

# Part One

## **HOW SUSTAINABILITY CREATES VALUE**

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# SUSTAINABLE COMPANIES ARE MARKET LEADERS

In the Introduction I promised to reveal how Sustainable Market Leaders are integrating sustainability into their daily activities in a way that enables them to create business value today and tomorrow. In this chapter I begin to prove this. I show how companies are separating from their peers by adopting the view that sustainability can lead to valuable competitive advantage.

## **Sustainability as Competitive Advantage: Three Examples**

It is easy to understand why the *Wall Street Journal* chose the Bacara Resort as the setting for its inaugural Economics conference. Set between the Pacific Ocean and the Santa Ynez mountains, along the picturesque coastline of Santa Barbara, California, the resort offers breathtaking views. In a stunning combination of water, nature, and beach, the resort invites guests to relax, unwind, and rejuvenate.

Several well-known chief executive officers (CEOs) provided their perspective on balancing environmental, social, and economic pursuits—the three legs of the ethos commonly referred to as “sustainability.” On March 12, 2008, perhaps the most enlightening view came at the beginning of the event. During the conference’s first session, entitled “The Environment and the Business of Business,” Jeff Immelt, General Electric’s (GE) chairman and CEO, sat down on one of the white couches at the front of the room to present his views on sustainability.

During this talk to three hundred of the world's most influential executives, academics, and sustainability practitioners, Immelt described why he and GE were committed to the business of providing technology for the development of renewable energy: "I'm a capitalist and a businessman. I believe I can drive earnings and make money by working to create clean energy, water, and environmental solutions."<sup>1</sup>

Three years later, Immelt's conviction continues to be rewarded. GE's "ecomagination" line of environment-conscious products delivered \$18 billion in revenue in 2009. In fact, since the launch of the ecomagination product line in 2005, GE has captured \$70 billion in revenue. Looking forward, the company believes "ecomagination revenue will grow at twice the rate of total company revenue in the next five years, making ecomagination an even larger proportion of total company revenue."<sup>2</sup>

Our second example comes from several other scenic areas of the world.

Australia & New Zealand Banking Group (ANZ) has adopted the view that sustainability and core strategy are one and the same. The 175-plus-year-old Australian company is striving to become a super-regional bank with operations throughout Australia, New Zealand, Asia, and the Pacific. ANZ's approach to sustainability strategy is integral to its business strategy, brand, and goal to establish and build market leadership positions in several Asian countries.

ANZ's expansion into Cambodia provides an example of sustainability as market entry strategy. Cambodia has a population of 14 million people; yet only 500,000 have bank accounts. In 2009 the bank launched a wholly owned subsidiary called "Wing." Wing is a branchless banking service that enables customers to make person-to-person payments and conduct other retail banking transactions over their mobile phones. In so doing, Wing has made money transfers between people in metropolitan areas and rural areas more equitable, safe, and affordable, supporting goals to increase access to services and greater

economic and social inclusion in rural parts of Cambodia. After its first year of operations, Wing already had about 100,000 customers.

This “bottom of the pyramid” service also provided valuable insights and experience for the development of “GoMoney™,” for retail customers in Australia. According to Julie Bisinella, ANZ’s head of corporate responsibility at the time (now ANZ’s group head of culture and engagement), “Our efforts to respond to economic and social development issues and opportunities in Cambodia also informed the build out of an innovation that is now serving more profitable customers in Australia.”

The travel industry provides our third example. The travel industry is instrumental in enabling people to rejuvenate at the Bacara Resort in California and experience the scenic beauty of Australia. But what enables competitive advantage in the U.S. online travel market? Conventional wisdom holds that advantage comes from lowest price, but lowest price is indefensible over the long haul.

Travelocity, the Dallas, Texas-based online travel service provider, is seeking to leverage its sustainability strategy to create business value in this intensely competitive market. In 2009 the company introduced its Green Hotel Directory, a part of its cause marketing program, “Travel for Good®.” The Green Hotel Directory identifies third-party-verified “green hotels” and aims to serve environmentally conscious travelers.

