

VALUING SUSTAINABILITY TO CREATE VALUE:

A BUSINESS PERSPECTIVE



DOES ENVIRONMENTAL SUSTAINABILITY MAKE ECONOMIC AND BUSINESS SENSE?

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Executive Summary

In this Anthropocene epoch, human activity has been the impetus for our global environmental woes. Driven by our propensity for economic progress, environmental impacts have often taken a backseat in key business decisions and public policy. Such a mentality has inevitably led to excessive plundering of natural resources, pervasive irreversible pollution and rampant generation of waste.

In recent years, environmental awareness has surged. Businesses have had to contend with stricter regulatory requirements, greater climate risks across supply chains and an evolving consumer landscape. The success of sustainability leaders like Natura and Nestlé has spurred on others to jump on the bandwagon of sustainability, though many still struggle to understand the value of it.

In Chapter 2, we highlight how sustainability can create value for the businesses by - (1) establishing a competitive advantage, (2) increasing employee retention, (3) lowering operating costs and (4) managing operational risks.

In Chapter 3, we argue that businesses still prioritise their short-term financial benefits over long-term sustainability goals because they fail to recognise how sustainability can potentially benefit their bottom line. We attribute this to 3 main issues and with each issue, we propose a solution for businesses to overcome that problem.

To realise these benefits, businesses need to set practical and meaningful targets to work towards their sustainability goals. In Chapter 4, we propose a four-step “MACE” approach - Materiality, Approach, Context-based and Evaluation. First, businesses must identify material issues which affect their long-term performance. Second, corporate leaders should actively approach stakeholders and engage them in the goal setting process to solicit their perspectives and priorities. Third, businesses should set context-based goals, which considers environmental limits and measures their progress towards sustainability. Last, businesses should implement metrics with elements of environmental sustainability to comprehensively evaluate their environmental sustainability effort. Therefore, businesses can create value from sustainability.

(300 Words)

RECONCILING SHORT-TERM GAINS & LONG-TERM SUSTAINABILITY GOALS



SUSTAINABILITY APPROACH: LONG-TERM BENEFITS



GOAL SETTING: THE "M.A.C.E." APPROACH



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1. Introduction to Sustainability

1.1 Definition of Sustainability

In business terms, sustainability is a “business approach to creating long-term value by taking into consideration how a given organization operates in the ecological, social and economic environment” (Haanaes, 2016).

1.2 A New Era

With growing climate awareness (Fig 1), businesses need to adapt to stricter environmental regulations (Fig 2) and an evolving consumer landscape.¹



Fig 1: Photo illustrating the YouthStrike4Climate student march on April 12, 2019, which took place across 130 countries. (Irfan, 2019)

¹ A 2015 Nielsen report on new product innovation showed that consumers want more new products that are “affordable, healthy, convenient, and environmentally friendly” (Nielsen, 2015).

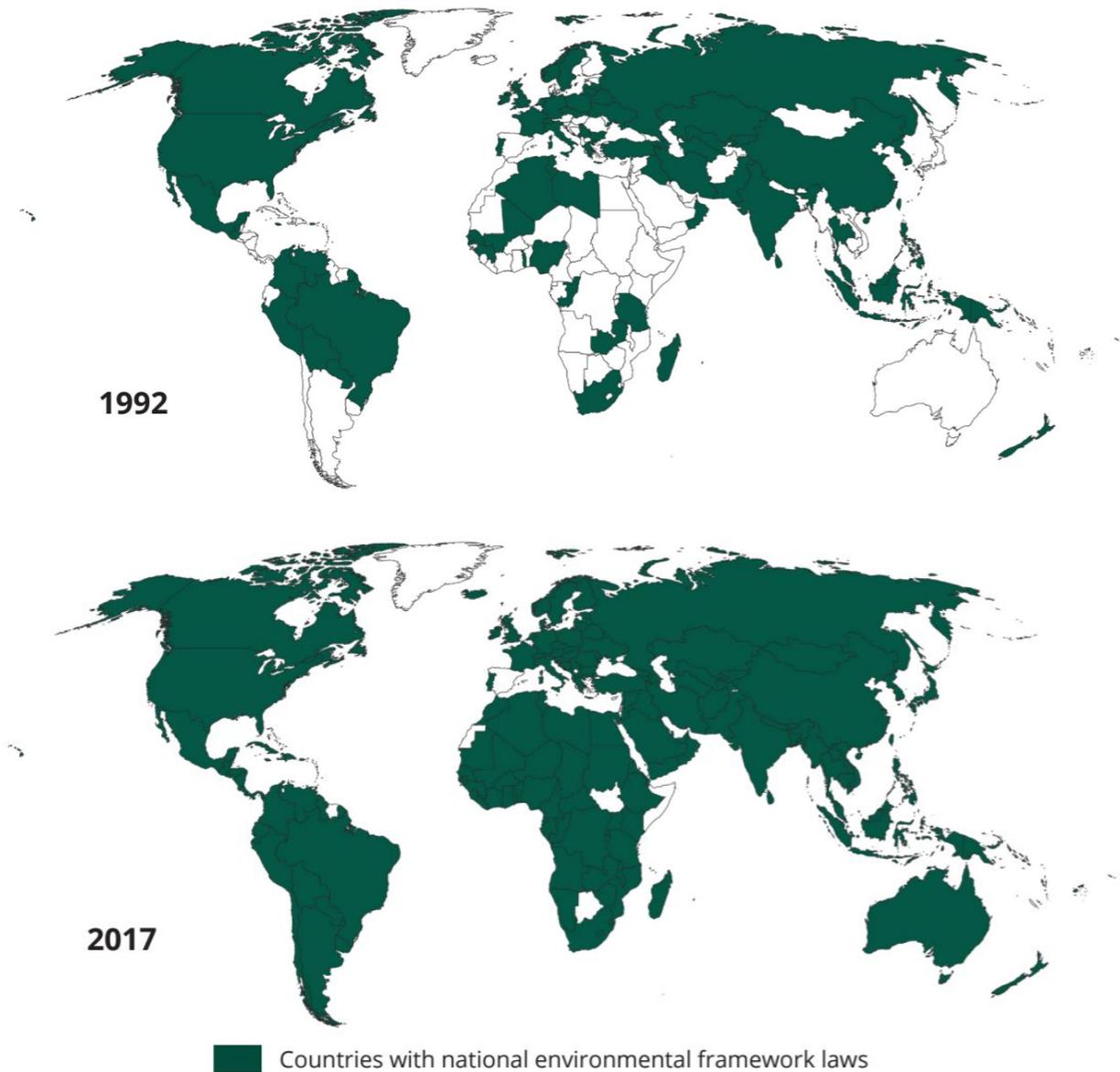
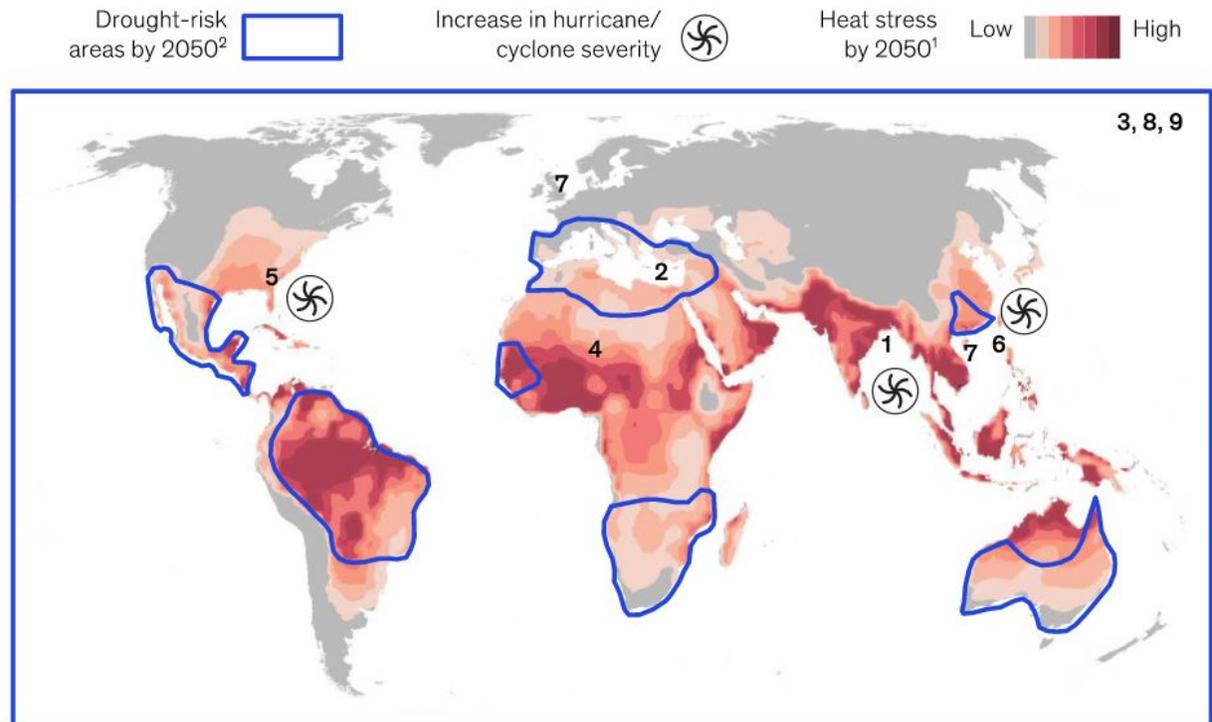


