Sustainability as Adaptability

This Perspective from The Boston Consulting Group’s Strategy Institute is the tenth in a series on the future of strategy. Earlier articles examined the central role of adaptive advantage in today’s turbulent and unpredictable business environment and the capabilities that contribute to it. This article discusses how this turbulence has created a new type of “sustainability” challenge—the continued viability of the business itself—and how companies can create advantage by adapting to changes in the business, ecological, and social spheres.

Over the past few years, CEOs have been paying increasing attention to corporate social responsibility, sustainability, and ethics. In a recent global survey of business executives conducted by BCG and MIT Sloan Management Review, more than two-thirds of the 4,700 respondents agreed that sustainability is essential to competitiveness. Moreover, nearly three-quarters said that it is permanently on their agenda and that their commitment will increase in the year ahead. Executives in resource-intensive industries were especially likely to make this claim.

There is little consensus, however, on just what sustainability, or the many other terms that are used to characterize the relationship between business and its broader context, mean in practice. (See Exhibit 1.) This confusion is manifest in the multiplicity and limitations of—as well as the inconsistency among—the principles that companies implicitly rely on when making decisions involving “beyond business” issues:

- **License to Operate.** Merely following society’s implicit rules and expectations can cause a business to miss opportunities to create positive advantage.

- **Business Ethics.** Doing what is right is laudable, but ethical principles don’t necessarily provide a framework for making tradeoffs. Furthermore, creating social or ecological value is not automatically rewarded.

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Reputation. Excessive concern with reputation can mislead a company into making decisions on the basis of shifting perceptions rather than substance and competitive advantage.

Sustainability. A commitment to future generations is admirable but doesn’t necessarily address tradeoffs between present and future value—and thinking in terms of sustainability tends to be biased in favor of environmental issues.

Shared Value. Combining profits with social contributions is desirable, but the shared-value approach doesn’t prescribe practical ways to achieve that desirable union.

Shareholder Value. Some executives assert that maximizing shareholder value is the only legitimate goal for business. But the time horizon for maximization is debatable and in practice is often too short to deal adequately with social and ecological feedback loops.

This lack of clarity can have serious consequences. Companies that are uncertain about how to make tradeoffs in a calibrated, holistic, and integrated manner can end up with the following challenges:

A Gap Between Intention and Action. Without practical guidelines, intention doesn’t necessarily translate into actions or desired outcomes. Although two-thirds of our survey respondents believe that sustainability is essential to competitiveness, only a quarter said that greater competitive advantage had actually been achieved as a result of their company’s sustainability efforts.

Misaligned and Insufficient Actions. Without a clear framework, managers run the risk of focusing on the wrong issues or not focusing sufficiently on the right ones.

Sustainability Issues Underweighted. Without clarity and precision, sustainability loses its credibility in the boardroom. Despite proclaiming its importance, only 14 percent of survey respondents perceive sustainability as a top management challenge over the next two years.

Meanwhile, the pace at which business models become obsolete and market positions decay is accelerating, as we have noted in earlier articles in this series. Indeed, the key sustainability challenge for corporate leaders today is the preservation of the viability and vitality of the business itself!

Approaches to Ecosocial Advantage

In an increasingly turbulent world, a company must continuously adapt its business model to changes in the ecological, social, and economic spheres over both short and long time horizons. We call the ability to do this “ecosocial advantage.”

Without adaptation, business models become obsolete. We can think of this process of adaptation as a continual retuning to avoid imbalances and limits in the flows of materials, labor, economic value, and trust in and out of those three spheres of activity. (See Exhibit 2.) In the ecological sphere, companies must replenish resources as they extract them and restore the environment as they degrade it. In the social sphere, they must create more trust than mistrust in order to attract talent and maintain their license to operate. In the economic sphere, they must adapt their business models to changing competitive and economic situations.

Creating social and ecological value doesn’t automatically confer economic rewards, but—with the right business model—it can. Although there are many ways of achieving such balanced flows, we have found that there are some common models of success. The cases studies below exemplify eight typical approaches to building a sustainable business model.

The Ecological Sphere. A company must manage ecological resources for the sustainability of its business model.

Minimize consumption by improving resource productivity. Finding itself with limited access to low-cost energy,
Sustainability as Adaptability

Exhibit 2. Sustainability Requires a Balancing of Flows Across Three Spheres of Activity

The rare-earth metals are a collection of 17 chemical elements that are used in batteries, magnets, and lasers. China currently produces most of the world’s supply. In 2009, however, China began reducing its export quotas to ensure an adequate supply for its own industry. That led Toyota to back-integrate into mine ownership in order to protect the inputs needed for its motors. Two years later, Toyota announced that it was developing a new electric-motor design with significantly reduced dependency on rare earths.

