

## **Sustainability and Business Strategy: an investigation model**

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### **Abstract**

This paper proposes a possible reference model to analyse the link between sustainability and business strategy. The study delved on the evaluation of the 2017 Non-Financial Statements of 30 companies listed in the Italian market according to the Legislative Decree n. 254/2016. A multi-sector analysis was conducted, and it involves companies from Media and Communications, Utility and Multi-Utility, Industrial and Financial sectors. Due to the fact that substantial differences between the national and European laws still exist among EU member states, the requirements of non-financial information are often considered unclear and ineffective. To counteract this situation, the EU harmonized the legislation, enacting the directive 2014/95/EU that establishes the main requirements for the reporting on social, economic and environmental topics. In such a vein, Italian government established that listed companies have to regularly disclose their non-financial information through non-financial statement. Drawing on authoritative academic literature, non-financial reports of the companies analysed, current articles and documents, an investigation model has been developed for assessing companies' strategic orientation towards sustainability. To this end, the model was structured in the following six main themes: 1) Strategy, 2) Governance, 3) Operations, 4) Performance, 5) Risk management, 6) Politics. The analysis highlights companies' approach in sustainability reports and its interconnections with company strategy, organizational structures, management policies, and risk management models.



**Keywords:** Sustainability, Non-Financial Statements, Business Strategy, Risk Management, Performance.

## **Trajnost in poslovna strategija: raziskovalni model**

Ta prispevek predlaga možen referenčni model za analizo povezave med trajnostjo in poslovno strategijo. Študija je preučila oceno nefinančnih izkazov 30 družb, ki kotirajo na italijanskem trgu v skladu z zakonodajnim odlokom št. 254/2016. Opravljena je bila večsektorska analiza, ki vključuje podjetja iz medijskih in komunikacijskih, komunalnih in večstoritvenih, industrijskih in finančnih sektorjev. Ker med državami članicami še vedno obstajajo bistvene razlike med nacionalnimi in evropskimi zakoni, se zahteve nefinančnih informacij pogosto štejejo za nejasne in neučinkovite. Da bi preprečila te razmere, je EU uskladila zakonodajo, s katero je sprejela direktivo 2014/95 / EU, ki določa glavne zahteve za poročanje o socialnih, gospodarskih in okoljskih temah. V takšnem smislu je italijanska vlada ugotovila, da morajo družbe, ki kotirajo na borzi, redno razkrivati svoje nefinančne informacije z nefinančnimi izjavami. Na podlagi avtoritativne literature, nefinančnih poročil analiziranih podjetij, aktualnih člankov in dokumentov je bil razvit model preiskave za ocenjevanje strateške usmeritve podjetij do trajnosti. V ta namen je bil model strukturiran v naslednjih šestih glavnih temah: 1) strategija, 2) upravljanje, 3) poslovanje, 4) uspešnost, 5) obvladovanje tveganja, 6) politika. Analiza poudarja pristop podjetij v poročilih o trajnosti in njegove povezave s strategijo podjetja, organizacijskimi strukturami, politikami upravljanja in modeli za obvladovanje tveganj.

Ključne besede: trajnost, nefinančne izjave, poslovna strategija, obvladovanje tveganj, uspešnost

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### **1 Introduction**

Sustainability and Business Strategy are two interdependent variables for a successfully corporate development and enterprises have to define and implement pragmatic decisions for realizing this orientation (Baumgartner et al., 2010). The incorporation of sustainability into business strategies is functional to the definition of courses of action in corporate strategy development and implementation; this task is, however, complicated by additional legislative and stakeholder-requirement considerations (Oertwig et al., 2017).

Complying with European Commission directions, by adopting with the legislative decree 254/2016, Italian government established that listed companies have to regularly disclose their non-financial information through non-financial statement ("*Dichiarazione Non Finanziaria*" - DNF). EU law requires large companies to disclose certain information on the way they operate and manage social and environmental impacts of their activities. Such information is relevant to investors, consumers, policy makers, and other stakeholders that can evaluate the non-financial performance of large companies to assess their responsible approach to business.

Currently, EU rules on non-financial reporting is only applied to large public-interest companies with more than 500 employees. This covers approximately 6,000 large companies and groups across the EU, including 1) listed companies; 2) banks; 3) insurance companies,



and other companies designated by national authorities as public-interest entities. Under Directive 2014/95/EU, large companies have to publish reports on the policies they implement in relation to:

- environmental protection;
- social responsibility and treatment of employees;
- respect for human rights;
- anti-corruption and bribery;
- diversity on company boards (in terms of age, gender, educational and professional background).

