CARBON TRUST

Making business sense of climate change

Raising The Bar - Building sustainable business value through environmental targets

Business briefing from Carbon Trust Advisory Services

On 17th May 2011, in line with advice from the independent Committee on Climate Change, the UK Government outlined its commitment to reduce the UK's greenhouse gas emissions to 1,950 MtCO2e between 2023-2027. This is equivalent to a 50% reduction in annual emissions from 1990 levels, putting the UK on course for an 80% reduction by 2050 from the same baseline. With business currently contributing to a significant part of UK emissions, this guidance from Government now provides a clear mandate and stable foundation from which organisations can set strategic emission reduction targets for the medium/long term.

A majority of the UK's top quoted companies now declare targets to improve their environmental performance. But closer examination reveals that not all targets are equal. There is a wide variation in their level of ambition and rigour, and an opportunity is being missed to ensure a profit generating sustainability approach is in place.

This paper reviews the targets being set by companies in the FTSE 100 to identify exemplars and trends, and asks "What makes a 'high quality' environmental target?" Through conversations with leading companies we explore how they decide on what targets to set, what benefits they derive from stretching, robust and transparent targets, what challenges they face and how their targets are likely evolve in the future.

"One word of advice to other organisations is don't be frightened about setting stretching public targets. CEOs will be delighted and surprised about the ingenuity of their own organisations in reaching the targets. And more importantly if you don't have targets in this area then in five or ten years' time your business is going to be in pretty poor shape. You need to protect future value of the business now and prepare for what is coming down the line."

Unilever

What makes a 'high quality' environmental target?

Organisational environmental targets are increasingly in the public domain, with 60% of the FTSE 100 having published such targets, and we expect many of the remainder to come under increasing stakeholder pressure to do so in the near future. However, our analysis also illustrated significant differences in the rigour and ultimately the quality of those targets which have been publicly set and reported. We began by applying a simple framework to assess the quality of each target:

- Targets must be precise in what is being measured, including the geographical and organisational boundaries, and the timescale in which the outcome is sought.
- It must be possible to measure the data behind the target accurately, with a solid baseline and any conversion factors clearly specified.
- Targets must be stretching and aspirational, since this is instrumental in driving collaboration and innovation, building future business value and future-proofing organisations against risks related to climate change and sustainability.

- Targets must be appropriate and relevant to a business and its sector, and can overlay local factors, e.g. water scarcity, onto global objectives.

Eight companies in particular seem to be exemplars in terms of having high quality targets as measured against these criteria.

Firstly, in our experience, such targets are likely to drive greater efficiencies and reduced environmental impacts as they are set in a way which is stretching and robust. Secondly, we have found that putting in place targets with a longer time horizon and breadth of ambition will stimulate innovation and creativity, in a way which promises to be a springboard for truly sustainable transformation in the coming years. Given these benefits, Carbon Trust Advisory Services would encourage all businesses to consider setting high quality environmental targets.

In addition to setting a high quality target, transparent communication will help businesses considerably as they engage with the wide variety of stakeholders who now expect business to raise the bar in terms of sustainable performance. Finally, as will be discussed later, it is also essential that there is true organisational accountability and leadership in place to deliver these targets.

"We believe that in publishing clear and transparent targets, we can demonstrate genuine accountability for all of our business processes and work with our partners to deliver tangible mutual benefits."

British Land

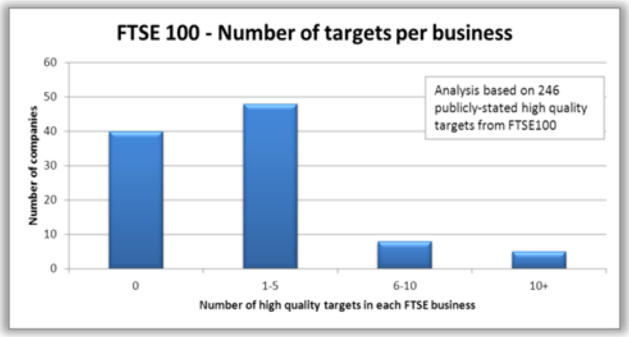
"We find that setting more granular targets specific to each area of the business is far more effective at getting results… it has helped us to get away from CSR being a bolt-on and embed it within our core business strategy."

