

# ADAPTING TO CLIMATE CHANGE: HOW TO TRANSFORM CLIMATE RISKS INTO BUSINESS OPPORTUNITIES

The Beginner's Guide to Design your Business Strategy for Climate Change



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# INTRODUCTION



Matti Rönkkö  
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*"At Cooler Future, we know that sustainability has become an imperative for viable business strategies in the face of climate change."*

2020 will remain on everyone's mind as the year of the pandemic. However, trends towards sustainability have only accelerated, urging decision-makers to take decisive action. Fighting global warming and striving to achieve the objectives set in the Paris Agreement is no longer optional. Today, the commercial incentives for taking climate action are proving too big to ignore, while not taking any action may be fatal.

This report will initially highlight the key risks and opportunities climate change poses to businesses and how companies can benefit from capitalizing on the opportunities.

Secondly, readers will find essential information on how to build a climate strategy, ranging from vision to mission from a sustainability point of view, including a how-to for a company emissions audit, to guidance on mitigating climate risks and turning them into actionable opportunities.

At Cooler Future, sustainability is at the core of the agenda. After all, sustainable investing is crucial to success in the fight against climate change. Paired with the consulting experience from Capgemini Invent, this report goes beyond the usual cautionary tale on climate change by outlining how aligning economic activities with climate action can lead to sustainable results.

# CLIMATE CHANGE:

## THE PROMINENT CONTEMPORARY CRISIS

### Climate reporting initiatives by corporates

A recent study scoured the Fortune Global 500 list for public reports to identify climate actions that have already been delivered, as well as commitments to deliver climate actions by 2030<sup>1</sup>. It was discovered that 23% of companies have public commitments to being carbon neutral, using 100% renewable energy, or meeting Science-Based emissions reduction Targets (SBT<sup>2</sup>) by 2030<sup>[1]</sup>.

While this number may seem small, it is a four-fold increase since 2015, the year the Paris Agreement was signed (by 31 companies at the time, and 114 at the time of writing). It is also essential to note that these companies have a combined revenue of \$8T and employ 18 million people around the world. By 2030, it is predicted that 79% of Fortune 500 companies will be carbon neutral<sup>[1]</sup>.

*1/4 of Fortune Global 500 companies have made public commitments that they will be carbon neutral, use 100% renewable energy, or meet SBT by 2030<sup>[1]</sup>*

*4x increase in the number of companies that made public climate commitments since the Paris Agreement was adopted in 2015<sup>[1]</sup>*

*79% of Fortune 500 companies will be carbon neutral by 2030<sup>[1]</sup>*

### Climate risk is a business risk

The reason such a major shift is taking place is not that climate action is simply "nice to have". If not taken seriously, climate change poses a serious risk of financial instability to companies. This has also been recognized by the Financial Stability Board (FSB)<sup>3</sup>, which led to the establishment of the Task Force on Climate-related Financial Disclosures (TCFD) in 2015. Also, public awareness is rapidly increasing, influencing consumer choices and policymaking. This makes climate change a defining factor in companies' long-term prospects.

In other words, **climate risk is a business risk.**

Decarbonization and profits are not a zero-sum game. The World Economic Forum found that eco-innovation-focused companies grow at an annual rate of 15% at a time when many competitors remain flat<sup>[2]</sup>. While this finding merely suggests a correlation, findings from the Capgemini Research Institute go even further by finding elements of causation: for example, 63% of organizations found that sustainability initiatives helped with boosting sales<sup>[3]</sup>. The main revenue drivers result from tapping into new markets, developing new products, increasing brand equity, and promoting innovation. Climate action is thus a win-win strategy: business performance increases while environmental pollution decreases.

Apart from the top-line incentive, neglecting the climate imperatives exposes to costly business risks:



Considering these factors not only better prepares a business for the various risks brought by climate change, but may also enable businesses to turn these risks into opportunities. Eventually, there will be companies that come out as the **climate winners**, and they will be the ones that recognized these risks early, reacted accordingly, and actively pushed their organizations to become more adaptive and responsive.

