



## Embedding sustainability into core strategy and business operations

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# Foreword: COVID-19 contextualisation

At the time of finalising this perspective, the world continues to urgently respond to the health, humanitarian, and economic crisis resulting from the COVID-19 pandemic. The pandemic and its systemic implications will reshape global economies and have long-lasting and disruptive implications on businesses and society.

Given the rapid escalation and all-consuming nature of the pandemic, it is somewhat unthinkable that only a few months ago Australians were in the midst of what was the most significant environmental and health catastrophe of a generation – the 2019/20 bushfires. Our collective attention has rightfully been re-focused on urgently combatting and recovering from this global crisis, and rebuilding our lucky country.

Amid these difficult times, we must remind ourselves that the fundamentals of our Australian economy, and continued societal progress is predicated on a sustainable, healthy and resilient environment.

Despite this known fundamental, we have not been effectively dealing with sustainability challenges faced by the country to anywhere near the level of urgency or collective focus that we are (thankfully) seeing from governments, business and society in fighting the pandemic.

The need for more comprehensive sustainability objectives to form part of the nation's goals, and organisations' strategies and decision-making criteria, remains—if not becomes—even more critical to our collective futures.

From crisis, there are always green shoots that emerge, with experiments and innovations that can, and should be invested in, to form part of the recovery and play an important role in a sustainable 'new normal'. Amid the tragedy that is unfolding, there are indicators that highlight new and more sustainable ways of working and consuming. Concurrently, we are also seeing numerous examples of partnerships and collaborations being formed across sectors and boundaries that will live on post-crisis.

The pandemic shows that as individuals, and collectively, we can take dramatic action once we acknowledge the urgency of a threat. Our goal of limiting global warming to 1.5°C is on the brink of becoming impossible. Our global collective efforts must deliver ~7.6% emissions reductions every year between 2020 and 2030 to achieve this outcome. The projections, amidst the dramatic changes to our way of life during COVID-19, are expected to decline by ~8%, with a caveat that in past similar situations, the rebound in emissions ended up being larger than the decline.<sup>2</sup> Short-term disruptions and reprioritisation are inevitable eventualities of the COVID-19 crisis; however, the incorporation and elevation of sustainability objectives for the country, government and business must remain front of mind, as was the case pre-COVID-19.

We believe that organisations and leaders that embed this focus in their future strategies and goals will be more resilient and able to create an enduring impact.

“The purpose of the corporation must be redefined as creating shared value, not just profit per se. This will drive the next wave of innovation and productivity growth in the global economy”

-Michael Porter

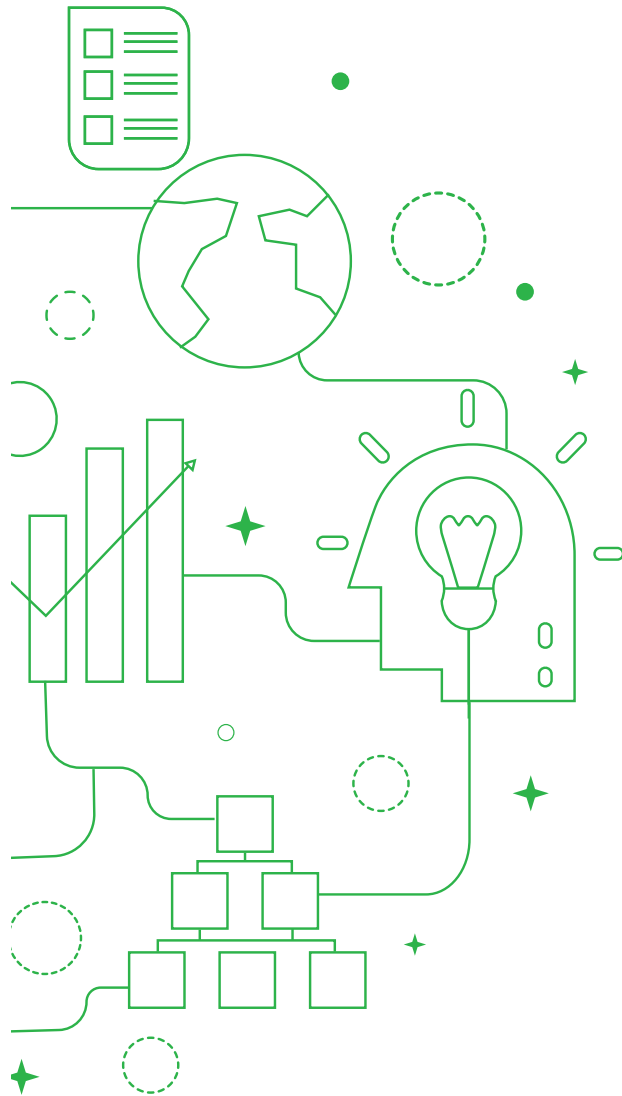
“To prosper over time, every company must not only deliver financial performance, but also show how it makes a positive contribution to society”

