

The Warm War – A Case for Business

Essay Question:

*“Is there a distinctive business case for reducing greenhouse gas emissions in the corporate sector, or are such efforts driven mainly by regulatory pressure?
Discuss with reference to two industrial sectors.”*



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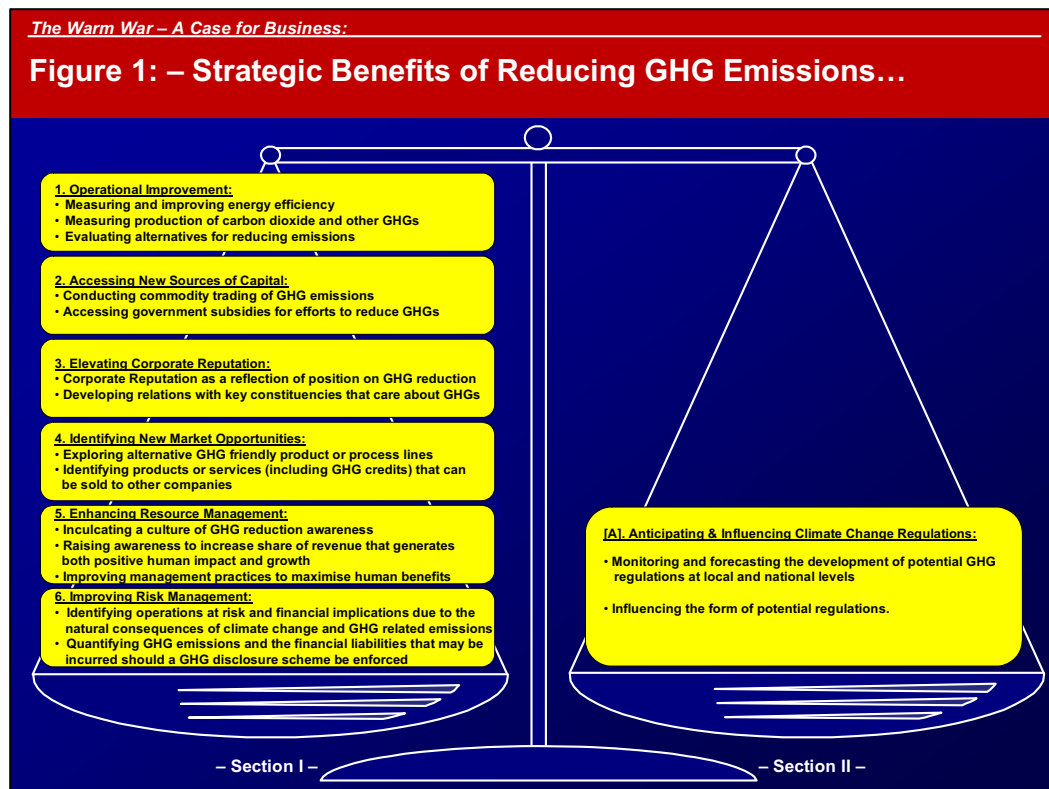
Introduction:

The 20th century saw the world divided by the Cold War. The 21st century may see the world united by, what this author has termed, “The Warm War” – the call to “benevolent arms” to address the global impact of climate change.

This essay analyses whether there is a distinctive business case for reducing greenhouse gas (GHG) emissions in the corporate sector, or whether these efforts are mainly driven by regulatory pressure. The two industries referenced are banking and oil.

Theodore Roosevelt IV recently stated: “The economic transformation driven by climate change will be more profound and deeper than globalisation, as energy is so fundamental to economic growth” [Horwood 2007: p2]. Corporates are thus fast becoming aware of the risks and opportunities associated with GHG mitigation [Hare 2008: p3].

Section I of this paper outlines the business case drivers for corporates in dealing with the Warm War, and Section II discusses the regulatory realities that may drive corporates’ decision making, as shown in **Figure 1**.



Section I – Business Case Drivers:

The case for business in its quest to win the Warm War will be analysed by six key improvement drivers as outlined in **Figure 1**.

1. Operational improvement: A key part of a corporate's business case response to the Warm War is the realisation of benefits from any effort to reduce GHG emissions, including improved process optimisation, reduced input costs and material, and decreased costs of transportation [Hofmann 2007: p104].

