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Sustainability's Next Frontier

Walking the talk on the sustainability issues that matter most

By *MIT Sloan Management Review* and The Boston Consulting Group

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Sustainability's Next Frontier

Introduction

For the past five years, *MIT Sloan Management Review* and The Boston Consulting Group have collaborated on an annual research project to assess how businesses address their sustainability challenges. In the past, we focused on sustainability broadly as a business agenda and how that agenda drives profits and business model innovation. This year, we turn our attention to sustainability's next frontier: addressing the most significant sustainability issues. These are the key social, environmental and economic issues that, if not embraced or addressed, can thwart a company's ability to thrive — or even survive.

We posed three questions to get at the heart of the matter:

- What are the most significant social, environmental and economic sustainability issues confronting companies? (See What is Material Sustainability?)
- How thoroughly are businesses addressing these issues?
- What are companies that thoroughly address significant sustainability issues doing differently than other companies?

Our findings are both encouraging and disconcerting. Although some companies are addressing important issues, we found a disconnect between thought and action on the part of many others. For example, nearly two-thirds of respondents rate social and environmental issues, such as pollution or employee health, as "significant" or "very significant" among their sustainability concerns. Yet only about 40% report that their organizations are largely addressing them. Even worse, only 10% say their companies fully tackle these issues.

Companies that perceive sustainability issues as significant and thoroughly address them share distinct characteristics. For example:

- More than 90% have developed a sustainability strategy, compared to 62% among all respondents.
- 70% have placed sustainability permanently on their top management agenda, compared to an average of 39%.
- 69% have developed a sustainability business case, compared to only 37% of all respondents.

These leading companies suggest a path forward. We call them "Walkers" — companies that "walk the talk" by identifying and addressing significant sustainability concerns. How they do so is a major

About the Research

For the fifth consecutive year, *MIT Sloan Management Review*, in partnership with The Boston Consulting Group (BCG), conducted a global survey. The 2013 survey included more than 5,300 executive and manager respondents from 118 countries. This report is based on a smaller subsample of 1,847 respondents from commercial enterprises. To focus on business, we excluded responses from academic, consulting, governmental and nonprofit organizations. Respondent organizations are located around the world and represent a wide variety of industries. The sample was drawn from a number of sources, including BCG and MIT alumni, *MIT Sloan Management Review* subscribers, BCG clients and other interested parties. In addition to these survey results, we interviewed practitioners and experts from a number of industries and disciplines to understand the sustainability issues facing organizations today. Their insights contributed to a richer understanding of the data and provided examples and case studies to illustrate our findings.

finding of this research. Walkers focus heavily on five business fronts: sustainability strategy, business case, measurement, business model innovation and leadership commitment. "Talkers," on the other hand, are equally concerned about the most significant sustainability issues, but address those issues to a far lesser degree. They also score much lower on the five fronts.

Although we found that some companies are making progress toward the next frontier of sustainability, data from the past five years shows that many organizations are struggling to move forward. For example, the percentage of companies that have established a sustainability business case has only grown from 30% to 37% during this period. The percentage of companies that have tried but failed to build a business case has increased from 8% to 20%. More than half of the respondents have either failed to establish a business case or haven't even tried to create one (see Figure 1).

The percentage of companies that report their sustainability efforts are adding to profits has consistently come in at roughly 35% since 2010 (see Figure 2). Many companies have hit a crucial inflection point. They have reaped the immediate gains from sustainability but have yet to thoroughly embark on the next level: addressing the most significant sustainability issues.

However, some companies — Walkers — have moved past this inflection point. Addressing significant sustainability issues has become a core strategic imperative that these companies view as a way to mitigate threats and identify powerful new opportunities. In this report, we look at how businesses are defining their significant sustainability issues and tackling this new frontier.

Identifying the Most Significant Sustainability Issues

We started by asking respondents how significant social, environmental and economic sustainability issues are to their organizations. Nearly 80% rate economic issues as significant or very significant. Seventy percent rate environmental issues similarly, and only 66% give the same ratings to social issues (see Figure 3).

Next, we asked respondents to rate the significance of specific social, environmental and economic concerns (see Figure 4). Across all industries, the top three social issues are the health and well-being of employees, the community and customers. The three most pressing environmental issues are energy efficiency, pollution and waste management. Competitiveness is the most significant economic concern, followed by market pressure and revenue growth.

The Industry Lens

We also examined significant sustainability issues by industry (see Figures 5 and 6). Often, but not always, these concerns reflect the most important sustainability issues in a company's specific industry. Respondents from commodities, for example, rank community health and well-being and the economic sustainability of local communities as more significant than do respondents from other industries. Mining companies often operate in remote locations in developing and emerging economies that place great stock in important socioeconomic issues.

Similarly, food security is high on the list in the chemical and consumer products industries, indicating the importance of chemical products in agriculture, fertilizers and nutrition businesses, and the importance of healthy and reliable products for consumer goods companies. IT and telecommunications companies consider energy efficiency more important than do respondents in other industries,

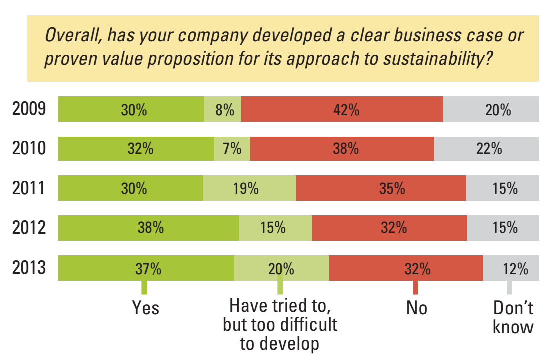


FIGURE 1
BUSINESS CASE
In the past five years, an average of 33% of the companies surveyed state that they have developed a clear business case or proven value proposition for sustainability.

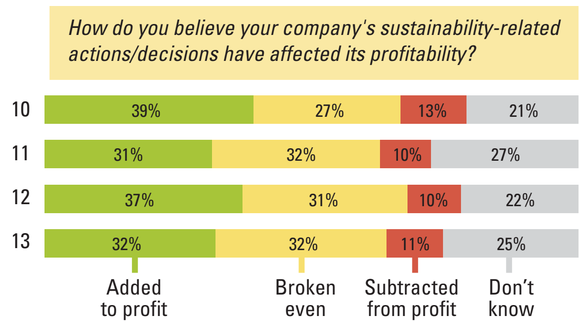


FIGURE 2
PROFITABILITY
Most companies are still not able to connect sustainability with profits.

reflecting the substantial energy needed to operate and cool large data centers as well as the energy needed to power IT and telecommunication devices. Healthcare respondents, not surprisingly, put consumer and community health at the top of the list.

However, we also found that some important social and environmental concerns aren't receiving what is arguably their due.

Education, for example, falls toward the bottom of the list in healthcare, chemicals and consumer products — only 2 to 3% of respondents in these industries rate it as one of their top three significant issues versus 7% of all respondents. Companies in these industries may perceive that they already offer significant opportunities for the public to educate themselves on health and nutrition. However, given the complexities of these aspects and their potential risks, education should arguably be of greater concern.

Only 13% of respondents from IT and telecommunications say pollution is one of their top three significant sustainability issues, compared with 18% across all industries. The relative lack of concern suggests that many companies in these industries don't see the full gamut of sustainability issues across their supply chain, including the second-order impact of their products. Rare-earth elements, for example, are important for LED screens. However, in some countries, including China (the dominant producer of these metals), unregulated mining has caused widespread environmental damage, including water pollution with toxic chemicals and low-level radioactive waste.[1]

Only 3% of healthcare respondents identify climate change as a significant sustainability issue. However, as Kathy Gerwig, vice president of employee safety, health and wellness and environmental stewardship at managed care organization Kaiser Permanente points out, climate change is expected to have a major impact on health. Severe weather will increase the number of injuries and deaths worldwide. The consequences of a warming planet include changes in rainfall patterns and agriculture

What is Material Sustainability?

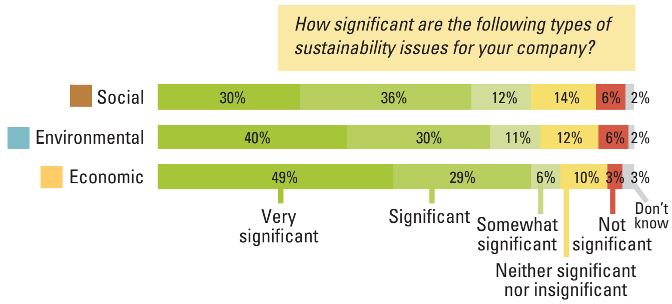
The focus of this report is, in large part, on the most significant sustainability issues: what they are, how they are addressed, and which companies are addressing them. This research examines a growing global expectation that companies assess and address the sustainability issues that are material to their existence over time. Material sustainability issues, in this sense, are those issues most relevant to the company's continued ability to function. Thus, what counts as "material" may vary considerably depending, for example, on which industry you look at, or even on the business model of individual companies in the same industry.

The expectation that companies should be addressing these material sustainability issues is reflected in a variety of new standards and practices. In the United States, for example, the Sustainability Accounting and Standards Board, accredited by the American National Standards Institute, is developing disclosure standards for 88 industries to provide investors with transparency into the significant sustainability risks of the companies in which they invest.[i]

In May of 2013, the Global Reporting Initiative (GRI) — a leading institution in developing guidelines on sustainability disclosures — released its new G4 reporting standard.[ii] This standard emphasizes the importance of identifying and disclosing material sustainability issues to meet stakeholder expectations — even if the organization is not yet prepared to manage them. It targets specific processes, such as procurement or distribution, to pinpoint each material sustainability issue a company faces both within and outside the organization. Reporting on these issues is a prerequisite for advancing material sustainability on corporate agendas.

Even with these advances, we've found that the concept of materiality in corporate sustainability is still developing. Numerous definitions are emerging and competing for acceptance. While we were inspired by the concept of materiality, to alleviate confusion in our survey, we chose to use the word "significant" instead, asking respondents about the significant social, environmental or economic issues that could have a meaningful impact on the long-term viability of their companies. We deliberately included issues that influence the macro context in which companies operate, including climate change, water scarcity and political factors such as human rights.

FIGURE 3
THE PERCEIVED SIGNIFICANCE OF SUSTAINABILITY ISSUES
As expected, economic issues are more significant than environmental or social issues.



that will affect food supplies, as well as changes in the geographical range of insect-borne diseases such as malaria and yellow fever.

