Climate change as a strategic opportunity: the why and how

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The 'Why': Integrating climate considerations into an organisation's overall strategy promises to yield significant benefits and reduce negative externalities

As decision-makers worldwide have emphasised, climate-related risks must be regarded as a systemic risk with the potential to affect companies, investors, and consumers. Climate risks such as physical, reputational, regulatory, and competitive are expected to increase over time and will have significant consequences for businesses that are unprepared to handle them.

Overview of life examples:

- A global mining company was impacted by a cyclone in Western Australia in 2021. As a precautionary measure, the company suspended its operations and evacuated its employees, resulting in a temporary halt in the production of iron ore and loss in revenue.
- An Australian food retailer company was criticised in 2021 for using vague and deceptive language in its marketing materials, including unsubstantiated sustainability claims. As a result of these accusations, the company faced backlash on social media and reputational damage.
- An Australian car manufacturer announced in 2021 that they would need to invest more than $A30bn in electrified vehicles through to 2025, in response to evolving consumer demand.

Alternatively, we have discovered that embracing the opportunities presented by the energy transition can result in the following advantages and financial gains for organisations:

- Generating increased revenue by venturing into untapped markets, acquiring new customers, and diversifying income sources.
- Optimising capital expenditure and achieving cost efficiencies by investing in greener and more efficient technologies.
- Taking a proactive approach towards legal and regulatory changes, allowing for innovation and the potential to access government subsidies and support.
- Accessing sustainable financing options, thereby reducing the cost of capital.
- Enhancing the enterprise value by strategically positioning the business, attracting higher sales multiples.

In this article, we highlight some of the opportunities this transition to a low carbon economy will bring, and which risks should be monitored and mitigated. We conclude by outlining the specific actions and next steps that those stakeholders who are prepared to swiftly adapt to this new reality, can take.

What are the climate mega-trends an organisation should aim to benefit from?

Resource efficiency

Shifting towards more resource-efficient production and distribution systems presents considerable opportunities. For instance, relocating production activities to highly rated energy-efficient buildings can reduce operating costs, as less energy is wasted in cooling or heating the building. It can also have benefits in terms of workforce management and planning, such as improved health and safety and higher employee satisfaction. Also, with only a fraction of material inputs being currently recycled in Australia, companies that succeed at factoring in circularity in their business model will be able to play a major role in safeguarding natural resources, transform the way natural resources are currently used and support a transition to a less energy-intensive economy.

Energy source

Businesses can reap financial benefits by using low-emissions energy sources. For instance, if a company installs solar panels and battery storage on its premises, it can decrease its vulnerability to fossil fuel price hikes and thereby lower its operating expenses. As more investors seek out environmentally friendly producers, it could also increase the availability of capital.

Businesses can also take advantage of opportunities the carbon market is bringing to maximise value out of their eligible projects. The Australian carbon market has undergone recent legislative and regulatory reforms, reinforcing its role in helping Australia reach its emissions reduction target. This provides an avenue for businesses to invest in sustainable and economically viable projects as the world moves towards decarbonisation.

Low-carbon products and services

Businesses that can diversify their operations and expand their offerings to include low-emission goods and services will be better positioned to reflect changing consumer preferences and gain a competitive advantage.

The emergence of green and transition bonds also provides an opportunity for businesses that prioritise projects with a positive environmental impact (e.g., renewable energy, pollution prevention, and public transportation) to access diversified financial assets.

What are the climate-related risks an organisation should seek to mitigate in order to minimise potential financial impacts?

Physical climate risks

Climate hazards, including flooding, increased temperatures, and bushfires, can lead to direct disruptions that impact business activities. Additionally, these hazards can also cause indirect disruptions by affecting a business's supply chain. Developing an adaptation strategy to mitigate the impact of changing weather conditions (e.g., farmers planting more heat-resistant crops, coastal production sites building sea walls) can help businesses proactively reduce their exposure and vulnerability to climate change.

Technology and market risks

Given the recent and ever evolving customer expectations, some industries and related companies will need to deploy resources to transition their product and services offering to lower emission offerings. This will involve a thorough review of their entire value chain to identify areas where technology and market risks can be reduced, and where they can substitute end products and production processes. In extreme cases, companies that have heavily invested in high-carbon assets, such as fossil fuel reserves or power plants, may face significant losses as the value of those assets declines to a point where they are no longer profitable to operate.

