The Seven Pillars of Sustainability Leadership

CEO BUSINESS IMPLICATIONS

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In 2015, CEOs included "sustainability" among their top five global challenges for the first time since *The Conference Board CEO Challenge®* survey's launch in 1999. Surveys from other organizations, including McKinsey & Company, The Boston Consulting Group, and the World Economic Forum, point to a similar rise in profile of corporate sustainability issues.

However, while business leaders increasingly recognize the sustainability imperative, many are unclear on *how* to address this imperative. What are the key business practices that define leadership in corporate sustainability?

To shed light on this question, The Conference Board consulted senior executives at more than 80 member companies. Their collective input reveals that leadership in corporate sustainability boils down to seven impactful practices. Among these practices, active engagement from the board of directors was the one the executives cited most frequently as a determinant of sustainability leadership.

1 The board of directors is actively engaged on sustainability issues

Sustainability oversight is now a board-level issue, driven increasingly by the scale of business risks and opportunities posed by sustainability issues and a sense of urgency given their potential impact. Global megatrends such as resource scarcity and climate change are becoming ever more relevant to board discussions about strategy, risk, and performance. Boards that are engaged on sustainability are more likely to take a longer-term view and thus are able to better foresee and prepare companies for potential risks and opportunities.

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Seven Pillars of Sustainability Leadership

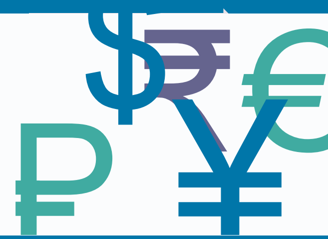
1 The board of directors is actively engaged on sustainability issues

2 The CEO and C-suite champion sustainability

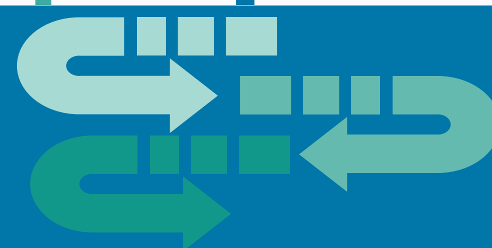
3 Sustainability is embedded in strategic planning

4 Sustainability goals are strategic, ambitious, and long term

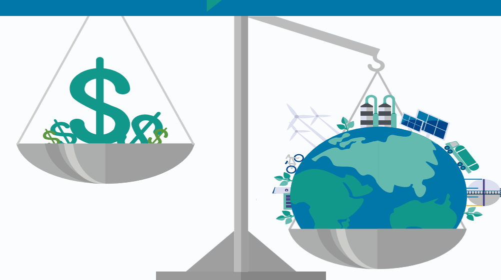
5 Executive compensation is tied to sustainability performance



6 Sustainability is part of the innovation process



7 Sustainability is woven into company reporting and engagement



However, few boards are adequately engaged to tackle sustainability issues. To improve engagement, company leaders need to recognize board engagement is a function of oversight, time, and expertise.

2 The CEO and C-suite champion sustainability

The companies most often recognized as sustainability leaders are typically led by a CEO who actively champions sustainability. It may seem obvious, but companies where CEOs and senior management take an active role in sustainability are more likely to succeed with their sustainability strategies. However, despite the rise of sustainability issues as CEO-level priorities, few CEOs devote enough time to these issues to see real progress. While not all CEOs can be expected to lead sustainability strategy, they can all be influential in strengthening their organization's sustainability profile.

Reporting structure matters The company's chief sustainability officer or other head of sustainability should report directly to the CEO and have regular access to the board of directors. This direct reporting structure is the way leading companies promote communication of relevant sustainability information to the board.

Internal and external advisors Sustainability steering committees also offer a useful mechanism for developing and implementing a company's sustainability strategy. These committees are most effective when chaired by the CEO or a member of the C-suite. For instance, Siemens' sustainability steering committee is not only chaired by the chief sustainability officer, it also includes four out of the seven members of the company's managing board. It is perhaps no coincidence that Siemens' Environmental Portfolio accounted for almost half (43 percent) of the company's overall revenue in 2015.

Some companies also choose to form sustainability committees comprised exclusively of external advisors, as these can provide additional subject matter expertise and an objective perspective.

3 Sustainability is embedded in strategic planning

Sustainability-related issues can no longer be ignored by companies wishing to remain competitive in the long term. Environmental risks, such as climate change and water scarcity, have been climbing up global rankings of business risks. In fact, as of 2016, an environmental risk has topped the World Economic Forum Global Risks Report for the first time since the report's inception in 2006. "Failure of climate-change mitigation and adaptation" is now the number one global risk in terms of impact. Companies are beginning to act: More than one-fourth of S&P 500 companies now include discussion of the risks associated with climate change in their annual SEC filings, up from just 5 percent in 2013.[1]

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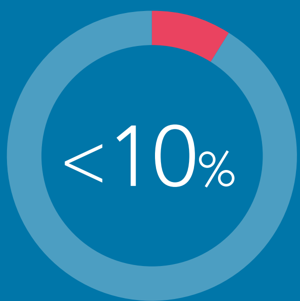
1 *Sustainability Practices 2015 Key Findings*, The Conference Board, February 2015, p. 8.

