

International Business Report 2007

Global issues

Grant Thornton 

Energy Environment

Interviews

7,200

32

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International
Business
Report

Welcome

This is the second focus study from the Grant Thornton International Business Report (IBR) 2007. It highlights the incompatibility between continued rapid growth in the global economy and the sustainability of the environment with global warming presenting an increasing threat to future living standards. In the first part of the report we focus on climate change and the response of governments and companies. The second part contains results and analysis of data collected as part of the IBR survey, identifying the attitudes of privately held businesses towards global warming and what action they are taking to limit the effects.



Alex MacBeath

Global leader – privately held business services
Grant Thornton International

Environmental
degradation is

one

key issue which
threatens long-term
economic growth
prospects.

Can the environment sustain rapid economic growth?

The global economy is in good shape. Growth is expected to continue at a robust pace boosted by the emergence of economic giants such as mainland China and India, and strong international trade and investment. Long-term projections, such as those in our emerging markets report¹, point to steady advancement of living standards around the world.

This encouraging scenario is not without major pitfalls – regional political tensions, terrorism, economic banana skins such as a dollar crash – could all jeopardise progress. But the consequences are likely to be relatively short term and regionalised. However, one issue – environmental degradation – threatens globally and over the long term. The effects, if unchecked would prevent the global economy powering ahead as forecast, and could be even more drastic, involving grave humanitarian issues.

There is growing recognition of the threat to the environment through air, water and land pollution; and through desertification and deforestation. Closely related to these effects is climate change and its consequences. Global warming has risen to the top of political agendas. In a bleak report, the UN Environmental Programme (UNEP) stated in February 2007 that evidence of worsening global warming was overwhelming and noted that the process is man-made. Although the debate as to the actual causes may continue, the report's conclusions have acted as a further spur to action.

Governments are also under pressure from their electorates to act to moderate climate change. As a result of recent evidence from heat waves, droughts, rising sea levels in the South Pacific, hurricanes and melting polar ice-caps, people are increasingly aware of, and concerned about, the dangers facing the planet. Worries are emerging regarding “carbon footprints” – the measure of the amount of carbon dioxide (CO₂) emitted as part of everyday business operations, energy usage in the home and travel. Examples of initiatives to increase pressure and to reduce carbon emissions include Earth Hour in Sydney, Australia where more than 2 million residents turned off their lights for one hour in March 2007; a more limited switch-off in Paris; symbolic blackouts of celebrated monuments in several cities; and strict controls over emissions from factories and cars in Mexico City, whose geography makes it extremely vulnerable to pollution.

Communities are also demanding more vigorous measures for carbon offsetting, such as tree planting or actions to avoid deforestation, aimed at achieving a net reduction in CO₂ emissions. In Mexico, for example, the government has launched a campaign to protect forests and there are stiff penalties for illegal tree felling. In Brazil too increasing regulation against deforestation is in place.

Government responses

Recognition of the problem is one thing, translating it into action is another. Voters will not readily accept painful measures to reduce their carbon footprint. But since a high proportion of CO₂ emissions comes from travelling, they might have to be prepared for firm government initiatives to curb travel. At the business level, any country opting out of the costs involved in reducing emissions of greenhouse gases stands to gain a potential competitive advantage to the possible detriment of others. The response must be on a global scale to be effective and it is crucial to get all major countries on board. Developing countries need to share the responsibility, but energy is the lifeblood of their economic growth and development. Achievement of the aspirations of developing countries to attain the living standards of the mature economies means that, according to some estimates, over 70% of new energy demand will come from these countries. It will therefore be very difficult to put in place any control or significant cost that obstructs the attainment of their growth objectives.

¹ Grant Thornton International Business Report
– Emerging markets, February 2007



Jim Maurer, Grant Thornton, US

“The recent commitment by the US government to seek new technologies to cut CO₂ emissions is welcome, but some states in the union have already adopted more fundamental measures putting pressure on Washington to follow suit.”

