White Paper

Sustainability with strategy

Having barely mastered the challenges of globalization, and while still trying to manage digitalization, many companies are now at the beginning a third major wave of change: the transformation towards sustainable business. According to numerous analysts and experts, sustainability will have a similar or even greater impact on companies and society than the previous waves of transformation. Many new risks and obligations, a massive change in processes, technology, and mindset, but also excellent opportunities lie ahead for companies. The question for executives is therefore: What is the best way to approach this Sustainable Business Transformation?

Greenwashing is not a solution

Through their activities, companies leave their mark on the environment and the social environment. This was also true long before industrialization. However, most of the time, the effects were only felt regionally, and the consequences were manageable, especially since there were more continents to discover, areas of land to settle, and supposedly infinite resources to exploit on this planet. However, the massive growth over the last two centuries and the associated environmental impacts have now thrown global systems out of balance. At the same time, the direct (e.g., child labor, inequality) and indirect (e.g., effects of climate change, competition for scarce resources) social consequences of current and past economic activity can no longer be overlooked. A fundamental shift toward a sustainable economy has long been inevitable. Every delay increases the pressure to act.

Due to the apparent threat, many companies have already realized that they can no longer avoid their obligations. However, some are still trying to avoid making fundamental changes and setting genuine sustainability goals by using anecdotal individual activities and euphemistic external presentations. Such greenwashing may have served its purpose for a while, but it is more of a transitional phenomenon stemming from old thought patterns.

This behavior has long since ceased to be a trivial offense. Companies are increasingly under pressure - on the one hand, from the introduction of legislation and standards, and on the other from stakeholders, both internal (employees and investors) and external (customers, NGOs, financial markets, media). Those who don't take sustainability requirements seriously risk draconian penalties, massive reputational damage, and significant restrictions on access to capital and funding.

Create transparency and fulfill obligations

A glance at the annual reports or investor relations websites of large corporations is enough to see that sustainability already plays a significant role in decision making. Depending on the industry, these companies publish surprisingly detailed information on emissions, resource consumption, waste volumes, equality, and much more. There have already been international efforts to establish uniform standards for this reporting, with additional developments underway.

Small and medium-sized companies have so far been able to largely avoid reporting requirements on sustainability issues. However, the Corporate Sustainability Reporting Directive (CSRD), which is expected to come into force for the first time in 2024, will massively expand the group of companies affected by the reporting obligation. The requirements of this directive apply to companies with 250 or more employees and corresponding sales. In addition, comprehensive data is required for many key figures, in some cases also from supply chains, and requirements are thus passed on. Therefore, corporations are obliged to make their suppliers provide the relevant data. In this respect, small businesses will also be increasingly affected indirectly by reporting requirements and will have to adapt to them.

For both large and small companies, the figures to be reported do not fall from the sky, nor should they be the product of wishful thinking or fantasy. Many key figures have already been clearly defined via legislation and international standardization bodies in recent years . Many more will follow. All these indicators must be based on data and facts and be verifiable.

Transparency, verifiability and traceability are a matter of course in the area of traditional financial ratios. Investors and tax authorities can rely on the figures because the rules of the game are clear, and the penalties for violations are high. Fraud and subsequent corrections tend to be the exception and usually have significant consequences for the company and management.

These requirements regarding quality and reliability apply equally to sustainability indicators. The various stakeholders must be able to trust reports and individual figures, but also be able to verify them. Meeting sustainability obligations therefore goes far beyond throwing together some information with some fancy words.

Sustainable Business Transformation is data-driven

Even the determination of many traditional financial key figures for the quarterly or annual reporting period generates a great deal of work for companies. And this even though most of the data is available in relatively well-structured tables in ERP systems such as SAP, the core of which has not really changed for decades.

