L.E.K. GLOBAL CORPORATE SUSTAINABILITY SURVEY

Putting Sustainability at the Heart of Strategy

How leading companies are embedding sustainability into strategy to drive growth and long-term value

Contents

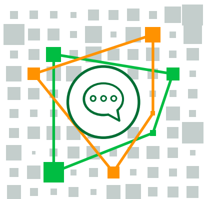
Key findings

Poor stakeholder alignment is holding back sustainability

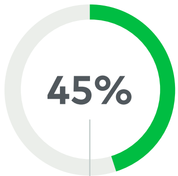
71% of companies are taking a proactive approach to sustainability:

51% are focused on ESG as a growth driver and **20%** are taking an innovation-led approach.

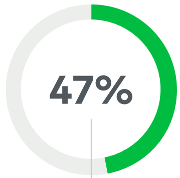
But alignment issues are undermining ambitions:



The **No. 1** barrier to long-term ESG ambition is lack of stakeholder alignment



Less than half have an executive team and board that are strongly aligned on ESG priorities

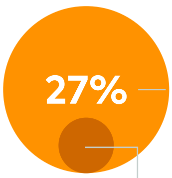


Almost half struggle to balance the interests of different groups, such as communities versus shareholders

Businesses must overcome three challenges to achieve their ESG goals

Demands for ESG transparency

87% feel pressure from investors for increased ESG reporting

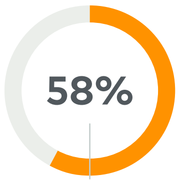


But less than **a third** have enterprise-level ESG KPIs in place

Including just **3%** that have a full suite of KPIs in place

Trade-offs

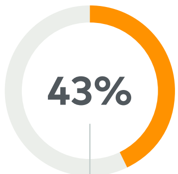
51% say addressing ESG issues should take precedence over short-term financial performance



But **over half** say their leadership team disagree on how to balance short-term priorities with long-term ESG goals

Accountability for delivery

The **No. 1** concern around delivery is not having the right rewards framework to drive behavior

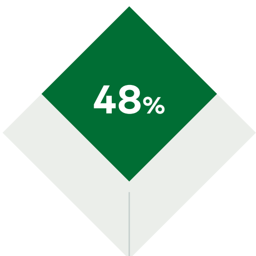


Companies that are concerned about inadequate reward frameworks for driving behavior, such as leadership pay aligned with sustainability KPIs

Answering the 'how' questions to turn sustainability ambition into reality

How to win

Align growth initiatives around ESG-related products/services



Say their current product/service portfolio fails to meet the needs of a more sustainable future

How to configure

Build a smart and agile operating model

Only 24% feel they have the agile organizational structure needed

Just 21% feel their teams have the skills needed to deliver their sustainability goals

How to get it done

Design best-in-class governance structures

The **No. 1** priority for improving sustainability governance is ensuring the executive team have the knowledge and skills to deliver ESG goals

"We need to be sustainable in terms of planet and people but also sustainable in terms of a business that makes sufficient profit to sustain its future."

Warren East CBE, Chief Executive, Rolls-Royce plc

Introduction

Today, CEOs, boards and their leadership teams are putting sustainability at the heart of strategy, framing decisions in terms of environmental, social, and human impact. They recognize the significant challenges facing people, planet, and companies, but also the exciting opportunity to build a more sustainable future and drive long-term revenue growth and value for all stakeholders, from investors to local communities.

The drive towards sustainability is most evident in the acceleration in the energy transition and focus on emissions reduction. But across sectors, sustainability has become a central consideration. It is rapidly emerging as a key component of governance in response to perceived public discontent with long-term damage that arises from short-term financial focus. Employees increasingly expect progressive corporate sustainability policies. However, establishing a sustainable business is complex. It requires balancing higher upfront investment against unusually tight timelines. Clear strategic choices are required.

We launched this global survey of 400 senior executives around the world to look deeper into how corporate leaders are tackling these issues. While we found that companies are taking a proactive approach to sustainability, with the vast majority taking a growth- or innovation-led approach to Environmental, Social & Governance (ESG) issues, they are running up against significant barriers to value creation. Alignment issues are proving problematic for many, with many companies struggling to achieve strategic alignment across key stakeholders: CEOs, boards, business unit heads and investors.

This report presents the survey results and our analysis, and covers three main themes:

- **Setting the sustainability ambition**
  Organizations today see a strong sustainability strategy and ESG program as a growth and innovation play – focusing on the 'offense' of value creation rather than the 'defense' of compliance – but alignment issues could undermine progress
- **Building strategic alignment and overcoming ESG challenges**
  As they design and deliver the required sustainability transformation to drive progress, CEOs and leaders are faced with significant challenges across governance, trade-off decisions, and performance measurement and reporting
- **Optimizing sustainability capability**
  To secure a long-term competitive edge in sustainability, organizations need to reconfigure their market strategy and product/service portfolio, build a new approach to capital decision-making and M&A, and create a sustainable operating model and supply chain

> "Everyone at USG – across the organization to our Board – recognizes that sustainability is one trend that is undeniable for a business operating in North America."

Christopher R. Griffin, President and Chief Executive Officer, USG Corporation

WHAT WE MEAN BY SUSTAINABILITY AND ESG

Sustainability refers, at a high level, to how companies are helping build a more prosperous and equitable future, often based on the UN's Sustainable Development Goals. These 17 global goals were agreed by all world leaders in 2015 to address challenges including poverty, inequality, the climate crisis, environmental degradation, peace and justice, by a deadline of 2030. While 'sustainability' is broad and thematic, **ESG** (Environmental, Social & Governance) and its elements allow for more specificity in focus, and refers to how companies evaluate sustainability risks and growth opportunities, make investment and other decisions, and report performance against their sustainability ambition.

ABOUT THE L.E.K. GLOBAL CORPORATE SUSTAINABILITY SURVEY

We surveyed 400 senior decision-makers from around the world, with a quarter drawn from the ranks of CEO or C-suite and the remainder from other senior roles, including those charged with ESG issues, such as Sustainability and Climate Change Directors. Respondents were drawn from across North America (100 US responses); Asia Pacific, with a focus on Australia (60 responses) and China (60 responses); and Europe: France (60 responses), Germany (60 responses) and the UK (60 responses). Over a quarter (28%) were from companies with revenues of $10 billion a year or more, and a wide range of sectors are represented, including Healthcare Services, Life Sciences & Pharma (100 responses), Industrials (150 responses, of which 64 were energy only), Consumer Products & Retail (75 responses), and Travel & Transport (75 responses).