<sup>1</sup> 2030 being the IPCC's deadline to limit the global average temperature rise to 1.5 degrees Celsius. IPCC stands for Intergovernmental Panel on Climate Change and is a UN intergovernmental body dedicated to providing the world with objective, scientific information about climate change.

<sup>2</sup> Science Based Targets is a joint initiative of the Carbon Disclosure Project (CDP), the UN Global Compact (UNGC), the World Resources Institute (WRI), and the World Wide Fund for Nature (WWF), aimed at helping businesses set a plan for corporate climate action.

<sup>3</sup> FSB is an international body that monitors and makes recommendations about the global financial system. Headquartered in Basel, Switzerland, the board includes, among others, all G20 major economies and the European Commission.



## Transition risk

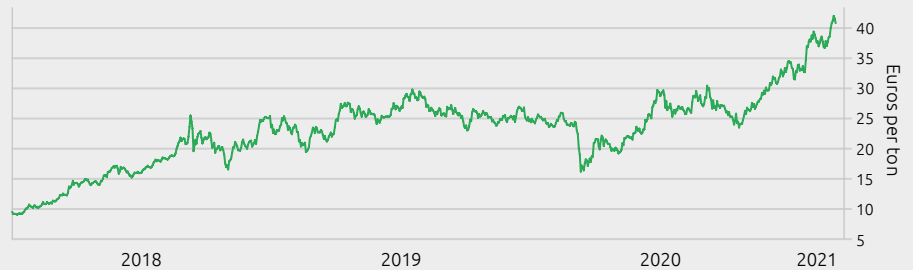
Transition risks include technology, liability, and reputation risks in the context of decarbonization. However, transition risk predominantly refers to risks due to policy changes. In the EU, the European Green Deal will lead to a myriad of initiatives changing the business environment significantly. These initiatives include Climate Law, the European Climate Act, and the 2030 Climate Target Plan.

Consequently, policy changes such as carbon taxes, minimum energy efficiency requirements, and reporting requirements are to be put in place to incentivize a shift from high-carbon to low-carbon economies. Companies that are not prepared for this may face substantial asset revaluations, increased cost of operations, and penalties or fines. Here, the most exposed companies are the ones that continue to operate “business as usual”.

The magnitude of the expected policy changes can be exemplified by European CO<sub>2</sub> certificates. As European CO<sub>2</sub> certificates can be purchased at auctions and are traded on exchanges, the price of the certificates does not reflect just the current cost of emitting CO<sub>2</sub>, but also the price of expected future regulation. In 2020, the price of those certificates reached record highs, increasing by 88% from March 2020 to more than €32 in December 2020<sup>[4]</sup>. This surge reflects the expectation that more ambitious climate targets will be set by the EU in the future.

## Luring Big-Money Investors

EU carbon prices soar on Green Deal



Source: Bloomberg

## Case Example: Ørsted

Ørsted is a Danish multinational power company based in Fredericia, Denmark. They have become a textbook example of how to transform your business into a predominantly sustainable business and reduce transition risk by being ahead of the curve. Ørsted had always been a traditional energy business, based on oil, gas, and coal. At a time, Ørsted (previously known as Dong Energy) formulated the 85/15 vision, where 85% of their power and heat production was black and 15% was green. In 2009, Ørsted laid out a bold and ambitious plan to phase out fossil fuels and flip that ratio around, so that at least 85% of their power and heat production would be green and 15% black. By 2018, Ørsted's green energy output was 75% and the company had reduced its CO<sub>2</sub> emissions by 72%. By 2025, green energy is set to account for 99%, while emissions are expected to fall by 98% compared to 2009. Now, Ørsted is the world's largest offshore wind energy producer and transformed from one of Europe's most coal-intensive companies to a green energy giant. Ultimately, Ørsted was selected as “The World's Most Sustainable Company of 2020”.



## Capital markets risk

Capital market risk in this context refers to the risk companies face when financing their assets with debt or equity.

In 2018, sustainable investment assets reached more than \$31T globally<sup>[5]</sup>, having risen 34% in two years. This is around one-third of global assets under management. Moreover, a comprehensive survey conducted by INSEAD<sup>[6]</sup> revealed that climate action was the most important sustainability factor when evaluating an investment target for institutional investors.

