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Corporate Sustainability

A progress report
KPMG's research preview

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In cooperation with

Economist Intelligence Unit The Economist

Contents

About this report

Corporate Sustainability: a progress report is a preview of an upcoming KPMG International research paper, conducted in cooperation with the Economist Intelligence Unit. It reviews the importance of sustainability within business today and executive attitudes towards this issue. It also examines the impact of sustainability on business practices and processes, the drivers behind sustainability, how companies are reporting on this issue, and what business wants from government. The full research will be published in January 2011.

For the purposes of this report, sustainable development for companies is defined as:

"adopting business strategies that meet the needs of the enterprise and its stakeholders today while sustaining the resources, both human and natural that will be needed in the future."

The report is based on the following inputs:

- A global survey of 378 senior executives, encompassing a range of industries, and evenly split between North America, Asia Pacific and Europe, with a smaller representation from the Middle East, Africa, and Latin America. Organizations of all sizes were represented: 40 percent of respondents worked for companies with revenues of at least US$1bn, whereas 47 percent were from companies with revenues of US$500m or less. The respondent base was very senior: 26 percent were CEOs, presidents or managing directors of their companies; half represented the C-suite or board; and all respondents were in a management position. The survey was conducted in October 2010.
- To complement this, and provide specific context, the Economist Intelligence Unit conducted extensive desk research and in-depth interviews with three sustainability experts, including: **Wayne Balta**, Vice President for corporate environmental affairs and product safety at IBM; **Sören Buttkereit**, Head of the corporate sustainability external office at Siemens; and **Victoria Mills**, Managing Director for corporate partnerships program at the Environmental Defense Fund.

Our thanks are due to all survey respondents and interviewees for their time and insights.

Corporate sustainability:
Rapidly emerging strategy

Key findings

- Sustainability has moved up the corporate agenda in the past three years. Sixty-two percent of companies surveyed have a strategy for corporate sustainability, up from just over half in February 2008; and a further 11 percent are currently developing one; just five percent are not planning to have such strategies, while the rest will create one at some point.
- More than half (56 percent) of these strategies were developed over the past three years; only 11 percent have held such a plan for at least a decade.

Sustainability has entered the mainstream of corporate life. In the past, sustainability was a niche activity for pioneers such as IBM, which established a corporate environmental policy in 1971. Now, what was once a concern of the few has become a strategy of the many.

In an Economist Intelligence Unit report released in February 2008, just over half of companies polled said that they had a corporate sustainability strategy in place, while nearly one in five said their companies had no immediate plans to develop one. In our October 2010 survey of business people, sustainability has become even more important, despite the global economic downturn. More than six in ten respondents say that their company already has a strategy in place for corporate sustainability.

In general, large companies are more likely to have a sustainability plan than their smaller counterparts. Among certain sectors, such as consumer goods, as many as eight in ten companies have developed such a strategy. Overall, just five percent of executives believed that such a strategy was not required by their company, while nearly all the rest are either developing one, or are planning to.

“Sustainability is no longer an ‘if’, it’s a ‘how’,” says Victoria Mills, a Managing Director at the corporate partnerships program of Environmental Defense Fund (EDF), a non-profit advocacy group.

Sustainability's main drivers are changing

Key findings

- Cost reduction is becoming an important reason for undertaking sustainable practices, but regulatory requirements, brand enhancement and risk management are among the main drivers.
- Yet, at the same time, executives see more expensive products or services as the main drawback of adopting more sustainable processes. The reason for this apparent contradiction is that following the global recession, cheaper energy prices and costlier credit have lengthened the payback period for some sustainability projects. Even so, 61 percent of executives agree that the benefits of sustainability outweigh the costs; just six percent disagree.
- Of all the barriers to sustainability, the economic environment is the biggest.

Regulatory requirements (42 percent) and brand enhancement (41 percent) are the two perennial drivers for the adoption of sustainability practices within companies, well ahead of all other factors. Another is risk management (29 percent), an issue highlighted by the 2010 environmental disaster at BP's Macondo well in the Gulf of Mexico. However, the need to reduce costs is now an important factor too, selected by more than one in four executives (27 percent). Indeed, the top two benefits that companies have derived from the adoption of sustainability have been better, or more efficient, processes, and increased profits or shareholder value.

