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CONSUMER MARKETS

Measuring Up: Improving Sustainability in Consumer Markets

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The issue of sustainability is increasingly becoming top of mind for consumer markets businesses. Whether sustainable initiatives are driven by regulators, shareholders, employees, customers or even competitors, companies of all sizes and in a wide range of industries are rapidly adopting business practices that will help sustain both natural and human resources.

Reporting on sustainable practices is also becoming prominent on corporate agendas. Establishing sustainable business practices seems to be only part of the challenge in truly delivering on, and benefiting from, sustainability initiatives. Reporting, however, is undoubtedly a challenge in itself.

Complex supply chains that many retail, food, drink and consumer goods companies rely on make it difficult to track and measure the true impact that a company has on its environment. A lack of standard measurements, or benchmarks for the industry, make it seemingly impossible to derive consistent figures from a variety of suppliers to tabulate reliable results.

In addition to understanding *how* to measure, many companies are also challenged to even understand *what* to measure. Although for some industries the metrics or key performance indicators (KPIs) that should be tracked are more obvious than others, for many, the choice of which metrics to track can run into the hundreds. Finally, once companies do establish their systems for tracking and measuring their KPIs, they are then faced with the challenge of effectively communicating the results to a wide range of stakeholders, each with their own unique agenda.

Recognizing these and the myriad of other challenges that our clients face in this area, we embarked on a study of 132 of the largest consumer markets companies around the world, to compare the sustainability reports of companies in different sectors. Specifically, what metrics are most commonly reported on in each sector, what KPIs are being measured, how frequently and effectively targets are being used, and how companies are communicating and reporting their progress to their audience.

Our findings from this research and other recent relevant studies by KPMG are presented in this report. The goal is to provide consumer markets companies with greater insight into what their peers and other industry leaders are doing to develop best practices in terms of sustainability initiatives, measurement, and effective reporting.

We hope that you find this report useful, and we would be happy to discuss with you how your company can improve the effectiveness of your own sustainability programs and reporting practices.



Willy Kruh
Global Chair
Consumer Markets
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What is sustainability?

For purposes of this report, we define sustainability as: “The adoption of business strategies that meet the needs of the enterprise and its stakeholders today while sustaining the resources, both human and natural, that will be needed in the future.”



Specifically, when choosing among similar products, **55 percent** of consumers indicated they are more likely to choose a product that supports a certain cause, and **70 percent** say they are willing to pay a premium for that product.





Introduction

The trials of the last few years have put the need for sound sustainability practices into sharper focus. With consumer buying attitudes cautious and financial and commodity markets still turbulent, consumer markets companies face a tough business environment. Many have found that operating 'lean and clean' is no longer an option, but a business imperative important to preserving margins and advancing growth.

A recent KPMG publication, *Articulating the Value of Sustainability to Mainstream Investors*,¹ revealed that a growing number of drivers are advancing the management of Environmental, Social & Governance (ESG) factors up the investment agenda. ESG management is seen as a proxy for risk management, management quality, business reputation, and fundamental to the long-term performance of a company as well as enhanced long-term sustainable returns to investors.

Similarly, a survey by Penn Schoen Berland in February 2010 shows that despite the recent recession, three-quarters of consumers polled say that social responsibility is an important factor in their buying decisions.² Specifically, when choosing among similar products, 55 percent indicated they are more likely to choose a product that supports a certain cause, and 70 percent say they are willing to pay a premium for that product.

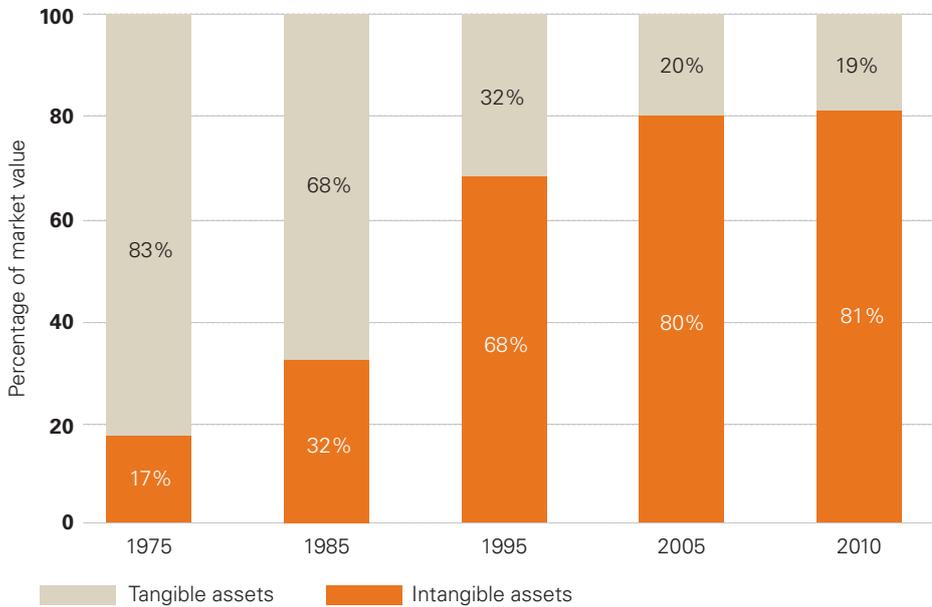
However, in order for consumers, investors and other stakeholders alike to make these types of informed decisions, a strategic integrated approach to managing sustainability is not enough. Companies must pursue greater disclosure of sustainability information to improve transparency of performance. This disclosure typically includes both qualitative and quantitative information. Common topics include "Social Responsibility" such as fair labor practices, and community contributions; "Environmental Impacts" on air, land and water; "Climate Change" policy on energy and carbon management; "Responsible Governance," including codes of conduct, sustainability strategy and policy framework, and "Environmental Innovation" such as approaches to use investment in technology to create innovative solutions to environmental challenges like pollution, scarcity of natural resources, and climate change.

Perhaps the strongest argument for implementing a solid sustainability strategy is the intangible impact on a company's market value. This is more important today than ever. Recent research indicates that a growing percentage of companies' value is comprised of its intangible assets (see Figure 1).³ Just a slight change in a company's reputation can have a significant impact on its market value by investors or lenders.

¹ Sustainable Insight - Articulating the Value of Sustainability to Mainstream Investors, KPMG International, January 2011

² "Corporate Social Responsibility Branding Survey," Penn Schoen Berland Associates, 2010.

³ Ocean Tomo <http://www.oceantomo.com/productsandservices/investments/intangible-market-value>.

Figure 1. Components of S&P 500 market valueSource: *Ocean Tomo*

In a recent KPMG survey of companies, **62 percent** surveyed have a strategy for corporate sustainability in place; up from just over half in **February 2008**.

Climbing up the corporate agenda

It is therefore no surprise to see sustainability moving up the corporate agenda. In a recent KPMG survey of companies,⁴ 62 percent surveyed have a strategy for corporate sustainability in place; up from just over half in February 2008. This growth occurred despite a tough economic environment that forced many organizations to focus on goals with immediate impact. Just five percent have no plans to create such a strategy, while the remaining companies are in the process of developing such a plan. Of the companies surveyed, the Consumer Markets industry companies surveyed ranked particularly high, with as many as 8 in 10 having a corporate sustainability strategy in place.

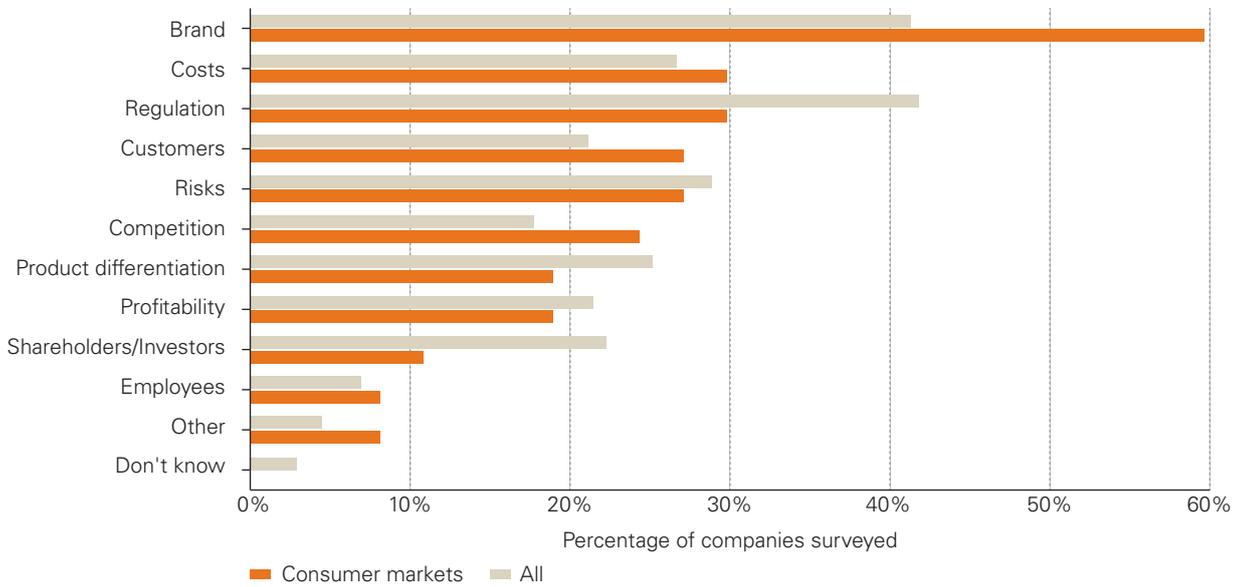
Top drivers for sustainability

Numerous factors have contributed to sustainability's increasing prominence on the corporate agenda. Among these are a widening array of laws and regulations and a desire to enhance brand reputation. For consumer companies in the KPMG survey,⁵ enhancing brand is clearly ranked as a top driver, being cited as a driver by nearly 60 percent of the respondents in that category (Figure 2). Other drivers include concerns about managing risks associated with sustainability issues (29 percent) and an interest in cost reduction (27 percent).

⁴ Corporate Sustainability: A progress report, KPMG International, March 2011.

⁵ Ibid.

Figure 2. Top drivers for adopting sustainability practices

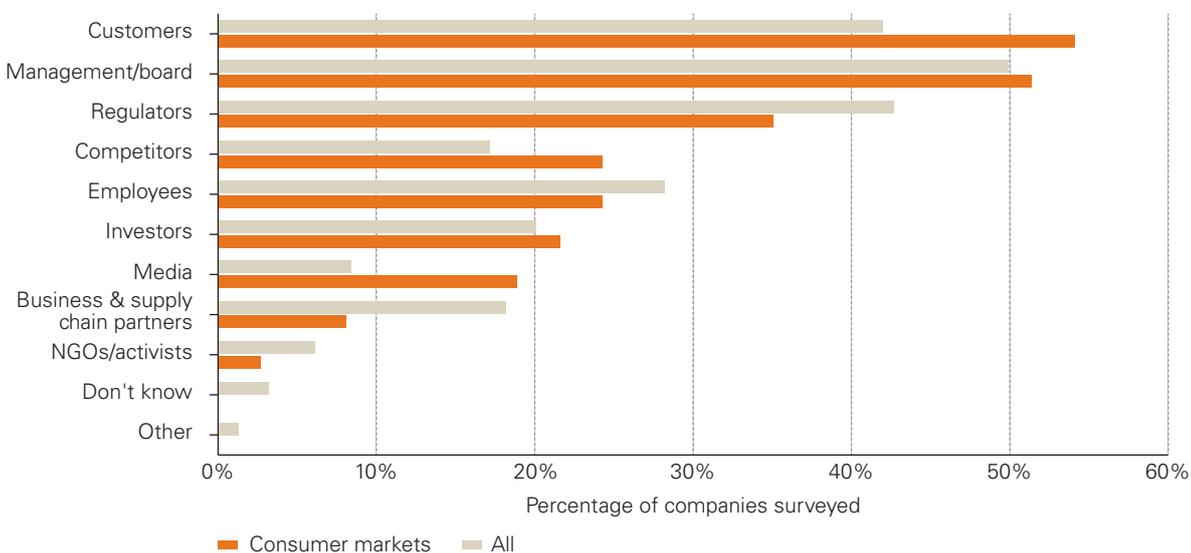


Source: Corporate Sustainability: A progress report, KPMG International, March 2011.

Influencing the sustainability agenda

Brand enhancement as a prominent driver for the adoption of sustainability practices is further emphasized by the fact that customers are the leading influencers for consumer markets companies, more even than the board or regulators, contrary to other companies, where the influence of customers falls as the third most important (Figure 3). In an industry where brand reputation can be a key differentiator for competitors and where customer preferences and demands dictate which products move from shelves, consumer markets companies are particularly susceptible to the growing pressure from consumers to employ sustainable practices.

Figure 3. Parties with most influence on companies' implementation of sustainable objectives



Source: Corporate Sustainability: A progress report, KPMG International, March 2011.

