Chapter 3

Environmental Responsibility

When consumers think about corporate social responsibility, many first think about environment responsibility (often referred to as "sustainability." There are many definitions of environmental responsibility as it pertains to the corporation. While the standard definition is "the duty that a company has to operate in a way that protects the environment,"[1] researchers at the University of Michigan's Erb Institute for Global Sustainable Enterprise define corporate environmental responsibility as "friendly actions not required by law, also referred to as going beyond compliance, the private provision of public goods, or voluntarily internalizing externalities."[2] The corporation's responsibility to the environment can also be defined as delivering on stakeholder needs without compromising the ability to meet the needs of future stakeholders.[3]

Whatever definition you choose, however, no one would doubt the importance of the environment today for corporations. Sustainable business practices that protect the environment not only help the planet, but also usually have a positive financial and public relations effect. Thus, this is the one area of responsibility corporations have embraced wholeheartedly.

THE EVOLUTION OF CORPORATE ENVIRONMENTAL RESPONSIBILITY

In the 1960s and 1970s, there was some concern over corporate environmental responsibility, but the conversation that occurred mostly pitted business against the environment. The 1960s did, however, see the beginnings of concern over how business growth was negatively affecting the environment.[4] During this time, many companies focused on controlling pollution and adding additional parts to existing machinery in response to rising awareness of the environmental consequences of their business operations.[5] The prevailing mind-set was that

business and the environment were entities whose competing interests could not be reconciled.[6]

The situation looked to be a zero-sum game, with decisions that positively affected business necessarily being bad for the environment and vice versa.[7] During the 1970s, there were trade-offs between environmental and financial performance, and the former were viewed as a mere distraction for managers.[8] As noted by Michael Porter and Classe van der Linde:

> The relationship between environmental goals and industrial competitiveness has normally been thought of as involving a tradeoff between social benefits and private costs. The issue was how to balance society's desire for environmental protection with the economic burden on industry.[9]

Beginning in the 1970s and continuing into the mid-1980s, there was resistance to adaptation of environmentally responsible behavior among corporations. Such compliance was mostly spurred by increased regulation, with corporations doing everything in their power to fight the new laws. This period of corporate resistance to environmental compliance was characterized by "delegation of environmental protection to local facilities, a widespread failure to create environmental performance-measurement systems, and a refusal to view environmental issues as realities that needed to be incorporated into business strategy."[10] During the 1980s, however, both corporations and regulatory bodies started to take a different approach to environmental issues. Instead of addressing the symptoms of environmental abuses such as pollution, both groups began focusing more on eliminating the underlying causes. In other words, the focus of the conversation shifted from assigning punishments to perpetrators of environmental offenses to preventing such offenses in the first place.[11]

During the mid-1980s to late 1990s, the approach shifted again—this time, with the conversation centering on "win-win" solutions and eco-efficiency—as a response to increasing concerns about the environment. In 1998, *The Atlantic* called eco-efficiency "the next industrial revolution" and cited a 1987 report by the United Nations' World Commission on Environment and Development as a major catalyst of the movement. The UN report linked business efficiency with environmental sustainability and outlined dire consequences for failure to address environmental concerns, warning that without more stringent pollution control, "property and ecosystems would be threatened, and existence would become unpleasant and even harmful to human health in some cities."[12] The UN commission also argued for the promotion of industries and operations that would use resources efficiently, generate less pollution and waste, rely on renewable resources, and minimize negative effects on both human health and the environment.[13]

Five years later, the Business Council (now the World Business Council) for Sustainable Development, a group of 48 corporate sponsors of the 1992 Earth Summit, including Dow and Chevron, promoted the term *eco-efficiency* following the event. The Summit was a gathering in Rio de Janeiro to address environmental issues and included 30,000 people from around the world, with 167 countries represented and more than 100 world leaders present.[14] What did eco-efficiency mean in actionable terms? Corporations would work to update their machinery with cleaner, faster, quieter engines, without a negative impact on financial prosperity. In other words, the goals of eco-efficiency ran diametric to the conventional wisdom that environmental and business interests were mutually exclusive. Eco-efficiency was designed to "transform human industry from a system that takes, makes, and wastes into one that integrates economic, environmental, and ethical concerns."[15]

One of the catalysts of the shifting views of environmental responsibility was the realization that approaching environmental issues proactively could lead to strategic cost-savings due to win-win measures. During the second half of the 1980s, regulation grew increasingly focused on environmental results versus compliance, and managers began to shift their approach to environmental issues, looking beyond a merely technical approach to think strategically about these concerns.[16]

During the 1990s, this trend continued, with managers beginning to understand that better performance on environmental issues could positively affect a corporation's financial bottom line.[17] A "greening revolution" began, in which some companies began to see the relationship between business and the environment as a strategic opportunity.[18] Companies realized that there were cost-savings to be attained through the minimization of resource usage and waste—win-win situations that both required less operational spending and put less strain on the environment. Managers focused on maximizing efficiency and creating competitive advantage. Eco-efficiency was "perceived as a 'win–win' solution, enabling the twin goals of economic growth and environmental protection to be maintained."[19]

Even so, some strong voices saw eco-efficiency measures as detracting from shareholder value, much in the same way that Milton Friedman saw all of corporate responsibility, with little potential for true gains to be made. A mid-1990s article in *Harvard Business Review* looked not at the cost-savings associated with environmental responsibility but at the additional costs incurred in establishing environmentally responsible business practices—and questioned whether there were really business advantages to be gained from engaging in them:

> Responding to environmental challenges has always been a costly and complicated proposition for managers. In fact, environmental costs at most companies are skyrocketing, with little economic payback in sight . . . win-win situations

> do . . . exist . . . but they are very rare and will likely be overshadowed by the total cost of a company's environmental program. Win-win opportunities become insignificant in the face of the enormous environmental expenditures that will never generate a positive financial return.[20]

The authors argued that while the prevailing conversation around finding win-win solutions to environmental issues was rhetorically effective, approaching such issues with the goal of increasing the efficiency and effectiveness of environmental spending would be far better, estimating that one-quarter to one-half of an industry's market value was susceptible to growth in environmental costs and charging that such costs would destroy shareholder value.[21]

There were other drawbacks to the win-win, eco-efficiency approach of the 1990s, namely, that it disguised the most pressing, most difficult to solve environmental challenges by focusing on those with quick paybacks and no need for significant reengineering of operations.[22] Additionally, this approach left some with the mistaken impression that all business resource efficiencies were environmentally sound.[23]

Another issue with eco-efficiency was that it was unsuitable as a long-term strategy. Instead of disrupting the existing approach to business problems to forge a new, strategic path for corporate environmental responsibility, eco-efficiency worked within the existing system and in many ways was a reactive versus proactive approach to environmental issues, marked by "moral proscriptions and punitive demands."[24] Eco-efficiency, rather than introducing new methods of doing business that would allow companies to unlock shared value—identifying cost-savings while preserving natural resources, for example—allowed corporations to focus on mitigating the negative effects of their destructive behavior instead of enacting widespread changes that would eliminate such effects going forward.[25]

From the late 1990s on, the conversation around corporate environmental responsibility moved increasingly toward eco-effectiveness and the idea of a greening revolution. Eco-effectiveness was introduced as a guiding principle of corporate sustainability, under which business practices were expected to stretch beyond pollution control and eco-efficiency to embrace business methods designed to both restore and enhance the environment.[26] What is the difference between the limited eco-efficiency and eco-effectiveness? In short, while eco-efficiency focuses on doing less damage to the environment, eco-effectiveness takes a more proactive approach, seeking instead to do more good for the environment.[27] In an article in *Business Strategy and the Environment*, eco-effectiveness was described as follows:

> The alternative to eco-efficiency is to enable business to operate in a manner that allows nature and business to succeed, to be productive, the objective being for business to seek a balance with the natural world in such a way as to remove negative impacts and to develop systems to restore and enhance the natural environment. The term eco-effectiveness was coined to describe these ideas. Eco-effectiveness ultimately requires industry to reinvent itself so that the new ways of doing business result in regenerative, not depletive, practices.[28]

The 1990s saw a steady increase in public concern for the environment, making it an ideal atmosphere in which environmental responsibility and eco-effectiveness in particular could thrive. Climate change became a major topic of discussion, which continued into the 21st century. People voiced deep concerns about the future of the planet, with human overconsumption and irresponsible resource management leading to an unsustainable strain on resources.[29] Climate change, meanwhile, would put additional pressure on the planet, and there was fear about the earth reaching a global "tipping point" at which the earth and its inhabitants would be negatively and permanently affected by the environmental crisis.[30]

A report by Business for Social Responsibility (BSR), a nonprofit that promotes social responsibility in business, described dire consequences if current resource consumption were to continue along the same trajectory:

> With population growth, increasing per capita consumption, and tremendous technological capacity leading to ever greater levels of production and consumption, we have begun to reach planetary limits, threatening the health and function of ecological systems that support all activity on Earth. . . . By recent estimates, our global footprint now exceeds the world's capacity to regenerate by about 30 percent, and if our current demands continue, by 2030 we will need the equivalent of two planets to maintain our lifestyles.[31]

Outside the sustainability realm, other stakeholders such as government officials also expressed fears about the consequences of the strain on the earth's resources. Lord Nicholas Stern, former UK Government and World Bank Chief Economist, expressed his belief that rising carbon emissions would not only have perilous effects on climate change in the short term, but also negatively affect economic growth over the long-term.[32] Stern charged that if nothing was done to curb such emissions, the equivalent of at least 5% of global gross domestic product (GDP) would be lost per year because of increased costs and risks. Going forward, this number could increase to 20% of global GDP. Meanwhile, the costs of addressing carbon emissions would be relatively small—roughly 1% of global GDP per year.[33]

Stakeholder concerns about corporations' externalities have increased as a result of these trends. As a result, corporations have become more serious about engaging in better environmental policies, with corporations across nearly all industries taking eco-friendliness into account in their decisions about product and service development.[34] *Harvard Business Review* described accounting for environmental externalities as "the key to becoming a contemporary corporate leader," explaining that the rules of doing business have changed in response to the negative social and environmental effects of traditional corporate policies.[35] Not only was it impossible to continue to ignore such externalities, but a positive outcome of the increased focus on them has been the development of cheaper, less-complex means of keeping tabs on them.[36]

A surprising turn of events in the early 21st century was the rise of longtime environmentalist and former U.S. vice president Al Gore as a prominent figure in the public conversation about environmental sustainability. Some notable examples of Gore's involvement in environmental initiatives have included co-founding Generation Investment Management, a socially responsible investing management firm,[37] and starring in the Academy Award–winning 2006 documentary film *An Inconvenient Truth*, which educated viewers on the evidence of global warming.[38] For his efforts, Gore was co-recipient of the 2007 Nobel Peace Prize, alongside the Intergovernmental Panel on Climate Change.

