The Journey to a Sustainable Business

Navigating the road ahead

The business of sustainability

ERM

Overview

Not long ago sustainability was the almost exclusive purview of specialist professionals. In fact, getting other parts of the business to take it seriously was a major challenge. Today, however, a far broader range of stakeholders have quickly moved from spectators to full participants in their organization's sustainability agenda.

ERM's latest survey of 150 companies with annual global revenues ranging from USD2Bn to USD42Bn, from a cross-section of industries, explores how executives currently view sustainability within their own organizations and how prepared they feel as it rapidly grows in importance to, and influence on, their business.

We found that executives are now serious – and intensely practical – as they confront the growing business risks and opportunities associated with climate change, population change and natural resource constraints. It's not surprising that three of the top ten threats cited by CEOs attending the most recent World Economic Forum meeting in Davos involve climate change.

Over the last two years investors have forced a move for sustainability and climate change from a marginal issue for boards and executive teams to a core element of the near-term business plan.

We are seeing the forces on the sustainability agenda evolve from regulatory and policy led initiatives, to customer and investor led drivers. These provide a stronger, clearer and unrelenting voice directly into boards and the C-Suite.

The push to integrate sustainability into mainstream business operations is being driven by multiple forces. Consumers continue to demand more sustainable products and services from brands. Those brands, in turn, are demanding their suppliers demonstrate performance that matches consumer expectations. Industry peers are doing better financially through sustainable business practices – often aided by new technologies that provide a competitive advantage. And employees – in particular younger talent – expect their companies to be tackling the sustainability issues they themselves hold dear.

None of this has been lost on investors who, as ERM's previous *Bridging the Gap* research[1] demonstrated, are demanding better information and accountability from companies as they make decisions based on the risks and rewards facing business. This as a driver cannot be understated.

Increasingly, executives who never considered sustainability to be part of their role are being influenced by these external forces and are realizing the power and importance of embracing it in order to keep their businesses – and their own positions – relevant in a changing world.

So what did we find in our latest survey? What does it mean for you and what can you do about it now?

How many companies currently can claim to have an overall business strategy shaped by sustainability? One where the executive board makes investment and growth decisions that are driven by sustainability priorities. Where sustainability and finance professionals work together to account for the total impacts and value of sustainability on the business. Where sustainability expertise contributes to research and development and new product lines. And where sustainability, communications and marketing functions work together to demonstrate how the business is contributing to society by being sustainable. Without such a business strategy, sustainability could become a double-edged sword – one that drives business growth, yet requires complex coordination within the organization. We wanted to test our premise. So what did we find?

Sustainability is no longer the exclusive purview of sustainability professionals.

In today's modern business world we found a far broader set of executives – including those with responsibility for finance, legal, investor relations and risk – taking a much greater interest in setting the direction and even more importantly, the implementation of sustainability within the organization.

In our survey 38% of respondents said that sustainability already is integrated into their organization's strategy, KPIs and targets. But as the number of interested parties increases their diverse agendas pose significant challenges as an organization seeks to balance its short and longer-term commercial needs.

The drivers of a firm's sustainability agenda have evolved quickly.

The majority of those surveyed (56%) still see regulation and disclosure requirements as a significant influence today. While this is a testament to the progress made in establishing sustainability as an accepted part of corporate accountability, it provides further evidence that those same organizations still have work to do in extending beyond EHS into core business and growth strategy.

