User's Guide to IFC's Sustainability Assessment and Improvement Tool for Midsize Growth Companies

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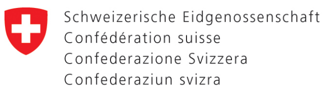

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Disclaimer

This is version 1 of the International Finance Corporation's (IFC) *Sustainability Assessment and Improvement Tool for Midsize Growth Companies.* Sustainability in the context of small and medium enterprises is a fast-evolving field with many variables. We plan to refine and evolve this Tool in subsequent versions, based on our operational experience and feedback from users. If you use this Tool and have observations to share, or if you want to create derivative products from this tool, please contact the program lead, Alexey Volynets, at avolynets@ifc.org.

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Introduction

Rapidly growing midsize companies are an important segment of small and medium enterprises (SMEs) and are critical providers of employment, innovation, goods, and services in developed and emerging markets. Such midsize growth companies (MGCs) face many of the same sustainability challenges as larger firms but with more nascent organizational capacity and constrained physical capital, human capital, and financial resources. Thus, every MGC stands to benefit from guidance and tools on environmental, social, and business sustainability that are tailored to MGCs' unique organizational and resource characteristics and limitations. The International Finance Corporation (IFC)—building upon its long-standing work on corporate governance, SMEs, and sustainability in emerging markets—has developed the *Sustainability Assessment and Improvement Tool for Midsize Growth Companies*. The Tool's structure and content are consistent with and reinforce IFC's evolutionary approach to SME governance and institutional development. It focuses on fit-for-purpose, practical solutions that consider the resource and leadership limitations that SMEs in emerging markets typically face.

This user's guide summarizes the philosophy behind the main features of the Tool (section 1, Why This Tool?) and orients users (principally business consultants to MGCs, MGC executives, and internal sustainability champions) to apply it in ways that provide MGCs with practical solutions to their sustainability challenges (section 2, Using the Tool).

Section 1. Why This Tool?

The Tool's Purpose

The Tool is designed to help MGCs (the upper and growth-affected end of the SME segment) understand, prepare for, and respond to the economic, environmental, and social sustainability challenges that accompany rapid growth. Its principal firsthand users are expected to be advisers to MGCs, such as business consultants. The Tool may also be useful to senior MGC executives, in-house sustainability experts, and internal champions.

The Tool is built to respond to business needs, not compliance requirements. IFC's work with SMEs has clearly shown that compliance considerations are rarely if ever sufficient to motivate SME leadership to embrace systematic attention to environmental, social, and governance (ESG) factors, at least in emerging markets.

IFC and Midsize Growth Companies

IFC has long been a leader among financial institutions in promoting environmental and social sustainability and best practices in corporate governance. IFC's Environmental and Social Performance Standards define IFC clients' responsibilities for managing their environmental and social risks.[1] Many public and private sector financial institutions draw on the IFC Performance Standards when developing their own criteria. Tools developed by IFC are the core of the Corporate Governance Development Framework, the methodology for evaluating and improving corporate governance in emerging markets companies adopted by nearly every other development finance institution.[2]

Rapidly growing midsize companies play an essential role in economic development. In emerging markets, SMEs generate up to 45 percent of total employment and about one-third of gross domestic product.[3] Larger, expanding SMEs—MGCs—are a particularly important bridge between the informal and formal sectors, contributing to the tax base and providing many workers with their first formal employment experience and entry into national social security systems.

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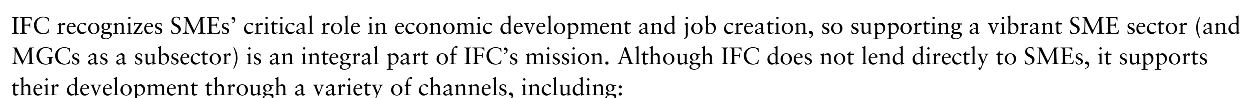
[1] See the IFC Performance Standards at https://www.ifc.org/en/insights-reports/2012/ifc-performance-standards.
[2] Governance Development Framework at https://cgdevelopmentframework.com.
[3] Organisation for Economic Co-operation and Development (OECD). 2017. *Enhancing the Contributions of SMEs in a Global and Digitalised Economy*. Paris: OECD. https://www.oecd.org/industry/C-MIN-2017-8-EN.pdf.



IFC recognizes SMEs' critical role in economic development and job creation, so supporting a vibrant SME sector (and MGCs as a subsector) is an integral part of IFC's mission. Although IFC does not lend directly to SMEs, it supports their development through a variety of channels, including:

1. Providing advisory services to SMEs and organizations that support them;
2. Investing in and supporting banks and other financial institutions that finance SMEs;
    a. Issuing credit lines and similar facilities to local financial institutions targeted to SMEs, such as the Global Trade Supplier Finance Program; and
    b. Investing in private equity and other investment funds that provide equity and debt financing to SMEs.

An Important Distinction: ESG versus Sustainability

Users of the Tool are encouraged to emphasize the concept of sustainability rather than using the term "ESG" in discussions with company owners and managers. The concept of ESG—combining environmental, social, and governance considerations in evaluating businesses—originated mainly in the investment community in the context of investments in large public companies.[4] Investors know that good governance is positively associated with company performance and investment returns, especially in the long term.[5] They have also learned that environmental and social factors may present businesses with severe, often catastrophic risks. Investors recognize that effectively addressing environmental and social risks requires the attention of a company's top decision-makers.