This is a big change, as just a few years ago the main barrier to further progress on sustainability was a concern about costs. Now, 61 percent of executives polled for this report agree that the benefits of investing in sustainability outweigh the costs. For companies with revenues of US$5bn or above, this proportion is even higher, at 72 percent. Overall, just six percent disagree, with most of the rest of respondents neutral on the point. Wayne Balta, Vice President for corporate environmental affairs and product safety at IBM, paraphrases an education aphorism, which is that if anyone thinks education is expensive, they should try ignorance:

> "And the analogy here is that if you think it is expensive to do things for the environment, you should try ignoring it. You'll find out how expensive it gets," he says.

Nevertheless, cost concerns persist: the chief drawback for adopting sustainable processes is that it might lead to more expensive products and services (selected by 36 percent of respondents), followed by reduced profitability (23 percent). This is partly influenced by the broader economic environment, which affects the relative prices of energy and other inputs. In this way, the economic downturn has dampened some sustainability-related initiatives. For example, a fall in energy prices has lengthened the payback period for energy efficiency projects. It has also been hard for companies to raise capital. Sören Buttkereit, Head of the corporate sustainability external office at Siemens, an engineering conglomerate, notes that not only is finance more difficult to raise, but banks' appetite for financial creativity has also waned.

Another issue comes from misaligned incentives, where one part of the company might pay for an improvement but doesn't benefit from the resulting cost savings. Among consumers, this often occurs where residences are rented. The landlord pays for better home insulation, but the tenant receives the gains in the form of lower bills. Among companies, the same kind of issue can occur, unless it is reconciled by a central party, such as the Chief Financial Officer:

"An example is in data centers – the engineers specify the equipment and they want to keep the temperature frigid. It doesn't actually need to be that cold, but they don't pay for the energy that is used," says Ms. Mills.

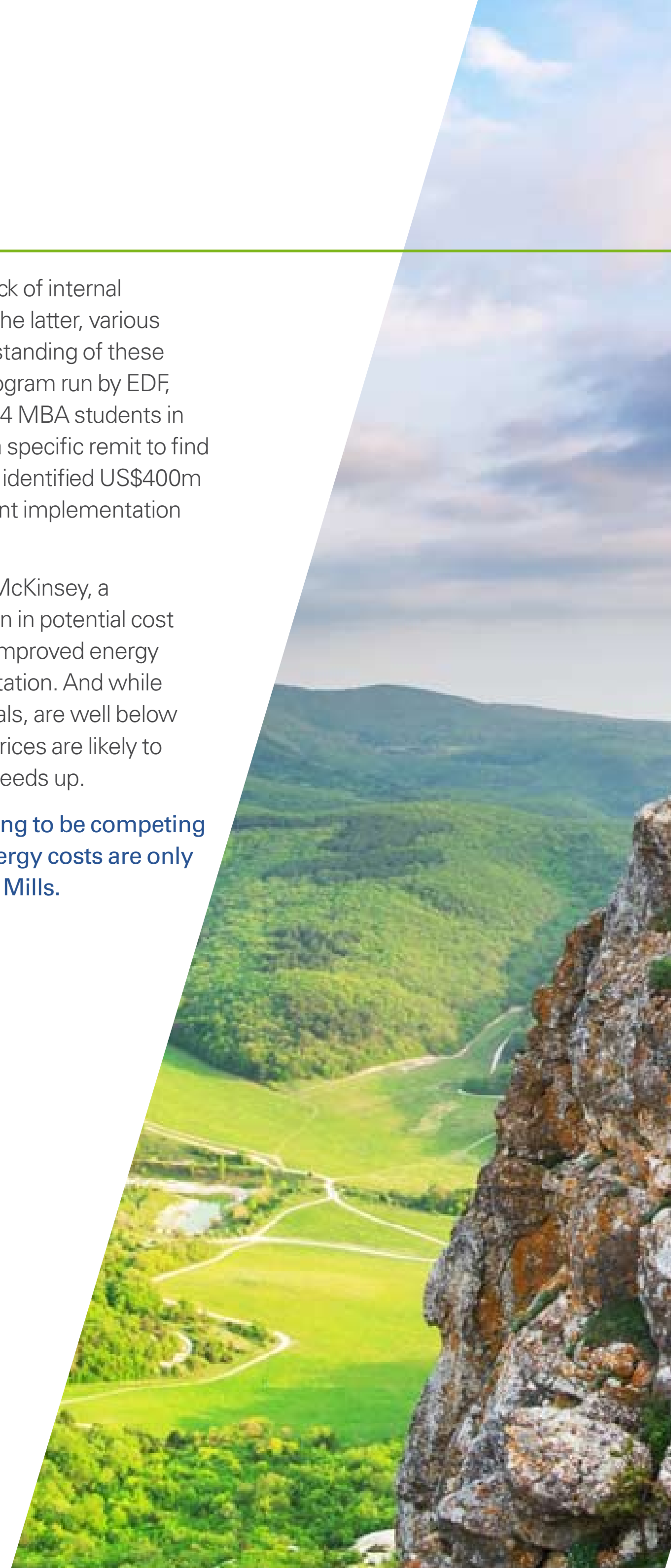
Despite these issues, two important factors helped to keep resource efficiency projects on the agenda during the downturn. One has been significant government-led stimulus spending on environmental technologies and renewable energies. The other is that some technologies still clearly justify their investment and thus warrant implementing anyway. At IBM, Mr. Balta says his company's decades-long effort to improve environmental performance has reaped major returns:

