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Understanding SUSTAINABILITY

How companies manage sustainability: McKinsey Global Survey results

Most companies are not actively managing sustainability, even though executives think it's important to a variety of corporate activities. Those that do are reaping benefits for themselves and for society.

More than 50 percent of executives consider sustainability—the management of environmental, social, and governance issues—"very" or "extremely" important in a wide range of areas, including new-product development, reputation building, and overall corporate strategy, according to the latest McKinsey survey.1 Yet companies are not taking a proactive approach to managing sustainability: only around 30 percent of executives say their companies actively seek opportunities to invest in sustainability or embed it in their business practices, for example.

This survey explored how companies define sustainability, how they manage it, why they engage in activities related to sustainability, and how they assess as well as communicate this engagement.

Companies are defined as being most engaged with sustainability if their executives say that sustainability is a top-three priority in their CEOs' agendas, that it is formally embedded in business practices, and that their companies are "extremely" or "very effective" at managing it.[2] These companies are much likelier than others to reap value in the form of reputation building, cost savings, and growth opportunities. Energy companies, not surprisingly, also take a more active approach.

Notes

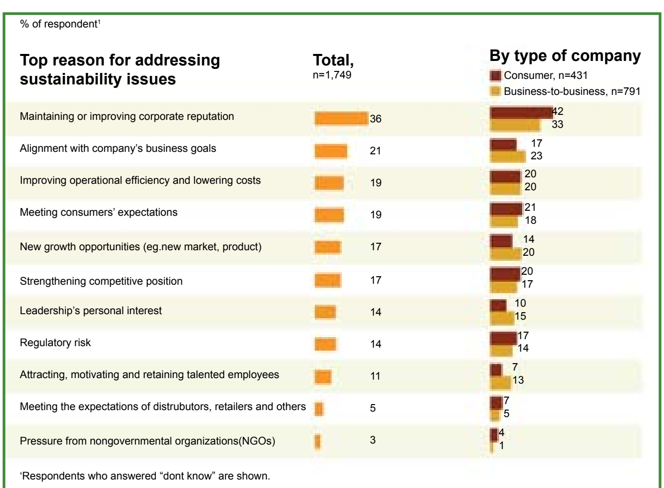
- 1. The survey was conducted in February 2010 and received responses from 1,946 executives representing a wide range of industries and regions.
- Energy companies, which are overall more engaged in sustainability activities than are companies in other industries (likely as a result of potential regula tion and natural-resource constraints), were excluded from this group.

Why companies engage in sustainability

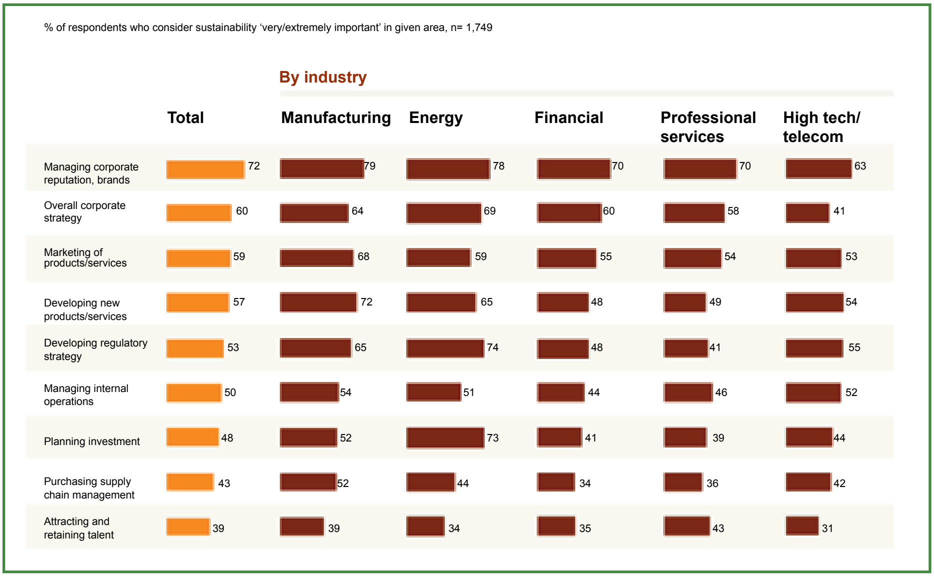
One potential reason so many companies don't actively address sustainability despite the attention paid to it by the media and some consumers and investors is that many have no clear definition of it. Overall, 20 percent of executives say their companies don't. Among those that do, the definition varies: 55 percent define sustainability as the management of issues related to the environment (for example, greenhouse gas emissions, energy efficiency, waste management, green-product development, and water conservation). In addition, 48 percent say it includes the management of governance issues (such as complying with regulations, maintaining ethical practices, and meeting accepted industry standards), and 41 percent say it includes the management of social issues (for instance, working conditions and labor standards). Fifty-six percent of all the respondents define sustainability in two or more ways.

