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# THE IMPACT OF ORGANIZATIONS: MEASUREMENT, MANAGEMENT AND CORPORATE REPORTING

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ROUTLEDGE

# LIST OF FIGURES AND TABLES

*page*

### Chapter six



### Chapter seven



### Chapter nine



### Chapter ten



### Chapter eleven



### Chapter twelve

## Tables

*page*

**Chapter three**



**Chapter four**



**Chapter five**



**Chapter six**



**Chapter ten**



**Chapter eleven**



**Chapter twelve**

*page*

## Chapter fourteen



## Chapter fifteen

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# PREFACE

This handbook was written during a time of global sudden changes: from the pandemic emergency to international conflicts up to increasingly frequent climatic and social crises.

In this context, the issues of sustainability and impact are becoming central to the strategic planning of organizations as well as for the management and mitigation of emerging risks.

Therefore, for corporate and financial organizations as well as public institutions there is a growing need of methods, tools and approaches that can help them in the management processes connected to these issues.

This acceleration is accompanied by growth of complexity regarding these two topics due to the presence of many questions that are still open today: how is it possible to define sustainability and impact? What are the links between the two approaches? Accountability and evaluation, what connection? Which reporting standards for which stakeholder categories? How can the organization go beyond reporting, towards the integrated and sustainable management of business processes?

In this scenario, through this handbook we aimed to offer our contribution putting together academic evidence and concrete experiences, following the hybrid approach changed by the Governance of Innovation and Impact Management Observatory (founded by Italiacamp and Luiss Guido Carli University) which edited this publication.

The ambition is to be a bridge between the academia and the market sector, to return know-how and useful tools to help the organization to face this systemic change. We believe that, to do this, are essential heterogeneous and multilateral points of view, skills and approaches. It is not an easy challenge that requires an alignment of languages, methods, experiences.

In this perspective, the handbook is divided into three sessions where the empirical experiences showed emergent organizational models to address the issues of sustainability and impact and academic experience captured implications that the sustainable approach had on performance and organizational models and identified some trends and scenarios that are opening thanks to the present evidence.

The three macro-sections focused on sustainability and impact management for: corporate entities, financial sector and public institutions.

The hope is that this work could represent the starting point for the development of increasingly integrated and interconnected research, application and development processes.

The authors

# Part 1

# FROM SUSTAINABILITY TO IMPACT EVALUATION AND MANAGEMENT: CORPORATE PERSPECTIVE

# Chapter 1

# SUSTAINABILITY PERFORMANCE AND ESG FACTORS: A NEW CHALLENGE FOR SMALL AND MEDIUM SIZED ENTERPRISES (SMEs)


## Roberto Tombolesi



ABSTRACT: *Managing sustainability performance is an important component of companies' efforts to generate enterprise value.*
*A growing body of research confirms this thesis, showing a positive relationship between sustainability performance and financial returns.*
*What began as a niche practice among values oriented and an effort to create a good reputation, improving own brand and positive impact while sacrificing financial returns, is now a mainstream practice where values and value have a direct and positive relationship.*
*ESG factors are becoming the almost of top mind for all companies and of necessity for all Small and Medium Sized Enterprises (SMEs).*
*All SMEs that want to maximize their ability to create market value and not only good reputation will need to develop a sustainable business strategy as opposed to a sustainability strategy. A sustainable business strategy and an ESG performance can reduce costs, improve workers productivity, mitigate risks potentials, create revenue-generating opportunities, can also impact cost of capital and contribute to success in the near, medium and long term.*
*But are Italian SMEs yet properly organized for this new challenge imposed by the market?*



KEYWORDS: Reputation – Sustainability – ESG factors – SMEs – Companies' market value – PNRR – Supply chains – ESG metrics – ESG Frameworks – Sustainable finance.




## 1. Introduction

The main objective of a company is the creation of value, traditionally considered only from a financial point of view and measured by comparing the invested capital and the return on investment. Cultural evolution and the raising of the level of civilization require companies to relate to the outside world dutifully considering that resources and goods are not infinite. In a sustainable economy, business value generation must be durable, repeatable over time and not based on the destruction of non-reproducible resources.

