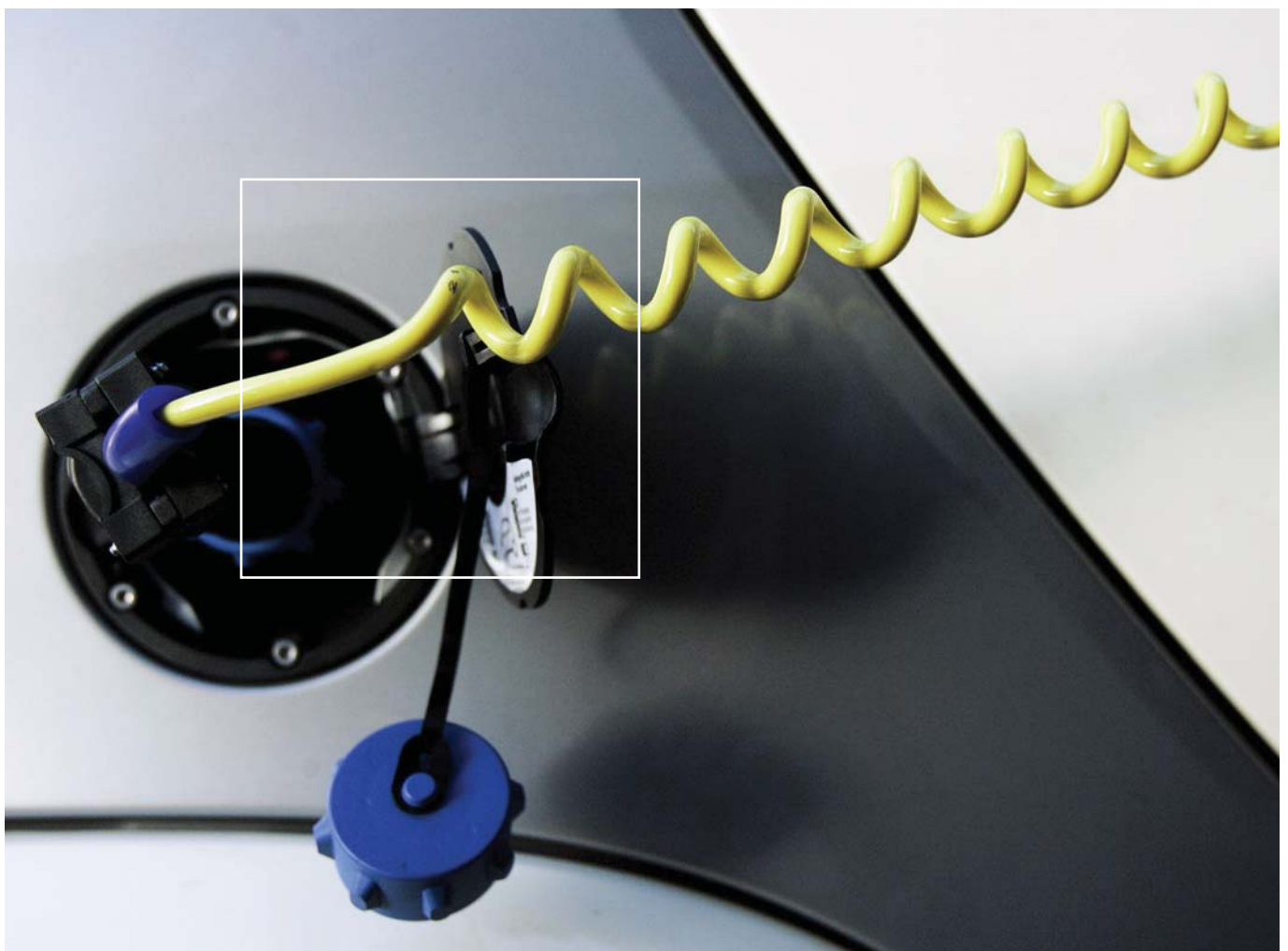


Integrity + Innovation = Sustainable Performance

The Sustainability Value Formula



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Executive summary

What do retail giants like Marks & Spencer, a telecommunications service company like BT, a healthcare specialist like Novo Nordisk and a bank like HSBC have in common? Leadership in such competitive and fast moving sectors takes more than a strong brand and careful management. These high performance businesses are increasingly demonstrating leadership and an intense focus on integrity and innovation.

