



# Business as Change Agent: Wal-Mart pioneers sustainability strategy

Frank Dixon

FRANK DIXON, principal of [Global System Change](#), advises governments, nonprofits and businesses – including Wal-Mart – on sustainability, system change and enhancing financial performance through increased corporate responsibility.

ON 24 OCTOBER 2005, WAL-MART CEO LEE SCOTT GAVE ONE OF THE MOST IMPORTANT BUSINESS SPEECHES EVER. In it, he committed one of the largest companies in the world to sell sustainable products, make zero waste and use 100% renewable energy.

The implications are huge and not just because Wal-Mart is huge. The company's ambitious goals cannot be achieved without systemic changes that are at least partly beyond the company's control – changes to supply chains, regulations and consumer awareness, to name a few. By addressing these challenges, Wal-Mart is pioneering what may be the first large-scale strategy that has the potential to achieve full sustainability.

Any full sustainability strategy must acknowledge the systemic forces that all but compel companies to negatively impact society. This article makes clear

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what those forces are. It also describes why sustainability will be *the* competitive advantage strategy of the 21<sup>st</sup> century. Finally, we'll see how Wal-Mart is translating those forces into opportunities for competitive advantage.

## Understanding the role of systems

All companies produce negative environmental and social impacts. As the world's largest company, Wal-Mart is highly visible for its environmental and social impacts. Several activist efforts have arisen in response to the company's impacts, including the film *Wal-Mart: the High Cost of Low Price*. Activist efforts have no doubt influenced Wal-Mart's decision to adopt an aggressive sustainability strategy.

Many of the environmental and social improvements over the past 50 years were initiated by such activist campaigns. Companies can improve in many ways, and activist pressure can effectively encourage such improvements. However, achieving sustainability probably requires that activist efforts focus on systemic issues as well. Individual companies cannot fully mitigate many of their impacts because overarch-

ing economic and political systems make it essentially impossible to do so.

To illustrate, criticisms of Wal-Mart made in *Wal-Mart: the High Cost of Low Price* could be made of many other companies. But because Wal-Mart is so large, it receives blame for larger systemic problems as well. For example, the decline of small-town America began long before Wal-Mart opened its doors. The vast majority of small US towns in decline don't have Wal-Marts. To be sure, the spread of chain stores contributes to the closing of local businesses, but this dynamic is not Wal-Mart's doing. Wal-Mart is simply the most successful at playing by the current rules of the game, rules that largely do not account for the closing of small businesses and the many other negative impacts of chain stores.

The much larger driver of the demise of small-town America, as well as nearly every other environmental and social problem, is our society's embrace of a system that does not adequately balance economic with other interests. Failure to focus on this creates frustration for all and ensures little progress in protecting future generations. No CEO wants to hurt society or leave a legacy of environmental destruction. Most CEOs want to enhance society by ensuring that their companies provide maximum value to customers.



There is no lack of good intention. Business leaders usually are trying to do the right thing in a system that often compels them to do the opposite. For example, we might encourage business leaders to focus on five things – the environment, children, employees, communities and shareholders. But then, we measure performance (and set rewards) for only one thing – taking care of shareholders. Business leaders understand that they could be fired and possibly sued if they put anything ahead of the interests of shareholders. This system of placing shareholders before all else guarantees that all other concerns take a backseat.

On the upside, mitigating negative impacts and acting more responsibly can enhance profitability and provide many business benefits – up to a point. Beyond that point, impact mitigation increases costs and weakens competitive position. If a company seeks to mitigate too many negative impacts, it will put itself out of business. In other words, companies violate their responsibility to shareholders if they try to mitigate all of their negative environmental and social impacts. Current economic and political systems unintentionally create a situation where corporate survival often demands that companies degrade the environment and society. Over the long term, this also will degrade business because businesses cannot survive without the environment and society.

Nearly all efforts in the corporate sustainability movement have focused on perhaps 20 percent of the problem – company-level issues such as reducing pollution, making safe products, taking care of workers, acting responsibly in developing countries, and so on. However, 80 percent or more of the unsustainability problem probably relates to the system level. If rules were changed in a practical and reasonable way that held companies fully responsible for the cost of negative impacts, then companies would act in a fully responsible manner because this would be the best or only way to maximize shareholder returns.

No doubt, activist efforts provide a valuable service to society by pushing companies to act more responsibly. However, when activists blame companies for impacts that essentially are systemically mandated and thus beyond the control of companies, everyone gets frustrated. Business leaders try hard and want to do better, but can't. Activists want more progress, but don't get it.



The fact that companies cannot mitigate many of their impacts does not absolve the corporate sector of responsibility. A more practical approach to sustainability is to shift some of the focus from corporations to systems. As companies recognize that systemic issues force them to damage society and the environment, they have an obligation to work for system change.

Activist efforts can be more effective by simultaneously working on two fronts: (1) encouraging companies to mitigate impacts wherever possible and (2) encouraging them to work for system change whenever impact mitigation is not possible.

