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Integrated Thinking and the Business model

1. 70 years ago the United Nations (UN) created the Charter for Human Rights. That was of historic significance after the atrocities of the Second World War. A document of equally historic significance was when 193 countries came together and endorsed the UN Sustainable Development Goals (SDGs) in 2015. These were developed together with civil society. The goals are outcomes based, for example, sustainable cities, responsible consumption and production, clean water and sanitation, affordable and clean energy. Seventeen goals in all.

2. The aim is, by 2030, to have a world of sustainable development as opposed to the unsustainable development of the 20th century.
3. In the document it is acknowledged that business will play a critical role in the endeavour to achieve these goals by 2030,
4. All stakeholders are called upon to act in a collaborative partnership in the endeavour to achieve these SDG's. In doing so the UN has acknowledged that the goals are integrated and indivisible and balance the three dimensions of sustainable development, the economy, society and the environment.
5. The question I discuss today is what is plan A by business, as a member of that collaborative partnership, to strive to achieve those goals by 2030? There can be no plan B as there is no planet B.

6. During the 20th century a company was said to be successful if the bottom line of profit increased, its share price increased and dividends paid to shareholders increased. Leaders of the corporate world through the 20th century focused on increasing the wealth of the shareholders because of a shareholder centric governance model.
7. This shareholder centric governance model had been reinforced by the well-known Ford Motor Company case and the doctrines of the economist, Milton Friedman.
8. In the Ford Motor Company case the court declared at the instance of the minority shareholder at the time, the Dodge brothers, that the excessive profits made by the Ford Motor Company in 1919 should first be declared as a special dividend to the shareholders before increasing the wages of employees and further modernizing the

plant. The Dodge brothers contended that they had primacy of place above other stakeholders. The court declared that the Dodge brothers were correct.

9. Friedman said that the sole purpose of the company was to make profit without deception. At what cost, I ask? What happened through the 20th century is that success consisted of three factors, increased bottom line, increased share price and increased dividends. This resulted in the collective minds of boards acting in the best interests of the shareholders. It was based on the false premises that the shareholders were the owners of the company and had primacy of place above other stakeholders.

10. These doctrines of primacy and ownership have been debunked. Shareholders own a certificate or today an electronic recordal of their shareholding. It is a

strange kind of ownership that people thought they had. A shareholder has never been able to even use a pencil belonging to the company, could not remove any of the company's assets, could not participate in the income of the company and only if the board declared a dividend and there was sufficient liquidity were they entitled to payment of a dividend. On bankruptcy they are at the back of the queue. Shareholders have no duty or responsibility to a company.

11. In an attempt to move away from this primacy of the shareholder the United Kingdom in 2008 passed Section 172 of the UK Companies Act which said that directors should ensure the success of the business of the company in the best interests of its shareholders while having regard to the community in which the company operated, society and the environment.

Having regard to is not taking account of and success is not defined. Consequently success is being read as Milton Friedman's success with the three criteria I have mentioned.

12. Throughout the 20th century we looked at companies through a financial lens. We determined value by the present value of discounted future cash flows and compared book value to market value.

13. But the Third Industrial Revolution in the 60's and 70's, with the arrival of the computer age, expedited research. The research showed that by 1997 only 20% of market capitalisation of companies on the great stock exchanges of the world was made up of additives in a balance sheet according to financial reporting standards. The rest was made up of what became labelled as intangible assets, the reputation of the company, long

term sustainable value creation strategy, embedding sustainability issues pertinent to the business of the company into the company's business model, what was happening in its supply chain, endeavouring to ensure that the company's business model would result in positive impacts on the economy, society and the environment.

14. At a meeting at the UN headquarters in Geneva in 2009 IFAC announced, under Chatham House Rules, that financial reporting was critical but was no longer sufficient. I announced, as chairman of the United Nations on Governance and Oversight and chairman of the Global Reporting Initiative (GRI) that sustainability reporting, which had become the mode to try and explain this difference in the make-up of market cap, was critical but meaningless without the numbers. But I

went further and said that, in fact, the financial and non-financial matters are integrated 24/7 and that to discharge the duty of accountability a board needs to report on how the company made its money, in clear, concise and understandable language and not in incomprehensible IFRS or GRI speak.

15. All this led to the establishment of the International Integrated Reporting Council (IIRC) flowing from the birth here in South Africa of integrated thinking and doing an integrated report. Critical in integrated thinking is applying the collective mind of the board to the six capitals, financial, manufactured, intellectual, human, natural and social, in developing the company's business model, or how the company makes its money.

16. Integrated thinking involves the collective mind of the board understanding, knowing and then planning

how the company will make its money and how it will maintain value creation in a sustainable manner. In order to do this the board must take account of the inputs into the activities of the business model, the outputs which would include waste as well as the company's product and the outcomes, both internal and external. The internal outcomes would be the money made by the company in order to service its borrowings; pay its wages and creditors and the external outcomes would be the effects of the company's product on the economy, society and the environment. It was accepted in the IIRC's Framework that the ability of a company to create value for itself is linked to the value it creates for other stakeholders. That thinking is in line with the SDG's being indivisible and integrated to improve the lives of people by having sustainable development by 2030.

17. Every company is dependent on the relationships between the company and its stakeholders and the resources its uses in order to create its product or service. There is a symphony between the resources used and the relationships. The board needs to apply its collective mind on an integrated basis with knowledge of the legitimate and reasonable needs, interests and expectations of the company's material stakeholder groupings. Today there is greater stakeholder expectations from civil society which can be much more disruptive with social media than shareholder activism.

