COMMENTARY

MOVING FROM NET-ZERO PLEDGES TO PLANS

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Climate change is no longer a matter for debate and is one of the biggest and most urgent issues the human race needs to address. We know what must be done to limit temperature rise to 1.5 degrees, and the actions necessary to reach net zero are well understood within the scientific community. In many parts of the world, the physical risk of climate change is already significant: it can damage assets, disrupt business activity and affect lives and livelihoods. There is a rapidly growing acceptance that the cost of inaction will be higher than the cost of action.

The strategic resources required to get to net zero largely reside in businesses, mainly due to their outsized share of the economy. Businesses are aware of and understand the net-zero issue. Many have even signed up for science-based carbon-reduction targets. For example, 163 of the Fortune 500 companies have formal targets[1] and a third of the FTSE 100 companies have signed up to the United Nation's Race to Zero campaign[2]. But many businesses have not yet allocated significant effort to moving toward the targets.

COP26 has given renewed impetus to the net-zero push. Whether more could have been accomplished at COP will continue to be debated, but one thing is clear: the path ahead is net zero. Most large countries with historically poor track records of carbon emissions have committed to net zero and pledged billions of dollars for the transition. Many countries have also begun to formalize the policy levers they will use to achieve net zero e.g., banning internal combustion engines by 2030, phasing down coal and making climate-related financial disclosures mandatory. More such policy changes are expected over the next few months, years and decades.[3] This shifting regulatory landscape has consequences for business. Getting to net zero is no longer just a moral imperative, but also involves a significant commercial risk and opportunity with the very real potential to directly affect businesses' bottom line. The transition to net zero has passed the inflection point: the focus has shifted from pledges to plans.

Understand what net-zero means for your business

Against this backdrop, many of our clients are asking: What action should I be taking now to transition my organization to net zero while we continue to generate value for shareholders?

Our response is simple: invest time and effort now in understanding what the net-zero agenda means for the business landscape you operate in. At a minimum, you need to be able to answer some key questions for your organisation:

- What is our emissions footprint and what are the carbon hot spots across my value chain? How quickly do I need to ramp down my emissions to be compliant with the latest science?
- How are regulatory and technological shifts changing the market economics of achieving net zero? How is this likely to lead to a capital reallocation in the industry?
- How can my organisation improve its competitive position, given these shifting tectonic plates, by developing convincing net-zero plans and making the right strategic decisions?

The UK Treasury has proposed that it will require UK-listed companies to share their net-zero plans no later than 2023. Until then, it will be those leaders who embrace this unique moment in history, understand this rapidly evolving space and determine where opportunities lie who are likely to build a lasting competitive advantage.

Sources:

1 Marcus Lu, "Visualizing the Climate Targets of Fortune 500 Companies", *Visual Capitalist*, June 3, 2021.

2 Rachel Cooper, "Third of UK's biggest companies have now signed up to UN's Race to Zero", Climate Action, 30 March 2021.

3 Jennifer Rankin, "EU aims to curb deforestation with beef and coffee import ban", *The Guardian*, 17 November 2021; Siladitya Ray, " 'Fit For 55': Here's What To Expect As The EU Unveils Its Ambitious New Climate Legislation", *Forbes*, July 14, 2021.

What to do next

1. Know where you need to change and by how much

Take time to understand the basic science of greenhouse gas emissions and use it to identify where carbon is created in your industry's value chain across scope 1, 2 and 3. Which parts of the value chain are carbon hot spots? Are they more concentrated upstream where your suppliers are or downstream where consumption happens? Then pull in the experts you need to baseline your organisation's carbon footprint. What are its emissions today, and how are they likely to evolve through 2050 if nothing changes? Understand the specific sources of the emissions and the degree of direct control you have over them. Once you have fact-based knowledge of your carbon footprint, study the degree to which your emissions need to drop, and by when, for you to be aligned with science–i.e., to do your fair share to meet the global 1.5-degrees goal.