To ensure the survival and prosperity of current and future generations, system change must become a major focus of business, government and civil society.

## Changing systems

Evolving economic, political and social systems in a way that maximizes the well-being of current and future generations is by far the most difficult challenge facing business and society today. There are no easy answers – probably no single person or group knows how to do it. Effective solutions only can be developed in a collective, collaborative manner.

Three principles or capacities can support system change efforts – systems thinking, responsibility and an orientation toward practicality.

**Systems Thinking.** Einstein said we cannot solve our problems with the same level of thinking that created them. Existing economic and political systems were developed from a reductionist perspective that does not take the whole system into account. Because these systems ignore relevant issues, they are inherently flawed. Evolving them in ways that eliminate conflicts

between the interests of business and the interests of society is a hugely complex task – but it is the only way.

Humans are surrounded by an almost infinite level of complexity, in our bodies and in nature. Being part of nature, we have the capacity to operate at a much higher level of complexity and sophistication than that shown in our current economic, business and political systems. The question is not, “Can we do it?”, but rather, “Can we develop the will to do it?”

Reality will greatly assist in this area. If we don’t find ways to voluntarily abide by the laws of nature, nature will force us to comply. Environmental and social problems are manifestations of humanity’s failure to think and act systemically. As these problems increase, pressure to think systemically and evolve our systems into sustainable forms also will increase.

**Responsibility.** There are many different economic-, political- and social-system flaws that compel companies to operate unsustainably. Most of these could be rolled up into one overarching system flaw – the failure to hold companies fully responsible for their negative impacts on society. In a competitive market, companies cannot mitigate impacts completely. Costs would become too high relative to companies that were not fully mitigating. Only when all companies are held fully responsible will sustainability and full responsibility be a viable option in a competitive market.

**Practicality.** Holding companies fully responsible will be difficult. Quantifying impacts, especially longer-term intangible impacts, is difficult, and existing regulations already are burdensome. Altering large, entrenched economic and political systems could be destabilizing to society if it is not done well. Finding practical, reasonable, incremental ways to hold companies more responsible over time is critical to success. For a systems-change strategy to work, it must respect and operate within existing systems. Evolution is more practical than revolution. On the corporate level, practicality means understanding and respecting that change efforts must be profit-enhancing or, at worst, profit-neutral. An approach called Sustainable Systems Implementation ([www.GlobalSystemChange.com](http://www.GlobalSystemChange.com)) provides a practical, profit-enhancing method of driving system change through collaborative efforts.

## Sustainability and competitive advantage

The sustainability movement includes corporate, activist and other efforts to ensure that future generations are able to survive and prosper. The movement has been growing rapidly in response to increasing environmental and social concerns. In the social area, technological advances, economic expansion, and increasing media and Internet access provide many benefits, but also dilute and disrupt traditional ways of life. Combined with population growth, a widening gap between rich and poor, and other factors, these changes are fueling social distress and turmoil in many regions.

Environmentally, population growth and rising living standards are driving rapid depletion of the world's finite resources. Increasing pollution and resource consumption have challenged nearly every life support system – clean air, clean water, forests, fisheries, wetlands, topsoil, aquifers, biodiversity, and so on.

Industry produces over 80,000 synthetic chemicals. Only a small percentage of them have been tested for safety by independent third parties. Basic physics tells us that many of these chemicals will disperse into the land, air and water, and then accumulate in humans. The human body did not evolve in the presence of these chemicals. As a result, many of them are contributing to increasing cancer, reproductive problems and other illnesses.

Carbon emissions from human activities (mainly the burning of fossil fuels) have increased atmospheric carbon to more than 30% beyond any level seen in the past 400,000 years. Carbon and other emissions drive climate change and pose great risks to society.

Business provides many benefits to society, but also plays a major role in the decline of environmental and social conditions. Historically, many of the negative environmental and social impacts of companies were difficult to identify and quantify. As a result, companies often were not held responsible for impacts. Now, as the scale of human activity increases in the finite global system, impacts are more obvious and companies are under growing pressure to assume responsibility for them. This pressure can take the form of increasing regulations, lawsuits, market rejection and activist campaigns.



Growing pressure to assume responsibility for negative impacts is making environmental and social issues more financially relevant to companies. Increasingly, companies that are more proactive than peers in addressing these issues gain many benefits, including enhanced reputation and brand value, increased ability to attract and retain a high-quality workforce, improved employee morale and productivity, better product and service quality, reduced energy and material costs, lower finance and insurance rates, enhanced community and stakeholder relations, and facilitated access to resources and new markets – all combining to yield enhanced profitability, market share and competitive position.

As the world in effect becomes smaller, the ability to think systemically and act responsibly will become the primary driver of business success in the 21<sup>st</sup> century.

### Wal-Mart's sustainability strategy

Environmental and social problems are becoming business problems, especially for a company of Wal-Mart's size. As the largest retailer of many types of products, supply constraints driven by environmental and social problems seriously threaten Wal-Mart's ability to survive and prosper.

