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The "Triple Bottom Line": A Boardroom Guide

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Why and how one company offers returns on economic, natural, and social capital.

On an ever-increasing basis, people and organizations are becoming aware of the "triple bottom line" and the related concept of sustainability. This article will explore these concepts from the perspective of society at large and, more particularly, from a practical corporate perspective.

The "Triple Bottom Line"

Traditional businesses currently recognize one principal form of capital contribution in corporations, and that is "cash capital." Cash capital includes all tangible assets, intellectual property, and sometimes services. The term "bottom line" refers to the return on that investment (profit), or what we might call *economic capital.*

The triple bottom line (TBL) concept recognizes that there are two other forms of capital contribution that should also receive a "return on investment," even if they do not appear on a "bottom line" in traditional accounting statements. The other two are *natural capital* and *social capital*.

Sustainability from a corporate perspective (*i.e.*, the ability for a corporation to persist in a healthy state for as long as the participants wish it to persist) results from producing a positive and balanced return to all three of these sources of capital—hence the triple bottom line.

Background

The concept of sustainability started getting traction back in the 1980s. It was first defined by the Brundtland Commission of the United Nations in 1987, which defined sustainability as

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"meeting the needs of the present without compromising the ability of future generations to meet their own needs."

This definition was framed within the context of environmental, social, and economic perspectives.

◗ In exploring the dimensions of sustainability, the Commission emphasized *environmental* resources. It articulated, that, at a minimum, humankind needs to radically alter its current patterns of consumption that treat our natural resources as though they are limitless, and must reverse the current trend toward destruction of our own habitat.

◗ We likewise need to pay attention to the *social* institutions that create the framework within which we can prosper and grow. The Brundtland definition of sustainability assumes that our social systems likewise are not infinitely elastic, and need to be nourished and replenished as well.

◗ Lastly, our *economic* systems are the glue that holds all of this together, said the Brundtland Commission. True sustainability means that these systems need to be healthy and robust also, in order to provide the framework within which society can persist.

These three components lay the conceptual foundation for the triple bottom line, defined as the "return on capital investment as evaluated and measured along financial, environmental, and social dimensions." For a corporation to be truly sustainable (*i.e.*, to persist and be profitable for all its stakeholders), it must be successful in terms of these three forms of capital.

Sustainability from the Corporate Perspective

Given the above, the logical question one might ask is "how is all this relevant to businesses and why should a business pay any attention to it?" The simplistic answer is that if humankind does not persist, neither will business.

However, for business executives whose current time horizons are tied to what will happen in the next quarter, the potential demise of humankind is not a current and meaningful problem, and rare is the manager who would spend any company time contemplating it, and justifiably so.

That is not to say that the issue is irrelevant and should be ignored by business. On the contrary, the threat to all life on this planet is very real, and business practices are at the center of the forces that are feeding this problem. Business is also the one institution on the planet best equipped to do something about it. What is needed is a reframing of the issue into terms that a business person can relate to and that have relevance to the goals and objectives of business as they are currently envisioned.

Unquestionably, the financial bottom line is the current overarching goal of business and making profit for the "stockholders" is the *raison d'être* for the creation and expansion of corporations today.

This was not always the case. In their early days, corporations were created principally to fulfill some specific social goal—build a road, bridge, dam, or other mechanism needed by society—and were usually constrained with a finite lifetime. Over time, the lifetimes of the corporations were made perpetual and their purpose shifted to a pure profit motive.

Today, the profit motive has become dominant, particularly in public corporations. Companies are forced to act with very short time horizons (quarterly profits) in order to maximize the short-term financial gains for the current stockholders. This takes place under the incessant drumbeat of "maximizing stockholder profits." Unfortunately, today those stockholders are all too frequently short-term speculators and not long-term investors who care little about a company's sustainability, but rather how they can make a fast buck.

Most managers of public companies would concede that such pressures can cause them to take actions that are financially favorable to the these stockholders in the short run, but detrimental to the corporation and all its "stakeholders," including the ongoing stockholders, in the long run.

