COMMENTARY

THE BUSINESS OF CLIMATE

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In the aftermath of COP27, where world leaders met at Sharm El-Sheikh to address delivery of net-zero goals and planning, we recap the progress made since Paris and COP26, simplify the conference agenda and share what all this might mean for business.

The world is falling short of its climate goals. Countries' emission pledges are insufficient to meet targets set at the Paris Agreement towards a global temperature increase of 1.5 C degrees. A landmark report released by the Intergovernmental Panel on Climate Change (IPCC) last year underscored the urgency of achieving net zero as well as the severe risks associated with a temperature rise above 1.5 C, declaring a "Code Red" for humanity.[1] Continuations of discussions from COP26 on net-zero strategy and implementation as well as new pressures – climate-related disasters and the crisis in Ukraine – were front and centre at this year's conference, along with a landmark agreement to establish a loss and damage fund for climate reparations to developing countries.

What's happened since Paris in 2015?

- **Increased incidence of extreme weather events**, severe and unprecedented flooding in Pakistan in addition to recurring fires in Australia and the US, heatwaves and more have led to more public awareness of climate change and clamour for climate reparations (loss and damage). Several protests and movements have been demanding action, e.g., Extinction Rebellion, Just Stop Oil.
- **Concerns around energy security and affordability rise** as the energy supply crisis is exacerbated by the war in Ukraine. Countries are veering slightly from net-zero aspirations to securing fossil fuel sources that meet near-term supply and reduce reliance on Russian imports.
- **Inflation and recessionary concerns complicate the transition** to net zero as countries and businesses face serious trade-offs in planning for net zero with limited infrastructure funding in the current economic environment.
- At COP15 in 2009, **developed markets agreed on an annual transfer of $100 billion to developing economies for climate action that has yet to be met**.[2] Lack of progress on funding has made climate finance more imperative than ever.
- Despite slow progress on international funding goals, **substantial investment and scaling of renewables along with capital incentives** have been spurred by significant pushes from legislation, e.g., the US Inflation Reduction Act earmarked $11.7 billion for renewables in addition to expanded tax credits – the largest provision in US history.[3]

The agenda at Sharm El Sheikh

1. **Increased ambition:** How can we limit the rise in global temperatures to 1.5 C degrees as agreed upon at Paris by securing net zero by 2050?
    a. *Pathway:* Updating interim 2030 targets i.e., NDCs (Nationally Determined Contributions) to more ambitious levels than initially presented at COP26.
    b. *Levers:* Aligning decarbonisation pathways e.g., phasing out of coal, investing in renewables and low-carbon substitutes (e.g., hydrogen), curtailing deforestation, pushing ahead with electrification, use of negative emissions technologies such as carbon capture as a backstop, carbon trading markets.
2. **Adaptation:** How can we help regions most affected by floods, droughts and extreme weather events adapt to protect their communities and natural habitats?
    a. *Saving lives:* Channelling funding towards building early-warning systems, defences, resilient infrastructure and agriculture to save lives in most vulnerable regions.
    b. *Saving ecosystems:* Protecting natural habitats to boost resilience to climate change e.g., mangrove forests planted on beaches to act as natural storm and flood defence systems.
3. **Climate finance:** How can we mobilise $100 billion annually to help developing markets realise the ambition and adaptation targets necessary to meet global goals? Is $100 billion the right target or is more financing prudent?

a. *Uses of funds:* Improving access to finance for vulnerable communities and ensuring investments in research and development and innovation needed to transition to a greener economy.

b. *Loss and damage:* Widening gap between developing country requests for monetary support and lack of action from rich countries has resulted in mounting pressure and attention for a new finance facility for loss and damage, which was finally agreed upon in the last hours of the conference (details to be worked out still).[4]

- **Sources of funds:** Mobilising funding from public and private sources such as governments, banks and insurers via loans, guarantees, export credits et cetera.

What this means for business

Resource assessment

1. **Urgency to reassess resource allocation** as businesses put a net-zero lens on their strategy and portfolio to adapt to upcoming regulatory requirements and public scrutiny. There is further clarity in policies that will be used to effect change, e.g., penalising emitters, encouraging low-carbon sources, complying with climate-related disclosures.

2. **Increasing pressure to improve energy efficiency and explore low-cost and long-term sustainable energy sources** as energy costs increase and economic concerns grow in the wake of the war in Ukraine.

Investor scrutiny

3. **Publicly listed high-emission companies are under greater scrutiny**. Most plan for a green transition by shifting their portfolio and reskilling workers whilst managing stranded assets. Potential shift of brown assets from public to private ownership – the latter where standards and transparency are arguably lower.

4. **Enhanced attention to corporate net-zero targets and pathways**, e.g., greater focus on short- and medium- term action to support long-term net-zero climate targets.

5. **Greater investor confidence in green industries** as certainty grows in regulatory frameworks, e.g., for EV, hydrogen, climate adaptation, nature-based solutions.

Financial impact

6. **Increase in climate litigation** as countries experience loss and damage from climate-related events and set-up commissions to address international inaction and pursue climate justice.

7. **Significant boost to the climate financing market**, including impetus for financing adaptation and mitigation in vulnerable countries as well as investments to scale innovation in hard-to-abate sectors such as aviation, shipping, cement and steel.

8. **Falling cost of capital for green companies** as higher ESG scores correlate with lower regulatory, environmental and litigation risks and as brown companies face more challenged access to capital.

Footnotes

1 “Intergovernmental Panel on Climate Change — Global Warming of 1.5 C.” IPCC, 2021, https://www.ipcc.ch/site/assets/uploads/sites/2/2022/06/SR15_Full_Report_LR.pdf.

2 “Report of the Conference of the Parties on Its Twenty-First ... - UNFCCC.” UNFCC, 2015, https://unfccc.int/sites/default/files/resource/docs/2015/cop21/eng/10a01.pdf.

3 “Inflation Reduction Act of 2022.” US Department of Energy, 2022, https://www.energy.gov/lpo/inflation-reduction-act-2022.

4 “Funding Arrangements for Responding to Loss and Damage Associated with ...” UNFCC, https://unfccc.int/sites/default/files/resource/cma4_auv_8f.pd

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About Marakon

Marakon is a strategy and organisational 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 better understanding of what drives client economics and value
  - 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 organisation 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.