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Topic # Q1-A ESG and Sustainable Targets

Presentation #6

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EXECUTIVE SUMMARY

Environmental, Social, Governance (ESG) has seen an astronomic rise in recent years with many questioning whether it's a foundational element of the modern-day corporation, a fundamental component of future success, or simply a fad.

This essay evaluates the role of ESG in driving profitable growth across the Australian retail landscape, assessing the most influential competitive unlocks whilst questioning the role of industry alignment.

It will be understood that:

1. The surge in corporate ESG focus will continue.
2. ESG is essential to delivering long-term results; businesses who fail to progress beyond strategy to execution won't survive.
3. Competitive advantage comes not from broad targets, but individualized approaches and ongoing operational integration.
4. The most critical unlock to deliver meaningful change lies in partnerships.

The concluding recommendation is that for retailers and suppliers to drive a line of competition whilst achieving ESG targets, they must ensure their roadmap meets key stakeholder needs, provides differentiation from competitors, and prepares for future operational requirements.

Most businesses will get there eventually if they go it alone. However, the more pertinent question is whether the industry would get there faster if we all work in partnership.

Can a business truly seek profit and help save the planet?

INTRODUCTION

“Today’s brands have come to understand that it is not enough to just make profits, expand their market or establish prestige. There is also a moral imperative to demonstrate that a company cares.” – Matt Friedman, CEO, The Mekong Club¹⁵⁵

The goal of the modern corporate business? To be profitable and morally just. The way major retail businesses are approaching this is with an emphasis on ESG; a tiny acronym driving significant changes to business operations.

ESG has shifted in recent years from abstract obscurity to everyday corporate vernacular, alongside a misconception that long-term statements of intent will be enough to deliver profitable growth. In fact, 92% of employees lack true understanding of the term.¹⁵⁶

For most retailers and their suppliers, ESG targets are aligned at an industry level in degree and timeframe, with minor variation on implementation roadmaps.

In the retail industry, which accounts for over \$300B in consumer spending¹⁵⁷ and employs millions of Australians, the efforts to build a more inclusive, sustainable economy are critical, whilst balancing profitable returns.

By pursuing ESG business targets with individualised approaches, businesses will thrive at the bottom line against their competitors, but it may come at a cost of true, meaningful, ESG-led change.

The solution: working differently whilst working together.

¹⁵⁵ M. Friedman, 2022, Letters: ‘The Importance of Partnering up to Improve Sustainability Efforts’, *South China Morning Post*, 24 April, www.scmp.com/comment/letters/article/3175152/importance-partnering-improve-sustainability-efforts

¹⁵⁶ SEC Newsgate, 2022, ‘Australia Report’ www.secnewgate.com/esg-monitor/reports/australia-report-2022/

¹⁵⁷ PWC, 2020, ‘Where Next for Retail and Consumer?’, *How the retail and consumer industry can reboot for a post-COVID-19 Australia*, page 2, pwc-where-next-for-retail-and-consumer.pdf

WHAT IS ESG?

In all its perceived simplicity, ESG is a multi-faceted business framework. It provides quantifiable measurements of a company's impact on society and the environment, using metrics which highlight return and business value.¹⁵⁸

A more contemporary, more accountable version of 'Corporate Social Responsibility', ESG programs are integrated into a business's risk management strategy and overall value creation for stakeholders. For long-term company growth, they are non-negotiable and non-optional.

