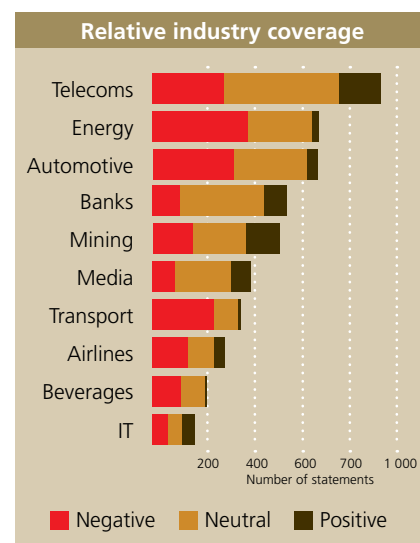
The SCM also provides early indication of reputational shifts by tracking quarter-on-quarter changes in media coverage. The five biggest 'movers up' and 'movers down' on the SCM from Q4 2009 to Q1 2010 are shown in the graph below. Currently the list of top 'movers' includes those companies that have recovered from media crises, such as SA Airlink and ABI, while various transport and airline companies, such as SAA and Metrorail, continued to face increased scrutiny in the build-up to the World Cup 2010 and competition authority-related issues.



Industry coverage in Q1 2010

The graph alongside shows the relative coverage across a number of industry sectors for the first quarter of 2010. Telecoms industry reportage was shaped by coverage on Vodacom and issues of corporate governance. The energy sector, and Eskom in particular, saw coverage on how renewable energy forms part of the utility's broader business model, a discourse triggered by the application for World Bank funding for the Medupi coal-fired power generation plant.

The automotive sector received a lot of attention relating to product quality and safety, on the back of Toyota and Honda's recall of vehicles. Various mining companies, such as Anglo American and AngloGold Ashanti, were in the news at the beginning of 2010 regarding the impact of higher energy tariffs on financial results, as well as potential partnerships between the mining industry and Eskom.



Early analysis of 2010 indicates an increase in the visibility of the majority of sustainability issues in the first quarter, compared to Q1 2009. It is predicted that key corporate challenges for 2010 will continue to centre on topical issues, such as transformation and 'carbon neutrality', which form part of the broader social and political discourse. In fact, there is likely to be a general increase in coverage on corporate environmental performance, which has, until now, remained low on the corporate sustainability agenda, despite the increase in global awareness of climate change.

The media focus will also remain on compliance, or rather the lack thereof. Affected companies need to find ways to respond appropriately, because remaining quiet in the face of controversy often makes the company more vulnerable to critical reportage.

On the other hand, in the face of growing consumer consciousness about societal issues, coverage of positive corporate performance in the media represents a good opportunity to enhance corporate reputation. ●



The Consumer Credit Act has helped contain rampant debt escalation, but a longer-term response is required in the form of improved financial literacy. Financial institutions, through the now uncertain Financial Sector Charter (FSC), are required to spend 0.2% of net profit after tax on financial literacy programmes. Some worthwhile progress has been made. The 'big four' banks all report that they have consumer education programmes in place, which generally incorporate classroom-type and awareness-based financial literacy initiatives. In its sustainability report for 2008, Absa reported that it decided to meet and exceed the FSC target by 10%, spending R20.6 million on consumer education. Standard Bank spent R19 million in the same year.

One hopes that with or without the FSC, institutions will continue to invest in financial literacy. After all, the benefits extend beyond making borrowers more self-empowered – through financial education, institutions can secure many new customers for tomorrow.

Broadening access

Without access to financial services, it is near impossible to invest in one's own future. This is the lot of the 'bottom half of the pyramid' where numbers are high and affordability low. It is not a space for quick and lucrative pickings for the financial sector and is an area of perceived high risk, yet there are examples of good and profitable business to be found here.

In Bangladesh, the Grameen Bank flouted conventional banking practice by removing the need for lending collateral. The local financial sector is also making some progress. In 2004, in a rare case of industry collaboration, the banking industry launched Mzansi as an entry-level bank account targeted at the bottom end of the market. By December 2008, more than six million Mzansi accounts had been opened. Today, at least one in ten South African adults has an Mzansi account; and one in six banked people are active Mzansi customers. The percentage of adults (age 16+) banked in South Africa has increased from 46% in 2004 to 63% in 2008.

Another example is BankSeta's flagship Letsema project, which was launched in March 2004 to train 5,000 unemployed learners within the Banking and Micro Finance Sector. Letsema

Risk management is the protective armour that banks use to prevent financial fall-out, but there is MORE TO SUSTAINABILITY in the financial sector than protecting against a flawed risk model.

When the words 'sustainability' and 'financial services' are used in conjunction, the first thing that comes to mind is the recent financial crisis and the inadequate risk controls that brought it on. Clearly, companies in the financial sector need to be uncompromising when it comes to risk management. Breakdowns in good governance of risk are all too frequent, with local examples such as Fidentia, Regal Bank and Saambou still top of mind.

But financial services are the backbone of the economy and the way products and services are packaged and sold touches everybody's lives. What is more, the sector has a massive direct economic footprint through the millions of people it employs, the supply chains it supports, the taxes it contributes, and the dividends it pays. An interdependent relationship therefore exists between financial institutions and their stakeholders.

