

# Finance factsheets for sustainability professionals

October 2018



In collaboration with





# Communicating on Finance to Sustainability Professionals

## Why

Estimates show that an additional USD \$2-3 trillion of annual investment is needed to achieve the Sustainable Development Goals (SDGs). The **financial sector** will play a key role. Through their investment decisions, financial actors can have important environmental, social and governance (ESG) impacts at a global level. The right decisions are likely to create positive ripples throughout the global economy.

## What

Despite this, sustainability and finance have not been adequately integrated – in part because many **sustainability professionals feel that they lack basic financial knowledge to connect with finance teams**. Sustainability and finance departments do not always communicate efficiently.

## How

To bridge this gap, WBCSD and Saïd Business School at the University of Oxford have developed these **short and accessible finance factsheets**. Their aim is to provide **important definitions and simple explanations** for mainstream finance concepts in a way that professionals with no financial background can understand. There is also a short section covering some of the links and potential disconnects between finance and sustainability concepts.

# How to use these Factsheets

These Finance Factsheets have been developed in a way that are **easily readable and printable**.

They are divided into three parts of increasing complexity:

**1. Finance fundamentals, 2. Insightful finance and 3. Advanced finance. Part 4** then highlights **links with sustainability**.

At the end, a **glossary** provides an overview of definitions.



Part 1

Finance Fundamentals



Part 2

Insightful Finance



Part 3

Advanced Finance



Part 4

Links with Sustainability

The concepts covered in these Factsheets constitute **key financial and accounting terms** and do not represent an exhaustive list. The Factsheets are structured as follows:



The following icons are also used:



Terms in bold and highlighted indicate that a separate Factsheet exists for that term.



This icon can be found on each Factsheet and provides a link to Investopedia with further explanation on the term. For a quick and simple representation of the meaning of the term, we suggest referring to these helpful infographics.



These call-out bubbles provide additional and useful information on the term.



When relevant, these indicate if the term is an element of a specific type of financial statement or a kind of measure.



The home icon provides a link to the index page for quick access to specific terms.



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# Part 1:

## Finance fundamentals

### Concepts covered

- Balance sheet
- Profit and loss statement
- Asset
- Current assets
- Liability
- Equity
- Income
- Expense
- Accruals
- Cash flow statement

# Introduction

In this part, we cover three important financial statements that companies produce each quarter and at the end of the year:

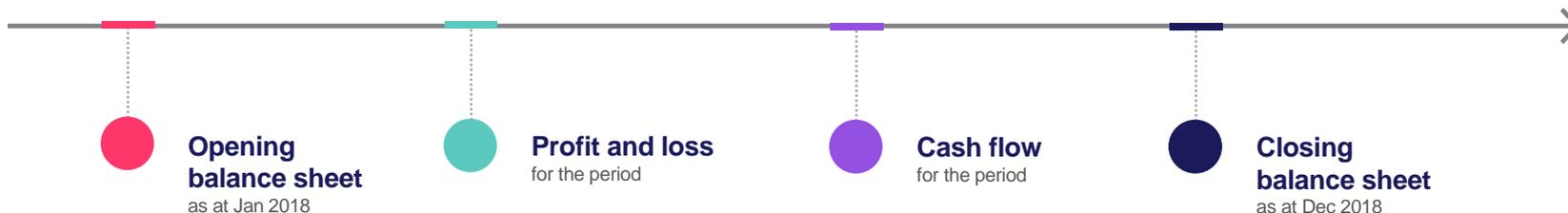
- **Profit and loss statement (P&L)**
- **Balance sheet**
- **Cash flow statement**

We also explain some of their key components such as asset, equity, liability, etc.

These statements are important sources of information for company management and investors.

- Management uses them to, e.g.: **inform decisions** (e.g. identify operational efficiency, risks, trends), **set goals** (e.g. increase sales, reduced costs), and **communicate** with shareholders.
- **Investors** use them to, e.g.: assess the **financial health** of a company, include in **calculations of metrics** (e.g. earnings per share), and provide an **indication of stock price**.

Source: Napkin Finance (2018). Profit and Loss Statement. Retrieved from <https://napkinfinance.com/napkin/profit-loss-statement-pl/>



## What is the difference between financial and management accounting?

Both represent important tools for a company but serve different purposes and target different stakeholders.

*Financial accounting* shows the financial health of a company to its external stakeholders (e.g. Board of Directors, investors, etc.) based on past performance.

*Management accounting* is a tool for managers to make decisions regarding daily operations based on current and future trends.





# Balance sheet

The balance sheet is one of a company's core financial statements and is a snapshot of what a company owns and owes at a point in time

A balance sheet as its name suggests, is based on the fact that it needs to balance out meaning, assets will always equal liabilities plus equity.