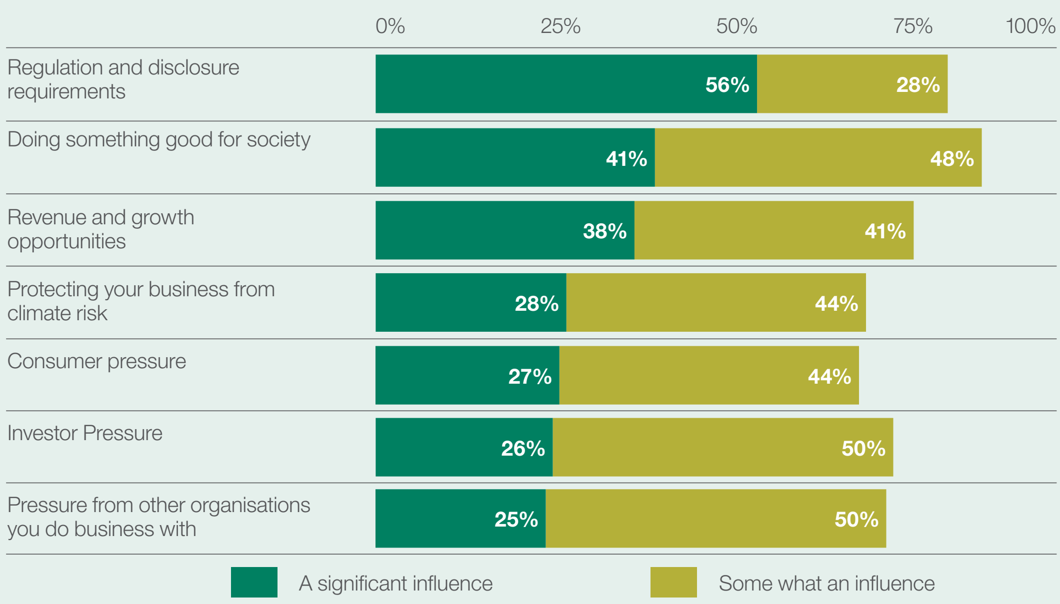
That status quo looks set to change, however. A combined 79% of respondents believe revenue and growth opportunities have an influence on their organization's sustainability agenda, and 71.5% say protecting the business from climate risk is a driver. Investor pressure is also moving away from issues of non-financial compliance towards a true convergence with business strategy, with 76% of respondents reporting that they are facing increasing pressure from investors.

Interestingly, a combined 89% believe a key driver of sustainability is doing something good for society. That point of view might once have been interpreted as little more than philanthropy. Today though, a growing number of industry leaders consider it a core philosophy for future business success. Good examples of this are Blackrock CEO Larry Fink's 2018 and 2019 letters extolling portfolio targets to contribute to society or risk losing the investment bank's support[2].

Our client experience in the last 12 months indicates that investor pressure is increasing quickly in the extractive industries.

Chart 1

Q: How much of an influence do the following drivers have on your sustainability agenda?

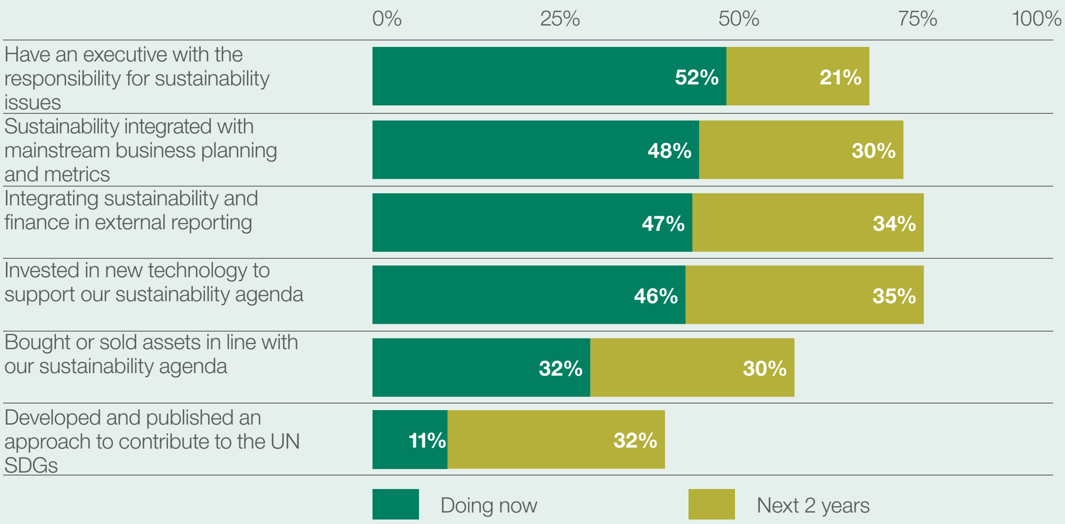


Executives and organizations are approaching sustainability from different perspectives and, perhaps, with misplaced levels of comfort. There is a danger that sustainability professionals could find themselves marginalized from key decision making exactly because 'their' topic is being embraced as a core business driver. Meanwhile those that see sustainability as a driver of growth and revenue may be assessing its potential without the detailed knowledge needed to make the right investment and planning decisions.

This increased stakeholder interest puts new pressure on sustainability professionals. More than 60% of survey respondents believe the function needs to become more commercial. More challenging still for sustainability professionals is that 69% say finance, procurement and other functions already have the skills and experience to deal with the issues. Is it time for sustainability professionals to reinvent themselves, or at least reframe and solidify their relationship with other key parts of the organization?

