A Long-Term Focus for Corporate Britain

Response by the Aldersgate Group

Contact: Victoria Fleming-Williams, Policy Officer

Introduction

1. The Aldersgate Group (AG) is an alliance of leaders from business, politics and society that drives action for a sustainable economy, seeking to trigger the change in policy required to address environmental challenges effectively and ensure the maximum economic benefit in terms of sustainable growth, jobs and competitiveness.

2. The AG believes that a healthy environment and the sustainable use of natural resources are at the core of long-term economic sustainability and that high environmental standards are essential to sustain growth and high employment.[1]

3. Please note that the views expressed in this consultation response can only be attributed to the AG and not to individual members.

4. Alongside this consultation response, the AG has presented notes from a roundtable the AG co-hosted on Wednesday 12th January with high level (generally Director level) stakeholders representing investors and large (FTSE 100) businesses to debate the BIS consultation *A Long Term Focus on Corporate Britain*. This was in partnership with Forum for the Future and UK SIF.

5. The outcomes from this roundtable should be regarded as draft notes. **They reflect the individual views of roundtable participants and are not necessarily shared by the Aldersgate Group or its membership.** The Aldersgate Group acted as a facilitator and due to the time constraints of the consultation process, these notes have not been approved by the Aldersgate Group Board or Membership. However, the outcomes could be helpful background to inform the decision making process.

[1] Aldersgate Group (2006) *Green Foundations: better regulation and a healthy environment for growth and jobs*

Question 1: Do UK boards have a long-term focus – if not, why not?

Question 8: What action, if any, should be taken to encourage a long-term focus in UK equity investment decisions? What are the benefits and costs of possible actions to encourage longer holding periods?

6. Recovery from the financial crisis and the global recession continues to dominate economic policy and business decision making. Just as critical as these short-term priorities is the need to address the longer-term challenges of climate change, energy security and resource depletion. Time is running out. Global greenhouse gas (GHG) emissions must peak within the decade and then rapidly decline to increase our chances of avoiding dangerous climate change. The economic costs associated with dealing with the consequences of failure far outweigh the more manageable, if still significant, costs of early action to prevent it. In addition, the UK economy is increasingly dependent on fossil fuel imports and there is a growing need to replace the electricity generating capacity that is due for retirement over the next decade.

7. The potential scale of these risks are demonstrated in the Coalition Programme, which states that: "the Government believes that climate change is one of the gravest threats we face, and that urgent action at home and abroad is required. We need to use a wide range of levers to cut carbon emissions, decarbonise the economy and support the creation of new green jobs and technologies"[2]. This point is re-iterated in the Conservative's Quality of Life Agenda (2010) which states that "we are all agreed that climate change is one of the greatest and most daunting challenges of our age"[3].

8. These challenges may be severe but they also represent exceptional opportunities. Prompt action will enable companies to become more competitive and create new opportunities to secure the jobs and wealth of the future. The race to develop green technologies will help define economic prosperity in the twenty-first century.

The transition to sustainable economy

9. The transition to a green economy will require spending in the short term to save money and create wealth in the longer term. Not only is the scale of the task enormous and the timetable challenging, but the pressure on public finance is considerable. Nonetheless only bold action will ensure success and early mover advantage is essential to drive investment and stimulate innovation in environmental markets. At a time when public resources are scarce, the environment must be put at the centre of the government's drive to support growth and drive job creation. This will also help to meet a number of other government objectives, including a more balanced economy, regional growth and creating a Big Society.

[2] HM Government (May 2010) *The Coalition: Our programme for government.*
[3] Conservative Party (April 2010) *Modern Conservatism: Our quality of life agenda.*

10. Those from the private sector insist that if they are to invest in the economic transformation, they need to be sure the transition will be carried through with determination, and that an appropriate timetable of regulation and capacity building will be set and adhered to. Therefore, the Aldersgate Group believe that regulation is a key driver to ensure Boards have a long-term focus and encourage long-term equity decisions.

11. Environmental policy must ensure that prices reflect environmental realities. While it is invariably complex to price environmental externalities (by which we mean environmental changes that impact human welfare and the biosphere but are not reflected in markets), current prices are a long way off providing a sufficient incentive for investments at the pace and scale required to meet environmental challenges.

12. This can most clearly be illustrated by the inadequacy of current policy to create a sufficiently stable, high and credible carbon price. Our report on low carbon finance (Financing the Transition) demonstrates that investment decisions for low carbon projects are strongly dependent on government policy to create markets that would otherwise not exist or would develop much too slowly. This produces risks for investors which adversely affect the commercial viability of low carbon investments; profitability is reduced if carbon emissions are higher, or the carbon price lower, than anticipated.

13. However, pricing policy alone is not sufficient to drive investment. Prices only work through markets and depend for their effect on markets working efficiently. There are many examples, not just in the environmental field, where this does not happen and other policy instruments are necessary to correct these market failures.

