

The Balance Sheet Blind Spot: How Sustainability Affects Competitiveness and Profits



Call it balance sheet blindness: Companies tallying up their profits and losses tend not to calculate what damage to the Earth is costing them or society.

In many cases, they assume they don't need to worry about it until some point in the future.

But in a recent SAP Insights global survey of business professionals who are knowledgeable about their organization's sustainability goals, actions, and reporting methods, respondents tell us that most of their companies are taking at least some steps toward greater environmental sustainability – and that the more effort companies put toward that goal, the more successful they expect their performance to be. In fact, we found a significant minority of respondents who say that environmental sustainability is already financially material* to their businesses and another group that believes it will become imminent in the near future.

The Material Now group, or the *Nows*, make up 17% of our survey respondents. Leaders at these companies not only see clearly that the fortunes of their businesses are inevitably linked to those of the planet; they're finding ways to make that link pay off. They are transforming their companies *and* achieving better business results than the companies represented by the remaining 83% of our respondents.

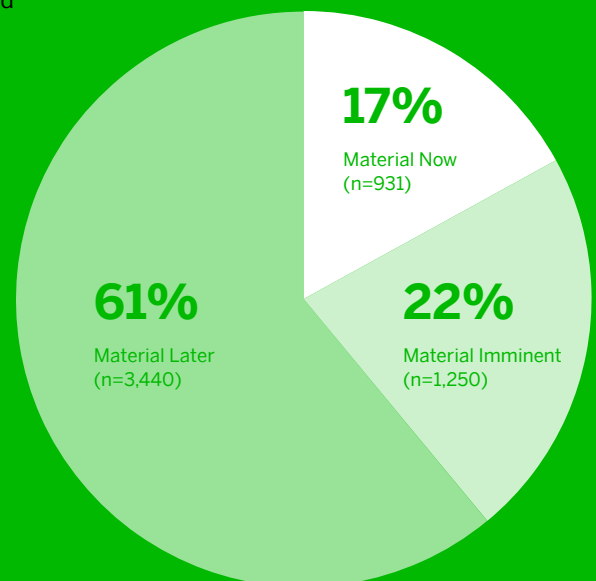
Even among this 83%, however, we found some respondents who have taken off their blinders: 22% think sustainability

will be material to their businesses within five years. This group, which we call the *Imminents*, says their companies are more likely to be taking action on sustainability – and to see business performance gains – than the remaining 61% of respondents, whom we refer to as the *Lateres*. (See Figure 1.)

Our survey data does not *prove* cause and effect between materiality and business success. However, across all respondents, there is a strong correlation between the two. And this strong correlation suggests that when business leaders look at value creation through the lens of sustainability, they find opportunities to grow and improve performance.

Figure 1
Who thinks environmental sustainability is financially material now?

How long do you think it will be before environmental issues become material to business results?



Source: SAP Insights

* By *material*, we mean an event, fact, or issue that is reasonably likely to affect the financial condition or operating performance of a company and should be publicly disclosed (along with the corresponding financial statements).



Who are the Nows?

The Nows, Imminents, and Laters each act differently when it comes to environmental sustainability. The sooner that respondents believe sustainability will be material to their companies' operations, the more likely they expect their companies to:

- See higher revenue for the current fiscal year
- Consider sustainability a high investment priority
- Collect data about sustainability for a longer period
- Use sustainability data to inform more decisions
- Be more satisfied with the quality of sustainability data
- Distribute responsibility for action on sustainability more broadly within the organization
- Have a greater understanding of the positive correlations between sustainability and profitability as well as sustainability and competitiveness

The Nows – the 17% of respondents who believe environmental issues are already materially affecting their companies' finances and operations – stand out because they are significantly ahead of even the Imminents in each of the areas listed above. They also have more committed leadership. Our survey shows that the Nows' plans to incorporate sustainability into business operations are driven from the top. The Now leaders see the need for change and drive it forward, while other respondents are doing less and moving more slowly.