Chart 2

Q: Which of the following actions is your organization taking as part of its sustainability agenda?



61%

believe the sustainability function needs to become more commercial.

81%

have plans to pursue integrated reporting, both to provide 'C-suite grade' data to the boardroom, and even 'investor grade data' to the stock market.

Organizations currently lack the culture and processes to fully integrate sustainability into business strategy.

When we look to the future, it is clear that companies are planning for sustainability to play a much larger and business imperative role. A combined 79% say they currently integrate sustainability with mainstream planning and metrics or intend to do so over the next two years. Even more (81%) have plans to pursue integrated reporting, both to provide ‘C-suite grade’ data to the boardroom, and even ‘investor grade data’ to the stock market. To prepare, 72% say they will have an executive in place with responsibility for sustainability issues and 81.5% intend to invest in new technology to support the sustainability agenda.

This confidence in their ability to make sustainability part of the business mainstream is heartening. Yet it raises questions about just how prepared organizations are to make this leap and whether the key players have the right skills, knowledge and experience to make it a success.

Sustainability executives, for their part, will have to up their game so that they move beyond simply working through the lens of compliance by relying on existing regulations and legacy reporting frameworks.

Respondents’ attitudes to two important new frameworks show how much progress still has to be made. Just 11% say they have developed and published an approach to contribute to the UN Sustainable Development Goals (SDGs) – even though external estimates suggest they offer a $12 trillion opportunity for business and could create or safeguard 380 million jobs.

Likewise, only 27% cited The Task Force on Climate Related Financial Disclosures (TCFD) as a framework that they were focusing on. This despite the important role it will likely play in providing climate-risk information to investors, insurers, lenders and other stakeholders – and the heavy backing it has received from high profile players like Governor of the Bank of England, Mark Carney, in his role as chair of the Financial Stability Board.

11%

say they have developed and published an approach to contribute to the UN’s Sustainable Development Goals.

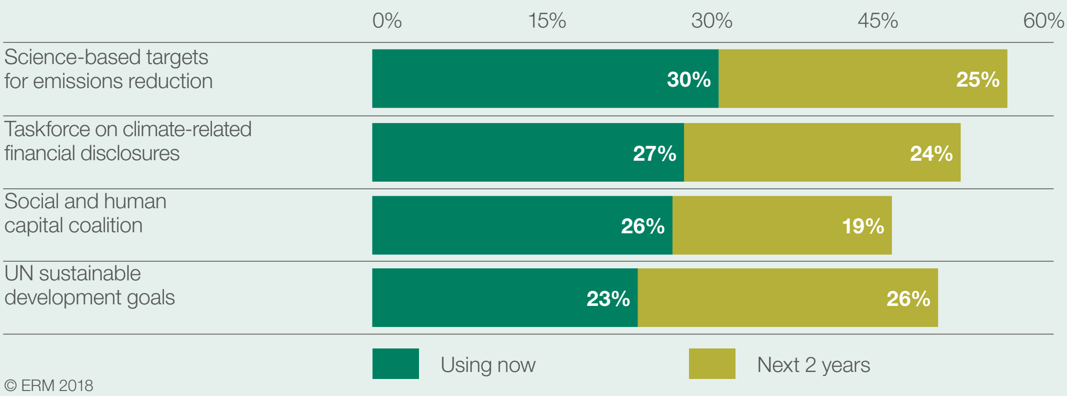
There are many paths to sustainable business success but organizations need a framework to choose the right one.

Our research and client experience suggests that, at present, executives are on a slow-moving maturity curve – one that begins with sustainability being viewed as a reactive function to comply with regulation around emissions and natural resources but evolves to understand that sustainability is a business imperative for future growth and corporate survival.

It is also clear that this is not a uniform journey. Within organizations different types of executives are embracing sustainability in different ways – often shaped by their role. Some continue to consider sustainability a 'by the book' exercise in compliance. Others take a broader view, realizing that faced both with climate-related risks and new growth opportunities sustainability is now a business driver that cannot be siloed or sidelined in one department. Others are taking an even more expansive view – one that demands the organization embrace doing good for society as part of its core purpose.

For many the center of gravity for the sustainability debate is shifting. From our conversations with clients it is now less about 'what' a company is working on in relation to sustainability. In reality the headline sustainability topics are the same and have been for a number of years – climate change, population and demographic change, social inclusion etc. The big changes are 'who' is working on it and increasingly 'how' it is being implemented.

