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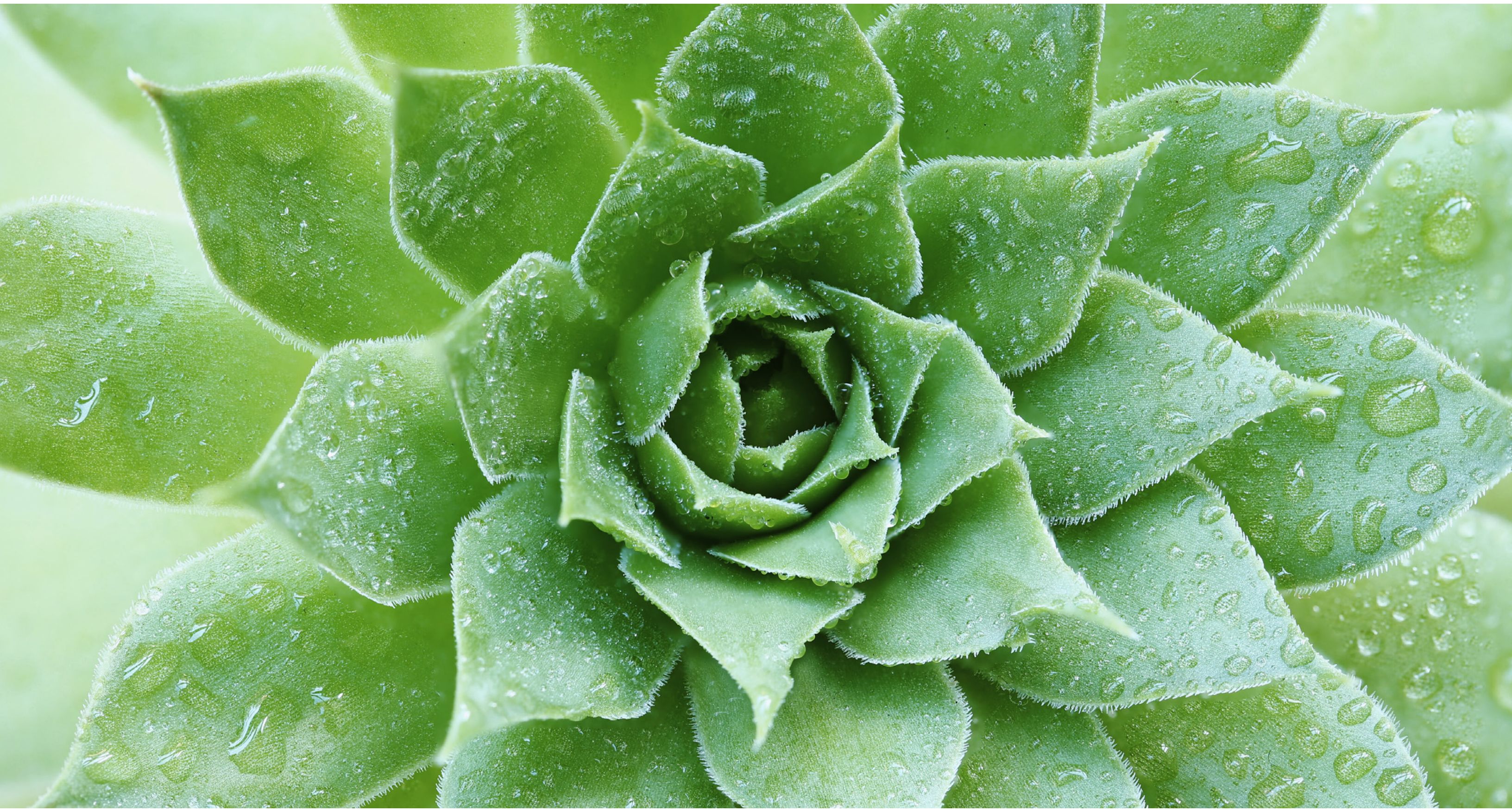
Organization and Sustainability Practices

Organizing for sustainability success: Where, and how, leaders can start

As sustainability becomes more of a strategic *and* operational imperative, executives must lead the way to set up a sustainability organization that's right for their companies.

by Aaron De Smet, Wenting Gao, Kimberly Henderson, and Thomas Hundertmark



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Sustainability and environmental, social, and governance (ESG) issues affect how all companies do business—and increasingly so in recent years.[1] More companies, and their investors, are recognizing sustainability as a strategic priority that involves significant business risks and opportunities. But historically, few companies have organizational structures that are designed to treat sustainability as a material business issue. Instead, sustainability activities—and the organizations that support them—have focused primarily on investor relations, PR, and corporate social responsibility.

