WINTER 2011 VOL.52 NO.2

MIT Sloan Management Review

By Knut Haanaes, Balu Balagopal, David Arthur, Ming Teck Kong, Ingrid Velken, Nina Kruschwitz and Michael S. Hopkins

First Look: The Second Annual Sustainability & Innovation Survey

REPRINT NUMBER 52213

WHO'S WORLD-CLASS? (AND WHAT'S DIFFERENT FROM LAST YEAR?)
This reputation "cloud" expresses the views of survey respondents about which companies are world-class at addressing sustainability. It's an argument starter. BP fell from 8th-ranked to 21st. Why not lower? Maybe managers are more understanding than others about the challenges of managing complex systems.

First Look: The Second Annual Sustainability & Innovation Survey

Is spending up or down? What does the C-suite think? Who's 'world-class?' More than 3,000 managers responded. Here is an early sample of what they said.

BY KNUT HAANAES, BALU BALAGOPAL, DAVID ARTHUR, MING TECK KONG, INGRID VELKEN, NINA KRUSCHWITZ AND MICHAEL S. HOPKINS

THE LEADING QUESTION
How are sustainability pressures changing management today?

FINDINGS

- **Businesses are increasing their investments and attention.**
- **A "two-speed" sustainability landscape is emerging, with a gap between "embracers" and non-embracers.**
- **The C-suite is increasingly on board, but not for environmental reasons.**

FROM A BUSINESS PERSPECTIVE (not to mention other perspectives), certain current events haven't treated sustainability kindly. Last year's much-publicized shortcomings of the climate talks in Copenhagen turned into this year's less-publicized replica in Cancun — leaving questions unanswered about the future regulatory and carbon-price landscape. And the global economy's "recovery" has been more halting than hoped, at least in the West.

All of which makes the findings of our second annual Sustainability & Innovation Global Executive Study — a collaboration between *MIT Sloan Management Review* and the Boston Consulting Group — more surprising than expected.

Two discoveries immediately stand out:

1. Despite the lingering weight of the downturn, businesses claim to have *increased* the management attention and investment they're committing to sustainability. In 2010, 59% of companies say they increased their commitment; only 3% decreased it and 34% reported "no change." What's more, in 2011 companies that plan to increase their investment rises to 68%, according to survey respondents asked about their strategic plans for the year ahead.

2. But the story is more complicated than that. More significant than the finding that business in general is aiming to capitalize on sustainability (even as governing bodies cannot) is the finding that when it comes to sustainability we are now entering a world with *two speeds*. Survey results show that a gap has grown between companies that embrace sustainability-driven strategy and management and companies that don't. Embracers define sustainability differently, prioritize activities differently and get different — and better — competitive results.

Signals pointing to this two-speed world appeared repeatedly during in-depth executive interviews that were part of the study. Small example: One energy company vice president described the sudden rise of sustainability-practice scrutiny by mainstream investment managers. One of the frameworks, the Goldman Sachs "Sustain" framework, is explicit.

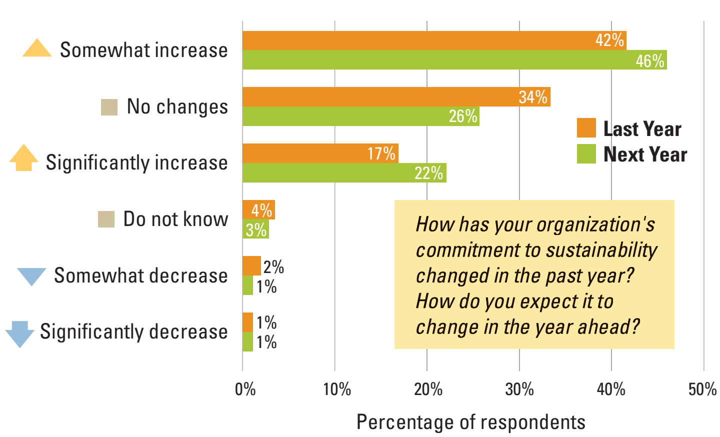
"The analyst industry is very competitive. They're always searching for predictors of company performance, and they're now looking at sustainability. They're acting on the assumption that our efficiency with resources, our employee retention — all of those sustainability measures — are predictors of overall business profitability."