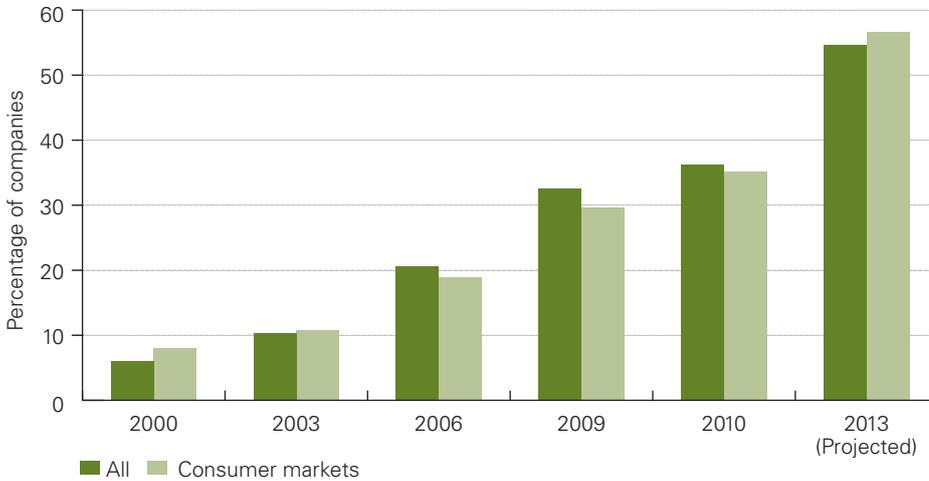
Sustainability reporting



Clearly, our work with CEOs and boards in consumer markets companies around the world reveal high-quality sustainability reporting to be a top priority. The number of dedicated sustainability reports produced by companies has mushroomed over the past decade as firms are increasingly measuring – and reporting – their sustainability performance. In 2000, only 6 percent of the companies surveyed had sustainability reports, compared to 36 percent in 2010, with an additional 22 percent planning to produce sustainability reports in the next two years (Figure 4).⁶

⁶ Corporate Sustainability: A progress report, KPMG International, March 2011.

Figure 4. Companies issuing a public report on sustainability performance, in addition to financial performance

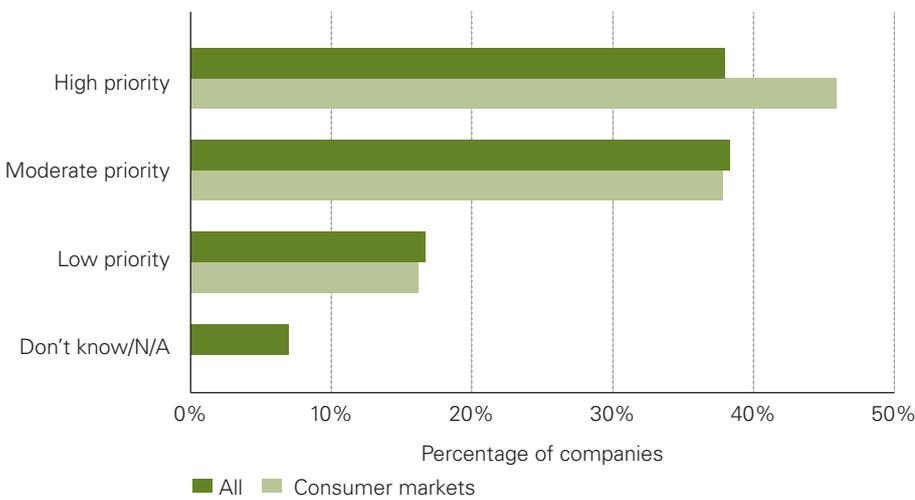


Source: Corporate Sustainability: A progress report, KPMG International, March 2011.

In 2000, only **6 percent** of the companies surveyed had sustainability reports, compared to **36 percent** in 2010.

The same KPMG study also revealed that for consumer companies, in the next 12 months, performance reporting on sustainability will be a high priority for 46 percent, and a moderate priority for 38 percent (Figure 5).

Figure 5. How high a priority is it to communicate your performance on sustainability to investors and other stakeholders?



Source: Corporate Sustainability: A progress report, KPMG International, March 2011.

The relative importance of communicating sustainability practices and performance to stakeholders is not a surprise, given the previous findings indicating the prevailing importance of brand enhancement and appeal to customer demand – without clear and adequate communication of a company’s sustainability efforts, the impact of such programs on brand and customer perception is diminished.

However, despite its apparent importance, our research into the sustainability reporting practices of 132 of some of the world’s largest companies in the alcohol, tobacco, food and beverage, consumer goods, and retail and luxury sectors show a high degree of variance in the quality and quantity of information being reported, and the types of data being captured. And although there is consensus among industry leaders and stakeholders that sustainability reporting needs to become more standardized and consistent, the scatter makes it difficult for investors, consumers and other stakeholders to compare performance and practices across the industry.

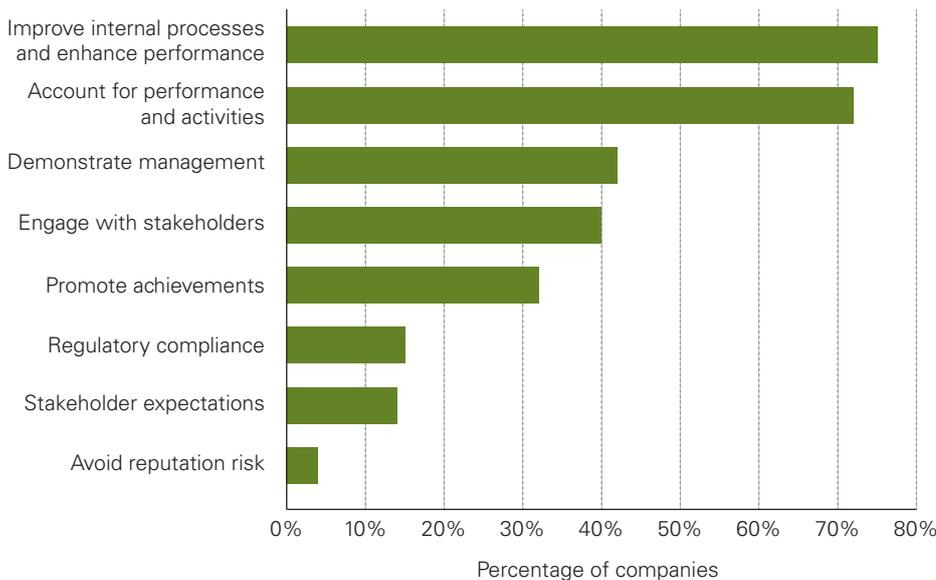
Why reporting matters

With performance in the spotlight, stakeholders want to see sustainability performance reporting becoming more measurable, consistent, widely available, and better integrated through public financial reports, voluntary reports, press releases, or websites. In addition to meeting the demands and requirements of stakeholders, better reporting also provides a number of valuable benefits to the companies themselves.

Innovation and improved performance

In a 2010 KPMG survey,⁷ the top two objectives of reporting on sustainability were cited as ‘improving internal processes’ and ‘accounting for sustainability performance and activities’ (Figure 6). In 2011, a KPMG study also supported the finding that, above any other business case for reporting, innovation and making real progress on sustainability are clearly the priorities. Forty four percent of the surveyed executives agree that sustainability is a source of innovation, and 39 percent see it as a source of new business opportunities.⁸

Figure 6. Top reasons for reporting



Source: Reporting Change: Readers & Reporters Survey 2010.

Increased market value

From an external standpoint, global banks, investors, and financial institutions are putting greater focus on the impact and design of sustainability programs to gain a better snapshot of a company’s ability to assess risk, respond to change, and deliver shareholder returns. A number of asset owners and mutual funds now evaluate companies on the sophistication and strength of their sustainability programs and include the outcomes in their investment decisions. These decisions are made with the help of various sustainability indices and risk and performance analytics provided by specialized rating agencies.

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⁷ Reporting Change: Readers & Reporters Survey 2010

⁸ Corporate Sustainability: A progress report, KPMG International, March 2011.

Enhanced brand – greater credibility and trust

One of the key objectives for many firms engaging with sustainability is the desire to enhance their brand. By incorporating sustainability, corporate brands can themselves become sustainable – transcending the typical brand life cycles and enduring for future generations. Accordingly, it is important to develop accurate and transparent reporting. This information is shared with a range of stakeholders, from potential investors and shareholders to clients and business partners.

Better industry practices – disclosure enables benchmarking

In order to provide a relative measure of how the business is performing, firms need to benchmark themselves against their industry peers. They can do so by reviewing industry metrics published through relevant organizations such as the World Business Council for Sustainable Development, or by sharing relevant data and best practices through industry bodies. This also helps to develop appropriate standards and benchmarks for particular industries.

Better performance of sustainability programs

By building public accountability and transparency into their sustainability programs, companies are more likely to deliver results through their sustainability initiatives. Reporting inherently requires companies to establish more formal processes for selecting and setting policies and programs, making commitments to them, and identifying ways to measure and maximize their success and return on investment (ROI).

By incorporating sustainability, corporate brands can themselves become sustainable – transcending the typical brand life cycles and enduring for future generations.



Importance of measurement

Even without reporting, companies seeking to embrace sustainability need to measure their existing performance on a wide range of metrics, from energy consumption to water usage. And for sustainability programs to be truly integrated into operational strategy, meaningful and reliable metrics must be developed in addition to underlying processes and systems to produce such information.

To determine long-term ROI and delineate bottom-line benefits, sustainability programs must include appropriate and relevant measurement that leverages both financial and non-financial metrics. Moreover, since this data will be used to evaluate overall performance, it should be subject to the same controls that apply to the company's financial systems to ensure the information is accurate and credible.

There is growing demand for the design of systems, processes, controls, and governance frameworks that can properly measure and analyze sustainability metrics. And increasingly, assessments and audits of company sustainability reports are being conducted to provide stakeholders with a clearer view into the business's progress and accomplishments.

There are a number of encouraging initiatives underway that seek to create industry benchmarks and reporting standards, such as the Global Reporting Initiative (GRI) activities and the International Integrated Reporting Committee (IIRC)'s work in this area. On a related front, new auditing standards are also under development: the International Auditing and Assurance Standards Board released a proposed new standard for Assurance Engagements on Greenhouse Gas Statements. But continued progress and collaboration among standard setters will be critical to furthering the meaningful reporting of sustainability initiatives globally.

Although many firms are making solid progress by cutting resource use in specific departments, leading global firms are setting the pace by establishing tough, long-term goals that define a vision, balanced with interim deadlines that force progress today. Both P&G and Anheuser-Busch InBev have set themselves ambitious goals for creating more sustainable businesses and are now focused on achieving initial deadlines and targets. Decisive action here can often put firms ahead of the regulatory agenda or industry peers.

As the management maxim holds, what gets measured gets managed. Companies need to start measuring resource usage and productivity across all parts of their business, from water used per unit of output to energy consumed per delivery mile driven. At the outset, this can be a challenge for newcomers, especially in areas where data is difficult to obtain or proper guidelines and standards are not yet established. Global guidelines and standards can be helpful and are widely used.





On a related front, **new auditing standards** are also under development: the International Auditing and Assurance Standards Board released a proposed new standard for **Assurance Engagements** on Greenhouse Gas Statements.

KPMG review of sustainability reporting in consumer markets

The goal of this paper is to provide the reader with insight into how Consumer Markets companies can improve performance by refining how they track and report on key performance indicators (KPIs). In the following section, KPMG advances a select number of strategic and tactical KPIs on a per sector basis, based on our observations and minimum reporting standards identified in the SD-KPI Standard 2010-2014,⁹ that we feel are particularly relevant to specific sectors within the Consumer Markets industry. We examine the current state of sustainability disclosure within the consumer markets industry and highlight some of the issues and steps companies can consider as they improve the quality and maturity of their reporting practices and provide a more comprehensive view of their overall approach.

Study overview

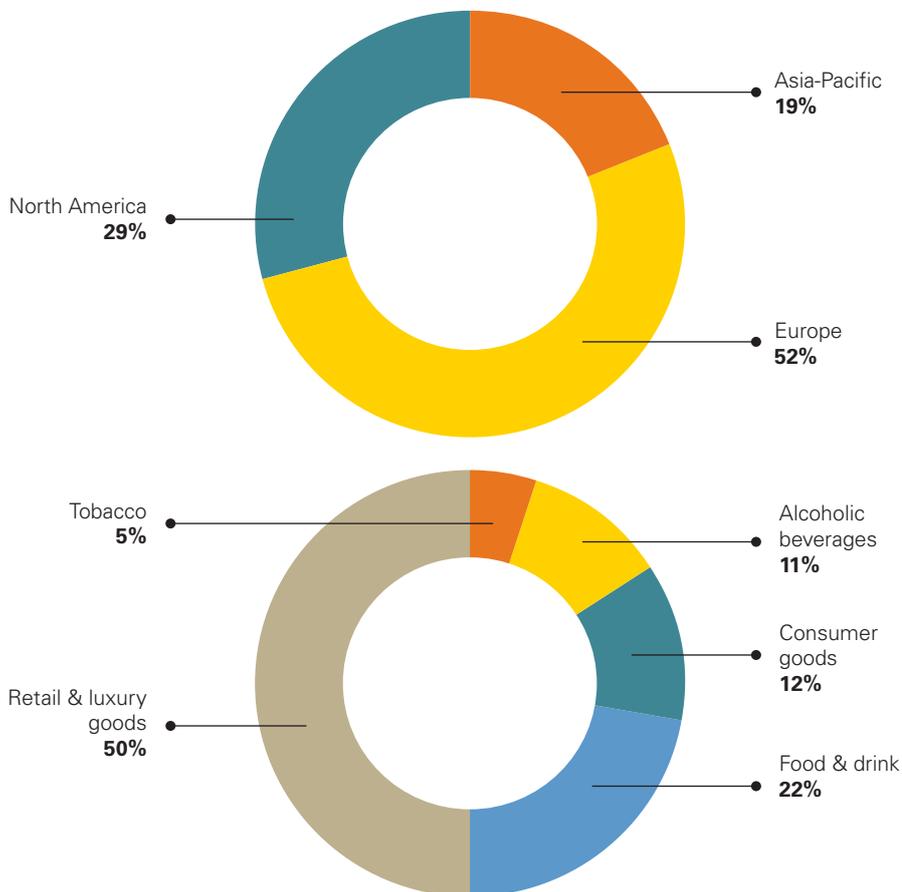
In early 2011, KPMG identified 132 of the largest consumer markets companies in the world, including companies from the retail and luxury goods sectors, and the food, drink, and consumer goods sectors (broken down by the tobacco, alcoholic beverages, consumer goods, and food and drink subsectors). Approximately one-fifth of the companies are located in Asia-Pacific, nearly one-third in North America, and just over half in Europe (Figure 7). We then looked at the most recent sustainability reports published by these companies, to identify which sustainability metrics they were publicly reporting on.

