# "Green" Winners

## The performance of sustainability-focused companies during the financial crisis

*As companies cut costs to get through the current global economic slowdown, there is often a temptation to abandon recent forays into sustainability. Yet a new A.T. Kearney analysis finds that companies committed to corporate sustainability practices are achieving above-average performance in the financial markets during this slowdown. So before tossing out those sustainability practices and initiatives, it might be wise to first determine the real value of the efforts—especially the possible rewards for staying the course.*

In the past few years, a decidedly "imperfect" storm of scarce resources, global warming debates, shifts in customer demand and regulatory changes have compelled many businesses to react to the sustainability challenge. Some companies react strategically, adjusting the corporate strategy to sustain the human and natural resources they will need to succeed now and for the long term. Their initiatives are usually transformational in nature, bringing a significant but potentially slow rate of return. They are less costly (mostly investments in energy efficiency) and often result in higher revenues through sales of *green* products and services.

Other companies take a more tactical approach, viewing sustainability first as an opportunity to improve their reputations. They make small efforts such as upgrading an environmental policy or rebranding existing initiatives under the guise of sustainability. The efforts are deemed complete when a sustainability report is published and an award is won for a track record of social responsibility.

As the financial crisis takes its toll, and sustainability-related projects add costs, many companies are considering abandoning their sustainability initiatives. But before quitting altogether, a note of caution. A recent A.T. Kearney analysis reveals that during the current economic slowdown, companies that show a "true" commitment to sustainability appear to outperform their industry peers in the financial markets *(see sidebar, Research Methodology on the following page)*.

Indeed, in 16 of the 18 industries examined, companies recognized as sustainability-focused outperformed their industry peers over both a three- and six-month period, and were well protected from value erosion.[1] Over three months, the performance differential across the 99 companies in this analysis worked out to 10 percent; over six months, the differential was 15 percent. The figure on the

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[1] *Sustainability companies are defined by inclusion in either the Dow Jones Sustainability Index or the Goldman Sachs SUSTAIN focus list.*

## Research Methodology

The research sought to determine whether companies engaging in sustainable practices may be protected from value erosion during a financial crisis by comparing the performance of sustainability-focused companies against market indices over defined spans of time.

For the purposes of this study, sustainability practices refer to those geared toward protecting the environment and promoting social well-being while achieving shareholder value. Sustainability companies were identified based on their inclusion in the Dow Jones Sustainability Index (DJSI) or the Goldman Sachs SUSTAIN focus list. Collectively, these two lists contain 99 different companies, with some appearing on both.

Analyses were conducted in 2008, for three months (September to November) and six months (May to November). Performance differentials were calculated in each industry by comparing the percentage point difference of average sustainability companies' indexed performance to the market indexed performance. Over the three-month period, the performance differential came to 10 percent; over six months, the differential was 15 percent.

following page illustrates the performance of sustainability-focused companies in each industry compared to peers. This performance differential translates to an average $650 million in market capitalization per company. Our findings suggest that investors may reward "true" sustainability-focused companies that demonstrate the following characteristics.

## A Focus on Long-Term Health Rather than Short-Term Gains

Planning for the long term can be a challenge in a business climate dominated by quarter-to-quarter thinking. For some, long-term planning means three-year forecasts and goals, leaving them ill equipped to react to external forces and capture emerging opportunities. While private companies (and public companies largely held by sovereign or pension funds) are best positioned to take a long-term view and invest accordingly, all companies with a long-term view are likely to attract the "right" kinds of investors.

Planning for the long-term requires a five-year or longer outlook by strategic thinkers, including academics, policy experts, scientists and others. Essentially, this group is made up of people who understand how present-day phenomenons and trends—including legislation and regulatory changes, irregular customer demand, demographic shifts and environmental challenges—will affect the future marketplace. Their insights help build the case for selective investments in technologies, processes and even people that may not bring an immediate return but will position the business for sustained future success.

