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Climate leadership wanted: How CEOs can better meet investor expectations

New PwC research suggests that CEOs are less concerned about climate change and less effective at confronting its risks and opportunities than investors would like. Forward-thinking CEOs can lift their standing with shareholders by using these findings to take action.

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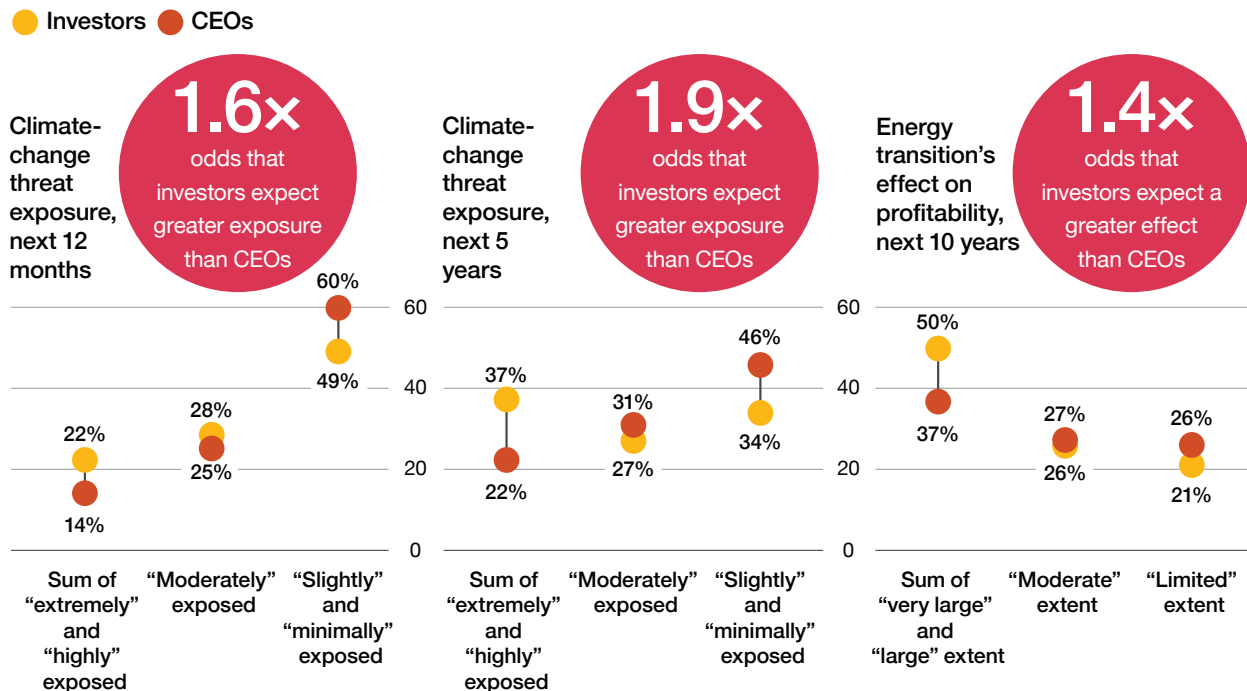
Most corporate leaders and institutional investors today seem to recognize that climate change demands close attention and a meaningful response; just look at the 2,500 companies that have set science-based emissions targets in recent years, or the US\$59 trillion invested by asset managers with net-zero pledges. But recent research by PwC shows that CEOs are less likely than investors to express concern about the possible financial impact of climate change on companies. CEOs are also less likely to report that their companies are taking actions on climate change—for instance, creating climate-friendly products and services—that investors see as broadly effective. These findings suggest that CEOs can benefit by connecting their company's climate strategy with those priorities that investors say they care about most—namely, profitability and innovation—and making the case for climate action in terms of value creation.

CEOs see climate change as less urgent than investors do

Climate change affects a company's ability to create value in two broad ways. First, physical climate hazards such as rising temperatures and violent storms can disrupt business operations. And so-called transition risks, posed by factors that can arise during the shift to a low-carbon economy—such as new environmental regulations and the influence of climate-minded customers and investors—can undermine the strength of a company's business model. But do CEOs and investors think these complex forces will have similar financial effects?

