Businesses must go up a gear to reach sustainability destination

GREEN POLICIES AND PRACTICES AMOUNT TO A GREAT DEAL MORE THAN THE CONSCIENTIOUS USE OF PAPER RECYCLING BINS. **PETER WILLIAMS** LOOKS AT THE SOBERING BUSINESS REALITIES OF DEALING WITH CLIMATE CHANGE.

Executive summary

- **At the start of the ACT Annual Conference in April, Paul Turner, head of sustainable development at Lloyds TSB Wholesale Banking, led a pre-conference workshop on the fundamental role that treasurers will play in helping businesses adapt to climate change and move to sustainable processes.**

The world is changing and the types of risk that corporates need to manage are changing with it. New risks need to be addressed by new thinking, innovation and leadership. So what is the new norm in such a volatile world? Sustainable development banker Paul Turner suggested that one definition of madness was continuing doing what had always been done yet expecting a different result.

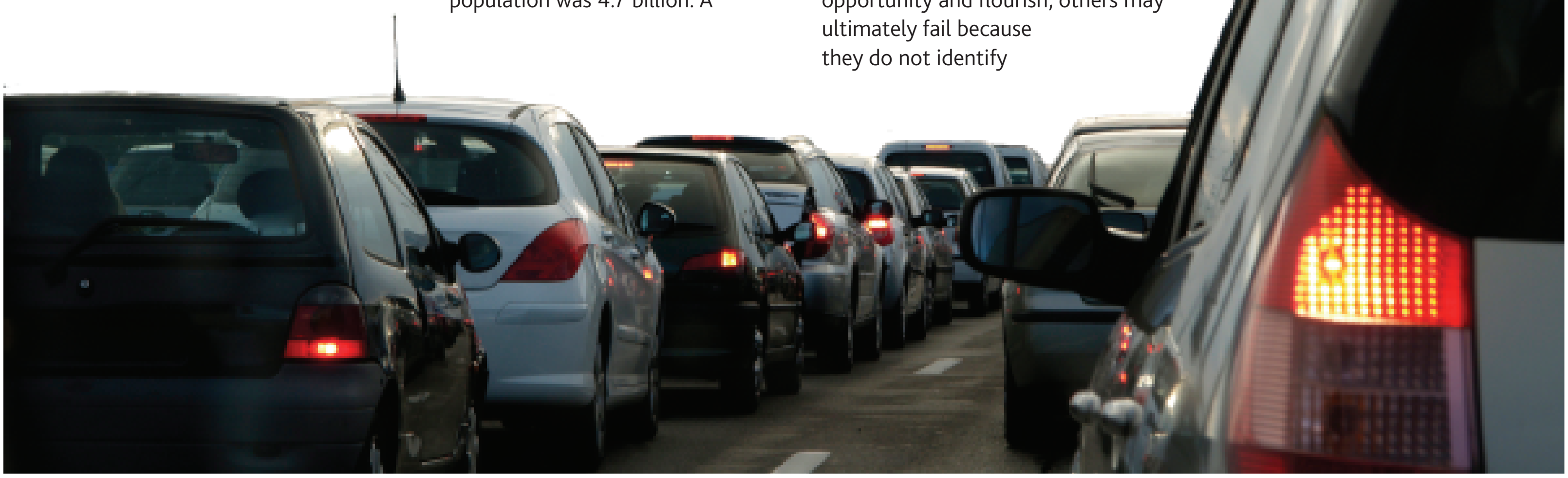
Turner is a banker with 30 years' experience, majoring on structured and project finance. He has master's-level qualifications in sustainability and business, tutors on the Cambridge University programme for sustainability leadership, is on the steering committee of the United Nations Environment Programme finance initiative, and is a trustee of Global Action Plan, an independent environmental charity. The subject is important to Lloyds TSB for the simple reason that climate change will affect all its customers.

WHERE WE WERE Look back 25 years and the world seems to have changed dramatically. In 1984 the miners were on strike in the UK and the Apple Macintosh computer was launched. And the global population was 4.7 billion. A quarter of a century later and the world's population is 6.8bn, a rise of 45%. In another 25 years' time – in 2034 – the figure is projected to be 8.7 billion, an increase of 85% in just 50 years. If they make it into their nineties, many adults living today will have seen the global population triple in their lifetime. This level of increase makes huge demands of resources: everybody needs food, water, energy and services. Turner said: "We are already placing unprecedented pressure on the system and this is already impacting business and supply chains."

It is easy to take so much for granted. Take car ownership. US per capita car ownership is around 10 times greater than in China, but, according to research by AC Nielsen in 2007, there are more people in China who aspire to own a car than any other country. If eight out of 10 Chinese were to have a car, US-style, then, according to Turner, the country would need 80 million barrels of oil a day to keep those cars running, which is more oil than the world is currently producing.

So where does that fit into our ideas on climate change? Scientists say that carbon dioxide levels are currently at their highest level for 800,000 years. The significant climate change expected will have an impact on all businesses and communities, as will the measures we may have to take. How, for example, would we cope with trying to cut global greenhouse gas emissions by 50%?

