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Consumer Packaged Goods Practice

How to prepare for a sustainable future along the value chain

Consumer-goods companies are setting ambitious sustainability targets for themselves. To reach those targets, however, changes are required along the entire value chain—with a concrete road map.

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80%

Share of consumer emissions that reside in supply chains. To meet the pathway to net zero, CPG companies need to work with their suppliers to secure green raw materials and supply

Our lives have changed radically as a result of the pandemic. But as dramatic as the impact of COVID-19 has been, it has by no means eclipsed another topical issue: the need to shape a more sustainable economy. In fact, this task has attracted heightened public attention following extreme weather events such as the devastating flooding all over Europe last summer. Last fall, decision makers from around the world met in Glasgow, Scotland, for the 26th United Nations Climate Change Conference to discuss the challenges ahead.[1] Although the debate primarily focused on major emitters, such as the energy, steel, and construction industries, the consumer-goods sector is equally called upon to take action.

But what exactly do we mean by "sustainability"? In its broadest sense, the term covers three areas: environmental, social, and governance—or ESG for short. Specifically, ESG encompasses the degree of responsibility that companies assume—irrespective of what they are legally required to do—for sustainable development in the three areas mentioned.

For many, sustainability is primarily about our use of natural resources and the climate impact of our actions. This is also highly relevant for consumer-goods manufacturers. As a rule, it is not enough to look only at one's own value creation. After all, a typical consumer-goods company's supply chain generates far greater environmental costs than in-house operations: for instance, it is responsible for more than 80 percent of greenhouse-gas emissions and more than 90 percent of the impact on air, land, water, biodiversity, and geological resources.

The consumer-goods industry is facing a huge environmental challenge: if it intends to meet the current EU climate targets, it will have to more than halve its greenhouse-gas emissions by 2030. Given that prosperity and consumption will continue to grow in the coming years, a fundamental change in thinking is required; new business models—especially those relating to the circular economy—will have to gain an increasingly firm footing.

Growing pressure and rising opportunities

Even beyond the climate targets that have been set, regulatory requirements for the economy are becoming more stringent—for example, through levies such as the "plastics tax." The European Union's Green Deal provides for all packaging in the EU area to be reused or recycled by 2030. The Circular Economy Action Plan also provides for products to have long life cycles and be repairable ("right to repair").

But it's not just from the regulatory side that pressure is growing. Other stakeholders are also demanding more sustainability from companies or setting their own new standards for sustainable business practices.

Consumers. Today's consumers are another pressure point since they no longer see sustainable products as simply an alternative.

They are partly basing their purchasing decisions on the sustainability of products and companies. Granted, what some refer to as an "attitude–behavior gap" remains. In other words, consumers don't always make purchasing decisions that are consistent with their sustainability preferences as expressed in surveys. That said, two-thirds of consumers now say they are changing their consumption habits in favor of a lower environmental impact[2]—and are staying true to their word: brands, such as oat-drink maker Oatly, that promote the ecological benefits of their products are recording above-average growth rates.

Employees. Sustainability is already a top criterion in choosing an employer for two-thirds of those under the age of 34. Across all age groups, three out of four employees would like their company to place a greater emphasis on environmental and social issues.[3]

[1] Harry Bowcott, Daniel Pacthod, and Dickon Pinner, "COP26 made net zero a core principle for business. Here's how leaders can act," November 12, 2021, McKinsey.com.
[2] "A natural rise in sustainability around the world," NielsenIQ, January 10, 2019.
[3] *Sustainable working environment index 2021*, Epson, June 2020, epson.co.uk.

Patagonia, a manufacturer of outdoor clothing, is one of the pioneers of the circular economy. By 2025, it aims to make its entire business, including its supply chain, carbon neutral.

