Bridging the Sustainability Gap

There’s a growing disconnect between the importance of sustainability to many corporate strategies — and its lack of relevance to mainstream investors. Bridging that gap between companies and investors will require a new approach to sustainability reporting.
Several recent studies point to the increasing number of companies that are translating their sustainability strategies into financial gains and competitive strength. Leading companies are generating sales growth with new environmentally conscious products and services, identifying eco-efficiencies that help them to trim costs and finding ways to better manage risk in a world of pollution challenges, natural resource limits and shifting opportunities for competitive advantage.

Nonetheless, most mainstream investors remain unconvinced that sustainability leadership translates into profits and marketplace success. Despite rising importance on the corporate agenda, sustainability — at least as currently understood and measured — interests only a small niche of investors. While some evidence exists linking sustainability leadership to market outperformance, most mainstream investors discount these findings and remain on the sustainability sidelines. Public companies and global stock market executives we have interviewed report very limited interest among investment advisors and analysts in corporate sustainability strategies. Most executives we spoke with agree that questions posed by mainstream asset managers or analysts about sustainability during quarterly earnings calls remain very rare.

One problem is that sustainability reporting continues to be framed in a language not familiar to mainstream investors. The prevailing sustainability metrics evolved over decades to meet the needs of “values” investors who were willing to sacrifice returns to promote their values — such as better social standards and environmental protection. These metrics, generally referred to as ESG (environmental, social and governance) data, grew in complexity as the sustainability umbrella expanded, enabling analysts to effectively screen for the presence or absence of a multitude of indicators for socially and environmentally conscious investors. While these data frameworks are essential for values investors and are useful for spotting downside risks, they were never designed to identify business value drivers. Today, these frameworks remain ill-suited to measuring the potential upside business benefits or financial materiality of sustainability. As a result, easily understood indicators that quantify the business value of sustainability in mainstream financial terms do not exist.

Corporate executives, already overloaded by requests for sustainability data, mostly from nonfinancial stakeholders, are reluctant to invest more in sustainability reporting until they see evidence of broad-based mainstream investor interest. At the same time, mainstream investors remain on the sidelines waiting for clearer indicators of sustainability’s financial impact. Bridging this gap and clarifying the linkage between sustainability leadership and business results represents a big challenge — but also a big opportunity for both companies and investors.

In this article, we draw on a decade of research with dozens of businesses to separate out the elements of sustainability that deliver competitive advantage and marketplace success. In addition, we introduce a tightly focused sustainability metrics...
framework grounded in commonsense business terms. This approach allows companies and investors to readily gauge the materiality of sustainability strategies to a company’s performance.

**Needed: A New Approach**

We advocate a “back to basics” approach and argue for measuring sustainability strategies’ direct impact on revenue growth, productivity and risk. Our aim is not to get mainstream investors to integrate a new sustainability model into their investment process but rather to get companies to offer the best possible evidence of how sustainability strategy contributes to the data and results that are already critical to investor decisions. Not all sustainability strategies are designed to impact key financial objectives. But through this focused lens, investors and analysts should more clearly see the elements of financial and competitive advantage that many companies are currently delivering. Our model is based upon the earlier work of Michael E. Porter and Claas van der Linde, as adapted by one of this article’s authors and Andrew S. Winston in *Green to Gold*. This book proposed that the materiality of sustainability strategies could be found by examining impacts on four fundamental factors: brand value, revenue growth, eco-efficiencies and risk exposure. We also draw on the work of Robert S. Kaplan and David P. Norton, especially their book *Strategy Maps*, which argues that all corporate strategies can be decomposed into their growth and productivity drivers.

Sustainability-driven (S) growth (G), productivity (P) and risk (R) analysis, which we call S/GPR analysis, should not be viewed as a prescribed template requiring that all companies fill in the same blanks. Rather, it’s a general framework through which each company can communicate the materiality of its sustainability strategy in mainstream terms. We believe that describing sustainability in terms already at the heart of most analysts’ (Continued on page 20)
models — revenue growth, productivity and risk — makes broader engagement with investors much more likely to occur. We further believe that this simplified framework will help companies sharpen their focus on defining and executing sustainability strategies that generate business results.

