Climate Risk and ESG Reporting: Reshaping the Future of Sustainability

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Introduction

The warming of the earth is inevitable. As we adapt to our new future, businesses must adjust their practices to address the realities of climate change.

A warming planet will trigger a range of consequences for businesses globally. This includes both known and unknown impacts resulting from changes to our climate and environmental conditions. As the effects of climate change cannot be fully anticipated, organizations must review their approach to risk management and adopt increasingly flexible ways of conducting business.

In addition to assessing and managing climate-related risks, it is important for organizations to assess their own impact on the climate. Reducing the corporate sector environmental footprint will contribute to the reduction of climate risk on a global scale. It is also important that businesses meet changing consumer expectations in relation to sustainability and environmental harm.

This white paper introduces the concept of climate risk and outlines how the growing popularity of environmental, social and governance (ESG) reporting is reshaping the future of transparency in the private sector.

Climate Risk in Context

Climate risk describes an organization's exposure to harm in relation to climate change. The risks posed by climate change are vast and varied.

Different organizations will face different types of climate risks, depending on the individual circumstances of the business, including its size, its industry and the location of its operations.

Not all climate risk will arise directly from global warming. Organizations must consider indirect effects that may result from changes in the environment. This may include resource shortages, supply chain issues, market instability, increased regulation, labor shortages, and changes in consumer demand and preferences.

Failing to address climate risks may have serious financial ramifications for businesses. An organization's capacity to be adaptable and resilient is key to managing the consequences of climate change. As demonstrated by the impacts of COVID-19 on global business, ripple effects can have a devastating impact on businesses that do not respond to change in a timely and responsive manner.

Inaction on climate change is also increasingly unpopular with consumers. Organizations that do not address climate risk may face reputational damage, loss of competitive advantage and shareholder activism.

Finally, businesses need to be aware of the growing regulatory environment in relation to climate issues. For example, organizations may be legally required to limit carbon emissions or to disclose or report on certain environmental impacts.

As legal requirements grow, organizations must take care to comply with all applicable local and international laws, regulations and contract provisions. Businesses may face penalties and other forms of loss for failing to meet their legal obligations.

Organizations must consider the impact of the indirect effects that may result from changes in the environment.

Illustration: Footwear Manufacturing the U.S.

A range of climate-related risks may befall a business in the footwear or garment industry. Consider a shoe manufacturing company operating in the United States.

Multiple components go into the production and sale of a single pair of sneakers. Garment and footwear manufacturers are known to have complex supply chains, some of which are so complicated that the complete chain of actors is not fully traceable.

A footwear company may, for example, be registered in the United States and distribute to retailers across Europe, the U.S. and Asia. Laces might be imported from China, tongues and textile panels are cut and sewn in Pakistan, rubber soles are sourced from Peru, and packaging is imported from Italy. The shoe may be partially assembled in Asia before having its final quality checks performed back in the U.S.

Businesses that utilize a global network of resources and human labor are highly susceptible to climate-related consequences. One possible impact will be a reduction in the availability of workers. For instance, decreasing livability in certain areas is expected to cause mass migration around the world. Pakistan is predicted to be one of the first places to experience extreme temperatures.

In the case of our shoe manufacturer, the supply of essential components of its shoes may be halted by labor shortages stemming from migration away from overheated urban areas like those in Pakistan. By extension, extreme conditions may also impact the cost and availability of water, an essential resource for turning cotton into thread for textiles.

It is well known that delays in the release of products can have significant consequences for a brand's reputation and longevity. Similarly, businesses that fail to help climate-affected workers transition into new roles may be judged harshly by increasingly socially aware consumers. Recent pushback against "fast fashion" has already put a spotlight on the fashion industry globally to take greater responsibility for their impact on people and the planet, and to be more transparent in their attempts to improve their processes.

Businesses that fail to foresee supply chain issues may suffer significant financial and reputational damage. While changes to the supply of resources and labor are not new challenges for many businesses, climate change is likely to impact supply in two significant ways: disruptions to the supply chain will be harder to predict, and they will be more immediate and more frequent than before.

In our changing world, business that establish robust frameworks for identifying risk and opportunity will be best positioned to meet the challenges of climate change. Businesses will need to be responsive, nimble and increasingly well-prepared. They must be willing to set meaningful climate goals, embrace a culture of transparency and accountability, and report truthfully on their progress.

