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EXECUTIVE STUDY AND RESEARCH PROJECT**

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# Investing For a Sustainable Future

Investors see a strong link between corporate sustainability performance and financial performance — so they're using sustainability-related data as a rationale for investment decisions like never before.

By Gregory Unruh, David Kiron, Nina Kruschwitz, Martin Reeves, Holger Rubel, and Alexander Meyer zum Felde

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# Investing For a Sustainable Future

## Executive Summary

**M**any executives embrace the conventional wisdom that mainstream investors care little about an organization's performance on environmental, social, and governance (ESG) metrics. Few companies make it a priority to communicate their sustainability performance to investors, or even develop a robust story about their sustainability performance. Why should they? Investors won't shift their investments, the thinking goes, based on a company's ESG performance. However, a growing number of investors are paying attention to ESG performance, as evidence mounts that sustainability-related activities are material to the financial success of a company over time. Investors care more about sustainability issues than many executives believe.

Understanding investor priorities is an important responsibility for a company's top executives and its board of directors. Based on their understanding of investor interests, an organization's leadership will often focus corporate strategy and behavior in one direction rather than another. If executives believe that their investors prioritize short-term profits, they will tend to organize sales, cost management, and research and development activities to maximize such profits rather than make certain long-term investments. With greater numbers of investors making investment decisions based on sustainability performance, it is time for corporate leaders to recognize that an increasing number of shareholders are (literally) invested in whether a company's ESG activities connect with its financial success. How should corporate leaders respond to this growing interest in sustainability among mainstream investors?

This is an especially important issue for today's corporate leaders since a wide range of investment organizations — from retail investors to asset managers to institutional investors — are making investment decisions using new assessment tools that connect ESG performance with corporate performance, some designed by investors themselves. Other tools are emerging from a diverse community of tool makers, consulting groups, and multinational organizations. Sustainability-oriented investment funds are also becoming more prevalent and have garnered assets worth trillions of dollars. Investors are beginning to seek out and develop their own stories about corporate ESG performance in lieu of companies connecting their sustainability performance with their financial performance.

A significant barrier for many organizations is that they don't have a strong story to tell — yet — about their company's ESG performance. Most companies acknowledge the importance of a sustainability strategy to their overall competitiveness, but only a minority of managers report that their organi-

zations have developed a business case for their sustainability efforts.

This global executive study on corporate sustainability from *MIT Sloan Management Review* and The Boston Consulting Group (BCG) presents an in-depth analysis of investors' new ability to connect sustainability performance with corporate performance, discusses how investors are using sustainability performance as a key criterion for making (and leaving) investments, and identifies what corporate leaders can do to stay relevant to sustainability-oriented investors. Below are six key findings that emerged from our 2015 survey of more than 3,000 managers and investors in organizations from over 100 countries.

### ABOUT THE RESEARCH

In 2015, for the seventh consecutive year, *MIT Sloan Management Review*, in partnership with The Boston Consulting Group (BCG), conducted a global survey of managers about corporate sustainability. The survey response set included 7,011 respondents from 113 countries. This report is based on a smaller subsample of 3,057 respondents from commercial enterprises. Within this commercial sample, 579 survey respondents self-identified as investors: Most were strategic (39%), institutional (24%), or retail (11%) investors. Few identified themselves as mission-oriented or socially responsible investors. The investment community was broadly represented in our sample and included respondents from pension funds, endowment organizations, insurers, banks, and asset management companies. Among these groups, a significant number of respondents came from asset management companies (36%).

Respondent organizations are located around the world and represent a wide variety of industries. To focus on business, we excluded responses from academic, governmental, and nonprofit organizations. The sample was drawn from a number of sources, including BCG and MIT alumni, *MIT Sloan Management Review* subscribers, BCG clients, and other interested parties.

In addition to these survey results, we interviewed practitioners and experts from a number of industries and disciplines to understand the sustainability issues facing organizations today. Their insights contributed to a richer understanding of the data and provided examples and case studies to illustrate our findings.

This report also includes findings from a 2015 survey conducted by *MIT Sloan Management Review* and the National Investor Relations Institute (NIRI), a professional organization of corporate officers and investor relations consultants. This survey, which focused on sustainability, netted 154 responses from NIRI members.

- **Managers' perceptions of investors are out of date:** Seventy-five percent of senior executives in investment firms agree that a company's good sustainability performance is materially important when making investment decisions. However, only 60% of managers in publicly traded companies believe that good sustainability performance is materially important to investors' investment decisions.
- **Investors believe that sustainability creates tangible value:** Seventy-five percent cite improved revenue performance and operational efficiency from sustainability as strong reasons to invest. More than 60% believe that solid sustainability performance reduces a company's risks. Nearly the same number also strongly believe that it lowers a company's cost of capital.
- **Investors are prepared to divest:** Nearly half of investors say that they won't invest in a company with a record of poor sustainability performance. Some 60% of investment firm board members say they are willing to divest from companies with a poor sustainability footprint.
- **There is a lack of communication within corporations and investment firms and between them:** At investment firms, more than 80% of board members believe that their companies

engage in responsible investing. But only 73% of middle managers and 62% of front-line employees have the same opinion. In corporations, nearly 80% of board members and 85% of C-suite executives are fully informed about their organization's sustainability efforts. But only 51% of senior managers and 31% of middle managers and front-line employees are equally well informed. The communication gap between investors and corporate management is just as large. According to investor respondents, sustainability issues arise in only 54% of the earnings calls and shareholder meetings they attend.

- Sustainability indices are losing their luster:** Just 32% of managers in public companies say their business is listed on a sustainability index. While more than 90% of these managers say their companies promote inclusion on these lists, only 44% say such honors are important. Investors are even more critical: Only 36% say that being included on a major index is an important factor in their investment decisions.
- Although a sustainability strategy is considered important, few companies have developed one:** This gap has been a consistent finding in all the years of our study. In 2016, nearly 90% of respondents say that a sustainability strategy is essential to remaining competitive. However, only 60% of corporations have such a strategy. Although a clear business case is central to the strategy, only 25% of respondents say that their companies have developed one. Business model changes are also central. Organizations that have made a sustainability-related business model change are twice as likely to report profit from sustainability than are companies that haven't.

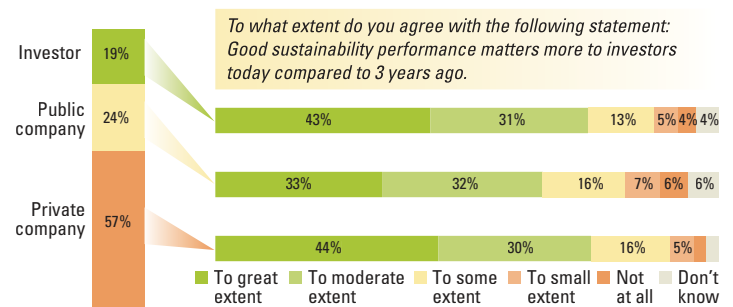
investments in sustainability. In the middle of the interviews, where executives proudly recounted their company's sustainability efforts, the conversations would often stop suddenly. Exasperated, business leaders would exclaim that the topic was moot since investors didn't care. In fact, only 22% of the executives in the study believed that mainstream investors would ever be major stakeholders in their company's sustainability efforts.<sup>1</sup>

Executives have long been gnashing their teeth about investors' short-term thinking and how it stands in the way of important sustainability progress. However, this year's *MIT Sloan Management Review-BCG* survey found that the perception has passed its sell-by date. (See "About the Research," page 4.) Investors are paying a great deal of attention to a company's sustainability progress. For example:

- Seventy-four percent of all surveyed investors believe that sustainability performance matters more than it did three years ago. (See Figure 1 and Figure 2.)

**FIGURE 1: CORPORATE PERFORMANCE ON SUSTAINABILITY METRICS IS INCREASINGLY IMPORTANT TO INVESTORS**

A strong majority of all respondents recognize that good sustainability performance matters to investors more today than in past years. And yet, investors indicate that they care more about good sustainability performance than respondents in public companies believe.



## Introduction: Sustainability Investing Is On the Rise

In 2009, Bloomberg LP researchers were delving into corporate executive attitudes about their company's

**FIGURE 2: SAMPLE INCLUDES DIFFERENT TYPES OF INVESTORS**

Nearly one out of five respondents identified themselves as investors. Most of the investors identified themselves as strategic investors or institutional investors.



- Seventy-five percent of executives in investment firms agree that a company’s good sustainability performance is materially important to their firms when making investment decisions.
- More than half of investors who are fully informed about their organization’s sustainability practices say their companies exclude or divest from businesses that have poor sustainability performance.

Executive attitudes, however, haven’t kept pace. Only 60% of managers in publicly traded companies regard sustainability performance as materially important to investors. Many executives fail to see the rise of sustainability-oriented investors who make and/or leave investments based on ESG-related corporate performance.

At least three factors are driving investor interest in sustainability. One is the growth of analytics and sophisticated modeling that shows how and when sustainability investments create shareholder value. These models are meeting growing investor demand for data on corporate sustainability efforts

that can be included in corporate valuations and comparative analyses. Large firms like Bloomberg and Thomson Reuters collect data on sustainability issues, and most large investment firms, including BlackRock, have specialized departments examining these issues. Organizations from accounting firms to the United Nations are developing and offering models that can assess and calculate the impact of ESG factors on a company’s performance and future prospects. “I have a list of 25 variables that are not found in financial statements,” says Sarah Teslik, former executive director of the Council of Institutional Investors. “Each is an ESG issue that correlates with future performance.”

