Climate Change: Weathering the Storm for Businesses

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Nature was once a protagonist acting as a provider of resources and the centre of life. In ancient Egyptian civilisation, the Nile River boosted the economy by providing a source of irrigation and transforming the dry area into lush agricultural land. The Malacca River witnessed a steady flow of the world's trade at the height of its former glory. Now, the story has changed. Years of environmental degradation is affecting flora and fauna, as well as humankind. From the deadly bushfire in Australia to the massive flood in Indonesia, the year 2020 was a year of truth. As Greta Thunberg put it in her speech at World Economic Forum, "Our house is on fire". In this fierce survival of the fittest, businesses must embrace the risk and impact of climate change on the business. The climate emergency has threatened the life of uncountable species and it could threaten the life of your businesses too.

What Is Climate Change?

National Geographic defined climate change as "a long-term shift in global or regional climate patterns". It refers specifically to the rise in global temperatures from the mid-20th century to the present. Earth's average temperature has been increasing faster than experts would anticipate over the past 150 years.

Climate change is caused by multiple interrelated factors. One of the major factors is human-made greenhouse effect due to gas emissions from industrial activities. Since the industrial revolution, humans are directly responsible for the excessive greenhouse gases in the atmosphere. The main source that contributes to the emission includes improper waste management, electricity generation, transportation, and energy production. Many of the gases remain in the atmosphere for tens to hundreds of years after being released. They accumulate and warm the climate leading to extreme weather events and natural disasters. The World Economic Forum in 2020 concluded that the main threat to businesses is the failure to mitigate and adapt to such threat posed by climate change. This article will discuss two aspects of climate change –

(i) the business and legal risks posed by climate change to companies; and

(ii) the Malaysian regulatory landscape for climate change.

Climate Change Posed Business Risks

We do not know precisely how climate change will alter our planet, but two things are certain: its complex environmental impact will directly affect business, society, and ecosystems; and governments will seek to mitigate its effects with far-reaching regulations. Until recently, companies have for the most part freely emitted carbon, but they will increasingly find that those emissions have a steep price, both monetary and social. As a result, businesses that continue to sit on the side-lines will be badly handicapped relative to those that are now devising strategies to reduce risk and find competitive advantage in a warming, carbon-constrained world.

Climate changes have caused changes in weather patterns and frequency of natural disasters. The main concern for Malaysian businesses is the increasing risk of flash floods and monsoon floods. The immediate impact is the damage to businesses' physical asset such as assets employed in the business, inventory, equipment, and vehicles. The disaster would impair the businesses’ asset and its ability to continue the business. In most cases, businesses, particularly Small and Medium Enterprises (SMEs), usually do not adequately insure their inventories and assets for damages caused by natural disasters such as a floods, thunderstorms and lightnings.

Companies that persist in treating climate change solely as a corporate social responsibility issue, rather than a business problem, will risk the greatest consequences. Of course, a company’s climate policies will be affected by stakeholders’ expectations and standards for social responsibility. But the effects of climate on companies’ operations are now so tangible and certain that the issue is best addressed with the tools of a strategist, not a philanthropist.

In the Insurance Business Asia news article published in 2019, the American International Group, Inc. (AIG) stated that in Malaysia more than 80% of businesses are severely under-insured and are at risk from natural disasters.[1] Ministry of International Trade and Industry has reported that the Kelantan flooding in 2014 itself has affected over 13,000 SMEs. Meanwhile, approximately 1,000 companies lost RM 3 million due to the Penang floods in 2017. Some businesses required a big sum of money to recover from this disaster, resume business operation and some even declared a total loss and needed to start anew. However, businesses, particularly SMEs are not prepared for the financially catastrophic event although it happens annually. The Insurance Business Asia news article also stated that only around 15% of SMEs are insured for flood insurance.[2]

In addition, the damage to the companies’ asset such as factory or vehicles would affect the integrity of the supply chain and the ability to fulfil market demand for a significant period of time. Apart from domestic disasters, in our neighbouring country, Thailand, severe flooding in 2011 affected more than 14,500 companies that disrupted the supply chain in Thailand. The flood affected the inflow and outflow of goods, availability of raw materials, and crippled the distribution network. This is a major obstacle for businesses especially those that practice just-in-time production to meet customer demands.

There is no one-size-fits-all approach to climate change. Each company’s approach will depend on its particular business and should mesh with its overall strategy. For every company, the approach must include initiatives to mitigate climate-related costs and risks in its value chain. Business leaders need to start treating carbon emissions as costly, because they are or soon will be, and companies need to assess and reduce their vulnerability to climate-related environmental and economic shocks. Every firm needs to get these basics right, as a matter of operational effectiveness.

