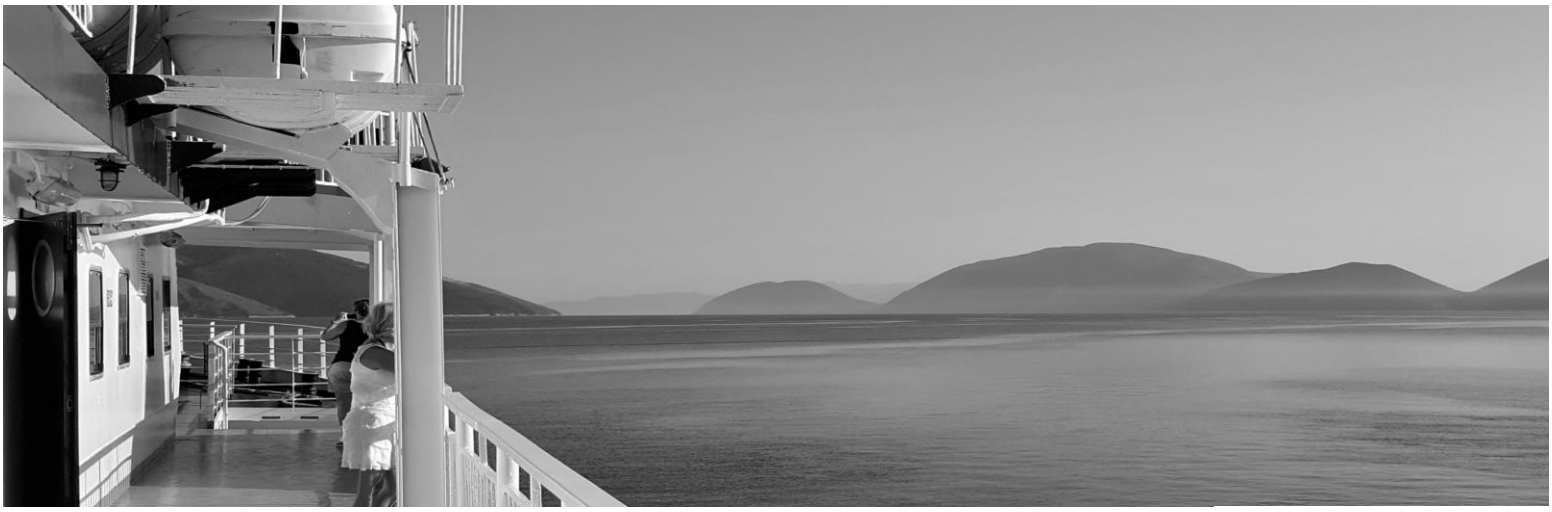

Image: Notwithoutrisk / Peter Deans

***Climate Change Risk – Time for Some Short, Medium and Long Term Scenario Planning by Businesses*.**

In the Oxford Dictionary, the idiom *the elephant in the room,* is stated to be 'a problem or question that everyone knows about but doesn't mention because it is easier not to discuss it'. For many businesses, climate change and climate change risk has been the elephant in the room for a number of years.

One of the first studies undertaken on climate change risk was the 'Stern Review on the Economics of Climate Change' in the UK in 2006, some thirteen years ago. Since then there have been numerous academic, government and private sector studies on climate change and its potential impact. This has not, until recently, resulted in meaningful strategic thinking and business planning – let alone actual changes in business strategies.

There has of course been much written on the why the world, governments and business have not responded to date. This contributed to the Oxford Dictionary declaring *climate emergency* the word of 2019. I won't dwell on the reasons for the delay, in acknowledging what is now a pressing issue for businesses, communities and countries.

I will instead focus on what steps businesses can take to begin to think about potential impacts on them from climate change. Assessing climate change risk should be considered an important part of building organisational resilience over the short, medium and long term.

Climate Change Risk –Unique Questions and Challenges

Climate change poses unique strategic, financial and operational questions and potential challenges for all businesses. These include:

- What time frame should we be looking at – 5, 10, 20 or 50 years ?

- How do we determine what assumptions we put into each scenario ? Should we have a range of scenarios for each time horizon ?
- How should we look to model unique geographic or business segment impacts if there is limited or no supporting scenario data available ?
- How do we consider and engage with suppliers and other business partners to assess jointly the impact of climate change ?
- How should we think about any potential competitor and government policy responses ?

There are no hard and fast answers to the above and the approach very much depends on the industry and nature of the business.

