Are Dutch companies addressing the right climate-related risks?

July 2019

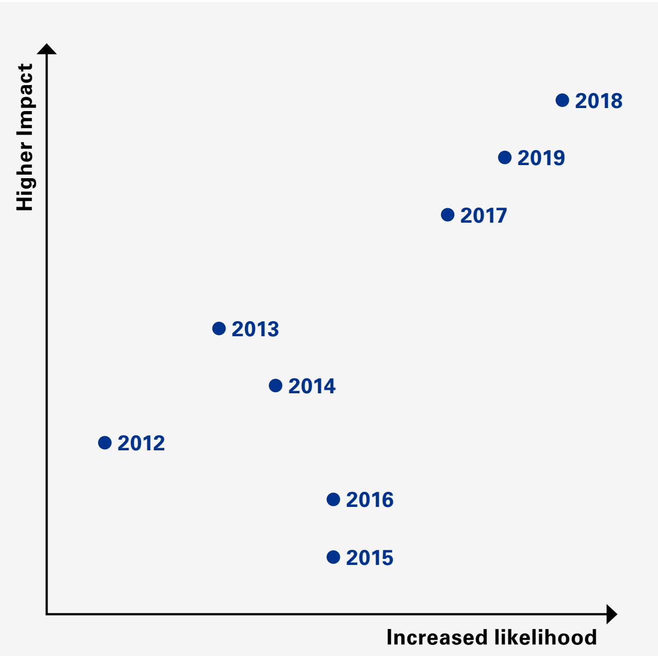
Introduction of the research

Climate risk stems from the world continuing to warm as a result of increasing levels of greenhouse gases in the atmosphere. Global warming is causing temperatures to increase, sea levels to rise, and more frequent and intense extreme weather events.
The Global Risk Report 2019 by the World Economic Forum indicated that extreme weather events are increasing in frequency and severity, and the impact on global value chains is likely to intensify. Already in 2018, the US was impacted by devastating hurricanes and wildfires, while heat waves and droughts in Europe heavily impacted agricultural productivity, power supply and transportation.
To avoid the worst impacts of climate change, regulators are introducing policy measures and carbon pricing, that incentivize low emission development.

Climate-related risks get increasingly high on companies' agenda. The recent **2019 Global CEO Outlook** published by KPMG, showed that CEOs see climate change now as the number 1 risk for their business. Also, the Global Risk Landscape as published by the World Economic Forum shows that CEOs both expect the likelihood and impact of climate risks to be increasing since 2012.

Figure 1

Increase in likelihood and impact of extreme weather events on the Global risk landscape – World Economic Forum 2012 to 2019



The Task force on Climate-related Financial Disclosures (TCFD), to which body KPMG International has contributed by providing a member of the Dutch member firm, has highlighted that the uptake of their recommendations to report on climate-related risks and opportunities is on the rise. However the TCFD has also highlighted in its **June 2019 Status Report** that disclosure is still insufficient and that further attention is needed for the financial implications of climate change. It is striking that CEOs see climate change as the key risk, whilst reporting stays behind. Reporting is a reflection though of actual management.

A key question is not only whether companies report, but also whether they report the right risks and opportunities.

To assess whether companies are addressing the right climate-related risks, KPMG has conducted research based on the climate-related risks communicated in financial filings and annual reports of the 25 AEX-listed companies. In our own analysis, we have concluded that almost all companies face financial risks or can create opportunities from climate change on the long run. The only sector where we don't see this yet are the publishing and (certain) services sectors.

Key conclusion: companies run the risk of falling short on value creation by not addressing the right climate-related risks and opportunities.

Our key conclusion is that many companies miss the point of addressing the long-term, financial risks and opportunities that are relevant for their sector and cover the full value chain. There is an increasing risk therefore that Dutch listed companies will not realize the financial value they could have created would they have started to work timely on climate-related risks in their business.

The results confirm that either some companies do not consider climate-related risks yet or when they do:

- they do not consider the risks that are expected from their sector
- they identified risks that are either already visible or short-term but lack longer term view
- they currently focus on risks impacting direct operations but fail to recognize risks arising in their value chain

This research follows our survey conducted with Senior Management of Dutch companies in November 2017, **Climate-risks and opportunities: the appetite in the Netherlands,** which highlighted that climate-related risks and opportunities deserved further attention, primarily with regards to the understanding of the financial implications of climate change.