Developing a company-level view of sustainability-driven growth, productivity and risk reduction poses challenges. Despite all the varied measurement efforts, today only a handful of companies are able to provide metrics that allow us to start conducting S/GPR analyses. The task of measuring sustainability-driven growth is one of categorization of revenue, something GE has done for years with Ecomagination branding and that Kimberly-Clark has done more recently, with about 22% of net sales from “environmentally innovative products” in 2012, up from 13% in 2011. Identifying this increase, which far outpaces overall revenue growth, is essential to communicating the relevance of sustainability strategy. These designations take time and effort to develop and apply, but they are among the most critical signals a company can send to analysts and investors who are looking for evidence of the materiality of sustainability.

Once revenue categorizations are in place, investors can gauge how much of a company’s total revenue mix comes from these sustainability-related products and how quickly such product revenues are growing in comparison to the company’s overall revenue growth rate. Understanding the scope of sustainability-driven growth may offer investors critical insight into a company’s ability to meet its future revenue forecasts.

While current reporting provides ample anecdotal evidence about how a specific facility or process reduces costs while improving sustainability-related outcomes, few companies report what most analysts would really want — that is, the total dollar value of savings from all sustainability-related initiatives for a given reporting period. In most cases, calculating productivity gains from sustainability requires aggregating data from disparate groups and functions across the enterprise for the amounts to reach material value. Understanding which cost savings to include, how to monetize resource efficiencies and how to calculate sustainability-driven productivity gains in a timely and consistent fashion to be relevant to investors is the key challenge. With modern enterprise resource planning (ERP) technologies and software, it’s a solvable problem if management has the will.

Finally, while the current data provide literally hundreds of risk metrics on thousands of companies, it’s often difficult for mainstream investors to know how to assess these indicators. Measuring sustainability-related risk for mainstream investors is about focusing on those factors critical to meeting strategic and financial objectives. Spotlighting and tracking those risks is specific to each business and requires analytic judgment. However, showing investors that the key risks have been identified and are being effectively mitigated is necessary to get their attention.

**DuPont’s Sustainability Performance**

DuPont is an example of a company that has taken some steps to enable investors and other interested parties to track its progress in transforming into a next-generation provider of sustainable business solutions through reporting about the business. In addition to absolute reductions in greenhouse gas emissions and total water use from the company’s 2004 baseline, DuPont has reported two key sustainability-driven revenue growth metrics for the 2007-2012 period:

- Revenue from products that reduce greenhouse gas emissions rose from $100 million in 2007 to $2 billion in 2012.
- Revenue from products based on nondeplet­able resources doubled, from $5.9 billion on a 2007 revenue base of $29.4 billion to $11.8 billion on a 2012 revenue base of $35 billion.

The success of DuPont’s sustainability-driven growth strategy can be seen in the substantial increase in its revenue from what we call sustainability-advantaged products. For example, DuPont’s revenue from products based on nondepletable resources increased 100% over the six-year period — compared to revenue growth of about 18% for the company as a whole during that time. In other words, the ratio of revenue growth from products based on nondepletable resources to the company’s overall revenue growth was more than 5:1. Through such calculations, any investor or analyst seeking to understand the revenue dynamics at DuPont can easily see the role being played by sustainability-advantaged products. This should provide both strong incentives for investors to understand the strategy and confidence that DuPont has and will continue to gain competitive advantage from its investments in sustainable solutions. DuPont backs up its outlook for the future with a report on R&D spending to create sustainability-related products; such R&D spending has grown from $322 million in 2007 to $879 million in 2012. These simple data points convey the current and likely future materiality of sustainability to DuPont’s revenue momentum and brand value.

