

**‘TOWARDS SUSTAINABILITY’**  
**THE UK AUTOMOTIVE SECTOR’S SUSTAINABILITY STRATEGY**

**THE BUSINESS CASE FOR  
SUSTAINABLE DEVELOPMENT**

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## What is Sustainable Development?

The concept of sustainable development, or sustainability, is development that meets the needs of the present generation in ways that are economically viable, environmentally sound and socially acceptable, but that also allow future generations to do the same.

### Background

The origins of sustainable development go back to the early 1980's when the United Nations set up a commission to examine the rate and irreversibility with which the earth's resources were being used. Gro Brundtland the Prime Minister of Norway headed this 'World Commission on Environment and Development'. Between 1983-1987 the Commission undertook consultations throughout the world, to review the concept of sustainable development. The Commissioners concluded in their report 'Our Common Future' that the future depends on sustainable development, defining it as:

*"Development that meets the needs of the present generation without compromising the ability of future generations to meet their needs".*

The issue being confronted by the Commission and subsequent developments (see box) can be expressed simply as follows. The world's population has passed 6 billion and is expected to grow by half as much again by the middle of this century. Most of the Earth's resources (including not only the finite raw materials extracted from the ground, but also the Earth's capacity to provide food and other renewable resources and to absorb wastes) are being consumed by the minority of these people in the developed world, while the remaining majority live in poverty. The world's poorest aspire to the quality of life of the world's richest, but their legitimate aspirations cannot be met within the Earth's available resources using current technology. We need to find very much better ways of doing things so that we can improve the quality of life of all.

### The Earth Summit

In an effort to build worldwide support for Sustainable Development, the United Nations held a Conference on Environment and Development in Rio de Janeiro in 1992 (known as 'The Earth Summit'). Attended by 180 countries and 108 heads of state, five key agreements were adopted:

1. The Rio Declaration on Environment and Development which sets out guiding principles for action, including the necessity of continued economic growth to fund environmental and social improvement and a commitment to the 'polluter pays' principle.
2. Agenda 21 which sets out a global plan for sustainable development that has since become the basis for many national and local plans worldwide.
3. Forest Principles which covers the management, conservation and sustainable development of forests.
4. The Framework Convention on Climate Change which seeks to stabilise greenhouse gas emissions.
5. The Convention on Protection of Biological Diversity which seeks to achieve the sustainable management and conservation of the world's biological diversity whilst ensuring the benefits from these generic resources are fairly distributed.

Subsequent summits and conferences have sought to progress these agreements; perhaps the most significant being the 1997 Kyoto Climate Change Conference which strengthened commitments under the Climate Change Convention. This resulted in legally binding emission targets for signatory countries. This included commitments by developed countries to reduce greenhouse emissions by at least 5% on average relative to 1990 levels by the years 2008 to 2012. The UK's Kyoto target is to reduce greenhouse gas emissions by 12.5% by 2010, and its domestic goal is to reduce carbon dioxide emissions by 20% by that date. The implications of the Kyoto agreement on UK business are becoming increasingly significant as legal requirements (such as Integrated Pollution Prevention and Control Regulations) and fiscal policies (such as the Climate Change Levy) are implemented.

Agenda 21 deals with social, economic and environmental issues. It has been adopted at by the European Union and the UK Government and requires local councils to develop local sustainability plans in consultation with local communities and businesses. At a local level businesses need to engage in the Agenda 21 process or their interests may not be addressed. The Central London car charging initiative is an example of an Agenda 21 type initiative.



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There are three key messages for business:

1. There is a recognition by all parties that development, or progress, is essential to sustainability.
2. New technologies are needed which are significantly better (probably by at least a factor of ten) at delivering the services people need in terms of the demands on the Earth’s resources.
3. This requires innovation, which business is best placed to deliver.

### ***Business and Sustainable Development***

‘Our Common Future’ identified that current progress was not sustainable. We are now embarked on a journey, both globally and locally, to become sustainable, and business is central to achieving the goal of sustainability. In order to engage in this process, companies need to manage their businesses holistically. For business, the challenge is to continue to create wealth and the benefits that this brings, but to do so in a way that is socially responsible and that protects the environment.

#### **Alternative definitions and terms**

There are other definitions of sustainable development, or sustainability. The UK Government defines it as:

*“Ensuring a better quality of life for everyone, now and for generations to come”*

The term sustainable development also shares many concepts with other terms, specifically Corporate Social Responsibility and Corporate Citizenship. Both of these terms focus specifically on the role of business, but, like sustainability, they incorporate the idea that, to be successful, businesses need not only to create wealth but also to contribute to a better society and a cleaner environment. Definitions include:

*“Corporate social responsibility is a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis.”*  
(European Commission Green Paper on Corporate Social Responsibility).

*“Corporate social responsibility is the commitment of business to contribute to sustainable economic development, working with employees, their families, the local community and society at large to improve their quality of life.”* (World Business Council for Sustainable Development: Corporate Social Responsibility).

Businesses have been responding on an individual basis and collectively. In parallel with the UN led sustainable development initiatives; business has been co-operating on an international basis. There are a number of organisations and initiatives in place including:

- ✓ International Chamber of Commerce Charter for Sustainable Development ([www.iccwbo.org](http://www.iccwbo.org))
- ✓ Coalition for Environmentally Responsible Economies ([www.ceres.org](http://www.ceres.org))
- ✓ International Institute for Sustainable Development ([www.iisd.org](http://www.iisd.org))
- ✓ World Business Council for Sustainable Development ([www.wbcsd.org](http://www.wbcsd.org))
- ✓ GoodCorporation ([www.goodcorporation.com](http://www.goodcorporation.com))
- ✓ Global Reporting Initiative (GRI) ([www.globalreporting.org](http://www.globalreporting.org))

The Global Reporting Initiative is of particular interest as it specifies a comprehensive range of key performance indicators that measure a company’s performance against the environmental, social and ethical issues. A number of multinational businesses are committed to the Global Reporting Initiative including Ford, General Motors and Nissan.

At the same time as sustainability has, of necessity, become more mainstream for businesses, it has become a subject of increasing interest amongst the financial community (see Sustainability and the Financial Community on page 10). As a result there is growing pressure on companies to disclose not only their economic, but also their environmental and social performance.



