

Sustainability: the missing ingredient in strategy

Ingrid Bonn and Josie Fisher

Dr Ingrid Bonn is Associate Professor of Strategy at the School of Business, Bond University, Gold Coast, Australia. Dr Josie Fisher is Associate Professor of Management at the School of Business, Economics and Public Policy, University of New England, Armidale, Australia.

1. Introduction

A survey by KPMG in 2008 found that 47.7 per cent of companies considered sustainability and corporate responsibility an important driver of innovation (KPMG International, 2008). However, for the majority of companies, understanding how to make their businesses more sustainable was a challenge. The areas that posed the greatest challenge for approximately 80 per cent of companies were identifying and prioritizing issues, developing strategies and policies and measuring performance. This finding is in line with anecdotal evidence from our consulting work. The Director of Sustainability of a large manufacturing company in New South Wales, Australia, for example, stated: "For us, sustainability is important, both at the strategic and the operational levels. That is why we created the position Director of Sustainability about six months ago. However, for me, as Director of Sustainability, the challenge is to identify the areas that need a greater sustainability focus, to develop appropriate strategies and to oversee their implementation. [...] It is a very complex process." Similarly, the owner of a small business in Victoria, Australia, commented: "My aim is to grow my business in a sustainable way, but I do not have the knowledge to do it. I have reduced waste and use more recycled materials, but I would like to implement a more comprehensive approach to make my business model more sustainable." These quotes illustrate the complexity and some of the difficulties managers experience when trying to make their businesses more sustainable.

In this paper we argue that for organizations to achieve sustainability, managers must address the different aspects of sustainability during the strategic decision-making process and incorporate them into their corporate, business and functional level strategies. Our discussion focuses on the broader holistic understanding of strategy (as opposed to an instrumental, operational-level approach aimed at enhancing the reputation of the organization). We develop a framework that managers and scholars can use to assess the degree to which organizations have strategically addressed sustainability and to identify opportunities for further improvements. An analysis of the individual elements of the framework is provided and illustrated with practical examples. However, it is first necessary to consider the term sustainability and how it has been used in a business context.

2. What is sustainability in a business context?

The World Commission on Environment and Development (1987, p. 8), headed by Gro Brundtland, defined sustainable development as meeting "the needs of the present without compromising the ability of future generations to meet their own needs." Crane and Matten (2007, p. 23) provided a more specific definition, referring to sustainability as "the long-term maintenance of systems according to environmental, economic and social considerations." In the environmental perspective the basic principles of sustainability focus on the effective management of physical resources and require addressing

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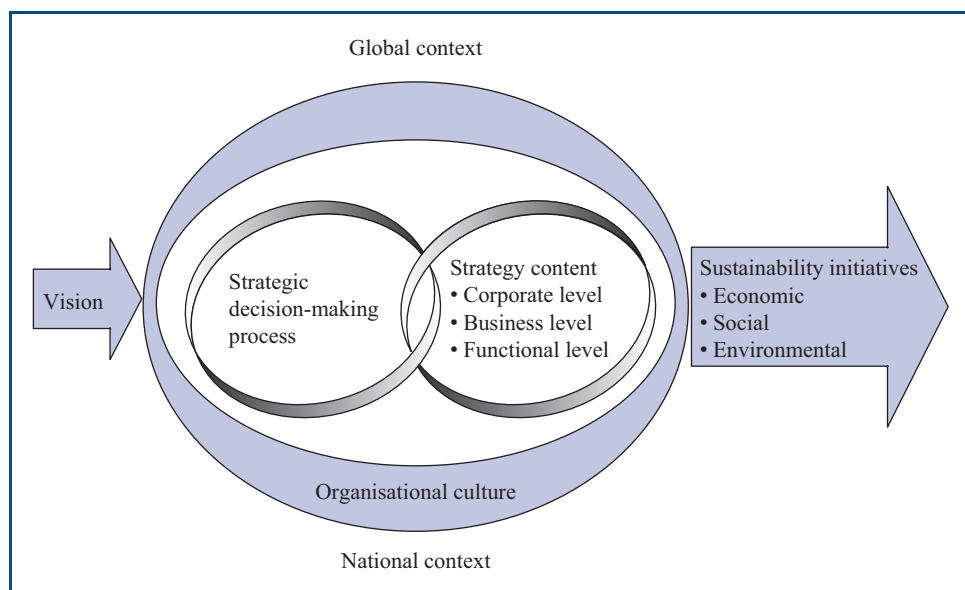
problems such as the depletion of non-renewable resources, the effect of industrialization on biodiversity and the production of pollution. Economic sustainability incorporates the long-term economic performance of the organization as well as the organization's approach towards, and impacts on, the economic framework in which it operates. Central to the social sustainability perspective is the notion of social justice, focusing on values such as freedom from extreme poverty, hunger and disease, the right to basic education, and the promotion of gender equality.

