



Sustainable portfolio steering

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Today's businesses are faced with the formidable challenge of translating government and consumer aspirations around improved environmental and social performance into attractive products and services. To rise to this challenge, companies must steer their portfolios towards products and services with



strong sustainability performance. Such strategic portfolio shifts make economic sense because portfolios of sustainable products and services often demonstrate substantially higher growth rates and superior returns on investment. Inspired by the successes achieved by peers and leading companies in other sectors, business leaders have come to realize that proactive portfolio steering, based on solid understanding of

sustainability performance, is therefore key to future business competitiveness. This article sets out how businesses in multiple sectors can use sustainable portfolio steering to create products and services with strong sustainability performance.

Understanding the sustainability risks and opportunities across the product portfolio is vital to creating tangible business value. However, assessing every product in-depth, in every market, can appear daunting. This article outlines how sustainable portfolio steering can provide a simple and comprehensive approach to delivering strong sustainability performance across the organization.

Creating tangible value from sustainability

Recent landmark sustainability agreements, such as the G7's commitment to decarbonizing the global economy and the United Nations' Sustainable Development Goals, confirm that sustainable development is top of the agenda for governments around the world. Likewise, growing numbers of consumers prefer products and services with superior sustainability performances. In the United States,

for example, 20 percent of consumers choose products that are manufactured sustainably, compared to 7 percent who do not¹. Sustainable-purchasing preferences are found to be even stronger in some emerging markets, including Brazil, India and Turkey³. This trend is not confined to consumers and corporate purchasers: leading business publications report that employees, investors and companies are all found to prefer working with organizations that perform well on sustainability-related indicators. BlackRock, the world's largest investment management firm, observes "an increasing positive correlation between effective management of environmental, social and governance (ESG) indicators and the longer-term value creation by a company."

For businesses, this new form of consumer- and regulation-driven disruption creates new opportunities and challenges. Some have found novel ways to create sustainable products and services that generate business value and appeal to a new generation of consumers. For example, food start-ups, such as Beyond Meat and Impossible Foods, are working to create meat substitutes from pea protein to satisfy consumer cravings for meat, while using fewer resources and demonstrating ethical credentials. Industry-leading players are also taking note. General Electric reports that its green products sold four times faster than its regular products and made up 30 percent of its overall revenue during 2015². Unilever also reports that its Sustainable Living brands grew more than 50 percent faster than the rest of its portfolio during 2016³.

Executives in these leading organizations are acutely aware that failing to understand how solutions contribute to the sustainability objectives of key stakeholders in a timely manner means potentially leaving attractive business opportunities uncaptured, or unwittingly exposing the business to risk.

1. NMI 2016 US Sustainability Consumer Trends Database

2. General Electric Ecomagination Strategy 2015

3. Unilever study among 20,000 adults across Brazil, India, Turkey, the UK and the US, Sustainable Brands

The long-term competitiveness of a product portfolio hinges on the extent to which it supports stakeholders in achieving their sustainability-related objectives. Or, as Eric W. Bischof, VP Corporate Sustainability of Covestro, puts it, "Taking sustainability aspects into account when managing your product or innovation portfolio just makes good business sense – doing so consistently, transparently and exhaustively may well be the competitive edge you are looking for."

For other businesses to emulate these successes and generate tangible business value, it is paramount to develop new sustainable value propositions (or improve existing ones). These must:

- **Address tangible sustainability goals in society or in the value chain, rather than following regulatory incentives.**

While regulation triggers temporary demand for more sustainable products, there are many examples of companies or whole industries collapsing when incentives are removed. The demise of the German biodiesel industry in the early 2000s is one such example. Successful product introductions cater to key unmet needs. P&G's and Ecover's recent introductions of shampoo bottles partly produced from plastic waste that was collected by volunteers on European beaches show how companies can successfully position their products in response to societal concerns.

- **Be cost competitive compared to conventional alternatives.**

While some consumer segments, such as millennials in western countries, will pay a small premium for sustainable products, the vast majority expect this as part of what a company offers. Companies report that willingness to pay for more sustainable alternatives is typically limited to single-digit percentage increases.