Another factor is research from academic institutions and investment firms that links effective management of material sustainability issues to strong financial performance. In a study of the world’s 500 largest companies, for example, Harvard Business School professor George Serafeim and Bethesda, Maryland-based Calvert Investments found that strong ESG performance has a high correlation with strong valuations, expected growth, and lower costs of capital. The study also found that high ESG performance correlates strongly with lower credit default swap spreads.<sup>2</sup>

A 2011 Harvard Business School study compared the performance of high- and low-sustainability companies. In examining differences in governance and culture, the HBS researchers found that high-sustainability companies significantly outperformed other companies in terms of stock market performance and other financial performance measures.<sup>3</sup>

In 2015, investment management firm Arabesque Partners and researchers from Oxford University released the findings of their analysis of more than 200 sustainability studies and reports. Ninety percent of the studies that the firm examined found that sound sustainability standards lower a company’s cost of capital. Nearly 90% concluded that solid ESG practices drive improvements in operational performance. Eighty percent of the studies discovered that good sustainability practices influence stock price.<sup>4</sup>

A third, related factor behind the emergence of the sustainability-oriented investor is a shift in attitude within the investor community about the connection between strong sustainability performance, value creation, and risk reduction. While it may have been the case at one time that only activist investors saw a connection between these activities, now 75% of investment community respondents see improved revenue performance from sustainability as a strong reason to invest. (See Figure 3.) Almost 75% of investment community respondents feel strongly that increased operational efficiency often accompanies sustainability progress. In addition, more than 80% of investor respondents indicate that good sustainability performance increases a company's potential for long-term value creation.

Risk and cost of capital also factor into the equation. More than 60% of surveyed investors believe that companies with a solid sustainability performance are less of an investment risk than are companies without that kind of performance. And nearly 60% of investors strongly believe that a solid sustainability track record lowers a company's cost of capital. Perhaps most important, investors believe that good sustainability performance is a sign of effective management.

Investors are acting on these beliefs. In 2014, according to the Forum for Sustainable and Responsible Investment (US SIF), \$1 of every \$6 invested was put into sustainability investment strategies — a jump of 76% since 2012.<sup>5</sup> “2016 is set to be the year of green finance,” says Achim Steiner, executive director of the United Nations Environment Programme. “Across the world, we are seeing a growing number of countries aligning their financial systems with the sustainability imperative.”<sup>6</sup> Agreements reached during the 21st session (2015) of the United Nations Framework Convention on Climate Change are a prime example. The agreement heralded a decisive shift to low-carbon economies and mobilized financial institutions and regulators around the world.

For a decisive majority of surveyed investors — more than 70% — sustainability is central to their investment decisions. “In the last two or three

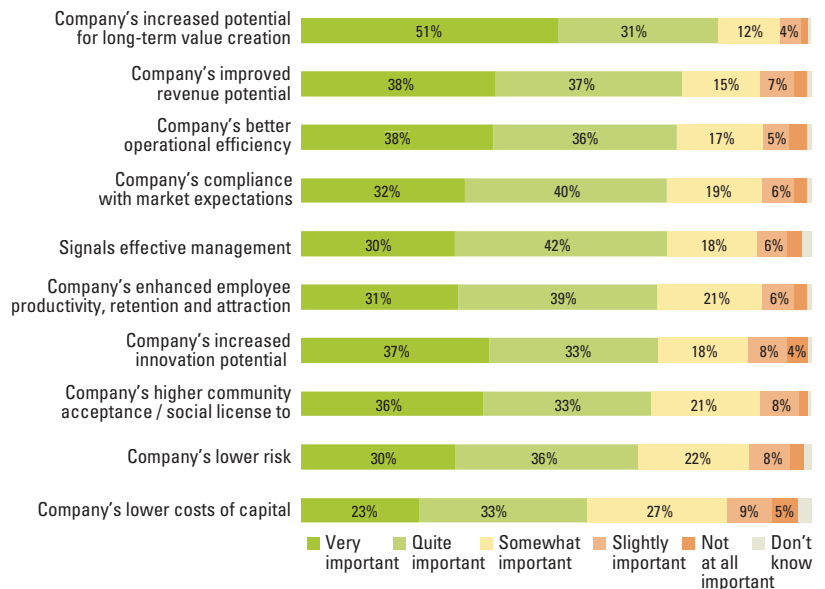
years, sustainability has been gaining momentum among mainstream investors,” says Antoni Bal-labriga, global head of responsible business at international banking group Banco Bilbao Vizcaya Argentaria S.A. (BBVA), based in Bilbao, Spain. “In the past, we might have received a few inquiries from socially responsible investors. Now there are many more events focused on socially responsible investment, and attendance by mainstream investors has gone up considerably.”

“Companies have been complaining that nobody cares about sustainability,” comments Robert Eccles, chairman of Arabesque Partners and professor

### FIGURE 3: INVESTORS CARE ABOUT GOOD SUSTAINABILITY PERFORMANCE FOR MANY REASONS

Investors recognize that good sustainability performance is a source of many types of business value. The top three are: increased potential for long-term value creation, improved revenue potential, and operational efficiency.

Why is a company's good sustainability performance important to your firm when making investment decisions?





## GENERATION INVESTMENT

In 2004, former U.S. Vice President Al Gore, cowinner, with the Inter-governmental Panel on Climate Change, of the 2007 Nobel Peace Prize, co-founded an investment firm that focuses on sustainability-related performance and has achieved above-average market performance.

Gore is no stranger to business. He is a senior partner at venture capital firm Kleiner Perkins Caufield & Byers and a board member at Apple. His investment firm, London- and New York-based Generation Investment Management LLP, has approximately \$12 billion in assets under management. Generation Investment's fundamental premise is that standard financial metrics such as earnings per share and analysis of market conditions provide a relatively small picture of a company's real prospects.<sup>i</sup> The firm enlarges the picture by including sustainability in its models.

During its 10 years of operations, Generation Investments has achieved an average of 12.1% return on its investments per year, which outpaced the MSCI World Index by more than 500 basis points. According to one analysis, Generation Investment's 10-year average return ranked it No. 2 among the 200 global equity managers studied.<sup>ii</sup>

of management practice at Harvard Business School. "But investors care, and companies need to up their game."

### From Exclusion to Inclusion

In the past, investors who cared about sustainability had data and information to develop only exclusionary strategies — identifying "bad apple" companies that harmed the environment. "Exclusionary criteria led investors to see their choices as binary," comments Pamela Styles, founder and principal with Next Level Investor Relations, a Virginia-based investor relations and corporate communications consultancy. "They either loved or hated you."

More sophisticated data and analytics are broadening investors' fields of vision by including more inclusionary factors. According to U.S. SIF, assets invested with inclusionary sustainability strategies now exceed those under exclusionary approaches.<sup>7</sup>

Styles believes that new indicators are revealing nuances that allow investors to include companies that they traditionally viewed as outcasts. "Today, a fossil fuel company is out of the investment picture nine times out of 10," she says. "But with more sophisticated analytics, an investor might put capital into a fossil fuel company because there are better performance indicators and the company is improving on many or all of them."

Integrating ESG indicators into investment models is the crux of these inclusionary performance indicators. The integration has been difficult in the past because, as BBVA's Ballabriga puts it, "Sustainability types speak in PowerPoint, and investors speak in Excel."

But a number of organizations are starting to bridge the gap. The UN Global Compact and the Principles for Responsible Investment Initiative, for example, have created a tool that companies can use to assess and communicate the financial impact of their sustainability strategies. The model assesses return on invested capital by adding sustainability into growth, risk, and productivity calculations.<sup>8</sup> Some companies are developing models that estimate the impact of sustainability-related actions on future earnings based on market dynamics and what regulators and stakeholders might do. Arabesque has developed a similar model that it uses to identify the top 1,000 responsible equities (out of approximately 77,000 listed global equities) based on ESG and business metrics.<sup>9</sup> In 2014, the company's Prime Fund outperformed the MSCI AC World Index by nearly 3%. Its Systematic Fund outperformed the index by 5%.<sup>10</sup>

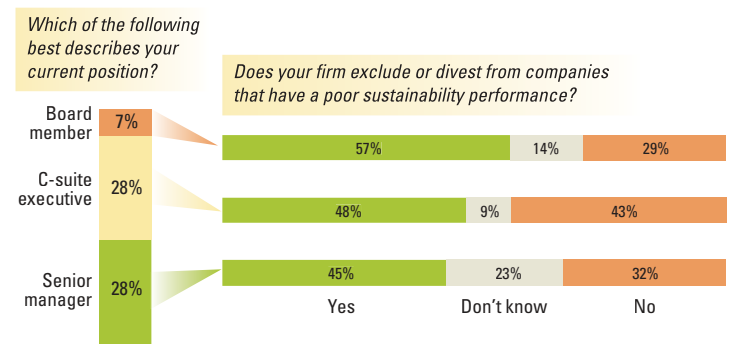
"Right now, there are very few investment products out there," says John Buckley, global head of the corporate social responsibility program at Bank of New York Mellon Corporation. "But I believe there will be more of these in the future because many buyers will want them."

### Poor Sustainability Performance Can Be a Deal Breaker For Investors

Nearly half of all surveyed investors — 44% — say that poor sustainability performance is a deal

## FIGURE 4: MANY TOP MANAGEMENT-LEVEL INVESTORS AVOID COMPANIES WITH POOR SUSTAINABILITY PERFORMANCE

Board members of investment companies are more likely to encourage their companies to avoid or divest from companies with poor sustainability performance.



breaker; they won't invest in a company with poor sustainability performance. Nearly 60% of investment firm board members say they are willing to divest from companies that have poor sustainability performance. (See Figure 4.)

