

Embedded Sustainability: A strategy for market leaders

By Chris Laszlo and Nadya Zhexembayeva

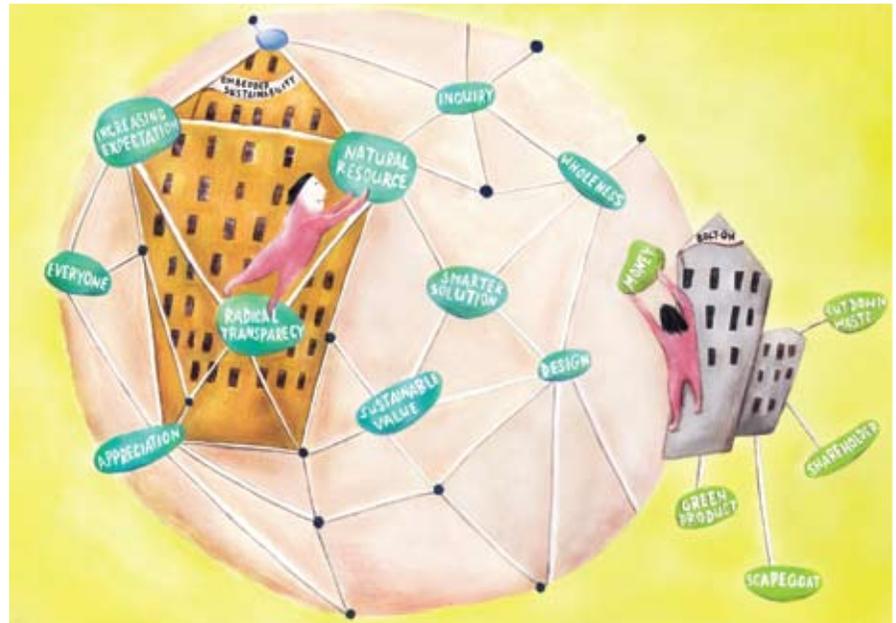
Consumers, employees, and investors are beginning to demand socially and environmentally-savvy products without compromise, while radical transparency is putting every company under a microscope.

In recent years three big trends – declining resources, radical transparency, and increasing expectations – have redefined the way companies compete. The linear throw-away economy, in which products and services follow a one-way trajectory from extraction to use and disposal, can no longer be supported, as we are simply running out of things to unearth and place to landfill. Consumers, employees, and investors are beginning to demand socially and environmentally-savvy products without compromise, while radical transparency is putting every company under a microscope.

With a new set of pressures on hand, what is business to do? We are not talking about the Body Shops and Ethical Banks of this world but rather the Unilevers and HSBCs: industry leaders pursuing middle-of-the-road customers, who find themselves often blindsided by ecological and social burdens. So, how are we as business unit and functional managers to treat social, health and environmental demands in the mainstream?

There are many managers who still go with familiar approaches, treating these new pressures as annoying obligations and merely tipping their hats to corporate social responsibility. While many more now recognize social and environmental performance as business opportunity, most continue to “bolt it on” to existing strategy and operations.

Only a handful are choosing to embed sustainability into the very DNA of what they do, incorporating environmental, health, and social value into core business activities with no trade-offs in price or quality. They



***Embedded Sustainability* is the incorporation of environmental, health, and social value into the core business with no trade-off in price or quality – in other words, with no social or green premium.**

are learning to leverage global challenges, such as climate stability, for enduring profit and growth. Through innovation – in product design, process and business model – these pioneers are creating even more value for their customers and investors than they would otherwise.

In a decade of working with companies in the US, Europe, South America and Asia – big and small, manufacturing and services – we have observed the following *lessons learned*. The first is that managers need an awareness of the external competitive environment that MBA programs and on-the-job training typically do not provide. The second is that embedding sustainability creates business value at many levels – not just risk mitigation or

cost efficiencies – that managers fail to fully leverage. The third is that the pursuit of sustainability involves hidden choices – whether to reduce negatives or provide positive solutions, and whether to pursue incremental change or heretical innovation – which are proving crucial to business strategy. The fourth and fifth lessons concern the nature of change management at the systems level.

While the five lessons form an integral whole for anyone embarking on the journey, it all starts with a better understanding of three megatrends and what they mean for value creation.