Two "first mover" examples are British Petroleum (BP) and Royal Dutch Shell (Shell) who have both addressed process optimisation through refinery plant re-configurations to improve process and GHG efficiencies, as well as reducing input costs and materials. They are both also investing in alternative, cheaper and more efficient forms of energy (e.g. wind, solar and hydrogen), thus mitigating against high oil production costs, whilst at the same time potentially reducing their transportation costs [CDP 2008].

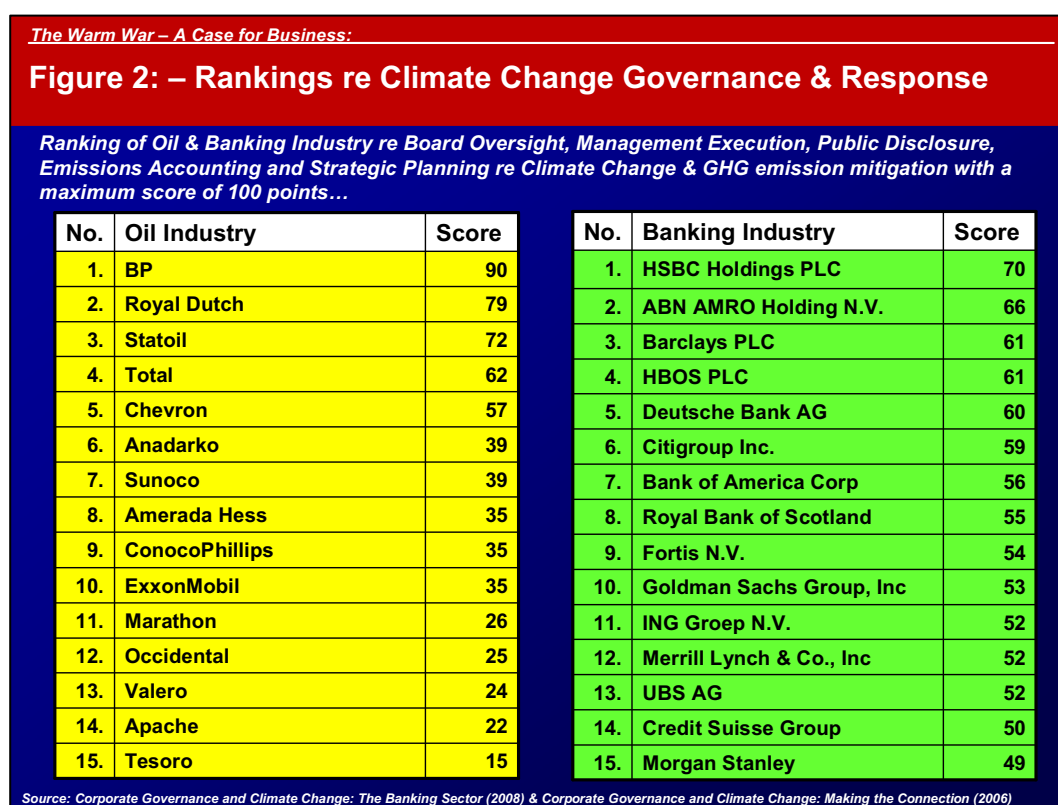
Whilst banks are not large GHG emitters on the scale of oil companies, they are proactively reducing GHG emissions to reduce their energy costs. Many banks (e.g. Goldman Sachs, Barclays, ABN Amro) are changing their energy procurement policies to renewable energy sources and integrating energy-efficient technologies into their real estate management, thereby reducing costs and improving efficiencies [Cogan 2008: p3].

2. Accessing new sources of capital: Another key reason for corporates to tackle the Warm War is the access to "new" capital from GHG trading and government subsidies [Hoffmann 2007: p106]. Barclays was the first UK bank to establish a GHG trading desk and is now the largest intermediary in the carbon market, which is a key new source of capital for the bank [Barclays 2008]. BP, Shell & Total are also increasingly entering this lucrative trading market in order to derive this new source of capital [CDP 2008].

Three new main sources of capital that banks are realising from emissions trading are the brokerage of GHG emissions allowances and credits, the financing and development of carbon offsetting projects and the speculative investing and derivative offerings in emissions credits [Cogan 2008: p31].

