



# The Green Gap

## *Avoiding pitfalls on the sustainability path to shareholder value*

Doing good for the environment and society has long differentiated consumer product companies, like Patagonia. The ROI associated with its closed-loop recycling system for polyester, which cuts energy use by 76 percent and reduced emissions by 71 percent compared to using virgin polyester<sup>1</sup>, is clearly understood by board members and outsiders alike. But when Patagonia pulled the popular Nalgene polycarbonate-constructed water bottles from its store shelves over worries about the chemical bisphenol A in 2005,<sup>2</sup> it is evident that more than an ROI analysis is needed to understand how being sustainable can build shareholder value.

Whether driven by consumer interest, rising commodity prices, retailer requirements, or pending legislation, senior executives are beginning to make sustainability a top agenda item. The markets agree—according to a 2008 study by the Economist Intelligence Unit, companies that embrace sustainability have achieved the highest share price growth over the past three years whereas companies with the worst performance focused less on sustainability.<sup>3</sup> It is clear the cost of doing nothing is too great, but what pitfalls exist for companies on the path to sustainability? Below are nine items companies should consider to ensure their sustainability efforts are delivering shareholder value.



## Pitfall #1: Confusion from the start

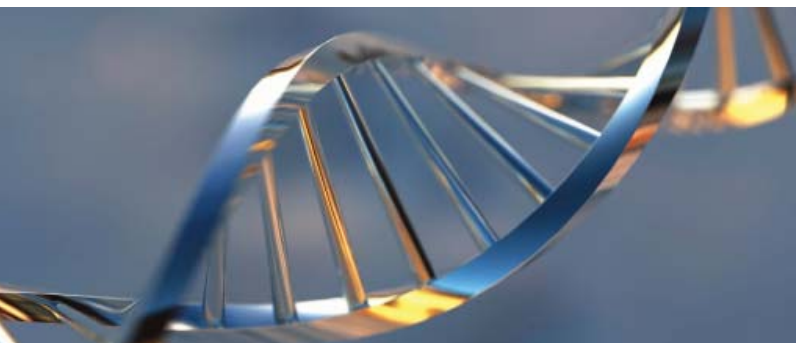
Sustainability is often left open to interpretation as it remains a broad and complex concept that has not been consistently defined. The UN Brundtland Commission developed one of the first definitions of sustainability: “Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs.” However, the Commission’s definition has not been consistently adopted by companies, thus complicating the sustainability landscape. For example, corporate philanthropic efforts to protect the environment or improve the conditions of local communities often get cited as examples of sustainability. Less obvious components of sustainability are efforts to mitigate raw material shortages or to improve corporate governance and transparency.

Despite the confusion, it is becoming commonly accepted that sustainability encompasses the triple bottom line, including environmental, social and economic factors. The strategic opportunity for sustainability is at the intersection of all three—considering both the environmental and social implications while continuing to build shareholder value. Where this may become tricky is when the environmental or social benefits outweigh the short-term financial bottom line.

Nonetheless, defining sustainability is a critical first step to leveraging it as part of an enterprise’s strategy. Employees need to clearly understand what it means—and does not mean—to help the salesforce, product managers, and public relations departments speak to external parties in a meaningful way. It also can help product engineers and operations managers design products and processes while considering the triple bottom line. Though many organizations have used the UN Brundtland Commission’s definition as a starting point for their sustainability definition, a more narrow definition may be required depending on a company’s culture.

## Pitfall #2: The missing link—organizational DNA

Defining sustainability is a critical first step, but a definition alone is incomplete. A sustainability vision statement should also be developed in order to serve as a guide post for decision-making related to strategic issues, such as capital projects or merger/acquisition targeting, as well as tactical issues including supplier requirements for back-office supplies. By having an inspiring, action-oriented sustainability vision statement, a company can further engage its employees and stakeholders. Such engagement is the first step in embedding sustainability within the company’s culture. Consider Patagonia’s unique sustainability vision: “Lead an examined life. Clean up our act. Do our penance. Support civil democracy. Influence other companies.”



