2020 Pressures Report

Summer 2020 - Australia

Global Compact
Network Australia

INTRODUCTION

The black summer of 2019-2020 has seen the Australian landscape suffer unprecedented destruction. Climate change will continue to dramatically alter our environment, threatening political stability, degrading entire ecosystems, displacing whole communities and undermining business operations. To respond, businesses will need to undergo drastic transformations, embrace emerging economic opportunities and deeply embed principles of sustainability. Businesses no longer have the luxury of time. They must step away from a business as usual approach and reposition themselves as more responsible and sustainably savvy.

In 2020, activism will continue to grow globally; lack of trust in both public and private institutions shows no signs of waning; investor pressures on businesses to perform better in environmental, social and governance (ESG) matters will become more pointed; the gap between those that understand business ethics versus those that do not will grow; and the need for business leaders to set bolder human rights and environmental targets will become more pronounced.

This report outlines the key pressures facing businesses in 2020, and what companies can do to take advantage of the opportunities presented by the challenges in our landscape to ensure their long-term viability.

The opportunity for business to respond and lead the change is clear. How they choose to tackle these major pressures however will be both critical and defining.

SPEAK UP

The time for quiet is over. A nation-wide poll from the Committee for Economic Development of Australia (CEDA) revealed that at least four in five respondents believed that corporate leaders should offer their opinion on issues broader than their operations.[1] Issues like climate change and mental health.

Whilst this pressure has been present for a number of years, it comes alongside falling faith in public institutions and an increasing reliance on business to take charge where governments fall short.[2] It is also occurring adjacent to the climate crisis, changing social norms, rising populism, growing inequalities and in the era of activism through social and environmental movements: the school strikes lead by Greta Thunberg, Extinction Rebellion, and social media campaigns such as the #MeToo movement.

Consumers, investors, employees and shareholders want to trust the businesses they work for and the products they purchase. They all expect leaders to have views on these issues, communicate their opinions and encourage respectful dialogue amongst stakeholders.[3]

This trust is eroded if the business remains silent.

Business leaders who remain quiet will find themselves being outcompeted by purpose-driven leaders and companies. Their silence will likely lead to reputation damage, loss of customers, and long-term decline in revenue. Alternatively, authentic public action will raise a leader's visibility, reinforce social licence to operate and demonstrate action beyond business as usual.

To do this, leaders will also need to ensure that they listen to their employees and key stakeholders. Their voices are crucial to understanding core values and what issues are of most concern to them. A good leader will assess those views and engage publicly on issues that are most relevant to the future of the company.

Business leaders can learn from CEOs who have already spoken up. BHP's former CEO, Andrew McKenzie, publicly described climate change as "an escalation towards a crisis";[4] Starbucks CEO, Andrew Johnson, closed all of its stores to conduct racial bias training to tackle "systemic racism";[5] and Google declined to renew its contract with a Pentagon drone programme following employee backlash.[6]

The expectation for CEO activism is not fading. Leaders who speak up, who authentically match words with action and drive societal change will reap the benefits.

RESPOND TO THE INTERSECTION BETWEEN CLIMATE CHANGE AND HUMAN RIGHTS

Without significant reductions in carbon emissions, global temperatures will continue to rise. Water sources will be depleted; catastrophic bushfires will decimate communities and wildlife; and land will be rendered useless.

Philip Alston, the UN Special Rapporteur on extreme poverty and human rights, declared, "climate change threatens the future of human rights".[7] Michelle Bachelet, the UN High Commissioner for Human Rights, described climate change as the "greatest ever threat to human rights".[8] And the Paris Agreement[9] references the coalescence of climate change and human rights.

These bold statements demonstrate that climate change and human rights cannot be viewed in silos. That the interlinkages can no longer remain a marginal concern. Urgent action is needed.

Australia is a 'hotspot'[10] for climate litigation and global developments can set a precedent. In an inquiry undertaken by the Commission on Human Rights of the Philippines found that the world's largest fossil fuel companies including Shell, and ExxonMobil, are "morally" liable for their role in "human-induced climate change" that "interferes with the enjoyment of Filipinos' fundamental rights".[11] This landmark finding may create an avenue for fossil fuel companies to be held legally liable for their impacts on climate particularly if evidence raised during the Commission's inquiry is used as a foundation for legal proceedings elsewhere.

