# Driving purposeful cultures: Embedding the cultural drivers of ESG in organizations

Culture is widely accepted as a key root cause of the major corporate failings that have occurred in recent history, causing harm to consumers, employees, investors and other stakeholders. Social expectations have changed, and public interest is raising questions around trust in firms. This trend is further amplified by the rise of ESG. Regulators, investors, employees, suppliers and many other stakeholders increasingly expect firms to improve their sustainability management, resulting in a plethora of competing demands that are impossible to reconcile. Growing concern about "greenwashing"[1] and related legal action[2] has raised the stakes for firms who "get it wrong".

But companies can't be everything to everybody. They undertake many activities that create benefits or cause harm – sometimes both – to society and the planet. A company's resources are limited so it must choose the business areas it wants to focus on. Many decisions involve trade-offs so organizations must choose which stakeholders to particularly serve (beyond ensuring compliance with legal minimum requirements).

Firms are starting to understand that a new sense of corporate purpose is needed – an aspiration that looks beyond the generation of financial returns to the real reason why a business exists: who it serves, its reason for being and the role it plays in the world.

Purpose is powerful because it provides the guidance firms need as capitalism moves away from the shareholder value concept of the 1980s and 1990s (requiring a focus on investors only) toward a more inclusive form of capitalism. Often referred to as "stakeholder capitalism"[3], this new view seeks to balance the need to generate profits with the legitimate expectations of its stakeholders, such as employee wellbeing or the environmental impact of a firm's operations. In the new world of multi-stakeholder business, purpose brings different stakeholders together in a common mission.

Boards now face the challenge of carefully considering how a firm's purpose is captured in the decision-making processes alongside financial considerations. How can purpose be made real?

[1] Greenwashing is a practice where sustainability-related statements, declarations, actions or communications do not clearly and fairly reflect the underlying sustainability profile of an entity, a financial product, or financial services. This practice may be misleading to consumers, investors, or other market participants (European Securities and Markets Authority (2023). Progress Report on Greenwashing. Paris.)

[2] United Nations Environment Programme (2023). Global Climate Litigation Report: 2023 Status Review. Nairobi.

[3] World Economic Forum (2020). Measuring Stakeholder Capitalism: Towards Common Metrics and Consistent Reporting of Sustainable Value Creation. White Paper. Geneva.

# How to make purpose real

## The purpose statement

Core content

**The WHY:** The contribution the company makes to the lives of others

**The WHO:** The stakeholders the company particularly endeavors to serve

**The SO WHAT:** The impact of that contribution on the stakeholders

Qualities of a purpose statement

- Focused and selective
- Both deliberate (top-down) and emergent (bottom-up)


## The five channels through which to embed purpose

**Governance:** It is important to consider board composition, assignment of responsibilities, committees, etc.

**Culture:** Purpose should be aligned with a firm's culture (perception of middle management, ambassadors, hiring, etc.)

**Strategy:** Purpose should shape the activities a company is involved in

**Operating model:** Purpose should be aligned with how a company runs its core operations

**Internal reporting:** Companies should gather a rich set of information on how employees, teams, projects, etc. are performing on purpose-related dimensions

## From reporting to communicating

- Set long-term targets for the value to be delivered to each stakeholder and report on progress achieved
- Move away from one-way "reporting" to two-way interactive communication and engagement with stakeholders
- Use monetization of impacts to ensure link to strategy

### Articulating your purpose

Purpose is far more than a statement. Yet, a statement of purpose is a necessary starting point to set an organization on the right course.

A corporation's purpose is always an "origin story" and is therefore found in the past[4]. It originates from two major sources: the motivations of the founders of the company or specific stories shared by members of the organization that represent what makes them proud to be part of it. It therefore follows that purpose can be both deliberate and emergent. While purpose tends to be more deliberate in firms that are managed by the founders, it is more emergent in firms where the founders have already withdrawn. More importantly, when workers have helped shape purpose, they feel ownership and are more likely to embed purpose in the culture of the organization.

Indeed, purpose always exists on both a macro and micro level within an organization. A company's purpose can trickle down to the purpose of a subsidiary, division, team or individual.

Purpose does not just need to be defined based on an exclusively internal perspective[5]. The firm's external stakeholders can also contribute to shaping its purpose, which further sharpens the purpose statement and ideally will lead stakeholders to rally around it.

A good purpose statement should be no more than one sentence and should contain three components:

- **The WHY:** the contribution the company makes to the lives of others
- **The WHO:** the stakeholders the company particularly endeavors to serve
- **The SO WHAT:** the impact of that contribution on the stakeholders

[4] S. Sinek (2017). Find your why / Simon Sinek with David Mead and Peter Docker. New York

[5] A. Edmans (2020). Grow the pie: how great companies deliver both purpose and profit. New York.

