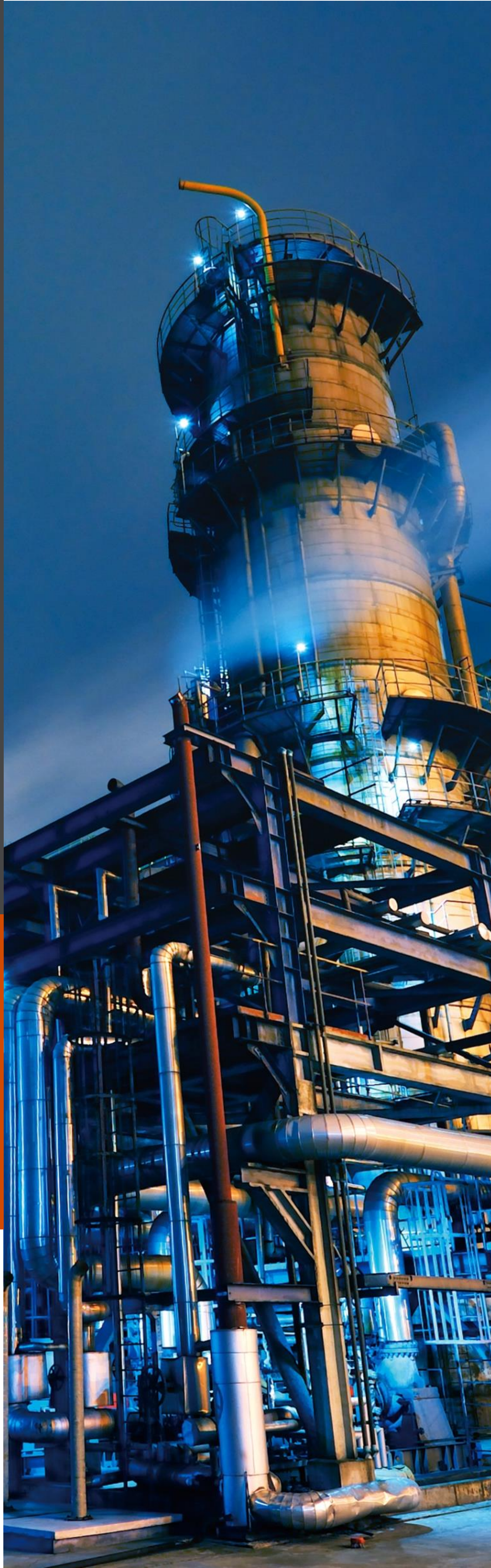
Capital efficiency and stakeholder capitalism

June 2021



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Redefining capital efficiency in an age of stakeholder capitalism

The pressure on organizations to operate in a more sustainable fashion has been steadily growing for the last 30 years. A convergence of the pandemic, technological breakthroughs, and regulatory and investor pressure has led to an inflection point. Whether driven by shareholders, supply chain, consumers or mandatory compliance: what was once a largely voluntary effort has now become a core expectation of any business. The emergence of Environmental, Social and Governance (ESG) reporting requirements is shining a light on how corporations are embracing and complying with emerging benchmarks of Stakeholder Capitalism, which focus on long-term value creation, as well as enhancing shareholder value.

Energy companies may face the heaviest lift to set and achieve their Net Zero targets, recognizing their products are part of Scope 3 emissions for consumers, and will be under pressure from their stakeholders.

Securing and maintaining the social license to operate a business is becoming increasingly complex. At the same time, the digitalization and decarbonization of many industries requires a profound rethink of asset investment strategies. The bottom line: selecting, deploying, and managing capital investments is more challenging than ever before.

Balancing these competing objectives requires greater agility and more rigorous processes to ensure that capital is allocated in the most effective and efficient way possible.

Considering the environmental and societal costs and benefits of an investment is critical to making sound decisions, and imperative for organizations that want to hold themselves accountable for corporate social responsibility.

Yet organizations often struggle to quantify and compare these non-financial value drivers with more “conventional” financial metrics. Often, significant effort is put into studying non-financial value. The lack of any sort of objective framework for comparable metrics means that the ‘value’ can only be defined and captured in narrative terms and cannot be easily included in any sort of evidence-based decision-making approach. This often translates into allocating separate budgets for hard to quantify environmental and social investments, without a clear grasp on their merits compared to “mainstream”, discretionary capital growth or sustaining capital investments.