Executives in business-to-business companies are likelier than their counterparts in consumer-facing companies to seek new growth opportunities through sustainability activities (20 percent, versus 14 percent).

Even with this range of definitions, most respondents see sustainability as creating real value: 76 percent of executives say sustainability contributes positively to shareholder value in the long term, and 50 percent see short-term value creation.
The difference in views on short- and long-term value creation may be explained in part by the fact that building reputation is in a class of its own when compared with other, more immediately financial reasons for engagement such as alignment with the company's business goals or improving operational efficiency. Indeed, 72 percent of respondents say considering sustainability is "extremely" or "very important" for managing corporate reputation and brands. In addition, 55 percent agree that investment in sustainability helps their companies build reputation, and 36 percent see building reputation as a top reason for addressing sustainability issues (Exhibit 1).



Given that reasoning, it makes sense that most respondents report their companies incorporate sustainability in reputation-building efforts. But companies consider sustainability in a



wide range of other business activities as well (Exhibit 2). Around 60 percent consider sustainability important to overall corporate strategy, for example.
Given sustainability's importance, it's surprising that only 27 percent of respondents say their CEOs or other C-level executives run their companies' sustainability initiatives on a day-to-day basis.3 Thirty-one percent say business units or functional managers take on this responsibility, and 25 percent say their corporate social responsibility departments do so.

Notes

- Also surprising, 11 percent of respondents say "no one" coordinates initiatives on a daily basis, and 5 percent are unsure.

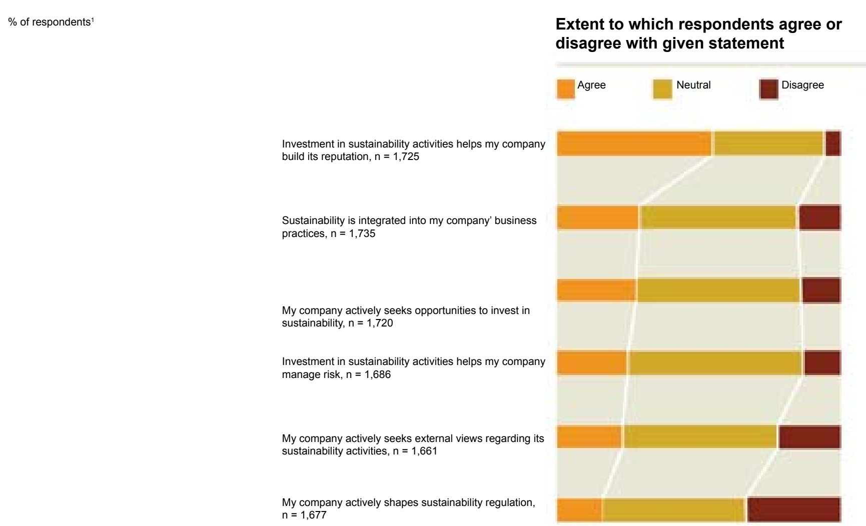
Uneven management efforts

Despite sustainability's importance to various corporate activities, only a quarter of executives say it's a top-three priority on their CEOs' agendas. The lack of weight in leadership's top agenda shows in the relatively small number of activities companies actually pursue related to sustainability: only 28 percent agree that their companies actively seek opportunities to invest in sustainability, 29 percent indicate that sustainability is integrated into their companies' business practices, and a mere 16 percent say their companies actively shape relevant regulation (Exhibit 3).

