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Climate on the board agenda

KPMG Board Insights podcast transcript

A conversation with Amanda North, founder and CEO of Plan C Advisors, with considerations for boards as they assess the business risks and opportunities posed by climate change.

Announcer: This is the KPMG Board Insights podcast, and this episode is about the business implications of climate change.

Welcome to the KPMG Board Insights podcast, brought to you by the KPMG Board Leadership Center. The KPMG Board Insights podcast series features conversations with directors, business leaders, and governance luminaries to explore the emerging issues and pressing challenges facing boards today.

In this episode, BLC Senior Advisor Susan Angele talks with Amanda North, founder and CEO of Plan C Advisors, about how businesses are navigating the risks and opportunities related to climate change.

Susan Angele: Hello, and welcome to our podcast. With me today is Amanda North of Plan C Advisors. And I'm Susan Angele, senior advisor with the KPMG Board Leadership Center.

Our podcast today is on the issue of climate change. And as we've seen, the impacts of a changing climate are already being felt as extreme weather increasingly impacts communities and businesses. The cost associated with events such as drought, storms, fires, floods, and extreme heat has been estimated at almost $100 billion in the U.S. last year. And in the last few months alone, communities where nearly one in three Americans live have been affected.

KPMG's recent survey of 400 U.S. CEOs paints a cautious long-term picture. We asked CEOs if major global changes, such as income inequality and climate change, are a threat to their company's long-term growth and value. Seventy-three percent either agreed or strongly agreed. And zero percent strongly disagreed. Yet, in a recent survey we did, 51 percent of respondents said that they consider it on their boards to either a limited extent or not at all.[1]

So, given these business impacts, we really know that this is a journey, that we're at a point where almost half of boards are wrestling with the issues. And we know that, going forward, it's going to be more and more a part of the board agenda.

We are pleased to introduce a paper called *Board climate competence: Getting ahead of the curve*. Amanda is my coauthor. And the paper includes some insights from a number of board directors and executives who are leaders in the field. And our conversation today is going to draw on some of the findings and recommendations in the paper, as well as our own collective experience.

So, Amanda, thank you for joining me. Let's start with risk. Thinking about how some of the issues can be incorporated in a risk assessment for companies, talk us through how you think about it and then also, how it is playing out in some of the examples in our paper?

Amanda North: We're hearing more and more about how we need to limit the change in temperature to under 1.5 degrees Celsius over pre-industrial levels to avoid the most catastrophic impacts on all of us. But right now, if you put together all the government commitments, we're on track to a 4.9 degree [Farenheit] increase.[2] And this is really why business is understanding we have to take a strong role, alongside the public sector, in reducing climate risks.

So, we're going to talk through how that's possible that companies can do that. But perhaps the most important thing we've learned is that we need to take

[1] Of 467 corporate directors surveyed during a September 23, 2021, KPMG BLC webcast.

[2] William Booth and Tyler Pager, "As climate pledges fall short, U.N. predicts globe could warm by catastrophic 2.7 degrees Celsius," The Washington Post, September 17, 2021.

a holistic view towards risk—the risk of climate on our companies. We used to think of it as a very specific topic that could be handled by maybe one team within the company, but we're now seeing that it affects every aspect of a company's operations and every one of our stakeholders.

So, let's really go through five different types of risks, all of which need to be considered by companies, because we'll see how these involve every single aspect of a business.

The first is physical risk, and these are perhaps the most obvious and attention-grabbing forms of risk. Many of us, most of us, have recently seen the threats of hurricanes, floods, and wildfires. Virtually every geographic region is, or will, be affected by extreme weather. And now we know that that's exacerbated by climate change. Companies with operations and supply chains are experiencing forced delays, accompanying loss of revenue, not to mention the huge costs of repair or possible relocation of their facilities.

