SUSTAINABILITY AS INSTITUTIONAL DESIGN: GOVERNANCE, CULTURE, AND STRATEGY IN ICELANDIC BANKS

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Abstract

This research investigates how sustainability is structurally and strategically embedded within the Icelandic banking sector, contributing to broader conversations on corporate responsibility and institutional transformation. The study explores how banks organize themselves internally to implement environmental, social, and governance (ESG) principles amid intensifying regulatory requirements, rising stakeholder expectations, and mounting climate risk (Eccles et al., 2014; Edwards et al., 2023). The analysis draws on qualitative data from four commercial banks in Iceland. It provides an in-depth examination of how sustainability is operationalized not merely as policy rhetoric, but as embedded practice (Lozano, 2015).

Sustainability in banking has evolved from a peripheral, voluntary concern to a strategic and regulatory imperative (Boyle et al., 2022). Yet this shift is neither linear nor automatic. Instead, it is shaped by internal structures, reporting lines, leadership decisions, professional roles, and organizational culture (Christensen et al., 2013; Galaskiewicz & Wasserman, 1989). A central argument of the research is that the organizational positioning of sustainability functions, whether housed in communications, risk, compliance, or strategic divisions, offers critical insights into the status and effectiveness of ESG integration. Structural marginalization often correlates with symbolic action, while

structural embedding within core units enables influence, resource access, and alignment with business priorities (Thornton & Ocasio, 1999).

The empirical foundation includes 21 semi-structured interviews with sustainability professionals, risk managers, compliance officers, project leaders, and executives across four Icelandic banks. Through this comparative lens, the research identifies diverse structural models, centralized, decentralized, and hybrid and examines the implications of each. The findings reveal that while many banks began their ESG efforts in communications or HR, regulatory pressure and internal leadership often prompted a relocation of sustainability functions into risk, finance, or strategy units. This migration from symbolic visibility to operational integration reflects evolving institutional logics and maturity levels (Mahoney, 2000; De Smet et al., 2021).

A significant focus is placed on governance arrangements, including sustainability committees, ESG task forces, and cross-functional councils. The effectiveness of these bodies depends not only on their formal authority but also on leadership engagement, clarity of mandate, and alignment with business operations (Farr, 2011; Boyle et al., 2022). In banks where chief executive officers (CEOs) and board members actively support ESG goals, sustainability becomes embedded in strategic decisions and risk frameworks. Conversely, committees struggle to generate meaningful change when they lack integration or rely on symbolic gestures.

The research also explores the role of sustainability professionals, highlighting the growing complexity and workload associated with evolving ESG demands. Many professionals operate dual roles as strategic advisors and operational coordinators, managing regulatory compliance, stakeholder engagement, and data reporting. Despite growing responsibilities, ESG roles often lack clear career pathways and adequate support. Emotional labor, burnout, and role ambiguity were common themes, emphasizing the need for professionalization, training, and institutional recognition of sustainability work (De Smet et al., 2021).

Cultural alignment emerges as a decisive enabler or constraint. Organizational culture, defined by norms, behaviors, and shared values, profoundly influences whether sustainability initiatives gain traction or remain superficial (Christensen et al., 2013; Lozano, 2015). Banks with open, learning-oriented cultures demonstrated more effective ESG integration, particularly when sustainability was framed in terms that resonated with core institutional identities and client-facing strategies. Storytelling, cross-departmental champions, and grassroots innovation played essential roles in shifting internal narratives.

Regulatory developments, including the Corporate Sustainability Reporting Directive (CSRD), the Sustainable Finance Disclosure Regulation (SFDR), and the EU Taxonomy, have accelerated the pace and depth of ESG implementation (European Commission, 2019, 2020).

While regulation provided legitimacy and urgency, it also introduced administrative burdens and compliance fatigue. The research shows that banks that treated regulation as a strategic opportunity, rather than a compliance obligation, were more successful in aligning sustainability goals with organizational change. However, regulatory complexity, limited human resources, and ambiguity in interpretation created challenges, particularly for smaller institutions.

The study also examines the interplay between structure, systems, and technology. Banks with strong ESG data platforms, integrated dashboards, and cross-functional workflows were better positioned to meet regulatory demands and track sustainability outcomes. In contrast, reliance on fragmented systems and manual processes impeded progress. Technological tools, clear accountability, and project-based governance are critical enablers of ESG execution. Ultimately, this research argues that sustainability in banking must be understood as an institutional design issue. Organizational structure, culture, leadership, and systems together determine the success of ESG integration (Lozano, 2015; Boyle et al., 2022). Treating sustainability as a core institutional function rather than an add-on or symbolic gesture requires careful attention to internal alignment. Banks that succeed in this endeavor demonstrate strong governance, empowered professionals, cultural coherence, and strategic use of regulatory levers.

While grounded in the Icelandic context, the insights from this research are applicable across European and global banking sectors. As financial institutions seek to align with climate goals and respond to rising ESG expectations, they must reimagine how sustainability is built into the fabric of their organizations. Effective ESG integration depends not only on what is measured or reported externally but on how sustainability is structured, supported, and lived internally. This research contributes to the understanding of corporate responsibility by showing how internal architecture roles, routines, cultures, and capabilities shape whether sustainability remains a rhetorical commitment or becomes a catalyst for institutional transformation.

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