Climate transition planning

An overview – The why and what of climate transition planning for organisations across Aotearoa New Zealand

Sustainable Business Council | WBC Global Network

XRB | Te Kāwai Ārahi Pūrongo Mōwaho EXTERNAL REPORTING BOARD

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Working draft

This guidance is a working draft. This means that you can provide your feedback, suggestions for improvement, or requests for clarification to us at **sustainability@xrb.govt.nz**.

This document was created by the Sustainable Business Council (SBC), in partnership with the External Reporting Board (XRB) and with support from SBC member Aurecon.

The XRB is an independent Crown entity that develops and issues reporting standards on accounting, audit and assurance, and climate, for entities across the private, public, and not-for-profit sectors.

SBC is an executive-led membership organisation that mobilises over 130 ambitious businesses through advocacy, collaboration and connection, driving towards a future where business, people and nature thrive together.

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This document

This document provides an overview of climate transition planning for businesses.

Its purpose is to provide an overview of:

- what climate transition planning is; and
- how it can help businesses transform deep uncertainties into an actionable long-term strategy.

This document is part of a suite of guidance notes.

- **Guide for directors**, using the four pillars framework of governance.
- **Guide for executives**, that covers executive's objectives and responsibilities over the transition planning process, and includes practical guidance on how to apply familiar tools to plan, lead and execute under high uncertainty.
- **Staff guide**, that includes practical 'how to' guidance and useful tools to get started, as well as an end-to-end example.

If your business is at the very beginning of the process, see the XRB's staff guidance: *Transition planning – Questions to get started* to understand the 'why' of transition planning for your business and for your stakeholders.

Important Note

These guidance notes focus on the climate transition planning process. For guidance about *disclosure* related to the Aotearoa New Zealand Climate Standards (NZ CS), visit the XRB's website.

Climate change is a systemic risk: What does this mean for businesses and how can transition planning help?

Increasingly, climate change is causing significant disruption. However, it can be perceived as one of a long list of topics to manage. But climate change is a systemic risk[1]: Its impacts are interconnected, deeply uncertain and unfold over a long-term horizon.

From an entity's perspective, a 'systemic risk' translates into significant and potentially sudden shifts in the entity's operating environment[2].

What this means is that everything and everyone will be impacted, directly or indirectly.

Deep technological changes are also on the horizon, driven by a need to reduce greenhouse gas (GHG) emissions. This is unlike past technological revolutions driven by economic forces through productivity gains.

Disruptions will arise from physical and social forces. By contrast, corporate strategy is mostly driven and influenced by market forces (competition, technology, consumers, regulation and more).

Climate change therefore requires different approaches and tools that some businesses may not be used to deploying on a day-to-day basis, such as scenario analysis.

This is not limited to climate change: nature, social and technology mega-trends are reshaping the operating environment at an increasing pace. Waiting is not a winning strategy, because:

Greater volatility requires greater adaptability.

Deeper uncertainty requires looking beyond the immediate horizon.

Increased complexity requires increased resilience and broader expertise.

Ambiguity requires experimenting and greater attention to assumptions[3].

Climate transition planning helps an organisation tackle these challenges.

Transition planning is about drafting a long-term adaptive strategy. In taking this approach, businesses will be equipped to navigate their shifting operating environment and position themselves for success.

Transition planning also translates insights gained from scenario analysis into actionable strategies. This enables businesses to adapt their core strategies, governance, and risk management practices to effectively address identified climate-related risks and opportunities.

The transition planning process described in this series of guidance notes is the continuity of the **scenario analysis process described in the XRB's guidance documents.**

[1] As the TCFD explained in its Guidance on Risk Management Integration and Disclosure (page 5), *"Risks associated with climate change are interconnected across socioeconomic and financial systems. Such interconnected risks are often characterized by knock-on effects and systemic effects, requiring a multidimensional perspective to assess the short-, medium-, and long-term implications for a company".*

[2] The Financial Stability Board (FSB) published its report *The Implications of Climate Change for Financial Stability* (2020) outlining the channels through which climate-related risks could cascade through the financial system and have a destabilising effect on national and global economies.