A Cloudy Horizon

The discussion above reveals that most companies focus on demonstrable, measurable sustainability challenges such as energy efficiency, waste management or employee health and safety. Concerns that are less tangible or less industry-specific — that are perceived as being on the distant horizon — are barely a blip on the corporate radar. Issues such as human rights, for example, fall to the bottom of the list of social sustainability concerns. Biodiversity loss and soil erosion or desertification fare no better.

Given its potential impact on society and business, we specifically asked managers how their companies are approaching one "distant" issue that affects social, environmental and economic concerns: climate change. The scientific community worldwide has been warning that it is one of the most pressing long-term issues. In its 2013 report, the U.N.-sanctioned Intergovernmental Panel on Climate Change concluded that human influence is causing global warming, and that if consumption patterns continue at current rates, dire effects on global living conditions, habitats and economies are likely. The report — the Panel's fifth since it was formed in 1990 — points out that many of the observed changes since the 1950s are unprecedented. In the Northern Hemisphere, for example, 1983 to 2012 was possibly the warmest 30-year period in more than 1,400 years. Ocean and air temperatures have increased, and the amount of snow and ice has declined. In addition, both sea levels and the concentration of greenhouse gases have risen.[2]

Despite the scientific attention, however, climate change is low on respondents' lists of significant sustainability issues. Although 67% of respondents agree that it is real, only 11% rank climate change as a very significant environmental issue. Not surprisingly, the level of preparedness is quite low. Only 9% of respondents strongly agree that their companies are prepared for climate change risks (see Figure 7).

The Cue from Reinsurance and Banking

Still, there are a few industries that buck the trend of lackluster interest in climate change's effects — for instance, reinsurance and banking. Companies in these two sectors depend on mitigating financial risk and are factoring in longer-term, less-tangible issues, including climate change. "There's a price tag on them," says David Bresch, head of sustainability at Swiss Re, the world's second-largest reinsurer. "Insurance is often an incentive to prevention and preparedness."

FIGURE 4
THE TOP FOUR SUSTAINABILITY ISSUES BY DIMENSION
Notably, employee health and well-being and energy efficiency are the most significant sustainability issues.

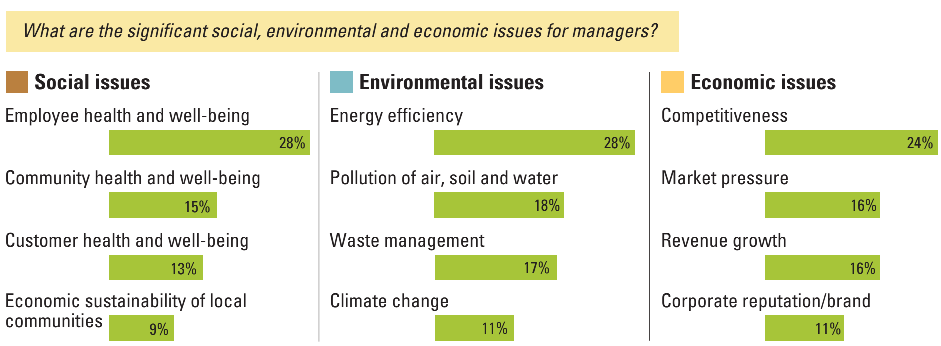


FIGURE 5
SOCIAL ISSUES
The significance of social issues varies by industry.

	Average	Automobiles	Chemicals	Commodities	Construction	Consumer products	Energy and utilities	Financial services	Healthcare	Industrial goods	Industrial services	Media and entertainment	IT and telco	Other
Employee health and well-being	28%	28%	29%	26%	28%	26%	25%	29%	28%	30%	26%	27%	29%	27%
Community health and well-being	15%	15%	16%	23%	14%	12%	22%	14%	21%	15%	17%	12%	12%	13%
Customer health and well-being	13%	13%	13%	6%	15%	17%	10%	14%	27%	13%	10%	8%	10%	11%
Economic sustainability of local communities	9%	7%		15%	10%	10%	16%	14%		6%	9%	8%	7%	9%
Labor practice	9%	12%	8%	7%	11%	12%	8%	6%		13%	14%	10%	8%	10%
Education	7%	8%		6%	7%			8%			6%	14%	11%	9%
Globalization	7%	9%	9%					6%		7%	7%	7%	10%	8%
Economic inequality														
Food security			9%			7%								
Human rights														
Population growth														

5% or less

FIGURE 6
ENVIRONMENTAL ISSUES
The significance of environmental issues varies by industry.

	Average	Automobiles	Chemicals	Commodities	Construction	Consumer products	Energy and utilities	Financial services	Healthcare	Industrial goods	Industrial services	Media and entertainment	IT and telco	Other
Energy efficiency	28%	30%	25%	16%	29%	25%	28%	29%	26%	31%	25%	29%	33%	29%
Pollution of air, soil and water	18%	29%	23%	19%	21%	16%	26%	12%	15%	19%	23%	15%	13%	20%
Waste management	17%	15%	13%	15%	19%	18%	10%	16%	26%	20%	22%	19%	17%	15%
Climate change	11%	12%	10%	8%	8%	8%	15%	14%		8%	9%	13%	13%	11%
Product stewardship	8%	10%	14%		6%	13%		6%	14%	10%	7%	9%	8%	8%
Water scarcity	6%		7%	13%	10%	11%	7%			7%	7%			6%
Land use				12%				6%						
Biodiversity loss				6%										
Erosion/Desertification														

5% or less

For example, Swiss Re creates scenarios to help regional and national decision makers understand the impact on insurability of inaction on climate change. The city of Hull in the U.K. is a case in point. Swiss Re examined historical disaster data, including wind, inland flooding and storm surge. The company then applied probabilistic modeling to estimate the expected economic impact of natural disasters through 2030. In the worst-case scenario, Swiss Re calculated that climate change would eventually cause annual losses of U.S. $90 million. Swiss Re developed a portfolio of steps Hull could take to limit its exposure, including education, reinforcing sea defenses, retrofitting buildings and changing building codes. These measures could reduce the potential losses by some 65%.

Crédit Agricole, France's largest retail bank and Europe's third largest wholesaler of banking services to large institutions, is also factoring in long-term sustainability risks. "People are now aware that any kind of project or banking relationship has environmental and social components," says Jérôme Courcier, the company's chief social responsibility (CSR) officer.

Through its Ceres committee, named after the ancient Roman goddess of agriculture, the bank assesses the inherent social and environmental risks in any new major investment or relationship. Certain investments are automatically out of bounds. For example, the bank eschews any deals involving surface oil sands, offshore drilling in the Arctic region, or any hydroelectric plant where the size of the reservoir is disproportionate to the energy generated. All other opportunities are subject to five stages of evaluation and up to 20 criteria.

But the bank is also factoring climate change into its retail business. "When we lend to people to buy their homes, we factor in the impact of climate change on energy prices," says Courcier. "We need to make sure that if heating and transportation costs go up, customers can still repay their loans." Along similar lines, the bank launched a sustainability lending program that guides consumers through the issues of energy-efficient remodeling: energy audits, project estimates and financing.

For long-term issues such as climate change, our research shows that many companies aren't taking the same heed as these financial institutions. The gap indicates a broader disconnect between thought and action on a range of sustainability issues across industries: Companies are far more likely to perceive significant sustainability issues than they are to act on them.

A Disconnect Between Thought and Action

This disconnect is clearly evident in the corporate sector's approach to social and environmental issues. Nearly 70% of respondents say that social and environmental issues are significant or very significant

FIGURE 7
PERCEPTIONS OF CLIMATE CHANGE
Managers believe climate change is real, but their companies aren't prepared.

for their companies. Yet only half of our survey respondents report that their companies are fully or largely addressing them (see Figure 8).

When looking only at companies that fully address their significant social or environmental concerns, the pattern is even more stark (see Figure 9). Across all industries, only a fraction of companies are fully engaged with social sustainability. Healthcare and industrial goods lead the industry list, but with only 17% and 15%, respectively. The numbers at the bottom are even smaller — only 6% of media and entertainment companies fully address their significant social issues. In industrial services, it's 3%.

Significant environmental issues don't fare much better. Energy and utilities lead the pack, but with only 25% reporting that their companies are fully engaged with these challenges. Only 6% of financial service companies fully address the environmental issues they are most concerned about. Only 3% of media and entertainment companies fully engage them.

Companies that operate on a global scale confront a broad range of sustainability issues and are the most likely to be addressing the significant ones.

Geographically, companies that operate in North America perceive fewer significant sustainability issues and are also less likely to be addressing the issues they do identify. Companies operating in Africa are the most likely to identify important sustainability issues, but aren't addressing them to a large degree. Conversely, companies in South America are most likely to turn their perceptions into action (see Figure 10).

Closing the Gap

How some companies are closing the gap between thought and action is a major finding of this research. To shed light on the issue, we focused on respondents who perceive sustainability issues as very significant for their companies. We then classified respondents into three groups based on their level of engagement with those issues: Walkers say they "fully" or "largely" address *all* of their significant sustainability issues; Talkers do so "somewhat," "barely" or "not at all." The third group — On the Road — are companies that engage with some, but not all, of the sustainability issues they see as significant (see What are Talkers and Walkers?).

Walkers versus Talkers

Walkers that substantially address important sustainability issues score much higher than Talkers on these five key dimensions:

- Creating a sustainability strategy
- Making sustainability a top management agenda item
- Developing sustainability business cases

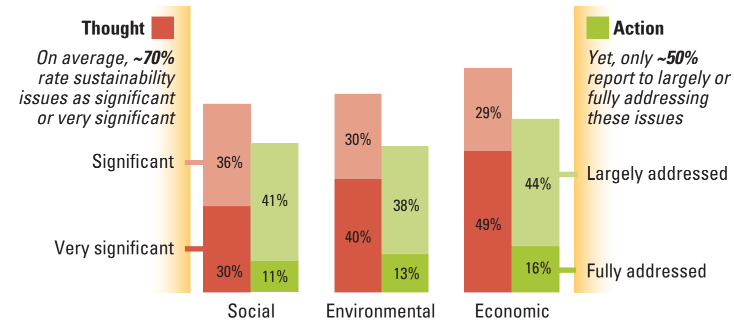


FIGURE 8
THE DISCONNECT
The significance of sustainability issues are not matched by action.