A company’s mission statement commonly defines the organization itself—so important, that it is sometimes referred to as the company’s DNA. With something so central to a company’s being, it is critical that the sustainability vision statement aligns closely with the company’s mission statement. For example, SC Johnson’s mission statement and sustainability vision share an unmistakable “family values” link:

- **Mission Statement:** Through five generations of *family leadership*, SC Johnson has become a leading consumer products company that *helps improve quality of life for families around the world.*
- **Sustainability Vision Statement:** SC Johnson is committed to doing what’s right. As a *family* company, we care about every *family*. From the products you use, to the air you breathe, to the community you live in, we’re working to make this world a cleaner, healthier, better place...today, for the next generation and beyond.

Based on the statements above, it is clear to both employees and external stakeholders that sustainability is a natural extension of SC Johnson’s core mission.

## Pitfall #3: Pursuing without priorities

Sustainability is a large, strategic issue that can impact multiple areas of an enterprise. Taking one large environmental challenge head-on, such as water consumption and quality, can require significant resources. Taking on many challenges on a smaller scale can dilute the desired environmental benefits or worse, and it can also confuse key stakeholders about what is really important to the enterprise. Developing clear priorities helps decision-making when the ROI is foggy or the payback appears further out. Hybrid vehicles, for example, can improve fuel efficiency and reduce greenhouse gas emissions for large fleet owners. However, these vehicles can cost over \$70,000—at least 75 percent more than conventional vehicles—sometimes requiring over a 10-year payback for the fuel savings differential.<sup>4</sup> The investment in these vehicles may not meet a company’s payback period, but the long-term cost of not taking sustainability seriously may be as considerable as the short-term cost of adopting sustainability initiatives.<sup>5</sup>

Defining priorities requires analyzing the enterprise’s inputs and outputs at the operational level. In assessing its inputs, a company may consider its top spend categories for raw materials. Accordingly, as some commodities experience increasing levels of volatility, companies may elect to make them a higher priority for both environment and economic benefits. For example, our oil-based economy presents challenges for almost every sector when the Energy Information Administration (“EIA”) predicts that “tight fundamentals, evidenced by low available surplus capacity and OECD inventories that are below five-year average levels, [will] continue to put upward pressure on oil prices” for 2008.<sup>6</sup> The proven cost volatility of oil thus may spur on a company to place energy management at the top of its strategic priorities.

<sup>2</sup>As used in this document, “Deloitte” means Deloitte Consulting LLP, a subsidiary of Deloitte LLP. Please see [www.deloitte.com/us/about](http://www.deloitte.com/us/about) for a detailed description of the legal structure of Deloitte LLP and its subsidiaries. Note: While a company’s delivery model will affect its opportunities, the target areas suggested in this paper are model-agnostic and, therefore, relatively appropriate for any CPG company.

On the other hand, stakeholder concerns compel companies to reduce the outputs generated from operations. For example, consumers are becoming increasingly aware of the negative impacts of greenhouse gas emissions, escalating the pressure on companies to reduce their emissions levels. As such, reduction of emissions has emerged as a top priority for many companies as well as the related causes of emissions, such as energy and transportation.

Social issues need to be considered as priorities as well, especially for consumer businesses which have brands to build and protect. Many times, these social priorities align closely with the brand portfolio's target markets. Estee Lauder has taken up breast cancer awareness as its cause-related marketing issue of choice to address a public health issue directly impacting its target market—women. Founded by Evelyn Lauder, the Breast Cancer Research Foundation developed the iconic pink ribbon and has raised more than \$180 million to date with the support of other consumer businesses such as Ann Taylor.<sup>7</sup>

McDonald's "Balanced, Active Lifestyles" program serves as another example of the importance of social priorities. To target the growing prevalence of obesity in America where consumers spent \$110 billion on fast food in 2000<sup>8</sup>, the program offers a three-pronged approach<sup>9</sup>:

- Increase menu choice by adding healthier food and beverage options, such as fruits, vegetables, fruit juices, and water bottles
- Offer nutritional information to help diners achieve their well-being goals
- Promote physical activity for children and families

As one of the best known brands in the world, McDonald's sought to use its brand stature to influence Americans' eating habits. For example, a survey of American children showed that 96 percent could accurately identify Ronald McDonald with Santa Claus as the only other character that was better recognized.<sup>10</sup> Accordingly, McDonald's also transformed its mascot, Ronald McDonald, into an ambassador for health to promote further its "Balanced, Active Lifestyles" message.<sup>11</sup>

