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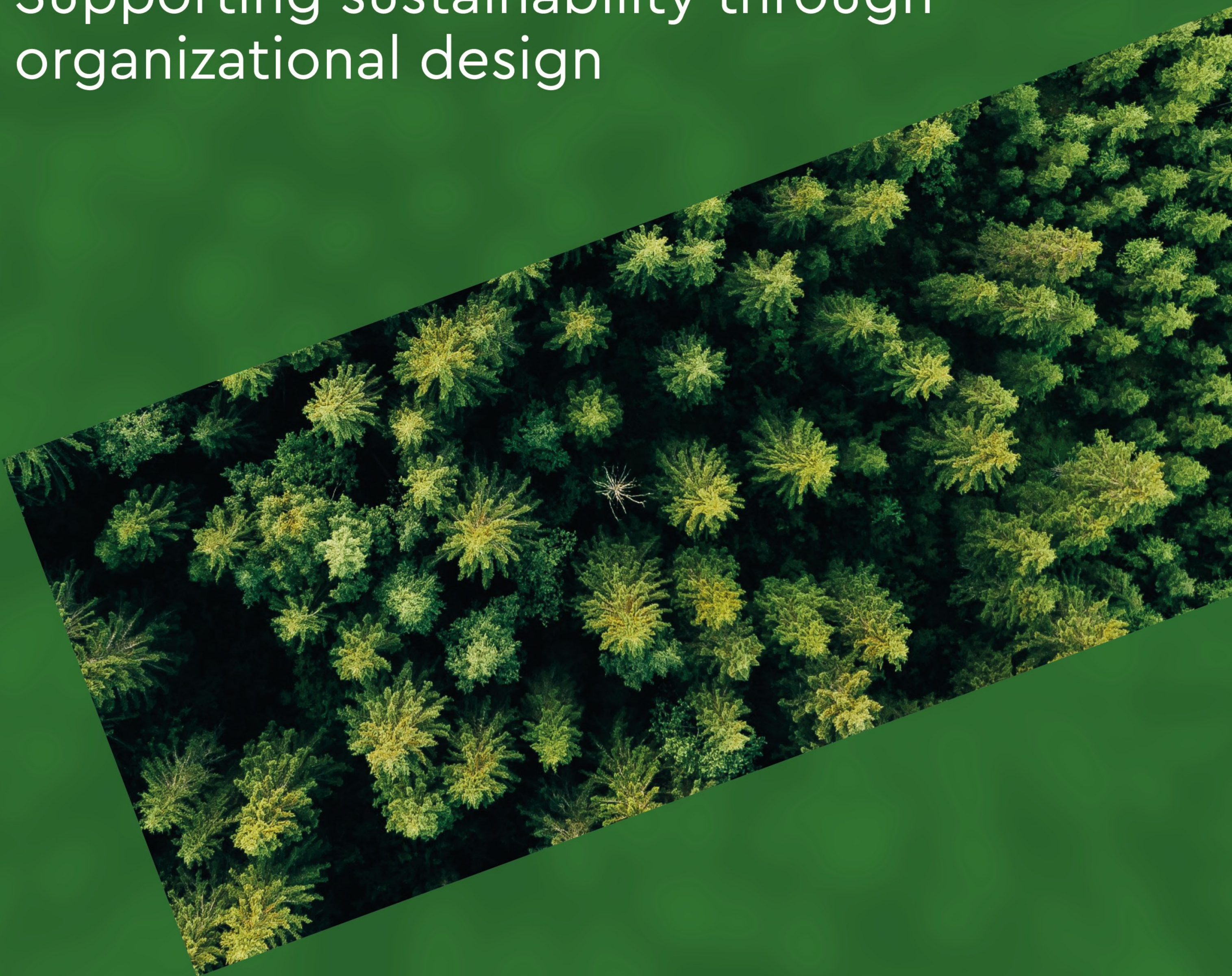
Sustainability goes beyond ESG reporting

Supporting sustainability through organizational design



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Embedding sustainability is a fiduciary duty for long-term value creation