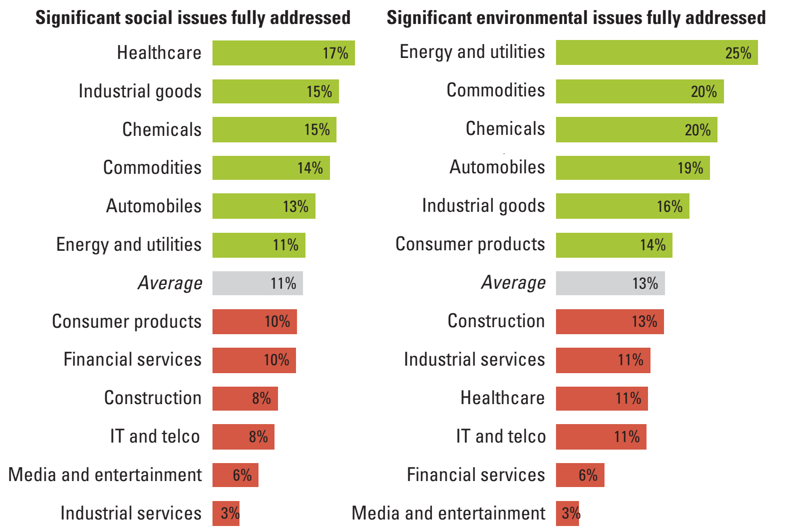


FIGURE 9
SIGNIFICANT ISSUES FULLY ADDRESSED, BY INDUSTRY
Energy and utilities are far more likely to fully address environmental issues than social, while healthcare is far more likely to fully address social than environmental issues.

•Measuring progress on corporate sustainability performance

•Changing business models as a result of significant sustainability issues

Walkers are the companies that focus most on all these fronts (see Figure 12). They walk the talk by creating comprehensive, dedicated sustainability efforts. Talkers, on the other hand, exert far less effort, despite their strong stated concerns about significant sustainability issues.

Companies "On the Road" are moving from talking to walking. Although they fall at various points in between, they are clearly closer to Talkers than Walkers. In terms of business model innovation — a key to translating sustainability issues into corporate value — they fall far behind the Walkers. These companies have yet to thoroughly embrace each of the five fronts and make important sustainability issues an integral part of their business models.

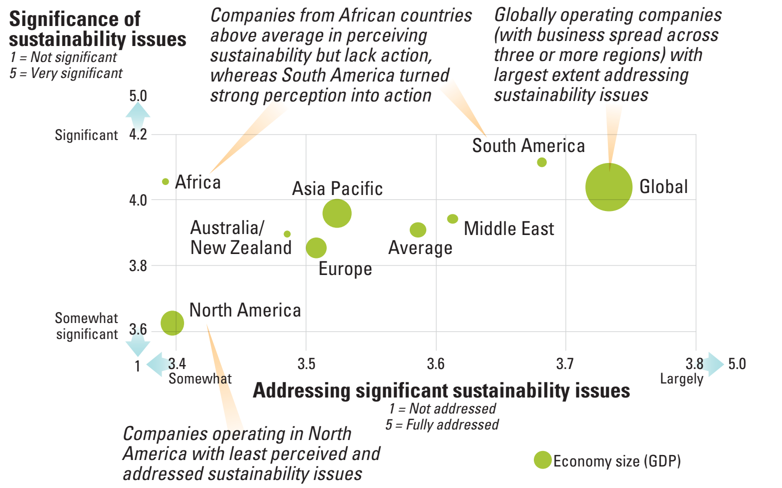
Creating a sustainability strategy is a hallmark of Walkers. More than 90% have developed a strategy, compared to only 46% of Talkers. Making sustainability a top management agenda item is also critical. Only 24% of Talkers report that it is a permanent item on their company's senior management to-do list. With Walkers, the number is nearly three times as high — 70%.

Sustainability business cases are nearly as important as top management support. Almost 70% of Walkers develop them, versus only 20% of Talkers.

Measuring progress on sustainability performance is similarly central. On average, nearly 70% of Walkers measure progress versus 31% of Talkers. Walkers also aggressively measure progress on the more intangible social issues such as the well-being of employees, communities and customers. For example, 60% of Walkers measure progress in social sustainability versus only 20% of Talkers.

Business model innovation is another strong marker. Nearly 60% of Walkers have changed their business models in response to significant sustainability issues. Talkers trail far behind with approximately 30%. Equally important, business model innovation is the only area where companies On the Road have made no more progress than Talkers. Most companies have yet to identify how tackling important sustainability issues translates into new business directions and opportunities.

FIGURE 10
THE DISCONNECT BY GEOGRAPHY
South American and globally operating companies are most likely to connect significance of sustainability issues with action.



Walkers by Industry

Walkers are more prevalent in certain sectors. For example, in resource-intensive industries such as commodities or utilities, Walkers outnumber Talkers nearly four to one. In contrast, Talkers outnumber Walkers by nearly two to one in service and technology industries such as media and entertainment. Resource-intensive industries must contend with resource scarcity and significant energy costs. Companies in these industries are creating direct economic benefit through greater resource and energy efficiency. The automotive industry is an exception — it has a nearly equal balance of Walkers and Talkers (see Figure 13).

Portrait of a Walker: Domtar

Domtar is a prime example of a company translating a critical sustainability issue into business value. The U.S.-based $6+ billion company faces a daunting sustainability threat — it's a paper products company that needs to become a wood fiber innovation engine. Turning this threat into a viable long-term business is at the heart of the company's strategy.

Domtar realized that its ability to sustainably source and manage a complex supply chain of fiber resources can anchor its efforts to transform from a paper maker to fiber innovator. The raw material of its sustainability expertise — trees — contains several chemicals that can help make products stronger, faster, better or lighter.

Lignin is one of them. It binds the cellulose and hemicellulose in trees, which is what gives trees their strength. As an alternative to the use of petroleum and fossil fuels, lignin can be utilized in adhesives, agricultural chemicals, coatings, food additives, carbon products, dispersants and resins.

In a major foray into fiber innovation, Domtar successfully launched BioChoice™ lignin in May 2013. Besides financial success, the launch attracted the attention of Tom Vilsack, U.S. secretary of agriculture, who is scouting for examples of advanced manufacturing. Domtar's sustainable fiber innovation also gives the company a powerful edge in the talent war: it is better armed to attract younger science- and technology-savvy professionals than are other paper industry companies. "Sustainability is our business model," says David Struhs, Domtar's vice president of sustainability. "It is redefining every aspect of what we do."

Given the central role of sustainability in Domtar's viability, the company implemented an extensive and intricate system of measures to track sustainability performance. For example, Domtar created dashboards that track 35 key sustainability performance indicators (KPIs). But equally as important, the measurement approach is carefully designed to avoid suboptimizing the system and inadvertently driving counterproductive efforts.

What Are Talkers and Walkers?

To understand the disconnect between thought and action, we focused on organizations that are the most strongly concerned with significant social, environmental and economic issues. We then examined which of these organizations are addressing the issues they are most concerned about. To identify these companies, we looked at how respondents rated the significance of social, environmental and economic issues to their organization. Significance for each issue was determined using a five point scale. Companies that reached a total of 11 to 15 points were included in the analysis.

We then grouped these companies by how thoroughly they addressed important sustainability concerns (see Figure 11):

Walkers — companies that report "largely" or "fully" addressing all significant sustainability issues

On the Road — companies that "largely" or "fully" address some but not all of the sustainability issues they deem important

Talkers — companies that only "somewhat," "barely" or don't address all of their significant sustainability issues

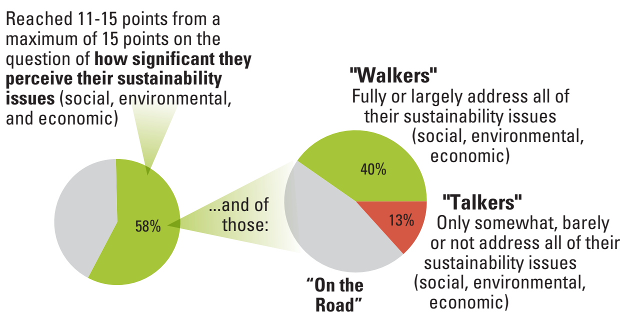


FIGURE 11
DEFINING WALKERS AND TALKERS
More than half of respondents describe *all* of their sustainability issues as significant to their organizations. Among these respondents, some largely or fully address these issues (Walkers) and others don't (Talkers). A third group, those "On the Road," address their significant sustainability issues to varying degrees.

Domtar KPIs are adapted to, not simply adopted by, each of its facilities.

"We wanted to avoid the mistake of setting broad corporate goals such as improving water efficiency by 15%," says Struhs. "Domtar's facilities are in different regions with different tree species, watersheds and pollution issues. A one-size-fits-all goal may not apply equally everywhere." To adapt a KPI, management teams in each facility develop their own unique sustainability agendas to meet company goals. That level of empowerment builds buy-in and accountability for what each facility signs up for.

To keep sustainability efforts front-and-center, Domtar created a corporate sustainability committee. But, by design, the vice president of sustainability never chairs it. To involve the entire organization, the chair rotates among top managers. Currently, it is led by Domtar's head of manufacturing and operations, with Struhs serving as an executive director charged with keeping momentum moving. "Sustainability can't be a pigeonhole," he says. "It must be a company-wide, interdisciplinary effort."

Obstacles and Catalysts

Companies are struggling to settle on and rally around the important sustainability threats and opportunities they confront. Competing priorities, for example, are the most common stumbling blocks with 41% reporting them. Difficulty quantifying sustainability's intangible effects stands in the way of 35%. Short-term thinking in planning and budgeting cycles follows closely with 31%.

Overcoming these issues tend to require organizational catalysts. Our research revealed several such factors at work in companies that effectively address significant sustainability issues.

Organizational Capabilities

Like any business issue, addressing important sustainability issues requires specific, hard-wired organizational support and capabilities — leadership, communication and measurement (see Figure 14). The importance of hard-wired organizational support is apparent when looking at Walkers versus Talkers. Approximately two-thirds of Walkers have strong support from their corporate leaders. Only one-third of Talkers do. Some 50% of Walkers clearly communicate responsibility for sustainability and report on it. Nearly 50% have developed KPIs to measure sustainability performance — only 25 to 30% of Talkers do. Only 2% of Walkers are not engaged in any of these activities. For Talkers, the number is more than 30%.