The survey was supplemented by in-depth interviews, and the L.E.K. team would like to thank everyone who contributed their insights and knowledge to this report:

- **Deanna Bratter,** VP, Global Head of Sustainability; and **Daniel Hart**, EVP, Chief Legal & Risk Officer; Crocs, Inc.
- **Chris Davies,** Group Chief Financial Officer, National Express Group
- **Rebecca Dunn,** Head of Sustainability, Spectris plc
- **Warren East CBE,** Chief Executive, Rolls-Royce plc
- **Brian Lowe,** Managing Director and Chief Executive Officer, Orora Limited
- **John C. Turner,** Jr., President and Chief Executive Officer, Gypsum Management & Supply, Inc. (GMS)
- **Christopher R. Griffin,** President and Chief Executive Officer, USG Corporation.

Section 1: Setting the sustainability ambition

"

We need to 'shout louder' about what we're doing in this space and the sustainability characteristics of public transport: we save lives; we drive social mobility; and we decarbonize the planet in a way that very few other industries can."

Chris Davies, Group Chief Financial Officer, National Express Group

In the sustainability domain, there can often be a gap between ambition and delivery of results. While companies may declare an ambitious goal – such as 'net zero by 2050' – it is sometimes less clear what the plan is to deliver it in a structured way.

"Today, sustainability is becoming central to how leaders need to think and develop strategy, with investors, employees, consumers and customers demanding action on ESG issues," says L.E.K. Consulting's John Goddard, a Partner and Vice Chair, Sustainability. "However, historically there has been a tendency to manage sustainability as a discrete set of activities. This needs to change fast: ESG cannot be something that happens on the sidelines any longer. CEOs need to put sustainability at the heart of strategy, operations, and value creation. Sustainability offers an exciting opportunity to develop new products, provide new services and meet changing customer needs. Success means putting sustainability center stage: identifying the opportunities, realigning strategic choices, evolving the business model, reconfiguring the organization and setting out clear delivery programs."

Three key findings emerge from the survey:

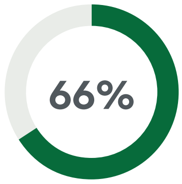
From defense to offence

Sustainability and the ESG agenda are seen as a major growth opportunity for organizations and key to addressing changing societal expectations. At a regional level, priorities differ, but there is an overall emphasis on driving growth, resilience and trust. US-based respondents, for example, put a major emphasis on meeting customer and employee expectations, while Europe-based respondents emphasize the growth agenda:

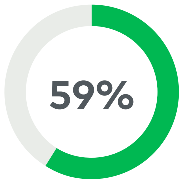
As they look to respond to these drivers, organizations are taking different approaches to sustainability, which we can broadly characterize as running from defensive to proactive. In our experience in this area, we see four clear types emerging: Minimalists, Pragmatists, Leaders and Innovators. And, as the research shows, most organizations (71%) are taking a proactive approach:

To what extent do you agree or disagree with the following statements about the importance of sustainability and companies' ESG agendas today?

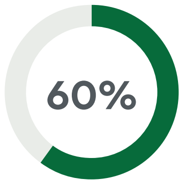
Europe US



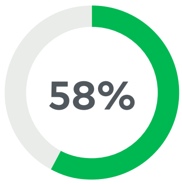
say sustainability is a major commercial and growth opportunity for companies



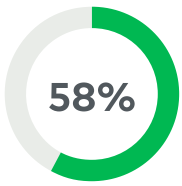
say customers and employees are putting increasing pressure on companies to do more on ESG issues



say a focus on ESG is critical to building trust with the public



say organizations that put a strong focus on sustainability are more resilient

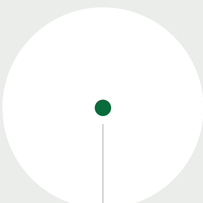


say a focus on ESG is critical to building trust with the public

Today, what is the major goal of your approach to sustainability and ESG?

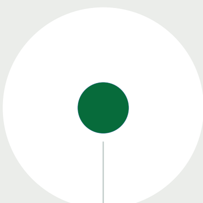
29% DEFENSIVE

Minimalists
Compliance-driven



4%
are focusing only on meeting regulatory compliance and disclosure obligations around ESG issues

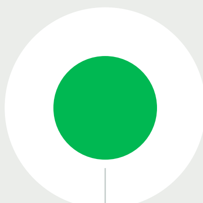
Pragmatists
Risk-driven



25%
are using a risk-based approach to decision-making to mitigate operational and reputational risks from ESG issues

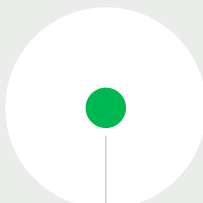
71% PROACTIVE

Leaders
Growth-driven



51%
are focused primarily on integrating sustainability into business strategy and seeing it as a growth driver for the organization

Innovators
Values-driven



20%
for 1 in 5, sustainability is driving the strategic agenda as they look to be an innovator within their sector and leverage sustainability as a major source of value creation

The fact that just 4% are taking a compliance-led approach reflects the fact that leaders recognize that the changes to their operating environment are so fundamental that sustainability cannot be seen as just an obligation. A compliance-led approach could mean the organization failing to meet the expectations of employees, customers and investors, as well as falling behind what competitors are doing.

