Moving to sustainability

By
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For businesses, pressures are mounting to act on sustainability. The social trend is strong and pushed by the workforce, clients and investors alike. The gathering sense of urgency is supported by the scientific consensus that the next ten years are key for climate change.

However, commendable exhortations to do more, more quickly often run straight into the realities of business and budgets. Claims that doing good for the planet will create financial value are hard to justify when the time comes for investment decisions. Data and evidence are missing or aggregated into broad ESG metrics which capture too much and are inconsistent with one another. There seems to be no basis for rational decision making.

What can senior executives do?

Not all businesses are equal on sustainability

They must first identify in what business they are relative to sustainability. There are five situations.

The first is the one of sustainability leaders. Some of them operate in "activist" niches. Patagonia is an emblematic example: its outerwear targets consumers who are willing to pay up to twice as much because it is sustainable[1]. Others are in businesses which are positively impacted by the sustainability trend because they are perceived as positive contributors (thermal insulation, heat pumps, forestry, recycling…). The question for those businesses is how to maximize their growth while keeping a positive contribution to sustainability. They may serve as benchmarks for other sectors, but there is often a question on the scale which can be achieved with similar business models elsewhere.

The second category is made of companies for which the transition is natural. They can accelerate on sustainability while only adding a fraction to their total costs. They are often in premium business models with a strong culture and values of respect (for example in luxury: for materials, for workers…) or in innovation, at the forefront of advancement (for example in technology). Acting on sustainability is financially doable, improves the overall attractiveness of the company and may have a diffuse positive impact on the business: it is a no brainer (at least to conduct some powerful or emblematic initiatives).

The third category is the one of businesses disrupted by sustainability. Those companies have intense social, political or regulatory pressure to change, compounded by pressure from innovative competitors quick to catch on the trend. An example is the car industry, where automakers increasingly commit to bold emission reductions and a transition to electric vehicles. For companies in this category, the transition must happen. It requires massive investments. It may be an opportunity to transform the industry and gain market share or capture greater value. In any case, those lagging behind risk disappearing.

The fourth category is the one of sustainability laggards. There is currently no technology which fundamentally solves the problem of their strong negative contribution to sustainability. Pending disruptive innovation, they can only conduct useful, but only palliative actions.

[1] The pricing also reflects contributions of other ESG actions (sustainable work…).

External and internal communication becomes a major issue. The only alternative is to exit or radically change the business.

The fifth category is the gray area. It covers a large share of businesses. Clients may increasingly be appreciative of sustainability but are not necessarily ready to pay the price. Shareholders and investors shun unsustainable practices, but they are not willing to give up their expected returns. There may be a tipping point in the future, but when will it happen?

Issues and priorities are obviously different in those five categories. The time and cost to achieve sustainability are different too. Improvement strategies must be designed accordingly.

How to build and implement a sustainability strategy?

Getting out of the stalemate requires a systematic approach with a recipe which is well-known in strategic changes:

- The first step is to provide overall steering: what is the group's current performance in sustainability? What baseline for the evolution in five, ten and fifteen years? How does this fit with technological, market, client and competitive evolutions? What are the key issues to be solved? What target should the teams work on? This overall steering requires first quantifications in good orders of magnitude and a common frame of reference (defining and sharing sustainability concepts internally).
- The second step is to prioritize solutions and assess the trade-off with financial performance (see table 1): what are the main levers to reduce the environmental impact? What costs or investments required? How do they impact the environmental footprint and the financial performance?
- The third step is to define the mechanisms to make things happen: what incentives (sustainability indicators integrated in performance reviews and compensation, internal shadow price…)? What financing (self-financing by business unit, corporate resources, carbon fund…)? What link with resource allocation? What organization, governance and monitoring for sustainability?
- The fourth step is to communicate internally and externally on the plan and its results.

The issue is often to start somewhere. While it may be desirable or required to have a first assessment of the current situation and a vision on most sustainability topics (carbon emissions, other greenhouse gas emissions, use of land, water pollution, atmospheric emissions, water consumption, waste…), carbon and other greenhouse gas emissions are often significant contributors and the most quantifiable topics. They are often the first ones to tackle.

Three prerequisites

There are three prerequisites on this path to sustainability.

It is necessary to deeply understand the business model and its economics within the entire industry value chain and not only its sustainability issues in a narrow sense. Indeed, going beyond the first quick and easy gains requires strong changes throughout the value chain and the company's business model. Supply, manufacturing, logistics, product characteristics, sales, client interactions, entire offer and approach… can be heavily redefined and optimized, often with some gains and not only costs for the business.