In the developed world there is worryingly also a considerable diversity of views. In the US, the federal government has only recently acknowledged the serious challenge of global climate change. Since the Democratic Party assumed control of Congress in November 2006, there has been a series of proposals with parts of the US having already acted. California has led the way, with strong measures to tackle the problem.

In the EU, divides also exist but are generally less sharp than in the US. For example, a recent EU law on car emissions was adopted but was subsequently watered down after pressure from large car manufacturers. Nevertheless, widespread top-level EU agreement exists to set a target for reducing EU greenhouse emissions by 20% below 1990 levels by 2020 and to forge a successor to the Kyoto Protocol when it expires in 2012.

Solutions

Science and technology may eventually come up with workable solutions to solve these problems. There is widespread encouragement to devise ways of reducing greenhouse gases. However, in the meantime, action is needed. Sir Nicholas Stern, a former World Bank chief economist, analysed the economics of climate change. His conclusion was that the cost of reducing emissions was likely to be about 1% of global GDP, while the cost of inaction was likely to be between 5% and 20%. This analysis has its critics, but it is widely accepted that action on climate change does not impose excessively onerous costs in relation to the potential damage if global warming continues unchecked. A number of options are possible, which together should reverse, or at least curb, the rate of growth in carbon dioxide emissions. These options include:

- expanding nuclear capacity – not an ideal solution but potentially more acceptable than relying on carbon fuels
- introducing green measures such as carbon taxes and extending cap-and-trade systems – effective but would need to be internationally adopted and there are concerns that these would involve an undesirable degree of control over economic activity
- renewable energy sources such as wave, river and tidal turbines, wind power (see figure 1), solar energy and biomass – while realistically these resources may only provide a limited solution, they are relatively uncontroversial and perhaps should be given primary consideration.

Figure 1: Wind energy capacities in MW

1	Germany	20,622
2	Spain	11,615
3	US	11,603
4	India	6,270
5	Denmark	3,136
6	Mainland China	2,405
7	Italy	2,123
8	UK	1,963
9	Portugal	1,650
10	France	1,567

Source: World Wind Energy Association, January 2007

Changing corporate attitudes

Many commentators feel that it is no longer possible for companies to deny the reality of global warming. Media attention and growing public scrutiny of the actions of large corporations have shifted the debate around the world. Companies are increasingly expected to act responsibly by protecting the environment and they need to consider the reputational impact of their actions. Consequently, corporate behaviour is changing. Controlled waste management and pollution reduction during the production process provide firm evidence of a company's environmental credentials.

This applies throughout the supply chain including retailers, many of whom are competing vigorously to communicate their green values to customers. Many large retailers in North America and Western Europe have issued strong statements about the need to improve environmental performance. There has been a surge in green announcements, with all the major chains announcing initiatives to reduce the negative effects of their operations on the environment.

Attitudes are also changing as a result of the opportunity to profit from new technologies. Dealing with climate change by producing low-carbon solutions will become a huge and profitable business for companies that have invested in the research and technology to develop such solutions.

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IBR highlights

The image features four white wind turbines of varying heights and positions against a solid teal background. The turbines are arranged in a diagonal line from the top-left towards the bottom-right. The largest turbine is in the center, with its blades extending towards the top-left and bottom-right. Two smaller turbines are positioned to its left and right, and a fourth, even smaller one is in the bottom-right corner. The overall composition is clean and modern, emphasizing renewable energy.

Energy Environment

Cost pressures

While companies increasingly scrutinise the environmental impact of their operations, they also need to be alert to the impact on profitability. In this section, we look at five types of cost: energy, transportation, raw material, property and staff. For most companies, there is little room for manoeuvre in controlling raw material costs, which are largely determined by world market forces. But they have much greater control over other costs.

The Grant Thornton International Business Report (IBR) finds that staff costs are expected to have a major impact on overall cost pressures in the coming year, with 41% of businesses globally citing this as the key factor, figure 2. This is not unexpected given the predominance of services in the composition of the business sector in today's economy. However the survey also highlights the importance of energy in the overall cost picture, with 37% of businesses globally saying that such costs will have a major impact, outweighing transport and property costs. Although raw material costs are largely uncontrollable, they also have a large impact on cost pressures across all businesses (44%).