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### ***The Journey to Sustainable Development***

Companies committing to the sustainable development agenda will all have differing starting points. In broad terms, there are three stages on this journey:

1. Compliance with legal requirements
2. Risk Management
3. Sustainable Development.

The starting point is achieving compliance with legal requirements. This not only includes environmental requirements but also those relating to health, safety and occupational health, as well as regulations relating to employment.

Beyond compliance, companies recognise the business benefits of managing risk and liabilities including those associated with health, safety and environment. This has led to companies implementing management systems aimed at reducing risks and achieving compliance with standards such as ISO 14001 (see box).

#### **ISO 14001 and other relevant standards**

ISO 14001 is an international standard for environmental management systems. It specifies requirements against which a company’s environmental management system can be audited. A key feature of ISO 14001 is that it is based on the management and continual improvement of the company’s environmental performance. It provides the basis for the environmental management systems requirements for the European Union’s Eco-Management and Audit Scheme (EMAS). EMAS additionally requires public reporting on environmental performance.

Many companies, including the large motor manufacturers, which have achieved ISO 14001 certification (i.e. they have been independently audited and found to meet the requirements of the standard) are introducing requirements that their suppliers also meet ISO 14001 requirements.

There are also standards and codes relating to, for example, occupational health and safety (OHSAS 18001), employee development (Investors in People), corporate social responsibility (SA8000) and reporting (GRI).

More latterly, companies have extended this approach to ethical, as well as environmental and health and safety, issues. This is particularly the case where supply chains extend to developing countries, where respect for human rights, working and employment conditions, as well as health safety and environment issues, fall well below standards in the developed world. The company supply chain that fails to achieve acceptable ethical standards can face significant protests from shareholders and customers alike.

Addressing sustainable development therefore means considering issues of concern not just to the site that a business occupies but also issues concerned with:

- |                             |                            |
|-----------------------------|----------------------------|
| ✓ Product Life Cycle        | ✓ Local Community          |
| ✓ Supply Chain              | ✓ Financial Stakeholders   |
| ✓ Customers                 | ✓ Other Interested Parties |
| ✓ Employees and Contractors | ✓ Performance Reporting.   |

Leading companies have progressed to reporting on their environmental, social and sustainability performance and to engaging in dialogue with stakeholders. However, many of these issues cannot be addressed by companies acting alone; they need to be addressed by the supply chain or even the sector as a whole.

The specific sustainable development challenges for the automotive sector are considered in more detail in the next section.



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## The Challenges for the Sector

### *Sustainable Development Issues for the Automotive Sector*

The motor vehicle has undoubtedly made a major contribution to improving the quality of life for everyone by providing unprecedented access to mobility. It allows us to move where we like, when we like. It offers freedom and convenience. However, the automotive industry now recognises the considerable sustainable development pressures it faces in its everyday operations and use of their products. These are outlined below.

#### Economic

The automotive sector continues to make a significant contribution to the UK economy<sup>1</sup>. It is estimated that 5.3% of GDP comes from vehicle and component manufacturing. The sector generated employment for about 850,000 people in 2000 and its exports totalled £19.8 billion. Taxes paid by the motor industry and road transport account for about 11% of the Government's entire revenue from taxation.

However, the sector suffers from problems of over-capacity and resulting low profitability. Over-capacity in the industry is estimated to vary from 25% in North America to over 30% in Western Europe<sup>2</sup>. In Europe, this amounts to about 6 million vehicles per year<sup>3</sup>. This over-capacity has led some manufacturers to introduce discounted and cheap leasing deals, and diversify product ranges. It is estimated that return on capital never rose above 3% during the 1990s<sup>2</sup>.

In the UK, the relatively high value of the pound increases the economic pressures on the sector, forcing some manufacturers to turn increasingly to non-UK markets for component sourcing in a bid to cut cost.

#### Social

The most notable negative impact of motor vehicles lies in the deaths and injuries caused by road accidents. In the UK, on average, about ten people per day are killed in road accidents and more than 100 per day are seriously injured<sup>1</sup>. Globally, 1.17 million people are estimated to die each year in road accidents<sup>4</sup>. Improvements continue to be made. In the UK, road deaths have fallen by 39% and serious injuries by 45% since 1985<sup>1</sup>, and the UK has the safest roads in Europe<sup>5</sup>. In addition, the EU motor industry is continuing to make strides in improving active and passive safety features and has committed itself to a voluntary agreement on pedestrian protection with the European Commission, currently being considered by the European Parliament. This would realise road safety benefits for passengers and pedestrians years before regulation could achieve the same results.

The greater mobility and freedom of movement offered by access to the car also brings about changes in the ways in which people live and work. Greater urbanisation is first of all enabled by the availability of cheap, reliable transportation of basic foodstuffs, but the concentration of motor vehicles in cities also brings problems of air pollution, noise, congestion and the impacts associated with the need to provide an adequate infrastructure. In pursuit of a better living environment, people who can afford to do so move to the outskirts of the towns and cities to live, although they continue to work in the centres.

<sup>1</sup> SMMT, 2nd Annual Sustainability Report, 2001

<sup>2</sup> Economist, *Incredible Shrinking Plants*, 23 February 2002

<sup>3</sup> SMMT Web Site: [www.smmt.co.uk](http://www.smmt.co.uk)

<sup>4</sup> SustainAbility, *Driving Sustainability: Can the Auto Sector deliver sustainable mobility?*, 2001

<sup>5</sup> [www.europa.eu.int/comm/eurostat](http://www.europa.eu.int/comm/eurostat)



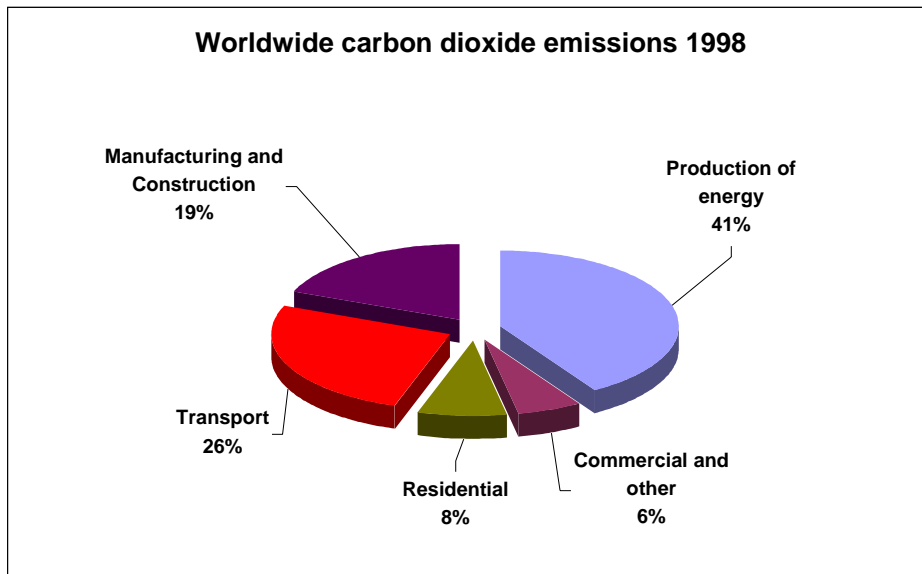
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The automotive sector is also a significant source of employment. Total employment in the sector is almost 3% of the total UK workforce<sup>1</sup>, but this percentage is much higher in some areas of the country. This employment provides a source of income and social benefits to those employed, and companies in the sector are increasingly investing in and working with their local communities on a variety of projects.