An approach that takes into account the economic, environmental and social aspects of sustainability is complex and requires organizations to integrate sustainability at multiple levels and throughout the organizational system. This approach goes beyond simply complying with legal and regulatory requirements and takes a proactive stance towards sustainability. We argue that if organizations are to become more sustainable, then managers need to ensure that sustainability is integrated into the strategy process from the very beginning and is addressed on an ongoing basis. More specifically, the organization's vision needs to reflect the organization's commitment to sustainability and sustainability needs to be part of the strategic decision-making process as well as the strategy content. In addition, sustainability initiatives need to be supported by the organizational culture in a proactive way. Sustainability issues are also influenced by the national and global contexts in which the organization operates, for example, the legislation of minimum standards for emissions and waste disposal. Figure 1 shows the framework we use to analyze how sustainability can be incorporated into strategy.

3. Vision

Organizational decision-makers are faced with a high level of uncertainty and incomplete information. They need to deal with complex and multifaceted projects that require taking the interests of different stakeholders into consideration. Managers who face such a situation need guidance or, as Weick (1995, p. 27) has argued, "values, priorities and clarity about preferences" to help them develop viable strategies and design appropriate courses of action. A commonly shared vision can provide this guidance and convey a sense of direction in the decision-making process, especially when tradeoffs among goals are necessary. It is important that such a vision is genuine (as opposed to being a mere slogan) and that it reflects the fundamental values of the organization.

Figure 1 Sustainability as an integral part of strategy



“Loving Earth fills a niche market for customers who are looking for products that are made according to specific environmental and social standards. The motto ‘Conscious consumerism: health, sustainable, fair’ outlines the three fundamental principles that underpin all aspects of Loving Earth’s operations.”

A vision that includes sustainability as a core value will include economic, environmental and social elements, signaling strong corporate norms and values and providing principles that guide the decisions of senior managers, line managers and employees. Such a vision supports a view of success that integrates the need to earn a profit with the responsibility to foster social justice and environmental protection. It requires the relationship between the organization and its stakeholders, including the natural environment, to be explicitly addressed and their diverse concerns and interests to be taken into account. This vision communicates to stakeholders and the society at large that sustainability is an integral part of the organization’s business approach. For example, the vision for sustainable development of the world’s largest mining company, BHP Billiton, articulates a commitment to their stakeholders and the three dimensions of sustainability: “Our vision for sustainable development is to be the company of choice – creating sustainable value for shareholders, employees, contractors, suppliers, customers, business partners and host communities. Central to our vision is our aspirational goal of Zero Harm to people, our host communities and the environment” (BHP Billiton, n.d.).

4. Strategic decision-making process

The vision provides the basis for making strategic decisions as outlined above. Strategic decisions are typically made by upper-level management and affect the long-term direction of the organization. They are complex and often difficult to define with managers being required to make sense of a variety of limited and often conflicting information. Strategic decisions are associated with different trade-offs, are highly interconnected with other decisions in the organization and set precedents for subsequent decisions (Wilson, 2003).

The strategic decision-making process is concerned with the way decisions are reached in an organizational setting and includes the activities that lead up to and support the choice of strategy. During this process decision-makers identify strategic problems and analyze their nature as well as their underlying causes. This involves scanning the environment to gather data and making sense of it by developing cognitive models and building mental representations that guide managers’ thinking and the direction of their decisions. These cognitive models structure the unknown, but they also define what decision-makers regard as relevant and act as a filter that influences their perception of organizational events and what should be done about them. Research suggests that managers who receive the same stimuli may use different frameworks to interpret them and, therefore, disagree about meanings, causes or effects. As a result, the same internal or external stimulus may be interpreted differently by managers in different organizations or even within the same organization (Starbuck and Milliken, 1988). Hence, decision-makers’ cognitive models will exert a strong influence on the strategy process by shaping their environmental sensing capabilities and by influencing the perception and diagnosis of strategic issues. For an organization it is important to understand its decision-makers’ cognitive characteristics, because they may consciously or unconsciously influence how strategic problems are framed and how strategic choices are made.

