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The sustainability transformation: Look ahead, look inside, and look around

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RESPONSIBLE BUSINESS

The sustainability transformation

LOOK AHEAD, LOOK INSIDE, AND LOOK AROUND

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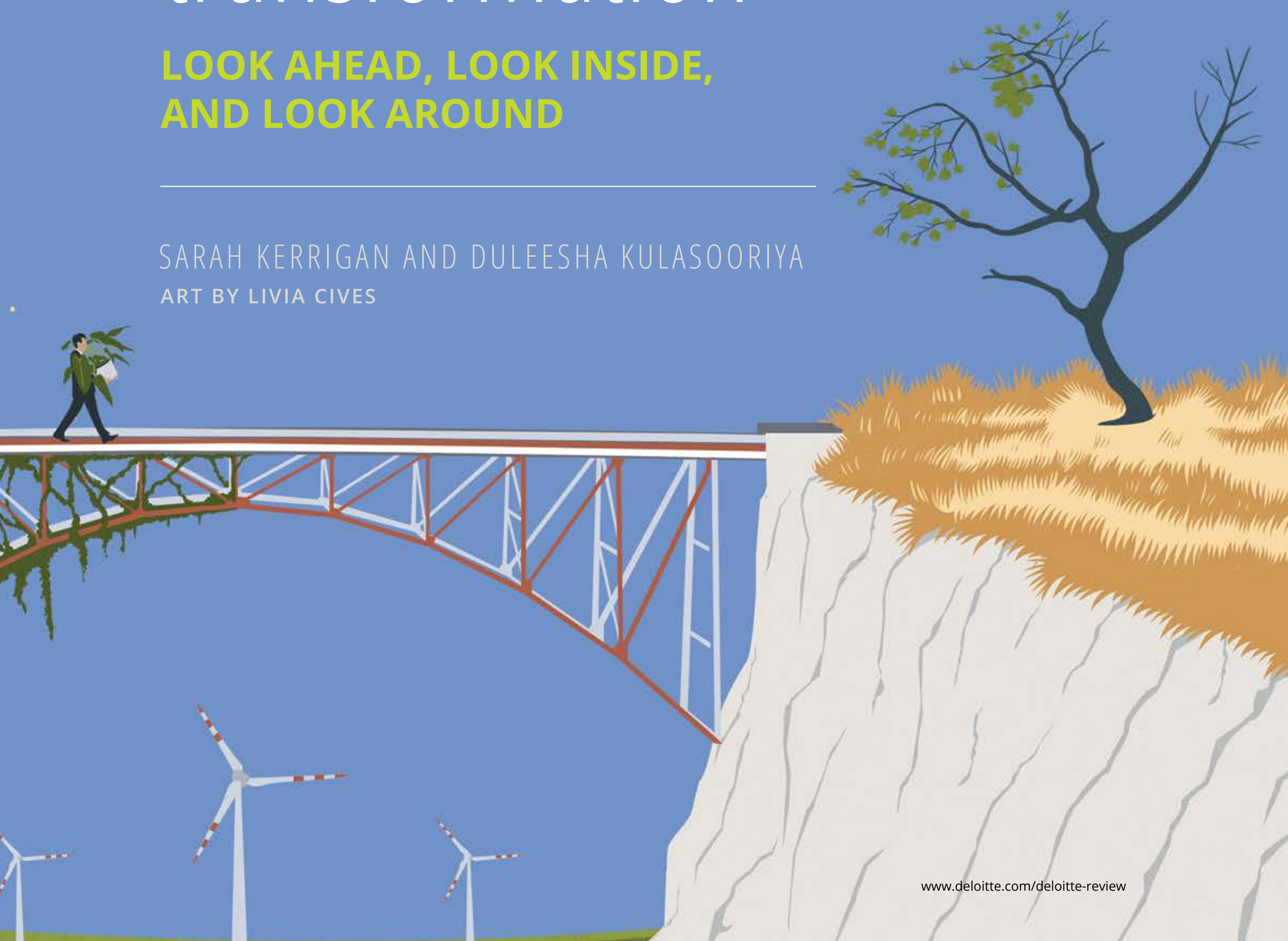


Climate change is a crisis of unprecedented magnitude that threatens to multiply a broad range of sustainability risks. Organizations are under increasing pressure to respond. Many will need to sustainably transform their business models to find new opportunities and avenues for growth for their future business.

In examining organizations that have started down this path, we have identified three basic actions that have enabled them to turn sustainability from a risk into an opportunity. First, they look *ahead* to understand how they can capture new growth opportunities from sustainability. Second, they look *inside*, within their business, to find ways to reconfigure their operations to help accelerate the transformation toward greater sustainability. Finally, they look *around* for opportunities to leverage their business ecosystem to help create competitive advantage in a sustainability-focused world. In this article, we explore what each of these actions entails, drawing lessons from some companies focused on sustainability.