Sustainability is not just about complying with ESG regulations and reporting eye-catching but low impact KPIs. Sustainability is much more of a fiduciary duty an entrepreneur has towards their employees, investors, the society, and the environment to enable business success in five-, ten- and fifty-years' time. In the short term, this ambitious goal may seem counterintuitive as it will certainly affect the current business of organizations. However, in our latest Kienbaum Corporate Governance study[1] with a sample of almost 120 German organizations from various industries, the majority of companies reported that the integration of sustainability into corporate management has led to more product innovation (55%), process innovation (53%) or even business model innovation (40%). The heated debate over whether and when to phase out the production of combustion engine automobiles is an example of current business fading away, while new business opportunities in BEV and battery technology emerge due to an increased sustainability rationale.

In the long term, there is no way around sustainable business models and organizational structures. Not only because it is ethically the right thing to do, but also because it is economically the only way to prevail in a rapidly changing environment where organizations and societies are challenged by climate change, its impact, and a more and more pronounced legislation on the subject. For this reason, sustainability ambitions of an organization should be strongly aligned with the CEO agenda and be supported by the entire C-Suite. The executive committee must understand sustainability as a strategic topic that is part of the company's overall long-term strategy and integrated throughout the entire organization.

Indeed, more than 2,000 empirical studies examine whether sustainability (mainly ESG) benefits companies by investigating the relationship between ESG criteria and corporate financial performance. Recent meta-analytic findings support these assumptions. While ESG disclosure on its own was found to be less impactful on financial performance, sustainability strategies implemented at a corporate level were found to drive better financial performance (e.g. revenues, EBIT). These results can be attributed to various sustainability drivers, such as increased innovation, enhanced reputation, improved operational efficiency and better risk management, which in turn drive financial performance. These findings support that organizations should aim at integrating sustainability into the organizational structure to drive a holistic corporate-wide sustainability strategy, ultimately leading to competitive advantage.

Sustainability goes beyond ESG! While focusing on ESG criteria and being compliant with legal regulations will not create long-term value, sustainability should be seen as a strategic and long-term topic to drive financial value and competitive advantage for the organization.

Looking at sustainability reveals different levels of maturity and work to be done

As the Corporate Sustainability Reporting Directive (CSRD) takes effect, more European organizations are obligated to produce sustainability reports. However, simply looking at the number of reports and ESG ratings can be misleading. A closer look reveals a more nuanced picture. Certain industries, particularly those with a significant B2C presence and extensive media coverage, have felt the need to prioritize sustainability (or at least report on their sustainability efforts) earlier than those that are hidden in the value and supply chains, with neither a B2C presence nor extensive media coverage of their business practices. These differences in the maturity of corporate sustainability efforts are striking. While some organizations still consider sustainability as a burden that every organization must comply with ("Burden"), others have recognized sustainability as a core driver for business success ("Leapfrog").

Mapping your organizational status quo against four key dimensions of organizational design can give you an indication of where your organization stands in terms of current sustainability efforts. In addition, future ambition levels can be defined for each dimension whereby critical next steps for improvement can be derived. However, it is not necessary to be a leapfrog in every single dimension in order to become sustainable. Rather, undertake a double materiality assessment and prioritize sustainability issues that matter most to your organization and its stakeholders, while recognizing their potential for differentiation and value creation. Also ensure that the targeted ambition levels are aligned with the overall strategy and that they are realistic and achievable. For example, if you are just getting started on integrating sustainability, you might first want to focus on managing sustainability-related risks ("Hygiene") rather than adapting core business models to leverage sustainability ("Leapfrog"). In the latest issue of the Kienbaum Corporate Governance study, we find that only 41% of the companies surveyed have integrated ESG criteria into their risk management, so this might be a good starting point. Based on the identified gaps between the status quo and future ambition level, a strategic roadmap driving sustainability can be developed, focusing topics from an operational and structural perspective.