## Pitfall #4: Baseless progress

85 percent of leading Consumer Businesses have pursued some sort of sustainability-related initiative<sup>12</sup>—whether to streamline production processes to reduce raw material inputs or retrofit lighting fixtures to use lower energy bulbs. What is critically lacking, in many cases, are established baselines against which year-on-year benefits can be measured. It is one thing to tell the Board of Directors that sustainability is an integral component of the company's strategy or that \$10 million was invested in energy saving technology; however, it is another and far more powerful message to communicate that manufacturing waste was reduced by 45 percent since 1998 like Nike delivered.<sup>13</sup> Beyond missing an opportunity to more effectively engage with key stakeholders, it is also difficult to pursue state or federal tax incentives associated with lowering environmental impact without baseline data.

Generally speaking, baselines should be established for each key sustainability priority. On the consumption side, this might include water, energy, pulp, recycled or agricultural inputs, while the disposal side might include greenhouse gas emissions, waste water, scrap

waste and recycled waste. Measuring some of these inputs/outputs is relatively straightforward depending on data availability and quality; for example, electricity is generally measured in kilowatt hours and the data can be aggregated from electricity utility companies.

A more difficult baseline to establish involves measuring greenhouse gas emissions, an issue that has been garnering increased public attention. To aid companies with determining their greenhouse gas emissions inventory, the Greenhouse Gas Protocol developed an accounting framework that provides guidelines and models that are available for free on its website.<sup>14</sup> Although both companies and governments have relied on the GHG Protocol standard, it has not been established as an official methodology. The lack of a formally sanctioned framework for calculating GHG emissions currently precludes the opportunity to accurately assess emissions levels across companies.

Another option that companies have been pursuing is to partner with The Carbon Disclosure Project ("CDP"). CDP is an independent non-profit organization that has emerged as a leader in measuring companies' emissions levels by gathering voluntary data via questionnaire. However, despite the large number of responses received—77 percent of Fortune 500 companies and 1,300 corporations answered the questionnaire in 2007<sup>15</sup>—CDP's methodology and processes are not subject to third-party scrutiny.<sup>16</sup> Nonetheless, CDP has also launched a joint effort with Wal-Mart to measure energy use and climate change effects throughout its entire supply chain.<sup>17</sup>

## Pitfall #5: Lifecycle Analysis Paralysis

Lifecycle assessments can be a powerful tool to compare the range of environmental impacts along the value chain for a particular product in order to select options with the least impact. However, the lack of a standardized methodology and trained resources may often prevent meaningful results. In addition, the resource and time requirements to conduct a thorough analysis across a company's product lines could be significant. A full lifecycle assessment may not be ideal for companies that lack the resources or the technical expertise in the initial phase of developing a sustainability action plan. Rather, an alternative to a full lifecycle assessment is to create a "sustainability index" that serves as an internal tool to evaluate each product line against the others based on products' sustainability attributes and overall value to the company. Determining the "sustainability index" requires developing criteria that aligns with an enterprise's value chain.

A typical value chain for a consumer products company may include sourcing, manufacturing, packaging, distribution, product use, and product disposal. For example, within the sourcing step, a company may consider if it is designing its product to conserve resources (e.g., recyclable materials, minimized components) or using low environmental impact materials (e.g., lacking hazardous chemicals). On the opposite end of the value chain within the disposal step, a company may consider if the product can be easily recycled, reused, or safely disposed by the consumer. Not all criteria are created equal nor do they have the same impact on the enterprise's mission to become more sustainable; therefore, the criteria in the "sustainability index" should be weighted according to the enterprise's sustainability strategic priorities.

## Pitfall #6: The Lone Rider

Going it alone when it comes to tackling sustainability challenges can be arduous, if not impossible. Companies must keep up with changing technology, which provides not only a better understanding of environmental and social effects of an enterprise's operations, but also new potential solutions to sustainability challenges. However, companies cannot take full advantage of technology's benefits without collaborating with external organizations to help them navigate the ever-changing sustainability landscape. Companies should collaborate with non-profit organizations, academia or industry groups to develop a more comprehensive understanding of the issues, to identify more innovative tactics or technology to address the issues, and to engage potential stakeholders, such as NGO's, to achieve their sustainability goals.

