

NATURAL CAPITAL PROTOCOL

PAVING THE WAY TO RESPONSIBLE BUSINESS DECISIONS

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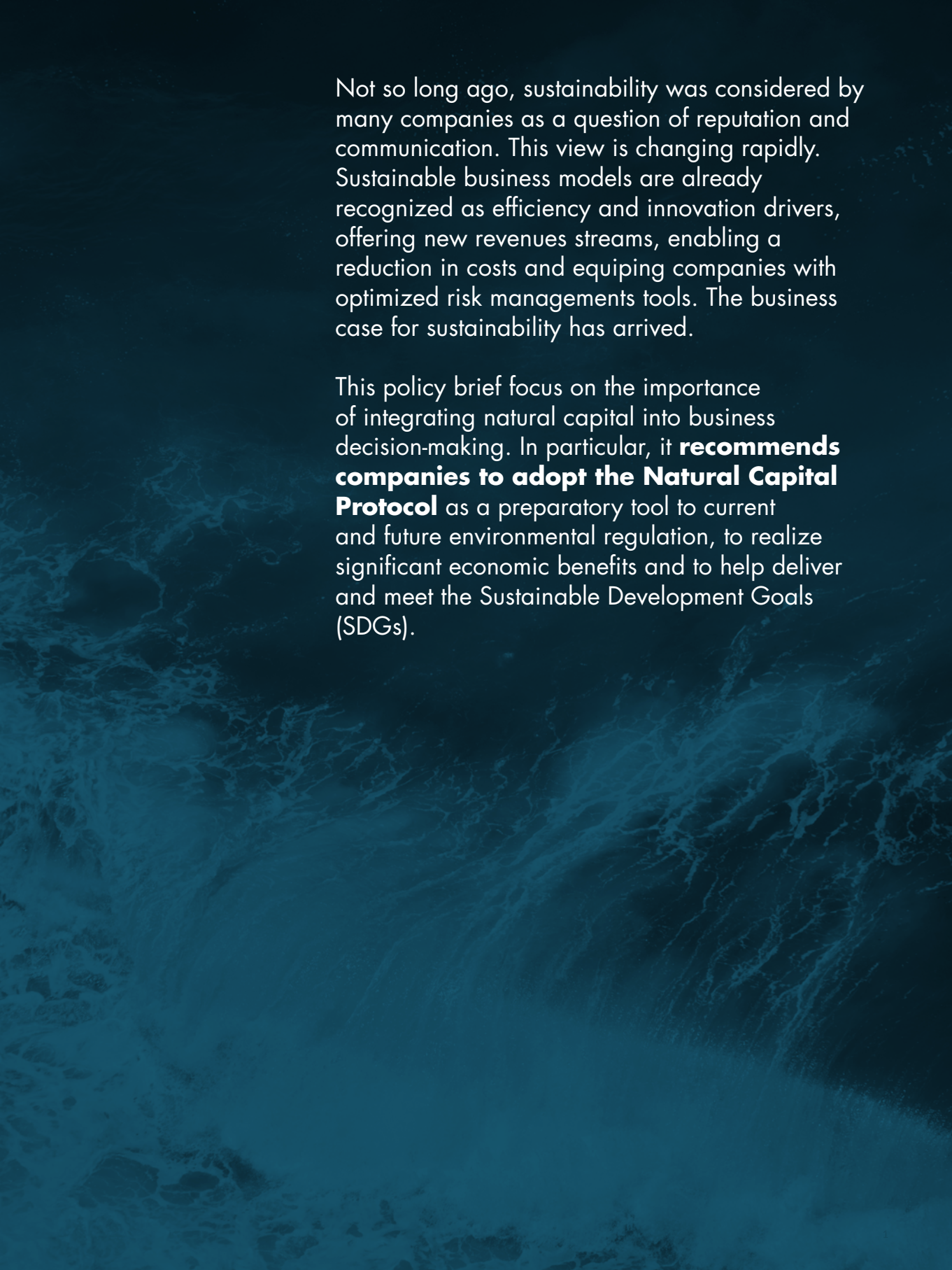
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Not so long ago, sustainability was considered by many companies as a question of reputation and communication. This view is changing rapidly. Sustainable business models are already recognized as efficiency and innovation drivers, offering new revenues streams, enabling a reduction in costs and equipping companies with optimized risk managements tools. The business case for sustainability has arrived.