Here are some examples of purpose statements of well-known companies:

| | |
|---|---|
| 1 | *"To connect (WHY) millions of people (WHO) in real life all over the world, through a community marketplace – so that you can Belong Anywhere (SO WHAT)" (Airbnb)* |
| 2 | *"To empower (WHY) every person and every organization on the planet (WHO) to achieve more (SO WHAT)" (Microsoft)* |
| 3 | *"To unlock the potential of human creativity (WHY) by giving a million creative artists (WHO #1) the opportunity to live off their art (SO WHAT #1) and billions of fans (WHO #2) the opportunity to enjoy and be inspired by these creators (SO WHAT #2)" (Spotify)* |

The statement should never contain WHAT the company does because this will change over time.

As mentioned above, the why is directly related to the motivations of a firm. It should therefore be based on the principle of comparative advantage with a focus on the activities enabling the company to deliver more value than others. A comparative advantage could be observed where:

- A firm controls an activity directly
- Where it has superior expertise
- Where the firm is particularly passionate about an activity

In contrast, the who should be based on the principle of materiality, i.e. which stakeholders are material to the firm (financial materiality) and which ones the firm is particularly concerned about (impact materiality). Just like the comparative advantage, passion is a source of (intrinsic) materiality because the leaders, colleagues or investors of a company care about serving them.

Finally, it is important to articulate the so what or impact of the company on its (key) stakeholders to keep the statement actionable. This is important for the purpose statement because it will serve as a benchmark that every important business decision of the firm will need to meet to achieve the desired impact.

Strong purpose statements are focused and selective. It is a reality that businesses face trade-offs that are uncomfortable. A broad purpose statement ignores this reality. An "uncomfortable" purpose statement can provide guidance in important dilemmas that firms face regularly, such as which stakeholders to prioritize, where to allocate a firm's limited time and resources and which business opportunities to turn to.

Once a purpose has been decided upon, it must evolve beyond being a statement and take root in the enterprise.

### Embedding your purpose

A remarkable feature of truly purpose-driven companies is that they manage to realize their purpose through all their actions: the products and services they offer, the business decisions they make, the people they hire or the way they organize their business. In contrast, "mainstream" organizations seem to be able to follow a purpose only in certain parts of their business and over a limited period. It would appear that "mainstream" organizations are failing to stick to their purpose, values or commitments when faced with conflicts of interest (e.g. a conflict between the interests or the firm and one or several of its stakeholders) or conflicts of principle (e.g. conflicts between two inherently virtuous values, such as prioritization of short term vs. long term, truth vs. loyalty or rules vs. principles). What a company therefore requires, is a "moral compass" providing not only guidance on the firm's purpose, but also its values, how it makes difficult decisions when faced with dilemmas and how it acts to sustain its purpose. To achieve that, firms should systematically embed their purpose at five key levels of their organization[6]:

- **Governance:** the "tone from the top" must promote behaviors that embody the firm's purpose
- **Culture:** this is critical to ensure that a company "lives" its purpose
- **Strategy:** a company's purpose should shape the activities it gets involved in
- **Operating model:** a company should align its core operations with its purpose
- **Internal reporting:** management requires transparency on the firm's performance on purpose-related dimensions

As Peter Drucker put it so eloquently, "culture eats strategy for breakfast". With this in mind, let us take a closer look at how purpose can be integrated into governance and culture.

[6] R. Steare (2013). ethicability / how to decide what's right and find the courage to do it. London

## Governance

Purpose should be a formal duty of the entire board[7]. The board should not perform its duties such as setting the strategy, approving investments or appointing the executive management without verifying that these are consistent with the firm's purpose. While overall responsibility should remain directly with the board, certain aspects could be treated by relevant sub-committees.

Acknowledging that formal and procedural measures are important, the right tone from the top is also a prerequisite for a culture that embraces, encourages and enforces a firm's purpose. People will do the right thing consistently and reliably if they are in a wider culture that celebrates and rewards such behavior. Such a culture needs to exists at all levels of an organization, but the behavior and values that create and sustain it must come from the top by leaders who consistently exhibit the behaviors and values that they expect from their people.

Two specific aspects of firm governance have been subject to public focus in the context of promoting purpose: the composition and behavior of the board and incentive schemes.

A question boards should revisit on an ongoing basis is whether the behavior and tone established in the boardroom is right, and whether it is reflected in how the organization is run. This assessment should consider leadership quality, checks and balances, diversity of skill sets, boardroom interrelationships and the level of independence of the non-executive directors from the CEO. Research[8] on the moral values found in individuals across various leadership levels suggests – in general – that business leaders tend to be arrogant in their pursuit of a corporate or personal goals, take little account of people in their decisions, and are frequently driven by personal status rather than the common good. Also, there is a clear tendency for traits like compassion, kindness and charity to get lost by the wayside on the journey to the top of an organization. Against this background, boards should assess the behavioral norms which are present and which influence the business. Critically, boards need to be skilled in recognizing a culture of fear or good news where the organization is driven to meet senior management's expectations regardless of reality.