## Environmental

It has been estimated that transport activities account for about 26% of total worldwide carbon dioxide emissions from the combustion of fuel (see figure below), about two-thirds of which (16.9%) is attributable to road transport<sup>6</sup>. The number of cars in the world is forecast to double to around 1 billion by 2010 and treble to 1.5 billion by 2035<sup>4</sup>.

In the UK, the picture is somewhat different (road transport is estimated to contribute approximately 20% of total man-made carbon dioxide emissions<sup>1</sup>) and some improvements are being made (for example, emissions of carbon dioxide from road transport fell by 1.7% in 2000 compared with 1999<sup>1</sup>). Nevertheless, the global figures clearly demonstrate that it is unsustainable for the developing world (currently about 80% of the world’s population) to achieve the living standards of the developed world using current transport technology.



The industry has made positive steps in reducing CO<sub>2</sub> emissions and is committed to significant reductions. Developments in technology have vastly reduced exhaust emissions from vehicles but these benefits can be offset by increasing numbers of vehicles on the road and increases in the distances travelled. For example, although passenger vehicles manufactured today emit 95% fewer pollutants than in the mid-1970s<sup>7</sup>, because of the imposition of emissions controls, total emissions from road transport are only between 20 and 40% lower<sup>8</sup>. Emissions from road transport still contribute the majority of air pollutants of concern, particularly in urban areas (see box on p6). It will require further technological developments including hydrogen-fuelled, fuel-cell powered engines to address the problems of air pollution, but these improvements may be limited to the developed world best able to afford to make the transition.

<sup>6</sup> IEA, CO<sub>2</sub> Emissions from Fuel Consumption 1971-1998. 2000 Edition

<sup>7</sup> SMMT Submission in response to the European Commission’s White Paper on Transport Policy

<sup>8</sup> Department for Environment, Food and Rural Affairs, Digest of Environmental Statistics, 2001



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**Contribution of motor vehicles to local air pollution in urban areas**

Road transport is an important contributor to emissions of pollutants for which objectives have been set in the National Air Quality Strategy, and this is particularly so in urban areas:

Pollutant	Contribution from road transport in 1998/99	
	% of national emissions	% of emissions in London
Nitrogen oxides	46	52
Fine particles (PM10)	24	69
Sulphur dioxide	1	36
Carbon monoxide	73	94
Benzene	65	71
1,3-butadiene	91	92

Figures taken from Greater London Authority, The Mayor’s Draft Air Quality Strategy

There are currently 27.2 million cars in use in the UK. This is estimated to rise by 15% (to 31.4 million) by 2020<sup>1</sup>. Over the same period, the average number of miles travelled is forecast to rise, so that car traffic will increase by between about 30 and 60%<sup>9</sup>. The resulting increase in congestion problems will have social and economic impacts as well as environmental impacts.

Manufacturing activities are also associated with impacts on the environment. In particular, carbon dioxide emissions arise from the use of energy in manufacturing (see figure). In order to meet its commitments under the Kyoto Protocol, the UK Government has introduced a number of initiatives aimed at reducing carbon dioxide emissions. In particular, the Climate Change Levy imposed a tax on all industrial and commercial uses of energy. In addition, the sector is a significant contributor to emissions of volatile organic compounds (VOCs), another factor in local air pollution. Legislation has been introduced at European level aimed at controlling and reducing releases of these substances from a wide range of industrial activities.

### **Government Responses**

Governments have been responding to these issues with policies and legislation including taxation. In the policy field, the European Community’s Fifth and Sixth Environmental Action Programmes both highlight the transport sector. The latter, which runs until 2010 and establishes a basis for future legislation, identifies the need for integration of climate change objectives into transport policies and the development of concrete actions for structural changes in the transport sector. The European Union’s Strategy for Sustainable Development highlights greenhouse gas emissions and traffic congestion as two of the main threats that need to be addressed. The European Commission’s recent White Paper “European transport policy for 2010: time to decide” set out a number of proposals relating to the problems of road transport described above. In particular, it proposes measures such as increased regulation, the internalisation of the external costs of transport (including environmental and social costs), and infrastructure and congestion charging. Further proposals for European legislation can therefore be expected.

There has been examples of EC legislation aimed at reducing exhaust emissions from vehicles for many years. More recent legislation addresses other issues as well such as recycling. The End-of-Life Vehicles Directive, which is specifically aimed at the issue of abandoned vehicles and the disposal (generally by landfill in the UK) of the waste currently not recycled (estimated to amount to around 450,000 tonnes per year in the UK<sup>10</sup>), and the voluntary agreement on limiting carbon dioxide

<sup>9</sup> Department for Local Government, Transport and the Regions, National Traffic Forecasts, 1997

<sup>10</sup> UK Government Consultation Paper on Implementation of the Directive on End-of-Life Vehicles, 2001



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emissions from vehicles. There is also a directive, recently implemented in the UK, introducing a requirement for new models in showrooms to display labels giving their carbon dioxide emissions and fuel consumption. Manufacturing activities are subject to pollution control and waste legislation.

In addition to these legislative requirements, in the UK, motor vehicle transport has been the target of several tax-based measures, including the (now abandoned) fuel duty escalator, car tax differentials and changes to the company car tax regime. Local authorities have been given the power to introduce congestion charging, and plans were recently announced to introduce charges for driving into Central London.