57%

of all start-ups in the consumer-goods sector are 'green' start-ups

Investors. The financial sector is, to some extent, already ahead of the real economy when it comes to sustainability. A survey of decision makers from more than 40 investment firms (including BlackRock, Vanguard, and State Street) shows that an ESG-oriented mindset is already an integral element of investment decisions.[4]

Increasing demands for sustainability stem partly from investors' risk management and partly from the increasing incidence of loans linked to sustainability criteria. Furthermore, sustainability-oriented funds are more resilient, as studies show: on average, 77 percent of ESG funds established ten years ago continue to exist today. Compare that to only 46 percent of traditional funds that have survived over the same period.[5]

New market entrants. "Green" start-ups are increasingly gaining market share in consumer-goods segments—be it in the footwear market, where the Californian–New Zealand start-up Allbirds has made a successful entry, or in the food segment, where products made from plant proteins (among others) are increasingly gaining popularity. According to the Green Startup Monitor 2021, three-quarters of all newly founded companies in Germany view their environmental and social impact as relevant to their strategy. In the consumer-goods sector, for example, 57 percent of all newly founded companies are now green start-ups.[6] Take, for instance, the marketplace Cirplus, which has set itself the goal of simplifying the currently complex and confusing global trade in recyclates and plastic waste.

In view of the growing pressure from all sides, for established consumer-goods companies, it is no longer a question of whether or not they need to operate sustainably—and most are also clear about what they need to do; however, there is still great uncertainty when it comes to how. What is needed is a sustainability strategy and, above all, a road map to implement the strategy in the context of a transformation.

Moving toward action

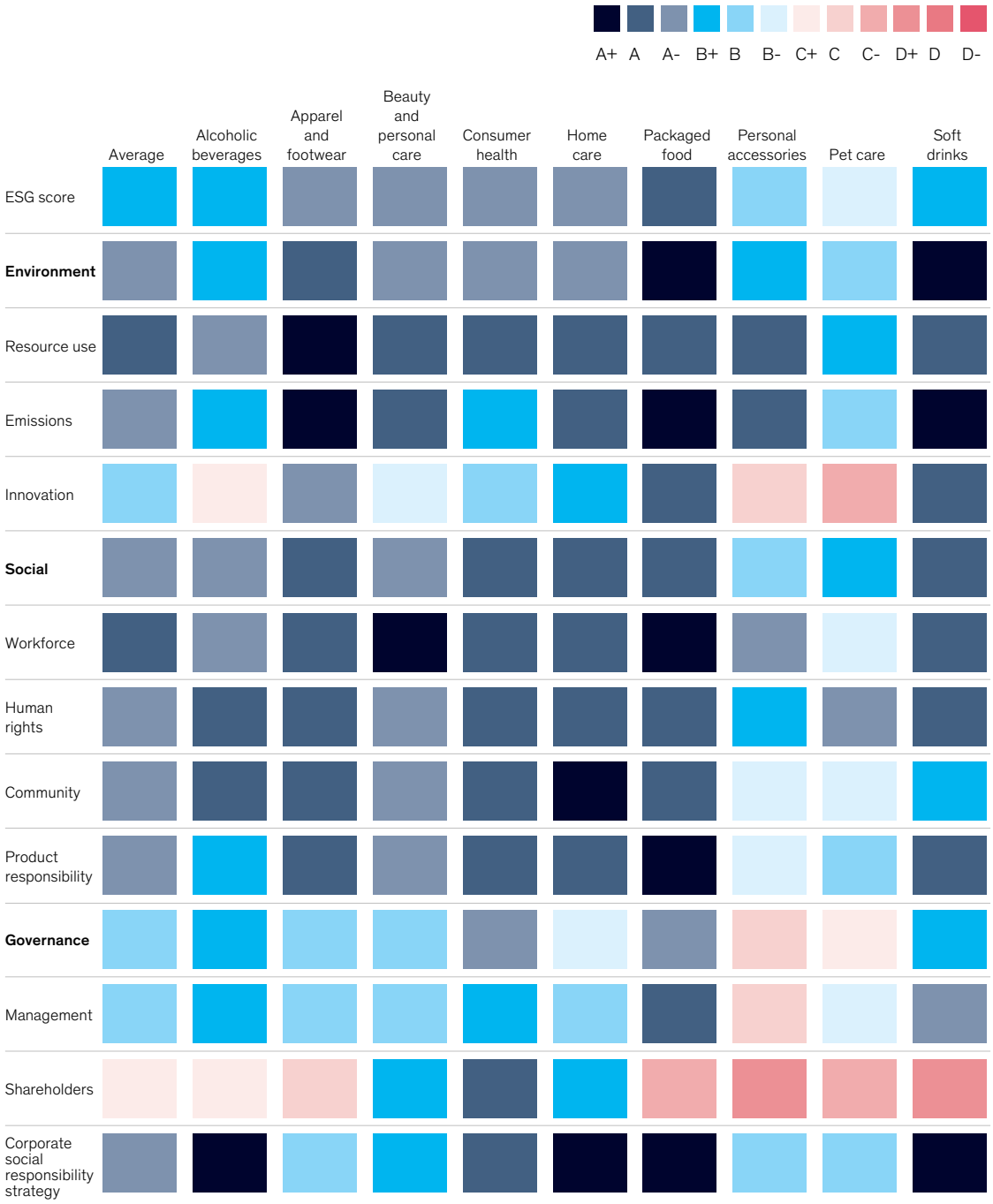
Where do companies currently stand in their efforts to make their operations more sustainable? Rating agencies such as S&P try to answer this question systematically by referencing an array of sustainability criteria. As the ESG score of leading consumer-goods suppliers shows, the industry performs well on average (Exhibit 1). In the social dimension in particular, the consumer-goods sector

