

FEBRUARY 2023



Climate change and organisational strategy

Developing strategy for a changing environment from
the perspective of the board

Embedding climate into organisational strategy

Embedding climate into organisational strategy often requires approaching climate change from a new angle. Climate considerations are often approached as stakeholder or reporting requirements rather than strategy requirements. Nonetheless, climate change mitigation efforts and the physical impacts of climate change itself will fundamentally change economies the world over, having significant impacts on economic and social conditions. In this setting, organisations that are not adapting strategy to take climate change into account are planning for a world which doesn't exist.

Strategy is centrally a question of creating value in the face of prevailing conditions. As such, the effective integration of climate into organisational strategy must combine an understanding of likely change with the regular process of strategy development.

Organisations display different levels of ambition and maturity in their approach to climate change. These range from responses grounded in traditional

corporate social responsibility through to those focused on evolving the organisation's value offering in the face of climate change (Figure 1). Organisations often move through these stages of development sequentially. Some organisations that have been developing their approach to climate change for a long time have had significant space to do so. However, many organisations who have begun developing their approach to climate change more recently are moving through these stages increasingly rapidly as the demands of stakeholders, regulators, suppliers and customers evolve.

The impact and influence of climate change must be factored in across an array of organisational considerations. These include not only the organisation's purpose and priorities, but also its business model(s) and its operating model. Developing effective climate strategy and bringing this strategy to life often includes changes across all these dimensions.



The human side of climate strategy

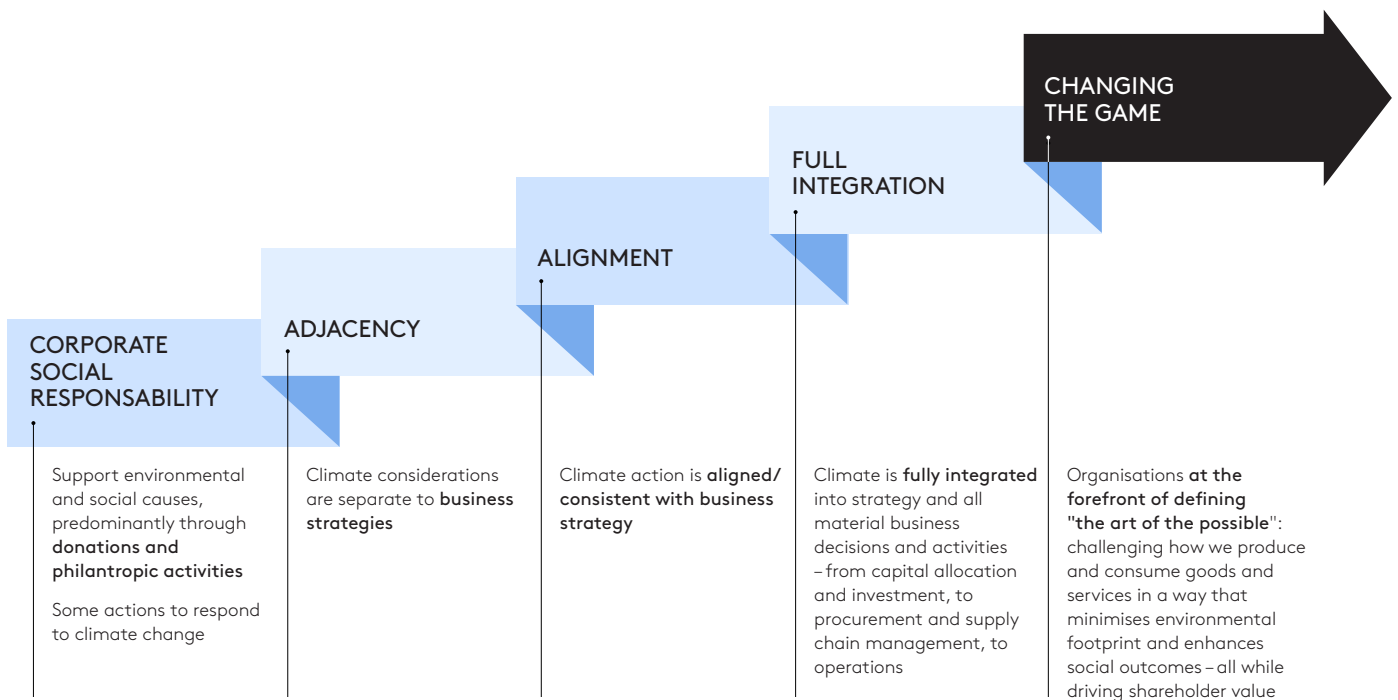
Bringing climate and strategy together requires adjustments to governance and people. Boards and their leadership teams must give climate change sufficient priority. This may seem simple but is often a fraught process in practice. Nonetheless, the board has a unique role to play in prioritising and legitimising climate change response throughout the organisation.

