

► **The Value of Public Perception:  
Transforming Environmental Efforts From  
Compliance-Driven to Risk Management**

White Paper

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# The Value of Public Perception: Transforming Environmental Efforts From Compliance-Driven to Risk Management

## *White Paper*

From the EPA's greenhouse gas (GHG) mandatory reporting rule to Title V compliance certification, compliance regulations have become omnipresent in business environments both in the U.S. and abroad. Companies have become increasingly familiar with environmental compliance and regulations at the federal, state and local government levels. While businesses have quickly evolved their sustainability reporting practices to meet reporting requirements, they often fail to account for the role and importance of environmental impact to the value of their

business and cost to operations. In addition, companies rarely consider the impact that an environmental mishap may have on public perception, which in large part can influence valuation.

This white paper highlights the need for the role of environmental management to transform from simply meeting compliance requirements to pervasive risk management. By examining how environmental efforts create risks for businesses – and how executives can calculate those risks to make informed business decisions based on that information – this white paper helps companies better understand how to manage their risks through environmental impact.

## **What's At Risk?**

Sustainability has been a noble and worthy business initiative for years. The recent increase in federal and state environmental regulation and oversight has made reducing environmental impact a priority for even more companies. Managing regulatory requirements, therefore, has become the de facto meaning of environmental management.

As a result, companies are failing to understand that their environmental footprint creates risk to their business that's on par with losing their largest customer. Environmental management needs to evolve past simply managing regulatory requirements to calculate actual risks, such as

the costs to their business when an environmental or safety related incident occurs. Left uncalculated and ignored, these risks place a company in jeopardy of extreme financial loss and devaluation.

### **The Power Industry: A Case Study**

Traditional heavy industrial markets are particularly vulnerable to financial risks relating to environmental impact. When an environmental and safety catastrophe occurs, such as an explosion or environmental disaster, it impacts not only the company directly involved, but the industry as a whole. The U.S. government often responds by stepping up safety inspections and penalties.

While entire industries suffer from the environmental risks taken on by a few, the companies to blame often suffer from devastating financial consequences. Environmental missteps are often – though not always – the result of companies making the calculated risk to bypass required environmental actions and processes.

When companies make these calculated risks, however, they often only think about accident-related costs. There are also a number of additional factors that need to be understood including:

- Damaged public perception in the equation
- Stock price

- Company valuation
- Reduced sales

The environmental landscape is practically microscopic now due to the immediate availability of information – companies have nowhere to hide after these incidents occur. Businesses need to realize that there's more at risk than they think.

### **Impact of GHG Reductions to Earnings**

The impact of carbon reductions to the power industry has been massive. The recent regulations around GHG reporting, however, are parallel to what the power industry endured at the passage of the Clean Air Act. It is important to note that there was a baseline criteria set for future allowance reductions that required either buying unused credits and/or installing pollution control equipment on plants. It is not uncommon to see a capital project of \$100-400 million per plant for such controls. In fact, New Mexico's biggest electricity provider has estimated that the installation of selective catalytic reduction technology at one of its plants – if done over a five-year period – would cost \$750 million to \$1 billion.

Companies need to be aware of the risks related to managing the data they send to the EPA, which will become the future reduction benchmark. Using the simplistic criteria established by the EPA is insufficient. For example, an industry that recently was required to report GHG emissions found that

taking a single sample of methane each quarter for reporting purposes as required by the EPA protocol does not account for the fact that sample outputs can range 20-30% based on barometric pressure at the time of sampling. Since this data will be used for future reduction measures, there is a significant percentage of earnings at risk if the data used for setting the criteria is not managed properly in the first place.

### **The SEC Weighs In**

In addition to the financial risk of damaged public perception resulting from environmental missteps, the SEC has also taken a position on the business risk of climate change. On January 27, 2010, the SEC voted to provide public companies with interpretive guidance on existing SEC disclosure requirements relating to business or legal developments involving the issue of climate change. The guidance encourages corporations to disclose the possible business and legal impact of climate change to shareholders.

In communications with shareholders about business risk, the SEC's interpretive guidance expects companies to address the following areas in which climate change may trigger disclosure requirements:

- **Impact of Legislation and Regulation** – The guidance advises companies to consider whether the impact of certain existing laws and regulations – as well as the potential

impact of pending legislation and regulation – regarding climate change are material.