This significantly changes the way capital markets allocate resources. Another study by Landier et al. suggests that investors are willing to pay \$0.70 more per share for socially responsible companies (as indicated by charitable giving) while penalizing socially irresponsible companies with -\$0.90 per share<sup>[7]</sup>.

Of course, many companies' equity or debt already counts as being a sustainable investment if their industry passes a negative screening. However, investors, rating agencies, and other stakeholders are becoming increasingly sophisticated in their analyses and resource allocation.

For example, more rigorous ways of evaluating if a company is truly sustainable include screening companies against common standards issued by bodies such as the UN or OECD, the implicit inclusion of Environmental, Social, and Governance (ESG) factors in the financial analysis, or even impact investing. Companies that do not look favorable in the eyes of a sustainable investor can experience adverse effects.

Shareholder activism<sup>[8]</sup> has played a large role in this transition, putting the necessary pressure on publicly listed companies to adopt climate-friendly practices, and putting the companies at risk of divestiture when failing to do so.

**\$30.7 Trillion** in funds were held in sustainable or green investments in the five major markets in 2018<sup>[5]</sup>

**34%** growth of global sustainable investment markets across the world<sup>[5]</sup>

**Carbon emissions of the portfolio companies per \$ of revenue** surveyed as the most important ESG metric of capital market investors<sup>[9]</sup>



### Customer risk

Reportedly, 79% of consumers prefer sustainable goods and services<sup>[3]</sup>. The primary driver is that 72% of consumers are personally concerned about their environmental footprint in their purchasing behavior. While some may argue that broad customer segments will always prioritize price over a product's carbon footprint, it turns out that decarbonization is unlikely to put a substantial price tag on products in the end. According to the Emission Transition Commission<sup>4</sup>, the impact of decarbonization on prices faced by end consumers varies by sector but is small overall. For example, the decarbonizing of steel for the production of cars adds a mere \$180 to the customer price, and using zero-emissions plastics increases the price of a liter of soft drinks by less than \$0.01<sup>[10]</sup>.

Moreover, COVID-19 further encourages carbon-conscious buying behaviors. In a recent study, 67% of consumers said that they will be more cautious about the scarcity of natural resources<sup>[3]</sup>. This cements the fact that ignoring current buying patterns is a missed opportunity in the short run, but will become an existential threat when competitors offer a similar quality product with fewer emissions in the future.



### Talent risk

The ability to attract and retain top talent is increasingly connected to climate ambitions. Younger generations are demanding companies take climate action. Now, Fridays for Future has not only arrived at family dinner tables but is also subject to increased employer scrutiny. At least 12 peer-reviewed studies found that "top jobseekers are highly attracted to organizations with sustainable practices"<sup>[13]</sup>. This finding is supported by a Hewlett-Packard survey<sup>[14]</sup>, revealing that, in 45% of cases, sustainability is a major factor for choosing an employer. Moreover, employees are more likely to be satisfied with their jobs if they work for a company that's perceived to be environmentally friendly, according to a study from the University of Dartmouth<sup>[15]</sup>. In it, a survey of 504 employees across different sectors revealed that 61 % of those whose organizations participate in environmentally friendly practices are "likely" or "very likely" to stay with their current employer. This sentiment underscores the fact that climate action supports attracting and retaining top talent, as employees are more motivated to work for a company aligned with their climate values.

### Case Example: Google

Google and Amazon are ideal examples to understand how sustainability can be means of employee retention. In mid-September 2019, 2,000 Google employees (as well as thousands of employees from Amazon, Microsoft, and other tech companies) participated in The Global Climate Strike, protesting over the tech giants' inaction on climate change. Later, 2,302 Google workers also signed an open letter<sup>[16]</sup> calling for Google to commit to a climate plan, which would include hitting a zero-emissions target by 2030. Workers spoke, Google listened: the tech giant has indeed committed to climate action<sup>[17]</sup> and aims to operate on fully carbon-free energy by 2030. As tech companies are now forced to address the climate issue to attract and retain top talent, many (e.g., Salesforce<sup>[18]</sup>) have followed suit.

