

The state of Sustainable Innovation

Frontrunners use sustainability as a key driver of innovation.

By Christiaan Kraaijenhagen, Leontine Gast and Fleur Embrechts

It's been 2 years since HBR article 'Why Sustainability Is Now The Key Driver of Innovation' was published. In short, it concluded that sustainability is not the burden on bottom lines, as many business executives believe. On the contrary, it has positive effects on cutting down costs, increasing revenue and enabling companies to create new businesses. Therefore, the authors concluded that sustainability should be a touchstone for all innovation within organizations; companies that understand the needs of people and the planet are in a pole position to achieve competitive advantage.

*Sustainability is defined as a combination of environmental, social, and governance issues also known as corporate (social) responsibility.

Goal

According to the new ranking of country by innovation and competitiveness of the World Economic Forum (WEF), the Netherlands are back in lead position of global top ranks and has now climbed to the 7th place. In a series of 'Meaningful Dialogues' – expert dialogues about sustainability* and innovation - we have

Hypothesis: 'Is sustainability a (business) driver of innovation?'

studied the efforts of leading companies in the Netherlands. We wanted to find out if sustainability is a driver of innovation in the Netherlands, and if so, to what extent?

Process

In fall 2011, the Meaningful Dialogues took place. CEOs, CSR Managers and Innovation Directors of 13 leading companies - from various sectors¹ in the Netherlands - have shared their insights and experiences on CSR practices within their company. In a 1-on-1 conversation, the barriers, opportunities and learnings to use sustainability as key driver for innovation were discussed.

We have mapped the current situation of these companies using the sustainability framework of Nidumolu et al. (2009). The authors describe 5 stages of change that we divided into 3 main phases: Compliance, Cost Reduction & Efficiency and Innovation & New Business Creation.

Phase 1 – Compliance: The most basic level of the sustainability scale. Companies are keeping pace with regulations and start running operations in a resource efficient way. The aim is to comply and manage risk.

Phase 2 – Cost Reduction & Efficiency: Value chain efficiency leads to reduce costs, particularly by reducing energy use, materials and waste. In addition, sustainable offerings or redesigning to become eco-friendly creates competitor advantage. Understanding consumer needs and carefully examining product life cycles is key. Aim is to reduce costs.

Phase 3 – Innovation & New Business Creation: Developing new

business models by exploring alternatives to current ways of doing business as well as understanding the changing needs and wants of customers and questioning the dominant logic behind business today. The aim is to create value.

Results

On the whole, participatory companies report a well-rounded understanding of sustainability. But there is a significant difference in the phases they are in and their viewpoint on the subject.

Most companies are in phase 1 or 2; sustainability is part of the strategy, and sometimes the company values. There is a general understanding that sustainability leads to increased efficiency and cost reduction. Life cycle analysis and footprint scans have shown the impact of the company on the environment. Goals have been set and the value chain has started to improve, including waste reduction and increased resource efficiency (phase 1). Some companies have started to redesign a number of their services or products (phase 2). For example, an aviation company started using biofuels and an FMCG organization introduced a range of eco products.

Typical of companies operating in phase 1 or 2 is that sustainability is not seen as a market opportunity and a way that is driving true innovation. Neither has it been integrated in the entire organization nor on the agenda of business managers, often missing the link to the commercial organization.

Sustainable leadership

A few companies came forward as sustainability leaders and have started to innovate by developing new business models and creating next practice platforms. They have taken a holistic approach on sustainability and are working together with their value chain partners to address customer needs leading to new business models. Sustainability is seen as a business opportunity rather than a risk or a cost driver. It is a benefit for the market and their customers, much more than a cost benefit for the company. Sales and marketing have a viable role to play in this process when it comes to identifying consumer needs and driving consumer behavior. For instance, a carpet company takes the environment of the consumer into account when designing new products: i.e. what can the carpet do for the air quality in offices? Or a waste service organization that turns the waste of its clients into new products by which it is able to generate joint revenues.

We have found some elements that differentiate sustainability leaders (phase 3) from others operating in phase 1 or 2:

Holistic approach. Sustainability is not considered as a single topic but as a holistic approach and a way to create novel business eco-systems. Every element of the value chain is transformed, from supply-chain management to communication on the positioning of the company. Holistic thinking continues in product development and in considering customer needs; a company that not only delivers a nice

carpet, but a solution: a healthy working environment.

