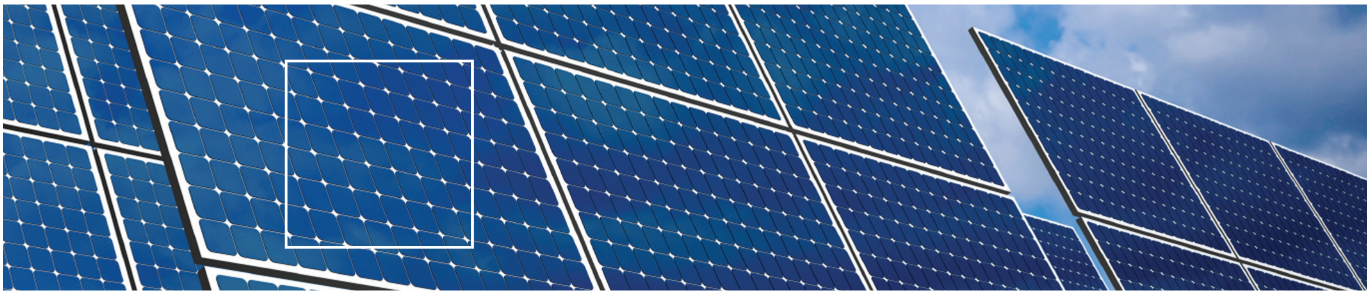
# Sustainable Performance

*A Case of the Emperor's New Clothes?*

*June 08*



**Scratch the surface of many companies' claims on sustainable performance and what lies beneath leaves much to be desired. Research by Arthur D. Little, for example, shows that even among Nordic companies, widely regarded as among the most environmentally responsible of corporate citizens, the response to the challenge of sustainability lacks rigour.**

Arthur D. Little argues that, by continuing to focus on traditional business objectives and paying little more than lip service to environmental issues, many companies risk losing out on the opportunities presented by sustainability – not least the opportunity to run a more competitive business and to attract the attention of investors who increasingly recognise environmental performance as an indicator of long-term success.

Sustainability – and how we are to achieve it – is one of the most debated topics of the moment. Stakeholders, including customers, want to see companies taking action on environmental issues and, in many countries, legislation now demands that companies publish details of their performance on sustainability as part of CSR reporting requirements. As a result, upbeat stories on environmental achievements are easy to find in any number of glossy, corporate publications.

However, a closer look at the reporting of sustainability performance and the corporate strategies supporting it reveals that, in many companies, the response to the challenge of sustainability is only skin-deep. Research by Arthur D. Little shows, for example, that even Nordic listed companies, generally perceived as having an excellent record on the environment, have failed to grasp the real opportunities presented by sustainability or to develop the strategies and reporting mechanisms needed to realise them.

## A force for change

It seems then that legislation, regulation and consumer demand have failed to influence corporate behaviour other than superficially.

