The Innovation High Ground

The business "tipping point" is approaching as leading companies understand how customers' environmental and social needs will drive breakthrough innovation in product and process design.

During the 1980s, 46% of the Fortune 500 disappeared from that list, most as a result of failing to anticipate trends with much needed innovation. As innovation leaders like Federal Express soared, over 200 'leading' companies fell.

Today, with pressure mounting daily to address global environmental and social issues, many executives take comfort in publishing sustainability reports. However, their business models remain largely unchanged and over 90% of corporate executives say they lack early warning systems to discern opportunities and threats. They risk the same fate as those companies from the 1980s.

To further explore this issue, Hedstrom Associates recently teamed with Arthur D. Little to survey 40 leading technology companies across Europe, the United States, and Japan. Our goal was to see what had changed since conducting a similar innovation survey in 1999.

Survey Findings

Two interrelated developments were strikingly different from the 1999 findings. Technology leaders are now focused on:

- **Winning tomorrow's customers.** Leading companies have shifted focus from managing risks to exploiting opportunities. They see customers – especially tomorrow's customers – as a mountain of opportunity to be reached through sustainability-driven innovation.
- **Reducing the full life-cycle impacts of products**. With sustainability firmly integrated into business strategy and product development, a few leaders are seeking radical cuts in full life-cycle environmental impacts.

Winning Tomorrow's Customers

In our 1999 survey, 39% of the companies said customers were pressing them for more sustainable products and services. In 2004, this number jumped to 70%! Today's focus is not only on keeping today's customers, but also on winning tomorrow's new customers.

The increasing customer pressure is driven largely by anticipating regulation– but that too is changing. While 70% of those surveyed said meeting legislative requirements is critical (especially European product and chemical legislation), they see regulatory requirements as relatively less important in the next five years.

Reducing Lifecycle Footprint

The leading companies are moving from *incremental* reductions in the footprint of their operations to *radical* reductions in the full life-cycle footprint of their activities.

Japanese companies are leading the way, as reported in an earlier issue of *Insight*. Sony, for example, has committed to cut its full life-cycle environmental footprint by 50% (2001 to 2011).

Lessons from the Leaders

Our research suggests five key lessons for CEOs, board members, and business executives:

1. **Governance.** Leading CEOs have actively engaged their board on these issues, both during and between board meetings. They also recognize the need to rethink and redesign their governance processes (going beyond Sarbanes Oxley) to incorporate sustainability drivers. The result? Breakthrough opportunities for innovation and environment fully integrated into vision, goals, and business strategy.

2. **Key Business Decisions.** Between 1999 and 2004, the number of companies reporting strong integration of sustainability into product and process design doubled. But fewer than five percent of the companies surveyed have successfully integrated sustainability into both product/process design and business strategy. The leaders keep it simple: What are the three to five key business decisions

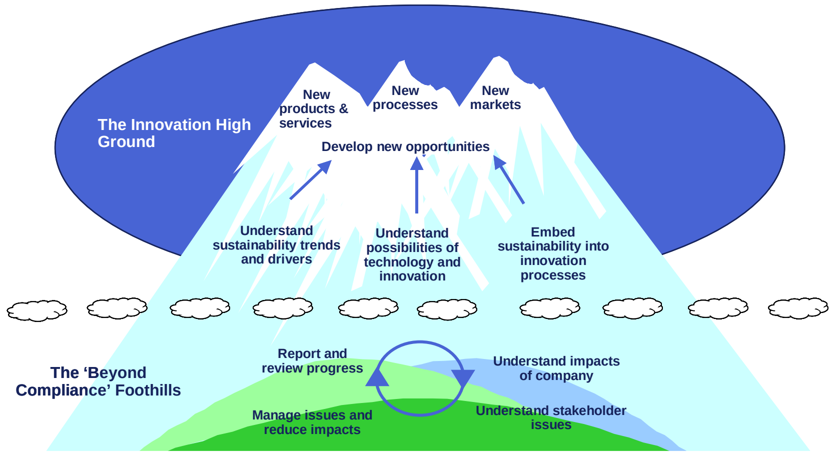

Figure 1: Moving from the "Beyond Compliance Foothills" to the "Innovation High Ground"

we will make in the next year? And, how do we integrate full life-cycle environmental and social considerations into those decisions?

3. **Customers.** When an executive of one of the world's most respected companies (that happens to have very minor greenhouse gas emissions) was asked what their major environmental issue was, the answer was carbon risk. Why? Because that is the top issue for many of their customers.

4. **Culture.** This can only come from the CEO and the pressure must be relentless. GE's recent 'Ecomagination' launch harnesses the creativity of its workforce and supports its stature as the world's most respected company (according to the *Financial Times*). GE sees its "good citizen" role as a business imperative, and sees growth opportunities in cleaning up the planet.

5. **Partnerships.** Leaders engage deeply with one or more well respected NGOs whose agenda aligns with the environmental and social impacts of their businesses and those of their customers.

The Innovation Tipping Point

From the Davos agenda to daily global business press, we are on the brink of a rapidly changing business landscape. We see a "tipping point" on the horizon – an exciting time when science, demographics, trends, and social behaviors cross a threshold, tip, and spread rapidly.

Today, a growing number of enlightened companies are using social and environmental drivers to innovate new products, services, processes, and markets. They are taking the "innovation high ground" to capture business value from the environment (Figure 1).

Meanwhile, companies that endlessly wander the "beyond compliance foothills" risk failure. By 2010, we may no longer hear from many of today's Fortune 500 companies – those lacking robust processes to anticipate and respond to rapidly changing risks and opportunities driven by global social and environmental issues.

About the Authors

Gib Hedstrom has 25 years of experience in helping senior executives and boards of directors manage environmental and social issues to reduce cost, limit risk, and strengthen reputation and shareholder value. Prior to 2001, he led Arthur D. Little's sustainable development team, and its EHS auditing, strategy, and governance work. He founded Hedstrom Associates in 2004.

Justin Keeble leads Arthur D. Little's Sustainability Services. Based in Cambridge, U.K., he leads ADL's work for the Global Reporting Initiative, the London Stock Exchange, and the UNEP-Finance Initiative. He led the development and analysis of this survey.

For information about the survey and its implications for your organization, contact Gib Hedstrom at info@hedstromassociates.com, or by phone at 978.371.9814.

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