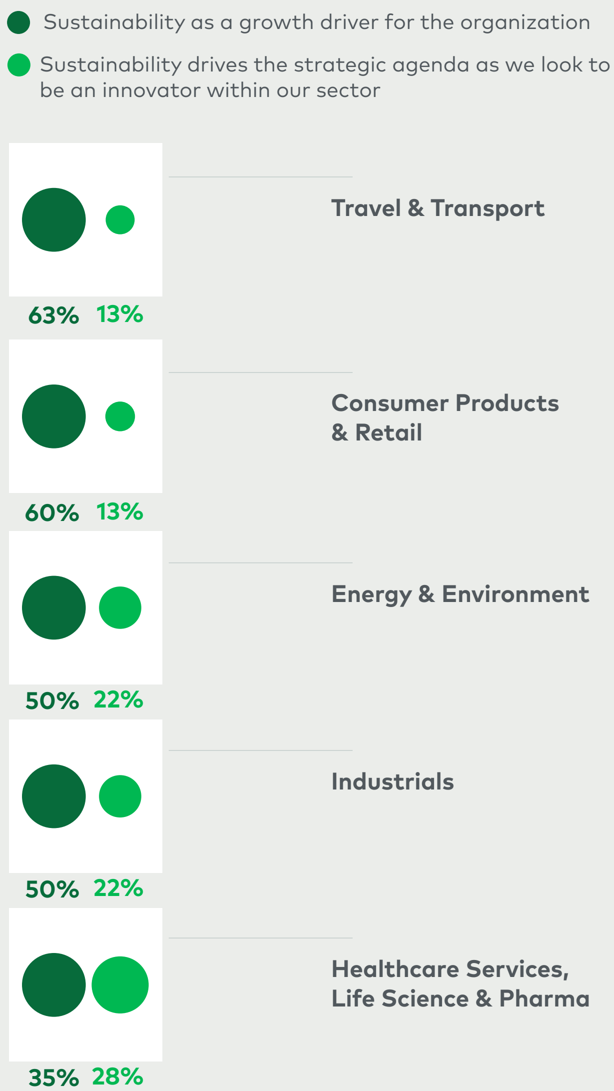
> "Major investors in the US have essentially put public companies on notice that ESG performance is an increasing focus for them, which certainly helps galvanize leadership thinking."
>
> **Daniel Hart, EVP, Chief Legal & Risk Officer, Crocs, Inc**

THE SECTOR VIEW: DEFENSIVE VS. PROACTIVE

The focus on a proactive approach to sustainability is largely consistent across different sectors. However, there are nuances within the data. Healthcare Services, Life Sciences & Pharma has the highest amount of innovation-led companies – 28% are pursuing an innovation-led approach to sustainability. At the same time, 22% of companies in both Industrials and Energy & Environment are taking an innovation-led approach. It is clear that some industries see themselves as wanting to innovate through ESG issues and drive a long-term competitive edge.

Of course, for companies across all sectors, achieving their growth ambitions will require significant changes. These will range from adjusting their current portfolio to focus on segments with significant sustainable growth potential to building new businesses where an entirely new market is being targeted.

Today, what is the major goal of your approach to sustainability and ESG?



Seizing the brand, talent and growth opportunity of ESG programs

Organizations are pursuing a range of outcomes from their sustainability strategies, from creating new sources of customer value to attracting and retaining better talent. Across the entire research sample, the major goal is building brand reputation with customers, and the top three priorities of the larger organizations in our sample (over ten billion dollars annual revenue) are:

– Strengthening brand reputation with customers and building trust with value chain partners (selected by 17% as the number 1 outcome they are looking to achieve with their sustainability strategy over the next five years)

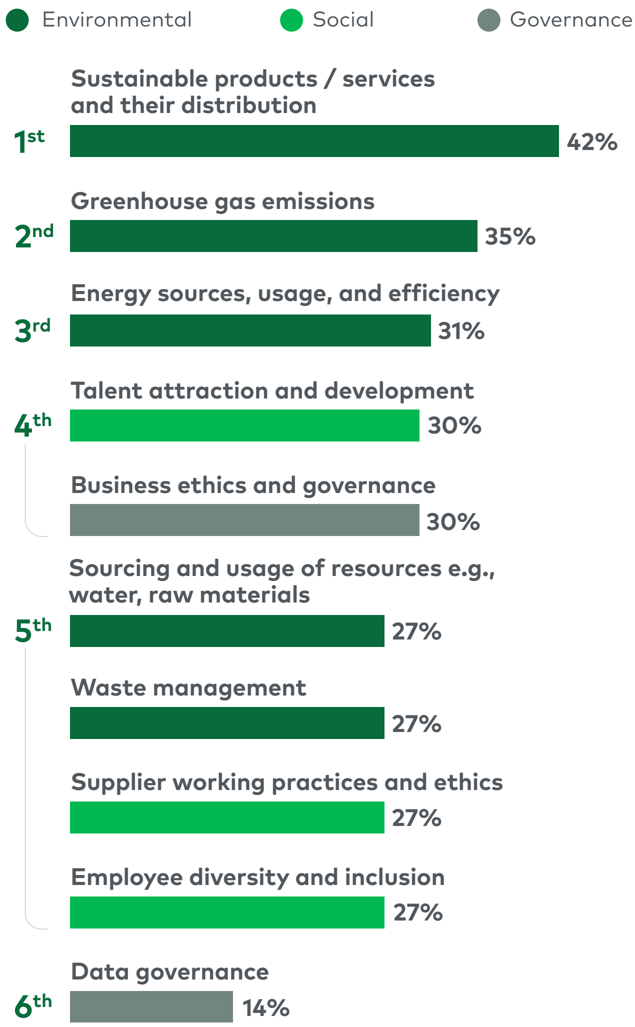
– Enhancing engagement with key stakeholders, from investors to regulators, and meeting their sustainability expectations (16%)

– Ensuring compliance with regulatory requirements (15%).

In terms of the goals and outcomes of a sustainability strategy, Europe-based respondents are focused on building brand reputation, Asia-Pacific corporates are looking to maintain access to capital markets, and US-based organizations are putting a priority on ensuring regulatory compliance and attracting new talent. The need to retain and attract talent is becoming increasingly urgent as many sectors are experiencing increasing attrition from workers voluntarily quitting as they re-evaluate their work-life balance post-pandemic. A positive ESG track record can be an essential part of attracting potential hires and keeping existing employees engaged and motivated.

As they look to achieve those goals, action and investment are focused on the 'E' pillar of ESG. If we look at those organizations in the research sample who we characterize as 'Innovators'[1], environmental issues are the top priority for action and investment, occupying the top 3 places:

Thinking about your overall sustainability agenda – across environmental, social and governance areas – what are your major priorities for action and investment over the next 5 years?



1 'Innovators' are the 20% who said "sustainability is driving the strategic agenda as we look to be an innovator within the sector and leverage sustainability as a major source of value creation".

At a sector level, the ESG area that is receiving the most attention does vary. For example, Consumer Products & Retail companies are focused on supplier working practices and ethics, which reflects the scrutiny that the sector is under when it comes to their supply chains. In the Industrials and Energy & Environment sectors, the focus reflects the overall emphasis on "sustainable products / services, and their distribution".