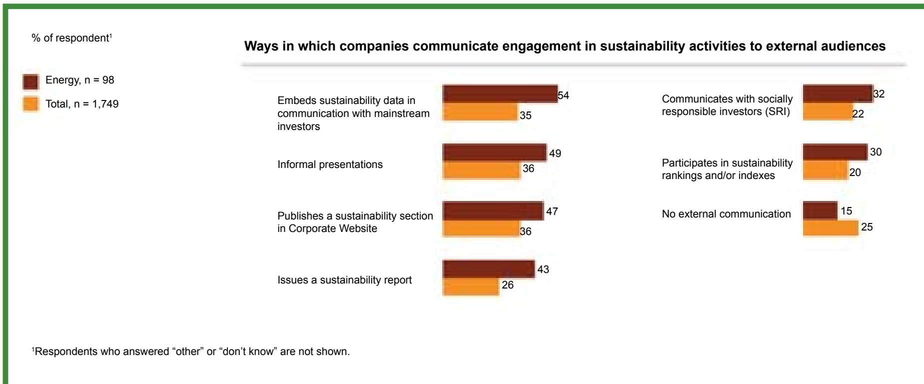
Companies where sustainability is a top-three priority on the CEOs' agendas

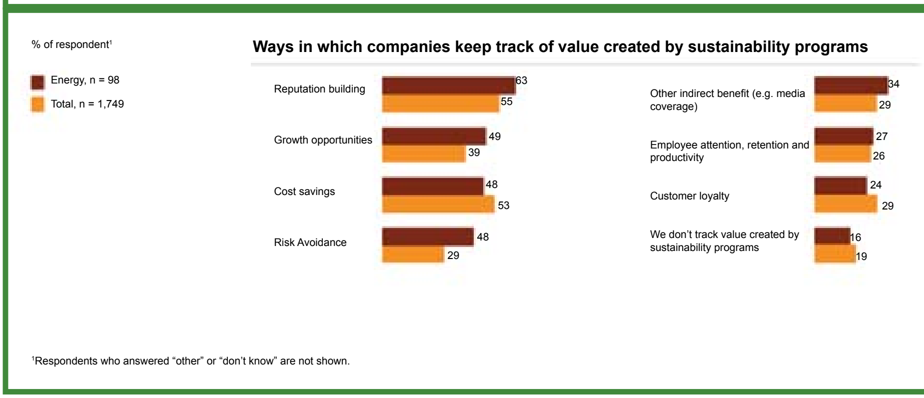
are likelier to pursue sustainability due to alignment with business goals (38 percent) than for building reputation (27 percent).
By contrast, senior executives in the energy industry take an active approach to managing sustainability, likely because of the potential for regulation and increasing natural-resource constraints. Indeed, 10 percent of energy executives say addressing sustainability is the top priority on their CEOs' agendas (versus 3 percent overall), and 31 percent say it's a top-three priority (versus 22 percent overall). Further, energy executives are much likelier than others to be active in seeking opportunities to invest in sustainability (40 percent versus 28 percent), to integrate it into their companies' business practices (43 percent versus 29 percent), and to shape regulation actively (29 percent versus 16 percent).