## Example

Example Balance Sheet							
Assets		=	Liabilities		+	Equity	
Current Assets	\$10,000		Current Liabilities	\$5,000		Share capital	\$20,000
Non Current Assets	\$40,000		Non Current Liabilities	\$15,000		Retained earnings	\$10,000
<b>Total Assets</b>	<b>\$50,000</b>		<b>Total Liabilities</b>	<b>\$20,000</b>		<b>Total Equity</b>	<b>\$30,000</b>
			<b>Total Liabilities &amp; Equity: \$50,000</b>				



The balance sheet is also known as the “statement of financial position”



# Profit and Loss Statement (P&L)

A statement of profit & loss is the second core financial statement of a company and reflects the financial performance of a company during a specific time period

## Example

A **statement of profit & loss** includes the amount of income a company has generated, expenses it has incurred and the resulting net profit or loss in a given financial year.

The net result is known as the **bottom line** as it is the last line of the P&L.

Example P&L statement	\$
Sales	25,000
Cost of Goods Sold (COGS)	(10,000)
<b>Gross Profit</b>	<b>15,000</b>
Rent	(5,000)
Salaries	(2,000)
Depreciation & Amortization	(1,000)
<b>Operating Profit</b>	<b>7,000</b>
Net finance cost	(500)
Income tax expense	(1,500)
<b>Net Profit</b>	<b><u>5,000</u></b>



Profit & loss statement is also known as income statement, or statement of financial performance

# Asset



Assets are resources controlled by an entity from which future economic benefits are expected to flow

The expected benefits of an asset may take the form of additional [income](#) or reduction in [expenses](#).

These benefits may be directly related to the asset - such as in the case of inventory which can immediately be sold for revenue. Or they may be indirectly related - such as in the case of manufacturing equipment.

Finally, an asset can be of two types: fixed or current.

A non-current asset is a long-term, tangible asset that cannot be consumed or sold in less than a year. Most non-current assets are subject to depreciation (see [EBITDA](#) card), e.g. buildings, computers.

A [current asset](#) is one that is expected to convert into cash within a year (e.g. cash, accounts receivable, inventory, etc.).

## Example

Manufacturing equipment for producing apple juice would be considered an asset because it enables the business to manufacture inventory (e.g. apples, apple juice) which will then generate economic benefits in the form of revenue.

The manufacturing equipment is therefore a fixed asset that is indirectly related to the revenue.



# Current assets



Current assets are a balance sheet item that represent the value of assets from which economic benefits are expected to flow to the company within the next 12 months

Current assets are important assets to companies as they can be used to pay expenses and fund daily operations.

## Example

**Cash** - the most liquid of assets. Cash changes hands through transactions on a day-to-day basis.

**Receivables** - a claim to payment which will flow to the company within 12 months.

**Inventory** - goods to be sold: revenue is expected within 12 months of the balance sheet date.

The 3 main categories of current assets are:

1. Inventory
2. Receivables
3. Cash

# Liability



Liabilities on the financial statements refer to the present financial debts and obligations of the business that will lead to the outflow of resources

A **liability** is a company's legal financial debts or obligations – typically from expenses that were not settled at the time of accrual (See [accruals](#) card). Liabilities may also arise in other circumstances such as loans, expectation of legal costs or fines, etc.

Usually classified as current (to be settled in the short term, i.e. 12 months or less) or non-current (to be settled after 12 months).

A liability is usually solved through a cash settlement. But, it can also be fulfilled when goods are delivered in the case of accrued income.

## Example

When goods for producing apple juice are purchased on credit from a supplier, the arising obligation to settle with the supplier is recorded as a liability on the balance sheet.

Similarly, if a customer prepays for apple juices, the company does not yet have a right to the cash it has collected.

Where a company has a loan repayable in 10 years time, it will be classed as a non-current liability for the first 9 years and then be held as a current liability in the 12 months before repayment.

Thus, companies need to record a liability to reflect their obligation to fulfil the service or sale, or even to refund the cash.



# Equity



Key  
Element  
Balance  
Sheet

Equity represents the value attributable to the shareholders of an entity

The equity value is the residual amount found by deducting all of the entity's assets from all of the entity's liabilities.

## Example

Equity is typically treated as the “leftover” claim that shareholders have on the assets of an entity after the portion of assets owed to creditors are allocated (i.e. the shareholders’ ownership interest).



# Income



Key  
Element  
of P&L

Income is the money that a business receives in exchange for providing goods and/or services or through investing capital.

Total income is made up of three components:

**Revenue** - money earned from selling goods or services that are part of the core business

**Other income** - money earned from business operations that are not part of core business

**Finance income** - money earned from financing activities such as interest

## Example

For a juice manufacturer that produces and sells apple juice, sales of apple juice would be reported as revenue.

Money from the sale of an asset such as the building where the juices are produced would be reported as other income.

Interest earned from a long-term deposit would be reported as finance income.

