

Sample Chapter

SUSTAINABILITY STRATEGIES

WHEN DOES IT PAY TO BE GREEN?

INSEAD
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About the book



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“Corporate environmentalism is not philanthropy but an indispensable new approach to the business model. How do we make it pay? Read this important book to find out.”
- André Hoffmann, Vice-chairman Roche Group, Switzerland and WWF international.

The request on managers to base eco-investments on solid grounds has never been so vital. They need to know what they should do first, and why. Should they focus on generating carbon credits via eco-efficiencies? Enhance corporate reputation by joining Green Clubs? Subscribe to eco-label programs? Explore emerging cleantech markets? Within the overwhelming possibilities, many spend precious resources without sound criteria.

By analysing the rationales for sustainability strategies, this book addresses a timely question for managers, academics and MBAs: “when does it pay to be green?” Based on solid theoretical foundations and empirical research, it clarifies the elements involved in the formation and evaluation of sustainability strategies in firms, helping managers to prioritize eco-investments and transform them into sources of competitive advantage and new market spaces.

Sustainability Strategies delves particularly deep into the troublesome global auto industry. By identifying the roots of economic and environmental problems of the sector, the book shows how to develop Sustainable Value Innovation: the creation of differential value for customers and contribution to society at both, reduced costs and environmental impacts.



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PREFACE

Environmentalism is subject to cycles of perception and interest. During the 1970s and 1980s, alarmist peaks of scarcity, pollution and biodiversity loss triggered only sporadic attention to ecological issues by the media, politicians and business. Environmentalism struggled to survive. The United Nations Conference on Environment and Development (UNCED) held in Rio de Janeiro, Brazil in 1992 started to change both the political agenda and the positioning of some large corporations. Environmental issues started to be treated in a more serious and systematic manner, and the remaining part of the decade was marked by intense activity in both practice and theorization. A large number of companies implemented tools, standards and reporting initiatives for proactive environmental management, often with help of consultants and in partnership with Non-governmental Organizations (NGOs). In the academic front, the decade was dominated by a heated debate about whether it pays to be green, which, not surprisingly, ended with no winners. As the end of the 20th century approached, empirical evidences of environmental protection and restoration were scarce, while the debate about the value of eco-investments tired academic circles, losing momentum. The result was another downturn for environmentalism.

In the early years of the new millennium, the focus shifted from environmental to social issues. An increasing number of books, academic papers and popular articles emphasized the social dimension of business responsibility and endorsed the need and advantages of good corporate citizenship. Prescriptions were justified more with carrots than sticks. According to the legions of proponents of Corporate Social Responsibility (CSR), positive rewards would not only outperform penalties but leadership in social causes would generate competitive advantages. In other words, the *pays to be green* debate had migrated to the realms of social responsibility. The issue moved to *does it pay to be nice?* This time, however, the discourse was more appealing. Besides

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the proclaimed business advantages, who would argue against societal demand for corporate accountability? From the point of view of citizenship, who would deny the need for corporations to be sensitive to human rights? In free and democratic societies, advocating against political correctness would simply be an oxymoron. The result was an overwhelming early success of the CSR discourse.

Corporate scandals in the United States (US) and Europe in the early 2000s, further sensitized public opinion and reinforced the business case for more ethics and governance in business. As CSR took the stage, there was a massive migration of scholars and consultants from the old and boring field of environmental management, to social issues in business. They proposed that environmental management should be under the umbrella of CSR, and be treated in the same way. This also caused a shift in focus of the corporate world. Instead of showing how they managed waste, for instance, corporations were keener in presenting their efforts to tackle social problems. Suddenly, the environment could speak, making CSR reports sexier than the former environmental accounts. Corporate representatives could collect testimonials from stakeholders, something almost impossible in the area of environmental protection. After all, air, water, soil and biodiversity do not speak and hardly attract any positive media attention, as people do. Because nature has no face, it is easily forgotten.

After much media attention, empirical evidence that CSR pays remained scarce,¹ causing some to start questioning the normative discourse. The ratification of the Kyoto protocol in the end of 2004 contributed to further change the political climate. More literal, however, were the escalation of climate disruptions influenced by global warming, such as the Hurricane Katrina in New Orleans in 2005. The personal crusade of Mr Al Gore, depicted in the *Inconvenient Truth* documentary, and the Nobel Peace Prize awarded to him in late 2006, legitimized climate change as the most pressing issue for humankind in the new millennium. By then, the anti-Kyoto standing of the George W. Bush presidency in the US started to wear out, and public demand for actions brought environmental issues to the center of political agenda, now consolidated in the term *sustainability*.² Candidates running for public positions, corporate executives and deans of business schools, suddenly started claiming their environmental credentials. Whatever caused the tipping point, the pendulum brought back the urgent need for societies to reduce the anthropogenic impacts on the natural environment, pointed out in the 1970s.