I. Awareness

You might have noticed that sushi restau-

Bolt-On vs. Embedded Sustainability: Key Dimensions

	Bolt-On Sustainability	Embedded Sustainability
goal	Pursue shareholder value	Pursue sustainable value
scope	Add symbolic wins at the margins	Transform core business activities
customer	Offer 'green' and 'socially responsible' products at premium prices or with diminished quality	Offer 'smarter' solutions with no trade-off in quality and no social or green premium
value chain	Manage company's own activities	Manage across the product or service life cycle value chain
organization	Create a 'scapegoat' department of sustainability	Make sustainability everyone's job

rants now regularly post *toro*, the fatty cut from the belly of the prized Bluefin tuna, at "Market Price." Traveling in airports around the world, you will also find it marked "Unavailable" on the menu. In all but the Antarctic waters the Bluefin has been so heavily overfished that stocks are now at less than ten percent of what they once were. It has become so rare that a single, healthy-sized tuna recently fetched \$396,000 in Tokyo's largest fish market.¹

Bluefin tuna is just one visible example of the decline of natural resources from clean water and top soil to food crops, fossil fuels, and biodiversity. During the 2007-2009 downturn, the World Wildlife Fund, a leading environmental conservation organization, warned that "the possibility of financial recession pales in comparison to the looming ecological credit crunch."² The signs of a crisis in natural resources are starkly evident: the Commodity Price Index, a measure of price movements for 22 basic commodities³, has more than tripled since 2002 and in 2010 alone rose 27 percent with commodities such as cotton rising almost 100 percent. Combined with higher-than-average price volatility, these upward price trends and growing scarcities pose a serious challenge for the security of supply chains.

To declining natural resources, we add two more trends: radical transparency and rising expectations. Fueled by unprecedented activism in the civil sector and enabled by rapid developments in information technology, transparency has become the dynamic, immediate, and substantive force of modern corporate life. It enables any interested person to peer into product and service lifecycles and find those impacts on society and nature that used to be hidden from public scrutiny. The third trend – rising expectations – invites companies to re-think the very essence of market demand. Investors, employees and, most importantly, consumers increasingly expect sound social and environmental performance. New parameters are becoming standard such as quiet, healthy, socially equitable or environmentally-friendly for every product and service in the economy. We don't want just any household cleaning product; we want it non-toxic and biodegradable. We drink fair trade coffee and bring reusable shopping bags to the supermarket. And we no longer accept to pay more for these attributes.

For some, these three trends present an immense threat to be countered at every turn. For others, it's the opportunity of a lifetime. The question is only: do we choose to ride this new wave on our own terms, or become its victims as the tsunami reaches our shores?

II. Sustainable value creation

For those pursuing embedded sustainability, there are many ways to create business value. Companies in every sector have already made great strides in complying with and anticipating environmental and social regulations. They have learned operational best practices in eco-efficiency – the process cost reductions that come from conserving energy, eliminating waste and improving material throughput – in some case saving billions of dollars as DuPont and 3M are purported to have done. But relatively few have focused on top-line (gross revenues) growth based on product or brand differentiation. Even fewer have used stakeholder value creation as a way to drive new markets and business context change.

Market leaders in every sector are finding that a brand/culture based on creating stakeholder value is rapidly becoming a source of competitive advantage.

Mainstream players such as Unilever and Nissan are democratizing green products by redesigning their value chains to enable product prices in line with their traditional (non-green) counterparts. It is now possible to buy an organic cotton shirt at Walmart for about the same price as one made from conventionally grown cotton. In financial services, HSBC and Itaú Unibanco (Brazil) are among those recognized for their leadership in integrating sustainability into banking operations⁴. Market leaders in every sector are finding that a brand/culture based on creating stakeholder value is rapidly becoming a source of competitive advantage. Among other benefits, a sustainability image draws in higher-income consumers, attracts and retains talented people, and can ease negotiations with government regulators concerned about industry impacts.

Here is one way to visualize the range of available value creation opportunities, with radical innovation cutting across and enabling the other value-creating levels. Companies can use radical innovation to simultaneously lower costs, differentiate their products and enter entirely new markets. (See figure 1)

At each level of sustainable value creation, managers need to ask a different set of questions. Mitigating risk is about avoiding value destruction by managing potential costly liabilities, as BP discovered in 2010. At the efficiency level, the query is into operational excellence: how can embedded sustainability contribute to greater savings along the lifecycle value chain? At the product differentiation level, the inquiry concerns consumer expectations and how these are changing to incorporate ever greater environmental, health and social attributes. In terms of new market opportunities, the probe is into business models: how can businesses find profitable solutions to global problems? One such new market/ business model example is that of meeting the unmet needs of poor consumers in emerging markets, as with Muhammed Yunus and his Grameen Bank model of unsecured micro-credit. At the level of image and reputation, the interrogation goes to the core identity of the company: to what extent are social and ecological goals parts of its mission or culture? At the

level of business context, it is about shaping government regulations or industry standards that favor the market leaders over the competition.

