



Charting a Path to Sustainability Leadership

by James Cerruti

Operational sustainability performance is becoming increasingly important to corporations and their stakeholders, but operational performance is not the only measure that matters. There is also considerable value in communicating the corporate sustainability story. This report looks at the potential benefits to corporations of demonstrating good environmental, social, and governance (ESG) performance and discusses five common characteristics of sustainability "leaders"—companies that excel in both the operational and communication dimensions of sustainability.

As economic and societal priorities change over time, so do the criteria that define corporate leadership. The world's "best" organizations have, at various times, been identified as those that excel in research and development and new product development, those that display excellence in operational and process reengineering, or those best able to focus on core competencies. More recently, the yardstick has been the ill-defined term "innovation"—the ability to be a game changer via breakthrough products or business models.

Not surprisingly, given the intense global competition for resources, talent, and market share, corporate sustainability has emerged as a new leadership benchmark. Especially among the largest and most influential corporations—those that control a large portion of the world's physical resources as well as its human and economic capital— sustainability is an increasingly important factor in both competitiveness and risk management. Corporate practices are scrutinized more closely than ever, and markets, supply chain partners, employees, regulators, and communities are all demanding proof of sustainable performance from these companies.



The focus on sustainability has given rise to the increasing adoption of universally recognized reporting guidelines such as those maintained by the Global Reporting Initiative (GRI), whose guidelines are now entering their fourth generation. New standards organizations, such as the Sustainability Accounting Standards Board (SASB), are emerging to provide uniform best practices for accountability and reporting (see box below).

Sustainability Is Bigger Than "Green"

Even as some consumer-focused studies suggest that sustainability still does not play a large role in consumers' purchase behavior, other studies have shown strong correlation—if not causality—between sustainability and performance in the marketplace, as well as lower cost of capital.¹ One notable Deutsche Bank study analyzed 36 leading academic studies, demonstrating a clear correlation between sustainability and corporate financial performance.² One study from The Harvard University Business School links corporate social responsibility with access to finance.³ Another examines the impact of a culture of sustainability on corporate performance.⁴ These findings point to an important and still too-often ignored concept: that sustainability is more than being "green."

In common parlance, *sustainability* is often equated with *environmental responsibility*. In reality, however, sustainability is also based on social and corporate governance factors, from workforce and community relations to regulatory compliance and reporting.

Sustainability Accounting Standards Board

The Sustainability Accounting Standards Board (SASB) is a 501(c)3 nonprofit engaged in the creation and dissemination of sustainability accounting standards for use by publicly listed corporations in disclosing material sustainability issues for the benefit of investors and the public. SASB intends to complement the work of the Financial Accounting Standards Board (FASB) and support the SEC by defining material sustainability issues and establishing standards for accounting for impacts that affect sustainable value creation in standard disclosure formats such as the Forms 10-K and 20-F. Using a multi-stakeholder, transparent process, SASB aims to define the materiality of key environmental, social, and governance issues within each industry and produce a set of concise, comparable industry-based sustainability accounting standards. Over the next 2.5 years, SASB plans to develop standards for 89 industries in 10 sectors.

Source: www.sasb.org

The collective term *ESG* encompasses the myriad environmental, social, and governance factors that go into sustainability performance.

This distinction is well understood by informed observers and sustainability executives and is reflected in the GRI. Yet, to the general public and those not heavily invested in sustainability, the distinction is sometimes lost. Indeed, most sustainability reports lean heavily on the green image even as they report on all three aspects of ESG, furthering the misperception that it's all about the environment.

Attending to all three parts of sustainability is crucial—perhaps not yet to most consumers, but certainly to other stakeholder groups that base important decisions on such factors as corporate citizenship and regulatory compliance. A corporation that can demonstrate good sustainability performance stands to reap many benefits over the long term. Prospective employees—particularly new graduates who are attentive to sustainability issues—may find a top performer more attractive. Supply chain partners with their own sustainability mandates will give preference to companies that meet ESG standards. Financing firms and insurers can offer better rates and terms to companies that actively manage risk issues associated with sustainability.