As well as the urgency around environmental issues such as global warming, this focus on the 'E' pillar of ESG reflects the overall focus on growth and innovation. Addressing environmental issues, such as net zero, can be a route to innovation, with organizations changing the rules of their sector and innovating their business model. 'Green' products are also a significant growth opportunity, from electric cars to plant-based meat substitutes, and have demonstrated the revenue potential of sustainability trends.

"

To my mind, it's still relatively early days in terms of how investors recognize, reward, or critique a company's sustainability direction, such as feedback on whether they think targets are perhaps too soft or whether in fact they think you're ahead of the competitive pack."

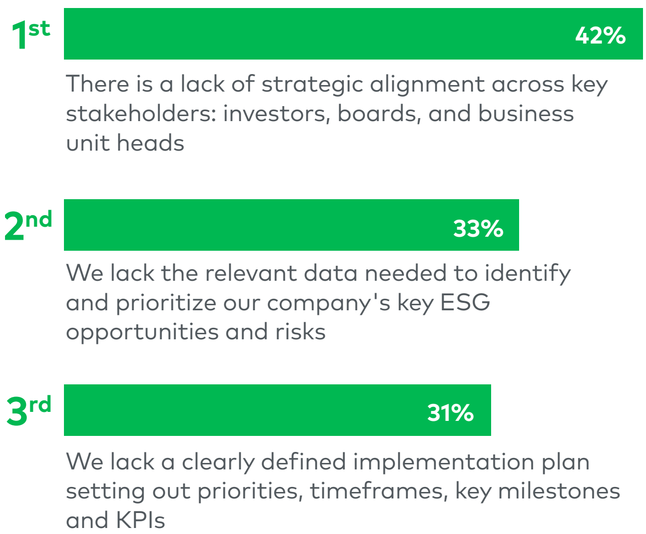
Brian Lowe, Managing Director and Chief Executive Officer, Orora Limited

The stakeholder alignment hurdle

However, a lack of strategic alignment between internal and external stakeholders could undermine ambitions and hold back sustainability progress. The number one barrier that stands in the way of organizations and delivery of their long-term sustainability ambition is "lack of alignment across key external and internal stakeholders – investors, boards and business unit heads".

This is true of all organizations in the research, but it is a particular concern for the large companies in our research sample, reflecting a link between scale and the complexity of an organization's stakeholder universe. For the larger companies in our research, which have annual revenues of more than ten billion dollars a year, the top three biggest barriers are:

What are the biggest barriers your organization is confronting as it strives to deliver its long-term sustainability ambition?



In fact, this alignment concern emerges as a significant issue across the research:

- **Less than half of companies (45%)** felt they had made strong progress when it came to having an executive management team and board that were fully aligned on the importance of the sustainability agenda and relevant priorities.
- **And close to half (47%)** say that they "do not have an established approach for balancing the interests of different groups when making sustainability decisions, such as communities versus shareholders".

In the following section, we look deeper at some of the issues that are relevant to this area, from how teams can agree and align when making difficult trade-off decisions to putting in place the governance systems needed for effective oversight and constructive engagement between boards, management teams and investors.

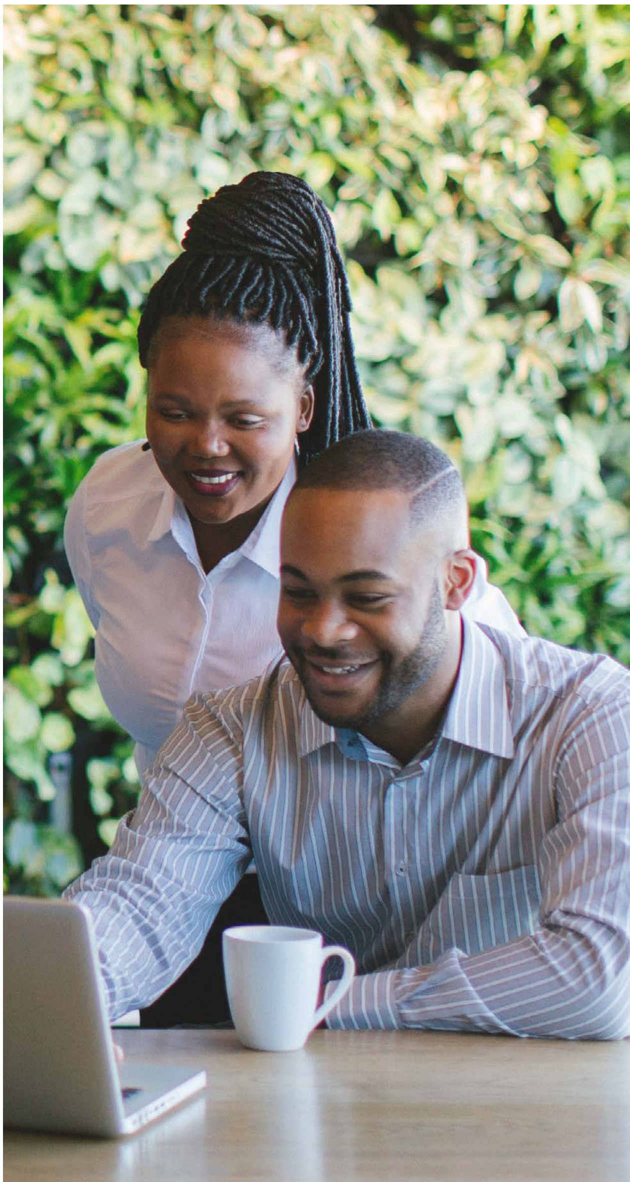
Section 2: Building strategic alignment and overcoming ESG challenges

"The skills you need as a leader in the sustainability space are the same core skills required of all successful leaders: emotional intelligence, the ability to influence and communicate at all levels, and the ability to maintain a focus on long-term success."

Rebecca Dunn, Head of Sustainability, Spectris plc

The expectations of stakeholders are changing, as issues such as climate change and inequality drive a significant shift in what customers, employees, investors, and regulators expect from corporates. However, the research has shown that a range of issues are holding back companies from achieving their sustainability ambitions, led by alignment concerns. CEOs and their teams are having to confront three challenges:

- **Governance systems and remuneration frameworks need reframing**
- **Leaders are having to make complex trade-off decisions**
- **Companies are facing greater demands for performance transparency and credible sustainability reporting.**



Challenge 1: Governance and remuneration frameworks

There is more to do to provide effective strategic oversight and boost accountability for ESG results, including changes to governance and remuneration systems.