Writing in *Review of Environmental Economics and Policy*, Thomas P. Lyon and John W. Maxwell explained how business needs have driven corporate responses to environmental issues: "The growing attention to corporate environmental initiatives in the business press strongly suggests that market forces—in the markets for products, capital, and labor—are increasingly powerful drivers of corporate environmental improvement."[39] Stakeholder demand for corporations to behave responsibly with regard to the environment is growing, particularly the perception that companies must internalize their externalities through the use of sensors that measure corporate environmental impact so that companies can mitigate it.[40] There are consequences for corporations that are believed to be taking minimal or no responsibility for externalities, in the form of riots, consumer boycotts, or regulation.[41]

Other consequences exist as well for corporations that fail to deliver on stakeholders' environmental expectations. Environmental issues increasingly cause obstacles to companies' ability to create value for stakeholders, because of environmental pressures and business liabilities.[42] Growth in areas of the world such as China and India has also resulted in tougher competition over natural resources, adding a new geopolitical dimension to the conversation around sustainability. Refusing to acknowledge or account for externalities can have dire consequences for corporations operating in this new world, as "investors consider them central

to a firm's performance and stakeholders expect companies to share information about them."[43] Meanwhile, increased concern about issues including climate change, pollution, food safety, and natural resource consumption means that, globally, many consumers are opting for products and services that are produced and rendered sustainably—and in some cases, demanding that companies alter existing products and services to make them more sustainable.

There are also examples of how environmental concerns can drive positive effects on market demand in emerging markets with weak regulatory systems, where international markets drive corporations to be more environmentally responsible. Colombia exports cut flowers to the European Union, where customers often choose suppliers partly by their pesticide usage. To respond to this demand, the Colombian flower industry started the Florverde program, which encourages its members to adopt environmentally friendly practices.[44] Each year, 1.3 billion stems and over 2,000 hectares of land are certified by Florverde Sustainable Flowers.[45] In this case, the shift in consumer demand arguably plays a larger role in advancing environmental responsibility than the country's pesticide regulations.[46]

There are also opportunities for business in that weak economies that are transformed by sustainable consumption strategies will serve as better environments in which to do business, creating new market opportunities worldwide by innovating new business models and devising new strategies.[47] Corporations at the forefront of innovation will find their competitors hard-pressed to catch up. By using the principles of sustainability to rethink existing business models, companies "will build resilience against the ups and downs of economic cycles and shifting consumer expectations, and they will deliver positive outcomes in new markets for themselves and for consumers."[48]

Sustainable consumption, beyond being a potential marketing tool in areas of the world where corporate environmental responsibility is valued and prioritized by consumers, is crucial to the future of the planet. The future of economic development must provide all people with the resources to meet their basic needs in a way that preserves healthy ecosystems. This would also help business, as corporations can leverage their dedication to sustainable consumption to become more innovative, especially in emerging markets.[49] Over the next two decades the middle class is expected to expand by 3 billion people, increasing the potential market for products and services presently enjoyed by wealthier economies—but only if sufficient attention is paid to developing these economies.[50]

Therefore, corporate environmental responsibility policies have become an essential part of every company's long-term plan. Today, there is widespread concern about sustainability, and corporate leaders must balance stakeholder expectations, which

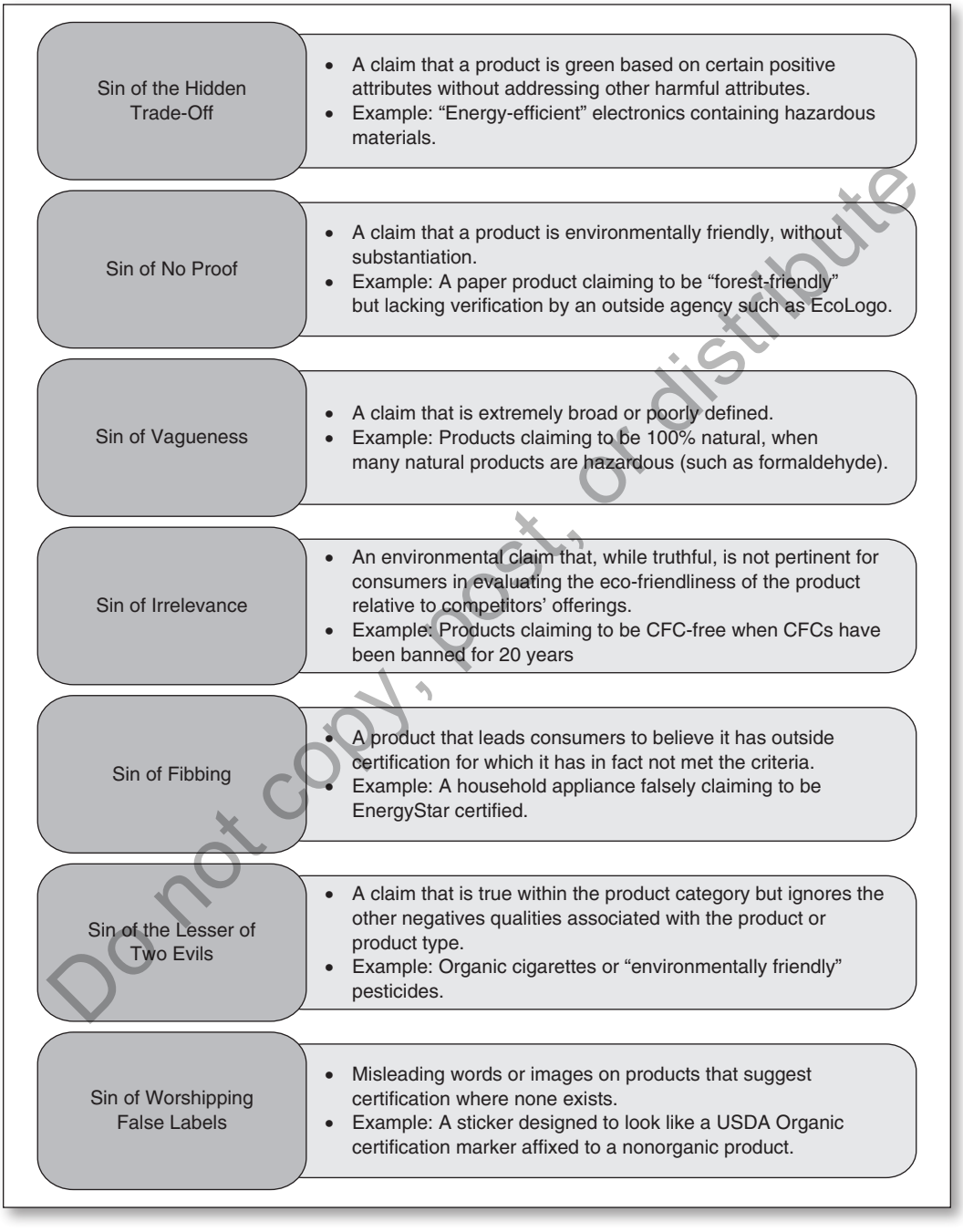
often conflict, with creating value for shareholders. Thinking seriously about environmental sustainability is a necessary means of addressing both goals.[51] Writing in *Business Strategy and the Environment*, Thomas Dyllick and Kai Hockerts declare, "Sustainability has become a mantra for the twenty-first century. It embodies the promise of societal evolution towards a more equitable and wealthy world in which the natural environment and our cultural achievements are preserved for generations to come."[52] Environmental preservation is not just good for society; it is also beneficial to corporations in the form of reduced consumption of resources and the development of new, innovative products that appeal to consumers.[53]

GREENWASHING AND SUSTAINABILITY RANKINGS

One result of the heightened trend of "going green" is greenwashing, which has become a big problem. What is greenwashing? *Greenwashing*, a term coined by New York environmentalist Jay Westerveld in 1986, refers to corporations' practice of disingenuously spinning their products or policies as environmentally friendly or beneficial. Greenwashing involves the deceptive use of green public relations or green marketing. There is great incentive for corporations to engage in greenwashing, which allows them to benefit from the positive public relations associated with environmental friendliness without having to invest resources to develop eco-friendly products and processes.

The Big Green Opportunity report, which collects data from 1,300 small businesses in the U.S., indicates that growth in green segments has outpaced conventional segments in every surveyed industry. For instance, the organic goods segment grew by 238% over a 10-year period from 2002 to 2011, whereas the overall goods market grew only 33% during the same period.[54] If corporations are not willing to create green products or engage in environmentally responsible practices, they may be leaving money on the table.[55] Accordingly, corporations must not only offer green products but must also communicate their eco-friendly business practices to consumers. Green advertising has increased tenfold in the past two decades, nearly tripling since 2006; meanwhile, more than 75% of S&P 500 companies have website sections focusing on their environmental policies.[56] As of March 2013, Worldwatch Institute issued a report saying that the number of new products that used green advertising grew from 100 in 2004 to 1,500 in 2009.[57] With companies intent on publicizing their green practices as a form of competitive advantage, it makes sense that some companies would engage in greenwashing at either the firm level (i.e., misleading consumers about a company's environmental practices) or the product level (misleading consumers about the environmental benefits of a particular product or service).[58]

Figure 3.1 The seven sins of greenwashing



Source: Adapted from Wasserman, E. (2014, April 23). "7 sins of greenwashing (and 5 ways to keep it out of your life." EcoWatch.com. Retrieved March 2015 from http://ecowatch.com/2014/04/23/7-sins-of-greenwashing.

TerraChoice, a Canadian environmental marketing agency that found that 99% of consumer products companies engage in greenwashing, organizes greenwashing into seven sins, as seen in Figure 3.1.[59]

Unsurprisingly, the practice of greenwashing has grown in popularity as more corporations have realized the marketing potential of eco-friendliness. Unfortunately, the prevalence of greenwashing can negatively affect consumer and investor confidence in green products—but trying to limit the effects of this practice can be very challenging, as there is limited regulation in place.[60] One difficulty is that there is no set definition of what qualifies as a green product, and the understanding of what it means to be environmentally friendly can vary greatly among industries, companies, or product classes.[61] Even with unclear rules, companies that fail to engage in the conversation about green products and services are in danger of being judged for not meeting confusing standards, or left in the dust by a competitor with a better understanding of green business—or a more proactive approach to it.[62]

A Harris poll found that corporations, rather than exhibiting a real commitment to sustainable practices, are generally more interested in disseminating propaganda suggesting such a commitment. Corporate executives surveyed expressed skepticism that attention to environmental issues would attract consumers; meanwhile, consumers are in disbelief that corporations' claims of eco-friendliness are genuine.[63]

Greenwashing detracts from the gains made by environmentally friendly products and services by negatively affecting consumer confidence.[64] And it is not just corporations that participate in greenwashing that suffer. When consumers perceive that greenwashing is occurring, they respond by purchasing less from the corporation suspected of the practice. NGOs, meanwhile, respond to greenwashing by attracting negative publicity to businesses. Finally, regulators may assess the validity of a company's claims and fine it for misleading consumers.[65] In 2011, the California attorney general filed suit against ENSO Plastics over the company's false claims that its products would biodegrade within five years.[66]

Even if a particular business has not been the subject of negative attention related to greenwashing, the existence of greenwashing within its industry will hurt competition and should be cause for concern.[67] Greenwashing shatters consumer confidence in environmentally friendly products and can damage investor confidence in eco-friendly companies, creating difficulties for socially responsible investment firms in attracting capital.[68] The prevalence of greenwashing can also lead to increased regulation[69] and slow the progress of environmental initiatives by increasing public skepticism of them.[70] Meanwhile, greenwashing creates obstacles to consumer understanding of the actual environmental impact of the products and services they purchase and use.[71] And dealing with greenwashing is a drain on resources that could be better spent enhancing environmental initiatives.[72]

What are the causes of greenwashing? Unfortunately, the downside of increased consumer demand for green products is increased incidence of false claims of eco-friendliness, as many corporations have responded not by developing better processes but by presenting the illusion of doing so.[73] BSR identifies five drivers of greenwashing as especially important:

1. Increased consumer demand for more environmentally responsible products

While green products were once a niche area that only dedicated environmentalists would choose over their less eco-friendly counterparts, their popularity has grown substantially. A May 2012 survey conducted by Harris Interactive on 2,451 adults in the U.S. showed that 79% of the respondents purchased green products or services, with one-third believing that such behavior was becoming a norm and what was expected of them. Survey respondents also indicated that they would rather dine at a green restaurant despite the higher cost.[74] This trend is not limited to the U.S.—*National Geographic* and GlobeScan's "2012 Greendex" surveyed 17,000 consumers in 17 countries and found that consumer environmental responsibility is on the rise globally as well.[75]

2. Rising sales of environmentally oriented products

Green products have seen rapid growth in the U.S. CBS News reported that green product launches by major U.S. manufacturers grew to 328 during 2007, compared with only five green products launched in 2002. Meanwhile, the organic industry has nearly tripled since 1997, with sales of organic personal-care items now totaling hundreds of millions of dollars.[76]

3. Continued strong demand for green products despite the economic downturn

Consumer attitudes toward green products were unaffected by the state of the economy, according to the 2009 Cone Consumer Environmental Survey conducted by Opinion Research Corporation. Of those surveyed, 34% responded that they were more likely to buy environmentally responsible products at that time, with another 44% stating that their green shopping habits had not been affected by the economy.

