ESG Knowledge Series

How to Develop a Corporate Decarbonization Strategy

New Development Bank

Introduction

Corporate decarbonization strategy refers to the clear plans made by businesses to cut or remove carbon emissions from their operations, products, and supply chains. Around the world, corporate carbon emissions differ a lot across sectors, with industries like energy and agriculture being big contributors.[1] By adopting sustainable practices and switching to renewable energy sources, companies help slow down the rise in global temperatures, protect ecosystems, and support vulnerable communities.

As a multilateral development bank focused on sustainable development and tackling global challenges, including climate change, the New Development Bank (NDB) sees the key role of corporate decarbonization in reaching these goals. By integrating environmental and social considerations into its financing activities and promoting sustainable business practices among its clients, the NDB helps move towards a low-carbon economy.

Why should corporates develop and implement a decarbonization strategy?

Companies will face costs from both global inaction and their own inaction in addressing climate risks. A report by the World Economic Forum (WEF) states that unprepared businesses could see 5% to 25% of their 2050 EBITDA at risk due to climate-related physical risks, such as extreme heat, flood and drought.[2] This depends on the sector and location, with infrastructure-heavy sectors being the most exposed. Unprepared businesses also risk higher costs from regulatory and market changes such as carbon pricing or comparable regulations.

Regulatory Pressure. As governments worldwide step up their efforts to fight climate change, regulatory frameworks are changing to set stricter emission reduction targets and carbon pricing mechanisms. The creation of national carbon markets and the tightening of disclosure requirements force companies to measure, report, and reduce their carbon footprint accurately. Not following these regulations exposes companies to fines and penalties. Additionally, since climate policies keep changing, businesses may find it hard to keep up and adjust, which can disrupt their operations and market competitiveness.

Financial Risk. The rising costs linked to carbon emissions pose significant financial risks for companies. Carbon taxes, imposed to internalize the externalities of carbon pollution, increase the operational costs of carbon-intensive industries, cutting into profit margins and competitiveness. Moreover, investors, who are more aware of environmental, social, and governance (ESG) factors, demand more transparency and accountability regarding companies' carbon management practices. Non-compliance or inadequate decarbonization efforts may result in loss of investor confidence, restricted access to capital, and higher borrowing costs. Additionally, clients are incorporating sustainability criteria into their supplier assessment processes, preferring partners with robust decarbonization strategies. Failure to meet these expectations risks existing contracts and future sales opportunities.

Reputational Risk. Companies face increasing scrutiny from non-governmental organizations,

customers, and other stakeholders about their decarbonization efforts. Insufficient decarbonization efforts by companies can cause public protest, leading to reputational damage and loss of customer trust.

In addition to addressing these risks, developing a decarbonization strategy gives companies chances to drive innovation, improve competitiveness, and secure long-term value creation.

New Business Opportunities. Decarbonization brings new business opportunities for companies ready to innovate and use emerging market trends. The move towards a low-carbon economy increases demand for renewable energy technologies, energy-efficient solutions, and sustainable products and services. Companies that invest in research and development to create innovative green technologies and solutions can capture a growing market share.

Operational Excellence and Cost Reduction. By optimizing resource use, streamlining processes, and adopting cleaner production methods, companies can achieve significant reductions in energy consumption and waste generation, lowering operational costs and improving profitability. The WEF report states that most industries could reduce between 10% and 60% of their carbon emissions at no additional cost, as levers like energy efficiency and renewable energy are already economically viable today. Moreover, integrating sustainability considerations into supply chain management enhances resilience and risk mitigation, ensuring continuity of operations in the evolving regulatory and market dynamics.

How can corporates develop a decarbonization strategy?

Developing and implementing a robust decarbonization strategy requires a systematic approach that involves thorough analysis, clear goal-setting, ongoing monitoring and improvement, and stakeholder engagement. By adopting best practices and using available tools, companies can effectively decarbonize, drive innovation, and support a sustainable future.

a) **Current State Analysis**
Before setting targets and developing decarbonization plans, it is important for companies to conduct a comprehensive analysis of the policy landscape. This includes reviewing and understanding regulatory frameworks at the local, national, and international levels. By staying updated on changing regulations and market trends, companies can align their decarbonization efforts with policy priorities.

Moreover, the foundation for developing a decarbonization strategy is to measure the company's carbon footprint accurately. This involves collecting data related to carbon emissions from sources across the company and its value chain, including direct emissions from operations (Scope 1), indirect emissions from purchased electricity (Scope 2), and emissions linked to the value chain (Scope 3).[3] Following internationally recognized standards, such as the Greenhouse Gas (GHG) Protocol, ensures consistency and comparability of emission data, aiding informed decision-making and stakeholder communication. Additionally, companies should also follow national and local accounting requirements and industry-specific standards.

b) **Establish Targets**
To effectively drive emissions reductions, companies must set clear and science-based targets aligned with the goals of the Paris Agreement, which aims to limit global warming to 1.5 degrees Celsius above pre-industrial level.[4] This involves establishing ambitious yet achievable goals to reduce emissions intensity and absolute emissions over a set timeframe. Methods for target-setting include benchmarking against industry peers, considering regulatory requirements and market trends, and adopting internationally recognized standards, like the Science Based Targets initiative (SBTi). Companies can also join initiatives by the Climate Group, such as

RE100, EP100, and EV100, to help reach their carbon emission targets.

c) **Reduce Emissions**

Once targets are established, companies need to identify and prioritize decarbonization pathways to reach their goals. This involves conducting a detailed analysis of emissions hotspots across the organization and the value chain. By using a mix of strategies such as energy efficiency improvements, renewable energy adoption, electrification of transportation and operations, supply chain optimization, carbon offsetting, digitalization, and investment in innovation and research, companies can create tailored decarbonization roadmaps that balance environmental impact with economic feasibility.