14. Some of the most effective government policies that have ensured environmental issues are increasingly on a Board's agenda have been targeted at behaviour change rather than just price signals. For example, the primary driver for many companies to reduce carbon emissions in relation to the CRC Energy Efficiency Scheme has not been the price of carbon (£12 per tonne in the first phase, increasing overall energy costs by around 10% according to some estimates) but the effect on reputation and brand value (associated with the league table element of the scheme).

Carbon reporting and accounting

15. Carbon emissions are now a financially material commodity with an economic and financial value to business, investors and the City. They need to be properly defined, measured, accounted for, audited and reported in the same way as other physical commodities and financial instruments. Too little is understood about the sources of carbon emissions in the economy. Measures introduced to control emissions do not have uniform financial effects on companies even within the same sector.

16. Companies are coming under pressure from investor demands to provide emissions data as part of their investment risk assessment processes. Many companies in Europe and North America now devote considerable resources to respond to those concerns. In many cases, however, where they make detailed quantitative carbon disclosures, those disclosures are often not adequate for investors to make meaningful comparisons.

17. The absence of comparable, standardised measures means that companies who reduce their carbon emissions are unable to demonstrate their success in relation to their competitors.

18. Investors are also vulnerable to 'green wash', where reporting consists of vague qualitative disclosures about the issue of climate change. The absence of reliable data allows companies that choose not to reduce their dependency on carbon emissions to avoid investor criticism. It also makes it difficult for markets to take account of carbon emissions within asset and liability pricing.

19. If companies report according to a common protocol, they will be able to demonstrate that they have used the appropriate process to assess risks, define boundaries, measure emissions and report on them in a way that is meaningful, consistent and comparable.

Current level of carbon disclosure

20. Despite improvements in the number of companies disclosing information on carbon dioxide and climate change, the overall level of disclosures are too low and figures are not comparable because of the use of different calculation methods.

21. The Carbon Disclosure Project (CDP), a not for profit organisation that collects information on carbon disclosure on behalf of 534 institutional investors with assets of over US$64 trillion, finds that 59% of the FTSE 350 disclosed GHG emissions in 2010[4] (a 4% increase from 2009). This represents less than two thirds of large UK businesses and the incremental improvements demonstrate the limitations of the voluntary approach.

22. It is also not possible for investors and consumers to make sensible comparisons between companies that do disclose their carbon emissions. This lack of transparency not only serves to obscure the true contribution of the corporate UK to national or international carbon emissions; it also undermines the comparative advantage that should accrue to companies with good carbon reporting and control. This slows down what needs to be going faster; our transition to a low carbon economy.

Material risks and liabilities

23. Current levels of disclosure on environmental risks are not providing shareholders and other stakeholders with sufficient information to challenge Directors.

24. For example, there has been significant media attention over the last year on the environmental and financial risks of producing oil in Canada's vast oil sands region. This is the world's largest energy project with $200 billion in funds committed from the world's leading oil producers.

25. Co-operative Financial Services and WWF[5] argue that while investors are beginning to take climate risk more seriously, mainstream financial markets and investment practices are still failing adequately to take account of the emergence

[4] Carbon Disclosure Project (September 2010) *FTSE 350 Report*
[5] Co-operative Financial Services and WWF-UK (April 2010) *Tar sands investments could turn toxic warns CFS and WWF-UK.*

of a carbon-constrained world and the long-term liabilities of carbon investment strategies. Their campaign calls for new legislation that would require oil, gas and power companies to disclose their future carbon liabilities, be they from product, process or those arising from strategic investments. This information should be included in company financial reporting and enable investors to factor these risks into investment appraisal strategies.

26. Related to this initiative, Fair Pensions, a campaign group for responsible investment, co-ordinated two shareholder resolutions, asking BP and Shell to publish details of the environmental, social and financial risks associated with their tar sands project. This led to a significant proportion of shareholders (over 10% in both cases) voting against the companies on this issue. As a direct result, BP and Shell had to engage more fully with their investors. Important new information came to light regarding BP's preparedness for catastrophic climate change, the ramifications of which are still being explored by oil and gas analysts as well as environmentalists. As for Shell, the resolutions prompted detailed disclosures on carbon price, predictions for oil demand, and their Carbon Capture & Storage plans for mining projects[6].

27. Fair Pensions believe that this campaign has shown that investor action is an important and viable tool for holding companies to account over environmental, social and governance issues in the UK. Several major investors have publicly said that they will be pressing BP and Shell for much greater transparency. Furthermore, it is clear that pension funds and fund managers have been forced to sit up and take notice of the views of the people on whose behalf they invest billions of pounds.

Mandatory carbon reporting

28. An amendment to the Companies Act led to the Business Review which requires directors' general duties to include "to the extent necessary" an inclusion of the impact of the company's operations on the community and the environment. However, directors continue to retain considerable discretion over how to calculate and present this information. Climate change is too urgent and too important to be left to the "discretion" of directors.