Putting theory into practice – How to drive sustainability by organizational design

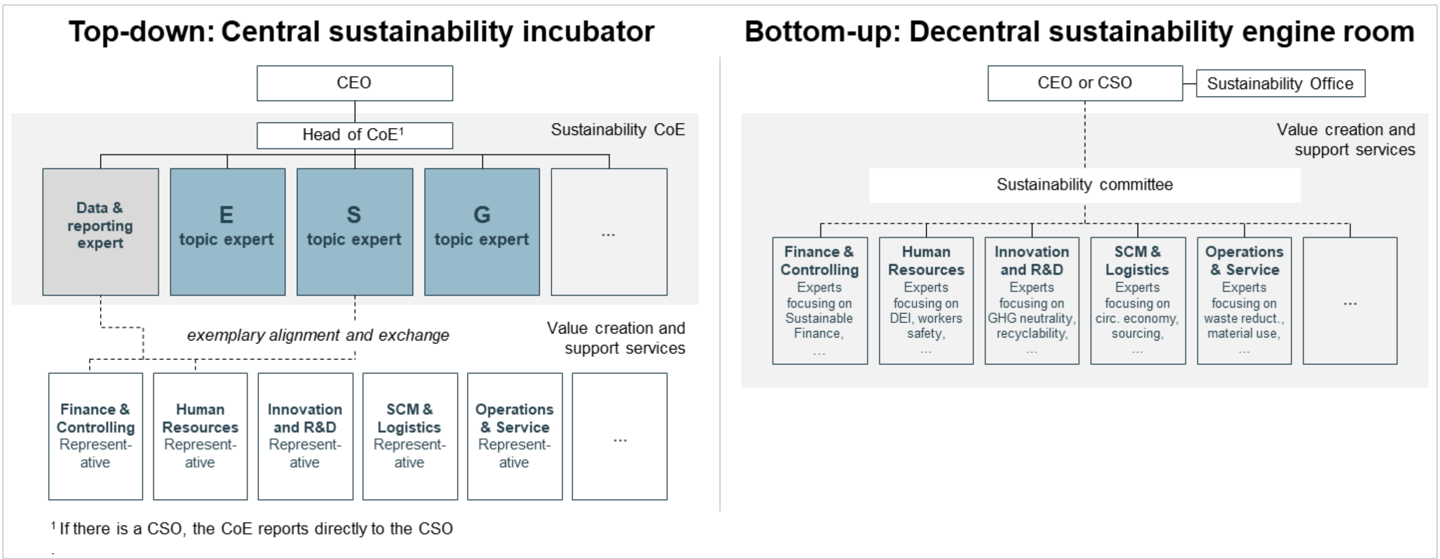
While most of the organizations (94%) surveyed in our Corporate Governance study recognize sustainability as a strategic topic and anchor it at the C-level, we see a very different picture when it comes to structurally embedding it into the organization. Sustainability teams (which exist in 60% of the companies surveyed) are mostly concerned with ESG regulations and reporting. Only 21% of the CEOs surveyed reported that their established sustainability teams drive sustainable innovation across the organization. To achieve long-term

	1 Disclosure "Burden"	2 Adoption "Hygiene"	3 Adaptation "Advantage"	4 Integration "Leapfrog"
Value creation	Sustainability activities that focus on compliance only	Focusing on sustainability activities in internal value creation	Integration of sustainability in internal processes and upstream value chain	Business models integrating sust. in internal, up- & downstream activities
	No or siloed sustainability efforts in functions	Business functions include sustainability in functional strategy	Compensation of negative impact on the environment	Business processes designed to maximize sustainable impact
Financial allocation	No distinct sustainability budgets allocated	Budgets based on assessment of sustainability related risks	Fixed sustainability budgets in all organizational functions	Fixed and variable budgets to adapt the business to more sustainability
	No defined sustainability KPIs or impact calculated	Sustainability KPIs used in investments, but no formal integration	Inclusions of sustainability KPIs in every investment process (RoS)	Every resource allocation optimized for the most sustainable outcome
Workforce allocation	Ad-hoc workforce deployment for sustainability compliance issues	ESG/sustainability team focusing on compliance and risks (typically small)	Sustainability team focusing on cross-funct. potential and initiatives	Sust. resources integrated into org. structure (top-down or bottom-up)
	No formal assessment & development of sustainability capabilities	Decentralized assessment of current sustainability capabilities	Forecast of sust. capabilities based on skill and competency frameworks	Organization-wide, predictive workforce allocation empowering sust.
Organizational steering	No definition and no steering towards sustainability targets	Steering of top mgmt. based on function specific sustainability targets	Steering of top mgmt. based on holistic sustainability frameworks	Holistic suite of sustainability steering targets & instruments at all levels
	Unclear data owner and siloed systems	Clearly defined, but varying data owners in business functions	Comprehensive sustainability data management (SSOT)	Real-time sustainability data in a SSOT, interpreted by AI assistance

