Net Zero Transition Planning:

From Apprehension to Opportunity

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Executive Summary

As efforts to limit climate change accelerate and governments make plans for net zero, they are increasingly asking the same of businesses. Many organisations will need to fundamentally change how they operate to comply. These net zero requirements are often complex, fundamentally transformational and long term enough to defy conventional planning cycles. Those businesses that get it wrong will face a range of challenges, whereas those that succeed can turn net zero commitments into points of differentiation. In this paper, Teneo set out how to successfully plan for your transition to net zero.

In major global economies, governments are now pursuing net zero agendas at pace. To enable this, they are mandating businesses to gradually reduce their emissions to zero; many businesses will therefore soon be mandated to publish net zero transition plans to explain how (and when) they will get there. While (initially) these regulations will generally only apply to the biggest organisations, they will need (and therefore mandate) their supply chains to follow suit to ensure the achievement of their Scope 2 and 3 emissions goals. As a result, the impacts of these regulations will rapidly ripple through supply chains, impacting many smaller businesses and requiring many to start plotting their course to net zero. Simultaneously, snowballing consumer awareness and pressure mean the debate keeps moving up the agenda. The UK has led the way on these mandates, but other governments are already following suit with similar schemes.

Many organisations will face new and complex requirements, and while some government guidance exists, the requirements remain alien and daunting for many. As they will inherently impact all areas of a business, a traditional, siloed approach to sustainability can't possibly deliver the required emissions reductions, mandating firmwide action at the CEO/CFO/Head of Strategy level. Furthermore, the long-term nature of these commitments means unavoidable uncertainty (from technologies and associated costs to regulation), thereby requiring a differentiated approach to traditional business challenges and necessitating engagement across the value chain, industry and with policy-makers. It is therefore not unreasonable that many businesses feel overwhelmed by the complexity of the regulations, however, those firms which are able to take a proactive, strategic approach to transition planning can turn net zero commitments into a point of differentiation.

To address these requirements, firms will need to build a detailed, data-led understanding of their current emissions base and the relative ease of abatement, before designing and implementing a long-term roadmap to net zero.

To do this, firms first need to understand the regulatory requirements that apply to them, and how they might evolve over time. They then need to build a robust and granular understanding of which inputs, activities and assets are driving emissions, as well as the cost (either in terms of Capex/Opex or direct or indirect foregone revenue) associated with abating each unit of emissions. This will help businesses prioritise which emissions to abate first. This is critical, as robust data must inform decision-making. Where abatement isn't possible, firms should consider removal strategies, prioritising high-quality carbon offset options. Based on that understanding, firms need to consider how they want to position themselves versus peers – do they want to lead their sector (and can they afford to) or do the bare minimum to meet regulatory requirements? Armed with this fact base and desired positioning, firms can then identify near-term next steps, as well as begin to factor the targeted end-state into ongoing planning processes. This must be accompanied by a carefully designed strategic communication plan to convey the firm's objectives to customers, investors and policy makers, balancing a desire to provide transparency with greenwashing concerns.

These requirements are complex, novel and, for many organisations, daunting. Teneo's unique mix of capabilities (spanning strategic communications, management consulting, policy and risk advisory, as well as carbon footprinting and carbon removal sourcing in partnership with our technical partners) allows us to support executive teams through every step of this complex, and increasingly urgent, journey.

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Macro Climate Context

Governments and consumers are increasingly demanding businesses put in place plans to reach net zero.

In the face of increased urgency in the fight against climate change, governments around the world are setting net zero targets – these will trickle down to businesses.

Major Economies are Progressing Towards Net Zero

- The UK government has set its own, legally-binding target of achieving net zero greenhouse gas emissions by 2050, across all sectors of the economy.
- The UK government has also established interim targets, including a goal of reducing emissions by at least 68% by 2030 compared to 1990 levels.
- In 2019, the EU passed the Green Deal, which set out the goal of reaching a climate-neutral economy by 2050.