Directive 2014/95/EU gives companies significant flexibility to disclose relevant information in the way they consider most useful. Companies may use international, European or national guidelines to produce their statements; for instance, they can rely on:

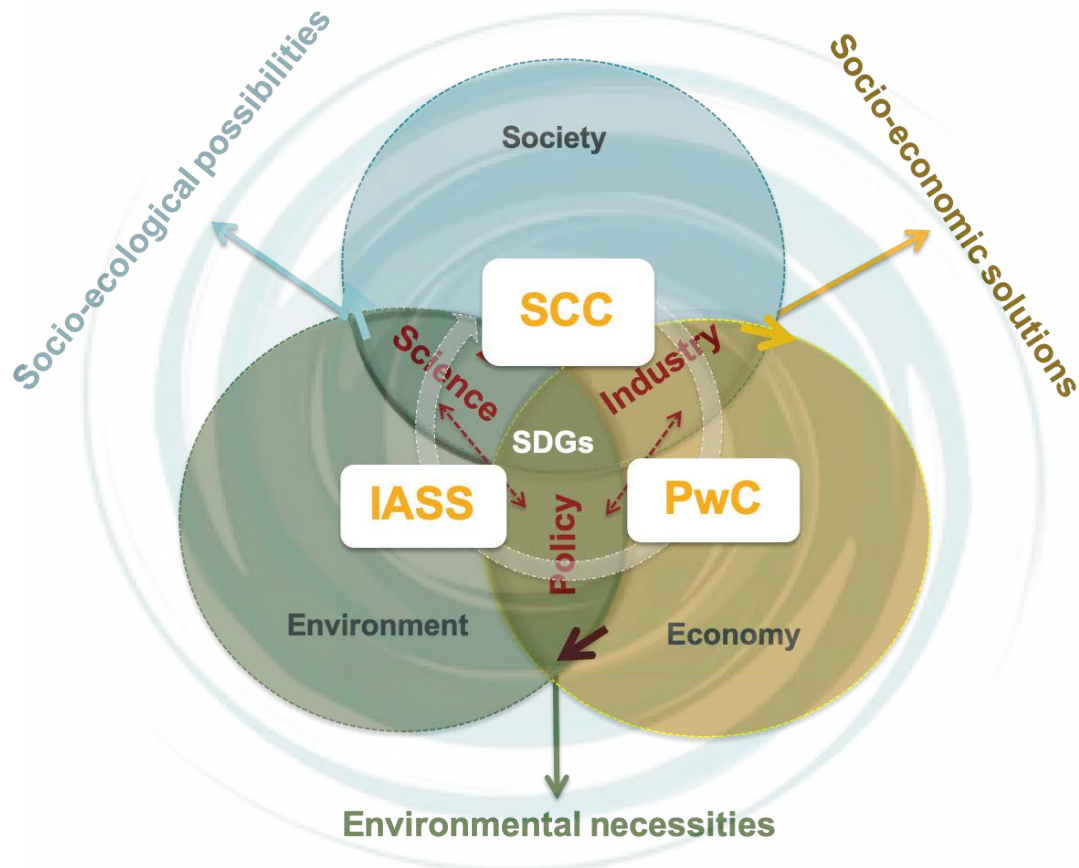
- the UN Global Compact;
- the OECD guidelines for multinational enterprises;
- ISO 26000.

Consequently, companies started to incorporate sustainability into the business strategy by devoting attention to the planning, measurement, and evaluation of the environmental and social impact of their activities in order to show a well-grounded orientation to sustainability. It should be said, however, that in many cases attention is put more on a formal legal compliance than on a substantial change of the business models (Barile et al., 2014; Saviano et al., 2018; Siano et al., 2007).

Based on this consideration, this paper proposes a model to investigate the relationship between sustainability and business strategy that has been developed by an Italian team of researchers and professionals from the *Italian Association for Sustainability Science* (IASS), the Italian consulting PwC (*PricewaterhouseCooper*) and the *Sustainability Communication Centre* of the University of Salerno (SCC). The research path follows the path of multi-disciplinarity traced by previous studies about sustainability (Clark & Dickson, 2003; Elkington, 2006) and summarized in the following Figure 1 with the aim for ensuring a representation for each of the domains involved in sustainability.