In 2020, the UN Human Rights Committee issued its first ruling on a request for asylum from the effects of climate change, finding that countries cannot deport individuals facing "climate-change induced conditions that violate the right to life".[12]

Pressure from investors is also rising. Since 2015 there have been over 40 shareholder resolutions against Australian companies[13] covering matters relating to climate change as well as human rights due diligence, with some focusing on the inter-connections between the two areas. Whilst none of these resolutions passed, they highlight the need for business to understand and disclose their climate related risks through initiatives like the Task Force on Climate-related Financial Disclosures (TCFD). BlackRock, the world's largest asset manager, recently joined Climate Action 100+ (CA100+)[14] adding a heavy weight to the initiative to ensure that the world's largest corporate greenhouse gas emitters develop ambitious climate plans.

Action speaks louder than words. Businesses that want to *respect human rights and drive climate action* will not wait for regulation. They will take the lead and address these interlinkages. Businesses who resist disclosure and/or do not have clear emission reduction plans will "be punished".[15]

HUMAN RIGHTS IN THE AGE OF AI

Artificial intelligence (AI) will provide significant productivity benefits to the global economy. McKinsey estimates that technological advances in disruption activities account for US$3.5 to US$5.8 trillion in annual value across a range of sectors.[16,17] However, underlying AI advances are concerns about transparency of systems and the impact of bias in their algorithms.

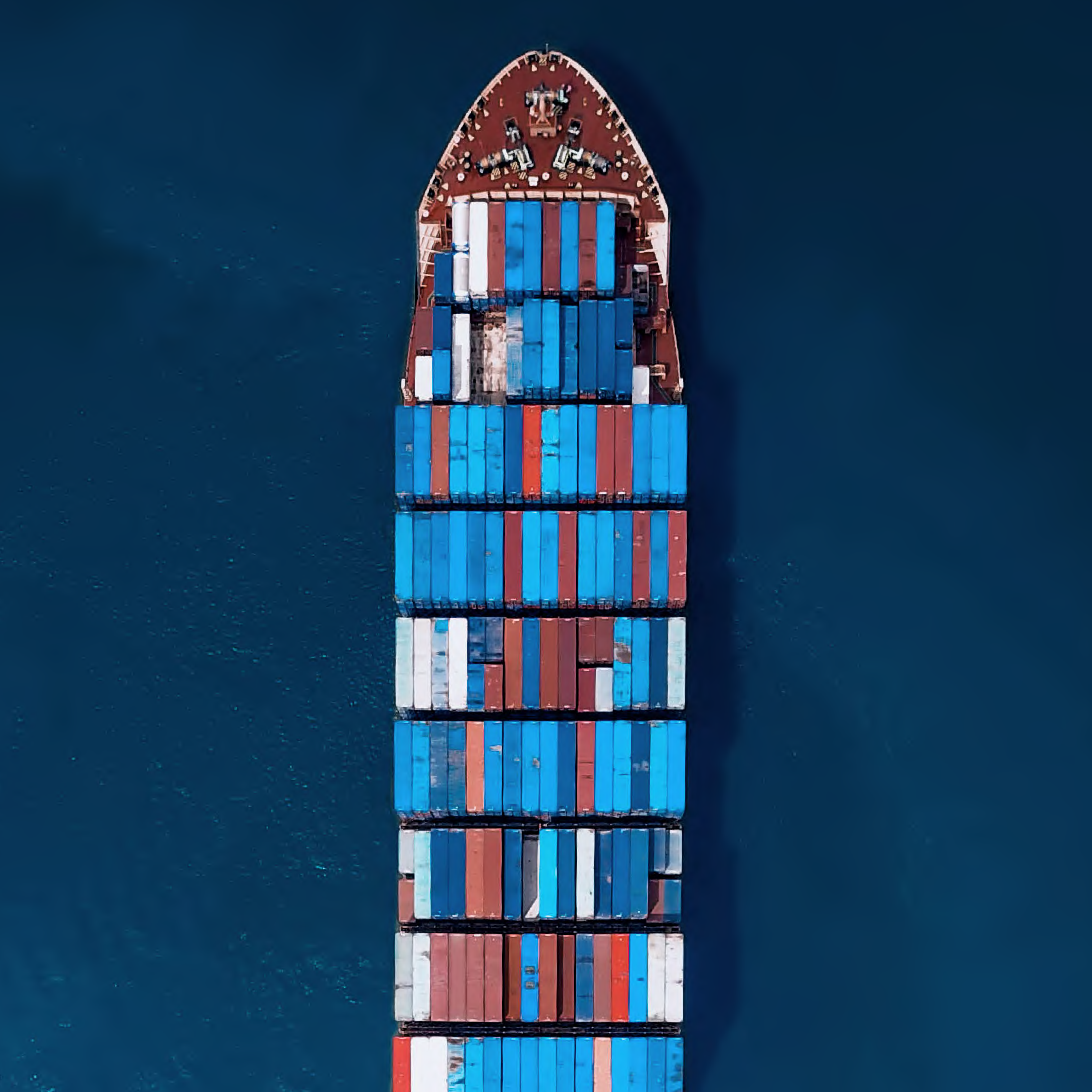
Rapid developments also bring risks. Whilst AI can bring about quicker decision making for business activities, such as home loan approvals, many of these algorithms can lead to unwarranted bias and negative self-reinforcing loops. This is of concern if the data the algorithm contains has inherent biases – gender, race, socio-economic status – which the machine will learn and amplify ultimately perpetuating negative stereotypes.