Whatever the sustainability project or company-wide initiative, managers can benefit from assessing, and acting on, its value creating potential at these multiple levels.

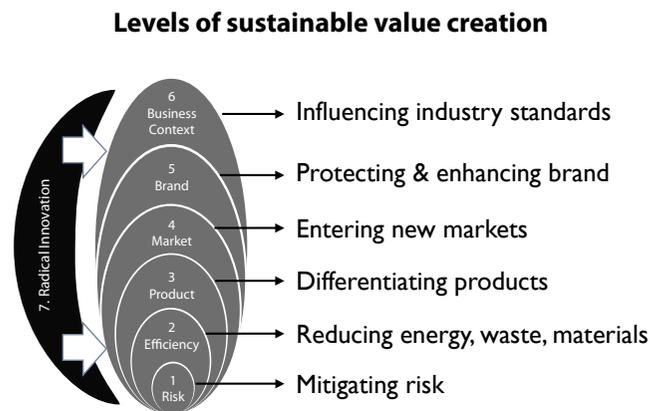


Figure 1

Source: From *The Sustainable Company*, by Chris Laszlo. Copyright © 2003 Chris Laszlo. Reproduced by permission of Island Press, Washington D.C.

III. Hidden choices

Are you intent only on making your products less wasteful and more energy efficient? If these are your sustainability goals, you are probably focused on doing less harm. On the other hand, if you are in the business of providing clean water or nutritional products to the poor – as do units within Unilever and DuPont – then you are helping to solve global problems. Of course many companies are doing both – witness General Electric’s efforts to clean up its impacts on the Hudson River while moving into eco-solutions such as wind turbines and water desalination. The point is only to be deliberate about the choice.

Once you know where you are and where you want to go, you also need to know what kind of change will get you from here to there. Is it incremental or disruptive? Both are needed – and baby steps can lead to more advanced ones – but unfortunately, too many companies set goals that amount at best to ‘rearranging the deck chairs on the Titanic’ and at worst to greenwashing. Setting future targets of reducing CO₂ emissions by five percent may be wholly insufficient for an energy intensive manufacturing facility, given the stated objective of the world’s scientific community to cut global CO₂ emissions by 85 percent by 2050⁵. A “mild hybrid” drivetrain is a poor ecological solution for a 4x4 Sports Utility Vehicle, the case for the 2010 GMC Yukon hybrid which touts itself as green despite getting only 20 mpg or 12 liters per 100 km. Instead, car manufacturers are being called on to rethink personal mobility from an environmental perspective, considering new technologies such as plug-in electric and even hydrogen fuel cell.

A good example of disruptive innovation comes from floor-

cleaning equipment leader Tennant. While its competitors were busy working to reduce the harshness of their cleaning chemicals, Tennant simply eliminated the use of its chemicals altogether. The company’s flagship product, the ec-H₂O, electrically converts plain tap water to perform like a powerful detergent, using 70 percent less water than traditional cleaning methods. Best of all, the ec-H₂O gives its customers the lowest possible total cost of ownership. It took asking heretical questions and an unlikely source of inspiration – the observed practice in Japanese hospitals of using ionized water to clean wounds – for Tennant’s R&D team to produce the innovation⁶.

IV. A messy process

Embedding sustainability is a complex, multi-activity and multi-actor challenge; no simple recipes are possible. Unlike the streamlined and often linear steps taken for bolt-on sustainability efforts, the task of embedding social and environmental value into the DNA of a business is iterative, repetitive and chaotic. It demands new thinking and unorthodox solutions that can spring from unlikely sources and in improbably ways. Having said this, the experience of market leaders suggests four interdependent and interconnected lines of action to help guide the journey:

- *Getting the Right Start*: mobilizing, educating, and acting around specific low hanging fruits. Building momentum in the organization for sustainability projects that support existing business priorities and provide demonstrable pay-off.
- *Building the Buy-In*: aligning company, value chain, and all other stakeholders around the vision of embedded sustainability.
- *Moving from Incremental to Breakthrough*: developing clear but unorthodox goals, designing the strategy and capturing value through co-creation and innovation.
- *Staying with It*: managing learning and energy while making sustainability ubiquitous but largely invisible in the business practice.

Engagement of one business unit after another demands a ‘right’ start; new action calls for education and training, while building true buy-in remains a daily task. Many low hanging fruit are pursued and harvested before companies are even ready to play with – let alone design – a masterful embedded sustainability business strategy.

We have found the following four competencies to be essential yet rarely valued in today’s corporate world: Design. Inquiry. Appreciation. Wholeness.