Figure 2: Major impacts on cost pressures



Source: Grant Thornton International Business Report (IBR) 2007

Businesses across different industries are likely to face different cost pressures. Over half of businesses in the manufacturing sector cite raw material costs as having a major impact on their cost pressures (64%) compared to staff costs at 36%. 43% of businesses in the service sector recognise staff costs as having a major impact compared to raw material costs at 30%. Energy costs are likely to have a major impact for 46% of manufacturing firms against 32% of services based companies.

However, these areas impact different countries in different ways. From figure 3 (overleaf) it emerges that raw material costs are likely to have the biggest impact in Spain, Botswana, Singapore and Thailand. These countries all have relatively large manufacturing sectors and it is therefore not surprising that raw materials will have such a major impact. Raw material costs are likely to have a lesser impact on businesses in the Netherlands, the US, the UK and Sweden. Again this is unsurprising as these are all predominantly characterised as service sector economies.

Staff costs are given as having a major impact on businesses in the fast-growing economy of Armenia and high inflation Argentina and Turkey, with little impact in mainland China, the US and Thailand. With real wages declining in recent years in the US, it is not surprising that staff costs are having less of an impact than for other countries. However, with wages rising at a rapid rate in the industrial heartland of mainland China, it is unexpected that staff costs are not regarded as having a greater impact on their cost pressures.

Businesses in the Philippines, Botswana, Germany, Thailand and Mexico are most likely to identify energy as having a major impact on costs. In Australia, Hong Kong, Brazil, New Zealand and Singapore businesses are least likely to suggest energy as a major driver on their cost pressures. Both groups are a mixture of service – and manufacturing – dominated economies, highlighting the fact that it is national factors other than simply industrial structure that plays a key role in this context.

Figure 3: Major impact on cost pressures

Raw material costs		Staff costs		Energy costs	
Spain	61	Armenia	81	Philippines	68
Botswana	60	Argentina	73	Botswana	65
Singapore	60	Turkey	71	Germany	58
Thailand	56	South Africa	69	Thailand	55
France	56	Japan	67	Mexico	55
Mexico	55	Spain	62	Turkey	52
Philippines	55	Sweden	61	Ireland	47
Armenia	54	Singapore	58	France	44
South Africa	53	Poland	58	Luxembourg	44
Italy	53	Australia	53	Italy	44
Malaysia	52	Netherlands	53	Poland	43
Taiwan	52	Greece	52	Japan	43
Germany	51	India	51	Armenia	42
Japan	51	Hong Kong	50	India	42
Mainland China	50	Ireland	50	Russia	41
Turkey	48	Brazil	49	Argentina	40
India	48	New Zealand	49	UK	40
Argentina	45	Russia	48	Malaysia	39
Poland	44	Taiwan	46	South Africa	38
Australia	44	Botswana	44	Canada	35
Brazil	42	UK	41	Spain	34
Luxembourg	41	Philippines	41	Sweden	32
Hong Kong	40	Luxembourg	40	US	32
Ireland	39	Italy	39	Netherlands	31
Greece	38	France	38	Taiwan	29
Russia	36	Mexico	37	Greece	28
Canada	34	Canada	34	Mainland China	28
New Zealand	34	Malaysia	33	Singapore	25
Sweden	31	Germany	33	New Zealand	25
UK	31	Thailand	32	Brazil	23
US	31	US	31	Hong Kong	23
Netherlands	29	Mainland China	28	Australia	18

Source: Grant Thornton International Business Report (IBR) 2007



Frédéric Zeitoun, Grant Thornton, France

“The EU has set ambitious targets for reducing greenhouse emissions, but as the EU only accounts for 15% of the world total, big contributors such as the US, mainland China and India need to consider the implications of competitiveness and adopt equally demanding goals.”