What is the connection between the Green Hotel Directory and performance? While a few more quarters of data will be needed before findings can be confirmed, Travelocity is encouraged by early results. Year-over-year growth of third-party-certified green hotels outpaced peer hotel bookings by 65 percent during the first quarter of 2010 compared with the first quarter of 2009. Sensing an opportunity to develop competitive advantage based on the Travel for Good program, the company has begun to ramp up the program and now has flagged more than 2,500 properties that have been third-party verified as being “Eco-Friendly Hotels” on its main travel website.

Traditionally, companies have viewed sustainability either as a type of risk that needs to be managed or as a vehicle for altruism. That is, one or more of the challenges of climate change, resource depletion, social divides, and the like can disrupt these companies' ability to create business value. As a result of this shortsighted view, many companies have adopted the view that sustainability is some sort of "stakeholder-imposed" Gordian Knot: Become sustainable or maximize financial performance. They simply want to find ways to cut or otherwise "deal with" the knot, then move on to other more competitive matters.

The three market exemplars I've just described have adopted a different view. They see sustainability and financial performance as partners in growth and competitive differentiation. For GE, sustainability is instrumental to revenue growth. For ANZ Banking Group, sustainability provides the strategy for market entry. For Travelocity, early results suggest that sustainability can lead to brand differentiation. In so doing, these companies are demonstrating that their business strategies can be enhanced through the integration of their approach to sustainability.

### **Are Many Other Companies Also Competing on Sustainability?**

In this book I distinguish between business competitive strategy and business corporate strategy. I rely on the watershed thinking of the strategy author, lecturer, and consultant Michael Raynor. In his seminal book, *The Strategy Paradox*, Raynor says that *competitive strategy* "is about creating and capturing value."<sup>3</sup> It is focused on short- and intermediate-term decisions taken to best position a company's products and services as the solutions of choice in the minds of target customers. As such, competitive strategy is crafted and employed by the business units.

By contrast, *corporate strategy* "may primarily be about the identification and management of strategic risk."<sup>4</sup> So corporate strategy entails risk assessments like "What happens if oil reaches

\$200 per barrel, carbon is priced at \$50 per ton, or an automotive fuel standard of 50 miles per gallon is reached and enacted globally?” As we will see throughout this book, employing sustainability in competitive strategy requires including sustainability issues separately in both competitive and corporate strategy processes; it also requires that competitive and corporate strategy-planning processes work jointly.

So: Are many companies making sustainability an essential component of competitive and corporate strategy, or are GE, ANZ Banking Group, and Travelocity exceptions to the general rule? One way to begin to answer this question is to count how many companies are taking some form of action to at least respond to, if not embrace, sustainability. Unfortunately there is no agreed-upon way of measuring a company's level of sustainability, no actual process for counting, that tells us how many companies are actively becoming sustainable. To build a proxy answer, let's review the number of companies that provide insights into their environmental and social sustainability thinking.

Regarding environmental impact, we look to the corporate response rate to the annual Carbon Disclosure Project (CDP) questionnaire. The CDP is a nonprofit entity that represents 475 institutional investors that collectively manage more than \$55 trillion of assets on behalf of institutional and individual investors. According to the CDP, 82 percent of the five hundred companies that comprise the FTSE Global Equity Index Series filed answers to the CDP's 2009 annual questionnaire on climate change.

While many companies are participating in the world's pursuit of environmental sustainability, many more companies are not. The Carbon Disclosure Project 2009 questionnaire response rate varies by region; for example, while 82 percent of the Europe 300 responded, only 66 percent of the S&P500 companies answered the CDP's 2009 questionnaire. In addition to location differences, a company's size affected its likelihood of response. Specifically, smaller companies were less likely to

respond. (I assume that suppliers to large companies are mainly small- or mid-cap companies.) Data from the CDP's 2009 Supply Chain Report suggests this group is either not willing or more likely not able to formally disclose facets of their environmental footprints: "The CDP Supply Chain Project invited 2,318 suppliers to complete a questionnaire created by the collective efforts of 34 member companies in 2008. Of those invited, 634 (27 percent) provided a response. Another 136 (6 percent) formally declined to participate. The remaining 1,548 (67 percent) did not log on or formally respond to CDP, although some suppliers indicated a willingness to respond in future years."<sup>5</sup>

As this data suggest, many large companies and a smaller but not insignificant number of smaller companies have begun to report their carbon emissions. While this step suggests that these companies intend to address the scope of their environmental footprint, it is not by itself much progress toward facing the broad range of issues of environmental sustainability.