### **Industry Responses**

Given the above challenges, it is not surprising that the automotive sector has been among the first to respond to the challenges posed by sustainable development. Most of the major manufacturers have expressed a commitment to the goals of sustainable development, and have begun reporting individually and collectively on their environmental, social and economic performance, the so-called "triple bottom line". There is a recognition by all of these companies that sustainable development is a key business issue for them. Examples of the statements made in some of the reports and on the companies' web sites are given in the box below.

#### **Sustainability and the UK Motor Manufacturers**

*"A commitment to environmental and social responsibility is at the heart of the values that guide actions and activities throughout Jaguar."* Managing Director, Jaguar Cars Ltd in Jaguar Environmental and Social Report 2000.

*"This triple bottom line of sustainability serves as the foundation for the long-term success of a company"* Chairman of the Board, BMW AG in BMW Sustainable Value Report 2001/2002.

*"Striving to Make the World a Better Place"* Strapline on Ford Motor Company Home Page.

*"Our aim is to build clean, safe vehicles whilst working to achieve affluent societies and a green Earth."* Toyota GB web site.

*"The door to the 21st century has been opened and a host of technologies that have been futuristic dreams so far are now about to become reality.... Surely, what the public demands most from the companies is that they should show the practical results they have achieved in their quest for opening up these vast future possibilities for the benefit of mankind."* Honda Annual Environmental Report 2001.

*"...the concept of sustainability and the need to run a successful business are inextricably linked."* Chairman and Managing Director, Vauxhall Motors in The Vauxhall Report for 2000.

As well as these statements in reports and on web sites, there are examples starting to appear in which these issues are being addressed in advertising campaigns. Some are a response to the changes to company car taxation, which are increasing the levels of awareness and interest of car buyers in carbon dioxide emissions from vehicles. Automotive companies are recognising that they are accountable both to consumers and customers within the supply chain.

The automotive sector was the first to respond to Government calls for sectoral strategies addressing sustainable development when the SMMT published its strategy in March 2000 and began reporting annually on the sector's sustainability performance (see box).



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## **SMMT Sustainable Development Strategy**

Acknowledging the importance of environmental protection in relation to the manufacturing and use of its products and recognising the need to balance economic progress with environmental care and social responsibility, the automotive industry was the first industry sector within the UK to publish a strategy for sustainability. In March 2000, SMMT on behalf of the UK motor industry launched its sustainability strategy 'Towards Sustainability: The Automotive Sector Strategy' outlining the industry's commitment to balance economic progress with environmental care and social responsibility. The strategy commits the industry to reporting annually on progress in these three areas against agreed sustainability indicators.

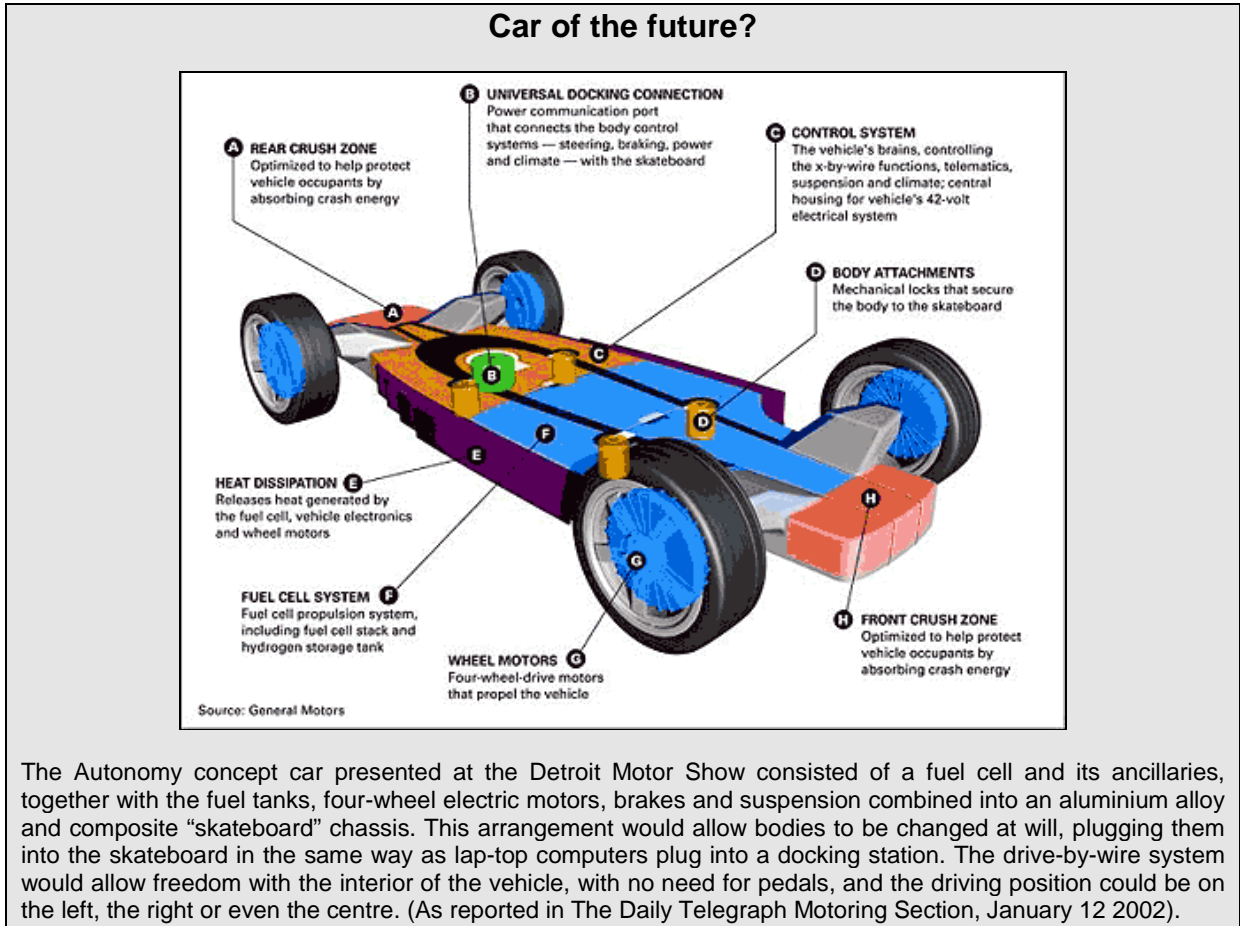
Following the launch of the Sustainability Strategy in March 2000 and first annual report in September 2000, SMMT, on behalf of the UK automotive sector, initiated a best practice programme on 'sector level sustainability reporting'. A draft guidance document presenting the findings of the programme was published in December 2001. This enabled SMMT to develop a more meaningful and inclusive reporting methodology which is reflected in the Second Annual Sustainability Report, launched in November 2001.