[3] What VUCA Really Means for You – by Nate Bennett and G. James Lemoine - Harvard Business Review

What is transition planning?

A transition plan is "an aspect of an entity's overall strategy that describes an entity's targets, including any interim targets, and actions for its transition towards a low-emissions, climate-resilient future"

NZ CS 1 Climate-related Disclosures

Transition planning is not only a key part of climate-related disclosures, but a core element of robust business planning and a business's overall strategy.

Transition planning asks the 'so what' question – so what is your business going to do in response to what it has learnt from making climate-related disclosures?

Transition planning is about repositioning and transforming your business model and strategy in response to climate-related risks and opportunities. As such, transition planning involves exploring the options available, charting a pathway informed by the different risks and opportunities identified, and taking tangible actions.

It requires an entity to formulate, implement, monitor and adjust a strategy that will enable it to operate, generate sustainable revenue, protect its assets and finance itself in a low-emissions, climate-resilient future.

The transition planning disclosure does not require a fully-fledged, certain and finished 'plan'. Transition planning is an iterative and dynamic process, with the disclosure evolving year on year.

"To enable primary users to understand how climate change is currently impacting an entity and how it may do so in the future. This includes […] how an entity will position itself as the global and domestic economy transitions towards a low-emissions, climate-resilient future."

Strategy disclosure objective from NZ CS 1 Climate-related Disclosures

Piecing together the climate transition puzzle

While the term 'transition planning' in the climate change context may be new, entities may find that they are already well on their way in their thinking and action.

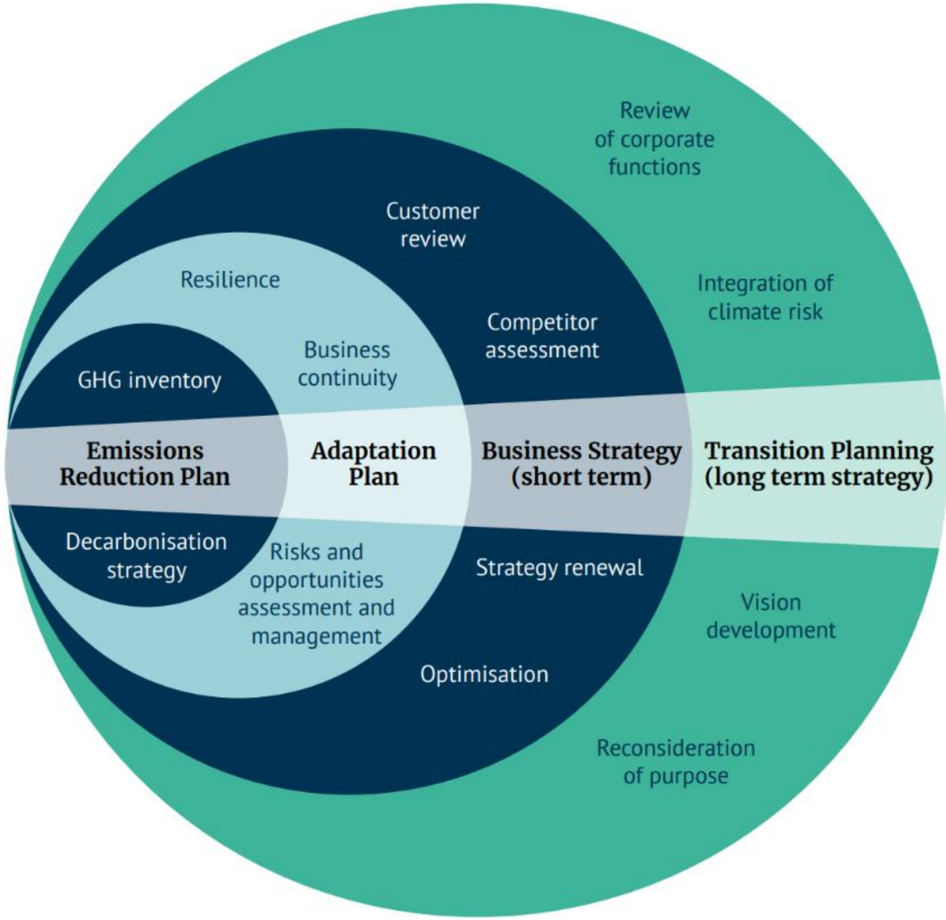
Many businesses would have already completed elements of transition planning, in the form of decarbonisation roadmaps, adaptation plans and activities supporting climate-related disclosures. Transition planning becomes the tool for ensuring these disparate parts are cohesive and tied into the business's broader strategy, as illustrated in Figure 1.