Chart 3
Q: Are you using or aware of the following initiatives?



27%

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We are seeing a shift from functional sustainability roles to those with real experience in delivering business excellence. This includes executives involved in product development in technology companies, supply chain in agri-businesses, marketing in FMCG companies, and finance or legal in those companies where investor pressure is acute. All bring a different flavor to problem solving and are arguably 'wired differently' to address these challenges for a company.

So, while there is no one path to a successful sustainable business and every organization is on a different journey we do believe that companies currently fit into five broad segments – each committed to sustainability but each at a different stage of maturity in the journey to create a fully sustainable business.

There is no one path to sustainable business and every organization is on a different journey.

The journey to a Sustainable Business

From our experience working with clients, we see five stages of sustainability for an organization.

1. The Compliance Meeters

Those companies and/or key individuals that fit into our Compliance Meeter segment are squarely focused on regulation and are represented by 21% of the total survey respondents.

Sitting at the foot of our maturity curve, these organizations demonstrate a strong focus on managing regulatory risks by following best practice reporting and disclosure requirements. This is quite a defensive approach. In the most part their strategy is driven by EHS professionals. Eighty one percent (81%) who identified with this segmentation are integrating sustainability and finance into external reporting and the same percentage say they are integrating sustainability with the organization's business planning and metrics.

In terms of their remit the Compliance Meeting companies are more confident than any other of our five segments that their sustainability and commercial goals are aligned. Just 22% of survey respondents in this segment felt constrained by access to data and few had doubts about the capabilities of their sustainability teams – perhaps because that is where the core responsibility for the compliance and regulatory work rests.

Chart 4
The Sustainability Maturity Curve

But could this group of skilled EHS experts be resting on their laurels as other parts of the business become more sustainability-literate? It was notable that a majority of those in our Compliance Meeting segment see themselves as working on different time scales to the rest of the business and just 53% want sustainability to be more commercially literate. More than 33% (the most of any of the segments) feel constrained by senior management and they harbor real doubts that either the finance or strategy departments are showing leadership on sustainability.

This potentially siloed mentality is highlighted by a failure to embrace new business-specific thinking around sustainability. Some 50% say their company is planning to develop an SDG strategy by 2020 yet there is a very low uptake of new disclosure initiatives. Only 38% expect to be following the Social and Human Capital Coalition framework by 2020, and only 41% will be using the guidelines formulated by the Taskforce on Climate-related Financial Disclosure (TCFD).

...the Stakeholder Pleaser strategy doesn't appear to be having a concrete effect on making sustainability a growth driver for the entire business

2. The Stakeholder Pleasers

Next on the maturity curve are the Stakeholder Pleasers, representing 20% of the total. While the Compliance Meeters approach sustainability from a regulatory and internal compliance point of view, the Stakeholder Pleasing organizations (whose strategy is led primarily by sustainability professionals) are heavily influenced by external communities.

Growing interest from the investment community is a key concern – 73% of the survey respondents in this segment said they were facing pressure from investors to disclose more transparently. However, these businesses are also acutely aware of how sustainability is perceived by the media, customers and consumers. More than half see it as an important responsibility for marketing and communications – in contrast just 38% of the overall survey put an emphasis on communication. The Stakeholder Pleasers are the most committed to the UN SDGs – over 50% say they expect their companies to develop a strategy for meeting the goals by 2020. Furthermore, a strong majority (77%) believe their executive committee shows leadership in shaping the sustainability strategy of the business.

Yet, despite this optimism and enthusiasm the Stakeholder Pleaser strategy doesn't appear to be having a concrete effect on making sustainability a growth driver for the entire business. In many ways it is quite reactive. This group were the least likely to see a need to make the sustainability team more commercially literate. In addition just a third believe the finance team is stepping up to the plate.

This disconnect between sustainability and finance can cause internal divisions and hamper the development of a business-centric sustainability strategy. Three-quarters of the Stakeholder Pleasers segment feel a tension between different teams. This can also create a dangerous dissonance between what is said to the outside world and what happens in practice. This desire to promote sustainability before it has been integrated into the daily workings of the business can create stakeholder distrust with investors, customers and employees alike.