If a corporation is to be *sustainable* and therefore create long-term value for stockholders and all other stakeholders, it needs to shift away from this obsessive focus on its quarterly profits, its short-term financial bottom line. This process can begin with a simple shift in defining the objectives of management, as dictated by the board of directors, from maximizing "shareholder profits" to maximizing "stakeholder value," a very different goal with a broader set of beneficiaries.

These stakeholders would at minimum include: stockholders, employees, creditors, suppliers, customers, the community at large, and nature itself. Most of these stakeholders inherently have longer (and in most cases perpetual) time horizons. By pursuing the goal of maximizing *stakeholder value*, managers would be able to work with these longer time horizons and include broader perspectives in their planning and execution.

As will be seen below, pursuing maximum stakeholder value will inevitably lead to recognizing that the triple bottom line is a more complete set of metrics for measuring the short-term and long-term success of an enterprise. As such, the triple bottom line facilitates the maximizing of value for shareholders and all other stakeholders.

Three Forms of Capital

As stated previously, the triple bottom line is defined as the "return on capital investment when evaluated and measured along financial, environmental, and social dimensions." This is based on the assumption that there are in reality, three primary forms of capital that contribute

DIRECTOR SUMMARY

To sustain itself over time, a corporation needs to obtain a return not only on its financial capital but also on its natural and social capital. Rolltronics has found a practical way to do this through the composition of its board of directors. ◗

The natural capital provided by the planet is no less finite a resource, and we cannot keep spending it without rebuilding its reserves.

to the success of a corporation, and so should receive a "return on investment." These three forms of capital are economic capital, natural capital, and social capital.

Economic Capital

Only cash or economic capital is widely recognized by business, and our current accounting systems reflect that recognition. The role of cash capital and the ways of measuring it are well known and will not be explored here. It is already well understood that a corporation has to realize gains on the financial bottom line if it is to be sustainable. The other forms of capital, and their relationship to sustainability from the corporate perspective, are not so well understood and will be explored there.

Natural Capital

Natural capital is represented by all the resources that are provided by our planet in the form of raw materials, plants, and animals. In our current mode, we are consuming these resources at an ever-increasing rate. We currently treat these resources as though they are limitless, which they obviously are not.

Anyone with even the most limited exposure to business knows that the endless consumption of cash capital cannot be sustained without adequate cash replenishment and will lead inevitably to the demise of the company.

What is less commonly recognized is that the natural capital provided by the planet is no less finite a resource, and we cannot keep spending it without rebuilding its reserves. Businesses that can no longer obtain the raw materials with which to make their products cannot sustain themselves, in much the same manner as those who run out of cash.

One way of addressing this issue is to alter the perspective of our current "cradle-to-grave" (*i.e.*, raw materials to landfill) mentality with respect to the production and sale of tangible goods. Businesses understand that waste reduction represents a direct cost savings to corporations. They should also recognize that waste represents a resource that should be recycled and reused instead of discarded. This approach is often called "cradle-to-cradle" to represent a closed loop.

Every company that has adopted the cradle-to-cradle philosophy in conducting its business has discovered significant gains on its financial bottom lines. These concepts are well covered in two pioneering books entitled *Natural Capitalism: Creating the Next Industrial Revolution* by Paul Hawken, Amory Lovins, and L. Hunter Lovins. And *Mid-Course Correction: Toward a Sustainable Enterprise: The Interface Model* by Ray Anderson. Anderson's company, Interface of Atlanta, recycles floor coverings for businesses.

Social Capital

The third form of capital, social capital, is a more subjective resource, but nonetheless is probably the most important form of capital contribution.

Social capital comes in two forms. The first is the *human capital* invested by people (employees, contractors, suppliers, and advisors) directly into the business. The second is the investment by the *social systems* that support the business.

