How Companies Can Leverage Lean to Achieve Their ESG Targets

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NO BUSINESS OR ORGANIZATION EXISTS IN A VACUUM, BUT INSTEAD EACH ONE OPERATES IN A COMPLEX PHYSICAL, SOCIAL, AND GOVERNMENTAL ENVIRONMENT IN WHICH EVERYTHING THEY DO CAN HAVE BOTH POSITIVE AND NEGATIVE IMPACTS. THE PROCESS KNOWN AS ESG, WHICH STANDS FOR ENVIRONMENT, SOCIAL, AND GOVERNANCE, IS A TEMPLATED APPROACH TO EVALUATING BUSINESS OPERATIONS ACCORDING TO THOSE THREE CRITERIA, LOOKING AT SUCCESS NOT JUST AS PROFIT AND SHAREHOLDER RETURN BUT IN HOW THE ORGANIZATION IS FUNCTIONING WITHIN THE WIDER ENVIRONMENTAL, SOCIAL, ETHICAL, AND REGULATORY ECOSYSTEM.

In order for companies to be resilient, successful, and sustainable, ESG frameworks must be built into their business models to ensure that they're achieving environmental goals and having a positive impact on their employees and communities, while following solid, ethical business principles and practices. In particular, methods of measurement, risk management metrics, standards, and monitoring systems must be available to document, evaluate, and oversee all projects.

Many leaders and managers mistakenly see ESG as a detour or distraction from the company's primary strategy, as well as a drain on resources. In fact, it's just the opposite. Making ESG a central part of a company's business strategy can help reduce costs, unleash new growth opportunities, overtake the competition, and set the organization up for exponential growth.

For all these reasons, ESG is a hot topic these days, one that leaders and managers are taking more and more seriously into account in their high-level decision-making and management strategy. According to a survey of Middle Eastern CEOs conducted in 2021 by consultancy firm PwC, 46 percent of respondents indicated that they plan to increase investments in ESG and sustainability initiatives over the next three years.

What is ESG and why do organizations need to understand it?

To understand what ESG is and how it works, we have to break it down into its three components.

Environment: These are the issues companies must consider in trying to be as green as possible. Primary examples include:

- Energy usage
- Water usage
- Carbon emission
- Natural resource usage
- Air pollution production
- Waste output
- Environmental policies

Social: These are issues related to a company's relationships with employees, customers, communities, and institutions. Primary examples include:

- Comparative living wages
- Health and safety
- Labor relations
- Diversity and inclusion
- Gender pay-gap
- Reskilling/training
- Corporate giving
- Employee morale and engagement
- Human rights

Governance: These are issues related to leadership and internal high-level operations as considered from the point of view of ethics, laws, and wider political involvement. Some primary examples:

- Executive pay
- Taxes paid
- Ethics and anti-corruption policies
- Quality of leadership

Where it gets even more complicated is that these factors interact and influence each other in complex ways. So, for example, implementing changes in the area of employee health and safety could impact resource management, and introducing new waste management systems might require employee training and skill-building.

Today’s challenges in ESG

There’s no question that creating a road map for ESG can be daunting given the enormous range of potential ESG issues organizations must take into consideration. In addition, companies operating internationally also face the challenge of different standards and competing frameworks for ESG reporting.

In its most recent report, the Intergovernmental Panel on Climate Change (IPCC) projects that limiting global warming to 1.5°C by 2100 will require major reductions in global greenhouse gas emissions starting now and will require reaching net-zero by 2050. That’s just one of seventeen Sustainable Development Goals (SDGs) set by the panel to bring about the scope of change necessary.

The good news is that achieving the SDGs could bring new economic opportunities, according to a report by the Business & Sustainable Development Commission (BSDC). Not only do the SDGs benefit planetary and human health, achieving them could generate up to 380 million jobs and provide economic gains worth at least US $12 trillion a year by 2030.

“The climate and other ESG goals set by successful companies today are ambitious and achieving them is going to require collaboration across governments, businesses, and communities,” says James Ryan, Senior Advisor at Four Principles. “Lean management provides a strategic and systemic framework for achieving this scope of organizational transformation, and Four Principles can help companies integrate Lean and ESG to succeed in this challenging environment.”

How Lean can aid ESG reporting and help achieve ESG targets

Companies and organizations that employ a Lean management style, utilizing a system of principles and practices designed to identify and weed out waste, streamline operations, and optimize efficiency, enjoy an enormous advantage in the ESG landscape. In particular, the use of multidisciplinary cross-functional teams is key here, since effective ESG planning requires pulling from different areas of knowledge and expertise.

“Companies looking to improve their ESG processes can benefit from Lean digital management, which is the most effective operational strategy for business transformation,” says Seif Shieshakly, Co-Founder and Managing Partner of Four Principles.

The Lean approach of analyzing a Value Stream, or an entire end-to-end process, is a particularly effective strategy for companies looking to beef up their ESG goalsetting, tracking, and reporting.

Value Stream mapping enables companies to diagram every step involved in the flow of material, information, and production, from concept to delivery, creating a model of the entire integrated system.

