WHITEPAPER

Management controls for corporate sustainability

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Introduction

More and more companies are striving to become sustainable, are disclosing their extra-financial performance and are benefiting from the array of opportunities presented by sustainable business practices across the environmental, social and governance dimensions of sustainable development. Naturally, companies seek to understand how sustainability could be managed optimally internally. At Acuity, the solution offered to clients is the Sustainability Management Control Framework Model (copyright, 2024) (Ghosh, 2020) that is based on seven management controls found primarily in a large for-profit organisation. The constituents of the Sustainability Management Control Framework Model are as follows:

1. Cultural controls
2. Strategic planning
3. Budgetary controls
4. Performance-measurement controls
5. Rewards-based controls
6. Administrative controls
7. Governance-related controls

These management controls are adapted for the effective management of both financial and non-financial dimensions of corporate activities and performance. The model is based on systems thinking, reflecting a holistic approach acknowledging the interdependencies that exist within each facet of management control.

Background

Several prominent scholars in the field of sustainability have pointed to the need to explore how organisations manage and control sustainability (Maas et al., 2016; Gond et al., 2012). For instance, Wood (1991) suggested exploring "managerial processes [that] apply to the development and implementation of responsive programs and policies and in particular to examine the role of organizational culture in mediating the transmission of ideas, support, information and resources relevant to social responsiveness" (p. 707). Ackerman and Bauer (1976) opined that an institutionalised approach to social responsiveness requires designing controls that will promote social responsibility holistically within organisations, highlighting the significance attached to the design and use of control systems in ways that institutionalises socially responsible behaviour and decision-making (Crutzen and Herzig, 2013). More recently, Bebbington (2007, p.6) pointed out that "if organisations are seeking to report on their contribution to sustainable development, one may expect that there are some internal mechanisms which guide activities towards this goal." Sinclair-Desgagne and Gabel's (1997) statement validates this line of argument. They state that "[an] increased environmental awareness on the part of shareholders and corporate board members will not change the firm's environmental record in a significant and durable way unless it is translated into concrete amendments of the existing managerial control system." (Sinclair-Desgagné and Gabel, 1997, p. 337)

Insights on management controls

A large body of literature that has evolved since Robert Anthony's Planning and control systems: a framework for analysis (1965) has put management controls as means of ensuring business strategies are implemented efficiently and credited management controls for shaping and informing strategies (Kober et al., 2007). These studies view management controls as the primary means of directing employee behaviour, managing expectations and ensuring organisational objectives and goals are met. Literature on management control has provided evidence of better organisational performance because of links between an entity's structure, systems, strategy and environment (Dent, 1990; Simons, 1987, 1990). Internal mechanisms or management controls can be defined simply as formal and/or informal processes or means to achieve an end result. These mechanisms enable managers to direct employee behaviour to meet set goals and objectives and to steer an organisation towards its mission and vision.

The management control package perspective

Literature on management control has called for studying management controls holistically or, as traditionally referred to, through the "control package" concept (Otley, 1980). Malmi and Brown (2008, p. 287) define the management control package as "a collection or set of controls and control systems" promoting employee behaviour to meet an organisation's goals. Several reasons for focusing on the package concept have been cited in this literature. For instance, Chenhall (2003) opines that management controls do not operate in isolation but are part of a broader system that guides and directs behaviour towards goal congruence. Fisher (1998) asserts the need to recognise the links between different control mechanisms. Furthermore, the literature highlights the contradictory conclusions that may be reached if a holistic perspective is not taken. Relying on the package concept would enable unravelling "how the effects of any one control are governed by the level of simultaneous reliance on other forms." (Abernethy and Brownell, 1997, p. 246)