Human Capital

Human capital is the capital that "walks out the door" every night. Long after the initial cash capital has done its job, the human capital is what continues to flow into an organization and sustain it. It is the personal investment made by people who invest their lives and time to make a company successful.

This human capital is the investment of intelligence, creativity, experience, skills, talents, passion, and education by employees and their families, suppliers, partners, advisors, and customers. Employees in particular are the most important asset in any corporation. Yet employees are considered an expense, a disposable item (like inventory) that can be decreased at will en masse on the assumption that this will produce a better financial bottom line.

Such large-scale workforce reductions, if viewed in terms of capital disposal, make as much sense as throwing away dollar bills (a company's cash capital) on a street corner. A number of studies have demonstrated conclusively that companies that get rid of a significant percentage of their employees in the interest of short-term cost cutting fair no better (and frequently worse over the long term) than similar companies in the same industry that do not lay off mass numbers of employees.

Yet boards of directors, senior managers, and the consultants who advise them, still employ this tactic in reaction to short-term market and financial pressures. Once again, it is the quest for short-term financial gains that drives bad decisions over the long term, which in turn, affect the overall economic bottom line. (Three good books dealing with this issue are: *The Emperor's Nightingale*, by Robert A.G. Monks, *Profit Building: Cutting Costs Without Cutting People* by Perry J. Ludy, and *Wealth Creation and Wealth Sharing* by Margaret M. Blair.)

Even when such companies do not need to consider workforce reductions, we see an overall pattern of not treating employees as a source of capital—and especially one for which a return is due. To be sure, employees receive compensation—in the form of salary and bonuses—but these are generally commensurate with what they give; they do not represent a real return on investment.

Various stock schemes (option plans, etc.) have been developed over the years to address this issue, but due to tax consequences and significant disparities in the distribution of these benefits, the majority of employees do not feel that they are fairly and equitably included in these systems.

For the majority of employees, an equitable share in the ownership of enterprise they nurture and sustain is an elusive dream and a source of growing discontent. Highly disproportionate compensation for senior executives and many other factors in the treatment of employees are fueling this discontent. This leads to increased turnover. And turnover, as a direct consequence of employee dissatisfaction with their company, detracts directly from the financial bottom line. Conversely, recognizing, positively conserving, and rewarding this human capital will translate to better a financial bottom line.

Social System Capital

The *social system* source of capital investment refers to the educational, governmental, and infrastructural institutions that provide the framework within which a business exists and becomes successful. Imagine trying to establish a successful business in a community:

◗ without a justice system or one that does not support contracts

◗ where distribution is by mule rather than high speed highways or the Internet

◗ where the labor pool is uneducated and without skills

◗ where the communication system is unreliable

◗ where the financial system is undeveloped and cannot generate investment capital, or

◗ where freedom to start a business is restricted by the state.

Like human capital, the social system source of capital is also not recognized in today's business environment. The social system institutions have to stand at the end of the line with a "tin cup in hand" in order to obtain their sustaining funds by taxes, grants, and other contributions. Yet without their capital contribution, businesses would not be able to survive and grow.

The sources of social system capital need a better way of realizing a return on their investment too. Doing so will in turn provide businesses with a better pool of employees, with customers that are better able to purchase their products and services, and with infrastructural resources that better facilitate the success of these businesses. All of this will translate to a better financial bottom line for each company.

Rolltronics and Sustainability

The owners and managers of my company are dedicated to the proposition that in order to be a truly successful and sustainable enterprise, the company must aggressively pursue a "triple bottom line" approach in all its activities. This not only contributes to sustainability but also helps lead the transition to more sustainable electronics industry and business in general. The Rolltronics leadership believes that this is both good corporate citizenship and good business practice.

Rolltronics promotes sustainability in three key areas:

Through its business practices. Sustainable business, technology, management, and reporting systems are being integrated into the corporate structure of the company, guided by principles, guidelines, and standards expressed internationally, including the Caux Round Table (Caux *Principles for Business*),* the Coalition for Environmentally Responsible Economies (CERES Principles), The Global Reporting Initiative, the International Chamber of Commerce's *Business Charter for Sustainable Development*, and the International Standards Organization's ISO 14001.