The term ESG has grown in prominence over the past 5 years. Executives of US S&P 500 companies mentioned ESG, on average, nine times in quarterly earnings calls in 2022, versus just once, if at all, in 2017.¹⁵⁹

Once simply considered another risk to be mitigated, ESG is now more commonly appreciated as 'one of the biggest value-creation opportunities of our time'.¹⁶⁰

Exhibit 1: Example ESG framework for Corporate Business¹



¹⁵⁸ PWC, 2020, 'Where Next for Retail and Consumer?' *How the retail and consumer industry can reboot for a post-COVID-19 Australia*, page 2, [pwc-where-next-for-retail-and-consumer.pdf](https://www.pwc.com/australia/en/issues-and-ideas/retail-and-consumer/where-next-for-retail-and-consumer.pdf)

¹⁵⁹ 2022, 'The Fundamental Contradiction of ESG is Being Laid Bare', *The Economist*, 29 Sept, www.economist.com/leaders/2022/09/29/the-fundamental-contradiction-of-esg-is-being-laid-bare

¹⁶⁰ J. van den Branden, P. de Paepe, M. Deryckere, and Jelle Dhaen, 2023, 'Belgian Companies Use ESG to Create Value and Differentiate', *Bain & Company*, 7 Feb, www.bain.com/insights/belgian-companies-use-esg-to-create-value-and-differentiate/

THE CRITICALITY OF KEY STAKEHOLDERS

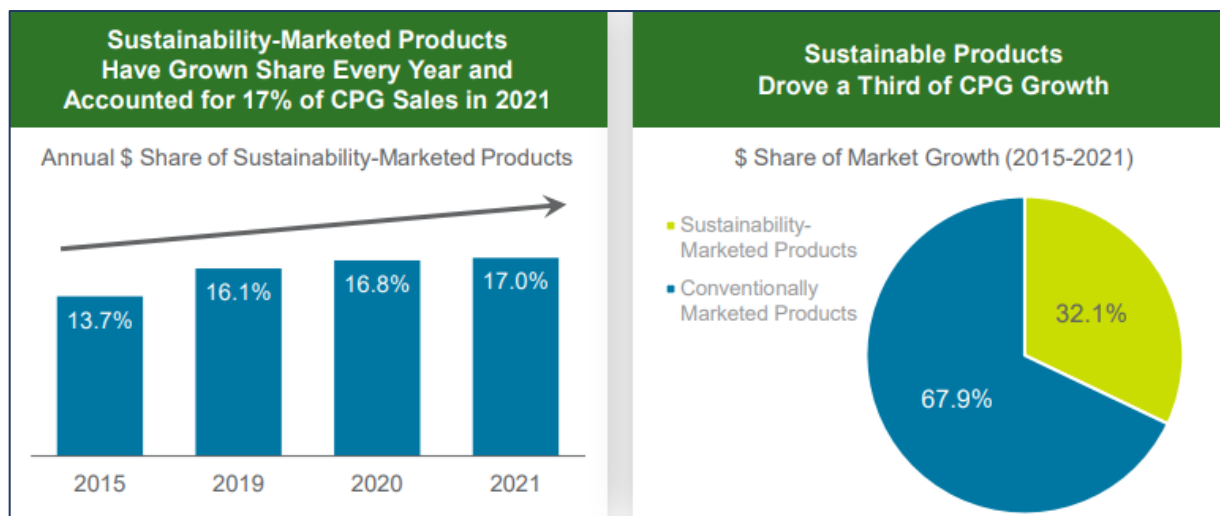
There are four major stakeholders of ESG-led initiatives, who are critical to long-term profitability and unlock true competitive advantage when managed effectively.

1. Consumers

Consumers are increasingly demanding a higher standard of sustainable practice, environmental footprint, resource circularity and positive societal impact from the businesses they interact with, especially within CPG sectors.¹⁶¹

Importantly, consumers are willing to pay a price premium on sustainability-marketed products, averaging 28% higher expenditure than conventionally marketed products¹⁶². This purchasing influence over-indexes with Gen-Z / Millennials, with 48% increasing their purchasing of sustainable products in the past 12 months.¹⁶³

Exhibit 2: Sustainability \$ Sales Trends Across 36 Core Edible and Nonedible Categories, MULO



Source: IRI POS data for MULO across 36 core categories; Analysis by NYU Stern Center for Sustainable Business

2. Employees

The importance of ‘Social’ agendas and its impact on human capital is a critical aspect of ESG, directly correlated to high-quality talent attraction and retention.