The "sustainability organizations" that still operate that way (and there are many) are tasked with managing stakeholder communications, target setting, and reporting. While those tasks are important, they are also insufficient for sustainability organizations to be successful. Our experience suggests that success is more likely when executives empower sustainability organizations to engage proactively and strategically hold them responsible for creating measurable impact. Only then will companies be able to maximize the value at stake from their sustainability initiatives (see sidebar, "A leader's guide to embedding sustainability in corporate strategy").

To get sustainability programs right, companies have big decisions to make. To start, they should choose which issues under the broader sustainability umbrella should be the responsibility of their sustainability organizations and which issues should be left to other parts of their businesses. The issues range widely, from building new low-carbon businesses and commercializing green products to managing environmental compliance and ESG reporting more proactively. As companies mobilize to respond to increasing sustainability concerns, many have struggled with the differences between sustainability and other business issues in the trade-offs involved, decision-making and governance processes, and even employee and leader mindsets.

A leader's guide to embedding sustainability in corporate strategy

To make sustainability a true organization-wide issue and a pillar of company strategy, CEOs and senior executives must be leading from the front. In our experience, leaders are most effective at doing so when they follow these three strategies (usually in this order):

— *Embed sustainability in the company's strategy-setting process.* This is a prerequisite for the effective management of sustainability—and something that senior leaders are best positioned to do. The goal is not simply to have a great sustainability strategy but rather a corporate strategy that includes sustainability as a core component.

— *Shape the portfolio to reflect an integrated strategy.* Once a company's sustainability-related priorities are clear, companies must make decisions on capital allocation, R&D funding, and portfolios accordingly.

— *Scale up sustainable business practices through a full transformation.* To incorporate sustainability in business planning and to empower and motivate the whole organization to take action on these issues, leaders should approach sustainability as they would any other new large-scale change effort. To ensure buy-in across the organization, it's important to be clear about which sustainability topics the company will and won't prioritize.

[1] Witold Henisz, Tim Koller, and Robin Nuttall, "Five ways that ESG creates value," *McKinsey Quarterly*, November 14, 2019, McKinsey.com.

So how do executives build sustainability organizations that are well placed and empowered to help their companies meet stakeholders' increasing expectations, manage sustainability-related risks, *and* capture business opportunities? In this article, we outline four ways that leaders can guide the organizational redesign of their sustainability work and why they must think differently about sustainability compared with other, more traditional business issues (Exhibit 1).

Design according to sustainability *topics*, not sustainability *overall*

Sustainability is often used as a catchall term covering a great many topics. But for any given company, few topics will be of equal importance. Our work shows that companies address sustainability issues more effectively when they design their sustainability organizations to focus on each sustainability topic the company is prioritizing (for example, green hydrogen or its subtopic, operational decarbonization).

Exhibit 1

There are four key ways that executives and their companies can organize their sustainability work for success.

To support sustainability work at the topic level, our experience suggests that a modular organizational design—rather than one holistic, central sustainability organization—often works best.

To do this well, companies should define the list of sustainability topics that matter for the organization, either because they are important to the business or because they are the areas in which the company is uniquely positioned to make a difference. One way to do so is with evergreen materiality assessments,[2] which account for the potential impact from, and likelihood of, a range of issues that could affect the company. Based on its materiality assessment, a company can then develop a short list of priority topics for its sustainability organization to cover. This will help companies make better decisions on resourcing and organizing around the issues that matter to their business.

When it comes to supporting sustainability work at the topic level, our experience suggests that a modular organizational design—rather than one holistic, central sustainability organization—often works best. A modular design gives companies the nimbleness to address emerging topics in a more agile way. Indeed, many sustainability topics arise quickly: for example, in 2018, the number of earnings calls that mentioned "plastic waste" increased 340 percent year over year.[3] In practice, even if there's a dedicated center of excellence for a certain topic, it doesn't necessarily need to be part of the central team. Instead, it could be embedded in a business unit that has particular expertise on the topic or will be primarily responsible for leading the company's response to it.

One company we worked with built a carbon-management organization that distributed initiatives among different parts of the company, rather than relying on a central organization that covered all sustainability topics or that managed all of the organization's carbon initiatives. The R&D department, for example, focused on researching and developing new low-carbon innovations. A separate business unit was created to commercialize low-carbon offerings to customers. Meanwhile, manufacturing sites set their own carbon-reduction targets, embedded their decarbonization initiatives in line with site-level turnaround schedules, and were held accountable for implementing those initiatives. The procurement team focused on decarbonizing the company's supply chain. Finally, a lean central team coordinated carbon-emissions reporting and other carbon-related activities across the company.