This report explores how the combination of integrity and innovation feeds business success and previews empirical research into the strength of the relationship:

Integrity + Innovation = Sustainable Performance

So erfolgreich ist die CO₂

Sanierte Wohneinheiten:

309863

Fördermittel durch die KfW:

5269104505

€

Sanierungsinvestitionen insgesamt:

5796015088

€

Die beste Energie ist die, die wir einsparen. Das Bundesministerium für Verkehr, seit Jahren die energetische Sanierung von Wohnraum. So sparen wir Heizkosten

Introduction

Common ground in diverse companies

Between 1999 and 2006, the number of companies issuing reports in accordance with the Global Reporting Initiative¹ guidelines – incorporating social and environmental with financial performance information – rose from 20 over 1000².

The activity of managing, measuring and reporting social and environmental performance is described by an often confusing plethora of terms, including sustainable development, corporate citizenship, corporate accountability, corporate social responsibility, triple bottom line management or corporate responsibility.

Responsible behaviour by companies is not new. Financial services provider Friends Provident was founded by Quakers in the first half of the 19th century, and these roots continue to inform its management ethos: long before Socially Responsible Investment (SRI) had become a buzzword, Friends Provident had established its Stewardship ethical fund range, encouraging investee companies to espouse similar values regarding ethical, social and environmental standards. Having grown steadily for over two decades, these funds topped £3 billion by the end of 2006. Also in the 19th century, the influential artist and writer William Morris was highly outspoken in his predictions of the problems due to unsustainable industrialisation, and developed processes of printing and design with reduced environmental impact. Early in the 20th century, cereal magnate W K Kellogg was one of the first people to put nutrition labels on his foods. Quoted as saying 'I will invest my money in people,' he lived up to his promise during the Depression, for example, by increasing the number of shifts at his factory so that more local people could find work.

What recent years **have** produced is a much greater focus, among companies across all sectors, on winning and keeping the trust of their stakeholders.

Limiting CO2 (carbon dioxide) emissions

An electronic billboard demonstrating the amount of energy saved when a building is properly insulated, in order to limit CO2 (carbon dioxide) emissions 21 March 2007 in Berlin.

This focus at least partly reflects growing public awareness about, and rising expectations of, corporate ethics – in both developed and developing economies. Breaches of trust can be severely punished: as, for example, British gaming group Wembley plc found when its share price plunged following the announcement that it was facing charges in the US for allegedly trying to influence public officials³. Similarly, the Consumer Federation of America and Bank of America noted that 42% of individual investors were less likely, after the Enron scandal, to invest because they felt mistrust and powerlessness over CEOs. Other high-profile examples include WorldCom, Adelphia Communications and Tyco.

There are, positive drivers also towards broader reporting criteria and greater investment in sustainable company practices. As an earlier Arthur D. Little report (**The Innovation High Ground**) has shown, leading companies are using sustainability-driven innovation to create real business value. US conglomerate GE has reported doubling of the sales of its Ecomagination range of 'green' products and services to \$12 billion in two years. Around the same time, Citigroup announced investment of \$50 billion over 10 years in environmental projects; and IBM pledged to spend \$1 billion a year on similar projects⁴.

While all this activity is taking off, the familiar competitive pressures of business are not going away. Instead, they continue to mount, compelling companies to keep finding new and better ways to deliver the goods and services that society wants more efficiently and profitably.

¹Source: globalreporting.org

²Source: corporateregister.com

³Source: BBC

⁴Source: FT, 23 May 2007

One indicator of the direction such innovations are likely to take can be seen in the Saïd Business School of Oxford University relaunch of its business plan competition. The reinvigorated competition is designed to encourage bold business ideas that will provide solutions to the social and environmental challenges of the 21st century.

The business landscape, overall, is undoubtedly changing. And there is considerable confusion as to how business should respond. Jargon around issues of corporate responsibility, social responsibility, corporate citizenship and accountability abounds. But it does little to help corporate leaders to identify the principles, policies, actions and metrics they need to build more sustainable businesses. Meanwhile, media scrutiny of corporate behaviour and alleged 'double standards' is widespread and condemnatory, to the extent that some companies hesitate to make necessary decisions and actions for fear of falling foul of the press.