How might this build competitive advantage: This is an opportunity to take an honest look at your value chain, prioritise working with partners who share your values, and help those who are serious about decarbonising by sharing resources and best practices. Active engagement with your suppliers and customers will help inject long-term effectiveness and efficiency into the value chain.

2. Understand the levers you can pull to transition

Once you have a clear view of where you stand and where you need to get to, understand what specific interventions you can make and how much each intervention will move the needle. When you look at your tool kit to get to net zero, what mix of abating (reducing the carbon you generate), sequestering (removing the carbon you generate), and offsetting (a potential interim solution) would you use? Possible interventions include technology uptake; changes in suppliers, raw material mix, or product design; and, in some cases, a more fundamental shift in business model. Continue the conversation a level down by understanding the unique role each business unit, each function and geography can play in achieving the net-zero target. For example, preventing deforestation might be a powerful lever in Brazil, whereas switching the energy base from coal to renewables might be a more influential lever in India.

How might this build competitive advantage: Net zero isn't just about doing what you already do but with less carbon. Net zero provides the opportunity to use sustainability as a lens to drive business model innovation. This could result in large-scale portfolio shifts. For example, Tesla, Beyond Meat and Orsted are companies that put carbon efficiency at the heart of their strategy. Their proactiveness has led to a shift in thinking among incumbents in their respective sectors. Examples include Ford and VW, which are shifting their portfolios toward a greater share of EV, and Unilever and Nestlé, which are developing plant-based foods.

3. Make the transition happen

Prioritise and sequence interventions to first tackle the quick wins to gain early momentum e.g., draft a clear environmental policy. Some interventions will be win-win because they create value both financially and environmentally e.g., energy- or water-efficiency measures. In parallel, make a plan to tackle the big emissions hot spots. Gain clarity on how much the transition will cost, and then find the resources needed to make it happen: people, capital, time. On the other side of the equation, it will be important to understand how the future funding environment will evolve if you need to access capital. While government incentives are still available, finding out how to access them and identifying the net-zero credentials government and the capital markets are likely to use in the future to choose which companies they invest in, will be time well spent. Dedicating a senior executive to lead the transition will be an obvious need. Less obvious, and therefore justifiable in terms of extra attention, will be how to create the right incentives and a team around them with the right level of corporate empowerment. This team will be critical to how your organisation engages with the transition and communicates it with clarity and honesty, both internally and externally.

How might this build competitive advantage:
A considered approach to prioritising and sequencing net-zero interventions will enable better alignment of the net-zero strategy with economic value-creation models. A nuanced view of the transition plan can also help gain earlier and better access to green funding, potentially lowering the cost of capital, as mentioned in our previous paper "**The Business of Climate**." Ultimately, being honest about your net-zero plans and their timelines will generate greater respect and loyalty from your customers, suppliers, shareholders and employees.

Doing nothing is no longer an option. Pressure from governments, investors, employees and the global population to see business leaders turn their net-zero pledges into plans is building exponentially. Those who adapt sooner by innovating at pace stand to gain and maintain competitive advantage going forward.

About the authors

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ABOUT MARAKON

Marakon is a strategy and organizational advisory firm with the experience and track record of helping CEOs and their leadership teams deliver sustainable profitable growth. We get hired when our client's ambitions are high, the path to get there is not clear (or taking too long) and lasting capabilities are as important as immediate impact.

We help clients achieve their ambitions for sustainable profitable growth through:

- Stronger strategies and advantaged execution based on:
  a. A better understanding of what drives client economics and value
  b. Insight into changing industry dynamics and the context in which clients need to succeed
- A stronger management framework to generate better ideas and link decisions and actions to value
- A stronger organization with a more focused top management agenda and well-aligned resources
- A more confident and effective leadership team that's focused, decisive, and strategic

We have a joint team delivery approach where client ownership and engagement is paramount. Partners are highly engaged in the work product and supported by strong analytical and industry relevant capability. We work as advisers and catalysts in close, trust-based relationships with top management teams.