Look for comprehensive analysis of these and other findings from the Sustainability & Innovation Study online at sloanreview.mit.edu in months ahead, culminating in a special report and, in the Spring *SMR*, a special issue. Meanwhile, this article describes some of the most interesting top-line data from the survey — which drew responses from more than 3,100 managers and executives, representing every major industry and region of the world. Where do they say sustainability fits on top management's agenda? What sustainability approaches correlate with top competitive performance? And what does the C-suite think?

Here, in charts and notes, is a first look at what this year's Sustainability & Innovation Study has begun to reveal.

Sustainability-Driven Spending — Up or Down?

Despite the effects of the financial crisis, a slow economy in much of the world and continuing inaction by political bodies, the level of business investment in sustainability activities has been steadily rising, and respondents expect their spending to grow further in the coming year.



More than half reported that they had either increased or *significantly* increased management attention and investment, and the trend is speeding up. The largest change projected for the coming year is in the category of organizations planning to "significantly increase" investments — which jumps by almost a third. Are these strategic intentions a reflection of deepening commitment to sustainability, or are they a broader sign that business spending in general is accelerating out of the downturn?

Results of other questions in the survey seem to confirm a growing sense that sustainability demands strategic attention. However, for most survey respondents this view is no more than a leap of faith. Only about one in three executives are able to say with any conviction that sustainability adds to profitability today.

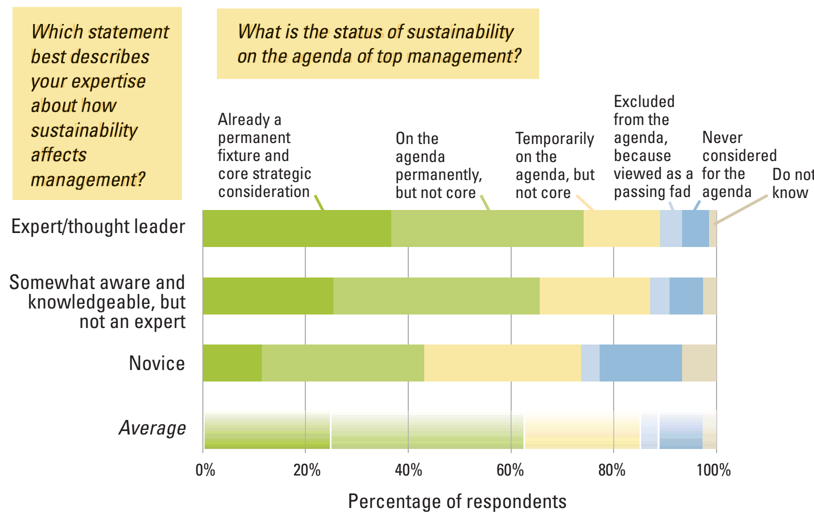
Sustainability and Top Management's Agenda — How Core? How Permanent? (And Who Says?)

What's the status of sustainability on the agenda of top management? The survey's answer is: It depends. The more an executive knows about sustainability's management implications, the more he or she is likely to judge them as key. Sustainability "experts" are more than two times as likely as sustainability "novices" to say that on the agenda of top management sustainability is "already a permanent fixture and core strategic consideration."

On average, though, the biggest cohort of respondents said they consider sustainability here to stay but not central. Only about a quarter of all respondents called it "permanent and core."

Cuts of the survey pool show several variances in how sustainability is assessed. Respondents at very large companies indicated sustainability was a much bigger concern than those at smaller companies.

Novices are by far the most likely respondents to say sustainability is a temporary concern or even that at their organizations it is "never considered for the agenda." In contrast, results throughout the survey suggest that for experts whose businesses have already begun acting on sustainability-driven strategies, sustainability is a sort of perpetual motion machine — the more they do, the more they learn, the more advantages they achieve, and the more they realize that there is more to do.



Some experts argue that this gap between "embracers" and "cautious adopters" presents a challenging and consequential question for CEOs. Does the divergence of opinion between experts and novices reflect a fundamental disagreement about sustainability's significance, or do those opinions simply illustrate how views naturally evolve as managers learn more? If the latter, then there are easy-to-spot educational solutions. If the former, it's harder to say how leaders can change the organization's cultural viewpoint.

Intangibles: Still Too Hard to Measure, Still Too Necessary Not to Count

As executive thought leaders frequently argued in Sustainability & Innovation Study interviews, it's possible that the biggest competitive benefits of sustainability strategies are intangible: employee engagement and productivity increase, talent is attracted, there are halo effects from increases in reputation among customers, investors or other stakeholders. But how well are companies measuring the costs and benefits of their sustainability efforts? And to what extent do executives include intangibles and other qualitative information in their decision-making processes?

