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Six insights on investing for net zero

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Aaron Maltais

Toby Gardner

Javier Godar

Michael Lazarus

Gökçe Mete

Olle Olsson

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Divesting from emissions-intensive sectors and companies seems to be the easiest solution to bring investments in line with the Paris Agreement's goal to bring global greenhouse gas emissions to net zero by mid-century. However, we have yet to see evidence that divestment is having a strong impact on emissions in our economies. Investors may achieve far more by using their financial power to advance the decarbonization of the sectors responsible for the largest share of emissions: oil and gas, agricultural commodities, steel and cement.

Large, very disruptive changes need to be initiated in the next decade to put these four high emitting sectors on track to decarbonize at a pace consistent with the Paris Agreement. That's because:

- For steel and cement, there are still no commercial-scale sites for zero, or close-to-zero, emissions production, although the first sites are under development.
- In the agricultural commodities sector, emissions are poised to increase significantly.
- In the oil and gas sector, there is a need for large and consistent annual decreases in production volumes, but production is currently on the rise.

Investors willing to engage with these sectors have an enormous opportunity to influence the level of emissions in the real economy. To do so, they need to put coordinated pressure on companies and other actors to initiate serious decarbonization transitions. This requires an understanding of:

- the actions that high-emitting companies and sectors should be taking to decarbonize production processes or to shift business models
- policies and other system conditions necessary for companies to succeed with their decarbonization strategies, and
- when it appears that sectors and companies can adopt credible transition strategies that investors can support, and when other strategies, such as divestment, are likely to be more impactful.

The results of such an approach may take time to materialize, but what matters most is to get companies to commit to a long-term decarbonization agenda – to fundamentally change their production systems and business models, and demonstrate that they are implementing these changes.

This brief is based on: Maltais, A., Gardner, T., Godar, J., Lazarus, M., Mete, G. and Olsson, O. (2021). What does it take to achieve net zero? Opportunities and barriers in the steel, cement, agriculture, and oil and gas sectors. SEI Report. Stockholm Environment Institute and Stockholm Sustainable Finance Centre, Stockholm. https://doi.org/10.51414/sei2021.023

IMAGE (ABOVE): Steelworks, UK © Monty Rakusen / Getty

Here are six key insights from our research:

Long-term transitions require immediate action

It will take decades to fully implement new production methods, so technologies, business models and investors must set high standards for immediate action from companies that want to be seen as frontrunners. Investors should make it clear that companies need to avoid any new investments in long-lived polluting assets. Along the way, investors should push for immediate emissions improvements in yearly increments, underpinned by science-based targets and judged against regular milestones. For heavy industry, current reinvestments and new investments in production technologies and infrastructure should be at least compatible with the technology pathways that can get companies to net-zero targets. In the oil and gas sector, no new investments in expanding aggregate production are compatible with global climate targets. In the agricultural commodities sector, companies must commit to adopting climate-smart approaches at scale, both on- and off-farm, including the elimination of deforestation from supply chains.

It is crucial to engage with value chains

Investors can help create markets for green steel and green cement by engaging with sectors such as transport and construction to encourage them to pay the higher costs of materials with lower climate impacts, thus integrating these costs into value chains. Curbing commodity-driven deforestation requires coordinated engagement with those companies that play central and concentrated roles in commodity trading. Investors can also work with companies higher up in food value chains to develop business models that can better incorporate the costs of sustainable production. They can also support policies to help level the playing field, enabling sustainable practices to be competitive.

Interventions should promote sector-wide transitions

Investors should be careful to adopt strategies that incentivize sector-wide alignment with climate targets – not just isolated actions by individual companies. In the oil and gas sector, for example, companies may sell off polluting assets to actors who will not reduce their emissions. Likewise, agricultural commodity buyers who avoid sourcing from emissions-intensive regions may do little to change the unsustainable practices of these regions if producers can secure other buyers. Investors seeking to advance sector-wide transitions need to push companies to fix problems with their polluting assets or supply chains, rather than offloading them. In heavy industry, technology transfer of low-carbon solutions will be needed to help avoid a situation where value chains for green steel and cement remain a niche, without broad global adoption.

Investors need to better understand their leverage points

The extent to which companies will be able to to transition will often depend on policy changes, new infrastructure development, and changes to both upstream and downstream value chains – all happening in parallel with their own efforts. This raises the question of whether there are multiple leverage points that investors can use to influence those conditions. This is an important area for further analysis. Because of the complexity of the changes needed in sustainability transitions, financial actors need to keep developing their knowledge base so they are able to engage effectively.

Coalitions of investors have had some success in persuading major oil and gas companies

Divest from the oil and gas sector, or engage with it?

to reduce the carbon intensity of production. However, they have been less successful in securing commitments to reduce levels of production. At this point, it remains unclear whether investors who wish to make an impact have a better chance of success through engagement, or by divesting from ownership of shares in oil and gas and refusing to fund debt. The evidence for cost-of-capital impacts from divesting from publicly traded stocks does not appear to be strong, but divestment might reduce the social licence and blunt the political influence of the industry through stigmatization. What investors can do is commit to not financing debt for new oil and gas exploration and development, to engage with banks to do the same, and to reduce financing for oil and gas in line with the declines in production needed to meet global climate targets.

Investors could push for more than trajectories and targets

Along with encouraging companies to reduce emissions along science-based trajectories for limiting global warming to 1.5˚C or well below 2˚C, investors may want to seek commitments to specific and concrete actions needed to achieve sectoral transitions. For example, they could set a target for the number of carbon capture and sequestration (CCS) projects initiated by cement companies, or for the share of oil and gas production fields that move into planned production decreases. We believe that investor coalitions can do more to coordinate around the specific steps they expect companies to take to achieve large emission reductions.

SEI Stockholm Environment Institute

Published by
Stockholm Environment Institute
Linnégatan 87D, Box 24218
104 51 Stockholm, Sweden
Tel: +46 8 30 80 44

Author contact
aaron.maltais@sei.org

Media contact
andrea.lindblom@sei.org

Visit us: sei.org
Twitter: @SEIresearch
@SEIclimate