29. A clear, consistent, comparable definition of carbon disclosure is vital for progress towards UK climate change targets. Now that the voluntary GHG reporting guidance has been published, it should be made mandatory for all large UK organisations to ensure greater accountability and transparency. This will help companies identify cost savings through greater resource efficiency and more effectively address material climate risks and opportunities. It would also create a level playing field, allowing investors and consumers to make meaningful comparisons, thus driving further emission reductions.

30. A commitment to mandatory reporting now will also cement UK leadership on the global stage and give greater credibility to government climate targets. There will be further economic benefits, accelerating the development of the low carbon economy and giving the City the backing it needs to become the world leader in carbon accounting and reporting.

31. For example, thanks in part to the UK's creation of its own voluntary emissions trading scheme a year before the mandatory EU scheme was introduced, London

[6] www.fairpensions.org.uk

was an early mover and is now regarded as the hub of the international carbon market. Though the UK scheme was criticised for its emission reduction achievements vis à vis cost, the benefits of establishing the trading infrastructure (including the development of verifiers and auditors) and the 'hands on' experience of trading, were considered to outweigh the weaknesses[7]. The UK must not lose the initiative and further leadership – such as the introduction of mandatory carbon reporting standards – would help entrench its position, and spur the development of expertise in carbon accounting and audit practices.

32. The legislation for mandatory carbon reporting is already in place. An amendment to the Climate Change Act commits the Government this year to evaluate the contribution that reporting on GHG emissions is making to the achievement of Government's climate change objectives. It then has to introduce regulations for mandatory carbon reporting by April 2012 or put forward a report to Parliament explaining why this has not happened.

33. A mandatory carbon reporting standard has extensive business support, as demonstrated by the signatories to the AG letter sent to BIS Secretary of State Vince Cable. A recent survey of 1,674 practitioners by the Institute of Environmental Management and Assessment finds that over 80% support GHG reporting becoming a mandatory requirement[8].

34. In support of the AG letter, Steve Waygood, Head of Sustainability Research and Engagement at Aviva Investors said: "We believe that climate change represents a profound market failure. There is a clear need for much tougher policy measures on the international stage, as well as at the national level. While Copenhagen failed to deliver internationally, the UK is well placed to make carbon reporting mandatory in the UK. This would allow investors to more easily identify climate change risks and opportunities. If we conclude that climate change is potentially material then we have an informed basis on which to make our investment decisions."

35. The Confederation of British Industry (CBI) also supports the move to mandatory carbon reporting. In a recent report[9], it outlines the benefits of carbon reporting for British businesses, puts forward the need for a big shift for businesses to effectively capture emissions data and publicly report them and sets out a suggested framework for Government action.

36. James Murdoch, the Chairman and Chief Executive of News Corporation, is just one of a number of high profile business leaders that support the introduction of mandatory carbon reporting. In an article published in the Financial Times, he wrote:

> *"At a time when some companies emit more greenhouse gases than entire nations, we need transparency about emissions. Shareholders need disclosure to understand risk. Employees deserve it. Partners will expect it. Ultimately it is in the interests of all companies to know their carbon footprints and to be open about how they manage them. This is a vital step towards reducing risk and aspiring to be more than merely sustainable…*

---

[7] Bowyer, C, Monkhouse, C, Skinner, I & Willis, R (2004) *Business Action on Climate Change: Where next after emissions trading. IEEP and Green Alliance.*

[8] Institute of Environmental Management and Assessment (September 2010) *GHG Management and Reporting.*

[9] CBI (August 2009) *All together now: a common business approach for greenhouse gas emissions reporting*

Saying we can tackle climate change without public-company disclosure is akin to thinking obesity can be solved if people do not weigh themselves. Increasing the regulation of emissions, through mechanisms such as the carbon reduction commitment, may force business into disclosing and trading emissions, but it will not integrate carbon risk on to the business bottom line. We need an internationally consistent framework tied to listing requirements to achieve this, as advocated by the Aldersgate Group, a coalition of companies and environmental groups.

The UK government is afraid this will be a burden, but many of the best companies already do it. They are finding cost savings and opportunities. As we move to a cap and trade scheme, we need to be prepared for the new lower carbon economy that can emerge from the global financial crisis. To make significant reductions in greenhouse gases it is essential to engage the private sector as soon as possible, to drive the world towards that new economy."[10]

37. There will be administrative costs associated with complying with carbon reporting legislation, but these are often more than offset by the economic benefits. The Government's recent impact assessment provides useful data which supports this case[11], including case studies with companies saving between £80,000 and £1.2 million per year. Measuring, managing and reporting environmental impacts is part of good business management which justify the compliance costs for all medium and large organisations.

[10] James Murdoch (November 2008) *The Financial Times: Carbon disclosure should be mandatory by 2010.*
[11] Defra (September 2009) *Impact Assessment of guidance on measurement and reporting on greenhouse gas emissions.*