So, one of the board directors we talked to is based in Hawaii. She is a board director of Hawaiian Electric Industries. And Celeste Connors put it, 'In Hawaii, climate is not a theoretical risk, everything's affected, and everybody understands it.' So physical risks are huge. They're real. They're happening. We can see them. But reputation risks can be equally or even more impactful for companies.

Recently, the Pew Research Center polled 17 economies, including the U.S. And 72 percent of the respondents are somewhat or very concerned that climate change will affect them personally at some point during their lives. And 80 percent say they're willing to make changes about how they live and work to reduce the effects of global climate change.[3]

So, companies that rely particularly on millennials or Gen Z for their talent or customers are particularly at risk, as these audiences are especially attuned to company action on climate and they've been shown to vote with their feet and their spending dollars when it comes to backing companies that act or don't act.

Another category of risk is regulatory risk—sudden significant change in regulations and policy around climate change. An example is there's a current movement in the U.S. and abroad to tax import products based on their carbon footprint. And this is because, increasingly, greenhouse gases are viewed as a significant externality that needs to be priced into products and services.

So, we spoke with Alaska Airlines, and they're well aware of this threat, but also of the economic benefits to making its fleet more fuel efficient and less dependent on conventional fossil fuels. Patricia Bedient, one of their board directors at Alaska Airlines, says, "These considerations, but also company values, are making the future of transportation a critical component of their board meetings."

Another area is what I would call existential risks. These are the profound changes that will affect companies' products and services. As they look at the impacts of climate change, boards need to consider how these need to evolve. And we're going to talk about that in a moment, in terms of the real opportunities that can exist if you face those existential risks head-on.

And the final area of risk I'll touch on today is investor risk. Now, because of these wide-ranging risks we've just spoken about associated with climate change, investors are making climate education and action a dominant theme in their company assessments.

Now, we've all heard Larry Fink said [that] BlackRock has, and will, vote against board directors who do not demonstrate significant attention to climate action.[4] But this philosophy is permeated throughout the investor community, not just public companies, but private equity and venture-backed companies as well. Literally no size company is immune from investor scrutiny on the topic of climate action.

As Linda Riefler put it, and she's a board director of MSCI and CSX, 'Climate is a tectonic shift to economic structures. It's going to upend many economic models of how we run businesses. So, we have to think differently.'

Susan: Very, very well said. Thank you for that.

Follow-up question on risk. So, enterprise risk management, or ERM, is a wonderful process. But we often hear, 'Well, it doesn't take into account climate factors because they're so long-term.' How do you think about this? And how can it be addressed?

Amanda: Well, Susan, I'd like to use a term that you've shared with me before. I really love this term. You've talked about climate change as a gray rhino topic. Now, we've heard about black swans, but a gray rhino is a threat that we acknowledge but may not do anything to avert until it's literally already upon us.

Many ERM policies and practices were formed to identify and act on threats that have relatively sudden or short-term impacts on companies. Some of the most visible impacts of climate may fall into that category, like the impacts of extreme weather. But these are really only symptoms of far-ranging longer-term problems.

If we address only the symptoms, we will not be taking the steps to curing the problem. And that's why looking 5, 10, or more years into the future of how companies

[3] James Bell et al., "In Response to Climate Change, Citizens in Advanced Economies Are Willing To Alter How They Live and Work," Pew Research Center, September 14, 2021

[4] BlackRock, "Our approach to sustainability," BlackRock Investment Stewardship, July 2020.

may be impacted by climate change is vital to making the right strategic decisions now. And that's why more and more boards we see are running climate foresight exercises as part of their strategic planning processes.

Susan: Sounds like a great process. Earlier you alluded to the fact that climate is really more than just about risk—that there are a lot of opportunities to be had for companies that are exercising innovation and really thinking about leveraging them. So, what are the keys to flipping this mindset? And give us a couple of examples.

