MSCI

TRANSCRIPT

Green Marine and German Diversity

Featuring:

Bentley Kaplan, ESG Research, MSCI

Florian Sommer, ESG Research, MSCI

Andrew Young, ESG Research, MSCI

Mike Disabato:

What's up, everyone? And welcome to the weekly edition of ESG Now, where we cover how the environment, our society, and corporate governance effects and are affected by our economy. I'm your host Mike Disabato. And we have two stores for you this week. The first is about a new push to decarbonize the marine shipping sector. And then we discuss a new gender diversity quota in Germany that might not work as well as regulators may have hoped. Thanks as always for joining us, stay tuned.

Mike Disabato:

There's a pretty good chance that the product you're using or staring at if it wasn't made domestically was at one point on a voyage across the ocean on a container vessel. That's because 90% of all international trade involves marine transport at some time or another. It's the reason the blocking of the Suez Canal by a wayward container ship was such a big deal. So the boat, its crew, and its emissions are all part of the global footprint of say those headphones you are listening to me with.

Mike Disabato:

There's also about a 50/50 chance that the product you were using was purchased on Amazon, unless of course you were in China. I don't have to tell you this, but I will, Amazon is the largest consumer internet and online services company worldwide. It accounts for about 41 cents of every dollar spent in the U.S. And its emissions are linked to the transportation industry. And it's not just me saying this, the company says as much in its annual report, quote, "Transportation is a major component of Amazon's business operations and the toughest part of our plan to meet net zero carbon by 2040."

Mike Disabato:

Today, I want to tell you about what is going on in the marine transport industry with regards to carbon emissions. And I'm going to tie it right back to that quote by Amazon. But first, I kind of need to tell you about Amazon and other giants in the global commerce industry. Well, not me exactly, Andrew Young is going to tell you about these companies because he helps cover the consumer sector for us. And I called him so he could first kind of tell us about Amazon's net zero target and then we can tie it back to the marine transport industry. Because as he told me, Amazon's net zero target is quite ambitious.

Andrew Young:

What I mean by ambitious, it includes scope three, which is really nice to see because we have seen several large companies that have sort of excluded their supply chain or their product and use emissions from their goals. So it's an ambitious target and included in this target is eliminating emissions from their transportation network. So what Amazon has done for example is they have ordered 100,000 electric delivery vehicles to be in service by 2013. And that's accompanied by a whole lot of other things like retrofitting their fulfillment centers with charging stations, technology solutions like pooling freight, better packaging. They've also got plans for better aviation fuels. All of these things are together are looking to chip away at that footprint.

Mike Disabato:

Amazon is not really alone in its ambitious targets, much of the corporate world is trying in some way to cut its emissions. I know this because we actively collect data on the emissions and targets of thousands of companies. And many of Amazon's peers such as Walmart, eBay, part of Alibaba, Target and others have a carbon reduction plan of varying ambition. Though, as Andrew said, what makes Amazon's plans so ambitious is it's trying to cut its scope three emissions as well as its scope one and two, which by the way I should say Walmart is also trying to do this. And Target is sort of trying to do this, but I'm just going to stick with Amazon right now because it really is a company without comparison. What's a scope three ambition means, especially for a company that has so much influence on global commerce as Amazon is the industry is going to have to move, especially the transportation industry where this whale moves.

Andrew Young:

Amazon because of its size, firstly, and then because of this position that they play in the center of this global transportation delivery network, when a company like this has such an ambitious climate target, what it could translate to is other companies striving to meet these kinds of standards. And the analogy I'd like to make is with the EU Green Deal, and part of that EU Green Deal is a carbon border adjustment mechanism, which means that products that are produced outside of the EU would have to meet to the EU's emissions standards or would have to purchase carbon offset credits. So in that way, encouraging markets outside of the European Union to level up to the European standard. And that's kind of how I'd see these Amazon targets. So if you want to deal with Amazon, whether you're upstream or downstream delivery to Amazon in order to win contracts with Amazon, you probably need to meet some environmental standards.

Mike Disabato:

And there are companies that are seeing the shift in environmental standards and trying to take advantage of this green demand, take Maersk. Maersk is the world's largest container shipping line, and it just made it $1.4 billion investment in a greener fleet. It ordered eight new vessels each costing $175 million each that can be propelled by cleanly made methanol instead of oil-based fuel. And they are set put delivery by 2024. How big of a deal is this? Well, according to my co-host and colleague, Bentley Kaplan, who also covers the transportation industry, it's at least a start.