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[2] A materiality assessment is the process of identifying and prioritizing the potential sustainability topics that are most important for a company to address because of their potential impact on the business or its stakeholders. The process requires the engagement of both internal and external stakeholders, especially business-unit leaders with profit-and-loss responsibilities, investors, customers, nongovernmental organizations, regulators, and other key partners to the business.

[3] Audrey Choi, "The business case for investing in sustainable plastics," World Economic Forum, January 20, 2020, weforum.org.

Give your central sustainability team the decision rights to execute change

In our experience, it's important for companies to have a central sustainability team to coordinate their work on these topics. Our experience also suggests that companies don't need large central teams to implement their sustainability agendas successfully. While we have seen many companies start their sustainability transformations by allocating more central resources to these issues, we have also seen that having a smaller central team and more dedicated resources in the business lines that execute the detailed planning and implementation of sustainability can be most effective. In fact, among the companies we have worked with, some of those with highly effective sustainability programs have lean central sustainability organizations whose mandate is to incubate new sustainability ideas and integrate sustainability initiatives across the company.

What makes the central team particularly effective is having the decision-making authority to execute change, particularly regarding priority sustainability topics that affect multiple functions or that have a material impact on the overall organization. This authority has several dimensions. First, the central group should also engage the board of directors on critical sustainability topics, since the board holds the ultimate decision rights on such issues and the company's strategic direction. The central team should also be empowered to hold others accountable, which it can do by setting centralized targets. Individual sites or businesses then come up with specific initiatives, timelines, and plans for pursuing those targets, and the central team tracks their progress while also maintaining a corporate-wide view of the company's performance on the topic.

To ensure broad engagement in and commitment to common sustainability goals, the central team can enlist the company's leaders to develop and define a corporate-level sustainability agenda. When the central team has a clear mandate from the business, it can better see that the sustainability agenda cascades through the organization and that business units have clear guidance on which priorities to take on.

At one company with a successful sustainability organization, an existing business unit worked closely with the central sustainability team to incubate a new business for end-of-life products. Once the idea reached a defined financial milestone and level of technological maturity, the responsibility of business building shifted away from the central team to that business unit. Since the business unit was involved in the effort from the start, the transition of the business's decision rights was smooth.

To be clear, not all decisions need to be made by the central team, which could overstretch it (especially if it's a small group) and divert attention from specific priorities. Rather, cross-functional decisions and those that are highly material to the full company are best suited for central-team oversight.[4] The right to make other decisions, such as those that involve single functions, can be assigned to leaders or teams that are more closely associated with those units.

Find the structure that best fits your sustainability agenda—and your organization as a whole

Reporting structure is usually the first topic that comes to mind when companies consider organizational redesigns, and so the first question we are often asked is, "Which organizational structure is ideal for capturing the full potential of sustainability?" In reality, there is no single "right" answer for the design of a sustainability organization and no one-size-fits-all approach, beyond the general principle that the structure should be well integrated into—and compatible with—the rest of the company's setup.

[4] For more on how to classify and make decisions appropriately, see Aaron De Smet, Gerald Lackey, and Leigh M. Weiss, "Untangling your organization's decision making," *McKinsey Quarterly*, June 21, 2017, McKinsey.com.

That said, we do see that some organizational models tend to be more effective than others at elevating sustainability as a true strategic priority (Exhibit 2).

Compared with two other models that we see most often today in which sustainability is embedded in a support function or fully decentralized within business units, these three models help link sustainability to an overall strategy and give a sustainability organization real decision rights:

— *Large central team with few business-unit resources.* In this model, a large central team plans—and maintains the decision rights to—most sustainability initiatives and also coordinates with individual business units that are actively working on specific sustainability issues or have expertise related to the topic. The central team incubates sustainability initiatives before handing them off to the business units and supports activities that have no other natural owners in the organization. It also ensures that sustainability priorities across the company have sufficient budgets and staff and that the organization stays focused on its priority topics. A central team may also have the best view of broader sustainability trends and stakeholder demands, though it's likely less equipped than business units to respond to new sustainability-related market opportunities and risks. As an example, Newmont Goldcorp (a leading gold-mining company) was prompted by shareholders and its board to improve its management of sustainability issues after completing a merger. It responded quickly, creating a centralized sustainability group from 2002 to 2007 to design and drive the implementation of global environmental standards across its operational sites. This central group also managed decision making and the allocation of execution resources to sustainability issues.

