

Doing good

Business and the sustainability challenge



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Preface

Doing good: Business and the sustainability challenge is an Economist Intelligence Unit report that investigates the impact of sustainability on business today. Lead sponsors of the programme include A. T. Kearney, Bank of America, Orange, Jones Lang LaSalle, PricewaterhouseCoopers and SAP, along with supporting sponsors ExxonMobil and SunGard.

The Economist Intelligence Unit bears sole responsibility for the content of this report. Our editorial team executed the online survey, conducted the interviews and wrote the report. The findings and views expressed within do not necessarily reflect the views of the sponsors.

Our research draws on three main initiatives:

- we conducted a wide-ranging global survey of senior executives from around the world in September and October 2007. In total, more than 1,200 executives, half of them from the C-suite and 26% of them CEOs, took part. They represented a cross-section of industries and a range of company sizes;

- to supplement the survey results, we also conducted in-depth interviews with 28 executives, including CEOs and sustainability chiefs, as well as other leading experts from international organisations, consultancies, non-governmental organisations and academia. A full list of interviewees is detailed on the next page;
- finally, an extensive programme of desk research was conducted, including a wide-ranging literature review.

Dr Paul Kielstra was the author of the report and Gareth Lofthouse and James Watson were the editors. Sarah Murray also contributed. We would like to thank all the executives who participated in the survey and interviews for their time and insights.

February 2008



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Interviewees

(Listed alphabetically by organisation name)

Dr Hameed Bhombal, CTO, President of Corporate Technology Strategy and Services, Aditya Birla

Roland Waardenburg, Director of Corporate Social Responsibility, Ahold

Edward Bickham, Executive Vice President, External Affairs, Anglo American

Michael Prideaux, Director, Corporate and Regulatory Affairs, BAT

Professor Pan Jiahua, Executive Director, Research Centre for Sustainable Development, Chinese Academy of Social Sciences

Dr Gail Kendall, Director, Group Environmental Affairs, CLP Group

Carl Kitchen, Public Affairs Manager, CLP Group

Ed Potter, Director of Global Workplace Rights, Coca-Cola

Dr James Suzman, Director of Corporate Citizenship, De Beers

Tod Arbogast, Director of Sustainable Business, Dell

Doug Cahn, Chairman, Fair Factories Clearinghouse

Tony Juniper, Executive Director, Friends of the Earth UK

Mark Kramer, Founder, FSG Social Impact Advisors, and Senior Fellow, Harvard's Kennedy School of Government

Julian Garrido, CFO, GE Latin America

Jane Nelson, Director of the CSR Initiative, Harvard's Kennedy School of Government

Adrian Hodges, Managing Director, International Business Leaders Forum

Francesca DeBiase, VP, Worldwide Supply Chain Management, McDonald's

Bob Langert, VP, Corporate Social Responsibility, McDonald's

Bart Alexander, Global VP, Alcohol Policy and Corporate Responsibility, MolsonCoors

Jing Ulrich, Chairman, Chinese Equities, JP Morgan

Daniel Vasella, CEO, Novartis

Pierre Poret, Head, Investment Division, OECD

Ivo Menzinger, Group Head of Sustainability and Emerging Risk Management, Swiss Re

John Elkington, Founder and Chief Entrepreneur, SustainAbility

Alan Rosling, Executive Director and Board Member, Tata Group

Georg Kell, Executive Director, United Nations Global Compact

Bjorn Stigson, President, World Business Council for Sustainable Development

Jill Brady, General Counsel, Virgin Atlantic

Doing good: Business and the sustainability challenge is an Economist Intelligence Unit research programme that investigates the impact of sustainability on business today. A total of 1,254 executives around the world participated in the survey. Half of all respondents were from the C-suite. Roughly 27% of respondents were based in Asia, 33% in western and eastern Europe, 33% in North and Latin America, and 7% in the Middle East and Africa.

Participants represented a range of company sizes, with 53% from firms with at least US\$500m in revenue; 22% were from firms with revenue of at least US\$5bn. The full breakdown of survey respondents can be found in the appendix, starting on page 46.

Please note that not all figures quoted correlate precisely with the charts provided, typically because of rounding.



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Executive summary

Being a good corporate citizen has never been so challenging. Companies have long been under public scrutiny for practices ranging from recruitment to workplace safety, from attitudes to overseas investment to environmental pollution. The emergence of climate change as a mainstream political issue, however, has served to drive home the breadth of ethical issues with which firms must now grapple. The business—and societal—implications of how companies address these are so far reaching that a new area of management practice has come into being to manage them, known by many as “corporate sustainability”.

Accordingly, grasping the nature and scope of the sustainability challenge—as well as best practice in addressing the attendant opportunities and risks—is of immense importance to the corporate community. However, this report suggests that companies are at an early stage in developing such an understanding. While 53% of firms worldwide surveyed by the Economist Intelligence Unit claim to have a coherent sustainability policy, only half of these extend this

beyond internal operations to encompass their supply chains. In all, less than one in three executives (29%) say their company has a coherent strategy that covers the whole business and its supply chain. Uncertainty also lingers as to whether sustainability can be seen as an opportunity, or if it is merely another drag on the bottom line.

To investigate this, and to assess the impact of sustainability on business today, the Economist Intelligence Unit drew on a wide-ranging survey of over 1,200 executives worldwide, along with numerous in-depth interviews with leaders of businesses and non-governmental organisations (NGOs) as well as other sustainability experts. Other key findings from the study include the following:

Business knows that it needs to raise its game... Out of a list of 16 sustainability policies, encompassing issues ranging from energy consumption and carbon emissions to diversity and governance, companies surveyed for this report had implemented an average of just 4.8 globally. Quantity

Defining sustainability

According to Timothy O’Riordan, Emeritus Professor at the School of Environmental Sciences, University of East Anglia, defining sustainability is like “exploration into a tangled conceptual jungle where watchful eyes lurk at every bend”. The number of definitions available, however, gives each publication the freedom to advance its own, as a courtesy to readers if nothing else. This study has called sustainable those policies and processes which enhance the financial, environmental, societal, human,

and other resources on which the company involved depends for its long-term health. Sustainability is the result of having such sustainable policies and processes, and aligning them so that goals in one area are not compromised in favour of those in another. This is really just an elaboration of the Bruntland Commission definition, which posits that sustainable development is that which “meets the needs of the present without compromising the ability of future generations to meet their own needs”. Obviously, the practical implementation of the definition will vary across industries, geographies and job functions, because at the core sustainability is an underlying approach rather than a definitive list of activities.



aside, many executives also rated the quality of their company's efforts poorly. More respondents say that their organisation's performance has been poor in individual areas of sustainability, than those who believe their firms are doing well. Just 6% rate their companies as outstanding when it comes to the reduction of greenhouse gases, waste and pollution, compared with 15% who describe themselves as poor. One exception is communication: talking about whatever programmes they have in place is something most companies feel they do well.

...but is often confused by such new and poorly defined demands. Companies are still figuring out what sustainability means for their business and how to implement it. The research shows that companies have difficulty devising useful targets, and aligning social and environmental objectives with financial ones. Moreover, management frequently lacks an understanding of what sustainable development means for the organisation. No small factor here is a lack of consensus on what sustainability entails. "Sustainability, at different times, can mean all things to all men," says Dr James Suzman, Director of Corporate Citizenship at De Beers.

The supply chain is the weakest link. Extending sustainability policy to suppliers is the area where companies gave themselves the worst marks: about one-fifth say their companies have performed poorly in setting stronger supplier standards on both environmental and human rights issues. About the same proportion have only implemented supplier controls in the last five years. The problem is not new, and examples of disastrous consequences from socially or environmentally damaging supply chains abound. "Every CEO should be asking, after a decade of work in implementing codes of conduct, 'Why haven't we fixed the problem?'" argues Doug Cahn, Chairman of the Fair Factories Clearinghouse. Besides, firms can gain from improving their supply

chains. "This is not charity: it is pure business. We create a better long-term relationship with suppliers, have better products, and better control over volume and price," says Roland Waardenburg, Director of Corporate Social Responsibility at Ahold.

Many companies lack clear leadership on sustainability. Tony Juniper, an Executive Director at Friends of the Earth, who has seen numerous corporate sustainability programmes, says "senior management or chief executive buy-in to the agenda is absolutely crucial" for real change to occur. Most firms understand that senior leadership is critical here: one-third of surveyed companies place responsibility for their sustainability performance directly with the CEO—and a further 26% place it with the board. But at many other firms sustainability responsibilities are dispersed throughout the organisation, and 11% of companies admit to having nobody in charge. "Sustainability needs a strong seat at the table like procurement and finance," argues Francesca DeBiase, VP for Worldwide Supply Chain Management at McDonald's. "It is the way everyone should be thinking."

Sustainability reporting needs more work. Although companies rate their performance on communication highly, efforts regarding formal reporting are less advanced. Only 22% of executives say their firms have formal Triple Bottom Line reporting, although a further 40% say they will adopt it within five years. There is, in Mr Juniper's words, "a huge level of disengagement" from sustainability reporting.

Sustainability does pay. Most executives (57%) say that the benefits of pursuing sustainable practices outweigh the costs, although well over eight out of ten expect any change to profits to be small. Specifically, sustainable practices can help reduce costs (particularly energy expenditure), open up new markets and improve the company's reputation. Part



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of this involves a shift away from defensive behaviour towards more active exploration of the opportunities sustainability can present. Some of these gains can be dramatic. GE's line of Ecomagination products added US\$12bn to its bottom line in 2006. The costs of implementation, however, are not to be ignored: respondents view this as the most formidable barrier to expanding sustainability practices.

There is a link between corporate sustainability and strong share price performance. In our survey, companies with the highest share price growth over the past three years paid more attention to sustainability issues, while those with the worst performance tended to do less. Causality is difficult to establish, but the link appears clear: the companies that rated their efforts most highly over this time period saw annual profit increases of 16% and share price growth of 45%, whereas those that ranked themselves worst reported growth of 7% and 12% respectively. In general, these high-performing companies put a much greater emphasis on social and environmental considerations at board level, while the poorly performing firms are far more likely to have nobody in charge of sustainability issues.

Business leaders are open to more regulation on social and environmental issues. Executives in our surveys are often opposed to increased regulation. Not here. Forty percent of those in our survey believe additional regulation is necessary to tackle social

and environmental challenges. Another 50% say that voluntary action is generally more effective, but that additional regulation may be required in some areas. However, this openness to new rules is combined with the desire for clearer guidance about what government expects from business. Nearly two-thirds (62%) of respondents agree that "uncertainty over government policy is making it difficult to plan strategies for corporate sustainability". The irony is that politicians appear to be looking to business to deliver the goods. "Governments are proponents of market solutions, and business is saying we want some regulation," notes Bjorn Stigson, President of the World Business Council for Sustainable Development. "From the outside, it can look pretty confusing."

The social and environmental issues facing companies today are not going away—and are likely to involve a redefining of relations between business and society. This often involves fundamental political and even moral questions. A good sustainability policy needs to know when, and why, to say "no" as well as "yes" to stakeholders' innumerable demands. "If you don't know your magnetic north, then the compass is useless," says Mr Stigson.

Companies need to adjust by integrating best practices in these fields into their operations and by joining the broader debate on the responsibilities of business, government and individuals in addressing these challenges. If firms do not get involved in the latter, it will hurt their own finances, as well as the environment and social conditions worldwide.



Doing good: Ten lessons for corporate leaders

The experience of companies in the sustainability field yields some important insights.

1. Work smart, not hard. Sustainability does not involve a simple checklist of activities, but an alignment of social, environmental and financial goals. However, in our survey, the companies pursuing the largest number of sustainability-related policies were not necessarily those who ranked their performance in this area highest. Quality counts.

2. Know thyself. Successful sustainability programmes are based on companies figuring out what they think is right and acting accordingly, rather than running after (often shifting) public demands. Distilling corporate values is an essential first step. As Bjorn Stigson, President of the World Business Council for Sustainable Development, says, "If you don't know your magnetic north, then the compass is useless." A good sustainability policy needs to know when to say "no" to campaigners.

3. Know thy impact. A good assessment of what sustainability issues a company should be addressing requires an accurate idea of how company activities are affecting those around it. These need not be negative. Moreover, such analysis should include all aspects of the Triple Bottom Line—environmental, social and financial. Too often companies forget the last, but as Jane Nelson, Director of the CSR Initiative at Harvard's Kennedy School of Government, points out, "the greatest business contribution to society is creating wealth".

4. Focus on your core strengths. Just as with the financial side of company operations, good performance comes from con-

centrating on what an organisation does best. Immediate demands might inevitably draw you into areas a business does not know thoroughly, but it is wise for firms to consider where they can make the greatest impact. A consultant, rather than planting trees, would probably do better to help an organisation already doing that to run more efficiently.

5. Ask not just what your company can do for sustainability; ask what sustainability can do for your company. Sustainability need not be a burdensome imposition from outside. Taking account of social and environmental issues can lead to extensive innovation that cuts costs in the long run. At its best, it can open the way to new market opportunities and prepare the company for the growing risks in these areas. Ivo Menzinger, Group Head of Sustainability and Emerging Risk Management at Swiss Re, stresses that firms "need to approach sustainability from a business angle ... there are environmental and social trends that will be relevant".

6. Have clear leadership and board-level support. Sustainability will not just happen. Success in these areas requires that somebody be responsible for sustainability issues. Moreover, wherever that responsibility is placed in the corporate structure, environmental and social priorities must have unequivocal support from the board, CEO and other senior management. Roland Waardenburg, Director of Corporate Social Responsibility at Ahold, notes that without such back-up from his CEO, "I wouldn't do my job, because it wouldn't make sense any more."

7. Remember your supply chain. Too few

companies are integrating their supply chains into their sustainability policies. Just as with the financial side of operations, poor performance by suppliers here can harm a company's sustainability record—and very quickly its public reputation—while a sustainable supply chain can greatly enhance an organisation's ability to deliver its own high social and environmental performance.

8. Monitor and report. "When you say you will do something and you communicate it, you ought to measure it," says Daniel Vasella of Novartis. Finding information and metrics is not easy, but too few companies are even trying. Existing reporting guidelines are not definitive solutions, but they do provide a place to start.

9. Integrate. Sustainability will not work as an add-on. It needs to be integrated into corporate structures and processes. Such change can be hard to manage, but is a key element of getting this right. Although some problems are sufficiently novel that new procedures and tools will be necessary to do so, companies should not forget traditional techniques of encouraging positive behaviour. Mark Kramer, Founder of FSG Social Impact Advisors, explains: "Until it affects somebody's compensation and performance reviews, it won't appear as a serious priority for middle management."

10. Engage. Sustainability is about the relationship of business to other elements of society. This means that a successful company will frequently cooperate with a range of stakeholders, including NGOs, that might on other occasions campaign against it. It also means engaging in public debates about the appropriate content and limits of corporate social and environmental policies. This may not always be comfortable, but it will contribute both to the success of business and of the sustainability agenda.



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Chapter 1: Sustainability: What is it, why now, and why us?

Key points

- There is a general sense of confusion about the definition of sustainability. It means different things to different firms and varies across industries and regions
- Climate change is the key concern today, but the underlying driver is the changing roles of business, governments and other stakeholders in the wake of globalisation

Three seemingly unconnected news stories appeared towards the end of 2007: a large multinational clothing company faced criticism for deaths at a supplier factory in the developing world; a major oil company's presence in a country known for human rights abuses came under the spotlight after another military crackdown on dissent; and Al Gore and the Intergovernmental Panel on Climate Change (IPCC) won the Nobel prize for their efforts to disseminate knowledge about climate change, while the US Congress debated legislation regulating greenhouse gas emissions.

Although distinct issues, all are part of a multi-faceted challenge that companies are approaching with increasing seriousness—sustainability. Georg Kell, Executive Director of the United Nations Global Compact, a multi-stakeholder, corporate responsibility initiative, describes interest in the field as being on a “total upswing”. It is a view that executives interviewed for this report consistently echo.

As will be seen, however, companies are often bewildered in their response to these issues. That confusion is understandable when something as basic as what to call the challenge sparks debate. “Sustainability”, “sustainable development”, “corporate social responsibility” (CSR), “corporate responsibility”, and even old-fashioned “corporate citizenship” are all terms used, often interchangeably, with different parts of the world exhibiting their own preferences. CSR has fallen out of favour among some Europeans because of associations with previous failures, whereas in parts of the US “sustainability” has anti-corporate connotations.

For companies, the specific content of the term—this study uses “sustainability” without any anti-business intent—is even more daunting. Most

lists include financial, environmental and social sustainability. The *OECD Guidelines for Multinational Enterprises*, a useful effort to provide advice on state-of-the-art best practice in this field, focuses on Disclosure, Employment and Industrial Relations, Environment, Combating Bribery, Consumer Interests, Science and Technology, Competition, and Taxation and has provisions on general policies in such areas as human rights and supply chain management. The UN Commission on Sustainable Development identifies over 40 relevant issues, including such disparate areas as “Mountains” and “Health”. Ed Potter, Director of Global Workplace Rights for Coca-Cola, notes that at the theoretical level “sustainability is unbounded”. Dr James Suzman, Director of Corporate Citizenship at De Beers, agrees: “Sustainability at different times can mean all things to all men.” In practice, it seems liable to mean anything that a business affects, or that affects a business, that is not purely financial.

A better approach than making lists is to examine the ideas behind the terminology. Jane Nelson, Director of the CSR Initiative at Harvard's Kennedy School of Government, explains that part of the problem is historical. “You are getting convergence of similar but somewhat disparate fields,” she says. Sustainability or sustainable development started out as a largely environmental concern, which has increasingly embraced both economic and social dimensions, whereas the origins of CSR, especially in the United States, are in corporate philanthropy. Both spread to encompass the other and more besides. The boundaries, however, remain fuzzy. “Many companies have a sustainable development or environment, health and safety function and a CSR function,” Ms Nelson notes.

An early, oft-used definition for sustainability



comes from the *Report of the World Commission on the Environment and Development*, the Brundtland Commission: “Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs.” The original focus was on the environment: development that destroyed or exhausted essential natural resources was inappropriate. Bjorn Stigson, President of the World Business Council for Sustainable Development (WBCSD), explains that in the late 1990s the concept of sustainability started to include corporate social responsibility, including governance in the wake of scandals such as Enron’s. The thinking, however, remained consistent. Just as behaviour that destroys the physical environment on which business relies is unsustainable, so too are activities that tear at social structures and stakeholder relationships equally essential for long-term survival.

CSR’s evolution was different. Adrian Hodges, Managing Director of the International Business Leaders Forum, a group working to enhance business’s contribution to sustainable development, argues that corporate involvement in the community some 20 years ago amounted mostly to philanthropy. “The main driver used to be the personal interests of the chairman or, more often, of the chairman’s wife.” From there, CSR “has moved through a long continuum to where today leading companies are looking at aligning business strategy with societal needs and working hard to eliminate negative operational impacts.” This approach, which now includes environmental responsibility, helps with stakeholder and risk management, as well as the search for new business opportunities and competitive advantage.