Business Model Innovation

For many companies, the need and opportunity for developing new business models can be a major catalyst. More than half of respondents report that, in

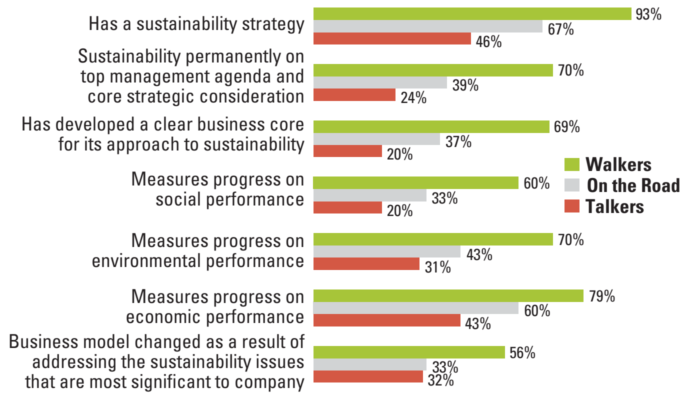


FIGURE 12
MOVING FROM TALKING TO WALKING
A key differentiator is business model change. Whereas a majority of Walkers have changed their business model because of sustainability, only a third of other companies have done so.

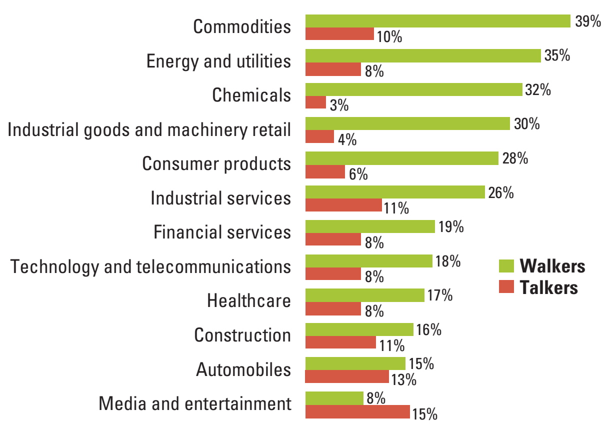
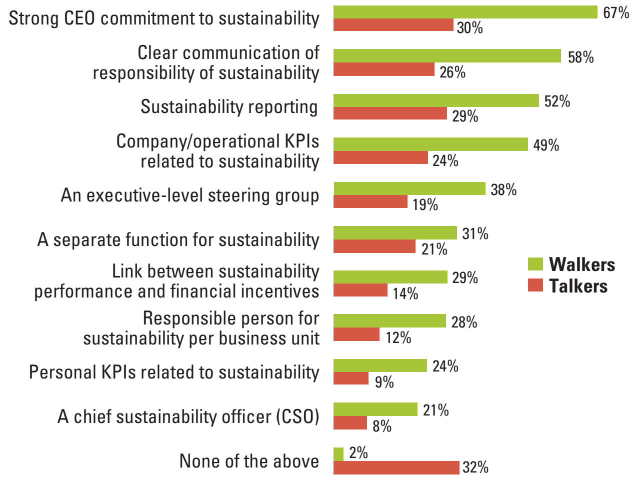


FIGURE 13
WALKERS ARE CONCENTRATED IN RESOURCE-INTENSIVE INDUSTRIES
Only one industry has a higher percentage of Talkers than Walkers: Media and Entertainment.

FIGURE 14
ORGANIZATIONAL CAPABILITIES
Walkers are more likely to address their sustainability issues in a focused way. Interestingly, 32% of Talkers do not have any of the listed capabilities.

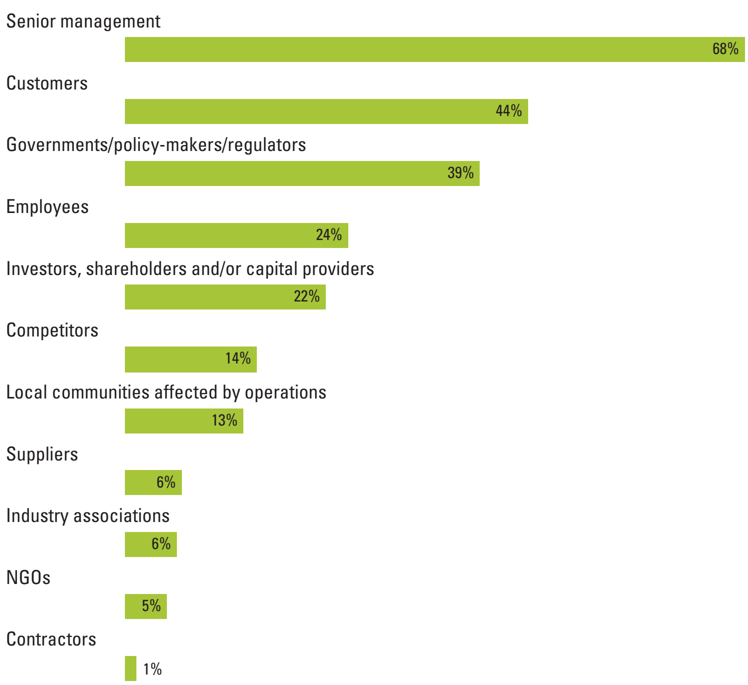


terms of significant sustainability issues, customer preferences are the most powerful driver for business model innovation. Political pressure is also important — 43% of respondents cite it. Competitors increasing sustainability commitment as well as resource scarcity rank third on the list.

In some cases, the opportunity behind business model innovation is straightforward, as was the case with Domtar. Avis Budget Group's 2013 acquisition of Zipcar is another example. Avis saw the sustainability issues and opportunities in the urban car rental market. Nearly half of the world's population lives in cities, and that number is expected to climb to 75% by 2050. As a result, urban lifestyles are changing, and car ownership is falling down the list of aspirations, especially among younger generations. Urbanites are equally concerned with the environment, including pollution from a growing number of cars and availability of land needed to park them. Zipcar addresses those concerns; every shared car can replace 15 to 20 owned cars and eliminate the need for up to three parking places.

In the industrial arena, GE saw a clear opportunity to help airlines to reduce fuel costs and reduce CO_2 emissions. GE developed an advanced engine, GEnx, for Boeing 787 and 747-a8 fleets. The new engine cuts $2 million in expense per plane per year. Its potential impact on carbon emissions is also considerable. If all similarly sized planes were outfitted with the engine, annual CO_2 emissions would be reduced by the equivalent of taking 800,000 cars off the road.

FIGURE 15
STAKEHOLDERS
Senior management and customers are the most influential in shaping sustainability agendas.



Scanning for Opportunities

For most companies, however, threats and opportunities are not as obvious and might be beyond corporate fence lines or on the distant horizon. To move sustainability from a competing priority to an agreed-on agenda item, some companies are developing processes to scan the landscape for sustainability issues and assess them as threats and opportunities.

It isn't an easy endeavor. More than one-fourth of respondents say they do not currently engage in activities that seek out opportunities. Another 17% do not know if this is even done at all in their companies. The remaining 57% use a wide range of monitoring and activities such as risk classification, customer surveys on sustainability or impact assessments and stakeholder.

Hilton Worldwide, for example, places opportunities into one of three concentric circles that define impact and value. The first circle includes opportunities where management can clearly see an immediate benefit such as cost savings. A light bulb that uses less energy and is less expensive is a prime example. The next circle evaluates opportunities that require investment but reduce costs over time. For example, Hilton installed sensors in guest rooms that turn off lights and control heat and air conditioning when guests are out. The third circle assesses impact on the guest experience and/or hotel operators.

"This is more difficult to do than reducing waste," says William Kornegay, Jr., senior vice president of supply management. "But we are very disciplined about talking to the front office, back office — everywhere — to make sure we spot what provides tangible business value." As an example, Kornegay points to Hilton's recycling of mattresses. Instead of hauling old mattresses to a landfill, Hilton has partnered with a supplier that breaks them down into recyclable material. Disposal costs are half of what they used to be, and guests appreciate the corporate social responsibility.

Dell poses a fundamental question to its entire supply chain: how is the company going to create and produce a sustainable laptop? According to Eric Olson, senior vice president, advisory services at The Business of a Better World, Dell doesn't have all the answers — but it does have deep strategic partnerships with original design manufacturers. Dell works closely with them to identify opportunities and assess their impact. Currently, efforts range from reducing the energy a computer needs to strategies that curtail electronic waste.

Similarly, Kaiser Permanente starts with an overarching principle: improving public health is critical to controlling healthcare demand and costs. "We take an approach aligned with disease prevention," says Kaiser vice president Gerwig. In 2008, Kaiser Permanente codified its sustainability priorities and identified five areas where it could have the greatest impact on public health — climate change, safer chemicals, sustainable food, waste reduction and water conservation.

The Leaders and the Led

Top management support is a very powerful catalyst of sustainability efforts — 68% of respondents say senior management has the greatest influence on sustainability endeavors. Employees are also part of the equation — 24% of respondents cite employees as the most influential (see Figure 15). Employees place great value in working for companies with strong sustainability footprints. And they are often at the ready to accelerate progress.

The Profit Motive

Profit is a powerful motive for corporate action. In this year's study, nearly 60% of Walkers report adding to their corporate coffers by tackling significant sustainability concerns. Only 19% of Talkers do

A 2013 study by Harvard Business School professors Robert Eccles and George Serafeim in conjunction with London Business School's Ioannis Ioannou followed the money to verify sustainability's profit potential. The scholars examined the financial performance of companies that had voluntarily adopted corporate-level sustainability policies against companies that hadn't — what they called "high-sustainability" versus "low-sustainability" companies. The researchers analyzed the financial performance of these companies from 1993 to 2009. They found that high-sustainability companies notably outperformed their counterparts. For example, if someone had invested $1 in a portfolio of high-sustainability companies in 1993, that investment would have grown to $22.60 by 2010. That same $1 invested in a low-sustainability portfolio would have delivered only $15.40.[iii]

Profit from sustainability accrues differently across industries. Compared to service and technology companies, for example, resource-intensive industries such as commodities and industrial goods claim to focus more on important sustainability issues and are more likely to report profit from those efforts. Resource scarcity and high energy costs are strong drivers with direct and substantial impact.