Consider divestments in the fossil fuel industry, especially coal. Although low returns have muted investor interests in the sector, sustainability concerns are also important. To date, more than 400 institutional and 2,000 individual investors in 43 countries have committed to divesting more than \$2 trillion in assets from fossil fuel companies.<sup>11</sup> According to a 2015 study by Arabella Advisors, the divestment trend has moved far beyond mission-driven institutions. Large pension funds and private companies now account for 95% of the assets slated to be sold.<sup>12</sup>

Norway's largest pension fund, Kommunal Landspensjonskasse, or KLP, is indicative of the trend. It has decided to divest all of its investments in coal companies. KLP will invest those funds in renewable-energy production companies in emerging economies.<sup>13</sup> As Bevis Longstreth, former U.S. Securities and Exchange commissioner under President Ronald Reagan, put it: "Fiduciaries have a compelling reason on financial grounds alone to divest these holdings before the inevitable correction occurs."<sup>14</sup>

Global insurer Allianz SE is another example. The company recently announced that it will divest from any company that generates more than 30% of revenue by mining coal or that bases more than 30% of its energy production on coal. In addition, Allianz plans to double its investments in renewable energies.<sup>15</sup>

In 2015, Corporate Knights, a Toronto-based media and research company, launched its Decarbonizer tool, where any investor can see what effect a divestment in 2012 from fossil fuels would have had on a fund or index performance in 2015.<sup>16</sup> The Bill & Melinda Gates Foundation, for example, would have been nearly \$2 billion ahead had it divested from fossil fuels.

Another example comes from a different side of the mining industry, where the "Aiming For A" coali-

tion of some 100 European investors is demanding that mining companies Anglo American Glencore and Rio Tinto demonstrate that they are working to lessen the impact of climate change on their businesses. The investor coalition includes Aviva, Amundi, and Schroders, which manage more than \$4 trillion in assets.<sup>17</sup>

Mismanaging a sustainability issue can also send investors running. In 2007, after lead paint was found in toys it manufactured in China, Mattel Inc. had to recall more than 20 million products. To help stem declines in the company's stock price and help its relations with China, Thomas A. Debrowski, Mattel's executive vice president for worldwide operations, publicly apologized to everyone affected by the recall, including the Chinese people.<sup>18</sup> China was by no means a new market for Mattel. It had been doing business there since 1959, and was known for scrutinizing its manufacturing partners. But in this case, their efforts fell drastically short.

More recently, Lumber Liquidators Inc., based in Yonkers, New York, one of the largest and fastest-growing flooring retailers in North America, found itself on CBS's *60 Minutes* and the target of short sellers banking on the fallout of a sustainability fiasco.<sup>19</sup> Lumber Liquidators sells hardwood and laminate flooring that is manufactured in China.

The company allegedly fell significantly short of U.S. health and safety standards governing the amount of formaldehyde that can be used in products, putting thousands of people at heightened risk of respiratory irritation, asthma, and cancer.

Lumber Liquidators had once been a darling of investors. Its stock price rose from \$13 per share in 2011 to \$119 per share in 2013. In November 2015, a few months after the *60 Minutes* report aired, the share price plunged to less than \$15.

On the other hand, managing sustainability well can attract investors. Mitsubishi Corporation is a case in point. In 2015, the company announced that it was making a \$1.1 billion investment in Olam International, an agricultural trading company based in Singapore. Many believed that the purchase was driven by Mitsubishi's desire to capitalize on growing incomes and consumption in emerging markets. But Mitsubishi was particularly drawn to the company's sustainability footprint and its expertise in working with small farmers and producers in remote areas of Asia and Africa.<sup>20</sup> Olam's sustainability footprint drove a 29% premium over the company's 2014 average share price.<sup>21</sup>

Richard Liroff, founder and executive director of the Investor Environmental Health Network, points to organic-grocery retailer Whole Foods Market Inc. as an example of corporate learning. In the 1990s, scientists began identifying hazards associated with plastic bottles made with bisphenol A. In 2004, Liroff's organization approached Whole Foods to address the issue that the retailer was selling baby bottles made with the chemical. But the company was already aware of the issue, which had been raised by some of its stockholders. In 2004, Whole Foods pulled the bottles from its shelves.

"Fast-forward to 2008," says Liroff. "The government said there might be risks, and suddenly major retailers were stumbling over themselves to pull these plastic bottles from their shelves. Businesses that were on top of those issues benefited tremendously." However, the experience of Whole Foods also points to the bigger picture of what investors are pursuing

— sustainability's impact on the business. A diligent focus on ESG initially helped Whole Foods gain its reputation among consumers and investors. But as the retailer's competitors started offering organic products at lower prices, they profited from organic products as well, and investors started criticizing Whole Foods. Increasingly, the measure of sustainability is its impact on the bottom line. That focus is being aided by a new generation of analytics tools.

### Sustainability Indices Are Declining in Value

At the same time, sustainability indices are losing their luster. Although they have been a mainstay for many years (for example, Dow Jones & Company has offered a sustainability index since 1999; the *Financial Times* has produced its FTSE4 Good Index since 2001), corporate executives seem to care more about these lists than investors do. The difference is stark. Consider the responses from managers in public companies: Within this group, 32% say that their company is listed on a sustainability index (36% didn't know if their company was or was not listed). Among those managers who said their organization was listed, more than 90% of corporate respondents say their company promotes inclusion on these lists, and 87% of respondents from public companies believe that their senior leadership cares (to a great or moderate extent) about their place on sustainability listings.

Investors care far less about a company's inclusion in a sustainability index, especially when making an investment decision: Only 36% of investors say that a company's inclusion in a major index is an important factor in investment decisions. One reason is that data in many sustainability indices is self-reported and usually vetted for completeness, not accuracy. German automaker Volkswagen AG spotlights the issue. Before its diesel emissions-control scandal, the company held the top automotive industry spot on the Dow Jones Sustainability Index.<sup>22</sup> Corporate leaders may care about their rankings on sustainability lists, of course, for reasons that have an indirect connection with investors. For example, they may believe their place on these lists or indices

has brand-reputation value that carries weight with consumers. Even so, the sheer number of reporting frameworks and sustainability indices that now exist is raising questions about whether the time and resources spent filling out sustainability questionnaires is worth the corporate effort and cost. Fifty thousand companies are annually subject to ESG evaluations by 150 ratings systems on approximately 10,000 performance metrics. The diversity of organizations and systems, ratings, and metrics has led many sustainability managers to the verge of “survey fatigue.”<sup>23</sup>

Corporate social responsibility offices often spend months just collecting data. The Global Reporting Initiative, an international standards organization focused on sustainability, includes 79 separate performance indicators in its Standards for Sustainability Reporting. According to Ann Klee, vice president of environment, health, and safety at General Electric Co., the company responded to more than 650 individual questions from ratings groups in 2014. The process took months to complete and required more than 75 people to finish. And it provided virtually no value to the company’s customers and stakeholders.<sup>24</sup> “The profusion of metrics and ratings is just creating more noise in the environment,” says Chris Pinney, president and founder of High Meadows Institute, a Boston-based research organization focused on business and the global economy. “For most investors, the ratio of signal to noise is just impossible.”

The materiality movement — an effort to promote corporate reporting that integrates both financial and nonfinancial material issues — is driving efforts to focus and simplify matters. Atlas Copco AB — a manufacturer of industrial tools and equipment, based in Stockholm, Sweden — is a case in point. In 2016, Atlas announced that it would no longer apply for inclusion in the RobecoSAM Dow Jones Sustainability Index. Instead, the “Group will use a materiality driven approach and the GRI G4 guidelines to disclose environmental, social, and governance information to investors.”<sup>25</sup> A recent study by Harvard Business School researchers uncovered evidence that sustainability investments create the most shareholder value when they address material issues.<sup>26</sup>

In the U.S., the Sustainability Accounting Standards Board is working to develop rules governing public disclosure of financially material corporate sustainability information. Project Delphi, an initiative between the European Business Network for Corporate Social Responsibility and State Street Global Advisers, is convening investors and financial analysts to develop quantitative sustainability indicators that can predict overall company performance. “With the maturing of the field, there’s better information,” says BNY Mellon’s Buckley. “With better information, there is better thinking.”

## A Glimpse Into the Future

Although translating sustainability data into indicators for investment decisions is still a work in progress, Gore’s Generation Investment sheds light on how material sustainability information will increasingly be used. A case in point is its decision to divest its holdings in BP plc several years before the 2010 Deepwater Horizon oil spill in the Gulf of Mexico — a disaster that cost BP and its investors a whopping \$54.6 billion.<sup>27</sup>

Generation Investment saw red flags and sold its investments in the company after several BP oil-related accidents during the mid-2000s. In 2005, an explosion at BP’s refinery in Texas City, Texas, killed 15 people and injured another 170 — the worst U.S. workplace accident since 1989.<sup>28</sup> Then in 2006, BP was responsible for the largest spill in the tundra of Alaska’s North Slope, dumping 267,000 gallons of thick crude oil.<sup>29</sup> Generation Investment noted these warning signs, saw an opportunity to reduce its portfolio risk, and withdrew from its position in BP.