Except among energy companies, reporting practices are relatively poor, considering the impact executives say sustainability has on business. Particularly in light of the role of sustainability in reputation-building efforts, for example, it's surprising that companies do not take an active approach in communicating their initiatives externally (Exhibit 4). Indeed, 62 percent of respondents say their companies do not report sustainability metrics to investors or are unaware of their companies' sustainability-reporting practices—even though more than 50 percent keep track of the value created by sustainability in terms of reputation building and cost savings (Exhibit 5).



[1]Excludes respondents who answered "don't know"; figures may not sum to 100%, because of rounding.



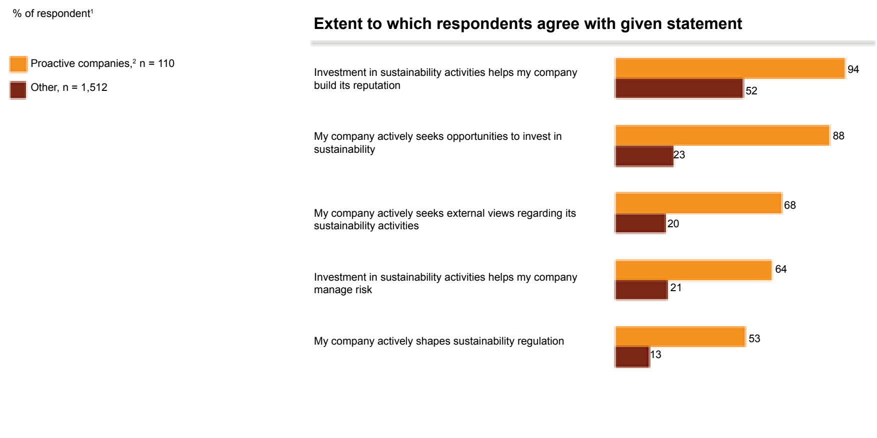


The picture is again different for energy executives: 74 percent of energy executives incorporate sustainability when developing their companies' regulatory strategies, compared with 53 percent of respondents overall. Similarly, 54 percent of respondents in the energy industry say their companies embed sustainability data in communications with investors, compared with 35 percent overall.

What the proactive do differently

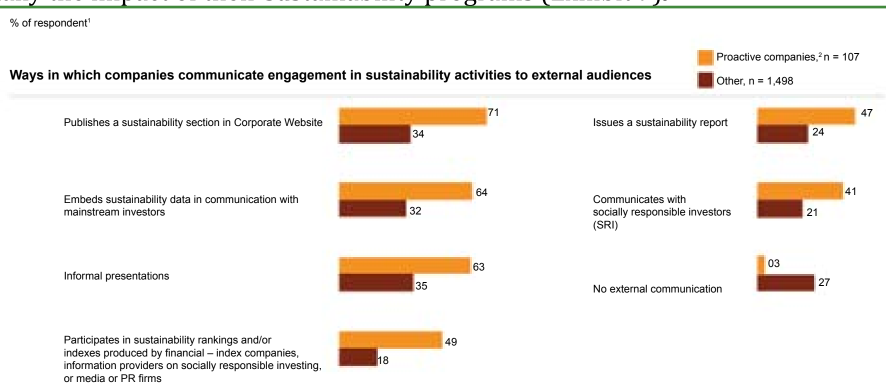
Just over 6 percent of executives say that sustainability is a top-three priority in their CEOs' agendas, that it is formally embedded in business practices, and that their companies are "extremely" or "very effective" at managing it. These engaged companies actively seek opportunities to invest in sustainability: 88 percent of the respondents in this group say so, compared with 23 percent of all others (Exhibit 6). Further, a strong majority consider sustainability important in a wide range of areas: developing and marketing products and services, planning investments, managing internal operations, developing regulatory strategy, managing corporate reputation and brands, and overall corporate strategy.

Other findings indicate how much sustainability is a part of the fabric of these companies. Their executives, for instance, are more aware than executives at other companies of the metrics their companies track. For example, 84 percent of respondents at engaged companies are aware of whether their companies measure their carbon footprint, compared with 40 percent of respondents at less engaged companies. More importantly, among the group that is aware of what's being tracked, the engaged companies are far more likely to be tracking relevant sustainability indicators such as waste, energy and water use, and labor standards for their suppliers and consumers.