— *Lean central team with decision rights and many business-unit resources.* In this structure, the prioritization of sustainability topics is largely a top-down process, led by the lean central team, to ensure that a common company-wide agenda and targets are in place. Business units have a mandate to develop specific initiatives to achieve company-wide goals, which they do by deploying their own resources. Business units also have the flexibility and resources to set up and work on sustainability initiatives of their own, in line with the central team's guidance. In our experience, this structure can be most effective at companies that have already embedded sustainability in the organizational culture, which increases

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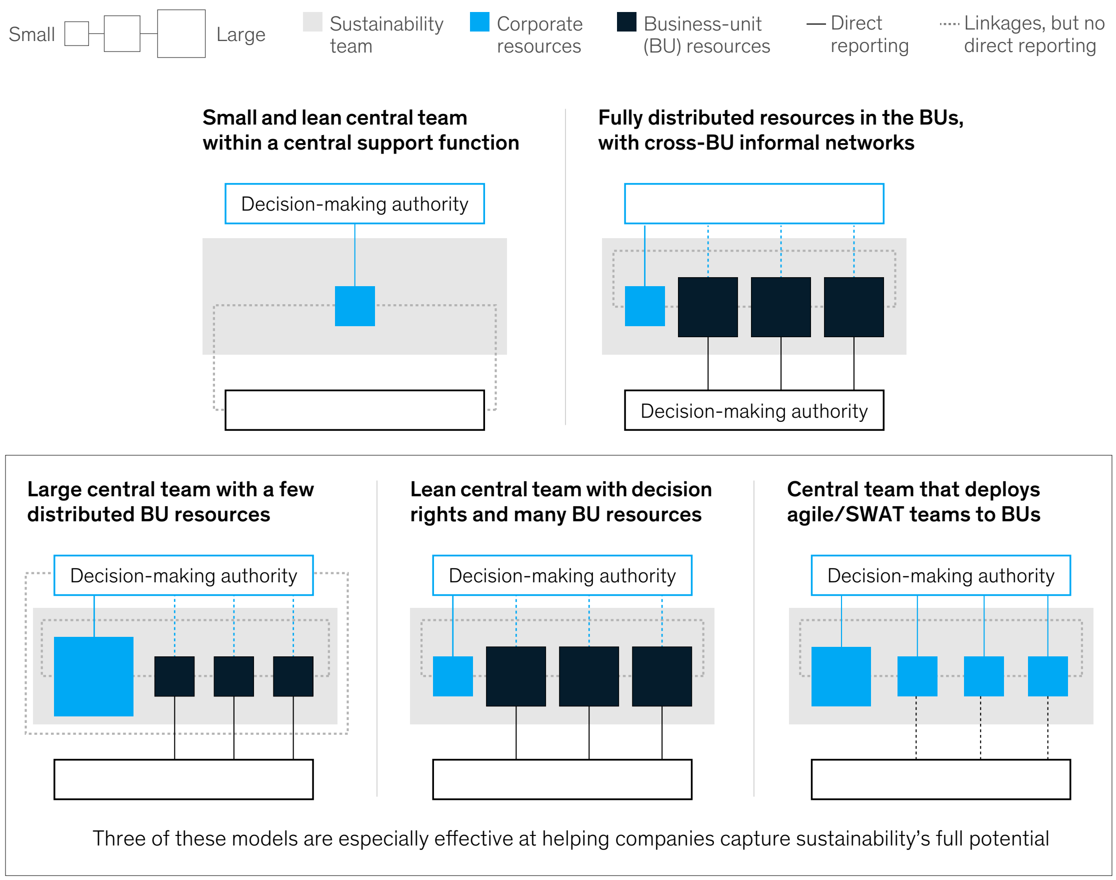
Exhibit 2

Certain organizational models tend to be more effective than others at elevating sustainability as a strategic priority.

Five commonly used models for sustainability organizations, scope of role in sustainability work



Pros	• Faster to elevate sustainability issues at corporate level • Centralized target setting, planning, and tracking • Consistent, cross-BU implementation of sustainability priorities	• Faster BU-level response • Empowered BUs receive clear central guidance • Less resource-intensive for central team	• Central team controls corporate sustainability agenda and resourcing • Agile resource deployment to meet evolving priorities • Easy sharing of best practices and expertise across BUs
Cons	• Resource-intensive for central team • Less responsive to BU-specific priorities • BUs not empowered to scale other BU-specific sustainability initiatives	• More speed and agility within BUs but not across BUs • Significant resource commitment from BUs	• Highly resource intensive for central team • Sustainability driven from the top down, so BUs are not empowered to drive initiatives

the likelihood that sustainability becomes a true cross-functional effort. Since 2019, this model has been in place at International Paper, a leading pulp-and-paper company. Its lean central team sets the company-wide sustainability agenda and focuses on both managing external relationships and integrating internal efforts. Meanwhile, business-line leaders drive the sustainability agenda. They set targets, develop the company's sustainability initiatives, assume responsibility for delivering on those initiatives (including the coordination of resources), and embed sustainability into day-to-day operations.