Overview of the results

Figure 2

Proportions of companies addressing some climate-related risks

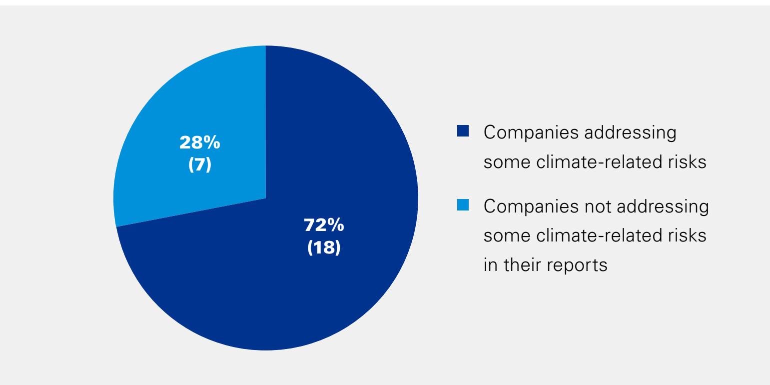


Figure 3

Transition risks being addressed by companies

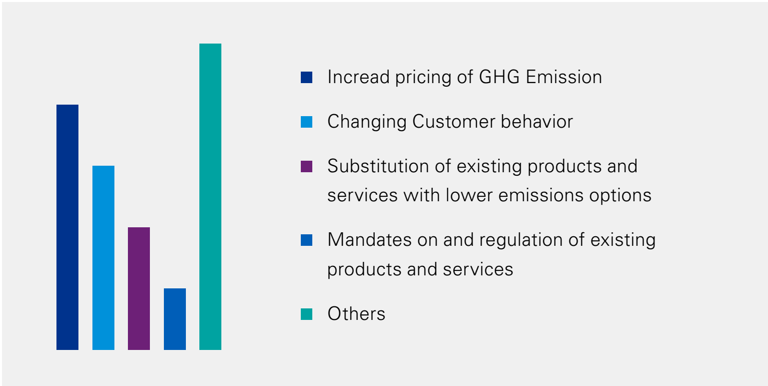
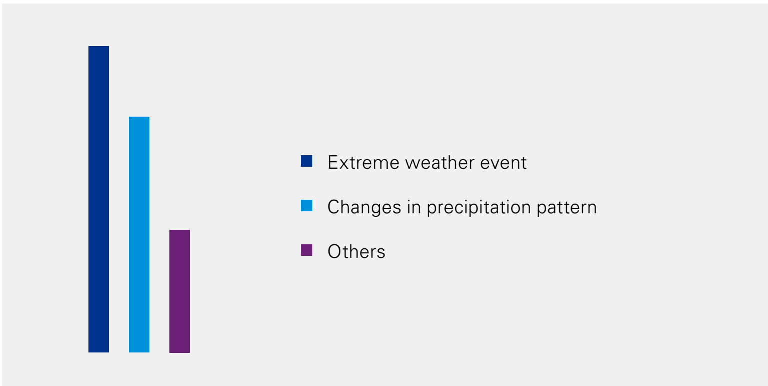


Figure 4

Physical risks being addressed by companies



Varying views of risk and no insight into magnitude and time horizon

- The 18 companies that disclose on climate-related risks consider between a minimum of 1 risk and a maximum of 10 risks, with a balanced consideration of physical risks (40%) and transition risks (60%)
- The majority of transition risks identified by reporting companies primarily relate to the increased pricing of GHG emissions, changing customer behaviour and substitution by technologies with lower carbon intensity.
- 8 out of the 18 companies addressing some climate-related risks consider extreme weather events as a main physical risk
- None of the companies show to have insights into the magnitude of the risk or its timing (long, medium short term)

Our findings explained

Most companies do not consider climate-related risks that are expected from their sector

Mostly companies in the oil and gas sector assess the right risks that are expected to financially impact them, such as policy change, reputational and liability risks, increase of carbon pricing and shift in consumer preferences. This is a logical consequence of the high scrutiny of the sector due to its contribution to global warming, emphasized by shareholder resolutions to address the TCFD recommendations or disclose how the companies' strategy matches the goals of the Paris agreement. Also, the recent Mercer report **Investing in a Time of Climate Change** states that these companies could lose 95% of their value by 2050 if governments take action to limit global warming to 2 degrees Celsius, hence the need for them to act rapidly. However, apart from the oil and gas sector companies in non-financial sectors fail to recognise some of the obvious physical risks. For example, the risk of extreme weather events that includes flooding, hurricane, drought, is expected to impact most companies regardless of their sector as these companies likely have diverse portfolios in different locations. However 56% of the companies discussing climate risks do not consider extreme weather events as a main physical risk. Transition risks are also underestimated and not addressed as companies lack the proper detailed insights and knowledge of market and policy future outlook as well as expected technological breakthrough.