<sup>4</sup> Emission Transition Commission is a global coalition of leaders from across the energy landscape committed to achieving net zero emissions by 2050.

# BUILDING A CLIMATE STRATEGY KIT

## Categorizing the scope of your emissions

The first step to defining a climate strategy is to determine your emissions baseline. Measuring and reporting emissions is on its way to becoming an industry standard – just as reporting financials are. In this section, we'll briefly explain the main components of the emissions your company is most likely generating.

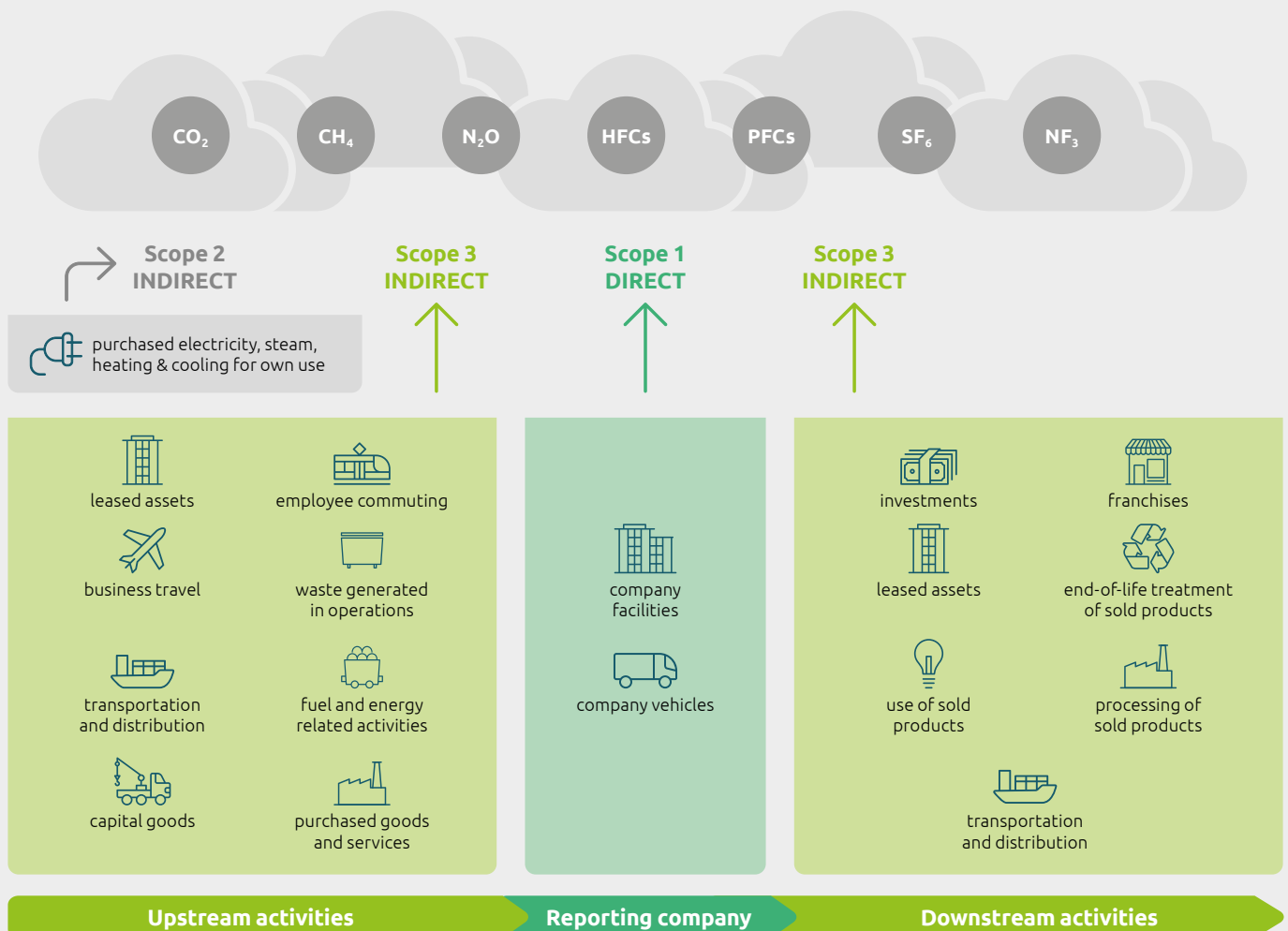
Measuring emissions is a sophisticated process, so make sure you collaborate with the right partners along the way.