4. Pending regulation and government action

Over the next 10 years, $3 trillion is expected to be paid out in stimulus money in 15 countries around the world, much of which will be put toward environmental goals. For example, the U.S. stimulus package is intended to double clean energy capacity and create 2.5 million green jobs. Consequently, the number of climate change lobbyists in Washington has grown significantly, providing additional incentives for corporations to promote an image of eco-friendliness.

5. Lack of standards for communicating environmental messages

The ability of the U.S. Federal Trade Commission (FTC) to regulate and monitor greenwashing is limited, given the sizable scope of the FTC's responsibilities.

Given the motivations for corporations to commit greenwashing, how can the practice be prevented? BSR recommends a three-pronged approach: (1) impact, (2) alignment, and (3) communication.[77] See Table 3.1 for more information.

MEASURING ENVIRONMENTAL FRIENDLINESS

While lists that rank companies and products or services on their eco-friendliness may seem like a good way to evaluate a corporation's environmental commitment, this is not always the case. Rankings are widely used, but not necessarily reliable. Most companies now report on their environmental impacts, with 93% of the 250 largest firms worldwide providing regular updates on their environmental initiatives and 82% of these companies referring to the Global Reporting Initiative's Sustainability Reporting Guidelines.[78] Rankings are important to both consumers and investors, as they enable shoppers to vote with their wallets, workers to evaluate potential employers, and socially responsible investment funds to make appropriate choices.[79] Most rankings, however, include only operational activities and not lobbying and campaign contributions around environmental policy, which often can have more impact than operations. One reason for this is the lack of transparency around corporate political activity, which translates to a lack of transparency about the real impact of a corporation's dealings in terms of environmental policies and regulations.[80]

Table 3.1 A three-pronged approach to preventing greenwashing

Impact: Make sure it's real	Messages about the environmental issues associated with products must be based on real, significant impact, as opposed to being mere PR ploys.
Alignment: Build support internally and externally	The initiative must be aligned with functions throughout the company.
Communication: Communicate it accurately	Communications must be clear and transparent, and companies should avoid self-aggrandizements in dialogue with stakeholders. It is also essential that partner organizations understand these principles.

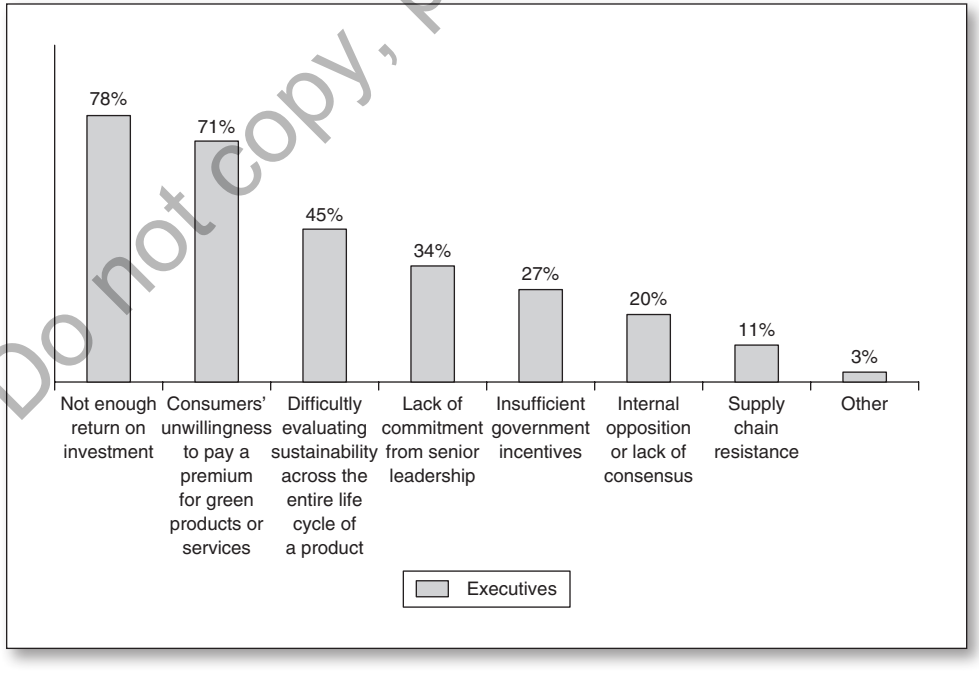
Source: Adapted from "Understanding and preventing greenwash: A business guide" (pp. 26–27). (2009, July). Business for Social Responsibility and Futerra Sustainability Communications.

While this is a big problem, it can be fixed fairly easily, according to Schendler and Toffel, who argue that "rating systems should factor in political contributions, CEO advocacy work and engagement with nongovernmental organizations among other actions."[81] Rating agencies can better serve stakeholders looking to evaluate corporations' eco-friendliness by partnering with environmental nonprofits to determine whether certain organizations strengthen or weaken environmental policy. The authors state, "Incorporating corporate advocacy can strengthen the competitiveness of ranking systems and enhance their differentiation in a crowded field of company ratings and rankings."[82]

THE CURRENT STATE/HEADING TOWARD A TRIPLE WIN

Even though corporate environmental responsibility has become a "megatrend,"[83] corporations still cite a number of issues surrounding their environmental initiatives that have kept them from becoming fully integrated into most companies' missions and strategies. A 2010 study identified eight inhibitors (see Figure 3.2).

Figure 3.2 Eight inhibitors of integrating environmental initiatives into missions and strategies



Source: "Perspectives on corporate sustainability." (2010). *Gibbs & Soell Sense and Sustainability™ study* (p. 10).

The number one cited obstacle to full integration of environmental policy into core business strategy and mission was the lack of return on investment (ROI) associated with environmental initiatives, with 78% of the executives surveyed citing insufficient ROI as a roadblock to going green.[84] In particular, such ROI is difficult to measure and prove in the short term, as we will see in Chapter 8's detailed discussion on the difficulties in measuring and reporting CR (viewed through the lens of corporate philanthropy). It can be difficult for companies to reconcile a long-term, visionary approach to sustainability with the need to demonstrate evidence of financial gains in the short term to validate the attention paid to environmental impact.[85] A study based on interviews with 400 CFOs of U.S. corporations found that 78% had sacrificed long-term value to "maintain short-term predictability in earnings and financial disclosures."[86]

A second obstacle to integrating environmental responsibility into core business practices was low willingness to pay—or at least the perception of it. In this case, 71% of the executives surveyed cited consumers' unwillingness to pay a premium for eco-friendly products or services as an obstacle to going green.[87] While it is true that consumers are likely unwilling to pay a premium for environmentally friendly products, 73% of consumers will choose a brand or product that is socially or environmentally responsible over a similar offering.[88]

The third most commonly cited inhibitor was difficulties with measurement, with more than two out of five executives reporting challenges in evaluating the sustainability over the life cycle of a product.[89] For example, some corporations have tried to calculate expenses associated with externalities to include in their analyses of profits and losses.[90] Such externalities could eventually be taxed by governments, forcing businesses to do a better job of managing the negative impact of their policies on the environment.[91] While these concerns are a source of motivation for companies to do a better job of accounting for environmental impact, measurement is a challenging component of all corporate responsibility initiatives, including environmental responsibility. Chapter 8, which deals with corporate philanthropy, provides a deeper discussion of corporate responsibility measurement systems.

And yet, there are companies that are overcoming these hurdles or simply proving them to be misconceptions, and in doing so creating entirely new dimensions of competitive advantage. Some companies have realized the ROI of environmental responsibility by unlocking measurable cost-savings in the form of reduced consumption of inputs. Being environmentally responsible also enables corporations to generate additional revenues by developing better products or introducing new business lines. Fortuitously, such benefits are also the goals of corporate innovation, so that "smart companies now treat sustainability as innovation's new frontier."[92] While attempts to minimize negative

externalities such as pollution were in the past believed to incur costs to business and to be motivated only in response to regulatory changes and taxes, Michael Porter and Mark Kramer point out that "today there is a growing consensus that major improvements in environmental performance can often be achieved with better technology at nominal incremental cost and can even yield net cost savings through enhanced resource utilization, process efficiency, and quality."[93]

Another way that corporations can overcome obstacles to engaging in environmentally responsible behavior is by delivering superior financial performance. A study of 180 corporations by *The Guardian* found that, over an 18-year period, high-sustainability companies had market returns of 4.8% more on average than low-sustainability companies, with the former's returns also being less volatile than the latter's.[94] The study differentiated between high-sustainability and low-sustainability corporations based on whether or not the companies had been voluntary early adopters of environmental and social policies.