Without due consideration of these biases, businesses risk widening the trust deficit. Business needs to take an inclusive approach in the development and ongoing monitoring of their datasets. This includes undertaking a stakeholder mapping process that considers a diverse group of people who might be impacted by the technology, as well as including minority groups and outliers. Businesses can also use the UN Guiding Principles on Business and Human Rights[18] as a framework to undertake a human rights risk assessment in the development of any disruptive technologies.

Having a response to ethical issues arising from the misuse of AI will be vital. A Capgemini report revealed that 62 percent of respondents would place higher trust in a company whose AI interactions were perceived as ethical, and 34 percent said that they would stop interacting with the company if an ethical issue arose.[19] Companies that recognise these risks, implement a transparent system and have a clear remediation path will be better positioned to navigate any potential negative impacts.

Business will not have to do this alone. They can engage with a variety of actors to advance an agenda for the ethical use of AI. For example, they can use the Australian Government's *AI Ethics Principles* to "achieve better outcomes, reduce the risk of negative impact [and] practice the highest standards of ethical business and good governance".[20]

The adoption of AI in business is a clear business opportunity that will have an overall net positive impact.[21] However, an ethical and human rights lens needs to be applied.



READY YOUR BUSINESS: SUPPLY CHAIN TRANSPARENCY

The International Labour Organisation (ILO) estimates that there are over 40.3 million people globally experiencing modern slavery with 75 percent of these people living in the Asia-Pacific region.[22]

Whilst global supply chains generate financial growth, employment, skill development and technology transfer, the presence of pervasive human rights violations, like modern slavery, and impacts on the environment such as waste, will hinder achievement of the Sustainable Development Goals (SDGs). Supply chain transparency is key.

In 2020 we will see the first 'Modern Slavery Statements' under the Australian Modern Slavery Act.[23] Businesses are likely to be judged by stakeholders not just on the robustness of their reporting under the legislation, but on their engagement with suppliers to manage their modern slavery risks. In addition, business will need to consider the growing expectations to be transparent about how they undertake human rights due diligence on their supply and broader value chain.

Recently, Apple, Microsoft, Dell, Alphabet and Tesla were named in a lawsuit regarding a claim that they are complicit in human rights harm by using cobalt in their products sourced from a mine in the Democratic Republic of the Congo that allegedly used hazardous child labour.[24]

This highlights the growing need for companies to deeply understand their supply chain and to implement measures, including human rights due diligence, to prevent involvement in human rights violations or environmental damage through their business relationships.