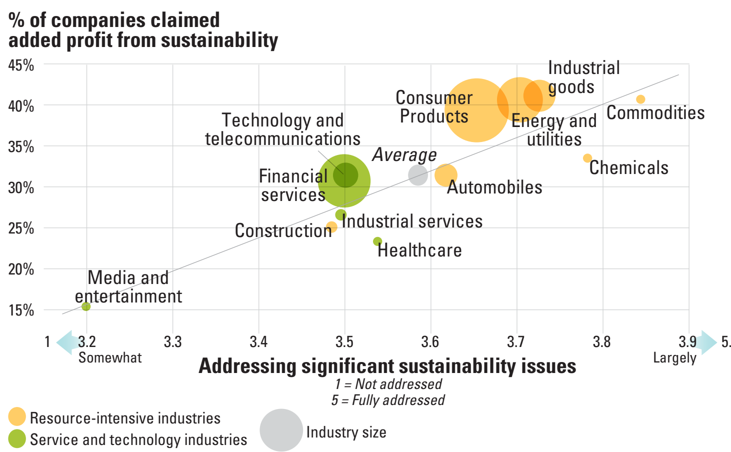


FIGURE 16
Profiting from sustainability varies widely across industries.

Caesars Entertainment is a case in point. The global casino operator's fortunes were in free fall after the financial crisis hit. In the wake of collapsing revenues, Caesars was forced to reduce its staff by more than 20%. Despite the fear and low morale, employees at many of the company's hotels began developing innovative ways to cut costs, reduce energy consumption and waste, and increase recycling. Caesars' chairman and CEO, Gary Loveman, had long been a proponent of sustainability, but had not formalized an effort. He seized the opportunity and created a full-fledged sustainability program built upon what had started as a global volunteer effort. Today, Caesars' sustainability program has become institutionalized across more than 50 properties. Managers are responsible for specific metrics such as energy reduction, customer impact and employee engagement through a carefully crafted scorecard. The company's sustainability reputation is also driving business value beyond cost cutting. Its properties are better able to attract highly sought-after conference business, and employee retention and customer loyalty are on the rise.

The Limits of Acting Alone

Pioneering companies are hitting the limits of what they can do alone," Sally Uren, acting chief executive of Forum for the Future, said at the 2013 annual Sustainable Brands summit.

Addressing sustainability issues by collaborating with stakeholders is critical — and nothing new. In this year's study, nearly 40% of respondents report increasing collaboration with customers and suppliers on sustainability matters (see Figure 17). Thirty-four percent of respondents say their companies have stepped up their engagement with governments, policy makers and regulators.

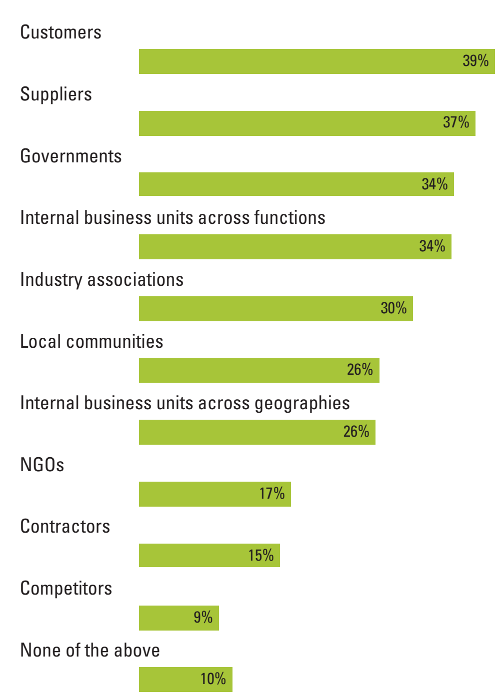
Power in Numbers

Collaboration is becoming more important since the solution to important, or material, sustainability issues might lie outside a company's direct sphere of influence. In addition, an individual company might not have the capabilities to address all issues on its own.

Working collectively, organizations can be more systematic and sophisticated in tackling significant sustainability issues across the value chain — from supply to finished product. As described above, Dell works with its supply chain partners to both design and manufacture sustainable laptops. In the mining sector, the Initiative for Responsible Mining Assurance (IRMA) is pulling together mining companies, manufacturers, NGOs, labor and impacted communities to create standards that assure everything from wedding rings to cars can carry a legitimate seal of approval indicating sustainably sourced resources.[3]

Under the auspices of Secretary-General Kofi Annan, the United Nations took an unusual tack. Instead of developing a legally binding global regulatory scheme, which many advocated, the U.N. launched the Global Compact — a learning network. Drawing on the success of networks and peer-to-peer groups, the initiative brings together private-sector companies, international labor and NGOs to work with the U.N. on worldwide corporate social responsibility opportunities, actions and

FIGURE 17
INCREASE IN COLLABORATION
Nearly 40% of respondents increased collaboration with customers and suppliers.



best practices. More recently, the U.N. Global Compact extended this learning network by launching the U.N. Global Compact LEAD.[4] This new program, focused on CEOs and Chairpersons at LEAD member companies, acts as an incubator to advance innovation, share experiences (both successes and failures) and further corporate sustainability.

Partnering with Competitors

In some cases, businesses are working with competitors — even archrivals — to address significant sustainability challenges.

Nestlé, for example, has turned to customers, advisors and competitors to develop what it calls "precompetitive" practices. Ten years ago, the company reached out to Danone and Unilever to help develop sustainable agriculture approaches. "We all faced the same problems of quality, scarcity and cross-border issues from child labor to pesticide residues to contaminants," says Hans Joehr, corporate head of agriculture. "Instead of each company going its own way, we looked at where we could work together and develop principles and practices and procedures."

General Motors and Honda have joined forces to develop hydrogen fuel cells to be used in each company's cars. Fuel cells use hydrogen gas stored in the car, along with oxygen from the atmosphere, to generate electricity. Cars with fuel cells qualify as zero-emission since water vapor is the only by product. By working together, both companies lower their development costs and shorten their respective time to market. But the partnership also doubles down the effort to encourage energy suppliers and governments to increase the number of hydrogen refueling stations. Availability of these stations is critical to gaining consumer acceptance of fuel-cell vehicles.

The U.S. beverage company Ocean Spray partnered with its competitor Tropicana to reduce transportation costs, delivery distances and CO_2 emissions. To supply its markets in the Northeast, Tropicana ships orange juice by train from Florida to New Jersey. After the boxcars were unloaded, Tropicana was paying to send them back — empty. Ocean Spray had recently established a new distribution center in Florida to meet growing demands for its products in the southern U.S. One of Tropicana's logistics suppliers realized that the companies could partner to fill the empty trains. The supplier offered to set up a road-and-rail line for Ocean Spray that included a competitive price for Tropicana's empty boxcars. Despite initial concerns about partnering closely with a chief competitor, the collaboration went forward, and Ocean Spray cut its transportation costs by more than 40% and its greenhouse gas emissions by 65%.[5]

Conclusion: Tackling the Next Frontier

There is little disagreement that sustainability is necessary to be competitive — 86% of respondents say it is or will be. Sustainability's next frontier is tackling the significant sustainability issues — or, in the parlance that is gaining currency, "material sustainability issues" — that lie at the heart of competitive advantage and long-term viability. Yet many companies struggle to match their strong level of sustainability concern with equally strong actions. They still wrestle with settling on which actions to pursue and aligning around them.

However, some companies are moving forward. They are making links between significant sustainability issues and business value and forging ahead along five fronts: sustainability strategy, business-case development, measurement, business model innovation and top management support.

For companies such as Domtar, Avis Budget Group and GE, the path forward is clear — but for many others, it isn't. To achieve clarity and tackle the next frontier, business leaders should be able to answer these questions:

•**What are the burning platform sustainability issues for my company?** Are there sustainability issues in our industry and across our value chain that fundamentally challenge the viability of our business?

•**What are the threats and opportunities inherent in these issues?** Do we have a system in place to identify the significant sustainability issues and signal when our company needs to take action? Have we identified the specific threats and opportunities of these issues for our company?

•**What is the business case?** Do we quantify the return on sustainability issues in terms of profit? Are there other non-financial metrics that we need to address? For example, if access to water or an educated workforce is critical for our business in the future, does our company have metrics in place that track progress on water consumption and recycling or vocational training?

•**What is the best strategy to approach the material issues?** How does our business have to change to address the significant or material sustainability issues? Is our organization prepared to make that change? Which issues can be addressed best by our business solely? Which need collaboration with other relevant parties? Whom can we partner with to best address the issue at hand?

Companies don't have to go it alone. Progress toward addressing material sustainability issues can be accomplished with collective action. For example, standards boards such as the Global Reporting Initiative are working with companies and stakeholders to identify the sustainability issues that will have the most significant impact. Industry associations partner with companies to foster broad-based sustainability efforts. The U.N. Global Compact is experimenting with an executive peer-to-peer learning network with similar aims. And we've already described how even direct competitors can work together — the partnering of Honda and General Motors to co-create hydrogen fuel cells and the collaboration between Tropicana and Ocean Spray around transportation are both examples of this type of joint venture.

"Understanding what we can do to improve our relationship with the environment can be a wellspring of business innovation," says Domtar's Struhs. "Companies that eschew waste, prize efficiency and innovate are the ones that will make it in the long run."

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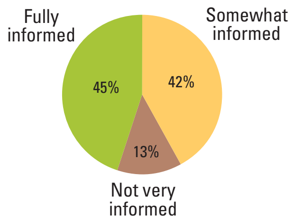
ii. Global Reporting Initiative, 2013, G4 Sustainability Reporting Guidelines. https://www.globalreporting.org/reporting/g4/ (accessed 10/23/2013).

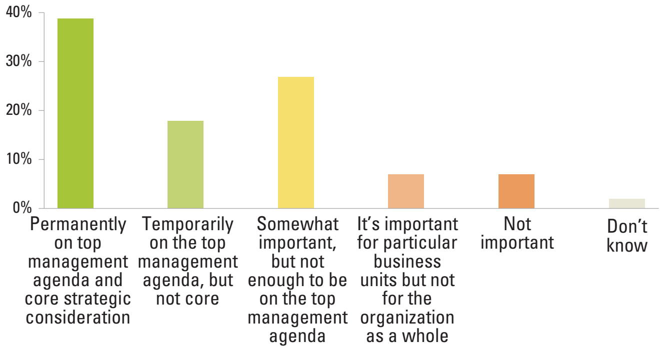
iii. Eccles, R.G., Ioannou, I., Serafeim, G. The Impact of Corporate Sustainability on Organizational Processes and Performance. Harvard Business School Working Paper (2-035). July 29, 2013.