To gain momentum and demonstrate early progress, companies should identify and implement quick-win initiatives that yield immediate emissions reductions with minimal investment and lead time. This may include low-cost efficiency measures, behavior change campaigns, or operational optimizations that result in tangible carbon savings.

Effective governance structures are essential to drive and oversee decarbonization efforts across the organization. This involves optimizing organizational structures, roles, and responsibilities to match the corporate decarbonization strategy. According to disclosure requirements of CDP, a global organization focusing on environment-related disclosure, key elements of governance include setting clear accountability mechanisms with board-level oversight, updating policies and guidelines to add sustainability factors, and embedding carbon reduction goals into performance metrics and incentive systems.

d) **Monitoring and Improvement**

To ensure the effectiveness of decarbonization efforts, companies must implement robust monitoring systems to track progress towards their targets accurately. This involves setting key performance indicators, collecting and analyzing relevant data, and reporting on emissions reductions and other sustainability metrics regularly.

e) **Stakeholder Engagement**

i. Share Information with Investors:

Companies should communicate clearly with investors about their decarbonization strategy, targets, and progress, so that investors will understand the company's climate-related financial risks and opportunities. Joining investor initiatives such as Climate Action 100+ shows a company's commitment to climate action and boosts its credibility and access to sustainable capital.

ii. Share Information with Value Chain Partners:

Working with value chain partners is key to drive collective action and maximize the impact of decarbonization efforts. Companies should engage actively with suppliers, customers, and other stakeholders to share knowledge, best practices, and challenges related to decarbonization. By fostering partnerships, companies can unlock new opportunities for emissions reductions and create shared value for all stakeholders.

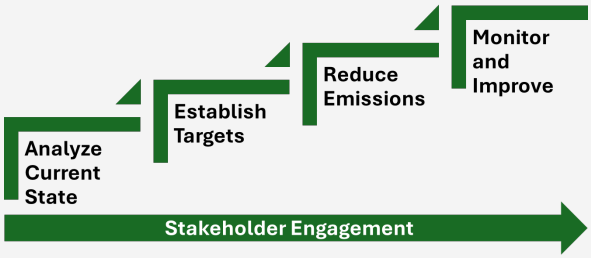
iii. Advocate for Supportive Policies and Regulations:

Companies have an interest in advocating for supportive policies and regulations that help and encourage decarbonization. This may involve engaging policymakers at the local, national, and international levels to push for sector-specific GHG accounting standards, ambitious carbon pricing mechanisms, renewable energy incentives, and sustainable procurement practices.

iv. Raise Awareness and Engage Employees:

Internal engagement and awareness-raising are crucial to mobilize employees and align organizational culture with decarbonization goals. Companies should educate employees about the importance of carbon reduction, empower them to contribute ideas and

solutions, and recognize and reward sustainability leadership.



Overcoming challenges of developing a corporate decarbonization strategy

Companies face several challenges in developing their decarbonization strategy. First, the lack of talent and knowledge, especially in sustainability and energy management, create challenges.

Additionally, companies struggle with setting science-based decarbonization targets and choosing the right technologies in a rapidly changing landscape. Using established frameworks and doing thorough assessments can help with these. Working with external experts can also address this gap by providing specialized expertise and resources.

Moreover, the absence of robust regulatory frameworks or standards to guide their actions is a challenge for some companies. To address this, companies must actively engage with policymakers, industry associations, and other stakeholders to advocate for stronger climate policies and regulatory incentives.

Finally, clearly communicating the business value of decarbonization is crucial for getting support. Companies need to create strong business cases and engage with stakeholders openly to build trust and gain support for sustainable initiatives.

Useful Tools and Resources

'The GHG Protocol Corporate Accounting and Reporting Standard'	
https://ghgprotocol.org/corporate-standard	
By: GHG Protocol	The standard gives guidance for companies and other organizations to prepare a corporate-level GHG emissions inventory. It includes guidance, calculation tools, and training materials.
SBTi Criteria and Guidance	
https://sciencebasedtargets.org/standards-and-guidance	
By: SBTi	SBTi gives general and sector-specific guidance for companies on setting near-term and net-zero targets that are considered 'science-based'.
CDP Questionnaire and Reporting Guidance for Corporates	
https://www.cdp.net/en/guidance	
By: CDP	The questionnaire and reporting guidance give companies best practices on what to focus on and consider when developing a decarbonization strategy.
Transition Plan Taskforce (TPT) resources	
https://www.ifrs.org/sustainability/knowledge-hub/transition-plan-taskforce-resources/	
By: TPT	The TPT framework and recommendations set out good practices for strong and credible transition plan disclosures.
Net Zero Company Benchmark	
https://www.climateaction100.org/whos-involved/companies/	
By: Climate Action 100+	The benchmark is designed to be an evaluation tool for investor engagement. It assesses the performance of focus companies on their net zero transition.

References:

[1] Global emissions published by Climate Watch.

[2] World Economic Forum, "The Cost of Inaction: A CEO Guide to Navigating Climate Risk."

[3] More details can be found on the GHG Protocol website.

[4] "What are 'science-based targets'?" by SBTi.