Although a limited number of control packages have been advanced in literature (Simons, 1995; Flamholtz et al, 1985), this model adopts the Malmi and Brown's (2008) framework. It provides means to empirically study the package concept broadly rather than channelling focus on exploring individual controls deeply. The strength of the model lies in its simplistic approach that could provide a snapshot of how companies are designing their control systems to control different sustainability strategies. It also considers both formal and informal dimensions of controls that have been found to be significant in promoting sustainability. The framework is based on a clear distinction between what constitutes managerial control. Malmi and Brown (2008) define it broadly to include "all devices and systems managers use to ensure that the behaviours and decisions of their employees are consistent with the organisation's [sustainability] objectives and strategies" excluding "pure decision support systems" (p. 290-291). Based on the parameters used for defining controls, business intelligence and IT systems as well as accounting systems would be classified as decision support systems and are, hence, excluded from the framework.

Decoding the management control package model

Cultural controls. The model considers three aspects of cultural controls:

a. Value-based systems or belief systems (Simons, 1995) that establish the (sustainability-oriented) values or the beliefs the organisation intends to adhere to, as reflected in the mission and vision statements.
b. Clan controls (alternatively, socialisation or personnel control) that disseminate the intended organisational values to employees to direct behaviour towards organisational goals.
c. Symbolistic controls to create a cultural system based on visual impacts.

De Marchi's research (2012) attached substantial significance to pressure from organisational culture fostering an environment of continued learning, generating awareness of socio-environmental issues and promoting creativity. De Marchi (2012, p. 48) points out that the "key to organising an enterprise for sustainable operation is for leadership to establish a culture that is proactive in formulating environmental and social objectives…" It advocates for an internally-driven cultural attitude that promotes the recognition of utility associated with continued training and creative holistic thinking for taking a sustainable approach to conducting business. Other means of promoting a culture of sustainable thinking include disseminating sustainable principles through ad hoc initiatives, newsletter-based communications and social interactions. (Riccaboni and Leone, 2010)

Example: In Norris and O'Dywer's (2004) case example, to make socially responsible behaviour a part of company culture, human resources policies were designed in a way that required new employees to follow an induction programme where norms and values are reinforced and to undertake CSR projects to make them realise the accepted norms and values. Employees from different levels were sensitised to reflect the social norms that were part of the organisation's culture. Ouchi's notion of clan control (1979) was very prevalent in the organisation. A value-based congruence of self and organisational value systems expounded through the vision and mission statements provided an invisible structure for decision-making based on social values that surfaced in the organisation. Whereas formal written rules on the corporate mission and vision encapsulating the social norms and values the organisation stood for were embedded as part of other formal HR controls, informal controls in the form of peer pressure supplemented the end objective of directing ethical behaviour, bringing employees together to proactively embed social aspects in corporate decision-making. The case highlights the role of clan controls to promote sustainability-oriented behaviour.

Key aspects of cultural controls for sustainable decision-making

» Aligning sustainability with corporate mission, vision and purpose statements
» Setting expectations around corporate sustainability, and legitimising actions
» Communication, shaping expectations, developing sustainability-oriented knowledge systems
» Creating shared value
» Internal training and capacity enhancement
» Employee-organisational value alignment

Strategic planning. The planning mechanism sets out the goals and objectives that the organisation needs to pursue, indicating the level of effort needed to accomplish the set standards required for achieving organisational (sustainability) goals. In other words, it establishes the goals that employees need to work towards channeling their activity and behaviour. The framework also distinguishes the planning mechanism based on temporal dimensions. For instance, Malmi and Brown (2008) refer to "action planning" as a means to describing the desired organisational goals over a short period of time or the immediate future (less than or equal to a 12-month period). Similarly, the distinction refers to goals and targets set for the longer term that require a strategic focus ("long-range planning"). This distinction is particularly significant to see how planning mechanisms are designed by more proactive firms, specifically those pursuing sustainability for competitive advantage versus those benefiting from efficiency-based sustainability practices. There is a need to set targets and goals for sustainability. The targets stem from a materiality analysis undertaken by surveying both external and internal stakeholders periodically. Scenario planning (e.g., RCP 4.5 for climate change)-based analysis is also undertaken to compile long-range plans.