Business also need to start integrating 'climate-smart actions' into their supply chain.[25] With climate-induced disasters, like the Australian bushfires, becoming more frequent and intense, they will need to consider how extreme weather events will disrupt their supply chain and operations. In Australia, the smoke from the NSW bushfires slowed down production at BHP's Mount Arthur coal mine[26], and the aftermath of Hurricane Maria in the Bahamas led to nation-wide shortages of critical supplies, such as IV bags used in hospitals.[27] Events like these will become more frequent.

Most importantly, these actions need to be visible. Businesses that invest in greater visibility of their supply chain will see more success – in reputation, their bottom-line and in consumer and investor sentiment.

EFFECTIVE WATER MANAGEMENT & GOVERNANCE

Water is complex. It is a necessity for life. Crucial to sustainable development. Vital to reduce disease. And critical to business and economic growth.

However, over two billion people live in countries experiencing water stress.[28] At home, Australia has continued to experience medium to high water stress over the last ten years.[29] We are also failing in our efforts to meet SDG 6 (Clean Water and Sanitation), with regard to ensuring the availability of, and sustainable management of, water.[30]

With four out of five jobs globally[31] being water-dependent and two-thirds of the world's businesses facing water risks[32], effective water management falls onto business. Much of the demand for water is driven by the agricultural sector[33], and this demand will increase alongside the need to have 42 percent more food to feed the world by 2040.[34] Other water-dependent sectors will also compete for water resources: forestry, aquaculture, mining, power generation and manufacturing sectors.

Business will need to develop a water governance and management approach that is reflective of sound water stewardship practices. According to the World Resources Institute, global water security could cost as little as one percent of global GDP, or 0.7 percent of Australia's GDP.[35] The benefits of which would far outweigh the cost with investments in water access and sanitation providing an average of US$6.80[36] in return for every dollar invested.

According to the CEO Water Mandate[37] an effective progression to mature water stewardship practices takes time. Business will need to: optimise operational water facilities; understand their water risks and impacts – including on the value chain; develop and implement a comprehensive water stewardship plan; work alongside stakeholders, including communities, to advance sustainable water management; and communicate with stakeholders through meaningful dialogue.

Advancing water stewardship is imperative. Businesses that implement sustainable water practices will reduce costs, protect themselves from operational disruptions and seize business opportunities that advance shared water-related goals.

TOWARDS A CIRCULAR ECONOMY

The existing model for economic growth has been reliant on one concept – produce, use and dispose; a model with little regard for the resulting waste.[38] If we continue under this model, we are risking our future prosperity by derailing our planet's ability to regenerate itself to provide the natural capital we are fundamentally reliant upon.

With close to five billion middle-class consumers by 2030[39] coupled with the threat of climate change and environmental degradation, this is fast becoming an urgent problem for people, planet and business.

This is where the circular economy model becomes vital. The model enables a transformation from degenerative to regenerative design. It puts an end to the 'cradle to grave' mentality and 'throwaway' economy.

Businesses that want to stay ahead of the curve will need to wave goodbye to the linear industrial economy and welcome this cradle-to-cradle model, applying it to product and service design and delivery.

In Australia, just over 65 million tonnes of waste is generated every year and that figure continues to grow.[40] To support our economy and reduce environmental impacts, the 2018 National Waste Policy[41] and 2019 National Waste Policy Action Plan[42] were developed to reduce total waste generated, phase out problematic plastics, halve the amount of organic waste sent to landfill, and dramatically improve resource recovery.

The business sector will play a key role in supporting this Plan. Business is the main proponent for the development of new markets for recycled products and materials; for helping to build industry capacity and infrastructure to collect, separate, recycle and remanufacture recycled materials; and to support a more coherent legislative framework that stimulates investments, encourages innovation and supports wide-spread behavioural change to enable the adoption of a circular-based economy.

Whilst the circular economy on paper certainly looks attractive, it is not a magical fix. As Kate Raworth explains in *Doughnut Economics*[43] a more accurate term for this process would be a cyclical economy as no industrial loop can recapture and reuse 100 percent of its materials. It does however push businesses to pause, rethink their models and fundamentally shift the way they do business. A new model that respects our natural capital and transforms the way we perceive and understand value creation.