Many of the major manufacturers had implemented environmental management systems meeting the requirements of the ISO 14001 standard prior to the launch of the SMMT's Sustainability Strategy. In the year 2000, 41 (93%) of the sites operated by of the signatories to the Strategy were certified either to ISO 14001 or to EMAS. Thirteen of the signatories (76%) had published an environmental report and an increasing number of these are sustainability reports. A growing number of these companies are expecting their suppliers to meet similar standards and are introducing environmental requirements for their suppliers, including requirements to achieve ISO 14001 certification themselves within the next few years.

### ***Trends for the Future***

As well as imposing requirements, the large companies are working with their suppliers to develop solutions to the challenges they jointly face. Examples include Jaguar's initiative with Coventry City Council which is helping supplier companies to achieve ISO 14001 certification. Increasingly close working relationships with the supply chain are likely to become widespread. The general trend for the future is considered by experts to be towards smaller scale, widely distributed manufacturing plants, which are more responsive to customer demands, and where most of the manufacturing is carried out by suppliers with possibly only brand ownership and product design, engineering and marketing remaining with the current major manufacturers<sup>2</sup>.

Vehicle designs will become more modular, enabling more flexibility and a "build to order" approach, and opening the door to radically different concepts, such as the Autonomy fuel-cell powered, electronically controlled "skateboard" chassis unveiled by General Motors at the recent Detroit Motor Show (see box below).



The Autonomy concept car presented at the Detroit Motor Show consisted of a fuel cell and its ancillaries, together with the fuel tanks, four-wheel electric motors, brakes and suspension combined into an aluminium alloy and composite “skateboard” chassis. This arrangement would allow bodies to be changed at will, plugging them into the skateboard in the same way as lap-top computers plug into a docking station. The drive-by-wire system would allow freedom with the interior of the vehicle, with no need for pedals, and the driving position could be on the left, the right or even the centre. (As reported in The Daily Telegraph Motoring Section, January 12 2002).

### Challenges for the Supply Chain

These trends, some of which are being driven directly by the challenges of sustainable development, will bring profound changes to the entire sector and to the supply chain in particular. The main threats and opportunities are outlined below.

Opportunities	Threats
<ul style="list-style-type: none"> <li>Gaining a lead over the competition</li> <li>Getting ahead of legislative changes</li> <li>Getting ahead of other pressures for improvement</li> <li>Enhanced reputation</li> <li>Easier access to finance, insurance</li> <li>Better able to attract and keep best employees</li> </ul>	<ul style="list-style-type: none"> <li>Fines, bad publicity from failure to comply with legal requirements</li> <li>Loss of reputation</li> <li>Loss of customers</li> <li>Less able to access finance</li> <li>Less able to attract and keep best employees</li> </ul>

The future survival of companies in the sector will depend on how well they minimise the threats and maximise the opportunities presented. The essence of the business case for addressing sustainability is set out in the next sections from the two perspectives:

1. that ignoring the issue increases business risk
2. that addressing the issue improves business performance



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## Sustainability – The Business Case

### Business Risk

*It takes 20 years to build a reputation and 5 minutes to ruin it.*

Warren Buffet, Head of Berkshire Hathaway Group

### Sustainability and the Financial Community

All businesses need access to capital in order to grow. To obtain capital they can borrow from a bank against the assets of the business or they can issue shares in the company to shareholders. In both cases, the investors in the business expect a return on their investment, either through growth in the value of the shares or in the form of payment of dividends or interest.

Whereas in the past the way in which a company managed its economic performance and risks was generally the only consideration of investors, this situation has changed. For example, banks have realised that assets, such as land or property, can become liabilities if pollution risks are not properly managed. It is standard practice as part of due diligence assessments for mergers and acquisitions to assess possible liabilities arising from contamination of land or property. More significantly, investors have increasingly realised that social and environmental issues also pose risks to business which need to be managed (see box). The value of socially responsible investment is estimated to have grown by 1,000% in the last four years in the UK<sup>11</sup>. In December 2000, it is estimated that the number of unit and investment funds in the UK applying ethical criteria amounted to 55 with a total value in excess of £3.7 billion (excluding pension funds)<sup>12</sup>.

### The Rise of Socially Responsible Investment

In July 2000, following an amendment to the 1995 Pensions Act, a requirement was introduced on pension fund trustees to state in their investment policies whether, and to what extent social, environmental or ethical considerations are taken into account when making investment decisions. While the funds are not required to take these issues into account, research shortly after this change was introduced suggested that around 59% of the main UK pension funds (which are considered to control, in total, about a third of the UK stock market) had already started to incorporate socially responsible investment criteria with their investment strategies<sup>12</sup>.

Guides have since been produced by the National Association of Pension Funds and the Just Pensions campaign to assist trustees and fund managers in addressing these issues. These were followed, in October 2001, by new investment guidelines from the Association of British Insurers (the member companies of which account for more than a fifth of investments in the London stock market). The guidelines encourage companies to adopt best practice when responding to external social, ethical and investment risks. They call on companies to confirm that they have assessed the risks and are managing them in such a way as to preserve or even enhance the value of the business.

In parallel, governments are introducing initiatives which are likely to accelerate these trends. Last year the European Commission issued a Green Paper on Corporate Social Responsibility on the need for a new framework to promote good practice in this area. Corporate Social Responsibility is seen as a voluntary approach that cannot replace regulation or legislation setting minimum social and environmental standards. However, the Commission is keen to encourage all firms, including small and medium sized ones, to take the step of voluntarily going beyond compliance. The Green Paper poses a series of questions on how to take this forward.

Recent proposals for modernising UK company law include recommendations for a statutory statement of Directors' duties. This is intended to encourage responsible behaviour by making it clear that, in promoting the success of the company for the benefit of its members as a whole, Directors must recognise the importance of relations with employees, suppliers, customers and others, the

<sup>11</sup> Statement by Mark Makepeace, Chief Executive of FTSE Group at launch of FTSE4Good, reported in Green Futures, January/February 2002

<sup>12</sup> WWF-UK, To Whose Profit? Building a Business Case for Sustainability, 2001



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need to maintain a reputation for high standards of business conduct, and the impact of their actions on the community and the environment.

