Economic Value Through Sustainability

Sustain Value Briefing Note 2 - November 2017

Natural Capital: Ten things all businesses should know

Natural capital has increasingly featured in boardroom discussions over the past few years, but what's it all about and where is it headed? Here are ten things you should know.

1) 'Natural capital' technically refers to the '*stocks of natural resources that provide benefits to people',* but is commonly interpreted more broadly to mean the measurement and valuation of environmental impacts and dependencies. The Natural Capital Protocol (the Protocol) was published in 2016 as a standardized framework to help businesses better understand and value their impacts and dependences on natural capital. Whilst the main focus is on company decision-making, the framework is also applicable to company reporting. The Protocol sets out how **'natural capital assessments'** (see Box 1) can be conducted to assess and value any environmental dependency or impact, covering issues such as biodiversity, water, GHGs, air emissions, waste and disturbances (e.g. noise).

Box 1: Key definitions:

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

Natural capital assessment*: *The process of measuring and valuing relevant (material) natural capital impacts and dependencies, using appropriate methods.*

Biodiversity: *'The variety of different habitats, species and genes on the planet'*

Ecosystem services: *'The benefits that accrue to people from the environment (e.g. water, recreation and natural flood protection)'.*

*From the Natural Capital Protocol.

2) The business case for companies to undertake natural capital assessments is multi-faceted and will grow stronger each year. There are numerous drivers, application opportunities and potential returns for companies adopting a natural capital approach. Business case arguments include: i) gaining better insight (e.g. into associated risks and opportunities); ii) improved decision-making (e.g. around prioritization, option appraisal and justifying environmental expenditures); iii) enriched project appraisals and net positive assessments (e.g. to inform mitigation, offsetting and compensation); iv) enhanced resilience (e.g. anticipating price changes, informing strategy and supply chain decisions); v) generating new opportunities (e.g. new products and inspiring innovation); and iv) strengthening communications and reputation. See EU B@B Guide to Selecting a Natural Capital Approach for other applications.

3) There's a proliferation of useful tools to assist, but often the best tool for a company to adopt is a simple bespoke Excel framework model. The WBCSD Natural Capital Toolkit is an excellent resource to identify tools to help assess natural capital. However, it can be difficult to find a tool that covers all the parameters and values a business may be interested in. Based on our experience supporting multinational companies, what many companies find most useful is a simple spreadsheet framework tool that aligns with internal requirements and which, if required, can draw upon outputs from other tools (e.g. areas of habitat affected and water stress indicators).

4) Key differences exist between natural capital assessments for business and government natural capital accounting, although the gaps will close. Governments tend to be more interested in the value of stocks, whereas businesses have tended to look more at valuing impacts (e.g. Environmental Profit & Loss Accounts). Government accounts don't put monetary values on the societal cost of pollutant emissions whereas companies are doing so. See the EU B@B Natural Capital Business, Government & Financial Institution report for more on this. However, there is a new commitment from businesses, banks and governments to work together to align the approaches more closely.

5) Natural Capital Assessments have considerable scope for supporting the SDGs, the Circular Economy, Creating Shared Value and Net Positive approaches. Natural capital assessments can help evaluate the extent to which SDG goals and targets are being met and quantify what the benefits are, and who they accrue to. The assessments can also strengthen the case for the Circular Economy, as negative impacts from a linear economy model are significantly reduced and the adoption of new environmental markets will further add to the financial case. The assessments also directly support Creating Shared Value and Net Positive approaches because they help quantify and value impacts as well as establish which stakeholders are affected, both aspects of which are fundamental to the two concepts.

6) Data is often a key challenge in natural capital assessments, usually due to lack of robust data, but sometimes due to data overload on specific issues. The key to undertaking effective natural capital assessments is to pinpoint the specific data requirements, albeit with some flexibility, and fill key data gaps with appropriate assumptions. Data gaps can relate to baseline bio-physical units, causal linkages and societal values amongst others. Data issues are discussed in the EU B@B Natural Capital Business, Government & Financial Institution report, and plans are in place to deal with data barriers in the Natural Capital Coalition Data Kit project.