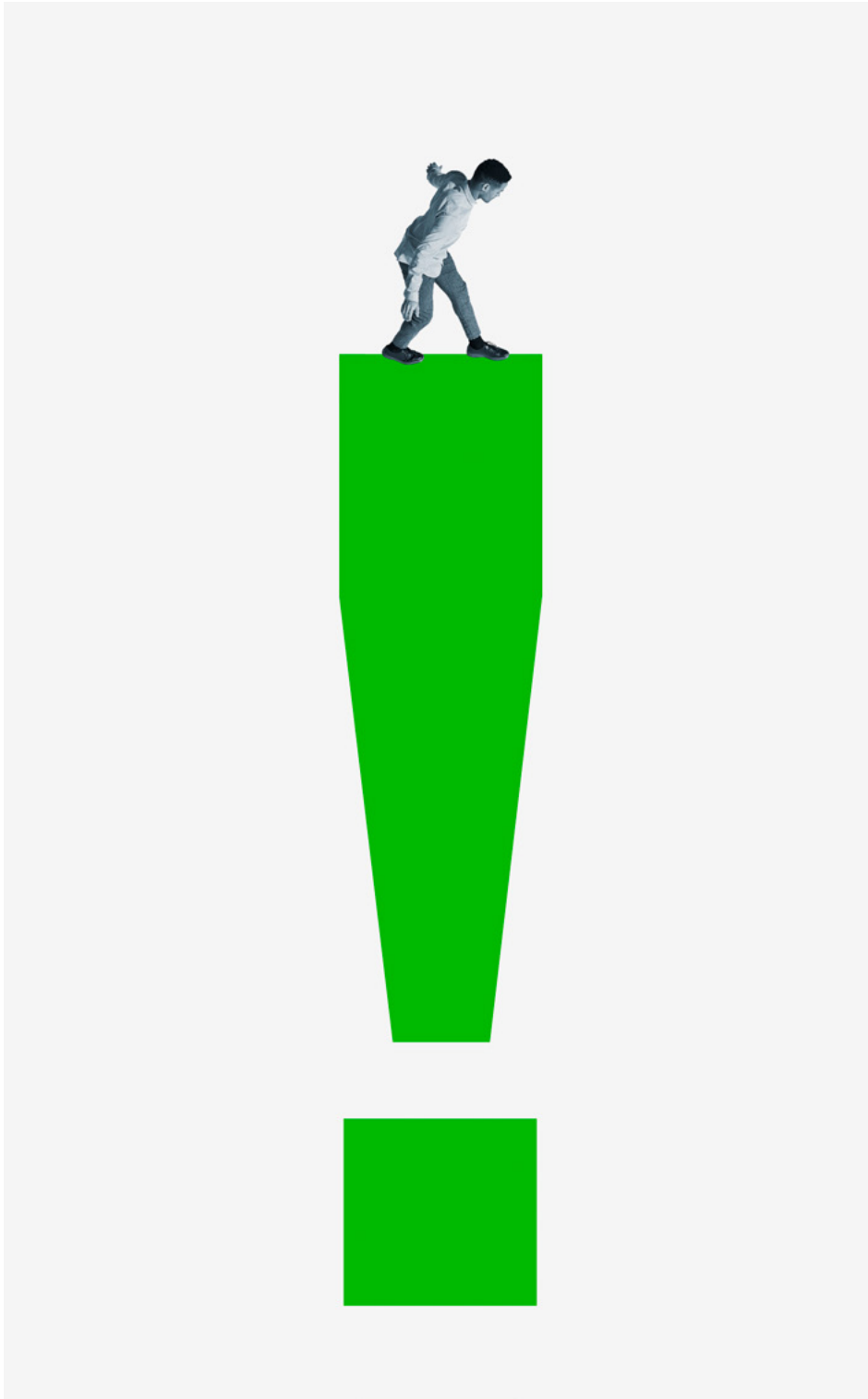
The Now respondents say their companies also have more data than the Imminents and the Laters about the environmental effects of their businesses, and they use it better. They see fewer barriers to action. They invest more, both in money and in people, to support sustainability. And, crucially, they consider sustainability an essential part of their business strategy.

In addition, the Nows are more optimistic about their companies' strategy: They are 11% more likely than the Imminents and Laters to expect that environmental sustainability will increase long-term revenues and profits.

That's not to say what the Now companies are doing is easy. Our survey found that pursuing sustainability involves a complex system of business drivers so intertwined that difficult tradeoffs could result. But even this could work to the Nows' advantage, allowing them to widen the competitive gap between themselves and companies that are postponing those decisions.

The complexity of acting on sustainability is lost on no one. But the correlation that we see between action and business success should be both a signal and a call to action for companies that are unsure about or resistant to making sustainability part of their business strategy and operations. Financial materiality for sustainability is already here: The question is no longer when to act, but how.

Motivations to act



Some major companies have already made [sustainability](#) not just a pledge but a strategy. U.S. automaker General Motors has [committed](#) to manufacturing only electric cars, vans, and SUVs by 2035. Meanwhile, German automaker Volkswagen has already made big changes to try to win market share early in the shift to electric. It will transform the bulk of its fleet – more than 30 models – to electric power within the next four years.

Such strategic bets aren't limited to the auto industry. In 2020, investment giant BlackRock made sustainability its [new standard](#) for investing its US\$2.7 trillion portfolio.

The big marquee names are no accident. Our survey found that the Now respondents are more likely to be from large (revenues of \$750 million or more) companies. Some reasons may be that the Nows are aware that their companies have extensive effects on the environment and that larger companies have greater economies of scale and the discretionary budget to measure and mitigate those effects.

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A different mindset

Across the board, the Now respondents think about sustainability differently from Imminents and Lateres. The most notable differences lie in their companies' motivations for pursuing sustainability, their methods for doing so, and what they expect the results to be. Notably, their approach seems to hinge on the actions (or lack thereof) of company leaders.

To illustrate: We asked respondents to choose up to five factors (from a list of 12) that motivate their companies to take environmental action. From that short list, we asked them to rank each factor in order of importance.

Among the Nows, the most frequently chosen number one motivator for their companies to take environmental action is CEO and board commitment, followed by government regulations, the company's stated purpose, commitment to the United Nations Sustainable Development Goals, and revenue and profit growth opportunities. These are primarily philosophical, future-oriented drivers that suggest the Now respondents' companies are being proactive about environmental consequences and consciously connecting them to business outcomes.