From an institutional investor's perspective, considering environmental, social, and governance together often makes sense. Investors traditionally divide investment risks into financial and nonfinancial categories. Nonfinancial risks can be conveniently organized under environmental, social, and governance headings. Investors, especially those in public markets, are increasingly demanding more quantitative measurement of nonfinancial risks by portfolio companies, in accordance with accepted ESG frameworks and reporting standards. These demands subsequently generate pressure for firms to establish more explicit and robust structures, policies, procedures, and goals for governing, managing, and reporting ESG risk.

As many users of the Tool will recognize from experience, the rationale for grouping environmental, social, and governance together is not always apparent to the people who run companies. In fact, entrepreneurs—especially those who run smaller, privately-held firms— may think that many of the ESG tools and guidance that investors have developed or promoted are strange or fundamentally misguided. To the owner-managers of such enterprises, many investor-driven demands regarding ESG can seem like distractions from the priority risks and challenges on which they need to keep their focus to run a successful business. This impression is especially true for midsize companies that may have not yet experienced pressure from their external investors or regulators to measure and disclose ESG performance.

Therefore, the Tool downplays the ESG acronym and defines its objectives around the concept of sustainability, a term its authors believe is more likely to get traction with SME and MGC owner-managers in emerging markets. Sustainability is a closely related concept to ESG, but it is also meaningfully distinct. Sustainability is a term that company advisers can use to describe an entire approach to running a business—at the highest, governance level—to make it more likely to survive and prosper in the long term. Sustainability ensures that the company is taking the right steps to have reliable and continued access to essential resources and the support of key stakeholders.

Sustainability certainly requires careful attention to environmental and social factors. Still, it incorporates a much broader view of business risks and issues known to be paramount for businesses' long-term development. Meaningful staff engagement is one example. Most important, sustainability starts from the *owner-manager's* view of the company—from the inside out instead of the investor's view from the outside in. So sustainability prioritizes the factors that the firm's leadership accepts as relevant to long-term success.

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[4] Georg Kell. 2018. "The Remarkable Rise of ESG." *Forbes,* July 11, 2018. https://www.forbes.com/sites/georgkell/2018/07/11/the-remarkable-rise-of-esg/?sh=2025cafb1695.
[5] Alexander T. Kraik. 2020. "Environmental, Social, and Governance Issues: An Altered Shareholder Activist Paradigm." *Vermont Law Review* 44 (3): 493–535.

The Target Audience: What Do MGCs Look Like?

The *Sustainability Assessment and Improvement Tool for Midsize Growth Companies* defines MGCs as larger SMEs that have experienced a recent (and often continuing) sustained period of high growth. In contrast to less dynamic (and typically less formal) smaller enterprises, MGCs have achieved reasonable scale and viability. The market values their products, and their business model has proved workable so far. Their scale and growth prospects are typically the rewards of considerable technological innovation, organization adaptation, and company leadership's laser focus on identifying and exploiting opportunities to produce and sell their core products and services at lower cost while staying ahead of the competition.

MGCs typically exhibit most of the following operational and governance characteristics:

Operational Characteristics

- Have 75 to 250 employees (varies by country and sector).
- Have significant capital requirements. They are in the market for additional capital and strategic partnerships to support further growth.
- Have a degree of delegated functions, but concentrated control. Some operational duties have been delegated, but the owner-managers retain complete strategic control. They receive limited strategic input from other executives and specialists, mainly through *ad hoc* meetings and consultations.
- Have organizational structures resulting from *ad hoc* decisions and that exhibit path dependence. Basic organizational structures and lines of authority coexist with a substantial degree of informality (and sometimes intentional ambiguity). Some functions and processes have been professionalized, while others remain legacy ("the way we have always done it" or "by the person who has always done it").

Governance Characteristics and Patterns

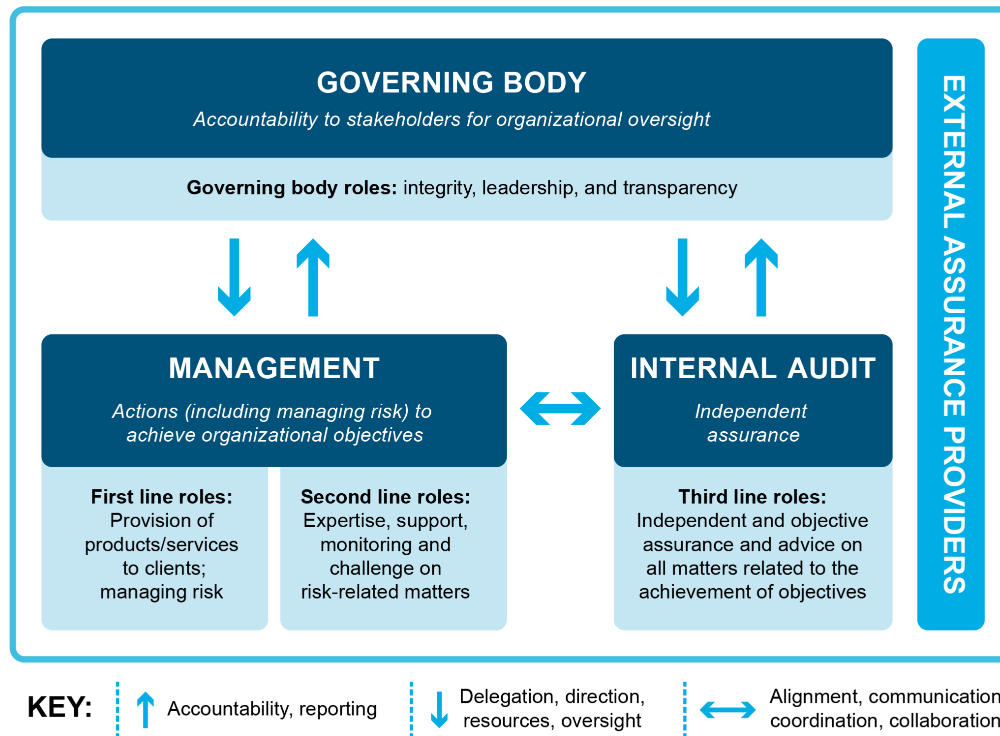
- Are owner-run. One or two main owner-managers, typically founders, are fully engaged in running the company. Minority shareholders may exist, but they are either employees or related to founders by family or friendship ties.
- Have limited institutionalized management. Management has started to function as a team but often informally and mainly focused on operational issues rather than strategic direction.
- Make decisions informally. Owner-managers make strategic decisions through informal meetings. The company either does not have a board of directors, or the owner-managers and their families and friends fully control the board.
- Exhibit fragmented reporting systems. Management information systems exist in silos. They produce inconsistent data using metrics and formats and are not reconcilable in real time.
- Have opportunistic, organically developed piecemeal internal controls and risk management. The overall risk management approach does not reflect the standards of the Institute of Internal Auditors' Three Lines Model.[6]
- Have family member employees. Some members of the founders' families work for the company.