More investors are coming to recognize the contribution of ESG factors to market volatility and corporate risk, issues that we discussed in more detail in last year’s joint *MIT SMR-BCG* report, *Joining Forces: Collaboration and Leadership for Sustainability*.<sup>30</sup> Our research during the past year indicates that many investors are trying to improve their investment models so they can anticipate the kinds of governance issues that lead to corporate scandals, such as Volkswagen’s diesel emissions

scandal, which led to investor losses of about \$33 billion in October 2015. Investors are developing or looking for increasingly sophisticated investment models that can make reliable assessments of good (or bad) governance on which they can act. With access to extraordinary volumes of data about a wide range of corporate behavior and the availability of new analytical techniques, new analytical models show promise as a source of actionable information about governance.<sup>31</sup>

### A Failure to Communicate

The emergence of these new analytical models, and investors' growing interest in them, signals burgeoning demand for sustainability-related information, yet executives are doing little to develop and communicate their sustainability story within their organization or to investors.

Knowledge about a company's sustainability activities tends to trickle down the management hierarchy. Within companies, nearly 80% of board members and 85% of C-suite executives say they are fully informed about their organization's sustainability efforts. But only 51% of senior managers and 31% of middle managers and front-line employees say they are fully informed.

This lack of communication is not an accident. Consider the role of investor relations (IR) departments, which are responsible for communicating important corporate information to investors. A 2015 survey conducted by *MIT Sloan Management Review* and the National Investor Relations Institute (NIRI) found that only 24% of surveyed IR professionals are asked by their organizations to tell investors about the value of sustainability to the company's bottom line<sup>32</sup> — about the same percent of companies that have a business case for sustainability in the *MIT SMR-BCG* survey. Nearly 40% aren't given direction on sustainability reporting at all. Nearly 80% don't regularly include sustainability talking points in investor presentations, and almost half of respondents from IR departments don't believe that a sustainability strategy is necessary to remain competitive in their industry.

According to a 2014 Nasdaq Advisory Services study of 500 publicly traded companies, barely one-fifth of U.S. companies were integrating sustainability into their investor communications. Although the figure was higher in Europe, the percentage was still just over half.<sup>33</sup> "Sustainability has always been associated with activism, and very few investor relations professionals understand its importance," says Next Level's Styles. "On top of that, investor relations departments are overwhelmed with questionnaires and fear a never-ending time commitment if they get more of them."

To get off the survey treadmill, Ballabriga at BBVA established a close working relationship between his sustainability group and IR to help develop a succinct sustainability story. The effort began as an information exchange, in which IR would reach out to Ballabriga's group when investors asked specific questions. As confidence built and investor demands increased, IR started asking Ballabriga to join earnings calls and other meetings with investors. Today, the relationship is a partnership, and the groups have jointly developed a process to create and update the story of how sustainability creates value and should be reflected in its share price.

"It's been an evolution," says Ballabriga. "We started as information suppliers. And now we really are a partner and the company looks at communicating sustainability as a real opportunity."

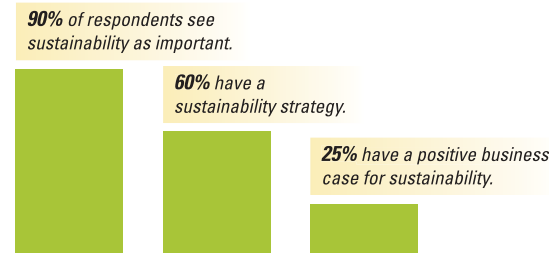
### Developing a Value-creation Story

Executives who want investor support need to develop and tell their sustainability value-creation story. That value, according to our survey, stems from three interrelated components: a sustainability strategy, a clear business case, and business model changes that realize the benefits.

There is little disagreement about the importance of a sustainability strategy. Nearly 90% of respondents say that a sustainability strategy is essential to remaining competitive. However, only 60% of corporations have such a strategy.

## FIGURE 5: MANY COMPANIES STILL STRUGGLING TO DEFINE A BUSINESS CASE FOR SUSTAINABILITY

While almost all respondents consider sustainability activities as critical to future competitiveness, only 60% have a strategy, and one-quarter have managed to develop a positive business case.



A clear business case is the crux of a sustainability strategy. However, only 25% of respondents say that their companies have developed a business case. (See Figure 5, Figure 6, and Figure 7.) “Many companies still base sustainability efforts on values,” says Cary Krosinsky, a former advisor at the Principles for Responsible Investment network, sponsored by the United Nations. “But it is the business case that really matters if we’re talking to the investment world.”

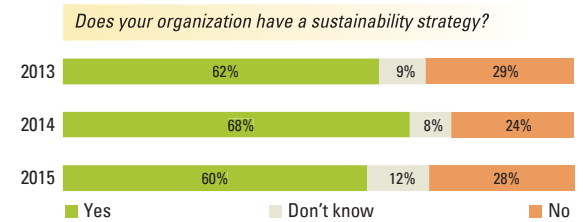
GE is a case in point. In 2004, the company embraced sustainability as a growth driver by establishing Ecomagination brands, focused on environmental safety. During the recent global economic crisis, these brands were GE’s only source of growth, growing by 12% while other revenues shrank by 2%. In 2010, Ecomagination products drove \$85 billion in revenue. By 2014, the number had jumped to \$200 billion.<sup>34</sup>

Florida Ice & Farm Company SA, based in Costa Rica, is another example. In 2005, the company responded to Costa Rica’s looming water access crisis by investing in water-saving measures. Within two years, the organization had decreased its use of water in production by an eye-popping 82%. The reduction drove down production costs and helped sustain 20% annual growth between 2010 and 2014.<sup>35</sup>

Pharmaceutical and healthcare companies are also making the case for sustainable business. Deerfield, Illinois-based healthcare company Baxter Interna-

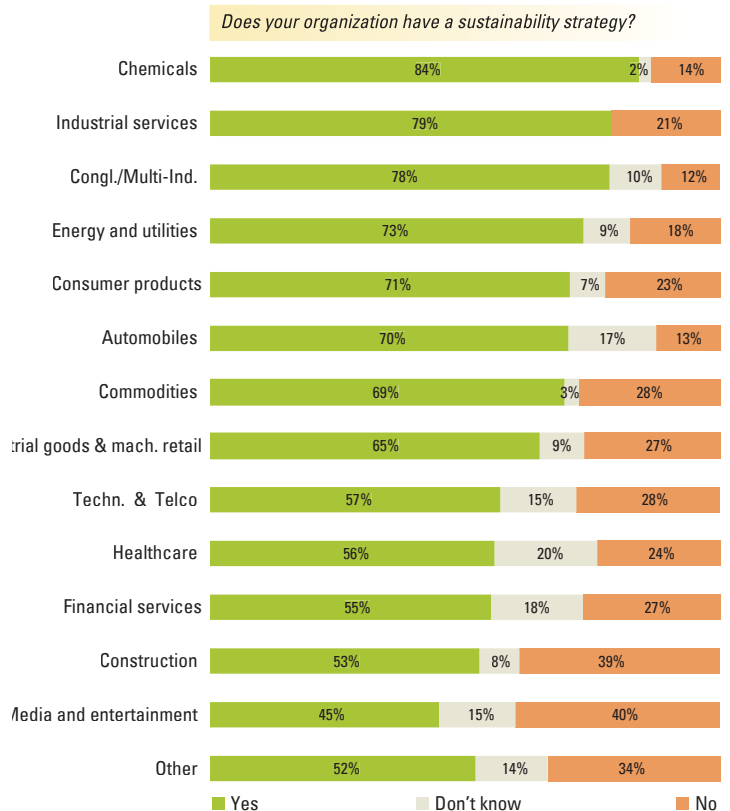
## FIGURE 6: FEWER COMPANIES HAVE A SUSTAINABILITY STRATEGY TODAY

A majority of respondents indicate that their companies have a sustainability strategy, but the majority is slightly smaller than in previous years.



## FIGURE 7: SUSTAINABILITY STRATEGIES ARE MORE PREVALENT IN SOME INDUSTRIES

Chemicals, industrial services, and conglomerates have the highest concentration of companies with sustainability strategies. As in past years, the media and entertainment industry has the lowest percent of companies with a sustainability strategy.



## HOW INVESTORS CAN INFLUENCE CORPORATE SUSTAINABILITY ACTIVITIES

Although investors are taking a stand and divesting from stocks that have poor sustainability track records, they have yet to stimulate clear and robust discussions about sustainability. The absence of such discussions creates uncertainty about investors' expectations.

As interest in sustainability indices continues to wane, investors need to define the criteria of what they expect from sustainability. A stringent review of these criteria is critical in order to detect and react to early warning signs that a sustainability investment is potentially losing value. Warning signs need to be transparent, and investors should discuss sustainability measures with companies and incorporate sustainability criteria into their investment strategy.

Specifically, investors should do the following:

- Consider mid- and long-term investment strategies in the context of sustainability issues
- Integrate sustainability into their investment strategies
- Develop valuation methods that account for nonfinancial sustainability issues
- Avoid relying on sustainability indices, which can be misleading

tional Inc. estimates it earns \$3 for every \$1 invested in environmental initiatives.<sup>36</sup> Johnson & Johnson is achieving a 19% internal rate of return on its CO<sub>2</sub> projects.<sup>37</sup>

Perhaps most important, sustainability strategies where business models change are the most likely to generate profit. For example, only about one-third of respondents say that sustainability-related actions and decisions in their company have increased profits. But if the organization has made a sustainability-related business model change, the percentage of respondents who report profit from sustainability jumps to 60%.