### Reporting – the Pressure Grows

A new law has recently been introduced in France which will require companies to disclose on social and environmental issues.

In the UK, the Government has a policy of “naming and shaming” companies which do not disclose their ethical, environmental and social performance, but it has also introduced new regulatory requirements relating to disclosure. UK listed companies are now required to disclose information on whether they have complied with the provisions of the Combined Code of the Committee on Corporate Governance. This includes a requirement to review the effectiveness of management systems for all internal controls, including financial, operational, compliance and risk management controls. The regulatory framework stresses the concept of the enlightened shareholder and requires Boards of Directors to consider the wider environmental or social implications of the activities of the business that might adversely impact on share price, corporate reputation or longer-term commercial prospects.

### Risks to Reputation

Against this background of increasing investor interest in a company’s environmental and social performance and increasing government requirements to disclose this performance, the company’s reputation becomes even more vulnerable. One of the most important risks to reputation lies in failure to comply with the law, particularly as the number of legal requirements with which companies must comply continues to grow. Many relate to environmental and social issues. Failure adequately to manage compliance with these requirements risks not only substantial fines, legal costs and even imprisonment, but also, potentially much more damaging, bad publicity and loss of reputation. As the examples in the box indicate, failure to comply is more often the result of a failure adequately to assess and manage the risks than of deliberate flouting of the requirements. However, the company’s stakeholders, including its major customers, shareholders and employees, may question whether they wish to continue to be associated with the company, and financial institutions, such as banks and insurance companies, may have increased concerns about potential liabilities and take action accordingly, for example by reducing credit ratings and increasing insurance costs.

### The risks of non-compliance

A garage-owner and its contractor were each ordered to pay over £20,000 in fines and costs for an incident which resulted in the death of over 8,500 fish in a lake in Wales. The company had been asked by the local authority to decommission some underground fuel storage tanks on its site. In carrying out the work, the company’s contractor had pumped the contents of the tanks (water contaminated with petrol and diesel) directly into the surface water drains at the site. The drains took the water to a stream directly linked to the lake.

A diesel engine manufacturer was fined £18,000 and had to pay costs of over £1,000 after pleading guilty to four charges relating to the Producer Responsibility Obligations (Packaging Waste) Regulations 1997. The company had failed to register under the regulations and failed to recover and recycle its packaging waste.

A foundry operator was fined £5,000 and had to pay costs of around £1500 after an oil leak polluted a brook. A leak of cooling water mixed with oil overflowed into a yard and entered surface water drains.

A welding company was fined £15,000 with nearly £10,000 costs after admitting to failing to deal with its waste in accordance with the Environmental Protection Act 1990. The company had failed to provide the haulier taking its waste to a nearby landfill with a written description of the waste. In addition, the waste contained chemicals at levels above the limits set down in the waste management licence. These offences came to light because of a fire in the company’s waste collection trailer caused by a chemical reaction between two waste streams and which resulted in local residents being advised to stay indoors and keep windows closed.

See the ENDS Report and the Environment Agency’s website: [www.environment-agency.gov.uk](http://www.environment-agency.gov.uk)



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As well as complying with legal requirements, companies increasingly need to comply with customer requirements. Companies which are managing their own risks may still be vulnerable to risks in their supply chain. Companies including Nike, Nestle, Mars and Cadbury have been adversely affected by reports of unacceptable labour conditions in some of their supplier companies. The growth of producer responsibility legislation, including the End-of-Life Vehicles Directive, could increase the risk of brand owners to materials in components supplied to them. Companies are improving the management of these supply chain risks by introducing supplier requirements relating to environmental and social performance. Most large automotive companies have developed supplier environmental requirements relating, for example, to hazardous substances in production and non-production materials supplied, and many suppliers are being required to achieve certification to the ISO 14001 environmental management system standard. Failure to manage compliance with these requirements could result in loss of a major customer and put the entire business at risk.

*Our supply chain is only as strong as its weakest link. To make our products more sustainable throughout their life cycle, we must rely on and support our suppliers in helping us to meet our goals.*

Ford Motor Company web site

Businesses also need to be able to manage the risks from external changes, such as changes to the tax regime. The introduction of environmental taxes, such as the fuel duty escalator and the Climate Change Levy, has had a significant impact on some businesses, and changes to vehicle excise duty and company car taxation may do so in future. Society's responses to issues are also capable of taking companies by surprise. For example, Monsanto severely misjudged the level of public concern over genetically modified foods in Europe. The resulting public relations disaster so badly damaged the reputation of the company that the value of the biotechnology part of the company completely collapsed.

### **Improved Performance**

#### Opportunities to Save Money

Just as companies with a poor reputation for risk management can expect to pay more for finance and for insurance, so companies with a good reputation will pay less. Volkswagen has noted a link between its environmental performance and attractive conditions offered by banks and insurers<sup>13</sup>.

In addition, it has been well documented that addressing, in particular, environmental issues leads to improvements in operational efficiency and, sometimes considerable, savings. Savings can be made by reducing material and energy inputs and by improving the efficiency with which they are used. This saves not only on the cost of the incoming material and energy, but also on the cost of processing the material and on the cost of disposing of the wastage.

#### **Using resources efficiently**

A manufacturer of automotive body components has saved over £500,000 per year from more efficient use of sheet steel. The company has been developing improvements to its press tools since 1995 with the aim of reducing the amount of sheet steel used. In addition, off-cuts and stampings are used wherever possible to produce smaller components. This involves matching "donor" and "recipient" components during the design process and taking them into account in production planning. Material use is monitored by the accounts department and the company estimates that it has saved about 6% of the cost of material purchases since the programme began. Other improvement projects include a new wastewater treatment plant which has enabled water to be recovered and used for pretreatment rinsing and an infrared, rather than gas-fired, process for curing sealant. The improvements have been identified as part of the company's environmental management system which has been certified to ISO 14001 since 1998. Total savings amount to nearly £700,000 per year.

Further details available from [www.envirowise.gov.uk](http://www.envirowise.gov.uk)

<sup>13</sup> Volkswagen Environmental Report 1999/2000



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By redesigning the process, it may be possible to reuse materials several times over rather than once only. This also saves on the cost of buying in new material and on the cost of disposing of used material.

