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New opportunities and value creation through corporate environmentalism

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Corporate environmentalism is quickly growing in popularity but the focus among Finnish companies seems to be mostly on reducing GHG emissions. In this article, we disaggregate corporate environmental responsibility to its sub-components and outline related value-creation opportunities from embracing all of them for investors, consumers, shareholders, employees, and society as a whole.

Executive Summary

Problem
Finnish companies focus largely on the reduction of greenhouse gas emissions but rarely act on other environmental responsibility measures.

Why it happens?
Greenhouse gas emissions have received the most publicity and regulation, often being seen as the only environmental issue to be solved.

Why it happens?
By taking a broader view on environmentalism, companies can grasp new business opportunities and refine their culture and strategy, thereby creating more stakeholder value by minimizing externalities.

Corporate environmentalism can enable companies to harvest new business opportunities in a world where societal norms develop rapidly. As companies look beyond mandatory responsibility reporting and financial benefits, embracing environmentalism as a core driver behind corporate culture and strategy, they create value for other stakeholders, including employees and society as whole.

Environmental responsibility should be comprehensive in its approach and scope

Corporate social responsibility is often thought to envelop not only social aspects, but also environmental responsibility, and has increasingly become intertwined with the themes of sustainable development (Blackburn, 2007). Consequently, if only the environmental part is considered, its success is often measured against the guidelines of environmental responsibility. Additionally, a company's environmental performance is composed of two aspects: the environmental impact of its operations and the environmental initiatives that it undertakes. Both aspects are necessary; while key indicators related to environmental impact can be used to assess progress towards environmental responsibility, they cannot describe how future impact is to be mitigated (Ones and Dilchert, 2012). Therefore, meaningful environmental responsibility requires both active reporting and measurable target setting.

Within this article, environmental responsibility is split into four main components: greenhouse gas emission reduction, waste minimization, non-greenhouse gas pollution reduction, and biodiversity maximization. These major topics are usually considered in environmental disclosures through well-known frameworks, such as the United Nations Sustainable Development Goals (UNSDG) or the sustainability reporting standards provided by the Global Reporting Initiative (GRI). It should be noted that both frameworks cover the abovementioned components extensively.

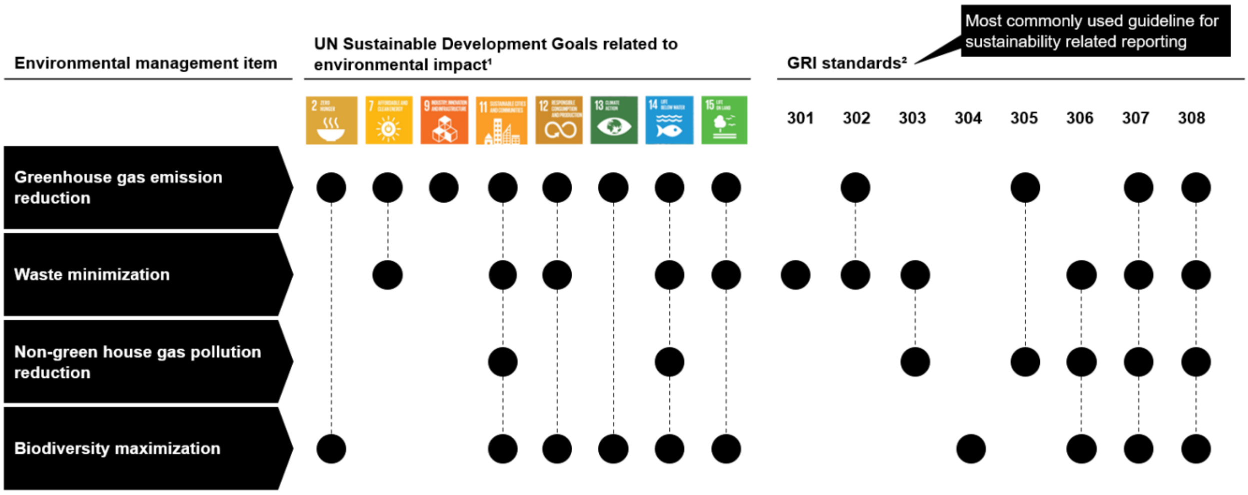

Figure 1. Scope of UNSDG and GRI frameworks.