MGCs are typically entrepreneur-driven and to a great extent still entrepreneur-dependent, which makes them people-dependent instead of process-driven. The demands of rapid innovation and growth, along with the constant threat of competition, impel management and staff to focus primarily on what appear to be the most urgent challenges, often excluding factors that will be crucial to their company's success over the medium to long term. The time pressures, bandwidth limits, resource constraints, and organizational limitations facing their leadership mean that a systematic approach to environmental, social, and economic sustainability has had to take a back seat.

[6] Institute of Internal Auditors (IIA). 2020. *The IIA's Three Lines Model: An Update of the Three Lines of Defense*. Lake Mary, FL. IIA. https://www.theiia.org/globalassets/site/about-us/advocacy/three-lines-model-updated.pdf.

The Three Lines Model

The Institute of Internal Auditors' Three Lines Model "helps organizations identify structures and processes that best assist the achievement of objectives and facilitate strong governance and risk management."[a] Before 2020, this approach was called the Three Lines of Defense.



The model breaks down the functions of an effective risk management model three lines:

1. Operational functions that provide products and services to clients (the ultimate owners of risk)
2. Internal functions that specialize in supporting, monitoring, and challenging on risk-related matters
3. Independent and objective assurance

In most companies, especially SMEs and MGCs, an individual person or business unit may play a role in more than one of these lines. The Three Lines Model places ultimate responsibility for oversight of the effectiveness and evolution of risk management with what it calls the governing body. In enterprises with more advanced governance, the governing body is the board of directors. However, the Tool's practical approach recognizes that in many (if not most) MGCs, boards are nonexistent or weak, and the owner-manager (or owner-managers) supported by the senior management team form the *de facto* governing body.

Source: Institute of Internal Auditors (IIA). 2020. *The IIA's Three Lines Model: An Update of the Three Lines of Defense*. Lake Mary, FL. IIA, 1. https://www.theiia.org/globalassets/site/about-us/advocacy/three-lines-model-updated.pdf.

Responding to the Special Challenges of Sustainability for MGCs

MGCs' experience of growth itself figures most prominently in generating their sustainability risk. Operational expansion outstrips the company's institutional development. As already noted, MGCs are typically entrepreneur- and people-driven. Organizational structures and operating policies and practices that such individuals found workable before the period of rapid growth often fall short in internalizing sustainability principles in their businesses along three dimensions:

1. **Company leadership has still not entirely identified or thoroughly analyzed the sustainability implications of existing business models and activities.** The Tool recognizes that in most (if not all) MGCs, institutional capacity (consisting of management, control and governance structures, policies, and practices) must catch up with and keep up with the size and complexity of operations that come with rapid growth. Users of the Tool will be working with companies that have recently experienced a period of rapid growth and may still be in the middle of it. Such growth creates a set of serious challenges for any company's economic sustainability. At least half of companies in emerging markets that experience a period of high growth exit the market altogether three to six years after the episode.[7] For example, rapidly scaling production may lead to organizational and managerial inefficiencies and a high concentration of risk in a few select individuals. Advisers to MGCs should see the Tool as a practical resource to help companies avoid the so-called "curse of fast growth" by transitioning to new governance, managerial, and organizational practices that are fit for purpose, considering the company's new size and complexity, and thus building the foundation for its long-term sustainability.

2. **Current governance structures, policies, and practices do not adequately incorporate considerations of environmental, social, and economic sustainability factors in strategic and operational decision-making.** A company's long-term sustainability ultimately requires its leadership to devote continuous attention to various business risks and opportunities. Two factors traditionally have not been systematically included in this analysis, but are increasingly recognized as critical to long-term success: environmental sustainability (such as air, water, and soil) and social sustainability (such as employees, customers, and community). Midsize businesses face increasing pressure from government, customers, supply chain partners, lenders, and others for information about environmental and social practices and the impact their operations and products have on the environment and community. Thus, environmental and social factors now need to feature prominently in sustainability analysis and action planning.