Figure 1: Attori chiave e ruoli di 'interfaccia'. Il Sustainability Helix Model





Fonte: Saviano *et al.*, 2018

The model allows assessing if and how the investigated companies (a sample of 30 selected companies listed in Italian market), in a multisector analysis, show a strategic orientation towards sustainability. The study is based on the analysis of the companies' DNF by focusing on six main themes: 1) Strategy, 2) Governance, 3) Operations, 4) Performance, 5) Risk management, 6) Politics.

Business strategy, organizational structures, management policies and risk management models have been combined in this model to interpret the link between sustainability, strategy and company performance.

Following this introduction, the paper proceeds with Section 2 that briefly outlines the main theoretical references on the links between Sustainability and Business Strategy and illustrates the proposed investigation model; Section 3 that presents the main findings and Section 4 that outlines final remarks, limits of the study, and future research directions.

## **2 Incorporating Sustainability into Business Strategies: the proposal of an investigation model for the Italian market**

In the following sub-sections, the link between Sustainability and Business Strategy is analysed drawing on an academic literature, non-financial reports of the sample of 30 large companies listed in Italian market and current articles and documents.



Finally, the model is illustrated to assess if and how the selected companies show a strategic orientation towards sustainability.

### *2.1 Sustainability, Business Strategy and Non-Financial Reporting: a theoretical overview*

In the last few decades, sustainability is progressively becoming a central topic in the discussion about companies' policies and organizational models (Shrivastava, 1995; Benn et al., 2014; Barile & Saviano, 2018). Several researchers and practitioners have progressively underlined the need for extending traditional companies' approaches to sustainability for embracing widened models able to integrate business strategies and sustainability pillars (Manzini & Vezzoli, 2003; Jensen & Berg, 2012).

In such a direction, multiple contributions have been provided with reference to the ways in which sustainability can influence companies' performance (Wiedmann et al., 2009), about the key role of sustainability as conceptual umbrella able to influence actors' behaviours and decisions (Scalia et al., 2016; Del Giudice et al., 2018), and with reference to sustainability effects on managerial paths and strategies (Caputo et al., 2018a, 2018b).

Among the multiple studies rooted in the research streams interested in the link between sustainability and business strategies, interesting contributions have been provided with reference to the role of communication in assuring an effective widespread of companies' attention in respecting 'sustainability rules' and in promoting paths and strategies able to assure a sustainable development of all over the time (Barile et al., 2018; Scalia et al., 2018). In such a direction, the studies about the Corporate Social Responsibility (Porter & Kramer, 2006; Deigh et al., 2018) and about the companies' communication instruments for wide spreading their attention in sustainability (Siano et al., 2015, 2016) have contributed to the emergence of a challenging debate interested in depicting the role of (voluntary and mandatory) disclosure in influencing companies-stakeholders relationships (Caputo et al., 2016a, 2016b), in defining possible measurement models for supporting both researchers and practitioners in defining instruments for communication able to enhance companies' attention to sustainability (Lee, K & Saen, 2012), and in tracing paths through which of companies' communication focus the attention on elements considered relevant by the market (Siano et al., 2015).

Following the path of reflections about the increasing relevance of communication as a driver for increasing the value of companies-to-stakeholders' relationships under the conceptual umbrella of sustainability, non-financial statement represents the new frontier and it requires humans to define possible investigation model for analysing companies' activities, their effects, and linked implications for market and social balances (Saviano et al., 2017).

### *2.2 The research path*

The present study focuses on the non-financial information disclosed in the non-financial statements of the 30 listed companies. The analysis was carried out on a sample of 30 large companies listed in the Italian market with more than 500 employees, active in Utility and Multi-Utility, Industrial, Financial and Media & Communications sectors (source: [www.borsaitaliana.it](http://www.borsaitaliana.it)).



The analysis is based on non-financial information disclosed in DNF, or, where present, in social, sustainability, and integrated reports available on websites of the considered sample of companies. The quality of DNF is assessed by using the content analysis, an established method used to analyse disclosure quality (Singhvi & Desai, 1971; Magness, 2006).

The study adopts a qualitative approach directed to interpret the information presented and disclosed by analysed companies. Subsequently, a review of the data was conducted in order to make the results obtained as homogeneous as possible.

In order to analyze the level of non-financial and diversity disclosure, the model identifies six different assessment grids for the following categories (or themes) of information:

- 1) *Strategy*: the objective of this category is to understand how the sustainability strategy of the sampled companies is structured and integrated.
- 2) *Governance*: the objective of this category is to understand how the sustainability governance of the sampled companies is structured.
- 3) *Operations*: the objective of this category is to understand the stakeholder engagement process, the materiality analysis and the disclosure method of the business model of the sampled companies.
- 4) *Performance*: the objective of this category is to understand how many companies are going beyond the concept of quantitative data reporting and are moving towards identifying KPIs and targets linked to the sustainability strategy and management remuneration policy.
- 5) *Risk management*: the objective of this category is to understand how much sustainability is integrated within the risk assessment process.
- 6) *Politics*: the objective of this category is to understand how the companies are structured with formalized policies, approved by the top management.