[4] "The investor revolution," *Harvard Business Review*, May 1, 2019.
[5] Siobhan Riding, "Majority of ESG funds outperform wider market over 10 years," *Financial Times*, June 13, 2020, ft.com.
[6] Klaus Fichter and Yasmin Olteanu, *Green startup monitor 2021*, Borderstep Institute for Innovation and Sustainability, 2020, deutschestartups.org.

Exhibit 1

Europe's consumer-goods sector has average scores for implementing sustainability; it scores best in the social dimension.

ESG score of top companies in each consumer-goods category,[1] 2019



[1] Per category, 3 to 5 of the largest listed consumer-goods companies by market share in Europe, the Middle East, and Africa.

Source: Refinitiv Workspace ESG Score Report 2019; Refinitiv ESG Score Methodology

almost universally earns high scores (As and Bs). This means good to excellent ESG performance and an above-average level of transparency in the disclosure of ESG data. The analysis shows that 30 percent achieve a score of A or A+ in at least seven out of ten ESG dimensions, and 52 percent achieve the same in at least five out of ten. There are also champions in individual disciplines: the consumer-goods companies listed below demonstrate strengths in certain sustainability dimensions—typically in areas that are particularly important for their business.

Nestlé has launched the Creating Shared Value program, which assures 30 million farmers and people in rural areas stable agricultural incomes through 2030, as well as the creation of fair and inclusive jobs.

By 2030, Danone wants to use solely renewable energy and lower its water consumption by one-quarter. The company was already a pioneer in discontinuing the use of genetically modified feed and supporting farmers worldwide.

Unilever aims to reduce the environmental impact of water, waste, and greenhouse gases per consumer use of product by 50 percent by 2030. The group has long been an advocate of sustainable palm oil.

Henkel aims to triple the value of its business in relation to its environmental footprint by 2030 and, among other things, is relying for certain brands entirely on "social plastic"—that is, old plastic packaging collected from people living in poverty for a fee. In addition, Henkel plans to make all product packaging recyclable, reusable, or compostable by 2025 and to make its operations climate-positive by 2040.