9 out of 10 Fortune 500 companies reporting to the Carbon Disclosure Project<sup>5</sup> use the Greenhouse Gas Protocol<sup>[19]</sup>, which provides the world's most widely used greenhouse gas accounting standards for companies. It divides emissions into Scope 1, Scope 2, and Scope 3 emission sources:

**Scope 1 refers to the direct emissions** from the activities of an organization or under its control. Including fuel combustion on-site such as gas boilers, fleet vehicles, and air-conditioning leaks.

**Scope 2 refers to the indirect emissions** from electricity purchased and used by the organization. Emissions come from the generation of purchased electricity.

**Scope 3 includes all indirect emissions (not included in Scope 2)** that occur in the value chain of the reporting company, including both upstream and downstream emissions. There are 17 different categories of Scope 3 emissions, such as business travel, capital goods, employee commute, and use of sold products to mention just a few.



Based on: GHG Protocol

<sup>5</sup> Carbon Disclosure Project, or CDP, is a not-for-profit charity running the global disclosure system for investors, companies, cities, states, and regions to manage their environmental impacts<sup>[27]</sup>.

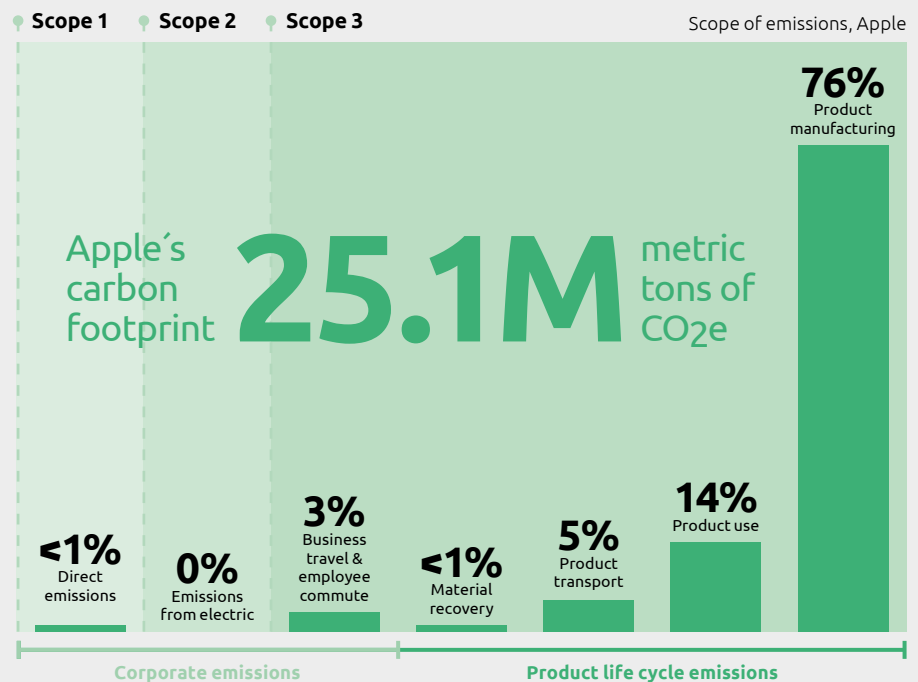


Scope 3 emissions are ultimately the hardest to measure, but in many cases, they cover almost 80–90%<sup>[20]</sup> of a company's emissions. Looking at Apple<sup>[21]</sup>, for example, and breaking down its emissions per scope, we can see that emissions from electricity (Scope 2) generate far fewer emissions than business travel and employee commute (which is only 1 out of the many categories in Scope 3):

Of course, scopes differ per industry. In the oil and gas industry, Scope 3 emissions are reportedly six times larger than Scope 1 & 2 emissions<sup>[22]</sup>. Considering only Scope 1 and Scope 2 is therefore misleading when assessing where the company truly stands in terms of emissions.

