Cool Brands versus Hot Brands?

To what extent are big companies and leading brands tackling climate change – and what should investors do about it?

Executive summary

This is the third of EIRIS' annual *Climate Change Tracker* reports to track the performance of the world's biggest 300 companies in tackling climate change.

Looking back over the last three years, our analysis finds encouraging signs that companies have made improvement in their response to climate change in the shape of improved governance, better strategies and more disclosure. However, no company achieved an 'advanced' assessment in their response to climate change, suggesting significant scope for improvement remains.

For the first time we have extended our research to investigate how the world's top brands, as identified by Interbrand[1], perform on climate change. Our analysis reveals some surprising differences in the extent to which leading brands are prioritising climate change.

Key findings:

EIRIS' analysis of the world's 300 largest companies finds that:

- 33% of companies have a significant climate change impact. Of this 33%, only 27% are adequately managing the climate change risks they face. In 2008, only 16% adequately managed climate change risks
- 60% have now established short-term targets (48% in 2008), but only 46% have set long-term targets (25% in 2008), leaving significant room for improvement
- In 2010, 31% of significant impact companies linked executive remuneration to carbon emissions, up from 14% in 2008

EIRIS' analysis of the Interbrand 'Top 100 Best Global Brands of 2010' list finds that:

- None of the world's leading brands listed on the Interbrand Top 100 is, at present, showing leadership on climate change
- Most (69%) brands are failing to adequately address climate change and are therefore not managing the associated risks to their brand value

[1] http://www.interbrand.com/en/best-global-brands/Best-Global-Brands-2010.aspx

Introduction

2010 was officially recorded as the second warmest year on record[2]. At the same time there is other evidence in the form of droughts and severe floods to suggest that the impacts of impacts of climate change are taking effect.

Since 2008 EIRIS has produced annual tracker reports focused on the world's largest 300 FTSE-listed companies (by market capitalization) to assess their performance in tackling climate change.

Our analysis tracks both climate change *impact* and *response*, enabling investors to understand the extent to which companies have the right policies and systems in place to respond to climate change and manage the associated risks to their businesses.

This paper gives an overview of the trends in corporate responses to climate change identified over the last three years. It also examines the extent to which top brands are leading on climate change and discusses some of the implications this could have on maintaining brand value.

Our independent responsible investment research has long been recognised and valued by global investors, businesses and academics.

EIRIS' Climate Change Toolkit and solutions such as the EIRIS Engagement and Voting services are recommended as essential aids for investors seeking to mitigate the potential risks to their portfolios posed by climate change.

International climate change context

The UN Climate Change conference that took place in Cancun, Mexico between 29th November and 10th December 2010 (COP16) did not achieve the comprehensive, all-encompassing climate change deal that activists and some governments hoped for. However, COP16 came to a close with a number of initiatives which provide a greater sense of direction for companies.

The Cancun meeting acknowledged issues such as the link between climate change and patterns of water availability. Evidence of this was observable in 2010 and early 2011 as droughts in Russia and floods in India and Australia damaged crops and impacted commodity prices.

Agreements were reached between developed and developing countries, something that had not happened at Copenhagen in 2009.

A greater emphasis on mitigation and adaptation was agreed in Cancun, as a response to developing country concerns.

This shift in emphasis may provide technological and strategic incentives for companies to address the climate change impacts of their operations. For example a Green Climate Fund to invest in low carbon and adaptation technology for developing countries was set up.

Additionally, a number of countries have furthered their commitments to reducing carbon output. This is likely to provide greater impetus to carbon reduction practices by companies and investors.

An example of this is the December 2010 UK government consultation on reforms to the electricity market to ensure the UK can meet its climate goals. The proposal includes reforms to provide long-term certainty for electricity investors and a new market for low carbon power. [3]

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[2] http://www.metoffice.gov.uk/news/releases/archive/2011/2010-global-temperature

[3] Department of Energy and Climate Change (www.decc.gov.uk)

EIRIS Climate Change methodology

EIRIS classifies companies into 57 sectors. These sectors are coded by their climate change impact as being very high, high, medium or low, taking into consideration the direct and indirect impact of company activity on climate change.