Fig 2: Map illustrating the increase in countries that implement national environmental framework laws from 1992 to 2017 (United Nations Environment Programme, 2019, p. 4).²

² As of 2017, 176 countries worldwide have environmental framework laws that are being implemented by hundreds of agencies and ministries. Legal instruments in 187 countries require environmental assessments for projects that impact the environment and at least fifty percent of countries adopted legislation guaranteeing access to information in general or environmental information in particular. (United Nations Environment Programme, 2019, p. 2)

Furthermore, climate risks emerge across businesses' supply chains, causing volatility and disruptions.³



¹Heat stress measured in wet-bulb temperatures.

²Drought risk defined based on % of month in drought according to Palmer Drought Severity index (PDSI).

Source: Woods Hole Research Center; McKinsey Global Institute analysis

Fig 3: Map illustrating the physical climate risks in the next 3 decades modelled by McKinsey (Woetzel et al., 2020).

Sustainability has now become an imperative for businesses, with most implementing some sustainability governance.⁴ This strengthens their climate resilience and enhances their long-term performance.

³ According to McKinsey's Climate Risk and Response Report 2020, in the absence of climate mitigation measures, there will be significant environmental shifts that impact global supply chains in the next three decades. They include reduced agricultural yields, increased risks of asset disruption and significant biome shifts.

⁴ 70% of McKinsey survey respondents say their companies have some form of sustainability governance in place (Bove et al., 2017).

2. Long-Term Benefits of Sustainable Approach

2.1 Establishing Competitive Advantage

“A competitive advantage is said to be sustainable if it cannot be copied or eroded by actions of rivals, and is not made redundant by environment developments” (Wit & Meyer, 2001, p. 201).

BIODIVERSITY

Our products are formulated with fair trade biodiversity ingredients from the Amazon, - such as Castanha, Açaí, Ucuuba and Patauá -, gathered by local Amazonian communities. We work with them to develop sustainable practices that collaborate to keep the forest standing.



Fig 4: Infographic explaining Natura's Ekos line (Natura, n.d.).

Businesses can differentiate themselves from competitors by marketing themselves as sustainability leaders. With the rise of eco-consumerism, consumers prefer to buy products that align with their values.⁵ Natura's iconic Ekos (Fig 4) is a vegan product range, which contains 95% natural origin ingredients and uses 100% recyclable packaging (Natura, n.d.). Its unique branding and product innovation target a niche market of eco-conscious consumers. With a strong competitive advantage over its competitors, Natura has now established itself as the world's fourth largest cosmetics company.

⁵ Nearly two-thirds of consumers across six international markets believe they “have a responsibility to purchase products that are good for the environment and society” — 82% in emerging markets and 42% in developed markets (Whelan & Fink, 2016).

Beyond just marketing, businesses may be able to develop a competitive advantage through a unique business model, while achieving sustainability targets. Through an open innovation model, Natura outcompetes rivals in product innovation by crowdsourcing new ideas (Fig 5), emerging as a global leader in innovation.

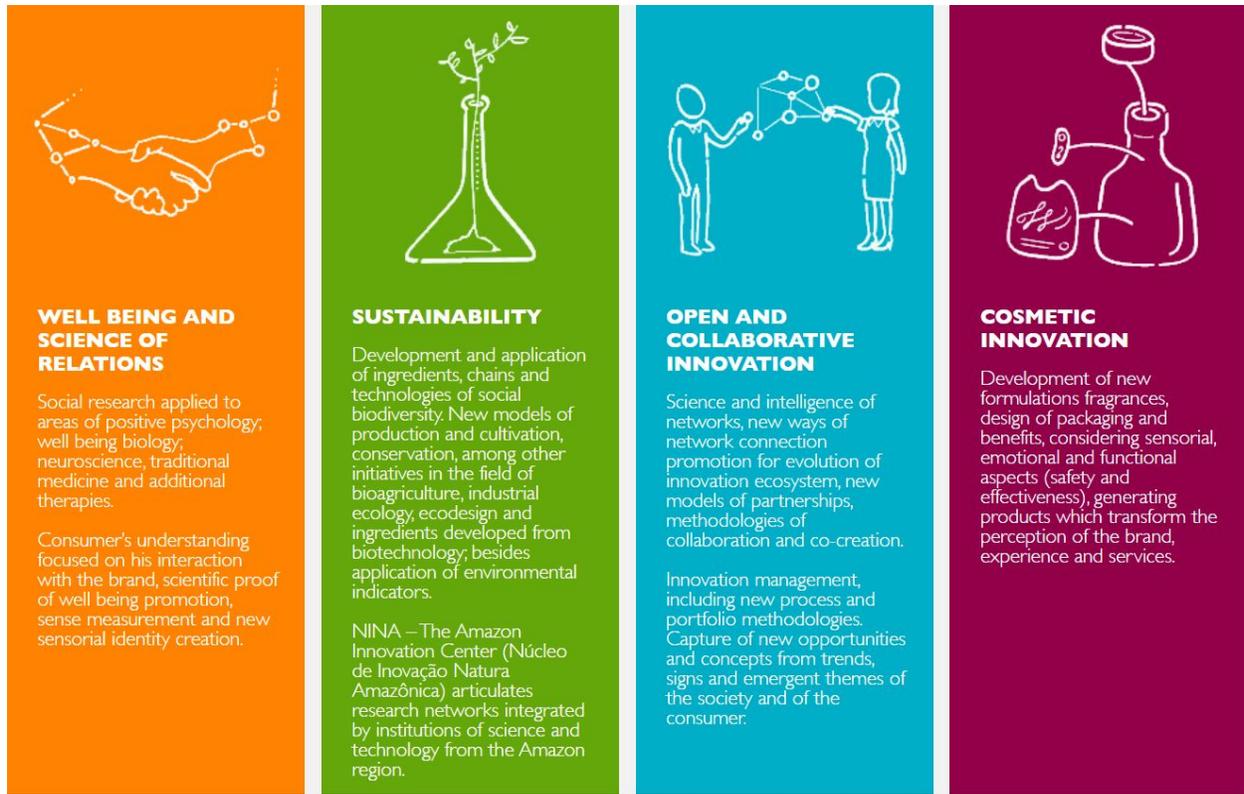
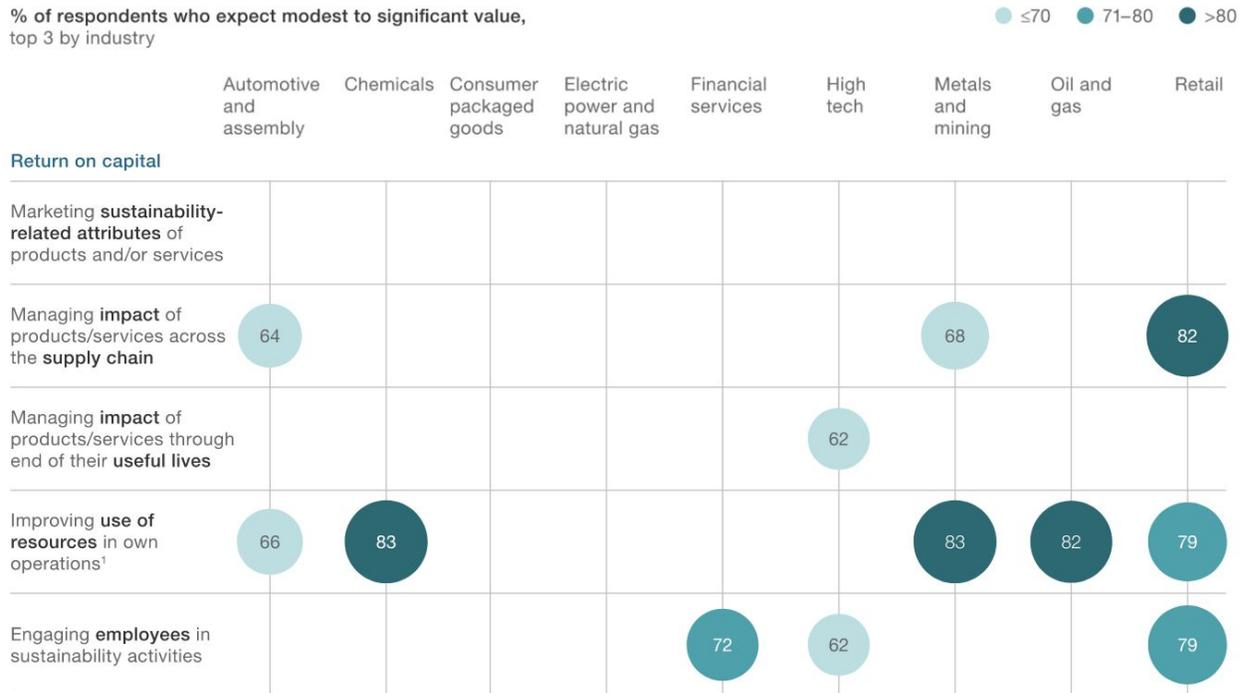


