

Pursuing Profit and Sustainability



in the Age of Climate Change

Building dual-agenda innovation capabilities is the way to go.

by Tracy Xie

At the end of the Copenhagen Climate Ministerial in March 2023, Dr Sultan Al Jaber, President-Designate of the 28th Conference of the Parties to the United Nations Framework Convention on Climate Change (or COP28), said, “The international community must unite in promoting bold, ambitious, and practical solutions while prioritising inclusivity, enhanced accountability, and transparency. All stakeholders, particularly big industries, must go further and faster to get the world back on track.”¹

The clear and open call to the world’s business heavyweights reflects the current zeitgeist appealing to corporates to help repair the overextended natural environment that has served as the source of industrial and economic growth for over a century. Investors now expect companies to build sustainability into their corporate strategies, and companies have responded to this pressure to address environmental issues.

The question is, can organisations pursue and attain environmental and economic (E2) goals simultaneously? I believe this can be done via dual-agenda innovation, which requires adopting a new idea or process to deliver a new product, process, or business model with a clear, pre-defined objective to achieve both goals simultaneously. This, in turn, requires organisational capabilities in digital transformation, cross-boundary collaboration, and stakeholder management.² The critical challenge is *how* to implement these concepts in practice, and this article uses an example from the real estate sector—specifically CapitaLand, a Singapore-based global real estate firm focusing on investment management and development with operations in over 40 countries—to illustrate how these capabilities play out in reality. It offers a pathway for companies to achieve superior E2 performance and build sustainable competitive advantages.

This article will first discuss the increasingly pressing nature of sustainability practices in companies driven by the expectations of the general public and the progressively exacting sustainability reporting standards. It underscores the challenges that companies face in pursuing E2 goals, and how dual-agenda innovation can help address both goals simultaneously. It then dives into the four core capabilities that underpin dual-agenda innovation.

THE GROWING IMPORTANCE OF CORPORATE SUSTAINABILITY EFFORTS

The clarion call has been ringing for a while: sustainability is no longer optional; it is an imperative. Investors believe sustainability leads to stronger returns,³ with some studies showing that it is so.⁴ Research has also found that environmental, social, and governance (ESG) factors have become recognised drivers of returns, especially among institutional investors.⁵

And from 2024, some 50,000 companies will be subjected to mandatory sustainability reporting under the EU's Corporate Sustainability Reporting Directive or CSRD, with reports to be published the following year.⁶ Throw in the International Sustainability Standards Board's (ISSB) publication of its first two Sustainability Disclosure Standards in June 2023,⁷ and the US Securities and Exchange Commission's proposal to "include certain climate-related information in its registration statements and periodic reports",⁸ and it is apparent that big companies must build sustainability reporting into their financial statements regardless of how they feel about it.

However, businesses struggle to balance their environmental and social obligations with achieving business growth, especially with cost concerns and capability gaps. For instance, the building and construction sector contributed nearly 40 percent of process-related carbon dioxide (CO₂) emissions in 2018, and companies have neither been meeting their sustainability goals in cutting emissions during the construction of the buildings nor have they been making themselves more energy-efficient.⁹ Coupled with population growth and the extreme weather brought about by climate change, it is likely that the energy consumed in buildings will continue to grow, bringing with it a direct impact on the many people living and working in these buildings.

REGULATING SUSTAINABILITY

According to the International Energy Agency (IEA) around half of the CO₂ emissions reductions by 2050 require technologies that are not yet commercially available.¹⁰ In fact, as the world attempts to build back post-COVID-19, less than one percent of that recovery spending is going into green research and development (R&D). That is even though such R&D positively addresses environmental issues in multiple sectors.

This is where governments and regulations can make a difference. In July 2023, Singapore's Accounting and Corporate Regulatory Authority and Singapore Exchange Regulation proposed mandatory requirements for public and private companies in the country to provide climate-related disclosures that are aligned with ISSB's newly-issued Sustainability Disclosure Standards.^{11,12} This is a step up from the current requirement where only listed companies in select sectors (e.g., finance and agriculture) are required to provide Task Force on Climate-Related Financial Disclosures (TCFD)-aligned climate reporting, while others apply TCFD on a 'comply-or-explain' basis.¹³

All these pressures require organisations to develop novel, transformative, and even potentially disruptive ways to address conflicts during E2 innovation. Specifically, solutions must be devised to resolve short-term versus long-term goal conflicts, resource constraints, and the functional/design dilemma.