Note: See below how *Income* differs from *net income* which is another term for *net profit*



Income can also be referred to as "revenue." However, technically, this only refers to income from core business operations

# Expense



Key  
Element  
of P&L

Expenses are the day-to-day costs of running a business. They are often divided into three groups:

1. Costs of goods sold
2. Operating expenses
3. Finance costs

**Costs of goods sold:** COGS are costs incurred to make/purchase goods, or provide services to generate a company's primary revenue stream.

**Operating expenses:** costs that aren't directly from products or services, but are general expenses incurred as part of operating a business; aka Selling, General and Admin (SG&A).

**Finance costs:** costs of using credit facilities, i.e. a loan or a bank overdraft.

## Example

When the juice manufacturer produces apple juice, the input costs of apple seeds, manure, water, packaging and labor costs for farm and factory workers are all COGS.

The cost of energy efficient lightbulbs in the admin offices of the juice manufacturer, will be operating expenses.

The juice manufacturer gets a loan of USD \$100 to purchase apple seeds for the year, and the bank quotes a 10% charge per annum for the loan, the manufacturer records a finance cost of \$10 per year.

(See [cost of capital card](#))



Controlling expenses is a key way of increasing profitability

# Accruals



Accruals relate to transactions that have already happened but for which no exchange of cash has yet occurred

Accounting rules require transactions to be recorded when they happen - on an **accrual basis** - as opposed to only when cash is exchanged.

Accruals may relate to transactions where income has been earned but payment has not been received - as with credit sales (i.e. trade and other receivables).

Accruals may relate to transactions where expenses have been incurred but not yet settled as with a utilities bill that is only settled at some future date (i.e. trade and other payables).

## Example

When sales are made on credit, the accrued revenue is recorded immediately in the income statement, while the related right to receive payment (asset) is recorded on the balance sheet as a trade receivable.

Accruals mean that an entity can consume now and pay later



# Cash flow statement

A cash flow statement is one of a company's core financial statements that records the amount of cash a company generates and uses during a given time period

The cash flow statement helps company management, analysts and investors evaluate how well a company is able to generate cash to pay its debts and fund its operating expenses.

There are three main components in the cash flow statement:

- **Operating activities** (cash flows from products or services)
- **Investing activities** (cash flows from investing in equipment, assets or investments)
- **Financing activities** (cash-in when capital is raised and cash-out when dividends are paid)



# Cash flow statement

## Example

The cash flow statement distinguishes itself from the P&L and balance sheet as it does not include the amount of future incoming and outgoing cash that has been recorded on credit. Therefore, cash is not the same as net income or net profit, which includes all sales, including those made on credit.

Cash flow statement		Balance Sheet Extract beginning of year		Balance Sheet Extract end of year	
Cash (inflow) from operating activities	\$7,000	Current Assets	\$10,000	Current Assets	\$14,000
Cash (outflow) from investing activities	\$ (2,000)	Non Current Assets	\$40,000	Non Current Assets	\$42,000
Cash (outflow) from financing activities	\$ (1,000)	<b>Total Assets</b>	<b>\$50,000</b>	<b>Total Assets</b>	<b>\$56,000</b>
<b>Change in cash</b>	<b>\$4,000</b>				
Beginning of year cash	\$10,000				
<b>End of year cash</b>	<b>\$14,000</b>				

A cash flow statement reveals how able a company is to pay their debts as they arise

# Part 2:

## Insightful finance

### Concepts covered

Cost of capital

RoI (return on investment)

EBITDA (earnings before interest,  
taxes, depreciation and amortization)

Gearing ratio

Earnings per share



# Introduction

Beyond purely accounting, financial analysts use specific ratios and metrics to assess the:

- **Financial return of investments:** such as the cost of capital, Net Present Value (NPV), Return on Investment (ROI)
- **Financial health of a company:** such as EBITDA, gearing ratio, free cash flow
- **Attractiveness for shareholders:** such as earnings per share, price earning ratio, dividend yield

## What is a financial analyst?

Someone who assesses the *financial state* of a company or an asset and helps to develop investment strategies.

## What is an ESG analyst?

Someone who assesses the *Environmental, Social and Governance*-related risks and opportunities of a company, investment or project.

# Cost of capital



Profitability  
measure

Cost of capital is the cost of the funds used to finance the business and is a measure used by investors to determine the attractiveness of an investment

When assessing new business ventures, a project must offer an expected return of at least the **cost of capital** to be worth doing.

The cost of capital therefore helps companies determine whether they should proceed with a project based on if it represents a good or bad investment.

Cost of capital is made up of the cost of each of the sources of funds – equity, bonds, loans, etc. The combination is referred to as **WACC** (Weighted-Average-Cost-of-Capital) and is typically given as a percentage.

## Example

If the juice manufacturer wants to install solar panels on all its factories, (s)he needs to assess whether this investment has an adequate financial return (in addition to the positive environmental impact).

The solar panels will cost \$100m, the project is over 10 years; and the required WACC is 15%. If the return offered by the solar panels is greater than or equal to 15%, then company should invest in the project.