To set a firm’s approach to climate change and assess the strategic opportunity, business leaders need to look “inside out” to understand the impact of the firm’s activities on the climate and “outside in” at how

[1] G. Olano, Over 80% of SMEs lack flood cover – AIG Malaysia, Insurance Business Asia, 2019

[2] Ibid.

changing climate (in both its physical and its regulatory manifestations) may affect the business environment in which the firm competes.

To understand the inside-out impact, managers need to study the firm's value chain. Any value-chain activity inbound logistics, operations, outbound logistics, marketing, sales, after-sales service can generate emissions. The simple ratio of profits to total emissions in the value chain can be a very telling measure of potential climate impact.

The impact of climate changes is not only unique to SMEs; it is also an economic hazard to large companies. For instance, climate changes caused prolonged drought and causing hot weather with searing heat, which accelerated the ageing of electrical equipment, making it flammable. The flame coming from affected equipment have triggered the wildfire. For instance, in 2018, PG&E Corps, a Californian power utility filed for bankruptcy due to USD30 billion liabilities and 750 lawsuits following the wildfire linked to their equipment. Experts suggest that this corporate casualty was not the last in the industry considering the increasing frequency of drought, drier grounds and less rainfall.

Climate Change Posed Legal Risks

As stated earlier, industrial activities along with other business activities, is one of the major sources of greenhouse gases because of the electricity consumption, mobility (vehicles) and production of waste particularly in the industry such as agriculture, transportation, forestry and manufacturing.

In response, authority such as the Department of Environment closely monitors companies to ensure compliance with the environmental law and guidelines.

In 2019, directors of P Tech Resources Sdn Bhd faced 15 charges under the *Environmental Quality Act 1974*, *Environment Quality Regulations (Scheduled Wastes) 2005*, and *Environmental Quality Regulations (Clean Air) 2014* for failure to conduct air quality monitoring and manage the company's scheduled waste according to the Scheduled Waste Guidelines administered by the Department of Environment. For such kind of violation, the company or officers can be subject to a maximum of five years' jail and a fine of not more than RM500,000. Their failure has resulted in the pollution of Kim Kim River in Johor and caused air pollution. Over 3,000 people living in the proximity of the river were ill and 111 schools were closed. In the long term, the accumulation of pollutants would flow to the sea and lead to ocean acidification which will speeds the rate of global warming and contribute to climate change.

Apart from violations of environmental laws, directors of companies could also face charges for a criminal offence under the penal code. In Selangor, four directors of Yip Chee Seng & Sons Sdn Bhd were charged under *Section 430* of the *Penal Code* for causing hazardous waste from the workshop to flow into the Gong River, leading to a water supply disruption to more than 1.2 million people. The hazardous waste can emit gases such as carbon dioxide, methane, and nitrous oxide. The concentrations of these gases in the atmosphere would deplete the ozone layer and warm the climate. The violation of *Section 430* of the *Penal Code* carries the sentence of imprisonment of not less than 5 years and not more than 30 years or with fine or with both.

Globally, year 2020 witnessed a soaring trend in climate-related litigation. U.S. Climate Change Litigation database by Sabin Center for Climate Change Law indicated that the legal action related to climate change have reached approximately 2051 cases in 33 jurisdictions as well as at international courts.[3] Based on the cases discussed above, Malaysian jurisdiction is not an exception.

Apart from domestic legal actions, companies and the officers could be charged at foreign court for cross-border cases if the impact of the pollutants affects the neighbouring countries. For instance, in year 2014 the Parliament of Singapore passed the Transboundary Haze Pollution Act. This law allows the Singapore regulators to prosecute any entity such as companies that cause severe air pollution in Singapore by burning forests and peatlands in neighbouring countries.

Based on the P Tech Resources and Yip Chee Seng cases, it appears that litigation at court can be detrimental because the cost and penalty may lead to the early demise of the company. The company has to deal with related costs such as the cost of rectifying a mistake, damage to the company's credit rating, and even possible loss of contracts and tenders.

Therefore, companies must be proactive to adhere to the environmental laws in the country in which they operate. In addition, companies must also be aware of international legislation concerning environmental matters that could affect their operations in their home country. The consequences of non-compliance are far more reaching and damaging that can be envisaged.

Current Regulatory Landscape of Climate Change in Malaysia

In 2015, the Paris Agreement, a legally binding treaty on climate change was adopted by 196 countries, aims to reduce global greenhouse gas emission to limit the global temperature increase to 2 degree Celsius by 2050. The key players behind the introduction of the Paris Agreement were the United Nations Framework Convention on Climate Change (UNFCC), the United States, France, China, and the European Union. The agreement is a catalyst for the adoption of a low carbon economy across the globe. As a signatory to the Paris Agreement, Malaysia pledged to reduce its greenhouse gas emissions by 45% by 2030. This has been translated into public policy, regulations and social expectation.[4] Henceforth, businesses must be prepared to adapt to such regulation transition.

