26

SUSTAINABILITY

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The focus of investors and policymakers on the transition to a low-carbon and sustainable economy means not only that a company has to be aware of its impacts on society and the environment, but it has to assess and mitigate the impacts that a changing business and regulatory environment – in response to the climate emergency and other sustainability considerations – can have on the company’s business model and bottom line in the short and long term. This is the emerging notion of “double materiality” in sustainability. As regulators and consumers put pressure on investors, banks, and companies to become part of the solution to dramatic environmental and societal issues, and as technologies and markets evolve, sustainability can pose a threat to the long-term viability of a business.

While the corporate social responsibility/environmental, social, governance (ESG) chapter of this book looked at the impacts that a business can have on its stakeholders, here we are taking the outside-in view. Furthermore, we are not only looking at the operations of a company, but also at how its business model and product offering can seize the opportunities deriving from the transition to a low-carbon and sustainable economy. As consumers change their preferences in response to their sustainability concerns, and

as new market opportunities present themselves, it's imperative that companies reflect on whether they are positioned well to benefit early on from these developments. This requires that the strategy department, the risk function, and the product development teams across a company's divisions cooperate to achieve a shared view of the sustainability risks and opportunities – and the resulting changing competitive landscape – that the company is faced with. Depending on the sector a company is operating in, some of these risks and opportunities will be more obvious, others more elusive and difficult to assess and quantify. It's important however to understand that a company's competitors will be struggling with the same challenges, and getting started in this journey – by asking the right questions – is more important than having all the answers to hand.

The context for the sustainability assessment of the company is provided by global policies and trends. First and foremost, the Paris Agreement on Climate, signed in December 2015, sets the ambitions of governments to avoid the disastrous effects of runaway climate change by limiting the rise in average global temperature well below two degrees Celsius compared to pre-industrial levels, by the second half of the century. This ambition is turned into national commitments (Nationally Determined Contributions or NDCs) set out in terms of absolute reductions in the greenhouse gas emissions of their economies, often identifying the specific strategies they are going to follow (for example, energy efficiency, renewable energy, afforestation and so on). Based on their NDCs, states have been developing local policies aimed at ensuring that their commitments are achieved.

Secondly, often in response to the climate challenge, technological innovation is leading the charge of the transition to a low-carbon economy by changing the way energy is produced, people move around, food is grown, and consumer goods are distributed and consumed. Technological innovation – and the associated change in markets and consumer behaviours – can pose a threat to the business models of companies which do not anticipate or adapt to these changes. Small to medium-sized enterprises are not exempt from these risks but are also in general better placed than larger companies to take advantage of the corresponding opportunities, because technological innovation is usually delivered by start-ups and smaller companies. Scenario analysis is a formalised approach to take account of the changing business context. It is based on the creation of states of the economy, regulation, and technology in the distant future. Scenarios are

narratives about possible future situations. Companies can create their own scenarios, or they can use scenarios made available by research bodies such as the International Energy Agency (IEA) or the UN climate research body, the Intergovernmental Panel on Climate Change. Scenario analysis consists in figuring out the impact of a specific scenario on a company's business model, profitability, competitive position, and ultimately its chances of surviving and thriving in different business environments and states of the world.

Questions to ask

- Is the company taking into account sustainability risks in its approach to enterprise risk management?
- Do the company's principal risks address any material environmental, social, and governance issues?
- Are the mitigation plans put forward by the company to address its principal ESG risks robust?
- Does the company perform scenario analysis with regard to its climate-related risks? Does the company have any plans to get scenario analysis done soon?
- Is the company aligning its greenhouse gas emissions with a trajectory compatible with the objectives of the Paris Agreement?
- What benchmarks is the company using to assess its progress on the sustainability agenda?
- How does the company compare to its competitors in the way it manages its sustainability risks and opportunities?
- Does the company provide any products or services that enable it to take advantage of the opportunities arising from the transition to a low-carbon and sustainable economy?
- Is the company making any investments (for example, R&D) now that will enable it to take advantage of the opportunities deriving from the transition to a sustainable and low-carbon economy in the future?
- Are the company's competitors moving faster in developing a product offering that incorporates sustainability considerations?
- What are the most promising markets or product lines for the company to develop a profitable sustainability offering?

- How sophisticated is the company's market intelligence with regard to sustainability risks and opportunities?
- Has the company developed an "equity story" or business narrative that incorporates sustainability considerations?
- Is the company able to explain in an effective and credible way to its investors – and providers of capital more broadly – how its strategy incorporates sustainability considerations?
- Can a robust sustainability strategy open the doors to new sustainability-focused investors and providers of capital, thus helping to diversify the company's sources of funding?
- Are there any reputational risks associated with the company's own positioning around sustainability, such as greenwashing?
- Is the company's policy engagement or lobbying activity consistent with its sustainability positioning?
- Is the company considering its compliance requirements – in terms of reporting and performance – as mere costs, or as investments to be leveraged?
- Is the company aware of its potential for market leadership in the space of sustainability?
- If the company is not a leader in sustainability yet, does it have a road map to achieve leadership over a defined period?