Approximately **one-fifth of the companies** in the study are located in **Asia-Pacific**, nearly one-third in **North America**, and just over half in **Europe**.

⁹ Cf. Hesse, A.: SD-KPI Standard 2010-2014 – Sustainable Development Key Performance Indicators (SD-KPIs): Minimum reporting standard for relevant sustainability information in annual reports/management commentaries of 68 industries, Muenster 2010.



Figure 7. Breakdown by region and sector of companies included in the study



Source: Measuring Up: Improving Sustainability in Consumer Markets, KPMG International, 2011.

The metrics looked at for each company fell into 1 of 10 categories:

Metric	Types of initiatives and issues included
Energy & carbon emissions	Energy use, greenhouse gas (GHG) emissions
Supply chain & agricultural practices	Use of fair trade suppliers, "food miles," sustainable sourcing, supply chain integrity, supplier controls and audits, support for suppliers, sustainable agricultural practices
Health & food safety	Product safety, health and nutrition, quality assurance and compliance
Water management	Water conservation and preservation
Fair competition	Consumer protection, corruption policies, anticompetitive behavior
Labor management, equity & diversity	Health and safety conditions, utilization of immigrant, illegal and child labor, training and education, employment equity, flexibility, diversity, non discrimination
Product performance & innovation	Life-cycle analysis and sustainability performance of products, environmental footprint of products
Waste & recycling	Control of waste in manufacturing, disposal and recycling of waste and products
Materials & packaging	Sustainable packaging, green retail, eco-labeling
Community development	Contributions to communities, charity, education

These metrics were chosen based on what KPMG's sustainability professionals globally are seeing as the most commonly reported sustainability initiatives among their consumer markets clients.

Measuring vs. reporting

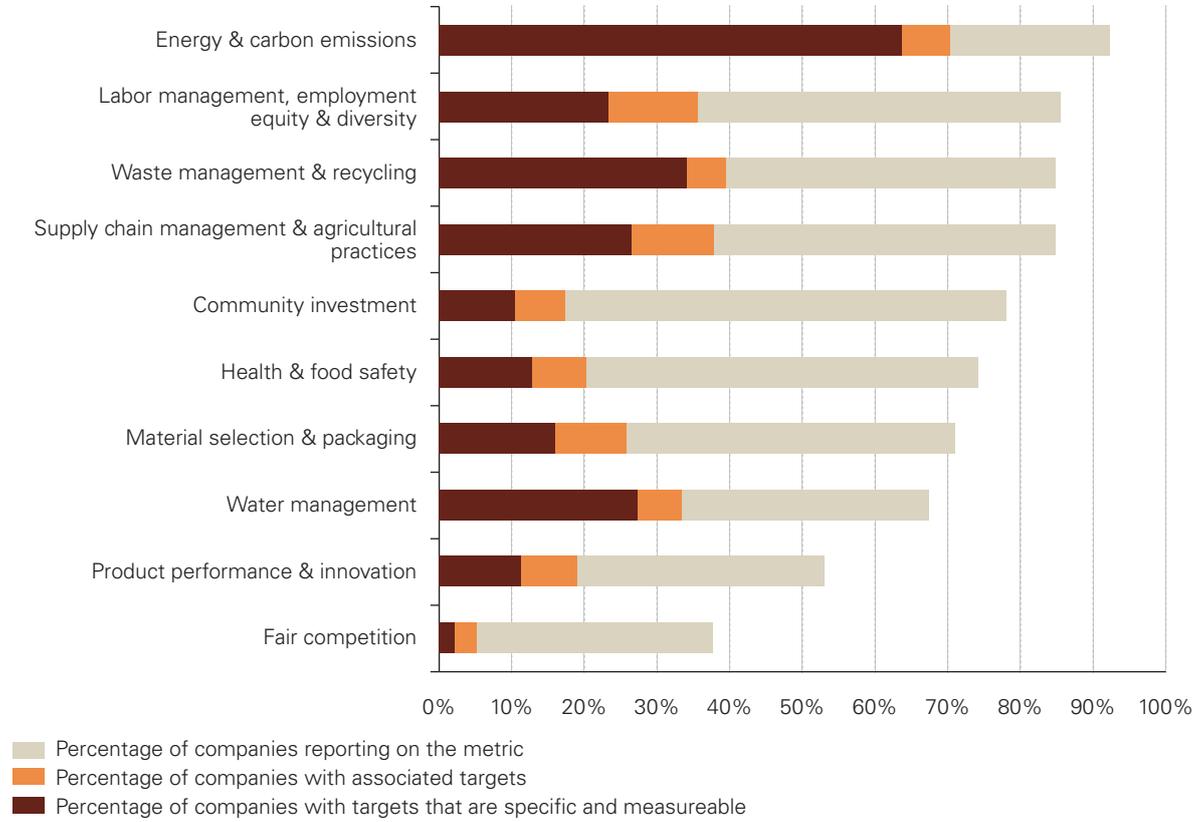
When reviewing the sustainability reports, we looked at not only whether companies were reporting on these ten metrics, but also:

- if companies were reporting associated targets
- if any targets reported were specific and measureable
- if the companies were reporting their performance against the targets.

One of the key findings was that the majority of organizations are at an 'early' stage in sustainability reporting. Although on average, the majority of companies reviewed are reporting on most metrics – with over 70 percent of companies reporting on 7 of the 10 categories – a significantly smaller percentage of companies are also reporting targets, and an even smaller percentage are reporting targets that are specific and measureable (Figure 8). The more 'mature' reporters in the study are reporting on most or all of the metrics, as well as reporting associated targets and performance results that are specific and measureable.

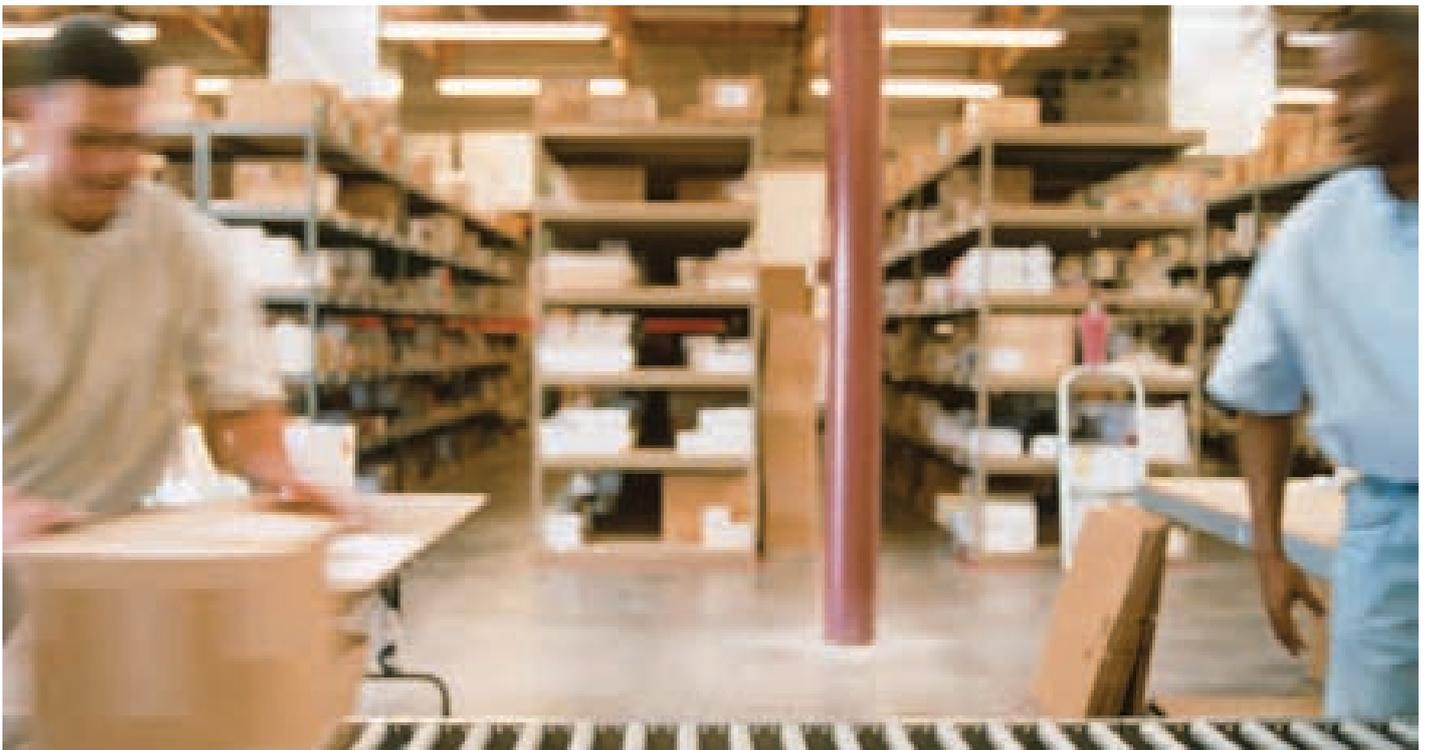
The more **'mature'** reporters in the study are reporting on most or all of the metrics, as well as reporting **associated targets and performance results** that are specific and measureable.

Figure 8. Percentage of companies reporting on, and reporting targets for, each metric



Source: Measuring Up: Improving Sustainability in Consumer Markets, KPMG International, 2011.

As we discuss throughout the rest of this report, setting measurable and specific targets, and reporting performance against them in a quantifiable way, is a key industry best practice to be strived for by less 'mature' reporters.



A sector-by-sector view on reporting issues and practices

In the following sections, this report takes a closer look at the state of sustainability initiatives and reporting practices among the alcoholic beverage, food and drink, consumer goods, luxury and retail, and tobacco sectors. For each of these sectors, the report focuses on the frequency and 'maturity' of reporting in each sector as compared to all consumer markets sectors on average, the key factors driving reporting for the sector, the most commonly reported KPIs, reporting best practices, and KPMG's recommendations.

To provide additional context for the reporting practices in each sector, the following sections also provide a brief overview of the state of sustainability adoption in each sector, including core concerns driving sustainability initiatives, and some leading practice initiatives.

Alcoholic beverages

The issue of sustainability ranks high on boardroom agendas in light of the adverse health and community effects that immoderate consumption of certain products can have.



Industry overview

The alcoholic beverage sector has been proactive in implementing sustainability programs and communicating them to consumers. The industry has initiated several programs to address abuse and misuse, educate consumers, and encourage responsible drinking. These include “Global Actions on Harmful Drinking,” a series of steps agreed to in 2010 by the chief executives of several major international alcohol producers. Run by the International Center for Alcohol Policies (ICAP), the actions address the issues of driving under the influence of alcohol, self-regulation of alcohol advertising and marketing, particularly with respect to low- and middle-income countries.

Some of these efforts no doubt spring from enlightened self-interest, particularly as governments around the world become more active in seeking to combat harmful drinking. In 2010, the World Health Organization (WHO) released its Global Strategy to Reduce the Harmful Use of Alcohol and called on alcohol companies to step up their actions and self-regulation. Those efforts are supported by a number of leading industry multinationals and IACP reports that programs are underway in 18 countries, including Russia, China, India, Sri Lanka, the Philippines, and Vietnam, to reach out to youth, poor, and other vulnerable populations.

Core sustainability concerns

Stemming underage and excess drinking: As consumer groups and government bodies take aim at beer, wine and liquor manufacturers, pressure on companies to demonstrate good-faith efforts to curb underage and harmful drinking mounts. “CEOs and senior management are treating the issue very seriously because the regulatory grip on the industry is tightening,” says KPMG’s Ian Starkey, a senior partner in KPMG’s Consumer Markets practice. Although cases such as Four-Loko, the caffeine-infused alcoholic beverage whose potency sickened scores of university students, are extreme, the swift government intervention that followed effectively took that product off the shelf. Such moves underscore the bottom-line impacts that can come when sustainability risks are not fully considered. Leading multinationals are responding by stepping up their self-regulation. These include efforts by industry bodies to set standards for the ethical use of alcohol advertising, as well as proactive labeling and a range of educational outreach programs.