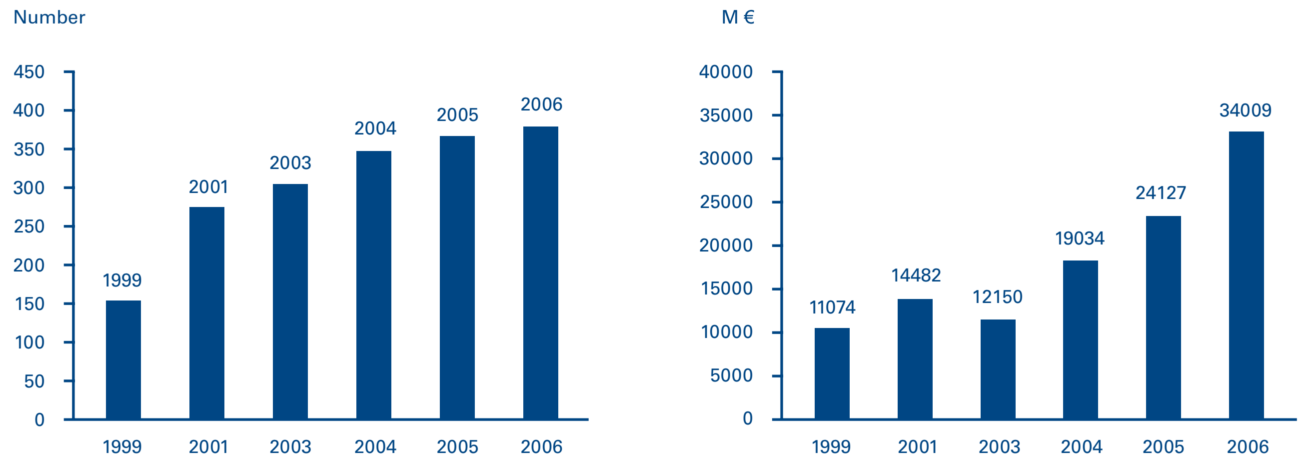
Legislation and regulations have been too laxly formulated to have the desired effect. Only where they have a direct effect on businesses' costs or are bindingly prescriptive do they bring about change. Similarly, consumers, while having the potential to influence through purchasing behaviour, will not generally read CSR reports or follow the business activities of the companies they buy from. They are influenced, if at all, by media reports and as a driver for corporate sustainability remain, at present, in many cases a very weak force. And, of course, companies do not have an adequate incentive to be good corporate citizens *per se*; their prime objective remains to satisfy the economic interests of shareholders.

However, there are clear signs that a powerful force that does have the ability to effect a rapid and deep-rooted change in corporate behaviour is emerging. The international investor community now recognises that those companies that are able to derive value from sustainability and carbon management will outperform their peers financially in the long run. As a result, the economic interests of shareholders and the drivers of sustainable performance are becoming increasingly aligned.

Figure 1: The amount of assets managed by SRI funds domiciled in Europe has grown by more than 40% between 2005 and 2006

**Number of SRI funds in Europe**

**Total Assets Under Management for SRI Funds Domiciled in Europe**




**Funds integrating sustainability criteria in their evaluations are becoming increasingly popular**

Source: Avanzi SRI Research (2006)

## Value from sustainability

Sustainable performance and effective carbon management allow companies to create economic value. By transforming their products, processes and operations in line with long-term environmental requirements, using resources efficiently and taking action to reduce both direct and indirect CO2 emissions, companies can cut waste, increase efficiency, improve the utilisation of resources, reduce costs and reduce risk. By building sustainability into business strategy, they can inspire creativity and innovation and attract superior talent. They also demonstrate superior management skills and become more competitive by offering environmentally superior products and services.

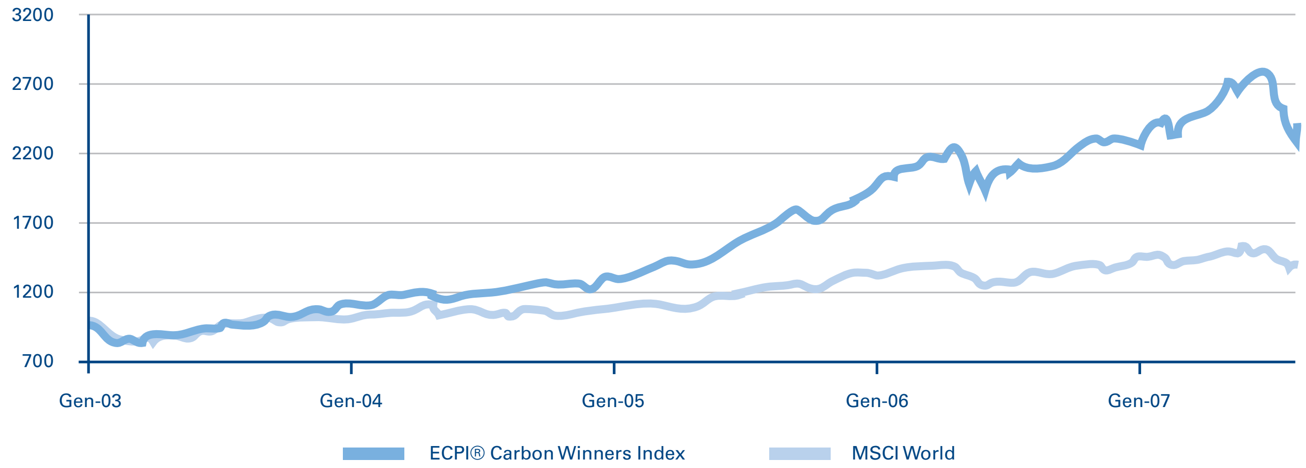
Many investors have realised this and are increasingly asking for investment opportunities in financial products that target companies that outperform others on carbon reduction potential and sustainability management. In fact, between 2005 and 2006, the amount of assets managed by SRI (Socially Responsible Investments) funds domiciled in Europe grew by more than 40% (see figure 1 above).