Measuring Scope 3 is thus crucial for companies to be able to report on emissions transparently. Also, it helps businesses do the following:

- ✔ Assess where they are emitting the most through the supply chain
- ✔ Identify resource and energy risks in the supply chain
- ✔ Identify energy efficiency and cost reduction opportunities in the supply chain
- ✔ Ensure and secure the right supply chain partners that are also taking climate action



Source: PlanA.Earth

## Aligning expected emissions with temperature targets

Once the emissions of a business are fully understood, managers may wonder what emissions target to set for their company. As one of the end goals of reducing emissions is to reduce the impact of climate change, and thus rising temperatures, significant research has focused on translating emissions into one actionable and easy to grasp concept: how much global warming can we expect if all entities operated at the same economic emission intensity as the entity in question? The results are expressed tangibly as degrees Celsius or Fahrenheit.

For example, a fairly decarbonized business may align its efforts with a global temperature rise of 1° Celsius, while a rather carbon intensive business may choose to align with a temperature rise of 3° Celsius. In both cases the concept makes the fictional assumption that all businesses operate at the same carbon intensity as the business in question.

The concept of temperature alignment has been gaining momentum in recent years not only because it allows for an intuitive and transparent target setting, but also because the financial sector, in particular, has been embracing the concept; after all, it allows for easy calculation of the climate impact of entire portfolios. However, as one might guess, defining the temperature alignment of a particular company relies on various assumptions and simplifications, making the comparability between companies far from perfect at present.



## Key Strategy Components



Vision



Target setting



Strategic options



Framing



Implementation



Initiatives

### Revamping business strategy for the sustainability imperative

Having fully understood the Scopes of emissions, the next step is to adapt your business strategy to the new sustainability imperative.

A critical factor is to **set the appropriate emissions or temperature alignment target** and ensure its implementation through the **coherence in the company's vision, strategy, and execution**.

The cornerstones of a coherent strategy are:

- ✓ Have a clear **vision** that incorporates the necessary climate ambition
- ✓ Set the appropriate **emissions target**
- ✓ **Rely** on the target to guide actions and business decisions

Keeping these unified helps to establish a sustainable business model (monetization) and operating model (enabling capabilities) while reducing emissions at the same time.

The strategic cornerstones can be broken down into six critical components: vision, emissions target, strategic options, framing, implementation, and initiatives. In turn, we distilled these components into key questions, which can be used to lay a foundation for developing a business strategy with a cutting-edge climate dimension. Supplementing the theory, we have two case studies from the earlier mentioned Ørsted, and retailer IKEA, on how they tackled the critical components. Ørsted is a textbook frontrunner at transforming its business model, while IKEA has recently initiated substantial emissions reduction commitments and has a long journey ahead.



#### Vision

Assess if you have a clearly formulated **vision**: are you aware of your climate goal?

- ✓ Does this vision appropriately incorporate today's and tomorrow's challenges and trends?
- ✓ As set out in this paper, one megatrend is going to be the decarbonization of the economy. So, does your vision incorporate this trend or benefit from it?
- ✓ Do you want to passively comply with the externally determined targets, or do you want to actively push a positive change to combat climate change by not only reducing your emissions but also advocating for change in your industry and community?

#### Case Example: Ørsted

Ørsted Vision – Let's create a world that runs entirely on green energy.



#### Target setting

Having understood the source and magnitude of climate emissions, the next step is to concretely determine the emissions reduction or temperature alignment target. This target is based on the respective Scope 1, 2, and 3 emissions targets derived earlier.

### Scope 1 reduction target: Prioritize energy efficiency

Scope 1 refers to the direct emissions that are created from business operations. Companies have been able to meet their short-term emissions reduction targets by upgrading their equipment, which simultaneously resulted in more energy-efficient equipment and lower costs<sup>[23]</sup>.