- **Impact of International Accords** – The SEC recommends companies consider and disclose, when material, the risks or effects on its business of international accords and treaties relating to climate change.

- **Indirect Consequences of Regulation or Business Trends** – New opportunities or risks for companies can be created via legal, technological, political and scientific developments relating to climate change. The example offered by the SEC is one of a company facing decreased or increased demand for goods depending on the greenhouse gas emissions produced compared to competing products. The guidance indicates that, for disclosure purposes, a company should assess the actual or potential indirect consequences it may face due to climate change-related regulatory or business trends.

- **Physical Impacts of Climate Change** – The SEC advises companies to evaluate the actual and potential material impacts of environmental matters on their business for disclosure purposes.

But what does this mean for public companies?

**Impact of Legislation and Regulation:** Public companies with significant carbon emissions or considerable carbon in their supply chain

could be severely affected by existing and potential climate change regulation and legislation, such as the passing of a cap and trade bill, particularly given the costs of emission reduction requirement compliance, and purchasing offsets or allowances.

**Impact of International Accords:** Global climate change agreements could impact the opportunity and risk evaluation of any public company operating internationally. Companies with international operations will need to evaluate and disclose any potential impacts of international climate change developments.

**Indirect Consequences of Regulation or Business Trends:** Corporate reputation and demand are typically thought to be the two issues at stake in this area. For example, demand may decrease for services using carbon-based energy sources, while those using alternative energy sources may increase. In addition, a company could experience adverse consequences for its business operations or financial condition based on public access to data and perception relating to GHG emissions.

**Physical Impacts of Climate Change:** Companies should evaluate and disclose the potential impact that its environment may have on business operations or financial results due to climate change, such as water scarcity, sea level change and weather conditions.

Interestingly, a survey of energy industry professionals attending EUEC 2010 found that 56 percent disagreed that the SEC guidance for disclosure of climate change-related risk and related carbon reporting was necessary, while 44 percent expressed support for the SEC's position.

Regardless of agreement with the guidance and need for additional reporting, companies need to be prepared for the financial implications and risks of carbon going on the balance sheet.

### **10,000% Compliance**

Not all industrial companies take calculated risks to bypass environmental requirements. One of the largest privately held companies in the world, for example, espouses a 10,000% compliance model. While being sustainable and environmentally friendly are priorities for this business, the company also understands that this model poses the fewest risks and costs. As a result, it has created a comparative advantage in the marketplace, giving it the opportunity to purchase other companies and get a significantly better return on those companies than others could accomplish.

As a recent example, their purchase of a company from another corporation found that their 10,000% compliance model offered a cheaper means of operating than the previous owner. Upon due diligence of the acquisition, they found numerous violations had occurred and by immediately self-reporting

compliance errors, saved additional millions of dollars in fines, as well as the amount of money spent on PR in protecting the company's public image.

### **Using EERP to Manage Risk**

Fortunately, environmental enterprise resource planning (EERP) systems are available to help companies both manage compliance and regulatory requirements, as well as understand their financial risks relating to environmental impact. EERP systems offer a compliance engine that allows companies to manage risk. In addition, the compliance engine helps ensure business processes are in alignment so that environmental mishaps and shortcuts don't occur.

### **Conclusion**

Companies required to report their environmental data have become adept at meeting compliance requirements. They often, however, fail to account for the influence of environmental impact on the value of their business. The role of environmental management needs to transform from simply meeting compliance requirements to effective risk management. Understanding how environmental efforts create risks for businesses – and including the cost of public perception in their risk calculations – companies can more effectively manage financial and environmental risks.

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### **About Enviance**

Enviance is the leading provider of Environmental ERP software. With more than a decade of experience providing environmental data management and expertise, Enviance's proven system is used by the world's largest corporations and government agencies.

Enviance maintains deep domain expertise in EHS management and technology, and has more than 17,000 users in more than 49 countries, including American Electric Power, Pfizer, Syngenta, Sempra Energy, U.S. Army, Chevron, Fujifilm, Conoco Phillips and DuPont. Industry leaders have used Enviance to streamline GHG management since 2006.

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