The Survey: Questions and Responses

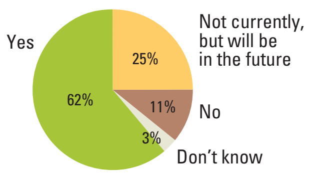
1. How well informed are you of your company's sustainability activities?



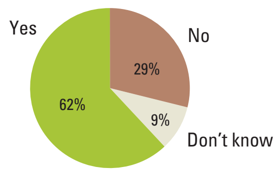
2. Which of the following best describes the place that sustainability has on your company's top management agenda?



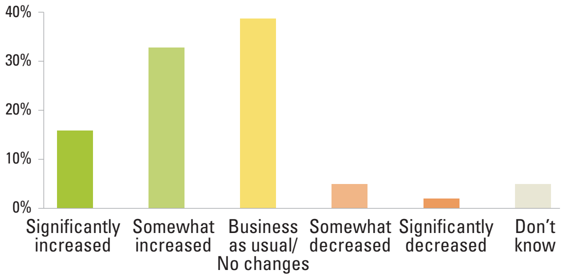
3. Is pursuing a sustainability-oriented strategy necessary to be competitive?



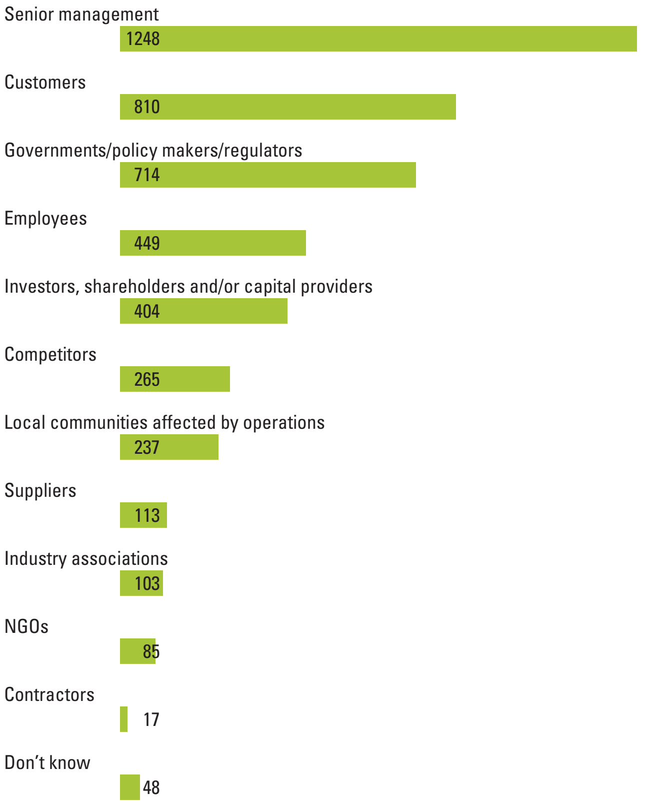
4. Does your company have a sustainability strategy?



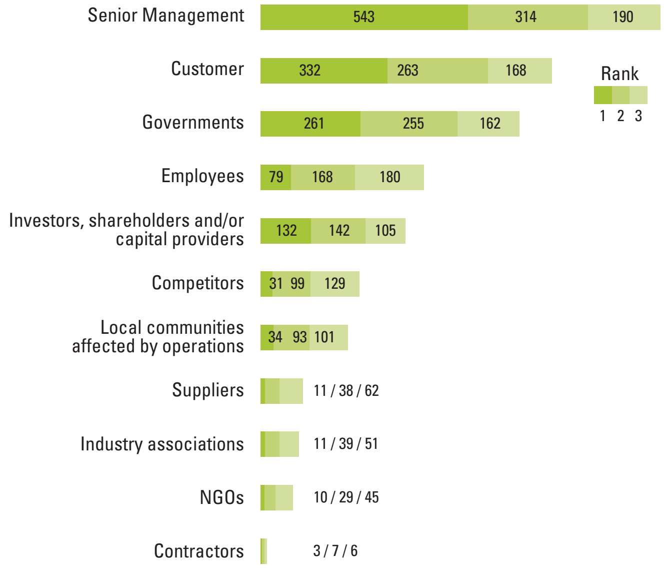
5. In terms of management attention and investment, how has your company's commitment to sustainability changed in the past year?



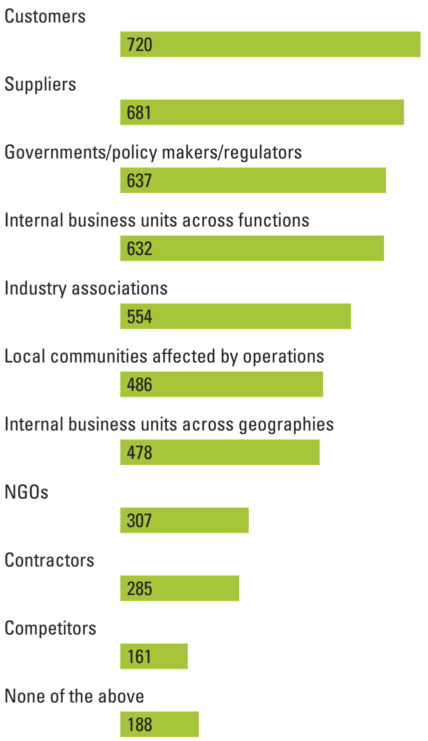
6. Which stakeholder groups are most influential in shaping your company's sustainability agenda? (Please choose up to 3)



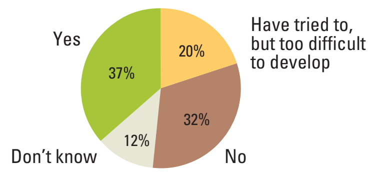
7. Please rank the most influential stakeholder group in order of priority, with 1 indicating the most significant



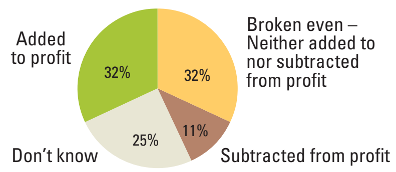
8. As part of your company's sustainability agenda, has collaboration with any of the following groups increased? (Please choose all that apply)



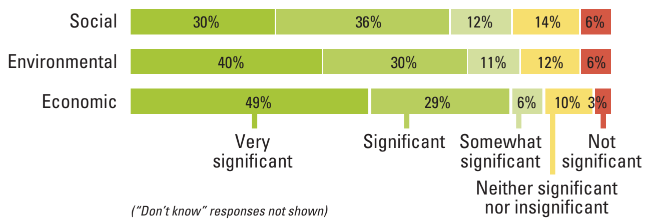
9. Overall, has your company developed a clear business case or proven value proposition for its approach to sustainability?



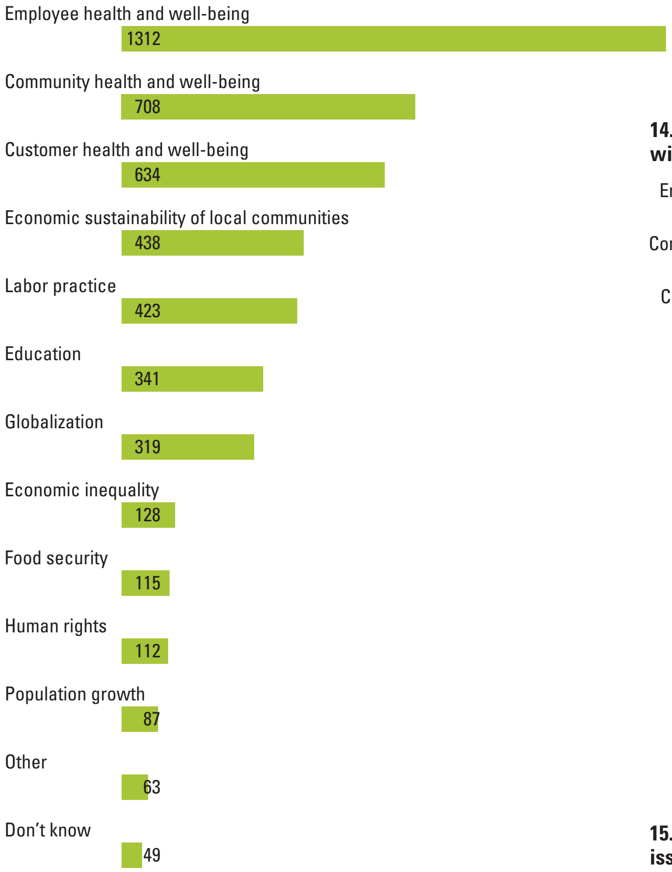
10. How do you believe your company's sustainability-related actions/decisions have affected its profitability?



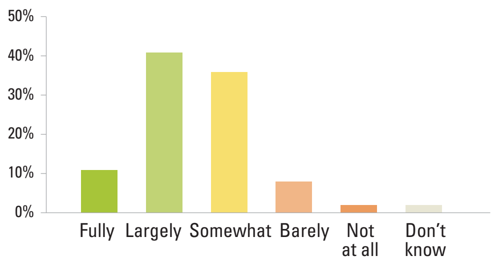
11. How significant are the following types of sustainability issues for your company?