Mr Hodges and Mr Stigson both present this history in a way that emphasizes the element of enlightened self-interest in sustainability. This certainly has some appeal to modern business. For example, the two most frequently cited benefits that firms expect

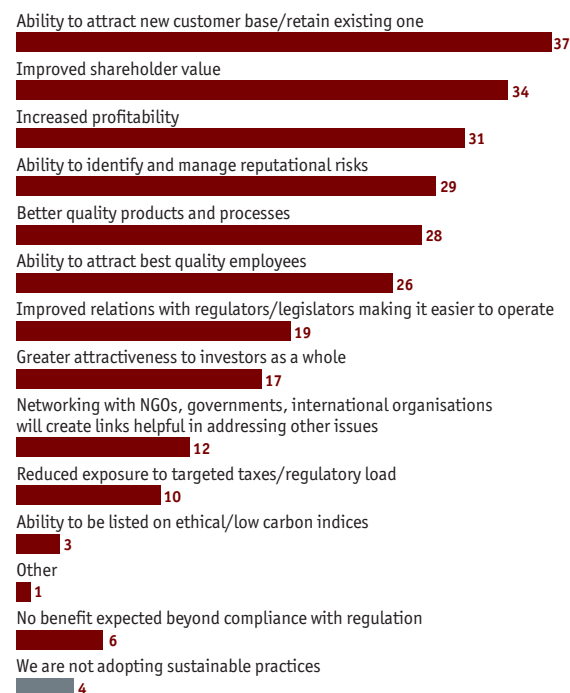
from sustainability policies relate to improved business outcomes: the ability to attract and retain customers (named by 37% of respondents) and improved shareholder value (34%). The third was straightforward increased profit (31%).

Time to care

Sustainability may have a long history, but why is the concept gaining traction in boardrooms now? The immediate impetus is closely tied to specific worries over global warming. John Elkington, Founder and Chief Entrepreneur of the consultancy SustainAbility, and coiner of the term “Triple Bottom Line”, notes that interest in this area comes in waves—this, he says, is the fourth since the 1960s. He sees the particular concerns driving interest as energy security, climate change and the growth of megacities. The

What are the biggest benefits that your organisation expects to derive from adopting sustainable practices beyond those of compliance (if any)? Please select up to three items.

(% respondents)



Source: Economist Intelligence Unit survey, October 2007.



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“[CSR] has moved through a long continuum to where today leading companies are looking at aligning business strategy with societal needs.”

Adrian Hodges, Managing Director of the International Business Leaders Forum

first two are related, and have clearly become greater political and popular concerns in the wake of extreme weather events and the release in 2007 of the IPCC report, which indicated a very broad scientific consensus that humans are causing climate change and

that this is likely to have a serious impact on the planet unless action is taken. Business is not blind to the implications. According to our survey, the leading area of activity in the past five years, and one of the most widespread priorities for the near future, is energy use reduction. Sometimes the change is more dramatic: Hurricane Katrina, for example, sparked a thoroughgoing change in how Wal-Mart approaches sustainability, particularly in environmental areas, but also in social ones.

Climate change, although very important to the current interest in sustainability, is in many ways just

the proximate cause. For decades now, globalisation and trade liberalisation have changed the relative positions of companies, governments and other stakeholders in society. Today’s sustainability agenda is a continuation of the ongoing attempt to redefine the roles of each to address the challenges facing societies (see box *Globalisation and sustainability*).

Business and morality

These issues are often political, and ultimately complex moral ones, such as what companies’ duties are to the communities in which they operate. For this reason, most executives interviewed for this report felt that their sustainability strategy has to start with principle, not profit. “CSR means different things to different people, depending on, for example, culture, religion, geographic location, or position in a value/supply chain,” says Mr Stigson. “In considering what you should do as a company, it really comes down to your own values. If you don’t know your magnetic

Globalisation and sustainability

Several executives interviewed for this report point to globalisation as the reason why sustainability has become an increasingly important issue for businesses. Edward Bickham, Executive Vice President of External Affairs at Anglo American, thinks the issue goes back to the fall of the Berlin Wall and the disappearance of a mainstream alternative to capitalism. As globalisation accelerated, opportunities for business increased—but so did worries that companies need to be more accountable. Dr James Suzman of De Beers dates a broader sociological shift to the same period, which resulted in companies having to meet new obligations in order to operate on a global basis. Georg Kell of the United Nations Global Compact also sees a strong

link between liberalisation, global integration and growing “expectations about business doing more or differently”.

The issue was not just about increased business influence in the wake of globalisation, but also a simultaneous decline of state power. “A lot of business risks and opportunities exist because of governance gaps or failures or because of changing boundaries and expectations of government roles,” says Jane Nelson of Harvard’s Kennedy School of Government. “So many of these issues are trans-boundary and would have been the role of government in the past. This is not to suggest that business should be taking responsibility for all these issues, but in today’s increasingly complex and interdependent global economy there is a need to re-negotiate boundaries and burden-sharing between the public and private sector.”

Globalisation has made it both more

important and yet more difficult to apply consistently high ethical standards to business. Different markets give rise to different responsibilities and expectations. Mr Bickham notes that in Anglo American’s British operations, “apart from being environmentally responsible and treating employees properly, our contribution is largely met by paying and treating our people decently, investing and paying our taxes.” He believes their responsibilities are different in the poorer countries, however, where the capacity of the government to deliver sustainable outcomes is low, and consequently the requirements placed on business are much greater. Stakeholders are knocking on business’s door not only for the problems firms might be causing, but also because companies may simply be the only ones capable of solving other pressing social and environmental difficulties for which they bear no direct responsibility.



north, then the compass is useless.” Daniel Vasella of Novartis, believes that the essential first step in this area is to “explore what your beliefs are and to act in accordance with them”. Julian Garrido, CFO at GE Latin America, and Bob Langert, VP for Corporate Social Responsibility at McDonald’s, also insist that

everything starts with setting the right values.

These days it is hard to escape the need for companies to crystallise their thinking on values. Michael Prideaux, Director for Corporate and Regulatory Affairs at British American Tobacco (BAT), the world’s second-largest tobacco company,

Case study **The Quakers, social responsibility and profit**

The correct conduct of businesspeople in society, and the link between social responsibility and profit, are not new questions. The case of the Religious Society of Friends—the Quakers—provides interesting insights into modern sustainability questions.

As a group, the Quakers go back to the mid-17th century. Originally blocked from entering the professions, many went into trade and later manufacturing. Their dress, language and close links with each other certainly set them apart within business and society, but so too did a number of traits, based on their beliefs, that would hearten the modern corporate social responsibility (CSR) executive.

- They were known, even by critics, for exemplary honesty. James Walvin, a leading historian, concludes in *The Quakers: Money and Morals*, “Their produce was sound, their prices fair, their services honest, their word good and their agreements honourable.” Although important today, such behaviour was even more so in previous centuries when bank regulation, for example, was poor at best, and adulterated food-stuffs all too common.
- Quakers avoided even highly profitable sectors that they deemed immoral, such as the arms industry and the slave trade—including, for a time, the closely associated sugar trade.
- They treated their employees very well by the standards of the day, both because it was the right thing to do and because they thought it likely to increase productivity. The Cadburys, at their Bournville facility, in the second half of the 19th century provided decent

housing, gardens, sports facilities and Saturday half-day holidays. In the early 1900s, they and the Rowntrees were among the first to set up worker pensions. Quaker employers might in retrospect seem at times highly patronising, but, compared to the alternative, that was a small price for contemporary workers to pay.

By the standards of today, did this eccentric behaviour have any impact on the financial bottom line? As with modern sustainability, it certainly did not hurt. Although Quakers in Britain never numbered more than 60,000, Mr Walvin notes that by 1900 it would have been easy to organise much of material life “around the products and services of a number of Quaker commercial enterprises. Financial transactions could have been conducted through a number of Quaker banks (most notably Lloyds or Barclays), confectionery was to be had from a range of Quaker manufacturers (Huntley and Palmer, Carrs, Rowntree, Fry or Cadbury), and shoes could be purchased from Clarks.” These were merely the most noted Quaker firms, which had an influence on British business completely out of proportion to the group’s size.

As with those firms that best exemplify sustainability today, the Quakers were not ethical in order to make money, but they did what they saw as right and, either despite or because of this, grew rich. The irony is that their money made them thoroughly uncomfortable—their precepts encouraged plainness, not luxury. As a result, even more wealth made its way to helping society. For example, Quaker businessmen were among the biggest backers of the anti-slavery movement—with both time and money—and for the past century Joseph Rowntree’s three independent charitable trusts have been campaigning on a series of social issues worldwide.

In the long term, honesty, integrity and loyalty to one’s values are clearly no obstacles to financial success—whether you want it or not.



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remembers that early on in its efforts in this area, “stakeholders were asking us what our business principles were. It hadn’t occurred to us that people would want that, but ... we went out and developed them.”

Morality, philosophy and values, however important, cause most businesses to tread warily. Some companies can draw on the religious precepts of founders and owners, such as Zoroastrianism at India’s Tata Group, or Quakerism at C&J Clark,

the British shoe company (see case study *The Quakers, social responsibility and profit*). Mr Hodges cites a study showing that the biggest driver of sustainability among Latin American small and medium-sized enterprises (SMEs) is the “values of the family member who started the business”. Most

modern multinationals, though, avoid a specific faith or ideology: if discussing religion is problematic for dinner guests, it can be fatal for sales or recruitment efforts.

Trying to rely on some broad sense of popular morality that will satisfy consumers, however, is also fraught with difficulty. Popular mores can change rapidly and be inconsistent within the same country, let alone around the world. Ms Nelson notes that “even with the best intentions in the world, companies have fifty different stakeholders telling them fifty different things”. Mr Vasella believes “one needs to be open, but not run after fashion”. Acting sustainably, he believes, is never easy. “There are a variety of stakeholders—shareholders, NGOs, the media, politicians—they all have an agenda. These agendas are not identical, and are sometimes contradictory. You enter into conflict whatever you do. Unless you stand behind what you really believe, you will not be sustainable because you will be

attacked.” Similarly, Mr Langert feels that, although it is important to listen to all sides on tough issues, “it is very difficult to satisfy all the constituents. We want to feel that we are doing the right thing.”

Inevitable disagreements over moral issues means that “sustainability” is becoming a term like “democracy”—everyone warmly supports the idea, but defines it differently. The contest over content is ongoing and could have profound effects. Jonathan Porritt, Chairman of the UK’s Sustainable Development Commission—the government’s independent watchdog in the area—wrote in a British newspaper, *The Guardian*, in November 2006 that almost by definition arms companies and cigarette-makers could not be sustainable. Mr Prideaux notes of BAT that “we’re very welcome in mainstream sustainability and CSR fora”, but the company is barred from anti-smoking ones. Mr Hodges thinks that ultimately “society will work through what is acceptable and isn’t acceptable. This is a question of changing values.” In the past, he adds as an illustration, slavery was considered acceptable.

The debate over values and what is morally acceptable may be an uncomfortable one for business. As Mr Vasella points out, “Something we have not been trained to do in business schools is how to [engage in] dialogue with peoples with other beliefs.” Too much is at stake, however, not to engage. At the very least, companies need to be part of the discussion on how far, if at all, current public concerns about climate change should affect a range of social issues as well. The future of whole sectors, which could find their social and legal licences to operate fading away, may depend on it. So too may the solution of many of the world’s pressing environmental and social problems. As Tony Juniper, Executive Director of the environmental NGO Friends of the Earth UK, notes: “We need business to be engaged in this in a positive way.”

“In considering what you should do as a company, it really comes down to your own values. If you don’t know your magnetic north, then the compass is useless.”

Bjorn Stigson, President, World Business Council for Sustainable Development



Chapter 2 Priorities and drivers

Companies are not philosophical academies but practical enterprises. How is the push towards sustainability changing the way they do business?

Overall, business is looking at sustainability challenges across the board, rather than focusing narrowly. Our survey asked respondents to rank the importance of a range of sustainability-related goals at their firms. Around one-half considered the following activities as very important: improving the environmental footprint of products (57%); improving energy efficiency (52%); developing new products to help reduce social or environmental problems (51%); and improving the impact of operations on surrounding local communities and environments (both 50%). At the top of the agenda, however, is communicating this performance to investors and stakeholders (61%), an issue which is discussed later in this report.

It is equally interesting to note which activities are ranked by executives as being of lower importance. Surprisingly, only around 40% of respondents see greenhouse gas reduction as an important priority. Given the interest of the public and politicians, businesses should almost certainly put more focus here. Says Roland Waardenburg, Director of Corporate Social Responsibility at Ahold, "It would be wise to work on this. In the long term you get penalties if you don't; in the short term you can reduce your costs while doing the right thing for the environment. A perfect example of how profit and planet can go together." Companies also seem to be focusing on getting their own houses in order. Supply chain issues are a less common concern, whether they relate to the environment (35%) or human rights (34%), a potential blind spot also discussed later.

The practical content of sustainability also varies

by sector. Respondents from the construction and agricultural industries, for example, gave a higher priority than the average to every one of the sustainability issues listed. Respondents in the latter were particularly concerned about local affairs, whether social (68% ranked it an important priority) or environmental (67%). Beyond the general, certain individual sectors also have specific concerns. Energy industry respondents are far more likely to place importance on issues such as energy efficiency (67%), greenhouse gas emission reduction (63%), and even—given their frequent need to obtain supplies in poorer countries—helping governments to promote sustainable development in countries of operation (56% compared with an average of 39%). Similarly, retailers are much more concerned than average with environmental and human rights issues in supply chains (54% for both), which can directly affect sales, and less so with developing new products (35%), a task they usually leave to others.

Such diversity is hardly surprising. Ivo Menzinger, Group Head of Sustainability and Emerging Risk Management at Swiss Re, notes that the implications of these issues will obviously vary by industry, with an insurance company and a manufacturer of wind turbines seeing different opportunities and risks. The variations should not, however, obscure the broader message of the survey: a large number of companies across all industries attach importance to a wide-ranging list of sustainability initiatives.

Same planet, different perspective

Different vantage points lead companies to take different approaches to sustainability. As Mr Kell of the Global Compact says, the push for corporate sustainability is "now truly a global phenomenon".

Key points

- Environmentally focused actions account for the bulk of companies' activities
- Global guidelines may be set, but how these translate into local initiatives will vary widely
- Customers and governments are two key influencers globally. Much less consideration is given to developing-world customers

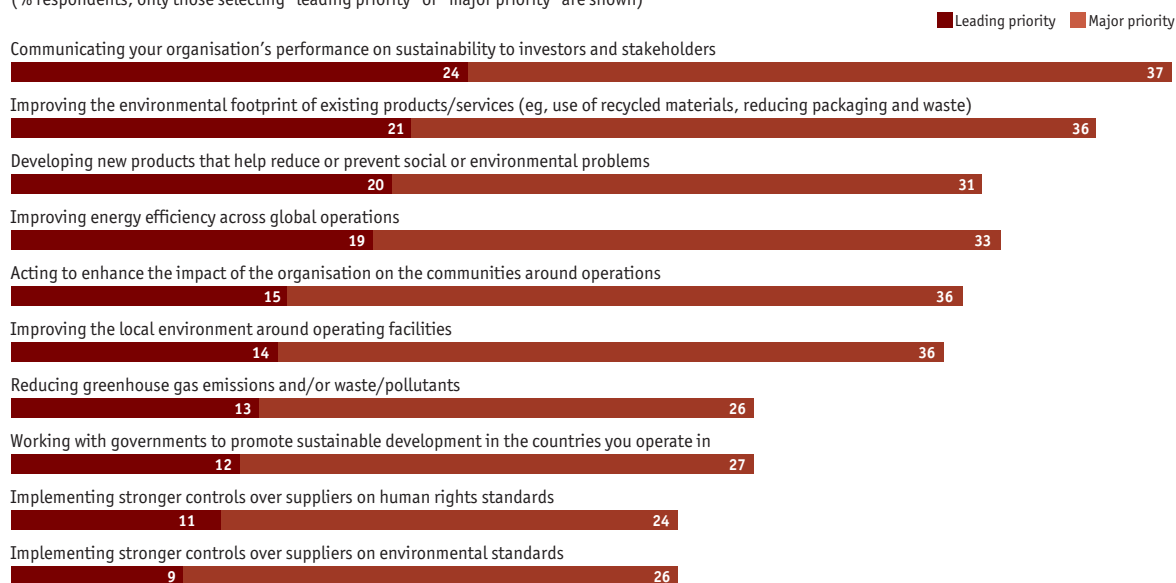


Doing good

Business and the sustainability challenge

How much of a priority will the following objectives be within your company over the next five years?

(% respondents, only those selecting "leading priority" or "major priority" are shown)



Source: Economist Intelligence Unit survey, October 2007.

That does not mean it is uniform. Instead, local implementation can make sustainability appear more like a mish-mash of concerns that happen to be headed in the same direction.

Values and cultural norms vary from region to region, sometimes even between or within countries. So do the drivers of sustainability. Our survey asked respondents to name the three stakeholders that would have the biggest effect on their sustainability policies. Worldwide, government policymakers, customers and competitors all featured, but with notable differences in emphasis (see chart on next page).

Competitors are a broadly shared concern, and the most pressing in North America. Mark Kramer, Founder of FSG Social Impact Advisors, a non-profit organisation working with corporations and other stakeholders in this field, explains that existing sustainability efforts have changed the playing field: "It used to be easy to say that you can't do anything because of competitive pressures. You can no longer argue that it is impossible for business to do this because many have."

Although other companies are a universal concern, thereafter the picture gets complicated. Companies in Asia-Pacific are more influenced by policymakers than any other stakeholders and also than respondents from elsewhere. Quite simply, the government is often the most active player in this region. Speaking about China, Jing Ulrich, Chairman of Chinese Equities at JP Morgan, says that "thus far the state is leading sustainability efforts". Government has intervened to close some of the worst polluters and to designate several larger firms as industry leaders. These leaders have been rewarded with access to capital and state assets, "but in return have greater responsibilities in terms of best practice," says Ms Ulrich. Dr Hameed Bhombal, CTO and President of Corporate Technology Strategy and Services at Aditya Birla, one of India's largest conglomerates, also notes that the environmental regulations he faces are tightening surprisingly quickly. As the figures show, consumers are not irrelevant in Asia either, although developing-world customers are generally given less consideration than those in the developed world. Even



in China, Professor Pan Jiahua, an environmentalist and Executive Director of the Research Centre for Sustainable Development of the Chinese Academy of Social Sciences, notes that domestic pressure on companies is seeing “a much, much faster change than expected. The general public seem to be empowered to report to the authorities. Companies seem to care more about their social images.” Nevertheless, the key concern remains the state.

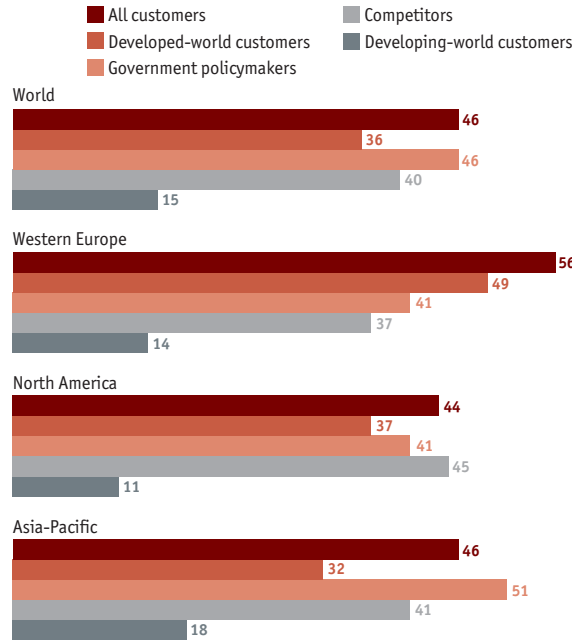
In western Europe, meanwhile, consumers are seen as the most powerful stakeholders of all in driving sustainability concerns. Mr Waardenburg of Ahold, for example, reports that his company usually acts ahead of any new regulations. To help the supermarket chain set its specific sustainability priorities, it consults customer opinion broadly. Francesca DeBiase, VP for Worldwide Supply Chain Management at McDonald’s, says that her company did a similar exercise in Europe, which it is now expanding to other regions. “It is fair to say that Europe leads the way in the sustainability discussion. This is simply because the European public, including NGOs, the government and the media, is more sensitive to sustainability and, in general, to a company’s inter-linkage with society.”

