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Case Study

The Sustainability Imperative

The View from a Chair

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This case study was written by Marc Le Menestrel, Affiliate Professor of Decision Sciences at INSEAD. It is intended to be used as a basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

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The Daughter: A family dinner is ruined by a discussion on sustainability

“You are arrogant because you are ignorant.”

Those were her words last night. Why was my daughter being so harsh? Surely it is she who is arrogant?

I had been looking forward to tell her about our latest board meetings at the Fund, the large institutional investment fund where I am the Chairperson. I thought she would be interested in the progress we had made on the Fund’s sustainability strategy. And we were delighted to have her home for dinner. Now that she has gone off to university to start her Environmental Science degree – we rarely see her.

At first, she seemed pleased to hear that we were formally addressing the topic of sustainability. But the conversation went downhill when I started to explain that, actually, Environment Social and Governance (ESG) values were at the core of our existence, part of our DNA.

She instantly launched into an indignant tirade, accusing us of being just one more cog in the machine, held ransom to money – not interested in sustainability, apart from the sustainability of our returns. She accused me of being the “Leader of Unsustainability” – the most hypocritical of all.

Those insults were tough to hear, and I wanted to respond, but she left. She didn’t even stay for dinner.

The Chair: Reflecting on the board’s discussions about sustainability

We have been discussing sustainability at the Fund for nearly two years now. Our position on the topic would inevitably shape the values of the portfolio companies we were invested in. So far, our discussion largely revolved around four arguments:

“Sustainability is a winning strategy. Many studies reflect a strong correlation between sustainability and financial success. The world’s energy supplies are in transition and Green Finance is becoming a leading business theme. It is not so difficult to understand why sustainability should be a foremost business priority:

Firstly, securing natural resources is critical for long-term profitability. Many industries highly depend on raw materials from both renewable and non-renewable resources. Industries like pharmaceuticals and agriculture rely on biodiversity, clean water and clean air – key products of ecosystem services. For instance, pollination from bees and insects is required for more than one third of the world’s crop production.

Secondly, good environmental performance is essential for strategic stakeholder management. Good environmental performance is sometimes a pre-requisite for a licence to operate. Regulators may require it for access to resources or new production sites. Lenders take into account environmental performance for access to credit. Consumers prefer purchasing from a company with a positive image. Millennials are three times more likely to seek employment with a sustainably-minded company.

Thirdly, by integrating environmental sustainability, companies limit strategic risks and prepare for the future. Our companies must adapt to environmental trends, such as climate change and resource scarcity. Anticipating new regulations and adapting to them early will give us a competitive advantage. We will be more likely to come up with green innovations (products and services) that meet consumer demands and are supported by policy.

Fourthly, by adopting strategic sustainability we are less likely to run into environmental accidents and societal disruptions with large-scale consequences (compensation payments, compliance, liabilities, consumer boycotts, etc.).”

However, these arguments were fiercely rejected by at least a third of our directors:

“The debate here is skewed. Our strategies must be fact-based and sustainability lacks a clear definition: it is a matter of perception and is not properly measured. While sustainability is a non-trivial concern, as investors, its primary purpose is advocacy and public relations. Like it or not, there are as many reports that demonstrate no correlation between sustainability and profits.

We should remain rigorous in our strategic intent and not fool ourselves. Our mission is to deliver maximum financial returns for our shareholders. If some investments have bad outcomes - directly or indirectly - we should not go into them, or divest: this is risk management. If some investments have a bright future, we should pursue them.

Sustainability is an idealistic concept. Going down this path is costly, difficult and can fundamentally threaten the economic viability of some of our businesses. As a social good, sustainability is the responsibility of governments and NGOs, not us.

Rationally, constraining our portfolio can only lead to lower returns. The freedom to invest and disinvest is the key to our long-term success.”

And finally, there was the independent director preaching to us:

“Ultimately, your responsibility is towards the people and the planet, not towards profits. When there are no fish in the oceans, no tree in the forests, no drinkable water in the rivers, you will realize that money cannot be eaten. The Earth’s natural resources are invaluable, and we should cherish it as we cherish our own lives. A holistic approach is needed to protect the environment as we pursue eco-friendly growth and development.”

Beyond the rhetoric, two main lessons emerged from our discussions. We should seek to improve our risk management and stakeholder engagement, as two pillars of our sustainability strategy.

- 1) Firstly, we need proactive and innovative risk management to flexibly adapt to the ‘sustainability’ agenda. Sustainability can be bad for business whereas some environmentally unsustainable industries offer higher returns. We can adjust the rate of decarbonisation to preserve the financial returns of non-renewable industries in our portfolio. In some cases, we may invest in renewable technologies at scale to slow down their growth and market capture. We must keep sustainable-equity strategies such as low-carbon indexes at arm’s length from our core investment activities. There’s no need to have the same strategy for all asset classes. Finally, to meet increasing

consumer demand for ‘sustainability’, we will invest in for-profit impact funds that finance social enterprises operating in emerging markets.

Secondly, sustainability is a matter of perception. We must learn to better manage perceptions by developing a social media presence, investing in standards for reporting, scoring processes and philanthropy. We should make sure managers and directors include sustainability issues and focus on the material facts: what effectively drives investors’ decisions, not public discourse.

In seeking to integrate ESG into our asset management, we should not stray from our central business objective of creating long-term, sustainable value for our shareholders and clients. This is how sustainability has always been in our DNA.

These were my reflections on the way to an event where the Prime Minister of a small country was speaking; a country that was consistently ranked as the happiest country in the world, despite having one of the smallest and least developed economies globally.