If the project provides a lower return, the project is not adequately compensating the company and should not be accepted.

The capital for new investments can either be in the form of debt, and/or equity

# Rol (return on investment)



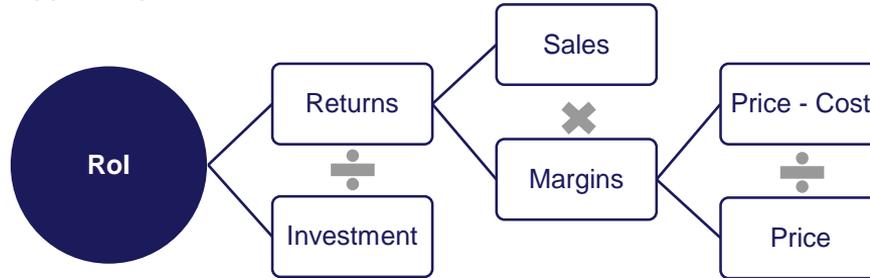
Return on investment is a profitability measure that evaluates the efficiency of an investment

In other words, **Rol** determines the benefit of investing your time, money or resources into something. It allows for comparison between different investments and investment types as it yields percentage result.

Returns represent gains on the initial cost. So a positive Rol means that the returns are greater than the amount invested, while a negative Rol signals that the costs are higher or than the return. This helps investors eliminate or select the best option.

## Example

Consider the purchase of an apple tree out of season. The tree is purchased for its ability to bear fruit. In season, the tree will yield apples. The tree represents the investment, while the apples represent the returns.



Rol is often useful in justifying which projects to pursue

# EBITDA



Performance  
measure &  
key element  
of P&L

EBITDA stands for Earnings Before Interest, Taxes, Depreciation and Amortization. It is one indicator of a company's financial performance

Put simply, **EBITDA** is the net [income](#) with interest, taxes, depreciation and amortization added to it.

EBIT is the same principle but adding only interest and taxes.

Depreciation distributes the cost of a tangible asset over its useful life. Amortization does the same for intangible assets (e.g. patents, trademarks).

EBITDA gives investors a good idea of how a company is doing financially and reflects how much cash a company may generate before paying its debts.

## Example

A retail company generates \$100,000 in revenue (see [income](#) card) and incurs \$40,000 in product cost and \$20,000 in operating expenses (see [expense](#) card).

**Depreciation and amortization expense** amounts to **\$10,000**, yielding an operating profit of \$30,000.

The **net finance cost** is **\$5,000**, leading to earnings before taxes of \$25,000. At a 20% tax rate, the **income tax expense** would be **\$5,000**. This gives net income of \$20,000.

Net finance costs, the income tax expense, and depreciation and amortization are added back to net income to give EBITDA.

EBITDA calculation	\$
Net income	20,000
Add back:	
Net finance cost	5,000
Income tax expense	5,000
Depreciation and amortization	10,000
<b>EBITDA</b>	<b>40,000</b>

# Gearing ratio



Financial health measure

The gearing ratio is a measure of financial leverage that shows how much of a company's equity would be required to payoff its outstanding debt

Another way to put it is that the **gearing ratio** reflects the proportion of a company's activities that are funded by the owner's versus creditor's funds.

A low gearing ratio indicates that a company has a **low proportion of debt to equity**, while a high gearing ratio means the opposite.

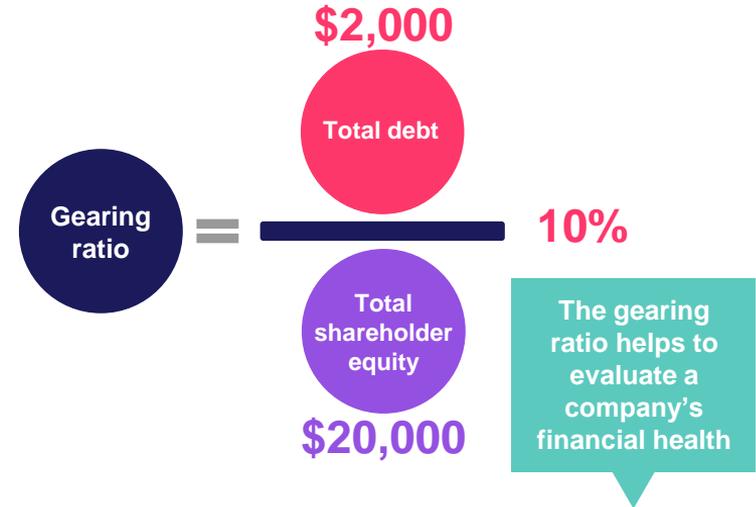
## Example

Take a company with \$2,000 in debt and \$20,000 in shareholder **equity**.

By dividing the total debt with total shareholder equity, the company would have a 10% net gearing ratio.

This means it would be able to pay off its debts and investors and lenders would consider it low risk.

Companies with ratios that are 50% or higher, represent a greater financial risk.