The nature and the specific characteristics of the decision-problem also have an important influence on the strategic decision-making process. The strategic choices made by

decision-makers depend on what issues their attention is drawn toward and how this attention is channeled and distributed within the organization. In particular, characteristics such as familiarity with the strategic issue or problem influence whether the issue makes it to the organizational agenda, how the issue is dealt with and what actions are taken. Research also suggests that emotional involvement with the issue (or lack thereof) influences what decision-makers regard as relevant and how they respond to it (Kollmus and Agyeman, 2002).

Understanding the deep-seated beliefs and cognitive characteristics of strategic decision-makers is important if an organization aims to become more sustainable. Imagine, for example, two hypothetical decision-makers. The first decision-maker is a proponent of the shareholder value approach that regards organizations as instruments to serve owners by maximizing economic profitability. Responsibility for employment, consumer welfare, local communities and the environment are not regarded as being an organizational matter, but as being issues for individuals and governments. For this decision-maker, sustainability would only be a “nuisance” that has to be dealt with. This view would be reinforced if the decision-maker has no emotional attachment or involvement with sustainability. This decision-maker is likely to deal with sustainability by taking a minimalist approach that merely satisfies any legal and reporting requirements.

Conversely, imagine a decision-maker who subscribes to the stakeholder value approach that emphasises the need to not only serve an organization’s shareholders, but all other stakeholders as well, in particular employees, consumers, suppliers, local communities and the environment. Profitability is seen as important, but needs to be balanced with the legitimate demands of the other stakeholders. For this decision-maker, sustainability is likely to be an issue that demands attention, especially if the decision-maker also has an emotional involvement with it. This decision-maker will incorporate sustainability concerns into the strategic decision-making process and the organizational system. The example of Scott Fry, founder and managing director of Loving Earth, illustrates this approach.

Scott Fry was involved in community development work in India and Mexico for 11 years. He coordinated various community development projects in India and set up and managed an organic agriculture project working with indigenous agricultural co-operatives in Mexico. After coming back to Australia, he set up Loving Earth in Melbourne (originally named Living Earth) in 2006 to source and supply high quality organic and traditional foods to health-conscious customers. He is passionate about working with indigenous growers and about informing consumers about the environmental, social and cultural context in which Loving Earth’s products are produced.

Loving Earth is a multi-million dollar business that has been growing at 125 per cent a year. The business supplies both manufacturers (with bulk products) and retailers. Loving Earth manufactures chocolate products that are minimally processed and contain no artificial additives or preservatives. The raw ingredients are sourced from indigenous co-operatives in developing countries that are members of the Fair Trade Federation. The products are produced to Fair Trade standards, but Loving Earth is working to go beyond the conventional fair trade system by empowering indigenous communities to add as much value as possible to their raw materials at the point of origin. Their cacao beans, for example, are de-shelled by the Mayan co-operative in Xoconusco, Mexico, to produce the nibs and their raw cacao powder and butter are cold pressed by the indigenous co-operative in Satipo, Peru. All products are grown without the use of synthetic fertilizers or chemical pesticides and herbicides and their cultivation helps restore native ecosystems, prevents erosion and supports water conservation. Fry is passionate about making traditional foods available in a way that honors the indigenous people that have cultivated them for thousands of years, and the earth and ecosystem in which they are grown (Kaplan, 2009).

Loving Earth fills a niche market for customers who are looking for products that are made according to specific environmental and social standards. The motto “Conscious consumerism: health, sustainable, fair” outlines the three fundamental principles that underpin all aspects of Loving Earth’s operations. These principles also reflect Scott Fry’s

philosophy and passion for social and environmental sustainability. They guide the strategic decision-making process and define the criteria used to source and develop all products.

The example of Loving Earth illustrates how the personal and cognitive characteristics of a decision-maker impact on the strategic choices made and, subsequently, on the way sustainability is integrated throughout the organization's activities. The challenge for decision-makers in organizations that are just beginning to move towards sustainability is to re-evaluate their current values and assumptions, in particular if they are not oriented towards sustainability. It is also important to recognize that addressing sustainability in strategic decision-making is a process (as opposed to a single event) that requires ongoing management attention and a continuous need to identify, analyze and create new strategies to promote sustainability in the long-term.