— *Central team that deploys agile or SWAT teams to business units.* This structure puts a central team in charge of deploying sustainability-focused task forces to individual business units. Once a task force is embedded in a business unit, it helps with the planning and initial execution of that unit's priority sustainability initiatives and builds capabilities so that the business can eventually run its own initiatives, once the task force leaves to support another unit. This facilitates the deployment of sustainability expertise and the sharing of best practices across the company, as well as the nimble reallocation of resources in response to the rapidly changing sustainability landscape. From a talent-development perspective, this model (what we call the "helix organization"[5]) also allows for a clearer separation of leaders—between those who help individuals develop capabilities and those who oversee employees' day-to-day work. The result is that sustainability talent can be developed both ways.

Prioritize the design of processes and governance—rather than reporting lines—that account for sustainability's complexity and dynamic nature

In our work on organizational redesign, we have found that many companies' default mode is to focus solely on reporting structure. But we know from experience and research that going beyond "lines and boxes" corresponds with a much higher chance for redesign success: in a McKinsey Global Survey on organizational redesigns, respondents were nearly three times more likely to report successful redesigns if they focused on improving multiple elements of the organization (for example, performance management, business processes, and culture), not just on changing reporting lines.[6] With respect to sustainability, which involves reorganizations that are more complicated and multifaceted than those of a typical function—and priorities that can shift much more quickly than in other areas of the business—we have found that it's critical to think about redesigning sustainability-related processes and governance early on. Several guiding principles can help with this kind of effort.

For one, companies' processes for making sustainability-related decisions should be robust and clearly define when an issue or decision should be escalated from the business unit to the central sustainability team. Decision-making processes should also include frequent discussions among stakeholders and fast decision cycles so that cross-functional or high-level topics can be identified and resolved quickly.

In most cases, the central team should be empowered to make decisions on topics that individual business units can't resolve on their own. If the central team, in turn, finds it can't resolve high-priority issues, it can escalate them to the executive team or a C-suite sustainability council. We have seen many companies fail to adapt their cadence on engaging with sustainability issues as they would with other topics. But that's what sustainability necessitates, since many of these topics require quicker decision making and responses than other business issues. For many companies in traditional and mature sectors (for example, petrochemicals, cement, steel, and other heavy industrials) that are used to longer decision-making cycles, this may require a significant mindset shift. The executive team can help effect such

[5] Aaron De Smet, Sarah Kleinman, and Kirsten Weerda, "The helix organization," *McKinsey Quarterly*, October 3, 2019, McKinsey.com.
[6] "The secrets of successful organizational redesigns: McKinsey Global Survey results," July 1, 2014, McKinsey.com.

a shift by clarifying that sustainability is a strategic priority that requires different decision-making approaches.

Another principle of effective sustainability processes and governance pertains to capital allocation. Sustainability investments often have different risk–return profiles and greater uncertainty than other, more traditional investment types. In our experience, many companies that lead on sustainability have set aside a separate pool of funds dedicated to sustainability initiatives, defined different hurdle rates for sustainability investments, introduced an internal carbon price to account for carbon impact and related risks, and put in place integrated financial and sustainability criteria to facilitate capital-allocation and M&A decisions.

Finally, it's valuable for companies to develop sustainability-specific performance metrics. While the specific metrics will vary depending on the topic, the same principles of good performance management of other business activities also apply to sustainability: setting measurable targets (both financial and nonfinancial), establishing incentives (such as linking compensation to sustainability performance), and putting in place regular performance reviews of sustainability.

Sustainability is no longer an issue of compliance for most companies but rather a strategic and operational one. Once senior leaders integrate sustainability into their corporate strategy, they will benefit from having a dedicated organization to support their sustainability efforts. There is no right structure that applies to every company; each will need a structure of its own and will likely need to adjust this structure as business conditions and requirements change. A well-designed sustainability organization, we find, can give the company the capabilities that it needs to capture value and manage risks from sustainability in a systematic and even transformational way.

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