DUAL-AGENDA INNOVATION: DIFFICULT BUT POSSIBLE

It is possible to achieve environmental goals without sacrificing economic ones, and vice versa. Some researchers observe a positive correlation between the two goals if companies pay proper attention to stakeholder management,¹⁴ while other studies have explored the driving factors behind the relationship

between economic and environmental performance, as well as the mediating and moderating effects.¹⁵ Researchers have found that innovation contributes to the apparent holy grail: simultaneous uptick in both economic and environmental performance via cost optimisation, and increased revenues linked to improved environmental metrics.¹⁶

From the resource-based view, innovation refers to a process and a set of distinctive capabilities that help companies create competitive advantages through superior products and services. There are many ways to slice and dice innovation: product/service innovation; process innovation; business model innovation; organisational innovation; as well as radical, breakthrough, or incremental innovation.

What about environmental innovation? Also known as 'green innovation'¹⁷, or 'eco-innovation' according to the United Nations Environment Programme or UNEP, it is "a new business approach which promotes sustainability throughout the entire life cycle of a product, while also boosting a company's performance and competitiveness".¹⁸ The expected benefits of such innovation include lower greenhouse gas (GHG) emissions, more efficient energy use, and waste management that reflects the 'reduce, reuse, and recycle' principle. As a corollary, it may also produce cost efficiency that improves short-term bottom-line performance, although evidence has been mixed.¹⁹

Hence dual-agenda innovation in this context represents the adoption of a new idea or process to deliver a new product, process, or business model with a clear, pre-defined objective to achieve E2 goals simultaneously. What is unique about dual-agenda innovation is that it has a specific, desired intention to achieve E2 performance concurrently. The dual-goal was imbedded in the process from the beginning as a guide to decide what to innovate and how to innovate, and serves as the success measure of the outcome of innovation.

Dual-agenda innovation has several challenges. Short- and long-term goals are sometimes contradictory, with significant upfront investment needed for environmental improvement. For example, heavyweights in the notoriously emissions-heavy fashion industry such as Lululemon and H&M are putting money into a US\$250-million fund to cut these emissions.²⁰ The expected benefits will come later, requiring patience and a commitment to absorb the initial outlay.

Meanwhile, these companies must generate enough revenue to cover their costs, or deal with a temporary rise in expenses that they would rather do without. Tesla, whose environmental performance (long-term goal) is clear to all, struggled for years to turn in a profit while waiting for consumers to embrace its

products. Tesla executives had to manage the balance sheet and cashflow (short-term goals) while waiting for the macro environment to mature in their favour. Even as recently as 2023, Tesla has had to aggressively cut prices to drive up its revenues, albeit in light of rising sales.²¹

The resource constraints described above can cause companies to deprioritise the environmental agenda. Sometimes companies face a design or functional dilemma regarding issues of implementation, such as technological limits or a reluctance to use disruptive and/or emerging technology even when it may be more profitable. Change management would be required to address these issues.

BUILDING FOUR CORE CAPABILITIES TO ACHIEVE E2 GOALS

Dual-agenda capabilities are anchored upon a company's ability to explore and exploit opportunities. By 'explore', it means the company is able to attain and understand the information promptly, as well as assimilate the information acquired into the firm's routines and processes to analyse, interpret and understand it. By 'exploit', the company can reassemble the internal and external knowledge, build new connections among the various bits of information obtained, and apply the knowledge to generate solutions.

Firms are more likely to achieve superior E2 performance by engaging in innovation that integrates its environmental goals with economic ones, and making deliberate decisions along the innovation process to achieve both goals. Be it a new product, process, or business model, dual-agenda innovation can be achieved by building on four core capabilities: value identification and quantification; stakeholder management; cross-boundary collaboration; and embarking on digital transformation.