3. **Policies and practices concerning *future* growth opportunities are still inadequate to identify and address sustainability risks and opportunities as the company's activities evolve and expand.** MGCs' experience of growth and their growth potential distinguish them from other medium-sized enterprises. The growth strategy and trajectory that an MGC pursues are essential determinants of the types and degrees of sustainability risk that come with its growth.

Advisers to MGCs need to help company management tackle two critical tasks at once to build resilient businesses that will be sustainable over time:

1. Fully identify, analyze, and understand the sustainability challenges of *existing* business models, production processes, and company strategies, and adopt sustainability policies and practices that are well-tailored to them (catching up, sustainability of current operations).

2. Prepare to identify and understand the sustainability risks and opportunities they need to *anticipate* because of the rapid evolution and expansion of existing ways of doing business, and the future adoption of the types of new products, production methods, systems, markets, sources of finance, and so on that will power additional growth (moving forward, prospective sustainability).

Proper governance structures, policies, and practices are inherent in any effort to tackle these two critical tasks sustainably.

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[7] Arti Grover Goswami, Denis Medvedev, and Ellen Olafsen. 2018. *High-Growth Firms: Facts, Fiction, and Policy Options for Emerging Economies*. Washington, DC: World Bank. https://openknowledge.worldbank.org/entities/publication/96a13576-bd21-5dad-96ed-075807b06707.

Catching Up: Responding to MGCs' Current Institutional Realities

Increasing institutional capacity and resilience does not mean blindly laying on bureaucratic burdens. The structures, policies, and processes that might be workable for larger companies can be wasteful or even counterproductive if applied to smaller, less established firms. For MGCs, the challenge is to achieve the same objectives that their larger competitors should be pursuing: incorporating consideration of sustainability factors in strategy and operations. But MGCs need to do so in ways that are consistent with the company's entrepreneurial nature and that make the best use of limited resources. For this reason, the Tool's approach explicitly considers the stage of a company's business evolution and of its institutional development.

The Tool adopts the approach to the evolution of SMEs set out in IFC's 2019 *SME Governance Guidebook* (Figure 1.1). The guidebook "specifically addresses the challenges and opportunities faced by SMEs at the various stages of their lifecycles, offering tailored corporate governance recommendations for these smaller businesses."[8]

Users of the Tool are encouraged to become familiar with the guidebook, which divides SME evolution into four stages:

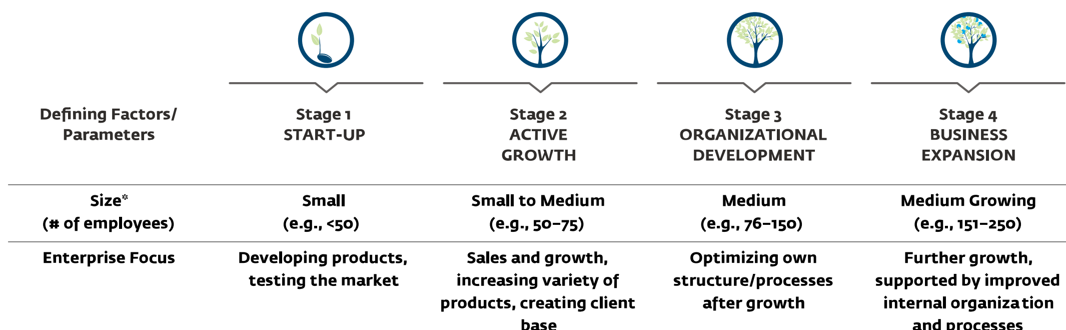
Stage 1: Start-Up. Product and service development and market testing are the first priorities.

Stage 2: Active Growth. The need for growth through sales, people, and increasing complexity are this stage's defining features. This growth remains largely organic, unplanned, and unbalanced.

Stage 3: Organizational Development. Once the organization has grown in size and complexity, it becomes a priority to correct the imbalances and develop the organization through specialization, professional policies, structures, and staff. The focus is on the company itself.

Stage 4: Business Expansion. Additional capital is often needed to take the organization to the next level. When this capital comes in the form of equity, an increase in the number of shareholders necessitates more formality in the corporate governance arrangements.[9]

Figure 1.1. Evolution of SMEs



Defining Factors/ Parameters	Stage 1 START-UP	Stage 2 ACTIVE GROWTH	Stage 3 ORGANIZATIONAL DEVELOPMENT	Stage 4 BUSINESS EXPANSION
Size* (# of employees)	Small (e.g., <50)	Small to Medium (e.g., 50–75)	Medium (e.g., 76–150)	Medium Growing (e.g., 151–250)
Enterprise Focus	Developing products, testing the market	Sales and growth, increasing variety of products, creating client base	Optimizing own structure/processes after growth	Further growth, supported by improved internal organization and processes

Source: SME Governance Guidebook

The Tool is designed principally for firms that fall into the guidebook's stage 3 (Organizational Development) or stage 4 (Business Expansion) categories. It may have some partial application for earlier stage companies with special motivating factors, such as the presence of outside investors or participation in global supply chains. The Tool effectively expands on the guidebook's governance-centric recommendations for these stages with a more in-depth treatment of sustainability issues. As such, the Tool can be thought of as a *governance for sustainability instrument,* adjusted for the realities of MGCs and focused on economic, environmental, and social sustainability. It draws from the lessons of IFC's long experience with SME development and reflects a tailored, fit-for-purpose approach to corporate governance and environmental and social sustainability in midsize companies in emerging markets.