There are now a number of indices building on the concepts of sustainability and carbon reduction potential, including E-Capital Partners' Carbon Winners Equity Index, FTSE4Good, the Dow Jones Sustainability Index and KLD's Global Sustainability Index. Most of them clearly show performance that outranks market indices. For example, the ECPI Carbon Winners Equity Index has outperformed the Morgan Stanley International Capital Index by 20% since 2003 (see figure 2 on page 3).

Companies, once included in the sustainability indices, are eager to remain part of them. They recognise that share-price development is closely linked to their continued inclusion since large financial institutions broker the companies that appear in these indices to shareholders.

Figure 2: The E-Capital Partners' Carbon Winners Equity Index has outperformed the Morgan Stanley International Capital Index by 20% since 2003

**ECPI Carbon Winners Equity Index Development 2003-2007**




Source: Avanzi SRI Research (2006)

## Making the grade

Arthur D. Little believes that companies that are not currently included in the sustainability indices should make every effort to become eligible. However, most companies will need to make significant changes to their environmental reporting, strategic goals, implementation and internal follow-up procedures.

For example, the Arthur D. Little survey of 99 publicly listed, large Nordic companies found that, in many companies:

- reporting is varied and not standardised and, as a result, not transparent.
- there is little comparability even within industries, since companies tend to focus on their own, absolute measures.
- few companies have quantified targets, or relate targets for improved sustainability to business objectives.
- few companies have clearly articulated strategies, and even fewer follow up or report on how they perform against their own targets.

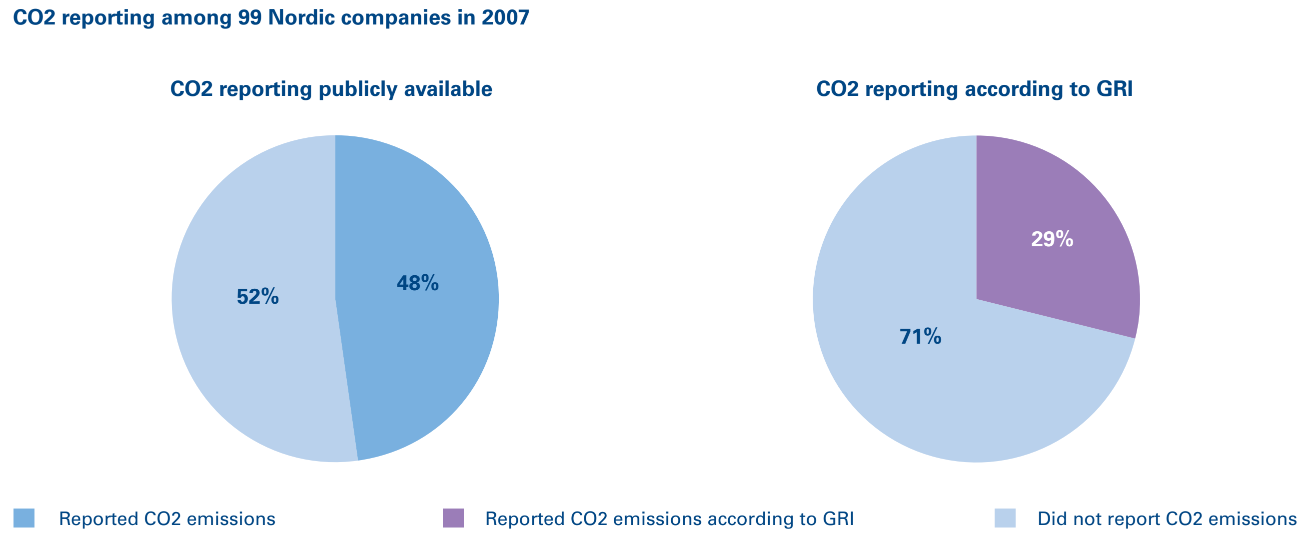
Specifically, the survey found that while 48% of the companies included reported C02 emissions in 2007, only 29% reported emissions according to GRI standards, the most widely adopted reporting framework and the one used by ECPI's Carbon Winners Equity Index (see figure 3 above).