Good ESG performance alone is not enough to generate competitive advantage. It is also necessary to communicate the ESG story effectively in order to establish an image of sustainability supported by fact.

Such a climate raises an important question for businesses: Is good ESG performance alone enough to generate competitive advantage? We believe the answer is no. It is also necessary to *communicate* this performance effectively in order to establish an image of sustainability supported by fact. It is a rich and valuable story that goes far beyond the numbers, one that can have a powerful impact on perceptions. Key stakeholders need to fully understand corporate commitments, activities, and achievements related to sustainability in order to make properly informed decisions. Without this understanding, they may make investment, business, purchase, or employment choices based on inaccurate beliefs about the company.

The Reality-Perception Gap

Examining both real sustainability performance and stakeholder perceptions in parallel can uncover important opportunities and threats related to corporate brand reputation. For example, a company that has achieved excellent sustainability performance but still has a poor image in the eyes of stakeholders is missing opportunities to attract talent, become a preferred business partner, and show that it can meet investor expectations. By the same token, a company that is thought of as highly sustainable but that does not have a record of performance to back up its image places considerable economic value at risk. The advantages associated with a good reputation for sustainability can easily be negated if stakeholder perceptions are not supported by corporate performance.

The ability to compare directly real performance and perceived performance provides sustainability and brand communications executives a means to identify where improvements are needed. Executives can then use this information to help guide investment decisions and communications initiatives on a global basis, rather than basing such decisions on crisis response or interest group agendas.

Sustainability IQ: A method for comparing reality to perception

The key to generating useful insights around real and perceived sustainability performance lies in finding a way to compare two different kinds of information. Sustainability performance is measurable using widely accepted, objective metrics that are readily available. Perceived performance, on the other hand, is highly subjective and influenced by audience, motivation, and circumstance. Measuring it requires a rigorous, consistently applied methodology. In 2011, Brandlogic created a framework to align and rationalize this information, called Sustainability IQ. It can be applied to any company that reports on sustainability, providing useful guidance on investment decisions related to sustainability initiatives, reporting, and brand communications. To prove the concept, the Sustainability IQ framework was used to analyze the performance of select global brands as part of an annual Sustainability Leadership Report.5

Sustainability IQ Sources at a Glance

Sustainability Reality Score (SRS)

175 metrics for rating companies

Five key performance indicators per ESG dimension

1,200 rated corporations

Sustainability Perception Score (SPS)

16,000+ company ratings

2,400 respondents from three "highly attentive" stakeholder segments

100 prominent global corporations covering nine of the 10 global industry categories

Six major countries covered

Source: Brandlogic/CRD Analytics

The Sustainability IQ is based on two indices: a company's Sustainability Reality Score (SRS) and its Sustainability Perception Score (SPS). Each is generated differently.

The Sustainability Reality Score is prepared in collaboration with CRD Analytics, the originators of the NASDAQ Sustainability Index. Using data drawn from their proprietary SmartView® 360 platform and database, companies are analyzed based on numerous ESG factors to produce a large quantitative data set. For the inaugural report, 1,200 companies were analyzed, based on five key performance indicators for each of the three ESG dimensions supported by 175 individual metrics. From this group, 100 prominent global brands were selected using criteria such as Global Industry Classification Standard (GICS) industry category representation and sector-leading brand value.

Key Sustainability Performance Indicators

Environmental Waste, energy, water, emissions, risk mitigation

Social Product responsibility, community, human rights, diversity and opportunity, employment quality