Policy and legal risks

Given the ongoing conversations around climate change, depletion of energy resources and environmental impact, it is unsurprising that government agencies at both federal and state levels are introducing regulations aimed at safeguarding the environment. In Australia, we recognise that environmental law enforcement is now ramping up from previous levels and this will impact organisations and investors. Concrete examples of this include enhanced emission/climate risk reporting obligations, such as the climate-related financial disclosure consultation paper released by the Australian Government in December 2022 that will require more significant climate reporting as early as 1 July 2024 for certain entities; and the Safeguard Mechanism reforms starting 1 July 2023. Anticipating regulatory changes and adapting accordingly will help businesses avoid any reputational shortcomings that could result from not being fully compliant.

The 'How' – A proactive and orderly approach can help organisations to overcome climate considerations' integration challenges

Incorporating climate considerations into an organisation's strategy involves two key steps. First, the company needs to identify the climate factors that could potentially pose risks or bring opportunities to its overall corporate strategy, its physical assets, its supply chain, and assess how these considerations may evolve over time. This requires building management's capacity and awareness around climate-related risks and opportunities, enabling them to identify material issues and develop a strategy to increase the organisation's resilience. Secondly, the company must translate these climate risks and opportunities into qualitative and quantitative financial measures that can inform its risk management and investment decisions.

Governance: Building capacity in board, executive team and beyond

Given that climate change is a critical concern that companies must address to secure long-term viability and competitiveness, it is essential for boards and executive teams to have a deep comprehension of the associated risks and opportunities as this will impact their duty of care and diligence.

As the materiality of potential risks increases, directors will want to seek greater scrutiny and assurance, including advice from management and/or independent experts. Additionally, including more experts with relevant climate change knowledge in the boardroom, regularly gathering to exchange insights and best practices and holding the board chair accountable for fostering progress towards the company's climate change goals will play a pivotal role in driving meaningful action within and beyond the company.

Strategy definition: Central in creating value

A climate strategy is key in implementing a climate action management system as it facilitates the measurement and comparison of a company's targets across its peers. However, developing a climate strategy requires precise awareness of the material risks and opportunities for the company's business model. Identifying the most material climate issues for a company is not a precise process, and what is material may vary between companies and industries. Tools like Sustainability Accounting Standards Board's (SASB) Materiality Map can offer some direction in this regard. In addition, as a company shapes its climate strategy, analysing the strategies of other industry players can help benchmark its own approach and determine an appropriate level of ambition for the sector.

Climate Risk management: Defining the right processes and successfully rolling them out

A business must define its climate risk management strategy according to the nature of the climate risk and link it to various value drivers, including costs, revenues, profits, and capital expenditures. This alignment can be achieved through qualitative means, such as categorising risks based on their sources and potential impacts using a probability/impact ranking matrix, or quantitative methods, such as adjusting financial assumptions in models. It is also important to analyse how these factors may affect a company's value chain (supply chain, operations, assets and markets) and to perform this analysis at various levels (physical asset, business, industry, country and macroeconomic level). Finally, it is important to ensure that climate risks have been embedded into the financial reporting assumptions and disclosures, including impairment considerations, provision, deferred taxes and going concern assumptions.

Metrics and targets: Overcoming data quality issues to enhance non-financial reporting

The disclosure of climate-related information differs depending on the location of the company, as well as its size and industry norms. Anticipating the upcoming disclosure regulations and investing in internal data collection systems will be key to navigating those additional reporting requirements.

Companies with limited funding may face challenges in allocating resources to address climate data issues. In addition to the costs associated with acquiring expertise in this area, businesses may face other expenses related to research, modelling, and verification. Potential solutions for businesses to overcome those issues are:

- Leverage off-the-shelf digital solutions designed to organise ESG data collection. These solutions may also provide stakeholders with dashboards to monitor the company's progress towards its sustainability goals.
- Deploy analytics platforms that provide internal visibility to operational units, allowing them to promptly correct inaccurate data.
- Incorporate data quality requirements into the procurement processes and supplier selection criteria.

Overall, businesses need to acknowledge that their climate data are unlikely to be perfect in the first years of establishing internal data collection systems. Nevertheless, this will be adequate for identifying hotspots of climate risks, engaging with relevant stakeholders, and enabling governance to enhance data quality over time. BN

What's next?

From our experience, incorporating climate considerations into a business strategy can pose significant challenges, particularly when resource-constrained, but the endeavour is undoubtedly worthwhile. This is the reason why businesses need to act now, find the right partners and get external support if needed, as taking the necessary measures will lead them to develop a strategic edge and exhibit greater resilience as we move toward a low-carbon economy.