Arguably, consumer behaviour and government action usually arise, directly or indirectly, out of popular opinion, whether exercised through the marketplace or electoral choices. The relatively small direct impact attributed to the media and NGOs on companies (cited by 20% and 13% respectively overall) is on the surface a surprise. Their undoubted influence comes through their effect on consumers, voters and regulators (see case study *Business and NGOs: A changing relationship*).

There is one caveat to the importance of popular views worldwide—some people are more equal than others. Location may explain why customers in the developing world—where two-thirds of the world lives—are a leading factor for so few North American (11%) or west European companies (14%). Even for Asia-Pacific businesses, however, only 18% place

Which of the following will have the greatest influence over your sustainability strategy over the next five years?

(% respondents)



Source: Economist Intelligence Unit survey, October 2007.

developing-world consumers among their top three influences.

If companies worldwide were facing varying degrees of pressure from governments, consumers and competitors, the results might not be that different. Complicating matters is that popular opinion varies by region. Even on an issue where agreement is growing, such as climate change, Mr Stigson of WBCSD notes that, in very broad brush strokes, Americans are more amenable to technological fixes, Europeans to tougher regulations that might hurt the economy, Japanese to voluntary agreements, and Chinese and Indians to solutions that recognise their needs to alleviate poverty.

“It is a very broad range of

“It used to be easy to say that you can’t do anything because of competitive pressures. You can no longer argue that it is impossible for business to do this because many have.”

Mark Kramer, Founder of FSG Social Impact Advisors



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mindsets out there.”

Going beyond climate change, the variety of views is even greater, often arising out of different levels of development and state ability. Mr Garrido of GE notes that in Latin America the growth of the middle class is changing expectations about areas ranging from healthcare to water use. Dr James Suzman of De Beers believes that “it is fairly widely accepted, when operating in Sub-Saharan Africa, that [Adam Smith’s] invisible hand may be invisible because it isn’t there. It is hard to avoid the need to engage with societal issues in a progressive way.” Gail Kendall, Director for Group Environmental Affairs at CLP Group, the Hong Kong-based power company, says the group’s fundamental dilemma is “how to provide energy that is legitimately needed, and at the same time be good on climate change. Even our mainstream environmental stakeholders agree that there has to be a role for a fuel like coal, and that people in countries like India are entitled to development.” She adds that local Chinese stakeholders are looking less at emissions and more on education and an improvement in living standards. In India, Aditya Birla’s social activities in 3,700 rural communities accordingly focus on development, with programmes addressing issues including education, health and women’s rights.

As Mr Bickham of Anglo American noted of Britain, in developed countries environmental stewardship, behaving decently to stakeholders and obeying the law is sufficient to address most concerns on sustainability. However, even developed countries have their differences. As Mr Menzinger of Swiss Re says, “It shouldn’t matter in theory what your setting looks like, but it still does.” He remembers a former Swiss Re CEO saying that “being Swiss, with Swiss characteristics, and having the glaciers retreating, could have been one of the factors why we became alert to climate change so early”. Bart Alexander, Global VP for Alcohol Policy and Corporate Responsibility at MolsonCoors, believes that although US companies and regulators have generally been

less active on climate change, they have probably been doing more in the area of financial compliance post-Enron. The general reputation of the country’s business sector as a “laggard” on Triple Bottom Line accounting is, in his words, both true and not true. “It is certainly true at the rhetorical level, but if you look at the functioning of North American companies, there is quite a lot of history of community outreach and concern about how people are treated.” When he started at MolsonCoors, Mr Alexander found that a lot of sustainable behaviour had already been internalised. Many sustainability-related activities have “been done by a lot of companies, but just not pulled together and labelled as CSR”.

Even in terms of broader benefits that companies see from the sustainability agenda, the story can be quite different in regional or country-specific contexts, according to Mr Kell. For some Chinese firms, it is assumed to be a necessary part of wanting to operate on a world stage; in Egypt, “businesses see it as a platform of modernisation, a counterweight” to those wanting to return society to an earlier time; and in more developed economies it is often adopted by companies that want to maintain leadership.

Regional priorities

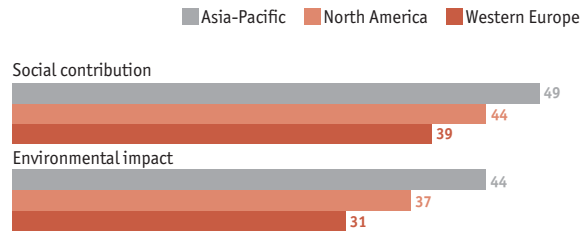
How are these differences playing out in corporate behaviour? Perhaps because of climate change, Europe has a reputation of being much more advanced on these issues. Our survey suggests a more complex picture, with Asia-Pacific companies rating themselves highly. There is an impression that foreign companies are leading sustainability efforts in the region—most members of the China Business Council on Sustainable Development, for example, are multinationals based in Western countries. Our survey figures indicate, however, that even domestic companies in this region claim to be as active in environmental and social areas as those elsewhere. As Ms Ulrich says of China, “Sustainability is a major concern here. It is certainly not considered just a Western issue.”



- In looking at priorities, far more Asia-Pacific companies consider working with governments to promote sustainable development (46%) than those based in North America (33%) or western Europe (31%). Perhaps surprisingly, for most sustainability priorities mentioned in our survey, a higher proportion of Asia-Pacific firms considered them important. Europeans were usually slightly ahead of North Americans, except in fields involving local communities, where the latter placed more emphasis.
- When asked about specific, sustainability-related policies and activities, Asia-Pacific firms on average had adopted more (five) than those in the other two regions (four in each).
- They were also less likely not to have anyone in charge of sustainability within the company—just 7% had no one, compared with 10% in Europe and 17% in North America.
- For companies that considered it relevant, the percentage of executives that thought a significant minority would pay extra for some element of sustainability—such as greener goods, carbon offset, ethical sourcing, socially responsible investment practices or brands associated with sustainability—was between 5% and 15% higher for Asia-Pacific companies than for their peers in Europe or North America.
- Asia-Pacific companies are more likely to think they are performing better than their peers when it comes to social (49%) and environmental (44%) issues. The North Americans are not far behind (44% and 37%), with the Europeans the most pessimistic (39% and 31%).

Although greenhouse gas emission in Asia, and especially China, is a real and pressing problem, it should not obscure the fact that sustainability is about more than one single issue, however important. Our survey and interviews instead paint a picture of companies facing a wide variety of challenges worldwide, with poor performance in one area

How do you believe your company's performance in the following areas rates against that of your main competitors?
(% respondents that selected "much better" or "better")



Source: Economist Intelligence Unit survey, October 2007.

not necessarily precluding positive performance elsewhere.

Such regional variety raises two questions. First, how should multinationals operating in many areas address issues with different salience worldwide? Sometimes the solution is to try to satisfy everyone. Tod Arbogast, Director of Sustainable Business at Dell, explains that “fortunately, within our industry, once we implement a sustainable change in a given region, it is beneficial for us to translate it across the globe”. Mr Waardenburg, speaking of Europe and America, says in practice the differences are “not too big” and that Ahold’s policies are able to satisfy all operating companies within the group. Even potentially more divisive issues do not necessarily cause difficulties. Mr Potter of Coca-Cola notes, for example, that his firm has a single worldwide policy on gender discrimination. “So far it seems to be working without any local hiccups.”

Universality, however, is not always easy. On the other hand, policies based on values cannot be completely elastic. Mr Vasella notes that Novartis is “not very flexible” on its rules. “We apply the same kind of standards across the world. That puts us at a disadvantage to some companies locally, but so be it.” Our survey shows that this attitude is not shared by all, even on questions where values are central. Just under one-quarter of companies have different standards on business ethics, corruption and bribery,



Doing good Business and the sustainability challenge

Case study Business and NGOs: A changing relationship

In popular imagination, relations between non-governmental organisations (NGOs) and companies usually involve angry confrontation—introducing the notion that the business community has been forced to address sustainability issues largely owing to the work of frequently hostile civil society groups.

The image may have historical justification, but the relationship has moved on. The main driver of corporate change is no longer activists with great media acumen chained to corporate property. Survey respondents put NGOs last in a long list of influences over their sustainability policies (only 13% placed them in the top three). Of course, civil society actors certainly affect more highly ranked groups, such as governments or customers, and a well-targeted NGO campaign can cause deep reputational damage. Instead, the apparent decline of NGO influence may be relative rather than absolute. According to Mr Kramer of FSG Social Impact Advisors, because of their success in winning over the public, “pressure from activists [now] falls on more fertile ground. Activist groups certainly continue to put on pressure, have gotten more sophisticated, and have moved from a radical fringe to an accepted part of the culture.”

More interesting than conflict is the increasing level of partnership between NGOs and companies. As Georg Kell, Executive Director of the United Nations Global Compact, notes, dialogue required change on both sides, with the former becoming less confrontational and the latter less defensive. Co-operation between individual firms and activist groups, which a few years ago might have been problematic, is now unremarkably commonplace. Ed Potter, Director of Global Workplace Rights at Coca-Cola, says that NGO input to policies at his firm is “quite important”. Coca-Cola’s recently released workplace rights policy saw “more external engagement with human rights NGOs than we probably did internally”. Bob Langert, VP for Corporate Social Responsibility at McDonald’s, comments: “We need them and their expertise. We don’t know enough about all of these technical issues. Even the campaign NGOs play an important role. These issues need more attention. I like the fact that there are these groups out there rattling the cages. They care, we care.” As with its suppliers, McDonald’s appreciates long-term relationships with partner NGOs, having co-operated with Conservation International for two decades. Dell too works with NGOs, using the same logic it has for business partners: they bring expertise that the company simply does not have in-house.

Across the fence, Tony Juniper, Executive Director of Friends of the Earth UK, says that after “a lot of greenwash over the last 20 years”, his organisation was seeing in some cases “a genuine engagement we haven’t seen before”. It is now working with

Eurostar and the Co-operative Bank, whereas “a few years ago we didn’t find partners out there that we trusted sufficiently”.

But despite numerous examples of co-operation, mistrust remains between the sectors. Mr Juniper sees “a very mixed level of engagement and performance on sustainability across the corporate world and within sectors”. Companies are doing “a lot of engaging in the communications sphere”, but only some who make claims are seriously addressing the issues. Daniel Vasella at Novartis points out that, like companies, NGOs are not all the same: “They range from 180 degrees collaborative to 180 degree oppositional.” He argues that companies “need to keep open a dialogue with the ones we can, but so do they”. Many executives see a simple market logic at work: in Mr Kramer’s words, there is “a separate industry of

“We need [NGOs] and their expertise. We don’t know enough about all of these technical issues. Even the campaign NGOs play an important role. These issues need more attention.”

Bob Langert, VP for Corporate Social Responsibility at McDonald’s

NGOs that needs to find wrongdoing on the part of corporations to sustain themselves. There are those who think business is fundamentally a bad thing. They are not going to change their views.”

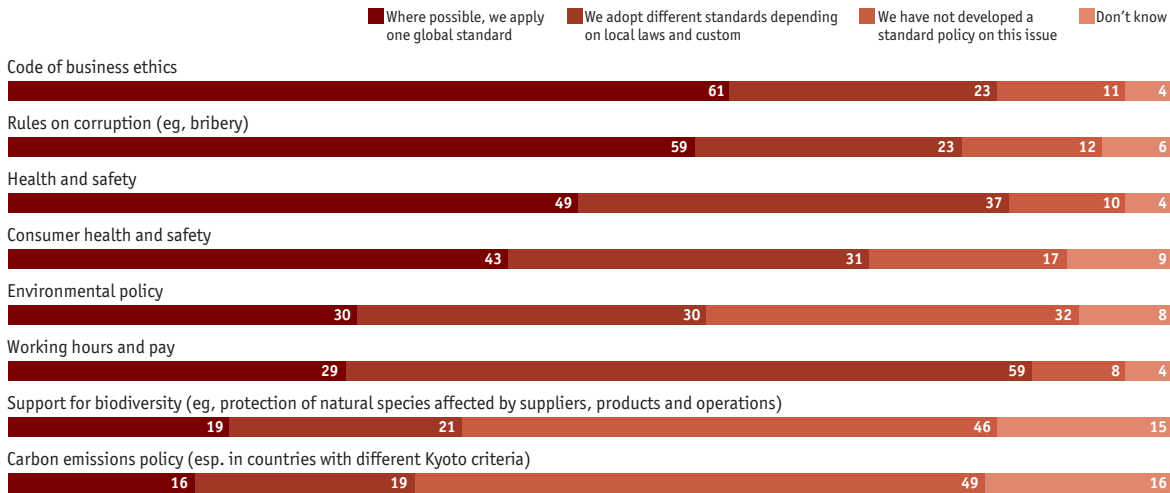
This continuing tension is causing less friction than it might because actors in both

sectors have realised that the other is not the key to these issues. At the Global Compact, Mr Kell was “never of the view that the business-NGO partnership dimension is so important. In the broader constellation of business, government remains in the driver’s seat.” Similarly, NGOs see attacks on companies as sometimes necessary but generally inefficient. Even the largest ones rarely have the resources to co-ordinate more than a few large campaigns at a time. Mr Juniper notes that at Friends of the Earth “our analysis has broadened into a different place, looking less at the performance of individual companies and more at the private sector as a whole and the role of regulation. That has led us to engage less with individual firms, and more with governments.” Even the International Business Leaders Forum, whose mission is to put “business at the heart of sustainable development”, according to Adrian Hodges, the Managing Director, “spends as much time working with NGO and government leaders as business, because the ability of business to be sustainable is as much a result of the attitudes and actions of these actors as of business itself”.

Overall, our survey result does not reflect business being able to ignore activist pressure, but rather a maturing relationship between the sectors and a realisation by both that limited resources are better focused elsewhere.



How do you apply standards in the following areas across your global operations?
(% respondents)



Source: Economist Intelligence Unit survey, October 2007.

depending on local laws and customs. Over one-third treat health and safety issues differently. Some flexibility may be necessary. Ms DeBiase agrees that there have to be global standards, but within such a framework certain issues depend on local needs: water use reduction, for example, might get a higher priority in dry areas. The kind of variation suggested in our survey, however, means that a significant minority of companies risk scandals that sustainability was supposed to help address: after all, developed-world consumers do not differentiate between bribes or sweatshops at home and those abroad. More important, these businesses risk missing the broader changes afoot worldwide.

The second question is: "Where does it end?" Critics of sustainability point out that companies are being asked to do things they are not necessarily very good

at, to the detriment of what they do well, thereby ultimately hurting society. As everything above shows, no simple answer exists and context is essential. Alan Rosling, Executive Director at Tata Group, says that his company considers these matters "case by case. There is a limit to what we can do with the resources we have, and we are restricted by what is legal and ethical. Beyond that we don't have any restrictions." Mr Vasella agrees that it is "not a question you can answer in general. You have to explore each and every time. You have to ask what do we really believe is needed and useful." Ultimately, leading companies limit these activities in the same way they do commercial ones, by asking where they can bring added value or make a unique contribution—and, more recently, by asking what aspects of sustainability will bring them competitive advantage as well.



Chapter 3

How is business doing?

Key points

- Few companies rate their efforts on environmental and social issues highly
- Key barriers include a lack of definition about what level of action is sufficient, and the need for deep cultural change within business
- Specific issues centre on leadership, firms' supply chains, reporting and metrics, and the challenge of turning values into processes

Despite numerous examples of companies with laudable sustainability efforts, business as a whole is at a relatively early stage of learning and adoption. Just 53% of surveyed firms worldwide have a coherent sustainability policy. About one-half of these address only company operations, not supply chains. Another 23% of respondents are currently trying to develop policies.

Execution is similarly problematic. Asked about performance on a range of environmental and social outcomes, less than 10% of respondents rated their efforts as outstanding on each, barring public relations (PR). Large majorities described themselves as average or worse.

The specific content of sustainability programmes also frequently leaves much to be desired. As noted above, just 55% of companies are reducing energy usage—and those doing so are not having much impact on their carbon emissions. The only other strategy adopted by over one-half of companies (51%) was to change governance structures relative to social and environmental activity. Basic steps, such as upgrading information technology (IT) to monitor performance or integrating sustainability into employee training, were minority tastes (27% and 31% of companies, respectively).

A large part of the problem is simply how new all this is to many, especially when, as Mr Stigson at WBCSD explains, the challenges are very substantial. “There is some humility in looking at these issues,” he says. “Most corporations have not been doing so very long. At the same time the agenda is exploding.” Similarly, Mr Kell of the Global Compact sees a lot of insecurity as to how to master these issues. “Business people recognise their importance, but when it comes to the practical question of what they mean to the

organisation, there is a lot of confusion,” he says. “Business has never explicitly embraced these issues. There is no ready recipe or toolbox.” Mr Potter of Coca-Cola thinks only a small part of the corporate world has achieved momentum in this area. Overall, business is “at the baby steps stage. This whole thing is a huge endeavour.”

The main impediments to progress confirm that companies are at an early stage in the learning process. After fear of costs (40% of companies), the second and third most frequently cited barriers are: difficulty devising useful targets, measures and controls to entrench sustainability (36%); and problems aligning these efforts with financial ones (31%). One-quarter even blame a broad lack of management understanding of what sustainable development means for the organisation.

These difficulties point to two wider issues. First, the lack of definition hinders excellence. Ms Nelson of Harvard explains: “Most companies are not sure what is enough. On climate change, what is enough? That you have a policy? That your emissions meet or

Does your company have a coherent strategy for corporate sustainability that covers the whole business and its supply chain? Please select one answer only.

(% respondents)



Source: Economist Intelligence Unit survey, October 2007.



exceed some publicly agreed level? And if so, who sets the level? There is even more fuzziness on spheres of social responsibility.” Jill Brady, General Counsel and in charge of sustainability at the airline Virgin Atlantic, agrees: “The issue is so big and people never know if they’re doing enough. I try and get my team to write down little successes along the way—because it’s easy to lose sight of what has been achieved.”

Second, progress requires not only new techniques and tools but, potentially, deep cultural change too. “Sustainability’s history of being imposed on companies has made it very hard to see it as a positive thing,” argues Mr Kramer at FSG. “It has been deeply ingrained for a couple of decades that it is really an attack on business, something to be avoided and handled through PR.” Thus, the starting point is simply taking the challenges seriously, thinking through one’s values and long-term business interests, and then acting accordingly. Mr Juniper of Friends of the Earth sees the key for businesses as aligning environmental, social and financial goals.

They fail if “they see this as a process of balancing challenges”, in which case “they finish up always trading off, and choosing the financial”. Creating such an alignment will often, according to Mr Elkington of SustainAbility, require “a fundamental rethink of the business model, which is really, really tough to do”.

Looking in detail, several issues stand out as needing attention by many companies.