Corporate environmentalism in Finland has been heavily oriented towards reducing greenhouse gas emissions

To explore how Finnish companies approach environmental responsibility, we studied public disclosures in 2021 from 34 companies across industries. Environmental ambitions were scored out of a maximum of 26 points based on the extent of reporting and measurable target setting in each of the four components. Compliance with environmental regulations was also considered. The scope of an environmental report was assessed according to how many of the components were included in each disclosure.

Based on these environmental disclosures, three clear stages of environmentalism were observed. Firstly, there are inactive companies that have just started or are yet to become active in disclosing environmental measures. The second group of emerging reporters are those who have understood the benefits of responsibility programs. While they make up the largest portion among the 34 companies, environmental objectives are not part of their core strategic agenda. There may be various reasons behind this, including a lack of significant pressure through legislation, consumer demand or financiers. Lastly, strategic environmentalists are companies that consider environmentalism to be a key driving force in their strategy development.

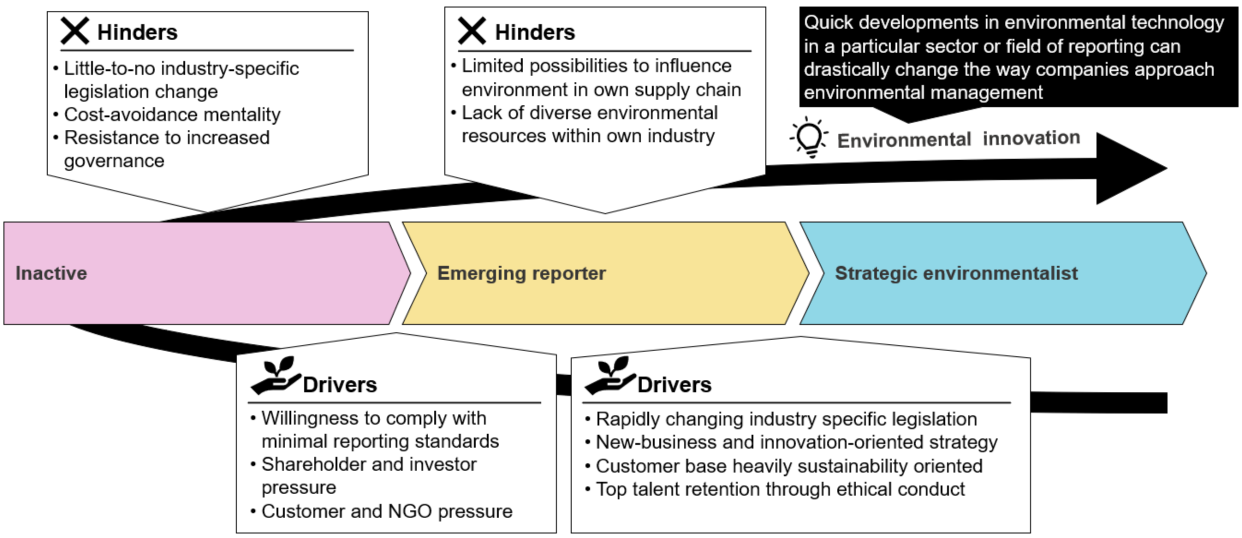

Figure 2. The three stages of environmentalism.

On average, Finnish companies reported their environmental performance on at least two components, greenhouse gas emissions reduction, and waste reduction. Especially, greenhouse gas emissions reduction was reported by every company. In terms of target setting, greenhouse gas emissions reduction receives the most attention, naturally so as companies aim for carbon neutrality in the coming decades. Additionally, waste reduction is another popular target but does not reach the same level of use or ambition in scope. Meanwhile, the remaining two components of non-greenhouse gas pollution and biodiversity improvement are still in an emergent phase in Finland. Especially, it is rare to find targets for biodiversity improvement.

From an industry standpoint, there is variability in how players are positioned. According to the analysis, the industries that are still in the beginning, “inactive” stages of environmental strategy are retail, finance, media, marine and construction, likely due to the lack of significant legislative and societal pressure prior to the 2020s. However, there is deviation within the industries. In some cases there are companies that are performing better than their peers in the industry.

Many industries were considered to contain emerging reporters. The industries within this segment typically have extensive strategies for greenhouse gas emissions and waste reduction. Even then, reporting and target setting for non-greenhouse gas emissions and biodiversity improvement remains sparse. Due to this preferential treatment between environmental components, strategic environmentalists are composed of companies that significantly venture into non-greenhouse gas pollution and biodiversity as important areas of environmental strategy. According to our analysis, the forest product industry currently hosts the highest density of such companies. In addition, players in the energy and tire manufacturing industries were considered to be strategic environmentalists due to the notable environmental efforts in most categories observed.