Fig 5: “Natura Campus” is a platform that fosters collaboration among universities, firms and entrepreneurs to innovate across four main innovation themes (Natura Campus, n.d.).

2.2 Lower Operating Costs

Opportunities for value creation⁶ vary greatly among industries (Fig 6) and can be achieved by lowering operating costs.

Perceptions vary by industry on the top value-creation opportunities from sustainability over the next five years.



¹For example, water, energy, or waste.

Fig 6: Chart showing the top value-creation opportunities from sustainability over the next five years (Bové et al., 2017).

Regardless of industry, companies creating value through sustainability primarily consider improving returns on capital though improved natural resource management (e.g. water conservation) and supply chain reforms (e.g. sustainable sourcing).

⁶ According to Business Dictionary (n.d.), value creation is the performance of actions that increase the worth of goods, services or even a business.

In 2009, Walmart decided to switch to a recyclable variety of cardboard, eliminating waste transportation costs and generating revenue from cardboard sales. (Fig 7, 8 & 9). The company also sells photo frames made from its polystyrene waste and recycles plastic scraps leftover from producing Walmart-brand diapers into material used in building new Walmart stores (Bhanoo, 2010).

How Walmart supports a circular economy



Fig 7: Infographic explaining Walmart's Sustainability Plan (Walmart, 2016).



Fig 8: Infographic illustrating Walmart’s Waste Management Plan (Walmart, 2016).

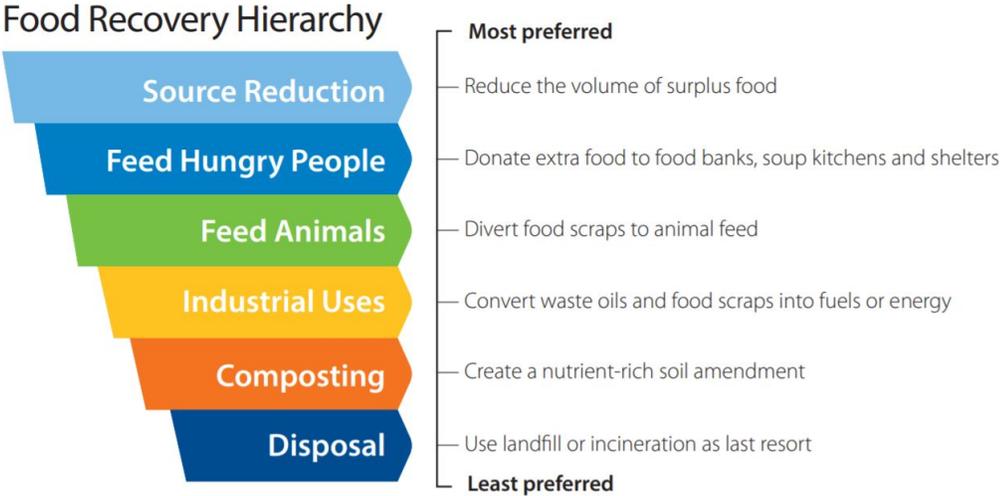


Fig 9: Infographic explaining Walmart’s Food Recovery Framework (Walmart, 2016).

2.3 Increased Employee Retention

As a result of heightened environmental awareness, employees are more willing to work for companies that are proactive with corporate environmental and social programs (Fig 10). By offering sustainable practices, businesses can recruit and retain a greater talent pool.



EDELMAN INTELLIGENCE / © 2019
 Q10: How much do you agree or disagree with the following statements? (top 2 box reported). C2: Thinking about the role brands/ companies have in making the world a better place and addressing societal issues, please indicate how much you agree or disagree with the following statements. (top 2 box reported) // Base sizes: Millennial OWs (Global = 1895, Canada = 186, China = 241, France = 169, Germany = 169, India = 264, Italy = 156, Mexico = 250, Spain = 179, UK = 142, US = 145), Gen X OWs (Global = 1956, Canada = 187, China = 174, France = 237, Germany = 203, India = 112, Italy = 239, Mexico = 139, Spain = 235, UK = 240, US = 190)

20

Fig 10: Bar chart illustrating HP Workforce Sustainability Survey 2019 results (HP, 2019, p. 20).

One study found that morale was 55% better in companies with strong sustainability programs, compared to those with poor ones, and employee loyalty was 38% better (Whelan & Fink, 2016). Better morale and motivation often translate into reduced absenteeism and improved productivity. As such, companies advocating sustainability can instill a greater sense of purpose⁷ in employees, leading to higher retention rates.

⁷ 21st century employees are focusing more on mission, purpose, and work-life balance (Whelan & Fink, 2016).

2.4 Better Risk Management

In an era of growing demand for sustainable products and services, good corporate governance and social responsibility (Bonini & Görner, 2011), limited resources and tighter regulatory requirements contribute to unpredictable material risks which affects both a company's reputation and profits. Hence, the pursuit of sustainability helps companies to mitigate key risks from operational disruptions, build capacity and develop adaptive strategies.⁸

⁸ An adaptive strategy emphasises continuous experimentation and real-time adjustment to manoeuvre unpredictable environments, associated with climate change (Boston Consulting Group, n.d.).



Fig 11: Infographic illustrating Nestlé Sustainable Cocoa Plan (Stones, 2015).

In particular, the agriculture industry struggles with lower crop yields due to volatile weather conditions and increased spread of pests. In 2009, Nestlé, launched a plan to promote the use of sustainable cocoa to mitigate potential supply constraints (Fig 11). This consists of the production of 12 million stronger and more productive plants over the next ten years, training local farmers to adopt a sustainable approach as well as purchasing beans from farms with sustainable practices.

3. Barriers to Environmental Sustainability & Solutions

Despite being more aware of sustainability benefits, businesses are pursuing insufficient growth-related sustainability activities and little value creation has been achieved (Bove et al., 2017). Many still struggle to understand the value of sustainability, leading to the apparent conflict between their short-term financial needs and long-term sustainability goals. This chapter examines the main barriers to sustainability and proposes solutions for businesses.

3.1 Business Financial Decision-Making

[Barrier] Given the intangible benefits of sustainability e.g. reduced energy price volatility risks and increased employee retention, current financial decision-making framework cannot quantify their returns of investments (ROI) accurately in financial terms.