According to our survey, most executives continue to struggle in this area, preferring to make decisions on the things they can quantify using traditional tools. The difficulty of quantifying costs and benefits of sustainability-related strategies and the difficulty of developing comprehensive metrics for assessing sustainability impacts are two of the most frequently cited obstacles for why it's so challenging to make the business case for sustainability.

As for the numbers, only one in five say they use intangibles or other qualitative factors in sustainability-related investment decisions; even fewer consider lower hurdle rates or longer payback periods for sustainability-related investments.

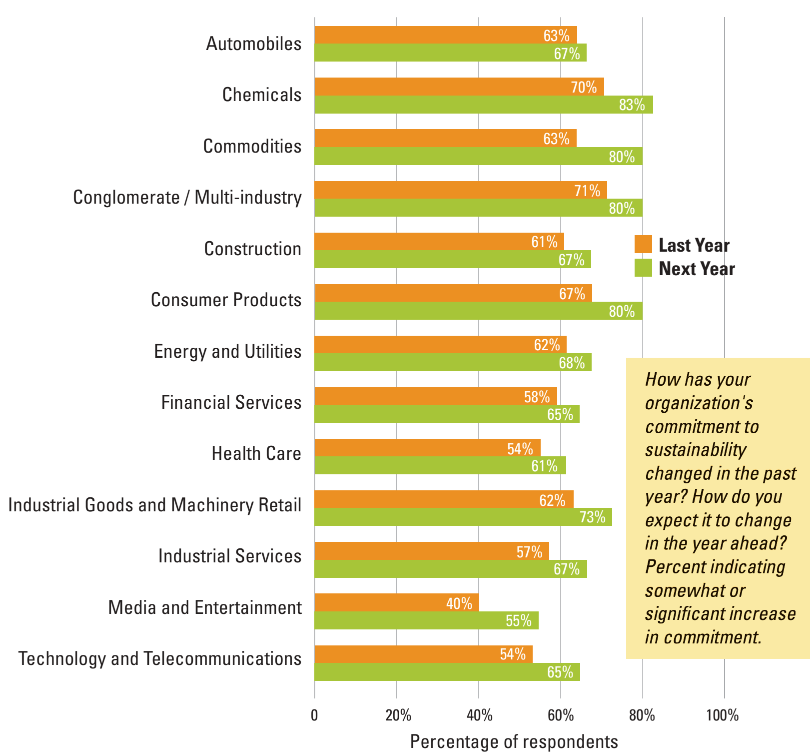
What's the Link Between Top Competitive Performance And Sustainability-Driven Management?

We can't yet answer the headlined question (correlation isn't causation), but it's provocative to consider the disparity that emerged between how top-performing companies and lower performers approach sustainability. Top performers are significantly stronger "embracers" of sustainability-driven strategies. Distinctions appeared in how they pursue efficiency gains and waste reductions within their operations; how they assess risk; how they view investor expectations; and where they see new opportunities. See the table below for a snapshot of top-performer characteristics revealed by the survey.

THE SUSTAINABILITY-RELATED HABITS OF TOP PERFORMERS

- They try to innovate more than others to achieve competitive differentiation.
- They place emphasis on the long term.
- They are far more convinced than other groups that sustainability-related actions lead to profitability.
- They quantify sustainability-related benefits across the board better than others.
- They assign managers to dedicated roles focused on sustainability.
- They rely on line leaders and non-leadership employees more than other companies to drive sustainability internally.
- They consider risk scenarios, intangibles and qualitative factors more formally than others.
- They are more confident about the business case for sustainability and see fewer implementation challenges.

Sustainability's Significance Varies Across Industries



A common refrain among executives interviewed for this study was, "Don't worry, you don't have to find sustainability; sustainability will find *you*." But sustainability "finds" some industries faster than others — often for reasons easy to understand.

There are industries for which sustainability is a mature concept. Data throughout the survey show those industries have a better understanding of the business case for sustainability investments and have already realized a competitive advantage from it. They have processes born of the core role sustainability is playing. Many of these early movers were chemical and resource-based companies, where sustainability began as risk mitigation and license-to-operate issues and later evolved into something more holistic.

Sometimes, though, an industry's maturation doesn't seem coherent. Automotive and consumer goods companies are the most likely to report competitive advantage as a benefit of sustainability, yet they are no more likely to have reported building a business case for sustainability than other industries.

What the C-suite Thinks (A Portrait in Pictures)

Sustainability looks different depending on where in a company's structure you're located. And it looks especially different if you're a C-level officer.