#### Make sure you don't rely on fossil fuels:

Fossil fuels used in company operations are still very common. Here are a few tips on how to make a change: electrify your fleet by switching from combustion engines to electric vehicles, and on-site upgrade from coal boilers to cleaner alternatives.

When formulating your Scope 1 target, make sure you focus on efficiency upgrades and optimizations. Being able to monitor the emissions is as important as the upgraded equipment, so having the proper data management software in place is vital.

### Scope 2 reduction target: Switch to renewable energy

The main things to include in a Scope 2 target are Energy Attribute Certificates<sup>6</sup> and switching to renewable energy. An initiative that is especially driving change within Scope 2 is RE100<sup>7</sup>, which aims to drive companies to use 100% renewable electricity.

Changing from electricity supplied via fossil fuels to renewable energy is a viable option in many countries. This is also one of the easiest ways for companies to start acting on climate change.

## Scope 3 reduction target: Innovate and optimize

Having Scope 3 reduction targets is not only a way to fight climate change, but it's also a very good business opportunity. GHG Protocol identifies the following business goals related to Scope 3 emissions:

- ✓ Identify and understand the risks and opportunities associated with value chain emissions
- ✓ Identify GHG reduction opportunities, set reduction targets, and track performance
- ✓ Engage suppliers and other value chain partners in GHG management and sustainability
- ✓ Enhance stakeholder information and corporate reputation through public reporting

### Case Example: IKEA

IKEA announced that it will become carbon positive by 2030. This goal was spearheaded by the commitment of the largest IKEA franchisee to reduce its Scope 1 and 2 emissions by 80%. In addition, IKEA's worldwide franchisor and entity responsible for the supply chain pledged to reduce value chain GHG emissions by at least 15%. This will result in an average 70% reduction of the climate footprint per IKEA product.<sup>[28]</sup>



## Strategic options

Sustainable transformations tend to be large-scale investments. It is therefore essential to evaluate your options appropriately and see what you can and cannot realistically do:

- ✓ Within the decarbonization dimension, where do you choose to play and not to play?
- ✓ Does your company have the resources, skills and know-how to enable you to reach your vision?
- ✓ In the sustainability field, what is a differentiator that makes you unique from your competitors?
- ✓ What strategy to win against current or emerging competitors has a clear sustainable edge?

### Case Example: IKEA

In summary, IKEA identified the following three strategic options to become carbon positive by 2030<sup>[28]</sup>:

- ✓ Putting the concept of the circular economy at the heart of every product by designing it to be repurposed, repaired, reused, resold, and recycled
- ✓ Relying to 100% on renewable energy across the entire IKEA value chain
- ✓ Being conscious of and advocating for business activity within the resource limits of the planet



## Framing

Formulate the appropriate goals, milestones, roadmap and guidelines:

- ✓ What goal milestones need to be set in order to achieve decarbonization?
- ✓ How does that translate into a strategic roadmap?
- ✓ Which emissions reduction program should be prioritized and/or established to progress the strategic roadmap?
- ✓ Which capabilities and strategic governance are needed to efficiently reduce emissions?

### Case Example: IKEA

IKEA developed a simulation tool to support the framing process. The goal of the tool is to help IKEA determine its Scope 3 target-based goals and areas for innovation. It covers 99% of the Scope 3 emissions and focuses primarily on "raw materials extraction and processing, production, food ingredients, customer travel, deliveries and product use in customers' homes". It can assess the emissions impact of different activities, identifies gaps, and recommends measures. The tool enabled IKEA to develop a concrete roadmap to reduce its emissions.<sup>[28]</sup>

<sup>6</sup> Energy Attribute Certificates (EACs) verify that one megawatt-hour of electricity was generated and fed into the grid from an eligible renewable source. By purchasing an Energy Attribute Certificate you are entitled to claim the environmental benefits related to green power generation. This is a flexible and cost-efficient option for companies not only to meet their green energy targets but to also reduce their Scope 2 carbon footprint<sup>[24]</sup>.

<sup>6</sup> RE100 is the global corporate renewable energy initiative bringing together hundreds of large and ambitious businesses committed to 100% renewable electricity<sup>[25]</sup>.