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As the pendulum swung to the sustainability side, it brought two curious outcomes. First, many believed that climate issues could be treated as another type of CSR issue, which so far was mostly peripheral to business. While social and environmental issues are two sides of the same coin – the coin itself representing economic development – quite often social and environmental issues require different treatment. As Porter and Reinhardt³ emphasized: “Companies that persist in treating climate change solely as a corporate social responsibility issue, rather than a business problem, will risk the greatest consequences”. Confronted with broad spectra of CSR and sustainability-driven initiatives, corporations still have to base their investments on sound rationales for competitiveness. Most of them, however, still do not know what to do and why. Although nowadays there is more awareness, by the end of the 2000s, a great number of executives are still uncertain what sustainability means for their businesses and, more important, what they can do about it.

Second, from the pessimistic perspective that greening never pays that dominated both the mindset of business and the specialized literature until quite recently, the pendulum moved to the other end: to the view that greening always pays. Unfortunately, from both the business and the environmentalist perspectives, this book will show that the scope for win-win scenarios is narrower than many wish them to be. Out of the vast array of actions taken by firms, only a few will be profitable, generate competitive advantage or create new market spaces. This is not, however, all bad news. After all, sustainability is similar to any other issues in business: the profitability of investments depends on the internal and external contexts of the organization. Therefore, to restore the balance between pro and against greening arguments, we need to identify when and why environmental investments pay.

The argument for conditional returns does not imply companies should do little to protect natural ecosystems. On the contrary, firms should undoubtedly deploy increasingly ambitious social goals and do what eco-activists and the general public expect: the reduction of the overall environmental impact of businesses, so that sustainable societies can eventually emerge. However, if strategy is about “doing better by being different”, as Joan Magretta⁴ elegantly put, then sustainability strategies require more than doing well. Managers need to identify the appropriate types of eco-investments to focus their efforts in the pursuit of competitive advantage or the creation of new market spaces. They will need to identify *when it pays to be green*. By revisiting this recognizably ample question, as well as others left unanswered

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by the specialized literature, this book redirects the attention to the importance of finding business rationales for sound *corporate environmentalism* – a term used in this book to represent the broad range of practices that have the potential to reduce the impact organizations cause to the natural environment.

The analytical reasoning and frameworks presented in the book can help managers to prioritize eco-investments according to the fundamentals of strategic management. Executives who are already convinced that they should do something about sustainability will find important insights in the book. *Sustainability Strategies* will help them to apply business principles to environmental and social issues, so as to increase the overall competitiveness of their firms. Through the systematic use of analytical frameworks, the book connects the variables implicated in the formation and evaluation of sustainability strategies. The frameworks also help managers to define and prioritize areas of organizational action and optimize the economic return on eco-investments. By doing so, managers can more easily align the sustainability strategy with the generic business strategy.

The book is based on analytical reasoning and studies of individual organizations and groups of organizations. Most case studies result from extensive research with a global range. Nonetheless, in order to avoid overloading the reader with scattered or unrelated examples, the cases used throughout the book are limited to those that help grounding theory. The presentation of an exhaustive number of successful cases, as many books on the topic do, is crucial to make the business case for corporate environmentalism. However, to a large extent, the business case has long been presented. Reasonably well-informed executives are already convinced that sustainability is indeed a core business issue. What is necessary now is to connect apparently disparate cases via grounded theoretical frameworks. Finally, the book not only builds on success stories but it also presents several examples of eco-investments that simply failed. Such experiences are equally important for managers to learn from when it does *not* pay to be green.

The book is divided into three parts. The Chapters 1 and 2 forming Part I (Fundamentals) explore the two fundamental research questions addressed by the book. Chapter 1 shows that answering *when it pays to be green* requires an understanding of the scope of corporate environmentalism, and the elements involved in the so called win-win scenarios of simultaneous economic and environmental gains. Overall, the conditions favoring or hindering returns on eco-investments have a plethora of methodological difficulties, addressed in the final

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sections of the chapter. Chapter 2 reveals the main differences between operational effectiveness and strategy in the realms of corporate environmentalism, by analyzing what sustainability strategies are. The chapter also presents the analytical frameworks that will serve as the backbones of the remaining chapters of the book. Four sustainability strategies used by firms to compete in existing industries are complemented by a fifth strategy used by companies to create new market spaces while addressing the demands for environmental and social responsibility.

Part II (Competitive Environmentalism) includes Chapters 3 to 6 wherein it discusses the four Competitive Environmental Strategies (CES). Chapters 3 and 4 address the strategies focusing on organizational processes, while Chapters 4 and 5 present the strategies in which the focus is on the products and services sold by the company. By exploring three areas of potential gains – lean thinking, industrial ecosystems and carbon credits – Chapter 3 presents the rationales for firms to adopt Eco-efficiency as a specific sustainability strategy. Chapter 4 delves into the intangible value of eco-investments, and identifies when positive reputation is prone to emerge for companies that join voluntary environmental initiatives or, as some call, Green Clubs. Chapter 5 addresses eco-labeling schemes as means of differentiating products and services. Eco-branding strategies, however, require more than eco-labeling, as the analysis of cases from Sweden and Australia demonstrate in the final part of the chapter. Finally, Chapter 6 analyzes the ways in which companies can be the leaders in both low costs and low environmental impact of their products and services.