“Our observations are based on a century of innovation consulting experience, and our track record as one of the first consulting firms to advise on sustainability.”

However, the way ahead is becoming clearer. Over recent years, Arthur D. Little has started to identify some strong common themes in the changing business landscape. Our observations are based on a century of innovation consulting experience and our track record as one of the first consulting firms to advise on sustainability. This combination gives us considerable evidence and insight to draw on.

Increasingly, we see industry's different sectors being led by companies – such as Marks & Spencer in retail, BT in communications, Novo Nordisk in healthcare, and HSBC in banking – that have two things in common:

- **Integrity:** consistently fulfilling their stated business principles as an integral part of their decision-making, rather than managing 'CSR' as an additional business activity.
- **Innovation:** finding successful new ways of value creation in response to the changing needs of markets, societies and the environment.

We are currently undertaking empirical research into how strongly this equation:

Integrity + Innovation = Sustainable Performance

correlates with current corporate behaviour across a range of industry sectors. We believe the research will yield proof points to support both strategic policy- and decision-making, and practical courses of action, for creating greater business value.

This document offers some of the anecdotal – but compelling – evidence that inspired us to undertake that research.

It's about trust

What is it about the combination of integrity and innovation that seems to lead to higher performance?

To understand this, it's worth taking a closer look at the attributes involved.

On the one hand, a person or company with integrity is one that doesn't let stakeholders down. Promises made become promises delivered.

On the other hand, strong innovation capability is characteristic of individuals or organisations that constantly deploy new, improved ways to deliver what they promise to their different stakeholders.

“Research by Arthur D. Little has shown that innovative firms achieve on average a six times higher EBIT margin than the underperformers, and on average a growth rate that is 13% higher than the underperformers’.”

Both integrity and innovation are intuitively connected with improving the overall performance of a business, and the sustainability of that performance, because both are inherent in the major routes to sustainable performance: cost reduction, risk reduction, creation of new opportunities and building stakeholder support.

The business value of innovation is well recognised. Most leading companies emphasise their innovation focus and strengths in external communication and for internal motivation. Although notoriously difficult to measure, the premise that effective innovation creates company value – in terms of additional sales or profits – is now generally taken as a given. Research by Arthur D. Little has shown that innovative firms achieve on average a six-times-higher EBIT margin, and a growth rate that is 13% higher, than the underperformers’.

Leading companies also understand the importance of being **seen** to be innovative, because a reputation for being innovative enhances a company's reputation – among investors, customers, business and government partners, staff and target recruits – and thereby generates additional value.

Less well recognised is the value created by integrity. But the logic is similar. Integrity breeds trust; trust creates a good reputation; and, once again, reputation builds value. Conversely, several incidents of recent years show how costly – and even economically fatal – loss of integrity can be (e.g. Ahold, Enron, Dynegy, Global Crossing).

Efforts to ensure company integrity take a variety of forms. Among the best known and most debated are corporate governance and responsibility. More companies are developing sophisticated approaches to handling these. Still, in most cases, such activities run parallel to – and largely separate from – the innovation efforts.

As a result, we believe, most companies are not achieving their full potential.

‘The way we do business’

Increasingly, outstandingly-successful companies in specific sectors and in the global marketplace appear to be those where both integrity and innovation are ‘the way we do business’ – not adjuncts to the day-to-day corporate working, relegated to a compliance committee or an R&D department head.

Such companies demonstrate integrity, evidenced by clear principles that are consistently fulfilled in the business as a whole. They also excel at innovation, turning their promises into creative action, in line with these declared principles, to meet their stakeholders’ needs and expectations in sustainable ways.

One example is Deutsche Telekom, which has undertaken a strategic overhaul of processes and operations to establish a more sustainable supply chain. The company recognises in this transformation the potential to deliver cost and risk reduction, create opportunities for profitable innovation and build stakeholder support and advocacy in a sector under increasing pressure on many fronts: health and safety, labour and employment, environment and ethics.