While opponents of corporate environmental responsibility have argued that sustainability destroys shareholder value, the study found the opposite to be true, with companies that behave socially and environmentally responsibly creating more value for shareholders by increasing the loyalty of their customers and employees.[95] With consumer expectations of corporate responsibility continuing to increase, companies that behave responsibly will see their competitive advantage grow. According to *The Guardian*, "the argument about sustainability is over. It is the key to creating value for shareholders and all other stakeholders over the long term, thus ensuring the sustainability of the company itself."[96]

Additionally, at high-sustainability companies, the boards of directors are more likely to include sustainability initiatives in their purview, plus top-executive incentives are more likely to be a function of sustainability metrics, than at their low-sustainability counterparts. Such corporations also think strategically, having procedures in place to engage stakeholders while keeping close tabs on nonfinancial information through measurement and reporting systems.[97] It is no surprise, then, that high-sustainability companies significantly outperform low-sustainability companies over the long term, in both stock market and accounting performance.[98]

Even under special circumstances such as market duress, the findings held true:

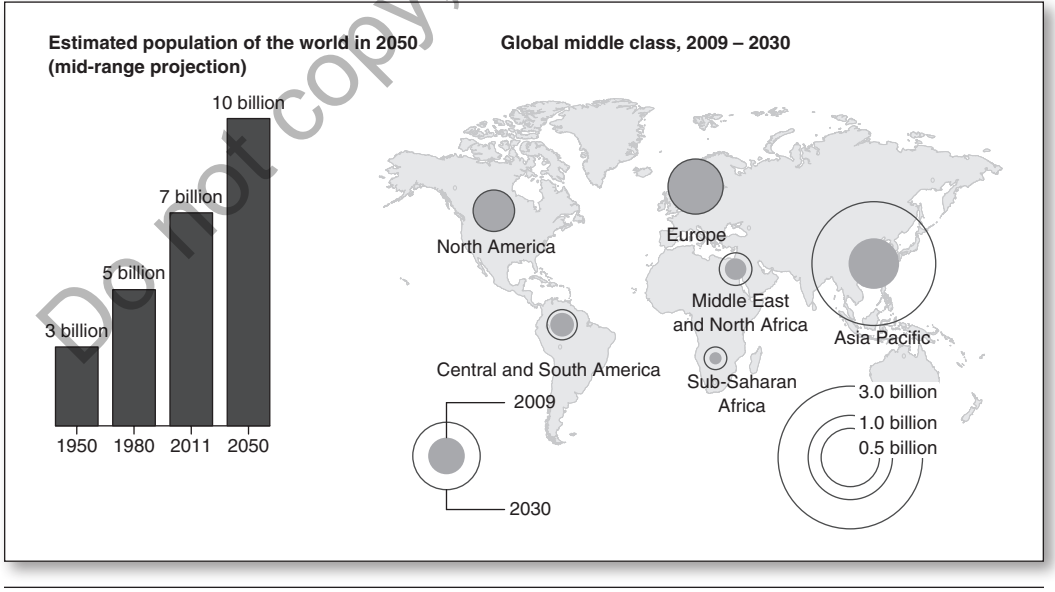
> Even in extreme market conditions, performance was not negatively impacted. Not only that, but outperformance was seen across the range of global sectors and geographies . . . the introduction of ESG [environmental, social, and governance] values into corporate strategy can lead to increased efficiency and innovation, and a consequent boost to revenues and profits.[99]

GROWING INVESTOR INTEREST

Beyond consumers and employees, there is another group of stakeholders for whom environmental responsibility is an important component of engagement with a corporation: investors. PricewaterhouseCoopers (PwC) found that investors are growing increasingly concerned with corporations' environmental behavior, meaning that being eco-friendly could have the added benefit of ROI in the form of increased investments.[100] According to PwC, "investors have begun to recognize that the social and environmental conditions in society can have a direct impact on the business operations of a company and its long-term viability." Sustainable practices are not just the right thing to do; they are also good business policies. The longtime perception of environmental responsibility as a minor issue has changed, with many investors now considering sustainability to be a vital component of their overall approach.[101] Both institutional and retail investors take sustainability into account. Some investors even use sustainability as an investment strategy itself, with an increasing number of funds focusing on ESG concerns.

There are concrete financial reasons for investors to take such concerns into account, with climate change risk being intertwined with expected population changes and growth of the middle class in emerging markets, as shown in Figure 3.3.[102]

Figure 3.3 Estimated population and global middle class

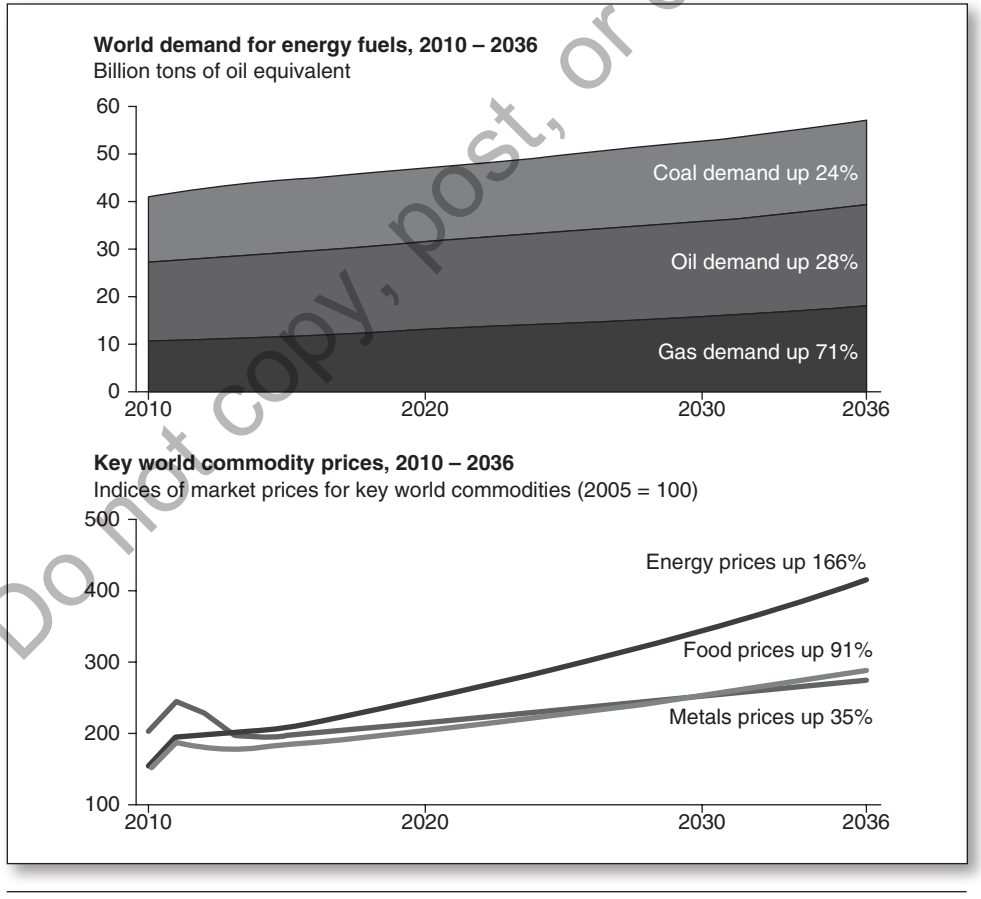


Source: "Do investors care about sustainability? Seven trends provide clues" (p. 2). (2012, March). PricewaterhouseCoopers.

Such changes are projected to result in strains on resources, including water, food, and energy, which will increase the prices of commodities (see Figure 3.4). Corporations that inventory their usage of such natural resources will be better equipped to comprehend social and environmental risks, as well as how such risks stand to affect their businesses, empowering them to create better, adaptive strategies for the future.

Interestingly, sustainable investing has seen faster growth than the broader investment universe in the U.S.—nearly one out of every eight dollars under professional management is involved in sustainable and responsible investing.[103] Echoing *The Guardian*'s findings, a Harvard Business School working paper discovered that sustainability leaders can be expected to have "better stock performance, lower volatility,

Figure 3.4 World demand for energy fuels, 2010–2036



Source: "Do investors care about sustainability? Seven trends provide clues (p. 2)." (2012, March). Pricewaterhouse Coopers.

and greater return on assets (ROA) and return on equity (ROE)," which the authors attribute to superior governance structures and stakeholder engagement.[104]

There are also benefits of environmental responsibility in terms of research and development. Higher attention to environmental issues, coupled with the greater availability of data, will result in corporations having more room for innovative, environmentally friendly products for which consumers will be willing to pay. According to *Harvard Business Review*:

> The developments we are seeing in scale, sensors, and sensibilities all fuel one another. The average company feels the effects because as measurement improves and access to those measurements becomes ubiquitous, people act on the information, thanks to heightened sensibilities. Formerly unseen and unremarked effects of doing business start getting measured, and affected people, armed with data, seek recourse.[105]

Porter and Kramer echoed this position in their own *Harvard Business Review* piece "Strategy and Society: The Link Between Competitive Advantage and CSR," explaining that corporations that include a social dimension in their value proposition are better placed in the competitive atmosphere. "Government regulation, exposure to criticism and liability, and consumers' attention to social issues are all persistently increasing. As a result, the number of industries and companies whose competitive advantage can involve social value propositions is constantly growing."[106]

Though measurement can be a challenge, it is possible and distinguishes companies that do it well. Corporate environmental responsibility initiatives create value in three key ways that are already measured by the market: growth, return on capital, and risk management.

Growth

While innovation is often a by-product of adopting eco-friendly policies, there is also an opportunity for corporations to deliver new products specifically designed to meet customers' environmental concerns. One such example is IBM's collaboration with the Nature Conservancy, through which the organizations are developing 3D imaging technology that will help them improve water quality, simultaneously addressing an environmental issue and identifying a new business opportunity for IBM.[107]

Another type of growth driven by corporate environmental responsibility initiatives is market share growth. Coca-Cola's eKOfreshment line includes coolers, vending machines, and soda fountains that are environmentally friendly, removing the need for hydrofluorocarbons (greenhouse gases) as a refrigerant and reducing energy consumption. This new technology provides benefits not only to the environment but also to

retailers who stock Coke products. It increases the equipment's energy efficiency by as much as 35%, meaning retailers realize financial savings on their energy bills, which Coke delivers in exchange for access to the best locations in retail outlets.[108]

Return on Capital

As we discussed earlier in the chapter, environmental initiatives enable corporations to realize cost-savings by improving energy efficiency, decreasing input usage, and developing better processes. While there are often upfront costs associated with improvements to existing equipment, upgrading technologies, systems, and products to be more environmentally friendly presents an opportunity for substantial cost-savings.[109] One example is Novo Nordisk's improvements to its operational efficiency after setting a 2006 goal of reducing the company's carbon dioxide emissions by 10% over the next 10 years. Novo Nordisk partnered with a local energy supplier to unlock energy savings at its production facilities in Denmark, which produced 85% of the corporation's carbon dioxide emissions worldwide. By using the cost-savings to pay a premium for wind power, the company eliminated a substantial portion of its emissions. The company set a goal that by 2014 all their activities in Denmark would be powered by green electricity. As of the 2013 annual report, the company was on track despite an increase in energy consumption by the firm. Additionally, Novo Nordisk has also optimized water and energy consumption at their production sites, reducing the company's total resource consumption in 2013. The company reduced its emissions, increased its energy efficiency, and cut costs—while helping to develop the country's renewable energy market.[110]

Risk Management

One way in which environmental responsibility assists corporations with risk management is by allowing them to take a proactive approach to their relationships with stakeholders such as policymakers. Verizon is an example of a company that prioritizes relationships with stakeholders and has sponsored research on how information communications technology leads to energy efficiency. One such example is their sponsorship of the research behind the SMART 2020 report, which details how this technology, along with broadband Internet connections, could allow the U.S. to reduce carbon emissions by 22% and reliance on foreign oil by 36% by 2020.[111]

Writing in *Harvard Business Review*, David A. Lubin and Daniel C. Esty identify four stages of value creation (see Table 3.2).[112]

Thus, in the four stages of value creation, some firms are finally entering the fourth, which will be necessary for long-term success due to increased consumerism and its effects on climate change. The fourth stage, new business model creation and differentiation, allows for the most significant opportunities for

Table 3.2 Lubin and Esty's four stages of value creation

Stage 1: Do old things in new ways.	Outperform competitors on regulatory compliance and environment-related cost and risk management.
Stage 2: Do new things in new ways.	Redesign existing products, processes, and systems to optimize natural resource efficiencies and risk management across value chains.
Stage 3: Transform core business.	Create new revenues and growth through sustainability innovations.
Stage 4: New business model creation and differentiation.	Exploit the megatrend as a source of differentiation in business model, brand, employee engagement, and other intangibles, fundamentally repositioning the company and redefining its strategy for competitive advantage.

