

Sustainability & Resource Productivity Practice

# The business of sustainability: Putting it into practice

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Companies should integrate environmental, social, and governance issues into their business model—and act on them.

**Sustainability has long been** on the agenda at many companies, but for decades their environmental, social, and governance activities have been disconnected from core strategy. Most still take a fragmented, reactive approach—launching ad hoc initiatives to enhance their “green” credentials, to comply with regulations, or to deal with emergencies—rather than treating sustainability as an issue with a direct impact on business results.<sup>1</sup>

That’s no longer enough. Material risks not only to a company’s reputation but also to the bottom line come from many, often unpredictable directions in an era of constrained resources and tighter regulatory requirements, as well as growing demand for sustainable products and services, good corporate governance, and social responsibility. Where such challenges arise, opportunities also lie: McKinsey estimates that the clean-tech product market, for example, will reach \$1.6 trillion by 2020, up from \$670 billion in 2010. The World Resources Institute estimates that people at the bottom of the income pyramid, who earn less than \$3,000 a year, embody a global market of more than \$5 trillion.<sup>2</sup>

Our research finds that a handful of companies are capturing significant value by systematically pursuing the opportunities sustainability offers. We believe the trend is clear: more businesses will have to take a long-term strategic view of sustainability and build it into the key value creation levers that drive returns on capital, growth, and risk management (Exhibit 1), as well as the key organizational elements that support the levers. Each company’s path to capturing value from sustainability will be unique, but these underlying elements can serve as a universal point from which to get started.

### **Approaching sustainability**

Our survey produced insights into the specific practices of a small group of companies that treat sustainability holistically. At all of them, it is a top-tier item on the CEO’s agenda, a formal program is in place to address it, and executives embed it in business practices and manage it actively. Much higher shares of respondents at these leading companies report that they are pursuing each kind of value-creating activity related to sustainability and integrating the organizational elements—mission and values, systems and processes, internal and external leadership, and organizational design—that support such initiatives.

The leading companies from our survey can thus serve as a model for others. Make no mistake, however: capturing sustainability’s full value potential is complicated. In essence, a company must first determine its baseline performance on sustainability issues and then decide on a portfolio of initiatives to create value in those areas. But

<sup>1</sup> According to McKinsey’s 2011 survey on sustainability, just 36 percent of executives say their companies have a strategic approach to it, with a defined set of initiatives.

<sup>2</sup> Allen L. Hammond, William J. Kramer, Robert S. Katz, Julia T. Tran, and Courtland Walker, *The Next 4 Billion: Market Size and Business Strategy at the Base of the Pyramid*, World Resources Institute, March 2007.

Exhibit 1: **Capturing value in three key areas**



while many companies understand the impact of their own operations on issues from carbon emissions to human rights, they often have little or no understanding of the impact of the entire value chain.<sup>3</sup> Moreover, most companies do not actively seek opportunities to invest in any area of sustainability<sup>4</sup> and therefore miss potential growth opportunities.

Opportunities to create or preserve the most value vary greatly among industries (Exhibit 2). An extractive-services company,<sup>5</sup> for example, could significantly reduce its costs through better management of energy and water. A retail company could reduce its resource intensity and costs by revamping its supply chain, since the biggest environmental impact within that sector can often be traced to raw materials, such as the agricultural products used in food or apparel. An energy company may have more opportunities than companies in other industries to create value through new products—for example, by commercializing investments in smart grids.

<sup>3</sup> Seventy-eight percent of respondents at leading companies say they have mostly or completely integrated sustainability into the management of their supply chains; 37 percent of all other respondents say their companies have done so.

<sup>4</sup> According to McKinsey's 2010 survey on sustainability, 88 percent of respondents at leading companies strongly agree that they actively seek opportunities to invest in sustainability, versus 23 percent of all other respondents. For more, see "How companies manage sustainability: McKinsey Global Survey results," [mckinseyquarterly.com](http://mckinseyquarterly.com), March 2010.

<sup>5</sup> This group includes survey respondents from the coal, metal, and other mining industries; oil and gas extraction; petroleum and natural-gas distribution; and petroleum refining.

## Creating value

Integrating sustainability into strategic initiatives is especially important because these issues play out over the long term. It's easier for companies where they are core concerns to understand trends and make strategic bets in advance of consumer preferences, stakeholder pressure, or regulation. GE, for example, placed early bets on climate change: in 2004, before Al Gore and Hurricane Katrina made this a top-of-mind issue, the company resolved to double its research investments and sales in clean technology. It also promised to "green" its own operations. As a result, GE's Ecomagination division has been a tremendous growth engine, with product sales reaching \$18 billion in 2009. Other companies too have found instructive ways to build sustainability into drivers of value.