Lloyds TSB used to look at the risk associated with the impact of its customers' activities on the environment, but now seeks to understand the environment's impact on customers' businesses and its own. New risks and new opportunities will affect every company. Some will seize the opportunity and flourish; others may ultimately fail because they do not identify



the risks. Shareholders, lenders, employees and customers all have a vital interest in knowing who is learning to adapt – and who isn't.

IN OUR HANDS In 2008, David Cameron, leader of the Conservative party, said: "The choice isn't between the economy and the environment; the choice is between progress and the past, and it is entirely in our hands."

Can we make the changes required? Scenarios for the 2020s, not very long off, suggested by Turner, include:

- a greater incidence of severe weather events;
- more environmental migration (Oxfam reckons the figure could rise by 50% to reach 375 million by 2015);
- carbon constraints on mobility; and
- resource shortages.

But we could also see many change in the workplace, in the way we work and in the technology used by business (see Box 1).

CREATING OR DESTROYING VALUE While many of these changes and predictions may seem remote and out of the control of individuals and businesses, that is not the case for treasurers. As part of the risk management team in businesses, treasurers have an influence on corporate financial strategy, what the business invests in, how it invests, and, perhaps most crucially, how the risks are managed and the optimal balance of risk and reward.

Ernst & Young's 2009 business risks report revealed the top 10 risks as perceived by business. The top four were: the credit crunch, regulation and compliance, the deepening recession, and radical greening. The rise of radical greening, up from number nine in the 2008 report, can be seen as a response to stimulus packages, increasing legislation and regulation, as well as the emergence of carbon markets. The climate change agenda will have an impact on all of these business risks to some extent.

The business recognition of the green agenda in the Ernst & Young report contrasts with the findings of another professional services firm. KPMG reviewed 50 reports on climate change and concluded that businesses were underestimating the risk and economic impact it presented.

The most frequently identified climate change risks for business are regulatory, physical, reputation and litigation. Every sector of business is exposed. As a next step companies need to integrate climate change risk into their business risk disciplines and account for this emerging business issue internally, as well as disclosing the information to shareholders and other stakeholders.

This will have a direct and material impact on the value of companies. A report by Carbon Trust and McKinsey in 2008 stated: "Tackling climate change could create opportunities for a company to increase its value by up to 80% if it is well positioned and proactive. Conversely, it could threaten up to 65% of value if the company is poorly positioned or a laggard."

All indicators suggest that companies must adopt a strategic approach to the issue, particularly when it comes to long-term investment. In April the Financial Times quoted Todd Stern, the US lead negotiator on climate change: "Businesses must not sink money into high-carbon infrastructure unless they are willing to lose their investments within a few years."

As Turner asked, how good will the business judgement of companies that make high-carbon choices now look in five, 10 or 20 years when it becomes clear that heavily polluting infrastructure has become deadly and must be phased out before the end of its useful life? The question of value is already having an impact. Goldman Sachs reckons that companies regarded as sustainability leaders have outperformed the overall stock market by 25%.

Box 1: Business scenarios by the 2020s

- Product push replaced by the re-emergence of trades and services.
- Rise of low-carbon transit systems (both personal and mass).
- Closed-loop manufacturing systems, eliminating waste.
- Flexible working with far more remote working.
- The end of daily commuting.

Box 2: A bottom-line clobbering?

Paul Turner told the story of an energy company that had built a power station one metre below sea level. The auditor signed off the accounts but asked the finance director whether the 20-year depreciation policy for the station had been checked against a climate change risk assessment, which might conclude that water levels could rise and destroy the plant before the end of its accounting life. If the depreciation policy were changed to reflect the environmental reality, it would have an immediate and material impact on the profit and loss account.

GLOBAL STIMULUS PACKAGES These are seen as a way to kickstart the economy and help the environment. The CBI calculates that if governments agree to an international framework to limit carbon emissions, the global market for climate change solutions could be worth $1 trillion in the first five years. Around the world, governments have allocated more than $430bn of fiscal stimulus (15.6% of the total stimulus package) to key climate change investment themes, with China and the US leading the way. Much of the stimulus is aimed at rail, transportation, water infrastructure and improved building efficiency. Much of the spending is due to take place in 2010.

MAKING IT PAY Much of the required investment in a sustainable future appears to make financial as well as environmental sense. Investments in energy efficiency can generate returns of 70% or more. BP's assertive energy-efficient initiative realised savings of $400m for an investment of $100m, representing its most profitable project in a decade. McKinsey estimates that by only using existing technologies that pay for themselves, projected global energy demand growth by 2020 could be at least halved, while additional annual investments of $170bn for the next 13 years could generate annual energy savings of $900bn by 2020.

Businesses will be affected in a range of ways by green issues, including insurance, reporting, logistics, brand and reputation, even employment and retention of top talent.

Business risk management strategies need to evolve to deal with a new normal that includes carbon as an asset and a liability – an asset that can lead to new markets, products and income streams, and a liability that has cashflow, balance sheet and profit and loss implications. No business is immune and the new risks aren't in some future world; they are here and now.

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For more on the ACT conference, see page 14.