Consider Papua, New Guinea-based New Britain Palm Oil Ltd., a leading producer of sustainable palm oil. As activists drew attention to the social and environmental impacts of palm oil production, the

company altered its business model by developing a fully traceable supply chain and reducing the use of petrochemicals such as fertilizer. The change enhanced the company's reputation and drove superior financial performance, including profit margins that are 79% higher than the industry average.<sup>38</sup>

Once a business has developed a strategy and business case, it is ready to tell its story. According to Ballabriga, the story should focus on material sustainability challenges that, almost by definition, a sustainability strategy will address. "At the end of the day, investors want to know about growth, efficiency, and risk," he says. "Sustainability is central to each."

Some multinationals have turned to buying smaller companies with sustainable business models. The 2014 buyout of organic-food producer Annie's Inc. by General Mills for \$820 million is a prime example. Typically, a large, established company buys an eco-niche company, such as the Clorox acquisition of natural skincare company Burt's Bees in 2007 or Colgate's 2006 controlling stake in natural oral care brand Tom's of Maine. However, the new parent companies still face the challenge of maintaining and expanding the sustainability approaches of their acquisitions and not relying on the short-term increases in consumer trust that they bring.

Recently, Generation Investment has gotten into the act. It invested \$30 million in the niche eco-home products maker Seventh Generation in 2014 to bolster Seventh Generation's ability to make acquisitions.<sup>39</sup> Early acquisition forays by Seventh Generation had included the Raleigh, North Carolina-based companies bobble,<sup>40</sup> which makes reusable water bottles, and Gamila,<sup>41</sup> maker of the reusable Teastick tea infuser. With Generation Investment's cash infusion, Seventh Generation could "remain a growth organization, a B Corp., and an independent entity," says CEO John Repogle.<sup>42</sup>

These acquisitions can be as much about burnishing a brand's reputation as about corporate survival. One of the authors of this report demonstrated — by analyzing the life spans of 35,000 public companies

— that the risk a public company will go out of business in the next five years stands at 32%, a six-fold increase from 1965.<sup>43</sup> That makes sustainability, especially economic sustainability, a critical business issue for corporate leaders.

Investors want to hear about a company's sustainability progress and are factoring that progress into their decisions to invest. Executives need to be in sync with this investor mindset and raise awareness about their company's sustainability progress. As Arabesque Partners' Eccles puts it: "If you think sustainability is important, it is incumbent upon you to put it out there and make the case."

## Conclusion: How Executives Should Respond

Putting a company's sustainability story out there means more than touting a list of awards or positions on sustainability indices. Investors want to be sure that a company's sustainability efforts are focused on the material issues that affect its ability to thrive and survive. They also want to know the business specifics of how sustainability is creating value for the companies they invest in. The roster of factors driving that value is comprehensive. It includes everything from reduced costs of capital to greater innovation.

Despite sustainability's importance, however, our survey found that many businesses have yet to build the foundation needed for it to have a significant business impact. Only about 60% of companies have a sustainability strategy in place. Only a quarter have developed a clear business case.

Advances in analytics and efforts to formalize material sustainability reporting are gaining steam. Sophisticated tools and methods are being developed by a wide range of private- and public-sector organizations to help organizations integrate ESG factors into how they assess and report performance. Accounting and standards boards in the U.S. and Europe are grappling with the essentials of what

sustainability issues must be disclosed to investors. Perhaps most important, investment firms such as Generation Investment are demonstrating that attention to nonfinancial material issues can produce favorable returns.

There is no one-size-fits-all solution for businesses to meet the needs of the sustainability-focused investor. But companies should prepare to capitalize on this trend. To do so, businesses should take the following steps:

- Build awareness of sustainability challenges and programs — both within the company and among stakeholders, including investors.
- Identify and analyze material issues and create alignment within the organization to ensure an integrated response.
- Invest in and focus on tangible and measurable sustainability outcomes instead of positions on ratings lists.
- Formulate a strategy once tangible sustainability measures are established.
- Incorporate the sustainability strategy into the overall corporate strategy, including a clear business case or proof of value.
- Engage investors, and a broad range of stakeholders, to discuss the company's sustainability strategy and progress.

As investor interest in sustainability mounts, sustainability laggards need to pay attention. Companies such as Walmart and Marks & Spencer are beginning to give preferred shelf space to sustainable products, and manufacturers are taking notice. A similar trend is brewing in the investment community. As major investors refine their models and prove the value of sustainability, companies such as Vanguard and Fidelity may do for retirement savings what Walmart has done for consumer products — shift the focus squarely onto businesses with solid sustainability performance. Lest one think the idea is farfetched,



few would have thought 20 years ago that Walmart would become a beacon of corporate sustainability. Executives across all industries should take notice ... and action.

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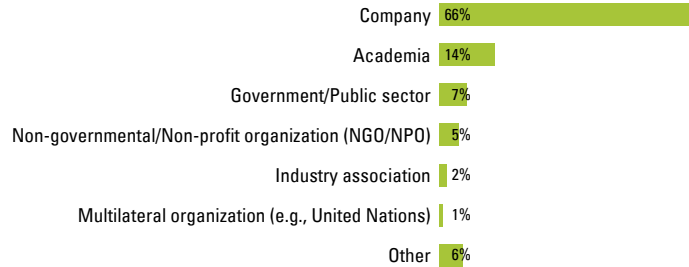
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## The Survey: Questions and Responses

\*Figures may not add up to 100% due to rounding. Figures based on commercial data set only.

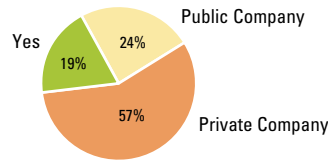
### 1. Which of the following best describes the organization where you are employed?

(Respondents could only choose a single response)

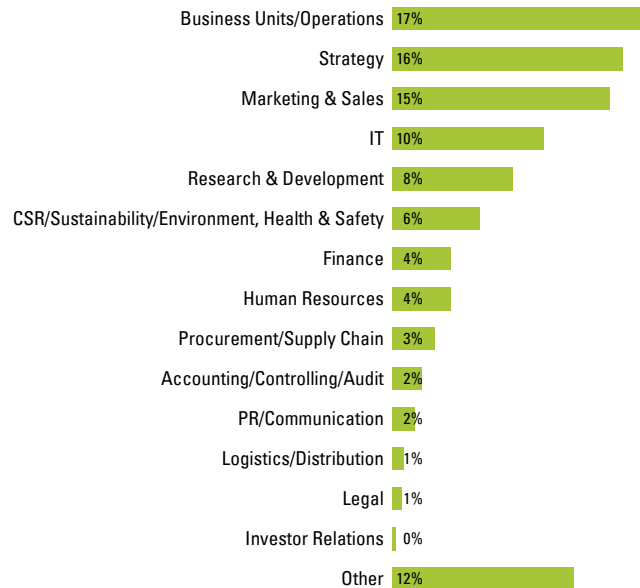


### 2. Is the company where you are employed an investor, asset manager, financial advisor or similar?

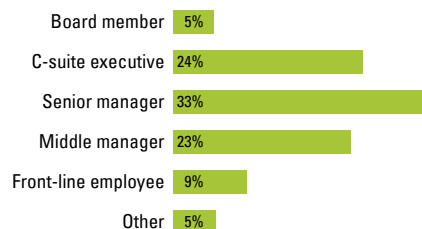
### 3. If NO, which of the following best describes the company where you are employed?



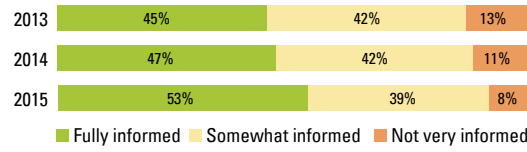
### 4. Which corporate department/function do you work in?



### 5. Which of the following best describes your current position?

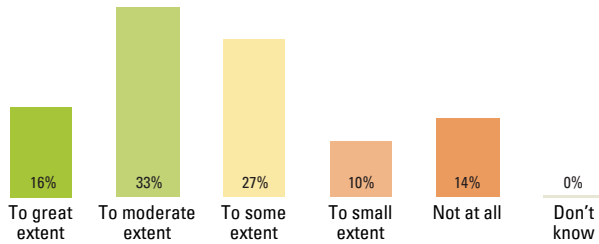


**6. How well informed are you of your organization's sustainability activities?**

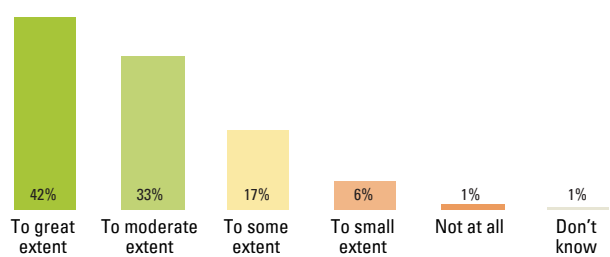


Note: Share of all respondents (full data set) answering "not informed at all," which declined from 4% in 2013 to 2% in 2015, has been removed from the above data set.