A best practice in corporate sustainability is having a board of directors that is actively engaged on sustainability issues…

…Yet CEOs fail to make this connection:



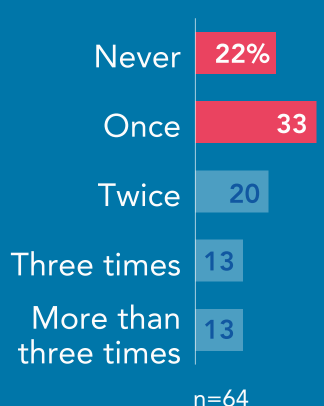
LESS THAN 10% OF GLOBAL CEOs

chose "strengthen board oversight of sustainability issues" as one of their top strategies for meeting their sustainability challenge.

Unsurprisingly, many of our sustainability council members indicate these issues may not be getting sufficient airtime at board meetings:

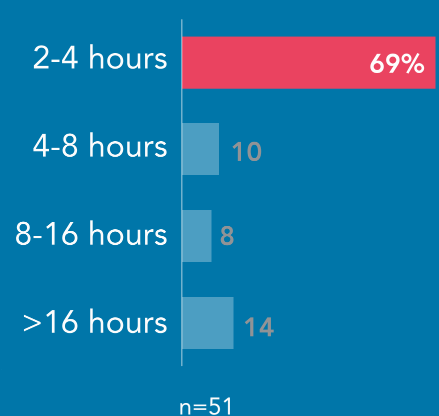
55%

say their boards meet only once per year or never on sustainability issues



69%

say their boards spend 4 hours or less per year on sustainability issues



Sources

TOP CHART: The Conference Board CEO Challenge 2016, The Conference Board, Research Report 1599, January 2016, p. 67.

BOTTOM CHARTS: 2016 survey of members of The Conference Board Sustainability Councils and Chief EH&S Officers Council

Sustainability leaders integrate environmental and social issues in their strategic planning process. This prepares them to manage sustainability risks and opportunities that can have significant business implications. Most companies begin by developing and regularly updating a priority list of sustainability issues most material to their business—a materiality analysis—with input from internal and external stakeholders.

4 Sustainability goals are strategic, ambitious, and long term

A fundamental change in the way companies think about value creation is evident in the types of sustainability goals leading companies are setting. Many of these goals are not just about operational efficiencies—doing "less bad"; they are increasingly about adding value. For example, as part of DuPont's 2020 sustainability goals, the company will measure and report on the quantifiable safety, health, and sustainability *benefits* from DuPont's major growth innovations.[2]

Setting corporate sustainability goals helps companies create accountability for improving sustainability performance and helps focus attention on the issues that matter most to the company and its stakeholders. The right sustainability goals can also help employees rally behind their company's sustainability strategy and can reinvigorate a culture of innovation. Sustainability leaders set goals that are strategic, ambitious, and focused on the long term.

- **Strategic** goals ensure targets are in line with a company's most important sustainability issues, typically identified using a materiality analysis process.
- **Ambitious** goals can help kick-start innovation and create a sense of urgency. Companies that set bold stretch goals—goals that are seemingly unattainable—often achieve significant improvements in performance, even if those goals are not ultimately met. One of Dell's corporate goals, for example, is that by 2020 the good that comes from the company's technology will be 10 times what it takes to create and use it.
- The time frame of sustainability goals is important, as **long-term** goals (with target dates of 2020 and beyond) help ensure companies adequately prepare for future risks and opportunities.

Consider the following examples of strategic, ambitious, and long-term sustainability goals:

- In 2012 **LEGO** announced a commitment to make all of its products from sustainable materials by 2030, thus replacing oil-based plastic.
- **Procter & Gamble** has a long-term vision of powering all of the company's plants with 100 percent renewable energy, using 100 percent renewable or recycled materials for all of its products and packaging, and having zero consumer and manufacturing waste go to landfills.

2 NB: A merger between DuPont and Dow Chemical is expected to be completed by the second half of 2016. The combined company, DowDuPont, is expected to be separated into three independent, publicly traded companies.

- **EMC** is committed to obtaining half of the company's electricity needs from renewable sources by 2050.[3]
- In 2011 **Novelis** introduced a goal of attaining 80 percent of the company's production output from recycled aluminum by 2020 (in 2011 recycled aluminum accounted for 33 percent of the company's output).
- In 2005 **Walmart** announced three aspirational goals that would become a key part of the company's sustainability strategy: 1) to be supplied 100 percent by renewable energy; 2) to create zero waste; and 3) to sell products that sustain resources and the environment.