A global consumer packaged goods company, featured on both the Dow Jones Sustainability Index and the Goldman Sachs SUSTAIN focus list, believes that its long-term success depends on creating value for shareholders and for society. The company views sustainability as not just a philanthropic endeavor but as a fundamental part of its business strategy, driving sustainability practices from the top down, and guarding against risky or ill-advised actions via strong corporate governance practices.

The company began its sustainability efforts more than a decade ago, and has since integrated sustainability practices at each stage of the value chain. Perhaps most admirably, the company decreases operational costs while reducing its environmental footprint and delivers solid annual results. Despite increasing production volume by 76 percent since 1998, the company has reduced its greenhouse gas emissions by 16 percent, energy use by 3 percent and water use by 28 percent over this period. Improved energy efficiency saved the company approximately $30 million in 2007, while optimized packaging volume saved more than $500 million over the past 16 years.

## Strong Corporate Governance

While the recent rash of corporate scandals has reinforced the need for strong corporate governance, many companies had already instilled a system of business ethics and self-checks, doing so well before enactment of legislation such as Sarbanes-Oxley. Corporate governance refers to policies, processes and people that serve the needs of stakeholders by overseeing management activities. Boards of directors, strongest when composed of individuals free of conflicts of interest and a chairperson who does not hold a dual role at the corporation, play a key role in governance.

Sustainability efforts typically call for a degree of transparency that companies without strong corporate governance are often not willing to grant. Investigations into the sustainability efforts of suppliers several tiers up the value chain and carbon usage data are a few examples of how the principles of corporate governance are being applied to sustainability efforts.

For one leading media company, strong corporate governance has been fundamental to its business success. The company adopted principles from the United Nations Global Compact—a strategic policy initiative through which businesses align with universally accepted principles in human rights, labor, environment and anti-corruption. The Compact is embedded into daily business practices and is applied to supplier codes of conduct, company policies, and compliance procedures for confidential reporting and auditing, among other areas.

The company issues an annual corporate responsibility report and widely shares its code of ethics and business conduct, communicating its standards to suppliers and auditing them regularly to verify compliance. Compliance committees in the head office and in each division provide an internal check for conformity to corporate governance practices. The company has reduced its carbon emissions by 13 percent since 2003 while scoring in the top quartile for corporate governance practices on the Goldman Sachs Sustain List.