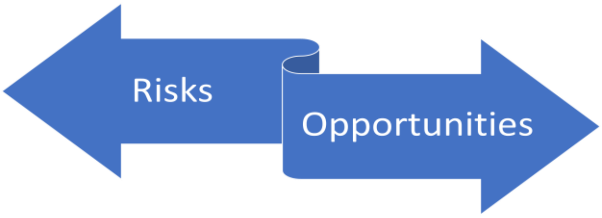
However, many non-financial key figures required in sustainability reporting are based on data from possibly multiple different, wide-ranging systems that are not readily accessible. While finance and controlling departments typically have direct access to the data necessaryfor conventional financial reporting, the data for sustainability indicators often first has to be located, prepared, and integrated. Sooner or later, many companies will have to create data platforms (data lakes, data warehouses) and data pipelines.

To make matters worse, a large part of this data is not stored in traditional SQL databases, but in files with a wide variety of structures. These can be documents or even emails in which the relevant information is "hidden" in the rest of the text and must first be extracted using text analysis, scraping, and Natural Language Processing. Often, such documents are also scanned as images, so that this data must first be made accessible via artificial intelligence using optical character recognition or image analysis methods.

Once you have built a database and a reporting system for different facets of sustainability, such a treasure trove of data is, of course, not only available for periodic regulatory reporting. Companies can also use this data for continuous internal monitoring. Above all, however, it opens up a great deal of potential for the targeted control and optimization of resources and processes. In particular, industries that are still a long way from achieving sustainability goals can more easily identify the need for action based on a solid data, derive suitable measures, and gradually transform production and other parts of the company toward sustainability.

Opportunities in change

Changes in the economy, technology, and society are always an evolutionary process. Familiar things disappear, are displaced, and replaced by something new, be it technical inventions, innovative business models, new forms of cooperation, or other previously unknown and unexpected phenomena. What seems threatening from one perspective can therefore be an opportunity from another. Accordingly, every economic, technological, or social change always brings with it a variety of opportunities in addition to risks and constraints. In the beginning, this is especially true for those who get involved early enough. Not all companies will benefit from the changes, but eventually the majority of them will. Those who resist change, however, will benefit least.



The transformation toward sustainable business (Sustainable Business Transformation) also includes a huge bouquet of opportunities. To name just a few:

- New products and services are emerging that enable sustainability trends to be covered earlier and, above all, better. Sustainability is increasingly becoming an innovation driver and investment-determining factor in the company.
- Sustainable products and services are more attractive to customers and are increasingly in demand. In some markets, new forms of partnership between customers and companies are emerging.
- Many investors already make their investment decisions based on sustainability criteria. The share prices of fair winners are rising faster than those of conventional companies. It is also easier for companies to raise outside capital if they have a good sustainability rating.
- A reputation as a clean employer helps to attract and retain employees and motivate them to perform at their best.
- Government funding - often essential for research and development, i.e., a company's future sales and profits - is increasingly geared toward sustainability goals. Accordingly, focusing on ideas in areas such as energy efficiency and circular economy today can ensure the company's continued existence tomorrow.

- Quite trivial: many sustainability measures lead directly to savings and help reduce costs.
- Given the increasing scarcity of many raw materials and other resources, prices will rise. Companies that think about economizing, recycling, and sustainable processes today will save massively tomorrow.
- Transparency of supply chains and measures for the traceability of raw materials and subproducts also create a wide range of new opportunities for increased efficiency and collaboration beyond the sustainability sector.
- In general, a variety of new business and cooperation models are emerging in the increasingly developing sustainable markets, with new players, new processes, and new value chains. An invitation for creative, entrepreneurial minds.

Not all opportunities are evident from the start. Sometimes, a revelation comes only after in-depth examination of specific issues, and from feedback to the first initiatives. Data that may have initially been intended only for reporting purposes may turn out to be the starting point for new insights and innovation, or a tool for controlling and optimizing processes and products.

More and more managers are seeing these opportunities for themselves and their companies. They understand that sustainability is more than a burdensome reporting obligation and are taking strategic steps to tap into the future potential of Sustainable Business Transformation.

Sustainability based on figures, data, and facts

As we all know, every long journey begins with the first step. At the beginning of a journey, it is not always clear how long it will last and where it will take you. This also applies to the transformation toward sustainable management.