The Sustainability & Innovation Study examined the views of the C-suite across all dimensions of the survey, with sometimes unexpected results. Would you have thought C-suite executives, charged as they are with driving financial success, to be more interested in long-term considerations than either senior managers or lower-level managers and professionals?

These four charts identify interesting aspects of C-suite thinking. (See "Sustainability, the View from the Top.")

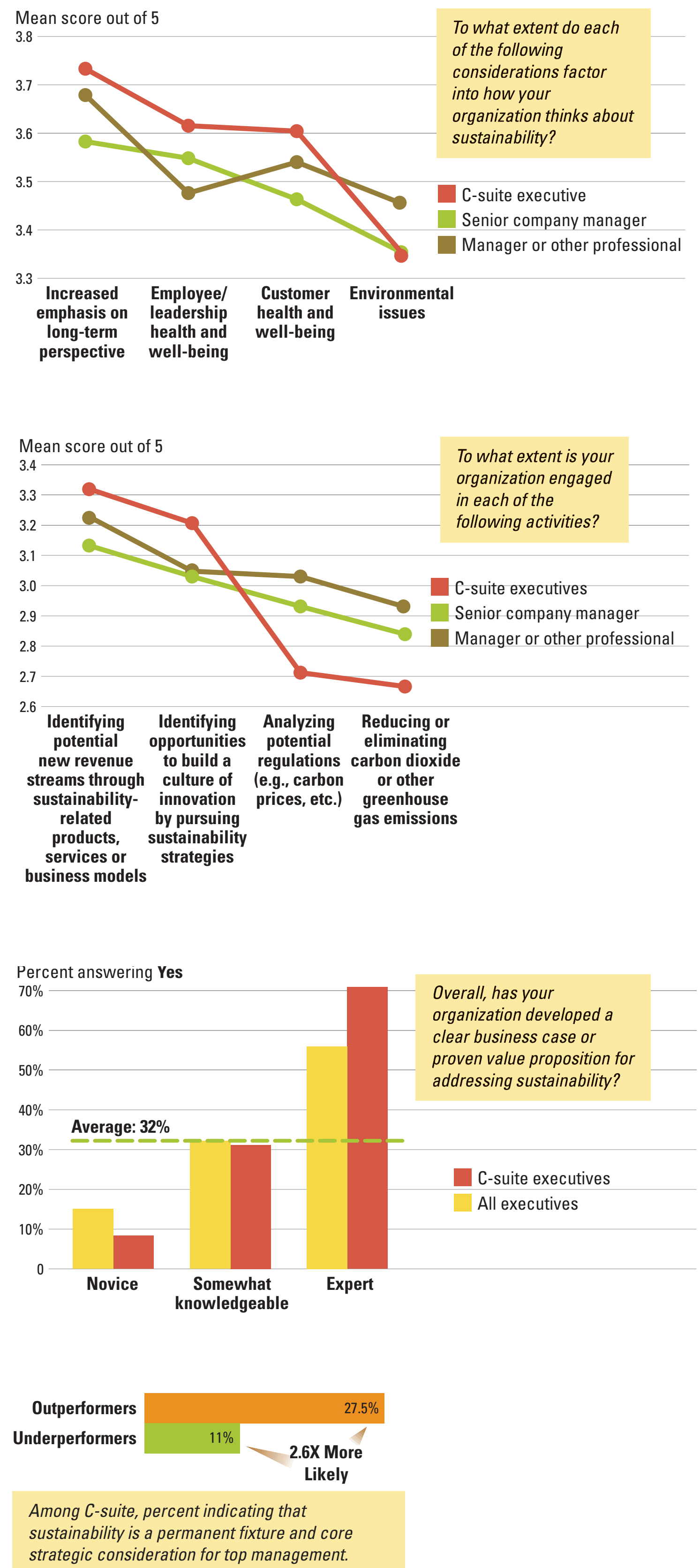
More emphasis on the long term. Two things are notable about the top chart. One is the variance between the weight the C-suite assigns to environmental issues and the weight it assigns to long-term considerations (particularly if employee and customer health and well-being are interpreted as long-term concerns). The other is that C-suite scores for the first three categories are consistently higher than those of the other managerial roles — suggesting larger valuation of sustainability's impact overall.

Innovation and opportunity, not environment. Consistent with the above, the C-suite rates greenhouse gas reduction and regulations analysis as low-emphasis activities, but ranks finding sustainability-driven new revenue opportunities and building an innovation culture as efforts worth high engagement. The focus on explicitly value-creating paths isn't surprising. The disregard for potential risk-producing outcomes is.