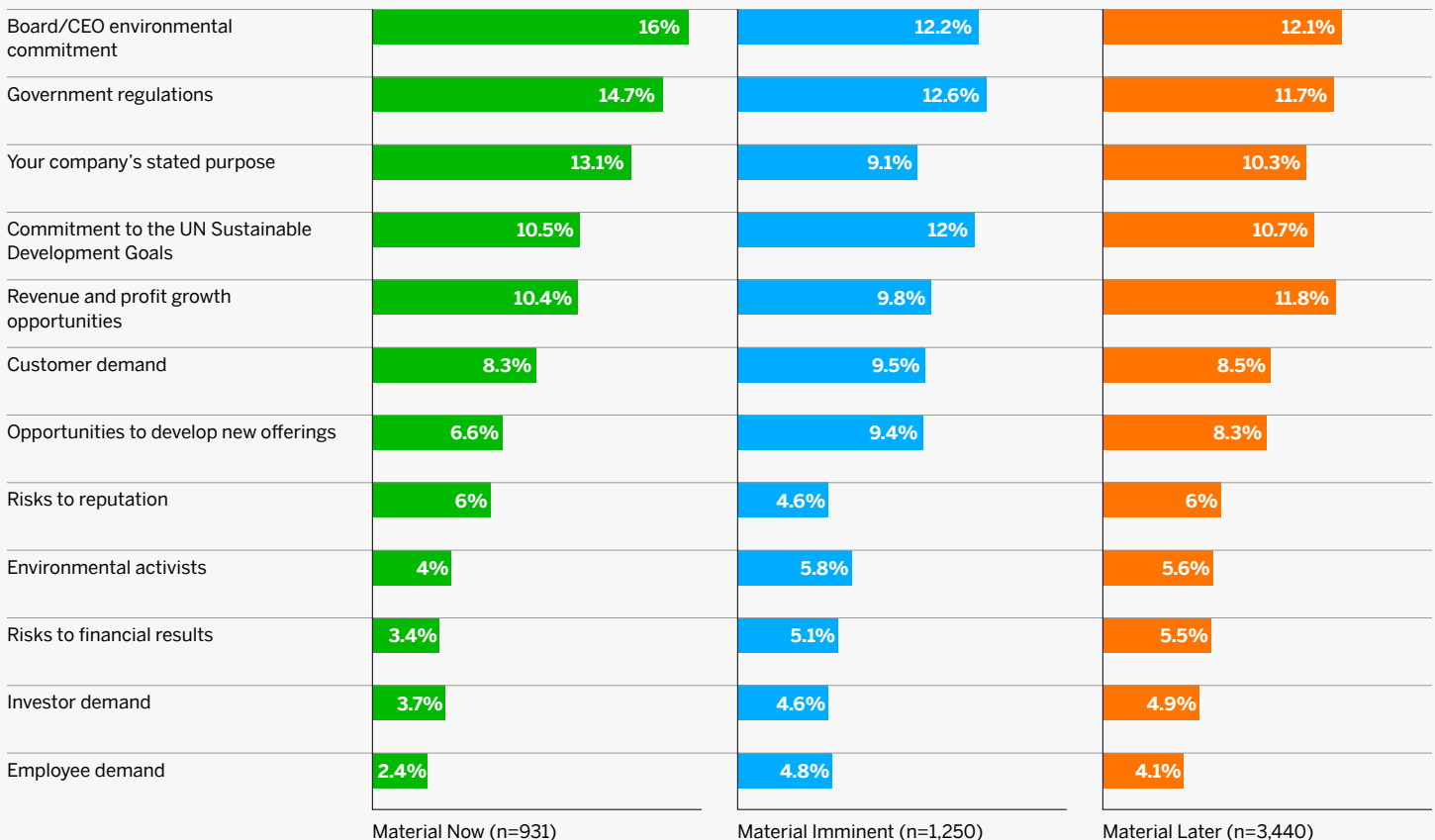
Both the Imminents and the Lateres say their companies are more influenced by traditional business priorities than the Now

organizations. For example, the Lateres are more likely than the Nows to be motivated by factors such as revenue and profit growth opportunities, whereas the Imminents are more likely than the Nows to be motivated by customer demand and opportunities to develop new offerings. (See Figure 2.)

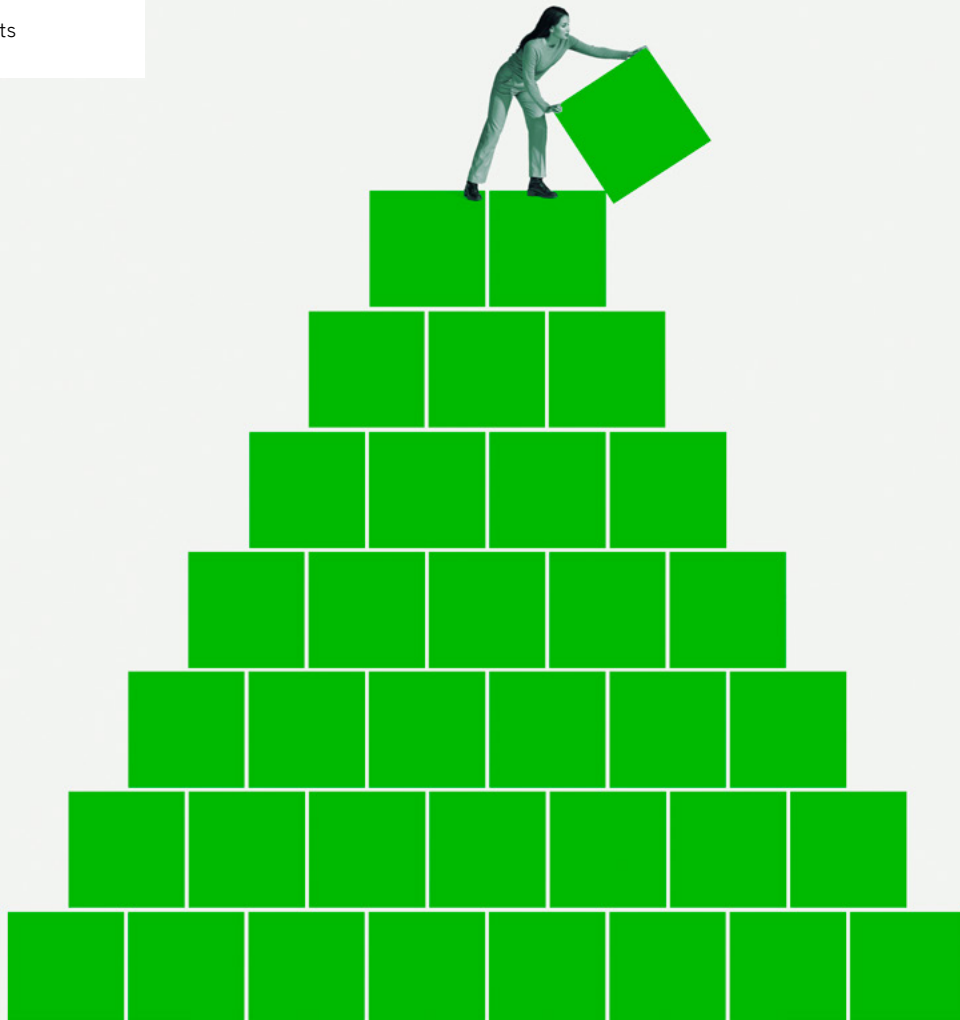
While the Nows say their companies have decided there are strategic benefits to moving quickly, the data doesn't tell us why – or why the Imminents and Lateres are slower to act. It may be that the latter two groups think that their companies are deliberately taking a "fast follower" approach, letting others shoulder the risk of experimenting with new solutions.