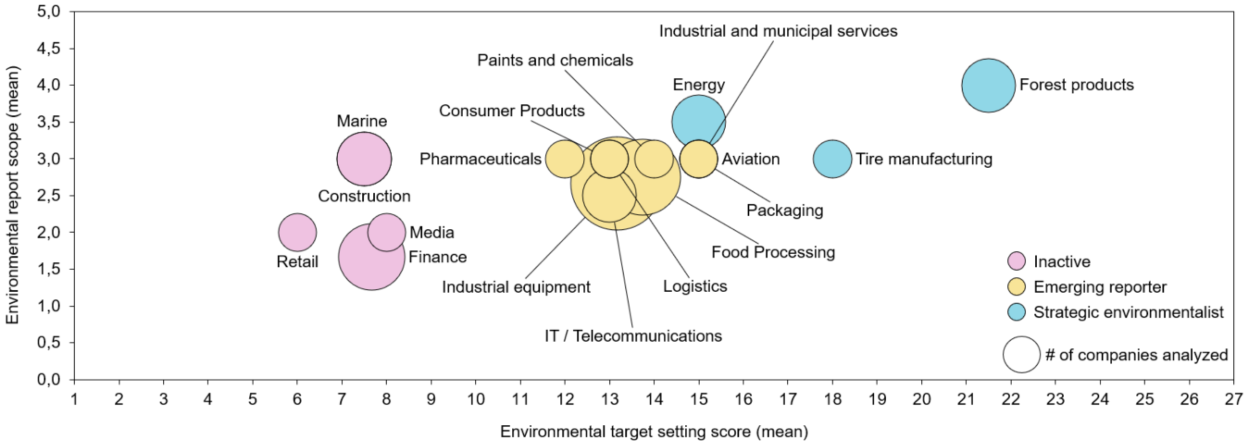

Figure 3. Environmental ambition scores and report scope by industry.

External forces of legislative change and consumer and financier pressure push companies to become more environmentally responsible

From the results we can see that industries are at different stages, depending on how the forces of legislation, consumer demand, and shareholder and financier pressure affect their industry. We consider national climate target setting to be part of legislative change.

There is variation on which force is the driving factor. In some industries, like marine, legislation is slowly starting to form but consumer pressure to operators is driving the change. On the other hand, the forestry and energy sectors have been earlier intervened by EU emissions trading schemes, LULUCF, and others, hence sustainability governance has been developed much further there. In these industries, we have observed that shareholder pressure as the main driving factor. As a case in point, recently the partly Finnish government-owned steel producer SSAB has faced strong shareholder pressure as the Finnish nation intends to transform one of its biggest carbon dioxide emission sources, steel plant in Raahe, into one of the most climate-friendly steel production sites in the world (Helsingin Sanomat, 2022). In addition to shareholders, pressure can also come from employees, including talent attraction and retention; many stock-listed Finnish employers, such as renewable fuel company Neste, aim to brand themselves as purpose driven companies that would resonate with the values of today’s employees.

In the context of strategy formulation, it is critical to pinpoint the key drivers for environmental responsibility within an industry: legislation, consumers, financiers and how all three should be addressed in the context of future competitiveness. Consumer pressure affects even B2B businesses, as the whole value chain must eventually become sustainable to fulfill the environmental requirements. By understanding the drivers of market shift, companies can identify and prepare for potential risks in its business arising from the changes. In general, being environmentally sustainable can be seen as a risk mitigation plan for future, as businesses doing “good” will have a lower risk of facing unfavorable regulation or bad reputation over those not improving their environmental performance.

Corporate environmentalism may be also rewarded via lower cost of capital and government funding for investments

There is some evidence from capital markets that the companies that embrace ESG aspects in their business have generated better risk-adjusted stock returns compared to their peers (Silvola and Landau, 2019). However, recent research published in 2021 by Research Institute Scientific Beta (Financial Times, 2021), accounts this equity premium to the quality of the companies (high ESG score firms just have high quality in their operations and business model in general, “quality premium”, see Kozlov and Petajisto, 2013) or explain it partly due to high inflow of capital to ESG investment funds lately. Either way, it seems that environmentally friendly business is also a quality business for the investors. This may be due to fact that investors consider these companies to have better long-term prospects to generate cash flow compared to ones that may see stricter environmental regulation cutting their growth and profitability. As discussed earlier, investors may also consider high ESG rating companies to bear lower risk, hence the lower required return compared to ESG laggard companies.