Listening to customer needs. The opportunity of reaching new customers or markets is created by recognizing customer's unmet needs when looking through a sustainability lens. From this perspective companies are changing their business model from product to service. We do not all want to own a car: we just want to move from a to b. More companies no longer sell a product but have switched to offering a service; they deliver the wanted goods, maintenance and repair, and take the products at end-of-life back for up cycling materials to new products. This way, customers can benefit from an affordable, healthier, sustainable and carefree option.

Top down and bottom-up. The way sustainability is secured in the organization defines the level of innovation. When it is supported by top management and translated throughout the organization, sustainability becomes a business priority rather than cost reduction or reputation management. Staff is committed and empowered to initiate and execute sustainability practices, i.e. in terms of budgets, time and human capital. The commitment of CEOs and senior executives together with change agents through the organization have acted as a catalyst for sustainable change and innovation.

Performance. Sustainability is not only aligned to the goals, mission and values of the organization, but it is also integrated into the existing performance management

system and the daily operations. Sustainability performance is measured on a quantitative basis with the right key performance indicators (KPIs). People are being held accountable, which leads to a sense of responsibility. Incentives are tied to the performance on sustainability initiatives. The implementation of sustainability and the way it is being measured strengthens the competitive position of the organization.

Relevance. Understanding the relevance of sustainability by staff is an important part of the implementation process. If the procurement department of the company is aware that sustainable purchasing leads to cost reduction, they will make that choice. If sales people are aware sustainability leads to customer loyalty and increased revenue, they will make it priority. Translating long-term benefits in short-term business wins, creates buy-in from the organization.

Barriers

Although there are many opportunities when it comes to creating shared value, the majority of the participating companies are in the midlevel of sustainability change. We have found some barriers for phase 1 - and phase 2 companies to capture the values from sustainability opportunities:

Customer perception. The perception still prevails that customers are unwilling to pay extra for sustainable products or services. Several studies show that 20-30% actually are willing to pay more or a premium price. Investing in innovation is seen a risk when competitors do not follow this transition and take their part in purchasing bulk

material. The perception of companies is that customers will go for the cheaper option and there is no return on investment.

Change curve. Although companies have included sustainability in the strategy and core values of their business, they are struggling to find a way to implement these into daily practices. When there is lack of sense of urgency, no powerful coalitions, no vision for change or when there is no effective communication within the organization, the transition will not succeed. Walking through the different stages of the change curve and having a true sustainable change vision is essential to overcome obstacles, to gain employee commitment and to move the entire organization.

People. Attracting and retaining people with the right capabilities and skills are needed to lead the change. There needs to be in-house talent that is accountable for sustainability in the company. Integrating sustainability into internal communications or employee engagement has to be on top of the list. Keeping employees informed at all levels, so they know how to deal with it on the job, will help make the most of sustainable value creation. On the other hand, company performance on sustainability is also a way to attract and retain talent.

Conclusions

All participating companies appear to use sustainability in their strategy and to some extend operations (supply chain) and have the intention to make the next step to use Sustainability as a driver for innovation to create new business opportunities.

However, a few make great strides in true innovation by creating new business models and developing next practice platforms in which the current way of doing business are questioned. This holds for production companies as well as service organizations (i.e. responsible investing by financial services, easy access to information by public transportation companies).

Sustainability appears to be a driver for innovation and opportunity to create new business when it is dealt with in a holistic manner. This means that it touches all organizational aspects and often approached as a change program: a clear vision with measurable goals is communicated by top management and is carried out consistently; Effective Communications that informs various stakeholders of the reasons for the change, the (personal) benefits of successful implementation as well as the details of the change, manage resistance, coaching and training people, champions or change agents lead by example; incentives fit the envisioned goals, monitor the implementation and fine-tune as required and lastly, celebrating milestones and success.

Background

- R. Nidumolu, C.K. Prahalad and M.R. Rangaswami 'Why Sustainability is key driver of Innovation' (HBR of September 2009).
- McKinsey Global Survey Results: The Business of Sustainability (McKinsey & Company 2011)
- ¹ Interviews with CEOs, CSR managers, innovation directors of 13 multinationals with HQs situated in the Netherlands within financial and technical services, electronics, consumer goods, food, FMCG, transport and industry

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