Managing integrity and innovation for sustainable performance

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Linking sustainability, innovation and integrity is a key to creating a successful company. This article examines why putting "integrity + innovation" into practice creates value, takes a close look at how the best-performing companies create sustainable solutions with integrity and innovation, and shows how other companies can learn from the leaders.

What do retail giant Marks & Spencer, telecommunications behemoth BT, healthcare specialist Novo Nordisk and global banking leader HSBC have in common? They deliver sustainable performance in competitive and fast-moving sectors not only through a strong brand and careful management but also through an intense focus on integrity and innovation. They demonstrate integrity, evidenced by clear principles that they consistently fulfil in the business as a whole. They also excel at innovation, turning their promises into creative action, in line with these declared principles, to meet their stakeholders' needs and expectations in sustainable ways. In other words, they convert their commitments about integrity into hard reality, i.e. products and services that customers are willing to pay for.

For example, healthcare company Novo Nordisk has developed a holistic view of balancing concerns for all its stakeholder groups with considerations for the environment and a view to long-term profitability. Focusing its efforts on the people who use its healthcare products – predominantly diabetes-related – the company's engagement with healthcare workers, government, international organisations and experts has led to a radically different model of therapy. This model recognises that each person with diabetes deals with a different set of circumstances. As a consequence, the majority do not achieve full health and quality of life despite the effectiveness of the therapies available. By leading the drive towards improving access to therapies, through its involvement in national diabetes programmes in 46 countries around the world and its DAWN programme uncovering diabetes attitudes, wishes and needs among people with diabetes and healthcare professionals, Novo Nordisk is visibly realising its publicly stated aspiration to be world leader in diabetes care, while generating a multitude of opportunities for next-generation innovation.

This article first explains why putting "integrity + innovation" into practice creates value. We then provide a number of specific examples of companies that are doing so. Finally, we explore how companies can actually measure and report on their "integrity + innovation" performance.

Why 'integrity + innovation' creates value

Jargon around issues of corporate governance, corporate responsibility, social responsibility, corporate citizenship, corporate accountability, sustainable development and triple-bottom-line management abounds. But the often-confusing plethora of terms does little to help corporate leaders to identify the principles, policies, actions and metrics they need to build more sustainable businesses.

In our view, the debate boils down to managing integrity and innovation, by which we mean the following:

Both integrity and innovation are intuitively connected with improving the overall performance of a business, and the sustainability of that performance, because both are inherent in the major routes to sustainable performance: cost reduction, risk reduction, creation of new opportunities and building stakeholder support.

- Integrity: a person or company with integrity is one that doesn't let stakeholders down. Promises made become promises delivered. Stated business principles are fulfilled consistently as an integral part of decision-making, as opposed to managing "corporate social responsibility" as an additional business activity.
- Innovation: innovators find successful new ways to create value in response to the changing needs of markets, societies and the environment. Strong innovation capability is characteristic of individuals or organisations that constantly deploy new, improved ways to deliver what they promise to their different stakeholders.

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The business value of innovation is well recognised. Most leading companies emphasise their innovation focus and strengths in external communication and for internal motivation. Although notoriously difficult to measure, the premise that effective innovation creates company value – in terms of additional sales or profits – is now generally taken as a given. Research by Arthur D. Little has shown that innovative firms achieve on average a six-times-higher EBIT margin, and a growth rate that is 13 per cent higher, than the underperformers.

Leading companies also understand the importance of being seen to be innovative, because a reputation for being innovative enhances a company's reputation – among investors, customers, business and government partners, staff and target recruits – and thereby generates additional value.

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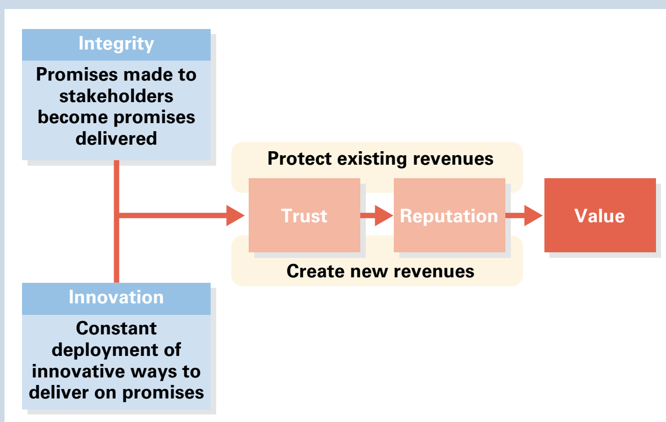
Less well recognised is the value created by integrity. But the logic is similar. Integrity breeds trust; trust creates a good reputation; and, once again, reputation builds value (see Exhibit 1). Recent years have produced a much greater focus, among companies across all sectors, on winning and keeping the trust of their stakeholders. This focus at least partly reflects growing public awareness about, and rising expectations of, corporate ethics – in both developed and developing economies.