BSkyB

Identifying exemplar targets within the FTSE 100

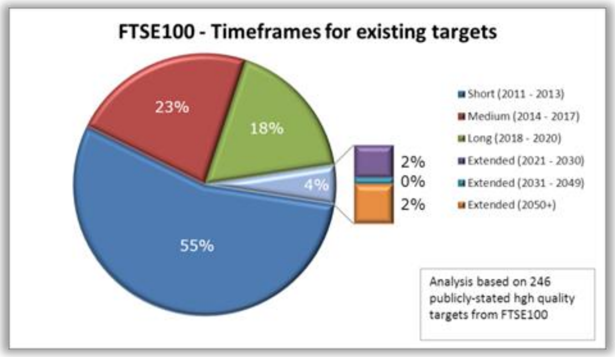
- In April 2011 Carbon Trust Advisory Services reviewed FTSE 100 websites, including online CSR and sustainability reports, to identify environmental targets being publicly declared.
- We identified the following exemplars: British Land; BSkyB; BT; Diageo; Kingfisher; M&S; Tesco and Unilever. All of their targets are precise. While the measurability, aspiration and relevance of targets are more difficult to assess from an external perspective, in the case of these eight businesses a significant degree of detail in the targets suggests they are measurable. A relatively high number of individual targets and a significant breadth of scope also suggest relevance to the business.
- Of the environmental targets published by companies within the broader FTSE group, a number should be revised and republished, as they have either outlived their target date, not stated dates for their target at all (e.g. "Reduce energy use by 5%"), or not stated a baseline year (e.g. "Reduce total direct CO2 emissions by 5% by 2012").
- With growing stakeholder and investor interest in environmental sustainability, it is likely that many large organisations will come under more pressure to publish targets in the near future.
- Most companies that have set good quality environmental targets declare between one and five targets each. Nine companies have set more than five, led by M&S, Unilever and Kingfisher.

Figure 1 *FTSE 100 – Number of targets per business*



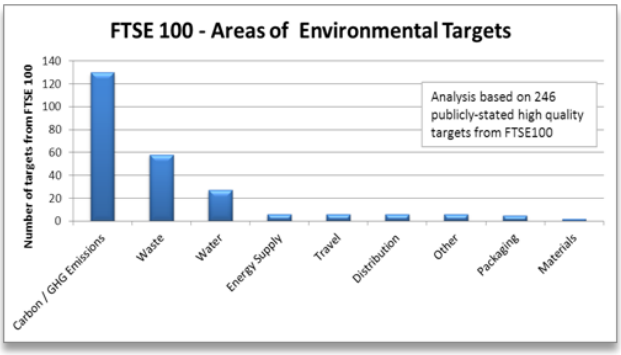
- Well over half of the timebound targets identified (55%) are short term, dealing with timeframes from 2011 to 2013 and indicating that companies are looking to make rapid environmental progress. However, it is useful to note that a significant proportion of targets (22%) have timeframes to 2018 or beyond. This suggests that some businesses are increasingly setting a longer term sustainability roadmap against which to shape future business strategy.
- A key example of longer term thinking is Unilever, whose CEO Paul Polman has gone on record praising the pursuit of longer term shareholder value as a business model. He said: "I discovered a long time ago that if I focus on doing the right thing for the long term to improve the lives of consumers and customers all over the world, the business results will come."

Figure 2 *FTSE 100 – Timeframes for existing targets*



- Analysis of the 240+ good quality targets set by FTSE 100 companies shows that 53% of these targets relate to carbon, greenhouse gas emissions or energy reductions (representing 59% of the FTSE 100). It is also encouraging to see 26% of FTSE 100 companies setting targets to reduce the environmental impact of waste and 22% setting targets to reduce water use.
- Only Kingfisher has a target to directly drive revenues from Eco products, although where organisations have targets to improve the resource intensity of their products and services (or more generally market their green credentials), this may also lead to increased revenues.

Figure 3 *FTSE 100 – Areas of Environmental targets*



Experiences of the exemplars

Through its work with many organisations over the last decade, the Carbon Trust has built up a strong understanding of what it takes to be a leader in setting environmental targets, and of the opportunities and challenges that come with that position. Carbon Trust Advisory Services is currently helping several companies in this regard. This section combines our experience with the views of six companies we have identified as being among the exemplars in target setting targets. The companies that contributed their opinions to this section were British Land, BSkyB, BT, Diageo, M&S and Unilever.

Benefits of strong environmental targets

In December 2010, the Carbon Trust surveyed 200 senior leaders at large UK companies (employing 1,000 people or more) about their attitudes towards the growth of the green economy. When asked about the benefits that green growth could bring – or is bringing - to their business, the most popular answer was “enhanced green reputation”, cited by 75% of respondents.