This policy brief focus on the importance of integrating natural capital into business decision-making. In particular, it **recommends companies to adopt the Natural Capital Protocol** as a preparatory tool to current and future environmental regulation, to realize significant economic benefits and to help deliver and meet the Sustainable Development Goals (SDGs).

Natural Capital and companies

WHAT IS NATURAL CAPITAL?

*Natural Capital is the stock of **Earth's natural resources** (e.g. water, soil, air, rivers, oceans and forests) that **yield a flow of benefits to people**, such as food, drinking water, medicines, renewable resources for energy production and the space to carry out recreational and sport activities.*

NATURAL CAPITAL FROM A BUSINESS PERSPECTIVE

The benefits provided by natural capital, together with other well-known forms of capital (e.g. human, financial, manufactured, intellectual and social) underpin the production processes and a series of economic activities (Figure 1). While companies are extremely knowledgeable about the value of their manufactured and financial capital, natural capital is usually not accountable within our economic and accounting systems, and thus excluded from business decision-making processes. If we don't acknowledge the value of an asset – financial, natural or of any other type – it becomes extremely difficult or even impossible to manage it efficiently. With many businesses relying considerably on natural assets, both directly and through their supply chains, it is fundamental to understand and value these dependencies, as well as the impacts of their activities on a (un)sustainable provision of natural capital.

The economic invisibility of natural capital can lead to inefficiency in business management, excluding significant risks and **opportunities** from decisions, challenging environmental sustainability, and bringing the financial stability of the corporate sector into question. This policy brief explores one major answer to this problem – **how and why companies can benefit from integrating natural capital into business strategy.**