To stay in business, their actions must encompass much more than responsible

risk management. There are a number of issues that, depending on how they are managed, either advance or retard the relationship between institution and stakeholders. A few stand out in terms of their impact and reach.

Promoting financial literacy

Selling products on hire purchase or layby to people who cannot afford them is not responsible nor sustainable. It might offer short-term returns when interest income exceeds debt impairment rates, but when interest rates and unaffordability rise, defaulting takes on a new dimension. Prior to the Consumer Credit Act, lenders were going the extra distance to grow their lending book – making hay before legislative restrictions came into effect. Then came the financial fallout and credit crunch that caused the house of cards to come tumbling down. In the end, a bad situation made worse by unsolicited lending, misleading terms, high interest rates and aggressive collection techniques.

is aimed at unemployed post-matric learners who are placed nationally with banks as well as micro-finance organisations.

Investing responsibly

As custodians of the country's wealth, insurance companies, banks and investment houses have the responsibility to ensure that those assets are invested profitably on behalf of their policyholders, clients and investors.

Arguably, they are also obliged to ensure that those assets are invested responsibly based on environmental, social and governance (ESG) considerations. This is certainly the view of over 720 asset owners and investment managers worldwide who have signed up to the UN Principles for Responsible Investment (UNPRI). Signatories recognise that applying the UNPRI will better align investors with broader societal objectives and believe that ESG issues can affect the performance of investment portfolios.

The principles to which signatories commit include, among others, that they will incorporate ESG issues into their investment analysis and decision-making processes, will seek appropriate ESG disclosure from investee companies, and will be active owners that incorporate ESG into their asset ownership policies and practices.

Although the list of signatories includes a number of South African financial institutions, it is not clear to what extent some of them have embraced the principles to which they've signed up. One local institution that is taking the issue seriously is the Public Investment Corporation (PIC), whose primary client is the Government Employees' Pension Fund (GEPF). The PIC, in partnership with University of Stellenbosch Business School, recently launched a corporate governance rating system that assesses company performance across a matrix of environmental, social and governance (ESG) issues. The rating system is based on publically available information and will therefore encourage more transparent and comprehensive reporting. It is not intended as a screening tool for investment decision making but rather a mechanism to support engagement with companies around ESG performance. With funds under management in the region of R800 billion, this new spotlight

on ESG performance is sure to influence investment policy in the broader investment industry.

The JSE also highlights companies that it considers socially and environmentally responsible by listing them annually on its Socially Responsible Investment (SRI) Index, based on annual scrutiny of their ESG practices. Currently 67 listed companies meet the standards required for inclusion on the JSE SRI Index.

Investment funds with a socially responsible investment mandate restrict their investment universe by applying positive or negative investment screening criteria. For instance, an SRI fund might 'screen out' certain 'sin' industries or, as a positive screen, might require companies to show evidence of sustainable business practice. However, investors with a short-term focus on quarterly performance are less likely to be lured by a long-term 'sustainable business' investment proposition, where returns may be more lasting, but years away.

Financial institutions that provide project financing are also encouraged to be more responsible about their lending. The Equator Principles are a voluntary code that binds signatories to minimise the social and environmental impact of their financing decisions for projects valued at more than \$10 million. In so doing, the Principles leverage the influence of financial institutions by preventing fund flow to large projects that might be environmentally or socially irresponsible. The business rationale is that contentious projects may run into difficulties, making loans provided for these projects difficult to recover. And no bank wants the reputational damage associated with an irresponsible project. About 67 financial institutions from twenty-seven countries have adopted the Equator Principles, including Absa, FirstRand, Standard Bank and Nedbank.

Protecting the environment

Financial institutions' direct environmental impact is expressed most prominently through their 'carbon footprint'. This is not necessarily trivial. The built environment is responsible for an estimated 52% of greenhouse gas emissions, to which must be added business travel and accommodation, third party transport, staff commuting and paper use. One can also extend the carbon footprint calculation to other

assets held, particularly investment properties owned by life insurers. Financial institutions also have other direct environmental impacts, particularly through water consumption and waste management (including electronic waste).

But the sector needs to look at opportunities beyond direct footprint to the influence it can have on markets and suppliers. One relates to the Clean Development Mechanism (CDM) and carbon trading, through which funds are made available for 'green' projects in developing markets. Internationally this is a R730 billion business – with 2,119 CDM projects registered to generate more than 1,750,000,000 certified emission reduction (CER) credits by the end of 2012. In Africa, the opportunity seems to have passed us by, with only 41 projects registered and accounting for just 2% of all registered CDM projects.

This article has concentrated on four sustainability issues specific to financial institutions. Of course, the financial sector also needs to address other impacts, such as BEE transformation, staff training and skills development, enterprise development and corporate social investment. All are important issues and the way they are addressed will affect the sustained future of the business and its relationships with stakeholders. Those financial companies that are able to understand how these issues and relationships drive their business forward strategically will be the ones with which stakeholders prefer working, doing business and investing for the long haul. ○

Our NEXT issue

The next edition will be published in July 2010. Look out for our special feature on sustainability reporting and our review of the Mining sector. We will also review sustainability-related legislation, events and corporate movers over the quarter, and revisit corporate sustainability reputations based on their coverage in the media.

To highlight your brand in this high-profile supplement, please contact Karen Petersen at *Dialogue* on 021 762 1166, or email karen@dialogue.co.za.

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January 2000 to January 2009

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