Corporates are focussing on the benefits of this “new” capital as it is estimated that the value of carbon trading is likely to eclipse that of oil in coming decades [Cogan 2008: p31] and the World Bank foresees a US\$10 billion market in GHG emissions per year to circa US\$100 billion per year after the Kyoto Treaty is fully implemented [Nesmith 2002: p8].

3. Elevating corporate reputation: A growing number of corporates are improving their corporate reputations by proactively addressing the Warm War. **Figure 2** details the top 15 banks and oil companies ranked by their response to climate change [Cogan 2006: p4].



Corporates, such as BP, Shell, Statoil and Total are also enhancing their reputations by openly declaring their carbon footprints, setting voluntary GHG reduction targets and identifying new sources of renewable energy [CDP 2008]. These efforts are aimed at increasing revenues and mitigating against reputational and litigation associated risks. BP boosted its reputation in 1997 when it was the

first major oil company to publicly state that "...the risks of climate change are serious and that precautionary action is justified" [BP 2007] and "...the oil industry has the privilege of being part of the solution to this problem" [Skjaereth & Skodvin 2001: p49].

Not all companies are as proactive. ExxonMobil is considered a "laggard" and has been notoriously slow in addressing the Warm War. It has always been apposed to the Kyoto Protocol, and (until recently) did not have any climate change related strategy [Skjaereth & Skodvin 2001: p44].

A number of banks are focussing on enhancing their corporate reputation and brand value by addressing climate change. HSBC's Chairman, Stephen Green, said: "HSBC will make responding to climate change central to our business operations and at the heart of the way we work with our clients across the world." [HSBC 2007]. ABN AMRO, Citi, Deutsche Bank, JPMorgan Chase and UBS are pursuing similar strategies and have all pledged \$1 billion to support an energy efficiency building retrofit program under the Clinton Foundation's Climate Initiative [Cogan 2008: p21].

4. Identifying new market opportunities: The attack on the Warm War is bringing about a market shift of new opportunities and benefits for corporates. These include Investment Opportunities (e.g. climate friendly products, investment in renewable energy and "clean technology"), Emissions Trading (i.e. establishing emissions trading mechanisms) and Advisory Opportunities (increased demand for risk management consulting services).

BP, Shell, Chevron, Total and Chevron made major financial investments in alternative energy sources, such as solar, wind and hydrogen to address their GHG emissions, thus improving their cost structure and driving new sources of revenue generation [CDP 2007; BP 2008].

The global financial sector represents approximately \$6 trillion in market capitalisation and thus needs to play a significant role in reducing global GHG emissions by understanding the financial benefits of investing in energy-friendly technologies [Cogan 2008: p1].

New global energy supply is expected to require in excess of \$20 trillion of capital investment over the next 25 years and banks such as HSBC, Barclays, ABN Amro and UBS are moving corporate and project financing away from carbon-intensive energy technologies toward more efficient and low-carbon alternatives [Cogan 2008: p1]. Growing demand for “climate-friendly” financial products and services are leading banks into new markets as they are factoring a market price for carbon dioxide (the main GHG) in lending and investment decisions, while building new markets through GHG emissions management, trading and brokerage, and advisory services.

5. Enhancing resource management: Another key driver for business is the balance of maximising bottom line returns, innovation and shareholder value while at the same time maximising its benefit to society.