In addition to the guidebook, the *Sustainability Assessment and Improvement Tool for Midsize Growth Companies* also draws on other important work by IFC and other standard setters, notably IFC's Environmental and Social

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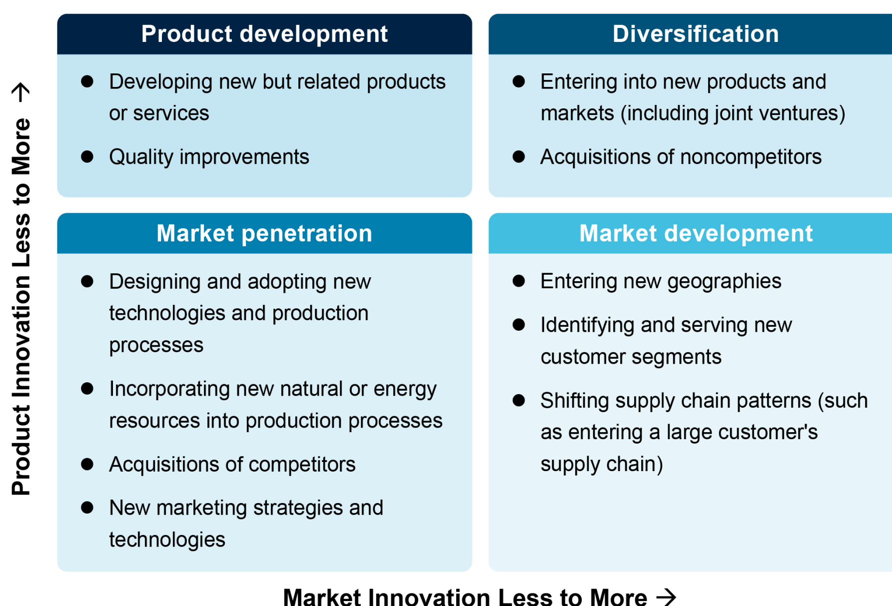
[8] International Finance Corporation (IFC). 2019. *SME Governance Guidebook*. Washington, DC: IFC, https://www.ifc.org/en/types/insights-reports/2010/sme-governance-guidebook.
[9] IFC, SME Governance Guidebook, 9–24.

Management System Implementation Handbook: General, its Internal Control Handbook, and the Committee of Sponsoring Organizations of the Treadway Commission and World Business Council for Sustainable Development's Enterprise Risk Management: Applying Enterprise Risk Management to Environmental, Social, and Governance-Related Risks. One of the Tool's main features is that it identifies and cross-references existing frameworks, tools, and standards for analyzing and responding to the types of sustainability challenges MGCs face.

Moving Forward: The Dimensions and Sustainability Risks of Future Growth

The Ansoff Matrix (Figure 1.2) is one of the oldest and still most often used frameworks for classifying and analyzing business innovation.[10] The Ansoff Matrix distinguishes enterprise growth along two dimensions: market expansion and product innovation.

Figure 1.2. Ansoff Matrix

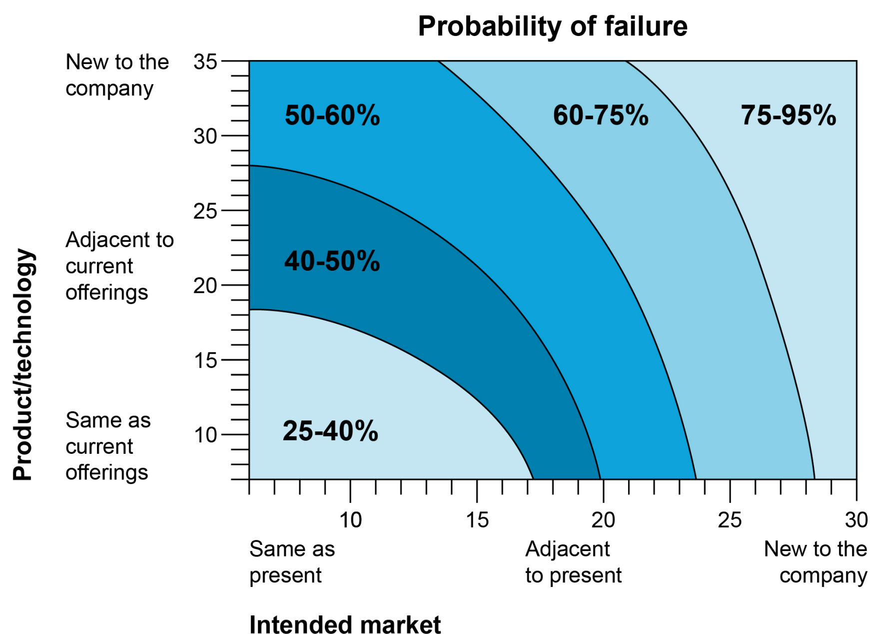


Source: https://www.ansoffmatrix.com/ and https://en.wikipedia.org/wiki/Ansoff_matrix

Each combination of market expansion and product expansion described in figure 1.2 poses different types and levels of risk for an organization, with entering new markets usually creating measurably higher chances of failure than developing new products for existing customers. Business consultant and educator George Day estimated the risk distribution as follows (Figure 1.3):[11]

[10] See Oxford College of Marketing. n.d. "Using the Ansoff Matrix to Develop Marketing Strategy." https://blog.oxfordcollegeofmarketing.com/2016/08/01/using-ansoff-matrix-develop-marketing-strategy/.
[11] George Day. 2007. "Is It Real? Can We Win? Is It Worth Doing? Managing Risk and Reward in an Innovation Portfolio." *Harvard Business Review*, December 2007. https://hbr.org/2007/12/is-it-real-can-we-win-is-it-worth-doing-managing-risk-and-reward-in-an-innovation-portfolio.