Same climate threat, different levels of urgency

Investors are more likely than CEOs to say that climate change will affect companies' financial performance across multiple time horizons.



Note: Odds ratios are based on regression analysis of two sets of survey findings.

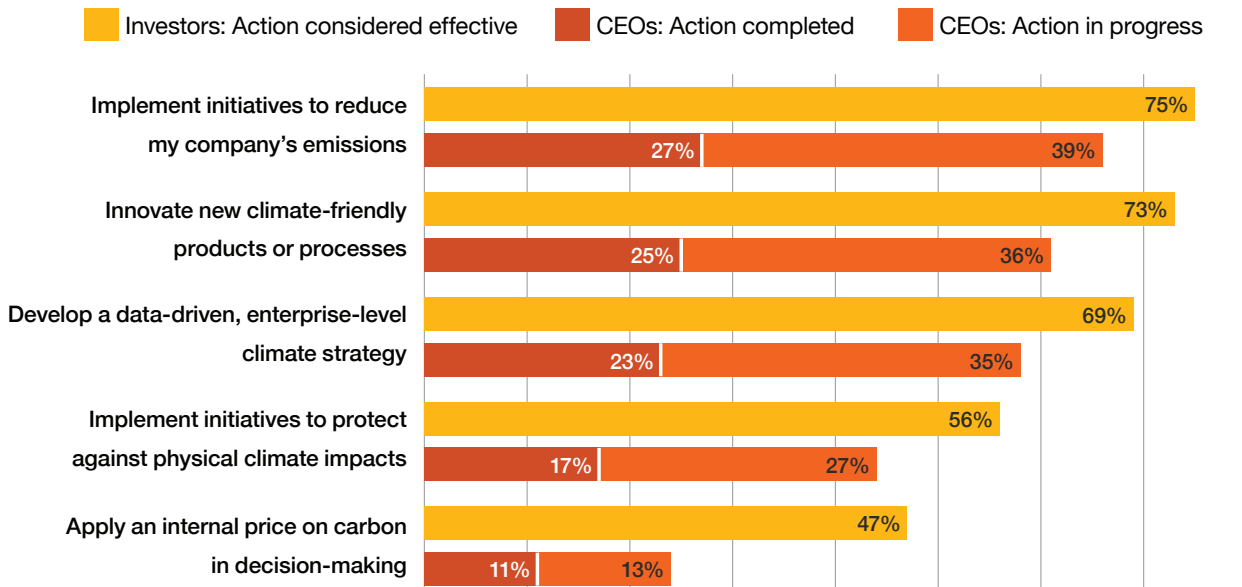
Source: PwC's 26th Annual Global CEO Survey, PwC's Global Investor Survey 2022, original analysis

To find out, we asked CEOs how exposed their companies will be to financial losses due to climate change—both physical hazards and transition risks—over the next 12 months and the next five years. Then we asked CEOs to say how much they think the transition to new energy sources will affect profitability in their industry over the next ten years. We also asked investors the same questions with respect to the companies they invest in or analyze.

Across all three time horizons, the odds of investors indicating a higher level of exposure to financial losses were 1.6 times the odds for CEOs. For the five-year climate threat, investors' odds of giving a higher exposure response were nearly twice the odds for CEOs. As for the ten-year effect of the energy transition on company profitability, the odds of investors expecting a greater effect were 1.4 times the odds for CEOs (see chart above).

CEO climate action trails investor expectations

When asked about five specific climate actions, investors were more likely to say that the action is effective than CEOs were to say that the same action is in progress or complete at their company.