For example, faced with a shrinking global supply of fish, Unilever collaborated with the World Wildlife Fund ("WWF") to establish the Marine Stewardship Council ("MSC") in 1997 to ensure the long-term sustainability of the fish supply and the integrity of the marine ecosystem.<sup>18</sup> The MSC established a global environmental standard for responsible fisheries using a two year consultation process with stakeholders, and in 1999, the MSC became an independent non-profit organization.<sup>19</sup>

In another example, the Coca-Cola Company partnered with the U.S. Agency for International Development ("USAID") and launched the Water and Development Alliance ("WADA") to address water scarcity and quality issues in developing countries. Since WADA was formed in 2005, it has succeeded in establishing water programs in 14 countries, which has benefited 254,000 people to date. The \$14.3 million that have been committed by WADA will continue to be used to increase access to sanitary water, promote hygiene, and establish sustainable water management systems in the developing world.<sup>20</sup>

## Pitfall #7: Lacking Leadership

Much like other major strategic issues, sustainability requires a senior executive champion to drive accountability, evaluate risks, overcome organizational barriers, and speak in an informed manner to investors and other stakeholders. Relying on lower-level managers to pursue sustainability does not tend to deliver the desired results. In fact, according to the aforementioned study by the Economist Intelligence Unit, "...high-performing companies put a much greater emphasis on social and environmental considerations at board level, while the poorly performing firms are far more likely to have nobody in charge of sustainability issues."<sup>21</sup>

In addition to pushing the sustainability agenda, gaining leadership buy-in will also help set the stage for attracting future leaders to carry out a company's sustainability priorities. A MonsterTRAK.com poll revealed that 80 percent of young professionals are interested in jobs that have positive impacts on the environment and that 92 percent prefer to work for environmentally friendly companies.<sup>22</sup> Due to the significant increase in demand for green jobs, MonsterTRAK.com partnered with ecoAlliance, a non-profit environmental group, to launch GreenCareers, an online job site that lists environmental job positions.<sup>23</sup>

## Pitfall #8: Communicating too early or not at all

Reducing greenhouse gas emissions, waste or water usage are all commendable steps an organization can take to reduce its impact on the environment and a natural reaction may be to broadcast its success to the world. However, before penning the press release, it is critical to assess the true benefits offered by a company's sustainability initiatives, products, and/or services to prevent the risk of being accused of communicating unsubstantiated claims. EnviroMedia, a social marketing firm, conducted a survey of delegates at the UN Climate Change Conference in Bali, Indonesia in December 2007. The survey results indicated that nine out of 10 delegates believe that, "Some companies are advertising products and services with environmental claims that could be considered false, unsubstantiated, and/or unethical."<sup>24</sup> In response to the growing prevalence of greenwashing, EnviroMedia launched a "Greenwashing Index," an online forum that allows consumers to submit advertisements by companies that make environmental claims.<sup>25</sup> The purpose of the website is to educate consumers about how to evaluate green marketing claims, hold businesses accountable for such claims, and promote sustainable business practices that actually reduce environmental impact.<sup>26</sup>

On the flipside, regulations and requirements for companies to publish their contribution to environmental issues, such as climate change, may be forthcoming, and preparing for such requests for information takes time and resources. In September 2007, a coalition of investors, state officials, and environmental advocates (such as Environmental Defense, Ceres, and State Treasurers from Maryland, Maine, Kentucky, and California) petitioned the Securities and Exchange Commission (SEC) to require public companies to fully disclose all financial risks that are related to climate change.<sup>27</sup> In addition, companies that have voluntarily developed sustainability reports are subject to inquiries from audit firms that are being asked increasingly to provide third-party assurance on these reports.