"For every dollar we spend, we are getting US$1.50-2 back."

Nevertheless, of all the barriers to sustainability, the business environment is the biggest: 45 percent of executives say that factors such as business survival and short-term financial pressures are higher priorities. This is nearly twice as much as the next largest issue, which relates to a lack of internal knowledge about sustainability. In light of the latter, various schemes are under way to broaden understanding of these issues. One example is a three-year-old program run by EDF, entitled Climate Corps, which has placed 84 MBA students in companies on a summer internship, with a specific remit to find ways to cut energy costs. The scheme has identified US$400m in annual energy savings, with an 84 percent implementation rate within companies.

The aggregate opportunity is even larger: McKinsey, a consulting firm, has identified US$1.2 trillion in potential cost savings by 2020 in the US economy from improved energy efficiency in industries other than transportation. And while energy prices, as well as some raw materials, are well below their peak, executives are conscious that prices are likely to increase when global economic growth speeds up.

"Companies are aware that they are going to be competing in a carbon-constrained world; that energy costs are only going up over the long term," says Ms. Mills.



Engagement and innovation

Key findings

- Environmental concerns top the sustainability agenda, and will remain the highest priority in the years ahead.
- Forty-four percent of executives agree that sustainability is a source of innovation, 39 percent agree that it is a source of new business opportunities; far fewer disagree.
- Other aspects of sustainability receive less attention; and for some, the supply chain is a blind spot.

Approximately seven in ten companies have undertaken a wide array of activities over the past year. These companies have improved the energy efficiency of their global operations (72 percent); reduced packaging and waste or taken other steps to reduce the environmental footprint of their products (69 percent); and cut either greenhouse gas emissions or other pollutants (67 percent). These measures show that companies are focused on the environment. Looking ahead, these are the same issues that will be accorded a high priority for the next year. Another issue that will become more important, says the survey panel, is that of communicating performance on sustainability.

These steps highlight the fact that businesses' engagement with sustainability has, in general, deepened in recent years. This is illustrated by the range of projects that companies have embarked on, especially in the environmental realm. Efforts have moved beyond the earlier "change the light bulbs and print less" approach and into a more comprehensive engagement, with a wider set of benefits. These benefits range from improved, or wholly new products, to a greater ability to compete in tough markets (see box Sustainability in practice: a snapshot of benefits).

One particularly important benefit is in the field of innovation. According to Mr. Balta, IBM's long experience in improving the environmental sustainability of various products and processes has in turn aided the company's ability to develop new solutions for its clients. Others agree: a significant proportion of companies polled for this report say that sustainability is both a driver of innovation (44 percent) and a creator of new business opportunities (39 percent). For Siemens, corporate sustainability has shifted focus from risk and compliance to something that can drive business expansion. Its portfolio of environmental products and services – including energy efficient gas turbines and offshore wind farms as well as desalination and water-cleaning technologies – outperformed the company's other businesses. In fiscal 2009, the company generated €23bn in sales from these products.