-Larry Fink

“We cannot solve our problems with the same thinking we used when we created them”

-Albert Einstein

# Introduction



**Sustainability is becoming an increasingly important priority for boards and executives across Australia and most progressive countries.** Historically, corporations have engaged with environmental and social themes in response to regulatory pressures, or as part of branding and marketing exercises. Over the past decade, however, we have seen organisations increasingly **pursuing the co-creation of commercial and societal value by embedding sustainability in their business strategy and core operations.**

**Examples of large corporations reinventing themselves as better, healthier and more sustainable versions of themselves in order to secure new competitive advantage are fast emerging.** From packaged meats empires repositioning as plant-based protein market leaders, to pharmacy chains closing cigarette retail channels, doubling down on health markets, and a multitude of consumer product and fashion retailers investing in, making mainstream, and driving growth through sustainable product ranges.

**Here in Australia, rather than largescale reinventions, we are seeing companies progressively maturing their sustainability approach and developing innovative initiatives that interlink financial and societal outcomes.**

- An Australian insurer investing a share of customer insurance premiums into investments that have both positive social and environmental impacts, and adequate financial returns;
- A large groceries retailer issuing Green Bonds certified by the Climate Bonds Initiative (CBI) to finance projects, assets or expenditure that will reduce the company's environmental impact;
- A diversified group's subscription to a sustainability-linked AU\$400 million loan with a leading Australian bank, tying environmental and social performance to more favourable financial outcomes; and
- An office and stationery retailer enabling customers to shop more sustainably by planting two trees for every one used based on the weight of paper products purchased, and driving significant sustainability impact (reduced waste, and increased recycling) alongside improved staff engagement by using balanced performance scorecards that track non-financial, sustainability targets, alongside financial metrics.

## What do we mean by sustainability?

While there is no single definition, the concept of 'sustainable development' was originally defined as "development that meets the needs of the present without compromising the ability of future generations to meet their own needs" by the World Commission on Environment and Development in 1987.

As it relates to business activities, 'sustainability' refers to environmental, social, and governance (ESG) dimensions of a company's operations and performance. It includes activities that maintain or enhance the ability of the company to create value over the long term.

**Despite many compelling stories of bold plays and commercial success, much of the Australian collective corporate imagination continues to equate sustainability with compliance, costs, and constraints.**

Businesses find themselves managing the elevated costs of meeting growing reporting and compliance requirements, mitigating the increasing complexity of risks and issues, responding to heightened stakeholder scrutiny, and proactively defending or explaining their sustainability efforts within media and shareholder forums. There also needs to be greater understanding of the potential for a net reduction in costs over time from many sustainability investments. Given this somewhat myopic focus, it is perhaps not all that surprising that only 18% of ASX150 companies have aligned their business targets with the United Nations Sustainable Development Goals<sup>3</sup> targets and indicators, despite the clear longer term—and necessary—benefits that this would create.<sup>4</sup> In the face of mounting investor and shareholder demands of companies to engage with sustainability risks and opportunities, and customers increasingly voting with their wallet and demanding more sustainable product options, businesses are under increased pressure to respond.