Figure 1.3. The Risk Distribution



Source: Harvard Business Review

1. Market share capture is the least risky strategy. It assumes growth with the same product or products in the same market. It is essentially a default strategy: "to continue doing what we have been doing so far," just more of it.

2. Product development increases the risks for the enterprise considerably. Production might entail unanticipated or unfamiliar requirements, the company might not prove particularly suited to making the new product, customers may not like it, and/or there might be strong competitors.

3. Market development strategies typically have a higher probability of failure than product development strategies. Moving into new geographies, new demographics, or new categories of customers is generally costly, involves high levels of uncertainty, and strains human resources.

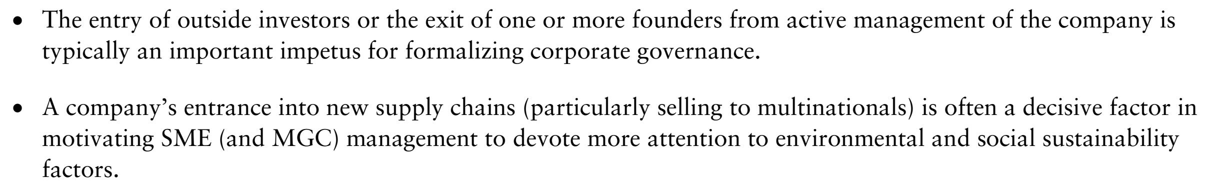
4. Diversification, pursuing product innovation and market development at the same time, is by far the riskiest strategy.

The Tool considers the dimensions of an MGC's current and likely future growth trajectory. It recognizes that the dimensions of growth just discussed increase the importance of certain sustainability risks or create opportunities to address them. Thus, the Tool prioritizes certain recommendations when an MGC's growth strategy is focused around product innovation and certain others when the strategy revolves around expansion into new markets:

- The core (unconditional) recommendations are intended for companies that plan growth of the market penetration type.

- Conditional recommendations are included to address the special sustainability issues and priorities that come with different growth strategies. For example, the Tool's recommendations for companies pursuing growth through product development emphasize enhancing risk governance systems that provide adequate oversight of environmental and social risks often associated with introducing new technologies. Similarly, MGCs contemplating market expansion are encouraged to beef up their strategic planning process, seek the support of experts with experience in the target market, and pay particular attention to the additional social risks that may arise from entry into such markets.

Two additional factors are given special treatment, based on IFC's experience with SMEs in general and MGCs specifically:



- The entry of outside investors or the exit of one or more founders from active management of the company is typically an important impetus for formalizing corporate governance.
- A company's entrance into new supply chains (particularly selling to multinationals) is often a decisive factor in motivating SME (and MGC) management to devote more attention to environmental and social sustainability factors.

Section 2. Using the Tool

The Tool's Structure and Design

IFC's *Sustainability Assessment and Improvement Tool for Midsize Growth Companies* is an Excel-based instrument. It allows users to conduct a structured examination of a company's current sustainability policies, practices, risks, and opportunities and identify specific priority actions tailored to its own business model and strategies. The Tool is organized around the following topics:

1. Vision, values, and culture
2. Decision-making and strategic leadership
3. Human capital
4. Risk governance and internal control system
5. Audit
6. Disclosure and transparency
7. Ownership
8. Governance of stakeholder engagement

The Tool breaks each topic into core sustainability principles, supported by specific recommended practices. In the Tool screenshot (Figure 2.1), for example:

- "Human capital" is a topic.
- "The company is prepared for foreseeable leadership contingencies" is a principle.
- "The company has a contingency or business continuity plan for the CEO and other key managers and technical specialists if they should depart suddenly or become unavailable" is one of the recommended practices to implement the principle.

Figure 2.1. Sustainability Assessment and Improvement Tool

	A	B	C	D	E
1	Recommended Practices	Status of Implementation	Action Items	Importance	Explanation and Guidance
38	Management and the board have clear and effective channels of communication with employees of the company				
39	The management has established clear channels to keep employees up to date on key developments affecting the company and changes in company policies.			High priority	Management-employee channels of communication, such as CEO e-mail or video updates, may also extend to include periodic "town hall" meetings or virtual video chats. However conducted, these should enable and encourage staff questions and feedback (including anonymous, where appropriate).
40	Management, shareholders, and the Board of Directors have agreed to a policy on Board communications with employees that accords Board members appropriate access to staff beyond the senior management team.			Conditional on establishing a board of directors	Board members will have a better understanding of the company if they can interact employees beyond the C-suite. To prevent mixed signals or the development of real or imagined back channels between the Board and the personnel, such communication should be conducted in accordance with a set of transparent policies and procedures. The company leadership needs to be informed of the purpose and outcomes of such communication.
41	Human Capital				
42	The company is prepared for foreseeable leadership contingencies (succession)				
43	The company has a contingency or business-continuity plan for the CEO and other key managers and technical specialists if they should depart suddenly or become unavailable.			High priority	Unexpected departures of key managerial and technical personnel is a leading cause of crisis in midsize companies.
44	The company has a detailed strategic (long-term) succession plan for the CEO, senior executives, and key technical specialists.				Management and the board should review the succession plan annually to ensure that it continues to provide a realistic roadmap for preparing junior staff to fill senior positions in the future and for sourcing outside talent.

