Creating Value for Business *and* Society

The 'business of business' is no longer just business. In the culmination of an eight-year study, authors from BCG and MIT present some of the principles required to jump-start a sustainable business.

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CORPORATE SUSTAINABILITY HAS ARRIVED AT A CROSSROADS. In one direction, corporate leaders in sustainability remain a minority and are unevenly distributed across geographies and industries. Stand-outs like **Unilever**'s **Paul Polman** and **Patagonia Inc**.'s **Yvon Chouinard** are still the exceptions. In another direction, the natural environment continues to change as a result of human activity. Catastrophic loss from naturally-occurring events like floods, earthquakes and droughts are becoming more frequent and intense, threatening regional economies and compounding resource-scarcity issues that afflict many areas. In still another direction, economic inequality presents growing risks to globalization and international market stability.

With populist and anti-regulatory leaders on the rise, trust in government institutions reaching a low point — and some political leaders denying the reality of climate change — the potential for corporate sustainability to lose momentum is all too real. If backsliding is to be avoided, corporate leaders must accelerate their sustainability efforts and resist the siren song of anti-regulatory incentives that tempt them to scale them back.

What exactly can corporations do to hasten their sustainability efforts? In our report, "Corporate Sustainability at a Crossroads" — based on eight years of collaborative research between MIT's *Sloan Management Review* and **The Boston Consulting Group** — we identify eight evidence-based factors that drive sustainable business practices across industries. In this article, we will provide a detailed analysis of five of these principles.

PRINCIPLE 1: Focus on Issues That Are Material to Your Business

Companies with successful sustainability strategies connect their efforts with issues and activities that are material to their business. 'Strategies' that focus on bike-to-work programs, recycling drives, or a CEO's pet philanthropy have little impact because they are not strategies for making a business sustainable over time. "If a bank has an energy-savings program and is headquartered in a LEED-platinum building, investors aren't going to care," says former Harvard Business School Professor **Robert Eccles.** "But if the bank's loan portfolio has a bunch of ESG

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[environment, social and governance] risk and stranded assets—those are things that are material."

Patagonia is an example of a company that connects its sustainability strategy with material business issues. As a leading textile manufacturer and retailer, it recycles plastic waste into its innovative fabrics and, with its Worn Wear motto, 'Better than new', encourages its customers to mend and repair Patagonia clothing rather than throwing it out and buying new. From 2008 to 2015, Patagonia had a compound annual growth in revenues of 14 per cent, while profits surged 300 per cent during this period. It also contributes one per cent of annual revenues to non-profit organizations that promote conservation of the natural environment that its customers love.

In some cases, external stakeholders encourage the company to make the materiality connection. Consider **Greif Inc.**, a supplier of industrial packaging products, such as large steel-drum shipping containers, to businesses in over 50 countries. Many of Greif's customers were shifting their priorities from *buying containers* to *seeking a sustainable shipping solution* that would help reduce emissions in their value chain. In the mid-2000s, more customers began asking Greif managers for environmental information, such as greenhouse gas emissions data.

In response, the company began lifecycle analysis (LCA) studies on its core products of steel, plastic and fiber containers. The analyses showed that the most effective way to improve the environmental performance of its containers was to make the containers heavier, longer-lasting, and easier to re-use. This result surprised Greif managers, who expected lighter or thin-gauged containers to be the most environmentally-sound solution. Based on this discovery, Greif determined that its core business should strategically shift toward reconditioning containers and related services. The LCA studies helped Greif identify strategic environmental risks in its value chain and develop a successful strategy for integrating additional sustainability services into its business model.

German chemicals giant **BASF SE** took a more proactive approach. Several years ago, executives began reassessing the company's entire business model through a sustainability lens. By 2014, the company had assessed 80 per cent of its product portfolio — some 50,000 product applications — on a sustainability scale that ranks whether a product is meeting, exceeding, or non-compliant with sustainability standards. At the top of the rankings are 'accelerator' products — sustainability all-stars that make a significant contribution to the market and exceed environmental and social standards for the product category. BASF has identified 13,500 accelerator solutions in its sales portfolio. 'Performer' products meet basic market standards and are followed by 'transitioners,' which are products actively addressing sustainability issues. At the bottom of the list are 'challenged' products that carry significant sustainability risks. Product teams are tasked with developing plans to move their products up the ranks.

BASF's reassessment of its products and subsequent overhaul of its business is an essential feature of its mission to 'Create chemistry for a sustainable future', which has full support from the CEO. The entire effort of reviewing the business through a sustainability lens was vetted by a council of business line presidents and eventually sanctioned and supported by the company's board.

PRINCIPLE 2: Innovate Your Business Model

The previous examples offer anecdotal evidence of the strong connection between *successful sustainable strategies* and *significant change to business models*. Our survey data also offers robust quantitative evidence for this connection.