Source: PwC's 26th Annual Global CEO Survey, PwC's Global Investor Survey 2022, original analysis

Investors see climate action as effective and want it to be a business priority, but relatively fewer CEOs report progress

As far as investors are concerned, businesses should act to address climate change. In our latest investor survey, 44% of respondents agreed that businesses should make reducing greenhouse gas (GHG) emissions in their operations and supply chains one of their top five priorities. Overall, GHG reduction landed in the fifth place on investors' list of business priorities, behind innovation (in first place, at 83%) and profitable performance (second place, at 69%). What's more, solid majorities of investors said they think that acting now will be effective in preparing for climate risk. Foremost among the various actions that businesses could take were implementing initiatives to reduce emissions (named by 75% of respondents), innovating new climate-friendly products and processes (73%), and developing a data-driven, enterprise-level climate strategy (69%). It's notable, then, that relatively smaller percentages of CEOs reported that their companies are making progress on these same actions (see chart above).

How CEOs can better meet investor expectations on climate

It's possible that some of the disparities between CEO and investor outlooks on climate risk in 2022 reflect the relative urgency of other threats, such as inflation and macroeconomic volatility. In 2021, one-third of CEOs surveyed by PwC said they were “very” or “extremely” concerned about climate change as a global threat that could negatively affect their companies in the next 12 months—far more than the 14% measured with a similar question in our 2022 survey. Nevertheless, the gaps between investors' views of which climate actions are effective and CEOs' assessment of progress on those actions suggest that CEOs might want to revamp their approach to engaging investors on climate issues. Our survey results point to several things that executive teams could consider doing differently.

Lay out a clear financial case for climate action. Small percentages of CEOs and investors said they see climate change as a threat to business over the next few years. But more members of both groups seem to appreciate that the energy transition could have significant effects on profitability over the long term. More than one-third of the CEOs we surveyed (37%) said that the transition to new energy sources will affect profitability in their industry to a large or very large extent over the next ten years, compared with the 14% who see climate change as a risk during the year ahead. Investors agree: 50% of those surveyed said that the energy transition will have a large or very large impact on company profitability during the decade ahead. And remember—investors' top two priorities for companies are profitability and innovation, with GHG reduction coming in fifth. When making the case for climate action, CEOs would do well to ground their logic in the financial implications of both climate risks and climate opportunities.

Maintain and demonstrate financial discipline. For CEOs, stating that climate programs are focused on value creation is just a starting point. Investors also expect executives to show positive financial results over time. Indeed, four out of five investors (81%) said they would accept no more than a one percentage point reduction in overall returns for companies in their portfolios that take sustainability actions relevant to their business. Many of the investors who

answered our survey also said that they want to see companies disclose the effect of sustainability risks and opportunities on their financial statement assumptions (70%), the relevance of sustainability factors to their business model (69%), and the business's external impact on the environment or society (60%). To meet these stringent expectations, CEOs will have to exercise discipline in managing and describing the financial impact of their climate programs.

Improve the relevance and quality of sustainability reporting. Clearly, few investors have confidence in the sustainability reports and disclosures issued by companies. Fewer than 40% of investors said that disclosures on GHG emissions reductions are effective. Just 61% said that they use companies' sustainability disclosures to a moderate, large, or very large extent when assessing how companies manage risks and opportunities; much greater shares said they rely on financial statements (89%), dialogue with the company (81%), narrative reporting other than sustainability disclosures (80%), and even third-party data sources (79%).

Most concerning of all, 87% of investors said they believe that sustainability reporting contains at least some greenwashing. Disclosing more of the information that investors care about could go some way toward improving the relevance of sustainability reports. So, too, would obtaining a higher level of assurance: 75% of investors said that an independent reasonable assurance opinion (the same level of rigor as in financial statements) would give them a moderate or higher level of confidence in the sustainability report. Only 54% said they would derive that level of confidence from a sustainability report that received an independent limited assurance opinion, which is generally the level of assurance that many companies provide today.

By several measures, investors report being more concerned than CEOs that climate change will have meaningful implications for businesses. Those concerns should prompt business leaders to not only act on climate, but to present a credible rationale for their decisions. By linking climate action with value creation, CEOs can provide the leadership that the capital markets are seeking.

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