Source: Lubin, D. A., & Esty, D. C. (2010, May). "The sustainability imperative." *Harvard Business Review*. Retrieved from https://hbr.org/2010/05/the-sustainability-imperative.

competitive advantage. To unlock competitive advantage through sustainability, corporations must come up with a vision for value creation and execute it.[113] The "quest for sustainability" has had a profound effect on the competitive landscape, with companies being forced to rethink their approach to products, technologies, processes, and business models.[114] Taking a proactive approach to sustainability issues will allow companies to develop capabilities ahead of the competition.

The growth of emerging economies will compound with the upward consumption trends, increasingly taxing the environment. Companies need to lead the way in influencing consumer demand for more environmentally friendly products and services to ensure their own long-term sustainability. According to *Harvard Business Review*, "Commercial activity has achieved planetary scale. The rapid growth of emerging economies will only accelerate the trend."[115] As transparency increases around the effects of human activity on the environment, consumer attention and concern about this impact—and how it relates to threats to human health and safety—will increase.[116] Corporations must balance the need to deliver environmentally friendly products and services against satisfying the practical needs of consumers.

HUMAN CAPITAL AND SUSTAINABILITY

Human capital is a crucial component of the creation of a low-carbon economy, with both leadership and talent being necessary resources. While today's economy has placed considerable stress on the planet, rapid changes in emerging markets

mean that our global economic system, which presently delivers on the needs of about a quarter of the people on earth, will need to fulfill the needs of twice as many people over the next decade. According to Nidumolu et al. in *Harvard Business Review*, "Traditional approaches to business will collapse, and companies will have to develop innovative solutions. That will happen only when executives recognize a simple truth: Sustainability = Innovation."[117]

In this rapidly changing world, adaptability is key. Corporations that wish to succeed must adjust to "the political, social, economic and fiscal drive towards a global low carbon economy," according to the SMART 2020 report, which notes that companies that turn challenges into opportunities are best positioned for success.[118] They will be better prepared than their competitors to develop necessary business models for adoption of low-carbon solutions, control their carbon emissions, and adapt to the changing world. According to SMART 2020, "A radical approach is required that incorporates different ways of thinking, living, working, playing, doing business and developing solutions. Action is no longer an option; it has become an urgent necessity."[119]

Another aspect of adaptability is conforming to or improving upon regulation's best practices. While many corporations have dragged their feet on complying with environmental standards, doing so only when absolutely required by law, taking a proactive approach is more beneficial over the long run. According to *Harvard Business Review*:

> It's smarter to comply with the most stringent rules, and to do so before they are enforced. This yields substantial first-mover advantages in terms of fostering innovation. . . . Contrary to popular perceptions, conforming to the gold standard globally actually saves companies money.[120]

Why is this the case? When corporations opt to conform only to minimal environmental standards, they run into different rules in each country in which they conduct business or source materials. Meanwhile, companies such as HP and Cisco that comply with the most stringent standards can establish a single norm throughout all facilities worldwide, enabling them to optimize supply chain operations.[121] It makes sense that, to ensure that the company is meeting the standards of the most harshly regulated country, the strictest standards become the universal norm.

As Charles Handy explained in his seminal *Harvard Business Review* piece "What's Business For?":

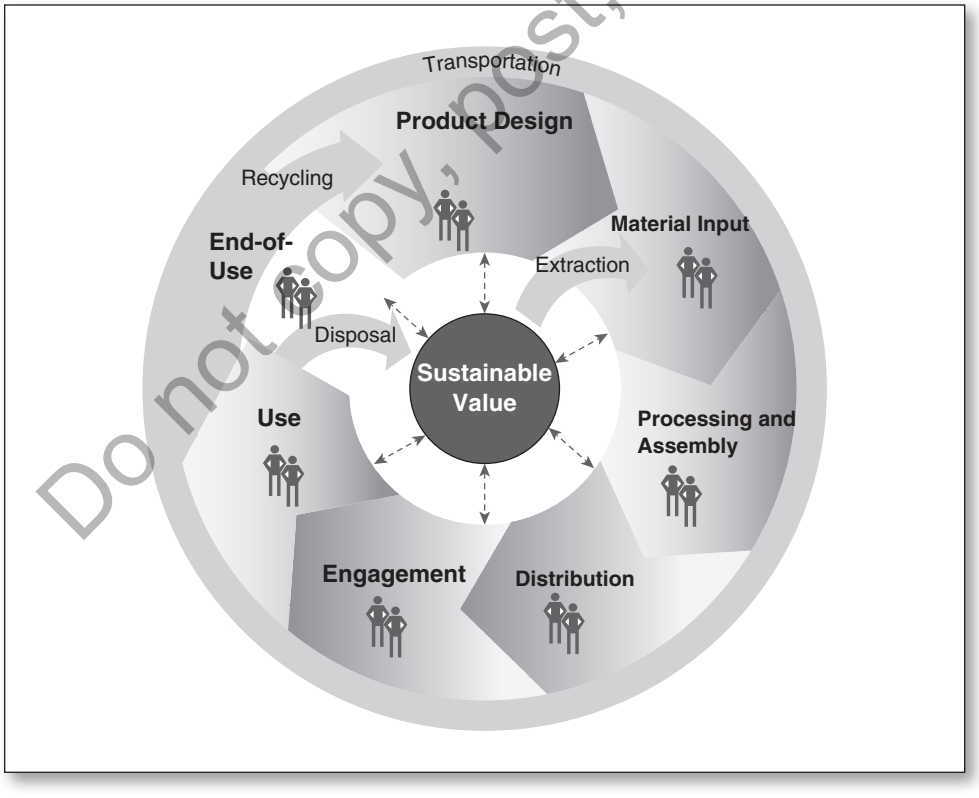
> Doing no harm goes beyond meeting the legal requirements regarding the environment, conditions of employment, community relations, and ethics. The law always lags behind best practice. Business needs to take the lead in areas such as environmental and social sustainability instead of forever letting itself be pushed onto the defensive.[122]

BSR offers strategic advice for companies looking to move forward to the next frontier of environmental responsibility. The nonprofit sees significant opportunity for sustainability growth "through a heightened focus on product design, consumer engagement, use, and end-of-use elements of the value chain cycle," and stresses the need to think of these elements as components of a common system (see Figure 3.5).[123]

BSR also provides a framework that corporations can use to articulate their sustainability strategies in the new frontier. The organization advises that companies look at redefining core business activities through four pillars: innovation, education, collaboration, and measurement. See Figure 3.6 for a better understanding of how looking at sustainability decisions through each of these lenses works in practice.

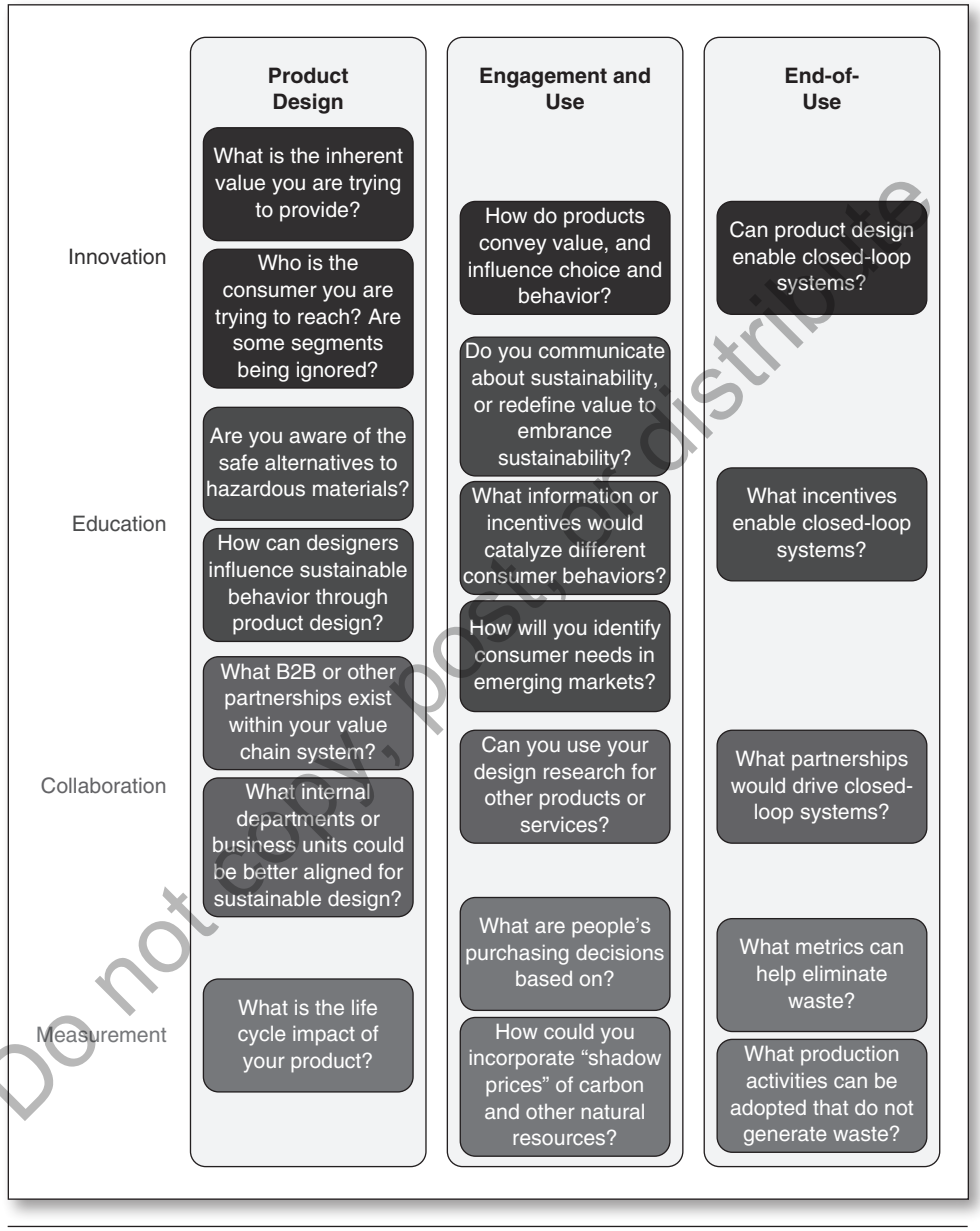
The ultimate goal of an effective, adaptive sustainability strategy should be the creation of a triple win through innovation in product development and production processes: (1) creating competitive advantage in the marketplace, (2) delivering new value

Figure 3.5 Opportunities to address sustainable consumption in the value chain



Source: "New frontier in sustainability" (p. 10). (2010, July). Business for Social Responsibility.

Figure 3.6 Framework for redefining core business activities



Source: "New frontier in sustainability" (p. 11). (2010, July). Business for Social Responsibility.

to consumers, and (3) transforming economic systems.[124] According to BSR, business today has an unprecedented opportunity "to develop economies that deliver more economic value and better human outcomes while significantly reducing environmental

impacts." Remember, however, that it is not enough to simply improve product offerings; instead, corporations must not only approach things differently, but do new and different things.[125]

A report from the Amsterdam Global Conference on Sustainability and Transparency noted that while it is evident that business is capable of innovating new technologies, systems, and services, "the full potential of capital markets to incentivize sustainable behavior has yet to be exploited and will be essential to achieving a sustainable global economy."[126] Not only will committing to sustainability have positive effects on the environment, but it also stands to pay dividends in the form of new technologies and jobs and reduce poverty and pollution.[127]

CONCLUSION

Corporate environmental responsibility has evolved dramatically over the past half century. While environmental responsibility was initially seen as a detraction from core business strategy, forward-thinking corporate leaders of today recognize it as a key component of business operations, one that not only has the power to deliver cost-savings in the form of smarter resource usage but is also a means of developing competitive advantage through innovation.