Moving from environment to social equity, we can tally the number of companies that have signed the United Nations Global Compact (UN Global Compact). The UN Global Compact is a strategic policy initiative for businesses that are committed to aligning their operations and strategies with ten universally accepted principles in the areas of human rights, labor, environment, and anticorruption.<sup>6</sup> Currently the UN Global Compact lists more than 8,000 organizations as active participants, including more than 5,000 companies. The UN Global Compact notes that the group of active participants is growing at a rate of 1,200 annually.<sup>7</sup>

While the data presented suggest companies are taking steps to embrace environmental and social sustainability, they alone do not provide a satisfying answer to whether integration of sustainability can promote growth and competitive differentiation.

## **My Research into Sustainable Market Leaders**

To better answer the question of link between sustainability and competitive differentiation, I analyzed every 2010 Global Fortune 500 company's sustainability strategy, governance, and stakeholder relationship efforts. I created a method to identify Sustainable Market Leaders (described in the Introduction of this book) from this list. For more information on this method, refer to Appendix A: Research Methodology.

The identification of Sustainable Market Leaders among the 2010 Global Fortune 500 helped me compile a list of companies to interview for this book. In total I conducted more than 100 interviews with sustainability, strategy, and finance experts at these companies. The interviews make up a core part of this book. I frequently rely on quotes and stories from these interviews to bring many insights and recommendations to life.

## **Research Findings**

My research revealed several useful insights:

1. *Sustainability efforts are paving the way to growth, lower costs, innovations, and enhanced agility through relationships with suppliers, stakeholders, employees, and even competitors.* In addition to GE, ANZ Banking Group, and Travelocity, companies such as Unilever, United Parcel Service, Cisco, Nike, and Starbucks have made powerful linkages between their efforts to embrace sustainability and their ability to "move the needle" of financial performance in the short and long term.
2. *Sustainability has changed the terrain of competition among organizations.* Sustainability has been embraced by some, but by not all, companies within the 2010 Global Fortune 500. As a result, the terrain of competition has changed.

The most effective way to see this is to evaluate the new balances of power in each of Michael Porter's Five Forces of Competition: suppliers, buyers, substitutes, new entrants, and industry rivalry (discussed further in Chapter Two). For example, Sustainable Market Leaders are mandating that their suppliers adhere to a series of sustainability-oriented behaviors and activities. If these suppliers don't, they run the risk of losing their Sustainable Market Leaders' business. The same dynamic applies during the procurement process. Two identical vendors bid to supply a Sustainable Market Leader with commercial grade paper. All things being at or near equal, the vendor that can demonstrate an ongoing commitment to sustainability has a greater likelihood of earning this business.

3. *Because sustainability enhances their competitiveness, Sustainable Market Leaders have mainstreamed their sustainability management efforts.* That is, these companies have installed sustainability management and governance structures to push sustainability management from the purview of the few to the responsibility of the many. In particular, Sustainable Market Leaders tend to install small, centrally managed sustainability teams that then develop, influence, and rely on an internal network of peers across all departments to integrate sustainability throughout corporate strategies, business plans, and value chain activities. The company's sustainability efforts and plans are overseen at the board level, either by the board writ large or by a subcommittee equipped to govern sustainability efforts.

