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TRANSCRIPT

# Can Companies Push Other Companies to Reach Net-Zero by Degrees?

***Featuring:***

***David Eichberg,*** *Managing Director & Global Head of Climate Strategy, HP Inc.*

***Joseph Gagliardi****, Head Of Corporate Services, MSCI*

***Meggin Thwing Eastman,*** *Managing Director, ESG Research, MSCI*

Adam Bass (00:03):

This is MSCI Perspectives, your source for insights for global investors and access to research and expertise from across the investment industry. I'm your host, Adam Bass, and today is January 27th, 2022.

Adam Bass (00:20):

Over the last year or so, we've all become used to discussing supply chain issues, their vulnerabilities, and more recently, the inflationary effects of their breaking down. But today on the program, we're going to look at another aspect of how global supply chains bind companies to each other, and to their investors, in terms of reaching net zero goals. Now that means talking about something called scope three emissions, and how companies are pressuring other companies into reducing their carbon footprints. We'll get there, but first let's talk scopes.

Meggin Thwing-Eastman (00:58):

So when we think about carbon emissions, there's three different scopes. No more, no less.

Adam Bass (01:04):

Please welcome back to the program...

Meggin Thwing-Eastman (01:06):

Meggin Eastman, I'm the editorial director for ESG and climate research here at MSCI. So scope one is direct fuel use. So, if you burn gasoline in your car, that is your personal scope one. Scope two is electricity. So, running your computer in your house, and scope three is everything else. So everything that you buy and bring in, and for companies, everything downstream as well. So for the auto manufacturer, it's the use of the car. So your scope one is their scope three.

Adam Bass (01:38):

Which is important for all of us to understand because...

Meggin Thwing-Eastman (01:43):

There's been a sea change in the financial and investment industry. And to some extent, also in the wider corporate world, in terms of companies and investors and financial institutions setting serious targets.

Adam Bass (01:57):

Targets, of course, being net-zero targets.

Meggin Thwing-Eastman (02:01):

I think there's wide agreement at this point that a two degree scenario, and better yet, a one and a half degree scenario, is where we need to head to get to limiting warming to a degree and a half or two degrees. To get to a net-zero economy or portfolio, the entire economy has to decarbonize.

Meggin Thwing-Eastman (02:20):

If we look across the MSCI ACWI IMI, which is a large market cap index, counts for about 99% of the public equities market. Only about 10% of those companies currently are on track for 1.5 degrees. And it's a bit less than a half that are aligned with a two degree warming scenario. And we're hoping to see that change, and pretty quickly, because there just isn't a lot of time left to get on track.

Adam Bass (02:46):

So everyone's steaming towards net zero. Now, ignoring scope three emissions. Well, it's kind of like ignoring that big, looming iceberg everyone's been radioing about. But if you're a company looking to reduce your scope three emissions, there's a bit of a problem.

Meggin Thwing-Eastman (03:05):

Scope three is complicated because it's not within company's own operational envelope. And so it means that all scope three reporting is effectively estimates. So they can control what they burn for fuel, and they have some control over how much electricity they use, and maybe even where they source it from. So whether they're buying green energy, say. For scope three, a lot of it's coming upstream from their suppliers, which they don't have a lot of control over. The downstream they may have some. So the use of their own products, the way they design those products. They can have some info over how those use energy and how those create emissions. But then also even a lot of the downstream is difficult, because it can be about transport and the way things get used and disposed once they come to the end of their life. And that is often well beyond companies' control.

Adam Bass (03:56):

And it's tricky because...

Meggin Thwing-Eastman (03:59):

Because to bring down your scope three emissions, you have to persuade someone else to bring down their scope one or two emissions. And so that means that if these companies decarbonize themselves, that's going to have a nice knock-on effect for everybody who's downstream. But it also means that in order to decarbonize themselves, they have to influence their upstream.

Adam Bass (04:22):

And everyone's feeling the heat. Here's David Eichberg, HP's global head of climate strategy. And our second guest today, with more.

David Eichberg (04:32):

Downward pressure from customers on suppliers to reduce carbon emissions is definitely happening. It's been happening and is only accelerating. We're increasingly seeing our customers focus on their upstream carbon footprint, which includes parts of our carbon footprint. They're asking us about our goals and plans and progress, just as we are asking our suppliers.

David Eichberg (04:52):

In 2021, in fact, 36 of our largest customers, representing nearly $1.3 billion in revenue, requested our CDP responses to support their own reporting on suppliers. Like us, they're using their influence to drive reductions beyond their control, but within their value chain to address scope three

Adam Bass (05:13):

CDP, that's the carbon disclosure project. Very important scorekeeper in this space.