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WAL-MART'S SUSTAINABILITY STRATEGY

We've come to believe through experience that you really can create environmental progress by leveraging corporate purchasing power. And who's got more purchasing power than Wal-Mart?

—Gwen Rutta, director of corporate partnerships at Environmental Defense, in a July 2004 article[1]

In October 2005, in an auditorium filled to capacity in Bentonville, Arkansas, Lee Scott, Wal-Mart's president and CEO, made the first speech in the history of Wal-Mart to be broadcast to the company's 1.6 million associates (employees) in all its 6,000-plus stores worldwide and shared with its 60,000-plus suppliers. Scott announced that Wal-Mart was launching a sweeping business sustainability strategy to dramatically reduce the company's impact on the global environment and thus become "the most competitive and innovative company in the world." He argued that "being a good steward of the environment and being profitable are not mutually exclusive. They are one and the same." He also committed Wal-Mart to three aspirational goals: "to be supplied 100 percent by renewable energy; to create zero waste; and to sell products that sustain our resources and the environment."[2]

In the past, Wal-Mart had dealt with environmental issues defensively, rather than proactively and as a profit opportunity. In 1989, in response to letters from customers about environmental concerns, the company launched a campaign to encourage its suppliers to provide environmentally safe products in recyclable or biodegradable packaging at no additional cost. As *Discount Stores News* reported, "What Wal-Mart has chosen to do, apart from reaping a large public relations windfall, is to deploy its clout with vendors to influence them to spend more on R&D to develop safer packaging—without passing those costs on to Wal-Mart."[3] The company's CEO at the time, David Glass, denied that the program was meant to be self-serving.

Regardless of the motive, the company did earn some "goodwill among environmentalists [as] the first major retailer to speak out in favor of the environment in 1989."[4] When vendors claimed they had made environmental improvements to products, Wal-Mart began promoting the products to consumers with "green" shelf tags (without measuring or monitoring the improvements themselves). At one point, the company had as many as 300 products with green tags in its stores.

However, not all the press was positive. In response to Wal-Mart's 1989 campaign, Procter & Gamble labeled a brand of their paper towels as "green" when the inner tube

was made of recycled content but the towels themselves were made of unrecycled paper treated with chlorine bleach. When the details behind the product were exposed, both organizations were heavily criticized.[5] By1991, Wal-Mart's green tags had declined to roughly 200 products.[6] Within another couple of years, the program seemed to disappear altogether.

In contrast to the environmental campaign of 1989, the sustainability strategy launched in 2005 would need to be long-lasting and deeply embedded in Wal-Mart's operations to meet Scott's ambitious public goals. Andrew Ruben, vice president of corporate strategy and business sustainability, and Tyler Elm, senior director of the same group, had been named by Scott to lead the sustainability strategy. As they looked to 2007, Ruben and Elm knew they had to keep environmental improvement tightly coupled with business value and profitability for the strategy to succeed, and they challenged themselves to find new ways to drive measurable results.

While Wal-Mart's environmental impact had not been as problematic as these other issues, "the company's environmental record was nothing to boast about either," said one *Fortune* article. "It had paid millions of dollars in fines to state and federal regulators for violating air and water pollution laws."[7] Wal-Mart had huge environmental impacts simply because of the scale of its operations. For example, in its retail operations, Wal-Mart was the biggest private user of electricity in the U.S. and emitted more than 19.1 million metric tons of carbon dioxide annually[8]—an amount equal to the pollution created by roughly 2.8 million households. Taking into account the emissions of Wal-Mart's suppliers, the quantity was estimated to be more than 10 times greater.[9]

For these reasons, Wal-Mart's reputation among consumers and environmentalists was deteriorating. According to a study conducted by McKinsey and leaked to the public by the public watchdog organization Wal-Mart Watch, between 2% and 8% of consumers said they had stopped shopping at Wal-Mart because of the company's practices.[10] Another study, performed by Communications Consulting Worldwide (CCW), claimed that if Wal-Mart had a reputation similar to that of its rival Target, its stock would be worth 8.4% more, adding $16 billion to the company's market capitalization.[11] Compounding Wal-Mart's problems, sales growth was slowing and the company was facing increasing resistance from local communities as it sought to expand geographically.

THE SUSTAINABILITY STRATEGY

Against this backdrop, Scott initiated a review of Wal-Mart's legal and public relations challenges in 2004. One area that the company wanted to evaluate was its environmental impact. "They were looking for help defensively from a strategic standpoint—'Where are we vulnerable?'" explained Jib Ellison, founder of Blu Skye Sustainability Consultants.[12] However, Ellison had bigger ideas for how Wal-Mart could profitably

reduce environmental impacts, which he pitched to Scott in June 2004. The basic proposal was that Wal-Mart could differentiate itself from its competition, continue to grow, and remain consistent to its commitment to serving customers through everyday low prices by pursuing an offensive strategy. "Sustainability represents the biggest business opportunity of the 21st century," said Ellison. In addition, he asserted that Wal-Mart and its complex supply chain could become even more efficient by making its operations more environmentally friendly. Intrigued by the idea, Scott hired Blu Skye to perform an environmental impact assessment and to consult with Wal-Mart on how it might launch such an initiative.

Getting Started

The next challenge was to figure out where to focus. Over the next four to six months, Wal-Mart worked with Blu Skye and a coalition of nongovernmental organizations (NGOs) to identify which of its products and processes created the greatest environmental impacts across five primary areas (greenhouse gas emissions, air pollution, water pollution, water use, and land use).[13] For each of the 134 product categories and impact areas under review, the Union of Concerned Scientists (UCS) estimated an environmental impact score per $1 spent by a consumer (e.g., greenhouse gas emissions in tons of CO_2 equivalents per $1 spent on electronics). Wal-Mart multiplied these environmental impact scores by 2003 sales in each product category to estimate its overall environmental impact in each of the five areas.

By June 2005, a team of top Wal-Mart executives, high-potential employees, and the consultants had identified three primary areas around which it would set environmental goals for reducing Wal-Mart's impact on the environment: energy, waste, and products. Increasing energy efficiency, transitioning to renewable energy, and reducing waste in retail operations were direct goals—goals that could be achieved by making changes that were within Wal-Mart's more immediate control. Providing more sustainable products, however, was an indirect goal that would require the involvement of Wal-Mart suppliers, and even its suppliers' suppliers, to accomplish. "We recognized early on that we had to look at the entire value chain," said Elm. "If we had focused on just our own operations, we would have limited ourselves to 10 percent of our effect on the environment and, quite frankly, eliminated 90 percent of the opportunity that's out there."

Wal-Mart's commitment to pursuing its sustainability strategy was galvanized shortly thereafter by Hurricane Katrina. The company played a sizable role in helping provide relief to people in New Orleans and its surrounding areas and, as a result, was "showered with gratitude, kindness, and acknowledgments," said Scott.[14] Joel Swisher of Rocky Mountain Institute (RMI) commented:

The overwhelmingly positive reaction that Wal-Mart received from its efforts to help the victims of the hurricane convinced Lee Scott that doing good things for people was the best way to generate goodwill, and was far more effective than any legal or PR activities the company had tried.

Wal-Mart was ready to take action.

Next Steps

The company defined 14 specific sustainability teams, known as *sustainable value networks*, to drive environmental improvements related to energy, waste, and products. An executive sponsor was identified for each network, as well as a network captain. The network captains were typically senior-level managers from Sam's Club or Wal-Mart who were considered to be among the company's top performers. Each one was responsible for leading a cross-functional team of Wal-Mart associates that would be focused on driving sustainability in different parts of the business.

Importantly, Wal-Mart decided to make sustainability a new responsibility for people in their existing positions rather than creating new jobs or building a separate sustainability-related organization. This way, sustainability was less likely to be considered a fringe initiative led by a disconnected group of individuals in the home office, but rather an integral part of the way work was performed. Aside from a small core team of five dedicated staff members, which included Ruben and Elm, no Wal-Mart associates were assigned to work on sustainability full time (with only a few exceptions in textiles and global logistics). Elm explained the approach: "Business sustainability isn't something you're doing in addition to your job. It is a new way of approaching your job." Ruben concurred: "People are absolutely stretched thin, but there's incredible power that comes from keeping sustainability within the business." To help make the model viable, in most cases each network was staffed with one or more external consultants from Blu Skye or RMI.

Another essential element of the sustainability strategy was to look outside "the Bentonville Bubble" for input. Over the years, Wal-Mart had become notorious for being internally and operationally focused. To open its door and seek strategic level input from outside parties represented a major cultural change for the organization, but Wal-Mart started "pulling ideas from everywhere"[15]—consultants, NGOs, suppliers, eco-friendly competitors, academics, and even critics. "What we found is that, when you're focused on heads-down execution and have an internally focused culture, it often results in a reduction in the diversity of ideas and a growing disconnect with external stakeholders," commented Elm.

Wal-Mart also began to engage in dialogue with government policymakers regarding climate change. In the U.S., either a tax or a cap-and-trade system for curbing greenhouse

gases seemed imminent. Wal-Mart opposed a carbon tax as regressive and costly to its customers. If allowed to participate in a cap-and-trade system, the company could unlock a "virtual gold mine"[16] of credits for CO_2 reduction in its supply chain. In testimony before the U.S. senate, Ruben testified in favor of immediate, strong federal regulation, and the company later publicly endorsed proposals for "market-based programs for greenhouse gas reductions."[17]

More About the Sustainable Value Networks

When the sustainable value networks were formed, they were given explicit guidance by Elm: "It's not an environmental initiative, it's a business strategy. Your overall objective is to derive economic benefits from improved environmental and social outcomes. It's not philanthropy." Furthermore, according to Elm, the networks were encouraged "to develop a 'sensing organization' that is aware of the external business environment, and able to incorporate this perspective into business decisions that create long-term value. And, also to transition the company from an organization that derives value primarily from transactions to one that also derives value from relationships." Beyond that, the networks were given the freedom to define their own sustainability objectives and plot their own course. Elm continued:

> Once we've identified all the issues that are out there, we develop a desired future outcome, and we look at developing a pathway to get from where we are today to that desired future state. We call that the sustainable pathway, which is made up of projects of different sizes. We've got *quick wins* that the business and stakeholders can immediately go after. We have *innovation projects*, which may take one to three years. These initiatives involve Wal-Mart, but often change entire industries. Then we also identify *game changers*.

Game changers were intended to result in a radical departure from traditional business practices (see Exhibit 3.1). Each network was asked to define six quick wins, at least two innovation projects, and one game changer. While some of the networks embraced this structure whole-heartedly, others seemed to pursue their sustainability initiatives ad hoc or opportunistically, taking advantage of the high level of autonomy they were given in developing and executing their plans.

In the early phases of the program, some networks, such as Global Logistics, were able to leverage existing programs to hit the ground running. By October 2006, the logistics network was moving so quickly that Tim Yatsko, network captain for that team, said, "I can tell you that we're already there . . . in terms of our short-term goal to achieve a 25-percent improvement in fuel efficiency by 2007. That equates to almost $75 million in annual savings to Wal-Mart and probably 400,000 tons of CO_2 per year out of the atmosphere."