Through its products, processes, and technologies. Company products, processes, and technologies will help to bridge the economic and digital divides. Nearly two-thirds of our fellow global citizens currently have no access to the information or the economic benefits that the Internet and technology have bestowed on us in developed societies. Rolltronics is committed to creating products and enabling technologies to help bridge that economic, digital, and technology divide.

Through its innovative corporate structure. Rolltronics supports the concept that a company is more financially profitable by also paying attention to the sources of social capital, which include human capital and social systems capital. The company is pursuing that goal by implementing an innovative corporate structure that recognizes these sources of capital and provides a mechanism for them to receive a return on their investment.

*Note: The Caux *Principles* appear on pages 7-9 of this issue of *DM*.

The company is pursuing sustainability by implementing an innovative corporate structure that recognizes these sources of capital and provides a mechanism for them to receive a return on their investment.

◗ Rolltronics has established a limited liability company to make stock ownership in Rolltronics available to those whose human capital makes the company a success—a partnership of all employees and contractors. This partnership controls a significant percentage of the stock and provides a mechanism for the company's human capital to have financial and governance participation in Rolltronics.

◗ The company has also established the Rolltronics Foundation, which also holds a percentage of the stock of the company, and which will foster and develop sustainability in every area of human life throughout the world. These assets will be used to contribute to the larger social whole through philanthropic and educational enterprises and research.

◗ Rolltronics encourages continuous stakeholder participation in all aspects of the company's evolution and improvement—employees and their families, shareholders, suppliers, partners, local communities, national and international society, and past and future generations.

Sustainable Business Practices

Advances toward sustainability will not happen by themselves. Specifically, Rolltronics has committed to at least four practices from the outset.

◗ It will develop a comprehensive environmental management system and enlist third-party assessment by seeking and maintaining registration under ISO 14001.

◗ It will develop and publish an annual environmental performance report that meets the specifications of the Global Reporting Initiative.

◗ It will subscribe to and implement to the fullest extent possible, the practices of leading environmental management systems.

◗ It will work actively with suppliers to ensure continual improvement in the social and environmental performance of the company's supply chain.

Products, Processes, and Technologies

Leading industry toward greater sustainability will require the best business thinking possible. Rolltronics will provide profitable leadership by promoting sustainability in two key ways:

◗ *Rolltronics will meet customer needs with electronics technologies that are substantially less harmful to the environment throughout their life cycle than existing semiconductor products.*

Technologies allow the company to produce products that:

- are fabricated at significantly lower temperatures
- eliminate the need for lead solder connections, and
- allow cost-effective recycling, since all the electronics are built, to the maximum extent possible, on recyclable materials.

In addition, Rolltronics will actively pursue research and development activities that eliminate environmental impacts from company products and processes. Over time, the company's processes will create additional advantages that will require effort and effective partnerships to realize.

◗ *Rolltronics will design products and enabling technologies specifically to help meet the needs of the 50 to 75 percent of the world's population not served by the electronics industry at present.*

- Our products can improve people's lives by enabling significant improvements in communication, education, health care, and other fundamental needs.
- Our production processes will dramatically reduce the capital cost to produce factories. As a result, entrepreneurs in developing countries will be able to produce products for consumption in their own countries, creating jobs without sacrificing the environment.

Summary

Financial investors need to see a return on their investment. Likewise, nature, human capital, and the social system need to have a bottom-line return on the investments they provide, from the companies that benefit from those investments. When companies learn to address these needs and provide a fair and balanced return to all of their investors—not only economic but also natural and social—then a sustainable system will result.

Substantial evidence is accumulating around the globe, that by paying attention to natural and social capital, companies are in fact realizing better financial bottom lines. They are finding that it is a smarter, better business model for achieving a financial return on investment than the single bottom line is by itself. ◗

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