Reaching the point of no return

The experience of Unilever over the last decade demonstrates that, despite financial headwinds, undertaking a sustainability transformation can create meaningful business value.

When Paul Polman took the reins as Unilever CEO during the global financial crisis, the firm was undergoing one of the most tumultuous periods of its 150-year history. In his first year, Polman created the Unilever Sustainable Living Plan, a decade-long scheme to double the company's revenue while simultaneously reducing its environmental footprint and increasing its social impact. But the Sustainable Living Plan wasn't "just" a sustainability plan. It was a business plan to grow Unilever's sustainable brands, drive innovation, and attract and retain talent.[1] During Polman's 10-year tenure (2009–2019), the company delivered consistent top- and bottom-line growth. His commitment to sustainably transform Unilever created excellent returns for its shareholders, delivering a total shareholder return of 290 percent.[2]

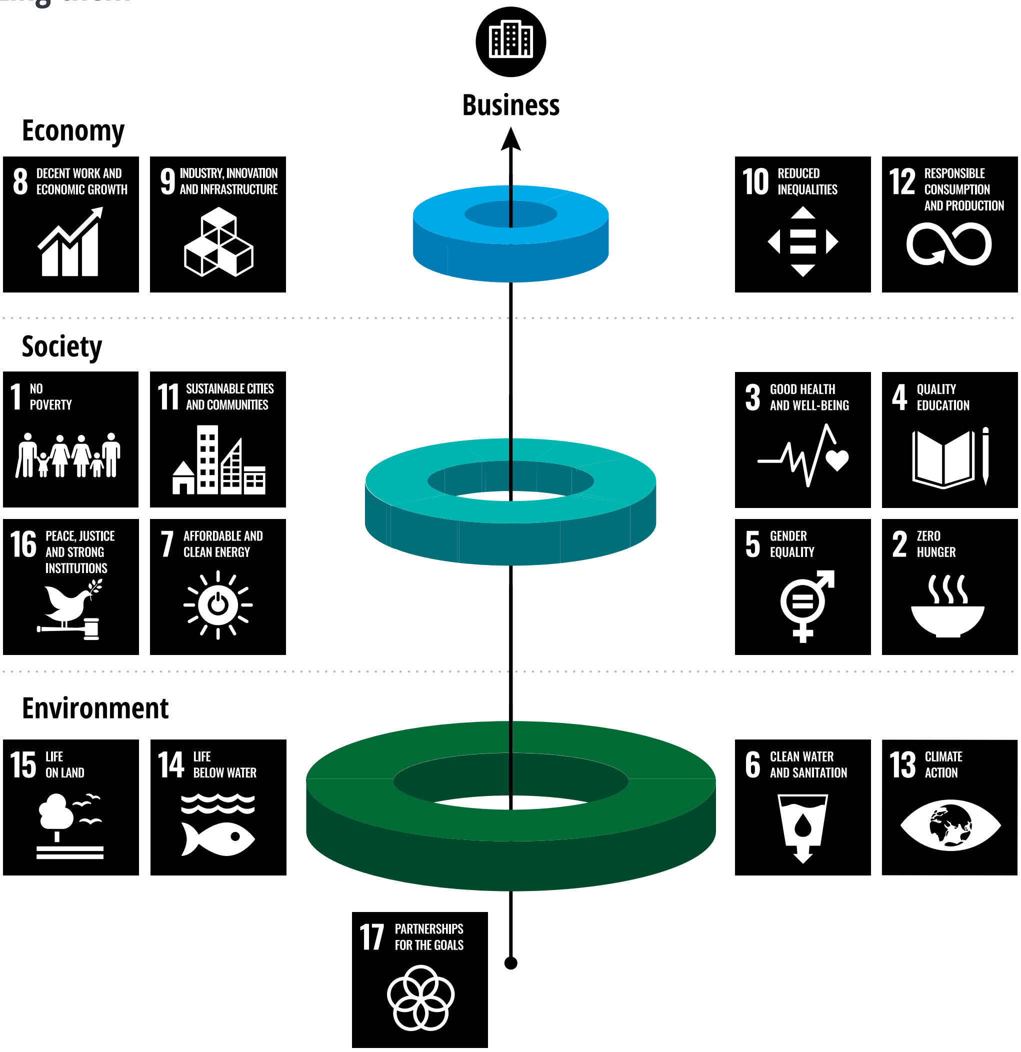
Polman has long held the conviction that expectations are changing, insisting that business leaders need to take a more active role in tackling the sustainability agenda to protect their future business.[3] That sustainability agenda, as articulated by the 17 United Nations (UN) Sustainable Development Goals (SDGs), recognizes that businesses are an essential partner for addressing the SDGs, from contributing finances to providing products and services that address sustainability (figure 1).[4]