... Principles | Action Planning Matrix | Resources

Source: IFC.

Reflecting IFC's evolutionary approach to SME development, the Tool has some characteristics of a progression matrix. The recommended practices under each topic progress from the basic to the more sophisticated and are listed in suggested sequential implementation order. Thus, an MGC using the Tool would ordinarily complete implementation of one recommendation under a principle before moving on to the next. But perhaps more important, the progression approach helps companies to use the Tool as a road map for medium- and longer-term action plans to make their sustainability approaches, policies, and practices adequate to the size and complexity of their current and future operations.

The *Principles* tab of the Excel-based Tool provides a quick summary of the sustainability principles. The *Action Planning Matrix* tab (depicted in Figure 2.1) is the heart of the Tool and provides the complete set of topics, principles, and action items. The *Resources* tab lists available tools and other resources that can provide additional detailed guidance in implementing the recommended practices for each principle.

Column A of the *Matrix* tab lists the recommended practices. Column B allows users to indicate the status of implementation (done or not done) or comment more extensively on partial implementation. Similarly, column C, Action Items, allows users to mark recommended practices to implement ("to do," for example) or comment more extensively if the recommended practices need to be customized.

Column D, Importance, provides space for users to indicate the priority level for the recommended practices they choose to implement (high, medium, or low). Some recommended practices have been pre-marked as "high priority." These practices can potentially generate high sustainability impact or influence multiple other practices in the company. However, these are intended as general recommendations, and users should feel free to change the level of importance of a given item, depending on the company context.

The topics in the Tool include high-level, strategic issues that in larger, more established firms typically fall under the purview of the board of directors. The Tool's recommendations are prioritized recognizing that MGCs often lack functional boards of directors (especially if there are no outside investors). So the recommended actions prioritize the value of building an effective management team by formalizing a management committee, hiring external advisers, and creating an advisory board that may eventually evolve into a proper board of directors.

The same column D also provides an indication of whether a practice is intended as "conditional." The importance of certain recommended practices included in the matrix depends on whether certain events or circumstances have occurred. "Conditions" that increase the importance of some of the recommended practices include, for example, whether the company is selling into multinational supply chains (which can trigger the need to adopt new environmental and social standards and reporting required by its customers) or the entry of private equity investors (who may demand more formal governance structures and practices and greater disclosure). The nature of the company's growth strategy is another important condition that users of the Tool are encouraged to keep in mind. As discussed in the context of the Ansoff Matrix, entry into new markets is typically a riskier strategy than product innovation. Thus, the Tool encourages companies contemplating market expansion to be particularly attentive to the operational standards and internal control implications of entry into new geographic or demographic markets.

Column E, Explanation and Guidance, provides the rationale for the recommended practices or guidance for implementation.

The application of the Tool should generate three outputs:

1. An assessment of the adequacy of sustainability, including related gaps in the company's attitudes, policies, processes, and practices. This assessment is initially articulated by the user under Status of Implementation in the matrix.
2. A plan of priority or immediate actions to synchronize the company's policies, processes, and practices with the size and complexity of its operations after a period of growth, drawn from the action items evaluated to be of high importance.
3. A longer-term plan for sequenced improvements to prepare the company for the sustainability risks and challenges associated with its expected future growth trajectory (especially if significant changes in the company's ownership structure or business strategy are anticipated), drawn from the recommended practices deemed to be conditional items or of lower current importance.

We recommend returning to the Tool periodically to regularly reassess the company's progress and plans.

Getting Started: Scoping and Orientation

Prioritizing the Tool's recommended actions inevitably requires its user to make certain judgment calls that depend highly on company-specific context. Therefore, before using the Tool, we recommend that the company's advisers conduct a preliminary analysis to reach a broad understanding of which company characteristics and conditions are most important to its ultimate sustainability in the context of its history and growth trajectory.

The appendix provides a Scoping and Orientation Questionnaire to help prepare the company and its advisers for conducting the Tool's diagnosis and action planning. We omit generic business issues that any adviser would need to understand, such as ownership structure, and focus instead on issues related directly to sustainability.

The questionnaire is organized into four broad topics: business model, company purpose, values and culture, and essential assets and resources. Company advisers should use the questionnaire to conduct a structured dialogue—among the adviser, the owner-managers, and other company leadership—to examine the company's strategy and growth plans through a sustainability lens. Advisers should compare the answers they receive from different individuals, operational and functional units, and employees at different levels of seniority and responsibility. Inconsistencies and ambiguities should be brought to the company leadership's attention and should motivate them to address gaps in practices and policies, inadequacies in communication with personnel, inadequate training of personnel, and shortcomings in corporate culture.

The concrete output of this work should be a report summarizing the adviser's understanding of the four topics, along with an initial assessment of the company's characteristics and conditions that are most important to its ultimate sustainability, along with the most immediate sustainability risks and opportunities facing the company. This preparatory work also has the added benefit of making sustainability consciousness part of the company mindset and culture.

We wish you a great sustainability journey and leave you with this quote from Colin Mayer, University of Oxford professor and academic lead of the Future of the Corporation Programme, led by the British Academy:[12]

> "The purpose of business is to solve problems profitably, and not to profit from causing or exploiting problems."

[12] Richard Lofthouse. 2020. "Purpose Unlocks Profit: An Oxford Professor Discusses a Blueprint for the Reform of Capitalism." Oxford Alumni, January 15, 2020. https://www.alumni.ox.ac.uk/quad/article/purpose-unlocks-profit.