For instance, the Riccaboni and Leone's case study (2010) provides evidence of including goals and targets in the planning mechanism. The sample organisation aims to improve its environmental profile by reducing waste and emissions by as much as 20%. In contrast, the company Durden investigated (2008) had not set sustainability-related targets; this hindered the development of a measurement template to support decision-making. This lack of sustainability goals restricted the company's systematic focus on sustainability. Companies may rely on a number of tools, including stakeholder and materiality analysis, to support sustainability planning. (Galbreath, 2010)

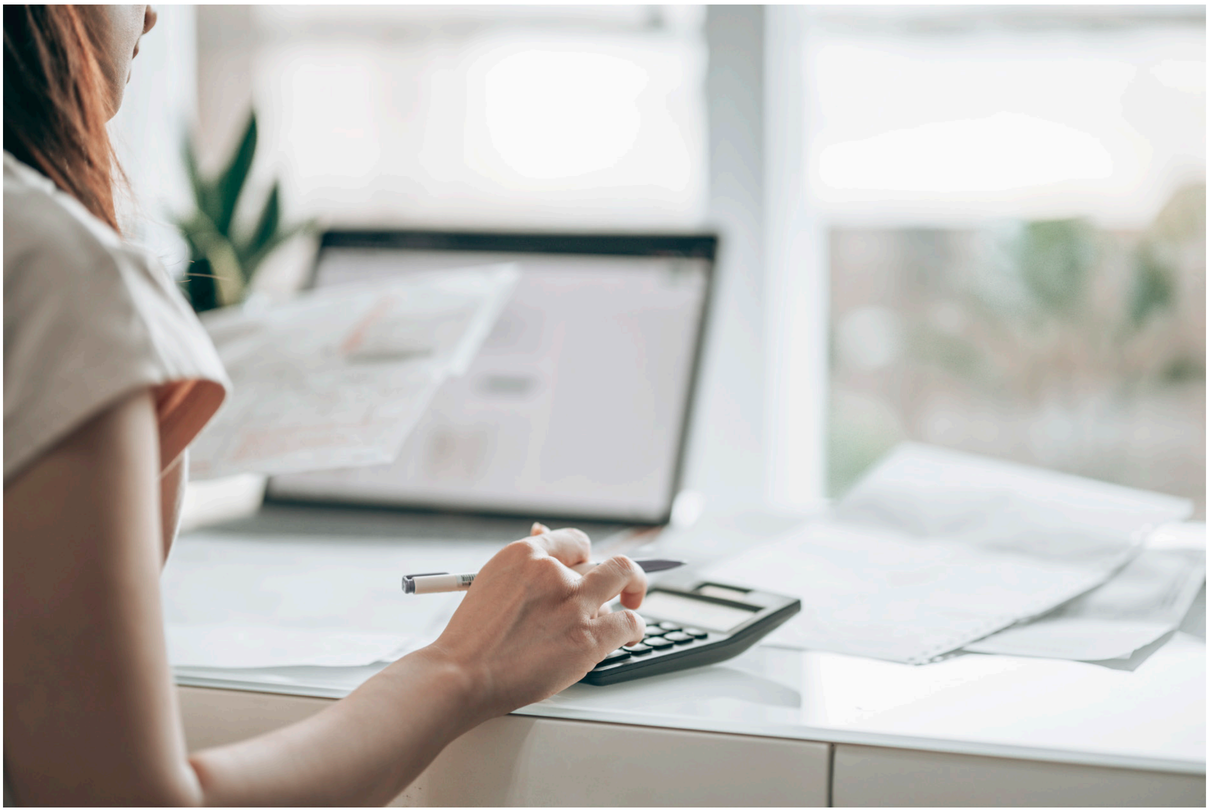
Key aspects of strategic planning for sustainable decision-making