Substitute resources. The rare-earth metals are a collection of 17 chemical elements that are used in batteries, magnets, and lasers. China currently produces most of the world’s supply. In 2009, however, China began reducing its export quotas to ensure an adequate supply for its own industry. That led Toyota to back-integrate into mine ownership in order to protect the inputs needed for its motors. Two years later, Toyota announced that it was developing a new electric-motor design with significantly reduced dependency on rare earths.

Replenish resources. Zhangzidao Fishery Group is a Chinese seafood-farming and processing conglomerate with subsidiaries around the world. It employs integrated multitrophic aquaculture (IMTA), a more sustainable form of biodiverse farming that uses the waste of one species to feed others. IMTA techniques allow the company to increase its productivity while decreasing waste through the conversion of byproducts into harvestable product. This also reduces the need to introduce artificial feeds into the system. While helping to preserve the quality of ocean ecosystems, Zhangzidao has been able to increase revenue annually by 40 percent, compared with an industry average of 13 percent, and to generate an EBITDA margin of 31 percent between 2005 and 2010.

Reduce pollution and waste. Bottled water is enormous-ly popular in Japan, but the nation’s recycling rate has been lower than that of other developed countries. Coca-Cola attacked this problem by reducing bottle weight by 40 percent, thereby saving 3,800 tons of carbon dioxide per year. The new bottle is also easily crushed, making it more efficient to transport and recycle. Although the source of Coca-Cola’s mineral water is not branded (unlike many of its competitors’ waters), the product has become the fastest-selling water in the Japanese beverage industry. The company won a DuPont Award for Packaging Innovation in 2011 for its innovative packaging technology.

The Social Sphere. A company must maintain society’s trust in order to attract customers and talent and maintain the license required to operate and thrive.

- **Help customers and employees realize their ethical and ecological aspirations.** Toyota has turned “conspicuous conservation” into a market-winning strategy. Thanks to the unique design and distinctive look of the Prius, drivers of the car signal to others that they care about the environment. As a result, Prius has a larger share of the market than its competitors’ hybrids, although those cars employ a similar technology and sell for comparable prices.

- **Create new markets and access.** In the Philippines, Manila Water Company decreased its levels of “nonrevenue” water (water that was not reaching customers because of leaks or illegal tapping) from 63 percent in 1997 to just 12 percent at the end of 2010. It accomplished this feat by providing low-income areas with affordable access to water and by turning potential water tappers into partners who help prevent illegal tapping. While expanding affordable access, the company delivered a total shareholder return of 24 percent in 2010 and grew the business by 20 percent from 2005 to 2010.

The Economic Sphere. Economic sustainability is essential in order for a company to survive, flourish, and create social and economic value. Adaptation to the economic and competitive environment is therefore also vital.

- **Continuously adapt the business model.** In the early 1990s, profitability in the computer hardware business began to decline as the technology became commoditized. So IBM adapted its business model to focus on

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software and services. It created a new global-services business, acquired PricewaterhouseCooper’s consulting division, and eventually sold its PC business to Lenovo. IBM’s income from hardware fell from $2.7 billion to $1.6 billion, whereas its income from software increased from $2.8 billion to $9.1 billion between 2000 and 2010. Celebrating its one-hundredth birthday in 2011, IBM is one of the longest-surviving technology companies in the world.

◊ **Build an adaptive ecosystem.** Multicompany ecosystems can be very adaptable in fast-changing and unpredictable environments. Li & Fung, a global design, development, sourcing, and distribution company for a variety of consumer goods, built an adaptive system of more than 15,000 suppliers to ensure the resilience and sustainability of its business. Because its suppliers are organized in a dynamic, modular, and redundant structure, the company is able to shift production from one location to another within a very short time. Another reason for the system’s adaptability is the presence of strong feedback loops on supply chain conditions and performance. As a result of its unique approach, Li & Fung has achieved 21 percent revenue CAGR over the past 19 years, a period when economic conditions, demand, and the supply competitiveness of different locations were constantly shifting.

### Assessing the Sustainability of Your Business Model

Managers can assess their business’s sustainability by examining how effectively it adapts to changes in the ecological, social, and economic spheres. If they discover imbalances in the flows of material, economic value, labor, or trust that impose limits on the current business model, they should develop strategies that will transform these red flags into new sources of ecosocial advantage. For companies just beginning this journey, the following questions will serve as a road map to building a sustainable business model:

◊ How does our business balance its flows of materials, labor, economic value, and trust within changing ecological, social, and economic spheres?

◊ Do the imbalances represent unexploited business opportunities and on what time horizon?

◊ Which of the approaches to ecosocial advantage described above might we employ to improve our business model’s resilience and sustainability, make it more competitively advantaged, and optimize its economic, social, and ecological value generation?

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