Return on Investment (ROI)

Return on Investment (ROI) measures the benefit an investor will receive in relation to their investment cost.

$$\text{ROI} = \frac{\text{Net Income}}{\text{Cost of Investment}}$$



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Fig 12: Diagram explaining ROI (Corporate Finance Institute, n.d.).

Furthermore, business investments are evaluated by their payback periods, measured in hurdle rates.⁹ Sustainability-related investments, such as new technologies to reduce water usage, often require longer time to generate returns and hence have longer payback periods. The implication is that such investments are valued to have lower ROI and are less prioritised.

⁹ A hurdle rate is the minimum rate of return on a project or investment required by a manager or investor (Kenton, 2020).

3.1.1 Internal Mechanisms

[Recommendation] Businesses can implement internal mechanisms to enhance business decision-making processes for sustainability-related investments. For instance, UPS lowers the hurdle rates for new fleet technologies that potentially reduces fuel usage (Perera et. al., 2013), whereas Diversey bundles its greenhouse gas emission projects into an integrated portfolio (Fig 13). This lowers the risks by diversification, while presenting a reasonable ROI collectively. Such aggregation hence allows for more diverse projects, including high risk R&D into new technologies (Davies, 2011).

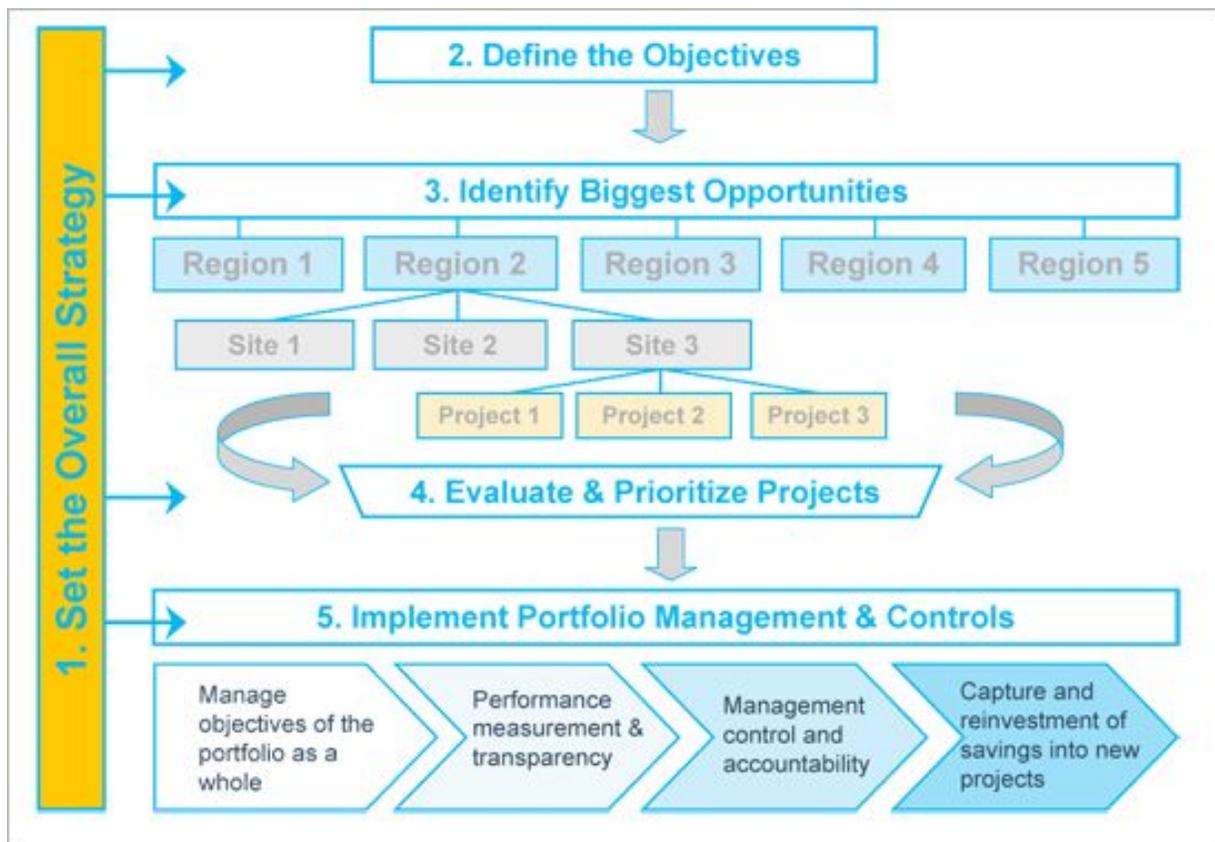


Fig 13: Flow chart explaining Diversey's portfolio development process (Davies, 2011).

3.2 Environmental Risks

[Barrier] According to Blanco & King (2017), only 28% of companies surveyed currently acknowledge the financial risk of climate change in their annual reports. Of those companies, very few quantify the potential impact of climate change in financial terms. This implies that most businesses lack a thorough understanding of environmental risks across their corporate value chain, and the potential financial costs that may be incurred.¹⁰ Therefore, businesses often overlook potential opportunities to mitigate these risks through sustainability-related investments.

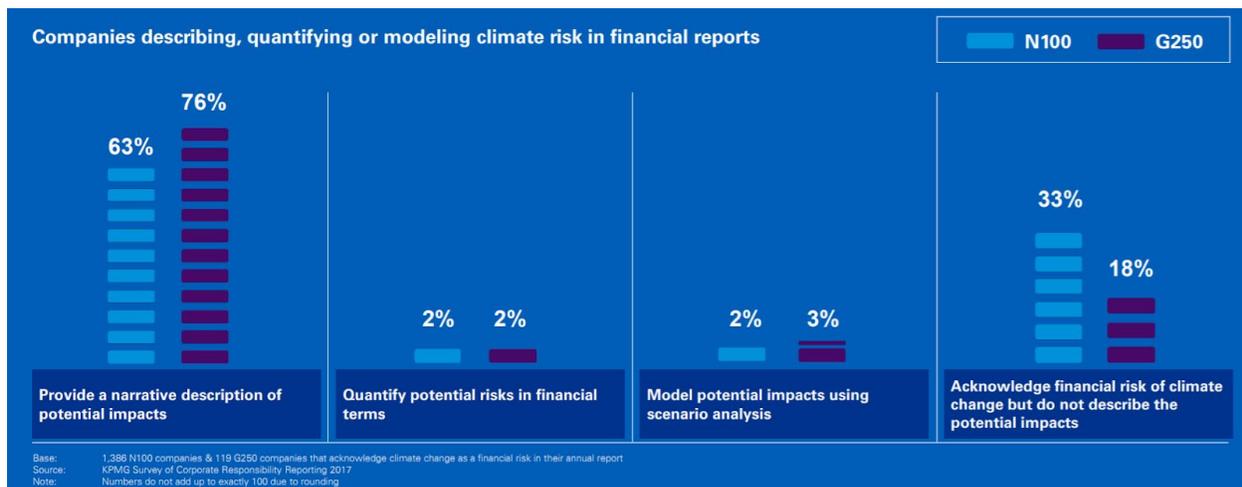


Fig 14: Bar chart showing percentage of companies describing, quantifying or modelling climate risk in financial reports (Blanco & King, 2017, p. 32).

¹⁰ For instance, flooding in 2011 in Thailand, harmed 160 companies in the textile industry and halted nearly a quarter of the country's garment production, increasing global prices by 28% (Whelan & Fink, 2016).

3.2.1 Metrics

[Recommendation] Metrics can be established to help businesses comprehensively understand the potential environmental risks across its value chain, especially with climate change. Thereby, businesses can develop sustainable strategies to mitigate risks, while strengthening climate resilience.