A long-term commitment to sustainability requires decision-makers to address sustainability concerns in all decision-making processes, in particular when there are significant tensions between economic, environmental and social considerations. Dealing with these tensions by focusing on long-term sustainability outcomes rather than short-term financial gains will provide clear messages to organizational members that sustainability is an important part of the organization's strategy. In addition, it is important that decision-makers carefully monitor sustainability initiatives developing within their organizations. They may also encourage their employees to make suggestions about new sustainability opportunities by providing an environment where such activities are encouraged and rewarded.

5. Strategy content: corporate, business and functional levels

The outcome of the strategic decision-making process is the strategy content, namely a particular set of strategies for the corporate, business and functional levels. Corporate-level strategy is concerned with the overall scope of an organization and how value will be added to its different business units. It is about developing, selecting and managing an optimal set of businesses that compete in several industries or product markets. Developing corporate-level strategies involves making decisions about product/market diversity, geographical coverage and the possible pursuit of acquisitions and strategic alliances. Decisions at the corporate level address how resources are to be allocated between the different parts of the organization and form the basis for all other strategic decisions.

If sustainability is a core value for the organization, the scope of the organization's corporate portfolio will need to include strategies for addressing the issues of over-consumption and waste in the developed world. This involves building businesses that develop and promote durable products that can be produced and consumed with minimal environmental impact. There may also be opportunities for cooperation between organizational units and/or organizations to make use of each other's by-products, thereby reducing overall waste. In addition, the scope of the corporate portfolio needs to address the question of global sustainability and develop businesses that produce culturally sensitive, ecologically sustainable and affordable products that meet the needs of people in the developing world. Finally, the individual businesses need to be balanced so that the corporate portfolio contributes to the long-term economic sustainability of the organization (Stead and Stead, 2004).

Managers therefore need to rethink their current business model and analyze whether their corporate portfolio achieves a balance between the organization's economic, environmental

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and social goals. Based on this analysis, managers might face a number of questions, such as:

1. Should we initiate changes to improve the sustainability of existing businesses or should we divest unsustainable businesses?
2. Should we add new sustainable businesses to our portfolio and, if so, should we develop these businesses or acquire them?
3. Should we establish strategic alliances to jointly build innovative businesses that focus on sustainable product and service development?

Business-level strategy deals with the individual businesses (or strategic business units) in which the organization operates and focuses on how to compete effectively in an industry or a particular product/market segment. A critical decision for an organization at the business level is the choice of which products or services to offer to the market. Organizations that aim to become more sustainable have to decide whether to modify their existing products (and services) to make them more sustainable or whether to develop new sustainable products. The sustainability of products (or lack thereof) is strongly influenced by the technologies that are used in their production. Production technologies influence, for example, the type of raw materials that can be used, the potential production efficiencies achievable, the type and amount of pollution emitted during the production processes, the health and safety of employees and the public, as well as the management of waste.

A commitment to sustainability requires organizations to conduct a product life-cycle analysis to assess each product's impact from its different life-cycle stages. This includes product development, raw material access and extraction, production and distribution, product use as well as the disposal of packaging and used products. Such analysis takes the whole “product system” into account and prevents the transfer of negative impacts and risks between the different stages in a product's life. The life-cycle analysis may result in a redesign of products and packaging and/or the development of more efficient production facilities that maximize material and energy conservation and minimize the release of by-products with harmful impacts. It may also lead to the development of programs to promote ethical sourcing, more stringent codes of conduct in terms of labor practices or increasing work-force diversity. Such life-cycle assessment is complex and requires extensive interaction and dialogue between an organization and its suppliers and distributors to ensure that sustainable business practices are used in both the upstream and downstream value chains. Its results should inform a comprehensive plan that identifies the goals and specific targets the organization aims to achieve in each life-cycle stage together with a timeframe and the person responsible for ensuring the goals and targets are met on time. In addition, such a plan needs to spell out the specific strategies necessary for achieving the goals.

The functional-level strategies give guidance to managers in areas such as operations, finance, human resources and marketing. For example, a human resource strategy that aims to address sustainability needs to include guidelines for recruiting and selecting employees who will support the organization's sustainability efforts. Such a strategy also needs to address the type of training and development programs that will be implemented to improve employees' knowledge and skills in the area of sustainability. Furthermore, a performance

appraisal and reward system is required that measures and rewards employees' contribution to the organization's economic, social and environmental performance criteria. Similarly, a marketing strategy has to ensure that the needs of the different stakeholders are met, that the organization's sustainability goals are supported and that the marketing processes are sustainable. This includes the development of a pricing strategy that incorporates the true environmental and social costs into the price of products and services, the development of promotional strategies that honestly convey the organization's social and environmental achievements and the use of sustainable marketing channels (Stead and Stead, 2004).