**The time has come to associate sustainability not with trade-offs, but with competitive advantage, and enduring business performance.** As shown in this report, companies that more proactively embed sustainability into their business strategy and core operations are benefitting from more resilient supply chains, efficient business practices, enhanced stakeholder interactions, improved governance, and ultimately better longer term financial performance and value creation. The outperformance of sustainability investment funds compared to traditional funds as financial markets endeavour to weather the COVID-19 crisis is a case in point, demonstrating

greater resilience where companies have companies with strong environmental, social and governance (ESG) focuses and standards.<sup>5</sup>

**Inherent organisational and systemic challenges are, however, impeding businesses from realising the full strategic potential of sustainability.** Competing stakeholder pressures, regulatory uncertainties, short-termism of economic systems and models, and the inherent complexity in aligning existing strategies and business models to sustainability imperatives are all examples of the challenges that need to be overcome. The systemic, and often long-term nature of environmental and social issues, combined with the difficulty in quantifying the impact of strategies focused on these areas, are hurdles to meaningful and lasting change. Organisations are undeniably faced with a “sustainability paradox”, whereby the minimal resources dedicated to addressing sustainability challenges are at odds with the existential threat that they bear on businesses and society.

**This perspective seeks to inspire confidence in business leaders to stay the course on what was already a rising agenda item across public and private sectors in Australia and beyond.** Our belief is that the strategic choices leaders take to address environmental and socio-economic sustainability imperatives remain as critical now as they were pre-pandemic and will remain over the next decade. Investment choices by businesses and governments which target sustainable infrastructure and the transition to a lower-carbon future can have a double positive of significant near-term employment while increasing longer-term sustainable resiliency.



# Embedding sustainability into the heart of business strategy

The rationale for embedding sustainability into an organisation's strategy is unfortunately often misunderstood and gets entangled in an emotive (and at times deeply political) agenda. Removing the emotion, the rationale fundamentally comes down to four points:

## 1. Environmental and social issues are intensifying.

The number of sustainability issues continues to grow, and the magnitude of the challenges posed is increasing in both actual terms and how visible it is. **The current trajectory of global warming is above two degrees by 2050**, an outcome which is expected to lead to large scale human migration, increased spread of infectious diseases, critical water shortages and huge biodiversity loss.<sup>6</sup> **Meanwhile, deep-rooted social issues such as social inequalities and injustice remain.** The world's richest 1% have more than twice as much wealth as 6.9 billion people, whilst men own 50% more of the world's wealth than women.

**For the first time in its history, the World Economic Forum identified the five top global risks in 2020 as environmental and social ones**, each with the potential to lead to major financial losses and systemic economic risks. The anticipated impact of these risks in Australia is significant. For example, the Australian property market is expected to lose AU\$571 billion in value by 2030 due to climate change and extreme weather, whilst the accumulated loss of wealth due to reduced agricultural productivity and labour productivity as a result of climate change is projected to exceed AU\$19 billion by 2030, AU\$211 billion by 2050 and AU\$4 trillion by 2100.<sup>7</sup>

## 2. Consumer, Investor and broader stakeholder expectations are intensifying.

As the time horizons to address these issues become more immediate, pressure from stakeholders is becoming more pronounced. Governments, regulators, investors, consumers, employees, the media, and civil society are increasingly turning to business as the necessary force to deliver the changes needed. They are demanding more transparency and action of business leaders to play their part in addressing sustainability issues, let alone stop contributing to them.

**Consumers are increasingly voting with their wallets** to reward good and penalise poor sustainability practices, empowered and informed by numerous information channels, social media, and benchmarking platforms such as Ethical Consumer.<sup>8</sup> A growing body of longitudinal studies show that consumers are walking the talk of wanting to buy more sustainable products with, for example, 50% of consumer packaged goods market growth from 2013 to 2018 found to have come from sustainability-marketed products in the US market.<sup>9</sup> **Businesses are facing increasing consumer activism too**, in the form of public backlashes, boycotts, petitions, and community mobilisations, increasingly resulting in abandoned projects and market or product retractions.