Similarly, strong self-regulation in the United States is widely viewed as having kept federal regulators at bay. A recent study conducted by CAMY, the Center for Alcohol Marketing and Youth, a critic of the spirits industry, found a 48 percent reduction in the exposure of youth to alcohol advertising in magazines from 2001 to 2008. Such success is likely to propel further self-regulation on the part of the industry to forestall tougher measures being imposed on them.

Water stewardship: Although social issues dominate the sustainability agenda for the sector, executives have also upped their engagement on environmental and governance issues. And while the bottling, brewing and beverage industry is less reliant on natural resources than others, water remains a primary ingredient and is used throughout the production process. In some parts of the world, notably Australia, India and China, where water resources are scarce, the issue has bubbled up as a key environmental and business risk. In response, many brewers are reformulating their recipes to create products that use less water. Anheuser-Busch InBev, for instance, plans to cut the amount of water that goes into producing every liter of beer by 30 percent by 2012, the equivalent of 25,000 Olympic-sized swimming pools.¹⁰ Other producers, such as Molson Coors and Heineken, have similar reduction goals. SABMiller has gone one step further, charting total water use across its supply chain. That benchmarking helps the company spot inefficiencies. For instance, when it found that its South African plant used considerably more water than its Czech plant, it was able to step in and make refinements.

Taxes and levies: Many countries have or are considering imposing excise taxes or minimum price standards on alcohol in an effort to curb harmful drinking. The British government, for instance, announced plans in January 2011 to introduce a minimum price level for alcohol. Similar measures exist in other locales. Proponents argue that taxation is better than prevention programs. But many in the industry suggest such measures can be counterproductive. As evidence, they point to the rise in black market trafficking of spirits that accompanied similar price hikes in Asia. As the industry and government bodies look for ways to balance pricing, taxes with other health and welfare efforts, it will be incumbent upon larger players to increase their level of engagement and negotiate good-faith efforts with regulators in the major regions.

Best practices

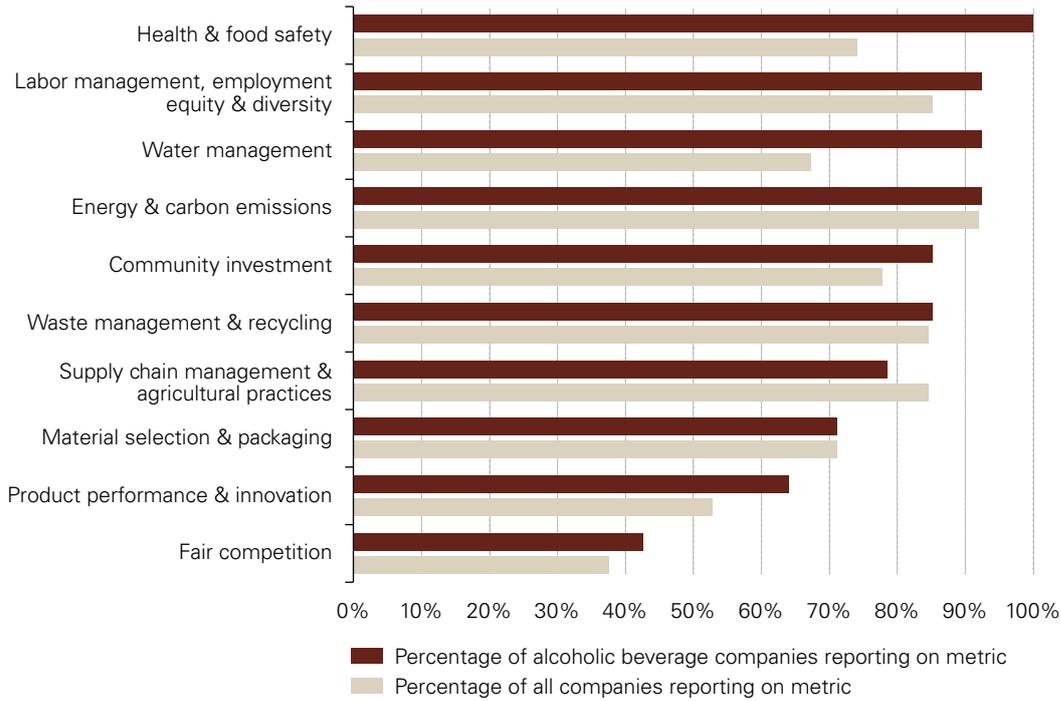
Advocating safe and healthy consumption: Diageo, the world’s largest alcoholic beverage producer, has launched several programs to increase education and awareness. Chief among them is its DRINKiQ initiative. This program, part web resource and part training vehicle, provides a one-stop-shop on alcohol-related information, from detailed research on how alcohol is absorbed in the body to videos showcasing responsible drinking initiatives from around the world. So successful was the program in training Diageo’s own employees on alcohol-related issues that professional sporting organizations in the UK and Australia engaged DRINKiQ to conduct training for their teams.

¹⁰ “World’s largest beer brewer cuts water use, braces for future risks,” World Business Council for Sustainable Development, <http://www.wbcsd.org/Plugins/DocSearch/details.asp?ObjectId=Mzc4NTU>

Sustainability reporting in the alcoholic beverages sector

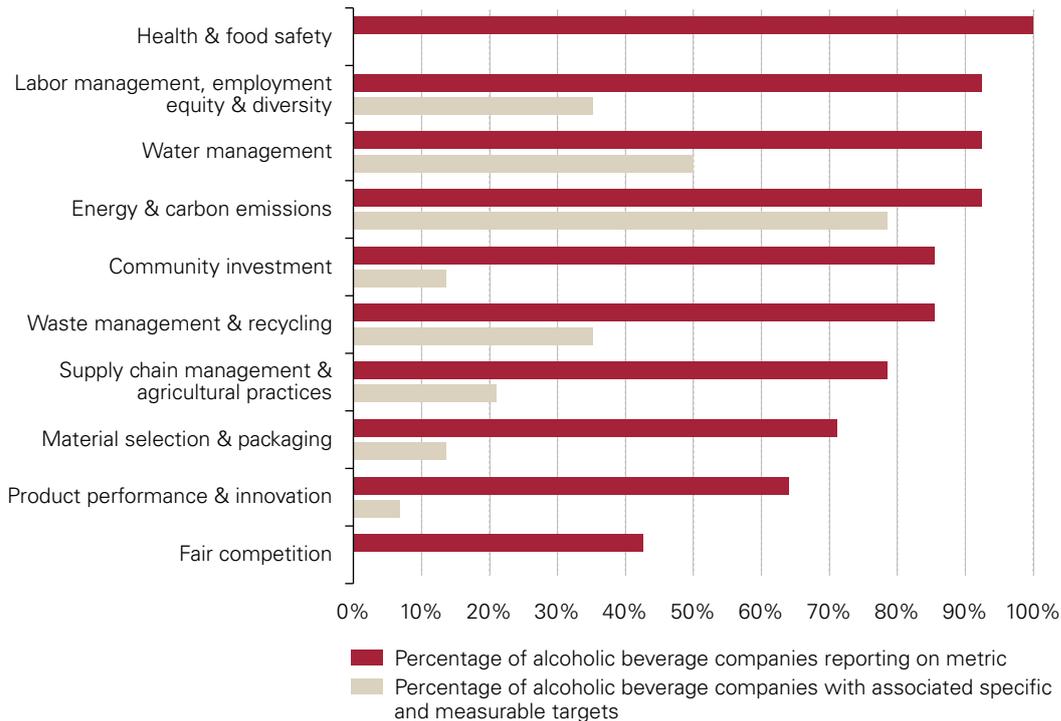
- The alcoholic beverage companies are more likely to report on nearly all metrics, compared to other consumer markets sectors
- Energy & carbon emissions and water management initiatives are the most likely to include associated targets
- Although the sector is very likely to report on health & food safety and community investment, very few, if any, companies have associated specific and measurable targets.

Percentage of companies reporting on each metric



Source: Measuring Up: Improving Sustainability in Consumer Markets, KPMG International, 2011.

Percentage of alcoholic beverage companies reporting on, and reporting targets for, each metric



Source: Measuring Up: Improving Sustainability in Consumer Markets, KPMG International, 2011.



Key performance indicators

- Advertising/responsibility campaign spend
- Percentage of employees trained regarding responsible drinking
- Water consumption per hectoliter of production
- CO₂ emissions per hectoliter of production.

Drivers for increased reporting

- To deter government-imposed sustainability program and reporting regulation
- To deter government-imposed minimum pricing and taxes to curb consumption
- Social and ethical concerns – to protect reputation through promotion of responsible consumption
- Charting water use helps to spot inefficiencies in the supply chain.

Recommendations

- Increase reporting of voluntary initiatives
- Clearly disclose what elements of the supply chain are included in water consumption measurement and reporting
- Report what percentage of water consumption is in water-stressed areas
- Clearly disclose what elements of the supply chain are included in CO₂ emissions measurement and reporting
- Report specific and measureable targets for labor management, health and food safety and community investment metrics.

Industry best practices

Clear and accessible reporting: SABMiller uses its sustainability report to provide a detailed accounting of the beverage-maker's 10 priorities, including accountability, the supply chain, and environmental oversight. Unlike companies that rely on bulky written reports, SABMiller publishes their results in a series of easy-to-use online charts and graphs that users can toggle over to get an 'at-a-glance' understanding of how well the company is doing compared to its targets. It is also much easier for the company to update. Such transparency lends authenticity to the SABMiller program and has been a useful way for the company to engage directly with stakeholders.

Energy & carbon emissions and water management initiatives are the most likely to include associated **targets**

Consumer goods

Having survived one of the worst recessions in history, consumer goods manufacturers have embraced efficiency measures and lean process improvements with zeal.

Industry overview

Across the sector, companies are demonstrating a renewed focus on eliminating waste, curbing excess inventory, and reducing unnecessary process steps. Sustainability, with its emphasis on smarter and more efficient resource use, aligns well with the industry's focus on cost reduction. As a result, the consumer goods sector is relatively advanced compared to other industries in the quality and rigor of its sustainability programs.

While regulatory pressures have been a major impetus for reform in other sectors, "one of the biggest catalysts for consumer goods makers," says John Hickox, a partner in KPMG's Sustainability practice, "has come from within the industry itself – particularly from large global players like Walmart." In 2009, the Benton, Arkansas, retailer introduced its Sustainable Product Index to oversee the energy, climate, and material efficiency of its supply base. In conjunction with The Sustainability Consortium, which it helped found with the University of Arkansas and Arizona State University, the index assesses the environmental impact of every product the company sells and presents that data in a consumer-friendly rating system.

P&G launched its own scorecard system in 2010. Using measurement standards from the World Resources Institute, the World Business Council for Sustainable Development, and the Carbon Disclosure Project, P&G's "Supplier Environmental Sustainability Scorecard" ranks supplier performance on the basis of their water consumption, energy consumption, greenhouse gas emissions, and waste. The consumer products leader is making the scorecard public for other organizations to use in an effort to develop accepted industry standards.

Core sustainability concerns

Improving manufacturing efficiency: Consumer goods companies have been quick to seize a number of initiatives to lower energy and fuel consumption, cut back on water use and reduce waste. The benefits not only help the environment, but also improve both cost performance and productivity. While most factories have basic measures in place, such as putting machines onto energy-saving mode when not in use, others are making significant capital investments, building 'green' factories that tap renewable energy sources, such as wind and solar, or using turbines that create electrical and heat energy at the same time.

Minimizing environmental impact: In late 2010, the Consumer Goods Forum, which represents consumer goods companies with combined revenues of more than US\$2.8 trillion, announced that its members have signed on to a commitment to achieve zero net deforestation by 2020. To do this, companies like Colgate-Palmolive, Johnson & Johnson, and L'Oreal have made double-digit reductions in their greenhouse gas emissions, water use and waste, from sourcing to consumer's disposal of the product at home. Producers are also finding creative ways to reuse output that would otherwise be disposed. SC Johnson, for instance, takes the palm shells from its palm oil operation and uses them as a source of fuel at one of its Indian manufacturing facilities, a move that cut carbon emissions by more than 15 percent, while reducing diesel fuel use by 80 percent.

Investing in smarter packaging: While packaging is an essential element in shipping and branding products, it is also one of the leading contributors to landfill waste. It is not cheap to produce either. Packaging can account for eight percent of the cost of food and up to 40 percent of the cost of manufacturing cosmetics. The industry has responded by redesigning its packaging and labeling to use less cardboard, corrugate and plastic. P&G for instance, threw out its old clamshell packing for its Olay product line, replacing it with blister-based designs. A newly tooled pump on its moisturizers is expected to save the company 800,000 pounds of plastic annually. Other consumer packaged goods (CPG) companies have reconfigured pallet designs to ship more products per truck run, allowing them to cut back on road miles.