Figure 1: Sustainability Maturity Map

competitive advantages, companies might want to set up an organizational structure that empowers the company to leverage sustainability, drive innovation and create business opportunities.

While there is no one-size-fits-all solution, the question becomes which one to pick from. In our experience, choosing one of two main directions, either top-down or bottom-up, is most effective. Briefly, in a top-down approach, a central sustainability incubator is the main driver for sustainability, holding decision-making authority and developing initiatives for all business functions, while the business functions implement these top-down designed initiatives in their processes. In a bottom-up approach, a smaller sustainability office is solely responsible for setting overarching sustainability goals and allocating budgets, but the main responsibility for driving sustainability lies within business functions, as they decide how to achieve these goals by developing initiatives best suited to their function and processes. By committing to either a top-down or bottom-up approach, organizations create a structure with clear responsibilities, enhanced accountability and clear pathways for action, thereby reducing governance complexity and potential conflicts of authority related to sustainability.



Pro

+ Centralized planning and transparency on company-wide sustainability strategy, performance and activities
+ Consistent and coherent sustainability effort across the organization and alignment of cross-functional potential

+ Maximum business proximity and adaptability regarding design and implementation of sustainability initiatives per function
+ Allows more agile and timely responses to sustainability challenges and opportunities without waiting for central approval

Contra

– Business functions may consider themselves as less responsible and empowered to drive sustainable change
– Potential for bureaucracy and slower decision making and implementation

– Lack of leveraging synergies regarding design and implementation of function-specific sustainability initiatives
– Increased silo thinking, potential impacting achievement of corporate sustainability agenda

Figure 2: Central sustainability incubator vs. decentral sustainability engine room

Creating excellence through central sustainability incubator – top-down

If you are just getting started on integrating sustainability into your organization and see yourself on the lower bottom of the maturity level, a top-down approach might be most suitable. Establishing a central sustainability team provides your organization with the necessary resources and symbolizes the prioritization of the topic, thereby increasing the likelihood of successful transformation. Such a central team pools all expertise and ensures that sustainability is not treated as a separate initiative but rather as a core aspect of the company's strategy.

Operatively, this top-down approach combines a propulsive central sustainability Center of Excellence with decentralized functional sustainability representatives (see Figure 1). The central *sustainability Center of Excellence (CoE)* reports directly to the CEO (Chief Executive Officer) or a CSO (Chief Sustainability Officer). Together, they develop and determine the company-wide sustainability strategy. The CoE oversees and monitors the company's overall performance on sustainability, allocates budget and resources for all activities, holds decision making authority, and provides transparency to all relevant stakeholders. The CoE should engage expert teams with different roles and responsibilities. One team comprises reporting and data specialists who focus on ESG data management (collecting and analyzing data from business units), reporting and regulations. They conduct risk assessments and match ESG data with financial data to provide insights into the overall ESG performance.

Second, to move beyond checking boxes, the CoE should consolidate topic experts on environmental, social and governance issues. This may include, for example, legal counsellors who focus on topics like labor law and occupational safety to address social sustainability aspects. In turn, experts with environmental backgrounds and expertise in supply chain processes may drive energy efficiency programs or waste reduction initiatives. The topic experts steer and develop sustainability activities according to the company-wide strategy while considering benchmarks, trends and evaluating stakeholder expectations.