GOVERNANCE

Effective governance is key to delivering against sustainability strategy. Organizations need boards that have the remit, insight, and knowledge to provide effective oversight of the sustainability strategy and achievement of the ESG program. Without an empowered board providing oversight, direction and a robust challenge, there is a danger that sustainability efforts could become fragmented, or efforts are not bold enough to match or outpace the competition.

Across all respondents, the most urgent improvement needed if governance is to provide effective sustainability oversight is "ensuring the executive team and board have the knowledge and skills needed to deliver major sustainability and ESG goals." This is also a particular focus for the CEOs and C-suite leaders in our survey:

Thinking about the governance framework you have in place for sustainability, what are the areas where you think most improvement is needed?

Governance areas requiring greatest improvement: CEO and C-Suite respondents only

Across all respondents, there was also a particular focus on leaders and boards having the insight and intelligence they need to provide effective sustainability governance. Over a third (37%) said that there was a pressing need to improve "the ESG management information and data provided to executive teams and boards, so they can make better decisions in a more agile way". This reflects that the sustainability picture moves very quickly, and therefore leaders need credible, high-quality and real-time ESG management insight if they are to react to unexpected changes to market conditions and emerging opportunities or risks.

EMBEDDING SUSTAINABILITY: KEY ISSUES TO CONSIDER

- **Building skills and knowledge:** To address the need for ESG skills and knowledge, organizations can undertake a skills audit to understand what skills are needed to deliver their specific sustainability strategy and the main gaps. Plans to address gaps can draw on a range of tactics, including introducing advisory groups and links to external institutes that provide specific expertise.

- **Achieving strategic alignment:** To support alignment, companies need to ensure they establish a common language, develop their sustainability goals and vision, and understand the strategic choices required to achieve the goals.

- **Establishing KPIs:** Effective oversight requires clear ESG KPIs, which involves defining what is required to achieve goals and targets; setting KPIs that enable measurement; and establishing data capture capabilities to enable reporting and tracking.

As they look to rethink governance systems for the sustainability era, operating model and organizational structures are seen as critical. When we asked respondents to say where they think boards should focus their efforts when it comes to putting in place the governance system needed to set and deliver against a sustainability agenda, "establishing an effective Sustainability Committee as part of the board structure and operating model" emerged as the top priority. It was a particular focus for high-growth companies, large companies, innovation-led companies, and those in the Industrials and Healthcare Services, Life Sciences & Pharma sectors.

Of course, making the right operating model choice – between a dedicated sustainability committee; assigning responsibility to an existing committee, such as the Audit Committee; or making it the responsibility of the board as a whole – will often depend on where a company is in its sustainability journey. There are also wider issues that will be key to success. For example, whoever has responsibility, they will need the time, data-driven insight, and skills required to perform their role effectively.

ESG AND EXECUTIVE REMUNERATION

The research shows a strong emphasis on the link between ESG results delivery and remuneration. When we asked respondents to nominate the area where they felt their organization was least equipped to deliver their sustainability strategy, the number 1 issue was concern about not having "the right reward and incentives framework to drive behavior, such as leadership pay that is aligned with sustainability KPIs".

And, as we saw previously, this is also a focus for governance reform. The CEOs and C-suite leaders in the survey feel more needs to be done to establish clear accountability for delivering against ESG goals, including "aligning executive remuneration to ESG targets", which is the 2nd most critical area for governance change.

According to that same group of CEOs and C-Suite leaders in the survey, the top three advantages of basing executive pay against the achievement of ESG goals are:

Given increasing stakeholder focus on aligning executive pay and ESG goals, what do you think are the advantages – if any – of basing a significant element of executive pay against the achievement of material ESG goals?

The design of sustainability-focused remuneration frameworks is a complex exercise. The approach will need to be tailored to the specific ESG priorities and strategy of the organization. Careful thought also needs to be given to how the scheme is designed, from what KPIs are used to how performance is monitored.

> "With a dedicated sustainability leadership role, Crocs has the opportunity to not only deliver critical goals like net zero by 2030, but also to drive the integration of sustainability into business processes and systems."
>
> **Deanna Bratter, VP, Global Head of Sustainability, Crocs, Inc**

Challenge 2: Complex trade-offs

While companies strongly believe that sustainability drives revenue growth and even an innovation advantage, that does not mean there are not tensions to manage. For example, CEOs and their teams need to understand how to create value for shareholders while maximizing ESG impact. Different stakeholder groups – such as shareholders and communities – may have divergent interests and needs. Leaders need to balance shareholders with environmental and social value.

The research confirms that many organizations are grappling with significant trade-off decisions, such as the willingness to take a short-term financial hit to drive long-term sustainability:

- **51% say that their company "should address ESG issues, even if doing so reduces short-term financial performance and profitability"**
- **53% say that their organization "should divest a currently profitable part of the business if that unit undermines our overall sustainability goals".**

But many organizations struggle to make these complex decisions, particularly when it comes to balancing short-term priorities with long-term goals or meeting investor expectations:

- **58% say there are "significant differences of opinion within our leadership team on how to balance short-term priorities with investments for sustainable growth"**
- **51% say "we continue to face short-term earnings pressure from investors, including activist investors, which impedes our longer-term investments in sustainability".**

EMBEDDING SUSTAINABILITY: KEY ISSUES TO CONSIDER

- As a start point, making difficult trade-offs requires a sophisticated scenario modelling capability, so that leaders can understand the end-to-end implications of different decisions.
- Along with a clear strategic picture of the key areas of the business that will drive value in terms of long-term, sustainable growth, CEOs can use this insight to make better decisions about the portfolio and balance short- and long-term priorities.
- Weighing up strategic choices and making effective decisions means analyzing the financial and non-financial benefits of different choices and engaging the full leadership team in that process.

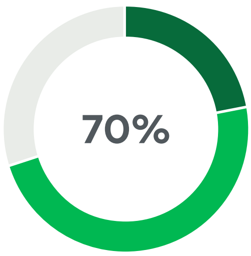
Challenge 3: Transparency and effective ESG reporting

Today, investors – as well as other stakeholders – are increasingly demanding that organizations provide trusted and credible ESG reporting on the material issues that help them understand how a company creates long-term, sustainable growth. In the research, 87% said they are feeling pressure from investors for increased reporting and transparency on ESG issues today, with 41% saying that this pressure is either 'significant' or 'very significant'.