By contrast, far fewer (40%) saw “increased revenues” as a benefit and fewer still (30%) said “increased profits”.

Companies that are setting the most ambitious environmental targets are likely to be among this more visionary 30%. The leaders in terms of target setting are looking beyond the obvious and relatively rapid benefits to corporate reputation, and using stretching environmental goals as a catalyst to generate longer term returns to the bottom line and share price.

The six exemplar companies we interviewed for this paper are clear that their sustainability programmes - of which their environmental targets are a crucial part - are not defensive strategies to shore up reputation, but proactive business-building initiatives designed to enable their organisation to grow and prosper in a changing world.

"Our targets enable us to develop strategies which provide us with lasting business benefits and competitive advantage."

British Land

"We are not setting these targets for unquantifiable reasons. We are doing it because we want to drive business value."

Diageo

"We are playing to win here and we are being very positive. We believe we can grow faster and save money by pursuing this agenda."

Unilever

Other benefits of setting and implementing robust and aspirational environmental targets include:

- **Preparedness for future regulation**. Environmental regulation is likely to get tougher. Having the tools, systems and governance in place ahead of future regulation provides significant cost and competitive advantages.
- **Mitigating business risks**. E.g. by minimising exposure to raw material price volatility, improving energy security or being more operationally resilient.
- **Saving bottom line costs**. Cost reductions are not limited to energy but also include savings on resources, operations and distribution. Sustainability helps to streamline business processes e.g. M&S is saving £50m per year through Plan A.
- **Business focus and accelerated product innovation**. Alongside short and medium term targets for immediate action, setting longer term targets will help to create innovation leading to new product and market opportunities.
- **Influence with policy makers**. Taking a leadership stance is seen to give businesses a stronger voice and position when engaging with policy makers.
- **Winning or keeping B2B business**. Increasingly organisations in the B2B supply chain are placing sustainability requirements on their own suppliers. BT, for example, has recently implemented a stringent green procurement policy. In this context, strong green credentials are likely to become a prerequisite for winning or holding on to business.
- **HR and talent retention**. Employees recognise that a company that sets ambitious environmental targets is serious about addressing sustainability. This makes it easier for such organisations to attract and retain talent.
- **Reputation**. Setting transparent and robust targets adds credibility to an organisation's sustainability claims, enabling them to be held to account. External verification of performance against some of these targets may be used to further enhance reputation, for example, by the 40% of the FTSE 100 who have achieved the Carbon Trust Standard for emission reduction.

"Green targets allow us to look at product innovation in a very different way … that has been a key benefit to the business."

Unilever

Consumer demand for greener products and services is not seen as a key driver at the current time. A number of leading companies believe that most consumers are not yet at the point where they are willing to pay a price premium for green products. Some businesses are also sceptical that awareness of their sustainability activity has achieved meaningful consumer cut-through or has driven increased consumer sales. Yet this trend may start to change with consumers increasingly expecting business to show leadership on emission reduction.

Interestingly, there is increasing evidence that corporate customers in business-to-business transactions are starting to ask more about environmental credentials.

"Our government and corporate customers are aware of our targets – evidence of our corporate responsibility and sustainability policies and achievements… in 2009-10 influenced bids and tenders worth a potential £2.1 billion."

BT

"Customers are in fact incredibly important because they are driving this agenda… the likes of Tesco and Walmart, global customers of ours who are hugely important to us."

Diageo

Specific challenges to be managed

- **Legislation**. Fluid or inconsistent regulation across geographies can have major and wide ranging impacts on a business' sustainability strategy, affecting both the long and short term agendas. At the same time, governments are expected to take increasingly stronger measures to require business to act on sustainability, creating even more demanding operating environments. Organisations in industries where regulation is currently relatively "light touch" may experience something of a culture shock with increased legislation around sustainability, and may be unprepared to deal with it.
- **Decoupling growth from environmental impact**. Large businesses need to grow in order to enhance future value. Absolute environmental targets linked to production are therefore challenging, and achieving them requires significant innovation.
- **Acquisition**. Bringing newly acquired companies under the corporate umbrella can be difficult as sustainability track records and reporting mechanisms are seldom in harmony with the parent.
- **Outsourcing**. There may be a win to make short-term reductions in emissions in a particular geography. However, it may in fact have a detrimental effect on the end-to-end lifecycle emissions of an organisation's overall impact on the environment.