The Australian wine industry provides an example of a major rethink in business-level strategy by some organizations and illustrates the broad range of initiatives that needed to be undertaken to move from unsustainable to more sustainable practices. In 2006 a severe drought and prolonged frost conditions affected many wine regions in Southeastern Australia and cut the national grape harvest by 30 per cent to 1.3 million tonnes, the smallest harvest since the turn of the century. The wine-growing region of Northeast Victoria was particularly badly affected because, in addition to drought and frost, the region was hit by severe bushfires around Christmas, covering the remaining grapevines in acrid smoke. Some wineries, including Arnie Pizzini's Chrismont Wines, lost almost everything: "We lost 75 per cent of our crop to that big frost in November. We've been growing grapes since 1980 and I've never seen anything like it." However, it got worse: "The fires started in our area on December 2 and went until January 20. They came right up to the boundaries of both of our vineyards" (Allen, 2007). Chrismont Wines ended up with a harvest of about one tenth of its normal crop.

The drought and fires of 2006/2007 have motivated many organizations in the wine industry to confront the prospect of climate change and to consider how they can make their businesses more sustainable. This included re-evaluating whether the traditional grapes used in Australia could be replaced by grapes that can better adapt to the Australian climate and require less water during their growing period. It also involved rethinking whether the current technology used for growing the vines has been the most appropriate and whether other strategies could be implemented to deal with a warmer and drier future. Leading the change towards a more sustainable wine industry is Bruce Chalmers, the owner of the largest vineyard nursery in Australia. Chalmers specializes in importing and selling grape varieties from the hot and dry regions of Southern Europe that are better suited to the Australian growing conditions than the traditional Sauvignon Blanc, Merlot or Chardonnay varieties. He has improved the design, management and maintenance of irrigation systems to minimize water usage and improve overall efficiency. He now uses a drip irrigation system (as opposed to overhead spray) and irrigates only at night to minimize run-off and evaporation. In addition, he uses strategies such as boosting organic carbon in the soil to maximize water retention and capturing rainwater. These techniques, combined with using grape varieties that require less water, resulted in water savings of around half the regional average.

6. Organizational culture

If a sustainable vision and sustainable strategies are to be successful, they must be supported by and reflected in the prevailing organizational norms, values and beliefs as well as in the informal problem-solving and decision-making processes. As a system of shared meaning, organizational culture plays a critical role in organizations that aim to become more sustainable. Sustainability-centered cultures reinforce a view that environmental and social values are important to the organization and guide the behavior of managers and employees. In addition, these cultures can influence the attitudes of other stakeholders, such as suppliers and distributors and possibly the wider society, in particular if organizations have the size or standing to take an effective sustainability leadership position (Stead and Stead, 2004).

Sustainability-centered cultures are built upon beliefs and practices that are consistent with the principles of sustainability and that encourage behavior that is sensitive to environmental

and social issues. The development and maintenance of such cultures requires organizations to formally include environmental and social criteria into their recruitment, selection and training processes as well as their job descriptions and performance appraisal and reward systems. Of particular importance are performance appraisal and rewards systems developed as part of the human resource strategy, because they are likely to influence behavior and have consequences for managerial decision-making and organizational strategy. If sustainability is to be taken seriously, the reward system needs to reflect the importance of environmental and social as well as economic criteria to the organization. It needs to encourage senior executives to focus on long-term horizons and to adopt a strategic approach towards sustainability. This can be achieved by including a high proportion of long-term and qualitative sustainability oriented performance measures in the remuneration package. Special recognition should also be given to individuals and teams for achieving outstanding results in economic, environmental or social sustainability initiatives.

There is also a need to create a centralized point of accountability for sustainability initiatives. This may involve a single appointment at senior management level, such as a Director of Sustainability, who acts as a visible “champion” for sustainability issues and who coordinates and facilitates sustainability initiatives throughout the organization. It may also involve appointing a board member who oversees the sustainability efforts within the organization.