The disclosure level was verified for each section and points were assigned to reflect the degree of completeness of disclosure found in the related reports. A rating scale from 0 to 2 (where 0 indicates the absence of disclosure, 1 indicates incomplete disclosure, and 2 indicates full disclosure) was used to assign a specific score to each section and generate an overall completeness rating for the non-financial disclosure in each of the three types of report (annual report, sustainability report, and integrated report).

The overall rating was calculated as a percentage by dividing the point score for each specific disclosure section by the maximum possible score for the section. This generated an overall compliance level based on six different dimensions of measurement.

### **3 Findings**

The analysis of the incorporation of sustainability into the various business dimensions highlights the following results:

A. The maturity of non-financial reporting of the 30 companies sampled shows that the 77% of the panel obtained a rating that highlights the need for improvement in the non-financial reporting of the 6 categories analyzed (Figure 1).



Figure 1: Maturity of non-financial reporting

| <b>Companies Cluster<br/>(Maturity of non-financial<br/>disclosure)</b> | <b>% companies on tot<br/>sample</b> | <b>Stratification threshold<br/>(overall rating)</b> |
|-------------------------------------------------------------------------|--------------------------------------|------------------------------------------------------|
| <i>Companies Best in class</i>                                          | <b>23%</b>                           | > 75%                                                |
| Companies with room for improvement                                     | <b>40%</b>                           | 50% - 75%                                            |
| Companies with critical issues                                          | <b>37%</b>                           | < 50%                                                |

B. The areas of the most mature orientations are “politics”, “operations” and “risks”, the categories most frequently referred to in Legislative Decree 254/2016. Strategy, governance and performance categories, which necessitate a greater commitment from senior management, are those that require more significant room for improvement (Figure 2).

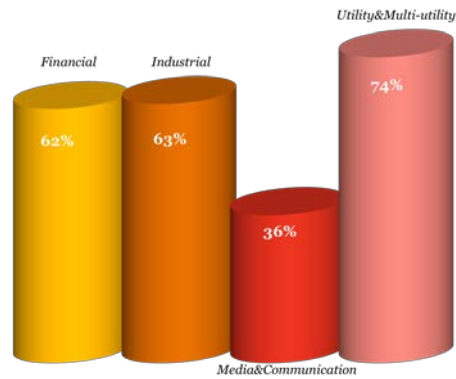
Figure 2: Maturity of the 6 mains themes



C. The integration of sustainability into corporate strategy and governance, as well as the definition of KPIs linked to the strategy, present areas for improvement in a rating for the sectors analyzed (Figure 3) especially in the media & communications sector.

Figure 3: Rating for analyzed sectors





D. From the analysis conducted it emerged that over half of the selected sample (70%) make a non-financial report for some time (more than two years). The remaining 30% of the sampled companies have a lower reporting maturity, carrying out such reporting for just one year (23%) or two years (7%).

E. Finally, the best results in terms of NFI score and all dimensions of this study were achieved by companies already involved in sustainability practices.

The overall results of this study show that there is still an important gap to fill between sustainability and business strategy, even among large companies.

#### **4 Conclusion and further research directions**

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The pathway towards non-financial reporting in Italy needs action in the field of strategy, governance, and performance. These actions need to be combined with best sustainability practices and strategies.

This allows us to assume that the contribution of the EU directive to non-financial disclosure is really important to fill this gap. In contrast to part of the literature, the regulation could improve the quality of information disclosure by large companies; it establishes that sustainability and business strategy have to become two sides of the same coin to reinterpret the company performance in a key more in line with the systemic interconnections present in the context in which the company operates.

From a general perspective, the study highlights the fact that the incorporation of sustainability in the business models, hence in the business strategies cannot be based only on a legal compliance logic but requires a deeper change. Such a change can be facilitated by the creation of context conditions also thanks to the actions of 'facilitator entities', like it has been exemplified in the Figure 1 where the interface role of hybrid organizations is illustrated.

From a practical point of view, the study enriches ongoing debate about sustainability and business strategies relationships and highlights the relevance of sustainability as a strategic asset for firm's value creation.



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