- **Have material sustainability benefits, backed up by credible evidence.**

Increasingly, self-educated and mistrustful consumers reward companies that clearly communicate environmental and social benefits backed by credible external evidence. For example, in 2014, H&M touted its No. 1 ranking in Textile Exchange's Organic Cotton Market Report until consumers discovered the minimal effort required to acquire the organic certification and the limited share of organic cotton H&M actually used.

What is “good” sustainable performance anyway?

Objective evaluation of the implications of the sustainability trend for individual products or services is far from straightforward because there is no universally accepted definition of what “good” sustainability performance looks like. There is no common language or standard within companies on how to describe or evaluate sustainability performance. This leads to widespread miscommunication, both internally and externally.

In response to this challenge, a flurry of industry standards, labels, certification schemes and regulations have emerged to aid businesses and consumers in making informed decisions. These standards often vary by geography and sector. The result is a complex and constantly shifting tangle of definitions based on a mix of fact and emotion. In this context, executives need to understand how key stakeholders view their solutions, and how these views are likely to affect regulatory and buying behavior.

Companies have traditionally relied on academic and highly granular tools such as life-cycle assessments (LCAs) to gain insight into the environmental (and sometimes social) impact of products or services. These powerful tools typically assess the impact of products in applications, yet are not designed to assess how the products' performances stack up against the expectations of the market or society in general.

The limitations of these traditional sustainability tools are painfully clear when watching companies vehemently defend products using detailed LCA reports, even as consumers move to competing products in accordance with changing preferences.

Another shortcoming of traditional sustainability tools is that they typically focus on existing regulations and requirements. Companies have a clear need for predictive tools that provide early warnings regarding potential risks or acts of legislation that may emerge. All too often, traditional tools confront decision-makers with obstacles after the fact. Production companies, for example, have a clear need for early-warning systems, as it may take anywhere from a couple of months to half a decade to perform substantial modifications to a product's formulation, changes to an asset during shutdown, or strategic alterations to product portfolios.

Companies require sustainability assessment approaches that go beyond life-cycle assessments to answer questions such as:

- Which solutions are exposed to risks due to stakeholder concerns about aspects of their sustainability performances? What percentage of revenues or profits could be exposed?
- How does our portfolio contribute to globally recognized initiatives such as the Sustainable Development Goals⁴ or the Circular Economy⁵?
- To what extent do our solutions comply with regulations? How could changing regulations impact our business?
- How do stakeholders perceive the sustainability performances of our solutions? How do these views affect buying behavior?

4. United Nations Sustainable Development Goals and 2030 Agenda for Sustainable Development adopted by the 193-member United Nations General Assembly in 2015

5. Ellen McArthur Foundation

- Are market discussions about specific sustainability concerns a material risk, an opportunity, or just hype?
- What solution provides both the functional and sustainability performance characteristics the market is looking for, at a price point that the market will accept?

Like a deer in the headlights

The perceived complexity of gathering and interpreting the information required for high-quality sustainability performance assessments can seem daunting. People new to the domain often feel overwhelmed, like deer in the headlights, when facing the immense breadth of relevant information.

- Relevant impact may include environmental, social and economic.
- Such impact needs to be considered across the full lifecycle (e.g., purchased materials, manufacturing, processing, use, end of life/recycling).
- The performance of a product in one application or region may be very different from that of the same product in another application or region.
- This performance needs to be evaluated against both stakeholder standards and competing solutions.
- Intentions initially communicated by governments and companies may diverge from actual decisions further down the line.
- Market requirements and performances of competing solutions are subject to rapid change, so assessments need to be regularly reviewed.
- Relevant information may be unavailable, scattered across different departments or geographies, or stored in various media, including websites, internal documents, financial systems and the minds of experts.
- Resources required to gather, structure and analyze information may be unavailable.

Companies need robust, fact-based methodologies supported by proper tools and processes to ensure that resources are focused on efficiently converting the most relevant insight into input for decision-making. Such an approach necessitates input from various departments and will only deliver maximum value when embedded in all day-to-day decision-making processes. Top management support is therefore critical to the methodology's successful implementation and use.

Improving your reflexes

Businesses across industries are putting tools in place to help steer product portfolio development in light of consumer preferences and regulations concerning sustainability. In 2009, Arthur D. Little developed the first "sustainable portfolio steering" approach together with Solvay. The accredited approach provides a clear overview of a portfolio's overall sustainability based on an objective review of the portfolio's constituent products. It provides strategic input for decision-making processes, including strategy development, mergers and acquisitions, capital investments, and innovation management.