A few years ago, we asked respondents to identify which parts of their business model they were changing in response to sustainability factors. A surprising combination of business model elements delivered the most potent results. It wasn't the game-changing products and businesses that one usually hears about in the context of innovation that drove sustainability value; it was the combination of innovation in the value chain and target segments that provided the strongest link. We found that 59 per cent of companies that profited from sustainability by changing

three or four business model elements pulled these two levers.

The coffee business unit at **Kraft Foods** (now a part of **Jacobs Douwe Egbert**) illustrates a constructive approach to driving sustainable practices in a supply chain. Sustainable sourcing in its value chain was a key part of the company's strategy, according to **Chris McGrath**, (then) vice president for sustainability. In addition to protecting the environment and helping farm workers improve their livelihoods, applying sustainability standards from organizations such as **Rainforest Alliance**, **Fair Trade**, and **UTZ Certified** helps boost crop yields and capacity — a critical need for a global food company dependent on reliable access to commodities.

More often than not, however, 'greening' a product is not the key to building new business in target segments — as Kraft discovered with its YES Pack commercial salad-dressing containers. The innovative plastic container requires 50 per cent less energy to produce and uses 28 per cent less primary packaging material than its predecessors. What opened doors to commercial segments, though, was the package design. The bigger, easier-to-use pouches — which were less expensive to produce — were extremely popular with restaurants, giving Kraft a competitive advantage with lower costs.

Companies that have a well-thought-out sustainability strategy and can identify business model opportunities are more likely to build a solid foundation for their sustainability initiatives. Successful innovators focus on opportunity creation — looking at market share, potential efficiencies and competitive advantages rather than risk, reputation and regulatory compliance. Companies that are reactive and respond to external pressures — essentially 'playing defense' and spending to mitigate externalities — are less likely to develop a strong business case for sustainability.

PRINCIPLE 3: Build a Clear Business Case

Adapting your business model to exploit material sustainability opportunities will work in the long term only if you can establish a business case for these efforts. A major hurdle for many companies is crafting an approach that improves the environmental and social impact of their operations while simultaneously producing business value. "You can keep 10 people busy on environmental and social issues, doing wonderful things that look great on a CSR report, but not necessarily creating any value," observes INCAE Business School Professor **Lawrence Pratt**. Without a sustainability strategy that is relevant to the core business and that advances the overall corporate strategy, companies are far less likely to profit from their sustainability efforts, and meaningful strategic change will stall.

Building a business case for sustainable business practices depends in large part on the scale of those practices in the organization. Footwear and apparel company **Timberland LLC** leverages industry standards to tie sustainability efforts tightly to its bottom line. The company developed its own version of a 'nutrition label' that it calls the Green Index. The index measures the climate impact, chemicals and resources consumed in the manufacture of certain footwear products. Using this index, Timberland can compare a product's score to its profit margin. "We can find out if shoes with higher environmental impact are better or worse for margin," says **Betsy Blaisdell**, (then) senior manager of environmental stewardship at Timberland. Sustainable products "may be more expensive to produce, but generate better margins."

Timberland's Green Index spurred the creation of the Higg Index at the **Sustainable Apparel Coalition**, a collaborative industry-wide initiative to measure the environmental and social impact of apparel products. According to Blaisdell, suppliers were frequently saying they had 'green' products, but there was no way to assess the claims or measure them against other products. Now, with the Higg Index, "brands, retailers and facilities of all sizes, at every stage can measure their environmental and social and labour impacts and identify areas for improvement."

Hilton Worldwide Holdings faced similar decisions in its procurement function, where the business case for buying products with different levels of green certification and different pricing structures was less than straightforward. "If you have the most sustainable product on the market, but it costs

The Procurement Leadership Group includes Hilton Worldwide, Allstate Corporation, Starbucks, Ocean Spray Cranberries Inc., Bank of America and Anheuser Busch.

50 per cent more than a non-sustainable product," said **William Kornegay**, senior vice president of supply management at Hilton Worldwide, "it's really about what our end user is willing to pay for that experience. And most of our end users would not be willing to pay a 50 per cent premium for the ability to say it was sustainable."

Hilton, like Timberland, began working with others to create a coalition of stakeholders to invent tools to help build the business case for procurement professionals. It worked with the global consultancy **BSR** to develop the Centre for Sustainable Procurement, which evolved into the **Procurement Leadership Group** in 2015. With its mission to bring together procurement professionals across industries to explore and innovate leading approaches to supply-chain sustainability that create business value and positive social and environmental impact, the group's members include Hilton Worldwide, **Allstate Corporation**, **Starbucks**, **Ocean Spray Cranberries Inc.**, **Bank of America** and **Anheuser Busch**.