Figure 2
Sustainability is motivated by top leadership

What forces motivate your company to take action to improve the planet's environment? (Percentages represent answers chosen as highest motivator.)



Source: SAP Insights



Putting green toward being greener

This is presumably because the Nows and Imminents want their companies' own commitments to that goal to be reflected throughout their supply chains.

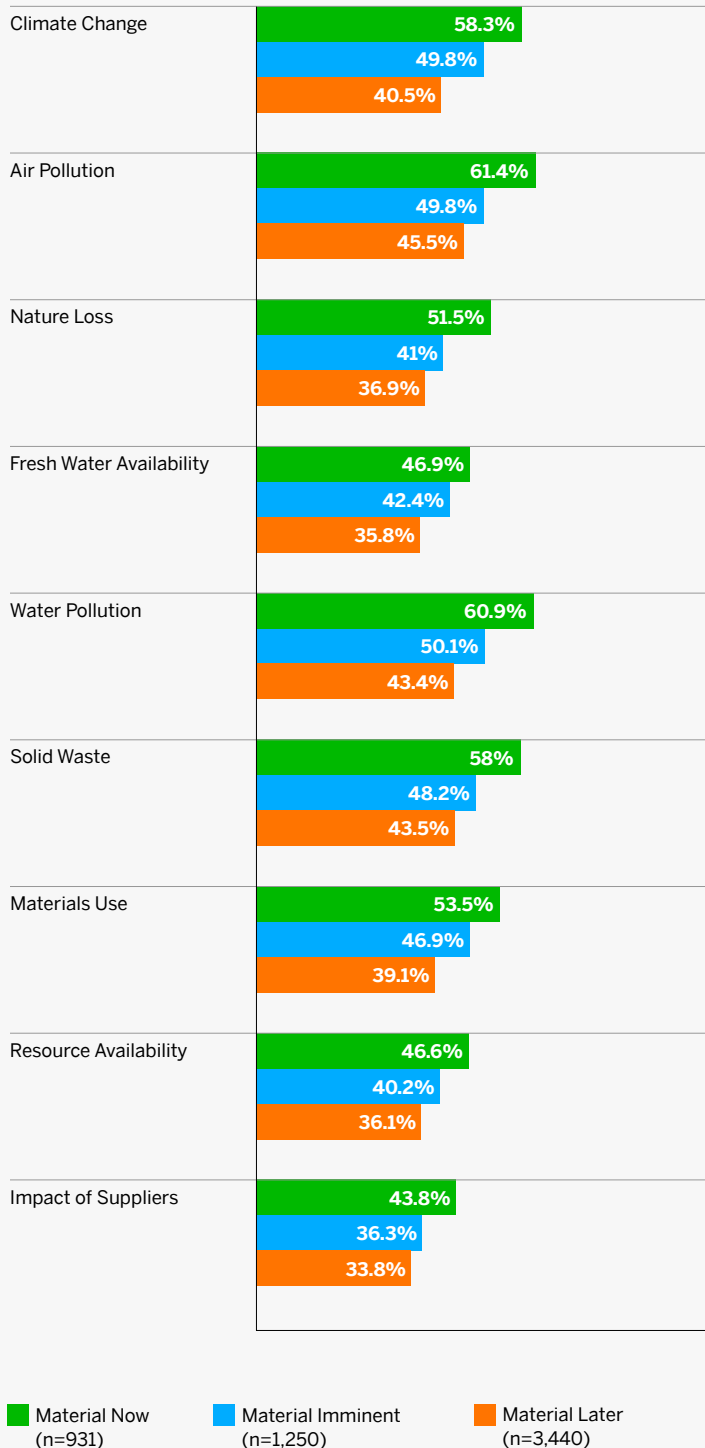
The Now respondents say that their companies are not just driving sustainability from the top: They also make sure that a sustainability mindset permeates the entire enterprise. Compared to the Imminents and Lateres, the Nows say their leaders have assigned accountability for actions that improve the environment to 21% more roles across the organization.