In terms of productivity gains from sustainability, data on precise gains per year are harder to come by. DuPont has reported $6 billion in aggregate cost avoidance from energy-saving efforts between 1990 and 2010. That level of savings suggests a material impact during that period on DuPont’s net income, which was $3 billion in 2010. Ideally, data on sustainability-related productivity gains should be analyzed and reported at least annually, as some companies are doing now, so that we have a clearer assessment of earnings impacts. But even seeing the big picture on a multiyear basis is a step forward in terms of understanding the financial impact of sustainability on productivity.
In addition to providing extensive sustainability data in accordance with the Global Reporting Initiative framework, DuPont’s sustainability-related risk management reporting highlights six key factors that the company believes provide insight into current and future potential exposure, including absolute levels of (and future goals for) greenhouse gas emissions, water use, water use in water-stressed locations, air carcinogen emissions and manufacturing plant certifications. Sustainability-related risk factors will vary by company and industry. While the absolute performance on these risk factors is critical, many investors would be interested in the relationship of these factors to revenue growth. For example, consider “water consumption in water-scarce or -stressed locations,” which DuPont reports declined from 6 billion to 5 billion gallons between 2007 and 2012. We compute a stressed water intensity of revenue that relates water use to revenue growth and find a 30% decrease from 0.20 to 0.14 gallons/dollar of revenue for DuPont for this period—a significant shift. Through such calculations, considered alongside the absolute impacts, investors can better assess the rate of change in risk exposure from key business processes for each of the key risk factors on DuPont’s scorecard.

There are many companies that, like DuPont, do extensive sustainability reporting and have integrated sustainability into their strategy. Such companies are now positioned to strengthen confidence in their business outlook by referencing the success of their sustainability strategies as a source of added value. For these companies, connecting the sustainability dots in ways that resonate with mainstream investors represents a big opportunity.

Closing the Gap Between Companies and Investors

How should companies start to report their sustainability results in ways that will put their sustainability performance on the agenda of mainstream investors? Most companies would be well-advised to begin with reporting metrics related to revenue growth. Some companies, such as DuPont, Pirelli, GE, Siemens, Philips and Kimberly-Clark are already reporting the power of their “green” portfolios to accelerate revenue growth.

Still, these data, even when made public, are often hard to find except by the most determined analysts. If your company currently tracks top-line revenue impacts from sustainability-designated products and services, consider creating a sustainability-driven growth metric (S/G). Include the metric in your primary business performance reporting on at least an annual basis. If, on the other hand, your company hasn’t yet begun to identify which of its products and services are worthy of a sustainability designation or the potential growth opportunity from developing sustainability-enhanced solutions, you have many excellent role models. It takes time to climb the learning curve, and the time to start is now. This is especially true if you see sustainability factors playing an important role in your company’s business sector.

If leading companies that are already obtaining material business benefits like revenue growth, productivity improvements and risk mitigation from their sustainability strategies report these results clearly, then many more mainstream investors will pay attention and act. Many separate efforts are underway to address this gap. We see interest in the S/GPR approach emerging in global initiatives such as the UN Global Compact and Principles for Responsible Investing.

Given that the expected steady increases in the impacts of climate change, regulatory pressures and evolving consumer attitudes are likely to make sustainability strategy even more important going forward, we believe mainstream investors will reward companies that demonstrate business gains from sustainability—provided investors can easily spot the sustainability winners. The greatest opportunity for such a “sustainability premium” is during the early stages of a comparatively new phenomenon such as the emerging sustainability imperative. That’s when superior performance creates the best chance for differentiation from competitors. Over time the field will tighten, as it has with past management trends such as quality and technology—and maintaining a lead will be even more challenging.

Now is the time for sustainability innovators to capitalize on the opportunity to gain greater investor interest in the payoff from sustainability investments. It will never be easier. To capitalize on this opportunity, companies must systematically capture and report the sustainability-driven business impacts they are already seeing, and those they aim to generate, in terms that mainstream investors comprehend. In a world facing decades of natural resource constraints, pollution damage and potentially severe climate change impacts, as well as changing customer expectations and brand exposure connected to sustainability pressures, there will be winners and losers. Investors seeking to capitalize on these forces must be able to distinguish companies that are pursuing carefully structured and successfully implemented sustainability strategies that deliver actual material business advantages from those with less well-designed or well-executed strategies.

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