Best practices

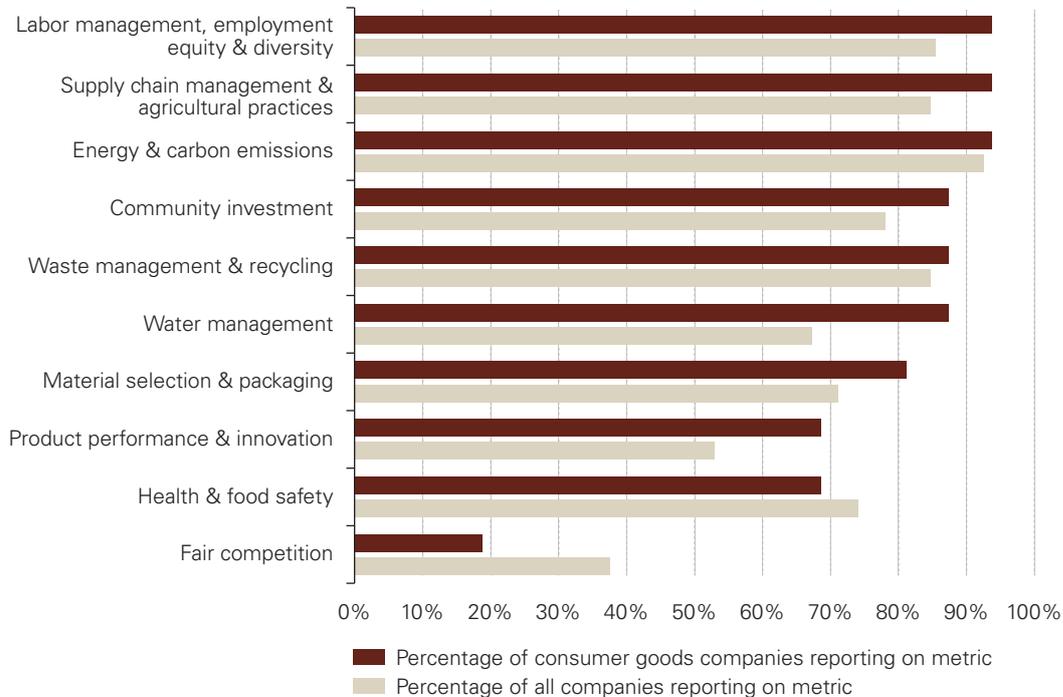
Supply chain oversight: Kimberly-Clark is the first big tissue company to require wood suppliers to have independent certification. It also gives preference to suppliers that can certify their paper products with Forest Stewardship Certification (FSC). The company funds efforts to map high conservation value forests in Brazil and Indonesia, the countries with the two largest deforestation rates. In recognition of its work, the non profit Forest Footprint Disclosure (FFD) ranked the company first in its sector for its sustainability efforts.

Greenhouse gas (GHG) reductions: A member of the Dow Jones Sustainability Index, Johnson & Johnson has staked a leadership position in lowering its energy consumption and costs across its operating footprint. Johnson & Johnson’s corporate strategy for reducing GHG emissions includes five tiers of best practices: energy efficiency improvements in all operations; cogeneration – on-site generation of electricity and recovery of the waste heat for overall efficiencies of 80 percent or more; on-site renewable energy that produces no CO₂ emissions; renewable electricity purchases; and carbon trading and sequestration.

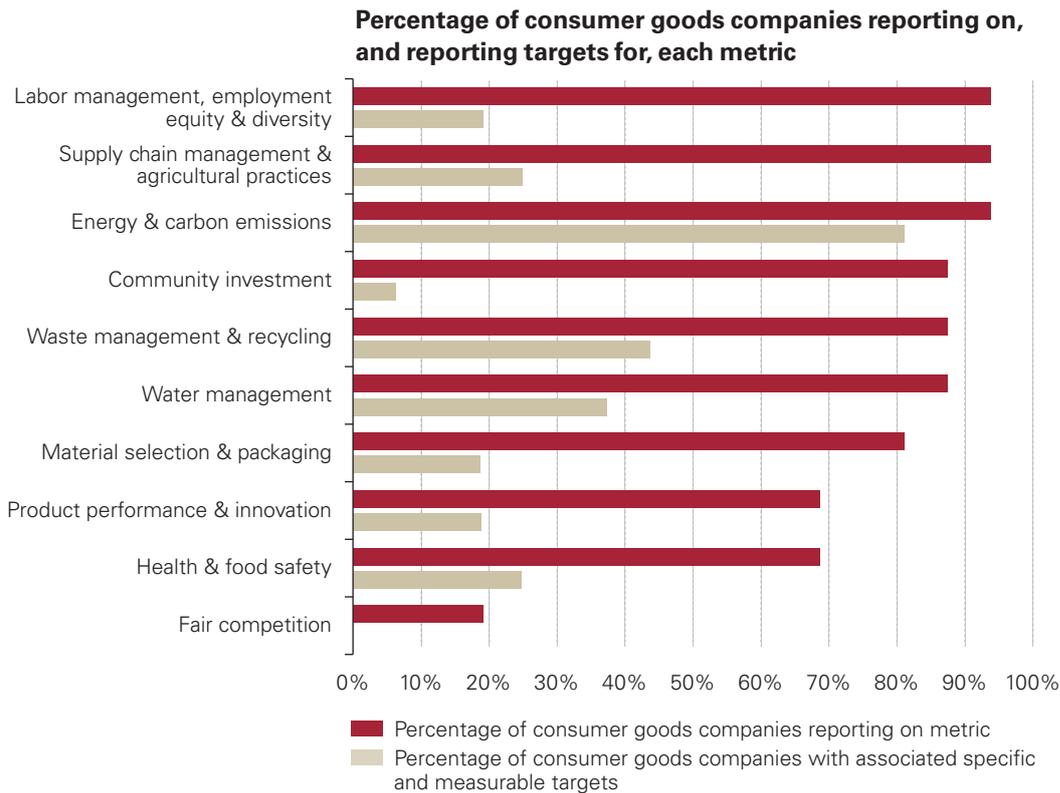
Sustainability reporting in the consumer goods sector

- Consumer goods companies are more likely to report on each metric except for health & food safety and fair competition than other sectors, on average
- Consumer goods companies are very likely to set specific and measureable targets for energy and carbon emissions
- 88 percent or more companies report on labor, supply chain, energy, community, waste, and water metrics.

Percentage of companies reporting on each metric



Source: Measuring Up: Improving Sustainability in Consumer Markets, KPMG International, 2011.



Source: Measuring Up: Improving Sustainability in Consumer Markets, KPMG International, 2011.

The industry is keenly **aware** that consumers will factor a brand's social and environmental track record into their **purchasing considerations**.

Key performance indicators

- Percentage of products with 'eco design system'/eco-labeling
- Audit coverage of International Labor Organization (ILO) standards (own operations and suppliers)
- CO₂ emissions per ton of production
- CO₂ emissions of products in use.

Drivers for increased reporting

- Efficiency and cost containment – Business and competitive pressures put these issues on the front burner.
- Social and environmental factors – The industry is keenly aware that consumers will factor a brand's social and environmental track record into their purchasing considerations.
- Pressure from retailers to comply with 'scorecards.'

Challenges in reporting

- Lack of transparency across the supply base – Many CPG companies acknowledge difficulties in aligning their supply base to foster a uniform approach to tracking and measuring KPIs.

Industry best practices

Measurement and management: Procter & Gamble (P&G), one of the largest consumer product manufacturers in the world, has established a set of five sustainability strategies that guide its business operations around the globe. These sustainability strategies include measurable goals to reduce the company's use of energy and water, and to lower the amount of waste and carbon dioxide produced in the process of making P&G products. P&G established its sustainability goals in 2007 with a target deadline of 2012. To its surprise, it has made faster progress than expected. As a result, it recently decided to raise their targets.

Food and drink

Few sectors are more reliant on natural resources than food and drink. As such, the acquisition, production and distribution of safe, healthy products have long been central to the industry's business model.

Overview

Amid concerns over water scarcity and depleting stocks of fish, grain, and other raw materials, the issue of sustainable sourcing, production, and marketing has gained prominence. The need to pare costs and preserve margins, exacerbated by wary consumer buying attitudes, has prompted many producers to double-down on efficiency drives, redesigning bottles and lids to use less plastic, shortening distribution networks to save on fuel, embracing Lean techniques to reduce waste and spoilage, and using cheaper, lighter, recyclable materials in packaging. For instance, a newly designed bottle is saving Aquafina, a subsidiary of PepsiCo, 75 million pounds of plastic annually. Likewise, Heinz, one of the largest manufacturers of canned foods, estimates its new pull tab opener will save the company 15,000 tons of steel and £400,000 (US\$660,000) per year in the UK alone.

Consumers have not been quiet either. Studies suggest that, all other things being equal, buyers will choose the greener, more sustainable product. And social networking has given them a louder voice and bigger audience with which to air their pleasure or displeasure. Pat Dolan, Head of KPMG's Consumer Markets Sector in the US, remarked that, "CEOs across the food and beverage industry are keenly aware that leadership in sustainability is becoming a competitive differentiator." Perhaps because of this, the sector tends to be further along than many other industries in adopting and reporting on a range of sustainability issues.

Core sustainability concerns

Health safety and nutrition: Products that contain high amounts of salt, sugars, fats, and additives have come under intense scrutiny by health agencies, consumer watchdogs, and the public at large. The grassroots campaign against trans fats, a substance linked to an increased risk of cancer, offers a telling example of the power of the public. Widespread concern over the ingredient resulted in the industry reducing or replacing trans fats in most of its products. Rising rates of diabetes in Asia and obesity in other parts of the world mean that producers are under pressure to balance the nutritional content of their portfolios. That pressure may grow stronger as governments and employers work to contain healthcare costs.

Sustainable sourcing: Large food and beverage companies know that their growth also depends on having reliable and sufficient stores of raw material. The Bank Sarasin, which issued a comprehensive review of the industry's sustainability practices in late 2010, noted that aggregate demand by sector leaders already accounts for a significant share of the world's production: 15–20 percent of the world's coffee, over 10 percent of its tea, tomatoes and peas, and around 5 percent of its palm oil. Given this dependence, most of the major producers have plans or are putting plans in place to ensure the long-term sustainability of vital ingredients.

Three of the world's largest food producers, Danone, Nestlé and Unilever, banded together to start The Sustainable Agriculture Initiative (SAI) Platform in 2002 to advance sustainable global agriculture practices. As part of their compact, they have also set aggressive targets for sustainable sourcing on a corporate level. Unilever, for instance, has committed to sourcing all its palm oil and tea from sustainable sources by 2015, and by 2020 the company intends to source 100 percent of its agricultural raw materials sustainably.

Improved labor practices: One area where the industry acknowledges it needs to do more is ensuring that fair labor practices are in force down through the supply chain. In the last several years, for instance, human rights organizations such as Global Exchange and the International Labor Rights Forum have revealed widespread issues related to human trafficking and child labor in the Ivory Coast, whose farms produce a significant share of the world's cocoa and much of its coffee. Major producers such as Cadbury/Kraft, Mars, and Nestlé have been quick to respond, instituting third-party attestation and Fair Trade labeling to ensure that their cocoa is sourced according to strict labor standards.

Still, the Bank Sarasin report notes, "the working conditions in the food producers' own manufacturing plants spread across the globe have not come under heavy scrutiny. In some factories more than half the workforce does not have an employment contract and is working on a casual basis." As the industry comes under further scrutiny by consumers and other stakeholders, that is likely to change. The industry's most proactive players are already making strides to improve attestation. They recognize that precarious working conditions in the value chain of branded products pose a threat to their brand's reputation.

Best practices

Innovation: Group Danone partnered with Muhammad Yunus' Grameen Bank to create a low-cost, nutrient-rich yogurt product for Bangladeshi children. Although it was not conceived as a profit-making venture, Danone has recouped its investment and then some by leveraging innovations from the project, such as putting specialized enzymes that aid digestion into new products for their mainstream markets.

