

Revenue at risk:

Why addressing deforestation is critical to business success

Written on behalf of 365 investors with US\$22 trillion in assets



Executive summary

On average

24%

of company revenues depend upon disclosed commodities

For any company active in the global trade in soy, palm oil, timber products or cattle products, deforestation has become a critical business issue. The production of these forest-risk commodities can contribute to habitat loss, greenhouse gas emissions and social conflict – resulting in direct and supply chain exposures for suppliers and customers alike.

Addressing these environmental and social impacts has become a priority for policymakers, with the forging of the Paris Agreement on climate change and the UN Sustainable Development Goals.

As a result, a growing number of investors want to know what companies are doing to address this major business challenge. This year 365 investors, over a fifth more than in 2015, with a total of US\$22 trillion in assets asked companies to disclose information via CDP about how they are managing deforestation risk linked to these four commodities – responsible for the majority of tropical deforestation globally.

Responses were received from more than 200 companies, up from 180 in 2015, including three of the four so-called 'ABCD' global commodity trading giants¹, the three largest slaughterhouses in Brazil and big-name brands from Nestlé to Starbucks.

We have analyzed the wealth of data² with the following questions front of mind: Are companies on course to remove deforestation from their supply chains? Have companies identified a sustainable and secure supply of key commodities, the building blocks of their business, to meet their future needs in the light of shifting regulatory and investor expectations? Is there evidence they are sufficiently engaged across their supply chains to meet these needs?

The analysis finds that:

A substantial share of company revenue is dependent on commodities responsible for deforestation.

- ▼ Companies report that, on average nearly a quarter of company revenues depend upon the commodities they reported on; and
- ▼ The total annual turnover at risk for publicly listed companies is estimated to be up to US\$906 billion.

Companies believe they will be able to access a secure and sustainable supply of forest-risk commodities in the future.

- ▼ 72% of companies report that they have identified sufficient future sustainable supply across all forest-risk commodities.

But this confidence may be misplaced, given existing commodity-related impacts and potentially inadequate forward planning.

- ▼ 81% of companies in the Agricultural Production sector, which sits at the top of global commodity supply chains, have experienced impacts related to forest-risk commodities that have resulted in substantive changes to operations, revenue or expenditure in the past five years;
- ▼ Despite these impacts, only one in five companies assess risks associated with deforestation beyond a six-year horizon across commodities; and
- ▼ Fewer than half (42%) of companies have evaluated the impact of the availability or quality of key forest-risk commodities on their growth strategies over the next five or more years.

The key barriers companies report to face in addressing these risks are: inadequate traceability systems, weak governance (and compliance enforcement) of national deforestation policies, and limited availability of certified materials and their costs.

- ▼ These most frequently cited challenges have not changed since 2013. As we approach 2020, when many corporate deforestation goals and commitments are due to be met, we need to see bolder corporate action if revenues, resilience and the future growth of the companies involved are not to be put at risk.

US\$906 billion

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¹ The Archer Daniel Midlands Company, Bunge, Cargill and Louis Dreyfus Company

² The analysis of this report is based on responses from 187 companies that disclosed before August 2, 2016.



81%

of Agricultural Products companies report impacts related to deforestation that have generated a substantive change in operations, revenues or expenditure over the past five years.

To ensure their future growth, companies need to improve their internal processes, move the responsibility for deforestation risk management into the boardroom, work with their supply chains and collaborate with their peers.

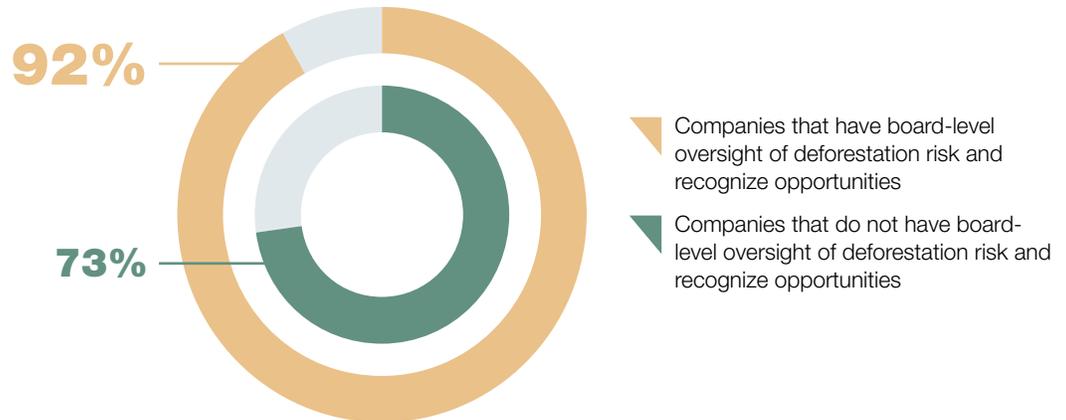
- ▼ More than a third (34%) of reporting companies do not have board-level responsibility for deforestation risk management;
- ▼ Fewer than half (47%) of companies have considered deforestation as part of a comprehensive, company-wide risk assessment for their full supply chain across commodities;
- ▼ Fewer than half (44%) of manufacturers and retailers with procurement standards in place monitor compliance with these standards and audit their suppliers across commodities. This is

despite the need for supply chain alignment to allow companies to meet their zero deforestation commitments; and

- ▼ There are benefits for companies that implement these actions. Manufacturers and retailers that work with their suppliers report far greater levels of traceability and are significantly more likely to identify business opportunities. Similarly, companies with board-level responsibility for deforestation risk identify 19% more opportunities than those that do not.

Companies also need to embrace more advanced approaches to commodity sourcing, which aim to tackle deforestation at the landscape or jurisdictional scale, and work with governments to ensure enabling regulatory environments are in place.

Board-level oversight is linked to more opportunities related to the sustainable production or sourcing of forest-risk commodities



Call to action

The will exists to address these challenges. We have seen an increasing level of investor concern regarding deforestation, corporate commitment to address the issue, and political momentum at the international level and within some jurisdictions. We believe that, to meet the challenge posed by deforestation, companies should:

- ▼ **Ask for transparency and disclosure from suppliers.** The biggest risks and greatest opportunities are to be found in the supply chain. Companies should ask their suppliers to disclose relevant information, and collaborate with them to implement change at scale;
- ▼ **Bring deforestation to the board room.** Board-level oversight of this issue varies around the world. Risk assessments that are comprehensive and company-wide will ensure that the issue of deforestation risk reaches the very top; and
- ▼ **Work cross-sectorally to find solutions.** Addressing the barriers to securing sustainable, deforestation-free commodities will involve working across sectors, and with customers, governments and civil society.

CDP Contacts

Paul Dickinson
Executive Chairman

Paul Simpson
Chief Executive Officer

Frances Way
Co-Chief Operating Officer

Sue Howells
Co-Chief Operating Officer

Lance Pierce
President, CDP North America

CDP's forests program

Katie McCoy
Head of Forests

Rafel Servent
Senior Project Officer, Forests

Anjali Fordington
Project Officer, Forests

Lena Meintrup
Europe Project Manager, Forests

Jillian Gladstone
North America Project Manager,
Forests

Rebecca Willcox
Technical Officer, Forests

Sareh Forouzesh
Account Manager, Forests

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Takejiro Sueyoshi

CDP North America Board of Trustees

Joyce Haboucha

David Lubin

Martin Whittaker

Martin Wise

David Wolfson

CDP Worldwide

Level 3
71 Queen Victoria Street
London EC4V 4AY
United Kingdom

Tel: +44 (0) 20 3818 3900
www.cdp.net
info@cdp.net



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www.see-design.com