The 17 UN SDGs are interdependent and interconnected. The climate crisis threatens to disrupt water supplies, food production, and energy security, harming the livelihoods and incomes of many.[5] In late 2019, UN Secretary-General António Guterres warned that a "point of no return" for climate change is "in sight and hurtling towards us."[6]

Yet crises can also be profound catalysts for change, creating opportunities to gain new perspectives. Businesses that see climate change—and

FIGURE 1

The UN's SDGs are interdependent, with business playing a critical role in realizing them



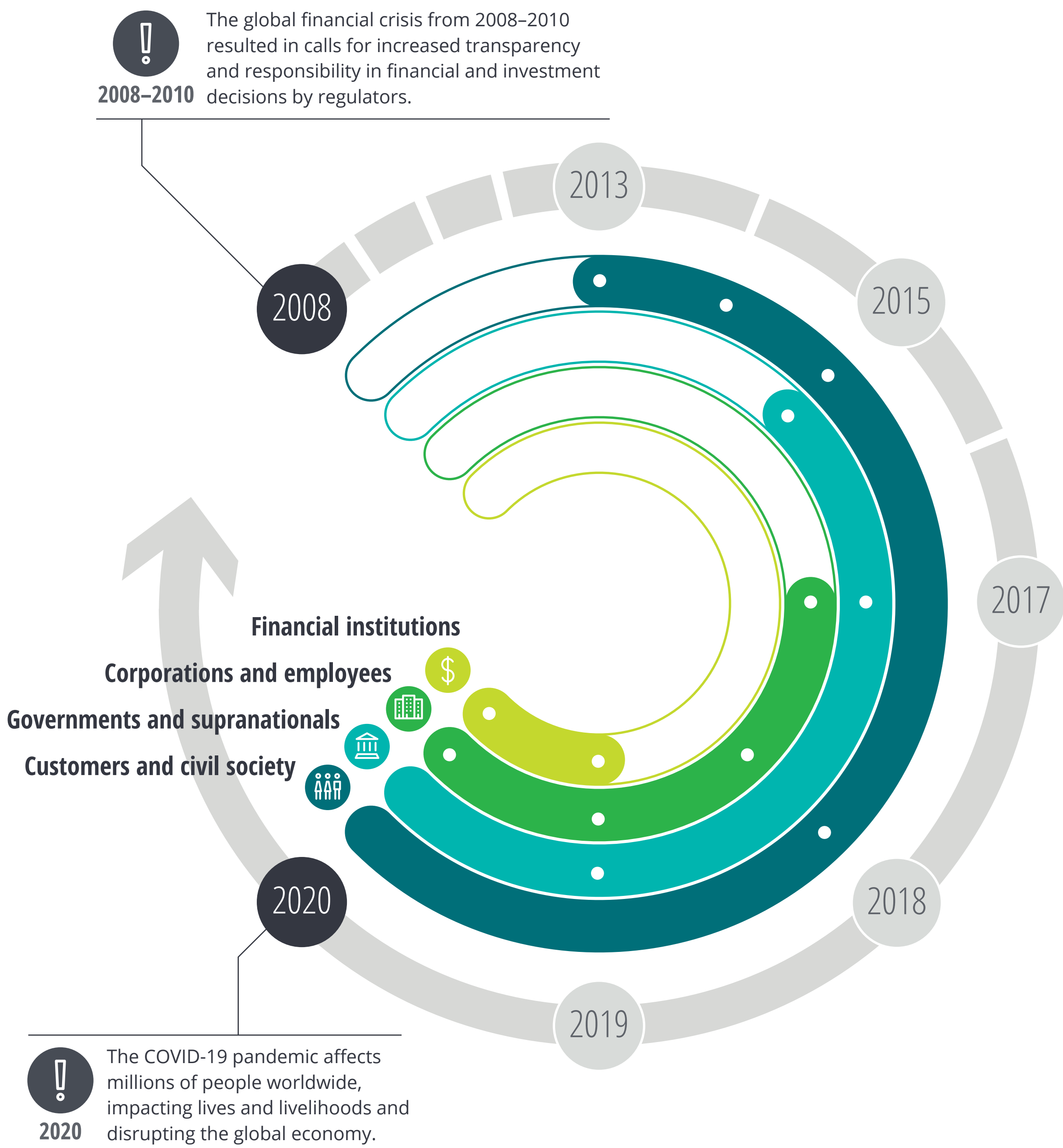
Source: Adapted from Stockholm Resilience Centre, “Contributions to Agenda 2030,” accessed April 18, 2020.

sustainability—not only as a threat but as an opportunity might be best placed to unlock new innovations and ignite unexpected collaborations. Businesses may need to transform themselves to thrive in an era where tackling sustainability is becoming an imperative.