Exhibit 1 **Value through integrity + innovation**



Source: Arthur D. Little Analysis

Breaches of trust can be severely punished, as, for example, British gaming group Wembley plc found when its share price plunged following the announcement that it was facing charges in the US for allegedly trying to influence public officials. Similarly, the Consumer Federation of America and Bank of America noted that 42 per cent of individual investors were less likely, after the Enron scandal, to invest because they felt mistrust and powerlessness over CEOs. Other high-profile examples of recent years that show how costly – and even economically fatal – loss of integrity include WorldCom, Adelphia Communications, Tyco, Ahold, Dynegy and Global Crossing.

There are also positive drivers towards broader reporting criteria and greater investment in sustainable company practices. As an earlier Arthur D. Little report (The Innovation High Ground, pp. 9-27, Prism/1/2005) showed, leading companies are using sustainability-driven innovation to create real business value. US conglomerate GE has reported a doubling of sales of its Ecomagination range of "green" products and services to $12 billion in two years. Around the same time, Citigroup announced investment of $50 billion over 10 years in environmental projects and IBM pledged to spend $1 billion a year on similar projects.

Responsible behaviour by companies is not new. Financial services provider Friends Provident was founded by Quakers in the first half of the 19th century, and these roots continue to inform its management ethos.

While all this activity is taking off, the familiar competitive pressures of business are not going away. Instead, they continue to mount, compelling companies to keep finding new and better ways to deliver the goods and services that society wants more efficiently and profitably. Increasingly, outstandingly successful companies in specific sectors and in the global marketplace appear to be those where both integrity and innovation are "the way we do business", rather than adjuncts to day-to-day corporate working, relegated to a compliance committee or an R&D department head. Let's have a look at a couple of specific examples.

Successful examples of 'integrity + innovation'

Responsible behaviour by companies is not new. Financial services provider Friends Provident was founded by Quakers in the first half of the 19th century, and these roots continue to inform its management ethos. Long before Socially Responsible Investment (SRI) became a buzzword, Friends Provident had established its Stewardship ethical fund range, encouraging investee companies to espouse similar values regarding ethical, social and environmental standards. Having grown steadily for over two decades, these funds topped £3 billion by the end of 2006.

One much more recent example is Deutsche Telekom, which has undertaken a strategic overhaul of its processes and operations to establish a more sustainable supply chain. The company recognises in this transformation the potential to deliver cost and risk reduction, create opportunities for profitable innovation and build stakeholder support and advocacy in a sector under increasing pressure on many fronts: health and safety, labour and employment, environment and ethics.

Another global telecommunications player has focused specifically on the innovation opportunities in sustainable development, identifying, quantifying and pursuing new technology solutions that will enable its customers to increase the effectiveness of their own contribution to a more sustainable world. This company's approach to sustainability and responsible business has gained it recognition as an international leader – customer feedback confirms that its approach has contributed to an increased win rate with new business bids, amounting to about $1.8 billion.

Vodafone has created a space where new products and services can be systematically identified, selected and piloted with the goal of delivering some explicit social or environmental value. Its mobile payment services – using mobile phones as a delivery channel for microfinance services to communities normally excluded from banking – have proven the viability of mobile-based services that significantly reduce transaction costs. At the same time, the communities have gained affordable, safe, convenient and efficient access to a wide range of services, such as loans, savings, withdrawals, funds transfer and electronic payments.

Computing infrastructure provider Sun Microsystems has identified business opportunities in energy efficiency and resource efficiency. By seeking ways to help customers to reduce power consumption and the space needed for computer servers, Sun has developed processor technologies that deliver substantial energy savings to its customers. At the same time, its integrated approach to design for the environment has ensured that 99 per cent of materials in the company's take-back schemes for unwanted equipment retain some follow-on value; only very limited amounts of material are sent to landfill. There is concrete evidence that customers buy Sun products because of their environmental performance.