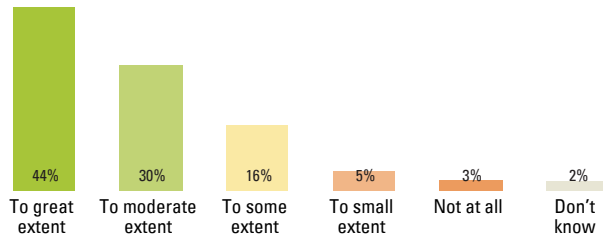
**7. To what extent do you agree with the following statement: Companies should focus exclusively on maximizing shareholder value (Private non-investors only)**



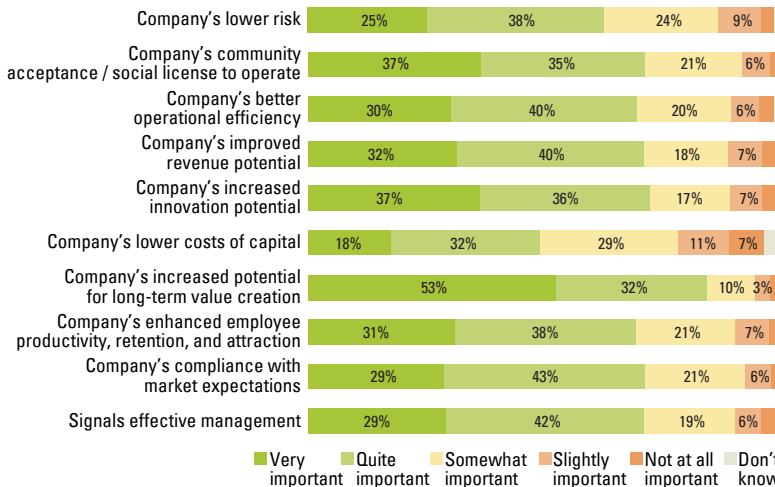
**Q8. To what extent do you agree with the following statement: A company's good sustainability performance is materially important for investors when making investment decisions (Private non-investors only)**



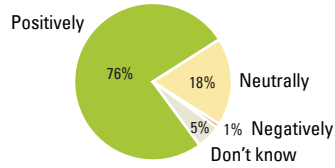
**9. To what extent do you agree with the following statement: Good sustainability performance matters more to investors today compared to 3 years ago (Private non-investors only)**



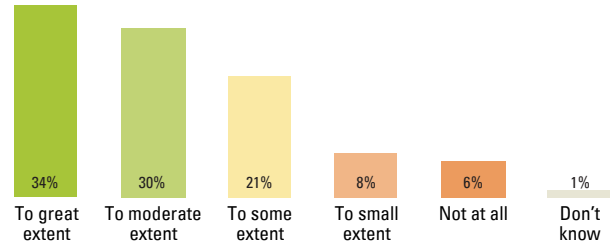
**10. Why is a company's good sustainability performance important to your firm when making investment decisions? (Private non-investors only)**



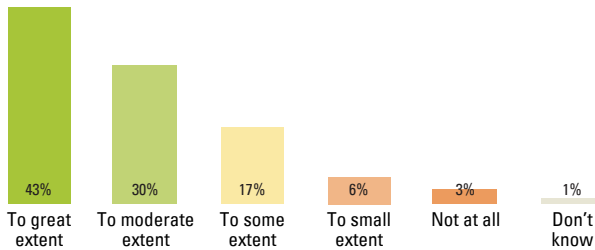
**11. How does good sustainability performance influence investors' decisions to buy a company's shares?** (Private non-investors only)



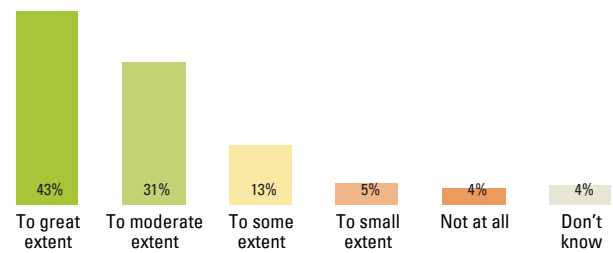
**12. To what extent do you agree with the following statement: Companies should focus exclusively on maximizing shareholder value** (Investors only)



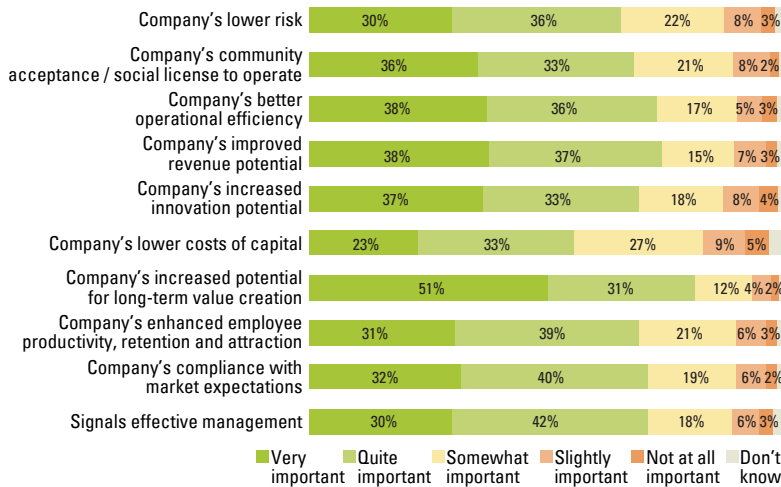
**13. To what extent do you agree with the following statement: A company's good sustainability performance is materially important for investors when making investment decisions** (Investors only)



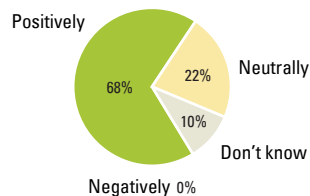
**14. To what extent do you agree with the following statement: Good sustainability performance matters more to investors today compared to 3 years ago** (Investors only)



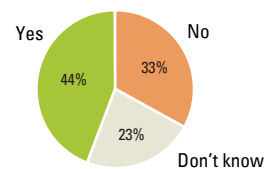
**15. Why is a company's good sustainability performance important to your firm when making investment decisions? Investors only (554 responses)**



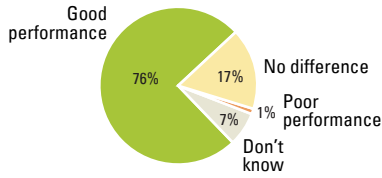
**16. How does good sustainability performance influence investors' decisions to buy a company's shares?** (Investors only)



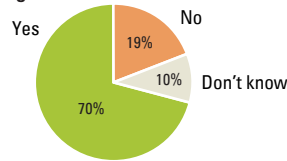
**17. Does your firm exclude or divest from companies that have a poor sustainability performance?** (Investors only)



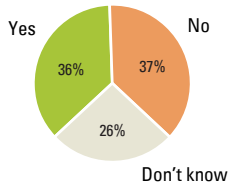
**18. Does your firm care more when a company has a good sustainability performance or a poor sustainability performance, other things being equal?**



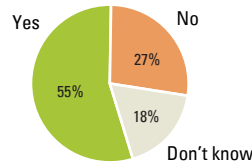
**19. Is your firm engaged in responsible investing?**



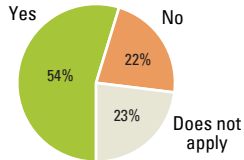
**20. Does your firm consider a company's inclusion in sustainability indices, when making investment decisions? E.g., DJ Sustainability Index, FTSE4Good**



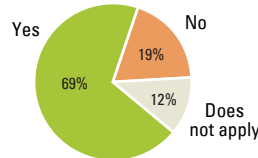
**21. Do companies your firm invests in promote these listings in corporate communications and external reporting? E.g., annual/sustainability report, analyst calls, shareholder meetings**



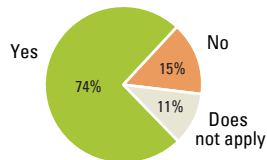
**22. Do sustainability issues arise in investor/analyst calls or shareholder meetings you participate in? (Investors only)**



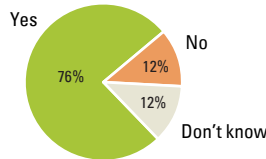
**23. If Q22 = yes, do companies your firm invests in proactively bring sustainability issues to investor/analyst calls or shareholder meetings?**



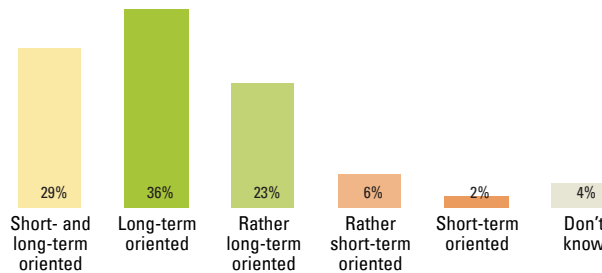
**24. If Q22 = yes, do you ask about sustainability issues in investor/analyst calls or shareholder meetings you participate in?**



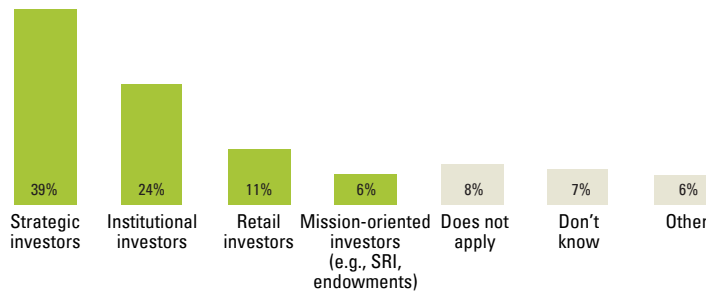
**25. Does your firm expect good sustainability performance from companies it invests in? (Investors only)**



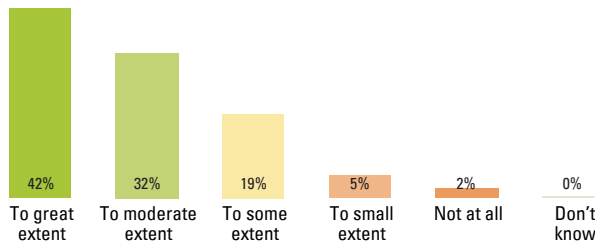
**26a. Please describe your firm's investment approach regarding time horizon**