V. New competencies

While traditional business skills remain vital when embedding sustainability into the DNA of your company, they must be complemented by new competencies. We have found the following four to be essential yet rarely valued in today’s corporate world: Design. Inquiry. Appreciation. Wholeness.

Design is first and foremost an attitude or mode of thinking. At its core is an assumption strikingly different from the one that underlies



the typical business decision. If decision-making is all about making a hard choice between easy-to-identify alternatives, design attitude assumes an easy choice between difficult-to-create alternatives. Tim Brown, CEO and President of IDEO, ranked among the ten most innovative companies in the world, illustrates this point in the following way: "a management philosophy based only on selecting from existing strategies is likely to be overwhelmed by new developments at home and abroad. What we need are new choices – new products that balance the needs of individuals and of society as a whole; new ideas that tackle the global challenges of health, poverty and education; new strategies that result in differences that matter and a sense of purpose that engages everyone affected by them. What we need is an approach to innovation that is powerful, effective and broadly accessible. Design thinking... offers just such an approach."⁷

The next two competencies – *Inquiry* and *Appreciation* – build respectively on what is possible and on the existing strengths present in every business system. We have had the privilege of working closely with Professors David Cooperrider and Ron Fry, co-originators of Appreciative Inquiry, a change management methodology that, as its name implies, has these two competencies at its very core. Appreciative Inquiry has enabled managers at leading firms such as Hewlett-Packard, Walmart and McKinsey to discover the best of their shared experiences and tap into the larger system's capacity for cooperation. Efforts to discover and elaborate the positive core – the past, present and future capacities of the whole system – lead to innovations that integrate societal stakeholder issues that are often excluded from consideration in conventional approaches to decision-making.

Wholeness is the final skill needed to master the complex challenge of embedding sustainability across entire business systems. It requires an ability not only to see the big picture, but also to understand the linkages within the system. Donella Meadows, the systems scientist, quotes an ancient Sufi teaching that captures this focus: "You think because you understand one you must understand two, because one and one makes two. But you must also understand and."⁸ Learning systems tools such as feedback loops, lifecycle analyses and

stakeholder value maps can help managers develop solutions that are less fragmentary and contradictory than bolt on sustainability measures developed in isolation.

From bolt-on to embedded: A growing competitive advantage

We know how to meet the demands of shareholder value – years of managerial excellence testify to this achievement. We know how to create stakeholder value: traditional approaches such as CSR and philanthropy that predictably lead to added costs. We also have a growing number of bolt-on sustainability efforts producing fragmentary and symbolic wins at the fringes of the company.

What we are still discovering is how to meet both shareholder and stakeholder requirements in the core business – without mediocrity and without compromise – creating value for the company that cannot be disentangled from the value it creates for society and the environment. Embedded sustainability is just such a strategy, one that will only grow as today's global challenges continue to deepen.

About the authors

Chris Laszlo and **Nadya Zhexembayeva** are co-authors of the just-released *Embedded Sustainability: the Next BIG Competitive Advantage* (2011), Greenleaf Publishing and Stanford University Press. www.EmbeddedSustainability.com

Chris is the author of *Sustainable Value* (2008) and *The Sustainable Company* (2003, paperback 2005). He is an Associate Professor at Case Western Reserve University's Weatherhead School of Management, where he is the Faculty Research Director at the Fowler Center for Sustainable Value. A former executive with building materials leader Lafarge, Chris is co-founder and Managing Partner of Sustainable Value Partners, LLC, an advisory services firm specializing in sustainability for strategic advantage.

Nadya is the Coca-Cola Chair of Sustainable Development at IEDC-Bled School of Management, the European business school based in Slovenia, where she teaches leadership and sustainability strategy. Her work centers on organizational design for sustainable value and whole-system approaches to managing multi-stakeholder issues. She is Vice President of the global youth think-tank *Challenge:Future* and an Associate Partner of Sustainable Value Partners, LLC.

Notes

1. "Fish Story: Big Tuna Sells for Record \$396,000", MSNBC news, January 5, 2011
2. World Wildlife Fund (2008) *Living Planet Report*
3. http://www.crbrtrader.com/crbindex/spot_background.asp
4. HSBC and Itau Unibanco were among the mainstream winners of the 2010 FT Sustainable Banking Awards
5. The Intergovernmental Panel on Climate Change (IPCC) Fourth Assessment Report, 2007
6. Winston, Andrew (2009), *Green Recovery*, Harvard Business Press
7. Brown, T. (2009). *Change by design*. New York: HarperCollins Publishers
8. Wheatley, M. J. (1994). *Leadership and the new science: Learning about organization from an orderly universe*. San Francisco: Berrett-Koehler.