Private Sector Working Group Brief

Barriers to Private Sector Action

The private sector is one of the foremost drivers of American innovation and a crucial part of the country's climate response, but a monumental effort will be needed to coordinate and leverage the private sector toward our green future. To gain a deeper understanding of the challenges facing the private sector, members of the private sector working group of the Commission on Accelerating Climate Action and American Academy of Arts and Sciences' staff conducted small-group listening sessions with twenty-one cross-sector experts representing different sets of stakeholders. The participants provided insightful comments on the challenges facing industry, but they represent the perspectives of only four large companies, three nonprofits that collaborate closely with businesses on sustainability issues, two pension funds, one labor union, and one small

contractor. The full diversity of the business community cannot be captured by such a sample; moreover, all the participants are actively pursuing climate action. Nevertheless, based on the perspectives shared in these sessions, we identified five core barriers to private sector action: 1) profitability, 2) political fragmentation and polarization, 3) limited expertise compounded by a lack of communication, 4) underrecognition of investment opportunities, and 5) ineffective corporate structure. This brief illustrates the barriers by synthesizing commentary and industry-specific examples from the listening session participants. It does not aim to excuse past or present inaction but to provide context that informs the solutions by which these barriers can be overcome.

Profitability in the Face of Uncertainty

Some business leaders have been hesitant to work toward sustainability because of the perceived cost of sustainability measures. A company's sustainability strategy, also referred to as its climate transition plan, will depend on size and sector, and few solutions are one-size-fits-all, but common approaches include changes to a company's supply chain or production processes. These changes can be time-intensive to execute and, crucially, have uncertain benefits because few models for success in this space are well-known, complicating a cost-benefit analysis. Our participants reported that this uncertainty includes companies' worries that they will be unable to access the greener market segment, which can lead them to resist change because they fear being at a disadvantage relative to competitors. Even when companies do publish climate action plans, they often set very long-term goals (for example, for 2050), which allows them to wait for other organizations to identify solutions to their shared challenges.

Environmental justice initiatives are another crucial part of ensuring that a company's climate plan does not have unintended consequences for its employees and surrounding communities. Such initiatives can likewise be perceived as costly because relationship-building is a long-term prospect with uncertain benefit and may involve hiring expert personnel. Our participants reported that it can be difficult to acknowledge historical negative community impacts without admitting fault and thereby taking on legal and public relations risks. The need to maintain profit can also be a barrier to collaboration with some environmental justice advocates, who might be valuable partners but may be hesitant to trust companies because they worry that profit-seeking is incompatible with just outcomes. Turning a blind eye to environmental justice implications, as has been business-as-usual for some companies, carries its own risks. Companies that alter their operations only after being the targets of litigation and paying large fines for environmental violations risk losing reputation in

the process. A proactive approach can be time- and cost-saving in the long term.

Climate action may have start-up costs, but it is also an investment with potential short- and long-term returns. Renewable energy use and energy efficiency measures are now commonplace business strategies because they have proven cost savings. Preparedness can mitigate the risk of costly physical damage to private-sector infrastructure, and recognition of the opportunity costs of inaction may also lead to climate action. Companies that take climate action, and especially large corporations with more freedom to take risks at the project level, may profit from business opportunities that are missed by their peers, such as gaining government and other large landowners as clients on resiliency projects, forecasting changes in land value or tourism patterns with climate data, and patenting technological alternatives like sustainable fuel. Even small businesses can benefit from implementing more sustainable approaches, like a family-owned farm increasing yields by learning to use no-till agricultural techniques. Climate change will radically alter all markets, and companies that are too hesitant to experiment with new approaches risk being replaced by more forward-thinking competitors.

Political Fragmentation

The policy landscape is fragmented and polarized, and some current policies are counterproductive to both decarbonization and effective capital management. In some states, recent legislation makes closing coal plants difficult, even when they are more expensive to keep running than alternative energy sources. Similarly, as of 2022, twenty states had passed legislation to preclude municipal bans on natural gas within their borders, advantaging energy sector incumbents and hampering the switch to renewable alternatives. Disagreement remains among climate advocates about the role natural gas will play in the near future, but evidence suggests that these preemption laws slow the deployment of building electrification technologies (for example, electric stoves and heat pumps) that, in addition to reducing emissions, have also been found to be cheaper and safer.[1] More than any one policy, though, politics can hamper governments' ability to send reliable signals about the direction of change. Partisanship,

1. Lori Riverstone-Newell, "The Rise of State Preemption Laws in Response to Local Policy Innovation," *Publius: The Journal of Federalism* 47 (3) (2017): 403–425, https://doi.org/10.1093/publius/pjx037; and Sherri Billimoria, Leia Guccione, Mike Henchen, and Leah Louis-Prescott, *The Economics of Electrifying Buildings: How Electric Space and Water Heating Supports Decarbonization of Residential Buildings* (Basalt, CO: Rocky Mountain Institute, 2018), http://www.rmi.org/insights/reports/economics-electrifying-buildings/.

our participants shared, can impede government affairs departments when companies fear they will lose clients or receive backlash if they support progressive climate policies. Moreover, rapid and unpredictable changes to the regulatory environment, like leaving and reentering the Paris Agreement, can complicate corporate strategic planning. Historically, many laws and court decisions leave significant ambiguity about the circumstances under which emissions can be regulated, so company leaders still lack clarity about what near-term changes to anticipate.