This article will discuss the four capabilities using CapitaLand (refer to box story) as an illustration. The urgency and the critical need to improve sustainability are particularly salient for the real estate sector it comes under: buildings take up 12 percent of the world's drinkable water and produce 40 percent of the planet's CO₂ emissions.²²

1. Value identification and quantification

To lay the foundations for the pursuit of dual-agenda innovation, businesses must identify and translate the positive effects of environmental initiatives into understandable baseline benefits. This could come in many forms, ranging from quantifiable boosts in revenue and cost savings, to improved brand reputation and customer experience.



In the case of CapitaLand, it involves integrating sustainability into the Group's real estate life cycle from the earliest stage of the investment process: design, procurement, construction, operations, and redevelopment or divestment. Sustainability targets are built into policies and processes, as well as how business operations are assessed. Best practices are encouraged, and progress is monitored and reported to ensure transparency on sustainability efforts. All performance metrics, including its global sustainability reports, are validated by external assurance agencies, and aligned to international standards.

2. Stakeholder management

Clear communication of identified value from ESG initiatives to all involved stakeholders will go a long way in enabling companies to pursue dual-agenda innovation. When the value of imbuing sustainability into the company's ethos is made clear to senior management staff, it would be easier to enact top-down change for these initiatives through all levels in the organisation. Obtaining and allocating resources to justify the company's involvement in going green would also be met with less contention, as key decision-makers are able to understand the rationale behind these proposals.

Besides internal stakeholders, effective engagement with external stakeholders is also critical to achieving E2 results. Research shows that companies that are able to identify and communicate with different stakeholders are also the winners through E2 innovation. However, poor (or worse still, misleading) communication could lead to allegations of greenwashing, and create obstacles. For example, McDonald's

supposedly eco-friendly paper straws turned out to be non-recyclable,²³ while Volkswagen infamously cheated on emissions tests while touting its vehicles' eco-friendly features.²⁴ Companies that cause such self-inflicted damage may have to devote even more resources to restore their brand image, which could have been avoided with proper stakeholder management policies in the first place.

CapitaLand has laid out its commitment to better engage its various stakeholder groups (including employees, customers, suppliers, investors, etc.) in its sustainability masterplan, so that it can achieve its 2030 targets. Sponsored at the board level, sustainability was established as part of CapitaLand's long-term strategy, and this has been communicated via different channels from the Group CEO to function and business unit heads. The leadership has been actively advocating the concept across different forums, inviting like-minded partners to join its mission.

3. Cross-boundary collaboration

Given the complexity and challenges of pursuing E2 goals simultaneously, no single company possesses all the resources required to be successful. Generally defined as one's ability to work with separate teams that individually bring unique perspectives and resources to the drawing board for innovation, cross-boundary collaboration helps address this challenge, allowing for a better exchange of fresh ideas, and possibly even resulting in open innovation networks being formed as companies band together to share their knowledge about going green for the greater good.

Cross-boundary collaboration can manifest in various forms. For instance, other than inter-departmental cooperation between the engineering and product management teams, collaboration can occur among companies in the same industry and/or across other industries to fulfil E2 goals. Research shows that E2 winners demonstrate the highest cross-boundary collaboration capability compared with that of their peers.²⁵

Within the building sector, sustainability innovation and collaboration can be strengthened by working with like-minded partners to create shared values, and sourcing globally for new ideas and technologies to meet sustainability ambitions. To that end, CapitaLand launched the CapitaLand Sustainability X Challenge (or CSXC) in 2021, the first sustainability-focused innovation challenge by a Singapore real estate company to be held on a global scale.²⁶ As an open innovation initiative that sourced ideas globally in certain domains, but with no problem statements, CSXC offers individuals and companies opportunities to test-bed and

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operationalise their sustainability innovations in CapitaLand's properties worldwide. Furthermore, at least half of the newly-established S\$50-million CapitaLand Innovation Fund is earmarked for sustainability projects.²⁷ With funding of up to S\$500,000 per project, this fund serves as 'internal innovation' resources for staff to solve day-to-day problems through innovation. As for 'external innovation', CapitaLand has also set up the Smart Urban Co-Innovation Lab with the Singapore government's support to work on industry-wide challenges.²⁸

4. Embarking on digital transformation

Businesses should embrace digital transformation in their sustainability blueprints. With digitalisation in the form of data collection, storage, and analytics, companies will have an easier time quantifying the possible economic benefits they can reap by working on their ESG goals, and also using data to predict future dividends or revenue streams.