Creating a consistent framework to represent and measure competing forces in your business, both tangible and intangible, supports the defensibility, transparency and auditability of decision making. It allows you to confidently compare all capital investment candidates on a level playing field, including those with financial, risk, strategic environmental and social value drivers.

Capital efficiency is a measure that provides a lens on how efficiently your organization allocates capital to its highest-best use. Combining a value framework with state-of-the-art investment portfolio optimization and performance management processes will help provide confidence and trust in all stakeholders, that you are applying a transparent, robust and agile decision-making framework to respond to today’s competing pressures and maximize capital efficiency.

Decision-making frameworks and ESG

All decisions within an organization should be aligned with its corporate objectives and definition of ‘value’. This core principle sounds simple enough, but the practice can be challenging, especially if the corporate objectives expand to take into consideration a growing array of competing demands and pressures from various stakeholders. Whereas purely financial objectives are easily quantified and measured, new goals around risk and ESG drivers might be more challenging to express in tangible terms that are agreeable to all parties.

This is where value-based decision-making helps. Starting from the premise that an organization acquires and operates assets to create value, developing a comprehensive value framework enables your organization to assess the overall value of every potential investment – including factors often considered intangible and difficult to quantify. By drawing upon an extensive library of value models and years of experience designing models for organizations managing critical infrastructure, Copperleaf and PwC can rapidly develop a value framework suited to your strategy.

Using a value framework to assess the overall contribution of each possible investment to the organization’s objectives allows you to confidently select which projects to favor, and defend your portfolio decisions both internally and externally. Also, having a well-defined value framework integrated with scenario modeling tools will make it possible to run alternative scenarios to identify which combination of investments will allow you to optimize financial goals while achieving specific ESG targets such as decarbonization, health & safety, water and energy consumption, recycling, etc.

High level capital efficiency requires the optimal use of all resources. The Copperleaf Decision Analytics Solution uses AI-enabled optimization to ensure the highest-value mix and timing of investment alternatives is identified for each portfolio of competing investments, while honoring risk tolerance, financial, resource, time and dependency constraints.

Governance and reporting

A key component of Stakeholder Capitalism and the current ESG reporting push is the need for stronger governance. Two key components of governance are enterprise risk management (ERM) and the rigor of capital decision-making. The adoption of a robust decision analytics solution can improve an organization’s governance on both counts.

Enterprise risk management is tied to the ability to identify, quantify and effectively mitigate internal and external risks. A decision analytics solution can perform systematic bottom-up analyses of the risks presented – today and in the future – by all your assets. Similarly, it offers you the ability to explore different “what-if” scenarios based on possible external or internal events. For instance: which portfolio of investment is best suited for a scenario where carbon taxes are introduced in 2030? Or in 2040?

By combining bottom-up risk analysis, a value framework and portfolio optimization techniques, you can develop risk-informed investment plans that deliver high capital efficiency while honouring your organization’s risk tolerance.

This enhances decision-making rigor by ensuring that all investment proposals are developed using a common value framework and set of rules; are evaluated using the same logic and metrics; are selected using rational, transparent decision-making criteria and optimization techniques; and are approved in full knowledge of what risks and benefits are attached to each investment. Crucially, every investment will be monitored during its execution phase to ensure that the benefits, costs, milestones and resource consumption are honoured, thereby enabling high capital efficiency to be consistently achieved.

Governance is tied to auditability.

Copperleaf’s Decision Analytics Solution offers a full audit trail of why, when, how and by who decisions were made – both for every investment and for the underlying value framework. Similarly, any change to a prior decision is fully documented and justified.

At PwC, we bring purpose, vision, and practicality to your unique set of challenges — and we’ve been where you are. We’ve been on our own ESG journey, and we’re ready to share our insights and successes to help you. PwC’s deep sector experience helps identify strategies to reduce emissions and help mitigate the potential financial impact of increased costs from regulations that limit or put a price on GHG emissions.