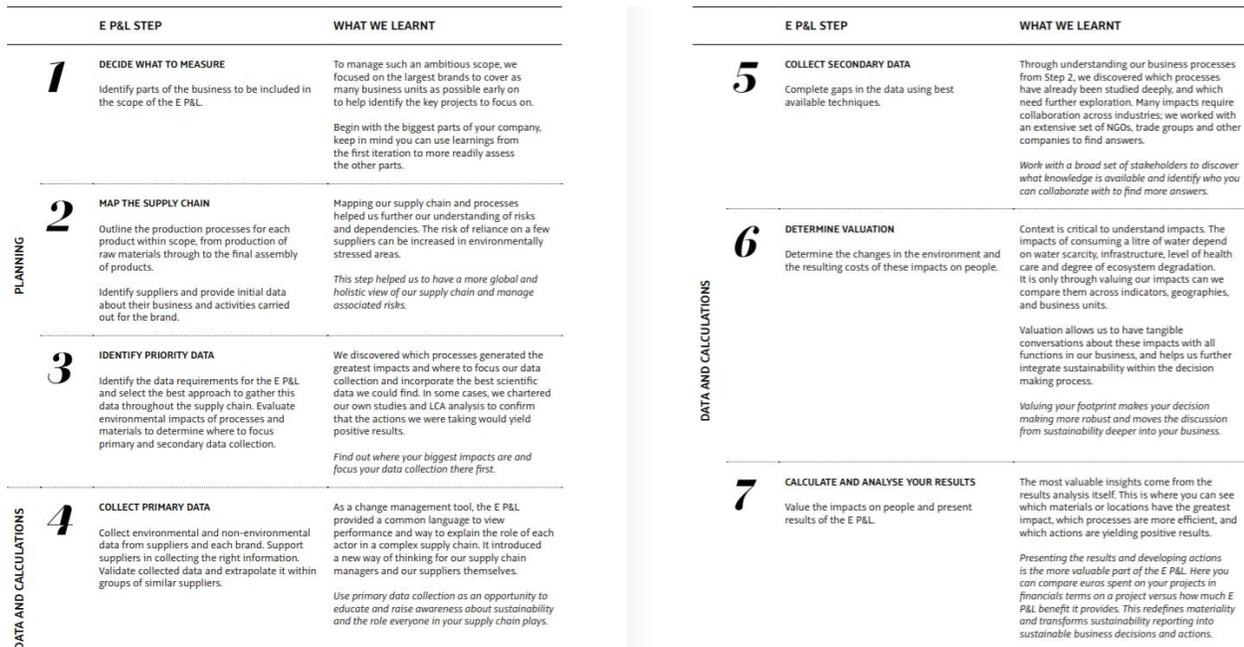


Fig 15: Infographic explaining 7-step methodology for Kering's EP&L (Kering, 2019).

Kering S.A., home to luxury brands Gucci and Balenciaga, developed an Environmental Profit & Loss (EP&L) account to measure and quantify the environmental impact of its activities (Fig 15). This account quantifies the monetary value of environmental impacts across its supply chain, including carbon emissions and water consumption. This information collected guides the company on ways to improve its processes and enhance its sustainability strategy (Kering, 2019).

3.3 Long-Term Business Strategy

[Barrier] Even as businesses are more engaged in sustainability,¹¹ few integrate sustainability into long-term business strategy, with merely 36% of companies having a strategic approach to sustainability with a defined set of initiatives (Bonini & Görner, 2011). Most businesses still adopt a fragmented approach towards sustainability, narrowly focusing on green branding to maintain their corporate reputation.¹²

¹¹ According to Bové et al., (2017), nearly six in ten respondents say that their organizations are more engaged with sustainability than they were two years ago.

¹² According to Bové et al., (2017), corporate reputation is the second most cited reason why companies address sustainability.

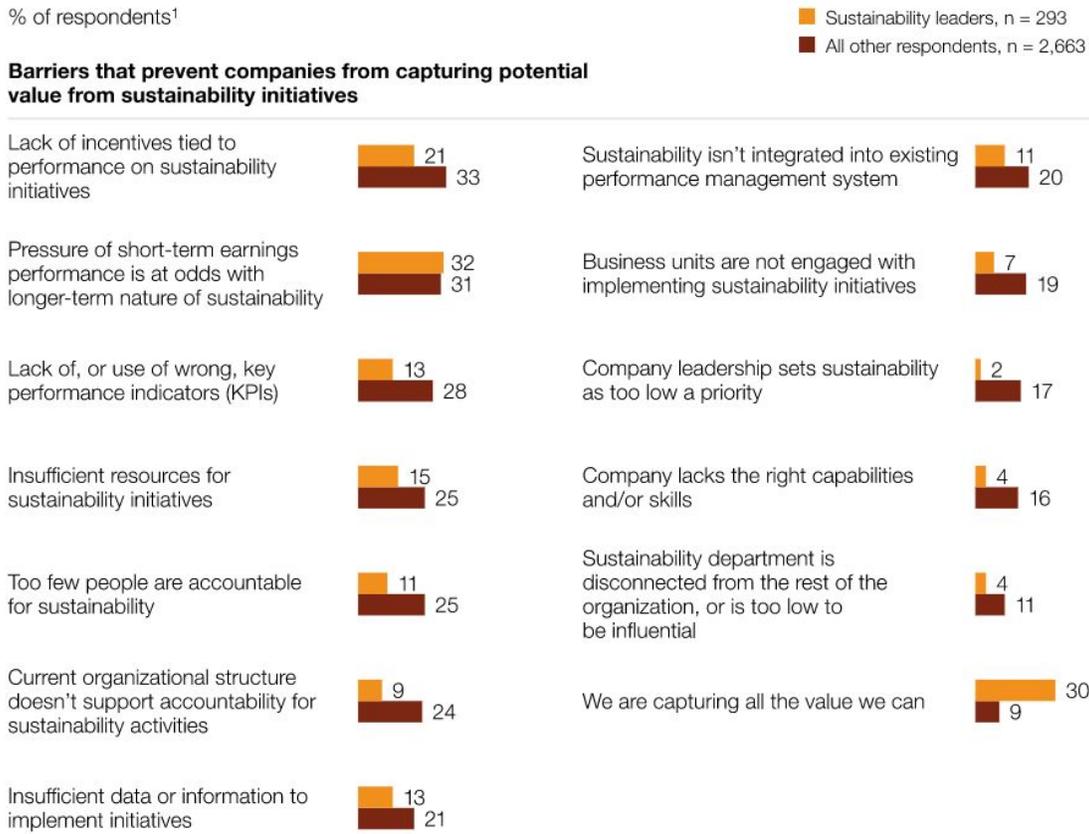


Fig 16: Bar chart showing the barriers that prevent companies from capturing value from sustainability initiatives (Bonini & Görner, 2011).

A key reason is a weak corporate sustainability culture. Bonini & Görner (2011) explains how employees are poorly motivated due to a “lack of incentives tied to performance on sustainability initiatives” (Fig 16). Furthermore, Bové et al., (2017) illustrates how employees are poorly engaged, with a poor understanding of their organisation’s sustainability initiatives.¹³ Consequently, sustainability remains a fringe activity and businesses fail to recognise how sustainability creates value for the organisation.

¹³ According to Bové et al., (2017), one quarter of respondents say that they don’t know how much, if anything, their organizations spend on sustainability-related initiatives—and a similarly small share say sustainability’s financial benefits are clearly understood across their organizations.

3.3.1 Corporate Culture

[Recommendation] As such, engagement of key stakeholders in the business is needed to create strong corporate culture and to generate an organisation-wide effort towards sustainability.

The Sustainable in a Generation Plan has three interconnected strategic Pillars that we believe are essential for sustainable growth:



Fig 17: Infographic showing the three interconnected strategic pillars of Mars' Sustainable in a Generation Plan (Mars, 2018).

To achieve its targets in the “Sustainable in a Generation” Programme (Fig 8), Mars Inc. focussed on building a culture of sustainability performance. Mars spent a year and a half to secure buy-in from its employees and worked closely with each business unit to develop a mutually agreeable strategy to achieve the targets (Mars, 2018). This consultation process helped increase employee awareness on the implication of climate change on the business and heighten employee motivation towards sustainability initiatives.

4. Goal Setting

To help businesses achieve sustainability, this essay proposes a four-step “MACE” approach to help them set practical and meaningful targets.



Fig 18: Infographic explaining the four-step “MACE approach”.