# Earnings per share (EPS)



Earnings per share (EPS) measures the amount of a company's profit allocated to each share

The **EPS** is an important measure which shows the **profitability** of a company and is often used by investors before buying a company's shares (see [stock](#) card).

A company with a high EPS indicates that it can generate high dividends for investors and therefore, represents a potentially good investment depending on the market price of the [stock](#).

Conversely, a low EPS can signal that a company is struggling.

A dividend represents the money paid by a company to its shareholders.

While an EPS is an important tool for investors, it shouldn't be considered in isolation, but rather in relation to other companies to better inform their investment decision.

# Earnings per share (EPS)



## Example

You decide to invest in the juice manufacturer which has:

Net income of \$200,000

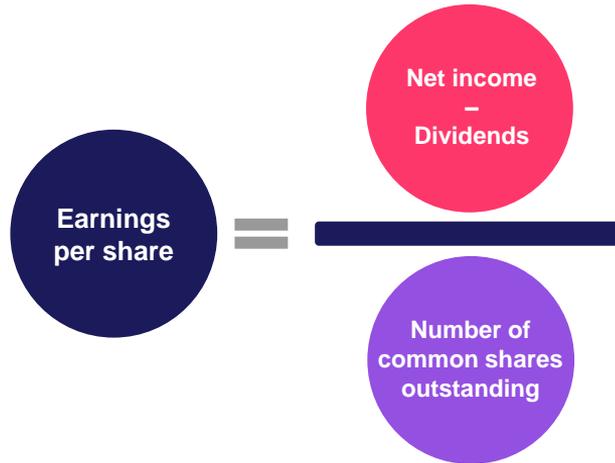
Dividends of \$40,000

Outstanding shares of 20,000

Your earnings per share would therefore be \$8

$((\$200,000 - \$40,000) / (20,000))$

In order to inform your investment decision, you also measured the EPS of another juice manufacturer which showed to have a lower EPS of \$6.



# Part 3:

## Advanced finance

### Concepts covered

Bond  
Green bond  
Credit risk



# Introduction

This part covers key **investment concepts**.

There are many types of investments which can range from what we call **financial instruments** such as bonds and stocks, as well as **investments conducted by individuals** like you and me when buying a house or lending money to a friend to help start a business. We also speak of passive investment when referring to savings in a bank.

Whatever the reason, investing is a big part of our economy.

Source: Napkin Finance (2018). Profit and Loss Statement. Retrieved from <https://napkinfinance.com/napkin/invest-money/>

## Who invests?

People who invest (i.e. investors) can be *individuals or companies* that put a certain amount of money into a corporation with the expectation of getting a financial return.

Those that receive the investment are usually entrepreneurs or companies that need access to money to fund their business or a project.

Investors have surplus funds enabling them to lend to others who need them now, and receive in exchange, an interest on their funds or a portion of the profits (a share) made by the investment project.

# Bond and Green bond



A bond is a category of loan usually issued or purchased as an investment by companies or governments

**Bonds** typically have a set of interest rates, either fixed or variable, for a defined period of time.

This is sometimes called the **coupon rate**.

Payments typically happen during the life of the bond on agreed frequencies – such as quarterly or annually.

Bonds may be issued at a premium or a discount from face value (par value).

A **zero coupon** bond is one that bears no interest but is originally issued at a discount.

A **green bond** is a type of loan used to finance sustainable projects and transactions. They differ from other bonds in that they typically finance environmental or “green” projects only. Therefore, they are preferred by investors looking to get environmental, as well as financial returns.

## Example

Consider a company (Company A) that needs to raise capital to fund a solar energy project. Company A then issues 100 five-year bonds with a par value of \$100 and a coupon rate of 10% per year.

Company A will record a liability of \$10 000 ( $\$100 \times 100$ ) on the balance sheet under non-current assets upon issue.

On the income statement, each year an interest expense of \$1 000 ( $\$100 \times 100 \times 10\%$ ) will be recorded.

The face value of the bond is known as the nominal or par value.

# Stock



A stock represents partial ownership in a company

When you buy shares of a company's **stock**, you own a piece of that company, including its **assets** and profits.

Once a stock is purchased, you become a "shareholder" (see **equity** card).

There are two main types of stocks:

- **Common stock:** often gives owners the right to vote and a claim on profits (dividends – see **earnings per share** card). But if the company is being liquidated, these stock holders are paid out only after creditors and preferred stock holders.
- **Preferred stock:** owners are paid fixed dividends and paid out before common stock holders in case of a liquidation.

(See **earnings per share** card)

When a stock price increases, it can be an indication that the company is profitable and successful. Conversely, if the company is performing poorly, the stock price usually goes down.

## Example

A company has preferred stock which receives a dividend of say \$1 per annum. It has 10,000 preferred stocks and 4,000 common stocks. If it had \$12,000 in total dividends to distribute, \$10,000 would be spent on the fixed dividend for the preferred stock and the remaining common stock holders would receive 50 cents each (\$2,000/4,000).