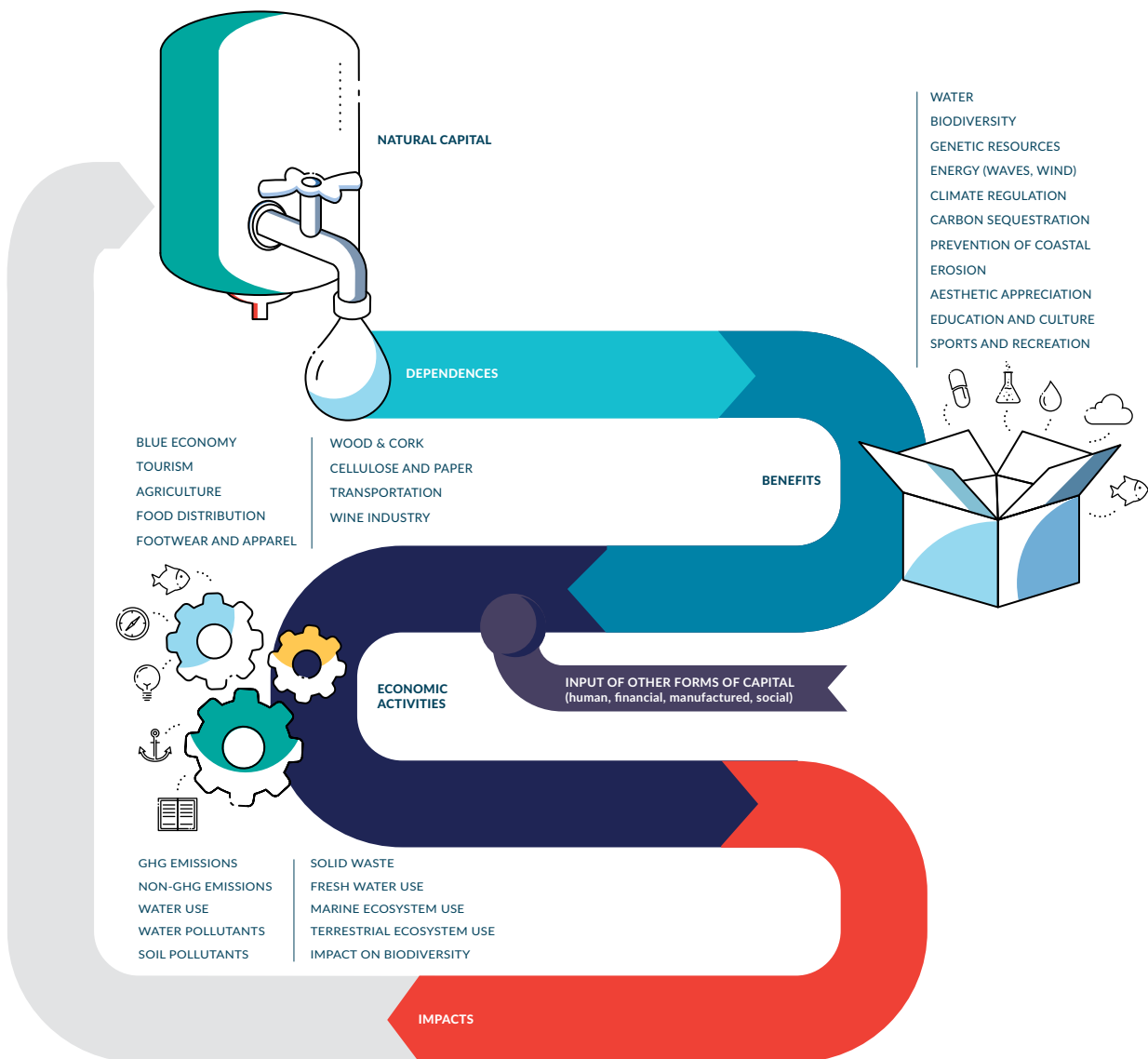


Figure 1/
The interrelations between natural capital and economic activity
Source: Gulbenkian Oceans Initiative

From invisibility of Natural Capital to economic opportunity

Currently, there are two main policy and business instruments that tackle the invisibility of natural capital:

Natural capital accounting / Process that involves identifying, measuring and/or valuing the impacts and dependencies between natural capital and business activities in order to sustain decision-making processes with more robust information.¹ This drives companies to replace risks by real business opportunities.

Non-financial reporting / process of gathering and disclosing data on non-financial aspects of a company's performance, including social, environmental, employee and ethical matters. This helps analyzing a company's performance and its impact on society, to improve the identification of sustainability risks, understand how a company creates and sustains value over the long-term and strengthen investor and consumer's trust.

In both cases the ultimate goal is to encourage companies to develop a responsible approach to business. While **accounting** and **reporting** are usually treated as completely independent instruments, we show how their complementarity can accelerate the transition to more sustainable and responsible businesses (Figure 2).



Natural capital accounting

NATURE OF TOOL

Decision-making

MAIN TYPE OF INFORMATION

Internal

MAIN END-USERS

Managers

APPLICABILITY

Strategic planning
Supply-chain assessment
Capital allocation

Investment/operational decision-making

MAIN BUSINESS BENEFITS

Increase business opportunities
Additional sources of revenue
Optimize risk management (legal, operational and financing)
Reduce costs
Enhance brand Image
Improve access to financing



Natural capital in non-financial reporting

NATURE OF TOOL

Communication

MAIN TYPE OF INFORMATION

External

MAIN END-USERS

Shareholders and investors' community

APPLICABILITY

Credit/financial capital lending choices
Customers' decisions and perceptions

MAIN BUSINESS BENEFITS

Mitigate and reduce legal and legislative risk
Enhance brand image
Improve access to financing

Figure 2/
Complementarity between natural capital accounting and reporting.

Understanding the impacts and dependencies between natural capital and economic activities leads to better-informed decisions, more responsible business strategies and important economic benefits.

1.

REPORTING IS MAINLY FOCUSED ON EXTERNAL USERS, WHILE ACCOUNTING IS MAINLY USED FOR INTERNAL INFORMATION

Natural capital accounting is a decision-making tool. It is mainly used by managers for strategic planning, supply-chain assessment, capital and investment allocation and operations decision-making. On the other hand, **non-financial reporting** is essentially a communication and transparency tool, used mainly by shareholders and the investor's community for capital and financial lending choices and to influence customers' decisions, trust and perceptions about the company. Non-financial reporting is a big step towards business transparency as it recognizes the importance of identifying and using non-financial information, such as natural capital. However, it might be counterproductive if companies focus mainly and/or exclusively on meeting legal requirements. In order to achieve the ultimate goal of sustainable, inclusive and responsible business models, companies need to change management models, attitudes and behaviors in addition to reporting natural capital and other non-financial variables.