- Identifying salient stakeholders, both internal and external
- Assessing stakeholder expectations and perceptions of sustainability aspects affecting the company
- Identifying material sustainability issues by surveying salient stakeholders
- Conducting scenario analysis
- Incorporating material sustainability issues in strategic plans
- Applying analytical techniques
- Developing firm-specific resources (internal capacity and capability)
- Encouraging cross-functional participation and dialogue
- Setting short-, medium- and long-term goals/targets

Budgetary control for sustainability. Burke and Logsdon (1996) contend that investment plans need to be made to support the delivery of planned outcomes. Roth (2008) considers the conventional budgeting mechanism as an effective cost (financial resource) management tool for sustainability management. Specifically, the author defines the role of a budget for sustainability control as a communication tool to promote sustainability objectives spanning a number of organisational levels (Roth, 2008). Roth (2008) also suggests the development of a triple-bottom-line budget that incorporates all three sustainability dimensions, helping in decision-making. It itemises each aspect of sustainability and the measures to be adopted.

Example: Roth's example (2008) includes benefits accrued from fuel-conservation efforts and costs incurred due to pollution itemised under the environmental category. Roth further opines that such an itemised approach to triple-bottom-line budgeting facilitates variance analysis for effective decision-making (for instance, carbon budgeting and carbon variance analysis). Burritt and Schaltegger (2001) also offer a similar opinion on the usefulness of budgets in that, if eco-efficiency goals set over the long term are to be achieved, such goals need to be incorporated into the budget detailing short-term plans. The budget needs to consider the monetary implications of social and environmental performance. (Roth, 2008)

Key aspects of budgetary controls for sustainable decision-making



- Integration with budgets, itemisation
- Investment plans
- Budgetary allocations for sustainability
- Immunity from financial distress
- Participatory budgeting
- Budgetary rigidity and sustainable innovation

Performance-measurement systems. Sole reliance on financial measurement systems and a lack of inclusion of sustainability objectives in performance planning and evaluation have been shown to have an adverse effect on promoting a balanced approach to decision making. (Norris and O'Dwyer, 2004)

Performance-measurement controls, therefore, cater to setting appropriate targets to direct employee behaviour through the quantification of a particular goal or aspect (Perego and Hartmann, 2009), for instance, by reducing emissions or increasing the eco-efficiency of a product and evaluating employee activity against set targets. It helps identify deviations from set targets monitored through a number of sustainability-oriented key performance indicators [e.g., the Global Reporting Initiative (GRI)].

Key aspects of performance-measurement controls for sustainable decision-making

- Monitoring sustainability-oriented goals
- Use of sustainability KPIs for internal decision-making
- Advanced PMS (e.g., lifecycle analysis)
- Stakeholder (including employee) input in the KPI development process
- Financially quantified sustainability KPIs (e.g., efficiency ratios)
- Balanced score card
- Interactive use of KPIs

Rewards-based systems. Lothe and Myrtveit (2003) make a strong case for companies to formulate effective compensation systems to direct employee actions towards "green efforts". The authors point to the conflicting aspects of simultaneously pursuing sustainability - and profit-oriented strategies. Since financial performance has traditionally been linked to compensation systems, it may not be easy to implement sustainability strategies in addition to financial objectives. The authors opine that the lack of a "goal congruent incentive system" may be the real reason why sustainability aims are not translated into action (Lothe and Myrtveit, 2003, p. 191). This may be significant specifically in firms where sustainability objectives are not clear or are only secondary to financial objectives. Due to the lack of a compensation system, the authors opine that managerial effort towards implementing sustainability objectives may remain dormant.

Example: How a corporate objective of producing a less-polluting product would directly contradict the objective of producing at a competitive cost. To channel efforts to meet both objectives, performance-measurement systems should include not only measures related to profitability but also sustainability indicators. The measures need to be then linked to remuneration systems so sustainability strategies may be implemented.

The above example highlights the reliance of one system (rewards) on the existence of the other (performance measurement), indicating that some systems need to operate simultaneously to promote corporate goals.