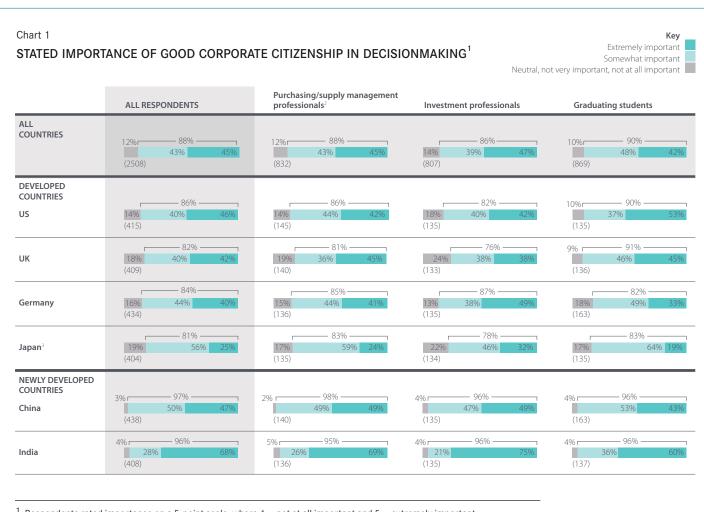
Governance Board functions, board structure, compensation, vision and strategy, stakeholder rights

The Sustainability Perception Score is derived from a global perception survey conducted by Brandlogic with support from The Institute for Supply Management. Rather than focusing on a single stakeholder group or a population that is not focused on sustainability (such as consumers), the survey is specifically designed to include three key—and more importantly, highly attentive—stakeholder groups:

- Investment professionals because they base their decisions on all aspects of corporate performance
- Purchasing managers because, increasingly, their own organization's sustainability policies give preference to suppliers that also operate sustainably
- Graduating university students because they are in the process of deciding where they want to work, and the longterm sustainability of prospective employers is of high importance to them

Recognizing that perceptions are highly varied by region and economic profile, the survey spans multiple geographies as well as both mature and emerging economies—China, India, Japan, Germany, the United Kingdom, and the United States. Comparing perception among these highly attentive audiences and across markets can provide useful insights (see Chart 1). For instance, divergences in a particular audience's perception in fully developed versus emerging markets might indicate that the company needs to do a better job of targeting its sustainability communications.

Each survey respondent was asked to rate up to seven companies on ESG factors that parallel the major categories tracked by CRD Analytics. The result was more than 16,000 individual company ratings spanning markets, industry sectors, and audiences.



 $^{{\}color{blue}1} \quad \text{Respondents rated importance on a 5-point scale, where 1 = not at all important and 5 = extremely important.}$

 $^{^2~\}text{U.S.}$ sample provided by The Institute for Supply Management $^{\text{TM}}.$

³ Survey was in field in Japan within 2 months of earthquake and tsunami natural disaster.

Sustainability is bigger than "green." Across all stakeholder groups, it isn't the environment that's most important. It's social responsibility, by a factor of two.

In addition to the category ratings, the survey sought to uncover the factors deemed most important by each stakeholder group. A group that emphasizes one aspect of ESG above the others will be more attentive to that factor when making decisions; therefore, this information is of use when telling the company's ESG story. This factor was held to be highly material to the development of the metrics that underpin the Sustainability Perception Score, and the survey did indeed find such an emphasis: Across all stakeholder groups, social responsibility was rated as more important than environmental or governance considerations by a factor of two. To reflect the respondents' own weighting of the stated importance of ESG, the raw scores were adjusted when generating the SPS.

Because the raw reality and weighted perception scores are not directly comparable, the final step is to translate them into the point-based SRS and SPS indices. These indices provide a two-dimensional data set for each of the 100 companies.

The Brandlogic Sustainability IQ MatrixSM

The SRS and SPS for each company was plotted along with the mean for each. The result is the Brandlogic Sustainability IQ Matrix, which divides the 100 companies into four groups:

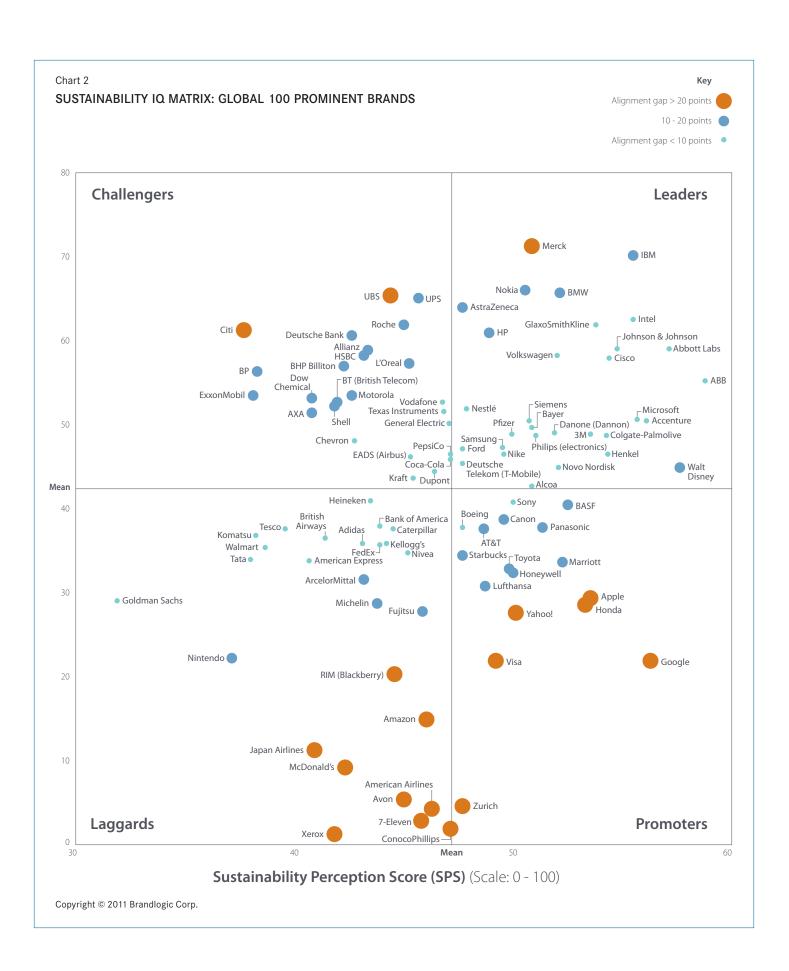
- Leaders Companies that outperform the mean in both real and perceived performance on ESG factors
- **Promoters** Companies with perceptions that are higher than actual performance and whose brand value is therefore at risk
- Challengers Companies with real performance that is higher than perceptions, suggesting that their accomplishments are not recognized by stakeholders
- Laggards Companies that trail on both dimensions

Viewing reality and perception this way makes it easier to see where sustainability-related opportunities and threats exist. Breaking out the 100 companies into individual industry sectors also allows direct comparisons between peers (see Chart 2 on page 6).

Learning from the Leaders

The methodology for—and findings from—the Sustainability IQ Matrix are discussed in depth in the 2011 Brandlogic Sustainability Leadership Report.⁶ The 2012 Sustainability Leadership Report and its new findings will be the subject of a future Director Notes. Here, we discuss the common characteristics shared by the companies categorized as Leaders using the Sustainability IQ Matrix. Those Leaders:

- Treat sustainability as an integral part of business strategy, not just a compliance issue. Some Leaders build a corporate strategy that focuses on the value of adherence to key sustainability principles in terms of enhanced operations, finances, and relationships. They have evolved a clear business case for sustainability initiatives and see that it is possible to "do well by doing good." Nestlé provides an example of how this principle is expressed in a way that links directly to business results. The company analyzed its value chain and found ways to collaborate with local leaders in countries from which it sourced ingredients to improve nutrition, water quality and rural development in those communities. By proactively working to secure the health of its supply chain and communicating that fact to attentive stakeholders, Nestlé is also helping to secure future earnings as well as access to investment and talent.
- Take responsibility for the impact of internal operations and those of associated entities, such as supply chain partners. Leading companies have issued formal codes of conduct for suppliers that define minimum performance standards on ESG and also hold suppliers responsible for the conduct of subcontractors. Having these codes shows an understanding that sustainability is not an isolated concept, but one that is based on understanding and managing interdependencies in the value chain of the business. ABB, for example, views suppliers as its "extended enterprise" and holds them to the same values and principles to which ABB itself adheres. To quote them: "We view our suppliers as an integral extension of our global enterprise and strive for a transparent and efficient collaboration with best-in-class suppliers from which all our stakeholders benefit—customers, investors, ABB, and suppliers."
- Implement GRI standards for reporting and ensure that the materiality of sustainability issues is understood by all stakeholder groups. Leaders excel at meeting the GRI standards fully and transparently. Using recognized standards is essential because it helps ensure acceptance by stakeholders. In addition, highlighting the materiality of sustainability issues in a way that is meaningful for each stakeholder group sets the tone for both operational and strategic decisions across the enterprise. BMW's GRI reporting is a good example.9 It is easily accessible, available in multiple formats (PDF and spreadsheet), and presented in a relevant, thorough way; it is also easy to quickly comprehend and download information that is highly material to each inquiring individual.