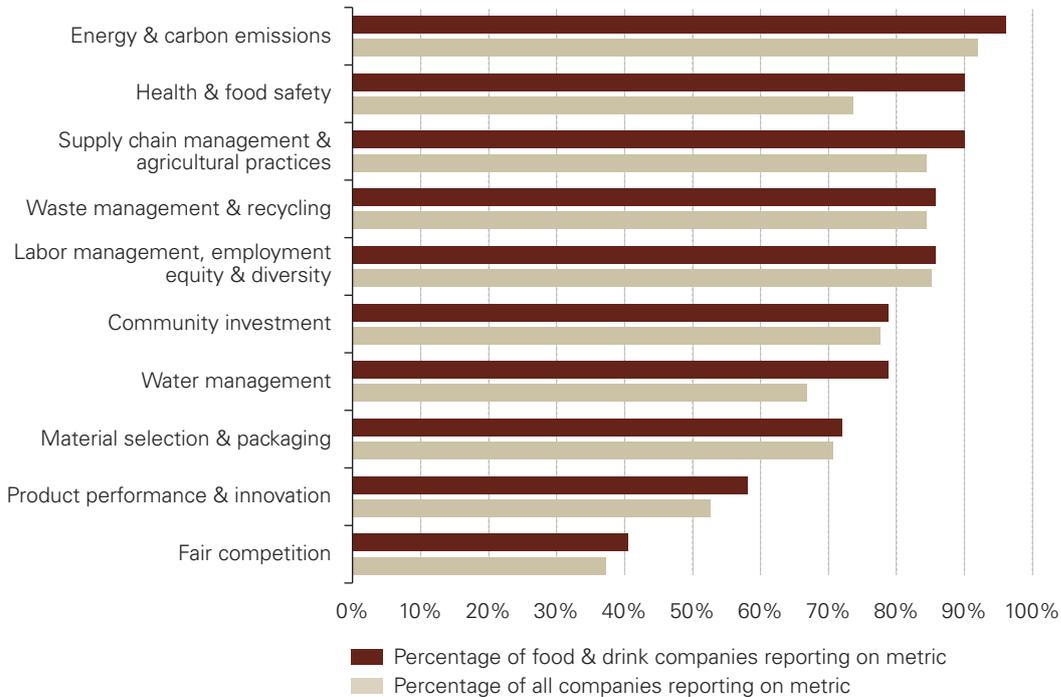
Water management: Coca-Cola and Pepsi-Co have taken water management to a new level. At the end of 2010, the two soft drink corporations published water stewardship reports that provide a supplychain-wide assessment of their total water footprint. The beverage giants each pledge to reduce their water footprint to zero, returning one liter of water to the earth for every liter used. In addition, they have invested heavily in water-distressed regions, such as India, providing communities with clean water sources and introducing new, less water-intensive ways to farm rice and other crops.

Supply chain accountability: Nestlé buys most of its dairy and agricultural needs directly from more than 660,000 suppliers. By going directly to its supply base, the food and drink giant can provide better accountability, traceability, and oversight. It also improves Nestlé's ability to partner with farmers and vendors to improve farming techniques and labor conditions. These initiatives help foster what the company calls "shared value" – ensuring the health, reliability and safety of its food and water sources while giving back to the communities where it operates.

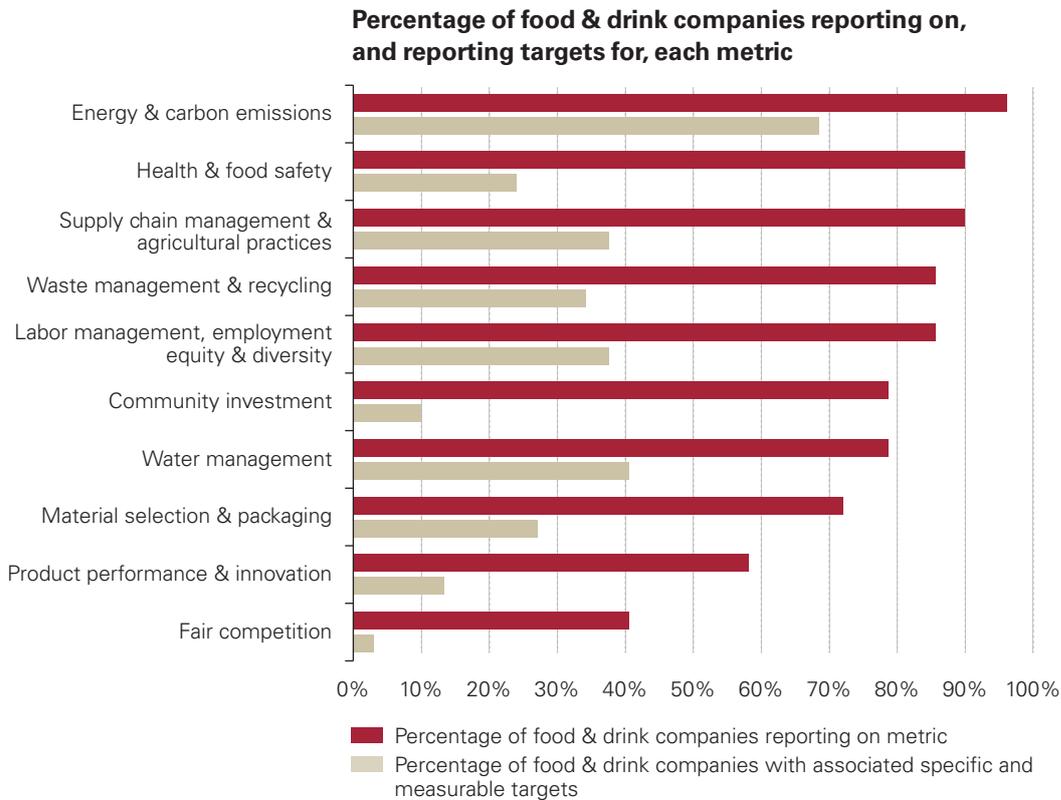
Sustainability reporting in the food and drink sector

- Reporting more often than other consumer markets companies on all metrics
- High percentage of companies reporting specific and measureable targets for energy and carbon emissions
- Almost half of companies reporting on supply chain, waste, labor and water initiatives also have specific and measureable targets.

Percentage of companies reporting on each metric



Source: Measuring Up: Improving Sustainability in Consumer Markets, KPMG International, 2011.



Source: Measuring Up: Improving Sustainability in Consumer Markets, KPMG International, 2011.

A lack of numerical data makes it difficult for **organizations to assess** the relative significance of particular issues and **prioritize** them accordingly.

Key performance indicators

- Proportion of sustainable products
- Proportion of sustainable ingredients
- Proportion of positive food safety audits
- Water consumption per hectoliter/ton of production
- CO₂ emissions per hectoliter/ton of production
- Third-party attestation of ILO standards.

Challenges in reporting

- A lack of metrics – A lack of numerical data makes it difficult for organizations to assess the relative significance of particular issues and prioritize them accordingly.
- Supply chain complexity – Traceability is key. Food waste, effluents, chemical additives, and other supply chain issues are likely to gain increased attention internally as the public and media organizations focus on downstream environmental impacts.

Drivers for increased reporting

- Increase efficiencies in supply chains and production to reduce costs
- Track reductions in materials used for new packaging
- Competitive differentiation – All things being equal, customers will choose ‘more sustainable’ products
- Increased consumer awareness – With health and wellness gaining traction, consumers are increasingly concerned about the quality, hygiene, and safety issues surrounding what they eat or drink

- Reputation and brand risk – Transparency is critical in an environment where social media lends to a loud consumer voice; further, food and beverage companies remain highly sensitive to the risk that scandals and safety problems can have on their bottom line
- Need for aggressive targets for sustainable sourcing of raw materials
- Pressure for attestation of fair trade sourcing – no human trafficking/child labor.

Recommendations

- Specify if emissions reported are for only the company or if it includes the supply chain
- Report what percentage of water consumption takes place in water-stressed areas.

Industry best practices

Stakeholder-centric reporting: Danone created a ‘dashboard’ by stakeholder group to provide easy access to the company’s commitments and progress for each stakeholder group. Stakeholders include the environment, consumers, employees, suppliers and communities.

Achieving savings through tracking: Since 2008, Kraft has tapped sophisticated software systems to track its fleet and truck movements to identify and eliminate ‘empty miles’ (miles driven without any cargo). These efficiency savings have helped Kraft remove more than 50 million road miles from its global transportation network.





Retail and luxury goods

The retail and luxury sector is particularly sensitive to consumer sentiment, and consumers have made it clear that social, ethical and environmental concerns are important factors in their buying decisions.

Overview

CEOs and top management have heard the drumbeat of corporate social responsibility for a longtime, influenced by vocal stakeholder engagement. Many see sustainability concerns as intrinsic to long-term shareholder value growth. In some ways, the math is simple. When executives ponder how to create top-line growth, the obvious route is by stepping up customer engagement. And study after study show that consumers are heavily influenced by social and environmental issues. So too are employees, and in a time when retailers are keen to hang onto experienced talent, leadership in these areas has proven an effective retention tool. Luxury brands, whose premium prices kept shoppers at bay for the most of the past two years, have been quick to seize many of the attributes associated with sustainability to reposition and distinguish their portfolios. These include durability, quality, timelessness, and individual craftsmanship.

With the most recent Retail Horizons survey¹¹ confirming cost containment as the most dominant agenda item, retailers have been quick to embrace energy and other operational efficiencies in their stores and distribution centers. “Net, net,” says KPMG’s Global and US Retail sector leader Mark Larson, “retailers see sustainability measures as an important vehicle to drive growth in a low-growth environment.”

It comes as little surprise then that, relative to other non-consumer markets industries, retailers and luxury good brands have relatively mature sustainability reporting practices. In fact, the annual Brand Sustainable Futures report, a global survey of 30,000 consumers across nine markets and 150 brands, shows retail to be a leading sector in sustainability with over 85 percent of all retail brands recording above average results.¹²

¹¹National Retail Foundation and KPMG, Retail Horizons: Benchmarks for 2010, Forecasts for 2011, January 2011.

¹²Havas Media, Brand Sustainable Quotient Survey, October 2010.

Spurring consumer demand: With consumers interested in both values and value, retailers understand that they need to do a better job making the case to consumers by showing how their sustainability activities translate into better value for the consumer. While some retailers, such as REI and Walmart have been leaders in this area, integrating social, ethical and 'green' actions into their marketing, brand management and labeling, others have not yet articulated a clear value proposition around sustainability. For instance, while the majority of retailers have embraced the concept of reduce, reuse and recycle from production to packaging, most communicate these improvements in sustainability terms rather than closing the loop with consumers from a value-add perspective, i.e., smarter packaging is good for consumer pocketbooks and the environment. As competition over 'share of wallet' intensifies, the retailers that find a way to communicate the values behind their brands will have the upper hand in converting shoppers into buyers.

Return on investment (ROI): With the economy in recovery, retailers are once again eyeing expansion and remodeling opportunities. Not only can such investment reinvigorate store layouts and introduce new branding, but it can also provide an ideal mechanism to generate long-term savings in the form of more energy efficient designs and tax incentives. At a time when cost containment remains central, 'green' building design in both the store front and distribution network can yield significant savings. A survey of 650 supply chain executives, 25 percent of whom came from the retail, consumer packaged goods and food and beverage industries, found that the financial ROI that can accrue from improving energy efficiency, recycling materials, and using low-carbon buildings is one of the major drivers pushing sustainability to the forefront of strategic priorities, second only to improving the customer experience.

Minimizing the carbon and water footprint: Carbon management and reduction has been a major sustainability focus for the industry. This is true not just for retailers, such as Timberland, IKEA, and REI whose brand identities are closely tied to sustainability leadership, but for mainstream brands as well. Strategies to reduce emissions and water usage vary according to the type of operation but most store owners have programs in place to lower energy use in-stores and across the distribution network, improve load management to cut down on empty miles, and invest in renewable forms of heating, lighting, and cooling. The large retailers are also beginning to look at ways to reduce their supply-chain-wide emissions footprint. This is a complex undertaking, since measures and practices differ widely from supplier to supplier. Over time, however, analysts expect the sector to create more standard approaches to assess carbon and water impacts.

Green power: Kohl's Department Stores has been honored with its second Green Power Partner of the Year award, co-sponsored by the Environmental Protection Agency, the US Department of Energy and the Center for Resource Solutions. The award recognizes partners who distinguish themselves through their green power purchase, leadership, overall strategy and impact on the market. Kohl's purchases renewable energy credits that support wind, solar, small-hydro, biogas and biomass energy generation. The retailer also generates its own solar power on-site at 100 locations in eight states. Depending on the geographic location, solar provides 20-25 percent of the energy for the Kohl's sites.¹³

Sustainable distribution: Crate & Barrel's 1.2 million square foot distribution center in Tracy, California, is notable not only for scoring a gold LEED designation – the design uses 34 percent less water than traditional warehouses current and more than 95 percent of the building's construction waste was recycled – but also for its innovative approach to materials handling. The company now uses a squadron of small, but sophisticated robots to automate its pick, pack and shipment operations. Crate & Barrel expects the robots will allow them to significantly lower their carbon emissions: The robots are energy efficient and, unlike humans, they can operate in the dark without the need for heating or cooling.¹⁴

Sustainable luxury: Recognizing that even luxury buyers are looking for clear signs of value, the French luxury goods maker, PPR introduced a series of efforts across its brands to reduce energy consumption and waste as well as ensure fair labor standards are in force throughout its supply chain.¹⁵ For its part the iconic diamond company DeBeers understood that the industry needed to play a bigger role in addressing thorny geopolitical problems. It has partnered with the United Nations and NGOs to help eliminate trade in conflict diamonds. Likewise, Bang & Olufson, the maker of high concept stereo equipment, knew that customers are less interested in disposable luxury and, instead want to know that they are buying a quality piece that will last for years – it now designs its sound products for a lifecycle that extends up to 15 years.¹⁶

¹³ "Kohl's keeps sustainability streak going," RIS news, <http://risnews.edgl.com/magazine/December-2010/Kohl-s-Keeps-Sustainability-Streak-Going56877>

¹⁴ "Crate & Barrel warehouse robots cut carbon footprint of retail," Triple Pundit, February 2010, <http://www.triplepundit.com/2010/02/crate-barrel-warehouse-robots-cut-carbon-footprint-of-retail/>