3. The Risk Proofers

Midway along the maturity curve sits a segment we call the Risk Proofers, representing 21% of our total respondents. They already understand the importance for the entire business of mitigating the effects of climate change and other externalities in order to make savings today and reduce potential future costs. This segment also feels investor pressure (84% say they are being asked to report on sustainability issues) but, unlike the Stakeholder Pleasers, they feel less influence from other external stakeholders. Only 59% of this segment cited consumer pressure as a key driver, the lowest of any category. That may well be due to the high proportion of this segment that work in B2B energy sectors – including Utilities and Oil & Gas.

Already, the Risk Proofers are taking material steps to systematically assess and address the long-term impact of climate change on their operations and for their investors. They are most likely to have integrated reporting internally, to have integrated business planning and to be investing in technology to achieve the corporate sustainability agenda. And they are being proactive by already planning to buy or sell company assets impacted by critical sustainability issues by 2020.

The companies in this segment have a strategy that views the business both through financial and non-financial lenses. They are the most likely to see finance (56%) and investor relations (56%) leading the sustainability agenda – and the Risk Proofers lead all other segments when it comes to external reporting. By 2020, 66% will be using science-based targets for emissions reduction and 59% say they will be following the TCFD guidelines.

Nevertheless, this fairly strict focus on mitigating risk may be hindering the adoption of a more expansive strategy that benefits the entire organization. Over half (63%) of the Risk Proofers (the largest proportion of any segment) said they had experienced tension between realizing their commercial and sustainability goals. Nearly 60% feel that budget constraints are a major problem for executing a broader sustainability strategy and 72% say that different parts of the business struggle to communicate. This is the place where deep operational changes are first encountered. Many firms we see struggle to get past this stage.

The companies in this segment have a strategy that views the business both through financial and non-financial lenses.

4. The Growth Seekers

There comes a time in the sustainability journey when the executive board – often led directly by the CEO – realizes that the real opportunities in sustainable business lie not just in mitigating risk but in realizing business growth. Representing 17% of our survey respondents, this is the Growth Seeker group – where sustainability is led from the top and integrated with strategy and business processes, allowing the company to take real action.

In our survey, 77% of this segment said their executive committee was leading the sustainability agenda while 65% said the strategy team was taking a leading role. Contrast this with the first three groups that sometimes struggle to integrate with leadership and strategy. Here sustainability is deeply embedded in business planning and in the remit of operations and procurement. As a result 46% of this segment said their company had already bought or sold an asset for sustainability reasons and a further 23% plan to do so by 2020.

The Growth Seekers see themselves as both early adopters and industry leaders in the pursuit of sustainable business opportunities but it's clear that business imperative drives their decision-making – 65% say realizing commercial goals are more important than societal expectations. Because of their proactive approach to grasping the business opportunities offered through sustainability these Growth Seekers are least likely to come under investor pressure for their approach to sustainability reporting and are least likely to be concerned about climate risk – possibly because they already developed strong climate risk mitigation policies before pursuing the more expansive growth strategy. Fundamentally Growth Seekers see sustainability as a differentiator.

As this Growth Seeker segment gains traction the traditional EHS and sustainability professionals risk getting left out of the decision making process. More than two-thirds of executives in this segment say that their sustainability and business planning use different time horizons, 38% believe the sustainability team needs new skills and capabilities to stay relevant and 85% (the highest of any segment) believe sustainability needs to be more financially literate.

However, even as companies in this segment look to drive sustainable business growth, they will need to demonstrate Environmental Social and Governance (ESG) expertise and robust reporting if they are going to convince investors and other stakeholders of its strategic value. Some 50% say they will be using Science-Based Targets for emissions reduction and ESG reporting frameworks like the TCFD by 2020, yet this is far less of a focus for this segment than it is for those that are more directly concerned with the environmental impact of their sustainability agenda. Notably the Growth Seekers are the least likely segment to have a plan to publish an approach to the SDGs by 2020.

77%

of this segment said their executive committee was leading the sustainability agenda.

5. The Vanguards

Could it be that the pursuit of quick profit isn't the only measure of corporate success? Just a few years ago that point of view would have been seen as heresy in the Milton Friedman-schooled board rooms of most major companies. Not any more. There seems a real mood of change in business towards an admission that creating long-term social value is as important as delivering short-term shareholder returns. It's a school of thought first championed by CEOs like Paul Polman (recently retired from Unilever) and now given fresh impetus by the likes of Blackrock's Larry Fink.