The U.S. Securities and Exchange Commission (SEC) has proposed a new rule that, if adopted, will require public companies to provide detailed reporting of their climate-related risks, emissions and net zero transition plans.

Figure 1: Transitioning to a Net Zero World Creates Obligations for Businesses

EU is targeting net zero by 2050

The EU introduces regulations to achieve the net zero target

Companies in the EU with more than 500 employees will need to disclose the proportion of their Capex that is related to environmentally sustainable activities

Drivers for ESG Performance

In addition to top-down pressure, consumers and investors are pressuring companies to improve their ESG performance, and rewarding those that do.

The green premium is real:

An American Express report indicated that **32%** of consumers surveyed are willing to spend more on an item with better environmental credentials. This proportion increases to **45%** among 18-34 year olds.[1]

ESG focused products are seeing revenue growth:

Products making ESG-related claims averaged **28%** cumulative growth over the past five-year period, versus **20%** for products that made no such claims.

Investors want to understand companies' readiness to transition to a lower carbon economy:

Under the Climate Action **100+ initiative**, investors are specifically targeting the world's largest corporate greenhouse gas emitters, seeking commitments to reduce their emissions.

ESG disclosure obligations will trickle down:

Regulators are mandating ESG disclosure obligations for asset managers and other financial markets participants, causing a trickle down effect.

Double materiality is becoming standard:

The EU regulator has adopted the double materiality approach into its CSRD, with investors, such as BNP Paribas and JPMorgan endorsing the approach and urging for international standards to adopt the concept.

Source:
1. https://www.americanexpress.com/en-us/newsroom/articles/amex-for-business/sustainable-shopping-remains-top-of-mind-for-consumers-despi.html

Implications for Business

In this context, many UK businesses will be mandated to publish their net zero transition plans in the coming years, setting out how they will reduce net GHG emissions to zero.

While many businesses are already reporting elements of transition plans on a voluntary basis (generally the more proactive, climate-focused firms, but also larger firms that are now subject to TCFD requirements), new requirements will mean more companies will be required to issue their transition plans. It is expected that most businesses will be required by law to produce transition plans by the end of the decade.

What is a Net Zero Transition Plan?

A net zero transition plan is a part of a firms' wider strategy, setting out practical steps to achieve net zero, including the roadmap it intends to follow, interim targets and governance mechanisms it expects to lead it there.

The Transition Planning Taskforce recommends businesses produce a standalone transition plan every three years, with material updates reported in annual reports.

Who Will Have to Make a Complete Transition?

Mandated companies

The Financial Conduct Authority (FCA) expects that the rules will initially apply to all 1,945 publicly listed companies in the UK. They are also expected to apply to 140 UK based asset management firms and 34 asset owners,[A] which together represent c.98% of the UK asset management market.

Further, in accordance with the Procurement Policy Note (PPN) 06/21,[B] all central government departments, their executive agencies and non-departmental public bodies should include a requirement to provide a Carbon Reduction Plan (CRP) for bidding suppliers with an anticipated contract value above £5m per annum.

Note(s):

A. Asset owners are defined as firms involved in investment decision-making or investment oversight, this would include life insurers and FCA regulated pension funds. Regulated investors would include Hedge funds, PE firms and a wide range of other institutional funds.

B. The Procurement Policy Note (PPN) sets out guidance and information for public sector bodies procuring major government contracts.

UK Regulatory Landscape

2021

At COP26, the Chancellor announced that the UK will make it mandatory for some companies to publish net zero transition plans.

In the same year, the FCA made TCFD[C] requirements mandatory for some UK businesses,[D] including a requirement to describe their plans for transitioning to a low-carbon economy.

2022

To support the Chancellor's 2021 target, the Transition Planning Taskforce (TPT) was commissioned by the government in April 2022 to develop the "gold standard" framework for private sector climate transition plans. It published its draft Disclosure Framework and Implementation Guidance in November 2022.[2]

2023

In the 2023 Green Finance Strategy, the UK government reconfirmed its commitment to introducing requirements for the UK's largest companies to disclose their transition plans.[3] These guidelines will complement the FCA's requirements and ensure consistency in disclosure requirements for listed and large private companies.