Mr. Buttkereit says that Siemens regards sustainability "not as a compliance topic, but as a strategy topic."

Environmental issues are clearly more important to companies than issues such as sustainable development and workers' rights among suppliers.

But companies may get into trouble if they ignore these matters. Criticism of Apple received widespread media attention in early 2010 after a series of suicides at one of its contract manufacturers in China, prompting swift moves to address the situation. This incident highlights that companies sustainability credentials may also be affected by their supply chains, something that many companies pay scant regard to: 30 percent of executives say that implementing stronger controls over suppliers on environmental standards will not be a priority for their business in the year ahead, and 34 percent say the same on human rights.

While many companies are finding ways to innovate in environmental areas, some are focusing on other aspects of sustainability and the benefits they might produce. In 2007, IBM launched its Corporate Service Corps, providing a new form of voluntary work by putting together international teams that work pro bono to help others, such as city governments, to develop new strategies in areas such as public transport, water supply and food safety. In turn, IBM uses the scheme as a form of training for promising executives. Other companies, including Novartis, Dow Corning and FedEx, are now looking at similar schemes.

Measuring the progress

Key findings

- About one in three (36 percent) of companies have issued at least one public report on sustainability performance, another 19 percent will do so soon; but 38 percent have no plans to do so.
- The main challenges companies are encountering with regard to reporting relate to finding good data and relevant benchmarks.
- Despite strong sustainability performances by many companies, nearly every such corporate initiative is viewed with suspicion by survey respondents as mere PR.

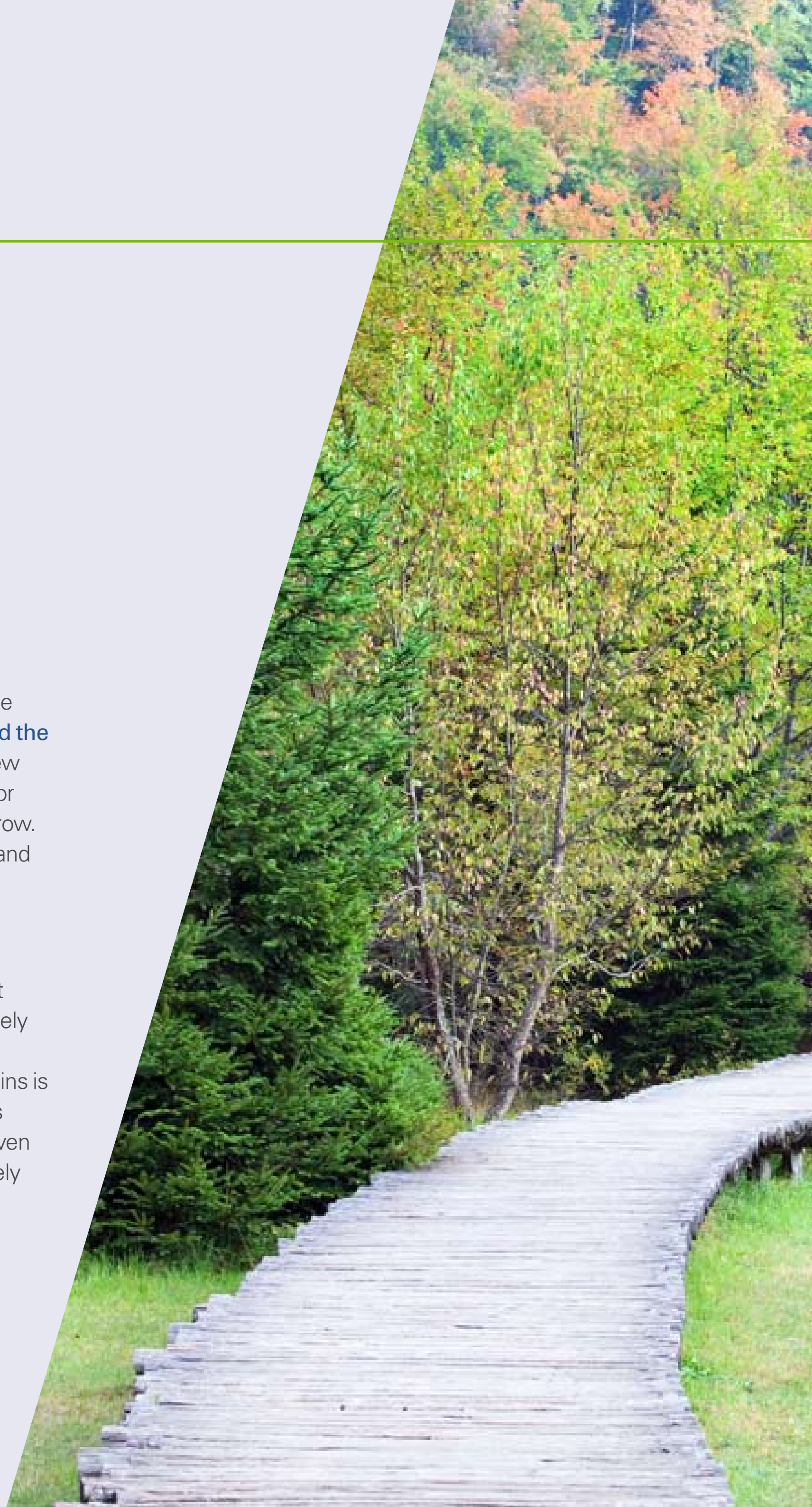
Reporting on sustainability may seem to be a priority in terms of communicating to investors and other stakeholders, but it remains an uncommon activity. About one in three companies surveyed do so now, although this proportion looks set to rise over the coming two years to more than half. But a sizeable minority (38 percent), predominantly among smaller, privately-held companies, will not seek to do so. Just 14 percent of large companies, with revenues of US$5bn or more, say they don't currently report on these issues.