Stocks are also referred to as equities

# Credit risk



Credit risk represents the risk of loss due to the borrower's inability to repay the debt on agreed conditions

You can never be certain whether or not a borrower will repay his/her debt, there is always a risk. Assessing the **credit risk** therefore allows the issuer to appropriately price the loan as the interest rate charged will reflect the level of risk.

There are five 'Cs' that a lender will look at to calculate a borrower's credit risk:

- **Credit history**
- **Capacity to repay**
- **Capital**
- **Conditions** of the loan
- **Collateral**

A borrower with a high credit score means that he represents a low risk to the creditor while a low credit score means the opposite.

## Example

The juice manufacturer needs credit in the form of a mortgage for the purchase of a green building.

The lender will assess the credit risk of the juice manufacturer to determine whether credit should be advanced to them.

After the assessment is concluded, the juice manufacturer is allocated to a risk category and this is used to predict expected losses due to default risk and to price the loan appropriately.

Credit risk is also commonly referred to as default risk

# Part 4:

## Links with sustainability

### Concepts covered

Short termism and discount rates

Sustainability value drivers

The role of business in society

Natural, social and human capital accounting



# Introduction

This part considers the **links between finance and sustainability**.

First it highlights some of the **potential disconnects between finance and sustainability concepts**, using commercial discount rates as an illustrative example.

Then it looks at the **ways in which sustainability initiatives can influence financial returns**, to help sustainability professionals make the commercial case for sustainability projects.

Finally, it considers how the **expectations of businesses with respect to sustainability are changing**, and how some of the emerging frameworks to account for business impacts on society compare to long established financial ones.

## Will accountants really save the world?

In 2012 Peter Bakker, CEO of WBCSD famously said that “Accountants will save the world” – why did he think that? Because to get all businesses involved in solving the world’s toughest problems, we must first change the accounting rules.

While CEO of TNT, Peter observed that through a partnership with the UN World Food Programme they were building social capital, but they didn’t have a way to tell their shareholders — or be held accountable to keep doing it. Similarly, you don’t have to be an energy company or pulp and paper producer to focus on those resources; all companies use water, energy, and paper. But few are held accountable.

That’s why we need to ensure that corporate reporting makes clear how a company is making its money, not just how much money it has made. For every robust, time-tested measure of return on financial capital, we need another for social capital and another for natural capital.

Adapted from HBR, March 2013, Accountants will save the world

# At present, financial approaches and sustainability principles are not always aligned

Finance	Sustainability (a 'multi-capitals' approach)
Focuses on financial capital and physical/manufactured capital as well as some aspects of human and intellectual capital	Considers wider capitals including natural capital, social capital and human capital
Focuses on private goods and services and private/market value	Concerned with public goods, non-market externalities (both positive and negative) and societal value
Prioritizes short term performance (e.g. through quarterly reporting, commercial discounting) and financial return on investment	Takes a long term view and considers overall social return on investment
Prioritizes financial efficiency	Prioritizes resource efficiency (sometimes but not always aligned with financial efficiency)
Assets depreciate with use and over time	Natural, social and human capital assets can regenerate, sustain themselves, and even appreciate over time

The use of commercial discount rates can encourage **companies to pursue less sustainable projects in preference to more sustainable ones**

- **Financial project appraisal** typically involves discounting future expected financial flows to their 'net present value' to calculate the **expected net contribution** of the project to the value of the company.
- **Commercial discount rates** of 10% or higher are not unusual and have the effect of **favoring projects that generate short term returns**, almost irrespective of their longer term consequences.
- Since **sustainability goals** are inherently **long term**, the use of commercial discount rates can encourage companies to pursue less sustainable projects in preference to more sustainable ones.

**Calculating present value**

Present values are calculated by applying a discount factor:

$$\frac{1}{(1 + r)^n}$$

r = discount rate  
n = years until the flow occurs

## Example

# Project A

Provides **\$500** in benefits in **two** years' time

Discount rate = 10%

Present value =  $\$500 \times 0.826 = \$413$

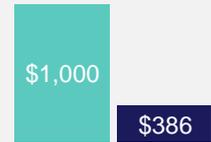


# Project B

Provides **\$1,000** in benefits in **ten** years' time

Discount rate = 10%

Present value =  $\$1,000 \times 0.386 = \$386$

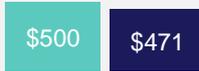


Decision

Choose  
A

Discount rate = 3%

Present value =  $\$500 \times 0.943 = \$471$



Discount rate = 3%

Present value =  $\$1,000 \times 0.744 = \$744$



Choose  
B

Key    ■ Value    ■ Present value

However, sustainability inspired projects can still frequently be **justified on financial grounds by identifying and quantifying relevant financial value drivers**