For the above reasons, a company must operate in harmony with the surrounding environment and can no longer limit itself to the allocation of *capital* and the use of production factors to achieve the economic objective, remunerating them on a lasting basis. The company, beyond to give an account in order the methods of remuneration of the production factors, must necessarily be concerned with the satisfaction and the requests of the stakeholders.

The social interest, from the perspective of shareholders and directors, must be balanced with the interests of the various stakeholders in what is called "the new paradigm" (Rolli, 2020).[1]

As matter of facts, the value of a company is today linked to its reputation, understood as ability to achieve the expectations and the value judgments of the stakeholders and the consequent level of appreciation (Pellegrini, 2020).

The sustainability extends to all ESG (Environmental, Social and Governance) factors and has acquired a significant impact also for small and medium sized enterprises (SMEs).

On the basis of these considerations' questions arise.

What's the impact of ESG factors in the world of SMEs?

Are Italian SMEs yet properly organized for this new challenge imposed by the market?

## 2. ESG and SMEs

SMEs play a central role in the Italian and European economy. According to recent data provided by the European Parliament[2] they make up 99% of EU companies. They provide two-thirds of jobs in the private sector and contribute to more than half of the total added value created by businesses in the Union.

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[1] R. Rolli (2020). *L'Impatto dei fattori ESG sull'impresa*. Il Mulino, Bologna. The reference is the document presented by Martin Lipton during the International Business Council of the World Economic Forum, 2 September 2016. The new paradigm, A Roadmap of an Implicit Corporate Governance Partnership, Between Corporations and Investors to Achieve Sustainable Long-Term Investment and Growth.

[2] Thematic notes of the European Union: https://www.europarl.europa.eu.

Furthermore, the functioning of the supply chains of large companies is ensured precisely by the preponderant presence of SMEs which determine their overall level of sustainability.

On the other hand, numerous researches show that for different types of products and services the largest share of the environmental and social impact (up to 90%) is linked precisely to companies of this type. For these reasons, the Italian economy cannot achieve the global Sustainable Development Goals set out in the UN 2030 Agenda without actively involving SMEs in a process of introducing virtuous behaviours aimed at the implementation of sustainability factors and in general ESG dynamics.

Figure 1. The 17 Sustainable Development Goals of the United Nations


Source: United Nations Foundation 2030 Agenda.

Without the full involvement of SMEs the transition would not occur: *"while those that don't, won't"* (Fundamentals of Sustainability Accounting Credential, 2021).[3] But for SMEs this challenge also represents also an incredible opportunity to acquire or consolidate their competitive advantage, not only for the innovative drive that a sustainable approach produces.

The increase in the attention of consumers and the pressures of the financial community and other stakeholders, prompt companies to rethink current models and create new business models.

With a new approach of management based on sustainable business

[3] Study guide SASB *Fundamentals of sustainability accounting credential.*

models, SMEs can guarantee access to certified supply chains, better conditions. Financing, strategic partnerships with public and private entities.

In addition, the dynamics of ESG must be respected by SMEs that want access to various action programs adopted and the funding adopted by the European Commission for their economic recovery, reconstruction and development following the impact of the Covid-19 pandemic (COM, 2020).[4]

Therefore, in the current economic context, adopting sustainable business models is no longer a facade choice but has become an obligation to remain competitive on the market.

SMEs that want to maintain a competitive advantage and increase their value in the long term must adopt a new managerial model focused on ESG factors of strategic integration of environmental, social issues and governance and based on dialogue and relations with the subjects that are in relationship with the stakeholders.

## 3. The central role of stakeholders

A company that believes in sustainability attaches great importance to the relationship with its stakeholders and puts them at the centre of its strategies.

Some studies have highlighted that for the development of a company it cannot be separated from good relations with stakeholders and their involvement is necessary not only downstream, in the phase of presentation of results in non-financial reporting, but upstream, in the setting phase of the strategic sustainability plan.

For SMEs it can be hard to know whether ESG factors will have an impact on their business.