[1]Exclusive energy executives
[2]Companies where executives say sustainability is a top-3 priority in their CEOs' agendas, formally embedded in business practices, and their companies are "extremely/veryeffective" at managing it.

In addition, these engaged companies do more than others to communicate externally the impact of their sustainability programs (Exhibit 7).



[1]Exclusive energy executives; respondents who answered "other" or "don't know" are not shown.
[2]Companies where executives say sustainability is a top-3 priority in their CEOs' agendas, formally embedded in business practices, and their companies are "extremely/veryeffective" at managing it.

Dealing with regulation

Regulation, particularly environmental regulation, can have a very strong effect on companies' sustainability activities. However, only about 35 percent of executives say their companies have quantified the potential impact of environmental and social regulation on their businesses; only 40 percent feel prepared to deal with regulation in the next three to five years and are personally confident about handling climate change issues.

Failure to reach an agreement in the recent Copenhagen UN Climate Change Conference was seen by respondents to this survey as twice as likely to increase uncertainty (30 percent) related to climate change regulation as to decrease it (15 percent); 55 percent say they saw no difference. And while 53 percent say the talks had no direct effect on their companies' sustainability strategies, many expect to collaborate more with some group as a result of the failure to reach an agreement. Indeed, 19 percent of the respondents say they are now planning to work with more partners such as nongovernmental organizations (NGOs) and other companies, and another 12 percent say they plan to work more with government.

Looking ahead

- Seventy-six percent of executives say engaging in sustainability contributes positively to shareholder value in the long term. Companies that manage sus tainability proactively are much likelier to seek and find value creation oppor tunities.
- Companies where sustainability is a top item in their CEOs' agendas are twice as likely as others to integrate sustainability into their companies' business practices. This suggests that senior executives who want to reap the benefits of incorporating sustainability into their companies' overall strategies must take an active role in the effort.
- A first step to gain recognition and improve the impact of sustainability activi ties could be to communicate better with investors and other stakeholders.

About the Authors

Contributors to the development and analysis of this survey include Sheila Bonini, a consultant in McKinsey's Silicon Valley office, Stephan Görner, a principal in the Sydney office, and Alissa Jones, a consultant in the Copenhagen office. They would like to acknowledge the contributions of their colleague Michaela Ballek.

Sustainable Marketing: Why it matters

1. What is sustainable marketing?

Sustainable marketing is both a challenge and an opportunity. Customers and society want more than just product and service performance, they want it with a conscience. Increasingly they want to know what all the impacts of your product and services are- what is the impact of making and using them, on health, people, environment? And what happens when a product's useful life is over, can it be recycled, reused, will it pollute? This includes consumables you use to provide your service.

2. Is it new?

Yes and no. Many companies are already taking some useful steps e.g. good employment practices, supporting the local community, reducing environmental impact. But doing a bit is not enough. A few trees planted or a few thousand to charity is just lip service if your products, services and business operations are part of the problem in the first place. In most cases that means some fundamental rethinking about how you operate.

3. Why should I care?

Society, consumers and legislators are all taking more interest and action in this area, so there are both market opportunities and risks. Increasingly, a company's footprint on society is bound up with its license to operate. Government measures are changing market behaviour, taxing company cars which emit more carbon dioxide for example has transformed the buying behaviour of car fleet managers, while the introduction of landfill tax is changing attitudes to waste. Another trend is to place responsibility on producers to take back their products. Consumers are more willing to discriminate in their purchases. At the very least you need to manage the risks. Better still focus on the opportunities.