New business pressures toward sustainability make this imperative critical. The combined actions of a range of parties—including communities, consumers, employees, regulators, corporations, and, recently, financial institutions—suggest that the momentum toward sustainability is reaching a tipping point (figure 2).

FIGURE 2

The momentum behind sustainability is accelerating



Source: Various public sources.

Customers and civil society

2013 Collapse of the Rana Plaza apparel factory in Dhaka, Bangladesh kills 1,132 workers and awakes the world to poor labor conditions in the global apparel supply chain.

2014 Exposé of debt bondage, trafficking, and abuse of migrant workers in the Thai fishing industry implicates global supermarket retailers in modern slavery.

2015 World leaders adopt the 2030 Agenda for Sustainable Development calling for urgent collective action to address the United Nations' 17 SDGs.

2018 Greta Thunberg stages a protest in August 2018 outside the Swedish Riksdag (parliament), holding a sign that read "Skolstrejk för klimatet" ("School strike for climate"), sparking a global movement in youth climate activism.

Governments and supranationals

2015–2020 New legislation, including the UK Modern Slavery Act (2015), French Duty of Vigilance Law (2017), Australian Modern Slavery Law (2019), and Dutch Child Labor Due Diligence Law (2020), call on companies to tackle social and environmental harms in their extended supply chains.

2015 Countries adopt the Paris Agreement at the COP21 in Paris, committing to limit global temperature rise to below 2 degrees Celsius and striving for 1.5 degrees Celsius.

2017 Launch of Network of Central Banks and Supervisors for Greening the Financial System (NGFS), with the aim of mobilizing mainstream finance to support the sustainability transition.

2019 The European Banking Authority (EBA) launches its Sustainable Finance Action Plan, which sets out its approach to integrate environmental, social, and governance (ESG) considerations into its risk management policies.

Corporations and employees

2017 More than 100 companies with a combined market cap of more than US$3.5 trillion and financial institutions responsible for assets of more than US$25 trillion publicly commit support for the Task Force on Climate-Related Financial Disclosures (TCFD).

2018 Patagonia CEO Yves Chouinard announces in November 2018 that he would channel US$10 million the company received through corporate tax cuts to protecting air, land, and water and finding solutions to the climate crisis.

2019 The Business Roundtable updates its decades-old definition of the purpose of a corporation; nearly 200 CEOs agree to eliminate its bedrock principle that shareholder interests must be placed above all else.

2020 Amazon CEO Jeff Bezos commits US$10 billion to address climate change through the establishment of the Bezos Earth Fund.

2020 Corporate leaders of major international brands take a stand on racial injustice by speaking out in support of Black Lives Matter, a political and social movement that campaigns against violence and systemic racism toward Black people.

Financial institutions

2019 World's largest pension funds and insurance companies representing US$2.4 trillion in AUM commit to transition their portfolios to become carbon-neutral by 2050.

2019 Goldman Sachs pledges US$750 billion across investing, financing, and advisory activities by 2030 to accelerate the climate transition and advance inclusive growth.

2020 Principles for Responsible Investment (PRI), an international network of responsible investors, hits 500th asset owner signatory milestone. PRI signatories, now representing over US$90 trillion in AUM, commit to mainstream sustainable finance.

2020 BlackRock CEO Larry Fink publishes letter to CEOs signaling the fundamental reshaping of finance.

Financial flows are being redirected toward sustainable practices. An important shift motivating change in business behavior has been the redirection of financial flows as investors, lenders, and insurers increasingly realize that sustainability risks generate financial risk. Investors, in particular, are playing a central role in accelerating capital flow toward sustainable funds. In 2019, sustainable funds in the United States attracted more than US$4 billion per quarter. Prior to this, flows had never topped US$2 billion in any quarter.[7] For investors, climate change is taking center stage. At the United Nations' (UN's) annual climate conference in 2019, more than 630 investors, collectively managing over US$37 trillion in assets, signed a statement urging companies to take stronger action to address climate change, including phasing out coal and supporting the transition to a lower-carbon future.[8] Larry Fink, CEO of BlackRock, the world's largest institutional investor with US$7.4 trillion in assets under management (AUM), has been a prominent advocate of this shift, stating in January 2020 that climate change has brought businesses to "the edge of a fundamental reshaping of finance."[9]

An important shift motivating change in business behavior has been the redirection of financial flows as investors, lenders, and insurers make the connection that sustainability risks generate financial risk.