Managing energy costs

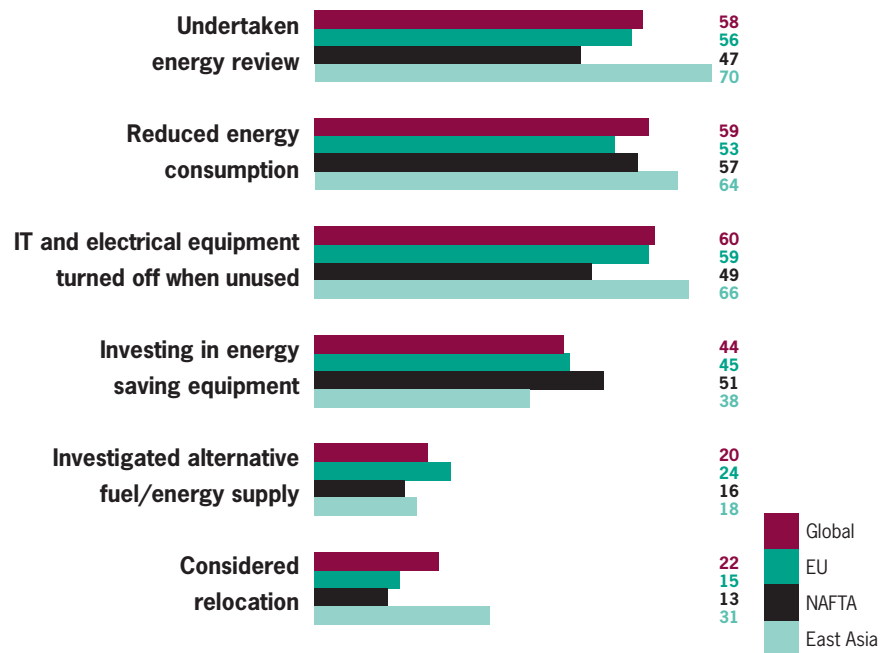
The effective control of energy usage by businesses can make a meaningful contribution to tackling the problem of global warming. It is also an important issue for individual businesses as energy charges are much more controllable and can have a direct impact on bottom line profitability. 37% of companies surveyed indicate that energy costs have a major impact on their cost pressures. We asked businesses what specific methods they have taken to manage energy costs.

Businesses realise that they need to address the energy issue not just because of the impact it has on the environment but more immediately it drives directly at the heart of their own performance. Figure 4 highlights that businesses in East Asia appear most likely to have taken action to manage their energy costs, probably driven by the need to address high energy input costs in essentially manufacturing-dominated economies.

The key points emerging from this analysis are:

- 58% of businesses globally have undertaken an energy review to understand where they might be wasting energy. Businesses in East Asia, led by the Philippines (83%), are the most likely to have done so
- 59% of businesses globally have reduced their property energy consumption. Businesses in East Asia come out top in addressing this issue, with the Philippines at 85% again prominent

Figure 4: Methods taken to manage energy costs



Source: Grant Thornton International Business Report (IBR) 2007

- 60% of global businesses have put measures in place to ensure that all computers and electrical equipment is turned off when not in use, led by East Asia (66%) with Malaysian businesses at 85%. Businesses in Thailand (16%) and Sweden (39%) are the least likely to put this measure into place
- 44% of businesses have invested in energy saving equipment with Brazilian businesses the most likely to invest in this (66%) and Singaporean the least (14%)
- 51% of businesses in North American Free Trade Agreement (NAFTA) countries have invested in energy saving equipment against 44% globally, making this the only action where the NAFTA proportion exceeds the global figure
- 20% of businesses have investigated alternative fuel/energy supplies such as bio-fuels, solar power and wind power. EU businesses are most likely to have investigated alternative supplies led by Germany at 40%. However alternative energies are the least likely method to be used to manage energy costs, as much depends on governmental rather than individual business actions and initiatives
- 22% of businesses have considered relocating to reduce transportation costs. Businesses in mainland China rank as the most likely to have considered this (46%), businesses in Thailand and Sweden are least likely with just 3% and 4% respectively considering relocation.