However, despite that increasing pressure, only around a quarter (27%) have enterprise-level ESG KPIs in place today: 24% who have some KPIs in place and just 3% with a full range of KPIs in place for all key ESG priorities:

Has your organization set clear, credible and measurable targets, at an enterprise-wide level, for achieving its main ESG ambitions, such as emissions reductions, diversity & gender, labor practices?

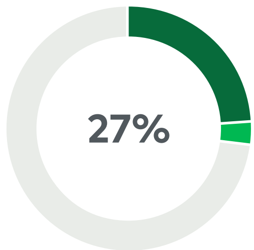
IN DEVELOPMENT



22% who are currently developing KPIs, but only for some priority ESG areas

48% who are developing KPIs for all priority ESG areas

IN PLACE



24% who have ESG KPIs in place, but only for some ESG focus areas

3% who have a full range of KPIs in place for all ESG focus areas

Note: Excludes those who replied 'no measurable enterprise-level ESG KPIs in place'.

Performance in this area does vary by projected performance and size. Companies that see revenues growing at ten percent or more this year are more likely to have KPIs in place (37%), as are larger organizations of over ten billion dollars annual revenue (38%) and those that are taking an innovation-led approach to sustainability (45%).

That said, it is clear that many organizations still have some way to go on this journey, which reflects that setting KPIs across ESG priorities is challenging. At a high-level, we have seen how companies are struggling to achieve alignment on their strategic direction, which will of course make arriving at an agreed set of KPIs that more difficult. At a more detailed level, effort is required to ensure KPIs are credible and provide strategic insight. For example, for KPIs to resonate with investors, they need to be material and have an impact on financial returns or nonfinancial outcomes. KPIs also need to give leaders the real-time insight needed to steer the business and understand progress against ESG goals. This will require that companies also establish the data capture capabilities required for effective reporting and tracking.

Without comprehensive and relevant ESG KPIs in place, it will be difficult for a company to produce credible sustainability reporting, which means it could struggle to tell a compelling narrative about its progress towards its long-term sustainability strategic goals to investors and other stakeholders. In fact, when we asked respondents about the areas of their ESG disclosures and reporting that need greatest improvement, the top three improvement areas included ESG data integrity and investor trust in external reporting:

- **1st** Building the quality of underlying ESG data by putting in the right data governance structures and sophisticated technology tools (47%)
- **2nd** Establishing investor trust in ESG reporting and data, including seeking independent, third-party assurance of sustainability disclosures (44%)
- **3rd** Improving the way we report on material ESG risks, including complex areas like climate risks that have a multi-year horizon (42%).

EMBEDDING SUSTAINABILITY: KEY ISSUES TO CONSIDER

- When it comes to rethinking their approach to external reporting, organizations can begin by identifying the material factors that are most relevant to them and the users of reporting, including investors.
- Stakeholders, such as investors, will need to trust in the disclosures, and building the integrity and credibility of supporting data will be key, from underlying processes and controls to potentially a form of external assurance.
- Of course, not all sustainability reporting will be purely numbers-based. Investors will also want to have qualitative, contextual information about the dilemmas and challenges that the executive team confronted as it made decisions about its sustainability strategy and some of the trade-offs that needed to be managed.

Section 3: Optimizing sustainability capability

"We pursue diversity and inclusion to build a better society, and if an acquisition target has the right culture already, I have no problem acquiring them and then helping them improve."

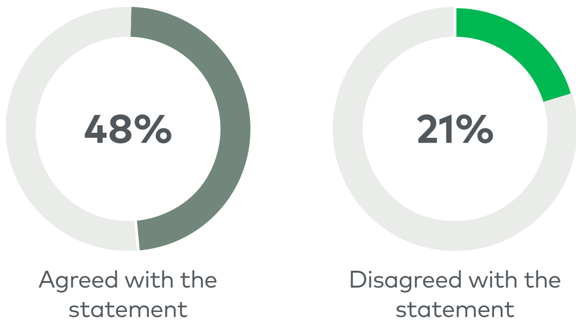
John C. Turner, Jr., President and Chief Executive Officer, Gypsum Management & Supply, Inc. (GMS)

It is clear from the previous section that organizations have more to do to put in place the capabilities they need to deliver their sustainability strategy. To deliver, organizations need to make a set of clear and integrated choices about what their goals are and where they will play in the market, as well as how they need to design the solution and get it done. The research points to three critical capabilities that organizations will need to put in place to secure a long-term competitive edge in sustainability:

Priority 1: Reconfigure market strategy and product/service portfolio for a sustainable future

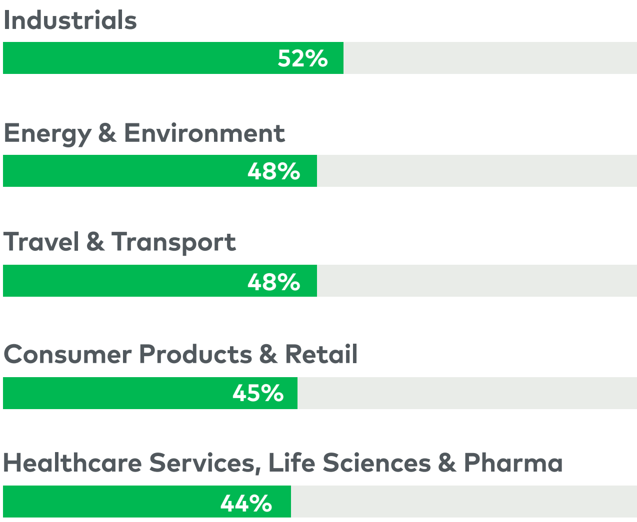
Close to half of respondents do not feel their current product/service portfolio meets the needs of a more sustainable future:

Our current products and services will not be sufficient to meet the need for a more sustainable future.



Note: Neutral responses are excluded.

This sentiment is consistent across different sectors. If we look at those respondents who say their services/product portfolio is not sufficient, there is little significant variance:



In addition, over half of all respondents see a future where entirely new products and services are driving a significant share of revenue: 53% say "that a significant proportion of our future revenues will come from new products and services that will benefit from sustainability trends". This sentiment is stronger for larger companies of ten billion dollars or more annual revenues (59%) than smaller organizations, dropping to 48% for organizations with revenues under five billion dollars.