Defining Climate Change Risk

The definition that I like to use for climate change risk is: *the risk that the firm or organization is impacted or suffers loss from the adverse consequences of climate change (actual or perceived) and its consequences on the firm or organization.*

This can be due to the direct impact of climate change on the activities and operations of the business or changes in business practices of the organization, its customers, its industry and/or governments. The risk can be direct or indirect and can manifest itself through changes in consumer behaviour, for example. The consumer driven move away from single use plastic bags and straws is a good illustration of this.

There is anxiety about considering climate change risk, given the long-time horizons involved and uncertainty in describing the future landscape. It is, however, in simple terms another exercise in dealing with uncertainty. Many businesses deal with uncertainty already – be it disruption, rapid technological change, changing industry dynamics, or government policy and regulatory changes – to name a few.

Six Key Steps

In developing an approach toward climate change risk, a six-step process is recommended. These steps will enable a structured approach which starts at a high level - to develop the time horizons and scenarios to be modelled - and then ends with development of a strategic road map.

The six steps are:

1) Define the time horizons
2) Workshop the high level, external landscape
3) Assess key business impacts
4) Consider external government, public policy & regulatory factors
5) Model the scenarios
6) Develop a strategic decision-making road map

1) <u>Define the time horizons</u>

I use the plural term time horizons deliberately. Given the impact of climate change will inevitably evolve and change (in emerging and unknown ways) it will be necessary to consider its impact over the short, medium and long-term. The choice of scenarios will vary from business to business and industry to industry. The time horizons could be anywhere between 3 years and 30 years (or even longer for some businesses such as those in the transportation, energy or agriculture sectors).

Do not be overly ambitious with multiple scenarios given the work that will be involved in collecting data to use in the scenarios. In reality, the difference between some time horizons - for example between 10 and 20 years – may not be a lot at a high level. It is not necessary to consume valuable management time on broadly similar scenarios. It may suffice for many businesses to simply choose two: for example, 5 years and 20 years.

2) Workshop the high-level external landscape

This will be part art, part science. This will involve collating data and information on the external environment (the physical, environment, the economy and society) over the agreed time horizons. What is the impact of climate change on your industry? What changes are likely to have been effected? How have consumers responded? What demographic changes have taken place? What business and community activities have changed, or are likely to have ceased to take place in their current form?

To assist with the task, seek to work with other industry participants, industry associations, suppliers and business partners.

3) Assess key business impacts

Once a clearer picture has been painted of the future external landscape for each time horizon, the next task is to assess the business impacts on the firm or organisation's activities. The analysis will be tailored to the nature and scope of the firm or organisation's business activities. Again, seek to involve and/or leverage off work that suppliers and business partners may have already undertaken.

Consideration should also be given to the impact on the firm or organizations' ability to raise equity, borrow money and insure its business assets. The impact will depend on the nature of the firm or organization's business activities.

4) Consider external government, public policy & regulatory factors

Business planning always needs to have a government, policy and regulatory lens run over it. For assessing climate change impacts, likewise, consideration needs to be given to potential policy responses.

This may be a challenging exercise to do and it may be worth looking at a range of subsidiary scenarios here. In addition, an industry wide response may in turn drive policy and regulatory initiatives.

5) Model the scenarios

Modelling the scenarios will be a high-level outline of the nature of the firm or organisation's business profile in the future – taking into account climate change impacts and the likely range of community, business, economic and policy outcomes.

The scenarios can be solely strategic – which will be more directional in nature - or they can be strategic and financial if it is possible for the latter to be undertaken in considerable detail.

6) Develop a strategic decision-making road map

Steps 1-5 will inform board and management of a firm or organization of the likely impact of climate change on its business activities in the short, medium and long term. The data collection, analysis and discussion will facilitate the development of a range of strategic issues to address and potential business opportunities.

More detailed work can be delegated to specific working groups, third parties or the management of business areas impacted, as necessary.

Summary

The six steps outlined will provide businesses with solid foundations to commence thinking about how to reshape its activities, strengthen its resilience and identify opportunities arising from the changes unleashed by climate change. The scenario planning exercises, and strategic planning that follows, will be both iterative and ongoing.

As noted, business deal with uncertainty every day, and climate change risk is another risk to be considered, albeit likely to pan out over a very long time horizon.

About

Notwithoutrisk Consulting, founded by former Chief Risk Officer Peter Deans, is an Australian based firm. It offers a range of strategy, business and risk advisory services to banks & financial institutions, corporate and government clients.

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