Managing Headwinds: Focus on Sustainability and Digital

By LIEW NAM SOON

Companies view strategic investments in sustainability and digital as key to overcoming risks to business growth – and boards can help them succeed with clear leadership and oversight.

Riding on the changes triggered or accelerated by the pandemic, many business leaders are now laser-focused on turbocharging their transformation plans. The *EY CEO Outlook Pulse* published in October 2022 found that executives remained resolute in transforming their organisation and reframing their strategic agenda despite the current market disruptions.

The study revealed that CEOs were most concerned with inflation, as well as the continuation or return of pandemic disruptions, viewing these as the greatest risks to business growth. Not far from their minds is the impact of climate change and the pressure to incorporate sustainability elements in their business. See box, "Topmost CEOs' Concerns of Risks to Business Growth ".

How boards work with the executive team to navigate these complex challenges and opportunities even as they continue to evolve is critical. The duality of emphasis by shareholders and stakeholders on both delivering near-term performance and creating long-term value makes the task at hand all the more pressing.

Whatever growth strategy they undertake, business leaders must recognise that they cannot rely on the same assumptions and principles that drove results in the pre-pandemic era. The 760 CEOs surveyed indicated that they would undertake a range of strategic actions, with sustainability and the digital customer experience emerging as two main focus areas.

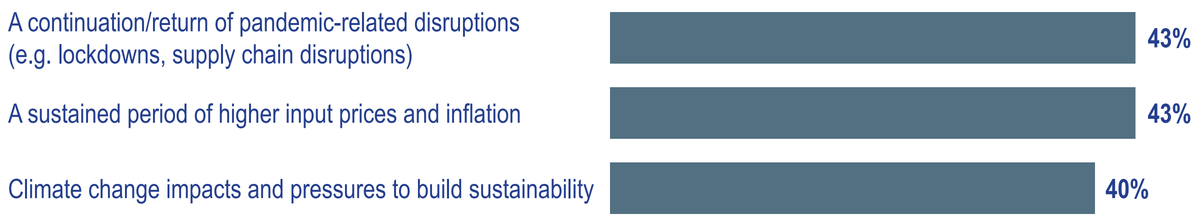
Sustainability: build trust and value

Many companies recognise the impetus for change in addressing the impacts of climate change, not least because consumers and investors are increasingly demanding that companies look beyond generating profits to focus on environmental, social and governance (ESG) factors to drive sustainable businesses.

Increasingly, leading businesses are seeing sustainability becoming part of a value-based narrative, with the focus being how the business can create value for sustainability as well as how sustainability can create long-term value for the business. A long-term view is inseparable from sustainability considerations. However, when it comes to the trade-off between short-term earnings and long-term value creation, a disconnect between investors and companies may exist.

The *2022 EY Global Corporate Reporting and Institutional Investor Survey* indicates that investors are much more likely to favour decisions that lead to sustainable, long-term value creation, even at the expense of short-term earnings shortfalls. However, finance leaders

Topmost CEOs' Concerns of Risks to Business Growth



are much less inclined to make that trade-off. The research found that over three-quarters of investors think companies should make this trade-off, but only around half of the finance leaders are prepared to take this long-term stance.

Investors also felt strongly about not getting the reporting and data-driven insight required to evaluate a company's growth and risk profile, and inform their investment decision-making. If finance leaders do not share investors' appetite for prioritising long-term, sustainable investments, it would be a challenge for a company's disclosures to reflect what investors see as strategic priorities.

These ongoing mismatches in sentiments and expectations with sustainability disclosures could potentially create a trust deficit, which must be of great concern for boards. How can companies provide a clear narrative on the strategy for growing and protecting long-term, sustainable value?

To be clear, the board's responsibility for monitoring and managing material ESG issues is a core principle mandated under the Singapore Exchange sustainability reporting rules. By extension, where climate change is identified as material to the business, disclosures in board statements should include specific actions that the board has taken to consider climate-related risks and opportunities, and how it oversees the management and monitoring of these factors. As such, boards must exercise keener leadership oversight and push for greater transparency on the companies' sustainability actions and disclosures.

Some boards have led the way by advocating for the appointment of a chief sustainability officer (CSO). The CSO's remit is to drive the formulation and execution of an organisation's sustainability strategy and establish its level of sustainability maturity. The CSO also helps to determine the ESG areas to prioritise and subsequently embed into the business strategy. In addition, the CSO is responsible for defining a sustainability action plan and overseeing its operationalisation by every function. For the CSO role to succeed and have a strong voice at the table, the tone at the top from the board is key.

Digital investments: build, buy or partner

The pandemic has accelerated the adoption of digital on multiple fronts, both from a business and consumer standpoint. More than ever, it is vital that companies make use of technology to improve product suites and services as well as manage pricing as a top strategic priority. Business leaders know this well. Customer acquisition, retention and experience will be among the top digital priorities over the next two years.

To achieve this, boards need to work with management to articulate a clear digital vision and roadmap for its digital transformation journey. Crucial actions include selecting the right mix of investment vehicles, measuring return on digital investments, and creating a culture that supports digital transformation.

Companies will need to decide whether to build internal capabilities or use inorganic investments. This affects how quickly they can bring products and services to market and deliver return on digital investments. Inorganic investments offer several advantages, including easier access to capital, as well as a faster pathway to access new technologies to fill capability and skill gaps.

Boards should also challenge the management to consider how the core competencies of the company can be enhanced by utilising ecosystems, and whether to participate in an ecosystem as an orchestrator, partner or enabler. Being part of an ecosystem drives benefits to enterprises in multiple ways. It helps accelerate the digital transformation journey of an organisation and facilitates effective resource-sharing among businesses and industries as they strive to create an integrated experience for consumers. All this opens up new revenue streams for business growth.

To achieve an optimal mix in their investments, companies should break down silos, synchronise the various investment types as well as align build, buy and partner decisions with their corporate objectives. A successful investment strategy requires alignment at the board level so that there is accountability when directing those investments.

Building fit-for-purpose boards

The heightened focus on sustainability and digital raises questions about whether some boards need to rethink their core operating model and whether enough time is dedicated to the sustainability and digital agenda, given the many demands on their time. Diversifying the board composition in terms of skills, experience, outlook and culture is also critical to having the combinative thinking required to rationalise multifaceted business decisions.

Building the board's skills and expertise in sustainability and digital is also critical if they ask the right questions of management. In addition to including these skills as criteria when assessing new candidates for board appointments, other interventions, such as putting in place advisory groups that comprise academics or practitioners who have a particular understanding of environmental or digital transformation issues, can help sharpen boardroom thinking and decision-making.

To enhance oversight of the sustainability and digital agenda, five questions for boards to consider are:

- Is sustainability a regular item on the board's agenda, and are clear management responsibilities assigned to driving and reporting sustainability matters?
- How is the board being apprised of regulatory, economic and societal developments related to sustainability, which could impact operations, risk and stakeholder support?
- How often do the board and management conduct portfolio review to identify growth opportunities and underperformance areas?
- Does the organisation have a clearly defined digital strategy that spells out its current and projected digital spend, technology requirements and a coherent path to execute its digital transformation?
- Does the company have a robust governance model to oversee digital initiatives and measure returns on digital investments? ■

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