It is clear that changing consumer behavior and customer expectations have left no industry untouched. Consumers in sectors such as retail want to buy products and services that are sustainable, not only in terms of their impact on the environment, but also issues such as fairness and equality, including areas like labor practices in the supply chain. At the same time, customers of industrial and other companies are also demanding similar changes of their suppliers and supply chain. These changing expectations offer an exciting opportunity to make brands relevant and drive above-average growth for sustainable categories.

However, while the intention is there to make sustainability a key element of the brand, portfolio and market approach, it will be challenging to deliver on that commitment. As they look to establish which markets to compete in, organizations are most concerned about bringing their people along on the transformation journey: the biggest challenge faced by companies is "building organizational awareness of the new strategy". This is also the biggest issue for European companies and a top-2 issue across the world, though US-based companies are particularly focused on "developing the right channel mix, including digital channels" and Asia-Pacific companies are concerned about "establishing which geographic markets to prioritize".

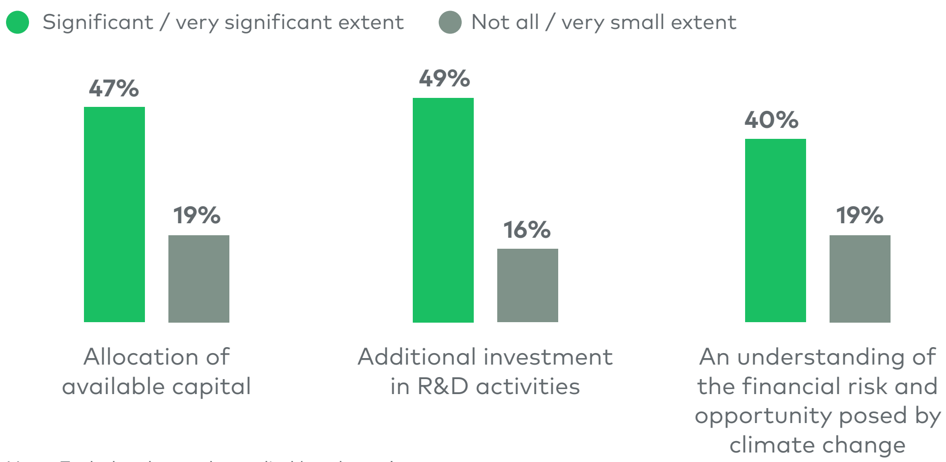
This primary concern about bringing their people along reflects one of the key success factors for building a winning customer and consumer offering: it will only work if sustainability is embedded into the organization's brand, purpose and products/services. Without this in place, a brand will lack authenticity and it will be difficult to build the value perception of sustainable products and services.

Priority 2: Embed sustainability and ESG factors into capital decision-making and M&A

With stakeholders – from consumers to investors – increasingly demanding that businesses address ESG issues, leaders are having to rethink their capital investment strategy, as they look to invest in sustainability alongside other priorities, such as digital transformation.

However, the research shows that organizations need to do more to integrate ESG factors into capital allocation, R&D and financial strategy. For example, less than half (47%) have made significant progress in integrating ESG factors into capital allocation, with around one in five (19%) making very little progress:

To what extent have you integrated ESG factors into the following areas of your capital and financial strategy today?



Note: Excludes those who replied 'moderate'.

Aligning sustainability strategy with capital decisions is a complex exercise. As a start point, it requires consensus among the many stakeholders involved, from boards who take oversight of major capital investments to investors who want to see evidence that investments are being made to achieve progress on ESG priorities. At the same time, effective capital allocation requires an understanding of the different risks, rewards and trade-offs involved in decisions about which projects to invest in. These will need to take account not just of traditional financial outcomes and risk-reduction benefits, but also nonfinancial outcomes.

A clear financial strategy that allows you to regularly evaluate the value of today's business portfolio will be essential. However, this will require an understanding of the impact of sustainability trends – such as climate change and the impact of the energy transition – on the value of the portfolio, and whether a business unit that faces significant risk in the long-term should have its allocation reduced and one with future growth potential allowed to invest aggressively.

However, as the previous chart has shown, only 40% feel they have made excellent progress in understanding the financial risk and opportunity posed by climate change.

There are differences in this picture based on the sector and type of ownership. For example, the Energy & Environment sector has made stronger progress in this area, with 52% feeling they have made progress, as have publicly listed companies (48%). This reflects the urgency of climate risk issues to the energy sector and the scrutiny that publicly-listed companies face.

A sophisticated data analytics capability – as well as scenario planning tools – will be needed to change how you model value and arrive at strategic guidelines for how capital is allocated across the portfolio.

AN END-TO-END APPROACH FOR ESG-FOCUSED M&A

M&A can play a significant role in transforming the ESG credentials of a business, providing an opportunity to differentiate quickly and accelerate achievement of strategies. We increasingly see ESG issues impacting inorganic growth strategies, approaches to due diligence, valuation considerations and deal outcomes.

However, the research shows that more needs to be done to integrate ESG across the M&A lifecycle. In many areas, less than half of organizations have integrated ESG issues to a 'significant' or 'very significant' extent: including portfolio composition (just 48% have made significant progress); acquisition strategy (46%); financial assessment of acquisition, including valuation (46%), and post-merger integration (49%).

Organizations are also struggling to assess the "value" associated with a potential acquisition as it pertains to its ESG strategy, the impact of sustainability trends on the business and how much additional "ESG value" can be created under new ownership.

The fact that there is more to be done reflects the challenge of integrating ESG factors into elements of M&A. Due diligence, for example, requires that an organization understands different risks and opportunities related to the target organization, such as work conditions or energy footprint. But quantifying ESG risks and opportunities is complex, not least because of the need to analyze large and unstructured data sets, and a broad range of qualitative information. An end-to-end approach – spanning the lifecycle from M&A strategy to integration and long-term value creation – will be critical.

Priority 3: Build a sustainable operating model and supply chain

Today, organizations need the operating model capabilities – from skills to technology – to deliver their sustainability ambitions, including a new approach to supply chain strategy. However, many organizations feel they have much more to do across many operating capabilities:

- **Skills**
- **An agile structure**
- **Partnerships**
- **Technology.**

For example, only 21% feel they have most or all of the skills they need to deliver their sustainability goals and one in five (20%) have made no progress in this area:

Thinking about the organizational requirements to successfully implement a strategy that achieves your sustainability goals, please say to what extent you have these capabilities in place?

Note: Some areas add to 101% because of rounding.