EIRIS' climate change methodology focuses on four areas:
- Governance – climate change policy, policy context, or remuneration linked to climate change performance
- Strategy – long-term, short-term or product-related targets
- Disclosure – absolute/normalised GHG emissions data, scope of data, external verification, and quantified disclosure of risks or opportunities
- Performance – year on year reduction in GHG emissions, or transformational initiatives such as large scale investment in carbon capture and storage

Companies are then given a score of *advanced, good, intermediate, limited* or *no evidence* depending on EIRIS researchers' analysis of their performance against these indicators.

EIRIS climate change trend analysis

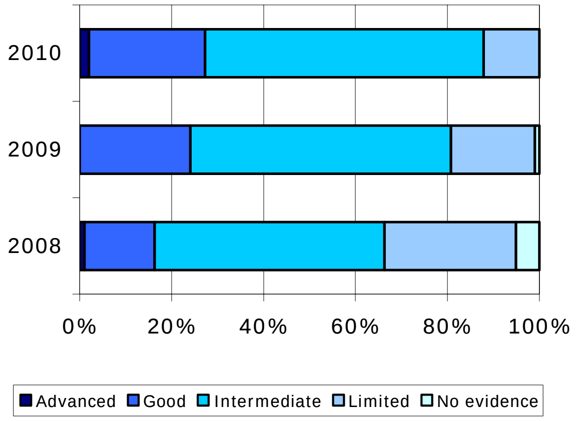
EIRIS climate change research enables investors to manage the level of climate change risk in their portfolios and the related financial risk.

The analysis in this paper is based on the assessment of companies operating in those sectors identified by EIRIS as high or very high risk, such as oil & gas producers or automobile manufacturers.

In general, the trends observed are consistently positive over the three year period.

The greatest room for improvement is in the areas of remuneration linked to climate change, long-term targets and quantitative assessment of risks.

Fig. 1 Climate change response by % number of companies (very high & high)



Source: EIRIS (as of September 2010)

As shown in Figure 1, by 2010 nearly 30% of companies have been assessed as having either a good or advanced response to managing their climate change risk. Although this is progress it still leaves over 70% of companies with considerable room for improvement

One significant factor in the improvements seen has been efforts by companies to minimize the impact of expected stricter rules and regulations worldwide in the near future.

Therefore, the additional regulatory and legislative certainty as a result of the COP16 could result in further investment by companies in areas such as technological improvements to reduce their climate change impacts.

Figure 2 (see overleaf) shows a granular analysis of Governance and Strategy indicators.

By 2010 nearly 100% of companies were committed to climate change mitigation, in that they had some form of climate change policy. For many of them the movement towards a tighter international regulatory framework on this issue was identified as the driver for their commitments.

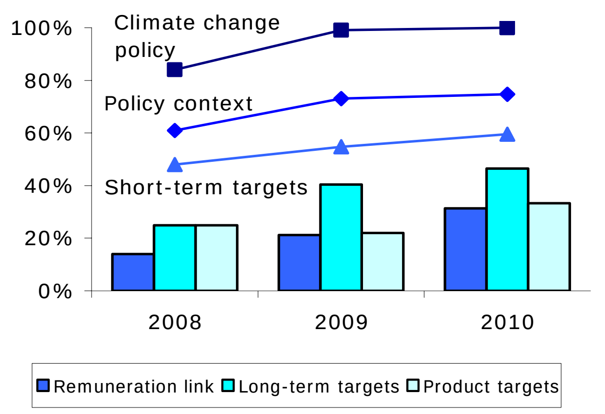
Although 60% of companies have established short term targets only 46% have set long term targets, leaving significant room for improvement.

Companies need to be setting long term targets if they are serious about tackling their climate change risks.

The area with the greatest room for improvement is the linking of executive remuneration to climate change performance. Creating a link between executive pay and climate change risk management would move companies closer to the post credit crunch consensus that executive pay should be more closely aligned with company performance.