- Integrate sustainability into their brand and client value propositions. Making sustainability a central part of the customer conversation can yield enormous benefits in terms of brand value, fundamentally changing how a company is viewed in the marketplace. A leading example of integrated sustainability can be found at IBM, which is one of the stellar Sustainability IQ performers. IBM has been brilliant in communicating its devotion to sustainability, making it a customer benefit rather than an inward-focused idea. IBM's Smarter Planet theme shows how the company can help its customers to enhance their performance in ways that foster sustainability. The company's advertising is focused on outcomes and social benefit rather than products and services. The overall impression is very much one of a shared agenda, rather than a sales pitch. GE, on the cusp of the Leaders quadrant, also has a customer-focused view of sustainability built on the idea that customer behaviorexpressed through the use of GE products—can have a much greater impact on global sustainability than anything the company itself does.
- Focus their operational initiatives and related communications on carefully selected themes tied to the core of the business.
 Leaders tend to use relevant themes to create varied, yet complementary, communications to key stakeholder groups.
 Cisco, for example, has an education initiative that helps people worldwide develop and use IT skills. This initiative also helps those being trained to understand and use Cisco's technologies, which in turn can help both Cisco and its customers develop and secure talent in the future. The effort thus becomes a virtuous circle that helps people while helping the company.

Conclusion

When addressing corporate sustainability, companies should consider both their operational performance as well as the perceptions of their key stakeholders. Focusing on both real and perceived performance can generate additional opportunities and highlight areas of risk. For example, a company with good operational performance can gain considerable brand equity by working to align stakeholder perceptions with reality. Moreover, both real performance and perception can be enhanced by implementing the five key practices demonstrated by sustainability leaders.

Endnotes

- 1 Corporate ESG/Sustainability Reporting—Does It Matter? Governance & Accountability Institute, 2011.
- 2 Sustainable Investing: Establishing long-term financial performance. DB Climate Change Advisors, Deutsche Bank Group, June 2012.
- 3 Beiting Cheng, Ioannis Ioannou, and George Serafeim, Corporate Social Responsibility and Access to Finance, Harvard Business School, Working Paper 11-130, May 2012.
- 4 Robert Eccles, Ioannis Ioannou, and George Serafeim, The Impact of a Corporate Culture of Sustainability on Corporate Behavior and Performance, Harvard Business School, Working Paper 12-035, May 2012.
- 5 For more information on the Sustainability IQ and the findings of the first report, see *Sustainability Leadership Report: Measuring Perception vs. Reality*, Brandlogic and CRD Analytics, 2011 (www. sustainabilityleadershipreport.com/).

- 6 Sustainability Leadership Report: Measuring Perception vs. Reality, Brandlogic and CRD Analytics, 2011 (www. sustainabilityleadershipreport.com/).
- 7 For example, see ABB's Supplier Code of Conduct (http://www.abb.com/cawp/seitp161/1c85f0f085e972e4c12577680059b934.aspx).
- 8 ABB, www.abb.com/cawp/seitp161/99ae918f4cd72613c12569ae005 8189b.aspx, retrieved October 23, 2012.
- 9 See BMW Group Sustainable Value Report 2010 (www.bmwgroup.com/e/nav/index.html?http://www.bmwgroup.com/e/0_0_www_bmwgroup_com/verantwortung/kennzahlen_und_fakten/ziele_kennzahlen.html).

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