DRIVING ACTION TOWARDS A NET ZERO CARBON ECONOMY

Australian business leaders, the Australian Prudential Regulatory Authority (APRA), the Bank of England, and International Monetary Fund all recognise the financial and non-financial risks posed by climate change.

A report by the Bank for International Settlements (BIS)[44] called for its members, such as the Reserve Bank of Australia, to integrate climate change into their monetary policy. The BIS warned central banks that climate change events that have critical consequences on the banking and insurance sector might force central banks to “buy a large set of carbon-intensive assets”.[45] In Australia, this would mean purchasing coal fired power stations from the private sector.

To avoid this, we need to move to a net zero carbon economy by 2050.

The United Nations Framework Convention on Climate Change (UNFCCC) has identified 1.47 billion jobs globally in sectors critical to climate stability.[46] The ILO has estimated that action to meet the Paris Agreement will create 24 million jobs in the clean energy sector.[47]

Moving towards this future will cause disruption. Australia is already seeing it with the closures of its ageing coal-fired power stations. This transition will see up to 8,500 jobs lost and result in major structural adjustment challenges for both the workers who have lost their jobs and the communities that have become dependent on the coal energy industry.[48]

To support this transition, we need to adequately plan for, coordinate and invest in a just transition in a way that is compatible with limiting warming to 1.5 degrees.

The Science Based Target initiative (SBTi)[49] supports this mitigation pathway. It calls on companies to take action to limit their emissions to well below 2 degrees Celsius. This is an opportunity for companies to enhance their reputation, strengthen investor confidence, build resilience against growing climate regulation, and develop a competitive advantage.

As said by APRA Board Member, Geoff Summerhayes, “the major economic transition underway presents substantial risks to businesses that are not adequately prepared, but it also offers opportunities for forward-thinking economies and businesses”.[50] The time for business to plan for transition is now.

FINANCING THE SDGS

Secretary-General of the United Nations, Antonio Guterres has called on business to apply a "transformational approach"[51] to deliver on the SDGs.[52]

Combined with the UN Global Compact's Ten Principles[53], the 17 SDGs provide business with a framework to raise ambition in business strategy and governance, deepen integration of social and environmental factors into operations and enhance stakeholder engagement.[54]

Whilst there is an estimated US$12 trillion[55] in market opportunities offered by the SDGs, globally there is a US $2.5 trillion[56] annual financing gap in emerging markets to deliver on the SDGs by 2030. To meet this investment gap and respond to growing demands from investors, businesses need to reorientate their investments towards sustainable development whilst continuing to meet their risk appetite and maximise shareholder returns.

A transformative approach will require engagement from the Chief Financial Officer (CFO)[57] to ensure that the company's priority SDGs are integrated into their financial strategy and business model. These 'stewards of corporate finance' will assist business by directing financial resources towards SDG priorities – including investments into research, capital allocation or into investments, such as bonds.

Business will also need to consider how they will invest in the bond market. With over US$6.7 trillion of annual issuance, bonds provide a cheap, reliable and scalable source of capital to help fill the financing gap. According to investment managers Pimco[58], the growth in SDG-linked bonds is a clear signal that investment markets are in a new phase – one that enables better conditions to finance the SDGs.

Investment and finance will also need to flow into foreign direct investment (FDI), financial intermediation and public-private partnerships to ensure that finance for the SDGs can be scaled. These types of investments will direct finance toward less liquid SDGs that are not usually attractive to corporate or institutional investors.

Ultimately, to close the SDG financing gap, business do not need to reinvent the wheel. Instead, they need to redirect their investments towards the SDGs, challenge their business as usual approach and be a catalyst for change.

UNDERSTANDING CHANGING SOCIAL NORMS

Social media, expectations on business leaders and politicians to speak up and changing consumer trends are shifting traditional social norms.

For business, this means being cognisant of how these norms affect the talent pool and their customers. The newest wave of potential employees, for example, are seeking opportunities with companies whose values and culture align to that of their own. To attract the best and brightest, businesses will need to invest in understanding how current company values intersect with changing social norms and the expectations that these norms carry regarding values and culture. A positive reputation can mean the difference between maintaining a high-performing team or losing top candidates to a competitor.

