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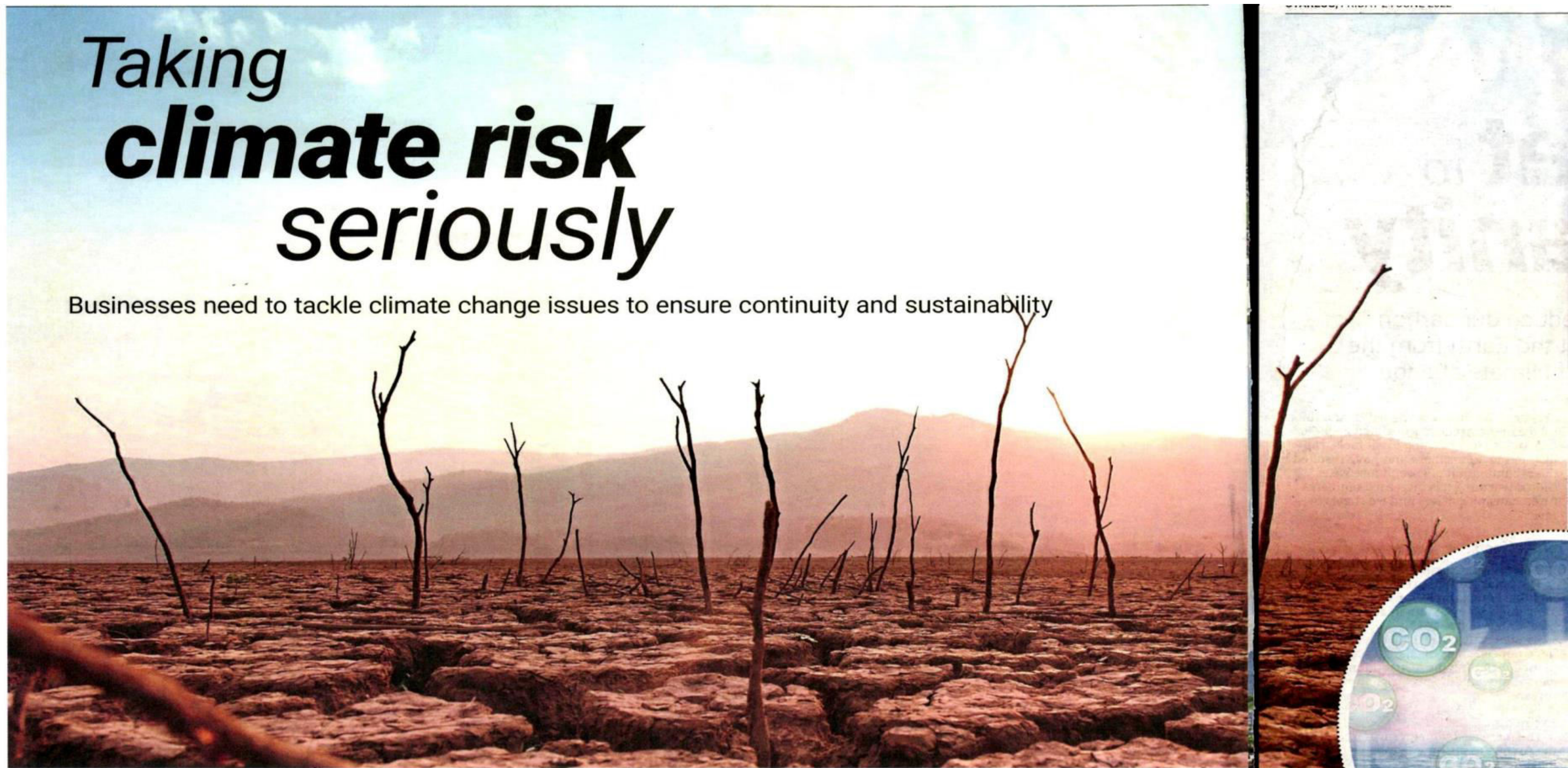
Taking climate risk seriously

Businesses need to tackle climate change issues to ensure continuity and sustainability



By CALYN YAP
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THE war against climate change has escalated in recent years, with all eyes firmly set on defusing its far-reaching impacts before we hit the point of no return – especially with the United Nations Intergovernmental Panel on Climate Change stating that greenhouse gas (GHG) emissions need to peak before 2025 to limit global warming to around 1.5°C, as per the Paris Agreement.

According to a PwC report released in April this year, titled *Positioning Corporate Malaysia for a Sustainable Future*, although Malaysia is already ahead in Asean and second only to Singapore in its environmental, social and governance (ESG) journey, there is room for improvement when compared to developed Asian nations.

That's not to say that the country has not made positive strides in the right direction towards a sustainable future via climate policies and net zero targets.

Malaysia has committed to keep global warming below 1.5°C, delivering on the four mandates from the Cabinet at the 2021 United Nations Climate Change Conference, better known as COP26.

These include climate change negotiations on rules governing international carbon markets, transparency of emissions reporting, common timeframe for the Nationally Determined Contributions, and climate finance.

There is also the Ministry of Environment and Water's Malaysia Climate Change Action Council, which will implement the Low Carbon Mobility Development Plan 2021-2030, including targets to reduce 165 million tonnes of carbon dioxide emissions, save RM150bil fuel expenditure over a decade and promote the use of electric vehicles and other low carbon transportation.

Moreover, Malaysia has the National Fourth Industrial Revolution Policy, which includes initiatives that support financing for IR4.0 climate technology, in order to achieve sustainable growth for the nation.

But that's the public sector. How, then, is the private sector playing a role in helping achieve a decarbonised world?