Digital transformation also lends credibility to the environmental cause, as stakeholders are likely to be more easily convinced when proper data is available to back sustainability initiatives, as opposed to having only theoretical deductions for decision-making. Other than supporting ESG measurement and reporting, my research found that digital transformation has an amplifier effect on the other three capabilities' contribution to E2 performance. Not only can it help solve the functional/design dilemma in pursuing environmental benefits, it can also make other activities more

effective if deployed properly, making it the most important capability for achieving E2 performance.

Companies in the building and construction sector could leverage sustainability trends and data analytics to track critical progress in energy, water, waste, and carbon emissions. For example, CapitaLand has implemented a cloud-based platform enabled by the Internet of Things (IoT) technology to centrally monitor key equipment, such as chiller plants, and conduct early fault detection and rectification.²⁹ Such data analytics-based insights help optimise equipment performance. In fact, these measurements, along with social indicators, are key to driving performance improvement across its properties.

To be clear, for digital transformation to succeed, there must be a focus on people and organisation-based capability-building. Skills training is essential to ensure a smooth transition to net zero and could help firms to mitigate the impact of increased commodity prices by improving production efficiency. In addition, vocational training and re-skilling are needed to allow workers to efficiently navigate the structural adjustment of the economy that high energy and commodity prices may bring.³⁰ However, green skills training accounts for very little in recovery plans, comprising no more than one percent of such budgets.³¹ CapitaLand's sustainability initiatives have meanwhile contributed significantly to its financial performance, such as a 10 to 20-percent cut in operations cost from energy and water usage, and lower interest rates from sustainable finance.³²



CONCLUSION

Sustainability, particularly the environmental agenda, has become a new mandate for companies. By building greater capabilities, the E2 performance of the firm can be improved. It is worth noting that the four capabilities listed vary in their level of importance towards contributing to successful dual-agenda innovation. Digital transformation is the most important as a standalone organisational capability and an amplifier of other capabilities, followed by cross-boundary collaboration, stakeholder management, and value identification and quantification capability. If companies are truly keen to reshape their identity and associate themselves with dual-agenda innovation, building on any single one of these approaches is insufficient.

Companies can start by assessing their current capabilities compared to those of their peers and identify focus areas

for improvement. For complex problems of this scale to be resolved efficiently and effectively, they require an integrated strategy involving varying combinations of these core capabilities. By leveraging a multi-pronged, synergistic approach, companies can then achieve their economic targets while upholding their ESG commitments.

Finally, strong and consistent leadership plays a critical role in engendering dual-agenda innovation both at the corporate and national levels. As governments start mandating reporting and set clear goals for sustainability, corporate leaders also need to set their transformational agenda, such as building their companies' core capabilities to tackle new challenges in achieving E2 performance and driving public-private partnerships to create early demand for their green products. Only then can we achieve the ambition that COP28 President-Designate Dr Sultan Al Jaber has articulated.

CAPITALAND

Incorporated in 2003, CapitaLand Investment Limited (CLI) is one of Asia's leading listed real estate companies, as well as one of the largest real estate investment management operations in the world. As of August 2023, CLI manages six listed funds valued at about S\$60 billion.³³ Its 2030 Sustainability Master Plan (SMP) has set ambitious targets that align with leading international standards and benchmarks, focusing on reducing its GHG emissions in line with the stipulations of the Paris Agreement.

The company is planning to use US\$6 billion in proceeds and interest rate savings to strengthen sustainability innovation. To effectively measure the impact of these efforts, it is developing a new metric, 'Return on Sustainability' (ROS), to complement its regular financial reporting. Its proprietary ROS metric includes interest rate savings from the organisation's sustainability-linked loans and utilities cost avoidance.³⁴

CapitaLand's sustainability efforts have been recognised by leading benchmarks such as the Global 100 Most Sustainable Corporations in the World Index and Dow Jones Sustainability World Index, as well as GRESB.³⁵

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Endnotes

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