Despite this uncertainty in the use of standards, many SMEs will need to start tracking ESG metrics soon, even though they may never publish a full externally facing Sustainability Report.

Two important areas that will drive the adoption of tracking sustainabil-

[4] The Commission communications of 10 March 2020 entitled "A new industrial strategy for Europe" (COM (2020-0102) and "A SME strategy for a sustainable and digital Europe" (COM (2020-0103), included proposals to help SME operate, grow, and expand. In response to the impact of the coronavirus pandemic on industrial supply chains and SME, in the European Parliament passed a resolution on coordinated EU action to fight the COVID-19 pandemic and its consequences in April 2020. On 25th November 2020, MEP passed a resolution calling on the Commission to present a revised industrial strategy.

ity data are customer management in the supply chains and corporate finance. In both activities, having detailed and consistent ESG metrics will give executives an advantage over the competition of SMEs.

Despite the obvious relevance of the topic, it has been amply demonstrated that SMEs are lagging large companies on the path towards adopting sustainable models.

## 4. Customer management of SMEs in the supply chains of large companies

The multi-national customers of SMEs are beginning to play a larger role in driving the adoption of ESG metrics and sustainability tracking.

These large companies have been focused on their internal sustainability metrics for several years, but as they start to look at where they need to generate more impact to meet their defined risk mitigation many have realized that the greatest opportunities can now be found by looking outward at their supply chains.

Many large companies, in particular listed on the stock exchange or operating on international markets, who were the first to voluntarily adopt ESG principles, orienting their strategies towards sustainability, have activated very strict control systems for suppliers.

The supply chain can, in fact, be a weak point and the correct management of suppliers is therefore becoming increasingly strategic.

Choosing reliable suppliers means minimizing inefficiencies, avoiding the damage associated with incorrect partner behaviour, improving reputation and competitiveness.

In the analysis of the weak areas of the supply chain, particular attention is now paid to the risk of reputation and economic damage that can result from poor performance in terms of sustainability.

In this context, greater involvement is required from the perspective of sustainability of SMEs that operate as suppliers, often not yet ready to change their business in a sustainable way.

For these reasons, large companies can play a very important role in orienting the productive economic system quickly, involving SMEs in their supply chains and developing the conviction that sustainability is the only possible way.

This is especially true when SMEs, as suppliers, are faced with customers with high bargaining power who are therefore able to force them towards sustainable transition.

Therefore, if large companies are forced to rethink the supply chain in a sustainable key by the pressure of investors and consumers, even SMEs must necessarily change their strategies quickly, also because they will have to deal with increasingly stringent regulations that arrive from Europe.

Transparency and skill tracking are key factors in improving the control of the supply chain, one of the objectives that all companies should strive for.

Knowing that many SMEs lack resources and knowledge on ESG data management, some of the Italian larger companies (like ENI, ENEL, TIM, Illy, etc.) are creating novel training programs to support their SME vendors.

In the actual dynamic business environment, it is as critical as ever to not only be responsive to customers, but also to anticipate their needs. As the customers of SMEs focus more and more on their supply base to meet their sustainability goals, organizations that have taken a proactive approach to gather and manage ESG data will have a competitive advantage in both retaining customers and gaining Starting the process of identifying and tracking ESG data, if not already begun, is the best way to stay ahead of the coming set of expectations from customers, and will position SMEs for better long-term performance.

## 5. ESG and corporate finance of SMEs

The competitive relaunch of SMEs after the difficult years following the recent economic crises (the reference is to the financial crisis of 2008, plastically represented by the bankruptcy of Lehman Brothers) and the economic paralysis consequences of the Covid-19 pandemic, will have to be appropriately supported on a financial level.

In this regard, it is appropriate to consider that the gradual contraction of resources made available in recent years in Italy by the banking world will have to be overcome with new forms of financing and also through the subsidized finance sources made available by the states of the European Union.

The Italian financial model of recent years, which has seen the bank as its main interpreter (so-called "banca-centrico"), has produced negative effects on SMEs that are today undercapitalised and with low financial culture.

Furthermore, the banking financial system offers a limited number of financial means to expand the business of SMEs and in the last ten years it