7. Sustainability initiatives: economic, social and environmental

There is a broad range of sustainability initiatives that an organization can undertake, for example, allocating a certain percentage of the research and development budget for developing products with improved environmental and/or social features, investing in cleaner technology, developing a child labor policy, implementing a labor code of conduct and safety program, and investing in social or cultural pursuits. To be effective these initiatives need to be addressed and supported by all the elements discussed throughout this paper. This includes a vision that incorporates economic, environmental and social aspects, a strategic decision-making process that is based on decision-makers' commitment to sustainability, strategy content that makes specific reference to sustainability at all levels (corporate, business and functional) and an organizational culture that promotes and supports sustainability efforts. Becoming a sustainable organization is a long and arduous process requiring continuous capability building and management attention and the need to integrate all sustainability initiatives so that they form a cohesive whole. However, it also provides opportunities to develop new businesses and products and may help to attract more motivated and loyal employees.

An example of an organization that has implemented a variety of integrated sustainability initiatives over an extended period of time is Migros, Switzerland's largest retailer and private employer. With a workforce of over 84,000, Migros operates 601 retail outlets including supermarkets and department stores, as well as banking and insurance units. Migros also owns 15 industrial companies, making it Switzerland's largest food

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manufacturer. In 2008 the organization's annual sales were approximately 25.8 billion Swiss francs (\$US24.82 billion).

Migros is a member of the Global Compact of the United Nations, a voluntary framework for businesses that are committed to aligning their strategies and operations with ten universally accepted principles in the areas of human rights, labor, environment, anti-corruption and reporting. Migros' group strategy includes a commitment to developing a balance between economic, ecological and social demands, stating explicitly that "Sustainability is an integral concept of group strategy that becomes evident in all aspects. With this strategy Migros is convinced it will be more successful in the long term and is even willing to accept short-term losses to achieve its goals" (Migros, 2008, p. 11). They have undertaken a number of initiatives to improve their social and environmental performance. For example, Migros founder Gottlieb Duttweiler introduced the Culture Percentage, which has allocated a certain percentage of the turnover to activities related to education, culture, leisure and social initiatives for about 50 years. Migros also operates a comprehensive environmental management system, which is coordinated by the ecology and energy departments in the Federation of Migros Cooperatives (FMC). Altogether, nine full-time employees in the FMC work on questions of operational environment protection and energy management, supported by environment officers in the regional cooperatives and factories. More recently, Migros started a new packaging offensive with the aim to reduce packaging material or replace it with climate-friendlier material. As part of this process, Migros conducted comparative life-cycle assessments taking into account the packaging life-cycle chain, including manufacturing and transport processes, disposal and reutilization.

Migros offers about 40,000 products, including a wide portfolio of ethical, fair-trade and organic food products, household articles, furniture and textiles. In early 2008 Migros started to market products with the CO₂ label from the independent organization Climatop. The aim of the CO₂ label is to make customers aware of the most climate-friendly products in a certain category. Before awarding the label, experts calculate the extent to which a product harms the climate during its whole life-cycle, including cultivation, production, transport and disposal. Products that cause at least 20 per cent less CO₂ than comparable articles are declared "CO₂ Champions" and marked with the CO₂ label.

The example of Migros demonstrates a long-term strategic approach to sustainability that has been very successful. Migros has adopted a variety of initiatives throughout their different businesses and placed particular attention on improving the sustainability of products and packaging. Their integrated sustainability approach resulted in Migros being recognized as "Responsible Retailer of the Year in 2009" by the World Retail congress (World Retail Congress, 2010).

8. Conclusion

In this paper we have identified problems managers experience when trying to make their organizations more sustainable. Some of these problems are due to managers addressing sustainability as an operational rather than as a strategic issue. Hence, sustainability is the "ingredient" that has been missing from these organizations' strategies. We have argued that for organizations to become more sustainable, managers must address the different dimensions of sustainability at the strategic level, both during the strategic decision-making process and as part of the strategy content at the corporate, business and functional levels. Managers and scholars can use the framework we have provided to assess the degree to which organizations have strategically addressed sustainability and to identify opportunities for further improvement. Although we have analyzed each individual element of the framework separately, it is important to recognize that all elements are interconnected and significantly influence each other. Developing an organization that regards sustainability as a cornerstone for doing business requires a strategic approach that integrates economic, environmental and social considerations in all aspects of business on an ongoing basis.

Keywords:

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About the authors

Ingrid Bonn is an Associate Professor of Strategy in the School of Business at Bond University, Australia. Her research interests include strategic thinking, strategic decision-making, sustainability, corporate governance, and performance and longevity of organizations. Ingrid Bonn is the corresponding author and can be contacted at: ibonn@bond.edu.au

Josie Fisher is an Associate Professor in the School of Business, Economics and Public Policy at the University of New England, Australia. Business ethics, corporate social responsibility, corporate governance and sustainability are included in her research interests.

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