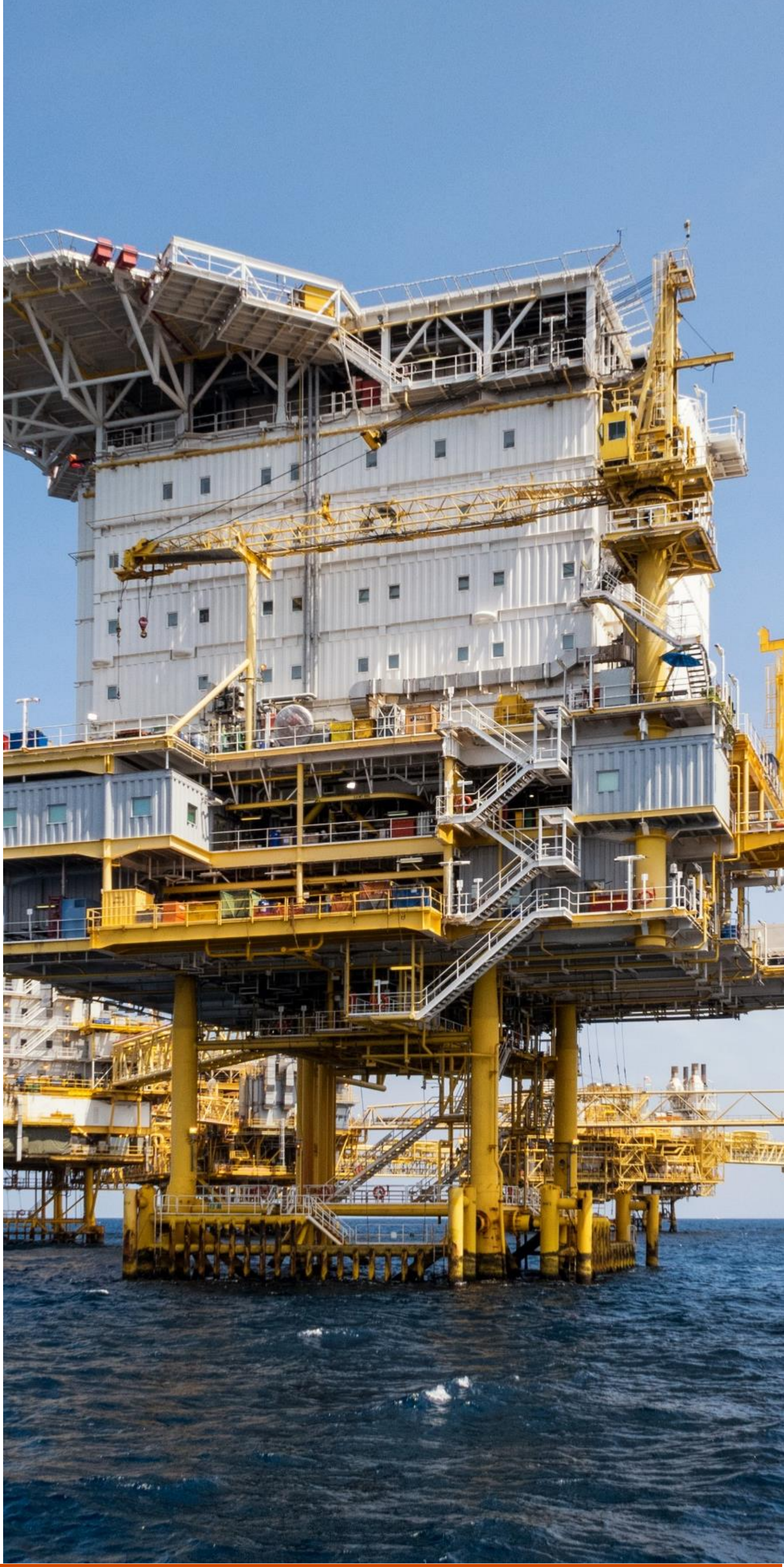
With Copperleaf and PwC, you can quickly get started on your ESG strategy, including areas such as climate risk and diversity, equity and inclusion, that can enhance capital efficiency, and fuel your strategy, growth and reputation. We understand and leverage the emerging ESG standards and frameworks such as SASB and TCFD to develop a compelling story for your investors, board, and other stakeholders, while developing carbon emission baselines, scenarios and investor-grade GHG metrics that your shareholders can verify and trust in your disclosures.

Tony Caletka
PwC Partner
anthony.caletka@pwc.com

Reid Morrison
PwC Global Energy Leader
reid.morrison@pwc.com

Brett Haynie
PwC Director
brett.haynie@pwc.com

Phil Jones
Copperleaf, Global VP of Sales and Business Developement
pjones@copperleaf.com



PwC
PricewaterhouseCoopers LLP, 300 Madison Avenue, New York, NY 10017
T: (646) 471 3000, www.pwc.com/us

Copperleaf
2920 Virtual Way, Suite 140
Vancouver, BC V5M 0C4 Canada
1.888.465.5323 | 1.604.639.9700
www.copperleaf.com