Forty-eight percent of the Nows and Imminents say their companies are aware of environmental actions taken by their business partners and suppliers, compared to just 39% of the Lateres. This is presumably because the Nows and Imminents want their companies' own commitments to that goal to be reflected throughout their supply chains.

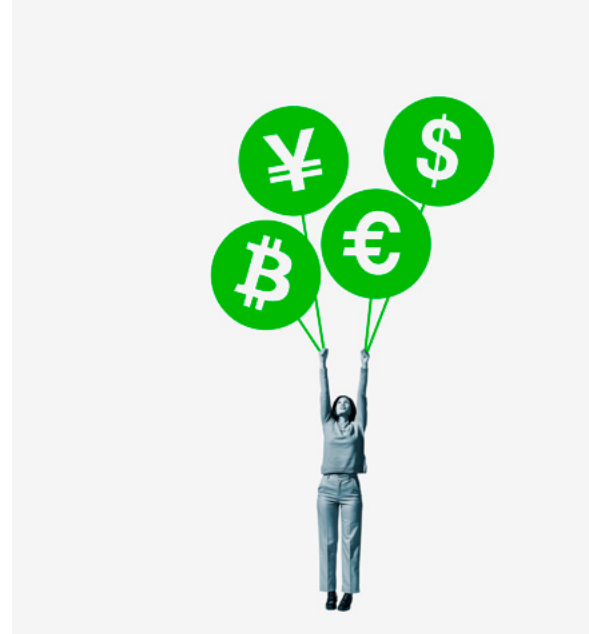
A company's investments are the clearest indicator of its strategies and goals. The Nows are more likely than the Imminents and Lateres to say that their companies are directing investments toward improving the environment, and Nows are more likely to be planning to increase those investments.

Figure 3
The Nows are spending more across the board

Please select your company's investment priority for the following environmental issues. (Percentage represents answers chosen as high priority.)



Source: SAP Insights



Taken together, the most frequently cited top priority investment for all respondents we surveyed is mitigating climate change, cited by 17%.

Interestingly, the next three highest priorities – use of recycled, reclaimed, or renewable materials; reducing solid and hazardous waste through recycling and reuse; and improving resource availability through products designed for reuse, repair, and remanufacture – are key components of the circular economy. That together they are a priority for 40% of respondents suggests a high interest in circular business methods.

However, the Nows say their companies consider every one of these circular-model investments a higher priority than the Imminents and the Laters do. The gap between the percentages of each group prioritizing each category suggests their companies' relative commitment. (See Figure 3.)

In addition, 44% of the Nows say their companies intend to increase spending on sustainability investments over the next three years. The Imminents are close at 41%, but the Laters are far behind, with just 30% saying their companies plan to increase their spending.

Indeed, 19% of the Laters say their companies intend to *decrease* their investment in sustainability or have no plans to invest in it, compared to 13% of the Imminents and just 9% of the Nows.



Data drives sustainability decisions

We think that the Now companies are more likely to prioritize environmental sustainability because their leaders are better systems thinkers. They understand that individual issues such as climate change are not independent but are part of dynamic, complex systems that constantly interact with each other. Systems thinkers know that outcomes are determined by the interconnected elements of the larger system that their companies are part of, and they prioritize long-term value creation over short-term problem solving.

For the Now respondents' companies, the environment is another important piece of an interconnected system. This can be seen in the fact that they've been collecting more data about their business and its environmental impact for a longer period of time. This data gives them the visibility to anticipate better business outcomes, which implies that they recognize the value of sustainability data in driving strategic and operational decisions.

Companies with more data tend to have a more holistic view of their business, which gives them more granular insights into the tradeoffs they can make to deliver better

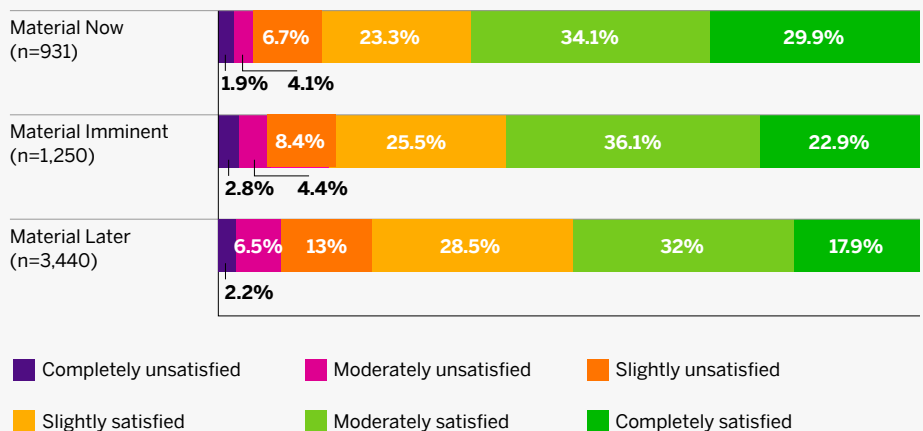
overall outcomes. Data about sustainability is part of this broader picture; the Now companies' wide array of data helps them see the well-being of the planet as not only intertwined with but inherent to the well-being of their businesses.

The consumer products industry offers an example of how a data-supported approach

to sustainability might play out. Many consumer products are packaged the same way, whether they're sold in Stockholm or Shanghai. However, as governments begin to regulate single-use packaging for environmental reasons, a packaging design may generate different costs and benefits depending on where it's used.

Figure 4
Who's not happy with data now?

For each environmental issue area where data is collected, how satisfied are you with the quality of the data?