Understanding consumer trends towards purchasing goods and services that have strong alignment to social and environmental causes, and/or are produced in an ethical manner is also key. Consumers are becoming more engaged with understanding a company's values when making a buying decision. Companies will need to embed social impact into their business and their brand and marketing strategies in an authentic manner and consider the brand's supply chain.

The investor community is also demanding more information on how companies are managing their environment, social and governance (ESG) risks. Businesses should consider how to clearly and transparently articulate what their social impact is and provide metrics to support their approach, ideally aligning it to the SDGs.

The shift in social norms also creates opportunities to lead. Businesses that are in-tune with social trends and the shifting norms will have more impact. This includes, for example, understanding how movements like #MeToo have shifted and influenced behaviours and expectations and what the role of business is to support these shifts. This might be a commitment to eliminate the gender pay gap, policies to manage workplace gender violence and bullying or identifying and addressing unconscious bias.

Businesses who can quickly adapt and respond to these changing norms will be able to shape the industry landscape on social and environmental issues that affect their business. As a reward, these businesses will also benefit from differentiating their brand, building greater trust and loyalty and attracting the best talent.

EFFECTIVE COMMUNICATION

A year after Commissioner Hayne handed down his recommendations from the banking Royal Commission, businesses continue to be under pressure to rebuild trust. The 2020 Edelman Trust Barometer[59] revealed a decline in Australian institutions against 2019, with fears of technology being "out of control" and job loss through the gig economy, recession and lack of training being major concerns. Whilst a "trust paradox"[60] exists where the informed public (i.e. those who are wealthier, more educated and consumers of news) have far greater trust in institutions than the general public, business needs to communicate in a manner that enables them to regain the trust of the 'uninformed' public.

To do this, business will need to align their communication strategy to their purpose; and that purpose needs to embed the company's approach to key sustainability issues like climate change, human rights and gender. Purpose will be key to engaging with consumers, including the next generation of influencers and purchasers – Gen Z. By the end of 2020, it is estimated that Gen Z will account for 40 percent of global consumers and an estimated US$44 billion in purchasing power.[61] This is the same generation who are opting for products and brands that align with their values.[62] As such, communicating sustainability priorities in an authentic manner that tangibly illustrates how the business is meeting their priorities is crucial.

Effective communication also means moving beyond reporting. Whilst reporting provides valuable insights on past achievements and progress against strategy, they are typically not an engaging medium for consumers. The leadership team will need to talk openly on key issues and the CEO should lead on commentary about how the business is responding to issues that are beyond business as usual. If public trust is to be regained, this will mean being radically transparent on the challenges and pitfalls, as well as the successes. It also means considering how to shift relationships with their employees, the media, civil society and communities to reduce the reliance on talking points and see leaders speaking unscripted – linking their personal experiences with the path that the business is taking.

Businesses that take a middle of the road approach to their communications will face limits in the level of trust awarded to them. Businesses who respond to the amplified demands to speak up, communicate transparently and enhance their interactions with society will be trusted businesses.

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The Ten Principles of the UN Global Compact

The Ten Principles of the United Nations Global Compact are derived from: the Universal Declaration of Human Rights, the International Labour Organization's Declaration on Fundamental Principles and Rights at Work, the Rio Declaration on Environment and Development, and the United Nations Convention Against Corruption.

HUMAN RIGHTS

1. Businesses should support and respect the protection of internationally proclaimed human rights; and
2. make sure that they are not complicit in human rights abuses.

LABOUR

3. Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining;
4. the elimination of all forms of forced and compulsory labour;
5. the effective abolition of child labour; and
6. the elimination of discrimination in respect of employment and occupation.

ENVIRONMENT

7. Businesses should support a precautionary approach to environmental challenges;
8. undertake initiatives to promote greater environmental responsibility; and
9. encourage the development and diffusion of environmentally friendly technologies.

ANTI-CORRUPTION

10. Businesses should work against corruption in all its forms, including extortion and bribery.

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