The linkage of non-financial targets with incentive packages is still a nascent discipline. However, despite overwhelming scientific evidence[9] that larger rewards lead to poorer performance on tasks that require cognitive skill, the current discussion still (which is the case for most tasks in today's working environment) centers on how non-financial goals can be integrated into the reward system. Instead, firms should consider playing to people's intrinsic rather than extrinsic motivation. Three key components of such a scheme could be:

- **Purpose:** contextualization of tasks within the purpose of the firm, thus allowing colleagues to feel part of something greater
- **Autonomy:** moving away from "management" toward more self-directed forms of work as well as providing a certain amount of "free time" for individual projects
- **Mastery:** allowing colleagues to get better and better at something that matters

## Culture

Historically, the mechanisms by which a firm's leadership has tried to set expectations around behavioral norms has been the code of conduct, mandatory trainings and self-assessment processes, all of which are often seen as a compliance burden.

There is a striking contradiction in attempting to enforce something as fluid and judgmental as purpose, values and culture by compliance tools which are inherently based on a binary system of "right and wrong". While absolute rules have their rightful place in any organization, their basic problem is that they remove people's responsibility for deciding what is right. Even worse, they tend to multiply – as the political responses to large corporate scandals has demonstrated time and time again (when a greed and fear-driven "obedience" culture failed in the first place). To establish a purpose-driven culture, companies should seek to cultivate behaviors that are based on people-based principles rather than rules-based processes.

[7] A. Edmans (2020). Grow the pie: how great companies deliver both purpose and profit. New York.
[8] R. Steare (2013). ethicability / how to decide what's right and find the courage to do it. London. pp. 40-45
[9] See literature on the "candle problem" first introduced by Karl Dunker. Among others: D. Ariely, U. Gneezy, G. Lowenstein, N. Mazar (2005). Federal Reserve Bank of Bosten Working Paper No. 05-11. Boston. or B. Irlenbusch (2009). When Financial Incentives Backfire: Crowding-Out Motivation at Work. London.

The different behaviors and motivations of a firm's employees have a direct impact on the risk the business faces. In this context, diversity becomes a central success factor, albeit with less focus on gender or inclusion of minorities but more on achieving diversity (and balance) of mindsets and an alignment of individuals' values with the values of the company. This ambition should not only underpin the company's hiring policy but also form an integral part of the reward system (i.e. who is held up as role model, what behaviors are celebrated and who gets to move ahead within the firm). Equally, culture should be aligned with the strategy of the firm. For example, a firm that prioritizes innovation is best supported by a culture that emphasizes autonomy, rewards risk-taking and tolerates constructive failure.

**Communicating your purpose**

A company should communicate its purpose and report on how it is putting this into practice. It should set long-term targets for the value it delivers to each stakeholder in the purpose statement, and then report whether it is on track.

As these practices are becoming increasingly typical under international non-financial reporting standards such as ESRS or ISSB, the next frontier will be to move from impersonal, one-way reporting to personal, two-way communication and to report in monetized terms if the company has delivered on its purpose.

Moving to a more personalized way of communication around a firm's non-financial performance is still only rarely observed although its benefits are likely to be significant and costs for firms are limited. For example, like the concept of "investor calls" a firm could present its non-financial report by means of a stakeholder call or meeting, thus allowing the firm to present a simpler and more personal narrative of its performance on purpose-related performance measures. Ideally, updates during the year on its recent initiatives, achievement of milestones and new targets could be provided. Such meetings should allow room for questions and discussion from stakeholders and could yield important insights, such as:

- Which of the KPIs the firm discloses are relevant for stakeholders, which are less important and which future KPIs would stakeholders like to see
- Views, guidance or observations on current challenges that the firm is facing in pursuing its purpose
- Observations on where the stakeholders see the firm against peers and what topics should be prioritized in the future

Monetizing non-financial impacts is still a nascent practice and therefore a double-edge sword. On the one hand, it creates the illusion of accuracy for matters for which there still are only very few standards established (for example, by the Value Balancing Alliance). On the other hand, monetization allows integrated consideration of financial and non-financial matters and therefore greatly enhances the strategic consideration of non-financial matters. A company can consider how negative impacts might fall back onto the firm (such as by means of new legislation, taxation or activist action) and how likely this would be. This represents an effective mechanism to incorporate a long-term perspective into firms' decision-taking by making future costs to the firm transparent, thus establishing a more accurate picture of the profitability of current investments.

### Conclusion

Culture, as a key root cause of major conduct failings, can contribute to unwanted impacts for a wide range of stakeholders. At the same time, social expectations have evolved and firms must do more to win and retain public trust. Regulation certainly plays a role in the transition to a more sustainable future but it can never replace the imperative on firms to engage in responsible behavior. Culture – as many lament – cannot be regulated. While this may be true, culture can be influenced and built around a firm's purpose: one that seeks to create value for all its stakeholders. It is therefore clear that purpose must be at the center of any firm looking to integrate ESG in a credible and effective manner.

## How KPMG can help

- **Purpose definition, articulation and value discovery:**
  Define purpose beyond financials, articulate it to stakeholders and understand the value it can unlock when embedded in strategy
- **ESG measurement informed by purpose:**
  Measure and articulate impact in a way that resonates with investors and other stakeholders
- **Reporting:**
  Fulfill regulatory requirements in reporting on purpose, culture and ESG as required by regulators, capital markets and other stakeholders

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