Newly industrialising countries appear to have done more to manage their

energy costs

than the service-oriented economies of Western Europe, North America and Australasia, but there are some surprises, with Singapore, Thailand and Taiwan featuring at the foot of the table.

Figure 5: Management of energy and environmental issues league table*

Philippines	410
Brazil	360
Mainland China	341
Malaysia	307
Germany	306
Turkey	303
Poland	298
Hong Kong	292
Mexico	283
India	282
Armenia	271
UK	258
Ireland	253
Spain	248
Greece	243
Italy	235
Australia	233
Canada	233
South Africa	230
US	229
Russia	223
Netherlands	217
Luxembourg	214
Argentina	213
New Zealand	212
Sweden	208
Taiwan	207
Japan	205
Botswana	191
France	186
Thailand	178
Singapore	143

Source: Grant Thornton International Business Report (IBR) 2007

Taking all six energy management factors into consideration, figure 5 shows how countries rank in terms of action taken to prepare for ever increasing energy prices and the need to conserve energy.

Newly industrialising countries appear to have done more to manage their energy costs than the service-oriented economies of Western Europe, North America and Australasia, but there are some surprises, with Singapore, Thailand and Taiwan featuring at the foot of the table.

Businesses in the Philippines appear to be in the best position to manage their energy costs for the future. They have scored highest in 3 out of the 6 factors and appear to have put the most measures into place to manage their energy costs. Given that businesses in the Philippines were the most prominent in citing energy as having a major impact on costs, this does not come as a surprise.

Four of the top ten countries are from East Asia indicating that countries from this region are better prepared and ready for future energy price increases. However, four of the bottom ten countries are also from East Asia and thus there appears to be a split emerging in anticipation of future energy price challenges. Thailand's results come as somewhat of a surprise given that 55% of their businesses said energy was a major impact on their cost pressures.

Germany is the highest ranked European country in the league table in 5th position with a large proportion of businesses having undertaken energy reviews to understand where they might be wasting energy. France is the lowest ranked European country in 30th position.

* Respondents were measured by whether they had undertaken six energy and environmental initiatives:

- if they had undertaken an energy review
- reduced energy consumption
- put measures in place to turn off electrical equipment
- invested in energy saving equipment
- investigated alternative fuel/energy supplies
- considered relocating to reduce transportation costs.

Each country in IBR was given a score based on the percentage of businesses who had carried out each of the criteria. For each of the six criteria, the highest score a country could receive was 100, with a total maximum score for the management of energy and environmental issues league table of 600.

Figure 6 illustrates countries that have cited energy costs as having a major impact on their cost pressures compared against their score of how much they have done to manage their energy costs. Globally, 37% of businesses focused on energy costs as having a major impact on cost pressures with a global average score for managing energy costs of 263.