For other networks, like the China Sustainable Value Network, more time and planning was required to define a focus. In 2005, Wal-Mart's Chinese exports climbed to an estimated $23 billion (greater than 1% of China's $2.25 trillion GDP). In total, the company worked with more than 50,000 Chinese suppliers and was the country's seventh largest trading partner.

After researching a broad range of environmental issues, Rob Kusiciel, captain of the network, and his team realized that Wal-Mart needed to consolidate its supply base and develop a more collaborative, long-term, influential relationship with each supplier. They decided to begin working with Wal-Mart's 20 largest Chinese suppliers to improve environmental performance and to build a sustainable and transferable sourcing model.

OPERATIONAL CHANGES

A closer examination of Wal-Mart's sustainable value networks for seafood and electronics demonstrates how the sustainability strategy was being operationalized.

Seafood

According to an international study released in 2006, all species of wild seafood were greatly depleted and predicted to collapse within 50 years.[18] Furthermore, fishing was an inefficient industry in terms of its fuel use; in 2000, fisheries around the world burned roughly 13 billion gallons of fuel to catch 80 million tons of fish, accounting for approximately 1.2% of global oil consumption.[19]

As wild fish stocks declined, an increasing percentage of the seafood supply was farm-raised.[20] Yet some studies had shown that farm-raised fish provided lesser health benefits in terms of nutrients, as well as increased health risks in the form of harmful chemicals and antibiotics used to fight disease in fish-farming environments. In addition, the conversion of coastal ecosystems to aquaculture ponds also destroyed wild ocean fisheries by degrading coastal waters with antibiotics, chemicals, feed, and feces, as well as increasing the risk of disease and genetic contamination when fish escaped from the farms.

Within this complex and ominous business environment, Wal-Mart was sourcing approximately $750 million in seafood annually, and the business was growing at roughly 25% per year. "I was already having a hard time getting supply," said Peter Redmond, vice president for seafood and deli and captain of the Wal-Mart seafood network. When Redmond learned about the Marine Stewardship Council's certification program for wild-caught fish, he saw it as a potential solution to Wal-Mart's near-term and long-term supply-related challenges.

The MSC program, established by Unilever and the World Wildlife Fund (WWF) in 1997, established a broad set of certification standards based on the United Nations' Code

of Conduct for Responsible Fishing. Certified fisheries displayed an MSC eco-label on their finished products as a signal that the fish was harvested in a sustainable manner, thus raising consumer awareness, which the MSC hoped would pressure the industry to shift to more sustainable fishing practices.[21]

Redmond recognized the benefits of leveraging a well-defined, established, and objective program that was developed and endorsed by organizations respected in the field. "It is a completely impartial process that is reviewed by a lot of different NGOs, including WWF and Greenpeace—groups that potentially could have been critical of us if we had decided to come out with our own standard and then go police them with our own people," he said. Tapping into the MSC program would also enable the seafood network to make faster progress. Wal-Mart went public with an ambitious seafood goal: the company committed to moving its wild catch to *22% MSC certified seafood within three to five years*.

WAL-MART'S APPROACH TO MSC CERTIFICATION

To accomplish this goal, Wal-Mart would have to work through its suppliers to increase the number of fisheries and processing plants in the MSC certification program. Suppliers would identify fisheries already using primarily sustainable practices to catch wild fish, refer them to the MSC for certification, and have them use MSC eco-labels on their products within six months.

Wild-seafood suppliers were also instructed to begin working with the WWF and a group of other experts to identify those fisheries that were potential candidates for certification, but might first need to adjust processes or practices. The WWF remained closely involved in the MSC program and could help fisheries and processors prepare to enter the certification process.

There was a third group of fisheries—many in countries such as Russia with no effective government regulation of fishing—that would require long-term, severe restrictions in the catch to become sustainable. Given the volume of Wal-Mart's demand, the company remained dependent on fish from these areas, at least in the near term, to adequately supply its customers. Fish from these areas was approximately 20 cents per pound less expensive than MSC-certified fish.

The Role of Suppliers

Because Wal-Mart had delegated the implementation of the MSC certification program to its suppliers (as well as NGO partners), companies willing to take the lead in driving sustainability into the supply base stood to differentiate themselves from the competition and further strengthen their relationships with the company. Manish Kumar,

CEO of The Fishin' Company, felt that his efforts were helping to secure and expand his business with Wal-Mart in the long term. "It's definitely brought us closer. I think there's a lot more trust now in our relationship," he said. "They're willing to let us talk on their behalf, defend their points, and explain to the businesses we work with how important this effort is. And, because we have the muscle of their business behind us, we can go to a plant or a fishery and persuade them to become certified." Additionally, because Wal-Mart was interested in acquiring as much certified fish as possible, suppliers were able to begin taking a longer-term perspective toward their business with Wal-Mart.

The Cost of Certification

The direct cost of MSC certification was paid for by boat operators and processing plants. Getting through the rigorous certification process could cost between $50,000 and $500,000 and take one to two years to complete. According to one estimate, another way of understanding the cost of certification was to add $0.03 to every pound of fish. There were other indirect costs associated with certification; for example, fisheries with the most depleted fish stocks were forced to reduce their catches while repopulation occurred.

Progress as of Late 2006

By the end of 2006, Wal-Mart expected to have 30% to 40% of its total wild-caught fish certified under the MSC. And, in the spirit of everyday low prices, there was no price premium, partly because consumers were unwilling to pay extra for sustainably caught fish. At that time, according to Redmond, the company would consider beginning to promote certified fish to its customers. "Right now, we have not put out anything from a marketing point of view," he said. "We want to have a greater percentage of our product MSC certified before we go out with the message."

ELECTRONICS

The electronics network was formed to address issues across the consumer electronics products and small appliances. Across these product lines, Wal-Mart had approximately 25 domestic electronics buyers, while Sam's had another 15. Within the U.S. electronics industry, the company had the second highest market share, just behind Best Buy.

The electronics network was led by two co-captains: Laura Phillips, vice president and divisional merchandise manager for entertainment/wireless for Wal-Mart, and Seong Ohm, vice president and divisional merchandise manager for electronics for Sam's Club. During its initial start-up phase, the team defined six key areas where it would focus:

- **Materials innovation:** Working on near-term product modifications to reduce environmental impact—for example, energy efficiency and transparency, elimination of hazardous substances (initiatives under way in 2006).
- **E-waste:** Recovery and safe disposal of electronics (piloting programs in 2006).
- **Legislation:** Collaborating with external stakeholders and governmental agencies to affect policy and regulation related to electronics (preliminary efforts under way in 2006).
- **Green engineering:** Working with suppliers and their research and development functions to rethink how products are designed and manufactured to drive fundamental change in the industry on sustainability-related issues—for example, designing for recyclability (started in late 2006).
- **Metrics:** Measuring and monitoring the performance of associates, the network, and suppliers in the area of sustainability (started in late 2006).
- **Training and education:** Informing internal and external stakeholders about changes in the electronics industry and the potential implications and opportunities related to sustainability (under way internally, but just getting started in late 2006 relative to external customers).

Subteams of eight or nine network members were designated to support each initiative. The teams also worked collaboratively, since many projects were interconnected and shared common goals. One such example was related to hazardous substances, such as lead, cadmium, and mercury, contained in many electronics. Computers and other electronics accounted for as much as 40% of the lead in U.S. landfills,[22] even though 80% of the e-waste collected for recycling was being exported to developing countries where the toxic components led to pollution levels that were hundreds of thousands of times higher than those allowed in developed countries,[23] as well as tragic, large-scale human health effects. While the e-waste team was working to dispose safely of lead and other hazardous substances in electronics, the materials innovation group was seeking ways to get them removed from computers in the first place.

Materials Innovation Project: Buying RoHs-Compliant Computers

One of the first quick wins in the electronics network was related to the issue of eliminating hazardous chemicals from production. Alex Cook, an electronics buyer and member of the sustainability network, was making a standard visit to a computer supplier in China in March 2005 when he noticed that the company was running two manufacturing lines for the same product. Inquiring about the reason, he was told that one line made traditional computers for the U.S. while the other made RoHS-compliant computers for customers in Europe. RoHS (Restriction on Hazardous Substances) was a new directive by the European Parliament to restrict the use of certain hazardous substances in electrical

and electronic equipment This particular manufacturer planned to ship RoHS-compliant products to Europe in January 2006. On learning more about the program, Cook asked if he could buy these machines on the same timeline.

Ultimately, the supplier agreed to sell the RoHS-compliant product to Wal-Mart as long as Wal-Mart would guarantee the order, essentially eliminating risk to the supplier by making a commitment for 12 weeks of inventory as opposed to the more typical four-week commitment. Wal-Mart's commitment also created an economic benefit for the supplier because it did not have to shift its production line between RoHS-compliant and non-RoHS-compliant machines, which was a costly and time-consuming process.

Shortly after Wal-Mart made its first purchase of RoHS-compliant computers, it started to ask other computer manufacturers for RoHS-compliant products. Before long, many of them informed Wal-Mart that they were switching all their U.S. customers to products meeting RoHS standards. "By July 2006, which was actually when the European mandate took effect, every computer that we bought and every monitor that we acquired from every supplier was RoHS-compliant," said Cook, even though there was still no such mandate in the U.S. The network also had started working on meeting RoHS standards for its TVs.

E-waste

E-waste brought the network greater trial and error. Initially, the team tried to leverage return centers within the stores to run recycling take-back programs for electronics, but the return centers did not have adequate space and labor to deal with even small recycling volumes. The next attempt was focused on Wal-Mart's "Box Program," run in partnership with the U.S. Postal Service, HP, and Noranda Recycling. This program offered store customers postage-paid boxes to package and ship their used electronics for recycling. The boxes (including postage) sold for approximately $15—roughly 35% to 50% of the actual cost. Unfortunately, even in affluent geographic areas, customers appeared unwilling to pay to participate in the program.

Wal-Mart then sponsored a series of electronics-recycling days at stores across the country. "We collected just over 70 tons of electronics at five events in September 2006," said Jenni Dinger, a Wal-Mart music buyer and leader of the e-waste subteam. However, even with the continued participation of HP and Noranda, the events were costly and there was no measurable connection between customer participation and increased in-store sales.

Legislation

As of 2006, the U.S. had no federal electronics regulation, but states were taking action; 19 bills were in play in eight states and at least three states had e-waste laws.

However, each state was implementing a different policy. For example, California required retailers to collect a $6 to $10 fee when selling any laptop, monitor, television, or similar "covered" electronic device, used to certify and compensate other firms for the collection ($0.20 per pound) and recycling ($0.28 per pound) of used electronics. The advance recovery fee would increase as needed to cover all collection, recycling, and administrative costs.[24] California also imposed RoHS for laptops and monitors (effective January 2007).[25] In contrast, Maine and Maryland required producers to take responsibility for collecting and recycling used electronics.

Against this backdrop, Wal-Mart focused primarily on advocating national standards for both hazardous substances and e-waste. "We can't effectively manage a national program with state-by-state solutions. It's burdensome and very costly for us. There's also a need to do something at the national level since some states are doing nothing," said Phillips. U.S. Environmental Protection Agency (EPA) administrators were interested in the take-back programs sponsored by Wal-Mart, HP, and Noranda. By demonstrating successful and cost-effective collection and recycling, the partners could influence the federal government to pursue "producer responsibility" rather than the California model of advanced recycling fees and government administration of collection and recycling.