4.1 Materiality

Businesses must first identify issues material¹⁴ to them i.e. those with potential to influence long-term performance of businesses. This allows them to set strategic goals which align to the core business strategy and create value, while making a long-lasting societal impact. Businesses can reference existing material, such as Global Reporting Initiative (GRI) Material Topics List,¹⁵ or conduct materiality assessments to identify sector-specific material issues (Fig 19 & 20).

¹⁴ Materiality refers to topics that reflect the organisation’s significant economic, environmental and social impacts or substantively influence the assessments and decisions of stakeholders (Global Reporting Initiative, 2015).

¹⁵ GRI Material Topics List, published in 2013, identifies sector-specific material topics across 52 industries (Global Reporting Initiative, 2013).

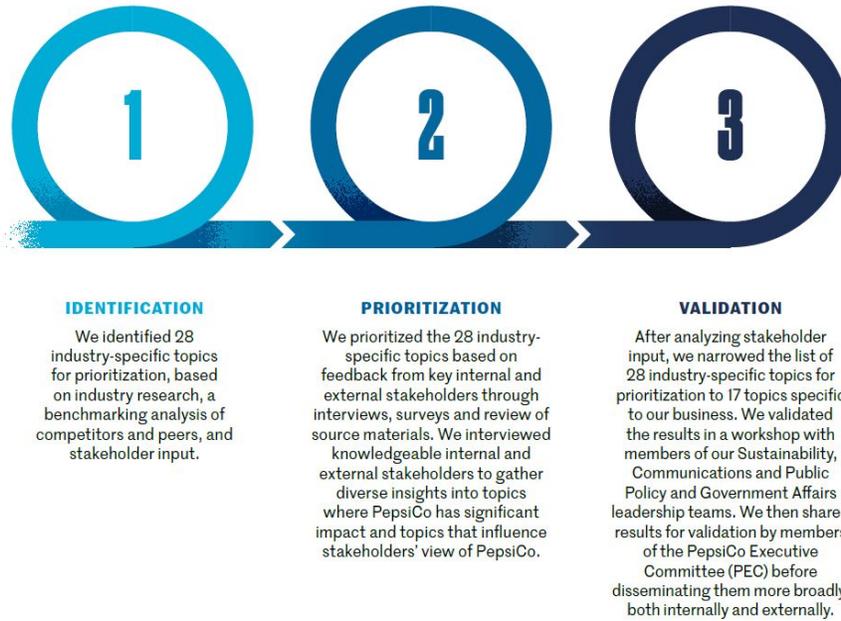


Fig 19: Infographic explaining PepsiCo's three-step process for its Material Topics Assessment (PepsiCo, 2015, p. 35).



Fig 20: Infographic explaining the 17 material topics PepsiCo identified through its Material Topics Assessment (PepsiCo, 2015, p. 35).

Businesses can also use Life Cycle Analysis (LCA) to understand the total environmental impact of their products (Fig 21), thereby designing new products with improved environmental profiles. With it, Procter & Gamble found that U.S. households spent 3% of annual electricity budgets on heating water to wash clothes. This inspired them to launch new cold-water detergents that require 50% less energy than conventional detergents. (Whelan & Fink, 2016).

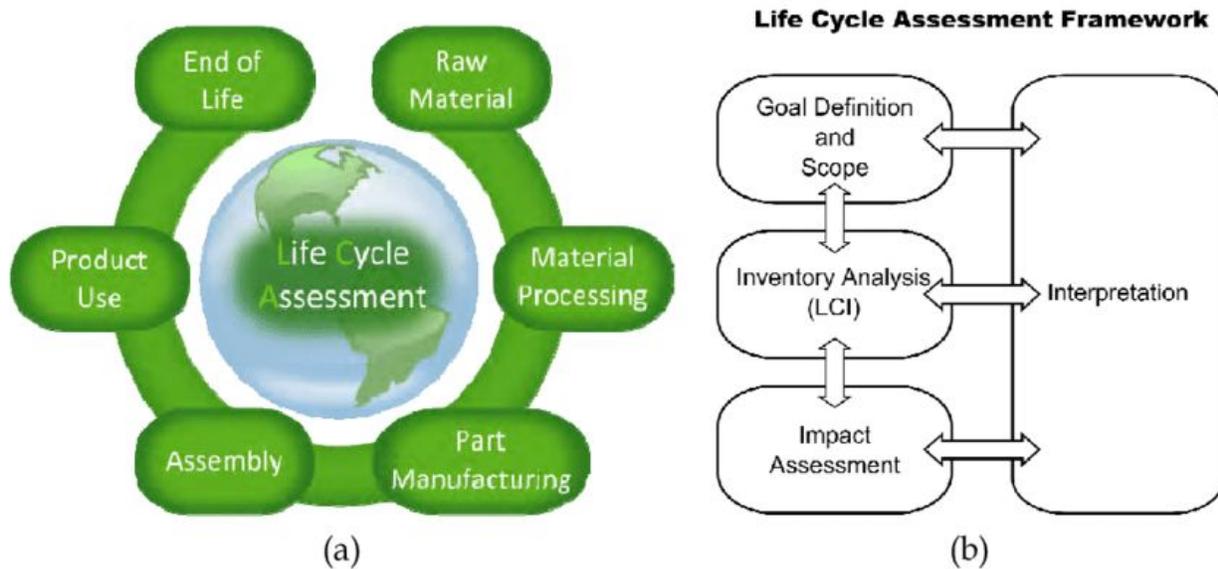


Fig 21: Infographic explaining (a) cradle-to-grave LCA and (b) LCA Framework according to ISO standards (Annick & Vasilis, 2012).

4.2 Approach Stakeholders

To shape their goals strategically, corporate leaders may solicit opinions from stakeholders including but not limited to shareholders, suppliers, consumers and business partners. Engagement with stakeholders manifests a company's thoughtfulness in its business approach and may enable them to set more achievable targets through collective wisdom. In particular, employees should be engaged in the goal-setting process, allowing them to have a stake in sustainability initiatives.



Fig 22: Infographic explaining Woolworths' Enterprise Risk Management Framework which includes actively engaging key stakeholders (Woolworths, 2019).

Woolworths conducts internal training sessions on their corporate sustainability strategy for employees and rewards them based on contributions to the company's sustainability efforts. Such practices empower employees to raise suggestions and incentivise them to contribute to environmental sustainability goals (O'Neill & McElroy, 2017).

4.3 Context-Based

An emerging trend in sustainability management is context-based sustainability (CBS). CBS reports the sustainability performance of an organisation based on how “its impacts on resources compare to norms, standards and thresholds for what they would have to be in order to be sustainable” (McElroy, 2013). CBS proposes that organisations should set context-based goals, which takes into account social, economic and environmental limits.

Science-Based Goals/Metrics	Context-Based Goals/Metrics	Ethics-Based Goals/Metrics
Climate-science-based emissions goals or metrics that <i>do not</i> take changes in organizational size and/or the number of global emitters over time explicitly into account		
Climate-science-based emissions goals or metrics that <i>do</i> take changes in organizational size and/or the number of global emitters over time explicitly into account		
		Fairtrade-based goals or metrics that <i>do not</i> take supply chain structures or dynamics explicitly into account
	Fairtrade-based goals or metrics that <i>do</i> take supply chain structures or dynamics explicitly into account by, say, focusing on more direct interventions with <i>Tier n</i> suppliers	

Figure 2 – Examples of Science-, Ethics- and Context-Based Metrics

Fig 23: Table explaining examples of context-based goals and how they differ from science-based and ethics-based goals (McElroy, 2015).

Best practices today “identifies the end-goal¹⁶ for the system challenge” (O’Neill & McElroy, 2017). Recognising the plastic waste catastrophe globally, where only 14 percent of plastic is recycled, PepsiCo sets an ultimate aim of “building a world where plastics need never become waste”. Hence, PepsiCo strives for all packaging to be recyclable, compostable or biodegradable and targets a 35 percent reduction of virgin plastic content across all beverage brands by 2025 (PepsiCo, 2018).