2024

The FCA is planning to launch consultation on transition plan disclosure rules for listed UK entities in the first half of 2024 – with plans to finalise its position by the end of the year.[4]

2025/26

The expectation is transition planning rules will come into force for all UK listed companies starting from 1st January 2025, with the first reporting therefore taking place in 2026.[5]

Beyond

It is expected that the mandate will extend to include all businesses over the next decade.

Despite imminent mandates, only c.5% of FTSE 100 companies have published net zero plans that would be deemed "credible" under the government's transition plan guidance.

Source(s):

2. https://transitiontaskforce.net/wp-content/uploads/2022/11/TPT-Disclosure-Framework.pdf
3. https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1149690/mobilising-green-investment-2023-green-finance-strategy.pdf
4. https://www.fca.org.uk/news/news-stories/fca-welcomes-launch-transition-plan-taskforce-disclosure-framework
5. https://www2.deloitte.com/uk/en/blog/emea-centre-for-regulatory-strategy/2023/transition-plan-taskforces-final-disclosure-framework.html

Note(s):

C. Task force on climate related financial disclosures.
D. Premium listed companies, banks, building societies, insurance companies and occupational pension schemes £>5bn.

The Global Regulatory Landscape

As an early mover, the UK has set the benchmark for climate reporting and disclosure. Other countries continue to develop their own legislation at increasing pace.

International

The International Sustainability Standards Board (ISSB) aims to establish unified and globally consistent corporate sustainability disclosure standards through IFRS S1 and S2, which were released on 26th June 2023. These standards are effective for annual reporting periods beginning on or after 1st January 2024, and are expected to form a global baseline of sustainability-related disclosures for capital markets, though compliance to the standards will remain voluntary for the time being.

ISSB S2 requires companies to disclose, amongst other things, how the entity plans to achieve any climate-related targets it has set/is required to meet by law or regulation – effectively mandating key elements of transition plans.

European Union

The recently overhauled Non-Financial Reporting Directive (NFRD), called CSRD6, mandates that current filers and c.50,000 additional EU companies report enhanced TCFD answers alongside comprehensive energy consumption and carbon emissions data.

Sustainable Finance Disclosure Regulation (SFDR) level 2 rules, which strengthen the reporting requirements for sustainable and ESG-labelled financial products, came into force on 1st January 2023.

United States of America

The SEC proposed a new rule in 2022 that, if adopted, would require public companies to provide detailed reporting on their climate-related risks, emissions and net zero transition plans. Both design and implementation of the rule remain uncertain given pushback from politicians, companies and investors.

Importantly, however, the state of California in October 2023 enacted legislation that will require companies with over $1bn of revenues and that do business in the state to publicly disclose their Scope 1, 2 and 3 emissions (the former two by 2026, the latter by 2027).

Canada

The Office of the Superintendent of Financial Institutions released a new guideline in March 2023 requiring federally regulated banks, insurance companies and pension plans to disclose their climate-related financial risks and account for how they intend to manage them, using appropriate governance and accountability structures. The guideline enters effect for systemically important domestic banks and insurers headquartered in Canada from fiscal year-end 2024 and for other regulated financial institutions from fiscal year-end 2025.

Businesses around the world will rapidly need to get comfortable with net zero transition planning requirements.

The Supply Chain Ripple Effect

As companies set transition targets, they will require their suppliers to follow suit to become truly net zero, forcing many other firms to develop transition plans mandating action from those who aren't directly impacted.

Figure 2

Example 1 – Apple

Since its initial announcement in 2015, Apple has made rapid progress in transitioning towards a greener supply chain.[6]

- Apple's operational commitments and clean energy usage, as well as commitments from its suppliers, are growing year on year, particularly in China.
- Over 200 suppliers across 26 countries have committed to 100% renewable electricity for Apple production.