### **Saving money by recycling**

A manufacturer of axle assemblies has saved over £13,000 per year by installing a unit to recycle metalworking fluid. The unit maintains the fluid at correct concentration, removes oil and dirt and controls bacteria and fungal growth. It circulates fluid continuously to and from 13 machines through fixed distribution and return pipework. Fluid drained from swarf collected in bins is also returned to the system. Installation of the unit has saved on the costs of purchasing new fluid, of disposing of spent fluid and in lost production time and labour costs while machines were cleaned out and refilled individually. An investment of £23,000 to purchase and install the unit resulted in a payback period of 21 months.

Further details available from [www.envirowise.gov.uk](http://www.envirowise.gov.uk)

Even when waste is produced, savings can be made if the waste is recycled rather than simply disposed of. The value of waste material for recycling can often depend on how well it has been separated from other materials. A good waste segregation system can yield high value material which can be sold for recycling rather than attract the cost of disposal.

### **One man's waste is another man's secondary raw material**

In conjunction with the new environmental management system being implemented at the new BMW Hams Hall engine plant, special teams were formed focusing on waste disposal, energy, and chemical control. Working with local employees, these teams were tasked with reducing environmental impacts in their areas. As a result of this work, a new waste material separation system was introduced designed to sort 20 different materials. The system has already paid for itself, and in 2001 alone the plant expects to generate nearly £100,000 from recovered waste materials.

See BMW Group Sustainable Value Report, 2001/2002

Most of these opportunities have been identified through challenging existing approaches and preconceptions. Many companies consider waste disposal to be an unavoidable cost and often do not know how much waste they produce. However, the cost of waste is not just the cost of its disposal. In fact, it also includes the cost of the purchased material which is wasted, as well as the cost of processing this material. Case studies, including those summarised above, have shown that the true cost of waste can be 5-20 times the cost of its disposal. They also provide evidence that many companies can achieve savings of 1% of turnover through waste minimisation<sup>14</sup>.

The same principles apply to the use and wastage of energy. With the introduction of the Climate Change Levy, even greater savings can be made through energy efficiency. More efficient heating systems and equipment, better lighting and even simple measures, such as informing employees when to switch equipment off, can result in substantial savings: 20% reductions in energy bills are typical<sup>15</sup>.

### Opportunities for Innovation

*Overall, innovators and entrepreneurs will view sustainable development as one of the biggest business opportunities in the history of commerce.*

Stuart Hall and Mark Millstein, Sloan Management Review<sup>16</sup>

It is clear that profound changes will be needed in systems of mobility in the future. Innovative companies will have increased opportunities to gain and maintain competitive advantage through the

<sup>14</sup> Envirowise web site: [www.envirowise.gov.uk](http://www.envirowise.gov.uk)

<sup>15</sup> Energy Efficiency Best Practice Programme.

<sup>16</sup> Quoted in SustainAbility, Buried Treasure: Uncovering the business case for sustainability, 2001



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development of new products and services. An example from the automotive sector is given in the box below.

### **Working with customers to improve design**

A leading supplier of braking systems to the UK and European automotive industry has made cost savings and environmental improvements across the whole range of its activities by taking a structured approach to minimising waste at all stages of the manufacturing process. As an example, when one of its major customers planned to launch a new model, the company took the opportunity to propose design improvements to its brake calipers. The resulting new design is smaller, lighter (26% less weight), requires less material and machining (62% reduction in machining time), has a shorter assembly time (19% reduction) and generates less metal swarf (59% reduction). The cost savings have been passed on to the customer through a reduction in the price per caliper, thus strengthening the customer/supplier relationship. The company has also worked with its customer to introduce reusable packaging for its products. The company financed the initial investment, which it recovered through a temporary increase in the unit price of its calipers. Once its initial costs had been recovered, it transferred ownership of the packaging to its customer and reduced the unit price of its calipers. Annual savings from the use of the reusable packaging compared with single use packaging amount to over £81,000. These improvements have been identified as part of the company's environmental management system which has been certified to ISO 14001 since 1997.

Further details available from [www.envirowise.gov.uk](http://www.envirowise.gov.uk)

This demonstrates how significant savings can often be made by re-examining a design or an approach from first principles. There is a tendency to do things a particular way because that is the way it has always been done. Taking a fresh look can often reveal that many assumptions (for example about prices, availability and capabilities of materials or infrastructure) upon which the original approach were based have changed to such an extent that they are no longer valid.

*People who seem to have had a new idea have often simply stopped having an old idea*

Edwin Land, Inventor<sup>17</sup>

Another example shows how the production of waste can be avoided altogether through the introduction of new approaches, in this case, to address the issue of testing.

### **Avoiding testing waste**

Vauxhall Cars introduced a new ultrasonic weld testing procedure at its plants during 2000. This enables welds to be tested non-destructively and avoids wasting perfect body parts that would otherwise be ruined by destructive testing. During 2000, savings amounted to £470,000.

See The Vauxhall Report for 2000

## Attracting the Best Employees

*The single most reliable predictor of overall excellence in a company is its ability to attract and retain talented employees.*

Fortune Magazine<sup>16</sup>

An important issue for companies in the future, particularly in Europe with its declining birthrate and ageing population, will be their ability to attract and retain the best employees. There is evidence that a company's stance on social and environmental issues is becoming an important factor in people's choice of employer. A recent survey of UK professionals by the Industrial Society found that a high proportion actively seek jobs in companies that reflect their own personal values<sup>12</sup>. For example, 82% of respondents agreed with the statement "I would not work for an organisation whose values I did not believe in". A survey of European employees found that 87% felt greater loyalty to socially-engaged

<sup>17</sup> Quoted on the web site of the Rocky Mountain Institute: [www.rmi.org](http://www.rmi.org)



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employers<sup>18</sup>. Asda recently came top in a survey of the best companies to work for in the UK<sup>19</sup>. It has achieved a staff turnover rate of just 2%.

As good employee management practices and engagement with employees are important components of sustainability, these findings are perhaps not surprising. However, employees who feel that the company they work for shares their values are also likely to be better motivated and more productive. There is evidence that these companies are more profitable and less likely to be affected by industrial disputes<sup>19</sup>.

**Making the most of your biggest asset**

BMW actively involves all employees in the on-going development of the company. This process is enhanced by regularly conducted employee surveys and the targeted integration of employees into operational improvement processes. In 2000, an average of three suggestions per employee were submitted at the plant in Steyr, Austria. The subsequent improvements resulted in cost savings of over 7 million euro – an average of 3,000 euro per employee. Company-wide, BMW AG saved over 46.8 million euro in 2000.