Regulations are increasingly supporting the adoption of sustainable business practices. Governments have numerous regulatory tools at their disposal to shape business practices, and they are increasingly using their regulatory authority to urge companies to adopt sustainable business practices. For example, in 2017, the French government enacted new regulations requiring that French multinational companies identify and prevent adverse sustainability impacts resulting from their own activities *and* the activities of their subcontractors or suppliers.[10] Additionally, we have seen supranational organizations such as the World Bank Group urge governments to adopt COVID-19 stimulus packages that will promote sustainable growth.[11]

Growing worker activism is pushing employers toward sustainability. Workers are emerging as a newly empowered and vocal group with the ability to materially influence a company's strategy and reputation. More than ever, workers are calling out perceived hypocrisy among their employers, such as donating funds to climate action while still investing in carbon-intensive industries. Companies are experiencing a growth in worker petitions, strikes, and walkouts over inaction on sustainability. Companies that fail to meet employee expectations on sustainability may see talent shortages or problems with engagement: Deloitte Global's 2019 millennial survey found that millennials and Gen Zs show deeper loyalty to employers that boldly tackle environmental and social issues that resonate with them.[12]

Customer preferences are tilting toward sustainable products and services. Continued changes in consumption and purchasing patterns are trending toward a greater overall emphasis on sustainable products and services. This trend is especially noticeable among millennials and Gen Zs. Deloitte Global's 2019 millennial survey found that 42 percent of millennials decided to purchase a company's products or services because they perceived it to have a positive impact on society or the environment.[13] These shifts in consumer behavior are creating market opportunities for sustainable alternatives. For instance, by 2028, the used-fashion market is set to skyrocket in value to US$64 billion in the United States, while fast fashion is expected to only reach US$44 billion.[14] Similarly, meat alternatives—plant-based meat substitutes—are expected to become a US$140 billion global industry in the next decade.[15]

These pressures are elevating sustainability as a priority among executives and boards. Shifting attitudes have made it an imperative for companies to place sustainability at the heart of their strategies. Indeed, the statement on corporate purpose issued by the Business Roundtable in 2019[16] stresses that businesses have an obligation to create value for their customers, employees, suppliers, and communities in addition to shareholders.

A number of high-profile business leaders have recently publicly committed to tackling sustainability issues, with a particular focus on climate change. In February 2020, Amazon CEO Jeff Bezos committed US$10 billion to address climate change through the establishment of the Bezos Earth Fund,[17] while Patagonia CEO Yvon Chouinard announced in November 2018 that he would channel US$10 million the company received through corporate tax cuts to protecting air, land, and water and finding solutions to the climate crisis.[18] These events illustrate business leaders' increasing concern about the climate crisis, as well as the willingness of some to invest in doing something about it.

BLACKROCK LEADS IN CALLING FOR CHANGE

In his 2020 annual letter to CEOs, BlackRock CEO Larry Fink called upon every government, company, and shareholder to confront the "new climate reality." BlackRock also announced it would remove companies generating more than 25 percent of their revenues from thermal coal production from its investment portfolios.[19]

Fink used his 2020 letter to signal to the market that investors are realizing that climate risk creates investment risk and that, therefore, organizations should anticipate "in the near future … a significant reallocation of capital."[20] He noted that companies that fail to integrate sustainability and climate considerations into their businesses risk being left behind as investors and businesses shift to a low-carbon economy, warning them that such firms may be profitable in the short term, but that negative externalities would catch up with them and destroy shareholder value in the long run.[21] Fink emphasized BlackRock's conviction that sustainable and climate-integrated portfolios will provide better risk-adjusted returns to investors, making them a key focus for BlackRock going forward.

Fink reaffirmed BlackRock's commitment to sustainability in a March 2020 letter to shareholders, saying that "the pandemic we're experiencing now highlights the fragility of the globalized world and the value of sustainable portfolios." Noting that "we've seen sustainable portfolios deliver stronger performance than traditional portfolios during this period," Fink sees an opportunity to accelerate the trend toward sustainable investment as the global economy recovers from the COVID-19 crisis.[22]

Toward a more sustainable enterprise

We have identified three business strategies that can guide the sustainable transformations of future-thinking companies:

- **Look ahead.** Understand what threats and, more importantly, opportunities the pressures toward sustainability present for the future of the business.

- **Look inside.** Consider how business operations could be reconfigured to accelerate the transformation toward greater sustainability.

- **Look around.** Leverage the surrounding business ecosystem to create competitive advantage.

LOOK AHEAD TO YOUR FUTURE BUSINESS

Businesses that want to succeed in the future need to look ahead to the future. Executives need to be aware of the shifts taking place and understand how growing sustainability expectations may shape their company's and industry's future.