Regardless of whether such documents are created and made public, though, companies seeking to embrace various aspects of sustainability need to measure their existing performance, in order to know if they have improved or not.

"We look at very basic measures like greenhouse gas emissions, energy and water consumption, solid waste – these are all important, countable things," says Ms. Mills.

But she adds that a lack of data makes it harder to widen the adoption of sustainability initiatives, **"or the data exists and the people just don't know how to find it and use it."** For a few companies, measuring and reporting have been going on for years. IBM has issued 20 annual sustainability reports in a row. These reports have helped the company to find good data and establish proper benchmarks.

Nevertheless, even leaders in the field, such as IBM and Siemens, are finding it hard to measure the impact of their business on the environment, in part because their product portfolio is so broad and complex. For example, it is extremely difficult to calculate how many tons of greenhouse gas emissions are saved if a lighter and more efficient set of trains is installed in a city, or if a new type of gas-fired power plant is brought on stream. In any case, skeptics abound: about seven in ten respondents agree that too many organizations merely use sustainability as a public relations tool.



Beyond Kyoto

Key findings

- Two-thirds of executives (67 percent) think a successor to the Kyoto Protocol is "very important" or "critical". Just eight percent think it is "not important".
- Corporate lobbying activity is weighted towards tighter national and international rules, despite the recognition of a greater regulatory burden and increased operating costs.
- In the absence of a global climate change agreement, the competitive landscape for "green growth" industries is intensifying.

A large majority of surveyed executives is overwhelmingly in favor of an effective, global successor to the Kyoto Protocol – the first phase of which is due to end in 2012. Nearly one in three (31 percent) think it's critical and more than a third (36 percent) think it's very important. Less than one in ten (eight percent) think it's not important. Many are following up these words with political action. One in five of the total survey sample are lobbying their government about domestic legislation dealing with climate change. And of those that are lobbying, twice as many want tougher domestic regulations than those looking for weaker rules. Nearly four times as many want tougher international regulations.

These survey findings may seem counter-intuitive. Indeed, 46 percent thought a global climate accord would add to their regulatory burden – and increase their operating costs (41 percent). Meanwhile, only 22 percent think such an accord would deliver a more level playing field within their industry, or indeed reduce the long-term strategic risks to their business (23 percent) from such things as an adverse climate. This highlights executives' low expectations of the negotiations over climate change. In reality, many companies appear to believe that there will be national legislation to limit carbon emissions at some point, so the sooner the regulatory picture becomes clear, the better.

"I think the worst thing that could happen is that you have uncertainty about regulation," says Mr. Buttkereit.