PEPSICO’S SUSTAINABLE PLASTICS VISION

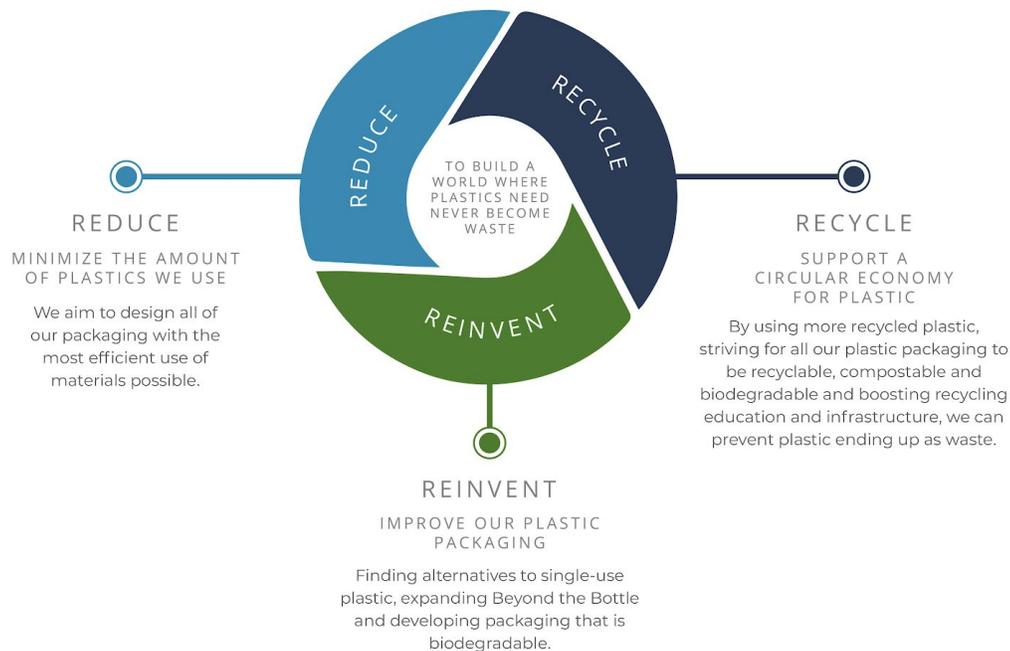


Fig 24: Diagram illustrating PepsiCo’s Sustainable Plastic Vision (PepsiCo, n.d.).

¹⁶ O’Neill & McElroy (2017) explains that “end-goal” refers to what is needed to achieve sustainability on that social, economic or environmental issue.

4.4 Evaluation of Progress

Companies can monitor the progress of their efforts on environmental sustainability through the use of rigorous and comprehensive metrics. Many existing models utilise the concept of Triple Bottom Line (TBL),¹⁷ an accounting framework comprising social, environmental and financial aspects.

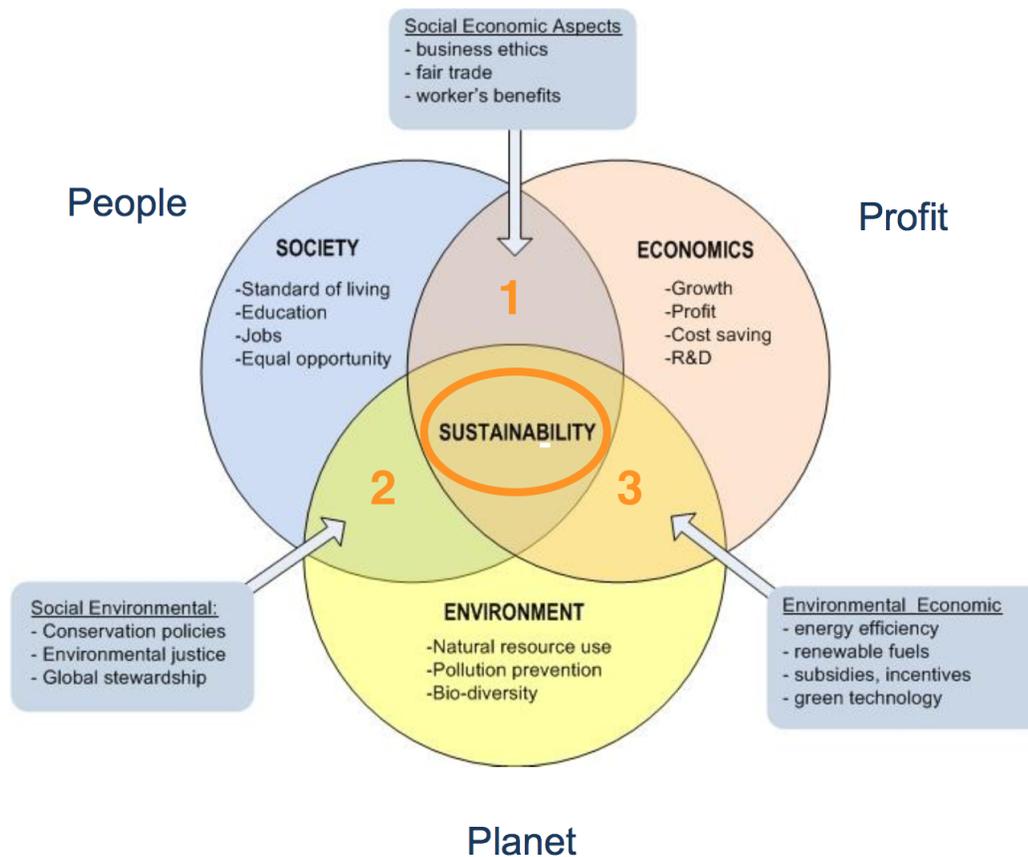


Fig 25: Venn diagram explaining the Triple Bottom Line Accounting Framework - the 3Ps. (Avramenko, 2018)

¹⁷ The triple bottom line (TBL) is a framework or theory that recommends that companies commit to focus on social and environmental concerns just as they do on profits. The TBL posits that instead of one bottom line, there should be three: profit, people, and the planet. A TBL seeks to gauge a corporation's level of commitment to corporate social responsibility and its impact on the environment over time. (Investopedia, n.d.)

4.4.1 MultiCapital Scorecard (MCS)¹⁸

Sample MultiCapital Scorecard

		Progression score (A)	Weight (B)	Weighted score (A×B=C)	Fully sustainable score (B×3=D)	Gap to fully sustainable (D-C)	Area of impact bottom line (C÷D)	TRIPLE BOTTOM LINE
SOCIAL	● Living wage	1	1	1	3	2	33%	-25%
	●●● Workplace safety	-1	5	-5	15	20	-33%	
	●●● Innovative capacity	-1	2	-2	6	8	-33%	
ECONOMIC	● Equity	2	5	10	15	5	67%	62%
	● Borrowings	2	1	2	3	1	67%	
	●● Competitive practices	1	1	1	3	2	33%	
ENVIRONMENTAL	● Water supplies	3	3	9	9	0	100%	53%
	● Solid wastes	1	2	2	6	4	33%	
	● The climate system	1	5	5	15	10	33%	
OVERALL PERFORMANCE				23	75	52		31%

NOTE AREAS OF IMPACT SHOWN ARE PURELY ILLUSTRATIVE AND ARE ALWAYS ORGANIZATION-SPECIFIC. WITH THE EXCEPTION OF "NATURAL," THEY USUALLY INCLUDE INTELLECTUAL CAPITAL.
SOURCE THOMAS & MCELROY LLC

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Fig 26: Sample MultiCapital Scorecard (Thomas & McElroy, 2017).

¹⁸ Designed by Martin Thomas and Mark Elroy, MCS is the world's first and only context-based integrated reporting system that makes it possible to assess performance across all aspects of the Triple Bottom Line.

MCS is a context-based methodology that utilises integrated reporting on the triple bottom lines using a consistent set of criteria throughout. Key features of the MCS include prioritisation and progression scoring. Organisations can attach different weights to different aspects, based on how important they are (Fig 26, Column B). In areas where sustainability targets have not been met, MCS shows the progression towards being sustainable rather than in absolute terms (Fig 26, Column A).¹⁹ This method of monitoring environmental sustainability efforts have been proven successful in 3 pilot projects - New Chapter Inc., Agri-Mark Inc. and Ben & Jerry's (Thomas & McElroy, 2017).

¹⁹ Based on the hypothetical example (Fig 25), the only aspects that the organisation performed sustainably is water supplies, where it achieved a maximum score of 100%. All other aspects are unsustainable, with the scores in Column A indicating their progression towards (positive number) or away from (negative number) achieving sustainability.