4. Opportunities

Brand value and reputation
A responsible approach to business can enhance brand value. The average reputation score for those companies with an expressed commitment to business ethics was between 4.7 and 6.7% higher than the score for the group without such a commitment.[2]

[2]Verschoor, C.: A Study of the Link Between a Corporation's Financial Performance and its Ethics, Business and Society, (1998), based on Fortune's 100 Most Admired Companies" list

Increased profitability and loyalty

Leadership in this area can create powerful brand differentiation and loyalty leading to increased profits. The Cooperative Bank for example has calculated that c. 20% of its profits come from its ethical and ecological positioning. [3]

But it's not just the leaders who are seeing benefits. 30%of people bought a product because of a link to a charitable product while 28% had boycotted a company's product on ethical grounds.[4]

Electrolux's Green Range of white goods that have a lower environmental impact achieved a 3.5% higher gross margin than the company's standard range.[5]

A growing market – not yet being effectively reached.

Conservative estimates suggest overtly ethical products in 1999-2000 were worth

well over £1.3 billion. Although market share is still small many of these are growing fast. The UK organic market has increased rapidly over recent years with growth rates of 30 to 50% per annum.6 Yeo Valley organic foods for example was the fourth fastest growing brand in the UK with sales of £25 million (A.C. Neilsen The Biggest Brands Report'). Sales of fairly traded coffee have been growing at about 9% a year in a fairly static market.7 The global market for wind power has been growing at over 40% year on year for the past 10 years from around 300MW of installed capacity in the early 1990s, to around 4.5 gigawatts by last year.[8]

The 30:3 syndrome: 30 % of consumers regularly claim to be concerned about companies' social and environmental records, but currently 'ethical ' products typically attract 3% market share. The gap presents a real opportunity for innovative and effective marketing.

What do the customers think?

42% of people think companies should be wholly or partially responsible for solving social problems[9]
49% of consumers take some note of green aspects when buying [10]
2/3 of 'alpha class' (high education/income) customers have considered switching brands because of corporate social responsibility issues.
Some of the most concerned consumers are also affluent. See section D) Who are the
sustainable consumers? for more information on consumer attitudes.

5. Time for action

Talk to your colleagues managing environment and sustainability. Undertake an audit. What are the main social and environmental impacts of your products and services? How do they matter to your customers? Which ones would interest your customers? How easily can you communicate them?

[3]Our impact, Partnership Report 2001 The Cooperative Bank

[4]MORI survey quoted by Sue Adkins in Cause Related Marketing- who cares wins (1999) Butterworth Oxford UK

[5]Hedstrom,G, Shopley J and LeDuc C Realising the Sustainable Development Premium (2000) Arthur D Little

[6]Sales in 2000-2001 amounted to £802 million, up by 33% on the previous year. 2001-2002 sales are predicted to be up a further 20% to over £950 million Source: http://www.defra.gov.uk/farm/organic/actionplan/prospects.htm

[7]Who are the Ethical Consumers? Roger Cowe and Simon Williams (2000) Published by the Cooperative Bank

[8]In the first six months of 2001 Vestas, the Danish Wind Turbine company and its associates delivered 995MW - 75% more than it did in the same period of 2000. source: HSToday: COMPANY FOCUS

[9]Simon Zadek, Doing Good and Doing Well: Making the Business Case for Corporate Citizenship, (November 2000) Conference Board

[10]Quoted in in Marketing and sustainability p7 by Martin Charter, Ken Peattie, Jacqueline Ottman and Michael J. Polonsky. (April 2002). Published by Centre for Business Relationships, Accountability, Sustainability and Society (BRASS), in association with The Centre for Sustainable Design. Or see: http://www.cfsd.org.uk/smartknow-net/smart-know-net.pdf

Sustainable Marketing: Some practical lessons

1. Introduction

At first glance some might argue that sustainability and marketing are incompatible. Some associate marketing with ever growing consumption, with creating desire for unnecessary things, and cynics might say with built in obsolescence, limited durability and endless product and service extensions that keep people coming back for more. Sustainability on the other hand is about consuming less, about making more with less, better and for longer. It is also about the 'world behind the product'.