Climate risk concerns

Reflecting the growing global concern over climate change, a fair number of companies are taking a long-term view on sustainability issues beyond financial concerns, with 18% of the top 20 public-listed companies committing to net zero and 38% of the figure being science-aligned.

Bursa Malaysia's ESG Programme Survey 2021 also finds that although 55% of Malaysian companies claim to have a sustainability plan and roadmap, 38% are seeking assistance to create one.

Among the biggest challenges that corporations – not just governments – would face is turning net zero pledges into near-term action, according to a January 2022 S&P Global report on *Key Trends that will Drive the ESG Agenda in 2022*.

While it noted that the number of governments and large companies setting net zero emission goals by 2050 grew tremendously, these commitments "often lacked interim emission reduction targets or plans to curb indirect emissions that occur along the supply chain."

That said, it also noted that rising pressure from various stakeholders will encourage the development of concrete, near-term plans to address emissions across the full value chain.

"Beyond the established focus on emission reductions, the spotlight will extend to how entities manage exposure to physical climate risks, including the presence and/or adequacy of adaptation and resiliency planning," the report stated.

Climate risk, according to the PwC 25th Annual Global CEO Survey, ranks fourth (59%) in the primary influential factors behind carbon-neutral and net-zero commitments, after meeting customer expectations 966%), government and/or intergovernmental targets (63%) and investor demands (62%).

Emerging challenges

With investors and other stakeholders seriously considering ESG risks relating to climate, pressure will also grow on corporate boards and government leaders to enhance their ESG skills, as they will be required to demonstrate that they can understand and oversee ESG issues.

In 2021, there has been an increase in shareholder activism in demanding better accountability from leaders, including votes against directors for lacking credible climate action plans, according to the S&P Global report.

It further added that the trend is set to pick up speed during the 2022 proxy season.

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There are three pressure points that can help push those in leadership positions to become more proactive when it comes to tackling climate risks, including growing financial pressures from financial institutions, stronger government decarbonisation commitments and improved non-financial reporting.

The PwC 25th Annual Global CEO Survey revealed that among those with net zero commitments, the most highly represented sectors are energy, power and utilities.

A May article in the strategy+business magazine, published by certain member firms of the PwC network, highlighted that "too few CEOs (chief executive officers) are looking closely enough at the physical and transition risks that a changing climate poses to their companies", aside from carbon-intensive sectors.

The report *Time to get Serious about the Realities of Climate Risk* revealed: "Climate risks are not only worrying business challenges for CEOs and other leaders, but deeply human challenges, too. One case in point: the massive investments that B2B (business-to-business) companies have made in back-office service centres in countries such as India – parts of which face life threatening heat and humidity spikes in the coming years."

But the issue lies in the fact that top management have a general knowledge of the impacts of climate change, yet there is a disconnect in the understanding of how these could specifically affect their businesses.

"We find that leaders have much less of an understanding of the specific impact that climate change could have on their business – for example, the physical risks to operations, infrastructure, or to a company's supply chain, let alone to the business-related transition risks that a societal and economic shift to a decarbonised world would bring, such as changes in demand, the impact on energy prices, building renovation requirements, or potential competitive impacts on logistics chains," the report said.

It goes on to say that climate risks "should factor more heavily in a CEO's thinking and start informing all of a company's climate-related decisions", as stakeholders will be ready to refocus corporate attention to the issue.

Even so, there are three pressure points that can help push those in leadership positions to become more proactive when it comes to tackling climate risks, including growing financial pressures from financial institutions to identify hidden climate risks in their portfolios, stronger government decarbonisation commitments – 90% of the global economy has net-zero pledges, compared to 16% in 2019 – and improved non-financial reporting via frameworks and standards such as the Taskforce for Climate-Related Financial Disclosures.

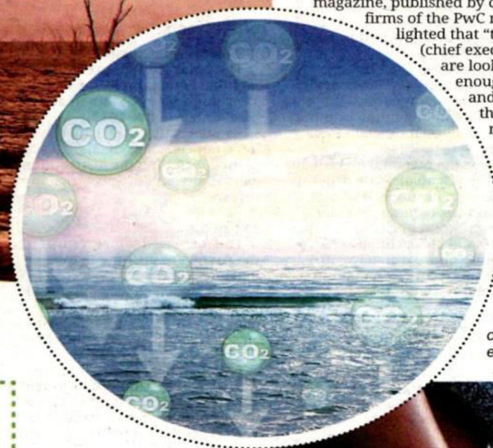
The report in turn strongly recommends that leaders look into serious climate risk assessment to help them "uncover and prioritise opportunities to thrive in a climate-challenged world", as companies that build faster understanding will have more strategic freedom to plan for climate risks, decarbonise and reimagine value creation for the years to come.

Furthermore, with the spotlight on the need for increased effort to avert a future climate disaster, it is no longer enough for companies to be carbon neutral. Now, specific, actionable net-zero targets are the way forward for companies.

Going beyond the early days of how GHG is determined, companies will have to go further in-depth into how they report and address their emissions, as stakeholders become increasingly ESG savvy – be it consumers, investors and policymakers, among others.

Universally, GHG is split into three groups: Scope 1 relates to sources directly owned or controlled by a company such as factories or production facilities; Scope 2 from energy purchased by a company; and Scope 3 for emissions arising from all other activities in a company's value chain.

The trend is seeing stakeholders focus on Scope 3, which means that the carbon footprint of a company can only be truly gauged if it takes into account GHG emissions along a company's entire supply chain.



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GHG emissions need to peak before 2025 to limit global warming to around 1.5°C, as per the Paris Agreement, before the impacts of climate change become irreversible.