Boards and leadership teams need to support the organisation to develop sufficient understanding and capabilities to provide input into, and implement, strategy. We often see leadership teams attempting to develop climate strategy without giving their teams sufficient support to understand likely changes and strategic pressures arising from climate change. In our experience, taking the time to build this understanding often unlocks creativity, buy-in and decision-making capability among senior teams. Similarly, establishing sufficient capability across organisations to respond to the needs of the strategy is often challenging. Boards and leadership teams should anticipate that providing sufficient resourcing and training across the organisation will be a key aspect of delivering against climate related ambitions.



In our experience, implementing climate-related strategy often requires the development of new partnerships with external parties, including customers and suppliers. These partnerships can provide critical visibility on the changing needs and expectations of key stakeholders, and the capabilities needed to execute on new ambitions. Boards and leadership teams should be prepared to navigate new relationships with these counterparties as they develop and deliver climate-related strategy.

FIGURE 1: MOVING FROM CSR TO TRANSFORMATION



Using scenario analysis well

Scenario analysis is an oft-used tool in climate strategy exercises. Scenario analysis was developed in the oil and gas industry to support decision making under uncertainty. Its use in climate disclosures and strategy is increasingly commonplace.

Scenario analysis can play two important roles for organisations (Figure 2). Firstly, and most simply, scenario analysis is increasingly used as a tool to represent the possible impacts of climate change on the organisation, and the organisation's preparedness for these impacts, in a consistent and accessible way. Secondly, scenario analysis can support the understanding of the board and the senior leadership team of climate change and its various impacts and implications, and in doing so support the formation of effective strategy. The first use is very common and must be undertaken in a way that is consistent with market expectations and norms. The second is extremely powerful, but often does not take place.

The use of scenario analysis for the first task is increasingly standard. Scenario analysis was adopted by the Taskforce for Climate-Related Financial Disclosures (TCFD) as a central tool to support climate related disclosures and strategy development. Listed organisations globally are increasingly asked to complete varieties of climate scenario analysis as part of their regulatory responsibilities. Similarly, regulated banks are increasingly asked to complete climate stress testing – a similar process – to assure their regulators of their preparedness for climate change.

Scenario analysis for consumption by external stakeholders must meet certain requirements. These exercises normally require the use of a scenario with high transition impacts, increasingly a 1.5 degree scenario (under which extensive economic changes are made to avoid climate change). They also require the use of a scenario which includes significant physical climate change impacts (often a 3+ degree scenario, in which climate change plays out with outcomes across numerous hazards). Importantly, scenario analysis should give decision makers a sense of both the risks and the opportunities to the organisation.

FIGURE 2: PATHWAYS FOR SCENARIO ANALYSIS

Scenario analysis has two major roles, and it is most powerful when it can act in both of these roles.

1 TECHNICAL

Assisting in risk identification, supporting TCFD disclosures, and specifying value at risk to providers of finance.

- Establishing major risks by asset or business under different scenarios
- Pricing the impact of these risks on balance sheet and P&L

2 INSIGHT

Supporting the leadership team to build their understanding, awareness and strategic intuition on climate change.

- Workshopping major scenarios with leadership teams
- Stress-testing leadership responses to different scenarios
- Utilising financing impact and adaptation costs in ongoing strategy discussions

This second role is often forgotten or neglected

Building capability of the board and executive team

Ultimately boards and their leadership teams need to develop strategic intuition about climate change.

