FUTURE-PROOF YOUR BUSINESS WITH A FOCUS ON SUSTAINABILITY

Trending Topics summarizes news, information and perspective on matters affecting businesses and business leaders today. This insight is being provided to keep you up to date on the latest developments and trends influencing these topics. These views do not necessarily represent the views and opinions of PNC. For additional research on these topics, please consult the sources cited in this article.

The concept of "sustainability" was once seen as not much more than a trendy buzzword. Businesses assumed it simply meant trying to find ways to be greener, such as recycling or reducing waste. But a cursory nod to green initiatives is no longer enough. In the face of global disruptive forces, forward-thinking companies are now putting sustainability at the core of their business models and reflecting these values throughout their whole supply chain.

Five years ago, renewable energy and waste management were the main areas of focus, but now diversity and inclusion have moved to the forefront, according to recent research from consulting group McKinsey & Co. (McKinsey). Firms are also having to look more closely at the way they treat employees and suppliers, technological innovation, bribery and corruption, product design, and information security, in the face of greater public scrutiny.

McKinsey reports that organizations are more engaged with sustainability issues than they were two years ago, especially in certain sectors such as infrastructure and consumer packaged goods. Among the top five reasons companies gave for this were the desires to meet changing consumer expectations, boost their reputation, and ensure future growth.[1]

INVESTORS DEMAND MORE

Sustainability is important to company shareholders and stakeholders as well as customers. Investors want to support those businesses that can demonstrate progress towards long-term sustainability because they think this strategy will deliver great returns. Are they right?

Jessica Ground, global head of stewardship at Schroders, addressed the issue of sustainability at a recent investment conference. Schroders' Global Investor Studies for 2016 and 2017 revealed that 67% of U.K. investors say sustainable investing has become more important to them, with millennials in particular demanding more than just investment returns. They tend to be "stickier" investors, willing to hold sustainable investments for two years longer than the average investor, almost double the timescale.

Ground also said about half of global investors surveyed by Schroders wanted to back those businesses that are proactively preparing for environmental and social change, rather than just excluding the controversial ones. "That is something that we think chimes well with what is going to create long-term sustainable value," she added.[2]

HOW SUSTAINABILITY BOOSTS THE BOTTOM LINE

Academic research supports the idea that focusing on sustainability helps companies to outperform and boosts shareholder returns.

One study conducted by the Harvard Business School looked at early adopters of sustainable values and how it affected them in the long term. It used a sample of 180 U.S.-based firms, of which half were classed as high-sustainability and half as low-sustainability, according to environmental criteria, including green supply chain policies and carbon reduction, social issues like diversity and work-life balance, and governance such as business ethics and customer safety.

It found that those firms that embraced sustainability in the early 1990s when it was first taking off as a concept had "dramatically outperformed" their low-sustainability competitors 18 years later. The annual above-market average return for the high-sustainability sample was 4.8% higher, with lower volatility, and they also outperformed in terms of return on equity and return on assets. This led the researchers to conclude there is "convincing evidence that sustainability pays off." They argued it is key to creating shareholder value and also makes for more committed employees and more loyal customers, ensuring the business itself is sustainable.[3]

SHIFTING TO A SUSTAINABLE MINDSET

It may not be easy for companies to switch to a more sustainable mindset that puts environmental, social and governance (ESG) factors at the heart of their business models. The move to more sustainable supply chains and corporate values may be a gradual one, but it will be essential if companies want to "future-proof" themselves.

So how can they best prepare for the transition? One important way to pursue sustainability is to embrace new technologies. McKinsey explains that sustainability-related technologies are getting much cheaper, lowering the cost barrier some firms might have faced in accessing them. Energy-efficient equipment, energy storage, digital platforms and advanced data analytics, for example, have all become more affordable in the last couple of years.

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Another key strategy is to aim for better integration of sustainability into core business functions, especially finance and IT. McKinsey notes that "integration with the finance function appears to yield the greatest value." Of those firms it surveyed, those that had formally integrated sustainability into at least one business function were at least twice as likely as others to report a positive financial impact.[4]

Deloitte suggests that company boards have an important role to play in implementing sustainability, as well as measuring and monitoring it afterwards. This is because board directors are uniquely positioned to link corporate purpose and strategy with sustainability values and to engage with investors. In a report in March this year, it said, "in a world where stakeholder expectations and reporting standards continue to evolve, some argue for a 'wait and see' approach to sustainability reporting. However, sitting on the sidelines is itself risky. The board can, and should, play a crucial role in moving the company's ESG practices and disclosure forward." Setting up a committee dedicated to sustainability issues could be a good first step for firms striving to improve their efforts here.[5]

However firms come to grips with sustainability, one thing is certain, they will need to do so if they are to remain competitive in years to come. With customers and investors wanting transparency and thoughtful business practices, the sustainability theme will be impossible to ignore.

To discuss these topics in more detail, please contact your PNC Relationship Manager or visit pnc.com/ideas.

1 "From 'Why' to 'Why Not': Sustainable Investing as the New Normal," by Sara Bernow, Bryce Klempner and Clarisse Magnin, McKinsey and Company, October 2017. Available at: https://www.mckinsey.com/industries/private-equity-and-principal-investors/our-insights/from-why-to-why-not-sustainable-investing-as-the-new-normal

2 "Sustainable Investing," by Jessica Ground, Schroders, May 22, 2018. Available at: https://www.schroders.com/en/uk/investment-conference-2018-manchester/main-platform/sustainable-investing/

3 "Is Sustainability Now the Key to Corporate Success?" by Robert Eccles, Ioannis Ioannou and George Serafeim, The Guardian, January 6, 2012. Available at: https://www.theguardian.com/sustainable-business/sustainability-key-corporate-success

4 "From 'Why' to 'Why Not': Sustainable Investing as the New Normal," by Sara Bernow, Bryce Klempner and Clarisse Magnin, McKinsey and Company, October 2017. Available at: https://www.mckinsey.com/industries/private-equity-and-principal-investors/our-insights/from-why-to-why-not-sustainable-investing-as-the-new-normal

5 "Sustainability and the Board: What Do Directors Need to Know in 2018?" by Dan Konigsburg, Kristen Sullivan, Michael Rossen, Christine Robinson, Deloitte, 2018. Available at: https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Risk/gx-sustainability-and-the-board.pdf

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