Bentley Kaplan:

So Maersk has more than 700 ships, so each ships puts it around 3% of the total transport fleet. And 3% doesn't sound all that massive, but it's a start. And if you're looking to mitigate climate change, then how quickly this start evolves into something bigger becomes pretty important. And currently shipping contributes about 3% of total man-made carbon emissions, but as demand for shipping takes up, as we say, buy more products online, but also just because of the increasingly global nature of supply chains then that sort of ramps up the industry's contribution to carbon emissions over time. And because of that, there's this increasing scrutiny on the shipping industry.

Bentley Kaplan:

So by 2050, the UN wants shipping's total greenhouse gas emissions to at least half relative to a baseline of 2008. And the International Maritime Organization, or the IMO is a UN agency that started pushing the industry towards this. The IMO has actually been much quicker to clamp down on sulfur emissions coming from ships using so-called emissions control areas, which is places like the North Sea or the Baltic Sea and some of the sort of coastlines around North America.

Bentley Kaplan:

But carbon is a different proposition. And a lot of the potential commitments and changes were probably kicked a little further down the road because of COVID. So the initial impact on trade directly affected the industry's revenues and the rates they could charge for freight, especially since over capacities created before the 2008, 2009 crisis still impact the industry's profitability today. So it's effecting these changes takes a really long time. You can see that lag from overcapacity. And this didn't really help push shipping to decarbonize especially as it was already lagging behind some of the other transportation sectors when it comes to cutting carbon emissions.

Mike Disabato:

Let's make a more realistic comparison for everyone, those ships Maersk bought they were basically the equivalent of a hybrid car. And hybrid cars have obviously been around for a while, actually since the early arts. The technology has gotten so out of date actually that the car industry has quickly moved away from hybrid to favor full electric vehicles as its carbon reduction flagship product. Now that isn't to hit mayor squall, it's making strides. The new vessels, which are built by Hyundai heavy industries will replace older ships in the company's fleet, saving about one million tons of carbon dioxide a year according to the company.

Mike Disabato:

However, these fleets also come with increased costs. The company told reporters that cost increase will translate to about a 15% rate increase by the company, which people are kind of using that as kind of a knock on the company's decisions. But most of these carbon reduction technologies do cost a bit more in the beginning, but they are important to actually deal with looming regulations, let's say, or this climate emergency we're all in.

Mike Disabato:

And it's actually kind of what the industry always says, the maritime transportation industry about any kind of carbon reduction measure put into place. They said the same thing about the low sulfur fuel mandate that was put into place by the International Maritime Organization. For example, Maersk said it's additional cost due to this new compliant fuel would increase by $1.1 billion. But the thing is, what we talked about earlier is that there are now companies that are sort of demanding that companies like Maersk take these initiatives. And here's where a company like Amazon comes into place.

Bentley Kaplan:

What Maersk is betting on and what others in the shipping industry like Euronav or Cargill are also betting on is that a company like Amazon can pay a premium on shipping that comes with a lower carbon impact, right? And that premium could be worth it for a number of different reasons, whether it's for Amazon's own targets or for avoiding carbon taxes or maybe even just because it matters to Amazon shoppers that they have a low carbon shipping option. Now Maersk has said that more than half of its 200 largest customers have set or are in the process of setting ambitious science-based targets or zero carbon targets for their supply chains.

Bentley Kaplan:

And we're looking at big names here. We mentioned Amazon, of course, but there's also Disney and H&M and HP, Puma, Microsoft, Procter & Gamble, Schneider Electric and Unilever. So companies that have committed to actively use and scale zero carbon solutions for the ocean transport. And that could trigger a kind of raising of the bar where competitors start looking at similar moves as well, so there could be a sort of cascading effect.

Mike Disabato:

What this all translates into is that Maersk believes it can charge these companies more for the chance to say to customers and regulators, "Look, we care about climate change. We are using a low carbon shipping method." But this also doesn't seem to be just a money grab from Maersk, the company is what we would call an ESG darling. We rated at AA, which is better than 70% of the marine shipping industry. It has its own carbon neutrality target for 2050 and reports heavily on its scope three emissions, something not a lot of marine shipping companies do. And it's even strengthened its ship recycling policy to be in line with what's called the Hong Kong Convention, you can go look that up if you want.

Bentley Kaplan:

Now Maersk is making a clear statement here around the importance of decarbonizing, but the company is part of a wider infrastructure and it can't just do this unilaterally. So we know that green methanol or so-called green fuels are technically feasible, but until they're scaled, the prices remain prohibitive. And then that sort of scenario Maersk bet on low carbon solutions becomes much more costly. The company has already said that finding enough carbon neutral methanol for these new shiny vessels from their first day of service is going to be challenging.

Bentley Kaplan:

But if Maersk and its competitors, can't entice fuel producers to come to the table to produce greener fuels than they are really going to battle to turn their emission trajectories around. So yes, it is a bold move and not one without risk. But if a company can sort of time it right then they effectively end up at the leading edge of a new trend.