Besides the time and resources required to publish sustainability reports, official guidelines and metrics to use for sustainability management and reporting are lacking.<sup>28</sup> However, it is likely that companies will seek to automate some of the required data to accelerate the process of report development. Automated data collection and analysis processes will have the added benefit of making the reports "more data-rich [and] transform them from a triumph of corporate communications to a useful tool for management."<sup>29</sup>

## Pitfall #9: Betting on the consumer

Going green appears to be a big deal on store shelves due to the growing number of consumers that are becoming aware of sustainability issues and modifying their purchasing decisions accordingly. A survey conducted by Information Resources, Inc. revealed that approximately half of consumers consider at least one sustainability factor when selecting which brands to purchase or stores to shop. Sustainability factors that may be considered include organic development, eco-friendly ingredients, eco-friendly packaging, and fair treatment of suppliers as well as employees.<sup>30</sup> However, it remains unclear whether consumers will sacrifice convenience or price for sustainability and thus, how lucrative sustainability will be for a company over the long run. A recent Ipsos Reid study revealed that *four in 10 Americans are not more willing to pay a price premium* for "green" products.<sup>31</sup>

Many consumers are also skeptical about green product claims and the company risks losing consumer's trust. For example, the Ipsos Reid study referenced earlier showed that 70 percent of Americans believe that "when companies call a product 'green' (meaning better for the environment), it is usually just a marketing tactic."<sup>32</sup> Men also tended to be more skeptical than women of companies' green marketing tactics. 75 percent of men believe that green product labeling is merely a marketing ploy whereas 65 percent of women shared this view.<sup>33</sup> Nonetheless, sustainability can certainly drive competitive advantage when targeting the right consumer segment.

## Creating a 'pitfall-free' foundation

Pursuing the right activities at the right time is critical to developing a strategic foundation that withstands the aforementioned pitfalls. Building the foundation should be done in four major steps, including strategic intent, operational strategy, governance and infrastructure, and operational integration.

**Strategic Intent.** The first step is to develop a sustainability definition and link it with an organization's DNA to create a sustainability vision statement—a guidepost for employees and stakeholders alike. Further, assessing how sustainability will impact the enterprise's competitive advantage—which involves analyzing both external market pressures and internal organizational readiness—is critical to identify top priority areas (e.g., greenhouse gas emissions, water, fair trade, diversity).

**Operational Strategy.** Once priorities are identified, it is necessary to establish an operational baseline to identify key metrics and targets, as well as to compare year-on-year progress for key inputs/outputs like water consumption. For consumer products companies, it is also necessary to analyze the current product portfolio using an internal sustainability index and value metrics to identify products that support its sustainability strategy, as well as those products that should be reformulated or discontinued. Finally, sustainability initiatives should be identified that align with the priorities and in some cases, leverage collaboration opportunities with academia or non-profit organizations to drive more innovation in the solutions.

**Governance & Infrastructure.** Identifying clear roles and responsibilities, including an executive sponsor should ensure that progress is being made towards the enterprise's sustainability priorities. In order to protect the firm, one of the first tasks of a Chief Sustainability Officer should be to establish a communication protocol for both external and internal audiences. To aid in the communication process, the CSO requires visibility into the sustainability efforts already underway. A process, as well as a tracking tool is critical to review/approve initiatives before they commence and provide visibility to the

senior executive team. As each sustainability initiative may deliver multiple benefits, the tracking tool should include a benefits hierarchy that allows for analysis at multiple levels; for example, Environmental > Water > Water Quality.

**Operational Integration.** Once learning the sustainability strategic intent and operational strategy, as well as the governance standards and infrastructure tools, employees will be equipped to generate innovative solutions that fulfill the enterprise sustainability aspirations. Generally speaking, these initiatives should fall into five major drivers: (1) cost and efficiency, (2) revenue enhancement, (3) stakeholder engagement, (4) risk management, and (5) regulatory compliance. The right personnel and tactics should be aligned with the strategic driver. For example, a revenue enhancement initiative should include marketing, sales and R&D personnel and should be designed to address a consumer need related to sustainability.

Given increasing pressures from a multitude of stakeholders, including consumers, retailers, regulators and non-profit organizations, it is clear why so many companies are marching down the sustainability path. What will differentiate those organizations who realize environmental and social benefits while delivering shareholder value is the strategic foundation they rely upon to avoid the pitfalls.

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## Endnotes

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