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INSIDE THIS ISSUE

COVER STORY
F-35

FEATURE INTERVIEW
Chief of the Defence Staff

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Defence Industry Steps Up

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ESG OR PROFITABILITY

Need it be one or the other?

BY LINDA WOLSTENCROFT

Of increasing importance in the business world, is a firm's responsibility to those touched by the business of the firm: its employees, its shareholders, the community, the general population, the environment. When marketing, special attention must be directed toward the customer, who is all-important when it comes to business growth.

ESG (Environmental, Social and Governance) measures the sustainability and societal impact of an investment in a company or business. The trend toward firms being held accountable for this responsibility is growing, and Defence is not excluded. Indeed, our world is in trouble because of the errors made in managing the environment which gives us life.

But is this objective not contrary to the purpose of a business, which is, in part and foundational, to make money? How can a business engage in being responsible, which typically costs money, at the same time as growing its profits?

Strategy guru Michael Porter, along with George Serafeim and Mark Kramer, all of the Harvard Business School, in their article *Where ESG Fails* (October 16, 2019, Institutional Investor), opine that profit-driven social impact, that they call "shared value", is a crucial element of a firm's success, if success is defined as the firm itself being successful in the face of its stakeholders.

There are "opportunities for higher growth, profitability, and competitive advantage that come from treating social and environmental issues as integral to a company's core strategic positioning." Evidence is emerging that this can actually lead to higher shareholder returns.

COUNTERINTUITIVE THINKING

This seems to be counterintuitive thinking around the traditional question of "how do we make money?" When addressing that question, traditionally one would only as an aside consider the impact on non-profit-sharing stakeholders. One would typically NOT include ESG as an integral part the response to the question of how to make money.

The key is not just any investment that satisfies ESG objectives but investing in areas which are consistent with the overall value the firm delivers to the world. For example, a health insurance provider can invest in providing programs to its customers that preventative measures to ward off ill health. If this is done in a strategic way that prevents its competitors from imitating the approach, its customers could have better health, less illnesses, fewer claims, and the health insurance provider would increase its profits.

Another example that can be implemented in the defence business is supplier development. Improving the performance of suppliers can result in fewer issues and lower supply chain costs. The ESG benefit is a social benefit; the supplier's business grows, is able to have more employment, and therefore improves lives. And strong suppliers can be of great assistance in marketing, too.

In defence, a key element of ESG is the contribution to international security. For myself, my own rationale for serving the defence industry is because defence contributes to international security, and I feel honoured to play a small role. Without this more altruistic outlook, I and like-minded souls may not feel an affiliation to defence, and talent could be directed elsewhere.

DECREASING THE CARBON FOOTPRINT

Because the defence industry outputs large pieces of machinery such as aircraft, tanks and ships, the first and most obvious opportunity for improvement is a goal of sustainable production and operations. As with all producers, from software to aircraft, there is a case for decreasing the carbon footprint associated with production and operations. Large and complex production lines have made improvements, and in large part this is due to the evolution of standards imposed by government.

So, what does all this have to do with Defence Marketing?

Sustainable procurement practices are becoming more widely used in governments. As our world changes and values change amongst the public, whom we serve in the long term, then paying attention to ESG will serve us. And the added benefit is that ESG as an approach can actually INCREASE business growth and profitability, as evidenced by the examples shown.

Following from this, advancements in ESG can be used as selling points. And selling not only to customers, but selling to other defence firms, attracting like-minded partners, attracting talent, etc. ESG is a progressive idea, and not all firms are willing or even capable to take on ESG. And therein lies an opportunity for nimble and flexible firms; leadership ESG positions in the defence industry are open.

Are we able to gain a competitive advantage on the basis of adopting ESG practices? Where do our competitors stand? Will making advances on ESG not only improve our bottom line but also improve our world for our children and grandchildren?

Let's think about it.

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