Senior leaders are expected to maintain a good sense of the strategic implications of structural or cyclical changes such as inflation, the rise of e-commerce, or a shift to remote working. Leaders must have an intuitive grasp of these topics to effectively lead and manage the organisation.

Climate change is no different and has similarly significant broad-reaching structural implications. Nonetheless, boards often need to work hard to develop this intuition. A working understanding of climate change has not been a requirement of boards and leadership teams until very recently, and many

board members have yet to develop their expertise in this space.

Australian boards have made progress on this front, but still have quite a way to go. A recent survey by AICD noted that 54% of directors in Australia did not have confidence that their board had the knowledge and experience to adequately address the strategic challenge presented by climate change (Figure 3). Despite this high need for capability development, measures to increase the skill of the board (such as director training, board skills gap analysis or recruitment for climate related competencies) were among the least popular responses to climate change.

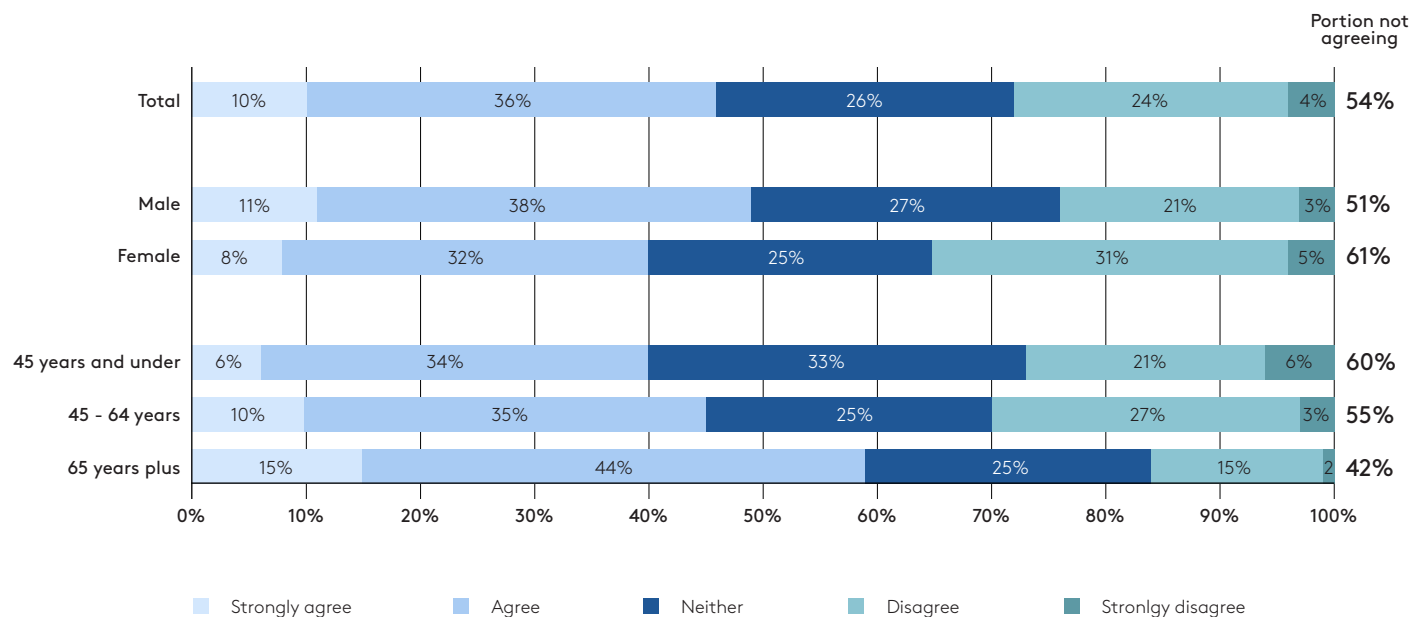
FIGURE 3: AUSTRALIAN BOARD CAPABILITY ON CLIMATE CHANGE IS STILL DEVELOPING

Boards (and their leadership teams) should develop capability across a number of fronts



Q. To what extent do you agree with the following statement?

"My board has the knowledge and experience to adequately address the climate governance issues facing our organisation."