It requires deep expertise of how emissions work beyond the first level: expertise on energy sources (scope 2, with indirect effects on the energy mix in a market-based approach); understanding of indirect impacts along the value chain and lifecycle (scope 3); and differentiation between catchlines and real impact. For example, an electric car is not necessarily more carbon free than a low-emission gasoline car: it depends on the country where the car is used (different energy mixes) and the battery manufacturing process is highly emission-intensive (see table 2).

It also requires that decisions be made topic by topic with concrete action plans and specific indicators. Aggregated ESG metrics may be useful for ratings and external communication, but for decision making they are black boxes with little value.

What to conclude?

A sustainability plan needs strong prioritization in a sequence consistent with the financial dynamics. Given the depth and breadth of the task, companies risk taking too long or being paralyzed if they try being thorough on all topics from the start.

It should differentiate between different types of actions: actions which reduce emissions; new business models which are "sustainability native" (second hand, renting…); compensation (carbon certificates, remediation actions like investments in forests…). Compensation actions are the least desirable but also the least disruptive for the business and can be a cheaper option (as long as demand for compensation is not too high). New business models are often hard to define and bound to remain a niche in the short to medium term. Reduction actions are or ought to be the core of the plan. They require significant resources to be prioritized and implemented.

The plan must also differentiate according to the level and the nature of the impact: actions with a significant contribution and which must be prioritized; emblematic actions which should be conducted to rally internal and external stakeholders but which have a low to medium overall impact; other actions which have low impact or a prohibitive cost, which must be de-prioritized.

It must clearly and objectively integrate at least two perspectives: the sustainability perspective and the financial value creation perspective. As always, analytical perspective and selectivity are key. Otherwise, no consensus and no action are possible.

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Estin & Co is an international strategy consulting firm based in Paris, London, Zurich, New York and Shanghai. The firm assists the management of major European, North American and Asian groups in their long-term growth strategies, as well as private equity funds in the analysis and valuation of their investments.

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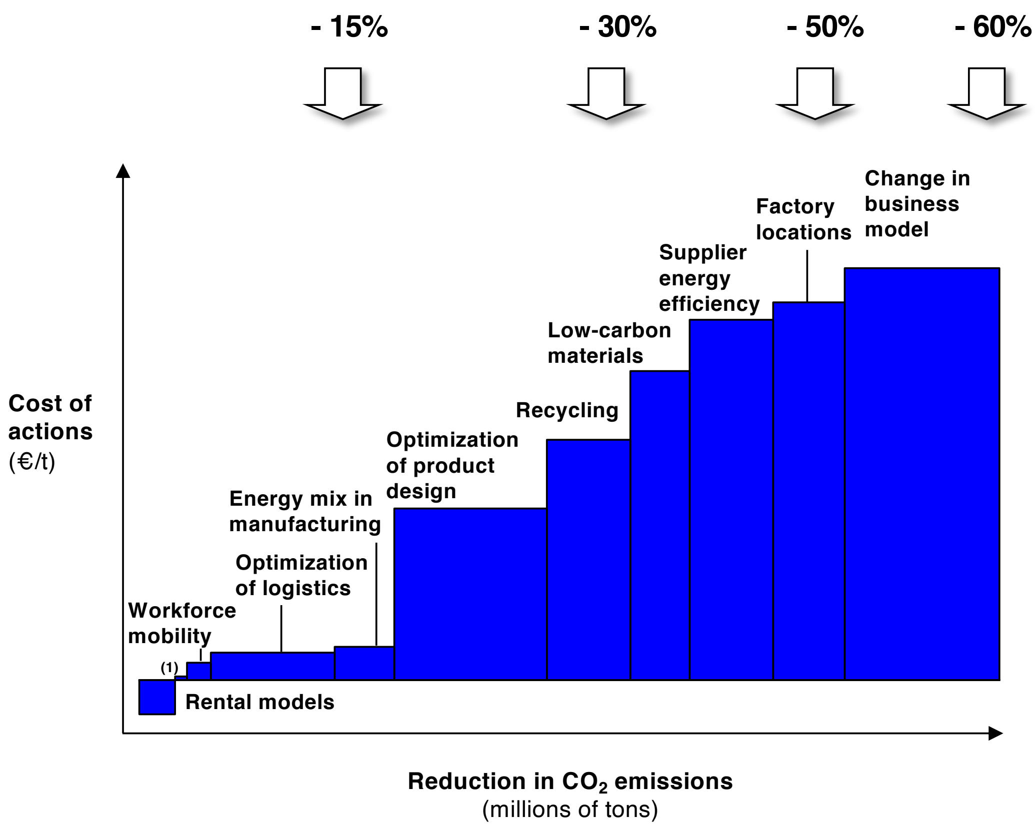
- Table 1 -