The Inflation Reduction Act (IRA), signed into law in August 2022, addresses many of the policy barriers highlighted by our listening session participants. For example, our participants expressed concern with the greater number of tax credits available for electric vehicles (EVs), a depreciating asset, than for electrifying housing, an appreciating asset, rendering sustainability a poor investment for some consumers. The IRA meets this concern through the inclusion of building electrification rebates. Many other policy avenues are available beyond the federal level. Carbon pricing, despite its mixed popularity among some climate advocates, was the single most-cited policy sought by our participants, and, as of January 2023, thirteen states have put in place market-based cap-and-trade carbon pricing schemes. Likewise, thirty-eight states have implemented energy portfolio standards that promote the use of renewable sources. Public utilities commissions represent another venue for state-level policy experimentation, such as by replacing common, cost-of-service regulation with performance-based regulation, which, to incentivize new reliability and efficiency goals, would change how energy is priced. Some of our participants reported that they are able to pursue a climate justice–oriented business strategy only because the states in which they operate have the necessary regulations, resources, and political impetus. Expanding that set of states has the power to enable climate-related business opportunities.

Limited Expertise and Inconsistent Signals

Maintaining open flows of communication between companies and their stakeholders was cited as essential for ensuring that companies have the information to handle climate risks quickly and cost-effectively. Company decision-makers often lack regular communication with experts on decarbonization. Our listening session participants reported that cultivating in-house climate expertise was beneficial for organizing their decarbonization strategy and that expertise in workforce and community engagement is a prerequisite for successful environmental justice programs. Companies for which climate action is not yet salient may systematically undervalue the utility of this expertise, and subsequently they may not seek out resources or partners from the not-for-profit sector who could otherwise help foster a greater

understanding of climate action. The presence of climate experts in industry associations and lending institutions could serve as a valuable on-ramp for these companies. Poorly standardized definitions are another source of confusion. Many of our listening session participants mentioned that corporations and academics disagree about what "net-zero" means in the context of emissions reporting and how or whether carbon offsets should form part of the solution. This is also true of equity-related terms such as *just transition*, which our participants reported were neither mainstream nor standardized.

Communication is also essential for ensuring that investors receive reliable information to make informed decisions about climate risk to their portfolios, and investors are increasingly advocating for their assets to decarbonize with transparency. Climate Action 100+ is one such investor-led initiative, hailed as a success by several of our participants. It has three core pillars on which it founds its engagement with companies: 1) a clear governance framework to ensure oversight of climate risk, 2) action to reduce carbon emissions, and 3) enhanced corporate financial disclosures. The last of these has also been taken up by the Securities and Exchange Commission, which proposed new mandatory disclosure rules in 2022.[2] Our participants from the finance sector regarded these proposed rules positively and hoped that new disclosure rules, especially those that include Scope 3 emissions,[3] will help investors align their portfolios with their values and help nongovernmental organizations hold laggards accountable. When companies are not responsive to emissions-related inquiries and transparent about their climate action plans, investors increasingly turn to climate-related shareholder proposals. Likewise, they are increasingly willing to elect company board members with more knowledge on climate risk, as seen at ExxonMobil in 2021.[4]

2. "The Enhancement and Standardization of Climate-Related Disclosures for Investors," 87 Fed. Reg. 21334 (April 11, 2022), https://www.federalregister.gov/d/2022-06342; and "Enhanced Disclosures by Certain Investment Advisers and Investment Companies About Environmental, Social, and Governance Investment Practices," 87 Fed. Reg. 36654 (June 17, 2022), https://www.federalregister.gov/d/2022-11718.

3. Scope 3 emissions, the lifecycle emissions generated as consumers use a product, are often excluded from companies' emissions reporting and target setting. This is in contrast to the direct emissions companies generate as part of production (Scope 1) and the indirect emissions generated during production via electricity usage, heating, and cooling (Scope 2).

4. Clifford Krauss, "Exxon Board to Get a Third Activist Pushing Cleaner Energy," *The New York Times*, June 2, 2021, https://www.nytimes.com/2021/06/02/business/exxon-board-clean-energy.html. Note: One of the new Board members, Alexander Karsner, is a member of the Academy's Commission on Accelerating Climate Action and a member of the Private Sector Working Group.

Breadth and Depth of Investment Opportunities

The technology needed for low-carbon models to be cost competitive does not yet exist for many industries because structural factors can make it difficult for projects in technology development, renewable energy, and resilient infrastructure to receive the investment they need to grow. These include lack of expertise on how to begin a climate-related strategic transition, which inhibits companies' ability to make savvy investments in climate-related technologies. Existing data are insufficient for these investments to feel safe; even companies that later prove highly successful can appear precarious early on. Some especially large investors may be less interested in sustainability projects, which tend to be small, because they may have the bandwidth to research and support only a small number of larger projects. The belief that these technologies constitute a "green bubble" on the cusp of bursting compounds fears. Even profitable and sustainable projects, such as replacing coal-powered facilities with new methods of production, can have undesirable spillover effects, such as community and workforce disruptions, that complicate transition planning.