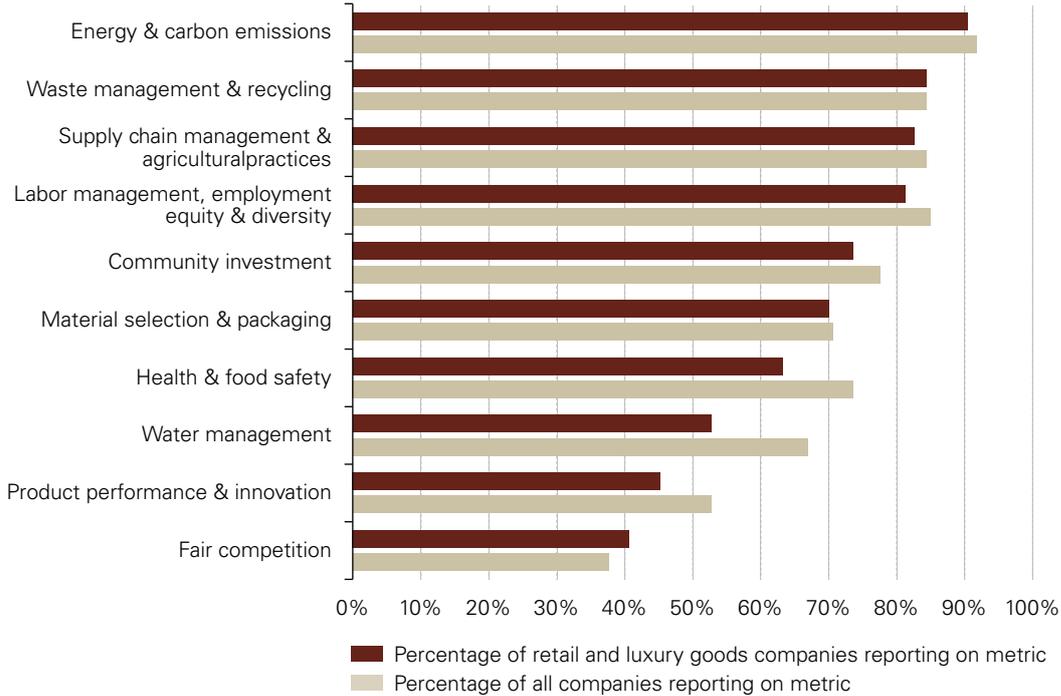
¹⁵ "Luxury goods makers embrace sustainability," New York Times, <http://www.nytimes.com/2009/03/27/business/worldbusiness/27iht-sustain.html>

¹⁶ "Luxury Goods: Premium brands respond to growing consumer awareness," FT <http://www.ft.com/cms/s/0/5133c2fa-bf90-11df-b9de-00144feab49a.html#axzz1BtBTZNoi>

Sustainability reporting in the retail and luxury goods sector

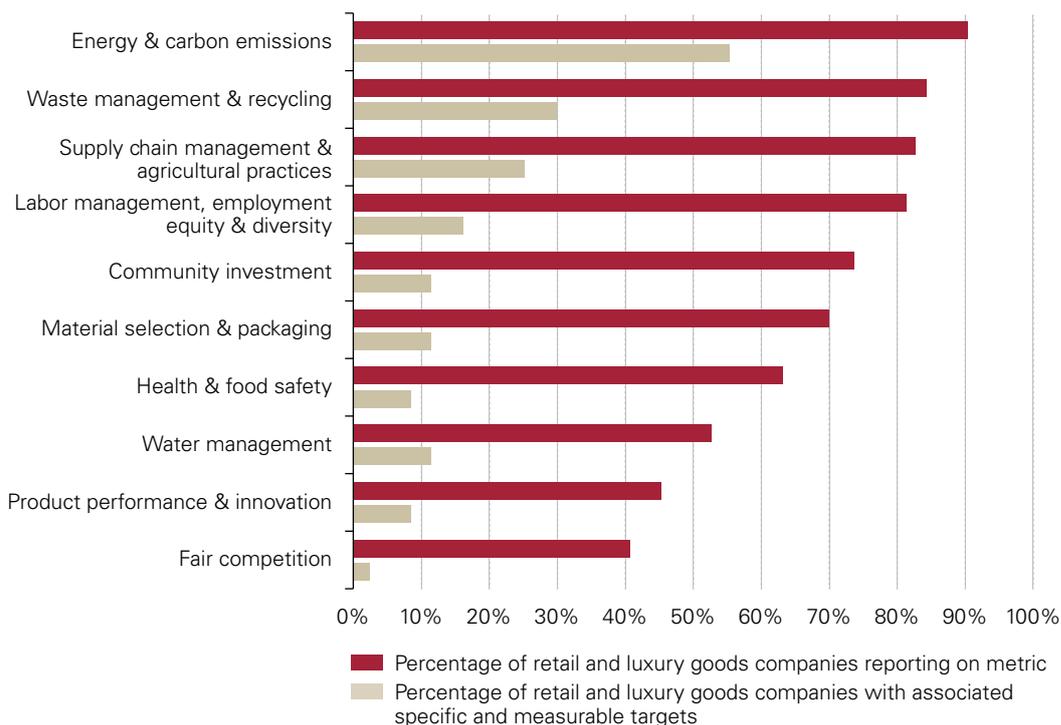
- Within the consumer markets industry, retail and luxury goods report on average, slightly less than manufacturers on most metrics
- Not surprisingly, this sector is least likely to report on metrics that are more relevant to manufacturers than retailers, including water management, product performance and innovation, and fair competition
- Retailers have a significant opportunity to influence a wide range of sustainability metrics by imposing minimum sustainability standards on suppliers and their own supply chains.

Percentage of companies reporting on each metric



Source: Measuring Up: Improving Sustainability in Consumer Markets, KPMG International, 2011.

Percentage of retail and luxury goods companies reporting on, and reporting targets for, each metric



Source: Measuring Up: Improving Sustainability in Consumer Markets, KPMG International, 2011.

Commonly used KPIs

- Audit coverage of environmental management systems in the supply chain
- Audit coverage of ILO standards in the supply chain
- Carbon footprint per turnover
- CO₂ emissions per ton of production/products distributed
- CO₂ emissions per ton per kilometer of products distributed
- Proportion of positive quality and safety audits
- Proportion of sustainable products (i.e. with eco/fair trade labeling)
- Total GHG emissions.

Drivers for increased reporting

- Brand reputation – industry is particularly sensitive to consumer sentiment
- Differentiation – luxury goods need to distinguish products as durable, high quality, timeless, unique
- Attract and retain high-quality talent
- Need to demonstrate how sustainable activities translate to better value for consumers
- Ability to affect sustainable practices in the supply chain
- Tracking and reporting enables cost containment and preservation of margins.

Challenges in reporting

- Making sustainability customer-centric – Marketing departments need to clearly communicate the impact of their sustainability initiatives to consumers, and choose sustainability investments that are likely to create the biggest impact and ROI from the consumer perspective. At present, ad hoc campaigns that tout environmentally sensitive packaging, LEED certified buildings, or reusable totes tend to present benefits from a company-centric position.
- Inconsistent data and sustainability standards – Incomplete, inconsistent and inaccurate data and standardization issues remain barriers to the adoption of more environmentally friendly supply chain initiatives across the sector.

Retailers recognize that they need to work more closely with their supply base to improve **transparency and accountability.**

- A need for greater partnership – Retailers recognize that they need to work more closely with their supply base to improve transparency and accountability. Such collaboration is also necessary for wider, game-changing improvements in distribution networks – through shared logistics in some case, and in minimizing their energy and water use.
- Factoring in geographic differences – The Brand Sustainable Futures survey¹⁷ finds that barriers to responsible consumption for retailers varies between regions, with price as a determining factor in western economies, while clear labeling and wider product offerings are needed in fast growing markets.

Industry best practices

Sustainability in the supply chain: IKEA's IWAY program specifies the requirements that they place on suppliers of products and services. Suppliers are responsible for communicating the content of the IKEA code of conduct to their employees and sub-suppliers. IKEA has a goal for FY12 for 100 percent of suppliers to meet IWAY requirements.

Some of the key points of IWAY include: Legal compliance start-up requirements; environmental standards social and working conditions.

IKEA has a goal for FY12 for **100 percent** of suppliers to meet IWAY requirements.

Tobacco

Given the scrutiny the tobacco industry has faced over the past decade, regulatory pressures stand as the primary catalysts for improved sustainability performance.

Overview

The well-documented health risks that tobacco products pose have resulted in costly litigation and reputational harm over the past two decades. As the industry emerges from that rocky chapter, it faces a much tougher regulatory environment and heightened expectations. More than anything else, those factors have given the sector a particularly acute understanding of the link between sustainability and financial performance.

As John Carver, a KPMG partner active in advising the tobacco sector, observed, "The industry is under enormous pressure from regulators, with the number of restrictions and compliance mandates growing to a point where they are becoming nearly unsustainable." But while regulators may be breathing down their necks, consumers are far less active in pushing for change than in other sectors. "While sustainability is an important issue and tobacco companies want to be good corporate citizens, they don't face the same consumer pressures," says Carver. "That's because people who purchase cigarettes know the health impacts, but still make the decision to buy, whether through choice or habit."

Pressure from investment analysts also appears more muted than in other industry groups. With less push from stakeholders, sustainability reporting tends to be less advanced than in other consumer markets sectors. Although some companies are doing a better job than others, most view sustainability as a compliance exercise.

¹⁷"Retailers poised to become the new Googles of the consumer goods industry," Havas Media, October 25, 2010.

Core sustainability concerns

Minimizing health impacts: While other consumer markets businesses, such as alcohol, fast food, and snacks, have faced questions over the health value of their products, most experts agree such products are safe to consume in moderation. That is not true of tobacco. When it comes to smoking or chewing tobacco, there are no safe levels. And nicotine's addictive properties elevate that risk further. Although the industry has had success expanding into developing markets, other avenues to growth have come under criticism. For instance, additives such as menthol, meant to make the cigarette taste better, have faced intense scrutiny by the US Federal Food & Drug Administration (FDA) and other bodies, since taste enhancers may make the product more appealing to youth. The bottom line consequences are clear. "With litigation risks easing and regulatory risks increasing markedly, the risk of incurring a large existential liability is essentially being replaced by the risk of reduced revenues and greater costs," says Christopher Collins, Associate Director at the US Credit Rating Agency, Fitch.¹⁸ To address this, research and development into nicotine substitutes, smokeless products and other innovations that may help curb tobacco's harmful effects will likely gain prominence. The industry will need to convince the public that its efforts to reduce exposure to at-risk groups around the world is sincere.

Sustainable agriculture: As an agricultural product, tobacco farming faces many of the same water scarcity and labor issues that affect other crops. In addition, some growing practices have been linked to a loss of biodiversity and decreasing soil fertility in regions where there are sensitive habitats, the heavy use of fertilizers and pesticides creates harmful runoff, and over-production of tobacco in some locales can lead to food shortages. Because tobacco farming, like other agricultural enterprises, relies on unskilled workers, the sector has faced incidents where the housing, treatment, and payment of laborers has come into question. Child labor issues have also surfaced, particularly in emerging markets countries. As the Dow Jones Sustainability Index notes, "[Tobacco] companies are therefore challenged not only by the direct risk of the use of their products, but also by environmental and social issues linked to the production of the raw material for these products."¹⁹

Chief challenges

Being taken seriously: Although the tobacco sector has contributed significantly to a number of important community projects, they seldom get any credit. Such is the level of anti-tobacco sentiment that the public is quick to assume an ulterior motive. Philip Morris International (PMI), for instance, funds major educational programs in Africa, Malaysia, Argentina, and Columbia, building schools and funding educational opportunities for the children of tobacco farmers, but these programs are often viewed with cynicism. Presentations on the subject at the company's Annual General Meeting have occasionally been overshadowed by anti-tobacco protests. Similarly, when BAT sought to initiate broad-based community dialogue with stakeholders when framing its first sustainability report, it had a hard time getting people to attend, especially voices critical of the industry. Michelle McKeown, a corporate communications executive at Benson & Hedges, once lamented, "If people took time to look at the company, they'd be pleasantly surprised, but no one listens."

Best practices

Innovation: Researchers at Biotechnology Foundation Laboratories have found a way to turn tobacco into a biofuel by genetically modifying the tobacco plant's DNA.²⁰ Although in its early stages, the research may lead to safer and more profitable outlets for tobacco companies as they look for ways to diversify their business model. In addition, where the use of corn as a biofuel has prompted concerns that it is exacerbating global food shortages, tobacco is a non-food biomass. As such, the effort is winning praise from some world health advocates.

¹⁸"Fitch: Outlook Stable for U.S. Tobacco in 2011; FDA Menthol Review Looms," Businesswire, Nov 16, 2010. <http://www.businesswire.com/news/home/20101116006363/en/Fitch-Outlook-Stable-U.S.-Tobacco-2011-FDA>.