**Investors, meanwhile, use their engagement channels, influence, and ultimately capital flows to promote the linkage between sustainability and financial outcomes.** Institutional investors are growing their focus on ESG considerations, with some funds increasing their internal oversight and investment controls to ensure ESG alongside financial outcomes, and others threatening to vote against public company directors who refuse to disclose carbon dioxide emissions. **Shareholder activism is also on the rise,** with shareholders using their equity stake in a corporation to propose new shareholder resolutions and put new pressures on management.

**Other stakeholders are also increasingly scrutinising and exposing business misconduct.** Australia's financial services industry continues to feel both the financial and reputational impacts uncovered by the Banking Royal Commission (2017-2019) and resultant regulatory changes. Organisations are also at risk of exposure from their increasingly vocal and organised employees, with numerous examples of employees accusing their own companies of misinformation and diverting attention from societal and environmental issues.

**3. These two combined factors are driving a reinvention of organisations' core purpose, which can no longer be one of profit maximisation alone.**

From responsible business to shared value and conscious capitalism, the last decade has given rise to alternative constructs of the capitalist corporation. The past 18 months has seen a real acceleration of corporate purpose entering the mainstream with a pronounced shift from shareholder to stakeholder value return. Businesses are no longer mere economic units generating shareholder wealth, but system players that fulfil societal needs and outcomes for a much wider set of stakeholders. This elevation of corporate purpose acknowledges the failures of short-term profit maximization and the need to find a more sustainable path for business and society. Businesses reinventing themselves with a more human and altruistic focus toward their stakeholders and operating environments can transcend some of the biggest challenges and conflicts found in organisations today, creating lasting value for themselves, their organisations, and society at large.<sup>10</sup>



#### 4. Embedding sustainability in business strategy is therefore an increasing pre-requisite for businesses to both grow and protect their business performance.

**Grow:** Sustainability offers businesses an opportunity to drive top line growth and long-term competitive advantage through:



**New sources of growth and innovation:** A multinational car manufacturer describes the challenge of sustainable growth as the biggest foster of innovation and company DNA, reflected in its product portfolio of 33 hybrid vehicle models globally and 10 million cumulative units of hybrid vehicle sales globally



**Brand differentiation and consumer loyalty:** A leading global FMCG group's "Sustainable Living" brands grew 69% faster than the rest of the business in 2019, delivering 75% of the company's growth



**Cost efficiencies from reduced waste and resource consumption:** A global food and beverage manufacturer reports over US\$375m in cost savings attributed to sustainability initiatives between 2010 and 2015



**Talent attraction and retention:** Companies with a strong commitment to sustainability are benefitting from a 25% to 50% reduction in staff turnover, along with an overall increase in productivity of up to 13%.<sup>11</sup>

**Protect:** Acting on sustainability today also saves businesses the costs and risks of no action for tomorrow, protecting their bottom line in particular from:



**The reputational risks and loss of social licence to operate:** A Norwegian energy company had to pull out of its \$200 million oil exploration project in the Great Australian Bight after sustained pressure from environmental activists



**The operational risks of a degraded and disrupted macro-economic, social and environmental context:** Deloitte Access Economics analysis estimates that the total economic cost of natural disasters to the Australian economy will reach AUD\$39 billion per year by 2050<sup>12</sup>, whilst a more inclusive society could yield an additional AUD\$13billion to Australia's annual economic dividend.<sup>13</sup>

All of this contributes to :



**Superior long-term financial performance and organisational resilience:** A meta-study of 190+ different sources by the University of Oxford found that good sustainability and ESG practices correlate with lower operating costs, better profitability and superior share price performance.<sup>14</sup>

Our recent Global Survey findings show the breadth of positive returns that business leaders are attributing to their organisation's sustainability efforts, including:



Original question: "Has your organisation's sustainability efforts yielded a positive impact in any of the following areas?"<sup>15</sup>



**Realising these benefits will require resolving for inevitable tensions.** In many cases, short-term financial performance and laying the foundations of longer-term value and resilience will compete. **The onus ultimately lies with business leaders to find a pragmatic balance between short-term and long-term priorities, and make strategic choices that inform an incremental and actionable path forward.** Acknowledging and embracing these inherent, inevitable tensions, and working through them—not dissimilar to the many other tensions and choices that business leaders face every day—will drive generative outcomes.

