

An unprecedented opportunity for a new start

Rethinking corporations' role for a sustainable future



Contemporary society has not been effective in transforming discussions around sustainability into concrete and strategic actions. Today, we see the results in terms of climate change impacts, rising inequalities, and natural environment deterioration. The pandemic further highlighted the need for radical change and offered the opportunity to rethink our societies and the way we do business. There are tangible benefits to basing organizations' purpose on sustainability drivers, and sustainable business models are gaining pace. Corporations should rethink their role in the context in which they operate and adapt their strategy, organization, resources, processes, and culture accordingly.

Walk the talk on sustainability

Institutions and corporations have discussed sustainability topics over the last decades, but results have not been enough to tackle the great challenges our planet faces. The guiding principles for sustainable development were developed almost 40 years ago, when in 1983 the General Assembly of the United Nations (UN) set up the World Commission on Environment and Development, asking to formulate *"a global agenda for change"* (released in 1987 in the so-called "Brundtland Report"). Intergovernmental and political institutions have set medium- and long-term objectives to preserve our planet and the quality of life for future generations, but with limited success in obtaining concrete results. In 2015, all UN member states adopted 17 Sustainable Development Goals (SDGs) as part of the 2030 Agenda for Sustainable Development, setting out a 15-year plan to achieve them.

The year 2030 is less than a decade away, and the UN's "SDGs Report 2020" showed that, even before the COVID-19 pandemic, progress remained uneven and the world is not on track to meet the goals, such as ending poverty and hunger; combating climate change; ensuring access to clean water, sanitation, and clean and affordable energy; and reducing inequalities.

The Paris Agreement on Climate Change entered into force in 2016 and, as of February 2021, had been signed by 194 countries. However, fossil fuels subsidies increased from US \$318 billion in 2015 to \$427 billion in 2018. (Source: IEA)

Many corporations still have not adopted sustainability at the core of their strategy, instead focusing on declarations of intent and policies, sustainability reporting, communication, or charity initiatives. The track record of S&P 500 companies that published a sustainability report increased from 20% in 2011 to 90% in 2019. However, only 36% of the reporting companies aligned with specific SDGs, and among them, few can honestly say that sustainability is the key driver of their business decisions.

Too little, too late: a situation rapidly deteriorating

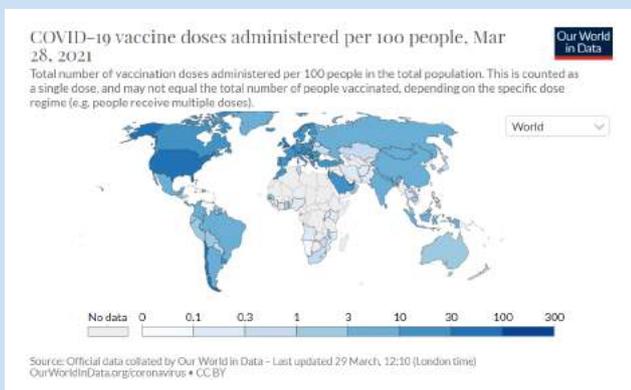
There is much evidence that the efforts put in place over the last decades have been inadequate to solve the challenges that the planet and its people face today:

- Even before COVID-19, the world was off track to end poverty by 2030, and global extreme poverty rose in 2020 for the first time in over 20 years, with the number of extreme poor expected to increase by as many as 150 million by the end of 2021.
- Climate change continues to exacerbate the frequency and severity of natural disasters. More than 39 million people were impacted by such disasters in 2018, with \$23.6 billion of direct economic losses.
- We are using natural resources in an unsustainable way: the global material footprint increased from 73.2 billion metric tons in 2010 to 85.9 billion metric tons in 2017. (Source: UN Department of Economic and Social Affairs)

COVID-19 and inequalities: a reciprocal reinforcement

The COVID-19 pandemic spread to almost every country, but its effects discriminated against the most vulnerable. As a result, extreme poverty will increase, particularly in Sub-Saharan Africa and Southeast Asia. The economic crisis is particularly impacting women, low-skilled workers, and people who rely on the informal economy. The International Labour Organization reports that, in India alone, more than 400 million people who are forced to rely on informal work risk sliding into poverty.