5 Executive compensation is tied to sustainability performance

It is no secret that incentive compensation of the C-suite drives focus, attention, resource allocation, and performance. Companies that are serious about sustainability are placing sustainability performance metrics squarely in their incentive compensation schemes. This is crucial as business leaders point to a lack of incentives as a significant obstacle to achieving their companies' sustainability potential.[4] Linking incentive compensation to a set of sustainability targets helps make sustainability a priority for the organization and can steer company leadership to consider initiatives with long-term benefits that may otherwise have been ignored.

While the number of companies that have introduced pay for sustainability performance is growing, the sample remains fairly low. For companies that introduce this practice, the sustainability benefits can be significant: Incorporating pay for sustainability performance can reward long-term thinking, elevate sustainability issues to the CEO's agenda, and drive performance against sustainability targets. DSM's short-term incentive scheme, for example, takes into consideration the percentage of successful product launches that meet the company's ECO+ criteria (products that offer performance superior to and an environmental footprint lower than competing mainstream products over their entire life cycle). The impact on performance has been significant: By 2015 DSM's ECO+ solutions accounted for 91 percent of the company's innovation pipeline.[5]

Incorporating pay for sustainability performance can reward long-term thinking, elevate sustainability issues to the CEO's agenda, and drive performance against sustainability targets.

3 NB: A merger between Dell and EMC is under way, with expected completion by the end of 2016.

4 *Profits with Purpose: How Organizing for Sustainability Can Benefit the Bottom Line*, McKinsey & Company, 2014, p. 10.

5 Royal DSM Integrated Annual Report 2015, p. 13.

6 Sustainability is part of the innovation process

The motivation for launching corporate sustainability strategies is shifting significantly from achieving compliance, risk, and operational efficiencies to spurring innovation and market growth opportunities. Leaders are quick to embrace sustainability initiatives as a source of revenue growth and business opportunities.

Companies seeking to address their sustainability challenges are generating demand for products and solutions to meet these needs, and suppliers are responding with innovative solutions that in some cases redefine an entire product category or open a new market. Products and services with improved environmental and/or social profiles can represent significant revenue growth opportunities. Revenue from Philips' portfolio of "green products," for example, grew by 60 percent between 2010 and 2014 and accounts for over half of the company's total revenue.[6] For this reason, several leading companies are investing heavily in sustainability innovation to meet growing customer demand for sustainability solutions. Industry leaders such as GE and DuPont invest about half of their R&D budgets in environmental innovations.[7]

7 Sustainability is woven into company reporting and engagement

Companies at the forefront of sustainability excel at transparency; they are comfortable with openly reporting sustainability challenges and not just opportunities, and they see value in discussing company financial and nonfinancial performance side by side. For these companies, sustainability is woven into communications with stakeholders and is an integrated and core component of the company's reporting process.

While the reporting of sustainability information has become common practice among large companies, there is still wide variation in the quality and scope of this reporting. Following standard guidelines helps ensure comparability, consistency, and materiality of reported information. And closer integration of a company's sustainability and financial reporting—still an emerging practice—also offers an opportunity to further embed sustainability into company strategy. Transparent communication can also improve sustainability engagement with company investors, a much-needed benefit as engagement levels remain low for many companies.

CEOs also play an important role, as their rhetoric in presentations, speeches, and interviews can buttress their brand's sustainability profile both with investors and with employees.

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6 Thomas Singer, *Driving Revenue Growth through Sustainable Products and Services,* The Conference Board, June 2015, p. 76.

7 Singer, *Driving Revenue Growth through Sustainable Products and Services*, p. 31.

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OUR EXPERTS

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The author would like to thank the members of **The Conference Board Sustainability Councils** and their program directors, **Gib Hedstrom** and **Uwe Schulte**, for their valuable input on this research.

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Is Short-Term Behavior Jeopardizing the Future Prosperity of Business?

China Wants to Go Green: Sustainability Imperatives for Multinationals

The Business Case for Corporate Investment in ESG Practices

Integrating Sustainability into Your Core Businesses—A Road Map

Sustainability Matters 2014: How Sustainability Can Enhance Corporate Reputation

Framing Social Impact Measurement

Proxy Voting Analytics (2010-2014)

RESEARCH METHODOLOGY

We surveyed 84 senior executives who are members of The Conference Board Sustainability Councils and Chief EH&S Officers Council and represent companies from a diverse set of industries. Council members were asked to identify the practices they considered to be most indicative of leadership in corporate sustainability (from a list of 15 curated practices based on a literature review and discussions with subject experts). The seven practices examined in this report were selected based on results from this survey. The order in which these selected practices appear in this report does not reflect a further ranking or prioritization. In addition, some council members provided input on a separate survey of 10 questions specific to the practices that were ultimately selected.

PEER NETWORKS FOR SUSTAINABILITY OFFICERS

The Conference Board Councils are peer learning networks in which executives share best practices and problem-solve in a highly confidential and collaborative environment. Our councils of sustainability officers include:

- Sustainability Council I – Strategy and Implementation
- Sustainability Council II – Innovation and Growth
- Chief EH&S Officers Council
- European Council on Corporate Responsibility and Sustainability

To learn more about our councils, visit
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R-1604-16-CEO
ISBN: 978-0-8237-1240-3