Many experts assess the value of climate-related investments in the trillions of dollars, and there are strong incentives to overcome the challenges associated with identifying sound investment strategies.[5] Some companies have successfully identified latent demand for green technologies that consumers cannot yet access due to infrastructure shortages, and they have created their own programs to tackle these infrastructure gaps. For example, electric utilities are incentivized to invest in increasing access to vehicle charging stations because such infrastructure expands electricity use, and pilot programs have successfully used infrastructure dollars to fund EV deployment in cities across the country.[6]

5. Simon Dietz, Alex Bowen, Charlie Dixon, and Philip Gradwell, "'Climate Value at Risk' of Global Financial Assets," *Nature Climate Change* 6 (2016): 676–679, https://doi.org/10.1038/nclimate2972; and Global Commission on Adaptation, *Adapt Now: A Global Call for Leadership on Climate Resilience* (Rotterdam: Global Commission on Adaptation; Washington, D.C.: World Resources Institute, 2019), https://gca.org/wp-content/uploads/2019/09/GlobalCommission_Report_FINAL.pdf.

6. Sam Brasch, "Xcel Energy Will Now Help Pay for an Electric Car—Depending on Your Income," *Colorado Public Radio*, September 9, 2021, https://www.cpr.org/2021/09/09/xcel-energy-electric-vehicle-rebate/; and Hugh Le, "What Role Will Utilities Play in the EV Charging Infrastructure Build-Out?" PwC.com, May 5, 2021, https://www.pwc.com/us/en/industries/energy-utilities-resources/library/ev-charging-infrastructure.html.

Managing Corporate Structure

Long-term sustainability is easily overlooked among the myriad other competing priorities that company leadership must balance. Thus, climate considerations can be more effective when company leaders choose to integrate them into the corporate structure, and climate response can arise naturally as it relates to issues like managing the supply chain, product design, or facility life span. Our participants reported that one of the common signs of an insincere or poorly managed climate transition is when a corporation's sustainability unit is working at cross-purposes with its government affairs department. This happens when those crafting environmental targets are siloed and do not have sway in the company's true decision-making processes; they can end up recommending against the same changes that other units are espousing. Structural issues also occur between subsidiaries and their parent companies. For example, even if the leadership and shareholders of a large utility company agree to increase the share of renewable energy in its portfolio, this change could represent an existential threat for the operators of the utility's fossil fuel plants, giving plant employees perverse incentives to slow or otherwise resist their company's restructuring.

When the priorities sought by sustainability-focused business units are buried in favor of the priorities of other business units, it comes from an undervaluation by company decision-makers of the importance of climate expertise in weighing investment opportunities, risk management, and beneficial partnerships. Senior leadership must take responsibility for holistically integrating a climate action plan into the corporate structure. Leadership must likewise recognize the importance of expertise in social areas linked to their sustainability strategy. A company's decarbonization plan can be accelerated by working with employees and community groups to meet their needs, thereby generating buy-in for ambitious changes. In engaged companies, the government affairs department, rather than working at cross-purposes, is often the source of conversations around environmental justice. These climate and social issue experts need to maintain open communication with one another, with other business units that work with policy and strategy, and with senior leadership.

We are grateful to Academy staff Carson Bullock, Kate Carter, Sophia Charan, Leo Curran, Tania Munz, Islam Qasem, Kelsey Schuch, and Jen Smith for their work on this publication. We are also indebted to listening session participants Chris Fox (Ceres), Thomas Koch Blank (RMI), TJ Conway (RMI), James Mitchell (RMI), Paolo Natali (RMI), Mark Dyson (RMI), Martha Campbell (RMI), EJ Klock-McCook (RMI), Lynn Paquin (CalPERS and CalSTERS), Elizabeth Gordon (NYSCRF), Heather Tansey (Cargill), Brian Mormino (Cummins), Karen Cecil (Cummins), Sarah Kapnick (JPMorgan Chase), Eliot Metzger (WRI), Amy Meyer (WRI), Anna Fendley (United Steelworkers), and Marna McDermott (Exelon Corporation) for their contributions and insight.

AMERICAN ACADEMY
OF ARTS & SCIENCES

ISBN: 0-87724-154-6.

This publication is available online at
www.amacad.org/project/accelerating-climate-action.

Suggested citation:
Commission on Accelerating Climate Action, Private Sector Working Group, *Barriers to Private Sector Action* (Cambridge, Mass.: American Academy of Arts and Sciences, 2023).

Cover image:
Construction workers sand the surface of a propeller at a tower base on the Lone Star Wind Farm. Photo by Robert Nickelsberg/Getty Images.

Please direct inquiries to:
American Academy of Arts and Sciences
136 Irving Street, Cambridge, MA 02138
Telephone: 617-576-5000
Fax: 617-576-5050
Email: aaas@amacad.org
Web: www.amacad.org