In the surveys, over 96% of the workers surveyed indicated that they regard BMW as a “great place to work”. This high level of employee satisfaction is also evident in the very low annual turnover rate of only 1.4%.

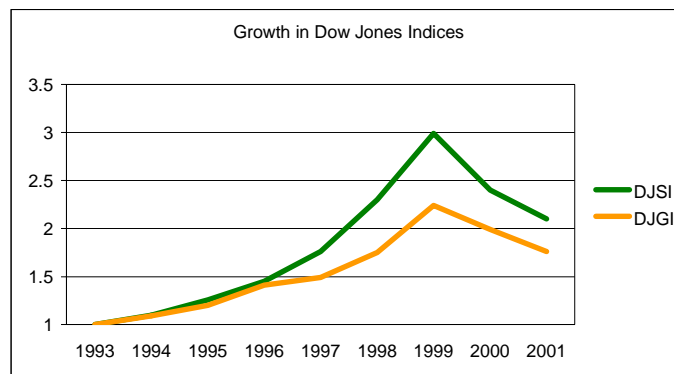
See BMW Group, Sustainable Value Report 2001/2002

Shareholder Value

*A coherent corporate social responsibility strategy based on integrity, sound values and a long-term approach, offers clear business benefits to companies.*

World Business Council for Sustainable Development<sup>20</sup>

There is now evidence that these improvements in performance are sufficiently significant that they are being reflected in the value of companies’ shares. Studies in the USA have demonstrated a link between the degree to which companies address wider stakeholder concerns and shareholder value. A group of 25 so-called “stakeholder superstars”, that were considered to excel in managing relationships with investors, customers, employees, suppliers and the communities in which they operate, were found to outperform the S&P 500 by more than double over the past 15 years<sup>18</sup>. A group of 11 “Built to Last” companies (visionary companies with goals that extended beyond merely maximising profit) were found to have a return on equity that was nearly 10% higher over a 10 year period and a ten-year relative total return to shareholders on average 63.5% higher than a similar group of non-“Built to Last” companies<sup>12,18</sup>. And, the Dow Jones Sustainability Index clearly outperformed the Dow Jones Global Index in the five years before August 2001. The DJSI had an annualised return 15.8% compared with 12.5% for the DJGI over that period (see figure)<sup>20</sup>.



<sup>18</sup> Reported in Conversations with Disbelievers, CwD12, www.conversations-with-disbelievers.net

<sup>19</sup> The Sunday Times 100 Best Companies to Work For 2002

<sup>20</sup> WBCSD, The Business Case for Sustainable Development, 2001



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This evidence will reinforce the growing interest of the financial institutions in the sustainability performance of businesses, increasing the risks of failure and the benefits of success. Sustainability is rapidly becoming a mainstream activity for all well managed companies.

### The Way Forward

What are the implications of these developments for the many smaller companies in the supply chain of the large manufacturers who are rapidly embracing sustainability? The majority of these smaller companies may not yet have achieved certification to the ISO 14001 standard. Furthermore, achieving certification to the standard is likely to be a priority for them, in view of the stated requirements of the larger automotive companies. How can they be expected to deal with all of these new issues as well?

There are no specific methodologies for becoming a sustainable business but a typical sustainable development strategy includes:

1. Creating and maintaining a profitable business
2. Providing customers with products and services that add value
3. Protecting the environment throughout the product life-cycle
4. Conserving natural resources
5. Creating and maintaining an ethical code of conduct for the company and its supply chain
6. Working with interested parties (stakeholders)
7. Benefiting the communities in which the company and its supply chain operates.

The first thing to make clear is that, as this list indicates, sustainable development is not an issue that can be addressed by any one company acting alone. Most of the challenges need to be addressed by the sector and the supply chain as a whole.

The second thing to make clear is that, in practice, good environmental management provides a sound first step and a good foundation for progress. Companies can make progress in environmental management by focusing on their own activities, at least initially, and it introduces them to the concepts of meeting stakeholder expectations. It also subsequently leads naturally to consideration of the environmental implications of supply chain activities and product life cycle concepts. So, implementing an environmental management system and achieving certification to ISO 14001 is entirely consistent with, and complementary to, addressing sustainability.

Thirdly, there is help and support available. The SMMT’s Sustainability Strategy provides a framework for companies in the sector to work together and a platform for reporting and target setting as a group. The sector-based approach enables the sector as a whole to establish a clear direction. For signatory companies, it also provides a less daunting introduction to reporting for companies wary of the concept, while at the same time ensuring credibility. The SMMT’s annual sustainability reports are widely recognised as a benchmark for sectoral sustainability reporting.

In addition, the SMMT can offer signatory companies:

#### **Access to expertise and advice**

Signatories can exchange ideas and experiences with each other through the Sustainability Working Group and with members of other groups, including the Manufacturing Environment Working Group and Industry Forum. There are also opportunities to collaborate with similar groups working in other sectors. In addition, the SMMT can provide a clearinghouse service, giving directions to other sources of help and support, including the Government-sponsored Envirowise and Energy Efficiency Best Practice Programmes, local Business Links, and the Groundwork Trust. Envirowise, for example, offers free best practice guides and case studies and, for small and medium enterprises, a free fast-track visit to identify opportunities for improvement.



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### **Resources**

Through its ongoing work in support of the Strategy, the SMMT provides signatories with the infrastructure and resources to set and review objectives and targets, engage with stakeholders and develop best practice through guidance. This should prove to be of particular benefit to smaller companies which often lack sufficient in-house resources.

### **Safety in numbers**

The data collected from signatory companies is aggregated and anonymised. This overcomes competitive issues which would otherwise preclude the inclusion of some details and relevant information.

### **Engagement**

Many of the issues of concern to stakeholders are sectoral issues. The SMMT strategy project enables individual companies to enter into dialogue with stakeholders and understand their expectations on a sector-wide and ‘safe’ basis.

### **Integration**

The sectoral strategy provides a means for improved integration by linking corporate approaches and national approaches.

The threats are real and growing; the opportunities are waiting to be grasped; the SMMT strategy provides the framework and platform to make a start.

*Like the tobacco companies before them, car companies have had their heads in the sand. They are about to get a rude awakening.*

Clarence Ditlow, Center for Auto Safety<sup>4</sup>