Source: SAP Insights

With good data, a company can explore the financial effects of creating unique packaging for individual markets to attract more customers, pursue zero waste aspirations, or lower the costs of following local environmental regulations. The company would even be able to predict the most cost-efficient timeframe for developing new packaging rather than letting regulations force the issue.

However, even the most comprehensive data sets aren't perfect. Among all respondents, 79% report being dissatisfied with the quality of the data they collect about environmental sustainability. The pain isn't evenly distributed; the Nows report the least dissatisfaction, followed by the Imminents and the Lateres. (See Figure 4.)

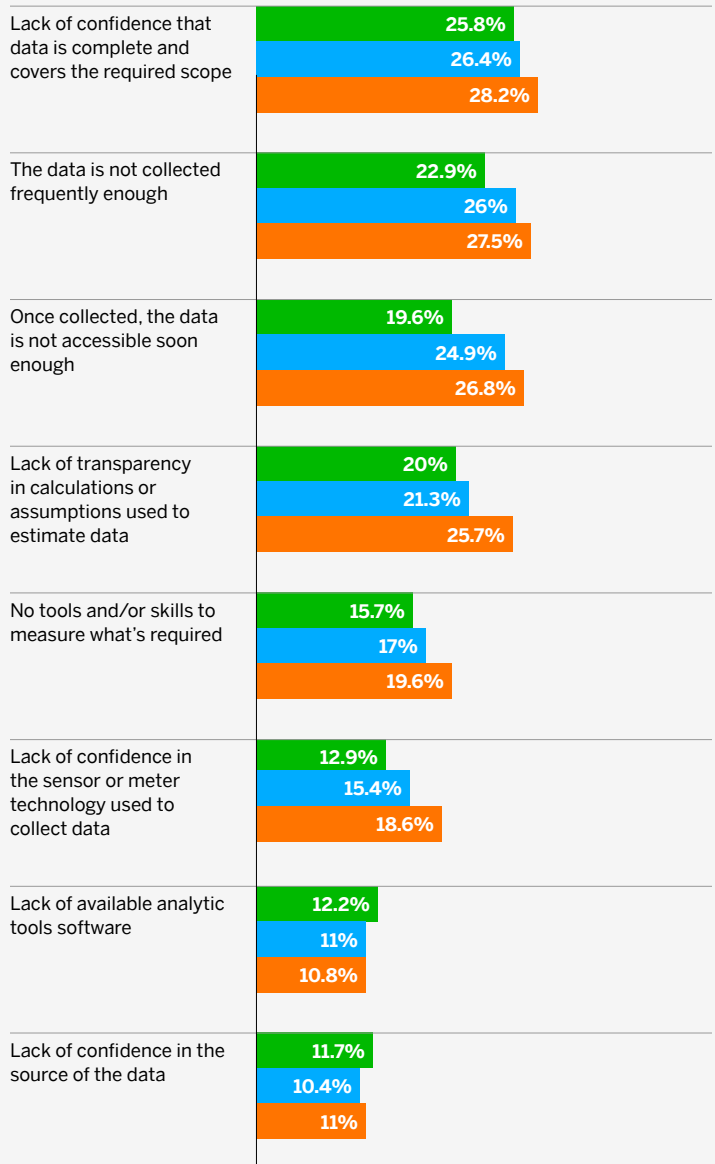
Although all groups share common complaints about data quality, the Now respondents' companies are less likely to experience them. The Nows are also less likely than the Imminents or the Lateres to lack confidence that the data is complete and covers the required scope, to want data to be collected more frequently, to need faster access, and to want more transparency in the calculations or assumptions used to make estimates. Though these barriers are all about data, they are as rooted in business processes as they are in technology. (See Figure 5.)

There are many possible reasons why the Nows say they are more satisfied with data quality around environmental sustainability. One may be that they say they have more data: 44% say they've been collecting relevant data for more than five years, compared to 34% of the Lateres and just 20% of the Imminents. This gives the Nows a larger and deeper database from which to derive insights they trust and can act on to achieve more useful and predictable results.