2.

NON-FINANCIAL REPORTING MEETS CURRENT REGULATORY DEMANDS, WHILE NATURAL CAPITAL ACCOUNTING IS THE PROCESS OF IDENTIFYING, MEASURING AND VALUING THE VARIABLES A COMPANY SHOULD BE REPORTING.

Relevance (or materiality) is key to ensure that reporting of non-financial information realizes the expected positive impact. In the context of the sustainability reporting guidelines of the Global Reporting Initiative (GRI), "*determining materiality for a sustainability report includes considering economic, environmental, and social impacts that cross a threshold in affecting the ability to meet the needs of the present without compromising the needs of future generations (...) and the threshold for defining material topics to report should be set to identify those opportunities and risks which are most important to stakeholders, the economy, environment, and society, or the reporting organization, and therefore merit particular focus in a sustainability report*".²

Natural capital accounting enables companies to value the relative importance, worth or usefulness of their impact and dependence on natural capital. This is the basis for identifying what is material to a company and therefore what they should be sharing with external stockholders through their reporting. This means that natural capital accounting procedures should be explicitly connected to environmental data reporting standards by designing a coherent relationship between data business needs and environmental data requirements.

Business Recommendations

We recommend that:

*all companies that depend on natural assets, both directly and through their supply chains, should be adopting the **Natural Capital Protocol** in order to integrate natural capital into decision-making processes and ultimately make responsible strategic decisions.*

What is the **Natural Capital Protocol**?

During the last years, NGOs, think tanks and researchers enriched the natural capital dialogue and brought the discussion on natural capital accounting to the business and financial sectors. At the same time, too many approaches, tools and initiatives have been presented in a scattered and fragmented way to end-users, which brought confusion and prevented comparability, consistency and mainstream adoption of natural capital decision-making tools.

The Natural Capital Coalition built upon the existing tools and methods, which includes the Corporate Ecosystem Services Review (WRI, WBCSD and the Meridian Institute)³ and the Guide to Corporate Ecosystem Valuation (WBCSD, IUCN, ERM, and PwC)⁴ with the development of the **Natural Capital Protocol**. The Protocol harmonizes the existing work and provides a single global framework, helping businesses to generate credible and actionable information related to natural capital impacts and dependencies.⁵ It was specifically designed for business managers to inform decisions by guiding them throughout nine steps (four stages) that will help them understand **why, what, and how** to identify, measure and value natural capital, and, finally **how could the results be successfully integrated in the decision making process** (Figure 3).⁶ It is applicable to any business sector, operating in any geography and at any organizational level (e.g. corporate, project, product).⁷

The Natural Capital Protocol is a standardized framework that enables companies to understand their relationships with nature in a systematic way. It is designed to generate trusted, credible and actionable information that can inform risks and opportunities and ultimately, help realize significant business benefits, such as reducing production costs, optimizing risk management, enhancing brand image and increasing revenue streams. On top of this, companies are able to provide significant benefits to communities and to the environment.