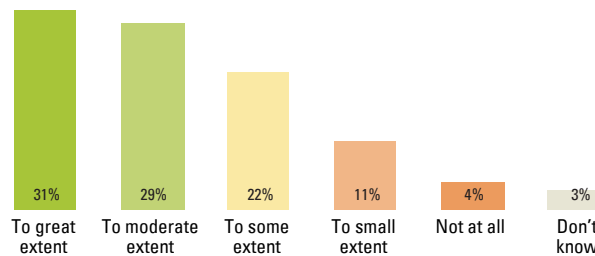
26b. Please describe your firm's investment approach regarding type of investor (Investors only)



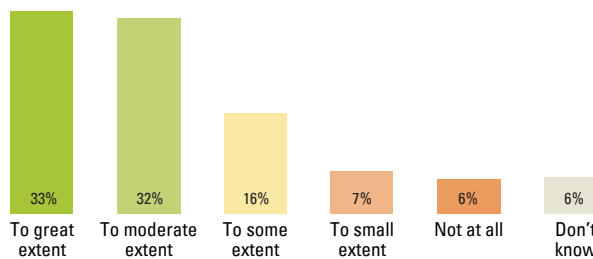
27. To what extent do you agree with the following statement: Companies should focus exclusively on maximizing shareholder value (Public non-investors only)



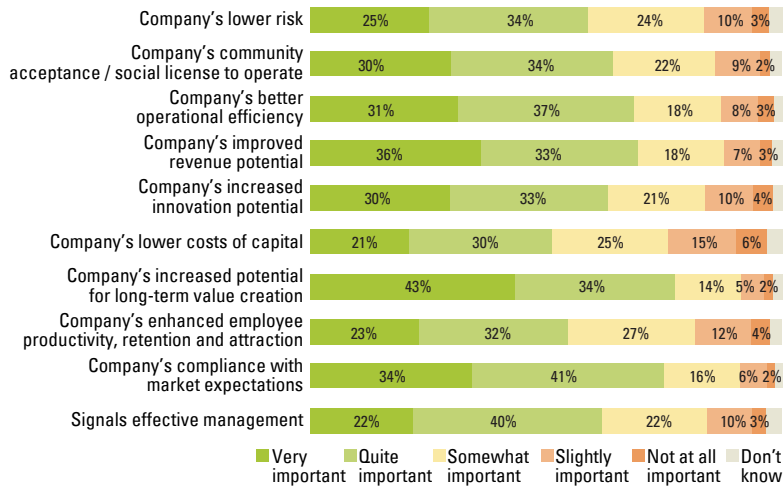
28. To what extent do you agree with the following statement: A company's good sustainability performance is materially important for investors when making investment decisions (Public non-investors only)



29. To what extent do you agree with the following statement: Good sustainability performance matters more to investors today compared to 3 years ago (Public non-investors only)

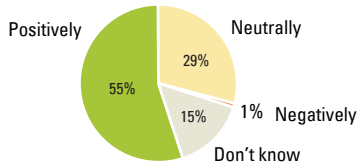


**30. Why is a company's good sustainability performance important to your firm when making investment decisions?** Public non-investors only (672 responses)

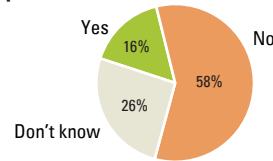


**31. How does good sustainability performance influence investors' decisions to buy a company's shares?**

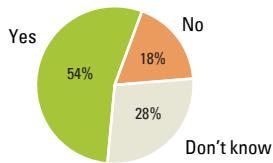
(Public non-investors only)



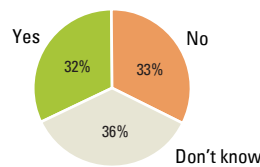
**32. Has your company been subject to sustainability-related shareholder activism? E.g., exclusion/divestment campaigns, shareholder proposals requesting better sustainability performance**



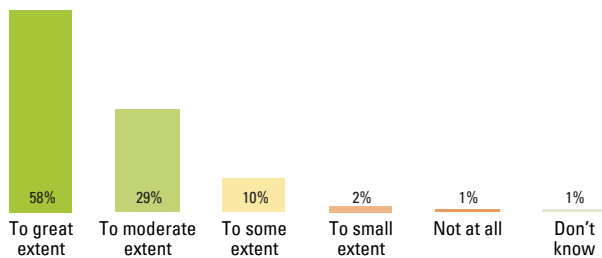
**33. Does your company seek to attract responsible investors?**



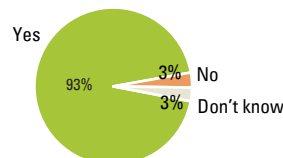
**34. Is your company listed in sustainability indices? E.g., Dow Jones Sustainability Index, FTSE4Good** (Public non-investors only)



**35. If Q34 = yes, to what extent does your leadership care about your company's place in these listings?**

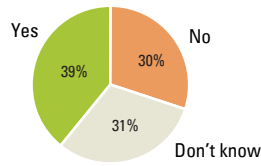


**36. If Q34 = yes, does your company promote these listings in corporate communications and external reporting? E.g., annual/sustainability report, analyst calls, shareholder meetings**

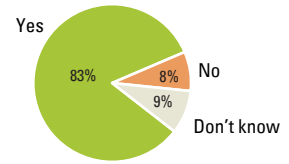




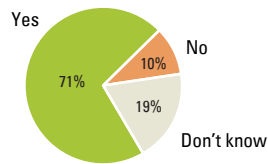
37. Do sustainability issues arise in your company's investor/analyst calls or shareholder meetings?



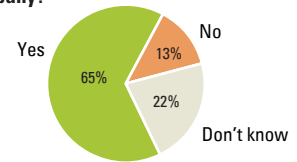
38. If Q37 = yes, does your company's leadership proactively bring sustainability issues to your company's investor/analyst calls or shareholder meetings?



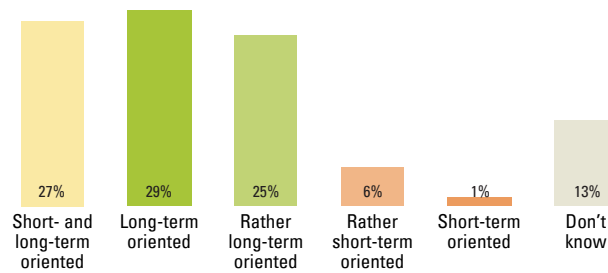
39. If Q37 = yes, do your company's investors ask about sustainability issues in your company's investor/analyst calls or shareholder meetings?



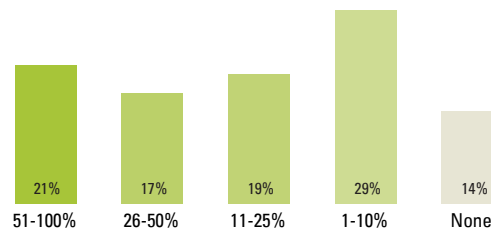
40. Do your company's investors expect good sustainability performance from your company?



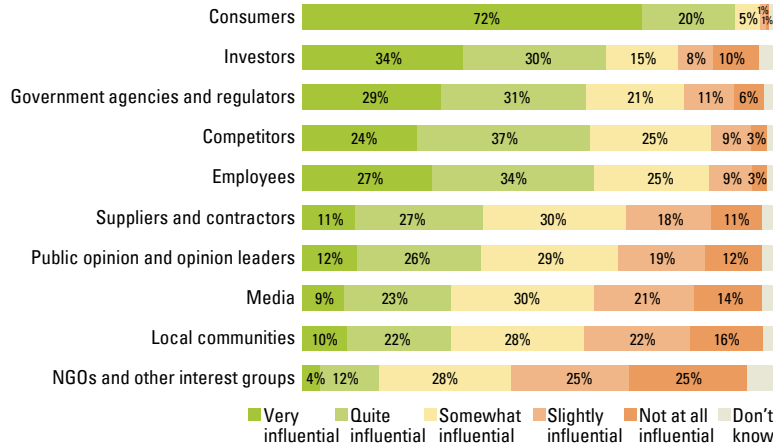
41. Please describe the investment horizon of your company's average investor



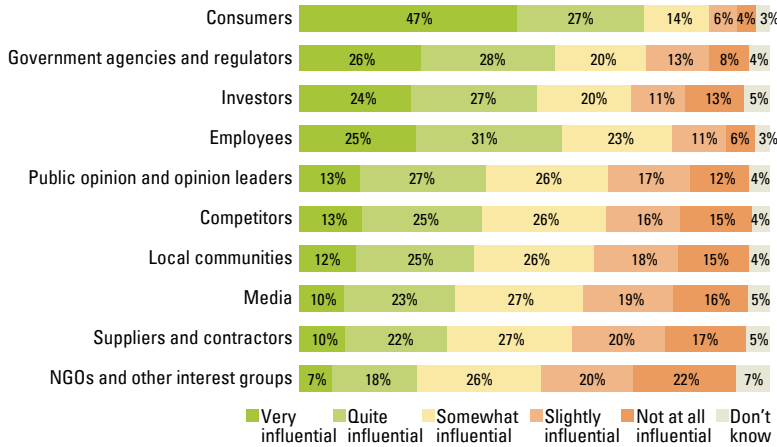
42. What percentage of your work is related to your company's sustainability activity?



