

## Part 3 UNDERSTANDING ESG AND HEALTHCARE INNOVATION:

# **WHY HEALTHCARE COMPANIES SHOULD EMBRACE ENVIRONMENTAL SUSTAINABILITY – AND HOW TO DO IT.**

This is the third in a series of papers taking investors and healthcare leaders on an “ESG journey”: what it is, why it matters, and how to put ESG into practice.

With growing environmental concern, paired with tightening regulatory standards, the need for corporate sustainability grows. As a result, environmental, social, and governance (ESG) reporting is becoming paramount for the long-term success of companies. In **Part 1** of this series, we introduced the concept of ESG and explained why it is an important issue for companies of any size. In **Part 2**, we defined the ESG reporting approach that we have implemented with our portfolio

companies and described the ESG priorities and recommendations for early- to growth-stage healthcare companies.

In this paper, we focus on the “E”. We describe why it’s essential for companies to embrace environmental sustainability and we provide recommendations tailored to healthcare companies looking to implement sustainability reporting into their business strategy.

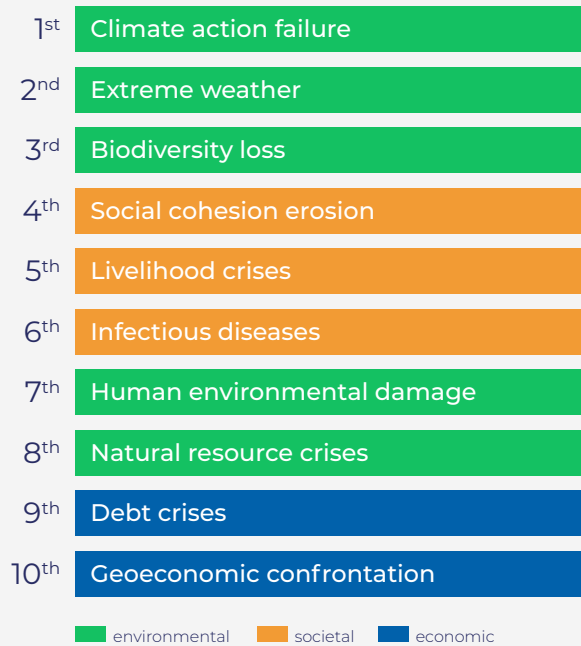
## An urgency to act

Failure to act on climate change is now considered the number one risk with the potential to inflict the most damage at a global scale over the next decade.<sup>1</sup> Recent reports from the UN have described that the earth is on track for irreversible climate breakdown, with “no credible pathway to 1.5°C in place”.<sup>2</sup> Current national pledges for action put the planet on course for a projected rise in global heating to 2.5°C by the end of the century.

### ABOUT THE PARIS AGREEMENT

At COP21 in 2015, 196 countries negotiated the Paris Agreement – a legally binding international treaty to limit global warming to well below 2°C, preferably to 1.5°C, compared to pre-industrial levels. To limit global warming to just 1.5°C, global emissions need to be reduced by 45% by 2030 and to reach net zero by 2050. To deliver on this, the agreement requires countries to submit their strategies for climate action to reduce their emissions.<sup>3</sup>

### TOP 10 MOST SEVERE GLOBAL RISKS OVER THE NEXT DECADE (AS OF 2022):



Source: World Economic Forum Global Risks Perception Survey 2021-2022

## Climate-related risks

The risks from climate change are not just limited to environmental damage, but also have far-reaching consequences for the global economy, geopolitical and societal cohesion, and human health. In terms of economics, more than half of the world’s output is dependent on natural resources,<sup>4</sup> so resource depletion and biodiversity loss represent a significant

risk to corporate and financial stability. Socially, climate change will put strain on the cohesion of communities, as food and water insecurity, floods, and wildfires increasingly force the migration and displacement of communities. And finally, climate change is already causing significant harm to human physical and mental health in all regions of the world.<sup>5</sup>