This last segment on our sustainability maturity curve embodies many of the principles underpinning what has become known as long-term capitalism. The 18% of surveyed companies represented by the Vanguard segment are motivated by both internal and external drivers – they understand the importance that sustainability now plays in the lives of investors, customers, employees and regulators. They also know that fresh reporting and measurement frameworks can help their decision-making. Seventy percent (70%) plan to use Science-Based Targets for emissions reduction by 2020, while 59% will be using TCFD and 56% the Social and Human Capital Coalition.

Over half of this segment (52%) consider revenue and growth opportunities to be a significant driver of their sustainability agenda.

38%

believe the sustainability team needs new skills and capabilities to stay relevant.

They are the most likely segment to have an executive committee member responsible for sustainability (59%) and, probably because of this, only 15% feel constrained by a lack of senior leadership engagement. Compare that with the 38% for both Growth Seekers and Risk Proofers. Also, because there is such top-level support, the companies in this segment don't feel great pressure from investors because on many levels they are leading the debate.

Over half of this segment (52%) consider revenue and growth opportunities to be a significant driver of their sustainability agenda and yet just 33% (the lowest of any segment) say they would prioritize commercial goals over societal expectations around sustainability. A further indication that the most forward-thinking companies realize that ignoring ESG considerations will hurt the business at a time when all companies are being scrutinized and judged by external stakeholders like never before.

As ambitious as these Vanguards may be, this segment knows it needs support from outside the business in the form of partnerships and advice. While just 19% feel that the sustainability team needs new skills and capabilities, and while 67% feel confident that their finance, risk and procurement have the capabilities to deliver the sustainability agenda, 44% – the highest of any segment – feel constrained by needing to find the right external adviser to deliver business value.

33%

say they would prioritize commercial goals over societal expectations around sustainability.

Corporate Sustainability Dissonance – walking the talk

In conversations with clients, one of the things we have noticed is the gap that often exists between what a client says, or reports on what they are doing, from what happens when we examine them in greater depth relative to a number of material measures. One case was with a large European chemical company that clearly struggled to deliver on the promises of a sustainable business it reported. That difference led to what was tantamount to a distrust, particularly with some investors.

This maturity curve offers the chance to understand the relative gap between what leadership and/or sustainability teams purport to be the position of the organization versus what is perceived by customers, investors or employees. We call the gap between the two 'Corporate Sustainability Dissonance'. The larger the gap, the greater the risk of a lack of credibility amongst customers, employees and, in particular, investors. Understanding that gap and setting out a path to narrow the gap will provide greater comfort to those stakeholders, so adding to your organization's credibility.

Chart 5
Corporate Sustainability Dissonance

How to move up the Sustainability Maturity Curve

We have sketched out five levels of sustainability maturity currently exhibited by organizations based on our survey findings. Yet, even though we've identified clear differences in the levels of maturity, we acknowledge that different companies can only progress at a pace that is in the best interests of the business as a whole. That will depend very much on their size, their model, their culture and the type of sector they operate in. This often gets focused on the business imperatives of growth, risk management and return on capital. However as the survey findings make clear, as organizations progress up the maturity curve they will need to improve their proficiency in four key areas.

A. Leadership, strategy and culture

In the short history of sustainable business we have seen that real progress is only achieved when the entire organization buys into the value of sustainability – both for the business and greater society. Invariably, instilling a culture of sustainability is easier when employees see that senior leadership embraces that vision – rather than being preached by the functional team alone. For companies to realize the opportunities, the CEO and executive team must play a central role. This will help shape the strategy and mould the culture where sustainability, finance, operations, marketing and communications all work towards the same business-driven goals that reward investors, employees and greater society. In the survey 54% of respondents identified a lack of senior leadership engagement as a problem for the business even though a majority said they felt they had the board members with the necessary competencies to address emerging issues.

67%

considered access to robust decision-ready sustainability data a problem for their organization.

B. Better data equals greater knowledge and insight

Of course, rousing words from the CEO aren't going to embed sustainability throughout an organization. What different functions need is information that allows them to understand the business opportunity in a way that is relevant to their role. That involves shaping data analysis and insight in new ways by freeing relevant data that might be siloed in different departments – often because no-one ever thought it might be relevant to the business as a whole. The survey showed that 67% considered access, or a lack of access, to robust decision-useful sustainability data a problem for their organization. Once organizations have a fuller picture of the business implications of issues like climate-related risk and the opportunities of new products and services they can take the necessary actions like investing in technology and buying and selling assets.