Wal-Mart always has been a pioneer, going against conventional wisdom. It has anticipated market opportunities and executed effective strategies to capitalize on them. It has revolutionized supply chain, logistics and service to rural areas. Now Wal-Mart is capitalizing on the sustainability opportunity. By using business power to improve environmental and social conditions, it will enhance its own prosperity.

This approach is highly consistent with Wal-Mart's founding values. More than anything else, Wal-Mart's

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unprecedented success is driven by a strong and enduring commitment to providing high value and service to its customers. The focus on sustainability is an evolution of the company's values. It is the recognition that serving the customer goes beyond providing high-quality, low-cost products – it also includes doing so in a responsible and sustainable manner.

Since 2005, Wal-Mart has implemented an aggressive sustainability strategy which has made rapid progress due largely to the strong commitment of senior management and existing organizational capacity to implement new strategic directions. People are motivated, and compensation schemes are in place to support them.

Beneath the sweeping and ambitious environmental goals are a host of sub-goals and initiatives. Past and ongoing environmental goals and initiatives include:

- Double truck fleet fuel efficiency within ten years (which would save over \$300 million per year).
- Design and open a new store prototype that improves energy efficiency and reduces greenhouse gas emissions by up to 30% in these stores.
- Reduce greenhouse gas emissions from existing stores, clubs and distribution centers by 20%.
- Establish a US program that gives preference to suppliers who aggressively reduce emissions.
- Implement a China program that gives preference to environmentally-responsible suppliers.

- Aggressively pursue regulatory and policy changes that promote energy efficiency and renewable energy.

- Reduce solid waste from US stores and clubs by 25%.

- Work with suppliers to reduce packaging, increase recycled content, and expand recycling of packaging.

- Eliminate PVC packaging from private label brands within two years.

In the social area, past and ongoing initiatives include:

- Sourcing: establish independent monitoring of Wal-Mart's factory certification program; separate the factory certification and buying functions; cease doing business with supplier factories that fail to meet Wal-Mart's ethical standards; collaborate with industry, government and NGOs to improve sourcing in developing countries.

- Healthcare: make healthcare insurance available to all employees for \$23 per month or less and their children for \$15 per month; put healthcare clinics in stores for employees and customers; provide volume discounts on healthcare insurance to small businesses; collaborate with business, government and others on US healthcare reform with the goal of lowering costs by as much as 25%.

- Wages: supported an increase in the US minimum wage; continue paying market wages.

- Communities: enhance existing community engagement processes with the goal of building mutually beneficial partnerships and better meeting community needs.

- Diversity: increase the percentage of women and minorities in management; tie management compensation to achieving diversity goals; use Wal-Mart scale to assist and grow minority-owned businesses.

This is just the tip of the iceberg. Sustainability is not a separate initiative at Wal-Mart, as it is at many other companies. Sustainability is being inte-

grated into all parts of the business. Beyond its own operations, an analysis of Wal-Mart's environmental impacts revealed that about 90 percent of them occur in the supply chain. As a result, Wal-Mart has established business networks in several areas, including buildings, fleet, waste, packaging, food & agriculture, seafood, wood products, electronics and apparel. The goal of these networks is to work with suppliers and other stakeholders to drive substantial improvements in sustainability performance. Suppliers proactively working to improve performance have the potential to receive preferred access to Wal-Mart.

Wal-Mart has over 65,000 suppliers, and many are largely or completely dependent on the company for their continued success. Wal-Mart thus has unprecedented power to drive change in many industry sectors. It is seeking opportunities to use its scale to drive commercialization of more efficient technologies in various areas including transport, refrigeration, lighting and HVAC. The company's size and aggressive approach can help make sustainability a major focus of business in the 21<sup>st</sup> century.

In today's markets, the healthiest, most sustainable products, such as organic foods, often are too expensive for many consumers. Wal-Mart is working to make these products affordable for everyone. Through economies of scale, it plans to lower costs for many types of sustainable products. For example, it is placing large orders for organic cotton and requiring that all US shrimp farms supplying Wal-Mart receive third-party sustainability certification.

Probably the most important aspect of Wal-Mart's sustainability strategy is the willingness to address system change in a practical way. In the business networks, Wal-Mart and other network part-

ners consider systemic barriers to sustainability and develop practical ways of addressing them. Actions might include seeking regulatory change, raising public awareness, and working with suppliers to develop more sustainable products.

**WAL-MART'S UNPRECEDENTED SUCCESS IS DRIVEN BY A STRONG AND ENDURING COMMITMENT TO PROVIDING HIGH VALUE AND SERVICE TO ITS CUSTOMERS. THE FOCUS ON SUSTAINABILITY IS AN EVOLUTION OF THE COMPANY'S VALUES.**

Wal-Mart's pioneering approach to sustainability has the potential to lead the sustainability movement to a new level. By improving its own operations, forming business networks and addressing systemic issues in a practical way, the company is implementing what may be the first sustainability strategy that actually has the potential to achieve sustainability. ■■■