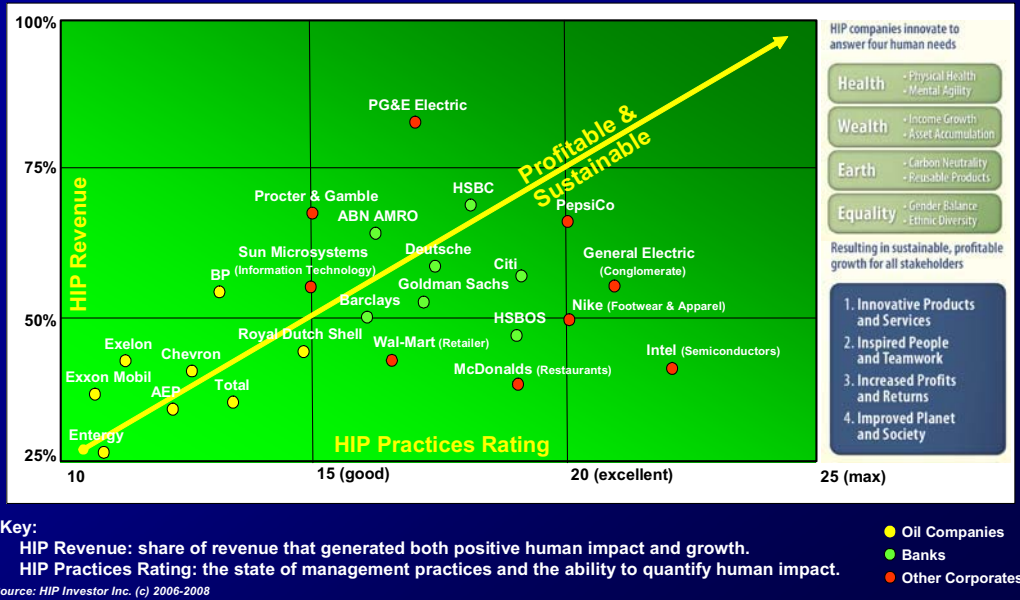
A unique measure for this is the “Human Impact + Profit” (HIP) measure, which compares a corporate’s **HIP Revenue** (share of revenue that generated both positive human impact and growth) and **HIP Practices Rating** (state of management practices and the ability to quantify human impact – with specific focus on carbon neutrality and reusable products), as shown in **Figure 3** [HIP Investor Inc. 2008].

Banks are, on average, more favourably positioned than the oil industry as they have less of a carbon legacy to address. BP and Shell’s HIP scores are consistent with their proactiveness and industry leadership with regard to the Warm War.

Companies are thus realising the positive aspects of addressing GHG reduction, whilst at the same time being profitable and sustainable, and attracting top talent for their organisations.

Figure 3: - Climate Change – Driving Profit Through Impact...

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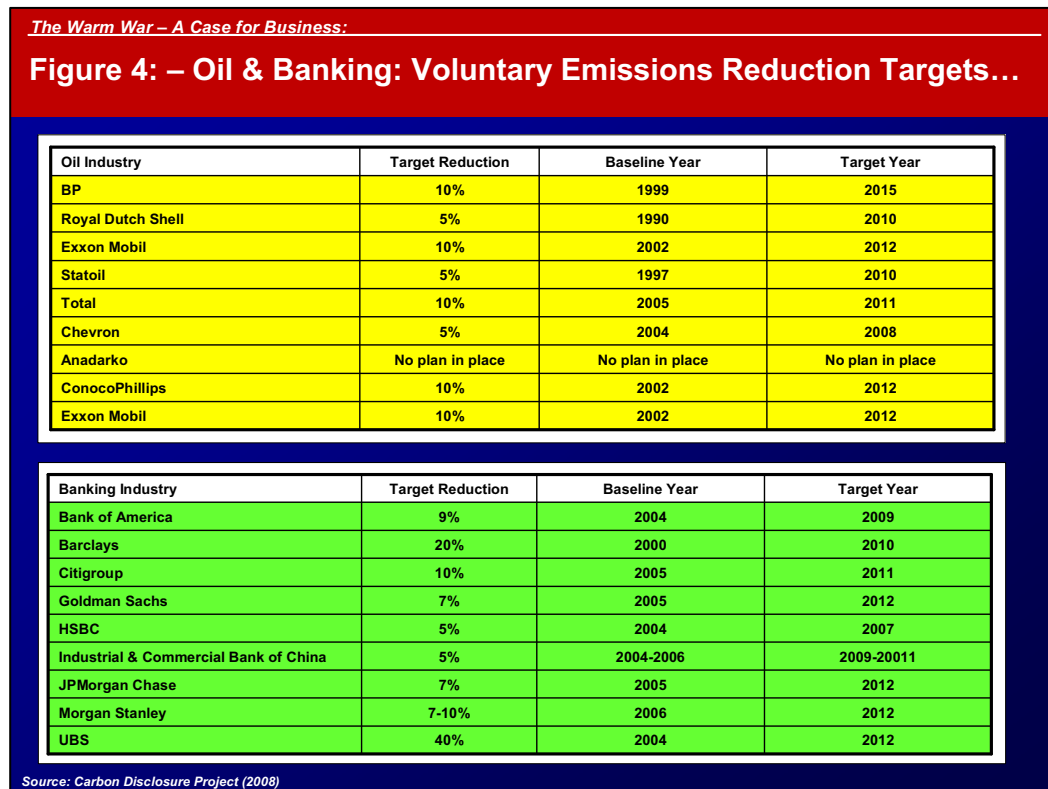


6. Improving risk management: Banks are on the leading edge of identifying the risk impact of the Warm War, as they have implemented the “Equator Principles” – a set of guidelines for assessing the environmental risks of project finance initiatives. This has resulted in increased environment risk screening in banks’ lending processes, resulting in reduced impairments, reputational and regulatory associated risks [Pennington 2008: p2].