18. Einstein said insanity is doing the same thing over and over again and expecting a different result. To carry on business focusing on profit at any cost, provided it

was without deception, would not change the result of unsustainable development.

19. The second stage is a recognition that we cannot solve our problems with the same thinking we used when we created them. One needs new thinking. The concept of integrated thinking and integrated reporting were concepts whose time had come, once it was accepted by the world's great bodies that we had reached ecological overshoot, that is using natural assets faster than nature was regenerating them. Consequently there was no longer an option to carry on business as usual.

20. The third stage of integrated thinking is to build a business model where the activities in making the company's product hopefully have a positive impact on the three critical dimensions of the economy, society

and the environment. Where the impacts of the activities are negative the company has to have a long term value creation strategy to eradicate or ameliorate those negative impacts, and where they are positive a long term value creation strategy to enhance them.

21. An organisation's business model is its system of transforming inputs through its business activities into outputs and outcomes that aims to fulfil the organisation's strategic purposes and create value over the short, medium and long term.

22. Integrated thinking will result in the incorporation into the company's business model of what yesterday we called CSI and CSR, for example, to the beverage manufacturer water is the most important natural asset. The conservation of water, the scarcest natural asset on planet earth, is an important issue but the strategy to

reuse, replenish, reduce and recycle water is built into the company's business model under the IIRC Framework.

23. For business to play its part in this collaborative partnership to achieve the SDG's, plan A is to adopt integrated thinking and have a business model which is based on value creation in a sustainable manner. Or put another way a business model which strives to achieve positive impacts on the three critical dimensions of the economy, society and the environment.

24. Plan A is to change the mindset of boards to steer their companies on a value creation process in a sustainable manner. To strive to make profit at any cost will result in society and the environment subsidizing that monetary bottom line. That, throughout the 20^{th} century, was the free part of the free economy. This led

to unsustainable development which is proven because by 1997, scientifically it was established that companies and individuals were using natural assets faster than nature was regenerating them, clearly not a sustainable matter. That did mean that we carried on business in the 20th century in an unsustainable manner - take, make, waste based on two false premises, limitless resources and an infinite capacity to absorb waste on planet earth.

25. During the 20th century directors committed lawful wrongs, an oxymoron indeed, but they steered companies on the basis of a shareholder centric model focused on increasing shareholder wealth rather than focusing on the long term health of the company.

26. Directors were lawfully steering companies to make increased profits but at a cost to society and the

environment. The innocent incapacitated company was seen to be committing wrongs against society and the environment. The outrage of society has resulted in a loss of trust and confidence in companies. But it has been corporate leaders of the 20th century who have not been conscious of these lawful wrongs. We can only have conscious companies seen to be good corporate citizens if they have conscious leaders.

27. The integrated reporting model drives sustainable leadership. It drives a board to adopt integrated thinking by embracing the six capitals in developing the company's business model to try to have a positive affect on the three dimensions. That is plan A. There is no plan B because we don't have planet B, as I have said. Integrated thinking and a business model based on the value creation process in a sustainable manner will

result in companies meeting SDG's pertinent to the business of that company, as clean water is to Coca Cola.

28. On 26 June 2018 the South African Institute of Charted Accountants (SAICA) launched its book, "Figure That" about the 163 year history of SAICA. In that book it is said that the single biggest innovation in accountancy since the advent of the double entry bookkeeping system is integrated reporting.

29. When Pacioli in the 15th century recorded the double entry bookkeeping system of the Merchants of Venice, he created the foundation of accountancy as we know it today. But that was purely financial. What is needed in the 21st century is a multi-capital approach to reflect value creation in a knowledge-based naturally resource constrained world. Integrated thinking and

developing a business model which has a positive impact on the three dimensions matches double entry bookkeeping for its global applicability and its resonance to the needs of today's business and society.

30. The Harvard Business School has collected evidence which shows that sustainable companies deliver significant positive financial performance and investors are beginning to value them more highly. The American Consultancy, Arabesque, and the University of Oxford have reviewed academic literature on sustainability and corporate performance and found that 90% of 200 studies analysed concluded that good environmental, social and governance standards lower the cost of capital; 88% show that good environmental and social governance practices result in better operational performance; and 80% show that stock price

performance is positively correlated with good sustainability practices. In short it has become good, hard-nosed business to ensure that a company's business model does not have adverse impacts against the three critical dimensions of sustainable development.

31. As there is universal recognition of crimes against humanity, which connotes conduct with wilful intent, there should be universal recognition of wrongs against humanity by steering a company for the maximisation of profit at any cost instead of focusing on its long term health which is in the better long term interests of all its stakeholders. Such focus is a moral necessity for those who come after us. After all, we are transient caretakers of this planet and have a duty to leave it in a state that

will not further prejudice the needs of those who come after us.

32. The revolutionary immensity of integrated reporting is in the integrated thinking which drives the board to focus on the six capitals, including the relationship between the company and its stakeholders, in approving a business model striving to achieve positive affects on the economy, society and the environment.

33. In conclusion, the concept of value has changed completely. Today value is looked at on the basis that business is at the junction of the economy, society and the environment. One could have the extraordinary situation of a company having a R100 M financial bottom line but with such negative impacts on society

and the environment that as a value proposition it is destroying value rather than creating it.

34. Integrated thinking removes us from the plague of short term capital at any cost and lets directors turn from directing companies down the street of profit at any cost into the avenue of inclusive capitalism.

35. Plan A is a business model that has a positive affect on all three dimensions of sustainable development, the economy, society and the environment. There can be no plan B because we don’t have a planet B.