Adidas is already a global leader in sourcing more sustainable cotton ("better cotton"). In doing so, it maintains production levels with minimal environmental impact and supports the livelihood of local producers. In addition, Adidas plans to use only recycled polyester across its entire product range by 2024.

Patagonia is a pioneer when it comes to the circular economy and good working conditions. For many years now, the manufacturer of outdoor clothing has offered to repair older articles and return them to consumers. By 2025, it aims to make its entire business carbon-neutral—including the supply chain, which is responsible for 95 percent of Patagonia's emissions.

Beyond Meat and Impossible Foods offer product portfolios that are based on sustainable alternatives and have created significant growth in the plant-based protein industry.

The Honest Company was founded by Jessica Alba for the purpose of promoting cleaner and more sustainable products in the baby space.

The initiatives show how seriously consumer-goods companies are now addressing sustainability. Almost all of them have set ambitious targets in a range of areas, from emissions mitigation and recycling to sustainable procurement and water use (Exhibit 2).

Explanation of Exhibit 2

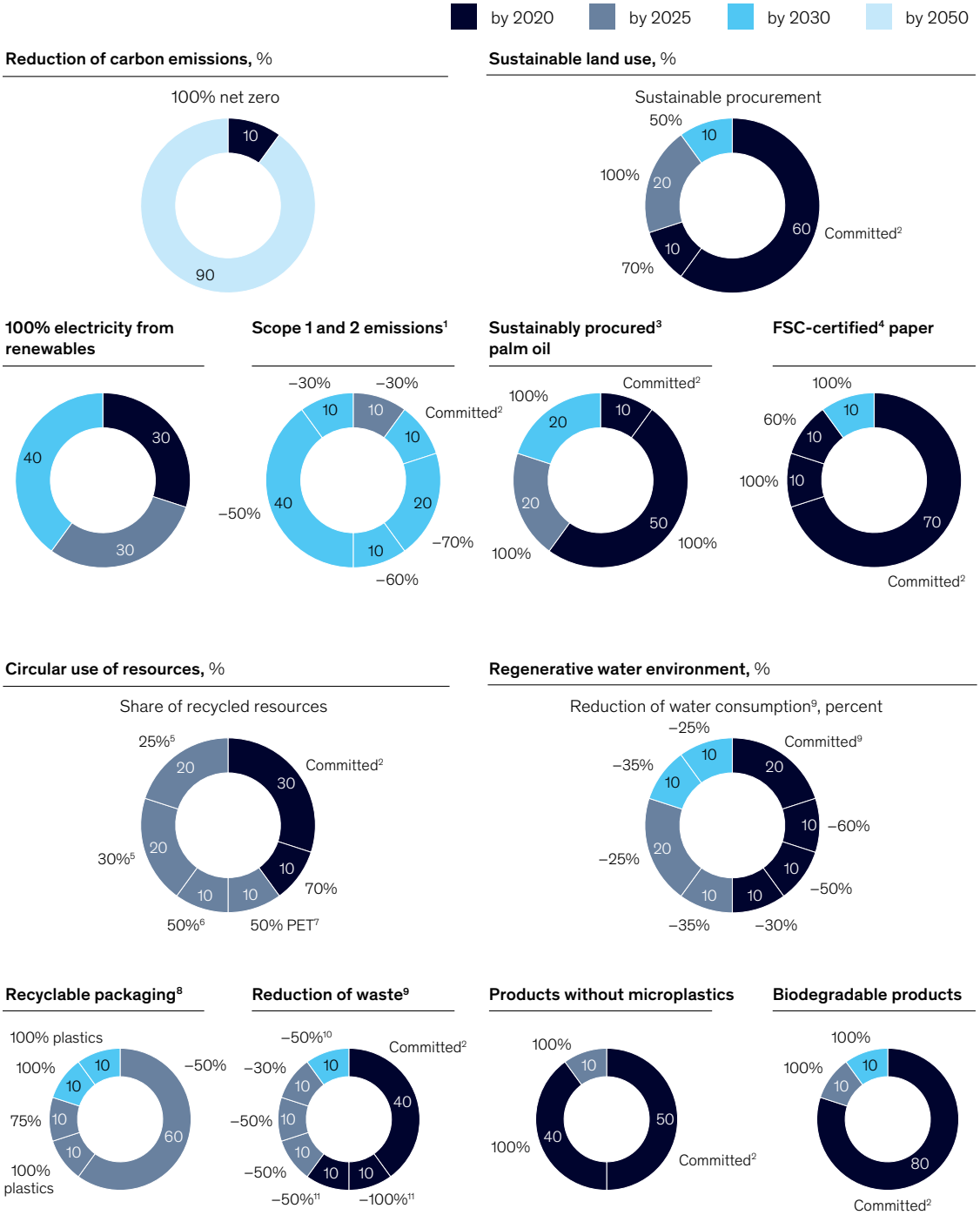
Exhibit 2 shows which sustainability targets ten leading consumer-goods companies aim to achieve by what year. The target year is indicated by the color code (with the palest shade being 2050), the percentage of companies making commitments is shown within the rings, and the magnitude of the planned change is indicated outside the rings. "Committed" means that these companies have committed to making reductions but have not explicitly specified a percentage.