		Value driver	Value pathway	Description
Value creation	Increased revenues	Product development/ innovation	Direct	Create a new product or service targeting unmet societal needs or finding alternative lower-impact ways to meet existing needs
			Direct	Develop new revenue streams through recycling waste, waste to energy and “service-ization”
		Product differentiation/ brand enhancement	Indirect	Command a price premium through sustainability labels or features
			Indirect	Increase sales / market share through enhanced customer loyalty, product or service differentiation
	Reduced costs	Eco -Efficiency	Direct	Reduce operating costs through eco- efficiency (energy, water, resource use, packaging and waste reduction)
			Direct	Reduce operating costs / compliance costs through sustainable practices
		Security and quality of supply	Indirect	Reduce procurement costs through secure sourcing of energy, water or raw materials
		Staff motivation and retention	Indirect	Reduce staff costs/ improve productivity through employee engagement, training and development
Value protection	Risk Management	Reduced reputation risk	Indirect	Protect license to operate, brand image and reputation by avoiding negative publicity, consumer boycotts, investor pressure, and risk from regulatory changes
		Reduced cost of capital	Indirect	Improve access to capital by achieving a lower risk rating in financial markets
		Reduced operational risks	Indirect	Manage risks to operations from stakeholder action or physical impacts of climate change
		Reduced supply chain risk	Indirect	Manage reputation, regulatory and market risks arising from the supply chain
		Reduced regulatory risk	Indirect	Manage risks from regulatory intervention through improved reputation with regulators

# Expectations about the role of business in society are changing.

## New 'multi-capitals' approaches are emerging to align financial and sustainability thinking

Historically, companies were tasked solely with maximising profits in order to increase shareholder wealth.

This assumption about a company's purpose is changing.

The narrow pursuit of short-term profits is no longer sufficient for success. Society is demanding more than just financial returns from businesses.

"There is one and only one social responsibility of business – to use its resources and engage in activities designed to increase its profits."

*Milton Friedman, Capitalism and Freedom, 1962*

"Society is demanding that companies, both public and private, serve a social purpose. To prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society."

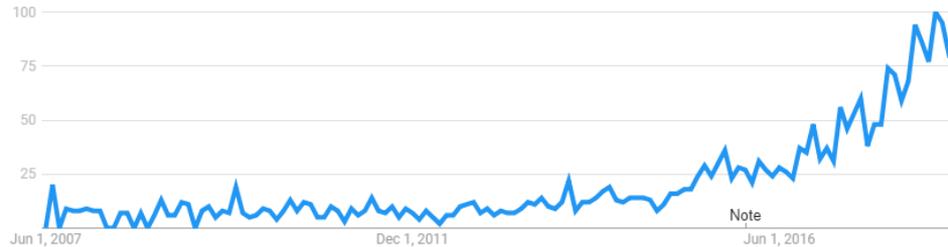
*Larry Fink, Chairman and CEO BlackRock, Annual Letter to CEOs, 2018*

"I don't think our fiduciary duty is to put shareholders first. I say the opposite. What we firmly believe is that if we focus our company on improving the lives of the world's citizens and come up with genuine sustainable solutions, we are more in synch with consumers and society and ultimately this will result in good shareholder returns."

*Paul Polman, CEO Unilever, Guardian Sustainable Business, 2012*

## Interest over time for the search term 'ESG investing' on Google

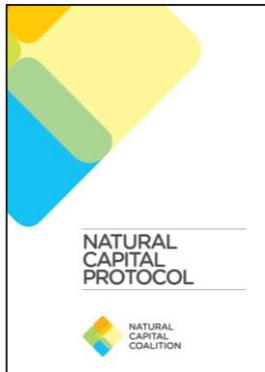
ESG is an acronym for environmental, social and governance. Numbers represent search interest relative to the highest point on the chart for the given region and time.



**A 'multi-capitals' approach is emerging as the de facto way that companies can demonstrate and enhance their overall contribution to society.**

This involves considering natural, social and human capital alongside financial and manufactured capital. Approaches for accounting, valuation and reporting for these wider capitals are evolving rapidly.

Three frameworks provide a strong starting point for companies that **want to account for their impacts and dependencies on natural, social and human capital**



- The **Natural Capital Protocol** provides a **harmonized process** and substantive guidance for all types of natural capital assessment.
- It covers **stocks and flows, impacts and dependencies**, and multiple different **scopes** of assessment (e.g. product, enterprise, project).
- It focuses primarily on **decision-making** applications rather than accounting or reporting.



- **The Social & Human Capital Protocol** provides a consistent process designed to generate **fit-for-purpose information** for business **decision-making**.
- The longer-term aspiration of the Social & Human Capital Coalition is to move towards **harmonized and comparable techniques** for social & human capital **measurement and valuation**.



- The UK government's framework for **Corporate Natural Capital Accounting** is most closely aligned with financial accounting and reporting approaches.
- It focuses on **accounting for and reporting on natural capital stocks** and is aimed principally at larger land owners or land managers.