The *functional sustainability representatives* are decentralized sustainability roles. They ensure that the common company-wide strategy and the defined measures and targets are implemented in their respective business functions. They are responsible for embedding sustainability and the initiatives developed by the CoE into the processes of their function. For example, if the overall goal defined by the CoE is to become a zero-waste company, the functional representative of the IT department might initiate processes to repair hardware whenever possible, or recycling anything that cannot be reused. Moreover, the functional representatives provide relevant data of their business functions to the CoE reporting and data specialist. In regular meetings, they also consult the CoE team regarding sustainability issues in their business units. This exchange offers the CoE the opportunity to consolidate potential cross-functional synergies and to coordinate and evaluate new ideas, activities and projects concerned with sustainability.

Driving sustainability from the engine room – bottom-up

As an organization grows, the debate around sustainability intensifies and becomes more complex. To manage evolving and heterogenous sustainability requirements throughout an organization, a bottom-up approach can be most successful. Such an approach takes into consideration that effective sustainability initiatives may differ as the context differs: customers, capabilities to perform or legal requirements differ from function to function. For example, research and development must consider raw material sourcing, recyclability and end-of-life concepts, while sales and marketing must develop product bundles and communication approaches that represent products and services as a holistic and sustainable solution. From an organizational point-of-view, driving sustainability from the engine room enables such close anchoring of sustainability in each function. The key value proposition implies that a sustainability office sets a company-wide sustainability agenda, but the business functions themselves are responsible for driving sustainability by designing and implementing function-specific sustainability initiatives.

From a bottom-up perspective, the function head or another functional management positions owns the sustainability mandate. They are responsible for defining function specific sustainability targets that are aligned with the company-wide sustainability strategy. Within business functions, dedicated *sustainability experts* – who know their business and processes best – evaluate internal and external environments, design initiatives, and ensure their roll-out into day-to-day operations. Such expert roles are either newly established or result from the enrichment of existing roles, e.g., the Production Quality Officer is responsible for leading sustainability initiatives. Each function is responsible for tracking their sustainability targets and for collecting and analyzing corresponding data. Beyond that, relevant data is provided to the sustainability office for company-wide ESG reporting. A company-wide system may ensure a certain degree of standardization and reduce administrative effort. Additionally, a *sustainability committee* consisting of the function head, and potentially the sustainability experts, meets on a regular basis to ensure regular alignment of individual initiatives and to share cross-functional knowledge and best practices. Moreover, this committee decides on how to allocate the budget provided by the sustainability office to each function.

Together with the CEO or a CSO, the *sustainability office* determines the corporate sustainability agenda by defining a company-wide sustainability strategy and providing a budget accordingly. The sustainability office communicates this overarching strategy to the sustainability committee, however, the committee decides on "what, when and how" to implement sustainability in their functions. Besides setting the company-wide strategy and budget, the sustainability office is solely responsible for ensuring that ESG reporting is performed according to organizational and external requirements.

Getting started on integrating sustainability

Depending on factors such as the maturity level, operating industry, the organization's size, and the overall sustainability goals, different set ups on the continuum of these two approaches can be effective. Even though there is no one-size-fits-all solution, the two outlined strategic directions can be considered and tailored to match the overall organizational strategy and resources.

To sum up, three takeaways are crucial:

1. **Assess your sustainability maturity level**: Scan your organization to identify where and to what degree it enhances the value creation of your organization to reach set sustainability objectives.

2. **Integrate sustainability into organizational design**: Reflect on the fit of your organizational structure to enable sustainability fully delivering future and current requirements within your organization – set up the respective organizational structures, establish processes and empower people.

3. **Aim for sustainability as a competitive advantage**: Even if initial expenses are high for ramping-up sustainability in its required scope within your organization: Ensure that sustainability is not perceived as a formal burden that has to be complied to, but rather as an edge over the competition. This dedication needs to be reflected in the top management's agenda and subsequently established within the organization.

There is more than one right way to integrate sustainability within your organization – depending on the initial situation and your main goals. It is now important to identify which option suits best to your organization and set objectives.

Sources:
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