Another global telecommunications player has focused specifically on the innovation opportunities in sustainable development, identifying, quantifying and pursuing new technology solutions that will enable its customers to increase the effectiveness of their own contribution to a more sustainable world. This company’s approach to sustainability and responsible business has gained it recognition as an international leader – customer feedback confirms that its approach has contributed to an increased win rate with new business bids (about \$1.8 billion).

Vodafone has created a space where new products and services can be systematically identified, selected and piloted with the goal of delivering some explicit social or environmental value. Its mobile payment services – using mobile phones as a delivery channel for microfinance services to communities normally excluded from banking – have proved the viability of mobile-based services that significantly reduce transaction costs. At the same time, the communities have gained affordable, safe, convenient and efficient access to a wide range of services, such as loans, savings, withdrawals, funds transfer and electronic payments.

Computing infrastructure provider Sun Microsystems has identified business opportunities in energy efficiency and resource efficiency. By seeking ways to help customers to reduce power consumption and the space needed for computer servers, Sun has developed processor technologies that deliver substantial energy savings to its customers. At the same time, its integrated approach to design for the environment has ensured that 99% of materials in the company’s take-back schemes for unwanted equipment retain some follow-on value; only very limited amounts of material are sent to landfill. There is concrete evidence that customers buy Sun products because of their environmental performance.

“BASF, a major chemicals group, has achieved substantial cost savings and environmental benefits through the ‘Verbund’ initiative, involving exchange and sharing of a range of resource and ‘waste’ streams between businesses.”

Meanwhile, IBM’s sustainable product stewardship programme has saved the company about \$11 million in packaging materials and distribution. BASF, a major chemicals group, has achieved substantial cost savings and environmental benefits through the ‘Verbund’ initiative, involving exchange and sharing of a range of resource and ‘waste’ streams between businesses.

As the influence of the European Union on national environmental policies grows, the Dutch Ministry for Housing, Spatial Planning and Environment (VROM) is working with the nation’s industry to establish greater clarity on long-term perspectives for environmental requirements, possible solutions and costs. As well as enabling Dutch companies to respond effectively to legislation that may be introduced in the future, this collaboration creates a basis for environmental innovation that will reduce costs associated with managing pollution, and opportunities to export know-how developed in the Netherlands.

Healthcare company Novo Nordisk has developed a holistic view to balancing concerns for all its stakeholder groups with considerations for the environment and a view to long-term profitability. Focusing its efforts on the people who use its healthcare products – predominantly diabetes-related – the company’s engagement with healthcare workers, government, international organisations and experts has led to a radically different model of therapy. This model recognises that each person with diabetes deals with a different set of circumstances, so – despite the effectiveness of therapies available – the majority do not achieve full health and quality of life. By leading the drive towards improving access to therapies, through its involvement in National Diabetes Programmes in 46 countries around the world, and its DAWN programme uncovering diabetes attitudes, wishes and needs among people with diabetes and healthcare professionals, Novo Nordisk is visibly realising its publicly stated aspiration to be world leader in diabetes care, while generating a multitude of opportunities for next-generation innovation.

“By leading the drive towards improving access to therapies, through its involvement in National Diabetes Programmes in 46 countries around the world, and its DAWN programme uncovering diabetes attitudes, wishes and needs among people with diabetes and healthcare professionals.”

Managing integrity and innovation for sustainable performance

These examples provide intriguing evidence of increased corporate value where integrity and innovation have come together in leadership strategies. Integrity and innovation therefore can and should be classified as corporate assets. And they need to be managed coherently as such.

One of the steps inherent in the process of managing any asset is its measurement and evaluation. As noted above, there is still considerable debate about how innovation is best measured. The concept of evaluating corporate integrity is even less established.

However, there are tools and techniques available. We have had considerable success with several clients seeking to evaluate the integrity of their leadership team and corporate relationships.

For example, when a major UK government department undertook a nationwide reorganisation during a time of intense activity, our diagnosis of the principles, values, governance and accountability factors helped to realise the reorganisation with lower functional costs and increased service performance, while retaining goodwill.

In the private sector, a multinational oil company requested our assistance when it was seeking to reduce the costs of friction between the corporate centre and privately-owned retail operations. Our evaluation of the ethical nature of their relationships; and resulting recommendations, led to reduced legal costs, increased retail revenue, and greater cooperation to increase innovation and competitiveness.