Part III (Beyond Competition) of the book includes Chapters 7 and 8. Chapter 7 presents the fifth and most challenging sustainability strategy. The logic embedded in concept of Sustainable Value Innovation (SVI) is uncovered via the analysis of several cases within the area of individual motorization. By delving deeply into one single topic, which is more directly related to the global automobile industry, the chapter explores the elements and subtleties involved in deploying SVI strategies. Finally, Chapter 8 concludes the book by revisiting the main benefits brought by the eco-investments and corresponding sustainability strategies analyzed in the preceding chapters.

Although the book presents a very comprehensive set of initiatives in the area of corporate environmentalism, it has some self-imposed limitations. First, *Sustainability Strategies* focuses on the choices managers have when deciding about eco-investments and their alignment with the general strategy of the business; it does not intend to be a

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handbook of environmental management or CSR. There are a wide range of useful practice-oriented books⁵ and handbooks available to managers to identify environmental aspects and impacts, as well as practical approaches and tools to address them.⁶ These materials also tend to cover the upstream (supply chain management) and downstream (product stewardship) activities, which are treated here as areas of strategic influence, rather than direct components of sustainability strategies. Second, *Sustainability Strategies* focuses on the elements involved in the development of strategy and its evaluation (also treated as strategy formation or definition). Since the implementation and control of sustainability strategies use similar logic of generic business strategies, there is not shortage of material to choose from.⁷ The end-notes of each chapter identify these supporting materials, as well as explanations about the various topics treated in the book, so readers interested in investigating them further find useful help from the notes provided in each chapter.

Of course, there are limitations that I would rather avoid. My research training, interests, values and heuristics might have influenced the perceptions constituting the reality expressed in this work. Although I tried to discipline and reduce interference from personal idiosyncrasies in the development of the study, the results represent, ultimately, my personal interpretation of reality, with all the cognitive faults that others might detect therein. For those faults, I take full responsibility.

Endorsements

'This book presents a clear and comprehensive analysis of the business challenge of using environmentalism as a source of competitive advantage. Orsato has made a sophisticated contribution to our understanding of the strengths and limitations of sustainable business strategies. It can be read with profit by both managers and scholars who want to better understand the dynamics of corporate environmentalism.'

—David Vogel, University of California, Berkeley, US

'Why is this book so good? First, it is wonderful reading - it reads like a novel. Second, it doesn't try to change my beliefs or attitude. Instead, it provides me with useful tools to formulate and realise a sustainable strategy of my own. Third, there is a lot of experience in it. You know what Bismarck said? "There is no experience like someone else's". You bet he was right. I am certainly suggesting it to some of my managers.' —Ton Doesburg, CEO Alliander, Germany

'Sustainability has become a hot topic in the corporate strategy realm. But it is not enough for executives to know that the whole world is going "green". Figuring out when and how and where to bring a green focus to business is critical. *Sustainability Strategies* helps clarify the opportunities and challenges in this regard with systematic analysis, carefully explained corporate examples, and thoughtful discussion about the limits of efforts to green business.'

—Dan Esty, Professor, Yale University and Director of the Center for Business and the Environment at Yale, as well as author of *Green to Gold*

'Orsato has produced a well structured and valuable set of insights into what makes for a winning sustainability strategy. The book is based on a robust blend of analytics, logic and examples. It is a practical guide about the real choices that drive sustainable competitive advantage. This research is an excellent contribution to strategic formulation in an area that will only grow in importance and significance to business leaders over the next decade.'

—Mark Spelman, Global Head of Strategy, Accenture, London, UK.

'I have been working and publishing on the topic of sustainability since the 1960s and it is always a pleasant surprise to learn something new. Orsato's book is such a surprise. It not only provides a well-grounded analysis of the rationale for more sustainable business models, but also provides fascinating stories about people and firms that have made the attempt, some successfully, some not.'

—Robert Ayres, Emeritus Professor, INSEAD

'In the long term, all businesses must live in harmony with their environments, but how to do so has long been the subject of anecdotal feel-good stories rather than real analysis. This book provides useful models, strategies and examples for charting a sustainable course into the future.'

—Frans Cornelis, Managing Director, Group Marketing & Communications, Randstad Holding, Holland

'Does it pay to invest in IT? Yes, but only if one combines the investment with upgrading people and organizational capabilities and if one links the investment to innovation. Does it pay to be green? Yes, but again, only if this investment is linked to upgrading capabilities and to innovative business models. That is what this long overdue book shows through a set of convincing case examples put in the framework of value innovation. Being green pays and this book tells the reader how to go about making green investments profitable.'

—Luk Van Wassenhove, Henry Ford Professor of Manufacturing, and Academic Director of the INSEAD Social Innovation Centre

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