Broader trends to be considered

- **Product lifecycle**. Companies will increasingly be held responsible for their products from cradle to grave. They will need to find ways to minimise the environmental impact not only from production and packaging, but also from use and end-of-life treatment.
- **Water**. Leading businesses say that minimising water consumption is already a major issue for them and this will become increasingly important – especially where their supply chain sources from areas with water scarcity.
- **Energy supply**. Concern over the future security of energy supply is driving innovation and leading businesses are looking to generate their own energy to mitigate this risk and to reduce costs.
- **Balancing**. Sustainability issues are interlinked in a complex mesh of choices and decisions. Businesses must understand the big picture impact of their actions in order to make balanced choices and not get stuck in introspective decision making. For example, a superficially sensible emissions reduction target may have an unintended consequence on other wider areas of corporate social responsibility.

"One thing that is very clear to us is that sustainability is a balancing act. Whatever you do in one place affects another."

M&S

"None of us can say for sure what the future will be like, only that it will be hugely different. The only parts of it we can predict are that we will be short of water, short of food and carbon is going to cost. So we must prepare for the new world order now."

Unilever

The importance of leadership

Vision and leadership from the top of an organisation have long been accepted as essential ingredients for progress in sustainability. All companies interviewed for this paper confirmed unequivocal CEO support for their sustainability agenda either directly or indirectly. In some organisations, such as BSkyB in the case of James Murdoch, the environmental mission has been led in the boardroom by the CEO themselves. In others, the CEO plays an active supporting role.

However, in all cases there is a board representative for sustainability. All interviewees agreed that their dynamic stance on sustainability could not have been adopted without a genuinely committed board level champion.

"We could not have done without the very active support of the CEO."

Unilever

"Our board actively support and champion sustainability which makes it an integral part of the way we do business."

British Land

"Sir Mike Rake, our Chairman, owns our Environment Policy… Our energy consumption targets are set by the BT Operating Committee, chaired by BT CEO, Ian Livingstone."

BT

Key advice for setting high quality targets

- Set short term as well as medium and long term targets. The long term goal and vision is crucial, while shorter term targets act as stepping stones which focus the business, and make sustainability an issue for the present day.
- Build the business case: celebrate successes and demonstrate value to all stakeholders to bring them on the journey.
- Set stretching targets: you'll be surprised at what is achievable.
- Act quickly: once the decision is made to go down a sustainability path it is important to get moving. Having sustainability on the agenda for a long time with limited action increases apathy.
- Collect data: build a baseline and have robust reporting mechanisms in place. If you do not know where you are, you cannot assess progress and determine where you want to be tomorrow.

"Plan A will be very out of date in five years' time, it will be old hat and we will have to move on in great strides."

M&S

Appendix

What should environmental targets be measuring?

Most corporate environmental targets focus on reducing the natural resources used in the company's direct operations. From a carbon emissions perspective, they are likely to be based around direct emissions to air (e.g. gas for heating, petrol/diesel for vehicles) – known as 'Scope 1' emissions, and the use of grid electricity – 'Scope 2' emissions. As Scope 1 and 2 emissions are controlled by the organisation, these are a natural area to focus on initially, as it is likely to be more straightforward to build a business case around investing to make the reductions and accruing subsequent savings and benefits.

Most organisations are also aware that their environmental impact stretches beyond their own operations and into areas such as their supply chain and customer/consumer use of their products and services. In carbon emissions terms, these areas are known as 'Scope 3' and include emissions associated with: purchased goods and services; capital goods; non Scope 1 and 2 fuel; transport and distribution; waste generated in operations; business travel; employee commuting; leased assets; investments; processing of sold products; use and end-of-life treatment of sold products; and franchises. In addition to an emissions view, reducing the actual use of water and other resources may also give rise to significant efficiency opportunities.

Beyond emission reduction targets, leading companies are seeking to exploit revenue generating opportunities from the low carbon economy and are sufficiently confident of success to have set targets accordingly. For example, Kingfisher plc (trading as B&Q and Screwfix in the UK) has a target to grow sales of Eco products by a further 4.4% in 2010/11 (they already account for 10% of sales). Globally, GE's Ecomagination products and services generated $18bn revenue in 2009, with a commitment to increase them at twice the rate of their overall revenue growth over the subsequent five years. And Siemens' 'environment portfolio' is targeting €40bn in revenues by 2014.

How should environmental targets be structured?

Broadly, there are two ways to structure environmental targets – either an absolute reduction (a specific positive environmental impact) or intensity reduction (relative to quantity or volume produced), and each can then be set either as a numeric target or as a percentage change on previous or benchmarked performance.