¹⁶¹ Sean Brown (host), 2022, ‘Why ESG is Here to Stay’, *McKinsey & Company Podcast*, 26 May, www.mckinsey.com/capabilities/strategy-and-corporate-finance/our-insights/why-esg-is-here-to-stay

¹⁶² 2021, ‘The Sustainability Imperative in Australian FMCG’, <https://www.iriworldwide.com/en-au/insights/publications/the-sustainability-imperative-in-australian-fmcg>

¹⁶³ Ibid.

78% of the millennial employee-base believe companies should be responsible for a better world¹⁶⁴, with 84% stating this takes precedence over professional recognition in the workplace.¹⁶⁵ Sustainable employees (high performance + good health) are 17% more productive than other employees, and 1.7 times more likely to stay at their organisation.¹⁶⁶

3. Investors

Investor interest in ESG has increased significantly, as evidenced by ongoing growth in sustainability-linked financing.

In Australia, sustainability-linked loans make-up a quarter of the total loan volume, equating to around \$7 billion in the first quarter of 2022*. Globally, ESG related assets under management (AuM) will soar 84% to US\$33.9 trillion in 2026.¹⁶⁷

Not only are investors willing to support the business sector's sustainability ambitions, but for many, their access to future financing and therefore growth, will become entirely dependent on their ESG credentials.

4. Businesses

Critically, paying attention to ESG does not compromise on value creation. A compelling and differentiated ESG proposition has a direct correlation to higher equity returns, a reduction in risk and delivery of improved cash flow through:¹⁶⁸

1. Top-line growth
2. Cost reductions (energy, waste)
3. Reduced regulatory intervention
4. Employee productivity and retention
5. Optimized investment & capital

¹⁶⁴ J, Butler, 2019, 'Like Honey to a Bee – Why do Millennials like Purpose Driven Companies', 26 April, <https://jeffbutler.com/2019/04/26/why-do-millennials-like-purpose-driven-companies>

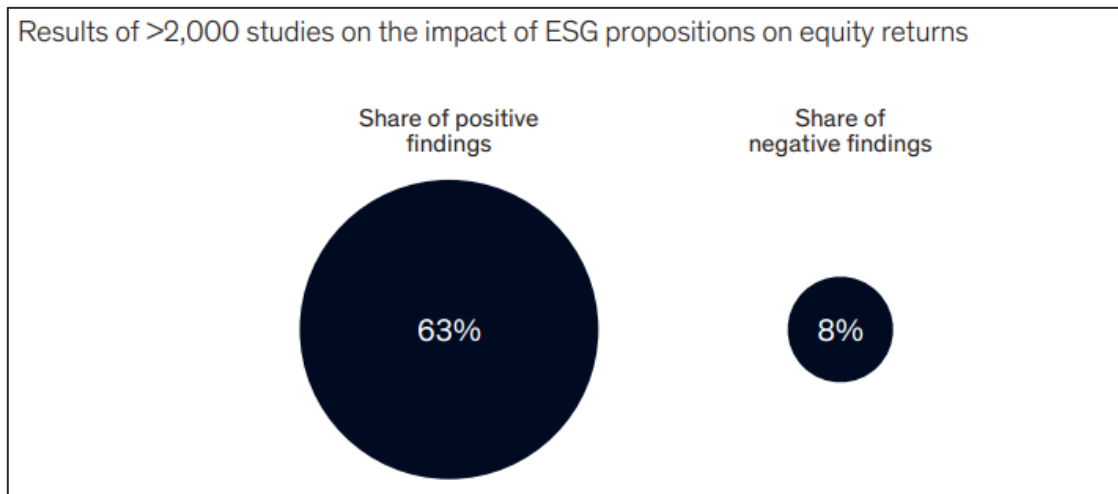
¹⁶⁵ Ibid.