Some business leaders may need to pull themselves out of the short-term thinking that is often driven by pressures for quarterly performance, and not lose sight of how they can create lasting value over the long term. Encouraging this kind of thinking can sometimes take radical forms. At Unilever, one of Polman's first actions as CEO was to end quarterly reports and earnings guidance, urging shareholders to focus on the long-term health of the business. Although the decision was heavily criticized and shares plunged by 8 percent, Unilever's strong performance over the next decade demonstrates that such a longer-term focus can be an effective way to manage a business.[23]

An example of looking ahead to identify these risks and opportunities comes from the energy industry, particularly coal, oil, and gas companies. In 2019, an estimated 6 million people in more than 180 countries, in probably the biggest climate protest in history, took to the streets to demand far more action to cut greenhouse gas emissions.[24] By the end of that year, more than 450 investors representing more than US$40 trillion in AUM signed the Climate Action 100+ initiative, which is committed to pressurizing the largest corporate greenhouse gas emitters to "curb emissions, improve governance, and strengthen climate-related financial disclosures."[25]

Executives need to be aware of the shifts taking place and understand how growing sustainability expectations may shape their company's and industry's future.

Investor pressure is pushing the clean energy transition forward in the fossil fuel industry, threatening its profitability while also creating avenues for new business models. As an example, in December 2019, Goldman Sachs announced a US$750 billion commitment to drive global climate transition and inclusive growth strategies.[26] BlackRock announced in January 2020 that it had raised US$1 billion for its Global Renewable Power III fund, which will focus on renewable power generation and energy storage and distribution.[27] It is expected that investment in solar, wind, and other green energy technologies will double over the next decade, with the world on pace to hit US$2.6 trillion for renewable energy investments by 2030.[28] A growing number of startups are responding to this opportunity by entering the renewable energy industry, aiming to gain ground while older companies work to adapt.

A number of incumbent energy companies have begun to reinvent themselves in response to these pressures. The Danish company Ørsted, for instance, is moving from coal to renewable sources of generation to meet growing demands for renewable energy. A decade ago, Ørsted was one of Europe's most coal-intensive energy companies. Today, Ørsted is in the midst of shifting entirely to high-growth renewable energies such as wind, solar, and storage solutions. The company estimates that it will completely phase out the use of coal by 2023 and generate almost 100 percent of its energy from green sources by 2025.[29]

As the energy industry's experience illustrates, the sooner a business can look ahead, the more likely its chances of turning future disruptions into new opportunities. These new opportunities have the potential to support a range of business models while answering societal needs. For instance, circular businesses that strive to minimize waste, regenerative businesses that may restore land, and inclusive businesses that aim to alleviate poverty.

To identify these opportunities, we recommend an approach termed "zoom out/zoom in." In this approach, strategic planners "zoom out" beyond the short-term time horizons typical of strategy planning to take a longer-term view of 10 to 20 years ahead.[30] Having understood what this future could hold, they then "zoom in" back to the immediate future to identify actions within the next six to 12 months that can help the business reach that future destination.

Scenario planning can be a useful tool in this exercise for illuminating possible futures for which to prepare. For instance, Royal Dutch Shell's SKY scenario, developed in 2018, illustrates a technologically, industrially, and economically viable route to limit global average temperatures to below 2 degrees Celsius.[31]

LOOK INSIDE FOR WAYS TO ACCELERATE YOUR TRANSFORMATION

With a longer-term narrative in place, executives can look inside their business to see what initiatives they could launch today to accelerate the path toward that future. Depending on the magnitude of the sustainability risks and opportunities they face, some companies may find that they need to go beyond integrative approaches—which seek to weave sustainability into *existing* business models, strategies, products, and services—to transformative approaches in which sustainability considerations drive the design of *new* business models, strategies, products, and services.

Organizations that take a transformative approach to sustainability have made several characteristic shifts to think and act differently (figure 3).