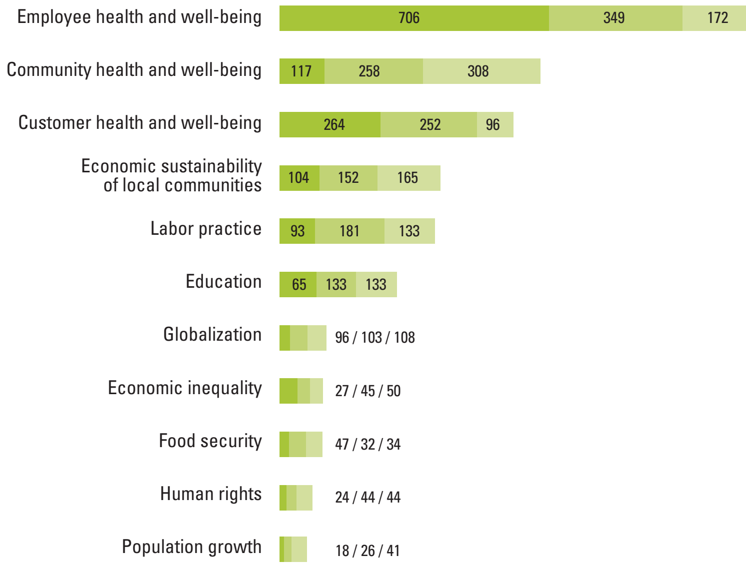
12. Which of the following are the most significant social issues for your company? (Please choose up to 3)



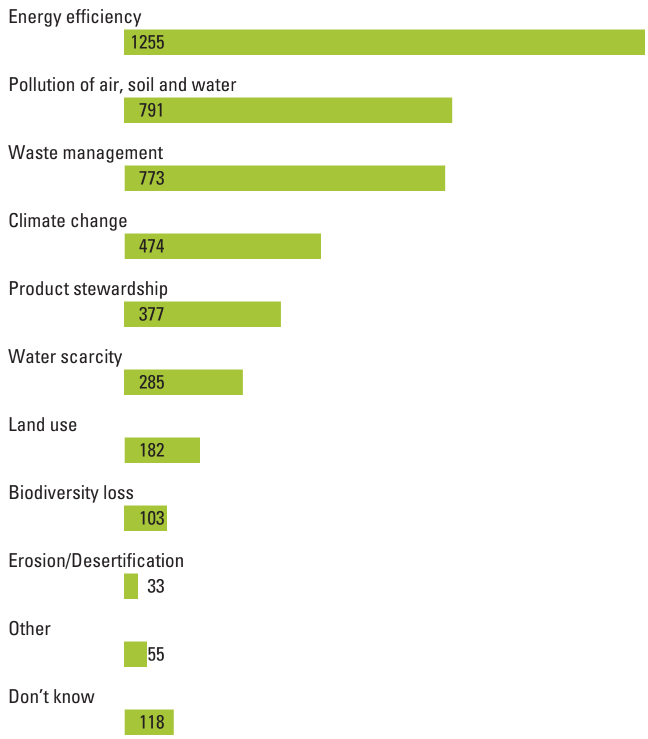
13. To what extent are the social issues you chose sufficiently addressed by your company?



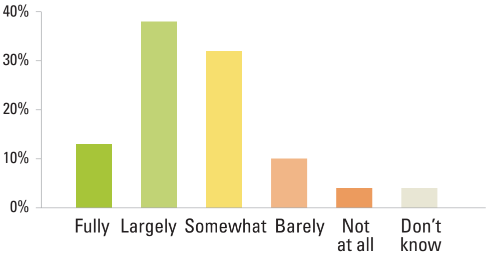
14. Please rank the social issues you chose in order of priority, with 1 indicating the most significant



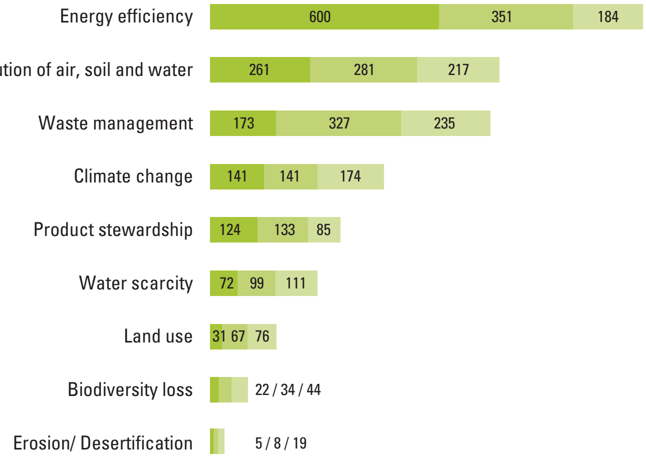
15. Which of the following are the most significant environmental issues for your company? (Please choose up to 3)



16. To what extent are the environmental issues you chose sufficiently addressed by your company?

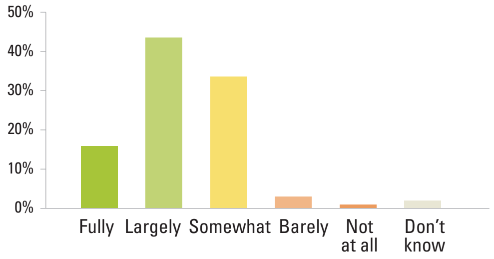


17. Please rank the environmental issues you chose in order of priority, with 1 indicating the most significant

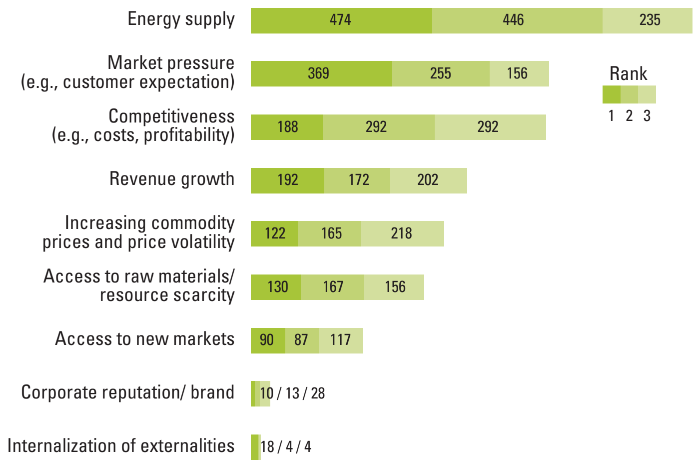


18. Which of the following are the most significant economic issues for your company? (Please choose up to 3)

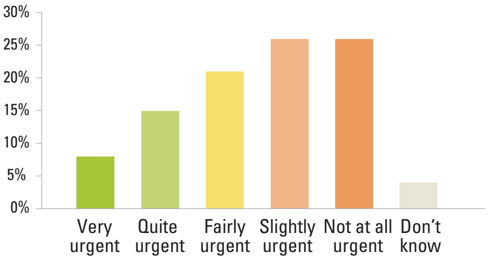
19. To what extent are the economic issues you chose sufficiently addressed by your company?



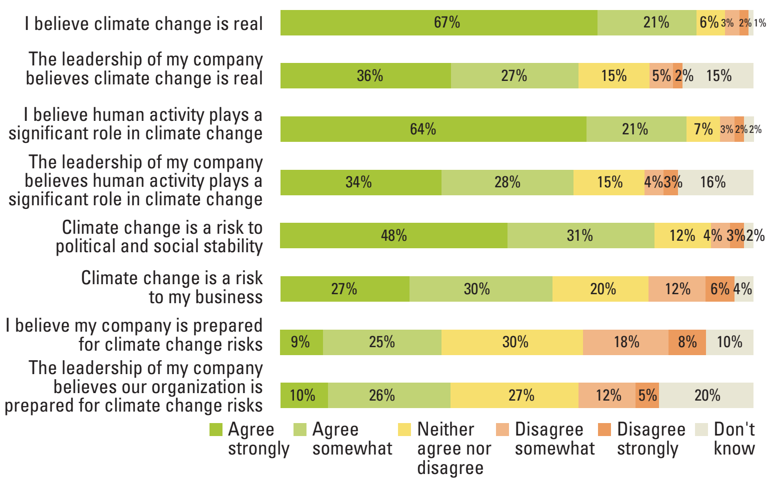
20. Please rank the economic issues you chose in order of priority, with 1 indicating the most significant



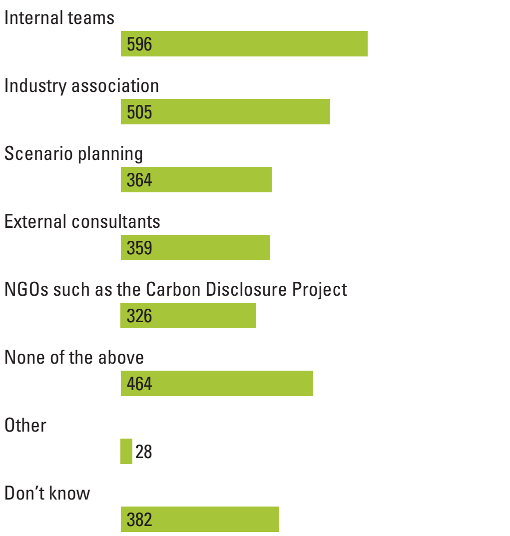
21. How urgent are climate change issues to your company?



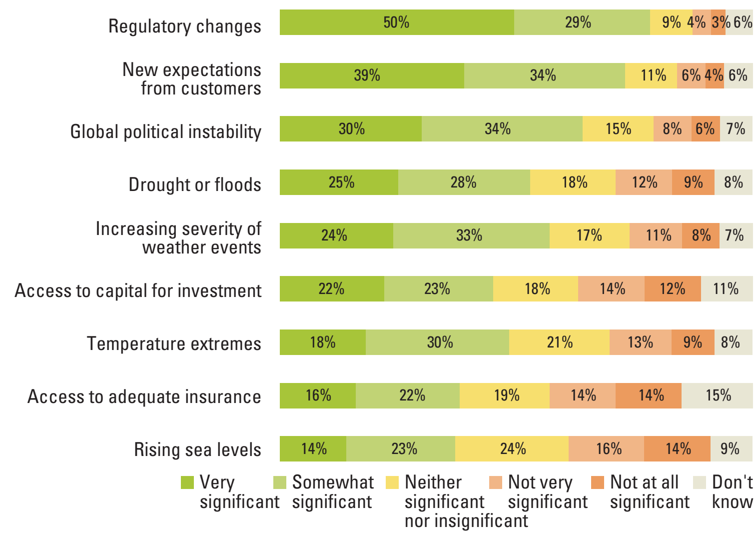
22. Please rate your agreement with the following statements