Arthur D. Little's sustainable portfolio steering approach considers the product portfolio in terms of its products and the applications and geographies that those products serve. Product-application-region combinations are assessed individually, using a fact-based model that is both simple and comprehensive. The result is a granular assessment of the sustainability-related risks and opportunities of each product-application-region combination, tailored to the individual company. When aggregated, insight can be obtained for entire portfolios or parts thereof: e.g., what percentage of the total turnover and margin is coming from highly sustainable products (that are likely to experience high growth), and what share is derived from products that are at risk?

Figure 1 illustrates the five steps that a best-practice sustainable portfolio steering approach must adhere to, according to the recently published Portfolio Sustainability Assessment, which was written by the World Business Council for Sustainable Development (WBCSD) and supported by Arthur D. Little.

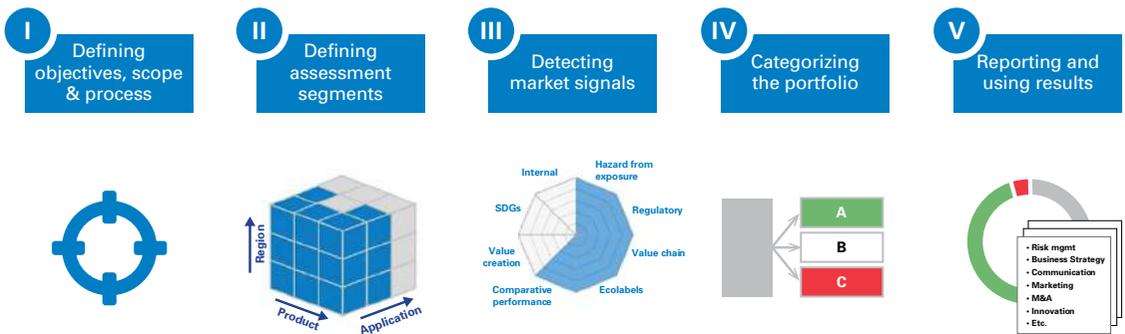


Figure 1: **Best-practice sustainable portfolio steering tool, as recommended by the WBCSD⁶**

“Several leading global chemical companies have already implemented sustainable portfolio strategies for some time, and found results that deliver sustainable business value. In order to steer such approaches further and to harmonize practices, the WBCSD led a collaborative process, supported by Arthur D. Little, to develop guidelines on how to evaluate the sustainability performance of a company’s product portfolio. These open-source guidelines are available for use by business and enable more companies to compete on sustainability performance of their products, rather than methodology.” Andrea Brown, the WBCSD’s Director of Circular Economy

6. SDG mentioned in the radar graph in step III, refers to the United Nations Sustainable Development Goals

Case example: Solvay focuses on sustainable solutions to achieve high growth

Solvay's methodology, dubbed sustainable portfolio management (SPM) and developed in collaboration with Arthur D. Little, is a prime example of how companies have created value through sustainable portfolio steering. The SPM tool provides Solvay's decision-makers with a high-level "heat map" of the various products within the company's portfolio in terms of product-application combinations (PACs). PACs are assessed in terms of the business risk related to their environmental footprints, as well as the sustainability-related market opportunities they offer. Realizing the importance of developing a common language on sustainability performance with all of its peers and stakeholders, Solvay has published a detailed guideline explaining all the intricacies of its methodology⁷.

Following implementation of sustainable portfolio management throughout its entire global organization and across all levels of decision-making, Solvay found that solutions with above-average sustainability performance delivered an average annual growth rate of 9 percent, compared to a 3 percent drop for solutions with below-average performance. Solvay is now able to place targeted emphasis on the development of high sustainability performance products.