Appendix: Scoping and Orientation Questionnaire

We recommend that before using the *Sustainability Assessment and Improvement Tool for Midsize Growth Companies,* the company's advisers should conduct a series of interviews to reach a broad understanding of the following aspects of its operations:

1. Business model
2. Company purpose
3. Values and culture
4. Essential assets and resources

1. Business Model

Numerous tools and analytical frameworks have been developed to help companies and their advisers analyze a company's business model. Most business consultants have their favorites. The Business Model Canvas, originally developed by Alexander Osterwalder and popularized through the Strategyzer platform, serves this purpose well.[13] Other frameworks are more attuned to the characteristics of companies operating in specific industries or at different levels of maturity.[14]

Most frameworks help the company identify and articulate its value proposition, key activities, customers, partners, and cost and revenue structure, among other relevant factors. For the purposes of the Tool, it is particularly important that the chosen framework help the company identify:

- Who are the key customers? What are their needs and values?
- What are the key assets and resources needed to deliver on the company's business model?

The latter should include intangible assets and resources that do not appear in the company's accounts—such as the firm's reputation and the degree of employee and other stakeholder satisfaction—but which are critical parts of the company's recipe for success.

2. Company Purpose

Any articulation of a company's business purpose is likely to be somewhat imprecise. Nevertheless, it is useful to company leadership and their advisers to try to articulate as clearly as possible what drives the company's ownership and management to pursue the business in which the company is engaged.

- Why was the company established? What was it set up to accomplish?
- Is this well understood throughout the company's ranks?
- How successful is the company in accomplishing its objectives? Where is it falling short?

Because most MGCs are entrepreneur-driven and still entrepreneur-dependent, their business purpose is inseparable from the shareholder-managers' own motivations for establishing the company to engage in its specific business. Engaging these individuals in open discussion about their personal motivations can help them and the adviser assess the degree of consistency of the company's objectives with those of its controllers and thus the long-term trajectory of the company.

[13] For more information about Strategyzer, see https://www.strategyzer.com/canvas.
[14] Julian Krumeich, Thomas Burkhart, Dirk Werth, and Peter Loos. 2012. "Towards a Component-based Description of Business Models: A State-of-the-Art Analysis." *AMCIS 2012 Proceedings* paper 19. https://aisel.aisnet.org/amcis2012/proceedings/EBusiness/19/.

- Is the company's purpose as understood by the top management consistent with the shareholder-managers' motivation?

- Is the company's purpose consistent with its business model? What possible contradictions might exist?

Any discrepancies and inconsistencies have to be articulated, brought to the shareholder-managers' attention, and resolved.

3. Values and Culture

Corporate values are the beliefs and principles that underlie a company's culture and ultimately determine its actions. If attitudes among the company's employees are inconsistent with the behaviors that executing the strategy requires, the company will fail.

Developing company culture is a highly collaborative process involving owners, management, and all staff. Its crucial elements and actions, such as its code of conduct and management-employee communication, are covered in the Tool. However, before the company can undertake specific actions to develop, improve, or change corporate culture, the shareholders and top managers need to have a good understanding of the key parameters of the desired outcome.

- What are the implications of the company's purpose and business model for the company's paramount values and culture?

- What aspects of the company's business should drive the key characteristics of the company's culture? Where does the company's culture currently fall short?

- What should differentiate the company's culture from those of its competitors?

- What leadership and employee behaviors and attitudes are needed to address customers' key needs and values?

- What leadership and employee behaviors and attitudes (elements of the current culture) are *not* consistent with customers' key needs and values? Why do such counterproductive behaviors and attitudes persist?

- How can company leadership set an example?

4. Essential Assets and Resources

In the initial examination of the company's business model, the leadership will have identified some of the most essential assets and resources required for the company's operations. Before using the Tool, the adviser and the company should explicitly inventory the *tangible and intangible assets and resources that are most critical* to the company's operations and success. They should give special attention to strategic assets and resources that are valuable, rare, or difficult to imitate or substitute.

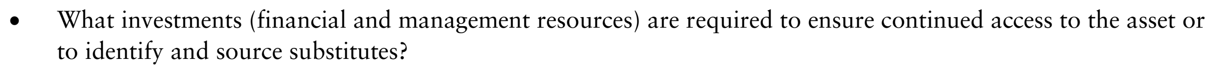
The key resources inventory collected as part of the business model analysis will likely be incomplete. However, the company and its adviser should identify with a higher degree of granularity the *environmental* assets and resources (natural capital) on which the company relies: water, energy, natural resources, and so on. Intangible assets may include social assets such as positive labor relations, a diversified workforce reflective of the community in which a company operates, an ethical supply chain or an outstanding product safety record. Properly identifying and understanding the company's essential assets and resources positions the company leadership and advisers to assess the sustainability of continued reliance on them.

- Is the company's use of assets consistent with its purpose and values? Is it consistent with the values of its key customers?

- How reliable is access to assets and resources at current and projected levels of consumption?

- What are the types of events that might impede the company's access to the assets?

- What substitutes exist, and what are the long-term costs of substitution?



- What investments (financial and management resources) are required to ensure continued access to the asset or to identify and source substitutes?

Working through the questions should put MGC leadership in a better position to consider the company's expected growth trajectory in the context of its current capacities and limitations and to prioritize actions recommended in the *Sustainability Assessment and Improvement Tool for Midsize Growth Companies*.

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