<sup>1</sup> World Economic Forum. The Global Risks Report 2022 17th Edition. [https://www3.weforum.org/docs/WEF\\_The\\_Global\\_Risks\\_Report\\_2022.pdf](https://www3.weforum.org/docs/WEF_The_Global_Risks_Report_2022.pdf) (Accessed 7 November 2022). <sup>2</sup> UN Environment Programme. Emissions Gap Report 2022. <https://www.unep.org/resources/emissions-gap-report-2022> (Accessed 7 November 2022). <sup>3</sup> UN. Net-zero coalition. <https://www.un.org/en/climatechange/net-zero-coalition> (Accessed 7 November 2022). <sup>4</sup> World Economic Forum. Half of World’s GDP Moderately or Highly Dependent on Nature, Says New Report. <https://www.weforum.org/press/2020/01/half-of-world-s-gdp-moderately-or-highly-dependent-on-nature-says-new-report/> (Accessed 7 November 2022). <sup>5</sup> Health Care Without Harm & ARUP. Health Care’s Climate Footprint. [https://noharm-global.org/sites/default/files/documents-files/5961/HealthCaresClimateFootprint\\_092319.pdf](https://noharm-global.org/sites/default/files/documents-files/5961/HealthCaresClimateFootprint_092319.pdf) (Accessed 7 November 2022).

# Healthcare's responsibility to decarbonise

Despite the importance of safeguarding the environment to protect human health, the healthcare sector is lagging behind when it comes to sustainability. Globally, the healthcare industry contributes to 4.4% of greenhouse gas (GHG) emissions.<sup>5</sup> Of this, 71% of emissions are derived from the healthcare supply chain,<sup>5</sup> meaning that providers of goods, services, pharmaceuticals, medical devices and equipment all have a key role in the decarbonisation of the healthcare sector.

Following initial ESG assessments for the companies in Endeavour Vision's portfolio, it was apparent that, while they score well on governance and social dimensions, they fall behind in terms of environmental measures. This is consistent with the industry trend: KPMG's 2022 *Survey of Sustainability Reporting*<sup>6</sup> shows that while the healthcare sector has made considerable progress in sustainability reporting since 2020, there are still opportunities for improvement. The survey, which analysed a sample of the top 100 companies by revenue in 58 countries, identified that the healthcare sector continues to rank in the bottom three of 15 sectors for disclosing climate targets. While the percentage of healthcare companies reporting climate targets has increased from 40% in 2020 to 67% in 2022, it still falls below the overall benchmark of 71%. Meanwhile, only around 20% of companies in MSCI's healthcare

index has an emissions-reduction target.<sup>7</sup> The sector also ranks lowest for adoption of the Task Force on Climate-related Financial Disclosures (TCFD; 27% for healthcare vs. 34% average) and second lowest for reporting business-related risks of biodiversity loss (17% for healthcare vs. 40% average).<sup>6</sup>

“Healthcare is wholly unprepared for the net-zero transition and this massive reallocation of capital. There is a real opportunity there for the healthcare sector to increase its efforts toward decarbonisation.”

– Julia Giguere-Morello,  
Vice President, MSCI<sup>7</sup>

## HEALTHCARE LAGS BEHIND ON SUSTAINABILITY REPORTING

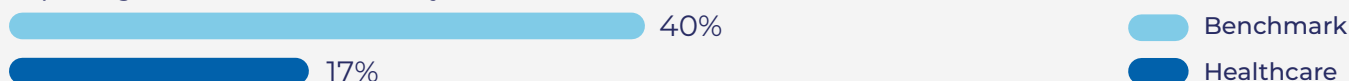
### Reporting climate targets



### TCFD adoption



### Reporting the risk from biodiversity loss



Source: N100 companies, KPMG Survey of Sustainability Reporting 2022, KPMG International, September 2022

<sup>5</sup> Health Care Without Harm & ARUP, Health Care's Climate Footprint. [https://noharm-global.org/sites/default/files/documents-files/5961/HealthCaresClimateFootprint\\_092319.pdf](https://noharm-global.org/sites/default/files/documents-files/5961/HealthCaresClimateFootprint_092319.pdf) (Accessed 7 November 2022). <sup>6</sup> KPMG, Big shifts, small steps: Survey of Sustainability Reporting 2022. <https://assets.kpmg/content/dam/kpmg/xx/pdf/2022/10/ssr-small-steps-big-shifts.pdf> (Accessed 7 November 2022). <sup>7</sup> ESG Clarity, Healthcare scores poorly for ESG but is a vital sector. <https://esgclarity.com/healthcare-scores-poorly-for-esg-but-is-a-vital-sector/> (Accessed 7 November 2022).





# Opportunities in transitioning

Mitigating and adapting to climate change doesn't just bring benefits for the planet. There are a number of commercial gains to be made by identifying and managing climate-related risks and opportunities.<sup>8</sup> For example, decreasing reliance on fossil fuels and transitioning to renewable energy will likely result in lower operational costs, less sensitivity to the rising cost of carbon pricing (i.e. a CO<sub>2</sub> emissions tax),<sup>9</sup> and reduced exposure to fuel price increases. Furthermore, it should result in improved supply chain reliability and a greater ability to continue operating through unexpected crises, such as the

recent fuel shortage triggered by Russia's invasion of Ukraine.