Crisis recovery is an opportunity to address global challenges, such as inequality. The richest countries are launching fiscal stimulus and recovery plans for their economies, although initial evidence shows that inequalities among and inside countries are worsening: vaccination plans have been launched only for a minority of world population, and vaccines are being unevenly distributed among countries. Despite organizational bottlenecks, rich countries such as the EU and the US deployed resources to vaccinate a minimum of 70%-80% of their populations by summer 2021, while most of the African and Southeastern Asian countries have yet to give a single dose.



An opportunity to rethink our societies and the way we do business

Then, COVID-19 changed dramatically the context, worsening preexisting disparities within and among countries in terms of access to education, health coverage, and decent working conditions. The situation calls for radical change. We are currently focusing on facing the crisis, but the pandemic also offers unprecedented opportunities for a new start. Should we go back to our pre-pandemic world? Or shall we rethink completely our systems and the role of corporations in societies? The crucial point going forward will be to put at the center of the decision-making process a new environmental, social, and economic awareness, with the possibility to create and distribute value out of all three of these dimensions.

Doing good, doing well

A sustainability goal can be the lever to unlock new sources for business differentiation and value creation, helping to:

- Develop new sustainable products, services, and business models and accelerating the transition toward long-term value creation for all categories of stakeholders.
- Refocus current product/service portfolio toward faster-growing sustainable products, which have typically lower risk profiles and higher long-term remuneration.

These approaches can be deployed both in reshaping business for existing corporations (e.g., Enel, which in 2015 adopted a sustainable business model, seizing opportunities related to decarbonization and electrification trends) or creating new business based on sustainability purposes (e.g., Seventh Generation or A Good Company). There are tangible benefits in basing organizations' activities on sustainability drivers.

Better financial performances

Investors are rewarding companies with better sustainability performances, underpinned by a growing trend of indexed climate change-related thematic investing. Players of the "old economy" are being left behind by the "new sustainable economy":

- The two-years' growth of the S&P 500 Environmental, Social and Governance (ESG) Index since its launch date has outperformed the S&P 500 Index by 4%, with better performances confirmed during the COVID-19 crisis as well.
- Companies such as Enel and Shell gained premium prices for sustainability bonds due to strong investor demand (e.g., Enel reported that the deal had saved it 20 basis points compared to a conventional bond).
- The MSCI World Sustainability Index (SRI) outperformed the MSCI World index at almost all times during the MSCI SRI's 12-year existence, showing also greater resilience in 2020, when the MSCI World lost 9.9% and the MSCI World SRI just 3.6%.

Risks prevention

A proper risk management system is an essential tool in driving innovation and value creation. Corporations that truly embed sustainability principles into their strategy can integrate advanced methodologies into daily operations, thus allowing for timely identification of risks and the ability to address risks in a consistent manner across the organization. Good sustainability practices further protect organizations from cases where insurers have used ESG criteria to refuse insurance coverage. A recent such example is AXA, which is dropping German energy company RWE over its coal operations.

Talent attraction, engagement, and retention

Talent management is a key factor for organizations' success, impacting the bottom line – due to hiring costs and loss of efficiency – as well as the top line – boosting innovation processes and supporting required transformational changes. Millennials and members of Generation Z highly value meaning in their work and are attracted and kept by organizations that demonstrate a sustainable purpose at the core of their business.

Attract investments

Sustainable finance has grown rapidly over the past decade, as an increasing number of institutional investors and funds have created different investment forms incorporating ESG investing criteria. The Organisation for Economic Co-operation and Development estimates that the value of professionally managed portfolios integrating key elements of ESG assessments exceeds \$17.5 trillion globally. Investment firms such as BlackRock already have made sustainability a core goal of their investment decisions, and soon all commercial banks will need to judge whether a company's ESG performance is good enough.

The opportunities coming from COVID recovery plans

In addition to the benefits we've highlighted so far, the unprecedented amount of government expenditures to support economy recovery is an occasion to leave business-as-usual unsustainable investment plans and to focus resources on fighting global social and environmental emergencies.

"Awareness is rapidly changing, and I believe we are on the edge of a fundamental reshaping of finance. The evidence on climate risk is compelling investors to reassess core assumptions about modern finance.... In the near future – and sooner than most anticipate – there will be a significant reallocation of capital."

BlackRock CEO Larry Fink's 2020 letter to CEOs

Rethinking corporations' role

Tackling sustainability concerns creates opportunities for long-term competitive advantage for companies willing to rethink their purpose and to create value for the society they operate in and for their stakeholders. There are already many mature circular businesses, and some of them may become the new way of doing business in place of old corporations.