Further improvement can also be achieved regarding product targets. This does not necessarily mean quantitative targets; it could take the form of a commitment by the company to develop products which have lower emissions, such as hybrid vehicles for car manufacturers.

Fig. 2 Governance & strategy performance by % number of companies (very high & high)

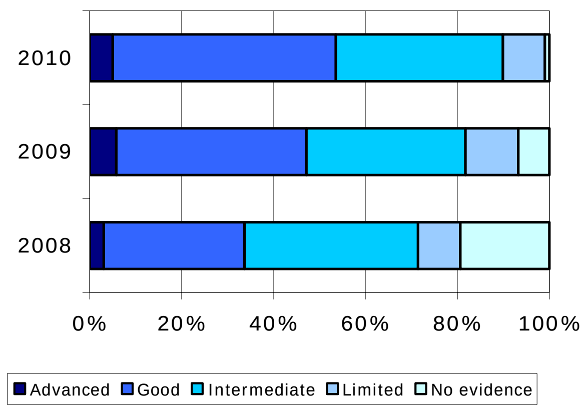


Source: EIRIS (as of September 2010)

The reporting data in Figure 3 shows a consistent trend improvement over the last three years, with a considerable reduction year-on-year in the number of companies assessed as having 'limited' or 'no evidence' of disclosure, from almost one fifth in 2008 to only 1% in 2010.

This improvement has been partially driven by engagement by institutional and other investors and the increasing mainstreaming of disclosure through initiatives such as the Carbon Disclosure Project.

Fig. 3 Climate change Disclosure by % number of companies (very high & high)



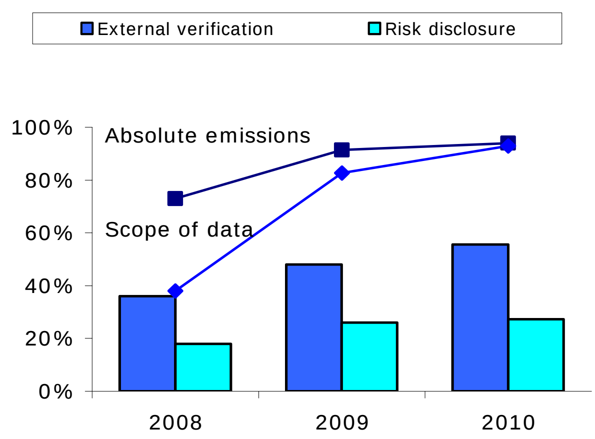
Source: EIRIS (as of September 2010)

Figure 4 drills down into the details of the indicators behind the disclosure assessments. It shows that disclosure of absolute or normalised emissions is becoming the standard for nearly all companies in the very high and high risk sectors.

The validity and accuracy of disclosed data, partially as a result of greater external verification, also improved to more than half of all companies.

Although most companies have identified generalised risks related to climate change, less than 30% have put quantitative figures against those risks. This makes it difficult to assess the true potential impact of climate change upon a company.

Fig. 4 Disclosure performance by % number of companies (very high & high)



Source: EIRIS (as of September 2010)

What next?

The context set by the COP16 meeting and 'The materiality of climate change' (Materiality III)'[4] report demonstrates that the focus on how companies manage their climate change risks is expanding beyond climate change mitigation to adaptation strategies and the impact of supply chains.

With evidence of an increase of extreme weather events such as the flooding in Australia or the droughts in Russia companies need to not only address their own climate change impacts but also how they are going to continue doing business in a world that has been altered by climate change.

Both companies and those that invest in them are going to have a significant role in meeting this challenge.

Cool brands versus hot brands?

Are inadequate corporate responses to climate change placing brand value at risk?