A. Leadership

As elsewhere in business, leadership is essential in reaching sustainability goals, but our survey indicates several problems. A handful of companies (4% of respondents) make no bones about the link between sustainability and PR, giving oversight of sustainability issues to their PR departments. More seriously, at more than one in ten firms, nobody has specific responsibility for sustainability. Overall, more than one in four businesses report that a lack of clear responsibility for sustainability at the board level is a major impediment to progress.

In which of the following areas did your organisation perform best over the past five years?

(% respondents, those selecting neither a positive nor negative response are not shown)



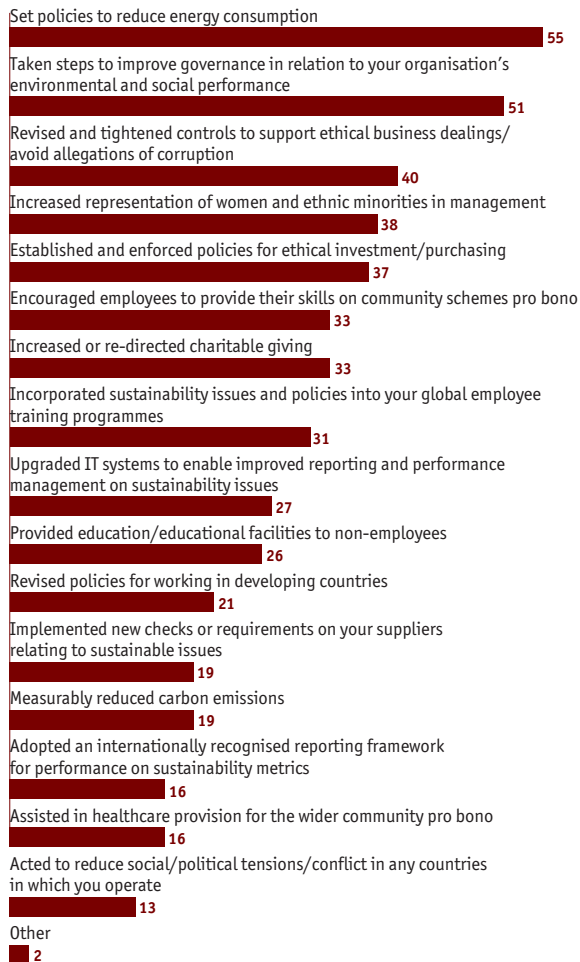
Source: Economist Intelligence Unit survey, October 2007.



Doing good

Business and the sustainability challenge

Which of the following has your company done over the past five years? Please check as many as apply.
(% respondents)



Source: Economist Intelligence Unit survey, October 2007.

Rather encouragingly, however, most firms (59%) give oversight of sustainability to the CEO or the board. Respondents' boards spend an average of 20% of their time discussing such issues, a figure they foresee rising to 29% in five years, indicating a general intent to spend more time on sustainability issues in the future. Perhaps unsurprisingly, the boards of the worst social and environmental performers spend less time (an average of 14%) on these concerns. Of course, CEO and board time

is of little value if those involved do not know the topic well—as noted above, a lack of management understanding bedevils 25% of companies.

Without proper leadership, sustainability policies will fail. In Mr Juniper's experience, for real change to occur, "senior management or chief executive buy-in to the agenda is absolutely crucial". Mr Vasella of Novartis similarly believes that, after thinking through one's values, the next key to success for CEOs is: "Do you have your board and management team with you?" If things go wrong, the buck stops at the top: if leaders are not acting in accordance with their values, "you should ask yourself 'why am I not doing what I should?'"

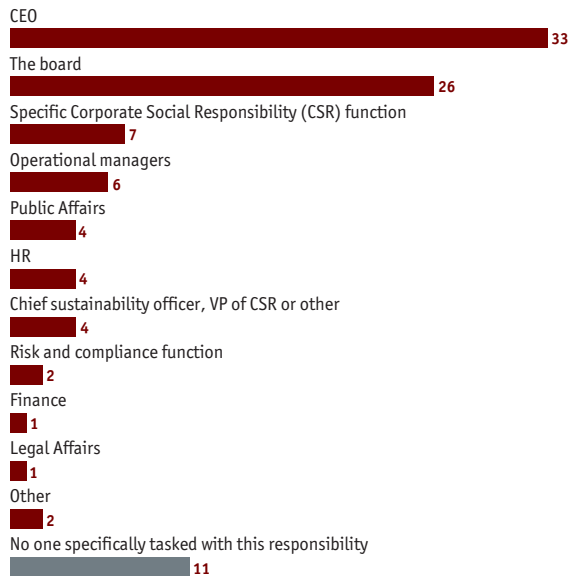
This tone from the top is all-important. Mr Garrido of GE believes that "90% of people want to do the right stuff". Good leaders allow this to happen, in part by "walking the talk". Sustainability has "got to be a value the leader believes in or people think the leader is a politician, not a manager", he argues. Mr Waardenburg of Ahold considers his CEO's insistence on integrating social and environmental performance into the company's business as crucial to success. "If that weren't the case, I wouldn't do my job, because it wouldn't make sense any more." Mr Arbogast of Dell agrees: "It makes my role much easier to have a CEO whose leadership is significant and active. Frankly, I feel for those who don't have the support of their chairman: they would have a fairly large challenge to overcome."

B. Global supply chains

Companies are paying surprisingly little attention to sustainability issues among suppliers. Respondents rate their performance in controlling environmental and human rights standards here as worse than any other area: over 40% describe themselves as below par. They are also less likely to report on supply chain human rights standards than on any other of 12 representative areas asked about. And change is unlikely anytime soon: only 35% consider action here



Where does primary responsibility for sustainability performance currently sit within your organisation? Select one. (% respondents)



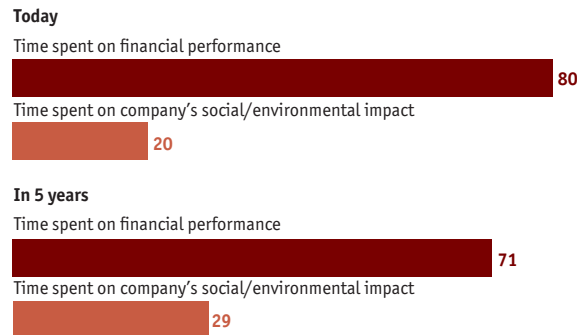
Source: Economist Intelligence Unit survey, October 2007.

an important priority.

Inattention to supply chains shows a failure to understand how societal expectations are changing. Labour conditions within developing-world suppliers, for example, have occasioned embarrassing controversies for their developed-world customers for years. Social auditing arose largely to provide independent confirmation of conditions in these establishments. Doug Cahn, Chairman of the Fair Factories Clearinghouse—recently founded to help share social audit information on clothing and shoe industry supplier factories in the developing world—says: “Every CEO should be asking, after a decade of work in implementing codes of conduct, ‘Why haven’t we fixed the problem?’” As supply chains become more global, Ms Nelson sees their management as a growing sustainability concern.

Worse still, such inattention shows a misunderstanding of one’s own company. Ms DeBiase remembers that at McDonald’s, which actively works

Within board-level meetings, how much time is spent discussing the following areas of corporate performance today, versus approximately how much time might be spent in 5 years’ time? (% respondents)



Source: Economist Intelligence Unit survey, October 2007.

on these issues with suppliers, “when we took a look at sustainability across the company we saw that the supply chain is such a big part of taking this seriously that we felt it was necessary to do”. But too few businesses share this view.

One reason is this area’s inherent difficulty. “Supply chains are very complex,” says Mr Cahn. “Relationships aren’t always transparent. There is a great deal of subcontracting. Even with robust licensing programmes, the chains are very hard to police.” He also points to the challenge of creating sustainable supply chains when operating in competitive markets with poor or virtually non-existent regulatory environments. “Some developing-country governments haven’t got sufficient enforcement,” he says. Add to this the thorny issue of company integration, tensions between those seeking compliance and those seeking to drive down prices, and crash orders placing hardships on factories to meet standards that companies are trying to impose, and it is clear that applying standards for sustainability can be a major challenge.

Sheer numbers increase the complexity. Mr Bickham at Anglo American explains that extractives as an industry use a lot of contractors. While his firm



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Big is beautiful?

Size matters a lot to sustainability performance. Three-quarters of large companies—those with annual revenue over US\$10bn—already have sustainability policies, most of which address supply chains. Only 5% have no plans to create one. Meanwhile, of smaller firms—those with revenue under US\$500m—just 48% have policies in place, and one in four have no plans to create one. Similarly, four times more large companies engage in Triple Bottom Line reporting, compared with small firms—and this ratio is set to increase over the next five years.

These differences may not reflect dramatic differences in the sustainability outlook. Adrian Hodges, Managing Director of the International Business Leaders Forum, points out that surveys on other policy fields would get the same answer. “Smaller companies tend to have fewer policies about things,” he notes. Georg Kell, Executive Director at the United Nations Global Compact, agrees, noting that small and medium-sized enterprises (SMEs) represent 40% of his organisation’s membership. They can do management overview without explicit policies, he says. Both he and Mr Hodges also believe that as larger firms focus on supply chains, smaller ones that are part of those chains will increasingly need to address sustainability issues.

Even so, the lack of coherent sustainability strategies does matter. On specific environmental and social outcomes, larger firms rated their efforts much higher than smaller ones, sometimes dramatically so: 38% of the former thought their efforts on greenhouse gas and waste reduction very good, compared with 19% of the latter. Even more striking, more than twice as many small firms ranked themselves as poor performers for every listed sustainability action. Larger companies were also more active, typically being involved in more than one and a half times as many sustainability activities as their smaller counterparts.

Why is this? Cost can be an issue for smaller companies, but is usually not a pressing one. Just 17% noted funding as a major barrier. Although this was much higher than the figure for large firms (7%), it was well down the list of issues.

Instead, small businesses are under less pressure to

deliver. In China, for example, Professor Pan Jiahua, an Executive Director at the Chinese Academy of Social Sciences, notes that whereas bigger companies see sustainability as part of what is expected of a business with global aspirations, the smaller businesses are “not ready yet”. Mark Kramer, the Founder of FSG Social Impact Advisors, notes that whereas global players need to have a strong corporate social responsibility (CSR) dimension, “SMEs are generally not the targets of activists, so they don’t have the defences”. The reason is simple and unlikely to change. As Jane Nelson, Director of the CSR Initiative at Harvard’s Kennedy School of Government, points out, campaigners “can’t go to 100,000 little companies”.

Another factor is that small companies tend to be more local. Mr Kell says that the Global Compact has found that success in social and environmental areas correlates positively to the degree of integration into global rather than local economies. For businesses operating in diverse geographies, it is “absolutely necessary to come to terms with environmental, social and government issues,” he says. Our survey did not contradict this: the differences between the most and least globalised businesses—as measured by percentage of total sales occurring outside the country of the firm’s headquarters—broadly reflected those between big and small companies.

Whatever the reason for their poorer performance, small businesses need to raise their game. They face the same opportunities and challenges as everyone else. Mr Kramer says sustainability is just as important to their strategy as it is to a large company. In fact, he argues, “in many ways, there are niche opportunities that small companies can fill that are too small for large corporations”. John Elkington, Founder and Chief Entrepreneur of SustainAbility, agrees: “Big changes in economies tend to come from a very limited set of actors. We will see unsuspected, unknown actors putting profound strategic and competitive pressure on mainstream companies.”

The performance of small firms has great implications for the success of sustainability. Some 80% of companies worldwide are small, notes Ms Nelson. Their individual activity, even if problematic, has little effect, but in aggregate it can be huge. On top of this, “some of the greatest innovation in terms of meeting social need comes from small companies,” she adds.



tries to address supply chain issues, he comments: “Does that mean we have a complete handle on all 40,000 suppliers? No, but it is a work in progress.” Coca-Cola, notes Mr Potter, has over 100,000 suppliers, making management of its supply chain “an immense activity”.

Supplier attitudes are also not straightforward. “We get a lot of reactions,” says Mr Arbogast, including positive ones. As Mr Potter notes, it is “a very resource-intensive activity to seek to influence businesses that you don’t own. Your sole leverage point is whether they continue to be your supplier. It is one thing to take an approach that you throw the rascals out, but that leads to a relatively unpredictable supply chain. You do throw out some rascals, and others leave,” but usually you need to work with what is there.

A hard line is also problematic, as its impact can be limited. Ms DeBiase explains that, although McDonald’s is clearly an influential buyer, “people tend to think we have more impact than we do. We can make changes but it doesn’t change the industry.” Mr Arbogast adds that not every company follows leadership in these fields. Indeed, faced with the reality that single-handed acts of responsibility often amount to little but quixotic failures to achieve anything of substance, some businesses form industry or broader stakeholder coalitions. According to Mr Arbogast, although Dell can do much on environmental issues, the complexity of IT’s supply chain makes social improvement easier to secure through the broadly supported Electronic Industry Code of Conduct. Similarly, although McDonald’s has sometimes created change on its own, such as on animal welfare, it needs help on other occasions, such as the recent controversy over soya from deforested Amazonian land. In this case, it helped to create the Soya Working Group, which included suppliers, producers and NGOs.

The novelty of co-operative solutions can also present legal challenges. The Fair Factories

Clearinghouse is unique in how it shares social audit information. Before it could start, however, the organisation thought it wise to get a business review letter from the US Department of Justice to ensure that the latter would not prosecute those involved for uncompetitive behaviour.

Despite all these complications, paying attention to supply chains is not only essential, it can also be highly beneficial. Leading companies, rather than dictating standards to suppliers, work with them to improve their performance—and thereby their products.

The benefits of such engagement can be substantial. BAT recently won a UK Business in the Community award for supply chain sustainability. Mr Prideaux says that it has long been helping farmers to improve crop yields:

“We work with them looking for continuous improvement.” Sustainability issues add one more part to the mix, but also provide new opportunities. Coca-Cola, says Mr Potter, usually sees problems here as “an opportunity to educate, to ramp suppliers up”. Mr Waardenburg points

to one of Ahold’s subsidiaries’ programmes, Albert Hein in Africa. Popular with suppliers, it insists that all of them, large or small, operate at an acceptable social standard. “This is not charity: it is pure business. We create a better long-term relationship with suppliers, have better products, and better control over volume and price,” he says. It is also a skills creation opportunity. “Every year, for Albert Hein, the market share and sales of these products is increasing.” Mr Alexander at MolsonCoors says that, even in the developed world, where the brewer’s suppliers are based, sustainability programmes allow it to raise performance.

The benefits from such efforts flow both ways. “If you work in a spirit of collaboration, it is amazing how you can get things done that are practical for

“Supply chains are very complex. Relationships aren’t always transparent. There is a great deal of subcontracting. Even with robust licensing programmes, the chains are very hard to police.”

Doug Cahn, Chairman, Fair Factories Clearinghouse



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the business and cost effective,” says Mr Langert of McDonald’s. A recent example is the company’s sustainable fish programme. Some 18,000 tonnes of fish sourcing has gone to more sustainable sources, based on a scorecard “developed with suppliers at the table all working in a collaborative way”.

The results can be even more powerful when, rather than simply obeying a purchaser’s strictures, supply chain members share its values. Mr Garrido at GE says his firm insists on this. “As we develop new

products, we need to have people who have the same thing in mind, who understand where we are going.” In seeking solutions for its Ecomagination range, for example, “we need people with the same mindset or we wouldn’t be able to cope”.

C. Reporting and metrics

Reporting is integral to modern business. As sustainability has risen up the agenda, corporate reports dealing with some or all of the issues involved

Case study Learning to share: The Fair Factories Clearinghouse

Social audits are relatively new devices, designed to verify compliance of (usually, developing-world) supplier factories with the employment codes of the (usually, developed-world) companies that are outsourcing their manufacturing to them.

The apparel industry was an early adopter, but its firms soon found themselves frustrated by their limitations. Conceptually based on financial audits, the first reports were not designed for easy sharing, even within companies, let alone with interested stakeholders, such as activists. Progress was hard to monitor, and patterns in data that could act as red flags were hard to spot. Most important, it became clear that social and environmental discussions with supplier factories had a fundamental difference from negotiations over price: for the latter collaboration with other purchasers was anti-competitive, in the former it was essential. Only collective leverage could change the sustainability practices of some of these factories, which in turn required shared information.

“Companies with supply chains and programmes to monitor factories were looking for better tools,” recalls Doug Cahn, Chairman of Fair Factories Clearinghouse (FFC), a non-profit organisation. “Some companies needed a data management tool that would help them to meet their commitments to transparency and public reporting.”

That tool began as software originally developed at Reebok, which then decided to share its work. Along with a number of other apparel and retail firms and trade bodies, it thus formed the FFC. Members can now use the database, which contains some 15,000 records, to more easily organise and access social audit information, including compliance records and history, for making purchasing decisions—something that major firms like LL Bean, Adidas and VF

Corporation do every day.

This, however, is only the first step. “Being able to manage information is one thing, but the ability to share non-competitive information is what companies really want,” says Mr Cahn. “When you have multiple buyers from a single factory, it allows for efficiency. More important, it allows for more effective communication about needed corrective action steps when compliance levels fall short of standards.” FFC has found that even companies satisfied with their own internal social audit databases are extremely interested in this aspect of its work. The benefits are not all one-way. If purchasers can share information, then factories with good records will not need to undergo so many time-consuming audits.

One advantage of the technology is that it helps overcome a problem that has plagued social auditing from the beginning—a multiplicity of codes. Mr Cahn notes that there was no common ground with early efforts by individual companies in this field. “Now you have hundreds, if not thousands, of codes of conduct, all of which are implemented in slightly different ways,” he says. “It has created a real mess and is terribly inefficient from a factory perspective and buyer perspective.” The database does not try to harmonise the codes—the FFC is neutral between them—but by including reports that use a range of them, Mr Cahn hopes that companies will understand the advantages and drawbacks of each, which in turn may spark efforts to greater harmonisation between them. “The FFC can be a forum in which the conversation about which standards may make more sense can take place.”

The FFC’s collaborative approach is now attracting interest from smaller firms. “These companies are not going to have the resources to build out a million-dollar database system,” says Mr Cahn. “For them, for a subscription fee, they can have access to the tool, to the information, and to hundreds if not thousands of other audits. Sharing is a huge opportunity for smaller and medium-sized companies.”



have appeared worldwide. Despite real progress, too many companies do not report on their efforts, and those that do still frequently grapple with central questions of what to report, how to do so, and what the results even mean.

Just 22% of survey respondents issue formal reports on their environmental and social impact and performance, along with their financial performance (the so-called Triple Bottom Line). Others are preparing to do so: 40% expect to publish such documents in the next five years. The other 38% have no plans to, although this does not mean that they are not monitoring these issues. Many report on specific items, including: programmes managing the impact of operations on communities (25%); energy use reduction (26%); jobs created by gender or minority group (40%); and donations to community and civil society groups (55%). Only 42% of respondents report nothing at all on environmental impact, and just 34% fail to report on employment conditions and social impact. These figures recall a point made by several interviewees, that companies have been doing a lot of this activity, but have just not called it sustainability.

Nevertheless, even the higher figures indicate, as Mr Juniper says, “a huge level of disengagement”. More striking, of those who did report any environmental or social data, a minority of respondents (41% and 31%, respectively) had it audited.