First impressions are not always accurate. Sustainability and marketing have much to offer each other. Marketing has the ability to understand customer expectations, behaviours and patterns and to influence them by persuasive communication and to influence product sourcing, design and packaging.
Marketing deals not just with individuals but with businesses, government and distributors. Sustainability offers marketers new opportunities: the potential to build reputation and brand value; outstanding loyalty; meaningful differentiation

and an impetus for radical innovation.

Sustainable marketing is still a new area; there are still relatively few experiences and extensive case studies to draw on. Nor is it an area without risk. Companies claiming sustainable credentials may find themselves under even more exacting scrutiny and vulnerable to charges of green-wash or hypocrisy if found wanting. Nor is a sustainable marketing strategy a magic bullet. It is still necessary to do the usual marketing homework of understanding the customer. Feel good claims will not overcome ineffective or overpriced products.

This short briefing pulls out some key points from a brief survey of articles and case studies and seeks to identify key learning points for sustainable marketing. See Resources section at end for further information.

2. Key sustainability marketing lessons

Understand the full impact your product or service is having throughout its lifecycle, socially, economically and environmentally.
What is the impact of sourcing the raw material and making the product? What is the impact on communities within the company's supply chain? How is the product used, what energy is used, does it have social consequences. How is it disposed of – can it be reused, does it pollute? Focus on the areas of greatest impact.

Integration and coherence is crucial.
Customers will look not only at individual products and services but also at the performance of the organisation as a whole. Brand values and broader organisational behaviour act as shorthand to support buying decisions

Performance, quality, price and convenience still matter.
Sustainability criteria differentiate.

Stress the benefits for customers and make things easy for them
remembering that these customers like any others will fall into different segments motivated by different attributes, lifestyle choices and cultural/ethical make-up.

Ensure your marketing effort is credible.
Make meaningful claims, don't overplay insignificant features or assume tweaking one or two aspects make a product or service sustainable.

Engage stakeholders.
They can bring important perspectives on your performance. Credible third party endorsement is more powerful than claims you make yourself.

Be proactive, demonstrate leadership.
Identify problems and deal with them, don't wait for others to prompt you. This builds credibility. You may need to help educate the customer.

Think differently.
To rise to the sustainability challenge you need to rethink how stakeholder needs are met. Rethink the value your product or service provides. What is the underlying need and how can it be met more sustainably, with less impact. Is a product needed? Think of your product or service as part of a system - what part does it play? How can you move from making a negative impact to making a positive one? Key characteristics: durable, non toxic, non exploitative, minimally packaged, reusable. Key trends 'dematerialising', from products to services; from creating social

and environmental damage to enhancing value.

3. Avoiding pitfalls

- Jacqui Ottman provides the following advice on avoiding a backlash:
- Ensure you position individual initiatives as part of a corporate programme
- Promote responsible consumption
- Consider the environmental impact of your marketing methods
- Use meaningful claims
- Be specific and prominent
- Provide complete information
- Do not overstate
- Enlist the support of third parties
- Consider eco labels –but be aware of risks here too

4. Case studies

Not surprisingly given the emphasis on not just talking sustainability but being sustainable, the case studies that most exemplify these points tend to be of 15 companies whose approach to sustainability is a core part of their positioning and strategy.

Who are the sustainable consumers?
Our understanding of customer behaviour on ethical and sustainable development grounds is still evolving. Particularly useful is groundbreaking research by Roger

Cowe and Simon Williams.11 They classified UK consumers by their use of 'ethical' criteria. Cowe and Williams propose the following segmentation.

'Do what I can' 49%

This most substantial segment tends to be older. They have ethical concerns but don't hold them very strongly. Service, convenience and brand name are most important to them. Their ethical concerns focus on treatment of employees.

'Look after my own' 22%

This is the segment least concerned with social, ethical or environmental concerns.