## Returns on capital

Most companies creating value through sustainability look first to improving returns on capital, which often means reducing operating costs through improved natural-resource management (such as energy use and waste). Dow Chemical, for example, reported that it invested less than \$2 billion since 1994 to improve its resource efficiency. To date the company has saved more than \$9.8 billion from reduced energy consumption and water

### Exhibit 2: Industry-specific opportunities

Potential value from sustainability activities over the next 5 years, by industry

■ Significant value ■ Modest value ■ Little to no value

	Energy	Extractive industries <sup>1</sup>	High tech, telecom	Retail
<b>Growth</b>	Significant value	Modest value	Significant value	Modest value
Composition of business portfolio	Significant value	Significant value	Significant value	Modest value
Innovation and new products	Significant value	Modest value	Significant value	Modest value
New markets	Modest value	Modest value	Modest value	Modest value
<b>Returns on capital</b>	Modest value	Modest value	Modest value	Significant value
Green sales and marketing	Modest value	Little to no value	Modest value	Little to no value
Sustainable value chains	Modest value	Modest value	Modest value	Significant value
Sustainable operations	Modest value	Significant value	Modest value	Significant value
<b>Risk management</b>	Modest value	Significant value	Modest value	Modest value
Operational-risk management	Little to no value	Little to no value	Little to no value	Little to no value
Reputation management	Significant value	Significant value	Significant value	Significant value
Regulatory management	Significant value	Significant value	Modest value	Little to no value

<sup>1</sup>Includes respondents from the coal, metal, and other mining industries; oil and gas extraction; petroleum and natural-gas distribution; and petroleum refining.

Source: 2011 McKinsey sustainability survey; McKinsey analysis

waste in its manufacturing processes, even as it continues to develop innovations. In 1996, through a separate initiative, Dow also created a set of goals for environmental, health, and safety issues, and it has ensured their integration into the company's processes by tracking progress with clear metrics. As a result Dow, with a 20 percent reduction in absolute greenhouse gas emissions, has gone well beyond Kyoto Protocol<sup>6</sup> targets.<sup>7</sup>

Companies are also driving down costs by systematically managing their value chains. Wal-Mart, for example, expects to generate \$12 billion in global supply chain savings by 2013 through a packaging "scorecard" that could reduce packaging across the company's global supply chain by 5 percent from 2006 levels. Moreover, companies can add value by improving employee retention or motivation through sustainability activities or by raising prices or achieving higher market share with new or existing sustainable products. Whole Foods Market, for instance, raised its sales by 13 percent a year from 2005 to 2009, in an economy experiencing single-digit growth.

### Growth

Companies that rigorously pursue sustainability also regularly revisit their business portfolios to determine the potential impact of trends (such as existing or potential climate change regulations) that could lead to new growth opportunities. Waste Management, for instance, reinvented itself as a provider of integrated environmental offerings by adding waste reduction and waste-to-energy solutions to its services. Companies also screen rigorously for unmet needs created by sustainability trends in line with their strategies and identify potential customer segments. ArcelorMittal, for example, embedded sustainability in its organizational design through a department for scientific analyses of the life cycles of steel products. The department creates offerings that minimize steel's negative environmental impacts—one result of the company's investment in innovative solutions. GlaxoSmithKline is looking not only to philanthropy but also to its business model in addressing diseases in less-developed markets. By adopting a range of flexible pricing models for patented medicines and vaccines so that they're affordable for customers in those countries—yet still profitable—the company hopes to garner a significant share of sales in potential new markets.

### Risk management

Better management of risks that arise from sustainability issues begins with detecting key risks of operational disruptions from climate change, resource scarcity, or community issues (such as boycotts or delays in getting permits for manufacturing). Faced with potential supply constraints, Nestlé, for example, launched a plan in 2009 that coordinates activities to promote sustainable cocoa: producing 12 million stronger and more productive plants over the next ten years, teaching local farmers efficient and sustainable methods, purchasing beans from farms that use sustainable practices, and working with

<sup>6</sup> *Kyoto protocol to the United Nations Framework Convention on Climate Change*, United Nations, 1998.

<sup>7</sup> *Mid-point Report: 2015 Sustainability Goals Update, 4Q 2010*, Dow Chemical, February 2011.

organizations to help tackle issues like child labor and poor access to health care and education. The mining giant BHP Billiton managed its exposure to emerging regulations by systematically reducing its emissions.

The choice for companies today is not if, but *how*, they should manage their sustainability activities. Companies can choose to see this agenda as a necessary evil—a matter of compliance or a risk to be managed while they get on with the business of business—or they can think of it as a novel way to open up new business opportunities while creating value for society. ○

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