¹⁶⁶ Sari Wilde, 2021, 'How to the Best Managers Improve Employee Performance and Health', Gartner, 8 Nov, <https://www.gartner.com/en/articles/how-the-best-managers-improve-employee-performance-and-health>

¹⁶⁷ 2022, 'Asset and Wealth Management Revolution 2022: Exponential Expectations for ESG' 10 October, <https://www.pwc.com/gx/en/news-room/press-releases/2022/awm-revolution-2022-report.html>

¹⁶⁸ Witold Henisz, Tim Koller, Robin Nutall, 'Five Ways that ESG Creates Value', *McKinsey Quarterly*, November, <https://www.mckinsey.com/~media/McKinsey/Business%20Functions/Strategy%20and%20Corporate%20Finance/Our%20Insights/Five%20ways%20that%20ESG%20creates%20value/Five-ways-that-ESG-creates-value>

Exhibit 3: Paying attention to ESG concerns does not compromise returns – rather, the opposite.



THE CHALLENGE WITH SAME, SAME BUT DIFFERENT

For businesses, there are three stages of ESG integration:¹⁶⁹

1. Review of Goals and Priorities
 - a. Entry-level integration
 - b. Regulatory and reporting focusedRisks: Greenwashing
2. Operationalizing and Strategic Integration
 - a. Meeting and exceeding regulatory obligations
 - b. Ability to attract green financing
 - c. Clear, aligned targetsRisks: day-to-day integration and retrofitting costs
3. Leading From the Front
 - a. Redesigned business models
 - b. Disruptors and innovators
 - c. Economy-wide impactRisks: initial profitability challenges

¹⁶⁹ 2022, 'Sustainability in Australian Retailers: Time to Level Up', KPMG, 4 April, [Time to level up sustainability in Australian retailers - KPMG Australia](#)

Across Australia, retail businesses have similar long-term ESG targets (straddling Stages 1 and 2) as they balance their appetite to drive profit, access capital and stay competitive whilst their moral compass guides towards a better, more sustainable world.

In 2022, the Australian Retailers Association (ARA) launched a Climate Action Plan, incorporating a net-zero roadmap:¹⁷⁰

- Net-zero emissions from electricity, by 2030
- Net-zero emissions along the retail value chain, by 2050
 - o incl. upstream from suppliers and downstream from consumers
- Zero waste to landfill, by 2050

40% of retailers have made net-zero commitments by 2050¹⁷¹, “a common target across corporate Australia”¹⁷² and reflective of broader global benchmarks.

All major supermarkets have incorporated this into their strategies, with aligned targets and timeframes, particularly on the path to Scope 3 emissions (inclusive of all indirect emissions within a value chain, up and downstream).¹⁷³

Exhibit 4: The United Nations Sustainable Development Goals¹



¹⁷⁰ 2022, 'Road to Net-Zero', Australian Retailers Association, <https://www.retail.org.au/sustainability>

¹⁷¹ S. Mitchell, 2022, 'The Climate Change Challenge Facing Retailers', Australian Financial Review, 12 May, <https://www.afr.com/companies/retail/the-climate-change-challenge-facing-retailers-20220511-p5akfe>

¹⁷² Kate Easteo, 2022, '2022 Sustainability Report', Woolworths Group, <https://www.woolworthsgroup.com.au/content/dam/wwg/investors/reports/2022/full-year/Woolworths%20Group%20Sustainability%20Report%202022.pdf>

¹⁷³ 2023, 'Briefing: What are Scope 3 Emissions?', Carbon Trust, www.carbontrust.com/our-work-and-impact/guides-reports-and-tools/briefing-what-are-scope-3-emissions

Coles has an aggressive goal to become ‘Australia’s most sustainable supermarket’¹⁷⁴ with a commitment to 100% renewable electricity by 2025, zero-waste landfill and net-positive carbon emissions by 2050. A target matched by Woolworths¹⁷⁵, Wesfarmers¹⁷⁶ and Amazon¹⁷⁷.