Table 1: *Absolute versus relative targets*

Absolute reduction target	Relative intensity target
e.g. reduce emissions by 30% (15,000tCO_2e) between April 2011 and March 2015	e.g. reduce CO_2 emissions by 30% (15g) per product manufactured between April 2011 and March 2015
Benefits:	Benefits:
• Easier to link to the absolute reductions (e.g. for carbon emissions) which are often required by national and EU targets	• Helps drive environmental efficiencies into the business, whilst still growing output volumes, returning clear value to shareholders
• Easier to understand in terms of its actual positive impact on the environment, so may be more suitable for engaging with certain stakeholders, e.g. consumers	• Carbon intensity 'per unit of revenue' in particular can drive longer term business innovation, e.g. by transitioning from a product to a service to meet an equivalent need in a more environmentally beneficial way

The choice of which approach is more useful is not straightforward and we recommend that a balance between both is adopted. Only stating an absolute reduction may make some shareholders nervous of the ability of the organisation to grow – and mere intensity metrics may open up an organisation to accusations of greenwash.

On the face of it, absolute targets can be easier to meet during an economic downturn, when output declines, and harder during a growth cycle. Relative intensity targets per unit revenue might become tougher in a recession where revenues fall, but other measured elements do not drop proportionally, e.g. energy use in a commercial buildings portfolio. To succeed in the long term, businesses need targets which can weather positive and negative economic cycles, which implies long term planning with robust absolute targets as part of the mix. A number of organisations have demonstrated that it is possible to grow successfully while at the same time meeting strong absolute reduction targets. Stretching absolute targets can themselves benefit the business by being a catalyst for breakthrough innovative thinking.

For most organisations, a 'per unit of revenue' carbon intensity metric can provide a powerful mechanism to incentivise growing a business in a more environmentally beneficial way. Being relative to the overall revenues of an organisations is useful, as this allows for creative ways to achieve the target, such as introducing business model innovations, revising the product portfolio to be less energy intensive, or offering a compelling proposition to consumers based on a service rather than products (e.g. hiring or rental).

An alternative intensity metric is measured as 'per unit of production'. For the majority of businesses, although this may lead to more efficient production, it does not address the volume of products sold and may inadvertently lead to an increase in absolute emissions. Sector-specific interpretations of this approach include:

- Manufacturing – emissions per unit of production
- Property-related (hotels, commercial property, retail) – emissions per square metre of space
- Service-based sectors (financial services, professional services) – emissions per employee

About the research

The analysis of the FTSE 100 was a desk-based exercise, conducted in April 2011. It relied exclusively on publicly available information from each organisation's website and/or online CSR report. The adherence of targets to our chosen framework was subjective with the aim of highlighting best practice. Different frameworks or approaches to target setting may be suitable for some organisations (e.g. if they fit better with company culture).

Although there may be other organisations in the UK who have strong environmental targets (e.g. privately owned, listed overseas, smaller organisations), the FTSE 100 was considered a useful representation of organisations to identify how published targets were being set.

As engagement is considered so important, Carbon Trust Advisory Services only considered targets which were stated on the company website and/or online CSR Report. We immediately excluded published targets whose end date has already passed (e.g. a 10% reduction in carbon emissions by the end of 2010), as they were no longer current.

Advisory Services at the Carbon Trust

Carbon Trust Advisory Services is a team of in-house experts on business and sustainability, dedicated to delivering growth to our large business customers, through understanding and addressing the strategic issues raised by climate change. We focus on: the impacts of climate change on our customers' businesses and brands; strategic and operational planning that delivers clear business benefits from early action; and maximising the cost reduction potential of our customers' resource use.

We offer a specialist service to businesses to review corporate environmental targets and compare them against competitors and sector leaders. We help organisations develop a robust carbon strategy, which can help define appropriate targets, helping an organisation be transparent in its engagement with stakeholders.

This paper was written by Richard Waters, a Principal in the Advisory Services team.

The Carbon Trust Standard

The Carbon Trust Standard recognises organisations for real carbon reduction. Based on a rigorous, independent assessment, it certifies that organisations have measured, managed and reduced their carbon emissions across their own operations, and are committed to reducing them year on year. Over 500 organisations have achieved the Carbon Trust Standard since it was launched in June 2008.

For more information or an initial discussion, please email businessadvice@carbontrust.com or call +44 (0)20 7170 7000.

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