David Eichberg (05:20):

Short of government regulation, the greatest pressure on a company to decarbonize comes from its customers and its investors. In fact, several of our largest commercial accounts have net-zero commitments as well. And like us, they're asking their suppliers, including us, about their climate goals and plans and progress, and asking them to raise their ambition.

David Eichberg (05:41):

This is key to driving the pressure and wielding the influence that's needed to achieve reductions beyond a company's own control. Investor interests is growing too. I do expect that investor pressure will grow as they decarbonize their portfolios, as many have now committed to do.

David Eichberg (05:59):

Now, achieving net-zero GHG emissions by 2040 is our ultimate goal. By the end of this decade, we aim to reduce our absolute value chain emissions 50% compared to 2019 levels. A target in line with the latest climate science and the 1.5 degree reduction pathway called for by the Paris Agreement. And this extends to our entire value chain, including our supply chain, our own operations, and the customer use of our products and services.

Adam Bass (06:26):

"So far," David said, "HP is doing pretty well."

David Eichberg (06:31):

HP's upstream footprint represents the largest share of our GHG emissions. About twice the size of our downstream footprint. And we're collaborating with suppliers to raise their climate ambition and accelerate their actions to propel them and us and the whole industry towards net-zero economy.

David Eichberg (06:49):

As for downstream, we focus on providing the most energy-efficient technology to reduce emissions during product use for the customer as well. We've exceeded our goal to reduce our products' GHG emissions intensity, or the average emissions per unit during customer use by 30% by 2025, compared to 2015. And we're coming in well ahead of schedule at now 33%. And we expect to exceed that even with this year's reporting.

Adam Bass (07:19):

Now, I don't want to be disingenuous here. MSCI's own investors have been asking about our plans in this area. Last year, you may recall MSCI committed to being net zero before 2040. We did an episode on it. You might remember. Anyway, we got in touch with Joe Gagliardi, MSCI's head of corporate services who was featured in that episode. And we asked him if he had any updates. Here's what he said.

Joe Gagliardi (07:49):

In the fall of '21, we spent a significant amount of time talking to a number of our top shareholders about our overall corporate responsibility program and a lot of our efforts in that program. We're definitely seeing increased engagement from our shareholders, compared to say, previous years. The previous year, we also conducted a similar outreach. We did spend a fair amount of time talking about MSCI's net-zero commitment, since that was new in '21. There were some other topics we talked about as well. But overall, the feedback's been very strong from the shareholder community.

Adam Bass (08:31):

Which makes sense because MSCI is in a bit of a unique position.

Joe Gagliardi (08:36):

So we're a major provider of ratings in the ESG space and products in the ESG space. So we feel we really need to demonstrate that with our internal operations.

Adam Bass (08:50):

And to do that...

Joe Gagliardi (08:51):

We've been emphasizing what we talk to shareholders, for example, about, what we're increasingly talking to employees about, as well as clients and our suppliers, is our intent to really walk the talk. How do we achieve net zero? How do we accelerate, potentially, our commitments around net zero. A lot of that's going to start with our engagement with the supply chain.

Joe Gagliardi (09:23):

One of the things that we are really focused on at this point, is outlining our expectations to our suppliers. The way we really start to do that is within our supplier code of conduct. We use that code to frame the engagement and the sourcing principles that we want to espouse. Those principles increasingly include ensuring that our suppliers, understand what our commitments are, and that they're aligned with our commitments, that they know what our priorities are, our practices are, and our ambitions. So we're setting targets. We expect our suppliers to similarly set targets.

Joe Gagliardi (10:15):

We remain focused to deliver, ultimately, the best products and services to MSCI at a combination of the best overall cost, the best performance, the best commercial terms. But increasingly part of that focus is making sure that these ambitions around the climate change, around diversity, that they're front and center of the conversations and the engagement that we have with suppliers.

Joe Gagliardi (10:47):

So really, they have to do the same things we're doing to source electricity in a renewable way, to reduce their own scope two emissions. We would look to them to travel more efficiently. We would look to them to implement methods to support their employees, in terms of how they commute and their modes of transportation.

Joe Gagliardi (11:14):

It doesn't come down to just, "What is the price I pay for this good or service?" There's a lot of other things wrapped into that. And obviously now, one of those things that wraps into that is, what are their carbon emissions going to look like? Are they reducing them? If not, am I going to have to reduce them by buying offsets? So increasingly the total cost of ownership is not just what's it cost to buy it, what's it cost to maintain it, what's it cost to mitigate any risks around it, but also what does it cost to manage the emissions that are coming from that source.

