GOVERNANCE

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What price climate change?

Alex Cameron and **David Archer** consider engaging company boards with climate change action planning and the fear of being a first mover.

In 2015 a study by the Economist Intelligence Unit[1] estimated the value at risk to the total global stock of manageable assets, as a result of climate change, as 4.2 trillion to 43 trillion dollars, between now and the end of the century. The timing and nature of the impact of a warming climate may differ across geographies and business sectors but the scale of disruption to markets, customer behaviours, supply chains, and therefore the whole risk environment in which companies operate, is potentially huge.

Climate change scientists have long made the case for urgent action – but this concern is spreading to a wider community of business advisors and investors. A recent report by Schroders[2] creates a dashboard of 12 indicators which track progress towards different temperature change scenarios. Their current aggregate analysis shows the world on a pathway towards an average 4° increase. And such an increase would trigger regional heatwaves that would make many currently densely populated areas uninhabitable and lead to sea level rises of 10m to 60m, swamping coastal conurbations across the world.

So how are boards responding to this challenge? The latest report from international Task Force on Climate-Related Financial Disclosure (TCFD)[3] states that globally 72% of large and mid-cap companies don't even acknowledge the financial risks of climate change in an annual report. We wanted to investigate what is happening in UK boardrooms and what actions directors are taking to prepare their companies to mitigate climate change risks to their future business.

In this article we want to share with you some research carried out by a team from Imperial College Business School[4]. We'll take these findings (and the comments we get in response to this article from *Governance* readers) to a roundtable dinner we are holding with a group of executive and non-exec board members in November. Here we'll get personal perspectives on the realities of getting board engagement with this complex topic in different sectors, and what could be done to increase awareness and effective strategic planning for mitigations. We'll share the results of these discussions with you in a second article later in the year.

Research findings

The Imperial team analysed the latest annual reports from 140 UK listed companies (the biggest ten per sector across 14 sectors) and followed this up with a questionnaire to company secretaries, supported by face-to-face interviews. At one level the findings were as you might expect – very few company boards are reporting on discussions of mitigation strategies to respond to different climate change scenarios – but on another level this lack is extremely worrying. Looking sector by sector the figures are stark. As you might expect, the Energy and Utility sector is the most engaged with 50% of the annual reports studied including climate change as one the top ten risks to the business and describing mitigation strategies. But this sector was very much the exception, in Engineering; Retail, Construction, Transport & Logistics, only one in ten of the reports analysed included climate change as a 'principal risk' – and for the Business Consulting, Media, Healthcare, Technology and Leisure sectors the score was a shocking zero out of ten.

To explore the reasons for this apparent lack of board engagement the research team sent questionnaires to company secretaries and held a number of face-to-face interviews with board members. Six barriers emerged from this phase of research. Some are very predictable: (a difficulty of accessing reliable information on climate change, a lack of understanding of the impacts, more pressing business risks on the board agenda); but others require some more reflection.

A lack of consistent financial evaluation of the timing and scale of climate change impacts was cited as a barrier by several respondents – and this was linked with another barrier, the perceived gap between the long-term effects of a warming climate and a much shorter-term focus to most boardroom discussions. For these two barriers it is clear that regulators and investors have a valuable role to play. For example, the TCFD has developed a standard framework for boards to report on different climate change scenarios. This will enable pension funds and other long-term investors to push companies to report in a consistent manner on strategies for the management of climate change risks. This in turn will mean active shareholders can compare the relative level of preparedness across their portfolio of investments and act on the results.

A final significant barrier raised was the 'fear of being a first mover'. In a situation where; the business risks may be large but difficult to quantify, and the mitigations may be very disruptive, add significant cost to existing operations, and might not work anyway, would you want to go first? Or is it better to sit it out and wait until regulators force you and all your competitors to take similar actions. Now of course some companies have taken the opposite approach and have used a message on climate change action as a part of their market positioning. Carlsberg in the FMCG sector with their 'together

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towards zero' targets and M&S in Retail with their Plan A initiative, are interesting examples[5] to explore. Here being a first mover is being used as a brand differentiator in markets with customer groups who are already engaged with the topic of climate change.

With these six barriers in mind, there are a number of different approaches that could be taken to push climate change planning up the up the board agenda in the UK:

- A sector led approach – where trade groups or other industry bodies could agree common standards and encourage members to report consistently on them. This might be especially useful in low margin sectors where no single company wants to pay the price of going it alone.
- An investor led approach – where groups of investors require the boards whose shares they hold to report on their strategic response to climate change impacts. This may be especially powerful in sectors where investors expect long-term stable performance.
- A customer led approach – where companies can boost their brand loyalty by declaring climate change plans which meet the concerns of their customer base. This might be especially suited to FMCG and Retail sectors.
- A regulatory led approach – where national (and international) regulators require compliance with certain climate change impact disclosures as part of a licence to operate. This might especially apply to Utilities and the Energy sector.

The research shows that the level of engagement for most UK boards with the impact of climate change is currently very low. This cannot continue. The need for boards to engage with the risks that climate change poses to the future of their business is real and pressing. To emphasise this, the 2018 version of the Corporate Governance Code places a renewed focus on long-term sustainability and board responsibility for monitoring 'risks to the future success of the business … the sustainability of the company's business model and how its governance contributes to the delivery of its strategy'.

So what are you seeing in the boards you work with? Are climate change related business risks and their mitigations on the agenda for your next board strategy day? We'd love to learn from your experience – we'll feed your comments into the plans for our roundtable dinner in November and report back to you in a second article on this topic soon afterwards.

Please send your comments and responses to the article via info@socia.co.uk

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1 https://www.eiuperspectives.economist.com/sites/default/files/

2 https://www.schroders.com/hu/sysglobalassets/digital/insights/2017/pdf/sustainable/climate-change-dashboard/climatedashboard-july2017.pdf The%20 cost%20of%20inaction_0.pdf co.uk

3 https://www.fsb-tcfd.org/publications/final-recommendations-report/

4 Research carried out by: William Cross; Diane Mouradian, James Roberts, Sudhiksha Unnikrishnan from the MSc in Climate Change at Imperial College – http://www.socia.co.uk/wp-content/uploads/2018/09/Engaging-Company-Boards-with-Climate-Action-Report.pdf

5 See https://corporate.marksandspencer.com/plan-a and https://carlsberggroup.com/sustainability/our-ambitions/