Improving Sustainability Results with Quantitative Leading Indicators

Robert B. Pojasek, Ph.D.

Many companies are seeking to lower their operational, regulatory and reputational risk by involving their suppliers in their sustainability and CSR programs. Most of these companies are using "scorecards" to help the suppliers focus on their sustainability results (lagging indicators). The overall score achieved may be linked to the amount of business that will be transacted with each supplier. However, the search for the perfect scorecard can only promote "short term thinking" without a "looking forward" component. One has to remember that results are merely the outcome of performance and do not measure performance directly.

In 2003, the United Nations' Global Compact organization signed a MOU with EFQM, a global non-profit based in Brussels (formerly called European Foundation for Quality) to create the "Framework for CSR" and the "Framework for Risk Management." These important frameworks helped link sustainability with the EFQM performance framework used by 30,000 companies in the European Union. Performance frameworks also exist in about 70 countries around the world. They focus on the improvement of business processes (e.g., leadership, strategic planning, employee engagement, stakeholder engagement, resources & relationships, and process management) which represent HOW products and services are realized. Each of these business processes have outcomes, or results, that the organization targets, measures and seeks to achieve.

Central to these performance frameworks is a means of converting the business process into a quantitative leading indicator. EFQM has developed a process that it calls, RADAR logic. It has four elements: Results, Approach, Deployment, and Assessment & Review. Here's how it works:

- An organization determines the ***results*** it seeks for its sustainability program; these results cover many of the lagging indicators found in the Global Reporting Initiative's (GRI) G3.1 reporting guidelines
- It plans and develops an ***approach*** to deliver the selected results both in the short term and over a longer term
- The organization deploys the approach in a systematic way to ensure its implementation
- Finally, the organization ***assesses and reviews*** the approaches and the deployment by monitoring and analyzing the results achieved through the ongoing activity.

Trained assessors use a standard matrix to score how the organization executes on each of the elements described above. The score for each of the RADAR elements becomes the quantified leading indicator. These scores can be "tagged" using open-source software known as XBRL. The numbers can then be aggregated and disaggregated for evaluation and reporting purposes. It is also possible to score the results using another matrix designed for this purpose. These scores or ratings are independent of the size of the operation and the sector within which it operates since they are unitless numbers. It is possible for investors to use the XBRL taxonomy to provide detailed evaluations of entire value chains and their component parts on an “apples to apples” basis.

Independent studies have shown that companies using performance frameworks, such as EFQM, outperform financially the companies that do not use these frameworks. Many companies are using performance frameworks to manage their business. However, their sustainability reports make no mention of them. When considering improvements to your supply chain management program, you should adopt a performance framework to provide a “looking forward” focus to your effort. It will be more effective than the use of even the best scorecard. Such an approach should help lower operational, regulatory and reputational risk throughout the value chain. Score approaches using the RADAR logic are widely available at this time.

Because of the pressure being put on companies to perform to the lagging indicators required by GRI and some investor groups, most sustainability and corporate responsibility (CSR) practitioners do not seem to be picking up on this opportunity to take a “looking forward” perspective, even though it is likely that their own company is already using the performance framework and other management systems.

There has been an argument that the use of quantitative leading indicators would compromise the competitiveness of the organization. This concern is completely unwarranted. Disclosing the use of a performance framework and sharing the RADAR rating score will not destroy competition. In fact, many companies in the United States actually publish their Baldrige performance report on their website. They see this as a proactive demonstration that their business is committed to managing the processes that produce results into the future (i.e., moving past the short term thinking of companies that focus only on lagging indicators).

There are number of papers that have been published on this topic. Although GRI has announced that it will not include quantitative leading indicators in its upcoming G4 revision, there are a number of early adopter companies that are beginning to this process. You will be hearing about them in the months ahead. The value proposition lies in the ability to reduce operational, regulatory and reputational risk with this approach. This proactive approach will also foster innovation in how the company can drive its sustainability results over the long term. The socially responsible investors will be very impressed with this looking forward approach.