Example 2 – Microsoft

Microsoft made a commitment to operate with 100% renewable energy by 2025 and be carbon negative by 2030.[7]

- Microsoft added sustainability requirements to its supply chain code of conduct to support its bold carbon ambitions.[8]
- With Microsoft's supply chain code of conduct, suppliers must accurately disclose Scope 1, 2 and 3[E] greenhouse gas emissions and demonstrate plans to reduce GHGs by a minimum of 55% by 2030.

Example 3 – Public bodies

Some public entities, such as the NHS, also require supply chain providers to publish sustainability reports.[9]

- For example, as part of the NHS roadmap for suppliers to reach net zero by 2045, from April 2023, NHS organisations require all suppliers of new contracts for goods, services and/or works with an anticipated contract value of more than £5m per year to publish a Carbon Reduction Plan. This will apply to all procurements from April 2024, and continue to become more stringent (and cover more suppliers) over time.

Even those companies not directly impacted by legislation will likely soon need to develop net zero transition plans. Consumers will also demand action from B2C companies.

Source(s):

6. https://www.apple.com/environment/pdf/Apple_Supplier_Clean_Energy_Program_Update_2022.pdf
7. https://blogs.microsoft.com/blog/2020/01/16/microsoft-will-be-carbon-negative-by-2030/
8. https://www.microsoft.com/en-us/procurement/supplier-conduct.aspx?activetab=pivot%3aprimaryr7
9. https://www.england.nhs.uk/long-read/carbon-reduction-plan-requirements-for-the-procurement-of-nhs-goods-services-and-works/

Note:

E. Scope 1 emissions = Direct emissions produced by an organisation in carrying out its activity, Scope 2 = Emissions produced by a third party, directly induced by an organisation in carrying out its activity, Scope 3 = Indirect emissions produced by third parties throughout the value chain, related to an organisation's activity.

Typical Transition Planning Challenges

These requirements are novel and complex, requiring cross-business engagement. Business surveys suggest organisations are facing a range of issues and often feeling overwhelmed.

Key Barriers Faced by Organisations on their Net Zero Journey

Understanding of requirements or best practice

Many UK businesses feel they lack the expertise to establish plans to achieve net zero, particularly among smaller companies, with less than **10%** of SMEs understanding the implications of the government's target.[10]

Technological uncertainty

Almost **50%** of the emissions reductions needed to reach net zero by 2050 are expected to depend on technologies that are at the prototype or demonstration stage; so most companies will have to deal with material technological uncertainty.[11]

Lack of strategy

Over **70%** of UK businesses lack a strategy for net zero despite the increasing pressure.[12]

Regulatory uncertainty

43% of European firms cited uncertainty about regulation and taxation as the biggest constraints hindering climate change related investment.[13]

Lack of visibility of their footprint (internally and through the supply chain)

Only **10%** of international companies surveyed by BCG reported comprehensively measuring their emissions across scopes 1-3 – inevitably making it harder to take action. Additionally, only 14% had reduced their emissions in line with their ambitions over the preceding five years.[14]

In addition to the above, our conversations with clients highlight a range of other challenges:

- Supply chain emissions: How best to engage and partner effectively with suppliers to start addressing supply chain emissions.
- Sustainability as a cross-company issue: As organisations face up to the transformational requirements of the transition to net zero, many struggle to fully embed transition planning activities across the business.
- Communicating the strategy: Many leaders find it difficult communicating their transition strategy to shareholders and the public, particularly with respect to balancing transparency with concerns around greenwashing.

Urgency is building, but many businesses still face major barriers as they look to set out credible net zero transition plans.