¹⁹Dow Jones Sustainability Index, selection and exclusions, http://www.sustainability-index.com/07_html/other/faq.html

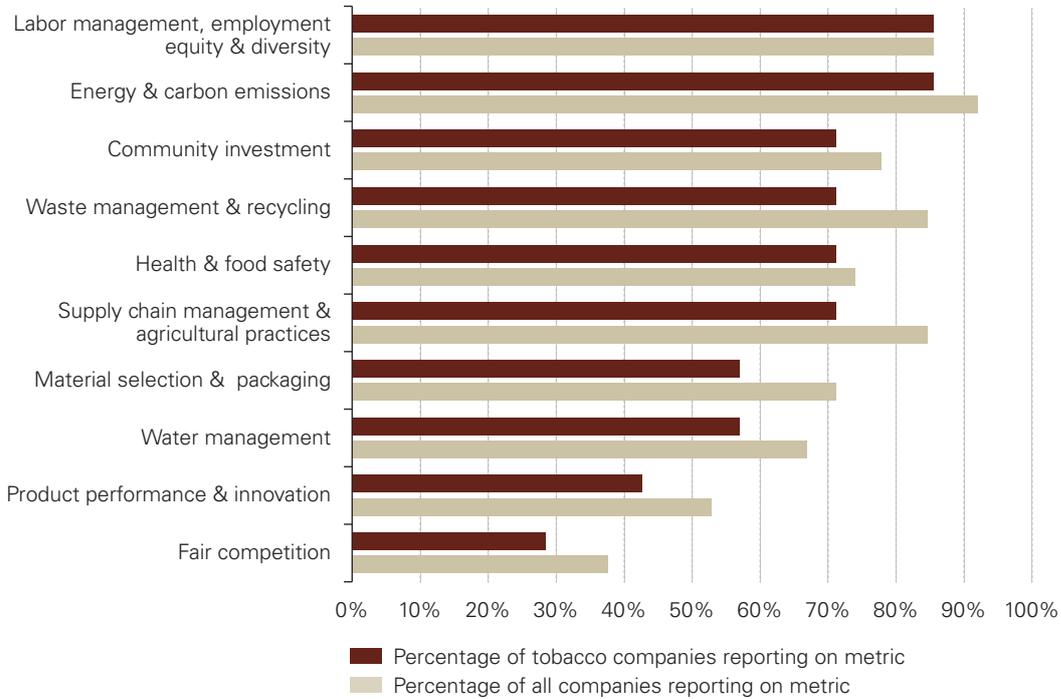
²⁰"Tobacco turns green leaf as possible biofuel, home insulation," The USA Today, Jan. 2010. <http://content.usatoday.com/communities/greenhouse/post/2010/01/tobacco-turns-green-leaf-as-biofuel-and-home-insulation/1>



Sustainability reporting in the tobacco sector

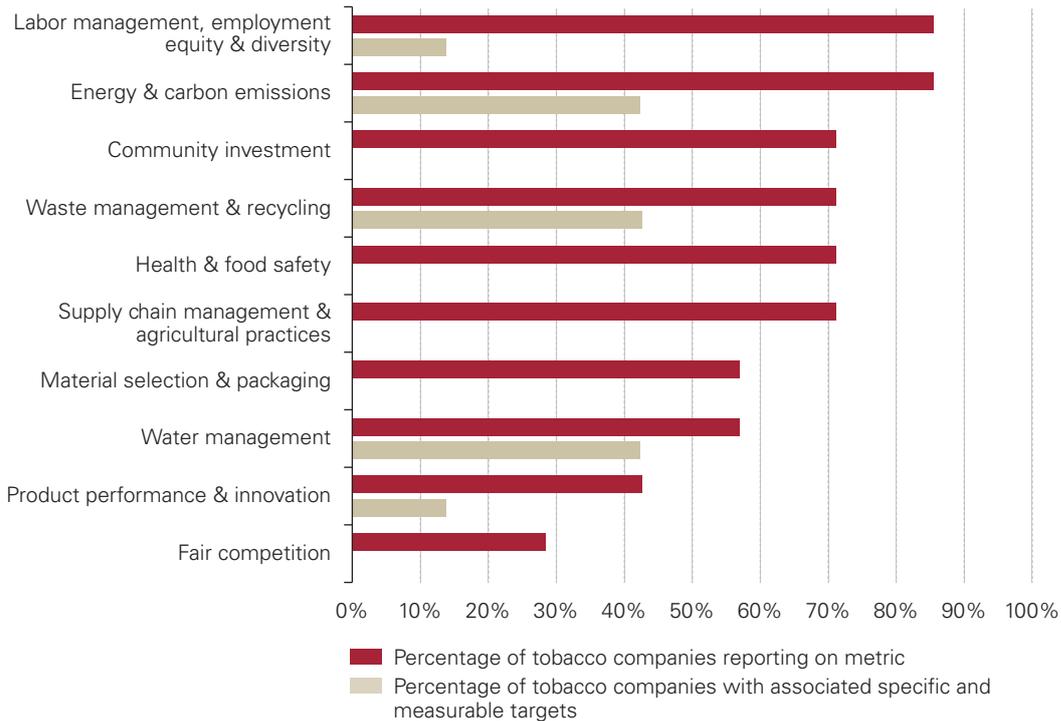
- Less likely to report on all metrics
- Over half of the companies reporting on energy, waste, and water also reported specific and measurable targets.

Percentage of companies reporting on each metric



Source: Measuring Up: Improving Sustainability in Consumer Markets, KPMG International, 2011.

Percentage of tobacco companies reporting on, and reporting targets for, each metric



Source: Measuring Up: Improving Sustainability in Consumer Markets, KPMG International, 2011.

Key performance indicators

- Proportion of sales exposed to stricter smoking regulations
- Disclosure of lobbying expenditures (to political parties/lobbyists)
- Litigation provisions
- Audit coverage of ILO standards in the supply chain
- CO₂ emissions per million cigarettes
- Water consumption per million cigarettes.

Drivers for increased reporting

- Heavy regulation – Few industries face the same degree of government oversight as tobacco. With penalties for compliance failures both severe and public, companies are keen to avoid them.
- Branding – With the industry working hard to restore its reputation, social and community investments offer a way to reposition the brand.

Challenges in reporting

- Being taken seriously – Rarely get credit for contribution to community projects; public assumes companies have ulterior motives.

Recommendations

- Specify if emissions and water consumption are for the company only or include the supply chain.
- Specify what percentage of water consumption takes place in water-stressed areas.

Industry best practices

Depth and quality of reporting: When it comes to sustainability, British American Tobacco (BAT) is seen as a leader the sector – the company was the first to produce a sustainability report back in 2002. The Dow Jones Sustainability Index, not the first place one would think to find a tobacco-producer being touted, selected BAT for inclusion in their portfolio, describing the company as “leading the industry in terms of sustainability.” And, in 2010, the company was awarded the ‘Best Sustainability Report in the FTSE 350.’²¹ To ensure its reporting remains focused on the right issues, the British-based multinational relies on an intensive series of focus groups, facilitated debates and discussions with consumers, health experts, academics, and non-governmental organizations. Either two to three senior managers, a Board Director, or the company’s CEO, attend each dialogue.²²

Either two to three **senior managers**, a Board Director, or the **company’s CEO**, attend each dialogue.

²¹ BAT.com http://www.bat.com/group/sites/uk_3mnfen.nsf/vwPagesWebLive/DO6ZKKSX?opendocument&SKN=1

²² CSR260 <http://www.csr360gpn.org/magazine/feature/stakeholder-engagement-at-british-american-tobacco/>



Conclusion

Despite tough economic conditions sustainability continues to move up the corporate agenda, where several factors have contributed to its increasing prominence. For consumer market companies, in particular, enhancing brand clearly ranks as the key driver for engaging with sustainability.

Sustainability reporting allows consumer-facing businesses to hold a mirror up to themselves and reflect a transparent image back to customers and other stakeholders demonstrating that they have responsible control over their business. In an industry where brand reputation can be a key differentiator, the ability to maintain and sustain a positive brand reputation is key to influencing consumer behavior.

Despite its apparent importance, our research into the sustainability reporting practices of 132 companies in the alcohol, tobacco, food and beverage, consumer goods, and the retail and luxury sectors, show a high degree of variance in the quality and quantity of information being reported, and the types of data being captured. Some companies are fully embracing sustainability reporting, and

have begun the process of incorporating it into business strategy. For others, the reporting process presents a number of core challenges:

Linking sustainability to the business

It is important, especially for those just starting out, to understand from a strategic standpoint why they are undertaking sustainability reporting, and to realize if reporting adds value to the company. Sustainability must connect to the overall business strategy. To start this process companies should engage both external and internal stakeholders – this not only builds credibility and trust but also enables companies to tap into a vital pool of knowledge to help understand what metrics are important, to whom, how and when.

Deciding what to report on – go deep not broad

The study evinces that many companies are grappling with the problem of deciding exactly what data to measure and how to measure it. However, the study also shows that companies are reporting on hundreds of metrics or Key Performance Indicators (KPIs). Recognizing that not all risks are equally material, leading consumer markets players are more likely to focus on those likely to have the biggest customer/stakeholder impact. The Global Reporting Initiative (GRI), which is the most widely accepted guidance for sustainability reporting, strongly suggests a specific process called materiality analysis for identifying report contents. By focusing their energies on issues that matter most to internal and external stakeholders, management can often forge a more credible and relevant report.

Establishing a robust reporting processes

Companies should realize that when they start sustainability reporting they are essentially embarking on a journey. The study has identified several considerations for consumer market companies implementing a sustainable reporting process: identify a credible champion who is going to “own” it; determine the operational and control structure (central coordination or integrated approach); set SMART targets and report performance against them; establish sector specific indicators to benchmark against peers; and perhaps most importantly build internal support by helping other functions understand its value to the wider business.

Communicating to stakeholders

A core challenge for reporting companies has been trying to cater to different audiences (who typically want different things in different ways and at different times) with a one-size-fits-all approach. The only consistency is that all stakeholders want sustainability metrics to be presented in clear terms that are “material” and “relevant” to their needs. Until recently there has been little innovation in the communicating of sustainability reports, where non-financial information has typically been made available (annually) via a downloadable PDF/hard copy report. New media channels and social media may be changing the game – where the ability to communicate bitesize datasets to an audience of one is not only becoming more pertinent, given consumption preferences and shortening attention spans, but also more economically feasible. Furthermore, these new channels provide unique opportunities to engage directly, in real-time, with influential stakeholder groups by providing the right data, to the right people, at the right time.

We hope these suggestions help jumpstart dialogue within the Consumer Markets industry and supplement organizations’ own efforts to make reporting and their approach to sustainability more consistent and robust for the long-term.

For consumer market companies, in particular, enhancing brand clearly ranks as the key driver for engaging with sustainability.

How KPMG can help

As companies pursue climate change and sustainability initiatives, they're looking for ways to quantify their efforts and communicate the return on their investment to stakeholders. KPMG can help. Our network of Climate Change & Sustainability (CC&S) professionals have a clear understanding of the issues, risks and opportunities presented by today's sustainability challenges.

We offer a holistic approach consisting of cross-functional teams (audit, tax, and advisory) working together and focused on the issues organizations are facing today ... and tomorrow. KPMG's CC&S professionals offer knowledge and experience spanning the science of climate change and energy conservation, the social responsibility of sustainability, the business risks and opportunities and the realities of regulation and policy change.

We've enlisted subject matter experts (including the United Nations' former executive secretary on climate change issues, Yvo de Boer) who understand the commercial and environmental impact of water usage, greenhouse gas emissions, climate change and other sustainability issues. We draw on the strong technical experience resident in KPMG member firms around the world to help companies:

- Capture the full benefit of energy and sustainability projects by identifying tax incentives, credits and grants that can improve return on investment, lower effective tax rates, and increase cash flow
- Reduce costs through increased resource and operational and supply chain efficiencies and grow revenue by capitalizing on responsible products and services
- Manage regulatory compliance and identify and help manage their enterprise sustainability risk
- Enhance their ability to track progress against specific reporting or sustainability targets, and communicate effectively with regulators, customers and investors
- Design and manage critical nonfinancial information streams with respect to carbon emissions, corporate social responsibility and the rapidly-evolving changes within the commercial supply chain, and ultimately,
- Provide assurance on these new information streams.

About KPMG

KPMG is a global network of professional firms providing audit, tax and advisory services. We have 138,000 outstanding professionals working together to deliver value in 150 countries worldwide. Our industry alignment and investment in knowledge helps our firms' clients tackle their most pressing issues.

KPMG's Global Consumer Markets practice is a network of experienced professionals based in member firms around the world. This practice encompasses food and non-food retailers, and companies in the food, drink, and consumer goods sectors.

KPMG's Global Climate Change & Sustainability (CC&S) practice is comprised of professionals who are specialized in assisting companies with their corporate sustainability-related issues.

Our aim is to help our firms' clients make the most of the challenges and opportunities presented by a constantly changing business environment. We offer a number of services to help our clients address the issues facing their industry, including the complex and evolving policy, regulatory, and business risks and opportunities relating to climate change and sustainability.

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Acknowledgements

We would like to acknowledge the significant contributions of Barend van Bergen, Wim Bartels, Katie Dunphy, Dr. Axel Hesse, Heather Kellett, Phil Ludvigson and Elaine Pratt.

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Designed by Evalueserve.

Publication name: Measuring Up: Improving Sustainability in Consumer Markets

Publication number: 110508

Publication date: June 2011