A strong ESG strategy also acts as an indicator of potential for long-term stability and growth, making it an important consideration for investors, business partners and employees. While only 11% of Merger & Acquisition executives extensively assess ESG in the deal-making process currently, 65% expect that this focus will intensify in the coming years.<sup>10</sup> Furthermore, companies with robust environmental disclosures are better prepared to comply with new regulations as they come into force.

<sup>8</sup> TCFD. Recommendations of the Task Force on Climate-related Financial Disclosures. <https://assets.bbhub.io/company/sites/60/2021/10/FINAL-2017-TCFD-Report.pdf> (Accessed 7 November 2022). <sup>9</sup> Our World in Data. Share of CO<sub>2</sub> emissions covered by a carbon price. [https://ourworldindata.org/grapher/carbon-tax-trading-coverage?tab=chart&country=~OWID\\_WRL](https://ourworldindata.org/grapher/carbon-tax-trading-coverage?tab=chart&country=~OWID_WRL) (Accessed 7 November 2022). <sup>10</sup> Bain & Company. The ESG Imperative in M&A. <https://www.bain.com/insights/esg-imperative-m-and-a-report-2022/> (Accessed 7 November 2022).

# The “ratchet” of increasing regulatory standards

The Paris Agreement works on a 5-year cycle, with countries submitting increasingly ambitious strategies for climate action with each new phase. Often referred to as the “ratchet mechanism”, this allows countries to gain momentum over time to achieve the long-term goal of stemming global warming. As a result, regulations are becoming more stringent as the ratchet tightens.

## EUROPEAN REGULATORY DEVELOPMENTS

Current EU law – specifically, the Non-Financial Reporting Directive (NFRD) – requires large companies to disclose information on how they manage social and environmental challenges in their operations. As of 28 November 2022, the European Council has given its final approval for the adoption of a new legislation, the Corporate Sustainability Reporting Directive (CSRD), which will amend and replace the NFRD.<sup>11</sup> The CSRD introduces more stringent environmental and social reporting standards, in-line with EU climate targets, including disclosure of climate-related risks and opportunities. The new rules will put sustainability reporting on an equal footing with financial reporting. The scope of the legislation will apply to large companies and listed small and medium-sized entities (SMEs), covering 50,000 companies compared to the 11,700 covered by the previous rules. Companies will be subject to third-party auditing and certification, to ensure compliance and prevent greenwashing.

The CSRD will be effective for large companies already subject to the NFRD as of 1 January 2025, covering the 2024 financial year. For other large companies, the effective date will be a year later. For listed SMEs, the effective date for reporting will be 1 January 2027.

Carbon dioxide (CO<sub>2</sub>) accounts for 80% of GHG emissions from human activities.

## US REGULATORY DEVELOPMENTS

In March 2022, the U.S. Securities and Exchange Commission (SEC) issued a proposed rule to enhance and standardise climate-related disclosures for investors.<sup>12</sup> Under this proposal, public companies are required to disclose their governance around climate-related risks, and the material impact of these risks to their business, its strategy, and outlook. Companies must also assess and disclose the impact of these risks on the assumptions included in their financial statements. Under this new ruling, US listed companies will also need to disclose their Scope 1 and Scope 2 GHG emissions (and Scope 3, if deemed material).<sup>13</sup>

The effective date for the proposed SEC rule change is not yet determined, but it is proposed that large, listed companies will need to disclose this information as of fiscal year 2023 (filing year 2024). Small listed companies will be expected to report a year later.

### GHG EMISSIONS ARE CATEGORISED INTO THE FOLLOWING SCOPES<sup>14</sup>:

**Scope 1 emissions** – direct emissions from sources owned or controlled by the company.

**Scope 2 emissions** – indirect emissions from the generation of purchased energy.

**Scope 3 emissions** – all indirect emissions from the value chain of the company that are not owned or controlled by the company, including both upstream and downstream emissions.

We describe more detailed information on emissions reporting on page 8.