Furthermore, many companies prefer to take appropriate steps in advance of legislation anyway. IBM, for example, decided in 1993 to stop using certain materials in its production processes, almost a decade before an EU directive required their elimination, thus avoiding any difficulties in complying with the rule changes.

Whether companies are lobbying or not, many executives do not expect a significant deal to emerge from the COP16 meeting and that the chances are greater of an accord at COP17 in 2011. This is not to suggest that regulatory activity is nonexistent, though: much action is occurring at both a national and a provincial level, such as the introduction this year of the CRC Energy Efficiency Scheme in the UK.

And then there is a significant proportion of executives who think that new rules on climate change would provide fresh incentives to innovate and create new products (40 percent), or encourage companies to adopt more wide-ranging sustainability initiatives (39 percent).

"Talking about 'green growth', you're saying you can actually increase growth if you are in the right industries, and by the way that will increase resource efficiency," says Mr. Buttkereit.

China has big environment-related ambitions in the five-year plan that begins in 2011, it wants to become a world leader in such industries as solar and wind energy.

"Obviously that brings a new dynamic into the market, where areas like Germany and the EU have to think hard about what they can do, regardless of UN negotiations, not to lose their prime positions," adds Mr. Buttkereit.

Setting a price for carbon would certainly affect corporate purchasing decisions, especially for companies in energy-intensive industries. But many companies are simply hoping for a level playing field, whether future climate legislation spurs or deters business growth.

The full results of this research, featuring more detailed analysis of how business is implementing corporate sustainability, along with in-depth case studies of leading companies, will be published in January 2011.

Sustainability in practice:

A snapshot of benefits

Corporate sustainability comes in many forms, and produces many different outcomes. In our global survey of business executives, which polled a wide range of industries and company sizes, executives were asked to provide an example of a benefit they had gained from a sustainability initiative.

Risk mitigation

"We have implemented a code of business conduct audit of our suppliers to ensure all of them meet certain minimum standards with respect to the environment, safety and treatment of employees. This has served to mitigate risk and protect our company."

Access to new markets

"Packaging from suppliers and by-products from the production process which were previously discarded are now being recycled or sold. This has reduced our costs and created potential new revenue streams."

Cost reduction

"Fuel and C02 savings lead directly to lower operating costs and lower industry operating levies. Better PR and image also."

"Managed to reduce carbon footprint by seven percent by sourcing green process suppliers and raw materials which translate into US$250,000 savings."

New products and services

"Expanding our range of products by being first to apply FSC certification to rubber products (non-timber forest product), as well as applying Fair Trade standards: New visibility, new customers."

"We worked with an OEM to develop a phone made to a great extent from recycled corn products. This was an industry first which attracted a new subscriber sub-section."

Better relationships – with suppliers, and clients

"Sustainability auditing has become a pre-requisite in our business sector, we have put this in place over the past two years. This has required building closer relationships with our suppliers and customers, which has synergistic benefits in terms of efficiency, profitability and competitiveness."

"We are a paper distributor so the FSC (Forest Stewardship Council) and other environmental standards are important to our end customers. We provide compliance, and compliance consulting, as a value-added service."

More ethical businesses

"Developed new organic cotton product line, trained and hired more employees, higher profits, acquired real estate, expansion and growth. We have improved the livelihood and living standards of an additional 30 women who had been forced through human trafficking to work in sexual slavery. They are now free and have new lives with fair trade wages, pension plan, health care, child care, and literacy classes."

Improved investor awareness

"An increased positioning in the sustainability index, enhancing the brand promise of sustainable growth to both consumers and investors."

Resource efficiency

"Water consumption reduction targets helped the Company continue operations during a period of relative water scarcity."

"Kept energy consumption flat despite doubling our top line in the last decade."

"Efforts to reduce the usage of acids in the production process lead to the development of a new pickling line. Key advantages: reduced production time, reduced CO2 emissions, reduced costs."

Happier employees

"The adoption of sustainable business practice has been a contributing factor to improved engagement levels for employees, and has been an attracting factor to new employees."

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Designed and produced by KPMG LLP (UK)'s Design Services.

Publication name: Corporate Sustainability

Publication number: RRD-229641

Publication date: November 2010

Printed on recycled material.