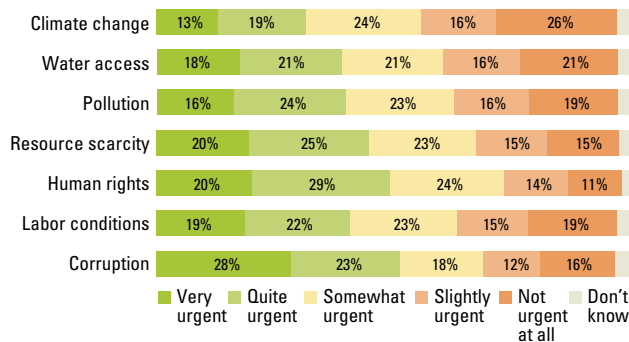
**43. Which stakeholder groups are most influential for your company's business activities?**



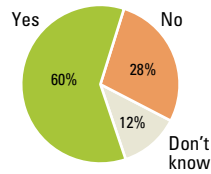
**43b. Which stakeholder groups are most influential for your company's sustainable agenda?**



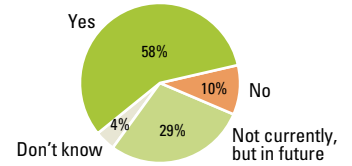
**44. How urgent are the following issues to your organization?**



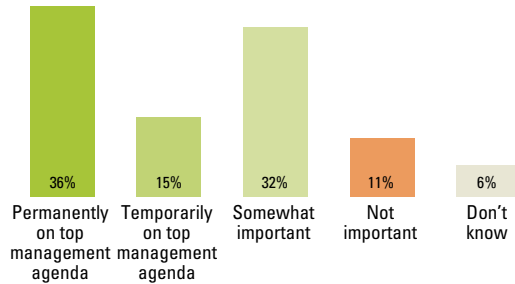
45. Does your organization have a sustainability strategy?



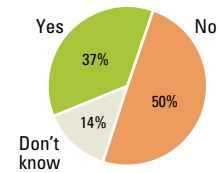
46. Is pursuing a sustainability-oriented strategy necessary to be competitive?



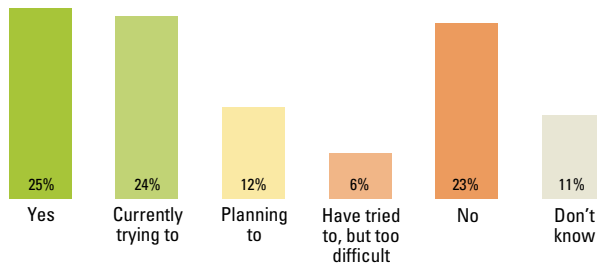
47. Which of the following best describes the place that sustainability has on your organization's top management agenda?



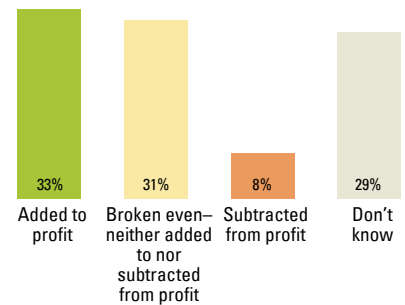
48. Has your organization's business model changed as a result of sustainability?



49. Overall, has your organization developed a clear business case or proven value proposition for its approach to sustainability?



50. How do you believe your organization's sustainability-related actions/decisions have affected its profitability?



51. Regarding sustainability in your organization, does your organization have: (Please choose all that apply)

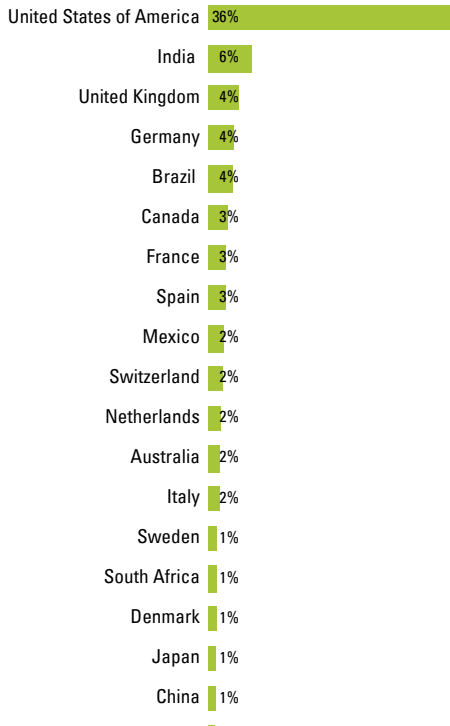


**52. What are the main obstacles to addressing sustainability issues more robustly?**

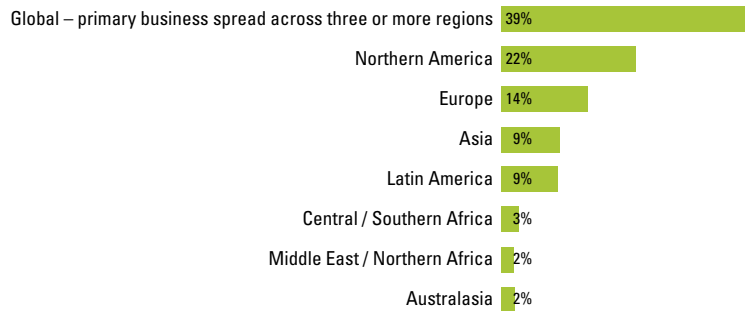
(Choose up to 3)



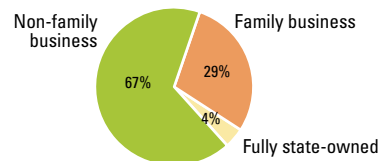
**53. Where is your organization located? (Top 20)**



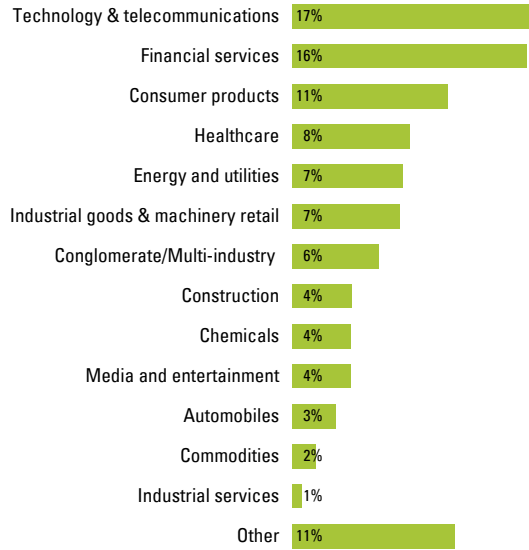
**54. In which region does your organization primarily conduct business?**



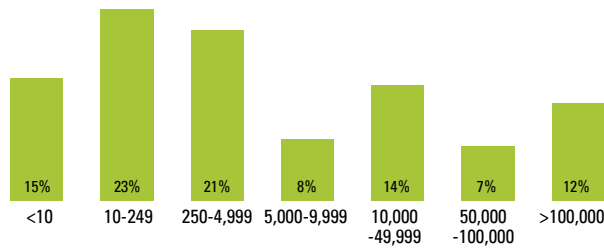
**55. Which of the following best describes your organization?**



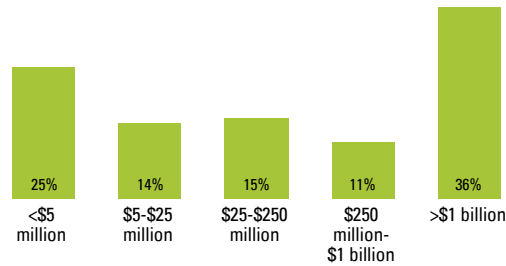
56. Which of the following best describes your company's sector?



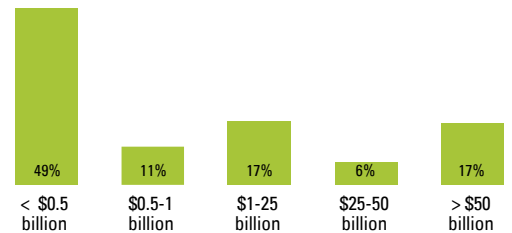
57. What is your organization's total headcount?



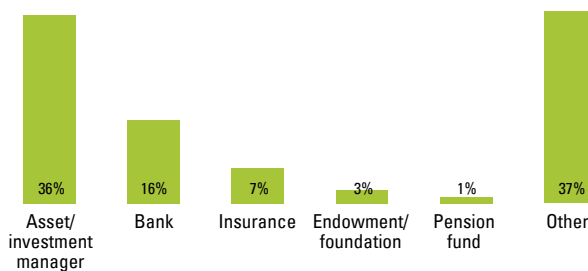
58. What are your company's annual revenues (in US\$)?



59. What are your company's assets under management?  
(Question only for investors, asset managers, and financial advisors)



60. Which of the following best describes your company's type?  
(Question only for investors, asset managers, and financial advisors)



## ACKNOWLEDGMENTS

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**Dave Stangis**, vice president of public affairs and corporate responsibility, Campbell Soup Company

**Pamela Styles**, principal, Next Level Investor Relations

**Sarah Teslik**, senior vice president, communications, public affairs and governance, Apache Corporation.

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*MIT SMR's* Sustainability & Innovation project is an exploration, in partnership with BCG, of how sustainability pressures are transforming the ways we all work, live, and compete. S&I's research, reporting, and community help managers to better understand the new forces that will affect their organizations, to navigate through the overwhelming mass of information about sustainability, and to fend off the threats and capitalize on the opportunities that sustainability issues present.

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