In addition, evaluation of the companies' CO2 strategies, revealed that 78% of the manufacturing companies surveyed and 93% of the food & beverage companies surveyed fail to achieve the Carbon Reductions Score required for inclusion in the Carbon Winners Equity Index.

In short, most Nordic companies do not even qualify to be considered for the CWEI, either in terms of their carbon footprints or in terms of carbon reduction potential.

In general, implementation of carbon reduction strategies is too poor even to reach international averages.

Figure 3: Carbon Dioxide Reporting in the Nordic Countries – 48% of the 99 evaluated companies reported CO2 emissions in 2007; but only 29% reported emissions according tO GRI standards




## Key questions for companies

Companies from any region that want to maintain their competitiveness need to act fast on sustainability issues. The competitive space is filling up rapidly as companies rush to unlock the hidden value of sustainability. Only those companies that manage to lead the way will be attractive to investors in the long run.

Any company that wants to realise the opportunities presented by sustainability needs to develop an effective strategy for sustainable business development and performance reporting. This includes companies that may be tempted to complacency by an existing reputation for good corporate citizenship. Where some form of environmental reporting is already in place, companies need consider whether they really do meet the standards of international best practice, whether there are still opportunities for improvement, and what they can do to catch up with the world leaders in sustainability and environmental reporting.

A review of any company's response to the challenge of sustainability should cover the following key questions:

- Do we have a clear understanding of the impact of sustainability on our business, today and in the future?
- Are we integrating sustainability into our strategy in order to build distinguishable competitive edge?
- Are we implementing and managing for sustainability by means of a systematic, target-driven performance management system that sets the direction and motivates the organisation to continuously look for and realise opportunities for improvement?
- Do we have a strong system for monitoring and reporting? Is it clear comparable, transparent and timely? Does it meet international standards, show commitment to meeting national targets and permit external communications that will satisfy stakeholders in general and the financial investment community in particular?

Companies that can give an affirmative answer will have laid firm foundations for maximising competitiveness and attracting investment from newly carbon-conscious investors.

Arthur D Little



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## About Arthur D. Little

Arthur D. Little, founded in 1886, is a global leader in management consultancy; linking strategy, innovation and technology with deep industry knowledge. We offer our clients sustainable solutions to their most complex business problems. Arthur D. Little has a collaborative client engagement style, exceptional people and a firm-wide commitment to quality and integrity. The firm has over 30 offices worldwide. With its partner Altran Technologies Arthur D. Little has access to a network of over 16,000 professionals. Arthur D. Little is proud to serve many of the Fortune 100 companies globally, in addition to many other leading firms and public sector organisations. For further information please visit **www.adl.com**



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