

Environmental edge

SMART COMPANIES ARE GOING BEYOND MERE COMPLIANCE AND FINDING WAYS TO USE CARBON RESTRICTIONS TO GET AHEAD OF THEIR COMPETITORS.

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business sustainability

There's no doubt the carbon economy is creating an opportunity for companies to create a competitive advantage. But it's also creating a challenge for analysts who have to figure out which companies will thrive in the new situation and which ones are merely adding a cost factor to their operations.

The new, carbon-constrained world has the potential to magnify already-existing differences in operational efficiency and innovation. While most businesses are getting the message, some – particularly in those industries that consider themselves part of the trade exposed and emission intensive industry (TEEII) – have set their efforts on lobbying policy makers to receive free carbon permits which will shelter them from a strong impact – at least for a while.

A different question

At some point along the upward slope of the Carbon Adoption Curve (see Figure 1), most companies come to recognise that – although we are probably not doomed – carbon restrictions will affect all companies in one way or another.

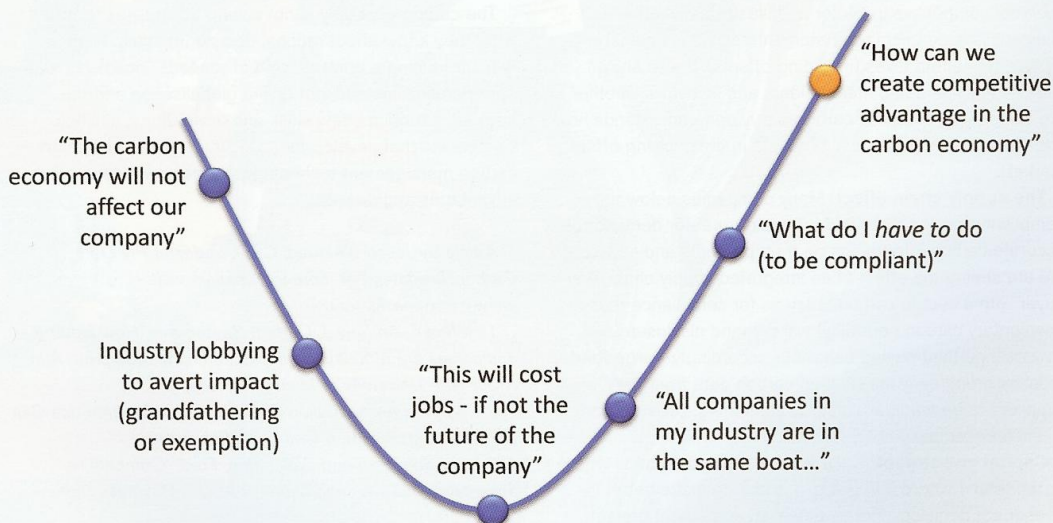
It's around that stage that many businesses ask what they need to do, by which they usually mean: what are the minimum requirements they need to meet to be compliant. But the answers are by no means trivial. In fact, the fine print of the *National Greenhouse and Energy Reporting Act 2007* (NGERS) will keep many consultants in business and many executives awake at night!

Perhaps more companies should be asking how they can turn this challenge into an opportunity.

Competitive carbon cuts

Smart companies get the 'bean counting' aspect of carbon compliance out of the way quickly. To them, carbon is not another report to write, but an additional dimension in which to make prudent investment decisions, drive innovative thinking and frame their products in a new light.

While clever firms know about the impact of their carbon footprint, their focus is on their performance relative to their competitors¹. As we move closer to the start of the Australian carbon market in 2010, the footprint discussion



Carbon Adoption Curve; Source: tradeslot Pty Ltd, adapted from Kubler-Ross

moves beyond being primarily about social responsibility and reputation, and incorporates cost management and strategic planning.

To beat competitors, the first step is to invest in smart abatement projects that reduce emissions. This is the ultimate goal of the carbon economy: a net reduction of CO₂ in the atmosphere through market pressure. Companies above or around the thresholds for compliance buying (most direct emitters of 25,000 tonnes or more will have to buy carbon permits) have a great incentive to have a good look at reduction opportunities.

No immunity

Meanwhile, some executives think that not being a compliance buyer (in other words, reporting less than 25,000 tonnes of direct emissions) means that they will be immune from the impacts of the carbon economy.

But, in fact, the opposite is true, as the following points demonstrate:

Declining emissions thresholds: The thresholds for mandatory carbon reporting and compliance buying of carbon permits will reduce over time, so more companies will become 'compliance buyers' of permits.

'Carbon-neutral' claims: Many companies have stated publicly that their company or products are or will be carbon neutral, but only a few understand the costs involved, and fewer have sufficient data to make a sound decision between internal abatement options or offsets purchased from third parties. This can result in higher costs and missed operational opportunities created by the impact of carbon price changes².

A competitive indicator: With a wide range of abatement and offset options, the internal cost of carbon varies from industry to industry and even from site to site. Between companies within an industry, this weighted cost is a powerful competitive indicator and illustrates whether a company is making smart abatement decisions against a backdrop of alternatives (including offsets). It also shows increasingly interested stakeholders and investors whether the management team is carbon-savvy and understands how to balance risk and financial outcome in the evolving offset market³.

The supply-chain effect: Many companies below the compliance-buying threshold are facing greater demand for accurate carbon information on their products and services. We are seeing the effect of an integrated supply chain. Any buyer with a cost to carbon (such as for compliance reasons or voluntary carbon neutrality) will demand disclosure and may change their buying behaviour accordingly. Large food retailers are already insisting on carbon data from their suppliers to be made available to customers, such as food miles, for example.

Capital investment: Once a company understands where it stands and where it is going, it is able to make better investment decisions. For example, an abatement project that doesn't meet the hurdle rates is, as a consequence, not viable today, but forecasting the company-specific cost of



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carbon could show that the project is doable if kicked off at a later stage. Conversely, an investment proposal may show a positive return today, but the planned facility may not continue to hit the required return on investment after the forecast weighted average cost of carbon is built in.

Sales boost: As with capital investment decisions, sales can receive a powerful carbon boost. Consider a capital goods manufacturer where the sales team models the future cost of carbon for the specific circumstances of a potential buyer (such as a compliance buyer or a carbon-neutral organisation). This effort results in a business case that combines general cost-and-efficiency benefits with a tangible 'carbon dollar' saving, hence lifting the return-on-investment and sales conversion.

A view to skill

The carbon economy is not asking businesses to forget what they know about rational decision-making. Neither is it introducing a universe void of rewards, incentives and opportunities. Instead, not unlike globalisation and the Internet, it requires new skills and navigational abilities. Companies that develop these skills, supported by smart carbon management technology, will generate competitive advantages and do well.

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1 Hoffman, Andrew J. *Carbon Strategies – How leading companies are reducing their climate change footprint*. Ann Arbor: The University of Michigan Press.

2 *Compare An Australian Cost Curve for Greenhouse Gas Reduction*, McKinsey & Company, Feb 2008.

3 Lash, Jonathan and Wellington, Fred. 'Competitive advantage on a warming planet', *Harvard Business Review*, March 2007.