Following the Paris Agreement, there is a growing inclination towards corporate transparency particularly on the disclosure

[3] Legal action related to climate change includes legal claims against corporations and individuals due to greenhouse gas emissions. U.S. Climate Change Litigation database, Sabin Center for Climate Change Law at Columbia Law School, Arnold & Porter LLP.

[4] Some of the national policies on climate change such as Green Technology Master Plan Malaysia 2017–2030 https://www.pmo.gov.my/2019/07/green-technology-master-plan-malaysia and National Policy on Climate Change 2009 https://asialeds.org/resource/national-policy-on-climate-change-of-malaysia/

of environmental, social and governance (ESG) principles. The introduction of the ESG disclosure will benefit the companies' sustainability position better than the traditional corporate social responsibility (CSR) reporting. CSR reports are inadequate for stakeholders to evaluate the efforts the companies making towards business improvement. The CSR is limited to social aspects of the business. In contrast, the ESG disclosure is a way for internal and external stakeholders to evaluate corporate behaviour and performance of the companies in addressing business challenges such as the climate change issues. The information is vital for the stakeholder to determine the future financial performance of the companies during the regulation transition.

Suruhanjaya Syarikat Malaysia (SSM) encourages companies to report on ESG as part of non-financial reporting as provided under the Fifth Schedule and s*ection 253(3)* of the *Companies Act 2016*. This provision is applicable to all types of companies and is to be applied on voluntary basis. Companies are encouraged to prepare and lodge the Business Review Report to the Registrar that comprised of information on the company that is not covered under the financial statements that includes information on the company's commitment towards conducting business operation in an economically, socially, and environmentally sustainable, transparent, and ethical manner. SSM has issued the Best Business Practice Circular 6/2017 on Business Review Report: Guidance to Disclosure and Reporting that provides useful recommendations for companies to prepare the Business Review Report.

Meanwhile, for public listed companies, the new *Malaysian Code on Corporate Governance* (MCCG) was introduced by the Securities Commission of Malaysia in 2017 to ensure the integration of economic, environmental, and social considerations in the business strategic plan. Companies must ensure that their strategic plan support long-term value creation and include strategies on economic, environmental, and social considerations underpinning their sustainability.

Bursa Malaysia Securities Berhad requires directors of listed companies to report on the application of the MCCG principles in the company's annual report. Bursa also launched the FTSE4Good Index to profile companies with good ESG practices.[5]

Nonetheless, the non-listed public and private companies are strongly encouraged to adopt the MCCG principles and report on the ESG practices even though they are not legally obligated to do so. ESG considerations are vital as it enhances accountability and transparency. It will also improve brand value and allow the business to secure capital easily from investors. The ESG is receiving more spotlight not just among regulators and shareholders, but also institutional investor such as the Employees Provident Fund (EPF). Presently, the EPF is championing sustainable investments by incorporating ESG principles in their investment considerations following the adoption of the

[5] FTSE4Good Index is standard to identify Malaysian companies with recognised corporate responsibility practice. For companies to be included in the index, they must meet ESG inclusion criteria. This index supports the investor to make investment based on ESG principles.

United Nations-supported Principles for Responsible Investment.

It is projected that the non-financial reporting requirement for non-listed public and private companies would be more significant and relevant in the near future because the impact of climate change has frequently materialised in the form of natural disasters. In early 2020, the World Economic Forum International Business Council (IBC) proposed an international reporting standard for ESG disclosure. This initiative aims to produce consistent reporting across all sectors and countries towards facilitating the verification and assurance process. Subsequently, it would advance the level of transparency and alignment among companies, investors and stakeholders. This has been well-received by the regulators because climate change is a global issue, which requires a globally standardised approach to ESG reporting.[6]

Periodically, major new forces dramatically reshape the business world as globalization and the information technology revolution have been doing for the past several decades. Climate change, in all its complexity and potential impact, may rival them both. While many companies may still think of global warming as a CSR issue, business leaders need to approach it in the same hard-headed manner as any other strategic threat or opportunity

In conclusion, the implications of climate change to businesses are not limited to just immediate physical risks. It also involves financial and legal risks. Considering the negative impacts discussed in this article, businesses should proactively adopt ESG principles and exercise non-financial reporting. This is a sustainable strategy to convert the business risks into business opportunities and leverage on it to remain competitive.

[6] Some of the regulators' global initiatives to support ESG principles such as the Global Standards for Sustainability Reporting by Global Reporting Initiative (GRI), European Commission's Sustainable Finance Action Plan, Sustainable Responsible Investing (SRI) Sukuk and Bond Grant Scheme by Securities Commission of Malaysia, and Bank Negara Malaysia's Climate Change and Principle-based Taxonomy.