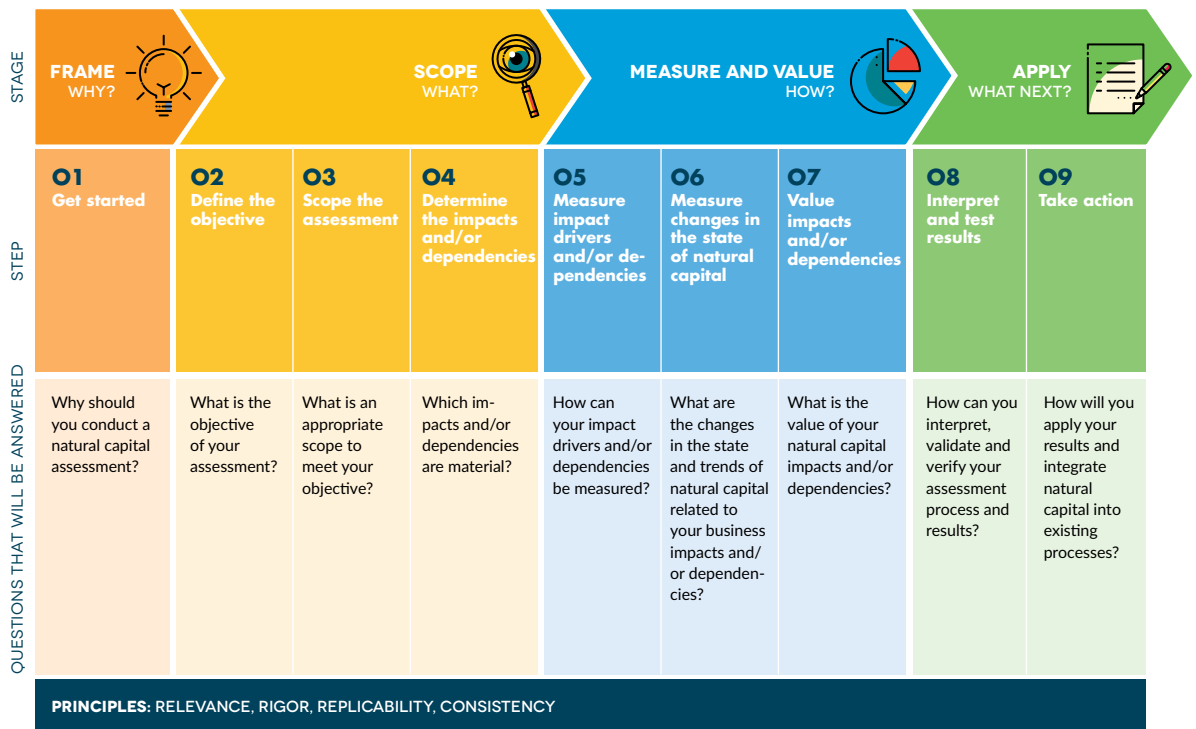


Figure 3/
The Natural Capital Protocol in nine steps⁸
Source: Natural Capital Coalition

Why should companies adopt the Natural Capital Protocol?

1.

TO OPTIMIZE LEGISLATIVE RISK MANAGEMENT

The Natural Capital Protocol is an effective legal risk management tool as it enables companies to comply with and get ahead of regulatory changes. In 2014, the European Commission approved Directive 2014/95/EU⁹ on the disclosure of non-financial and diversity information by large undertakings and groups. This directive is applicable to **“all large entities of public interest and with more than 500 employees [which] will need to include in the management report or in a separate report a non-financial statement containing information on environmental, social and employee matters”**.

In the European Union over 6,000 companies will have to report information on environmental, social and employee matters on fiscal year 2017.

The directive was transposed to Portugal's legal framework in 2017.¹⁰ The required environmental information should include details of the current and foreseeable impacts of the company's operations on the environment and, as appropriate, on health and safety, the use of **renewable and/or non-renewable energy, greenhouse gas emissions, water use and air pollution**. This information can be treated through the application of the Protocol. In fact, in order to help companies disclose relevant non-financial information in a consistent and more comparable manner, the European Commission published a set of non-binding guidelines which includes the Natural Capital Protocol.¹¹ **Companies who apply the Natural Capital Protocol are better prepared to comply with the European legislation regarding non-financial information and to make the most use of it.**

The Natural Capital Protocol is one of the frameworks recognized by the European Commission and included in the set of non-binding guidelines published by the Commission in July 2017.

2.

TO ATTAIN SIGNIFICANT ECONOMIC BENEFITS

Applying the Natural Capital Protocol (Figure 3) leads companies to better-informed decisions and drives them to reduce risks and identify real business opportunities. The related benefits are many, such as: **reduce costs** by realizing productivity and efficiency gains in the use and/or exploitation of resources; **increase revenues** by creating **new business opportunities** that integrate innovative and sustainable products and services; **enhance brand image** by increased transparency; **attract customers** by strengthening their trust in the company; **improve access to finance** by attracting investors and lenders who are currently much aware of the social and environmental performance of companies; and offer innumerable **benefits to local communities and natural ecosystems** which are increasingly exposed to negative externalities (Figure 4).