## Implementation

Develop strategies on different organizational levels:

- ✓ It is vital to address how to achieve the strategic decarbonization objectives (strategic roadmap goals, milestones) throughout your organization
- ✓ Are the strategies across all organizational levels aligned with the overall strategy?
- ✓ Which strategic targets are obligatory to succeed on the strategic roadmap to decarbonize?
- ✓ How can the organization achieve them?

### Case Example: Ørsted

Ørsted tackled this challenge by installing governance which drives the sustainability imperative within the strategy. At the top, there is an Executive Committee managing three subcommittees: 1) Compliance Committee, 2) Sustainability Committee, and 3) Quality, Health, Safety, and Environment Committee. In summary, the Executive Committee proposes sustainability targets as part of the corporate strategy, approves the portfolio of sustainability programs, and monitors the implementation of initiatives by the business units and global functions. The structure ensures harmonized sustainable strategies across all organizational levels<sup>[29]</sup>.



## Initiatives

Finally, develop strategic initiatives to decarbonize your business:

- ✓ How do you implement and execute the strategy on the operational level? What strategic initiatives / projects need to be run?
- ✓ Initiatives to consider: Science Based Targets (setting emissions reduction targets that are aligned with the Paris Agreement), Carbon Disclosure Project (quantifying your current emissions levels), RE100 (committing to acquire 100% of the electricity used from renewable sources).

### Case Example:

In order to make the options for actions tangible, Science Based Targets recognized different emissions reduction levers from Scope 3<sup>[26]</sup>:

#### Business model innovation

- ✓ Put a price on carbon
- ✓ Increase product lifespans
- ✓ Consider shifting toward product-service systems
- ✓ Increase efficiency in logistics

#### Supplier engagement

- ✓ Engage with suppliers so that they reduce their emissions, ideally in line with climate science
- ✓ Identify key suppliers to engage and maintain a collaboration via two-way communication channels, monitor progress regularly, and create incentives for action

#### Procurement policy and choices

- ✓ Continue purchasing the same products, but from suppliers with a lower carbon footprint
- ✓ Shift toward low-carbon alternatives

#### Product and service design

- ✓ Design products that are more efficient so that the lifecycle emissions intensity is lower
- ✓ Integrate circular economy principles in product and service design

#### Customer engagement

- ✓ Engage customers either directly through education, collaboration, or compensation; or indirectly through company regulation, or customer motivation via marketing and choice architecture

#### Operational policies

- ✓ Develop operational protocols
- ✓ Launching operational incentive programs

#### Investment strategy

- ✓ Invest in low-carbon projects, companies, and resilient development, and shift investment away from fossil fuels, accelerating the transition to a low-carbon economy

This from vision to initiatives breakdown is a starting point to highlight the quintessential factors you need to address to decarbonize your business. The time to start creating your sustainability and climate strategy is now.

# CONCLUSION

In 2021, responding to climate change is not an option – it's a strategic imperative.

Due to its profound impact on the world and our society, climate change will continue impacting virtually every aspect of your business. Taking action on reducing emissions has to become a top priority on the agenda of business executives.

As outlined in this paper, regulatory changes are on the horizon and every business will have to adapt. Future climate winners will excel – and it'll be those who have understood the source of their emissions, set the appropriate emissions reduction targets, and successfully transformed climate risks into business opportunities. And, customers and talent are increasingly drawn to sustainable businesses that have clear climate ambitions.

So the final question remains: will climate strategy be part of your business strategy in 2021?

Would you like to discuss your ideas on business strategy for climate change with our experts or read more about sustainability in business? See below for our expert contacts and further reports & articles from our portfolio.



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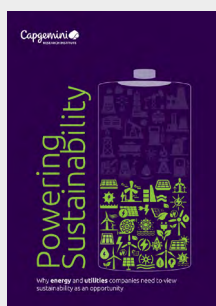
## Climate AI

How artificial intelligence can power your climate action strategy



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How sustainability is fundamentally changing consumer preferences



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## Powering Sustainability

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