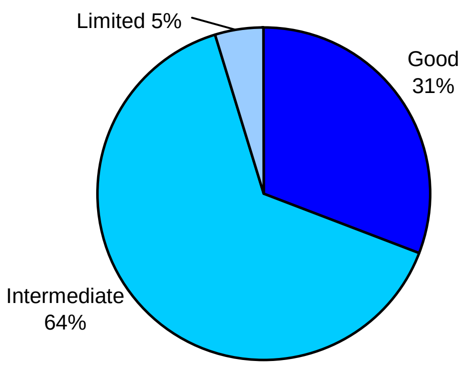
EIRIS applied its climate change methodology to assess the climate change performance of leading brands listed on Interbrand's 2010 ranking on the '100 Best Global Brands'. Interbrand's methodology focuses on the financial performance of branded products and services, the role of brand in the purchase decision process, and on the strength of the brand.

EIRIS' research methodology measures the extent to which efforts to tackle climate change are embedded within corporate culture. Our research parameters include product impacts, long-term targets, executive remuneration and disclosure.

EIRIS research identified 42 brands from the Interbrand top 100 as having a significant climate change impact (e.g. their business activities result in significant indirect, direct and product-related green house gas emissions).

However, none of these 'high impact for climate change' brands achieved an 'advanced' assessment from EIRIS on climate change. This means that none of the Interbrand top 100 brands is, at present, showing climate change leadership.

Fig. 5 Climate change Response by 100 top brands



Source: EIRIS (as of September 2010) and Interbrand

Only 31% of brands with a high climate change impact received a 'good' assessment meaning that they have the minimum policies, management and reporting and disclosure mechanisms required to tackle climate change and manage the associated risks to their brand value.

Leader of the pack?

Gillette (ranked 3rd in Interbrand's top 100) achieved the highest overall climate change rating in EIRIS' analysis. Gillette is owned by Procter and Gamble which differentiates itself from others companies in the 'Household Goods' sector by establishing long-term targets on emissions reduction and by displaying strong reporting against those targets.

On the other hand, Porsche (ranked 72nd in Interbrand's top 100) achieved one of the lowest climate change scores in EIRIS' climate change analysis. This contrasts with other leading brands in the automobile and parts sector such as Toyota, Mercedes-Benz (Daimler), BMW and Honda.

[4] http://www.unepfi.org

Each of these companies publish absolute and normalized climate change emissions data as well as trends in performance, whilst Porsche does not. All four companies also report against published emissions targets while Porsche doesn't. Additionally, all four have targets related to reducing the climate change impacts arising from their products. Again, Porsche does not. This is a key difference as product (vehicle) emissions make a significant contribution to climate change.

Pepsi Challenged?

The Coca-Cola Company is at the top of the Interbrand 100 list, while PepsiCo is positioned at number 23. However, when looking at their relative responses to climate change, a different picture emerges.

While Coca-Cola has an assessment of 'intermediate', with a number of unidentified or unmanaged risks, PepsiCo scores 'good' according to EIRIS' methodology. Unlike Coca-Cola, PepsiCo is therefore considered to have adequately managed its climate change risks. The following table highlights the main contributing factors to the difference in the grade.

	PepsiCo	**The Coca-Cola Company**
Interbrand rankings	23	1
EIRIS grade on climate change	Good	Intermediate
Quantitative climate change targets	Long-term energy use reduction targets	Long-term targets but not covering its whole operation
Operational emissions reductions	Clear significant emissions reductions in the last few years	No significant emissions reductions in the last few years

Apple versus Dell?

EIRIS' research also reveals key differences in the extent to which big name technology brands such as Apple and Dell are taking steps to tackle climate change.

Dell (Interband rank 42) has linked executive remuneration to climate change performance, established both long and short-term targets and has improved product-related climate change emissions.

However, Apple (Interbrand rank 17) has failed to implement any of these measures. On the other hand, Apple has shown an improvement in reducing its GHG emissions whilst Dell's GHG gas emissions have increased. However, it should be noted that other factors such as new business acquisitions, fluctuations in turnover, etc, can account for increases/decreases in GHG emissions.

So are top brands exposing themselves to the erosion of brand value in the future by failing to reflect the climate change concerns of consumers and regulators? Are stakeholders voicing their concerns sufficiently? In 2009, a joint study by the Carbon Trust and Marketing magazine found: "Increased consumer awareness of carbon emissions means it has become a key factor in brand choice"[5].