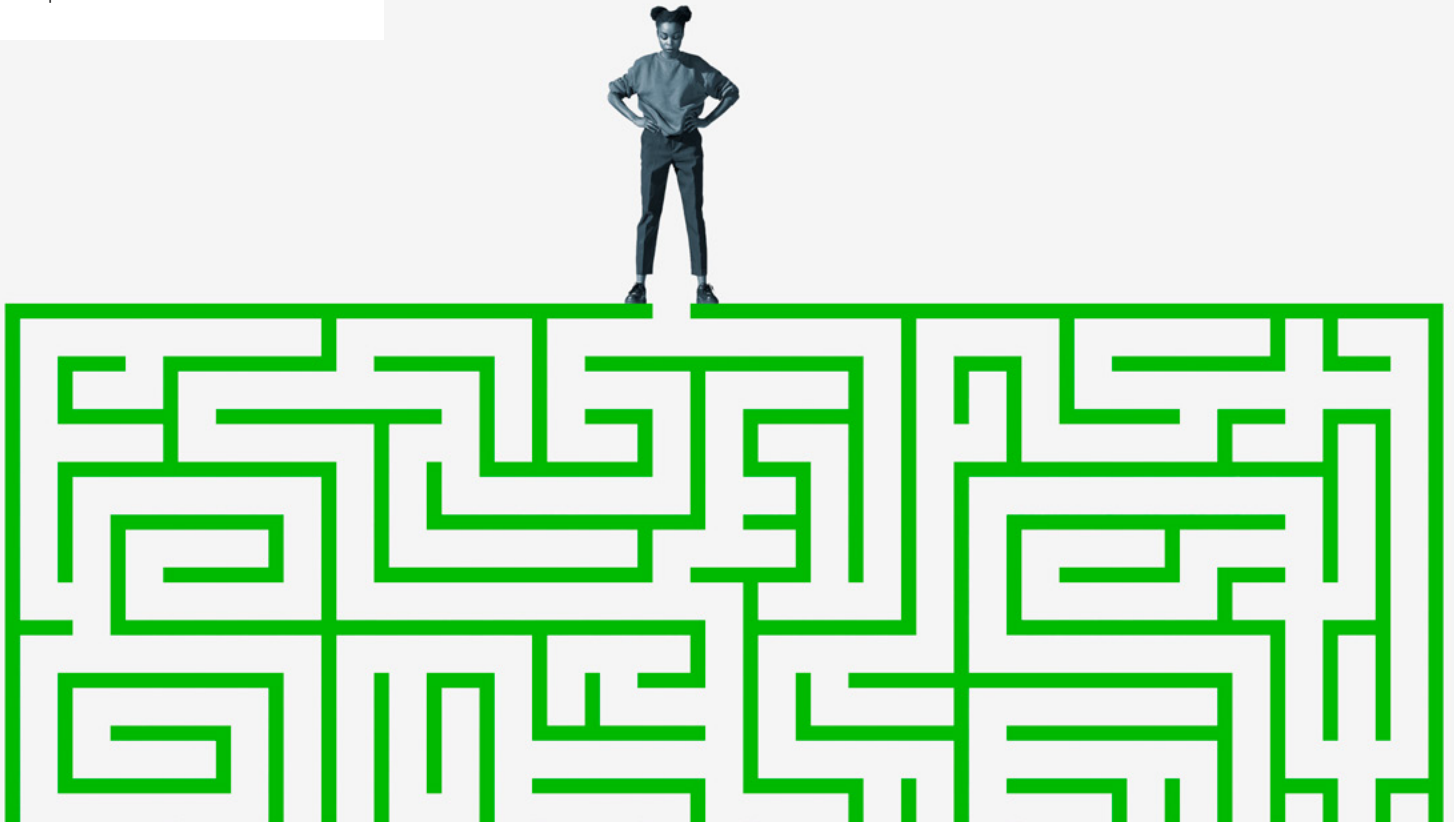
However, given the extent of dissatisfaction with data quality, it's not surprising that *all* respondents say that the most significant barriers to acting on environmental issues are data-dependent uncertainties.

Figure 5
What's spoiling the data party?

For the environmental issue areas whose data quality you're not fully satisfied with, which reasons apply? (Multiple responses allowed.)



Material Now (n=931) Material Imminent (n=1,250) Material Later (n=3,440)



What are the top challenges?

Looking more broadly, the top three overall challenges to acting on environmental sustainability for all respondents are related not just to data but also to operations and strategy. They all say that it's not clear how their companies should embed sustainability into processes and systems. Nor is there clarity about how to align their efforts with business strategy or confirm ROI.

However, the Nows say their companies see fewer barriers to action. In fact, the Nows are far more likely than either the Imminents or the Lateres to say that they have no specific barriers.

The Imminent and Later respondents say that their companies are hampered by an absence of leadership at the top. For example, they're significantly more likely than the Nows to say that environmental sustainability lacks support from senior management, that it's not a business priority, that there's organizational resistance to acting, or that they don't know where to start. (See Figure 6.)

We didn't uncover a definitive reason why the Nows find it easier to overcome the obstacles to acting sustainably. It's possible that because the Nows have more enthusiastic leadership, more widespread accountability, and higher motivation to act, they're less daunted by any individual barriers.

Figure 6
The biggest challenges to sustainability action

What are the main barriers in your company for taking action to improve the planet's environment? (Percentages represent barriers to action.)





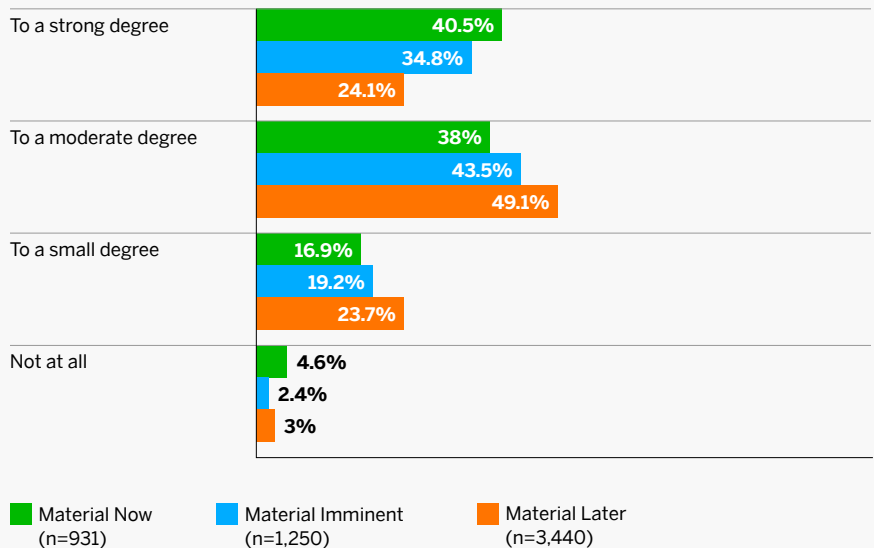
The three things that matter most

In examining what differentiates the Nows from the rest, three things stand out:

- Data matters.** The Nows are more likely than the Imminents or Lateres to apply their environmental sustainability data to a strong degree to their operational and strategic decisions. (See Figure 7.)
- Sustainability is not a drag.** The Nows are also much more likely to believe that taking action to improve the environment will increase their competitiveness as well as increase long-term profit. (See Figure 8.)
- Leaders are leading.** Financial statements alone are not telling the Nows to act – their leaders are. The leadership of the Now companies understand that a healthy environment contributes to the performance of the business and have decided to embrace sustainability for benefit.