Key aspects of rewards-based controls for sustainable decision-making

» Rewards system alignment with sustainability KPIs
» Used in rewarding workforce at different levels
» Use of financial/non-financial rewards
» Short-term/long-term perspective

Administrative controls. Directing behaviour through how the organisation is structured (for instance, through functional specialisation). This is important in terms of enabling sustainable behaviour across the organisation/unit, as implementing sustainable principles requires aligning sustainability actions transcending individual departments, establishing the need for dialogue between departments (Ditillo and Lisi, 2014). Furthermore, the positioning of the sustainability department within the organisation would also hold the key to how sustainable behaviour is promoted, for instance, under the direct supervision of top management committees. (Ditillo and Lisi, 2014)

The supporting administrative functions that drive sustainability practices within an organisation are deemed as areas that showcase the best practices for maintaining sustainability protocols. The key components of an administrative system are as follows:

- Sustainability Committee – creates an ordered structure made up of a handful of dedicated members, generally comprising senior management, to drive non-financial targets and strategies.
- Sustainability Council – helps integrate all material stakeholder perspectives into sustainability measures to establish a pragmatic and actionable ESG disclosure framework. It comprises representatives from departments and vertical and horizontal functions to enable internal dialogue in an integrated manner.
- Sustainability Department – comprises sustainability experts to drive targets of the ESG governance and administrative protocols.
- External Committees – external stakeholders to advise on technical and financial implementation methodologies for sustainability tasks relating to the organisation's goals and targets.
- Formalised internal reporting. Such a mechanism is crucial for maintaining structured information and providing regular updates on sustainability-related developments to the intra-company stakeholders concerned. Internal reporting becomes more efficient when a dotted-line reporting structure links different departments with top and senior-level management.
- Leadership roles. These refer to a head of sustainability, chief risk officer and chief financial officer on sustainability matters.

Corporate governance. Sustainability-oriented corporate governance is at the core of running a business operation judiciously and responsibly while meeting the overarching business targets. It refers to governance structures establishing authoritative mechanisms to monitor employee behaviour, coordinating activity of different departments/units and promoting accountability. In the sustainability context, the composition of sustainability governance may hold the key to how closely sustainability initiatives are coordinated and managed. (Ditillo and Lisi, 2014)

It includes

- Policies and procedures in place to direct and restrict employee behaviour by establishing boundaries within which to operate (Simons, 1995). Examples include developing and enacting policies relating to the environment and social aspects of organisational performance.
- Senior-leadership profiles that include sustainability-related skills, specifically ESG- related skills, experience, knowledge and diversity.
- Internal and external reporting to enhance accountability and meet the information needs of internal and external stakeholders.
- Verification and assurance, as evidenced by the presence of an external auditor to evaluate all sustainability workflows and outcomes.
- Nominations and Remuneration Committee. Its role is to recruit board members and senior management based on sustainability-related credentials.
- Chair of the highest governance body for sustainability – the leader assigned to oversee the company's overall sustainability-related performance (e.g., CEO, CFO, CSO).
- Evaluation of the performance of the highest governing body on sustainability matters.
- Frequency of discussing sustainability-related issues at board and senior management level.
- Each ESG sphere has its specific risks and business opportunities that, once identified, can be effectively monitored and addressed. Corporate governance mechanisms should be adapted to identify sustainability-related risks and opportunities.
- Governance mechanisms should be adapted to promote sustainability-related innovation internally.

How Acuity Knowledge Partners can help

We provided a brief overview of the relevance of each component of management control in promoting sustainable behaviour and an optimal way of managing sustainability internally. We help organisations assess their preparedness for management control. We provide a short questionnaire to employees at all levels, based on each of the management controls described above. It attempts to evaluate an organisation's sustainability management practices and identify gaps and current focus areas. This enables us to gauge how an organisation manages sustainability internally and to identify best practices to address shortcomings.

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