Examples of expected climate-related risks for some sectors

We have identified the key risks from climate change that could be expected for the various sectors in scope – based on their type of products, value chains and type and levels of public scrutiny amongst others, which we therefore would expect in the various sectors. Below are two examples of risks that could be expected to be addressed by companies of certain sectors but could not be evidenced in our research:

Table 1

Examples of climate-related risks and financial impacts for specific sectors

Sector	Climate-related risks	Potential financial impact
Chemicals	**Shift of consumer behaviour** Companies could expect the risk that customers change their behaviour towards more environmentally friendly products or low carbon technology.	▼ revenue due to a decline of product demand ▲ costs to adopt/deploy new business model, innovation ▲ stranded assets of carbon-intensive technologies
Agriculture / food retail	**Extreme drought** The changing weather patterns and acute weather changes can lead to the decrease of the water level of ground water levels in certain areas where the company cannot continue to produce without creating concern for the surrounding communities or will face water availability issues for its own production.	▲ costs as the company has to find other ways to source water ▼ revenue due to lowered production ▲ stranded assets if the risk is acute and the site has to be closed as well as write-offs and early retirement of existing assets ▼ revenue due to shift in consumer preferences as a consequence of local reputation damage ▲ costs due to legal prosecutions for non-access to water

KPMG view: Identify the obvious climate-related risks for your sector

Missing or underestimating certain risks can lead to significant financial consequences, including loss of revenue, stranded assets, increased operating and liability costs, but also result in a missed chance to capture opportunities that the market could offer in the next decades. That would therefore at a minimum result in non-optimized value creation of the company. As a first step, companies should internally identify the risks that are the most relevant and expected to their sector, considering the diversity of their portfolios, the locations of their assets – especially for physical risks that are very local – and their operational profile and future strategy. For example, hurricanes could be a risk for companies with operations in some areas where these are frequent, as the USA, whereas sea-level rise could be particularly relevant for operations and assets located in lowland areas as the Netherlands.

We recommend a qualitative approach based on the insights from experts from within the company, helped by a proper risk assessment methodology. It is important not to consider risks in isolation, but to also review the interdependencies between them. For example, extreme drought would not only result in risks to crop yields for a food company, but could also result in changed consumer behaviour due to unavailability of products or increased prices.

Most companies identified climate-related risks that are either already visible or short-term but lack a longer term view

Climate risks are long-term and non-linear, therefore uncertain by nature – in terms of likelihood and impact – and different from most traditional business risks. Our research found that the majority of companies mainly focus on climate-risks that have already shown impacts to the business and are the most exposed in the media, such as storms leading to production disruptions, cyclones/flood reducing asset integrity and price of carbon increasing operational costs. However, they seem not to consider longer term risks – mainly relating to transition risks– driven by emerging climate policy mechanisms, regulatory requirements and market, consumer or technology change, as a consequence of a lower carbon world.

Examples of expected long-term climate-related risks

As part of our analysis we have also identified potential risks and opportunities that would typically occur on the long term. Below we have included two examples of risks that we would expect to be addressed by companies of certain sectors but could not be evidenced in our research:

Table 2

Examples of long-term climate-related risks and financial impacts

Sector	Climate-related risks	Potential financial impact
Semi-conductor / steel	**Increased regulations** A company producing electronic devices or using certain components may not anticipate changes in local regulation for carbon-intense mining of precious metals used in their products, and may not be prepared timely enough to substitute these materials, risking lowered market share and/or higher cost of sales.	▼ revenue due to decreasing market share ▲ costs as a result of more expensive substitute components
Chemical	**Shift of consumer preferences for lower carbon products** A tier-3 supplier of the chemical sector producing accessories ultimately used for the automotive sector, may anticipate the risk of an increased carbon tax and implement measures to reduce emissions of its main operations, but may miss the shift of society and consumers towards lighter vehicles.	▼ revenue, due to a ▼ demand for the products as society targets other markets ▼ revenue due to a change in revenue mix ▲ costs to adopt/deploy new business model, innovation

KPMG view: Go beyond the obvious climate-related risks and try to look long term

Companies need to go beyond the obvious risks that have already materialised. Climate-related risks are assumingly long-term, the change to the business may be much quicker than expected though. It would therefore benefit both the preparedness for such more instant changes as well as strengthen the company's capabilities to think really long term in a world that is stressed by climate change. Showing this recognition of the issue on the long term should increase confidence by investors in the company's business (model). We advise companies to get a more holistic and longer term view of climate risks, their impact, timing and velocity, recognising these can be difficult to assess and scenario analysis would be more appropriate than forecasting or setting targets. Not capturing these risks however would be a missed opportunity and could put the future long-term value and continuity of the company at risk.