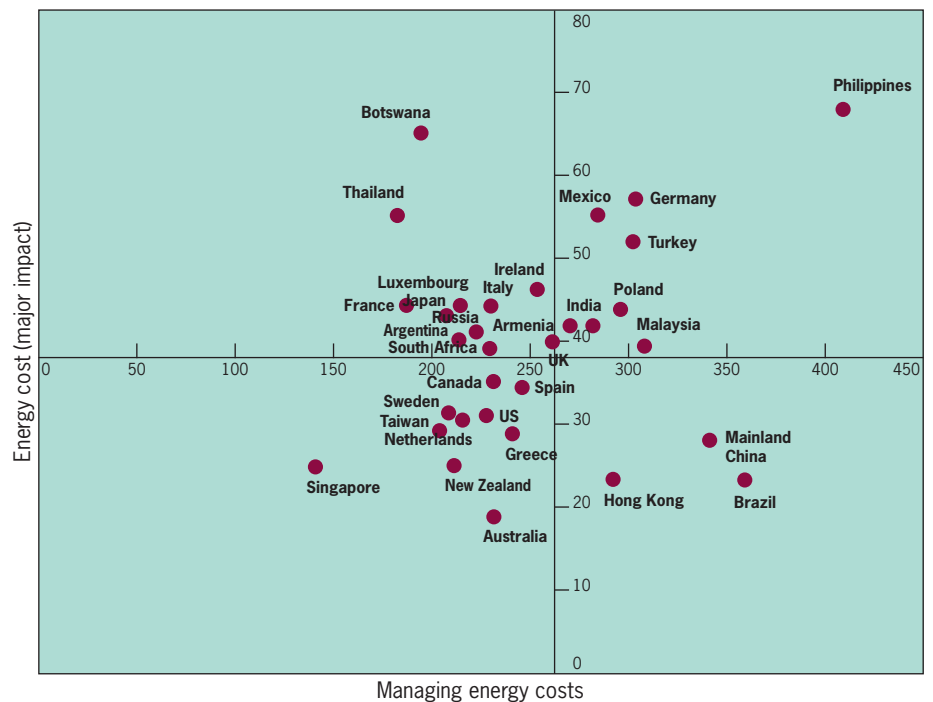
In the **lower right-hand quadrant** are businesses in mainland China, Brazil and Hong Kong suggesting that their actions have helped prevent energy prices having a major impact.

By contrast, in the **lower left-hand quadrant** is a group of countries led by Singapore having done relatively little to manage their energy costs with little perceived future impacts.

Businesses in the Philippines, Germany and Malaysia feature prominently in the **upper right-hand quadrant**. They seem to not only have recognised the issue, but have also done something about it by continuously putting measures in place to manage these costs.

Finally, in the **upper left-hand quadrant** are countries such as Botswana and Thailand who but have done little to manage energy cost pressures with major impacts anticipated. Perhaps these countries could look at the likes of the Philippines as a source of inspiration for increased profitability from energy cost management.

Figure 6: Comparison between the impact of energy costs against the level of energy management by businesses



Source: Grant Thornton International Business Report (IBR) 2007

Summary and conclusions

Environmental degradation is a major threat to economic progress

The global economy is in good shape and strong output growth is expected to continue, but living standards across the globe are at risk from global warming.

International action needed

The response to climate change must be on a global scale, but this raises many difficult conflicts as countries seek to realise their economic aspirations.

Corporate behaviour changing

Businesses are becoming increasingly aware of the impact of their actions in relation to the environment on their reputation. The need to act responsibly by introducing proper waste management systems and reducing pollution in the production process is being recognised.

Energy saving measures widely adopted

All countries in the IBR have energy saving measures in place, or are managing energy inputs by investing in energy saving equipment.

Widespread review of energy usage

Almost 60% of businesses have undertaken a review to understand where they might be wasting energy. The rest should look to do so, if for no other reason than to improve profitability.

Action to address energy costs

This is most prominent among businesses in the Philippines and Brazil. Germany is far ahead of the rest of Western Europe.

Not surprisingly the data suggests that environmental issues are addressed more promptly by businesses when their profitability is directly impacted.

The green future for business

Environmentalism and waste management is quite simply good business. To place the “blame” at the door of governments is to miss the point that sound cost management is a primary driver for businesses to adopt a more “world-aware” perspective. Customers may well demand a “greening” of business, governments may introduce changes in legislation and regulation to green-spray their practices. However, as ever, the greatest imperative for business remains; bottom line profitability improvements are directly impacted by tight, well planned cost management.

The “greening” of business is simply not just good for the planet it is good for business.

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The International Business Report (IBR), formerly known as the International Business Owners Survey (IBOS), provides insight into the views and expectations of over 7,200 privately held businesses across 32 economies. This unique survey draws upon 15 years of trend data for original participants of IBR's predecessor the European Business Survey (EBS) and 5 years of trend data for original participants of IBOS. The research was conducted by Experian Business Strategies and Harris Interactive.

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