23. Which of the following is your company using to help assess climate change risk? (Please choose all that apply)

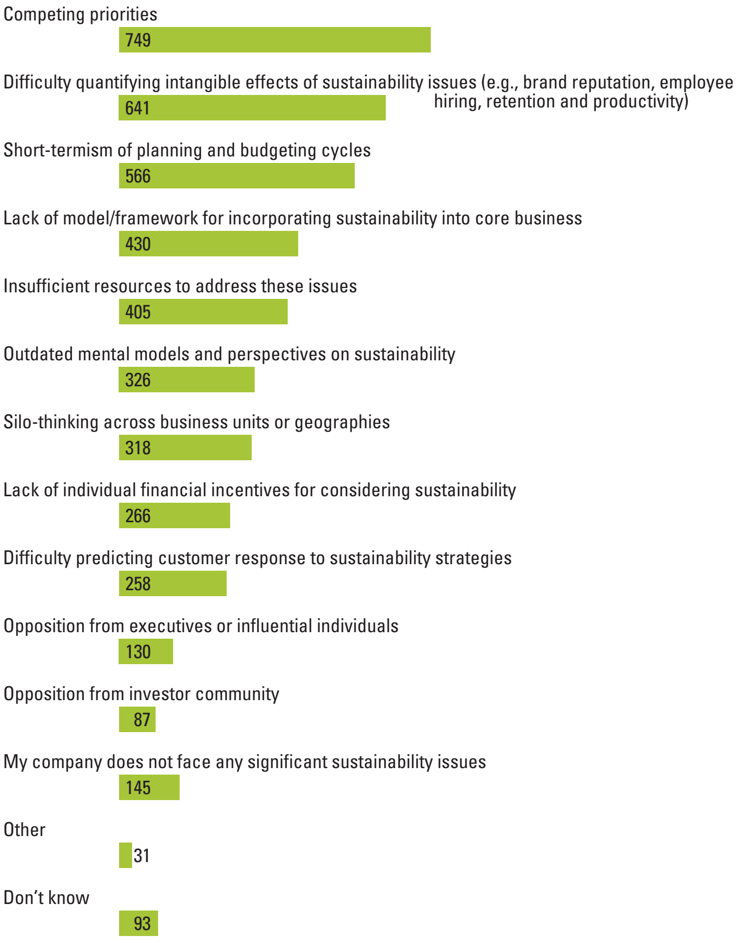


24. How significant are the following climate change-related risks to your business?



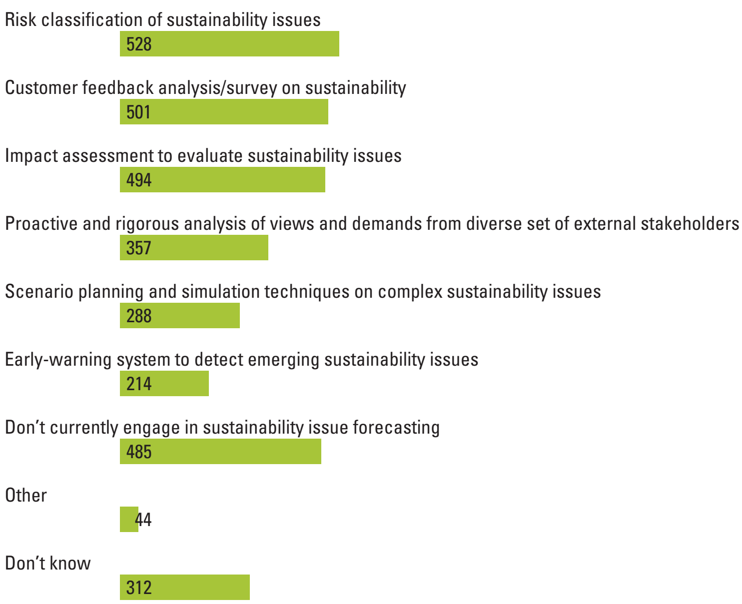
25. Which of the following does your company use to address its significant social, environmental, and economic issues? (Please choose all that apply)

26. What are the main obstacles to addressing significant social, environmental, and economic issues more robustly? (Choose up to 3)

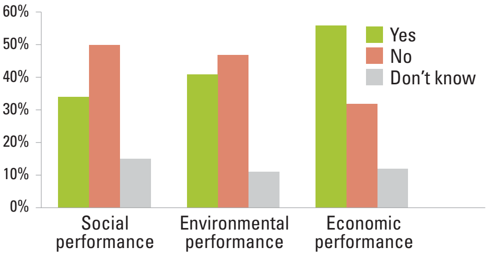


26. What are the main obstacles to addressing significant social, environmental, and economic issues more robustly? (Choose up to 3)

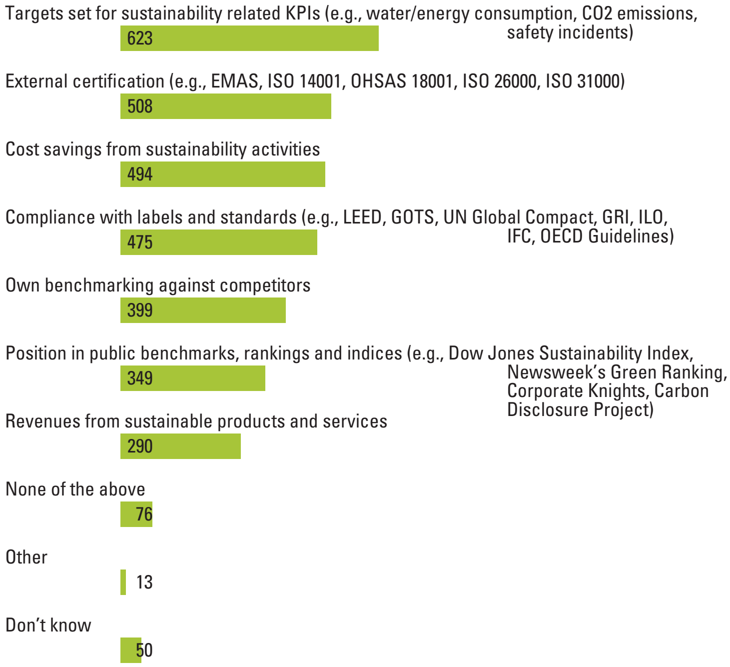
27. How does your company decide which sustainability issues are going to become significant? (Please choose all that apply)



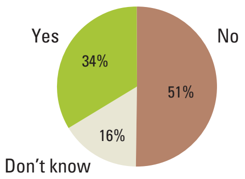
28. Does your company currently measure the effectiveness of your performance on sustainability issues?



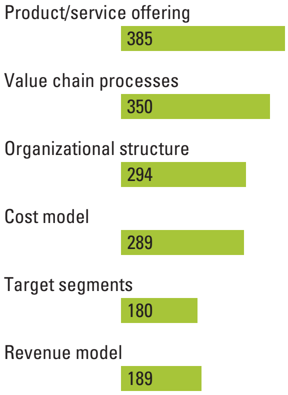
29. How does your company measure progress on these issues? (Please choose all that apply)



30. Has your business model changed as a result of addressing the sustainability issues which are most significant to your company?

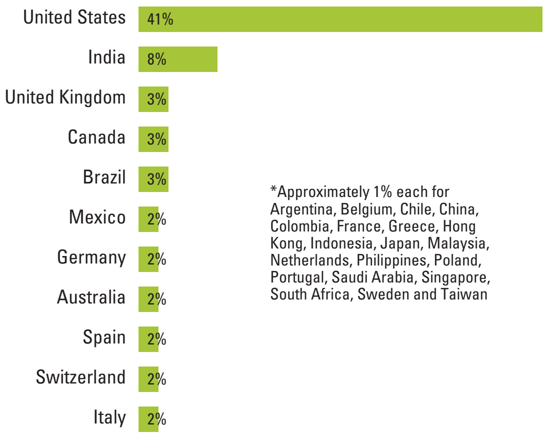


31. What business model elements has your company changed in connection with the material sustainability issues? (Please choose all that apply)



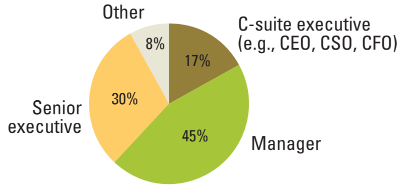
32. Which factors have led to changes in your business model? (Please choose all that apply)

D1. In which country do you currently reside?

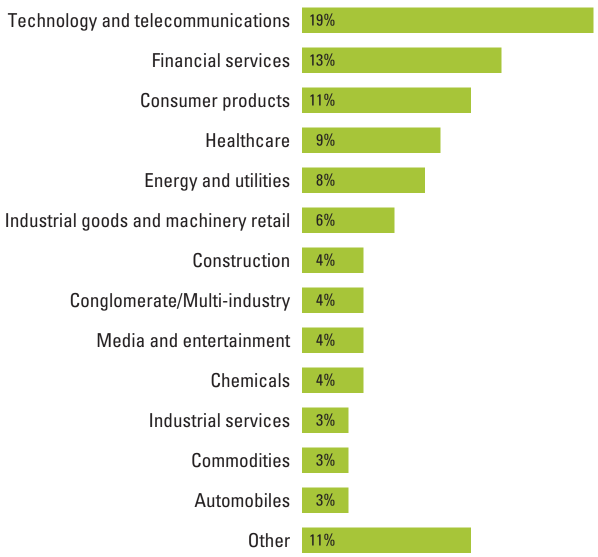


*Approximately 1% each for Argentina, Belgium, Chile, China, Colombia, France, Greece, Hong Kong, Indonesia, Japan, Malaysia, Netherlands, Philippines, Poland, Portugal, Saudi Arabia, Singapore, South Africa, Sweden and Taiwan

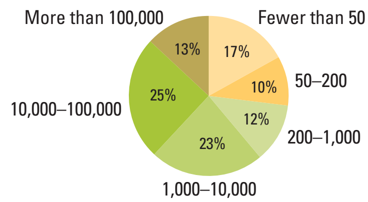
D2. Which of the following best describes your current position?



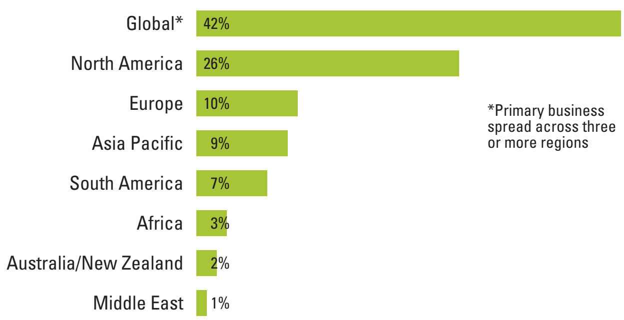
D3. Which of the following best describes your company's industry?



D4. What is your company's total headcount?



D5. In which region does your company primarily conduct business?



*Primary business spread across three or more regions

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