Whilst it is critical that net-zero 2050 targets are aligned to ensure industry-wide accountability, for most major retailers and suppliers their pathway to ESG goals are on par, easy to imitate and lack truly differentiated benefits for key stakeholders.

This will not drive immediate competitive advantage.

In a data analysis of over 4000 global businesses¹⁷⁸, major organizational sustainability and governance converged in the eight years from 2012 – 2019, indicating a major lack of differentiation in this sector.

Exhibit 5: Coles ESG statements¹

Exhibit 6: Woolworths ESG Goals¹



THE KEY TO UNLOCKING TRUE ADVANTAGE

1. Differentiation

This study suggests that a significant first mover advantage exists for those corporates willing to truly lead from their peers by articulating and, most importantly, delivering on unique ESG objectives.

In times of economic uncertainty, differentiation is even more critical.

¹⁷⁴ 2022, '2022 Sustainability Report', *Coles Group*,

https://www.colesgroup.com.au/FormBuilder/Resource/module/ir5sKeTxxEOndzd00hWJw/file/Sustainability_Report.pdf

¹⁷⁵ Kate Easteo, 2022, '2022 Sustainability Report', *Woolworths Group*,

<https://www.woolworthsgroup.com.au/content/dam/www/investors/reports/2022/full-year/Woolworths%20Group%20Sustainability%20Report%202022.pdf>

¹⁷⁶ 2022, <https://www.wesfarmers.com.au/sustainability>

¹⁷⁷ 2023, 'Taking Action to Increase our Sustainability' *Amazon Australia*,

<https://www.aboutamazon.com.au/planet>

¹⁷⁸ George Serafeim, 2020, 'Social-Impact Efforts That Create Real Value', *Harvard Business Review*, September-October Edition.

Whilst current inflationary pressures are superseding climate change concerns amongst Australian consumers (65% v 45% are 'extremely concerned'), 81% of shoppers believe climate change is occurring and concerns are up 12pp vs 2020.¹⁷⁹ Even if sustainability takes a slight backseat during this time of turbulence, the impact will be temporary.

During a cost-of-living crisis, winning retail businesses are creating unique benefits coupled with value proposition.

It shouldn't be viewed as an 'either/or'.

➤ *Everyone Gives a Crap*

A winning example is Who Gives a Crap, whose mission is to ensure every person globally has access to a toilet¹⁸⁰. They offer a product made from 100% bamboo, twice the length of leading brands, delivering price parity for a product which also lasts longer.

2. OPERATIONALISATION & PREPARATION

For many retailers, sustainability goals are integrated into core business strategy. However, a critical unlock is integrating ESG into everyday operations, particularly future physical and technological builds.

➤ *Bunnings nailing sustainable expansion.*

For Bunnings, all new store openings include enhanced levels of insulation, energy efficient lighting, on-site solar systems, and internal segregation. At a new store in

Melton East, Victoria Scope 1 emissions have reduced by 32% (vs previous store format) and Scope 2 emissions are 34% lower.¹⁸¹

For suppliers, regardless of size, consideration of ESG into future innovations (versus retrofitting) will see long-term cost benefit and progression away from the competitive pack.

In 2021, roughly 50% of new product development in the sector was sustainable, +20pp from 2017, with significant growth in personal care, cosmetics, and meat alternatives.¹⁸² Sales of these products are also growing 2.7x faster in their respective categories.¹⁸³

¹⁷⁹ 2021, 'The Sustainability Imperative in Australian FMCG', www.iriworldwide.com/en-au/insights/publications/the-sustainability-imperative-in-australian-fmcg

¹⁸⁰ Who Gives A Crap, 'About Us', <https://au.whogivesacrap.org/pages/about-us>

¹⁸¹ 2023, 'More Sustainable Building Design', *Sustainability at Wesfarmers*, www.wesfarmers.com.au/sustainability/our-stories/more-sustainable-building-design

¹⁸² 2021, 'The Sustainability Imperative in Australian FMCG', www.iriworldwide.com/en-au/insights/publications/the-sustainability-imperative-in-australian-fmcg

¹⁸³ 2022, 'Sustainability and the Consumer', IRI, September, page 5, www.iriworldwide.com/IRI/media/Library/IRI-NYU-Sustainability-2022-PDF.pdf

Exhibit 7: Bunnings solar panning on new store builds.