C-suite officers who are "experts" are most confident of business case. C-suite execs who are sustainability "experts" or from top-performing companies have been better able to get on top of the business-case challenge than almost any other category of survey respondents. Note how much wider the novice/expert gap is among C-suite occupants than it is among all executives.

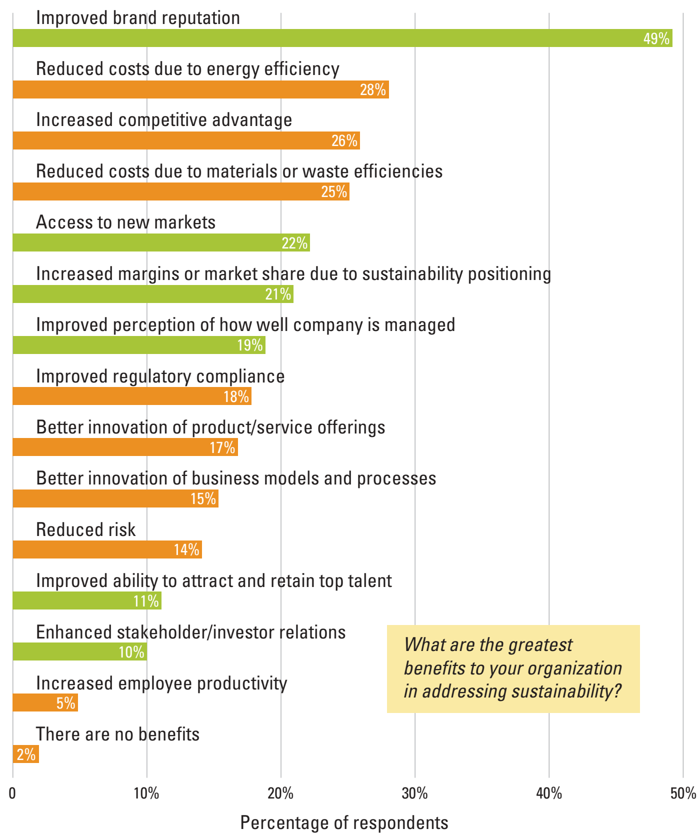
The better the company's performance, the more sustainability is core to agenda. In addition to being more likely to name sustainability as a core strategic agenda item, C-suite officers from top-performing businesses are more likely to say that sustainability strategies "added to profit."

SUSTAINABILITY, THE VIEW FROM THE TOP



Are Executives Misunderstanding the Sustainability Payoff?

Far and away, survey respondents named improved brand reputation the biggest win among potential sustainability benefits. Nearly half of the respondents ranked this as their number one benefit, and it ranked twice as high as the next most-valued benefit — cost savings from energy efficiency.



But interpretations vary regarding what that outlier "branding" result means. A cynical view: Sustainability-related branding is too often greenwashing, its reputational benefits a product of superior communications skills instead of superior sustainability performance or management. But you don't need to look further than the reputation "cloud" on the opening page of this article (browse the names) to be reminded how competitively useful a healthy sustainability brand can be.

But the survey also suggested that a stronger brand may be less its own reward than an umbrella concept covering a diverse set of related benefits that go beyond the normal parameters of brand. For example, companies with good reputations have a better chance of capturing several of the other, lower-ranked benefits on the surveyed list, such as successfully entering new markets, increasing margins or market share, and improving their ability to attract and retain top talent.

There are potential financial benefits as well. As noted in this article's opening, there's evidence that strong performance in sustainability is increasingly being viewed as a reliable indicator of overall management quality, which can lead to enhanced stakeholder and investor relations and, obviously, to higher valuations.

Executives interviewed for the Sustainability & Innovation Study argued that engagement with sustainability inevitably breeds an improved understanding of system effects. As sustainability engagement increases, companies recognize benefits ranging from the tangible (cost savings, access to capital, access to natural resources) to the more intangible (product and process innovation better relationships with suppliers, community and government and an enhanced ability to attract, engage and retain talent).