Most companies currently focus on climate-related risks impacting directly operations but fail to recognize risks arising in their value chain

Companies mostly report certain physical risks of climate change, as these are easier to predict with available scientific information and already have a direct impact on operations and assets. Among these risks are cyclones destroying assets or flooding within operations leading to an interruption of the production. Our research showed that only 56% of the companies consider climate-related risks in their value chain. Generally, the reasons are that these risks have been assessed as not material, or that there are potential legal issues associated with reporting, or, most likely, because of a lack of awareness and understanding of these type risks.

Examples of expected climate-related risks impacting the value chain

We describe two examples of risks that we would expect to be addressed by companies of certain sectors but could not be evidenced in our research:

Table 3

Examples of climate-related risks and financial impacts in the value chain

Sector	Climate-related risks	Potential financial impact
Financial services	**All climate – related risks** It is expected that banks and insurance companies have exposure to the risks the different sectors they are connected to depending on the diversity of their portfolio.	Reduced value of their investment/financing due to: ● failure to get loan repayment on damaged infrastructure, flooded production site or destructed crop ▲ stranded assets for real estate in flooding areas or banks with investment in or financing of controversial sectors, such as coal or oil and gas
Agriculture / food retail	**Changing seasons** This risk can lead to more precipitation or heat stress leading to the destruction of particular food commodities in certain regions and therefore impacting negatively crop yield. However changes in the length of the growing season can also have some positive effect.	▲ costs due to import of food commodities from other locations ▲ costs due to supply chain disruptions and delay of the production

KPMG view: Go further in the value chain

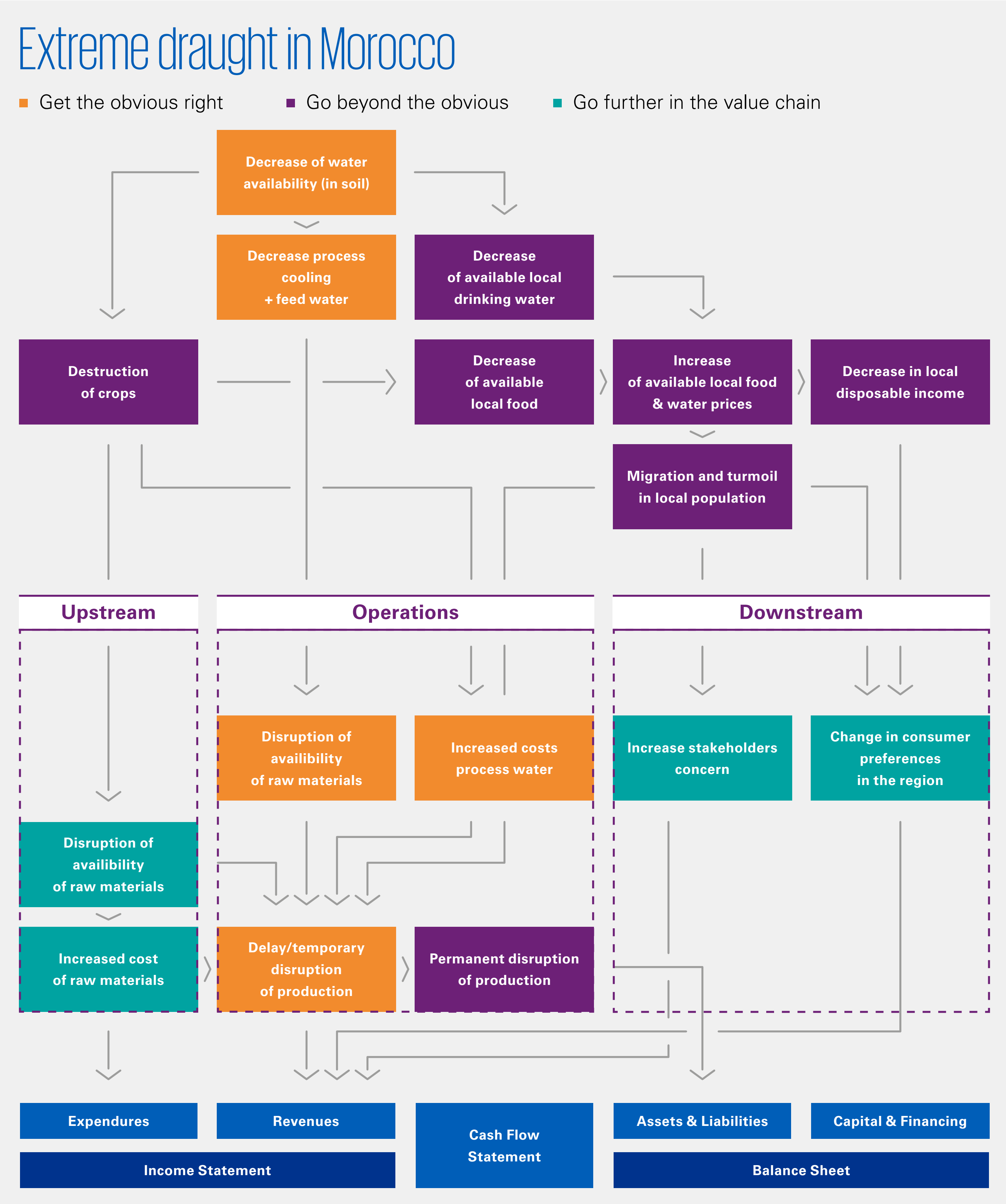
Risks are greater when companies do not have control over them, which is typically what can happen in the upstream and downstream value chain of a company. This is true also for climate-related risks. Companies need to understand their value chain, upstream and downstream: this means understanding the types of tiers 1 and 2 suppliers and customers at first, knowing where they are located, and aiming to perform a similar assessment as on their own operations for the most material ones.