Adam Bass (11:51):

It's a big challenge. So how are Joe and his team taking it on?

Joe Gagliardi (11:57):

So our approach across our entire corporate responsibility program is really threefold. First and foremost, we want to make sure we measure and report, right? So we have whole transparency. So we're looking at the list of our suppliers, we know who they are. We either know directly or indirectly what we feel their contribution to our scope three emissions is. Do they have a net-zero commitment? If they have targets, what type of targets are they? Are they interim targets? Are they long-term targets? Do they report to CDP? What do they report? Do we feel like they've got a good management program in place to really identify, understand, report and manage their footprint? We're looking at TCFD reports, we're looking at SASBi.

Adam Bass (12:58):

Regular listeners may recognize TCFD. That's the Task Force on Climate-Related Financial Disclosures. SASBi is the Sustainability Accounting Standards Board. But back to Joe.

Joe Gagliardi (13:12):

Do they have size-based targets? Increasingly I think you're going to hear a lot more reliance on science-based targets and what companies are committing to in that regard. So once we've established the criteria and we understand what the commitments are of our suppliers, we then move on to figure out how do we mitigate, reduce the absolute level of greenhouse gas emissions that they're accountable for.

Joe Gagliardi (13:51):

We do that in several ways, right? As part of our boarding process, we are also looking at not only the onboarding process, but as also part of our periodic supplier review. We're looking at and asking questions about how they're progressing. Once we've measured and understood, once we've mitigated as much as we can, it would be at that point, and only at that point, that we would look to try to offset our overall emissions or offset the proportion of emissions that can't be avoided or reduced. Ultimately, we're all in this together.

Adam Bass (14:38):

Meggin agreed.

Meggin Thwing-Eastman (14:41):

Trying to bring companies in line and influence their behavior, influence their efforts to reduce their own emissions, is going to be good for whatever your commitments are. But it's also going to be good for the big picture that we all need.

Adam Bass (14:55):

So today we've looked at two companies, one of which happens to employ yours truly. And we've made some claims that there's a knock-on effect of companies pressuring other companies to report and reduce their emissions, but is there really? Does the research bear this out? Well, just so happens that Meggin and her team looked at the big cloud computing providers, that's Microsoft, Amazon, Alphabet, and Alibaba. That's a lot of As. Anyway. They looked at these companies as well as their suppliers.

Meggin Thwing-Eastman (15:32):

So these companies buy lots of servers and tech storage equipment, and they operate these data centers and are working with building products and supplies, chips, semiconductors, and so on. So they've got to exercise their influence out in those directions, in order to bring down their own emissions, in order to have that knock-on effect downstream. What we did basically, is say we don't have the information about which specific suppliers each company uses, but we know what are the main industries. And we know who are the biggest players in each of those industries. So we're looking at companies like Intel and Taiwan Semiconductor and Broadcom and Samsung and Dell and Lenovo and HP, and then building products, Johnson Controls, and a few companies like that. And what we saw is that, interestingly, the buildings products companies have not brought their operations in line with the lower temperature as quickly as some of the tech hardware and semiconductor-focus companies have.

Meggin Thwing-Eastman (16:36):

Now, there aren't very many on this list anywhere that are below two degrees, much less one and a half, but there's a handful. And the way that they get there is by operating very efficient operations. And by setting these targets where they are looking to bring their supply chain operations or their supply chain in line with a net-zero scenario, as well as their own operations. So it really does make quite a circle because you've got, say, one of these big four buying servers from HP or Lenovo, but then HP and Lenovo are also buying semiconductors from Intel and TSMC and so on. And they're buying raw materials. So it really is like one step at a time. Each one is influencing the next.

Adam Bass (17:26):

Accounting for scope three emissions, it's one of those subjects that's better to think about while sitting down, because it really drives home just how interconnected we all are as investors, as well as global citizens. Will the market at large get us where we need to be? Will the influence of corporates and investors be enough to bring us to a 1.5 degree world? Or will governments and regulators need to get involved? Time will tell.

Adam Bass (17:55):

That's all for this week. A big thank you from co-producer Joe Collevecchio and me, to Meggin, David, and Joe Gagliardi, and to all of you for listening. For more insights on this topic and for other ESG trends to watch for 2022, visit www.msci.com.

Adam Bass (18:17):

Next up on Perspectives. Last fall, the US Department of Labor proposed new regulations, and these regulations would allow retirement plan providers to consider ESG issues when selecting investments for their planned participants. What's the impact of this? We'll find out. Until then, I'm your host, Adam Bass, and this is MSCI Perspectives. Stay safe, everyone.

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