Business Case for Sustainability: The Stakeholder Perspective

By Atalay Atasu , INSEAD

If the environment were the new business stakeholder, could we still afford to ignore it?

Business and the environment are becoming increasingly intertwined. Globally, environmental regulations in the European Union, United States, Japan, China and other parts of the world are pressing companies to play a greater role in sustainability. Laws aside, companies are paying attention to the social and environmental impacts of their businesses, as it has become clear that the consequences of ignoring them are far from trivial.

Among the most discussed sustainability issues is the climate crisis. Over a century of burning fossil fuels and unsustainable energy and land use have led to **global warming**, which has caused more frequent extreme weather events at higher intensity. Reports by the **Intergovernmental Panel on Climate Change** have warned of the new burdens on both people and businesses, at least over the next decade, resulting from rising temperatures and extreme weather events.

The question is: To what extent are businesses aware of and prepared for such **disruptions**? Why and how should business leaders capture environmental and social externalities in their business decision-making?

Edging towards environmental limits

To address this question, we use a tragedy of commons exercise in several INSEAD programmes. While such simulations often speak to public policy discourse, they can be designed to illustrate the intricate relationship between business decision-making and the effects on renewable resources – or the environment in general.

We demonstrate through such exercises that as companies see healthy profits from their business, they tend to grow their profits and asset valuation by investing in ways to expand their operations. However, as they continue to do this without taking environmental externalities into account, their profits and valuation soon start to decline with the depleting critical resources.

For over a decade, the results of this classroom exercise have been invariably similar across different groups of participants. Even with a renewable resource that can regenerate, participants pursuing growth in profits and shareholder returns tend to lose sight and eventually completely deplete the natural resource their business is dependent on (See figure 1).

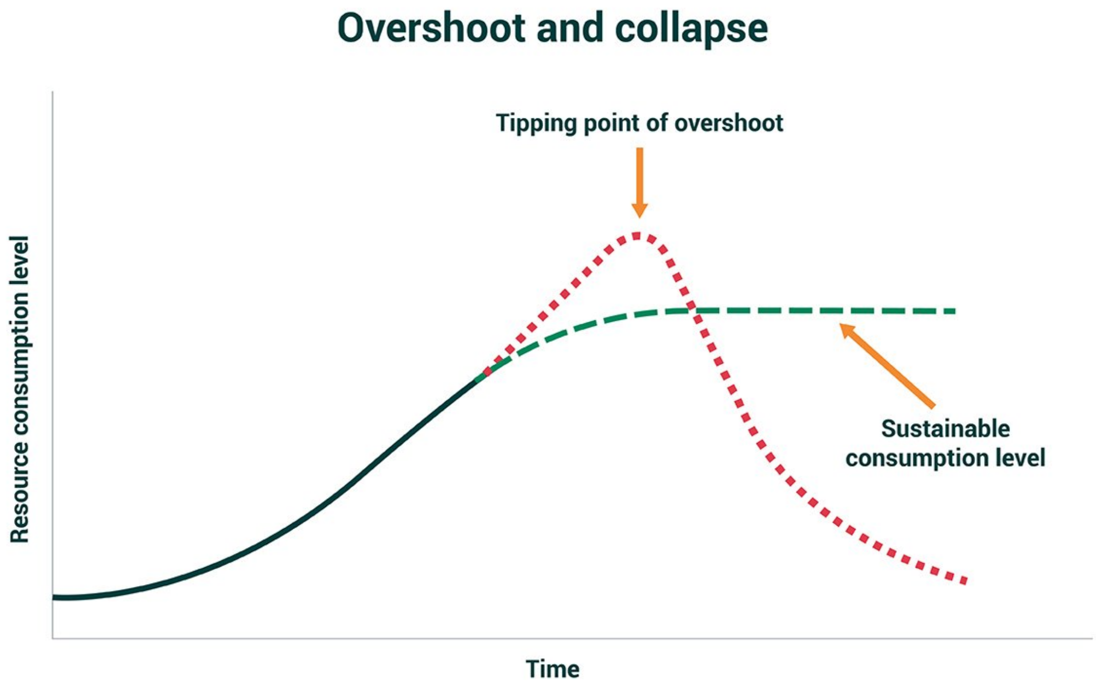

Figure 1: Illustration of overshoot and collapse of a natural resource. Source: John Sterman, MIT

What's interesting about this exercise is that the eventual bankruptcy of all companies in the simulation may not necessarily be driven by collective irresponsibility. All it takes is just one firm's greedy behaviour to drive the critical resource to depletion – and the whole business ecosystem to collapse.

The tragedy of the commons

This exercise allows us to better understand how managers make decisions that impact environmental and social issues. While it seems to be about a specific critical resource (such as biofuels, water or forests), the resource in the simulation is in fact a metaphor for any shared finite natural resource or social externality. The depletion of the critical resource in such a simulation actually represents **climate change**, plastic waste, electronic waste and other forms of pollution, as well as social issues such as **labour abuse** and **irresponsible sourcing**.

What is driving this phenomenon? Is it the short-sightedness of the participants? Or is it simply managerial reflexes at play?