The following is an illustration of the risks identified for a company in the agriculture and food retail sector, operating and doing business in Morocco, a country with water availability issues, similar to South Africa.

Here, we identified the obvious and deeper-embedded climate-related risks in the value chain.
By understanding how companies directly and indirectly contribute and are affected by climate-related issues, their long term risk management can be optimized.

Figure 6

Illustrative example



How we can help

We talk to our clients every day and most of them do not know where to start and where to get the right insights.

Typical questions we hear in client conversations

1. **Is my strategy resilient to climate-related risks and opportunities?**
2. **What do they mean and how can they be assessed?**
3. **Where in the value chain and in which countries is my company most exposed to physical and transitional climate-related risks?**
4. **What are the difference between climate-related risks and other types of risks (e.g. operational, financial, strategical)?**
5. **What are relevant scenarios for my company to consider?**
6. **How will my strategy perform under different climate scenarios, including a 2°C?**
7. **Which climate-related risks and opportunities may impact my business and what are their financial impacts?**
8. **How can my company develop models that respond to the implications of each scenario?**
9. **How to select and implement material indicators for effective monitoring of climate-related risks?**
10. **How robust are my processes including metrics measuring to manage & monitor relevant climate-related risks and opportunities?**

KPMG member firms can provide tailored climate services to help clients address climate-related financial risks and embrace the associated opportunities. Our support covers the following areas:

Our service overview

Map climate-related risks
KPMG can help you to understand your company's exposure both to the physical effects of climate change and to the likely regulatory and economic impacts of the shift to a low-carbon economy. We can identify the areas of your business, as well as the countries where your operations are located, which are - or will be - most affected by climate change.

Use scenario analysis to assess resilience
KPMG can help you understand how climate-related risks and opportunities could affect your business in a variety of regulatory, economic and climate scenarios. We can explore what these scenarios would mean for your business in the short, medium and long term and develop tools and procedures to assess and quantify the potential financial impacts.

Inform business strategy
KPMG can help you identify the climate risks that are most pressing for your company. We can provide recommendations on how to develop a robust climate resilience strategy for operations and product portfolios taking into consideration the different scenarios that could pan out in the future.

Adapt investment strategies
KPMG can work with asset owners and managers to review and adapt their investment strategies in order to reduce exposure to climate-related risk.

Assess and improve readiness for reporting
Using advanced tools, KPMG can evaluate the extent to which your business's processes, methods and disclosures currently fulfil the TCFD recommendations. We can benchmark your company's performance against industry best practice to show where you stand in the market.

Manage and report on risks
KPMG can help you define appropriate data collection systems, metrics and targets to monitor, manage, and report on climate-related risks in line with the TCFD recommendations. We can provide advice on how best to disclose your climate-related risks in your financial disclosures and provide good practice examples to guide your reporting.

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