Initially, the focus for many companies is certainly on fulfilling regulatory obligations. In view of the upcoming extensions of legal requirements (e.g., CSRD and Supply Chain Act), which will increasingly affect more SMEs, companies would be well-advised to at least investigate their situation, and carry out a risk assessment.

External relevance checks can provide more security against unpleasant surprises without directly incurring high costs. Specialized consulting firms - such as Ingdilligenz - offer suitable questionnaires and initial assessments that help to gain clarity about acute and more strategic needs for action. Even beyond reporting requirements, such an assessment can provide initial insights into potential wins and opportunities of sustainability.

However, making a decision on the sustainability strategy or defining a roadmap is generally not possible using just this initial report. This usually requires more in-depth analyses of processes and data. Depending on the size and complexity of a company, this can take anywhere from a few days to a few weeks, or even a few months in the case of large corporations. Additional expenses may arise if essential information in the company or its surroundings has to be made available using technology. It is not uncommon for strategy development and information gathering to go hand in hand. The data foundation gradually grows in depth and breadth, therefore allowing additional analyses and key figures (e.g., carbon footprint, resource consumption, waste volumes), which facilitate decisions. This information may also raise new questions, for which further data are then required.

The understanding of patterns and cause-effect relationships underlying the data is assisted in particular by the use of Big Data Analytics (Data Science, Artificial Intelligence, Machine Learning). Effects and causes that are initially hidden from the human eye and mind due to their complexity come to light. Appropriate measures can be taken in a targeted manner.

Challenges of fact-based sustainability management

Typically, information procurement for sustainability reaches limits that can hardly be overcome without major investments in business processes and IT systems and cooperation with partners. Reasons may be, for example, that certain data has not been stored before - or not permanently. This data may be in an unsuitable format or of insufficient granularity or quality. Particularly at the company's interfaces with the outside world, many purchased components and raw materials become a black box.

Fundamental changes and deep interventions in existing processes and IT applications are required to remedy this situation. These often require extensive projects that can extend over a long period of time. However, many companies - though not all - have already learned the mechanisms of these projects in the course of digitization. Many companies are therefore quite well prepared.

Due to time pressure and the need for action in sustainability, interim solutions are often required. Estimates and manual data collections can at least provide approximate values and indications. The quality and efficiency of many transitional solutions can often be improved by small digital tools (scripts, macros, Excel sheets...) and the use of software robots (Robotic Process Automation) or even Artificial Intelligence (e.g., for automated text and image analysis).

Temporary solutions can also help in understanding data and sustainability requirements, and ultimately make it clear where it makes sense to permanently adapt existing processes, applications, and interfaces so that data can be collected and merged more accurately and with less effort.

Of course, any investment in transitional and later permanent solutions also needs to be carefully considered, especially as the range of possibilities is enormous. No later than when initial decisions have to be made, a company should have at least a rudimentary strategy and a rough vision of how far the sustainability perspective extends for the company. A few medium-term goals should also be defined, as well as the next steps.

The scope of a company's sustainability vision may differ for many reasons. For some companies, it may make sense to focus on reporting requirements, at least initially, to satisfy key stakeholders and manage legal risks. Besides the need to comply with government regulations, the company may, for example, have an important customer that also has to comply with regulations and makes the continuation of the business relationship dependent on the delivery of specific data. Providing this data may also require major adjustments on the supplier end. Or an investor requires evidence of key ESG **(E**nvironment, **S**ocial, **G**overnance) indicators before they will support the company financially.