Some companies use 'business case' to refer to a positive return on investment for a specific sustainability project. This is a narrow view of sustainability: While incremental improvements to the existing business model can provide sustainability returns, the company may be overlooking broader, more systemic innovation opportunities that promise a bigger impact, says Lubber.

In our research, survey respondents who said their organization profits from sustainability were almost 200 per cent more likely to have a business case. That doesn't mean that companies with successful sustainable business practices always start with a business case, however. As **Campbell**'s **Dave Stangis** explains, "If I'm spending my time and effort on trying to build a business case, convincing the company to be more sustainable or to think like me, I think I'm wasting my time." Stangis sees a trend to go ahead even without a solid case — a 'just do it' zeitgeist, more akin to start-up entrepreneurs than efficiency-focused managers. A business case may emerge from the process of exploring sustainable solutions, learning what is possible and taking action. In some respects, this is what happened when Greif discovered a business case for improving the longevity and reusability of its containers.

PRINCIPLE 4: Develop a Compelling Value Creation Story for Investors

Once a business has developed a sustainability strategy that focuses on material business issues, has a business case for addressing them and has board-level backing for its agenda, the next step in capturing value is sharing its sustainability story with interested stakeholders. "At the end of the day, investors want to know about growth, efficiency and risk," says **Antoni Ballabriga**, global head of responsible business at **Banco Bilbao Vizcaya Argentaria** (BBVA), the Spanish banking group. "Sustainability is central to each."

With growing interest among investors about corporate performance on ESG factors, executives have a robust opportunity to communicate with their stakeholders. A 2015 survey conducted by *Sloan Management Review* and the **National Investor Relations Institute** found, however, that only 24 per cent of surveyed investor relations professionals are asked by their organizations to tell investors about the value of sustainability to the company's bottom line. Close to 40 per cent aren't given any direction on sustainability reporting at all; nearly 80 per cent don't regularly include sustainability talking points in investor presentations; and almost half don't believe that a sustainability strategy is necessary to remain competitive in their industry.

To get an upper hand in shareholder outreach, Ballabriga established a close working relationship between his sustainability group and Investor Relations (IR) to help develop a succinct sustainability value story for BBVA. The effort began as an information exchange, in which IR would reach out to Ballabriga's group when investors asked specific questions. As confidence built and investor demands increased, IR starting asking Ballabriga to join earnings calls and other meetings with investors. Today, the relationship is a partnership, and the groups

have developed a process to create and update the investment story of how sustainability creates value and should be reflected in its share price.

PRINCIPLE 5: Embrace Collaboration Within Your Ecosystem

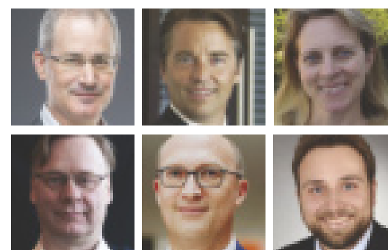
Companies with sustainability as a top agenda item are more than twice as likely to collaborate strategically than companies in which sustainability is only 'somewhat' or 'not important'. In addition, companies that have sustainability as a top management item and that collaborate strategically are up to five times more likely to do the preparation required to ensure successful outcomes. This includes steps like clearly defining roles, having reporting frameworks in place, and developing clear governance structures for partnerships.

Before 2000, 40 per cent of companies we surveyed had no collaborations on sustainability efforts, and 19 per cent had just one to three collaborations. In 2014, we found that most companies were engaged in some form of sustainability collaboration and fully 16 per cent said they expected to have more than 50 collaborations in the future. Strategic needs are the most common motivation for entering into these partnerships. When **Stonyfield Farm Inc.**, the Vermont-based yogurt manufacturer, faced a strategic challenge — uncertainty in the supply of its organic banana puree — it solved it through transformational collaborations that have changed the face of how its suppliers go to market. "We had been buying organic, rare bananas, but the growers historically relied on downstream processors to make them into puree," says **Wood Turner**, (then) vice president of sustainability innovation. "There has been considerable instability on the part of those downstream processors, which made our supply chain unreliable."

To address this challenge, Stonyfield worked with the nonprofit **Sustainable Food Lab** to develop small-scale fruit-processing operations. "We decided — in collaboration with the growers — to disrupt their business model by installing small-scale processing capability at the grower-association level," explains Turner. "Growers are now not just responsible for bananas, but also for processing and selling them to the global marketplace." The collaboration solved Stonyfield's supply issue and gave the growers more independence and access to a wider market.

In closing

The sustainable success achieved by the companies discussed herein is inarguably impressive, but the ultimate test of industry's collective success will be whether it contributes meaningfully and constructively to our common future. It is not clear at all, however, that progressive action is happening fast enough. Based on our eight-year study of this topic, we can say with certainty that the time has come to deepen and accelerate corporate sustainability efforts across the board. **RM**



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