4.4.2 Global Reporting Initiative (GRI)

GRI is an international independent organisation that has pioneered the corporate sustainability reporting process since 1997. GRI has helped increase global corporate transparency through its sustainability reporting standards and multi-stakeholder network.

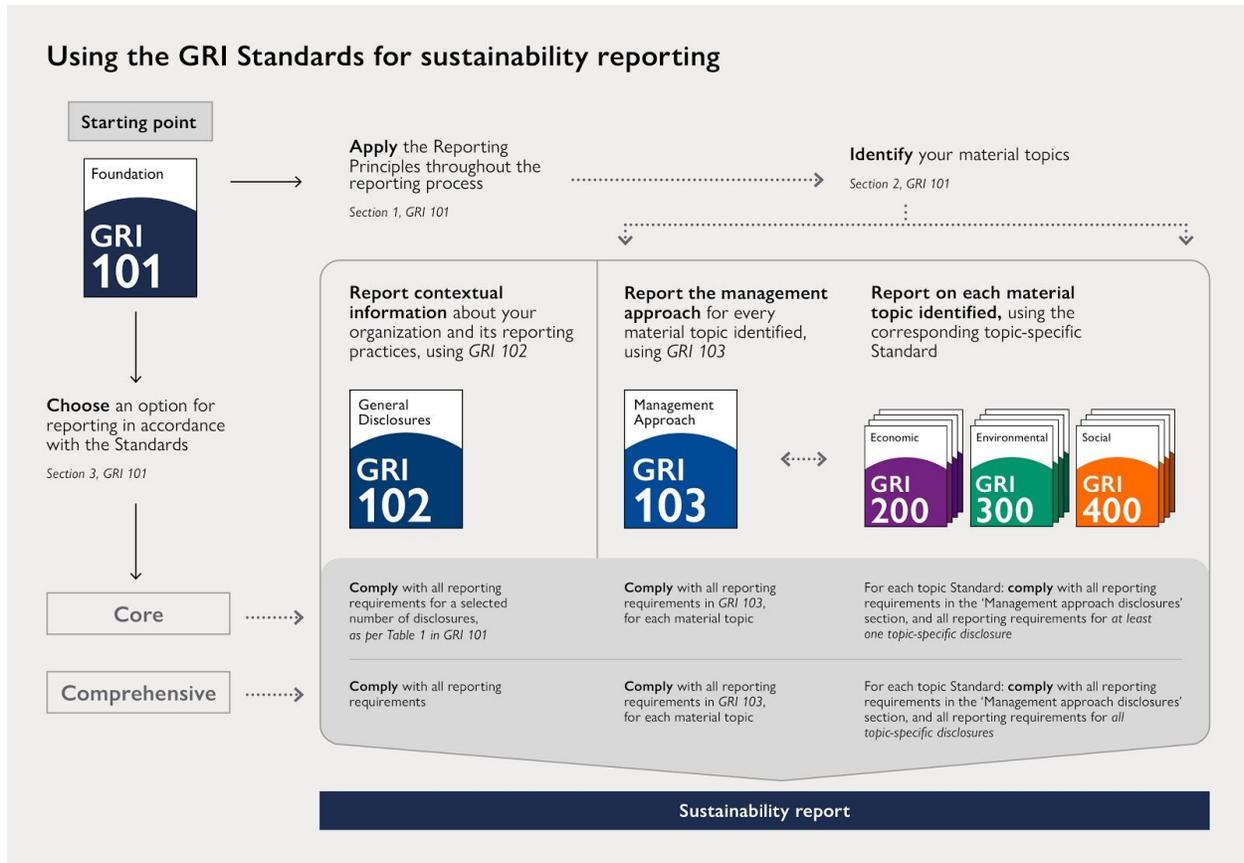


Fig 27: Flowchart explaining GRI Standards for sustainability reporting (Taneva & Bergkamp, 2018).

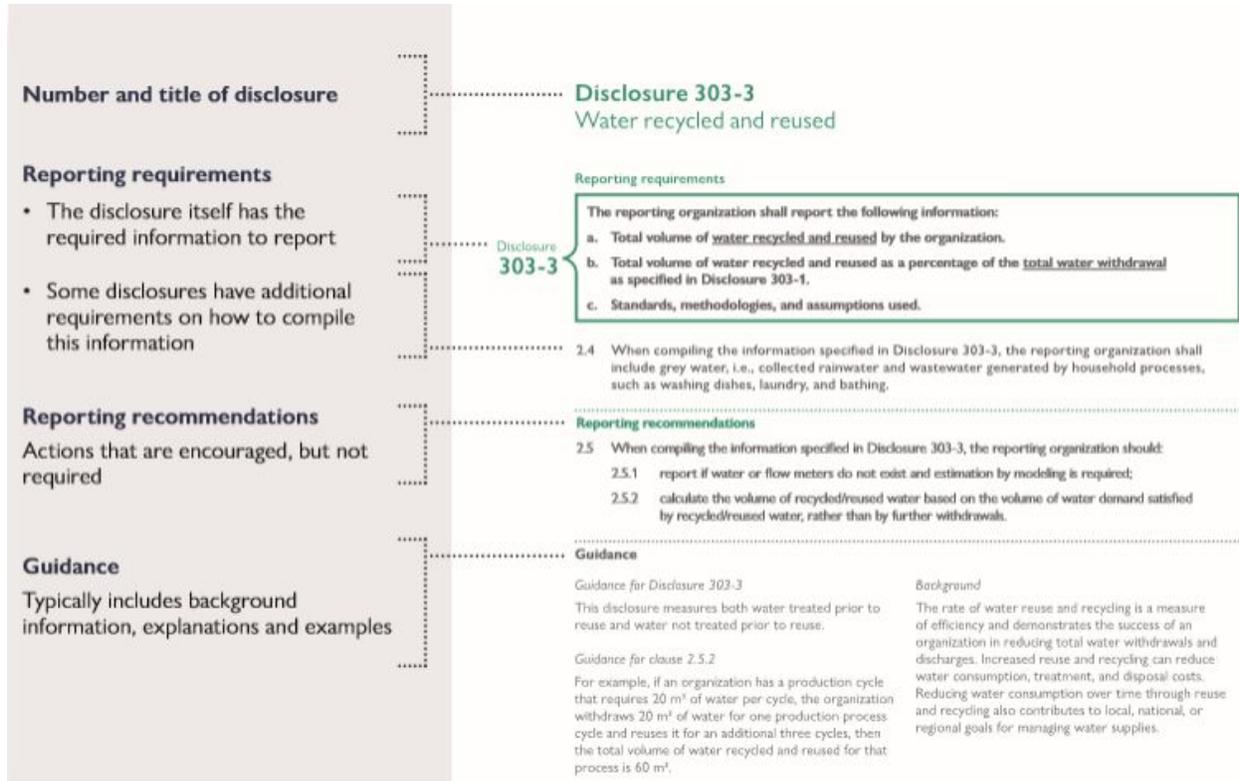


Fig 28: Infographic explaining an example of GRI guidelines, Disclosure 303-3 of Environmental Standards (Taneva & Bergkamp, 2018).

The GRI standards include 3 universal standards which are applicable to all organisations, namely reporting principles, general disclosures and management approach. It also comprises 33 topic-specific standards categorised into economic, environmental and social aspects, which organisations can report depending on their specific “material issues”.

Combination of Metrics

While the GRI analysis is more comprehensive in coverage of material issues, MCS’ unique progression scoring is absent in GRI. Ultimately, the use of a combination of metrics more accurately assesses the effectiveness of environmental sustainability efforts.

5. Conclusion

“When you are finished changing, you are finished,” declared Benjamin Franklin.

In this era of environmental consciousness, businesses have to recognise that environmental sustainability not only makes business and economic sense, but is vital to the sustenance of the company.

They must understand the interdependent relationship between business and environment, and thus adapt to the changing business landscape, by considering environmental risks and reviewing existing business models. To move towards sustainability, they should be transparent in information disclosure and realistic in goal setting, engaging key stakeholders in the process.

In essence, sustainability has to be valued by the business, for sustainability to create value for the business.

(1973 Words)

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