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POLICY BRIEF #1

# Climate change and business: Managing risk and leveraging opportunities

## Corporate strategies and the role of public policies

This document has been prepared for the purpose of disseminating the learnings of the **Community of Practice on Private Sector Engagement in Climate Policy Processes (CoP).**

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Climate change-related issues dominate the top 5 of the main risks identified globally by the World Economic Forum's[1] network of business, government, civil society and thought leaders, both in terms of likelihood, occurrence and impact.

Risks and opportunities for companies derive both from climate change physical impacts and from policy and market changes resulting from the deep and systematic transformation of the global economy to achieve the mitigation and adaptation goals set forth in the Paris Agreement. The fact that, in this ever changing environment, the most successful companies will be those that manage to adapt, reduce their vulnerability, anticipate new legal frameworks and take advantage of new market conditions is becoming increasingly clear.

The role of governments is key to managing climate risk and taking advantage of business opportunities. Even though policies, regulations and services establish a goal framework, game rules and tools for corporate action, the uncertainty regarding said policies may be a significant source of insecurity for potential investments. Therefore, it is important to generate a convergence of agendas that pursue a common goal of low-emission resilient companies and economies.

1 World Economic Forum. Global Risks Report 2020. https://bit.ly/2F9UNUv

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# Climate-related risks and opportunities

## Risks

**Physical risks** caused by climate change derive from the direct and indirect impacts that the manifestations of this phenomenon may have along the value chain; for example, damages in infrastructure, disturbances to the supply chain, impacts on personnel and customers due to extreme weather events, impacts on energy consumption due to heat waves, shortage of water and other natural resources.

**Transition risks** are related to the transformation towards a low-emission resilient economy. They include potential changes in regulation, technology, consumer preference; other companies' procurement practices; society's attitude towards the actions taken by the companies in response to climate change. Therefore, political, regulatory, technological, market and reputational risks are mentioned.

Both physical and transition risks translate into financial risks that must be considered comprehensively in each company's risk analysis and management processes, and they must be evaluated using the tools applied to the analysis and management of other business risks.

## Opportunities

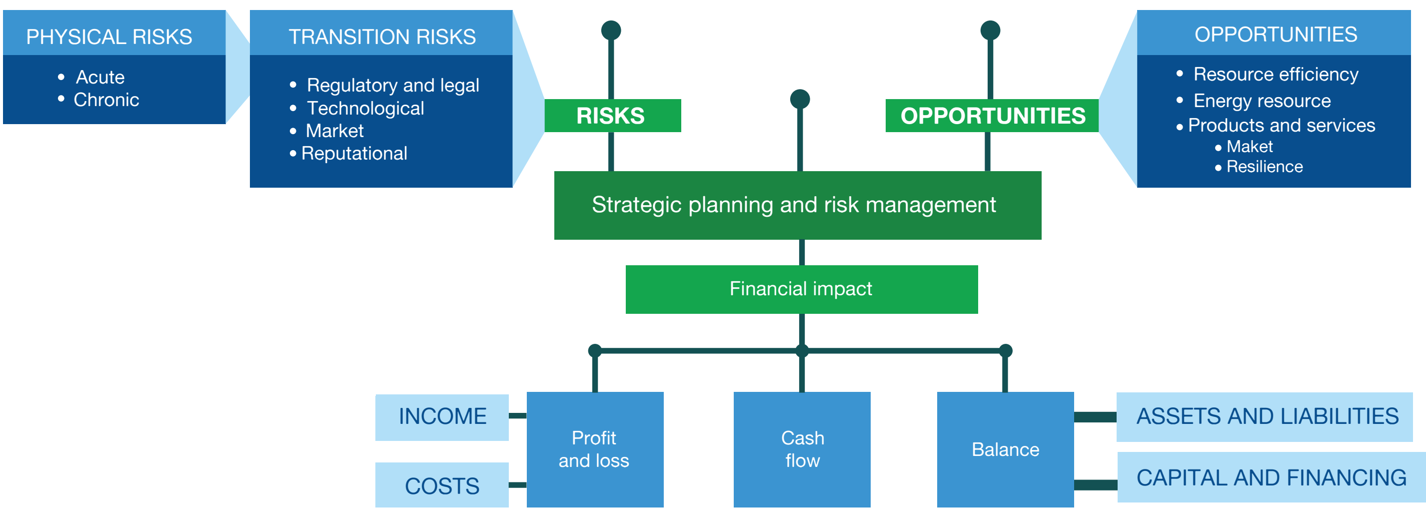
In addition to understanding climate change-related risks, it is crucial for companies to recognize that attention to this global phenomenon brings operational, market and financial opportunities. It is clear to many organizations that emission management throughout a company's value chain translates into a greater operational efficiency in terms of energy, materials and waste. But from a more strategic point of view, there are opportunities to improve or extend the company's competitive position by:

- Creating products that contribute to the solution to climate crisis - new products, new markets.
- Restructuring their industries in order to face climate change challenges more effectively.
- Innovating activities affected by climate change to generate a genuine competitive advantage.
- Improving their relationship with governments and other key stakeholders and promoting incentives and favorable legal frameworks.