	OPERATIONAL	LEGAL AND REGULATORY	REPUTATIONAL	FINANCIAL	MARKET AND PRODUCT	SOCIETAL AND ENVIRONMENTAL
 AVOID RISK	<p>Higher costs due to scarcity of resources;</p> <p>Shortage of supply due to extreme weather events and degradation of natural ecosystems.</p>	<p>New fines, suspensions, lawsuits, among others, due to overexploitation and pollution of natural ecosystems, and due to lack of reporting non-financial information (environmental and other).</p>	<p>Brand damages in what concerns consumers and investors, due to environmentally irresponsible practices.</p> <p>Weakening relationships with suppliers, employees, customers, investors and creditors.</p>	<p>Lower margins;</p> <p>Increase in credit risks.</p>	<p>Losing customers to other environmentally friendly companies;</p> <p>Products' obsolescence.</p>	<p>Degradation of the ecosystems with consequences such as coastal erosion, decrease in water quality, decline in fish stocks, etc.</p>
 GRASP OPPORTUNITY	<p>Realize productivity and efficiency gains in the use and/or exploitation of natural resources;</p> <p>Improve and innovate the manufacturing processes and product design.</p>	<p>Meet and stay ahead of changes in legislation that may limit production options;</p> <p>More bargaining power with local and national authorities;</p> <p>Engage governments to develop policies and incentives to protect ecosystems that provide services needed by companies.</p>	<p>Increase clarity and transparency;</p> <p>Attract and retain customers by strengthening their trust in the company;</p> <p>Brand differentiation in relation to competitors;</p> <p>Attracting investors and lenders who take increasingly into account the environmental performance of companies.</p>	<p>Improved access to financing;</p> <p>Better informed investment allocation decisions.</p>	<p>Create new business opportunities that integrate innovative products and services that are sustainable from an environmental and economic point of view;</p> <p>Responding to pressure/demand of consumers for innovative products/services that are sustainable from an environmental point of view.</p>	<p>Improve well-being of communities and environment.</p>
 REALIZE BUSINESS BENEFITS	<p>Reduce production costs</p> <p>Optimize operational risk management.</p>	<p>Optimize legislative risk management.</p>	<p>Enhance brand image</p>	<p>Increase margins;</p> <p>Better financing and credit conditions;</p> <p>Ensure financial sustainability in the medium and long run.</p>	<p>Increase revenue streams.</p>	<p>Philanthropic values, i.e. intrinsic value of nature.</p>

Figure 4/
Main business benefits of adopting the Natural Capital Protocol

3.

TO HELP DELIVER AND MEET THE SUSTAINABLE DEVELOPMENT GOALS

Up to 2030, the global agenda is going to be driven by the Sustainable Development Goals that were adopted by the 193 Member States of the United Nations in September 2015. Business has a significant role to play in achieving the SDGs. The SDGs articulate how business and economic success depend on, and are innately connected to, social and environmental success.

The concept of capitals provides businesses with a structured approach to focus its contribution to the SDGs. The Natural Capital Protocol provides its users with a frame to assess how dependent they are on nature; and what impacts they are having on it. These two questions will have to be faced by any stakeholder (governments, businesses, associations and individuals) and not only in relation with natural capital but also with social and other types of capital, as the SDGs are indivisible.

The capitals approach, and the Natural Capital Protocol, not only allow organizations to ask themselves these questions, but provide a pathway to the answers, by supplying a standardized framework to identify, measure and value impacts and dependencies on the capitals, bringing them into the decision making process, and working to deliver on the SDGs.

*In preparation for the 13th Meeting of the Conference of the Parties to the Convention of Biological Diversity, the Council of the European Union called on the business sector to use the **Natural Capital Protocol** to increase its involvement in, and contribution to, achieving the Aichi Biodiversity Targets and the biodiversity-related **Sustainable Development Goals**.¹²*

The Business Cases of the Natural Capital Protocol

Over 50 large global companies have tested and applied the Protocol. Examples include Dow Company, Hugo Boss, Roche, Natura, Nespresso, Nestlé, Shell, Olam, Coca-Cola, H&M, Philips, Novartis, Akzo Nobel, Tata, Land Rover and Jaguar.