3. LEADERSHIP & PARTNERSHIP

What is most challenging, yet ultimately separates standout ESG organizations are those building a sustainable, inclusive economy in partnership with their value chain.

One of the criticisms of corporations is the lack of collective ambition to drive ESG agendas. Companies regularly report on their internal ESG advancements but are notably gapped on their collaboration with other industry partners, both up and downstream.

➤ *Tesco's new technology*

Tesco, Britain's largest retailer has a commitment to net-zero by 2050. However, to reduce Scope 3 emissions it will need new partnerships to fast-track innovation and technology for methane reducing emissions from livestock¹⁸⁴ – a non-existent technology... yet. With work underway, this will position Tesco to leverage their differentiated advantage whilst also creating real economy-wide change.

➤ *A winning example in Nestlé*

Like most leading FMCG brands, Nestlé has a roadmap to net-zero emission by 2050. To achieve their Scope 3 targets, they recognized they must 'work with the dairy industry'¹⁸⁵. In February, Nestlé NZ announced a partnership with Open Country to assist farmers in offsetting greenhouse gases by planting native trees on unproductive farmland; the areas where Nestlé dairy ingredients are sourced.

In 2022, they led the way by announcing *KitKat* would be the first food in Australia/New Zealand to be packed in a wrapper which uses 30% recycled

¹⁸⁴ 2022, 'Sustainability in Australian Retailers: Time to Level Up', *KPMG*, 4 April, [Time to level up sustainability in Australian retailers - KPMG Australia](#)

¹⁸⁵ 2023, 'Open Country and Nestle help farmers get ahead in offsetting greenhouse gases', *FMCG Business*, 10 February, [www.fmcgbusiness.co.nz/open-country-and-nestle-help-farmers-get-ahead-in-offsetting-greenhouse-gases/](#)

plastic¹⁸⁶, meeting consumer demands whilst paving the way for retailers to put pressure on other industry suppliers.

In FY 2022, Nestlé reported the Oceania region recorded high single-digit growth on Kit-Kat.¹⁸⁷

These types of partnerships take strong leadership but are ultimately the greatest unlock to industry wide ESG impact and can still deliver profit.

CONCLUSION

ESG is here to stay!

Across the Australian retail landscape, ESG targets are now commonplace, with broad alignment in scale and timeframe.

To realize a competitive advantage, retailers and suppliers must meet the growing ESG related demands of their consumers, employees, and investors. Through improved talent retention, consumer demand, access to finance and deregulated risk, businesses put themselves in the best position to achieve profitable returns.

However, to successfully outperform the competition, businesses need to select, and deliver on ESG approaches that are difficult to emulate, whilst continuously investing in ESG-related operations as they arise.

Ultimately, it is the untapped opportunity to collaborate with their value chain that will see a business deliver the greatest advantage to themselves, society, and the planet.

It is these organizations who will not only deliver on stakeholder needs but will create industry-wide impact and access previously untapped profitability.

There is a sense of optimism in stating everyone can benefit from working together, however the key to future success is indeed, a future. The way a business is nothing without its employees, the future does not exist without the planet.

So, can businesses truly seek profit and help save the planet?

Indeed, this is the only answer.

¹⁸⁶ Chris O'Donnell, 2022, 'KitKat wrapped in recycled plastic', *Nestle Planet*, August, <https://www.nestle.com.au/en/stories/kitkat-wrapped-in-recycled-plastic>

¹⁸⁷ 2023, 'Nestle Reports Full Year Results for 2022', *Nestle*, 16 Feb, <https://www.nestle.com/media/pressreleases/allpressreleases/full-year-results-2022>