<sup>11</sup> Council of the EU. Council gives final green light to corporate sustainability reporting directive. <https://www.consilium.europa.eu/en/press/press-releases/2022/11/28/council-gives-final-green-light-to-corporate-sustainability-reporting-directive/> (Accessed 29 November 2022). <sup>12</sup> US Securities and Exchange Commission. SEC Proposes Rules to Enhance and Standardize Climate-Related Disclosures for Investors. <https://www.sec.gov/news/press-release/2022-46> (Accessed 7 November 2022). <sup>13</sup> McKinsey & Company. Understanding the SEC’s proposed climate risk disclosure rule. <https://www.mckinsey.com/capabilities/strategy-and-corporate-finance/our-insights/understanding-the-secs-proposed-climate-risk-disclosure-rule?cid=eml-web> (Accessed 7 November 2022). <sup>14</sup> The Greenhouse Gas Protocol. A Corporate Accounting and Reporting Standard. <https://ghgprotocol.org/corporate-standard> (Accessed 24 November 2022).

# A phased approach for sustainability reporting

For organisations looking to implement sustainability reporting, we have developed a three-phase approach. This process will prepare your company to comply with increasing regulatory standards, to cater to growing expectations for corporate sustainability, and to minimise its environmental impact. We recommend designating a responsible party within the organisation's management or the ESG committee to oversee and manage this process.



1

## PHASE 1:

### DRAFT AN ENVIRONMENTAL POLICY AND IDENTIFY CLIMATE-RELATED RISKS AND OPPORTUNITIES

#### I) DRAFT AN ENVIRONMENTAL POLICY

The aim of an environmental policy is to provide a framework for integrating environmental measures into the organisation's strategy and operations. We have provided an environmental policy template on our [website](#), which can be used as a basis for this. The policy should state the company's commitment to environmental sustainability, the key objectives for achieving this, and the delegates who will govern the process.

#### II) IDENTIFY CLIMATE-RELATED RISKS AND OPPORTUNITIES

To inform this process, we recommend reading the TCFD 2017 report,<sup>15</sup> which provides clear examples of climate-related risks and opportunities and describes the impact that these may have on financial statements. Management or the ESG committee should assess and describe the impact of these risks and opportunities on the organisation's strategy, operations, and its financials. They should then determine how these risks should be governed, the metrics for assessing them, and set targets to manage them. The identified risks and opportunities can be included in the environmental policy described above.

## 2

## PHASE 2: MEASURE ENERGY CONSUMPTION AND WATER USE

In line with the Global Reporting Initiative (GRI) Standards' *GRI 302: Energy*,<sup>16</sup> and the Sustainability Accounting Standards Board *standard 130a.1*,<sup>17</sup> organisations are recommended to monitor and report on energy consumption, the portion of energy from renewable sources, and water use to inform actions to lower their environmental footprint.

To deliver on this, companies should first determine the boundaries for which they will calculate energy consumption. This could include their office building, company-owned vehicles, transportation, manufacturing, and production. Utility bills and meter readings are a good source to obtain this information, and smart meters may simplify the task. To calculate annual consumption, the most accurate method is to monitor usage throughout the year, however, it may be estimated by extrapolating data from a shorter period (e.g. 1 or 2 months). If the latter method is used, adjustments should be made to account for variability (e.g. change in the number of employees or reduced energy use in summer), and such assumptions should be documented.

Results from this activity should be used to inform targets for reducing energy use by adopting more energy-efficient practices and increasing the proportion of renewable energy use. The results can also be used as input for emissions reporting, as described in Phase 3.



<sup>16</sup> The GRI Standards. <https://www.globalreporting.org/how-to-use-the-gri-standards/gri-standards-english-language/> (Accessed 5 December 2022). <sup>17</sup> SASB Standards. <https://www.sasb.org/standards/download/?lang=en-us> (Accessed 7 December 2022).