Transition planning requires organisations to think beyond reducing emissions, including consideration such as:

- Adaptation and resilience to physical risks
- Management of climate-related transition risks, such as changes in policy, litigation activity, market drivers
- Value chain resilience
- Responding to changing customer and stakeholder expectations, and social licence
- Taking advantage of climate-related opportunities

Transition planning can also be a vehicle for driving a business's strategy and action in fields such as biodiversity, circular economy and social outcomes. This could help streamline strategy and planning exercises and avoid duplicating effort.

Figure 1: Climate change planning tools and processes



Source: [Transition planning – a guide for directors | Chapter Zero]

Transition planning is a change process that requires strategy and planning

Fundamentally, transition planning is a process that will drive change at every level of a business. Transition planning will influence how a business sets its vision of success and strategy development, which then cascades down into business planning functions.

Undertaken in isolation (e.g. as a sub-plan within a sustainability team), transition planning risks being an inefficient and ineffective exercise. To help prepare a business for a low-emissions, climate-resilient future, it should be part of the strategy development and business planning process.

Businesses may find that many of their existing strategic and planning tools can be applied in the climate transition planning process. However, considering the systemic nature of climate change, some practices will need to be adjusted.

For strategy, this means:

- A need to challenge implicit assumptions
- A need to look for signals beyond a given sector or supply chain
- A reconsideration of the organisation's value-proposition
- A need for adaptive approaches to strategy[4]
- A need to apply multiple approaches to strategy

For planning, this means:

- Planning over the long-term
- Planning for different potential outcomes in parallel
- A greater importance of signals to monitor ahead of decision milestones

In essence, a climate transition plan builds on existing strategies, but is longer-term, adaptive, and explores assumptions that are often implicit.

[4] See the strategy palette from BCG

The value of transition planning

Ultimately, transition planning makes good business sense.

Undertaking transition planning is important for entities needing to meet disclosure requirements, provide transparency, take accountability, and meet expectations of stakeholders and investors.

But the *why* behind transition planning goes further. Organisations that choose to explore this *why* stand to benefit as they move toward the future.

Reducing exposure to business risk

A credible climate transition plan, and the underlying process required to get there, is an important risk mitigation tool for any business.

Using **trade risk** as an example, over 80% of New Zealand exports by value go to markets that have mandatory environmental, social and governance (ESG) reporting either in place or proposed[5].

Global-facing companies, and businesses that are part of their value chain, are facing increasing expectations for transparency, emissions reporting and verifiable transition activities. The ability to trade internationally is increasingly reliant on businesses being able to demonstrate that they are actively managing climate and other environmental impacts.

Similarly, looking at **legal risk**, there is increasing scrutiny of the gap between high-level ambitions and targets, and plans to achieve those targets, including capital allocation. Bridging that 'say-do'", or strategy-action gap via transition planning helps to manage the potential for greenwashing, liability risk, and retain stakeholder trust and confidence.

Climate litigation is increasingly used to push for more decisive action to slow climate change. The Aotearoa Circle commissioned a series of legal opinions related to the management of climate-related risks[6,7,8].

Access to capital and market value can also be enabled by transition planning. For some businesses, a lack of a credible transition plan can increase the risk of reduced access to capital. On the other hand, a credible transition plan presents an opportunity for a business to unlock the funding needed to transition toward new value propositions.