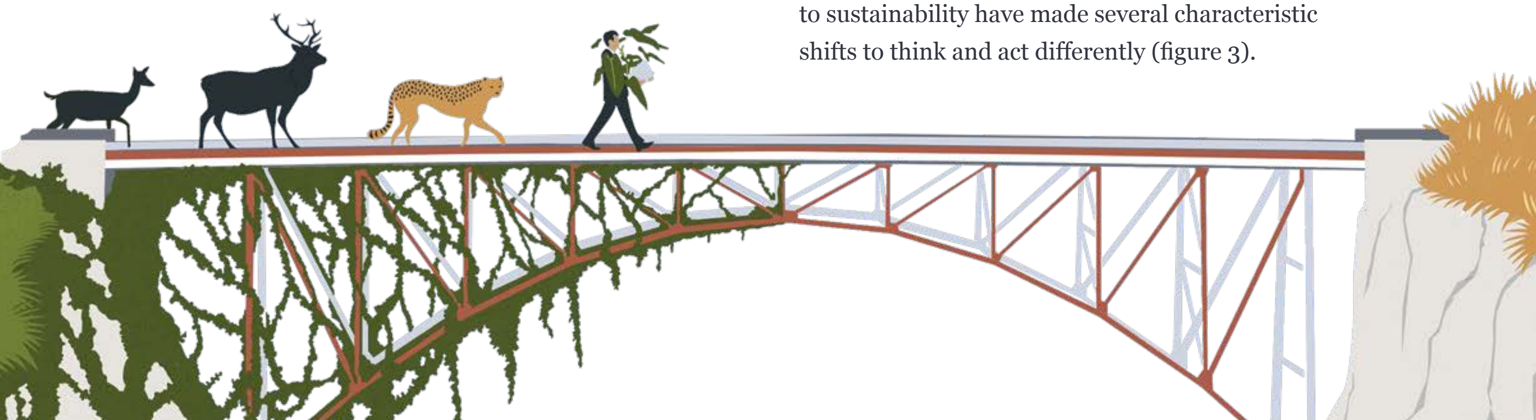


FIGURE 3

Several key shifts characterize companies that take transformative approaches to sustainability

	FROM		→ TO	
01	Risk-focused	Companies see sustainability through the lens of disruption and risk, focusing on how sustainability could damage the company's bottom line.	Opportunity-focused	Companies see sustainability through the lens of growth and opportunity, focusing on how sustainability could increase the company's bottom line.
02	Opaque	Companies do not reveal information about their sustainability performance, choosing to shy away from technology or reporting practices that could expose poor performance.	Transparent	Companies adopt technology advances to enable radical transparency, and openly discuss sustainability performance and improvement areas.
03	Profit-driven	Profit-driven companies are committed to create financial returns for their shareholders. Profit-driven companies draw on the commitment to profit to drive strategy and decision-making.	Purpose-driven	Purpose-driven companies seek to create long-term value for all stakeholders, not just shareholders. Their purpose guides strategy and decision-making.
04	Enterprise-focused	Enterprise approaches operate within a company's traditional boundaries. Interactions with external stakeholders, such as customers, suppliers, or communities, are transactional rather than reciprocal.	Ecosystem-focused	Ecosystem approaches aim to transcend a company's traditional boundaries to involve the wider ecosystem, recognizing the company's interdependencies with external stakeholders.
05	Consultative	Consultative approaches aim to raise awareness, exchange information, build support, and secure buy-in from stakeholders.	Collaborative	Collaborative approaches aim to engage in co-innovation and partnerships with stakeholders to build mutual interest in sustainable outcomes.
06	Preservative	A preservative model aims to sustain the present state. This model adopts a "do no harm" approach to sustainability.	Regenerative	A regenerative model aims to go beyond the current state to restore and reconstruct. This model aims to "do more good than harm."
07	Linear	Companies take a linear, "take-make-consume-waste" approach to using resources. The raw material is transformed into a product, which is thrown away after it ends its life cycle.	Circular	Companies strive to adopt a circular model with the aim of preventing waste. A circular model is renewable by design and aims to gradually decouple growth from the consumption of raw materials to preserve finite resources.

Source: Deloitte analysis.

By viewing sustainability through the lens of growth and opportunity, businesses have been able to apply their creativity and innovation to tackle some sustainability challenges while also opening up new business models, strategies, products, and services. By innovating for sustainability, businesses can also identify ways to accelerate toward their future business, as illustrated by the following examples:

Opportunity-focused: Volkswagen embraces opportunity in the electric vehicle market. By 2028, Volkswagen plans to sell 70 models of fully electric vehicles (EVs). Volkswagen anticipates producing 22 million EV units by 2030, when EVs are expected to comprise 40 percent of the automaker's offerings.[32] The automotive manufacturer, one of the most aggressive movers into the electric car market, intends to leverage the increased demand for EVs as a new market expansion opportunity.

Transparent: Olam International enhances supply chain transparency through the development of a sustainable and traceable sourcing solution. Agribusiness Olam International is meeting growing consumer demand for transparent and sustainable food supply chains through its subscription platform AtSource. The platform offers subscribers a line of sight into the environmental and social footprint of raw ingredients by providing access to a range of metrics and insights into the efforts underway to improve sustainability performance.[33]

Purpose-driven: Patagonia paves the way for purpose-driven businesses. Patagonia is the first B Corp in California, a certification that designates any company with "an explicit social or environmental mission and a legally binding fiduciary responsibility to take into account the interests of workers, the community, and the environment."[34] Its purpose-driven strategy has driven the brand's differentiated business model to new heights as the company has developed a strong following, earning over US$1 billion in annual revenue by 2018 and increasing the legitimacy of mission-centric companies.[35]

Ecosystem-focused: The Ellen MacArthur Foundation's Make Fashion Circular initiative promotes collaboration and innovation among leading apparel brands. This industry initiative brings together industry leaders, including Burberry, Gap Inc., H&M Group, HSBC, PVH, Stella McCartney, and other key stakeholders to stimulate collaboration and innovation at scale across the textile economy to reduce waste and pollution. For instance, one effort sponsored by the initiative, The Jeans Redesign project, is working with brands, manufacturers, and fabric mills to launch renewable jeans products.[36]