### **The Longevity and Agility of Sustainable Market Leaders**

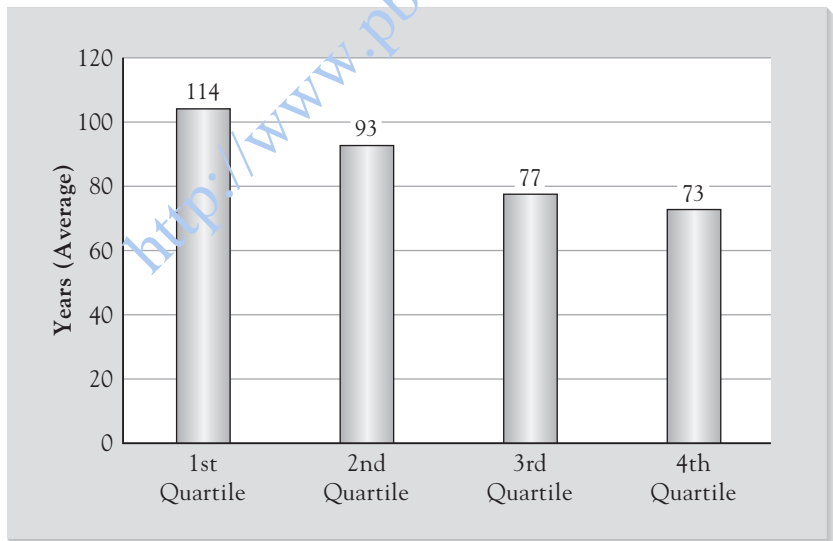
By labeling exemplars of sustainability management "Sustainable Market Leaders," I mean to call attention not just to sustainability in the narrow environmental and social respects but to the fact

that typically these leading companies have *sustained themselves* longer than have others. Sustainable Market Leaders (the first-quartile set of Global Fortune 500 companies that appeared most frequently on the most widely accepted sustainability rankings) have existed, on average, twenty-one years longer than the companies in the next quartile down. (See Figure 1.1.)

My study suggests a possible explanation for these companies' extraordinary lengths of existence. When faced with a new imperative, in this case sustainability, these companies employ remarkably similar response approaches:

- First, they seek to understand the imperative in terms that are relevant to them: what the imperative's impact

**Figure 1.1 Average Years in Business per Scored Sustainability Leadership Quartiles Within 2010 Global Fortune 500**



*Note:* The standard deviation of years in existence for the top quartile was 66 years; for quartile two, it was 72 years. The top quartile's smaller standard deviation validates the finding that top quartile companies have operated for a longer period of time than their closest peers.

on the art of competition will likely be, and what the imperative's impact on the company's financial performance could be.

- Next, they undertake an assessment to identify the imperative's attributes that are most meaningful to their business, as seen both through their and external observers' eyes. Based on this information, the next step is to evaluate their current performance relative to these attributes, set target performance levels, and create detailed plans to complete a portfolio of adjustments to achieve these goals.
- Finally, they execute their plans, measure their progress, and pursue continuous improvement based on brutally honest feedback.

These companies see sustainability as a means to growth and long-term success and have taken decisive action. Their successful approaches offer clear lessons for companies seeking to ensure their own sustainability over the long term. The combination of competitive advantages earned from their efforts to embrace sustainability and enhanced corporate agility make it more likely that these companies will continue to sustain their existence for longer periods of time than their peers.

### **What Sustainable Market Leaders Do**

To create value today and into the future, Sustainable Market Leaders

- View sustainability as a means for value creation today and tomorrow and reject the view that sustainability is achieved through altruism and risk mitigation
- Challenge assumptions about market dynamics to identify and explore adjacent business opportunities

- Identify environmental and social problems to solve with available capabilities in a (mutually) beneficial way
- Employ sustainability as an additional lens to evaluate operational inefficiencies and a telescope through which to view distant but approaching growth opportunities
- Accept that embracing sustainability is prickly and hard, not warm and fuzzy; as a result, employ small, smart changes to what they already do to create value
- Go beyond employee engagement to employee co-creation (engagement is good, what companies do with the engagement is far more valuable)
- Develop networks of peers, non-peers, academics, and NGOs to find and evaluate ideas to build a pipeline of innovations and enhance corporate agility
- Continuously renew their sustainability strategy and management efforts

## **Conclusion**

Sustainable Market Leaders inextricably link their sustainability management, corporate, and competitive strategy efforts to create value for stakeholders. They sharpen their value chain activities by integrating sustainability initiatives. And they engage with stakeholders to continuously renew their ability to create value into the future. As a result, Sustainable Market Leaders have become adept at managing two seemingly competitive demands: creating value today and tomorrow. Chapter Two sheds a critical light on how these companies are embracing sustainability as a means for competitive differentiation.

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