An example of how to read the "Sustainable procurement" chart is as follows: 20 percent of companies want to make their procurement 100 percent sustainable by 2025.

Exhibit 2

Major consumer-goods companies are setting sustainability targets that go beyond simply optimizing their carbon footprint.

Sustainability targets of 10 leading European consumer-goods companies, shares in %



[1] Direct and indirect emissions. [2] Committed = commitment without specifying targets. [3] Sustainably sourced or certified. [4] Forest Stewardship Council (certification system for sustainable forestry). [5] Plastics in packaging. [6] Postconsumer recycling materials (PCR) in packaging. [7] PET = recyclable polyethylene terephthalate. [8] Reusable, refillable, recyclable, or compostable. [9] Production-related. [10] Food wastage. [11] Landfill waste.
Source: McKinsey analysis of publicly available information as of September/October 2021

Since 2015, Adidas has worked with the environmental organization Parley for the Oceans, which organizes the collection of plastic from beaches. Adidas uses Parley Ocean Plastic as an eco-innovative substitute for virgin plastics.

Implementing sustainability goals effectively

Effectively implementing the envisaged sustainability goals is an all-encompassing organizational challenge and often means change for both the product portfolio and the organization, including its culture. Given the scope involved, it is not enough to launch individual initiatives sporadically and hope for success. Instead, sustainability must be seen for what it is: a transformation of company operations spanning the entire supply chain. Four elements are crucial here:

Set the right target level. The first step begins with a realistic outside-in assessment: What are regulatory expectations? Where are competitors raising the bar? What are the expectations of customers and other stakeholders, including investors? It is usually strategically advisable to take the lead in a small number of relevant dimensions and determine what the future minimum requirements will be in all other dimensions. The level of the targets and the speed of their achievement should be based on realistic assumptions and plans. Knowledge of the levers and the technical possibilities to arrive at a realistic ambition is of particular importance.

Plan the transformation and set the framework. Once the target level has been set, senior management should make the transformation a visible priority for everyone and plan it in detail. To this end, measures need to be developed and incorporated into an overall road map. Governance is also crucial for successful implementation at this point; thus, instituting a sustainability officer at the senior-management level is an important framework condition. This does not necessarily have to be the chief sustainability officer, as long as the organization ensures that the central team works effectively with the operational units and can not only create initiatives but also enforce them.

Secure and track implementation. For the implementation process, it is worth setting up a transformation office that regularly measures the degree of target achievement. This enables the prompt adoption or reprioritization of countermeasures. It is also imperative that adequate resources be made available. To change ways of thinking and behavior within the company, it also makes sense to recruit employees as change agents. In this context, the communication and anchoring of sustainability goals in the organization—for example, through incentive systems—should also be addressed.