Figure 7
Does sustainability guide your strategy?

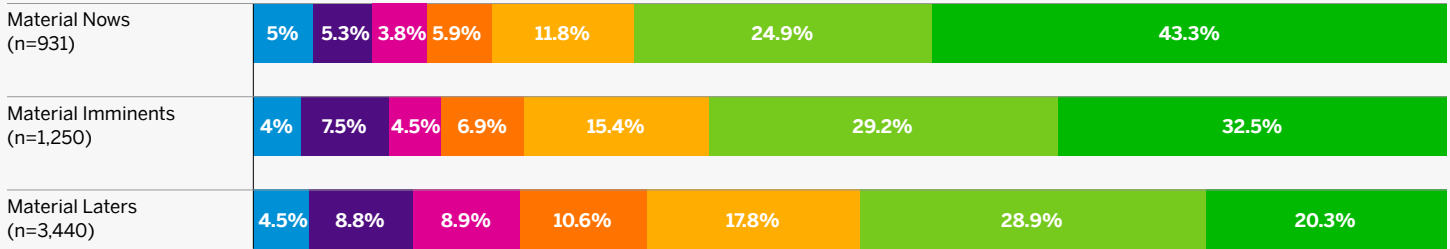
To what extent does your measurement and reporting on environmental issues inform your company's strategic and operational decision-making?



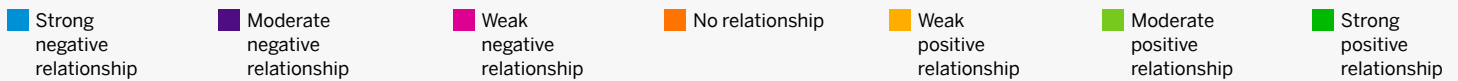
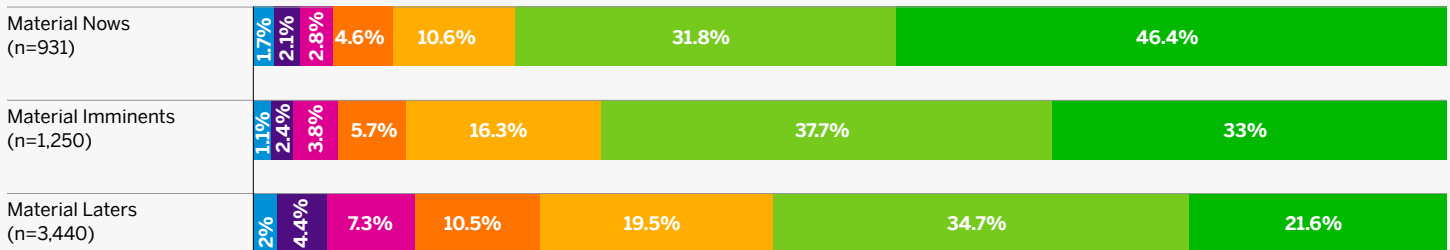
Source: SAP Insights

Figure 8
Sustainability sustains competitiveness and profits

How do you perceive the relationship between your company's long-term competitiveness and environmental sustainability?



How do you perceive the relationship between your company's long-term profitability and environmental sustainability?



Source: SAP Insights

Of course, believing in something isn't enough to make it true. When respondents believe environmental factors already affect their company's performance, or will do so sooner rather than later, they are more likely to use environmental data to inform decision-making. This suggests that the Nows are taking a broader, more long-term view that has led them to address sustainability, even though they may not see immediate results.

Meanwhile, the Laters face a classic dilemma: If they have perfectly good revenue streams from doing things that don't account for the environment, they probably see barriers to change as being too high. For example, shifting from single-use to reusable containers will require massive infrastructure changes for manufacturers and retailers. The handful of innovators in

this area have yet to deliver solutions at the necessary scale.

But in light of inescapable and increasingly urgent research demonstrating the damage wrought by environmental issues such as climate change and resource scarcity, we were frankly surprised that the Laters constitute such a large majority: 61% of respondents. They are saying they don't believe environmental sustainability will be material to their financial results for five years or more.

The data clearly shows that all respondents see sustainability as a major strategic and operational challenge. It may be that the Laters have decided to wait until meaningful carbon taxes, supply chain regulations, and other legal requirements affect their bottom line, which could be years into the future.

But after years in which public interest, political will, and business response weren't unified, we've reached a moment when they are. Companies that once only aspired to make incremental annual cuts to their carbon emissions are now committing to science-based targets and cutting emissions by half, in less than a decade. Many are going much further by putting sustainability at the core of their business strategy. It's a big leap, one that requires believing that sustainability is crucial to future competitiveness.

Though the balance sheet may not always say it yet, sustainability is already material to companies. And viewing it that way won't just help save the planet, it will also improve business performance – sooner than many business leaders think.

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About This Research

The SAP Insights research center conducted this survey to measure the challenges companies face in fighting and reversing environmental degradation and when they believe environmental issues will affect their financial condition or operating performance. The study took place between November 2020 and January 2021, and 7,423 responses (5,621 usable) were collected across 16 industries, 19 countries, and four continents.

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