The value of reporting is straightforward and centres on measurement. Mr Vasella believes that “when you say you will do something and you communicate it, you ought to measure it”. If not, “you don’t know if it is being done”. Companies need the “courage to be accountable”, which spurs them to find innovative ways to keep commitments. Reporting “has a lot of effects on the organisation and credibility,” notes Mr Vasella. Mr Langert adds that one important outcome of McDonald’s CSR report has been enhanced transparency within the company. Indeed, employees will be one of the many stakeholders interested in such reports, along with governments, regulators,

consumers, NGOs and, of course, other businesses. Mr Potter of Coca-Cola says he is an “avid reader” of sustainability reports. This varied readership makes for a tough balancing act. A significant portion of respondents (43%) say that meeting the needs of such a multi-stakeholder audience is either a major or moderate challenge. Just 18% say it isn’t.

As with many things, however, the devil is in the detail. Among companies for which it was relevant, over-half faced important challenges from basic reporting questions, such as establishing appropriate key performance indicators (60%); finding reliable, relevant, internal data (58%); developing tools to monitor performance (53%); and meeting the reporting needs of different stakeholders (51%). The problems may be even more widespread: Mr Cahn notes that “everyone interested in social compliance needs to find better tools”.

Novelty is again an issue. Mr Potter says that establishing the right key performance indicators is tough: “I don’t think anyone has found the path to do that. To a large extent, this kind of work in a serious way has been going on for 15 years, but is still pretty embryonic.” Mr Bickham, although more positive, still has concerns. Devising metrics, he says, “is a work in progress, but it is quite well progressed”. Mr Prideaux of BAT agrees, and says “it is hard to find metrics, but it can be done”. The ideal “is to find something that you are already doing and use that”. For example, BAT used its Dow Jones Sustainability Index score in its latest annual financial report.

Several organisations have worked on reporting frameworks or standards, ranging from ISO 14000 certification to the AA1000 assurance standard. In fact, says Mr Bickham, if anything, Anglo American’s difficulty is that “we almost have too many benchmarks and metrics to report against”. The most popular current standard is that of the Global Reporting Initiative (GRI). Although comprehensive, the GRI’s guidelines “can look like a shopping list” of numerous suggested metrics, says Mr Bickham. Rather

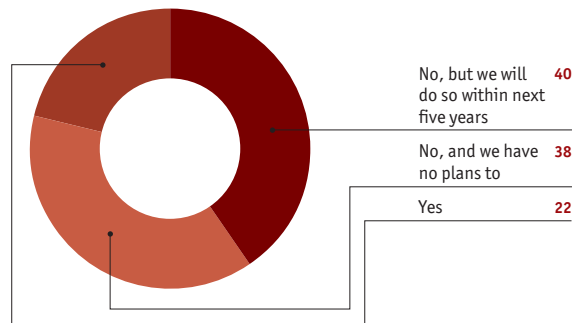


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Does your company formally report on its environmental and social impact and performance, as well as financial performance (known as Triple Bottom Line Reporting)?

(% respondents)



Source: Economist Intelligence Unit survey, October 2007.

than providing a solution, the work is a starting point from which companies need to select what is relevant to them and then decide how to report on it. The issues of finding data, devising monitoring tools and getting stakeholder agreement still remain.

Some companies are experimenting with alternatives. Mr Alexander explains that MolsonCoors decided not to produce a traditional CSR report, because it is “not clear that these get widely read”. Data-driven ones, reliant on the GRI or other standards, also can hide the deeper story. “Although aware of the standards, we wanted to look at the key issues to our stakeholders, consumers, owners and employees, to start with those, and build a report around how our business impacts those stakeholders.” Accordingly, rather than producing a static document, MolsonCoors plans to relaunch its website, with new interactive details of its sustainability performance.

Best practice is still clearly in flux. But as governments, especially in Europe, consider activists’ demands for mandatory sustainability reporting, more companies should start addressing these issues.

D. Turning values into processes

Sustainability requires more than corporate values. Efficient individuals do not inevitably create efficient

organisations: they need efficient processes too. Similarly, ethical individuals will not inevitably create ethical companies without the right structures.

One challenge lies in integrating long-standing values into corporate behaviour. As Mr Vasella notes, “thought about minimising negative impact has been around for a long time”. The change is that environmental and social impacts were not assessed so systematically before. Dr Bhombal of Aditya Birla agrees. Although his firm often tried to save energy for financial reasons in the past, all “processes developed today are as efficient as possible from an emissions point of view. You can’t do it the way you did it in the past.” Similarly, on pollution, previously “we cleaned up waste streams after the fact, now we are trying to design processes to avoid pollution”.

All interviewees agreed that such thoroughgoing integration of financial, environmental and social goals is essential for successful corporate sustainability. As Dr Kendall of CLP Group says, “You can’t bolt this on and have a department in a closet thinking good thoughts and writing reports.” Mr Prideaux of BAT insists that corporate behaviour, not philanthropy, is the right starting point. But creating such alignment throughout the company is not straightforward. At Anglo American, “at the international big picture level,” says Mr Bickham, “we are increasingly getting toward that integration. Making certain that it happens consistently at every site remains more of a challenge.”

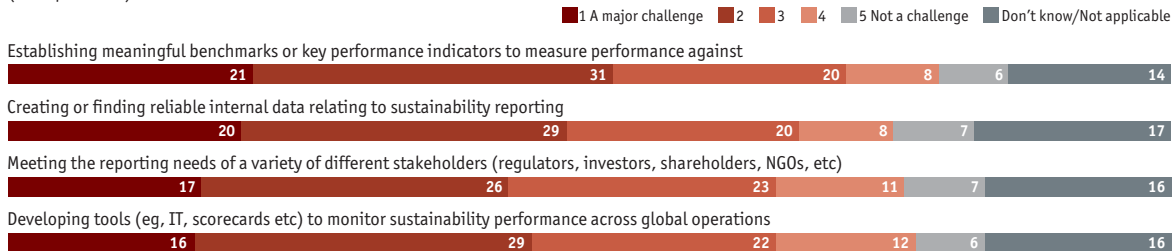
Traditional tools can help. One is money. “It is very hard,” Mr Kramer explains, “to get people within the company to get it. Until it affects somebody’s compensation and performance reviews, it won’t appear as a serious priority for middle management. People are not sure if CEO speeches on CSR are PR nonsense or important: they look to compensation and performance reviews.” Mr Garrido also believes that companies get what they create incentives for and measure. It is also sometimes possible consciously to structure sustainability into how the organisation operates, such as with Aditya Birla’s energy efficient



How much of a challenge are the following when it comes to reporting on sustainability issues?

Rate on a scale of 1 to 5, where 1 = A major challenge and 5 = Not a challenge.

(% respondents)



Source: Economist Intelligence Unit survey, October 2007.

processes. Ms DeBiase says McDonald's has included a full-time sustainability person in its supply chain management. "Sustainability needs a strong seat at the table like procurement and finance," she argues. "It is the way everyone should be thinking."

On other occasions, these issues need new skills and innovative process-driven models. Working with communities, for example, requires consultation more often associated with development workers. Such activity, Mr Potter believes, will not be successful unless firms have a robust, multi-stakeholder programme in every community in which they operate. "A company could lose the forest for the trees and not contribute, because they come in with a pre-conceived notion of what is needed." In fact, the largesse imposed by the company may be

neither wanted nor required. Mr Rosling of Tata Group also stresses that programmes have to be owned by local people in order to be effective, simply because local needs differ. It will take time for businesses to acquire these skills: just 15% of respondents rank community leaders among the greatest influences on sustainability strategy, well behind the media. A good example of where best practice may be headed, and the kind of new challenges that sustainability is demanding of business, is Anglo American's socio-economic assessment toolbox (see case study *Anglo American's approach to social impact*).

"Sustainability needs a strong seat at the table like procurement and finance. It is the way everyone should be thinking."

Francesca DeBiase, VP, Worldwide Supply Chain Management, McDonald's



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Case study Anglo American's approach to social impact

Several years ago, mining giant Anglo American was considering how to get appropriate information to improve its understanding of stakeholder perspectives and to improve its developmental impacts on the communities in which it operated. The company conducted social impact assessments when opening a new mine, or before a major expansion. But this was an initial step, rather than a repeated exercise.

Edward Bickham, the company's Executive Vice President for External Affairs, explains that "we were grappling with the difficulty of measuring in the social sphere. If you judge performance only by quantifiable metrics, you do it based on what you can measure, not what necessarily matters." The relevant information, however, is crucial in addressing social risks. The company piloted its socio-economic assessment toolbox (SEAT) process at three sites, in Australia, South Africa and Brazil. Since 2004 it has been used at over 60 locations, with feedback leading to an improved SEAT II in 2007.

The SEAT process involves seven steps:

- i. Profile the Anglo operation.
- ii. Profile and engage with the community(ies) associated with the operation.
- iii. Identify and assess social and economic impacts, key local socio-economic development needs and existing social management initiatives.
- iv. Improve the management of relationships with stakeholders and of socio-economic issues and impacts.
- v. Create initiatives for supporting community development.
- vi. Develop a management and monitoring plan.
- vii. Prepare a SEAT report and feed it back to stakeholders.

The idea is not to reinvent the wheel—where the necessary data are already available, for example, the process does not require that they be gathered again. And for each of these steps, the company has developed practices and tools to improve results. Step five, for

example, which deals with community developments, has 11 tools to help with everything from establishing partnerships to small-scale water and sanitation projects. This does not mean the process involves the company identifying and fixing problems on its own. Consultation with community stakeholders and establishing partnerships are absolutely essential and frequently repeated parts of the process.

Although the company had already been covering some of this work in various ways, the introduction of a formalised process has been highly beneficial. "By talking with stakeholders in a structured way," Mr Bickham says, "we have understood more about the challenges around us, especially as we are putting social investment in place." This knowledge means that useful investment need not always be expensive. For example, simply moving one of its mine's fences to open land for livestock grazing helped everyone in the local area, and many of the action points arising out of these assessments revolve around basic improved communication. Anglo Brazil's sustainable development manager reported that simply running the consultation exercise improved the company's reputation among local people.

Mr Bickham notes that SEAT assessment also allows a number of issues to surface. "It is allowing us to understand the dynamics between stakeholders, as well as between ourselves and stakeholders, which did not come naturally to us before." Now, not only is Anglo American better informed than before, but SEAT is also helping it improve performance. The management and monitoring plan in step six involves, in part, development of local key performance indicators (with a relevant tool to help). And the report in step seven includes public commitments on improvements, such as water quality, as "a key part of process", adds Mr Bickham. He believes that this is a useful way of focusing management attention. The overall results of SEAT have been very positive—so much so that Anglo American's board has made SEAT assessments mandatory every three years at all its operations.

Although some of the social and environmental challenges of sustainability may force companies to deal with novel challenges, SEAT shows that using a business-like, process-driven approach can be as valuable here as in other areas.



Chapter 4 Does sustainability pay?

One perennial and unresolved debate about sustainability is whether taking it seriously improves financial results. Convincing data are elusive, although most people assume a small, positive relationship. Among survey respondents, 57% hold that the benefits of investing in these fields outweigh their cost. Also, although slightly more people expect such spending to yield a profit rather than a loss, of those for whom the question was relevant, 89% thought the effect either way would be slight. Mr Potter of Coca-Cola notes that demonstrating the link for an entire company would involve important measurement issues. “I don’t think that anyone has established the connection in accounting terms,” he says. “Much of this is based on faith, and a belief that there is a clear connection.” Mr Prideaux of BAT agrees. The link is difficult to demonstrate mathematically, he says. “It is an implicit one: if a business is not seen to be sustainable, it is unlikely to be highly valued. I’m absolutely convinced that it is there, but can’t prove it. As far as costs are concerned, good behaviour doesn’t cost much and, on the environmental side, if you use less raw material, you can save money.” Mr Bickham says “some parts of the agenda cost us money, and some help us to make money including in areas like energy efficiency.” He says some people make “Panglossian speeches” about the benefits of anticipatory expenditure to further sustainable development, but the net financial effect can be in either direction.

Our survey results indicate that, although it is no magic carpet to prosperity, attention to sustainability is consistent with, and may cause, higher share price growth and profits.

The most striking data relate to differences in attitude towards sustainability between companies

with high share price growth—of over 50% in the past three years, hereafter described as share price climbers—and those whose value declined by more than 10% in that period (share price losers).

- Share price climbers put a greater emphasis on social and environmental considerations at board level.
- Share price climbers place higher importance on social and environmental goals, from improving human rights within supply chains (40% ranked this an important priority, compared with 18% of share price losers), through reducing greenhouse gases (38% compared with 24%), to developing products to address social or environmental problems (49% compared with 35%).
- Share price losers are 2.5 times more likely to have nobody in charge of sustainability: share price climbers usually give this task to the board or CEO.
- Sustainability also left the worst performers the most confused: their biggest impediments to progress in this area were poor management understanding, and lack of board responsibility (42% cite each); high growth companies instead face problems of implementation, such as finding the right targets, controls and processes (39%).

So a correlation between a serious approach to sustainability and high share price growth exists, but is the link causal?

According to our survey, the companies that adopted the highest number of sustainability policies had only marginally better profits than their peers. Instead, quality may matter more than quantity. When asked to rank themselves relative to peers on environmental and social performance, about 6% of respondents rated

Key points

- Companies that think they are doing well on sustainability are generally seeing better financial results than those who believe the opposite
- Sustainability itself has not yet become a major draw for investors
- A shift to so-called “sustainability 2.0” involves the possibility of exploiting new markets and opportunities



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themselves “much better” in both. The average net profit growth of this self-selected group was 16%, but share growth over the past three years reached 45%, well ahead of the average. At the other end of the scale, those companies that ranked themselves “worse” or “much worse” than their peers in social and environmental fields saw annual profit growth of just 7% and share price growth of 12% over three years. Although subjective ratings can be problematic, clearly companies that think they are doing well on sustainability are seeing dramatically better financial results than those who believe the opposite.

The bottom line

Despite this generally positive, or at worst neutral, picture about benefits and profits, concerns over cost remain an issue. The risk that sustainable practices would raise expenses relative to competitors was the

“In the short term, there is absolutely no question that doing these things better costs money. It’s an investment. Over the long term it can be profitable.”

John Elkington, Founder and Chief Entrepreneur, SustainAbility

most common impediment cited by respondents to furthering these policies (listed by 40%). Mr Elkington of SustainAbility considers this apparent schizophrenia to be a timescale issue. “In the short term, there is absolutely no question that doing these things better costs money,”

he says. “It’s an investment. Over the longer term it can be profitable.” The risks grow with the degree to which sustainability impacts the company, with a big gap between what Mr Elkington describes as modest housekeeping and market redefinition.

The overall business case, then, may be no stronger than “sustainability probably helps and at least it does not hurt”, but an attempt to find aggregate implications can hide important details. Sustainability is not a single process, but a change in how issues are approached, with numerous different practical results. Any business model variation has benefits and drawbacks and the overall results depend on execution as much as underlying ideas.

Far more useful than searching for some overall net financial benefit is to look in detail at the economic opportunities sustainability provides.

Cost reduction

For nearly two decades companies have been finding that “eco-efficiency”—a WBCSD-coined term from 1992—and social sustainability can bring savings. DuPont, for example, has cut costs by US\$2bn since 1990 through increased energy efficiency, while reducing greenhouse gas emissions by two-thirds. Substantial improvements can continue for a long time. Mr Vasella reports that Novartis, which has been increasing water and energy efficiency for several years, considered 32 environmental projects in 2006 “which could save US\$50m over ten years”. Multinational conglomerate 3M, after cutting energy intensity by 34% and saving US\$82m in expenses between 2001 and 2005, achieved further reductions of 9% in 2006, saving an additional US\$10m.

Such benefits are often unexpected for the first companies addressing issues. Anglo American, for example, began offering HIV/AIDS testing and free anti-retroviral treatment in its South African mines in 2002. They now reach 65% of workers, with participation rates of over 90% in the company’s best performing mines. “We have surprised ourselves,” says Mr Bickham. Not only is the programme probably slowing the pandemic among workers, but “in the best operations it is becoming self-funding, through balancing savings from reduced absenteeism and preservation of skills”.

Once potential savings are discovered, other firms would be sensible to adopt emerging best practice. Too few are. Mr Elkington notes that many companies are “profligate” when it comes to resource usage: “Often companies audited on energy and water efficiency are shocked to see the state of affairs.” Our survey bears this out. Although 55% of companies instituted policies to reduce energy consumption in the past five years—the most common sustainability-



related policy change—45% have not. The impact of these policies is also questionable: only 19% have measurably lower carbon emissions. Infrastructure may be an issue here. A survey of Asia-Pacific, American and European commercial real estate sectors by Jones Lang LaSalle, in collaboration with CoreNet Global, showed that in 41% of European and American executives see limited availability of sustainable real estate in some markets. Although more than 90% of respondents saw a cost premium associated with sustainable new buildings, 77% said they are willing to pay the premium to get energy cost savings and other benefits.

Savings found elsewhere—such as process standardisation—might be greater, but aligning environmental, social and financial goals can cut costs, and more attention here would benefit many companies.

Reputation and PR

Another oft-cited benefit of sustainability policies is enhanced reputation, with knock-on effects for brand value and reduced reputational risk. Respondents to our survey considered this their leading objective: 79% ranked enhanced brand reputation as a “very important” goal for their programmes. Among the benefits they expected from these policies, they put first an opportunity to attract and retain customers (cited by 37%), and fourth the ability to manage reputational risk (29%). Similarly, 18% of firms thought that most of their customers would pay extra for “a brand renowned for its commitment to sustainable development”, and a further 37% thought that at least a “significant minority” of customers would pay more.

Seeking such benefits is perfectly legitimate. And why not, asks Pierre Poret, Head of the OECD’s Investment Division. “This is not incompatible with behaving responsibly. It’s just fine if they capitalise on the positive impact on their reputations” if they are actually behaving sustainably, he argues. The leading sustainability-related focus by far among respondents

was not any particular social or environmental issue, but rather communicating performance to investors and stakeholders: 61% considered this an important priority, including even 39% of the worst performers. Similarly, when asked what they were doing right on sustainability, 12% rated communication of their efforts as outstanding, and 30% as very good, far higher than any other activity.

Reputational benefits from sustainability certainly exist. At a basic level, good credentials here can be essential for a social, and sometimes literal, licence to operate. Dr James Suzman of De Beers explains that the diamond industry as a whole “recognises that our survival depends on us being able to ensure that the consumer proposition is not interfered with by awkward ethical questions”. Mr Rosling of Tata believes that acting sustainably is both right to do, and also smart, as the firm is then welcomed in the community and people trust it. “A reputation for fair dealing makes a difference,” he says. “Going to another country, governments are more likely to welcome us. It does matter.” Brand value is also key. Mr Stigson says, “at a normal global company, the majority of the assets underpinning market capital are intangibles. That is a different story than in the past. The business case for sustainability is now increasingly connected to brand and reputation.”

Reaping these benefits, however, is neither straightforward, nor easy. First, empty claims rarely fool anyone. Even 71% of those surveyed agree that “too many organisations use sustainability merely as a public relations tool”—just 5% demurred. Second, pursuing sustainable policies simply to garner good reputation is bad business strategy. Mr Menzinger of Swiss Re explains that such motivation makes it “very uncertain whether you are going to keep going down that road if the key individuals, such as the CEO, change”. Moreover, it will be unclear where to focus—

“A reputation for fair dealing makes a difference. Going to another country, governments are more likely to welcome us. It does matter.”