Evidence shows that businesses that proactively respond to climate risk are likely to be rewarded by the market: those that don't may be punished[9].

In New Zealand, major banks have reporting obligations including disclosure of their scope 3 'financed emissions'. Banks are increasingly required to consider and manage the climate-related risks and opportunities associated with their lending practices. The insurance sector is also increasingly factoring climate-related risks into insurance policies. Therefore, they may require climate-related information from their customers and may reflects climate-related risks in their premiums or financing choices.

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[5] https://www.theaotearoacircle.nz/reports-resources/protecting-new-zealands-competitive-advantage
[6] Sustainable Finance Forum Legal Opinion, 2019
[7] Managing climate risk in New Zealand in 2020 – A toolkit for directors
[8] Legal duties of New Zealand trustees to identify and manage climate change related investment risks
[9] Corporate Climate Risk: Measurements and Responses | The Review of Financial Studies | Oxford Academic

Unlocking opportunities

While change brings risks, it always comes with opportunities. Transition planning should surface climate-related opportunities.

Not everything we do (and are in the business of) will remain in a climate impacted future. But as the world changes, new needs will arise. Businesses that align their value proposition accordingly are more likely to survive and thrive. Every problem to solve is a business opportunity. Businesses that think in terms of 'value proposition', 'problem to solve' or 'jobs to be done',[10] will stay ahead.

For example:

Battery makers are not actually in the battery market, but in the 'portable energy' market. Currently, batteries are a relevant option to provide portable energy for some uses. That might change in the future as technology progresses, as happened in the photography market when digital replaced film as a solution for recording photos[11].

A business that specialises in making steel products could see itself in several ways: as an expert in steel, competing with other materials, or as an expert in manufacturing solutions for the construction and industry sectors. Steel happens to be the most competitive option for many uses in construction and industry sectors today, but that might change in the future. If the business sees itself as a steel expert, then it could aim at promoting the use of steel, seek to procure low emissions steel, and/or partner with businesses that have expertise in other materials to leverage the unique property of steel while staying relevant. Alternatively, it could diversify into other materials to maintain relevance in its core markets and continue to meet the demand for solutions in the construction and industry sectors

Linking the problems that a business is currently trying to solve to its climate scenarios provides a useful framework: the current value proposition might be less appealing or even become irrelevant for customers in some future scenarios. Conversely, new problems that the business may be well-placed to solve could become priorities for these customers (or new ones) in the future, and a significant part of the business offering.

Some businesses with sunsetting activities could choose to adopt a winding-down strategy, maximising current returns without making further investment decisions that may not be aligned with a world affected by climate change.

Providing long-term direction

Climate transition planning is an opportunity to connect climate-related risks and opportunities to strategic priorities, capital allocation, metrics and targets. Undergoing the process of transition planning is an opportunity for a business to write and own its own narrative.

In doing so, it allows to:

- Define a robust long-term strategic direction to enable better decisions, avoid lock-ins, and ensure timeliness and right sizing of execution.
- Improve the business' ability to navigate the increasing uncertainty of its operating environment, not just from climate change but from other disruptions as well.
- Create confidence in, and support for, the case for change and transformation in the business.
- Develop capabilities, as it demands continuous dynamic and adaptive optioneering, planning and operationalisation.

[10] What is the Jobs-to-Be-Done framework (JTBD)? | Built In

[11] Innovation and the transition to a low carbon future, EECA

Bring a leader's mindset to transition planning

Make it happen

- Integrate climate transition planning into strategic decisions
- Demand actionable insights
- Ensure teams are equipped, supported and incentivised

Be a change catalyst

- Knowledge is power – learn about climate
- Lead by example – stress the importance of transition planning
- Take ownership of transition planning

Challenge the status quo

- Disrupt to evolve – challenge existing practices
- Question norms – scrutinise existing frameworks
- Get new perspectives by engaging with your stakeholders

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