Source: AICD 2021

Asking the right questions in the board room

Boards can ask some key questions to prompt the development and testing of organisational strategy that accounts for the risks and opportunities presented by climate change.



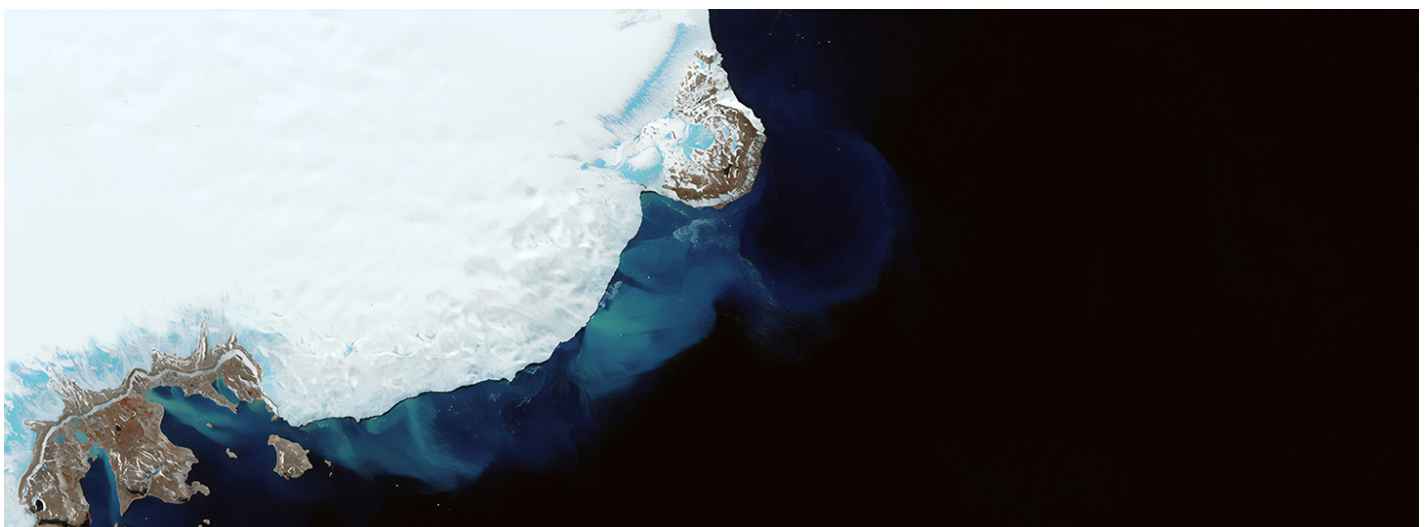
Questions that should be answered in the strategy process include:

- 1 How will a changing climate impact our assets, operation and supply chain?
- 2 How can we contribute to building resilience – physical, economic and social?
- 3 How can we use our capabilities to “win” in an economy undergoing this transformation?
- 4 What of our existing value is at risk?
- 5 Where is there opportunity?
- 6 How can we support our people and the communities we operate in to thrive in a changing world?



They also include questions designed to get a sense of the depth of existing strategy, such as:

- 1 Has our climate risk and opportunity analysis driven any material change in our strategy?
- 2 Who is accountable for the organisation’s response to climate change (this may be many people) and is this reflected in their incentives?
- 3 How are we staying across climate-related developments? Are we updating our scenario analysis, and how frequently?
- 4 Who should we be partnering with?
- 5 How is the management team maintaining their expertise on the topic?





For further information, please contact:

Zoe Whitton

Managing Director

zoe.whitton@pollinationgroup.com

pollinationgroup.com

DISCLAIMER

This material has been prepared by Pollination Capital Partners LLC and Pollination Law LLC. The information provided in this publication does not, and is not intended to, constitute legal advice; instead, all content in this publication is for general informational purposes only. Readers of this publication should contact their attorney to obtain advice with respect to any particular legal matter.