EMBEDDING SUSTAINABILITY: KEY ISSUES TO CONSIDER

- To build the operating model and capabilities they need to deliver their sustainability ambition, companies need to map out requirements against the key areas: processes, controls, workforce and skills, partnerships,and technology

- For example, in the process domain, leaders need to understand the requirements for information flows. In other words, that the processes are in place to allow critical ESG-related performance information and commitments to flow across the organization, allowing teams to flag risks and executives to measure and manage progress against sustainability commitments.

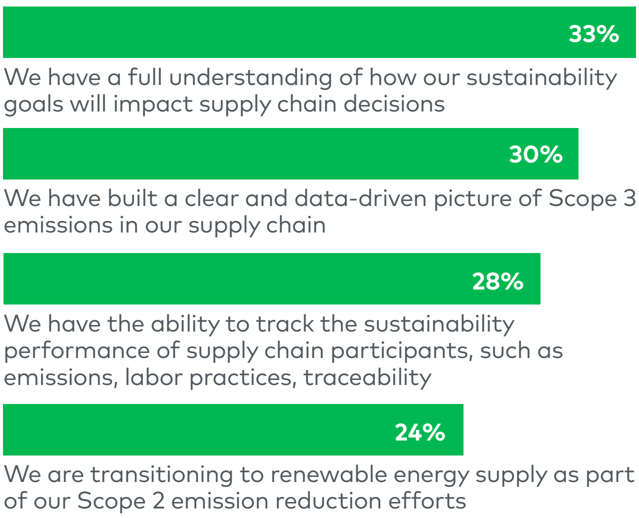
- This also has a systems and data management/integration dimension: understanding the technology tools needed to measure, manage, and communicate ESG data. As we show in 'The sustainable supply chain: a new era of digital supply chain transparency', new technologies will be critical to building next-generation operating capabilities.

THE SUSTAINABLE SUPPLY CHAIN: A NEW ERA OF DIGITAL SUPPLY TRANSPARENCY

Maturity levels are also low when it comes to the extent to which ESG factors have been integrated into supply chain strategy, with only a minority feeling they have made strong progress in critical areas:

To what extent have you integrated ESG factors into your supply chain strategy?

Respondents who have made excellent progress in these areas:



A mature approach will be critical to drive sustainability in key environmental and social areas. For many products, for example, a large proportion of greenhouse-gas emissions are "Scope 3", including indirect emissions that occur across the extended value chain. On the social front, companies need to manage the risk of any poor labor practices in the extended chain of suppliers.

A critical strategic priority, therefore, is building transparency in the supply chain. Innovative new technologies exist that can track and trace the lifecycle of a product, from input of raw materials to it eventually being discarded by a consumer. As well as helping sustainability goals, such as insight into the provenance of raw materials, this drive for transparency is also critical to building more resilient and market-responsive supply chains.

The way forward: how to win at a must-win game

The research has shown that a disciplined approach to sustainability will be key to delivering on a company's ambitions. While it is important to set aspiration – deciding on 'what' your goals are and 'where' you will play in the sustainability space – the 'how' questions are equally important if you are going to turn aspiration into reality. While priorities will vary by company and sector, we would point to three areas of focus for CEOs and other leaders:

HOW TO WIN

Align growth initiatives around products and services to address climate change and other critical ESG issues and evaluate the implications for your supply chain and approach to M&A:

- Embed sustainability into the organization's brand, purpose and products/services to ensure you bring your people on the sustainability journey, thereby reinforcing the authenticity of the brand and increasing the value perception of sustainable products and services.
- Understand how a sustainability strategy will affect your relationships with suppliers and build transparency into the supply chain by drawing on innovative new technologies.
- Establish how M&A and partnerships can support your goals, embedding ESG factors into the M&A lifecycle, from acquisition strategy to post-merger integration.

HOW TO CONFIGURE

Build a smart and agile operating model that allows you to stay ahead of sustainability-driven disruption and change, including selecting and deploying new technologies in support of sustainability goals:

- Set out a blueprint for the operating model and capabilities you will need to deliver your sustainability vision, mapping out requirements against key areas: processes, controls, workforce and skills, partnerships, and technology.
- Put in place the processes that allow critical ESG-related performance information and commitments to flow across the organization, allowing teams to flag risks and executives to measure and manage progress against sustainability commitments.
- Identify the technology tools needed to measure, manage, and communicate ESG data.

HOW TO GET IT DONE

Design best-in-class governance structures to inform sustainability choices on an ongoing basis:

- Undertake a skills audit across leadership teams and boards to understand what skills are needed to deliver the sustainability strategy and the main gaps, drawing on solutions that include advisory groups and links to external institutes that provide specific expertise.
- Establish comprehensive ESG KPIs that set out what is required to achieve goals and targets and how progress will be tracked and reported, including the data capture capabilities required for effective reporting.
- Design a sustainability-focused remuneration framework that is tailored to the specific ESG priorities and strategy of the organization.
- Rethink the approach to external reporting, ensuring that you are reporting against the material factors that are most relevant to investors and other users of reporting, and improve the integrity and credibility of supporting data to build trust in ‘the numbers’.

Today, just ‘being in the game’ is not enough when it comes to sustainability. Playing to win at ESG – and being on the winning team – has never been more important for the long-term value of the company, but also for the long-term future of a more sustainable planet and a more equitable society.

info.lek.com/sustainability-strategy

About L.E.K. Consulting

We're L.E.K. Consulting, a global strategy consultancy working with business leaders to seize competitive advantage and amplify growth. Our insights are catalysts that reshape the trajectory of our clients' businesses, uncovering opportunities and empowering them to master their moments of truth. Since 1983, our worldwide practice — spanning the Americas, Asia-Pacific and Europe — has guided leaders across all industries from global corporations to emerging entrepreneurial businesses and private equity investors.

With ESG now at the heart of any smart business strategy, sustainability is a key priority for every board of directors and executive team. But understanding how to lead your organisation's sustainability journey takes expert thinking and a sharply focused ESG lens. L.E.K. Consulting's Global Sustainability Centre of Excellence and our expert team of strategy consultants draw on L.E.K.'s deep case and sector experience, proprietary research and insights, and rigorous approach to analysis as we help clients build and activate their sustainability strategy.

From setting ambitions to creating, executing and monitoring strategies — we help corporate leaders understand how sustainability trends impact business, identify sustainability-related risks and opportunities unique to each sector, determine the right sustainability strategy and road map, and develop thoughtful M&A approaches focused on ESG. Looking for more? Visit www.lek.com or email sustainability@lek.com