Secondly, banks are also under pressure from regulators and shareholders to cut their own emissions as well as the emissions of their loan portfolios. Therefore, EU published the Taxonomy for sustainable finance regulation, which will force companies under the Non-Financial Reporting Directive (more than 500 employees) to report their business’ alignment to Taxonomy’s criteria for sustainability, which includes all the 4 abovementioned components. This helps banks to calculate their exposure to non-environmentally friendly businesses and may lead banks to favor companies in financing companies that are Taxonomy aligned to fulfill their own targets. More financing will flow to Taxonomy aligned businesses which can result in banks offering lower interest rates to these firms. So, there is potential evidence that companies can lower their cost of capital by embracing the environmentally responsible behavior fully.

Thirdly, since climate change is one of the biggest challenges of our generation, societies need firms that can help to solve it by developing new green technologies and services. Vast sums of governmental relief money are flowing into green investments in the coming years. EU funding is also subject to fulfilling EU’s Taxonomy eligibility criteria that follows companies’ actions’ impact on all the four environmental responsibility components. Availability of government financing coupled with surging CO_2 emission permit prices in the EU should trigger businesses to put environmentalism at the core of their strategy to have supportive environment to invest in new growth opportunities and to cut their costs.

Companies embracing environmentalism can create competitive advantage out of responsibility actions

At its best, corporate environmentalism serves as a compass which directs corporate strategy and thus ensures that companies are ready to capture new business opportunities arising from changes in legislation and demand. This is especially evident in Finland’s energy and forestry sectors, since they largely adopted a decade ago the leading concept that the post-fossil fuel era is approaching sooner than we previously thought. The businesses that align to changes early have an advantage when the large audience is then starting to enforce this shift.

As more nations adopt carbon neutrality targets and circular economy legislation, markets will shift to favor environmentally friendly actors. Although corporate environmentalism is far from "ticking the responsibility box", it should be thought as an innovation platform for rethinking operations and business models for a carbon neutral, waste and pollution free future. A great example of new business building through environmental responsibility is the development of adjacent revenue streams through industrial symbiosis; companies from various industries work together to maximize material utility by offering their previously underutilized side streams to each other. Innovative solutions of this "industrial symbiosis" are observed in side-stream utilization in the bio-industries as well as construction and infrastructure industries. New business models arising from industrial symbiosis reduces greenhouse gas emissions, waste and at best upcycles side streams to new usable products for companies and consumers (Finnish Industrial Symbiosis).

Moreover, despite there being clear business cases and financial value for driving environmentalism, one should not view environmentalism only from the direct P&L perspective. Corporate environmentalism aims to encompass future societal norms, hence the purpose of doing good for the environment is also deeply rooted in corporate strategy; are the company and the people working for the company relatable to consumers, suppliers, financiers, new potential recruits, legislators as well as all other members of society?

Biodiversity preservation and improvement is an aspect of environmentalism which often lacks clear indicators for measurement, but which serves as a great example of non-business-related environmental work. Joining forces together with NGOs to improve biodiversity in local surroundings or supply chain related ecosystems can greatly improve the perceived value to external stakeholders, but also provide a sense of purpose for company's employees. Companies can also show thought leadership by pinpointing areas where further research is required to ensure sustainable business practices. The tire manufacturer Nokian Tyres has adopted this approach with microplastics; microplastics often stem from tire usage, but currently lack clear specification and legislation. Hence, Nokian Tyres openly brings the research issues related to microplastics forward (Nokian Tyres, 2021). In such cases, thought leadership shows that a company has the courage to bring forth difficult issues for public debate, which they can then tackle together with the public and NGOs. While these non-profit-generating actions will not seek for direct financial gain, their reputational effect on personnel and public trust can exceed the money invested in the long run.

As a conclusion, putting corporate environmentalism at the core of corporate strategy can become a source of a competitive advantage to pioneer companies in the industry. As discussed, sustainable company culture attracts talent, may lower the risks of continuity of the business, and ensures that the company is aware and nimbly innovating to find new future-proof business opportunities. In the best case scenario, all this starts a self-feeding loop where companies avoid major risks, get talented and empowered employees which enables them to improve reputational and financial performance, which in turn helps them to grow and attract more talent. This creates a path to success which is not easy for competitors to replicate.

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