These policies will protect against long-term erosion of value due to climate change and related environmental issues, as climate change will contribute to an increase in defaults and a decline in asset value in credit portfolios. Banks are thus directly benefiting from the enhanced risk management controls and leveraging off the investment potential of new carbon and green energy markets, products and services [Wyman 2008: p2].

BP, Shell, Total and Chevron are also proactively embedding similar initiatives to mitigate against reputational, litigation and physical risks through their focus on voluntary GHG emissions reductions and new sources of renewable energy [CDP 2007].

Corporates are reducing GHG emissions voluntarily as they realise the clear business case and opportunities associated with the Warm War [Sussman 2008: p1]. Key drivers for this are competitive advantage, cost savings, liability and risk management (including regulatory, physical, reputational and commercial risk), investor pressure and community resilience [WSCD 2008: p4]. **Figure 4** details the voluntary emission reductions set by companies in both the oil and banking industries.



Section II - Anticipating and influencing regulations:

Although companies have been proactive in the quest to win the Warm War, there is pressure for mandatory climate legislation to address laggards. Japan, China and many European countries are lobbying to reduce GHG emissions under a cap-and-trade carbon emissions trading programme already valued at over \$30 billion a year [INCR 2008]. In the USA, eleven states have already implemented GHG reductions, impacting on at least 33% of all new cars and light trucks sold in the USA.

Bank of America, Citi, Goldman Sachs, JPMorgan Chase and Merrill Lynch have all spoken out in recent years in favour of climate change legislation in the USA to tackle companies (and countries) which have not joined the quest of the Warm War [Pennington 2008: p2].

Thus banks and oil producers alike, who have not yet reacted to climate change, will be impacted by these fast-spreading regulations aimed at forcing laggards to join the Warm War.

However, BP and Shell believe these regulatory requirements offer opportunities because they are creating fast growing profitable markets for low carbon sources of energy such as solar, wind, gas-fired power generation and hydrogen power, which both companies are proactively pursuing [BP 2008; Shell 2008].

For their positive contributions, BP and Shell have both been asked to assist in designing the UK and European GHG trading systems, thereby also influencing future potential regulation.

Banks have also been proactively influencing legislation. The UN Environment Programme for Financial Institutions Initiative (UNEPFII) and the British Bankers' Association (BBA) have working groups focusing on climate change strategies. These industry groups can lobby regulators and legislators to ensure that future policy decisions address the salient issues as well as develop economically viable solutions within which the banks can participate [Cogan 2008: p53].

ABN Amro, HSBC and Barclays are proactively assessing the costs of the Warm War and emerging GHG-reducing regulations that will alter the costs of production, the pricing of securities, the size of liabilities and the assignment of credit and asset valuations. The banking sector has already issued 100 research reports related to climate change and the impending regulatory changes, which demonstrates the importance that the top tier of the industry attaches to this issue [Pennington 2008: p3].

Conclusion:

Corporates in both oil and banking have responded proactively, and have capitalised on the business case benefits of reducing GHG emissions. The main benefits have been derived from obtaining new capital through carbon trading, process optimisation, realising new market opportunities and enhancing corporate reputation and brand value.

Climate change presents significant economic opportunities that executives, shareholders and employees simply can no longer afford to ignore.

International and national regulatory pressure will inevitably be the wake up call for “laggards” to join the Warm War, although the “first mover” advantage enjoyed by companies such as BP, Shell, Total, Barclays, HSBC and ABN Amro may, by then, be long gone.

Although not all corporates have been as proactive as most, it is this author’s belief that there is a clear and compelling case for business to realise commercial benefits from addressing the reduction of GHG, and his desire is that they join the Warm War today.

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