Digitization and advanced analytics are playing an increasingly important role in Lean management, helping companies predict, track and monitor production and identify issues and reduce revenue loss from both technical and nontechnical sources of waste. These real-time data sets provide insights that companies can use to improve decision-making, comply with changing laws and regulations, improve customer engagement, and adapt to dynamic economic and social pressures.

Next-generation data management technologies provide interactive views of energy, materials, time, and personnel inputs and outputs and give proactive alerts and suggestions for improvement. Companies can use the measurements and insights from these new tools to iterate rapidly and implement performance improvements.

Lean digital systems can also enable the production of valuable reports that can be used to document compliance with regulations and usage requirements and back up ESG assertions under scrutiny.

Case Studies: Global Brands use Lean to achieve ESG targets

Take the example of DP World, a multinational logistics provider headquartered in Dubai that has become a world leader in using ESG reporting to document and demonstrate sustainability efforts and impacts. In 2019, DP World signed a so-called “green loan” linking the loan margin to the company’s carbon emissions output. The innovative financing structure, which used financial incentives to motivate a reduction in greenhouse gas emissions, involved the participation of 19 financial institutions, guaranteeing the step would have an extensive impact.

By linking DP World’s financial health to its environmental performance, the company gained a strong motivator to increase its progress on a number of sustainability goals, including reducing carbon emissions and energy use, increasing reliance on renewable energy, improving its natural resource conservation, and reducing waste. In addition, the company is taking steps to have a greater positive social impact by improving safety and employee well-being, promoting gender equality, and supporting local communities.

In a particularly innovative effort to support these goals, DP World created a Sustainable Development Financing Framework that enables it to issue green, social, or sustainability bonds –*sukuks* – the proceeds from which will be used to pay for sustainability and social improvement projects. Examples might be investments in land and ocean conservation, renewable energy, and economic development projects benefiting women.

While DP World's sustainability efforts have gained the company international attention, less attention has been focused on the fact that the company's Lean management strategy and forward-looking digital transformation have been a huge factor powering its sustainability success. Facilitated by a Lean operations style, DP World was an early adopter of IoT, automation, robotics, AI, cloud computing, and other digital tools and technologies, making it a leader in digital transformation in the Middle East. The company credits its Lean/agile management style for its ability to continually introduce new advanced technologies and operational innovations.

Mars Wrigley, a long-term Four Principles client, which merged to form one mega-brand in 2017, is another example of a global organization that is baking sustainability into their strategy and operations by connecting financial and social performance.

Like many companies in the food and beverage industry, Mars Wrigley's approach to ESG is complicated by the fact that supplier operations account for 50 percent or more of the company's financial costs. This is because like many other global brands in the food and beverage industry, Mars Wrigley sources agricultural commodities from farmers all over the world. The company, which has operations on every continent, also operates both directly and through subsidiaries and must manage those complicated relationships. In the Middle East, where the company's Galaxy Kenz chocolate line has experienced tremendous growth, the company recently purchased its Dubai subsidiary.

What this means in practice is that the links between revenues and profits and the social and environmental impacts of Mars Wrigley's operations are complicated, indirect, and not easily seen or documented. Most of those supplying the confectionary and food giant are small farmers, from sugar suppliers in South America to cacao suppliers in Africa and Indonesia, and Asia. And while ingredients from these sources cost less than those obtained from large-scale commercial growers in developed countries, they may use older and less well-regulated agricultural practices that lead to social and environmental issues. Deforestation, water overuse, child labor, and pesticide contamination are all issues that can result from supplier practices yet affect the global brand's bottom line - and its ESG reporting.

The solution? Mars Wrigley began tracking the carbon footprint and water intensity of the crops it purchases across the globe, along with farmer revenue, and setting baseline ESG performance measures for climate, water, land, gender-specific income, and human rights across each of its commodities. Even more challenging, the ESG footprint for each commodity is different. Deforestation and farmer poverty are the most important ESG factors for cocoa growers, while land and water use are the big issues for dairy farmers. There are even variations within one commodity, such as sugar; sugar beet farmers contend with water use issues, while sugarcane plantations raise issues of poverty and human rights.

Mars Wrigley could have overlooked these supplier environmental, social and governance issues in an effort to maximize profit, or it could have switched to sourcing higher-priced commodities from large-scale commercial farmers to boost ESG performance but cut into revenues. And moving away from smallholder farmers would leave them in greater poverty.

Instead, using big data, sophisticated input and output tracking, and other Lean digital technologies, Mars Wrigley has integrated ESG factors into its procurement process, enabling the company to maintain a cost advantage while investing in help and support for small farmers, communities, and supply chain partners willing to change their practices. The result is a win-win: A reduction in poverty and harm to the environment without a significant hit to the company's bottom line.

Companies seeking to follow the model of DP World and Mars Wrigley and become leaders in ESG reporting can benefit from working with a Lean consultant who can perform a strategic analysis of company operations and identify areas of waste and overuse. For example, Four Principles might work with your company to analyze and map energy use and compare the energy consumption of alternative manufacturing and engineering methods to identify areas of waste where energy usage could be reduced.

"We can help organizations to set or rethink ESG goals and then implement systems to identify and eliminate the barriers and gaps getting in the way of those goals," says Mehdi Chelhi, Partner at Four Principles.

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