Source(s):

10. https://www.britishchambers.org.uk/news/2023/02/action-on-net-zero-held-back-by-lack-of-understanding/
11. https://iea.blob.core.windows.net/assets/76426d5e-0c9c-4f9f-809f-feca6bde702e/Theneedfornetzerodemonstrationprojects.pdf
12. https://www.edie.net/less-than-one-third-of-uk-businesses-have-net-zero-strategies-survey-reveals/
13. https://www.eib.org/attachments/publications/eibis_2020_report_on_climate_change_en.pdf
14. https://www.bcg.com/publications/2023/why-some-companies-are-ahead-in-the-race-to-net-zero-and-reducing-emssions

Developing a Net Zero Transition Plan

These challenges, as well as the longer term horizon for net zero transition plans necessitate a different approach to traditional business planning. We set out seven steps all businesses should undertake as they begin planning their route to net zero.[F]

Net zero transition plans will impact every part of an organisation (from operations and sales to finance and IT). A siloed approach to sustainability will not deliver the required change.

Further, the unique nature of these challenges requires a different approach: engaging across the value-chain, industry and with policy makers.

And while the disclosure framework launched by the UK Transition Planning Taskforce in October 2023 provides some guidance, the exercise is likely to remain challenging for many organisations.

01 Build regulatory understanding

- Build a clear understanding of regulation that applies to you, how that might change in the future and how you might need to respond.

02 Carbon footprinting

- Determine where your emissions are coming from today, in the business and its supply chain.
- Build a robust database demonstrating how much carbon is being generated by each supplier, asset or activity.
- This data forms the basis of future decision making.

03 Ambition setting

- Decide where you want to be positioned vs. your peers (should you be a sustainability leader or just meet basic legislative requirements).
- Benchmark commitments and plans of peers to inform your positioning, as well as the priorities of your investors/potential investors.

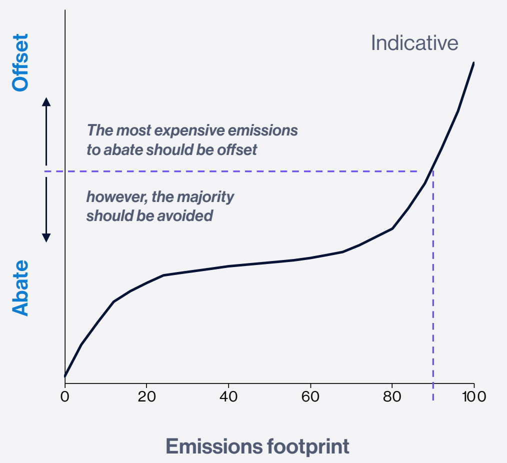
04 Strategy development

- Armed with an understanding of emissions drivers and your ambition, determine which emissions should be cut and when (and at what cost).
- This must be informed by a robust understanding of the relative cost (in monetary or revenue cost terms), prioritising the lowest cost abatements first. (see below)
- In parallel, develop your removal strategy. It's increasingly expected that residual emissions will have to be offset with durable carbon offsets (not traditional emission avoidance offsets) to truly achieve net zero.

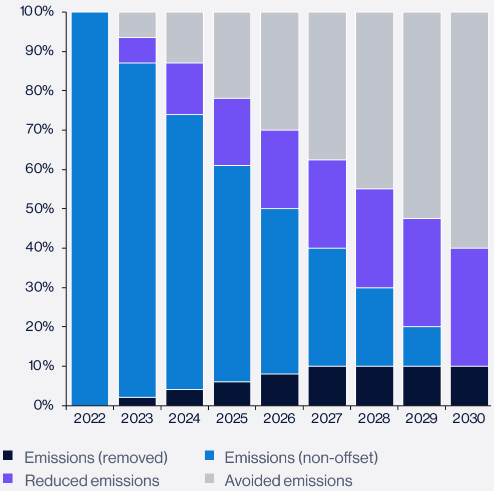
Note:
F. All tasks shown within each step are non-exhaustive.