Meanwhile, IBM's sustainable product stewardship programme has saved the company about $11 million in packaging materials and distribution. BASF, a major chemicals group, has achieved substantial cost savings and environmental benefits through the "Verbund" initiative, involving exchange and sharing of a range of resource and "waste" streams between businesses.

Integrity and innovation therefore can and should be classified as corporate assets. And they need to be managed coherently as such. One of the steps inherent in the process of managing any asset is its measurement and evaluation.

As the influence of the European Union on national environmental policies grows, the Dutch Ministry for Housing, Spatial Planning and Environment (VROM) is working with the nation's industry to establish greater clarity on long-term perspectives for environmental requirements, possible solutions and costs. As well as enabling Dutch companies to respond effectively to legislation that may be introduced in the future, this collaboration creates a basis for environmental innovation that will reduce costs associated with managing pollution and create opportunities to export know-how developed in the Netherlands.

Measuring 'integrity + innovation' performance

The above examples provide intriguing evidence of increased corporate value where integrity and innovation have come together in leadership strategies. Integrity and innovation therefore can and should be classified as corporate assets. And they need to be managed coherently as such.

One of the steps inherent in the process of managing any asset is its measurement and evaluation. As noted above, there is still considerable debate about how innovation is best measured. The concept of evaluating corporate integrity is even less established, even though the number of companies issuing reports in accordance with the Global Reporting Initiative guidelines – incorporating social and environmental with financial performance information – rose from 20 to over 1,000 between 1999 and 2006.

Evaluating innovation is as complex as evaluating integrity. However, more than a century's experience in innovation management has enabled us at Arthur D. Little to develop rapid and intense assessment tools that help companies to establish a clear vision at board level of how becoming more innovative will raise the corporate performance.

However, there are tools and techniques available. We have had considerable success with several clients seeking to evaluate the integrity of their leadership team and corporate relationships. For example, when a major UK government department undertook a nationwide reorganisation during a time of intense activity, our diagnosis of the principles, values, governance and accountability factors helped to realise the reorganisation with lower functional costs and increased service performance, while retaining goodwill.

In the private sector, a multinational oil company requested our assistance when it was seeking to reduce the costs of friction between the corporate centre and privately owned retail operations. Our evaluation of the ethical nature of their relationships, and resulting recommendations, led to reduced legal costs, increased retail revenue and greater cooperation to increase innovation and competitiveness.

Evaluating innovation is as complex as evaluating integrity. However, more than a century's experience in innovation management has enabled us at Arthur D. Little to develop rapid and intense assessment tools that help companies to establish a clear vision at board level of how becoming more innovative will raise the corporate performance. Our approach imparts a deep understanding of the barriers to innovation and the actions needed to overcome them. Our innovation audit culminates in agreement on how much potential for increase in the value of the business is available through adding innovation capacity, and this becomes a measurable target for senior management.

The research we currently have under way is designed to take our understanding to the next level, through the connection between innovation and integrity – which can be summarised, in a sense, as "living the positioning". The research passes on a number of key performance indicators on both the integrity and innovation dimensions. Indicators in the integrity dimension include:

- Is there evidence that the business operates to a set of business principles, guiding strategic planning and decision-making and visibly endorsed by senior management?

- Can the business demonstrate that it is actively engaging with its stakeholders, identifying and prioritising material issues and setting goals to address these issues?

- Is there clear evidence that the company consistently fulfils the promises set out in these principles and goals – i.e. is it delivering on its performance commitments?

Indicators in the innovation dimension include:

- Is the company targeting its innovation effectively, deploying innovative business models meeting requirements to manage complexity (product portfolio, customer segment, brand variety)?

- Can the business demonstrate that it is innovating effectively, including resource planning and development, idea management and product development?

- Is the company effective in identifying possible future societal requirements, including the availability, performance and applications of technology?

Insights for the Executive

Sustainability issues continue to emerge. As customer choices and societal expectations change in response to these issues, the competitive playing field is changing – fast. There is considerable confusion as to how business should respond. Media scrutiny of corporate behaviour and alleged "double standards" is widespread and condemnatory, to the extent that some companies hesitate to make necessary decisions and take necessary actions for fear of falling foul of the press.

However, the way ahead is becoming clearer. Our work with many of the leading high-performing businesses highlighted in this article has helped us to identify the shared characteristics that make these firms leaders in sustainability, sector by sector. What they have in common is an intense focus on integrity and innovation. They don't let stakeholders down – promises made become promises delivered. And they constantly deploy innovative ways to deliver what they promise to their different stakeholders.

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