Alan Rosling, Executive Director and Board Member, Tata Group

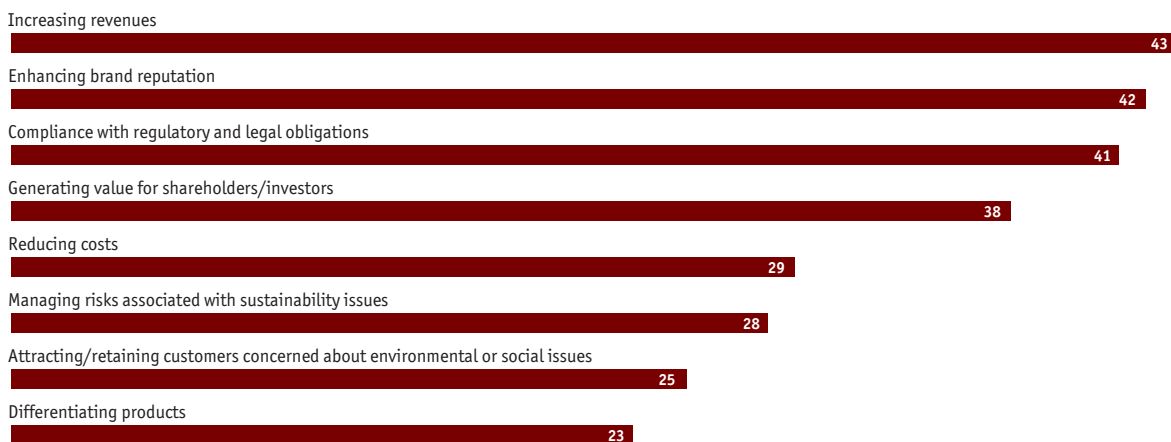


Doing good

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If you have or are developing a strategy for corporate sustainability, how important is it to your company that this strategy meets the following objectives?

(% respondents, only those selecting "Critically important" are shown)



Source: Economist Intelligence Unit survey, October 2007.

especially as popular mores are not fixed. "These issues are shifting from country to country and year to year," says Mr Kell at the Global Compact. "Currently it is climate change, last year it was poverty." What might win praise one year could easily seem inconsequential, or an embarrassment, the next.

Finally, sustainability's reputational advantages are equivocal. A good record only goes so far. Mr Potter of Coca-Cola sees little public relations benefit beyond the hope that moderate activists will wait to hear Coca-Cola's side of the story before condemning it for an alleged incident. More broadly he says, "there is no getting around the fact that we are symbolic of potentially three things: globalisation, multinationals, and America." Accordingly some people will condemn his business whatever it does. Others go further and argue that a good record can itself also attract problems. Mr Kell believes that "a psychological element" stops companies from claiming sustainability successes. "When you say you are best in class, you open yourself up to scrutiny," he notes. This is such a problem that Ms Nelson of Harvard thinks "companies are worried about trumpeting their own efforts or they will get slapped down by NGOs and journalists. I'd be amazed

if I could identify one company that said that it was doing right." Mr Rosling notes from experience that "the bigger your reputation, the more willing people are to have a go at you. Sometimes it feels as if people are going for us because we are nice, have a reputation, and may cave in easily to make the attacks to go away." Although critics may sometimes have a point, on other occasions "you have to stand tall if some bully tries to go for you".

Mr Menzinger sums up the best approach: "It doesn't hurt to take into account that sustainability may help your reputation, but if that is your sole goal, it will not be sustainable in the long run." Instead, companies should "treat reputational benefits as a positive side effect".

Investor attraction

Another suggested financial benefit of sustainability is the attraction it might have for investors—both the specialist socially responsible investment (SRI) community and more mainstream ones.

The direct practical impact of the former on companies is comparatively small. Only 3% of respondents rated the ability to be listed in ethical/low-carbon indices as a leading benefit of



their sustainability policies. Mr Elkington, who has worked for 15 years with a variety of SRI funds, is not surprised. “I think they’ve done great work, and helped wake up investor relations people, but the total amount of money moved by SRI is still very small and relatively volatile.” On the other hand, he says, “companies are quite proud to say things like ‘we are in the Dow Jones leaders category’, but this sits at a brand enhancement level”. Mr Arbogast of Dell finds the biggest benefit of his meetings with the SRI community is the chance to discuss performance and best practice rather than easier access to funds. Mr Menzinger, who sees a strong business case for Swiss Re to consider various environmental and social issues when selecting investments, is “a little bit sceptical, to be perfectly honest” about sustainability ratings. In his view, they are too backward-looking and not necessarily based on criteria relevant to the financial outlook for a company.

Far more important is how more mainstream investors approach sustainability. FSG’s Mr Kramer considers this a key issue: “Investor behaviour drives a lot of business behaviour and the weight of the investment community is not yet there.” Similarly, Ahold’s Mr Waardenburg senses that the number of investors interested in seeing sustainability data and performance is rapidly increasing, but it is a small segment in the market. Our survey backs these impressions. On the one hand, 58% agreed that investors would increasingly reward companies with above-average performance in this area, and 34% considered increased shareholder value a leading benefit of sustainability. On the other hand, only about one in five said their shareholders would be playing a leading role in setting sustainability strategy, and 29% ranked the short-term focus of investors as one of the biggest barriers to progress in the field.

Such apparent contradictions arise when investors are considered a monolithic bloc. Mr Elkington delineates “different trophic levels in the financial ecosystem”, with reinsurers, insurers and pension

funds showing greater sensitivity to long-term issues, and financial analysts—“often working on nano-second time scales”—struggling to appreciate their significance. Also, the correlation between sustainability and share price growth indicates that many companies with active programmes are having no trouble getting funds. Investors in a company know how the company is run when they put money in. For Mr Garrido (GE) and Mr Alexander (MolsonCoors), the values surrounding, and approach to, sustainability form part of what makes their companies worth buying into. “Our investors understand that,” says Mr Alexander. “They may not be demanding sustainability results, but they expect us to make decisions that sustain the investment in the long run.”

Sustainability 2.0

In the past, corporate sustainability pioneers were as often defending themselves against reputational or regulatory risk as looking for value. Cost reduction, reputational benefits and increased attractiveness to investors brought limited financial gains. Now, however, leading companies are moving from “sustainability 1.0 to sustainability 2.0”, as some describe it. The latter involves exploiting the markets and opportunities that an understanding of the issues, and of the consumer reaction to them, presents.

Among the best-known examples of this trend is GE’s Ecomagination product range—with products varying from low-energy light bulbs to car and truck fleet services. It added US\$12bn to the bottom line in 2006, a figure expected to reach US\$20bn by 2010. Mr Garrido admits that it is a surprise to see such benefits arising from a simple idea. “We came to the conclusion that we can make money by facing environmental challenges, because our customers are demanding it.” After consulting consumers, environmentalists

“It doesn’t hurt to take into account that sustainability may help your reputation, but if that is your sole goal, it will not be sustainable in the long run.”

Ivo Menzinger, Group Head of Sustainability and Emerging Risk Management, Swiss Re



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and other stakeholders, GE saw that the needs of some sustainability challenges matched what existing products could provide and new products could be developed to meet other problems. "It was a no-brainer," says Mr Garrido. "We always believed that providing such products was the right thing to do," he says. "Now, it is not only consistent with our values, but we can make money out of it. If other companies don't see that, then that's even better for us."

Generally speaking, though, companies have started to realise the possible opportunities that exist here. Mr Kramer believes that they "are only just beginning to consider CSR as a competitive advantage and move beyond defensiveness. It will get much, much more common". Our survey suggests that the desire is there, but not necessarily the ability. Just over one-half (51%) of respondents say developing products that address social or environmental problems is an important priority going forward, a higher figure than for reducing greenhouse gas output. But far fewer, just 32%, thought they had done well in this area recently. The International Business Leaders Forum's Mr Hodges, author of *Corporate Social Opportunity*, describes many companies as being at the aspirational stage. They "don't necessarily have the right processes in place to make it a normal part of the business cycle," he says. "Do you have the right skill sets inside the business to understand how social trends may impact the business?" Relationships with community institutions or organisations in developing-country markets or open communications channels with socially conscious young consumers in developed countries, can provide new insights compared to more traditional sources of intelligence for research and development (R&D).

Indeed, exploiting these market opportunities requires not so much the invention of novel products, however helpful, as cultural change to align internal economic, social and environmental thinking. Mr Menzinger points out that Swiss Re's insurance products designed to address global warming risks take

no carbon out of the atmosphere, but they did arise from an understanding of the issue. In other words, although the challenges differ in each sector, the possibilities of sustainability 2.0 are open to all firms once they focus on them. GE's Ecomagination may have started with energy-saving products, but it has now moved on to items such as credit cards where up to 1% of net purchases are set aside each month and will be used to buy carbon offsets every year on Earth Day.

In assessing the financial benefits of such market-seeking sustainability, it is difficult to go beyond the anecdotal. It is noteworthy, though, that among surveyed companies with the worst share performance, the leading benefit of sustainability was defensive—the ability to identify and manage reputational risk (cited by 45%). Share price climbers instead focused on improved shareholder value (47%) and the ability to attract new customers (35%).

Although leading companies are finding profits from sustainability, it would be a mistake to see it as an optional route to wealth for some. The risks of not addressing these issues are also great. Mr Elkington, for example, expects that the changes likely to be imposed in the wake of climate change will initiate a period of experimentation. "If businesses think this is going to be easy, they are deluded," he says, "Creative destruction pressures are going to elbow out of markets a huge number of companies." Mr Menzinger is one of the few executives interviewed to stress straightforward strategic thinking rather than underlying values. "[Firms] need to approach sustainability from a business angle. From a risk and opportunity perspective, what does it mean?" he asks. "People think of it as corporate citizenship rather than thinking about it as affecting their business model." One example he gives was the relatively sudden decision to ban incandescent lighting in some countries, something which will clearly affect its manufacturers. Awareness of sustainability issues may become not an additional business tool, but a key to survival in 21st century markets.



Limits of the business case

Interviewees for this report caution against placing too much weight on building a business case for sustainability. Mr Rosling of Tata says, “I don’t think we have a business case for what we do”. Owned by charitable trusts, the group’s *raison d’être* is

ultimately to improve society. “[Sustainability] is in the business interests of Tata companies, but that is not the reason why they do it. It is right to do it. Anyone producing a business case would be shown the door,” he says. “What we do is manage it in a strict businesslike way, and we certainly budget and plan fully for it.” More traditionally owned firms are

Case study View from 30,000 ft: Virgin Atlantic

Although corporate interpretations of sustainability encompass everything from monitoring labour standards in suppliers’ factories to promoting ethnic diversity in the workplace, for Virgin Atlantic Airways, one issue dominates the agenda: climate change. “We have environmental targets that include other resources like water,” says Jill Brady, General Counsel at Virgin Atlantic, who is in charge of sustainability. “But climate change is certainly the biggest focus for us.”

Part of the reason for that focus is consumer perceptions. Although the airline industry contributes a relatively small proportion of the world’s man-made greenhouse gases and aircraft engines are now about 70% more efficient than they were 40 years ago, environmental campaigners have been joined by the public in putting aviation under the spotlight. “In the UK there is a perception that aviation is one of the biggest causes of climate change, and that’s driven by NGOs and the media,” says Ms Brady. “It’s one we all have to deal with whether it’s right or not.”

However, although the contribution of airlines to climate change is currently small, it is increasing. “The industry is recognising that it is a polluter,” says Ms Brady. “So while we’re a relatively small polluter, we’re growing and that’s something the industry has to deal with.” And it is not only individual consumers that want to see airlines address climate change. Ms Brady says many of Virgin’s corporate clients are pushing the company in this area in order to reduce their own carbon footprint. “We know a lot of customers are interested in what we’re doing in relation to climate change,” she says. “And corporate customers certainly are. A large proportion of

the tenders they send in for business contain questions around sustainability impact.”

As a result, Virgin Atlantic has been addressing its carbon footprint in a number of areas. For a start, at the group level, the Virgin Green Fund (formerly Virgin Fuels) is investing in companies developing renewable and alternative energy sources, as well as in companies working on technologies that generate fuel efficiency. The initiative is part of Sir Richard Branson’s pledge—made at the 2006 Clinton Global Initiative meeting—to invest US\$3bn of the profits made in the next ten years from his transport businesses in efforts to combat climate change. As well as such group-level initiative, Virgin Atlantic itself has set a target of improving fuel efficiency by 30% by 2020. Initiatives range from the development of alternative fuels to aircraft acquisitions—introducing the Boeing 787 Dreamliner to the fleet, which is 27% more efficient than its current aircraft. It is also enhancing working to enhance engine efficiency and investigating more regular polishing of fan blades.

Along with this, the airline is reducing fuel consumption on the ground by shutting engines down in queues, towing aircraft at airports and plugging aircraft into ground power sources while stationary to avoid running engines simply to keep the air-conditioning and other equipment running. A “Weight Watchers” team works on eliminating unnecessary equipment onboard and ensuring that new products designed to go on board are made of lightweight materials.

However, for Virgin, the savings on fuel costs mean its sustainability efforts soon pay for themselves. “A lot of what we were doing already around fuel efficiency and being an efficient business fits well with the sustainability agenda,” she says. “This has given us another lever to engage people and has put more urgency around some of the targets.”



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“If you are going to do this because it is about values, it doesn’t mean you can’t do this because it is good for the business. Any CEO should be able to articulate both cases.”

Jane Nelson, Director of the CSR Initiative, Harvard’s Kennedy School of Government

surprisingly similar. Mr Potter of Coca-Cola and Mr Bickham of Anglo American both think that the data for the business case are not there. Instead, what is driving change at Coca-Cola is “a broad philosophical” commitment to sustainable communities.

Meanwhile, Mr Bickham believes that “in our business, sustainability is a threshold requirement”, with any competitive gain staying “at the margins”. Dr Kendall of CLP says that its retrofitting of power stations to reduce emissions “is nothing to do with competition in the market. It is our stakeholders’ and regulators’ expectation that this is correct thing to do in the community.” Her company is not addressing climate issues “to make a quick dollar or out-position competitors. We see it as the right thing to do.”

Ironically, other stakeholders seem more likely to play up the business opportunities of sustainability than corporate executives. Mr Juniper, from Friends of the Earth, often surprises companies by telling them “climate change is the biggest business opportunity in history”. Indeed, non-profit organisations understand perfectly well the importance of the market to broader sustainability efforts. Mr Waardenburg says NGOs frequently encourage him to make sure his programmes make money, because “without a profit for us, it is not going to be sustainable”.

Thus companies point to ethics, leaving the defence of Mammon to NGOs. Ms Nelson sees this as “a false dichotomy and a false debate. If you are going to do this because it is about values, it doesn’t mean you can’t do this because it is good for the business. Any CEO should be able to articulate both cases.”

Nevertheless, sustainability debates often focus on the financial case for two reasons. First, as Mr Stigson points out, “self-interest is very much connected to market solutions and much easier to implement”. The moral questions at the core of sustainability are simply harder. Second, the public may consider corporate talk of values overblown. Mr Kramer says, “I’m not sure anybody believes business if they claim to be virtuous.”

But there is another element, encompassing sustainable development, that often gets too little attention. Perhaps because Milton Friedman’s dictum that “the social responsibility of business is to increase its profits” was used to oppose CSR, even corporate discussions of sustainability tend to focus on the social and environmental. Business’s contribution to society is, however, undeniably economic—ultimately providing the money for almost all social and environmental progress. Dr James Suzman cites De Beers’ joint venture with Botswana’s government. The latter receives US\$1.6bn in dividends, about 50% of the national budget. “As a direct result, Botswana has gone from third-lowest on UN development indices to near the top,” says Dr Suzman. This is a tiny but striking example of how, in Ms Nelson’s words, “the greatest business contribution to society is creating wealth”. Noting the dearth of references to this area in the vast majority of CSR reports, she thinks “business has been its own worst enemy in some ways. Much of the CSR debate has been shaped by activists, NGOs and the media.”

A proper understanding of the Triple Bottom Line requires greater appreciation of the benefits arising from the original bottom line. Whatever the merits of the business case for sustainability, the sustainability case for business is unquestionably far stronger.



Chapter 5 What will deliver: Markets or regulation?

How far can business's sustainability efforts go to improve the world's physical, social and political environment? And where should the line be drawn between the responsibilities of individual businesses and the responsibilities of government?

Obviously, companies can do a lot, especially in their areas of expertise. When asked about the state's proper role, however, respondents gave an unusual reply for a business survey. A large proportion, 40%, believe that more government regulation is necessary if society wants to change the impact of business in social and environmental areas. Half of executives polled held that, although consumer and investor demands leading to voluntary business action would be the more effective route to change, state regulation in certain fields would nevertheless be necessary. Even North America, traditionally a more free-enterprise culture, had similar numbers.

Why do companies think that markets alone are insufficient?

First, as Mr Alexander of MoltonCoors notes, to be successful, "sustainability has to embrace consumers as well". As discussed earlier, 46% of respondents listed their firm's customers as the stakeholders with the greatest influence over their sustainability policies, tied with government as the leading choice. Although people as citizens are making clear their support, the same individuals as economic actors are displaying less straightforward behaviour. Customer influence has geographic variations, with consumers having a far greater effect in Europe. Moreover, among companies for which it was relevant, only 10-15% thought the majority of their customers would pay a premium for greener products, ethical sourcing

or socially responsible investment. About 40% thought that a significant minority of buyers would do so, but the general consensus was that few consumers would support values with their wallets.

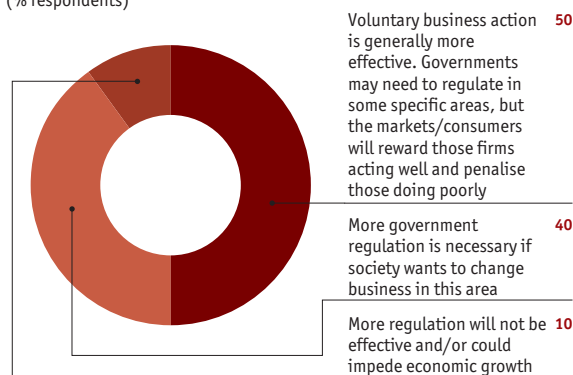
This range of behaviour has predictably had an uneven market impact. Some firms, such as GE, have made money from developing more sustainable products. Ms Brady says that for Virgin Atlantic, quite simply, "It is a competitive issue, because consumers are interested to see what big businesses are going to do about this." At Dell, Mr Arbogast notes that "many of the strategic initiatives around sustainability are a direct reaction to customer feedback", including those involving energy efficiency and product recovery. "Part of sustainability's focus here is driven by customer needs," he says. Companies as diverse as McDonald's and De Beers noticed increased consumer interest in different sustainability issues going back to the 1990s. Now says Mr Langert, "customers care more about this than ever". Professor Pan at The Chinese Academy of Social Sciences even sees a rising interest

Key points

- Perhaps surprisingly, a large proportion of firms believe that more government regulation is needed
- Collaboration between business, government and society is critical
- Governments are often constrained in their ability or desire to act, whether owing to a lack of political will, limited power, or a simple lack of know-how

What is your view on the role of regulation in relation to reducing companies' environmental and social impact?

Please check one answer only.
(% respondents)



Source: Economist Intelligence Unit survey, October 2007.



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among Chinese consumers.