In Portugal, the Calouste Gulbenkian Foundation and the Business Council for Sustainable Development Portugal promoted the **Natural Capital Protocol Training Program** which was facilitated by the Natural Capital Coalition. It was attended by more than 50 participants from 36 different companies. At the end of the training, all companies were invited to participate in the **Natural Capital Protocol Challenge**, which aimed to demonstrate the business applications of the Natural Capital Protocol. Three Portuguese business applications of the Natural Capital Protocol are presented below.

The Natural Capital Protocol Training Program in Portugal consisted of four intensive workshops and several private meetings with the Natural Capital Coalition technical experts. It was attended by 55 participants from 36 large companies from 25 different economic sectors.

CTT APPLIED THE NATURAL CAPITAL PROTOCOL TO STUDY SUSTAINABLE ALTERNATIVES FOR ITS PRODUCT PORTFOLIO

CTT, a Portuguese postal services company, used the Natural Capital Protocol to analyze sustainable alternatives for its product portfolio and to evaluate the possible extension of eco-friendly features to more products. In particular, the Protocol was used to identify which attributes of their products' design can be enhanced in order to reduce negative societal impacts (e.g. through an increase in the use of recycled paper and exclusive use of eco-friendly inks and labelling) and to improve communications effectiveness. Through the natural capital assessment, the company was able to identify all main impacts and dependences between their supply chain activities and natural capital, and to match materiality issues with business and societal risks and opportunities. According to CTT, the main benefits of applying the Natural Capital Protocol include: i) reduce costs by investing in "green" products services; ii) gain or maintain investor's interest and confidence; iii) improve access to finance; iv) accommodate growing demand for credible certified products, such as eco-labeled paper; and v) Improve the ability to attract and retain employees.

TRANSTEJO USED THE NATURAL CAPITAL PROTOCOL TO ASSESS THE NEGATIVE IMPACT OF THE COMPANY'S AIR EMISSIONS

Transtejo, a ferry company that operates in Tagus River (Portugal), applied the Natural Capital Protocol to measure and value the negative impacts of the air pollution caused by their economic activity. The main goal was to use the results obtained to identify specific measures that aim to reduce carbon and non-carbon emissions, which provides benefits to local communities bordering the Tagus River, to the environment and to the company. Based on the application of the Protocol, Transtejo highlighted two major impacts on society: i) the company's activities in 2015 imposed a cost on society of €973,868 in terms of greenhouse gas (GHG) emissions; ii) the company's non-GHG emissions, in particular NO_x , SO_2 and $\text{PM}_{2.5}$, increased on average 2,6% per year between 2013 and 2015. According to Transtejo, the main benefits of this natural capital assessment include: i) anticipate new regulation that might limit air pollution; ii) position the company as a sustainable form of transport, which enhances its brand image; iii) benefit local populations by reducing health costs and mitigating climate change. Next steps include improving the energy performance through low carbon solutions, and strengthening the assessment of the company's impacts on communities.

JERÓNIMO MARTINS APPLIED THE NATURAL CAPITAL PROTOCOL TO VALUATE THE SOCIAL COSTS OF USING DIFFERENT PACKAGING COMPONENTS.

By implementing the full nine steps of the Natural Capital Protocol, Jerónimo Martins aimed to measure and value the comparative life cycle societal impacts on natural capital related to the use of PVC and alternative plastic materials (LDPE and PET) in packaging components for its Private Brand products¹ sold in the Portuguese market. Although results of the three scenarios evaluated varied significantly, it was possible to conclude that, unlike previously expected, the impact drivers with higher social cost were SO_2 , $\text{PM}_{2.5}$ and NO_x air emissions and not GHG or toxic releases — such as dioxins — from PVC production.