Collaborative: Mars Incorporated identifies new routes to market through a collaborative business model management innovation. Consumer goods company Mars Incorporated increased market access by piloting a hybrid collaborative approach to working with microentrepreneurs and forming citizen sector partnerships. Launched in 2013, Mars's "Maua" EoM initiative has engaged more than 1,000 microentrepreneurs in impoverished urban and rural areas that are difficult to reach through traditional channels to distribute and sell Mars products.[37] This constituted the first practical application of the firm's "Economics of Mutuality" (EoM) business model for management innovation, which holds that greater economic and societal value is simultaneously created—without trade-offs and in scalable ways—when a business and its stakeholders mutually benefit from a company's activities.

Regenerative: Danone Ecosystem Fund tests new business models in regenerative farming. Food products company Danone is testing future-focused regenerative business models. The 100 million-euro Danone Ecosystem Fund supports projects codesigned by a local Danone subsidiary and a not-for-profit partner.[38] Projects are organized into four areas corresponding to key activities in Danone's value chain: *sourcing and watershed* for sustainable water resources and sourcing of key raw materials; *distribution* to create new product distribution channels; *caring services* to strengthen knowledge and access to nutrition and health services; and *recycling* to reinforce the circular economy.

Circular: IKEA launches a new rental model to strengthen relationships with younger customers. Representing one instance of the growing product-as-a-service trend, furniture retailer IKEA announced plans to start renting its furniture in 2019, allowing customers to acquire, care for, and pass on IKEA products more sustainably. In the Netherlands, IKEA allows students to rent a bed, desk, table, and chairs for a monthly fee of up to 30 euros (about US$33.68). A senior IKEA executive notes that "our future success will lie in our ability to reshape and improve our business model … and become a more affordable, accessible, and sustainable business."[39] IKEA's move toward a more circular economy comes at a time when many young consumers say they want to minimize their impact on the environment, preferring to rent items ranging from clothing to cars.[40]

LOOK AROUND TO LEVERAGE YOUR BUSINESS ECOSYSTEM

Companies that look ahead to identify risks and opportunities to their future business can look inside to identify actions to accelerate toward that future. They can then look around to support their sustainability transformation and may gain competitive advantage by tapping into their broader business ecosystem. This strategy begins with the realization that it is not always necessary for businesses to build the capabilities—the knowledge, skills, and technology—or the influence needed to transform in-house. If the needed capabilities exist within others in their ecosystem, businesses should consider seeking to engage and mobilize ecosystem partners to help support their own sustainability transformation.

Executives can look around in two ways: first, by *leveraging others' capabilities* to accelerate their sustainability transformation, and second, *leveraging others' influence* to create a favorable environment for their transformed business.

Some businesses may lack the necessary knowledge, skills, or technology to achieve the desired scale or pace of their sustainability transformation. Rather than building or buying these capabilities, companies can leverage the capabilities of others within their ecosystem.[41] For instance, consumer goods company Nestlé has made a commitment that 100 percent of its packaging will be recyclable or reusable by 2025.[42] Recognizing that the company would struggle to achieve this alone, the company opened the Institute of Packaging Sciences in 2019 to codevelop and test new environmentally friendly packaging materials and systems together with suppliers, research institutions, and startups.[43] Through this approach, Nestlé is able to leverage the technology and innovation of ecosystem partners while also sharing the financial cost and accelerating the pace of innovation needed to develop recyclable packaging.

Executives can similarly leverage the influence of like-minded businesses in their ecosystem. Leveraging influence entails the coordinated mobilization of multiple companies. A benefit of this strategy is that it enables businesses to effectively shape the strategies of those around them, supporting the creation of a favorable business environment that will enable their own future business to flourish.[44]

As one example of leveraging influence from the ecosystem, four leading food companies—Mars Incorporated, Danone, Nestlé, and Unilever—came together in 2018 to establish the Sustainable Food Policy Alliance (SFPA), which aims to shape food-related regulation in five key areas: the environment, nutrition, consumer transparency, people and communities, and food safety.[45] SFPA initiatives include shifting the industry toward a more circular economy; working together to minimize waste generation; designing reusable, recyclable, or compostable packaging; and extending the useful life of materials and products. These efforts support innovative business models that could create value for farmers, ranchers, consumers, and other stakeholders. This ecosystem approach enables these companies to distribute and thereby reduce market risk by uniting their efforts to shift the policy environment around sustainable food, thereby accelerating the sustainability transformation at both the business level and the industry level.

It's time to transform

Many businesses will likely need to radically transform their business models to respond to shifting market conditions calling for greater sustainability. Looking ahead, looking inside, and looking around can help companies understand not only how the pressures toward sustainability could be a threat to their current business, but what opportunities they may hold for their future business.

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