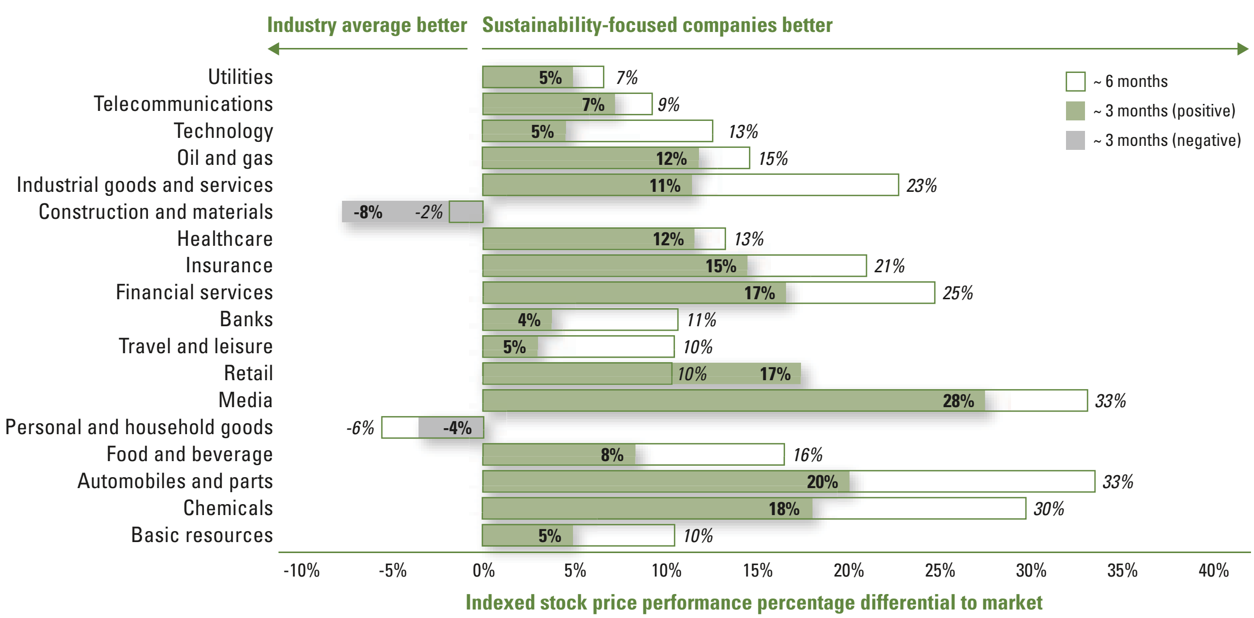
## Sound Risk Management Practices

Prudent risk management practices often evolve from the same approaches used to develop and execute long-term strategies. Risk management requires identifying areas of potential liability or weakness and crafting strategies to avoid disruptive events from occurring due to weak links in the supply chain, such as environmental changes due to geopolitical happenings.

As with a long-term strategy, effective risk management requires a five- or 10-year outlook to consider how today's trends and events might threaten tomorrow's business. What if a key supply source or manufacturer spots movement away from open markets? What if unrest or weather makes a key facility unusable? It takes a network of experts studying the "risk radar" to help forecast and prepare for such happenings, a willingness to grapple with the what-if questions, and investments in alternatives if potential risks become reality.

A leading research-focused healthcare company focuses on the sustainable development of products and services, using risk management techniques to help determine future areas of need.

**FIGURE:** Sustainability-focused companies outperform peers




*Note: Indexed stock prices at ~ 3 months = September 8, 2008 and ~ 6 months = May 19, 2008 to current date, November 24, 2008. Percentage performance differential calculated by taking the percentage point difference of averaged sustainability companies' indexed performance to the market indexed performance over the market indexed perofrmance. Sustainability companies include DJSI World 80 2008/2009 + DJSI 2008 Supersector Leaders + Goldman Sachs SUSTAIN focus list for mature industries.*

*n=99 sustainability companies*

*Sources: Bloomberg; A.T. Kearney analysis*

The company considers the implications of risks related to sustainability and develops plans to manage them. It also has processes in place to flag identified risks, and reduces future risks by integrating sustainability practices into its global business strategy.

## A History of Investing in Green Innovations

Green innovations—such as reducing waste and emissions, using alternate energy sources, and producing natural products—have become something of a "me too" cause in recent years. Yet companies with a history in green innovations have reaped the most benefits. And those that continue to make meaningful investments will continue to prosper, both in terms of business results achieved and public perception. For example, a leading global automaker made sustainability a core value and has therefore been able to be opportunistic—using technological innovations to create leading-edge automobiles and monitoring trends to respond quickly to foreseeable issues. Ahead of the curve in reducing carbon dioxide emissions, this automaker is developing alternative fuels to reduce emissions and formed a dedicated team to constantly assess markets, competitors, technologies, politics, laws, natural science and medicine. What the team learns is shared across the company to better understand the future impact of present-day events. The company strives to make every new model more energy efficient than older models and competitor's vehicles, and plans to use electric drive systems to reach a zero emissions goal for its vehicles.

In North America, President Obama's green policies will provide opportunities across industries for innovation in the areas of construction and infrastructure, renewable energy, and transportation.

## The Real-World Implications

With the apparent link between sustainability practices and financial performance, what lessons can companies learn during these challenging economic times?

The primary take-away is to examine all sustainability practices and determine how genuinely committed the firm is to them. If the commitment is less than complete—where efforts are simply to improve public relations or catch up with industry leaders—and there is little payback, it might make sense to reduce or eliminate sustainability investments and redeploy this capital to areas that will help the company weather the current crisis.

However, if sustainability is transforming the business, it makes sense to maintain this commitment and, where possible, even consider increasing investments to improve future positioning. The most sustainability-focused companies may well emerge from the current crisis stronger than ever—recognized by investors who appreciate the true long-term value of sustainability.

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