In April 2010 the first carbon trading scheme in the UK came into force. Known as the Carbon Reduction Commitment (CRC), it will result in the publication of a league table for the most energy-intensive companies.

The Carbon Trust stated, "a bad ranking will impact on a brand's reputation," and that "carbon output will have a direct impact on a company's bottom line, as poor performers will be penalized."

With increased regulation, growing consumer and investor awareness, and the trend for improved climate change management responses in general, we expect climate change and other sustainability issues will become increasingly important factors in the determination of brand value.

Investors considering investing in top brands need to judge whether the company is protecting their brand's value by fully managing its current and future climate change risk.

[5] www.decarbonisingthebrand.com

Conclusions & recommendations

EIRIS' trend analysis shows that companies' management of their climate change risk has continued to improve year-on-year. However, top brand companies still have a long way to go.

These companies are responding to their climate change impact, however, they are failing to lead on the issue. Excellence in climate change management has generally not yet been identified by companies as a brand enhancer.

The potential reputational damage to brand value associated with a failure to address the risk of climate change can directly impact a company's profitability. A lack of mitigation measures could lead to the loss of productivity and business interruption. Therefore, engagement activities can contribute to enhancing companies' brand value. EIRIS offers a solution to this risk through its focus on best practice and engagement.

As climate change becomes a clearer reputational risk, companies have an opportunity to position themselves ahead of the curve.
Early adopters of cleaner technologies have the opportunity to reap the benefits of a better reputation and lower the risk of falling foul of financial instruments to regulate climate change.

Investors need to evaluate the climate change risk of their portfolios. They should engage with top branded companies on this issue to protect their investments. Failure to do so could result in long-term damage to the profitability of their investment.

There are key opportunities to engage with companies around linking remuneration to climate change mitigation, long-term targets and quantitative risk identification as these are the areas where their performance is weakest.

EIRIS' Climate Change toolkit and its Engagement and Voting services provide investors with all the instruments needed to evaluate risk and manage it accordingly. Investors can use EIRIS climate change research in their voting and engagement strategies.

Previous EIRIS tracker reports

Asia:
http://www.eiris.org/files/research%20publications/ClimateChangeTrackerAsia09.pdf, May 2009
North America:
http://www.eiris.org/files/research%20publications/ClimateChangeTrackerNorthAmericaOct09.pdf, October 2009
Europe:
http://www.eiris.org/files/research%20publications/ClimateChangeTracker(Europe)2010.pdf, June 2010

How we can help

EIRIS Climate Change Investor Toolkit
EIRIS has a suite of products to help investors assess their portfolios and design investment strategies in response to the challenge of a carbon-constrained economy.

- *EIRIS Carbon Profile* - assesses the climate change performance of a portfolio against major market indices by considering both climate change impact and company responses. It is designed to help investors understand the quantitative climate change impact of their portfolios. It provides a qualitative assessment of company responses to climate change.

- *EIRIS Carbon Engager* – helps investors to target their engagement on climate change and identify key priorities. It provides detailed reports on individual company performance and best practice examples to support a variety of engagement approaches.

- *EIRIS Carbon Risk Factor* - quantifies individual company performance on climate change. It provides a risk-weighted score based on each company's carbon impact and management response to climate change. It is designed to be easily integrated into analysts' models.

EIRIS Enhanced Voting Service
EIRIS' Enhanced ESG Voting Service supports investors through all phases of enhancing their voting including integrating ESG considerations into proxy voting policy, providing voting recommendations, supporting engagement and assisting with reporting on voting and engagement activity.

EIRIS Engagement Service
EIRIS' Engagement Service enables investors to outsource their engagement activities to one of the world's leading experts on responsible investment. Whether you are completely new to engagement, or wish to expand your existing engagement capacity, EIRIS' Engagement Service provides all you need to leverage your influence and enhance shareholder value through active engagement with companies on relevant ESG issues.

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