C. Measurement and reporting capabilities

Armed with decision-useful data, organizations can start evaluating exactly how issues like climate risk and resource scarcity are impacting the bottom line while also planning new growth strategies. However, providing accurate projections for internal stakeholders as well as investors requires measurement and reporting capabilities that encapsulate everything material to the business. In our survey, while 49% of respondents had either started using the UN SDGs or planned to do so in the next two years, a further 26% had no intention of adopting the goals and 25% had never even heard of them! It was a similar story when asked about the TCFD and the Social and Human Capital Coalition frameworks. Until companies learn how to measure and report on the total impact and value of their operations they'll struggle to execute on sustainable business strategy and answer many of the questions posed by investors.

D. Partnering for insight

The final area of potential improvement lies in partnering and looking outside of the business for insight. Most organizations that have demonstrated sustainable business success in recent years haven't done it alone. They've realized they are part of a system that needs changing and that expertise can be sought from a range of external partners – whether competitors, NGOs, government or third-party experts. Nearly 60% of our respondents identified finding the right external advisers who deliver business value a problem on some level to the business – ranging from a minor concern to one that is critical. For many companies, looking externally for solutions can be hard but in this new era collaboration is king.

So what should I do right now?

If you're a CEO, or a leader addressing your organization's sustainability challenge, what should you be doing now?

1. Figure out **where your organization is on the maturity curve**, using verifiable data, not just opinion. Be honest about Corporate Sustainability Dissonance – how big is the gap between what you say you are doing and what is really happening on the ground? This can impact everything from customer and employee attractiveness and retention, to longer term brand issues.

2. Fully **understand and have a plan to mitigate the major risks** to your firm – depending where you are on the maturity curve and your appetite and ability to move up it.

3. Conversely, **understand the potential benefits for your organization in seizing the opportunitie**s of moving up the curve particularly in terms of competitive advantage in areas such as operational excellence, business integrity, and access to market and capital.

4. Ask your **investors and policy makers** what they want in terms of disclosure now and what should you start addressing to fulfil future requirements.

5. Build a **plan for the programmatic change required as sustainability moves up the corporate agenda**. At the very least, you will likely have to mirror, or surpass, your competitors to maintain your position in the market.

In conclusion

From our research, we see a number of shifts in the sustainability debate that could mean significant changes for companies going forward. At the heart of these shifts are the types of people in an organization now actively involved in delivering sustainable business outcomes.

The emergence of a wider range of executives who consider sustainability part of their business is having a major impact on the way companies are addressing sustainable business as a whole. As more parts of the organization start to embrace the importance of sustainability as a driver of growth, understanding how mature your program is, the dissonance between what you say and what you do, and your ambition, will all shape the route and speed you choose to take.

This journey will require careful thought, analysis and engagement to explore the opportunities and risks this shift presents. It will also mean considering new ways of looking at things you have done for a long time as you move from the 'what' needs doing, to the 'how' you do it (and 'who' you ask to lead). Meeting the challenges of moving up the sustainable business maturity curve may at first seem daunting. However, as our survey findings show, all companies, in their own way, are starting to look at sustainability as a business imperative. Doing nothing is no longer an option.

Methodology

We surveyed 151 executives globally from a number of sectors including, chemical & pharmaceuticals, technology, media and telecoms, mining, oil & gas and energy & power to explore how successfully organizations are making that transition. We used computer aided telephone interviews and some personal follow up in-depth interviews. For transparency the research was carried out using an independent research company Meridian West.

1. https://www.erm.com/globalassets/documents/presentations/2017/erm-bridging-the-gap-between-sustainability-and-finance.pdf
2. https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter
3. https://www.wbcsd.org/Overview/News-Insights/General/News/Achieving-the-Sustainable-Development-Goals-can-unlock-trillions-in-new-market-value

ERM wishes to acknowledge Meridian West in undertaking and compiling the research that supports this paper

Some of our offices

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Is a leading global provider of environmental, health, safety, risk, and social consulting and sustainability related services. We have more than 5,000 people in over 40 countries and territories working out of more than 160 offices. ERM is committed to delivering solutions while providing a service that is consistent, professional and of the highest quality to create value for our clients. We have worked with many of the Global Fortune 500 companies delivering innovative solutions for business, providing advice that has underpinned billions of dollars of investment decisions. For all we have helped them understand and manage the sustainability challenges that the world is increasingly facing.

For more information contact us at www.ERM.com