### Compete

Defensive strategies and business models to maintain and grow existing competitive advantage



### Collaborate

Collaborative ecosystem-led strategies and business models to create and strengthen competitive advantage



*While increasing their focus on hybrid and electric drivetrains, a global motor vehicle manufacturer recognised an opportunity to expand their competitive advantage by enabling an ecosystem of players to pursue solutions that support customers living more electrified lifestyles overall. Together with leading solar energy, semiconductor, power management, and home appliances companies, a program was developed, exploring ways in which hybrid electric vehicles, solar power systems, energy-efficient appliances, and home design can be integrated to reduce the total carbon footprint.*

### Internalise

Embedding sustainability within the boundaries of businesses controlled core operations



### Influence

Embedding sustainability across the organisation's broader supply chain, and networks



*A Singaporean global food and agri-business' core purpose is to re-imagine global agriculture and food systems. They have embedded themselves into new knowledge and value networks to influence and transform their whole industry to find a more sustainable path. They recently secured a US\$176 million loan to provide support, stability and market access to smallholder farmers, securing their own supply chains in doing so.*

### Efficiency

Traditional industrial and manufacturing methods driving efficiency and low costs



### Environment

Higher cost green methods and technologies to produce carbon neutral products, or circular economy outcomes



*A global specialist energy management company has been awarded for seeing the potential to drive energy efficiency whilst simultaneously delivering environmental improvements. Applying circular economy principles to its product design, supply chain, corporate governance and elsewhere, they delivered advantages through prolonged product lifespan, innovative business models, and take-back schemes into their supply chain. Circular activities now account for 12% of their revenues, and will save 100,000 metric tons of primary resources from 2018-2020.*

**While a growing number of Australian and global businesses have already taken steps in the right direction, the scale and pace of change is not enough in the face of the challenge ahead.**

# Actions leaders can take to embed sustainability in their business strategy

**There is inherent challenge and complexity to embedding sustainability at the heart business strategy.** Challenges abound, from translating sustainability considerations into relevant business objectives and performance measures, to solving for tensions between sustainability imperatives and current business models, practices, and sources of differentiation, to the challenge of sourcing appropriate and effective data to evaluate whether the strategies employed are having the desired impact for monitoring and reporting purposes. But all of these can be overcome, and should not be an excuse for not taking action.

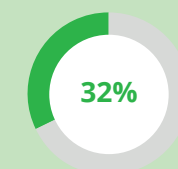
Business strategy and sustainability choices have historically been pursued independently (if at all), with sustainability considerations largely being viewed as an add-on externality falling under the mandate of the sustainability, or risk and compliance division alone. To realise the intended potential of sustainability in business strategy and the operational performance of the organisation, the first step is to **elevate and incorporate sustainability objectives with overall business objectives**, including in the setting and delivery of financial metrics.

However, we should not confuse compliance-related activities with how sustainability can create new sources of competitive advantage – these two activities should be treated separately. That said, to elevate sustainability objectives means they need to be incorporated into the strategic dialogue at both the executive and board level. **Evaluating sustainability objectives inherent in strategic options, and incorporating the cascading implications of those choices into business plans and operations is the most tangible action that leaders can take.** Leaders should seize this as an opportunity for new value creation within their own span of control and for the business as the whole.