But companies that are equally active on sustainability issues have had different experiences. Carl Kitchen, Public Affairs Manager at Hong Kong-based CLP Group, notes that the firm's Australian power customers only began to drive demand for renewable energy within the past 18 months. "Until then, it wasn't there," he says. His colleague, Dr Kendall, adds that in the power sector, the customers are not quite there yet. Only "a small percentage are asking for low carbon industry", she says, noting that "markets in India and China will not pay the extra costs of clean energy without government or international support".

If uneven customer demand makes markets an imperfect, albeit still powerful, tool for societal

change, so does the limited power of corporations themselves.

Companies cannot always bring about environmental or social improvement on their own, and the novelty of co-operative solutions poses its own potential legal risks, as noted earlier with the FFC.

It would be far simpler for companies if the state dealt with these questions. In our survey, 62% agree—and only 10% disagree—that uncertainty over government policy "is making it difficult to plan strategies for corporate sustainability". Businesses are even beginning to lobby for regulation: the best example is the US Climate Action Partnership, a club that counts some of the country's biggest blue-chips among its members, which is pushing for mandatory carbon emission caps. A good regulatory framework could do much to address the confusion that surrounds what is expected of businesses. The OECD's new *Policy Framework for Investment* outlines one of the top goals of public policy in this area as "providing an enabling environment which clearly defines respective roles of government and business", and asks states

whether they "actively assume [their] responsibilities and avoid *de facto* privatisation of public roles". The OECD's Mr Poret adds that government and business responsibility go hand in hand.

Companies are not, however, seeking highly proscriptive regulation. On climate change, for example, many agree with Mr Rosling of Tata that "the best long-term solution is likely to be market-based, but you can't have market solutions without a government-designed system. You need incentives to reduce your carbon footprint because it is much cheaper to have non-sustainable energy." Mr Stigson (WBCSD) adds that "it is important to recognise that there is no inherent conflict between markets and regulation". In fact, leading companies can benefit from working with governments on regulations. Mr Waardenburg explains that his firm does not feel threatened when discussing sustainability issues with the EU. "Most of the time we are ahead of what they set as a target anyway. It is more an opportunity to work with governments, and to show alternative ways to do things. Sometimes they tend to say very specifically how to do what, but we can suggest better ways." In Dell's case this involved helping Texas create mandatory computer recycling based on the company's voluntary experience.

Still, governments are taking some action—and this does not necessarily always mean legislation or imposed regulation. Mr Poret points out that "there are other ways of communicating expectations: such as joint regulation, self-regulation and soft law". Such communication can also take place within the workplace, with local communities, with trade unions, through discussions with investors, dialogue with other civil society organizations, via the press and so forth. For these other communication processes to work well, governments have the responsibility to protect the human and other rights framework. Although the various strategies that each state chooses "may look multiple, they are all underpinned by the same values and principles",

"Most of the time we are ahead of what they set as a target anyway. It is more an opportunity to work with governments, and to show alternative ways to do things."

Roland Waardenburg, Director of Corporate Social Responsibility, Ahold



on which there is broad agreement among OECD and partner countries. He notes, for example, that beyond the OECD's core membership, Brazil and nine additional countries have adopted its *Guidelines for Multinational Enterprises*. These not only provide a detailed and comprehensive set of voluntary standards and principles of responsible business conduct but also require adhering governments to institute national contact points, which handle and conciliate complaints over alleged violations, a facility used some 160 times by interested parties since the revision of the Guidelines in 2000. In Mr Poret's view, sustainability will advance through "a combination of both markets and proscription, with the balance changing all the time".

Reluctant governors

A certain irony arises from the current views of stakeholders on that balance. Mr Stigson notes that "governments are proponents of market solutions, and business is saying we want some regulation. From the outside, it can look pretty confusing." Mr Juniper of Friends of the Earth has noticed the same dynamic: "There is now a reversal of roles." Government is arguing for a market role, but companies are moving away from a knee-jerk opposition to regulation and encouraging it. In fact, for Friends of the Earth, instead of focusing on helping business change themselves, now "the bulk of our effort with them is in seeking to get companies to change their regulatory environment," says Mr Juniper.

Government reluctance to take firmer action may be owing to a number of things. In some cases, like companies, its powers are limited. In China, for example, Professor Pan notes that, whatever the central government's wishes, "institutions need to be built step by step. Local governments are very powerful and work together with factory owners in a way that hurts the environment, because they

want revenue." Ms Ulrich adds that, although China's policies reflect its growing recognition that the country has paid too high an environmental cost for its development, the central government will increasingly face demands from localities for compensation of economic losses they suffer to comply with stricter environmental rules. This, she says, will slow the process of reform, but not derail it.

More than power, Mr Stigson points to a lack of political will. Governments "don't want to regulate consumer behaviour" because it is too fraught with political danger, he says, "but you won't be able to get away from that if you want to create a sustainable world". In Mr Juniper's experience, beliefs play as big a role as politics in explaining the difference. "Governments are ideological and companies are quite practical. I get the impression that carbon trading is used by the UK government as a tool which fits the ideology rather than doing the job. There is no debate on what works. Companies don't do that. You are starting to see some saying we need a different mix of tools." Our survey suggests that, whether for ideological or practical considerations, the will to act within the public sector is not great: only 48% of respondents within government thought that more regulation was essential for change, and 42% considered voluntary action, along with some state help, as the best way forward.

Another cause for a lack of government appetite to regulate may be that civil servants are as confused as everyone else. In looking at their own organisations, 43% considered a lack of management understanding as a major impediment to the pursuit of goals in this area, 17% had nobody in charge of these issues, and fully 46% had no plans to report on environmental or social performance—all figures well above the business averages. If governments are going to mandate change for companies, then they must set their own houses in order as well.



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Conclusion

The debate over the role of the state and business leads back full circle to the definition of sustainability and the reason why it has become such a pressing issue. Although currently being driven by growing anxiety over the impact of climate change, the underlying questions about the relationship of business with the world's societies—developed and developing—have been given a new urgency by the impact of globalisation. The social and environmental benefits of sustainable business practices are what governments and citizens are likely to demand in return for an open world economy.

Sustainability is not, however, a check list of activities. It is a change in attitude that aligns financial, social and environmental goals. Fortunately, businesses rarely need to establish clear values for themselves. Instead, they need to apply the ones they have. In practice, companies are defining sustainability widely, looking at a range of relevant environmental and social goals. The specific form that sustainability policies take, however, will inevitably be shaped by differing drivers and needs—economic and regulatory, as well as environmental and social—around the world, leading to a bewildering range of activities involving every function within business.

Although a few companies have a long history of addressing sustainability issues, business as a whole is still, as Mr Potter of Coca-Cola puts it, at the “baby steps stage”, scrambling to address the issues and experiencing the pains inherent in learning to master a new area. The necessary rethinking of business models, is “very, very tough to do”, notes Mr Elkington of SustainAbility. Four key areas currently receiving too little attention within business are: leadership; supply chains; reporting and metrics; and the transformation of values into processes. At present, weaknesses in one or another of these will

condemn too many companies to poor performance in this area. This presents more than a social or environmental problem. The financial benefits of sustainability remain unclear, but an understanding of where the economic advantages are—in particular cost reduction and a range of untapped market opportunities—can be very helpful to profits. Perhaps more important, as the social and environmental forces driving sustainability reshape the global economy, an inability to understand and perform in this area could be fatal for businesses.

Neither business, nor government, nor any other stakeholder, can meet these challenges on its own (indeed, many seem to wish that somebody else will do it for them). If they are to be addressed, however, it will be through a messy period of redefining, among other things, business's relationship with the world around it, as well as the legal and regulatory framework in which it operates. Companies must, at the very least, be part of that debate, for their own sakes as well as for that of society as a whole.

In the end, sustainability will require changes, but not perhaps those the public expects. Businesspeople have long realised that the image of an immoral private sector motivated only by greed is a caricature, and a poor one at that. Most think that their economic activity serves the public good. Moreover, the executives interviewed for this study held that corporate values were not window-dressing, but at the core of what their firms did. The innovation that sustainability demands is to integrate these values into the structures, processes and incentives that mould behaviour inside companies. Social and environmental initiatives should not be something that firms do in addition to making profit: instead, they should become a central part of the strategy for corporate prosperity.

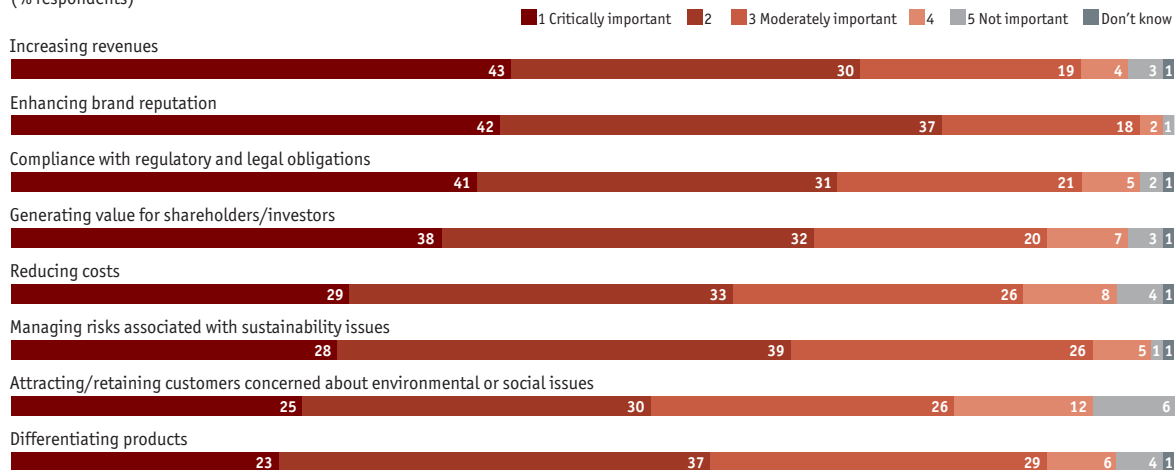
Appendix: Survey results

In September and October 2007, The Economist Intelligence Unit surveyed 1,254 executives from around the world. Our sincere thanks go to all those who took part in the survey. Please note that not all answers add up to 100%, because of rounding or because respondents were able to provide multiple answers to some questions.

Does your company have a coherent strategy for corporate sustainability that covers the whole business and its supply chain? Please select one answer only.
 (% respondents)



If you have or are developing a strategy for corporate sustainability, how important is it to your company that this strategy meets the following objectives? Rate from 1-5, where 1=Critically important, 3=Moderately important, and 5=Not important.
 (% respondents)



Appendix: Survey results

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How much of a priority will the following objectives be within your company over the next five years?

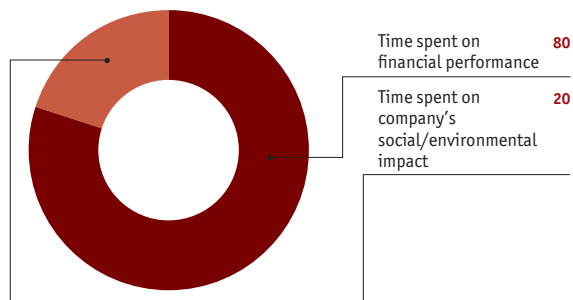
(% respondents)

■ 1 Leading priority ■ 2 ■ 3 ■ 4 ■ 5 Not a priority



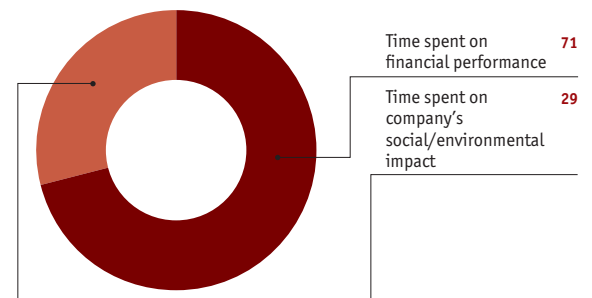
Within board-level meetings, how much time is spent discussing the following areas of corporate performance today?

(% respondents)



Within board-level meetings, approximately what percentage of your time might be spent discussing the following two areas of corporate performance in 5 years' time?

(% respondents)



In which of the following areas did your organisation perform best over the past five years?

Rate on a scale of 1 to 5, where 1=Outstanding and 5=Poor.

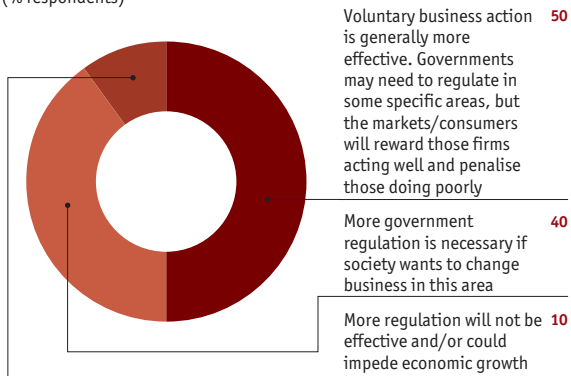
(% respondents)



What is your view on the role of regulation in relation to reducing companies' environmental and social impact?

Please check one answer only.

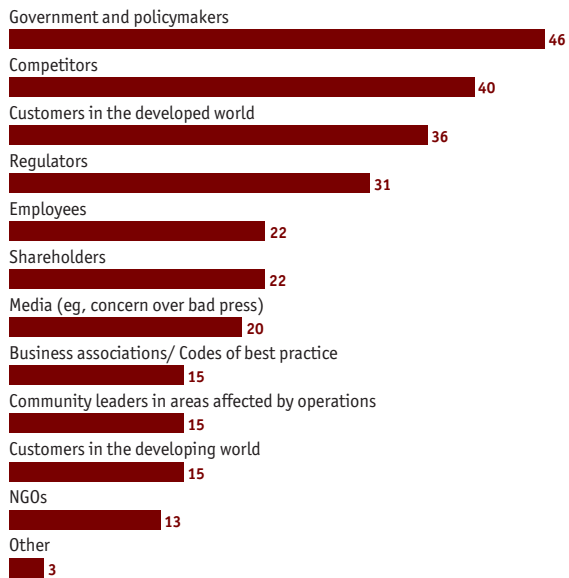
(% respondents)



Which of the following will have the greatest influence over your sustainability strategy over the next five years?

Please check up to three responses.

(% respondents)



Appendix: Survey results

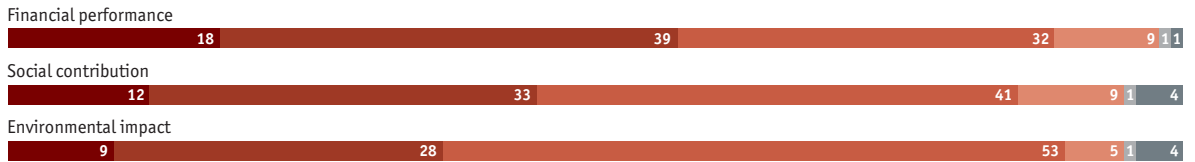
Doing good

Business and the sustainability challenge

How do you believe your company's performance in the following areas rates against that of your main competitors?

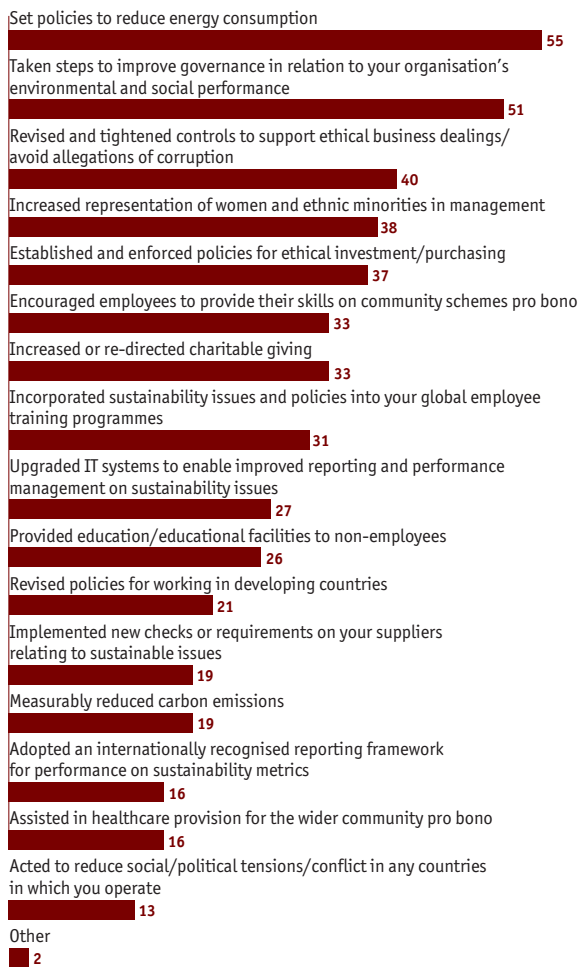
(% respondents)

■ Much better ■ Better ■ Roughly the same ■ Worse ■ Much worse ■ Don't know



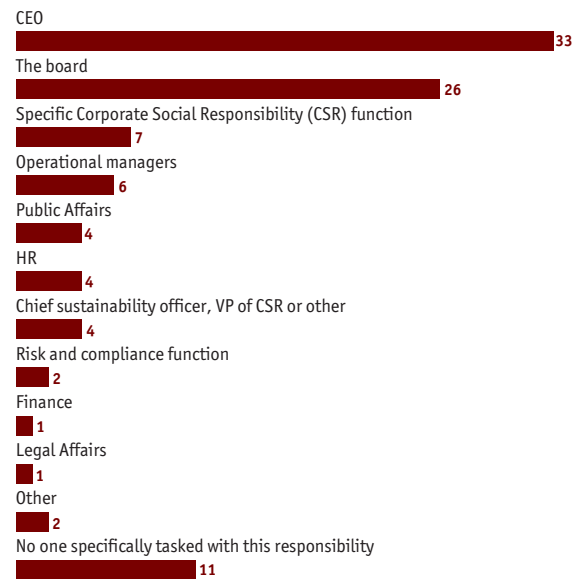
Which of the following has your company done over the past five years? Please check as many as apply.

(% respondents)



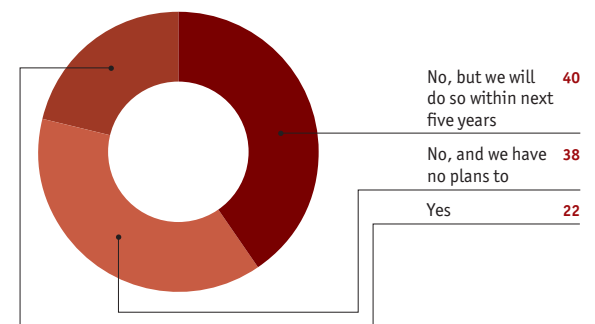
Where does primary responsibility for sustainability performance currently sit within your organisation? Select one.