7) Incorporating values for biodiversity impacts is challenging, but approaches to do so are available. Biodiversity provides a complex set of values that include: i) supporting all ecosystem services; ii) enhancing some ecosystem services (e.g. eco-tourism); iii) generating conservation/non-use value (e.g. people are willing to pay to protect species); iv) ecological function value (e.g. maintaining ecological systems); v) enhancing ecological resilience; vi) providing insurance value (e.g. supporting subsistence after hurricanes); and vii) having its own intrinsic value (i.e. its right to exist). These values are difficult to ascertain in full (see CCI Biodiversity at the Heart of Natural Capital Accounting), but techniques exist that can indicate the extent of some of these values. For example, this includes using restoration costs, change in production, willingness to pay questionnaire surveys and other quantitative and qualitative approaches. Intrinsic value is by definition a separate non-anthropocentric form of value. A Biodiversity Supplement to the Protocol is currently being developed to address this topic.

8) Natural capital assessments don't need to be expensive - they just need to be 'fit for purpose'. Subject to your objective, if you know what you are doing in terms of selecting the right valuation techniques, data and assumptions, then natural capital assessments can be undertaken at low cost. Depending on your context and objective, qualitative or quantitative approaches may suffice. If undertaking monetary valuation, applying 'value transfers' (i.e. drawing upon valuation results from other studies) enables monetary values to be estimated with ease, although expert involvement is strongly advised and great care is needed in their application.

9) Undertaking natural capital dependency assessments and developing natural capital 'balance sheets' will become more important. It is apparent that dwindling natural capital resources (e.g. water) and deteriorating ecosystem services (e.g. coastal storm protection) that businesses can often depend upon, will increasingly threaten business viability. The fact that multiple ecosystem service benefits arise from natural habitats, and that many such benefits accrue offsite is also increasingly recognized. As a result, the financial sector is focusing more on 'dependency' risks, and pressure is mounting from the finance sector, governments and NGOs for companies to better understand the natural capital stocks and full flow of associated values on their landholdings. This will also encourage more collaborative landscape/catchment management approaches and Payments for Ecosystem Services. The finance sector's interest in natural capital is also evidenced by the forthcoming Finance Sector Supplement.

10) Whilst adopting a natural capital approach is a great step forward, to be truly sustainable, businesses should adopt integrated assessments covering impacts and dependencies on all capitals (e.g. social, human and manufactured). In our work, we advocate inclusion of other capitals, (e.g. around social issues of training and jobs), which can lead to different recommended outcomes. Accordingly, we converted our environmental risk, opportunity and valuation tool (EROVA) to become ESE-ROVA, adding in social and economic dimensions allowing coverage of all capitals. See Sustain Value Briefing Note 1 on Net Impact and EU B@B Natural Capital and Net Impact report.

Sustain Value is a network based consultancy that draws on international and local experts around the world to provide credible, cost-effective support to businesses on natural and social capital issues. We help measure, value and report on associated impacts and dependencies for decision-making and reporting. The team is led by **James Spurgeon** who has 25 years' experience quantifying and valuing environmental and social impacts for numerous multinational companies (e.g. Antofagasta, Hitachi, International Paper, Kraft, Rio Tinto, Roche, Shell, Thames Water, Total, Veolia and WPP), financial institutions, governments and NGOs in the UK and globally.

James was a lead technical advisor and a main author of the Natural Capital Protocol, and is on the Protocol Advisory Panel. He led the **EU Business and Biodiversity (B@B)** natural capital workstream for three years and was an advisor to the Prince of Wales's A4S Integrated Value group. He also has a rare blend of environmental, social, economic and financial accounting training through his BSc, MSc, MBA and CIMA qualifications.

Recommended citation: *Spurgeon, J.P.G (2017) Natural Capital: Ten things all businesses should know. Sustain Value Briefing Note 2. November 2017.*

For further information on the topic or to see how we can help you, contact James Spurgeon, Director at Sustain Value on 0044 (0)1235 821446 or via james.spurgeon@sustainvalue.co.uk

CONFERENCE ALERT:

Please join us at our second **'Net Impact Approaches: Bringing the strands together'** conference (jointly organised with Consciam) in London on 22nd May 2018. See the Sustain Value Events web page for details.