Create transparency. Last, investments should be made in data and transparency because retailers, consumers, regulators, and investors are increasingly demanding it. In particular, traceability across supply chains poses a challenge. This makes it all the more important for companies to deal with the sustainability data of their own products right from the start and to develop the corresponding analytical skills.

No function is left untouched when changes of this magnitude are needed: everyone is involved and responsible for bringing sustainability to life in their area—from purchasing to production and logistics to marketing and sales (Exhibit 3). For successful implementation, the key actors in the individual divisions need to develop both function-specific and overarching measures.

In purchasing, for example, the focus may be placed on biologically derived ingredients, recycled plastic for packaging, biodegradable and certified materials, and regenerative agriculture.

To do this, it is first necessary to assess the volume of emissions caused by each purchasing category and what reductions are possible in each area. The procurement team is also responsible for ensuring suppliers adhere to social standards.

Exhibit 3

Sustainability can be implemented along the entire value chain in all dimensions.

	Sourcing	Logistics	Manufacturing and product design	Marketing sales
Environment	Bio-based ingredients, circular resources, traceable and biodegradable materials, regenerative agriculture, and certified materials	Reduction of last mile emission and optimized delivery routes, alternative propulsion (eg, e-mobility, H_2 trucks), sustainable warehousing incl renewable energy and sustainable cooling technology	Energy efficiency, sustainable packaging, waste reduction (incl food waste), and water stewardship	Product transparency, product ecodesign with ecoscores and labels, environmental certification, product life cycle assessment
	CO_2 reporting and Scope 1, 2, and 3 split; GHG emissions reduction; maximized water circularity by recovering, reusing, and recycling wastewater; renewable energy usage; reduction of food waste			
Social	Farmer training and financial empowerment; responsible sourcing	Upskilling and safety trainings, incentives for low fuel consumption	Health and safety management system at production sites	Promotion of responsible consumption
	Human rights policy; child labor policy; gender score; gender pay gap regulation and publication; management of gender balance; diversity and inclusion practices; donations to social causes (women empowerment, violence victim support, etc); modern-slavery transparency statement			
Governance	Compliance programs and communication; data protection regulations; conflict of interest policies; anti-corruption, anti-trust and bribery regulations; traceability system integration; risk mitigation plans			

Source: McKinsey analysis

In logistics, it is key that companies consider alternative propulsion systems for their vehicle fleets or the use of more sustainable transport options. In the field of warehousing, organizations should review cooling technologies and use renewable sources to ensure energy supplies, employing their own solar panels if necessary.

Production should first optimize its energy efficiency. In addition, consideration needs to be given to the use of renewable and sustainable energy sources for electricity and heat at production sites. It is also necessary to investigate how water and other resources can be used more efficiently and how waste can be reduced.

Meanwhile, R&D teams can work on more sustainable designs and formulations (design to sustainability). This can involve sustainable packaging or formulas for new products that lead to greater sustainability in use—such as laundry detergents that clean textiles thoroughly even at low water temperatures. L'Oreal, for example, has developed the Sustainable Product Optimization Tool (SPOT), an evaluation tool focusing on ecological design on two levels. First, it simulates different design options, evaluates their impact on the environment and society, and identifies improvement measures. Second, SPOT quantifies the effects of sustainability on various product attributes, such as packaging; the environmental footprint of product compositions and chemical processes; and social implications.

The initiatives described above for illustration purposes show that sustainability is not an issue that can be left to a central unit; rather, it reaches deep into all functions of consumer-goods companies. Citizens, policy makers, investors, and new competitors are increasing the pressure to act. Above all, however, it is the companies' own sustainability ambition that requires a structured and holistic approach if the goals set are to be achieved.

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