7. More information about Solvay's sustainable portfolio management approach can be found at: www.solvay.com/en/binaries/Solvay-SPM-Guide-154709.pdf

Sustainable Portfolio Management at Solvay

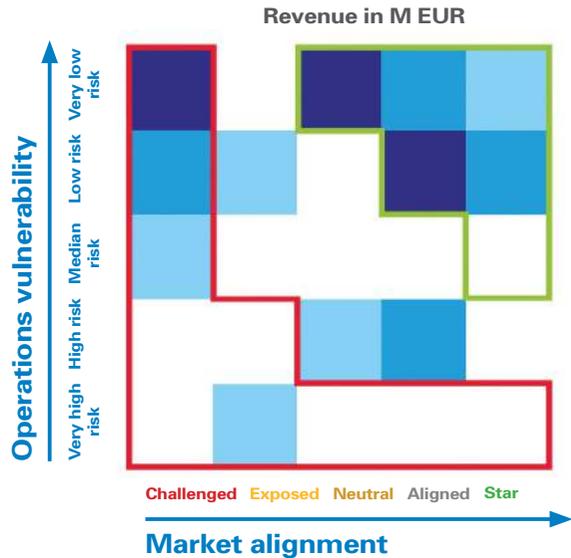


With over 150 years of history, we are deeply aware of the importance of value that stands the test of time. Sustainability without strong profits is not sustainable, while strong profits to the detriment of sustainability undermine the longevity of a business. At Solvay, when we look at valuing the performance of the business, we go beyond financial elements. We have this unique framework called Sustainable Portfolio Management (SPM). This is a lens through which we assess and guide the business, on one axis, to lower the environmental impact and therefore reduce risk, and on another axis, to bring solutions that meet our customers' needs, which helps us to generate higher growth. The combined perspectives help us to generate superior sustainable value. The good news is that half of Solvay's business portfolio today is a solution. It means it grows faster and it has a lower-risk profile. That is good for our customers, good for the planet and good for our bottom line.

Karim Hajar,
CFO, Solvay



The SPM Heat Map:



Businesses experienced in sustainable portfolio steering report that the approach directly contributes to improving profitability and accelerating growth on the back of better-informed decision-making. Executives point to five key benefits:

1. **Predictive insight**, earlier, by means of a future-oriented “radar” that captures signals on all relevant market requirements and objectives, and enhances strategic decision-making with fact-based insight on relevant future risks and opportunities.
2. **Improved sharing of sustainability-related intelligence** across departments and geographies, based on **common, fact-based decision logic** on sustainability-related risks and opportunities.
3. **A shared internal definition of what “sustainable performance” means and how to credibly measure it**, which enables faster convergence on priority actions.
4. **A structured, traceable process** with credible reporting and communication on sustainability performance. The approach is transparent and auditable; results can be relied upon.
5. **A clear foundation for understanding and measuring corporate sustainability values, which are aligned with day-to-day decision-making across the organization.**

Insight for the executive

Over the past two years, sustainable portfolio steering has become a hot topic on the executive agenda because:

- Business **value** from sustainable portfolio steering is now well understood and has been demonstrated by leading companies in several industries. Failing to act means missing out on revenues and value.
- The **risks** for companies that fail to apply sustainable portfolio steering are rapidly growing, particularly given the increasing speed of market developments. Companies not privy to the shared language on

sustainable performance risk being caught by surprise with information that will directly affect the long-term competitiveness of their product portfolios, such as emerging legislation, guiding recommendations from institutes, substances blacklisted by large customers, and novel solutions with superior sustainability performances.

- Sizable first-mover advantages may still be achieved by companies that act quickly. These advantages may include:
 - o Early insight into solutions at risk, which enables preemptive development of competitive alternatives or divestment
 - o Opportunity to solve customer issues before they appear
 - o Influence on sustainability metrics and resulting business decisions within specific value chains
 - o Ability to attract the ecosystem partners which are best positioned against the sustainability trend
 - o Early view on innovative solutions entering the market, and whether and when these solutions will gain traction

What might your company be risking without proactive portfolio management based on social and environmental sustainability? Can your organization afford to make strategic business decisions without a clear understanding of the sustainability risks and opportunities in your portfolio? What first-mover advantages could be achieved with sustainable portfolio steering?

The impact of consumer- and regulation-driven disruption means companies must develop objective and defensible approaches for managing sustainability risk within their product portfolios. Sustainable portfolio steering is a simple and comprehensive approach that helps large organizations create tangible business value by embedding fact-based sustainability intelligence into the daily decision-making conducted by employees across departments and geographies.

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