Amanda: Sure. Well, you're exactly right, Susan. I'd like to say opportunity is the flip side of risk. As we really begin to understand the profound impacts of climate change on our businesses, it's important to think ahead how that impacts the products and services and what we need to do to evolve those.

As we've seen from the COVID pandemic, companies that were early in identifying the risks and evolved their practices accordingly, they're actually coming through relatively well. And that'll be true of climate change also, and its impact on value creation.

Let's give an example of CF Industries, which is the biggest provider of agricultural fertilizers. Now, they're a major emitter of greenhouse gases, and therefore they're open to the possibility of significant regulatory actions that could affect their core business. But understanding that possibility, the board of CF have backed major investments to explore the use of ammonia as a means of transporting hydrogen, which is a key component in the low-carbon economy.

Now, this will require a significant investment in the short term. But the upside of the new business opportunity is huge for CF, and its investors agree. In spite of this short-term investment, the stock price has risen significantly after investors were briefed on these new directions.

Another example I'd like to bring up comes from the apparel industry, which also is affected by existential threats. In this case, cotton is a major input to many garments. And it's increasingly threatened by droughts around the world, exacerbated by climate change.

Lisa Bougie, board director at apparel maker Eileen Fisher, told us that they've been exploring aspects of the circular economy, which is taking a regenerative instead of linear approach to the use of materials. So, in the case of Eileen Fisher, this means encouraging customers to return products after use that may be repurposed into other garments. They also are encouraging regenerative agricultural practices throughout their supply chain.

Now, these have a lot of positive implications for the business. But one side effect that they didn't necessarily see in advance is that it's helped them access a younger population of consumers than had been their original core customers because these new consumers are really appreciative of the climate-forward actions being taken by Eileen Fisher.

Susan: So, I want to hit on the topic of integration now. And as we've talked in the past, we both deeply believe in the importance of ESG. And I once made a comment that you came back to me on, and it really resonated with me because it made me think about it in a different way. I had made a comment about climate change, because it's environmental, being the E in ESG. And you came back and corrected me. Why was I wrong? Explain that.

Amanda: Well, first of all, I don't want to diminish the importance of ESG. It's critically important, I think, as a framework to look at every aspect of business. And indeed, climate change has significant effects on the environment in which we live and work.

However, if you look at it only through that lens, I think it's possible that we can ignore the human consequences of climate change—really the S in the ESG. And, increasingly, we understand that climate is disproportionately impacting marginalized communities who are in harm's way from fires, floods, drought, and other perils.

Now, even our actions to mitigate climate action could have adverse impacts on these people if we don't engage their voices in the climate planning process. We need to make sure that the communities where we do business are included in our list of key stakeholders, and take their perspectives into consideration when siting facilities, making significant changes to workforces, and other areas.

And looking back again to CF Industries, their facilities are located in many economically underserved communities around the United States. And they really rely on these communities for their workers. So, the board is aware of the situation and encouraging management to have strong programs to engage these communities and also to let them know about how the business is being transformed and give them opportunities to advance within the organization as CF itself goes through a transformation.

Susan: So, one of the questions that frequently comes up is, 'How have you found boards most effective in really driving these issues into the DNA of the company?'

Amanda: Yes, it's a really important question. And I think, first is for the board to really take this holistic view of climate action that we talked about and send signals that the entire organization needs to be involved. One of the ways they can do that is by asking climate questions of a whole broad range of the management team, not just a select department.

We spoke with Diana Birkett Rakow, who's Alaska Airlines' VP of public affairs and sustainability. And she said that, for them, implementing ESG is a kind of culture change for the company, moving from operating in silos to operating cross-functionally. So, that holistic view is a really important aspect of driving the DNA.

Another can be the kind of language that is used and the kind of directives the board gives as to priorities. For instance, at Ford Motors, we spoke with board director Kim Casiano, and she tells us that the board helped drive immersive climate action by coming up with a new mantra for the organization around fuel efficiency. So, this is now the buzzword within the entire company and what every single person in the organization is gearing their actions towards.