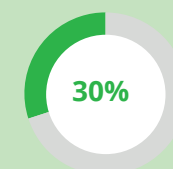
**To guide this action, and support leaders address the 'knowing – doing gap', a pragmatic approach that builds off the Monitor Deloitte StrategybyDesign™ methodology is outlined below.**

The approach focuses on aligning executive decision-makers on the available options and necessary actions required to achieve the overall aspirations of the organisation, given the current context and enacted strategy. Embedding sustainability in business strategy starts with having a clear intent and a compelling aspiration that highlights the integrated goals of the organisation, including how the corporate outcomes will be strengthened by incorporating sustainability. Developing and evaluating the strategic options available to an organisation that satisfy the aspiration need to be done so iteratively, incorporating divergent thinking and providing strategic flexibility as the choices made are put into action.

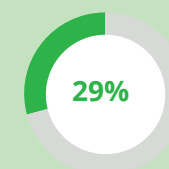
Our recent Global Survey findings also speak to some of the concerns and challenges holding back companies leadership from taking greater and faster action. In particular, business leaders report:



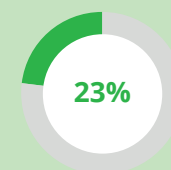
Difficulty developing an impactful strategy



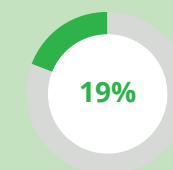
Focus on near-term business issues/demands from investors/stockholders



Hard to measure impact we are making on the environment

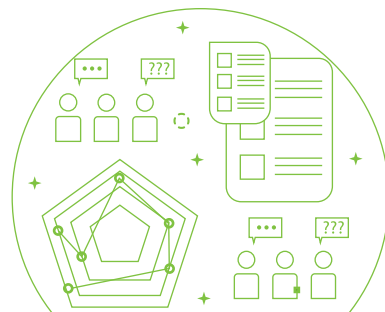


No function or executive specifically responsible for leading environmental-sustainability efforts



Not a natural fit with our business strategy model

Original question: "What, if anything, do you believe is holding back your company's leadership from taking more concrete actions to address climate change?"<sup>15</sup>



### 1. CURRENT STRATEGIES REVIEW

#### GET FOCUSED

Develop a clear expression of the current corporate and sustainability strategies

1. To what extent are our company and sustainability strategies aligned and mutually reinforcing?
2. To what degree are they in conflict and tension with one another?
3. Are our actions consistent with our strategies?

#### GET REAL

Analyse and “stress test” the existing sustainability strategy through a variety of lenses

1. How well is our strategy performing relative to our expectations and competition?
2. What is our current social license to operate/ trust levels with key stakeholders including investors, shareholders, customers, suppliers and employees?
3. Is our strategy dynamic enough to respond to the evolving regulatory environment and stakeholder pressures?

- Integrated view for board and executive on:
  - Current strategy (articulated, communicated and practically enacted strategic choices), and
  - Degree of embedment of sustainability in core strategy and business operations

- Identified strategic tensions and gaps in embedding sustainability in core strategy and business operations
  - Clear view of current stakeholder pressures and how they are likely to evolve
  - Emerging view of key opportunity areas for change



### 2. OPTION DEVELOPMENT AND SELECTION

#### GET CREATIVE

Develop strategic options and translate them into actionable strategies that drive sustainability and competitive advantage

1. Where and how can we better protect and enhance our business resilience and social licence to operate?
2. Where and how, within our business model, ecosystems and value chains, are we uniquely positioned to create and capture competitive advantage?
3. How can we build the ability to deal with uncertainty into our strategy?

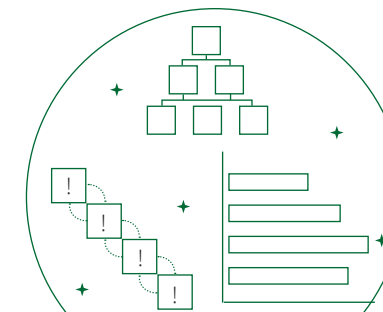
#### GET DECISIVE

Select strategic option(s) by focusing on the specific set of issues that act as barriers to choice

1. What are the key assumptions underlying our choices, that need to be true for our choices to be good strategic moves?
2. How do we balance short-term performance with long-term value creation and sustainability imperatives?
3. How can we drive to “final” choices for today, while keeping options in play to prepare for the unknown future?