Developing a Net Zero Transition Plan (continued)

Illustrative abatement curve[G]



Illustrative path to net zero through emissions avoidance, reduction and removal offsets



05 Communication strategy

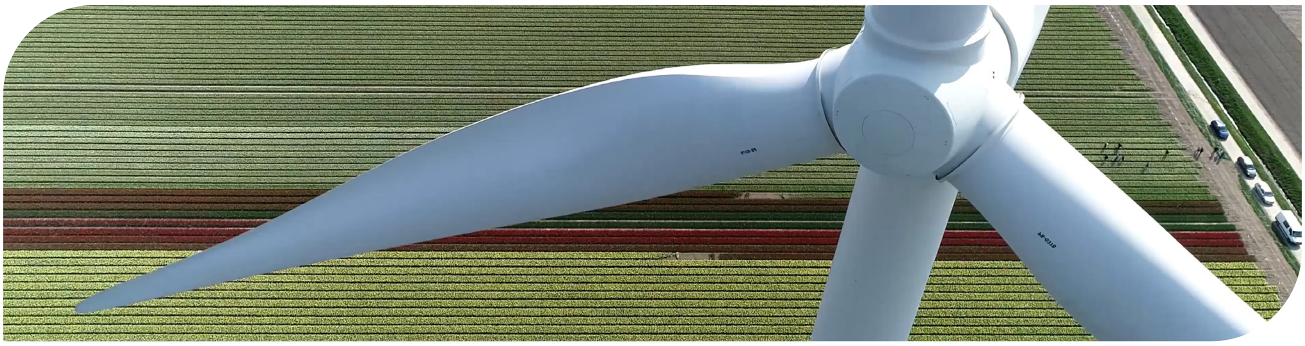
- Communicate the strategy, both externally (customers, investors and media) and internally.
- Balance the desire to provide transparency with the risk of being perceived as greenwashing, simultaneously emphasising the ongoing focus on financial delivery.

06 Implementation planning

- Develop a plan to execute on the strategy.
- Design governance and reporting mechanisms to monitor implementation.
- Set interim milestones to ensure you remain on track.
- Build buy in across the business and weave net zero initiatives into broader business plans.

07 Implementation

- Establish and track key metrics/KPIs to ensure adherence to targeted transition trajectory.
- Monitor progress and intervene when/if targets are missed.



Source:
Teneo Research & Analysis

Note:
G. Presents costs expected from different opportunities against the potential volume of emissions that could be reduced if implemented.

How Teneo Helps Clients

Teneo is uniquely placed to provide end-to-end support to businesses coming to terms with their net zero commitments.

Example Areas of Teneo Capabilities

	Teneo support	Outcome
End-to-end net zero strategy development	End-to-end transition planning support, from carbon footprinting and ambition/strategy setting to implementation planning.	Optimised net zero transition strategy, ensuring compliance with minimised impact to commercial positioning and financial performance. Shareholder/customer/management alignment in support of plan.
Carbon footprinting (in collaboration with our technical partners)	Gathering Scope 1, 2, and 3 data emission abatement prioritisation. Gathering Scope 1, 2 and 3 emissions data and developing an optimised plan for emissions abatement.	Detailed understanding of drivers of carbon emissions throughout the organisation and its value chain.
Strategic communications	Expert support, helping organisations work through potential reputational risks, craft the narrative and plan the ongoing communication and engagement strategy, both externally (customers, investors and media) and internally.	Clear understanding (both internally and externally) of a firm's desired positioning, what it's already doing to reduce its emissions footprint, and a broad appreciation of the pathway it is planning to take to reach the targeted end state. Striking a balance between providing transparency and the risk of being perceived as greenwashing; simultaneously emphasising the ongoing focus on financial delivery.
Regulatory advisory	In-depth and bespoke regulatory scans to inform decarbonisation strategies.	Comprehensive review and assessment of the impact regulations will have on the business.
Ambition benchmarking	Strategic benchmarking of competitor strategies, targets and focus verticals.	Insights to inform your own transition strategy, including points of best practice and potential differentiators vs. peers.
Transition governance	Development of KPIs, interim targets and forums to deliver transition plans.	Provide a framework to ensure delivery of transition plans.

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