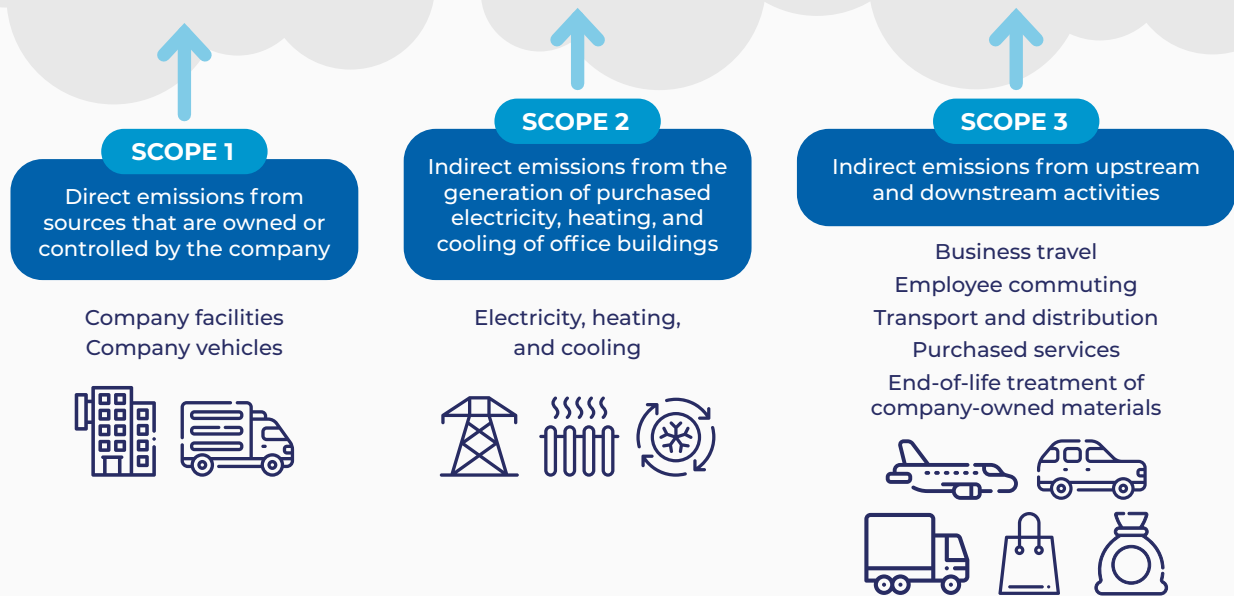
### 3

## PHASE 3: REPORT GHG EMISSIONS AND SET TARGETS

To report GHG emissions, companies should first identify which activities contribute to their emissions and define the boundaries within which to report. [Working 9 to 5 on climate change: An office guide](#) provides step-by-step guidance on defining which activities to report on and provides examples of office-related emissions. Scope 1 and Scope 2 emissions (which the company has greatest control over) are the most essential to report, and the total annual energy consumption measured in Phase 2 can be used to calculate this. Indirect Scope 3 emissions are more complicated to measure, but, as they can contribute significantly to a company's carbon footprint, reporting these will improve the completeness and accuracy of the reporting.

There are several websites available to help convert energy consumption or transport miles to a CO<sub>2</sub> equivalent value, such as [US EPA](#) and [myclimate](#). The [GRI 302-306 Reporting Standards](#) offers further guidance regarding when and how to report emissions.

### EXAMPLES OF GHG EMISSIONS FROM AN OFFICE-BASED ORGANISATION



### EXAMPLE: CALCULATING EMISSIONS FROM BUSINESS FLIGHTS

Endeavour Vision recorded the Scope 3 emissions from employee air travel for company activities over a one-month period. For each trip, we recorded the departing airport, the destination airport, and the distance to the meeting location. Next, these data points were entered into the myclimate calculator and converted to a CO<sub>2</sub> equivalent value. For example, a return economy flight from Geneva to New York generates a CO<sub>2</sub> equivalent of 2.0 ton.



# Conclusion

As global temperatures continue to rise, our weather systems, biodiversity, economy, geopolitical and social cohesion, and human health are all put at risk. In a worldwide effort to limit global warming, 196 governments have adopted the Paris Climate agreement and committed to substantially reduce GHG emissions. To achieve this, accurate reporting is required from companies to document GHG emissions from economic activity. Governments, through their regulators, are imposing more stringent regulations, and requiring a greater number of companies to disclose their climate-related risks and opportunities, energy consumption, and GHG emissions. Consistent with our own portfolio analysis, research shows that the healthcare sector is lagging in terms of environmental reporting, and

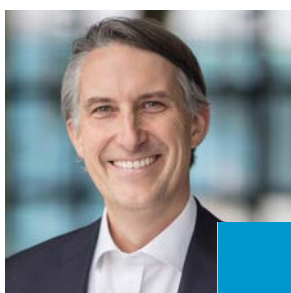
has ground to make up to meet new regulations.

As outlined in this paper, there are several steps companies can take to improve their environmental reporting. The first step is to be aware of this topic by identifying climate-related risks and opportunities, preparing a strategy, and documenting this in a policy. The next step is to begin measuring and reporting annual water consumption and energy usage. Lastly, early- and growth-stage companies should measure and report their GHG emissions.

By incorporating the above steps, healthcare companies will comply to the new and more stringent environmental regulation, will become more attractive for investors and companies seeking M&A, and make an important positive contribution to the global challenges.

For more information on this topic, our presentation given to our portfolio companies, titled 'Assessing the "E" of ESG', can be found in our [collection of ESG resources](#) on our website.

# About the authors



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