



# Prepare your business for the new cost of carbon

In the near future, carbon won't be free.

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Governments are about to tax it. Retailers are looking to communicate it on product labels. Consumers have started to make purchase decisions based on its presence in products. Business customers will demand visibility into the way it's used in their supply chains. These trends will drive new costs and shift the playing field for every business, sometimes in unpredictable ways.

If you haven't started planning scenarios for the new cost of carbon, now is the time to start. There are six consequences that follow from the carbon's new costs--and the new social contract that goes along with these costs. To prepare for this new future in the short term and long term, executives must:

**1. Reevaluate the value proposition of existing products:** The profitability of your current product portfolio will change, both relatively and absolutely. The carbon intensity of some products, and of their production and distribution processes, will lead to cost hikes that will make them uncompetitive. Other products will become marginal, i.e., the cost hikes will either erode their margins to low levels or drive price hikes that reduce demand for the product. Most firms will find it necessary to either withdraw from parts of markets, or to develop replacement products or production processes for a big part of their portfolios.

**2. Rethink investment priorities.** Investment priorities will change in two ways. First, there will be a surge in investment to create new products or change production or distribution in ways that restores the product portfolio to some semblance of its prior health. Second, firms will be looking at a very different landscape of opportunities. Segments and product types that once looked promising will be saddled with unacceptably high carbon costs; others once considered marginal will look safer. Many firms will also have to repair their balance sheets because they will find that the underlying value of assets that support carbon intensive production or products will drop. It will be a good time for executives to take a hard look at the way they make money, and try to shift toward less carbon-intensive business models.

**3. Make innovation central to your strategy.** New technologies that mitigate the impact of carbon emissions to meet the new carbon rules will be a growing source of value and competitive advantage. At a minimum, the carbon tax will cause firms to look for ways to replace existing products and production and distribution methods with newer, less carbon-intensive versions. Competitive dynamics in most industries will not let firms simply stop improving the functionality of their products on other, non-green dimensions, while they work out better replacements. Thus firms will have to look for ways to make their innovation processes more productive.

**4. Engage constituents in an ongoing conversation about sustainability.** Navigating the world of sustainable business operations means participating in continuous, authentic conversations with a broad range of constituencies (including business partners, non-governmental organizations and customers) about what they care about and what you're doing about it. With the rise of grassroots communications and social networks, these conversations help you sense shifts that could be a problem or opportunity for your business.

**5. Realize that success will be less dependent on operational excellence.** Raw materials and commodity goods become more expensive (and more regulated) based on their carbon footprints. The increase in raw materials cost will have a diminishing effect on the margin improvements made through traditional operational improvement mechanisms. As a result, companies will need to rely on new profit maximizing tactics to drive growth.

**6. Plan for different scenarios.** Expect many more changes ahead. The future is going to be tough to anticipate. You will do well to create flexibility in your menu of strategic choices. Consider evaluating choices through scenario planning, rather than traditional forecasts. Seek tighter relationships with value chain partners, and opportunities for risk sharing and cooperation in areas that will drive find growth.

A first step on the journey: Companies of all types will need to invest in new relationships, to develop greater understanding of the market shifts underway and those which are on the horizon. The implications of running a profitable business in a post-carbon world are bigger than most executives are preparing for. Executives need to create insight, scenarios, options and plans for how they will adjust before the new economic realities force decisions they would rather not make.

Source: [harvardbusiness.org](http://harvardbusiness.org)