Evaluating innovation is as complex as evaluating integrity. However, more than a century's experience in innovation management has enabled us to develop rapid and intense assessment tools that help companies to establish a clear vision at board level of how becoming more innovative will raise the corporate performance. Our approach imparts a deep understanding of the barriers to innovation, and the actions needed to overcome them. Our innovation audit culminates in agreement on how much potential for increase in the value of the business is available through adding innovation capacity, and this becomes a measurable target for senior management.

Our experience as advisors and innovators ourselves, backed up by recent research carried out among over 100 European companies, fully supports our view that success is not about innovation for its own sake. Rather, for a given company, it results from a clear understanding of the role the company plays within its industry, its use of innovation specifically to support that role, and focus on innovation that its clients or customers expect and appreciate. In other words, coherence between innovation and positioning is all-important.

The research we currently have under way is designed to take our understanding to the next level, through the connection between innovation and integrity – which can be summarised, in a sense, as 'living the positioning'. The research passes on a number of key performance indicators on both the integrity and innovation dimensions. Indicators include:

Integrity dimension

- Is there evidence that the business operates to a set of business principles, guiding strategic planning and decision-making and visibly endorsed by senior management?
- Can the business demonstrate that it is actively engaging with its stakeholders, identifying and prioritising material issues and setting goals to address these issues?
- Is there clear evidence that the company consistently fulfils the promises set out in these principles and goals – i.e. is it delivering on its performance commitments?

Innovation dimension

- Is the company targeting its innovation effectively, deploying innovative business models meeting requirements to manage complexity (product portfolio, customer segment, brand variety)?
- Can the business demonstrate that it is innovating effectively, including resource planning and development, idea management, product development?
- Is the company effective in identifying possible future societal requirements, including the availability, performance and applications of technology?

Conclusion

Sustainability issues continue to emerge. As customer choices and societal expectations change in response to these issues, the competitive playing field is changing – fast. Is your business aligned and equipped to meet the future that awaits it?

Our work with many of the leading high-performing businesses highlighted in this paper has helped us to identify the shared characteristics that make these firms leaders in sustainability, sector by sector.

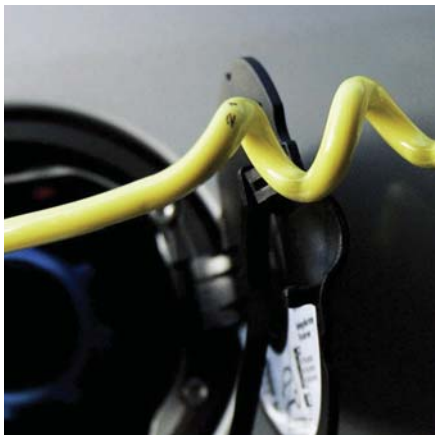
We look forward to sharing the findings of our ongoing quantitative research with you and exploring their implications for your business. In the meantime, if you have any questions or would like to discuss any of the issues contained in the publication, please visit www.adl.com/iplusi or contact your local Arthur D. Little office

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Free electric vehicle charging points launched in London

Detailed view of the fuel flap on an electric vehicle on December 6, 2006 in London. Westminster council is the first to launch free on-street electric car charging points in the UK.

Arthur D. Little

Arthur D. Little, founded in 1886, is a global leader in management consultancy; linking strategy, innovation and technology with deep industry knowledge. We offer our clients sustainable solutions to their most complex business problems. Arthur D. Little has a collaborative client engagement style, exceptional people and a firm-wide commitment to quality and integrity. The firm has over 30 offices worldwide. With its partners Altran Technologies and Cambridge Consultants Ltd, Arthur D Little has access to a network of over 16,000 professionals. Arthur D. Little is proud to serve many of the Fortune 100 companies globally, in addition to many other leading firms and public sector organisations. For further information please visit www.adl.com

Our Sustainability and Risk practice supports companies across the world to find performance through integrity and innovation. Our work is rooted in the origins of the firm. Since the days when Arthur D. Little himself advised clients on finding commercial uses for their process waste, we have combined our in-depth sector knowledge and expert advice in business strategy and performance, technology and innovation with a strong track record in advising companies on environmental and social responsibility.

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