At an international level, financial institutions are paying more attention to the financial impacts related to climate change. To respond to the increasing demand of information, the Task Force on Climate-Related Financial Disclosures (TCFD) has been developing, since 2015, voluntary and consistent standards for the companies to assess and report climate-related risks and opportunities, in a way that is useful for investors, funders, asset managers and insurers.

The following graph shows the climate-related risk and opportunity classification and the way in which they impact the companies' financial results. The way in which the company incorporates said risks and opportunities in their strategic planning and in their risk management will have a positive or negative effect on their revenue, costs, cash flow and balance and, subsequently, in their ability to access capital and funding in the future.

**Figure 1: Risk, climate opportunities and their financial impacts.**




**Source:** Task Force on Climate-related Financial Disclosures (TCFD)

## Managing risk and leveraging opportunities

Despite the increasing corporate awareness on climate change and the interest to make decisions accordingly, it is still necessary for companies to develop climate strategies that become an integral part of their business models and plans. To this end, the approach to climate-related risks and opportunities needs to extend beyond sustainability or social responsibility and include the core business tasks: financial, strategic planning, innovation and business development.

Companies need to review their business models and investment portfolios in order to incorporate resilience and emission reduction as part of their strategic planning to mitigate risks and leverage opportunities. To this end, they must have methodological frameworks that help them incorporate environmental, social and governance risks in their corporate risk management processes.

These methodological frameworks emphasize the need for risk and opportunity assessment and management throughout the value chain, i.e. understand and evaluate the vulnerability of the company's activities, products, supply and investments to potential climate risks in the short, medium and long term. To this end, there needs to be a framework that enables the identification and evaluation of the organization's risks and opportunities, the identification of options to approach key climate risks, and develop and implement a response strategy. A decision making process or criteria on the risk prioritization, mitigation, transfer, acceptance and control should also be in place.

### Methodological frameworks for climate risk and opportunity management

- Guide for environmental, social and governance (ESG) risk management from WBCSD and COSO. Additional information here.
- TFCD recommendations to address the identification and assessment of climate-related risks andopportunities, as well as their governance, communication and reporting. Additional information here.
- Climate Disclosure Standards Board (CDS) framework for reporting environmental and climatechange information in a consistent and comparable manner for investors. Additional information here.
- UKCIP's Wizard Program offers a process to assess and approach the organization's key climaterisks. Additional information here.

Considering the aforementioned transition risks, it is clear that establishing ambitious mitigation goals, as well as investing in mitigation are crucial for corporate resilience and these need to be made alongside adaptation efforts. This aims to prevent even worse climate risks and reduce the cost of adaptation to physical risks and; additionally, reduce regulatory uncertainty, improve competitiveness associated with carbon management and increase innovation in companies.

It is also important to work with other actors throughout the value chain to identify any significant risks to operations, supply chains and the communities in which they operate; as well as finding more efficient and effective solutions that consider the stakeholders' perspective. In this context, it should be noted that responsible participation in the discussion and implementation of climate policies is equally relevant for managing and addressing climate risks in the short and long term. The business sector should be an active actor in the design and implementation of government plans for adaptation and risk response.

Lastly, it is necessary to highlight the importance of transparent reporting of climate-related risks and opportunities identified by the organization in the short, medium and long term. To this end, organizations should define metrics and goals to address their own specific climate risks and opportunities. The TCFD provides some illustrative examples that can inspire organizations when thinking about their own metrics. Stakeholders, particularly investors and clients, are paying increasing attention to risk management and adaptation skills in the business sector.

## The role of public policies and public-private collaboration

Public policies and regulations constitute an action framework for every company. They become even more relevant for climate change, since it is a global phenomenon with local specificities than cannot be dealt with in isolation by a sole organization. Both mitigation and adaptation require common and coordinated visions and efforts between different actors and sectors.

Promoting and supporting the incorporation of climate change to the companies' - both large and small - strategies is crucial for countries to achieve their national goals, fulfill their international commitments and direct their economic activities towards a path of sustainable development. Governments may enable said incorporation by means of:

- Clear and ambitious goals
- Predictable legal frameworks
- Sectorial roadmaps
- Access to information and data
- Incentives for resilience actions
- Coordination and support to the design of risk and emergency response plans

One of the main challenges posed to converging agendas towards a common goal of low-emission resilient economies and societies is generating a virtuous circle between government policies and private sector action. To this end, governments must achieve greater participation and engagement of the companies in the design and implementation of climate policies and facilitate an enabling framework that provides confidence and security for decision making. Public-private dialogue and engagement can be facilitated and promoted by each sector's associations and business chambers.

A possible way could be creating a roadmap from the dialogue between actors, that includes a long-term vision, clear and ambitious climate goals, mitigation and adaptation priorities, a transparent framework to measure, manage and report private sector climate actions, and a group of policies and incentives that promote resilient investment and carbon reduction. All of this will result in value creation to move towards a more sustainable economy, which is even more important in the context of the pandemic crisis and the need to promote routes for sustainable recovery.

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