'Conscientious consumers' 18%

More upmarket than the first two segments. More likely to be car owners home-owners and shareholders. Quality is more important to them than brand, so if quality and price are removed then ethical considerations influence their decisions. They will buy or avoid products because of company reputations.

'Global watchdogs' 5%

This is the most concerned segment and most likely to act on their concerns. They are also the most affluent with 10% having a household income of over £40,000 a year. They are typically 35-55 and professionals. They actively seek information on ethical considerations, with brand unimportant to them.

'Brand generation' 6%

Many of this group are young. They are concerned with ethical issues and talk about them to their friends, but when shopping, brand names quality and value for money are most important. Their sustainability concerns focus on treatment of employees and environmental impact. They could be described as the Nike generation influenced by the publicity over sourcing practices.

The 'Global watchdogs' segment is the one with the most obvious potential but the other segments offer opportunities too, notably the conscientious consumer and the Brand generation.

In the US Roper Starch World-wide12 has identified five segments of customers with varying degrees of concern and action:

True blue green 11% major green purchasers and recyclers

Greenback Greens 5% will buy or give green but won't make significant lifestyle changes

Sprouts 33% who care but would only spend a little more to buy green

Grousers 18% see the environment as a problem but somebody else's

Basic Browns 31% essentially don't care won't care

Research by Weber Shandwick Worldwide13 demonstrates the potential of social responsibility issues such as environmental or employment policies, to cause 'Brand switching'. A survey of 8000 customers worldwide suggested that two thirds of all 'alpha class' (high education/high income) customers have considered switching brands because of corporate social responsibility issues.

A study by Pulse™/UNEP study14 sought to gain a better insight into how young people view Sustainable Consumption. The research took place in 28 countries across Europe, Asia Pacific, South and North America. The study found general confusion regarding the terminology 'Sustainable Consumption', but found that young people have strong concerns about three sustainability related issues: the protection of the environment, animal testing and human exploitation in developing countries. The study suggests that young people want to 'Have it All'. They are both hedonists and idealists, they want a sustainable planet and their favourite brands. This is the 'use and throw' generation, but at the same time, they have dreams of a private and wonderful world. They are not yet aware of the consequences of their own shopping behaviour. There is a feeling that they are 'unable to change the world'. Yet they want the world to change.

[11]Who are the Ethical Consumers? Roger Cowe and Simon Williams. (2000) Published by the Cooperative Bank

[12]Quoted in Marketing and sustainability p7 by Martin Charter, Ken Peattie, Jacqueline Ottman and Michael J. Polonsky Published by Centre for Business Relationships, Accountability, Sustainability and Society (BRASS), in association with The Centre for Sustainable Design, April 2002. Or seehttp://www.cfsd.org.uk/smart-knownet/smart-know-net.pdf

[13]Quoted in "Can Sustainability Sell?' (2002) McCann-Erickson / UNEP. Also at:http://www.uneptie.org/pc/sustain/reports/advertising/can-sustainability-Sell .pdf

[14]Pulse UNEP study quoted in "Can Sustainability Sell?' (2002) McCann-Erickson / UNEP Also at: http://www.uneptie.org/pc/sustain/reports/advertising/can-sustainability-Sell .pdf

[15]Examples of UNEP trend studies are "The Global Consumer Class" and "Is the Future Yours?" can be found on UNEP's website:http://www.uneptie.org/sustain

[16]Business Ethics and Company Codes, Simon Webley, (2001) Institute of Business Ethics

[17] Who are the Ethical Consumers? Roger Cowe and Simon Williams. (2000) Published by the Cooperative Bank

[18]Who are the Ethical Consumers? Roger Cowe and Simon Williams. (2000) Published by the Cooperative Bank

[19]Quoted in "Can Sustainability Sell?' McCann-Erickson / UNEP2002Pulse UNEP study

[20]Business Ethics and Company Codes, Simon Webley, Institute of Business Ethics (2001)

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