Progress as of Late 2006

Commenting on the overall progress of the electronics network, Phillips noted, "We've made a lot of progress because most of the changes make business sense to our suppliers." She added, "Where they push back is when they have to take on added costs," citing e-waste as an example of a project where cost-savings had not been realized through increased efficiency.

Another complicating factor in the electronics arena was supplier sensitivity around intellectual property. Scot Case of Blu Skye explained, "For example, if one factory is significantly more energy efficient than others, it's got an advantage. And if it shares that information, the competition might gain a much better understanding of its production costs and, therefore, its profit margins." Some even feared that this type of information could be used by Wal-Mart in its price negotiations with the supplier.

On the other hand, said Case, "anything that can be easily tested, most suppliers are more comfortable providing. Information about how much energy a product consumes is not particularly sensitive." This hesitancy to disclose was challenging to Wal-Mart not only from a performance management perspective. Ohm added, "If someone comes up with a better, more sustainable way to do something, we want to encourage them to share that with other suppliers to increase the impact." One way the network was encouraging its suppliers to accomplish this was by encouraging suppliers to license their environmental innovations. The opportunity to derive additional revenue from an environmental innovation would increase the incentive to suppliers for investment in innovation, while

licensing the innovation also would lead to improved environmental performance across the industry and more widespread benefits for Wal-Mart.

MEASURING SUSTAINABILITY

As of late 2006, sustainability metrics and monitoring processes were still under development. At the network level, each team had been asked to define the "sustainability attributes" of its products and services. These sustainability attributes would become the "North Star" toward which each network would direct its improvement efforts. Next, each network would define specific performance metrics that corresponded to its sustainability attributes to support decision-making (e.g., regarding product assortment and pricing) and to enable communication with customers and the public, as well as to motivate suppliers and associates.

Product Assortment, Pricing, and Communication With Customers

Wal-Mart needed new metrics to drive sustainability into its product assortment and pricing decisions. Expanding the product assortment would increase the company's sourcing and inventory costs. While new green products might draw new customers or result in additional purchases, they also cannibalized sales of conventional products. As Wal-Mart considered adding green products, new metrics were needed to help the company decide how many and which of these green products to offer, which conventional products should be retired, and how to price the related green and conventional products.

Wal-Mart had to consider multiple perspectives when devising these new metrics. For example, many NGO partners advocated against the use of PVC due to negative human health effects associated with toxins generated by the production and incineration of PVC. On the other hand, some suppliers argued that the negative health effects of PVC were unproven and that customers demanded the strength and flexibility in certain products (e.g., shower curtains, inflatable swimming pools) that only PVC could provide. Wal-Mart had to manage this tension as it decided on what metrics would drive its product assortment and pricing decisions.

Wal-Mart also needed new metrics for communicating with customers. Wal-Mart faced two primary problems with communicating products' sustainability-related attributes. First, the networks had to be careful about promoting the performance of green products in such a way that conventional alternatives would appear undesirable (e.g., MSC-certified versus noncertified fish). Second, Wal-Mart often did not have enough reliable information to definitively explain or defend a product's environmental and health benefits to customers. If the company was uncertain about the safety, effectiveness, or environmental impact of a product, for example, because it relied on suppliers to

self-police (e.g., RoHS-compliant PCs), it could not promote those attributes. These two problems were evident in the compact fluorescent light bulb (CFL) initiative, coordinated by the global greenhouse gas network.

Compact Fluorescent Light Bulbs

In 2006, driven by the sustainability attribute of improved energy efficiency, Wal-Mart announced a goal to sell 100 million energy-saving compact fluorescent light bulbs (CFLs) per year by 2008. If the company accomplished this objective, total sales of the bulbs in the U.S. would increase by 50% and the corresponding savings to Americans in electricity costs would be approximately $3 billion.[26] It would also result in a dramatic reduction in CO_2 emissions, since lighting accounted for approximately 8% of total U.S. CO_2 output[27] and each CFL used 75% less electricity.[28] From August 2005 to August 2006, Wal-Mart sold only 40 million CFLs compared to roughly 350 million incandescent bulbs.[29]

Sales of CFLs would directly cannibalize Wal-Mart's own lighting business, because each CFL lasted 10 times longer than an incandescent bulb. Nevertheless, Wal-Mart lowered its prices on CFLs from roughly $8.10 for a three-pack of bulbs to $7.59 (versus approximately $1.50 for three incandescents), expanded the presence of CFLs in the stores by moving the bulbs to eye level on the shelves, and heavily promoted CFL technology through creative marketing partnerships, media product placements, and other less-traditional communication strategies.

Wal-Mart further invested in in-store displays to help educate consumers on the benefits of CFLs, giving up precious selling space to showcase information about the value of the bulbs (each CFL was expected to save the consumer $30 in energy costs over its lifetime).[30] Concurrent with these promotional efforts, Wal-Mart was closely monitoring the reduction in CO_2 emissions achieved by its CFL initiative and other energy efficiency projects, but had not yet shared the detailed CO_2 emissions data with policymakers and the public.

Communication With the Public

In his October 2005 presentation to Wal-Mart associates and suppliers, Lee Scott admitted that the goals he announced were "ambitious and aspirational and I'm not sure how to achieve them . . . at least not yet."[31] According to Roger Deromedi, the CEO of Kraft at the time of Scott's speech, Wal-Mart exposed itself to risk in publicizing such bold objectives, particularly when it would be dependent on suppliers to achieve them.

Specific and measurable goals (e.g., to carry only MSC-certified wild fish within five years) were more compelling to the public, but also more risky. McDonald's was

sued for failing to keep a public promise to eliminate trans fats in its products by early 2003, and settled the suit by donating $7 million to the American Heart Association and spending $1.5 million to notify the public about the trans fats in its cooking oils.[32] By publishing goals that were aspirational but nonspecific, Wal-Mart invited less positive attention, but also reduced the risk of future criticism and liability.

Despite the risks, Ruben favored publicizing goals and results. He commented, "We get a lawsuit every few seconds anyway. One of the really liberating factors is how much criticism already exists." He also seemed relatively unconcerned about missing some of the deadlines made public as part of the company's efforts:

> We're going to miss some things. If we miss 90 percent of what we say, I think there are big costs. If we miss nothing, I think there are also costs. If we miss 10 percent, then I think we're about right. There's a believability about it, a realness about it, and an aggressiveness about it.

Supplier Performance Measurement

More than ever before, Wal-Mart was dependent on the cooperation of its suppliers to meet its public goals. As a result, effective supplier measurement and motivation was essential. The packaging network, under captain Matt Kistler, vice president of package and product innovations, was furthest ahead in this area. This group was in the process of implementing a web-based scorecard that would evaluate each product's packaging against nine metrics, such as the percentage of recycled content and the product-to-package ratio.

On February 1, 2007, Wal-Mart's 60,000-plus suppliers would be asked to begin using the scorecard for a one-year trial period to determine how their packaging innovations, environmental standards, energy efficiencies, and use of materials rated relative to their peers. The scorecard was perceived as an important enabler for helping the company achieve its public goal of reducing the packaging used by all its suppliers by 5% between 2008 and 2013. If achieved, this five-year program was expected to generate $3.4 billion in savings.

Ruben explained how Wal-Mart would seek to exert more influence over supplier behaviors as it sought to consolidate its business with a more select group of high-performing direct suppliers. "Right now we account for 2 percent of a lot of people's business, especially overseas. We know that needs to be a lot larger—maybe in the 50 or 60 percent," he said. This positioning would motivate suppliers to participate to maintain or expand the amount of business they received from Wal-Mart. "We're trying to stimulate a race for the top," said Phillips.

Associate Performance Measurement

Internally, Wal-Mart planned to translate sustainability attributes into an objective measurement system to track the performance of associates in important functions such as merchandising, strategic sourcing, and other roles that were directly linked to its sustainability efforts. However, as of late 2006, decisions regarding how (and if) to measure these contributions had been left to the discretion of the networks captains. In some areas, such as electronics, broad preliminary metrics had been put into place. For example, electronics buyers for Sam's Club were required by Ohm to have at least 25% of the products they bought (by SKU) involved in some form of sustainability initiative (e.g., packaging reduction, RoHS compliance, improved energy efficiency). However, in most areas of the business, a formal system for measuring associate involvement in sustainability did not exist, which meant that individuals were forced to try to distinguish their sustainability-related contributions against largely subjective criteria.

LOOKING FORWARD

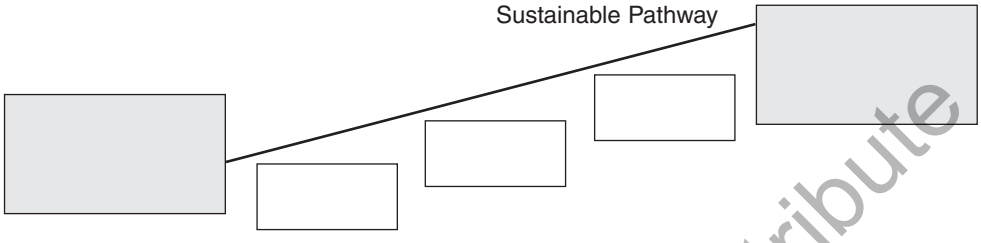
At the end of 2006, Ruben and Elm estimated that the profits generated by the sustainability strategy's quick wins in the first year were roughly equivalent to the profits from several Supercenters. They saw an overwhelmingly large array of opportunities that remained untapped, and resolved to continue to identify and pursue the opportunities with greatest environmental benefits and business value.

Case Questions

1. Thinking about Wal-Mart's environmental strategy as described in the case, where does it fit into the different approaches to sustainability discussed in the chapter? For example, is Wal-Mart proactive or reactive in addressing environmental concerns?
2. Do Wal-Mart's environmental stewardship efforts compensate for its shortcomings in other areas of corporate responsibility?
3. Wal-Mart's consumers, in general, are unwilling to pay a premium for environmentally friendly products. In light of this, how is Wal-Mart's environmental strategy an example of shared value creation?
4. What are some ways in which Wal-Mart ensures that it keeps deriving commercial value through sustainability?
5. Wal-Mart's sustainability strategy has generally been very profitable; however, two initiatives described in the case benefit society and the environment but apparently decrease Wal-Mart's profits. How would you justify pursuing those initiatives?

Exhibit 3.1 How Networks Drive Sustainability Goals

Using competitive forces to create a race to the top



TO

FROM

Today's Business Practices

- Fossil fuel dependence
- Waste in many forms
- Products that don't account for full costs to society

Unintended negative consequences for our customers and business

Quick Wins

< 1 year

- Actions that make business sense based on available technologies, products, and processes

Innovation
Projects

1 to 3 years

- Opportunities that make sense based on emerging technology, processes, and innovation

Big Game Change

Ongoing

- Changing the "rules of the game" to tilt the playing field to favor sustainable practices, in areas where we can lead, so that the market works for sustainability, not against it

Sustainable Business Practices

- Use 100% renewable energy
- Produce zero waste
- Sell products that sustain our resources and environment
- A win for society and a win for business

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31. "Sen. Jeffords introduces legislation to protect Americans from hazardous chemicals in consumer products." (2005, July 13). Retrieved January 25, 2007, from http://www.epw.senate.gov/pressitem.cfm?id=240542&party=dem

32. Ibid.