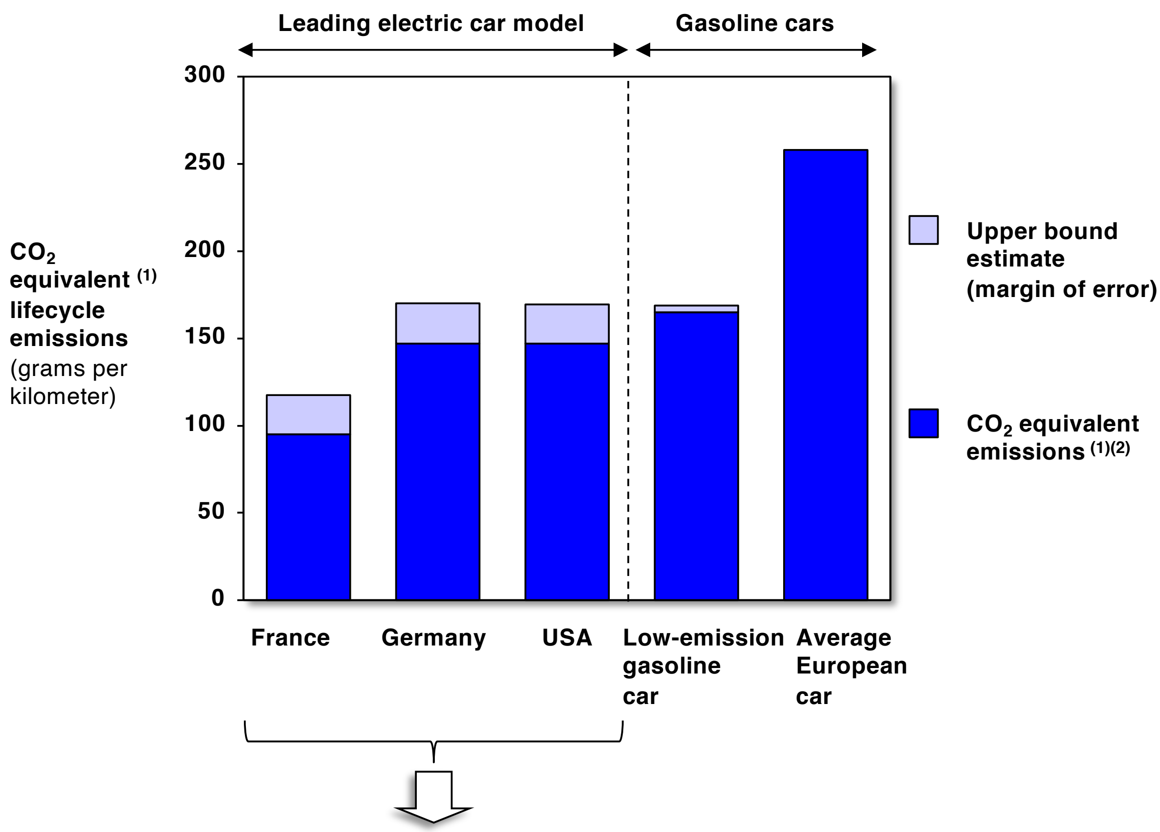
Sustainability actions must be prioritized and combine at least two perspectives: the environmental impact and the financial cost
- Illustrative example -



(1) Sustainability in headquarters (no plastic cups, buildings with energy efficiency certifications…)
Sources: Estin & Co analysis and estimates

- Table 2 -

Is an electric car better for the environment than a low-emission gasoline car?



- *Battery manufacturing strongly generating emissions*
- *Differentiated impact of car charging based on country energy mix (nuclear in France; fossil in Germany and in the USA)*

(1) CO_2 equivalent emissions aggregate emissions from various greenhouse gases into one figure; (2) Average estimate
Sources: IVL Swedish Environmental Research Institute, The International Council on Clean Transportation, Harvard Kenny School Belfer Center for Science and International Affairs, Carbon Brief, Estin & Co analysis and estimates