Approaches for accounting, valuation and reporting on natural, social and human capital aren't as mature as their financial equivalents. Some of the differences are summarized below but approaches are evolving fast, so experimentation is encouraged.

	Financial accounting, valuation and reporting (examples are non-exhaustive)	Natural, social and human capital accounting, valuation and reporting (examples are non-exhaustive)
<b>Prescriptive standards?</b>	Yes, for regulated disclosures e.g. IFRS	No, but increasing levels of guidance available and standards are emerging
<b>Used for internal management?</b>	Yes, widely used in management accounting and internal project appraisal	Increasingly, natural, social and human capital assessments are being used in a wide range of strategic and operational decision contexts within companies
<b>Used for external disclosure of performance?</b>	Yes, all listed companies must report periodically on their financial performance	Sometimes, but reporting is not required and formats are not standardized
<b>Results comparable between companies?</b>	Broadly yes – if companies publish accounts following the same reporting standards (e.g. IFRS)	Generally no, but the process of standardization is under way. Companies and investors can choose to apply common approaches, values and reporting formats if comparability is a priority
<b>Is there a standard assessment boundary?</b>	Yes – financial statements cover the revenues, costs, assets and liabilities attributable to a legal entity	No, the assessment boundary depends on the purpose of the assessment
<b>How are monetary values derived?</b>	Transaction values based on market prices, historic costs (assets), present value after discounting (financial assets and liabilities)	Market values where applicable, 'cost-based' approaches in some instances, established non-market valuation techniques (willingness-to-pay based) in other areas
<b>Stocks, flows or both?</b>	Both: Balance Sheet (stocks) P&L (flows)	Natural capital: large land owners/managers tend to focus on stocks while flows are more commonly considered by downstream companies. Social capital: primary focus on flows. Human capital: both stocks and flows.
<b>Assurance / third-party verification of results</b>	Mandatory for regulated disclosures by large companies	Optional, and currently lacking prescriptive guidance on how assurance should be performed

# Glossary

**Asset:** a resource controlled by an entity from which future economic benefits are expected to flow.

**Accruals:** transactions that have already occurred but for which no exchange of cash has occurred yet.

**Balance Sheet:** one of a company's core financial statement and is a snapshot of what a company owns and owes at a point in time.

**Bond:** a category of loan usually issued or purchased as an investment by companies or governments.

**Cash flow statement:** one of a company's core financial statement that records the amount of cash a company generates and uses during a given time period.

**Cost of capital:** the cost of the funds used to finance the business and is a measure used by investors to determine the attractiveness of an investment.

**Credit risk:** the risk of loss due to the borrower's inability to repay the debt on agreed conditions.

**Current asset:** a balance sheet item that represents the value of all assets where economic benefits are expected within 12 months.

**Discount rate:** also called the hurdle rate is the expected rate of return for an investment.

**Earnings per share:** measures the amount of a company's profit allocated to every individual share of the stock.

**EBITDA:** stands for Earnings Before Interest, Taxes, Depreciation and Amortization. It is one indicator of a company's financial performance.

**Equity:** the value attributable to the shareholders of an entity.

**Expense:** represents the day-to-day costs of running a business.

# Glossary

**ESG:** Environmental, Social and Governance

**Gearing ratio:** a measure of financial leverage that shows how much of a company's equity would be required to payoff its outstanding debt.

**Green Bond:** a type of loan used to finance sustainable projects and transactions.

**Human capital:** people's competencies and capabilities, knowledge and wellbeing.

**IFRS:** International Financial Reporting Standards.

**Income:** the money that a business receives in exchange for providing goods and/or services or through investing capital.

**Liability:** the present financial debts and obligations of the business that will lead to the outflow of resources.

**Natural capital:** stock of renewable and non-renewable natural resources (e.g., plants, animals, air, water, soils, minerals) that combine to yield a flow of benefits.

**Profit and loss statement (P&L):** one of a company's core financial statement of a company and reflects the evolution of its wealth in a year.

**Return on Investment (RoI):** a profitability measure that evaluates the efficiency of an investment.

**Social capital:** societies' relationships, shared values and institutions.

**Stock:** a type of investment that represents partial ownership in a company.

## Acknowledgments

Eva Zabey and Katia Bonga (WBCSD) led this work and would like to thank Prof. Richard Barker and Oxford MBA students Shruti Vijayakumar, Barati Mahloele, Zafeer Nagdee and Lwandlekazi Mazule who developed the material in parts 1-3, as well as Lizzy Fitzgerald (PwC) for her contributions to parts 1-3, and Will Evison and Lottie Greenhalgh (PwC) for their contributions to part 4.

We also wish to thank the group of reviewers that have provided insightful inputs: Mario Abela, Ravi Abeywardana, Nicolas Davout, Peter Dickinson, Rodney Irwin, Alan McGill, Michael Ofosuhene, Hannah Pitts and Juliet Taylor.



# Notes

**Lead.**  
**Transform.**  
**Succeed.**