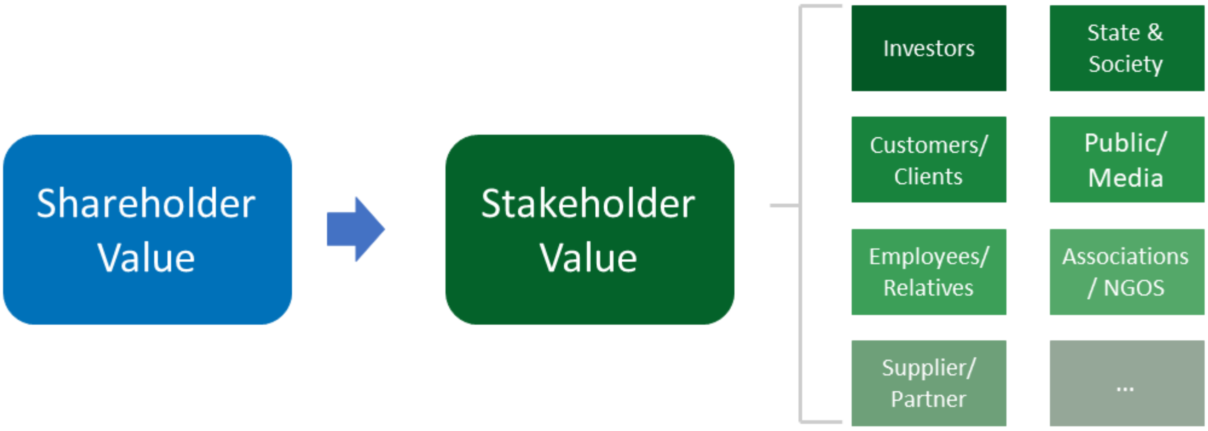
It is advisable to review, and if necessary, adjust the strategic focus when the first reliable information is available. This should also be done periodically in response to interim changes in legislation and the market environment. The company can then address new issues that have become relevant and take appropriate action. However, additional benefits (potentials, opportunities) and possible "quick wins" in the area of sustainability may also have become apparent.

The role of stakeholders

Coordination with key stakeholders is indispensable for all strategic decisions if you want to be sure of their lasting support. They must be on board, and their viewpoints and requirements taken into account. In the course of implementation activities, it may be necessary to involve other stakeholders. Clever communication is required here, and in many cases, conscious and careful change management at all levels.

The demands on communication and change management in the context of sustainability can be significantly higher than is familiar from other transformations, simply because of the large number of stakeholders and the potentially strongly divergent requirements of interest groups.

Unlike in previous decades, which were dominated by the idea of **shareholder** value, the actions of companies are no longer geared exclusively to the goals and objectives of investors. Instead, the **stakeholder** value approach is followed. In the future, the interests of employees, customers, the partner network, and last but not least, the environment and society (in the form of NGOs and authorities) will also be mapped.



Like any major change, the transformation to sustainable business naturally encounters resistance, and the mindset of those involved is not always open to change. Potentially, this can be the case for all groups of stakeholders. Accordingly, companies must set up target group-specific communication measures and change management that takes the concerns and arguments of the doubters and blockers seriously, and gets all stakeholders on board.

Each of these groups of stakeholders may need to be addressed differently through a range of channels and with distinctive arguments. However, it is important for everyone to be able to trust the company's statements, key figures, and plans. Trust comes from transparency. Companies of the future will communicate openly, be living embodiements of reliability, and build trust, knowing that hidden problems will be uncovered sooner or later, and the reputational damage can be irreparable.

Stakeholder management must also focus even more than before on the media, NGOs, and other independent and critical observers. Those contribute to transparency from the outside, where this may not be sufficiently implemented from within the company - whether willingly or due to a lack of information (e.g., in cross-industry comparisons). They help define objective standards and establish them as benchmarks for each individual company.

Author

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About Ingdilligenz - we make fair winners!

The future belongs to companies that achieve success with a clear conscience and an awareness of their responsibility. Tomorrow's companies are sustainable, data-driven, and transparent. They learn continuously and become more successful and better every day: fairer in their dealings with customers, employees, and suppliers; cleaner in production and supply chains; and more sparing in their use of resources. We support you in changing your organization and mindset, and in sustainably developing your processes and products. To do this, we draw on a broad set of methods and digital solutions - some tried and tested, some innovative. All based on decades of experience.

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