Benefit corporations and benefit companies

A benefit corporation (B Corp) is an organization that wants to make a profit while simultaneously addressing social, economic, and environmental needs. Being a B Corp is a way to rethink business, implementing a "B economy" – a global movement of people using business as a mean to compete to be best for

the world and the people living in it. Many companies – including large ones – are joining the B Corp movement, both as certified B Corps and through other accessible options to be like a B Corp.

A benefit company (BC) is a legal structure for a business, empowered to pursue positive stakeholder impact alongside profit. Some companies are both certified B Corps and BCs, with the BC structure fulfilling legal accountability requirements of B Corp certification. BCs are regulated by laws in Italy, 36 US states, Colombia, Ecuador, British Columbia (Canada), and France, while legislation is moving forward in Australia, Argentina, Chile, and Canada. These laws usually define a "common benefit" as the creation of positive effects (or reduction of negative ones) for individuals, communities, environment, cultural heritage, entities and associations, or other stakeholders.

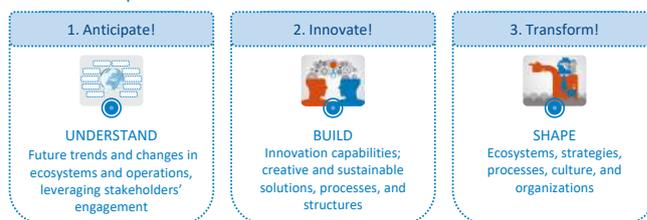
Circular ecosystems

The current global economic model is causing an unsustainable depletion of resources and missing significant economic opportunities that are possible by adopting approaches based on circular production and end-of-life management. To address these concerns, circular ecosystems were developed to turn "make" processes into a circular loop and decrease waste. Adoption of a circular economy model has proven to have benefits to any entity pursuing it, including financial and socioeconomic ones. Several examples of circular ecosystems are found in refining, chemicals, and furniture sectors.

The three steps of a new sustainable mindset

Corporations must rethink their mission and role in the context they operate in and define new operating modalities and mechanisms. This positive rethinking process requires a new mindset that can be deployed into a three-step approach: anticipate, innovate, and transform (see figure below).

The three steps to build a new sustainable mindset



Source: Arthur D. Little analysis

Sustainability integration into high-performance business models

A correct system structure is key for complex organizations to ensure sustainability integration into high-performance business models (HPBM). All the elements of the HPBM structure shall be involved in order to deploy an organic transformation process (see figure below).

Integration into high-performance business models



Source: Arthur D. Little analysis

- Strategy and purpose.** Being a purpose-driven company requires concrete objectives that can benefit society, defining why the organization exists, how it can contribute in creating shared value, and directing vision and mission toward stakeholders' satisfaction. The deployment of long-term objectives requires a change of outlook, going beyond the typical four- to five-years' timeframe of industrial plans and setting roadmaps with a long-term perspective (30 years).
- Organization.** Define a governance model for integrated management of all ESG sustainability dimensions: it is paramount to create an organization where the sustainability aspects are infused in it, rather than coordinated or directed by a specific function.
- Processes.** Develop metrics and decision-making models based on the above concepts, such as externalities and social ROI (SROI) to measure processes' impacts on materiality topics (e.g., decarbonization, incident risk reduction). Sustainability should perfuse all business processes rather than standing alone.
- Resources.** Ensure human, technology, and asset resources are aligned with strategy to support transformation into a sustainable company by investing in right talents and training and leveraging on metrics.
- Culture.** A common sustainability "language" should pervade the entire organization. The management of sustainability concerns should be based on a delegating governance, raising awareness from top management to all employees, and creating a collaborative ecosystem involving key stakeholders.

Conclusion

Rethinking corporation business models is essential to preserve our planet and the quality of life for future generations, but it is also the only way corporations can survive in the long term. This paradigm shift requires a combination of flexible and comprehensive approaches and new mindsets, enlarging the prospective of business decisions from the short-term to the long-term horizon. Arthur D. Little has developed unique competences in anticipating future trends, fostering innovation through creative and sustainable solutions, and transforming organizations – leveraging proven frameworks and tools for externalities and SROI assessments across a wide range of cases in different industries and countries.

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Arthur D. Little

Arthur D. Little has been at the forefront of innovation since 1886. We are an acknowledged thought leader in linking strategy, innovation and transformation in technology-intensive and converging industries. We navigate our clients through changing business ecosystems to uncover new growth opportunities. We enable our clients to build innovation capabilities and transform their organizations.

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