The Prime Minister: The Chair is caught off balance by butterflies

It was a disconcerting speech by the Prime Minister that started like this:

“Ladies and gentlemen, I live in one of the richest countries of the world. Let me tell you why.”

As a predominantly agricultural country, we have 80 species of agricultural crops, several uniquely adapted to our environment. We cultivate 350 rice varieties, 47 of maize, 24 of wheat, and 30 of barley. There are numerous wild relatives of both indigenous and introduced cereal and horticultural crops. We breed diverse livestock with marked genetic differences and uniqueness.

This economic wealth would not exist without the natural environment that we have preserved. As development cannot be achieved at the cost of the environment, we have been striving to live in harmony with nature throughout the centuries. In fact, it is our constitutional duty to conserve the country’s natural resources and to prevent the loss of the wealth of our environment.

*Our diverse ecosystems have made our country home to a wide array of flora and fauna. We host 4,523 species of seed plants and 411 species of ferns. We have up to 200 species of mammals, and 700 species of birds. We count 36 species of amphibians, 83 species of reptiles, and 91 species of fishes. Rather than gross national product, **this** is the wealth of our nation.*

For example, let me show you the beautiful butterflies unique to our country...”

As he spoke, I felt a troubling scepticism rise up within me – I was not convinced by the vibrant picture he painted. Yes, the Prime Minister looked happy, but this was after all a rich representative by the political elite. How would such a speech resonate with poor people struggling to make a living?

Just as these doubts started to grow in my mind, the Prime Minister’s story about butterflies caught my attention. Butterflies have always been a family passion. Beautiful, graceful, varied and enchanting, they are a pathway to the sunny side of family life. Twenty years ago, we embarked on creating a butterfly garden, and we loved to listen to the laughter of our daughter chasing these beautiful creatures with her hands outstretched.

Journeying back to the past, I felt a lightness, like butterflies in the garden. But they were inside my stomach now. The stinging memory of yesterday's disastrous dinner swiftly cut short my reminiscence. My daughter's accusations were ringing afresh in my mind. Did she have the facts right, after all?

She argued that science presents a grim reality that businesses are conveniently ignoring:

- There has been an unprecedented scale of climate change impact events globally: bush fires, heatwaves, animal extinction, melting ice, droughts. Earth's biosphere is at a tipping point. As the system loses balance, the disruptions can be severe, and it is unlikely to be a linear process. She said we face a systemic climate crisis that fundamentally threatens natural life on Earth.
- Two-thirds of the Earth's terrestrial and aquatic ecosystems are significantly degraded due to human activity. Nature has contributed enormously to economic wealth creation, yet its valuable inputs have not been accounted for. As such, businesses continue to freely draw on this "natural capital" as inputs for economic production.
- Substantial, direct environmental impact is due to a handful of major transnational corporations, across non-renewable industries such as agriculture, forestry, seafood, cement, minerals and fossil energy. Increasing power lies with these companies and the institutions that finance them. To date, their dominance and social-economic influence has largely been used to hinder the global shift towards sustainability. These businesses have an obligation to act now, before it is too late.
- Businesses should aim to lead the game, rather than follow an outdated paradigm. It is probably a matter of time that as the tide turns, governments will raise sustainability on national agendas, including it as a requirement for corporate reporting, and in business operations.

I felt a deep sense of discomfort. I had always taken profit maximisation as my primary responsibility, and it has anchored our success at the Fund all these years. I had always dismissed the idealist approach to sustainability, best left to the naïve. I was now in doubt. Could it be the reverse? That the pursuit of profit without regard for nature is naïve? That sustainability is the critical responsibility that pragmatists should embrace?

The Champion: A woman illuminates what's missing

At that moment, I ran into a former colleague and friend, the head of the NGO that was hosting the event. An accomplished musician, she was one of the brightest high potential executives at the Fund before she left to head the NGO. When I told her about my daughter, she proposed that we continue the conversation on the roof terrace. This is what she said:

"What you are missing is freedom. Sustainability requires an entrepreneurial spirit, but your mind does not let your soul speak. Your thinking is constrained by your fear to let go of long-held beliefs that you know are only half-truths. What you told me about the butterflies is an invitation to recover your dreams. It is only by allowing this connection that pursuing sustainability as a goal can be truly inspiring, meaningful and effective.

You need to 'play' with life again and inspire your employees. Find a way to express your dreams and give them an opportunity to express their own individuality, ideas

and values. You need an organizational strategy that can effectively harness the energy which makes us all creatures of nature.

Give it a special budget, one that can either be expenses or investments depending on the goal for each project. Doing so will show commitment, to transcend the tension between creating business value and respecting natural values.

Get inspiration from a framework like the United Nations Sustainable Development Goals, but feel free to create a set of customised KPIs and standards. Do not limit yourself to the areas where you are doing something but be systemic and include sustainability factors emerging from the organizational process. Just being explicit makes a huge difference. Let the solutions emerge from the unconscious collective.

It is not just the planet that we have to save; it is also ourselves from ourselves. When you say “Sustainability is not a new inspiration but is in our DNA,” you are deceiving yourself. You should say the opposite: “Sustainability has not been part of our DNA and we want it to be a new source of inspiration.” It is by exposing your vulnerability that you create trust and unleash momentum.

Your daughter will come back to you in the way you connect to the world.”

Alone again: The Chair reflects on the way forward

Is freedom, rather than rationality, the key to unlock prosperity?

Maybe I should breed butterflies inside and outside the office. We could even have butterflies in the boardroom!

Questions Before the Session

1. Identify three ways this case study resonates with your own experience.
2. From your point of view, what are the three main difficulties expressed in this case study?
3. Given these difficulties, what are the needs of the chair, the directors, and the board as a whole?