Mike Disabato:

The sentiment runs true for companies like Amazon. There are a lot of ambitious statements out there for reducing carbon emissions, but ultimately it will come down to whether companies use their vast wealth to push for the market to develop. It's the reason why investors are so adamant that companies begin to report and prepare for a low carbon future now. Because aside from the climate destruction we are already seeing, getting the products that are needed to reduce our economies absolute emissions take time and require inter system coordination.

Mike Disabato:

Electric vehicle emission reductions, for example, those will be moot if there's not an accompanied electric grid that runs off renewable energy. So it's all about the long game. And hopefully companies understand the risk that may come to ahead and continue to push that long game forward. Because let me tell you all something, we have these models called climate value at-risk models, and they predict the loss of value in various climate warming scenarios. And the outlook for companies like Maersk are rather grim if things don't begin to change quickly.

Mike Disabato:

When it comes to sovereign governance, Germany, it's an interesting case. It is Europe's largest economy and has a reputation of industrial might. But it has also been mired in a number of significant corporate governance scandals in the past decade. There's the Wirecard accounting scandal recently, for example, and there's also the Volkswagen diesel dupe, just to name a few. You might think to yourself that these scandals were an issue of oversight, but Germany actually has a robust system in place around corporate governance.

Mike Disabato:

In Germany, there's what's called a dual board system where senior executives sit on a management board and are overseen by a non-executive supervisory board. And on those supervisory boards, you have what is called mandatory code determination for large listed German companies. Code determination is a law that dictates that workers and must select up to half the members of those supervisory boards, which by the way, those boards make strategic level decisions including how to invest profits and whom to hire for senior management positions.

Mike Disabato:

And workers also elect representatives to work councils that are shop for organizations that deal with day-to-day issues such as overtime pay, major layoffs, and monitoring and evaluation. This is all great in terms of corporate governance oversight, but it hasn't done much for gender diversity representation at companies. But that is all set to change with an expansive new gender diversity law being proposed by the German government. So to talk about that, I called them my colleague Florian Sommer who just finished researching the law in German corporate governance in general. And here's what he had to say about it.

Florian Sommer:

So the German reforms here are very interesting because they focus just on the management level. So Germany has actually had a mandatory gender diversity quota for the supervisory board since 2015. And you can see that this has really helped push up the level of gender diversity on the supervisory board, but it's a bit of a different story at the senior management level. There's only one female CEO of a German company in the aqui. And so the government essentially agreed a new law and that was passed the summer. Essentially from next year, big German list of companies with big management boards have to have at least one woman on this management board, it's a big step. But as you can already tell, there are a number of conditions attached to this requirements.

Florian Sommer:

Essentially, it's a company with more than 2000 employees, which then means you have to have at least 50% employee representatives on your supervisory board. If you don't have that, you don't fall under quota. At the same time, you have to have a large management board, and that means you have to have at least four members on your management board. If you don't have that, you don't fall under the new quota. And because of that, a lot of companies fall outside the scope of this new requirement. And specifically, most companies with all male management boards are not covered likely as up to date by this new quota. So in that sense, the new rules in effect might miss a lot of these companies that don't yet have any women on the management board.

Mike Disabato:

Okay. So how is this being received in Germany at the moment?

Florian Sommer:

So what's interesting is that if you look at the timeline, the government initially announced plans for this new quota last October. And between October and now a number of companies have actually already appointed their first woman to their management board. So, for example, Bayer, for example, Adidas. So high profile, a German listed companies have reacted to this initial government announcement and they seem to have taken that into account and it seems to have sped up their sort of recouping processes. And so I think this is sort of an interesting point about how government plans and government lawmaking can influence company practices.

Mike Disabato:

And that's it for the week. I wanted to thank Andrew and Bentley and Florian to talking to me about this week's news with the ESG twist. And I want to especially thank S.K Kim. S.K Kim did a lot of the research for us that we used for our first story on marine transport and carbon emissions. We basically took everything she did and set it out loud. So S.K, we really appreciate it. I hope everything is going okay for you right now. If you like what'd you heard, don't forget to rate and review us that always helps. And subscribe wherever you get your podcasts. Thanks as always for listening. Talk to you next week.

About MSCI

MSCI is a leading provider of critical decision support tools and services for the global investment community. With over 50 years of expertise in research, data and technology, we power better investment decisions by enabling clients to understand and analyze key drivers of risk and return and confidently build more effective portfolios. We create industry-leading research-enhanced solutions that clients use to gain insight into and improve transparency across the investment process. To learn more, please visit **www.msci.com**.