- Expansive range of strategic options to:
  - Enhance sustainability and business model impact
  - Create competitive advantage
  - Build resilience

- Rigorously and collaboratively defined set of prioritised and actionable strategic choices



### 3. INTEGRATED STRATEGY DEPLOYMENT

#### GET COMMITTED

Determine actions required to execute the emergent strategy and how success will be enabled

1. What are the specific areas of transformation needed to embed sustainability in core business operations, and how prepared is our organisation for this?
2. How can we develop robust targets that demonstrate our commitment and provide a meaningful way to track our performance against the strategy?
3. How do we influence adjacent sectors, and ecosystem players within our value and supply chains?

#### GET GOING

Develop clear and effective action and communication plans for the new strategy, supported by a performance tracking system

1. What changes are required to give effect to our strategic choices, in what order of priority?
2. What measures and indicators will we use to track our combined business and sustainability impact? How will we integrate reporting, and enable iteration on strategic choices where required?
3. How can we best communicate, our strategy to, and galvanise our business and various stakeholders?

- Translation of new strategy into pragmatic roadmap of:
  - Discrete set of high impact, actionable initiatives
  - Defensible targets underpinned by robust rationale and methodologies

- Organisational readiness, processes and management systems to deliver on new strategy

#### Top 3 strategic questions

#### Outcomes

# About Deloitte and our strategy, sustainability and economics offerings

Embedding sustainability in business strategy and core operations requires careful consideration, planning and evaluation. We bring to you the combined expertise across Strategy, Sustainability, and Economics to pursue sustainability as a business outcome and not as an incidental issue.

Monitor Deloitte is Deloitte's strategy consulting practice. It assists senior executives of multinational companies in their efforts to achieve and reinvent growth, innovation, and competitiveness. Founded in 1983 by six entrepreneurs affiliated with Harvard Business School, including Michael Porter, the firm is now fully integrated within the Deloitte network and employs 2,500 consultants in 32 countries.

With a team of 50 consultants located across capital cities in Australia and 1,000 in the global network, Deloitte Risk Advisory Sustainability team works with clients across all areas of sustainability from strategy, leadership, environment, safety, social impact and supply chain. Their purpose is simple: to support Australia to become a more sustainable country and society for the long term.

Deloitte Access Economics is Australia's pre-eminent economics advisory practice and a member of Deloitte's global economics group. Deloitte Access Economics offers a full suite of economic advisory services including economic forecasting, modelling, analysis and advisory services to help our clients plan for the future, understand the implications of major decisions, and navigate the complexities of economic policy.

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# Footnotes

01. <https://www.unenvironment.org/interactive/emissions-gap-report/2019/>
02. <https://www.iea.org/reports/global-energy-review-2020>
03. The Sustainable Development Goals, also known as “Global Goals”, are a globally recognised agenda that defines shared aspirations for sustainable development, articulated around 17 Goals encompassing environmental, social and economic agendas. Since their introduction in 2015, they have gained a lot of traction as an agenda setting and reporting framework amongst for-profit, not-for-profit, and government organisations
04. “Research Report: SDG Measurement and Disclosure by ASX150”, RMIT and Global Compact Network Australia, October 2019, p. 31
05. See for example, Bloomberg analysis on ESG fund falling 12.2% in 2020, almost half the decline of the S&P 500, HSCB analysis of stocks with the highest ESG ratings outperforming the market by c.7% on average, or Morningstar analysis of 44% of ESG funds were top quartile in Q1 vs. 11% bottom quartile
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15. Survey conducted by Forbes Insights and Deloitte Global, engaging 350 executives from North America, Asia, Europe, and Latin America, across all sectors and industries. Access the full survey here: <https://www2.deloitte.com/global/en/pages/about-deloitte/articles/covid-19/business-climate-check>.



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