(% respondents)



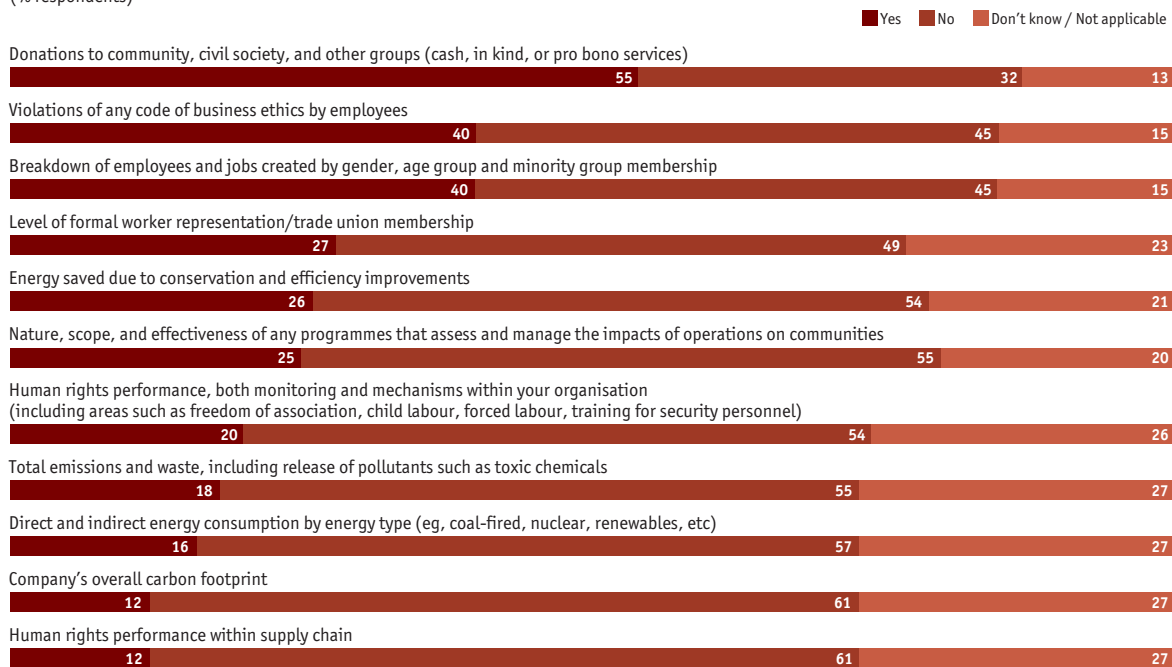
Does your company formally report on its environmental and social impact and performance, as well as financial performance (known as Triple Bottom Line Reporting)?

(% respondents)



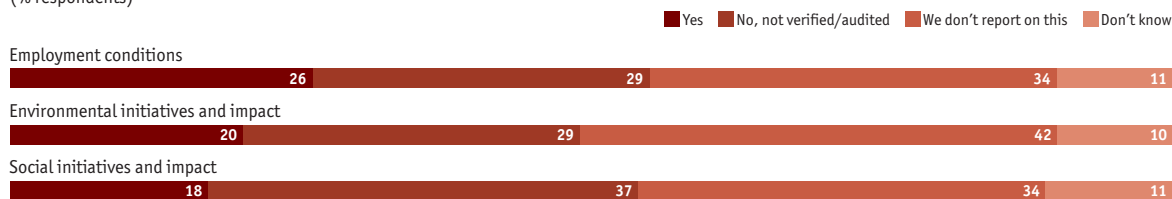
Specifically, does your company formally report on the following?

(% respondents)



Is the following information in your sustainability reporting independently verified/audited?

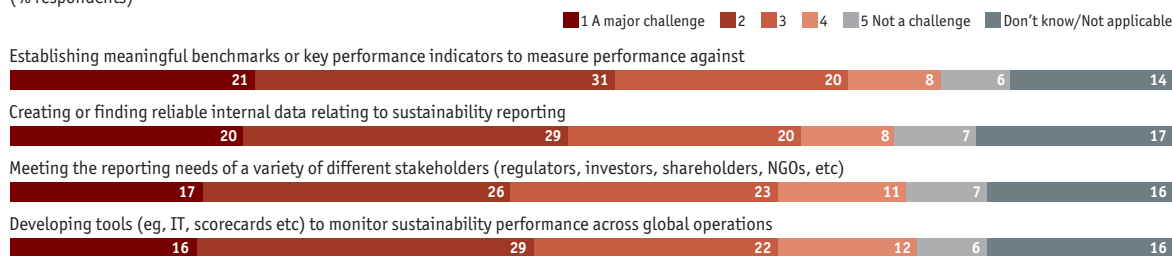
(% respondents)



How much of a challenge are the following when it comes to reporting on sustainability issues?

Rate on a scale of 1 to 5, where 1 = A major challenge and 5 = Not a challenge.

(% respondents)



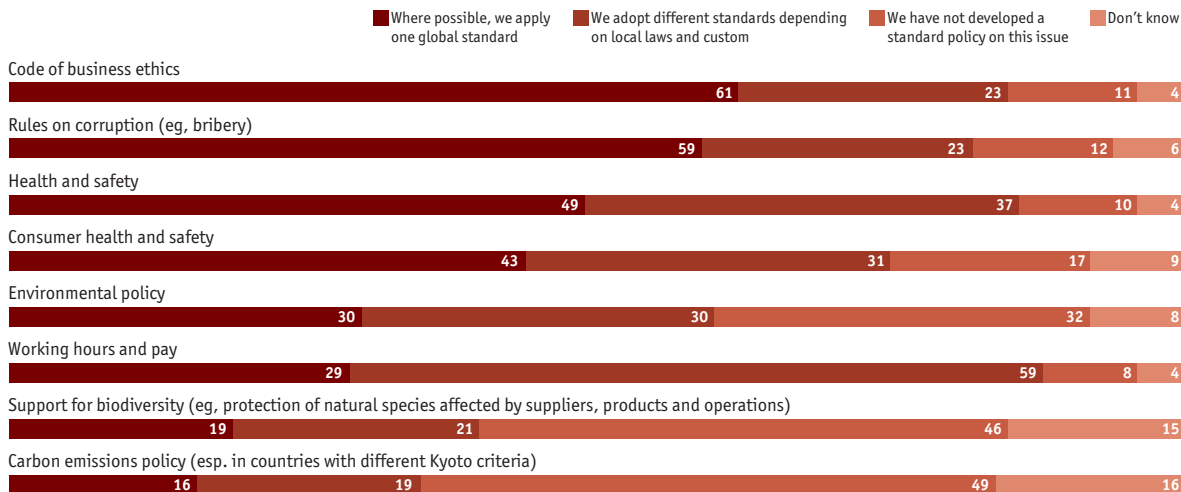
Appendix: Survey results

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Business and the sustainability challenge

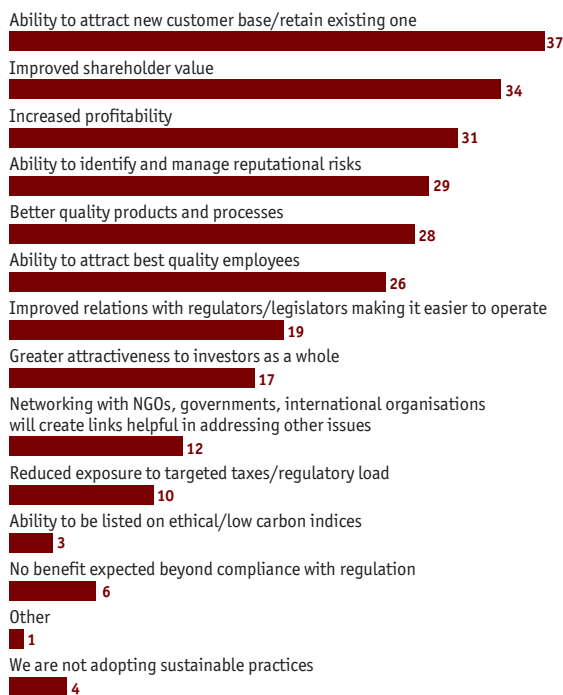
How do you apply standards in the following areas across your global operations?

(% respondents)



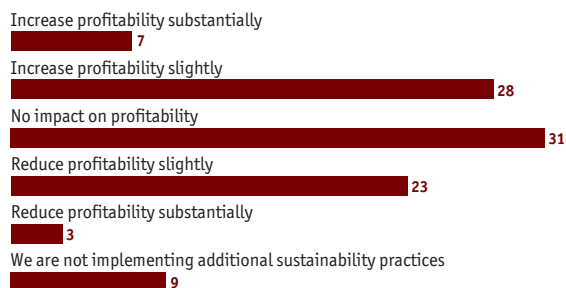
What are the biggest benefits that your organisation expects to derive from adopting sustainable practices beyond those of compliance (if any)? Please select up to three items.

(% respondents)



How do you expect the adoption of sustainable practices to impact your profitability over the next five years?

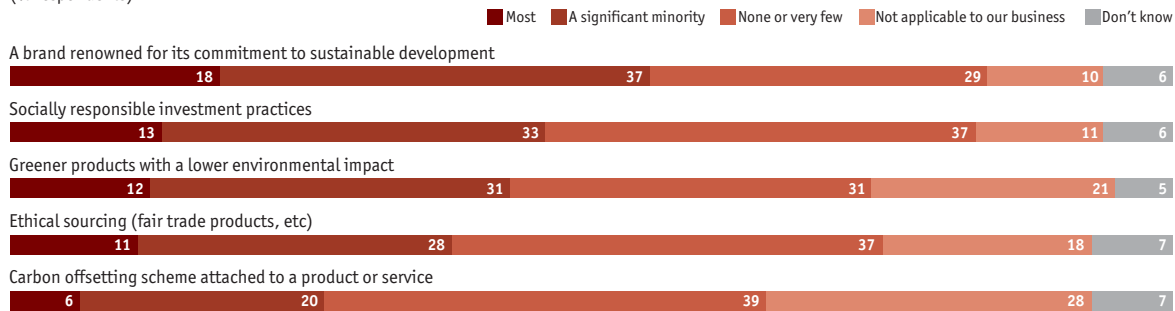
(% respondents)



In your view, how many of your customers would be willing to pay extra for the following?

Please check one column for all applicable options.

(% respondents)



Do you agree or disagree with the following statements?

(% respondents)



Appendix: Survey results

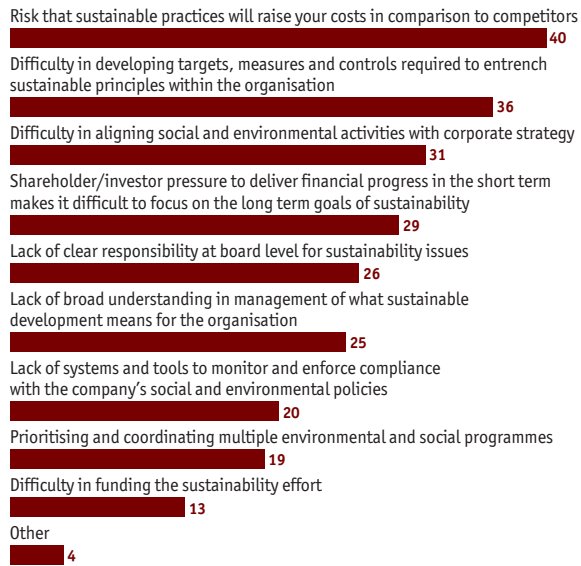
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Business and the sustainability challenge

What are the major barriers to making further progress on sustainability goals in your organisation?

Please check up to three answers.

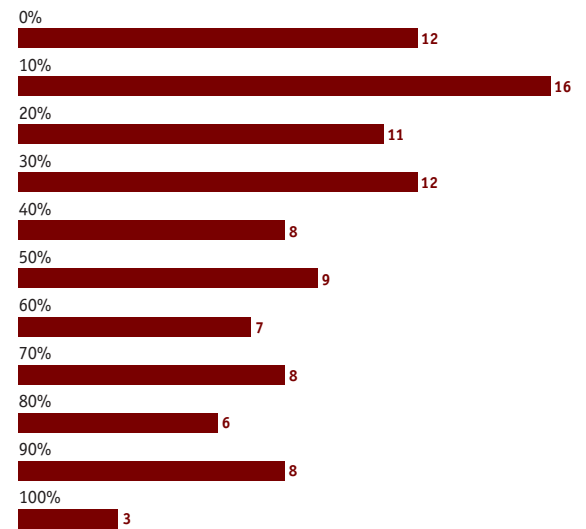
(% respondents)



About the respondents

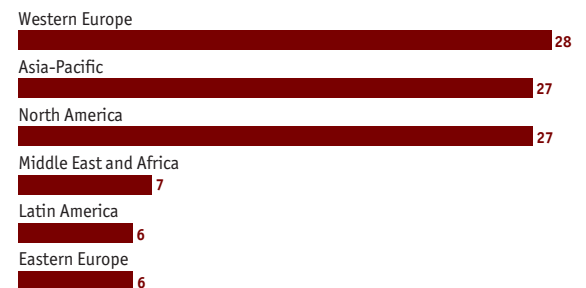
Approximately what proportion of your company revenue is accounted for by markets outside of the one your organisation is headquartered in?

(% respondents)



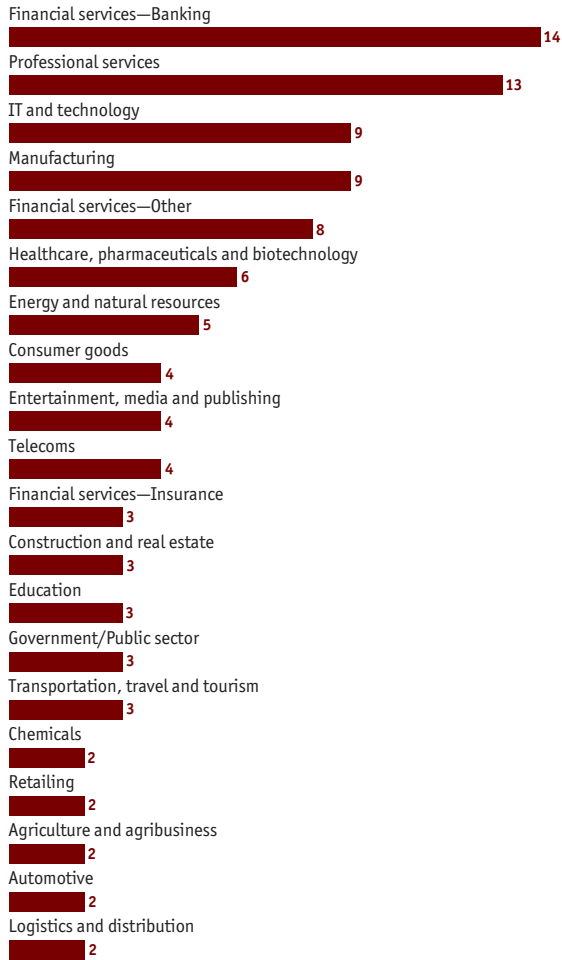
In which region are you personally based?

(% respondents)



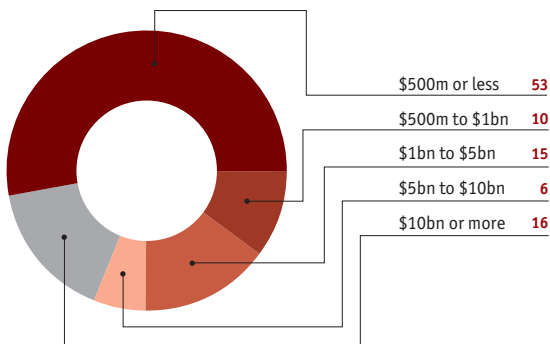
What is your primary industry?

(% respondents)



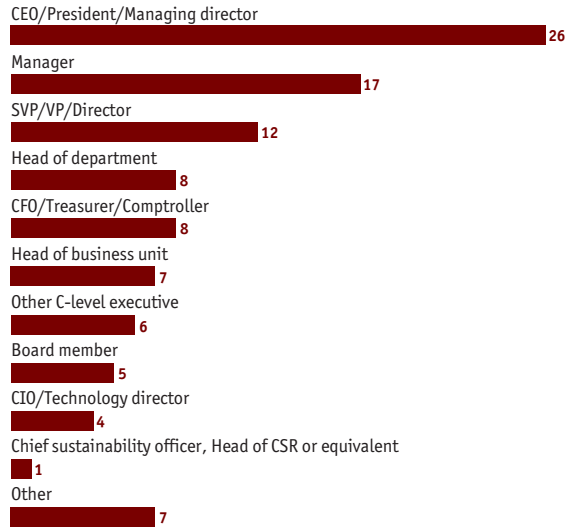
What are your company's annual global revenues in US dollars?

(% respondents)



What is your title?

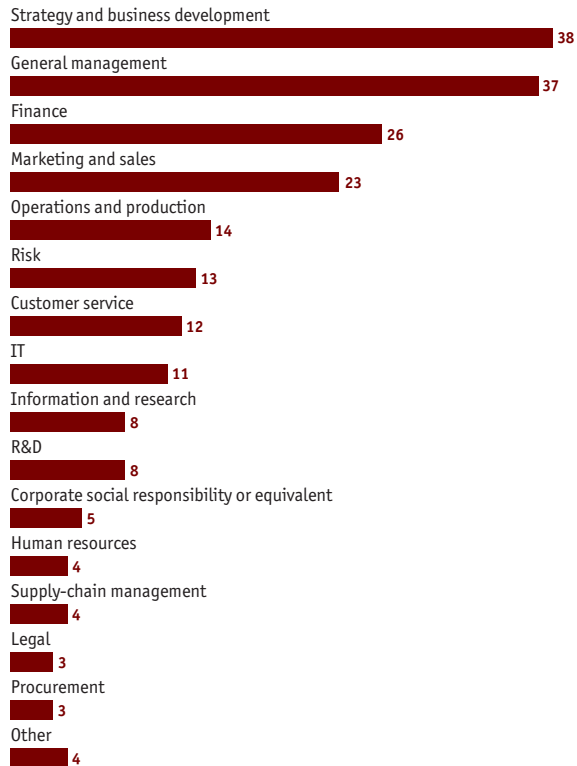
(% respondents)



What are your main functional roles?

Please choose no more than three functions.

(% respondents)



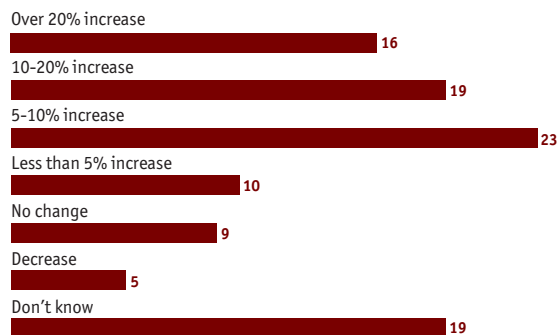
Appendix: Survey results

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Business and the sustainability challenge

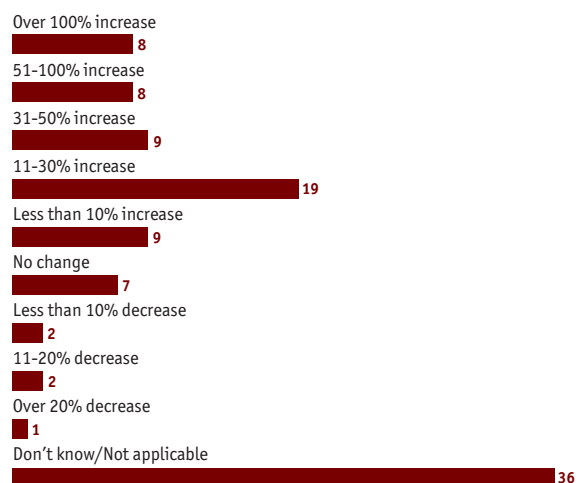
How has your company's EBITDA changed each year, on average, over the past three years?

(% respondents)



How has your organisation's share price changed over the past three years?

(% respondents)



Whilst every effort has been taken to verify the accuracy of this information, neither The Economist Intelligence Unit Ltd. nor the sponsor of this report can accept any responsibility or liability for reliance by any person on this white paper or any of the information, opinions or conclusions set out in the white paper.

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