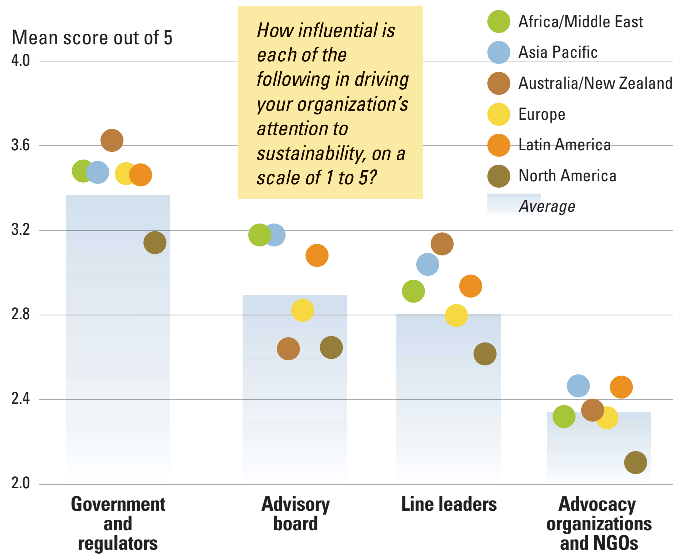
The "embracers" claim that increasing engagement and system awareness leads to increased clarity about choices. Options become less confusing. Uncertainty is diminished.

Who's Driving? Who's Determining How Aggressively Businesses Act on Sustainability Opportunities?

The push for greater sustainability is not coming from any single direction but from several at once. Survey respondents report that their own company's senior leaders are the top driver of action and organizational attention, but customer pressure is a close runner-up. Apparently, this applies to both consumer-oriented markets, where customers are demanding more sustainable offerings, and business-to-business, where companies are looking to build greener supply chains.

Not surprisingly, respondents say regulation also plays an important role in shaping their sustainability efforts, but here there are some noteworthy regional differences. The role of government is seen as strongest in Australia and New Zealand, followed closely by Latin America; in contrast, regulators in North America are seen as having appreciably less influence.

A similar picture emerges on the relative influence of advocacy groups and NGOs. Although the biggest companies (those with more than 100,000 employees) say advocacy groups play a bigger role than smaller companies do, outside groups seem to wield less influence in North America than in other regions. The highest performers and those who consider themselves experts also tend to pay more attention to what rank-and-file employees have to say than other groups.



Size Matters. But How? And Why?

Responses to questions throughout the survey suggest that big companies are more willing than smaller companies to be sustainability "embracers." It may be because they have more resources, more experience, or see themselves as having higher visibility or reputational risk if they *don't* exhibit a sustainability strategy. It could be defense more than offense.

In some cases, however, big companies are playing offense. They act on opportunities to bring about changes that extend beyond their own organization to the broader supply chain (as Wal-Mart has famously done by setting new standards for its suppliers). The biggest companies (those with more than 100,000 employees) are more convinced that sustainability-driven efforts add to profitability; they are heavily focused on key environmental issues, particularly reducing carbon dioxide, other greenhouse gases and waste.

What's more, big global companies are far more likely to have accepted sustainability as a permanent part of the business landscape and a fixture on the management agenda. This acceptance of the need to push forward is displayed in a variety of ways. Big companies are more likely to have managers in central staff roles dedicated to driving sustainability programs throughout the organization. The biggest companies are almost twice as likely as small companies to say they have proven the business case for sustainability. Although they say they do more than others to quantify the benefits, they also are more inclined to consider intangibles and qualitative factors when making decisions, or to allow longer payback periods on investments.

Smaller businesses, on the other hand, have a few concentrated sustainability-related advantages, the survey suggests, and on average they plan to invest more money and management time in sustainability-driven strategies next year than they have in past years. Their speed and flexibility enables them to capitalize on two principal opportunities: improved brand reputation and sustainability-enabled access to new markets. The smallest organizations, in fact, may have the greatest opportunity to base an entire culture on sustainability-related positioning, potentially gaining outsized recognition and market presence.

__Knut Haanaes__ is a partner in the Oslo office of The Boston Consulting Group, and is global leader of BCG's sustainability initiative. __Balu Balagopal__ is a senior partner and managing director in BCG's Houston office. __David Arthur__ is a consultant in BCG's Oslo office. __Ming Teck Kong__ is a project leader in BCG's Singapore office. __Ingrid Velken__ is a consultant in BCG's Oslo office. __Nina Kruschwitz__ is sustainability editor of MIT Sloan Management Review. ***Michael S. Hopkins** is editor-in-chief of* MIT Sloan Management Review*. For more about Sustainability & Innovation, visit sloanreview.mit.edu/sustainability. Further results from the Sustainability & Innovation Global Executive Study will appear in coming months.*