Another thing that boards need to do—and they do this on lots of different topics, but it's never so important as climate action—is to continuously poll the mood in the middle and the buzz at the bottom. But when you do that, it's really important to ask the right questions.

We were talking with Jim Massey, former global VP of sustainability at AstraZeneca. And he told us that, in response to a survey, over 90 percent of their employees said they understood the company's sustainability goals. But in responding to the question of whether they understood their own specific role in advancing those goals, that number went way down. So, a huge gap between the company goals and what employees thought they could do about supporting those goals.

And Jim decided to work on narrowing that gap by instituting a social media platform to crowdsource employee ideas on climate action. This is hugely successful; they have something like 20,000 employees who are active on the platform. And as you can see, this is sourcing very positive ideas on what actually to do. But perhaps even more importantly, it's driving engagement throughout the employee base.

Susan: When you talk about changing culture and driving engagement, that is such a wonderful example. Another question that frequently comes up is about the linkage with compensation plans. What are you seeing across companies?

Amanda: Well, certainly, compensation is one of the clearest signals that companies can send about what's important to them. And, increasingly, we are seeing that nom/gov committees on boards are including climate targets [as] part of executive compensation. Now it's super important, when that's done, to make sure that those executive comp targets are consistent with the company's publicly communicated climate goals. But climate action can be even more powerful if compensation is used as a motivator throughout the company.

We spoke with Patricia Bedient of Alaska Airlines, and she said that to get their whole organization to buy in, they included carbon reduction in the short-term incentive plans that cover the entire company. And as she said, 'As the workers on the ramp see their goals as consistent with those of top management, it's really a powerful driver of cultural change and even differentiation for them as they seek the next generation of climate conscious employees.'

Susan: So, I just want to ask you, as we conclude, what [are] the one or two takeaways that you'd like to see board directors bringing back to their boardroom on these issues?

Amanda: I guess the overarching comment is this is a board topic. And it's really exciting to see the dramatic change in boards' recognition that this is something that they need to be competent and they need to understand, and they need to oversee action on.

And I think the two things I would suggest are, again, taking a holistic view of climate action in organizations—really creating and [supporting] a culture of readiness throughout the company to promote early detection and management of climate risks—and involving the entire management team, and indeed, the entire company.

Beyond that, it's to include all stakeholders. Make sure they have a voice in the planning. Make sure that the company understands their viewpoint on what climate issues are most important to them. They can use a materiality assessment to uncover that kind of work.

So, to understand the voices of stakeholders, understand all the different kinds of risks that can impact a company, and then to also recognize how to get ahead of it and how to really take the courageous actions to evolve products and services to respond to these threats and maybe move beyond it.

And I think there's a tremendous potential for innovation, not just from a technology standpoint, but also in the ways that companies do business. And so, I think we have an opportunity, as companies, for boards to take a leadership position and really affect climate action in their companies that can make them stronger in the long haul because of the actions they take today.

Susan: Thank you so much for this. As board members are stewards of long-term value, these considerations are more and more important and coming more and more to the forefront, both, as you said, assessing risk, looking for opportunities, assessing and incenting talent, and also really just sending a communication and a message to stakeholders about what the company really stands for.

So, thank you. I think there's a lot of great information and practical suggestions in here. So, again, thank you for joining us.

Amanda: Thank you, Susan.

Susan: And to all of you, thank you. And I hope that you got some great suggestions to take back to your own boardroom on this very, very deeply important issue.

Announcer: Thank you for listening to this episode of the KPMG Board Insights podcast. Be sure to visit the Board Leadership Center website at kpmg.com/us/blc for more resources and information for board members and business leaders, and be sure to subscribe to the Board Insights podcast to be notified of new episodes.

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Contact us

kpmg.com/us/blc
T: 1-800-808-5764
E: us-kpmgmktblc@kpmg.com

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