The unsustainable behaviour, in my view, is mostly driven by a combination of managerial reflexes based on traditional metrics such as profitability and asset valuation. It shows the dire consequences of the failure to incorporate the real cost of externalities into managers' KPIs.

Internalising sustainability as a business driver

Today, due to the increasing availability of science-based reports, growing influence of the media and the speed and scale at which information can be shared via social media, the environmental and social issues arising from business are increasingly visible. As the links between these issues and business practices become more apparent, stakeholders including regulators, consumers and investors are increasingly demanding businesses to **take action**.

In other words, sustainability has become a business fundamental. Therefore, internalising sustainability is not only unavoidable, but can lead to competitive advantage when companies take a proactive stance.

According to the **Triple Bottom Line** approach, companies need to look beyond the economic value they bring to the table to also consider the environmental and social value that they add – or destroy. This means that they must find or build a more holistic purpose in their DNA and drive their employees to share that purpose.

However, sustainability concerns must be internalised by businesses and their employees, even though it can be challenging to find the right incentives to make this happen. Leaders in INSEAD classrooms often suggest that a new framework is needed to think about how the sustainability paradigm is disrupting business. Such a framework could help organisations cope with disruptions and even leverage them for competitive opportunities.

How to get there

The sustainable business paradigm needs a stakeholder view. Businesses are used to listening and responding to the needs of stakeholders, be it customers, investors or employees. They need to recognise that nature and natural resources are the new business stakeholders, or drivers of their business. To this end, the "Stakeholder Disruption Framework" (see figure 2) is a viable way to take into account externalities such as the climate and nature.

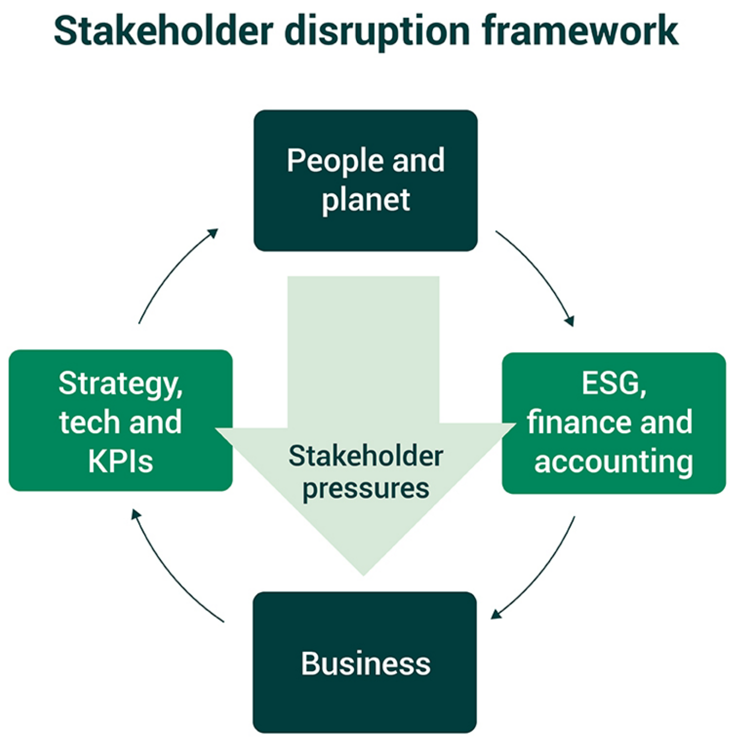

Figure 2: Stakeholder disruption framework
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The question is: How can businesses transform to cope with and respond to the demands of these stakeholders? First, they need credible top-down stimulus to start the ball rolling. Second, it helps if managers have direct exposure to sustainability-related risks. Third, to ensure that sustainability is effectively internalised, leaders need to devise and implement sustainability-focused performance metrics. The right metrics will influence decision-making and encourage managers to explore new value-added sustainability initiatives. Finally, managers need to review the team's capabilities to take on strategic sustainability initiatives and plug the gap where needed.

The good news is that businesses are not alone in this journey. Along with the increase in visibility of environmental and social issues tied to business is a corresponding increase in resources to set businesses on the right path. In addition to complying with existing legislations, such as the EU's **Corporate**

Sustainability Reporting Directive, companies can reference reports by organisations such as the **Task Force on Climate-Related Financial Disclosures** for best practices and recommendations.

Find article at
https://knowledge.insead.edu/responsibility/business-case-sustainability-stakeholder-perspective

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About the author(s)

Atalay Atasu is a Professor of Technology and Operations Management, the Bianca and James Pitt Chair in Environmental Sustainability and the academic director of the Sustainable Business Initiative at INSEAD. His research focus is on socially and environmentally responsible operations management, including the circular economy, extended producer responsibility and environmental regulation.

About the series

Sustainable Business

The **INSEAD Sustainable Business Initiative** (SBI) was founded to develop novel solutions for business challenges at the interface between social and environmental responsibility. INSEAD faculty in SBI actively collaborate with academic institutions and businesses, as well as support organisational sustainability transformation.

Besides research and teaching, SBI also develop frameworks and tools to help business leaders integrate sustainability into core business functions and innovate business models to create value for companies and society. SBI aspires to be a collaborative platform for sustainability- and circularity-focused organisations to share best practices and ideas, and form partnerships.