Implementing an ESG Reporting System

Environmental, social and governance (ESG) reporting is a form of non-financial disclosure. An ESG report discloses the organization's performance in relation to its environmental, social and governance impact through qualitative and quantitative measures. The report evaluates the risks, strategies and opportunities that exist in relation to ESG matters.

ESG reporting is generally optional. However, there is increasing momentum to formalize and regulate ESG reporting, and certain aspects of ESG reporting have become mandatory in some countries. For example, ESG reporting will be required for select public interest companies in the EU starting in 2022.

The information that may be disclosed in an ESG report will vary substantially from organization to organization.

ESG impacts that are commonly addressed in an ESG report include:

- Greenhouse gas emissions
- Climate change
- Biodiversity
- Waste
- Human rights
- Labor conditions
- Privacy
- Community engagement
- Organizational governance and ownership
- Board composition
- Regulatory compliance
- Business ethics
- Responsible investment

Implementing an ESG reporting system can bring numerous benefits. These include

- Encouraging the organization to establish and work toward its sustainability goals
- Providing greater accountability and transparency for stakeholders, including shareholders, business partners and consumers
- Clarifying the extent and nature of an organization's ESG impacts, and highlighting areas that may require attention
- Enhancing the organization's credibility and reputation as a leader on sustainability issues
- Improving access to finance because of accurate and verifiable disclosures
- Gaining greater employee engagement and commitment to business goals
- Enhancing ease of doing business within the supply chain based on sustainability goals and disclosures

An ESG report discloses the organization's performance in relation to its environmental, social and governance impact through qualitative and quantitative measures.

Selecting an ESG Framework

Many ESG reports reference or apply an ESG reporting framework. Frameworks provide structure for measuring and communicating an organization's ESG impacts.

Multiple organizations have created frameworks for reporting on ESG matters; these include the Climate Disclosure Standards Board (CDSB), the Global Reporting Initiative (GRI), the Sustainability Accounting Standards Board (SASB) and the International Integrated Reporting Council (IIRC).

Some organizations also utilize other benchmarks or standards such as the UN Sustainable Development Goals (SDGs) or the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD).

There are considerable differences between the ESG frameworks. For example, some frameworks are industry-specific while others can be applied to all sectors. Some frameworks may emphasize environmental factors over an organization's social or governance impacts. The organization will need to determine which framework or frameworks (if any) are best suited to the business.

Organizational Culture

ESG reporting requires an organization-wide commitment. Organizations that publish an ESG report must establish a workplace culture that promotes the organization's ESG goals. This commitment to improvement on ESG matters must be upheld at all levels, from entry level to senior management.

Fostering an organizational culture that prioritizes risk awareness and ESG compliance will place the business in the best position to deliver meaningful ESG reports and to maintain a competitive edge in the relevant industry.

Reshaping the Future of Sustainability

ESG reporting represents more than best practice for climate-conscious businesses. It is a yardstick against which stakeholders and the public can measure a company's long-term commitment to sustainability and to the reduction of environmental and social harm.

Organizations that do not complete ESG reports should consider the risk reduction benefits and opportunities that come with the establishment of an ESG reporting system. Organizations that already partake in ESG disclosures should ensure that their reporting approach and framework are suitable, effective and up to date.

About the Expert

Dr. Rachel Baird

Director at IcebergSRC

Dr. Rachel Baird is an experienced environmental professional with a unique understanding of the interplay between state, commonwealth and international laws. Her major project experience provided a valuable practical lens to her legal skills and experience with social impact. Her research (Masters and PhD) addressed international environmental law including marine resource management, regional and high seas fisheries, and marine pollution.

Baird has lectured on international environmental law covering topics such as climate change, resource management and transboundary pollution. She has authored many articles and books addressing sustainability topics and is a regular expert reviewer for LexisNexis®.

Baird currently facilitates a Sustainability Law course run in partnership by Pearson and Oxford University and has provided ESG workshops/presentations for the CEO Institute, Governance Institute of Australia, Women on Boards and the Malaysian Institute of Accountants. Having now built a practice in governance advisory, Baird has a particular interest in ESG and draws upon years of practice and academic research to advise boards and management teams on organizational sustainability strategies.

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