For the Jerónimo Martins Group the application of Natural Capital Protocol seems to contribute to a more in-depth knowledge, namely on the identification of: i) environmental risks upstream of the supply chain; ii) possible contamination of plastic waste stream due to the use of PVC; and iii) ongoing discussions on the development of regulations that may increase costs due to eco-taxes, waste disposal fees or increased complexity of plastic sorting by type of material used.

¹ Note: All PVC currently used in Private Brand packaging is not in direct contact with food.

The Natural Capital Protocol: understand first, adopt later

This plan, designed by the Calouste Gulbenkian Foundation, can be easily transposed and adapted to other contexts.

In the preparation phase of this project, the following main challenges were identified:

1. Lack of general knowledge about natural capital.
2. Difficulty in valuing natural assets due to lack of technical knowledge.
3. Lack of incentives for business engagement in measuring and valuing natural capital accounting.

To overcome these challenges and to accelerate the adoption of the Natural Capital Protocol in Portugal, Gulbenkian's team developed a 4-step action plan.



OBJECTIVE: INCREASE AWARENESS & CREATE BASELINE KNOWLEDGE

Action 1. Conduct a survey about the importance of natural capital, which was answered by 201 Portuguese maritime organizations.

Action 2. Publish a study with the main results of the survey, which was vastly disseminated through conferences, presentations and workshops in Portugal and abroad.

Action 3. Conduct meetings with key stakeholders (corporate sector and key consulting companies).

This phase was conducted in partnership with Fórum do Mar (former Oceano XXI) and PwC – Economics of the Sea.



OBJECTIVE: CLIMB THE LEARNING CURVE

Action 4. Create strategic partnerships with other entities working on corporate natural capital accounting (BCSD Portugal and the Natural Capital Coalition).

Action 5. Hold a wide information session on the Natural Capital Protocol.

Action 6. Provide a Natural Capital Protocol Training Program for the corporate sector.



MAJOR OBJECTIVE: ACCELERATE ADOPTION

Action 7. Natural Capital Protocol Challenge: to ensure applicability for the training program (Action 6), participants have the opportunity to participate in the challenge.



MAJOR OBJECTIVE: RECOGNIZE EARLY ADOPTERS

Action 8. Promote opportunities for companies to share the work done in the context of the Natural Capital Protocol Challenge. Recognition is the main incentive here.

NOTES

¹ Spurgeon, J.P.G (2014). Natural Capital Accounting for Business: Guide to selecting an approach. Final Report to the EU Business and Biodiversity Platform, ICF international.

² Available at: <https://www.globalreporting.org>

³ Available at: <http://www.wri.org>

⁴ Available at: <http://www.wbcsd.org>

⁵ Climate Disclosure Standards Board. Connecting the Natural Capital Protocol and the CDSB Framework. Available at: <http://www.cdsb.net/strategic-alliances/natural-capital-coalition>

⁶ Natural Capital Protocol. Available at: <http://naturalcapitalcoalition.org/protocol>

⁷ This was identified through a dedicated Business Engagement Program which included interviews with more than 80 companies. In addition, the public consultation on the draft Protocol received over 3,200 comments, making it one of the most significant consultations in recent years. Available at: <http://naturalcapitalcoalition.org/protocol>

⁸ This figure was gently provided by the Natural Capital Coalition.

⁹ European Commission. Banking and Finance. Non-financial reporting, 2016. Available at: http://ec.europa.eu/finance/company-reporting/non-financial_reporting/index_en.htm

¹⁰ Decree-Law 89/2017. Available at: <https://dre.pt/home/-/dre/107773645/details/maximized>

¹¹ Official Journal C 215 of the European Union, July 5th 2017. Available at: [http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52017XC0705\(01\)&from=EN](http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52017XC0705(01)&from=EN).

¹² Available at: <http://naturalcapitalcoalition.org/natural-capital-protocol-recognised-as-important-tool-in-reaching-the-sustainable-development-goals/>

The Calouste Gulbenkian Foundation is a Portuguese private institution of public utility, which was created in 1956 in accordance with the last will and testament of Calouste Sarkis Gulbenkian. It actively pursues its statutory aims in the fields of the arts, charity, education and science in Portugal and abroad, including through its UK Branch and Paris Delegation. The Foundation promotes a wide range of direct activities and grants supporting projects and programs.

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