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Decarbonization in the A&D industry

By Grant McDonald

2023 is set to be the hottest year on record.

Every day brings fresh examples of the impact of climate change around the world from dangerously high temperatures, flash flooding, droughts, and epic wildfires. As a colleague recently pointed out, we shouldn't despair but rather view this as a call to action.

Aerospace and defence (A&D) companies face a significant challenge to meet the goal of net-zero carbon emissions by 2050. Aviation has contributed about 4 per cent to global warming to date while the defence industry and the global armed forces produce 6 per cent of heat-trapping greenhouse gas (GHG) emissions.[1]

To map the A&D industry's progress in reducing emissions, KPMG International recently analyzed the environmental, social, and governance (ESG) and net-zero emission announcements from 22 of the world's largest A&D companies by market capitalization.[2]

The analysis found that just half of these A&D giants, primarily Europe-based entities, have publicly stated their commitment to achieve net-zero carbon emissions by 2050.

Half – with four headquartered in the U.S. - have set clear "absolute" scope 1, 2 and 3 emission targets. An absolute target refers to a target that aims to reduce emissions by a set amount. Six companies have gone part of the way, such as outlining their broad commitment to reducing emissions, but they haven't said by when, and five have not made any commitments to reducing scope 1, 2 and 3 emissions.

To recap, scope 1 covers carbon emissions from sources an organization owns or controls directly and scope 2 are indirect emissions created by the production of energy that an organization buys. Like scope 2, scope 3 are also indirect emissions but they are produced by customers using the company's products or those produced by suppliers making products that the company uses.

On the scope 3 front, half of the A&D companies are aligned and working closely with suppliers to reduce GHG emissions and 18 per cent plan to include suppliers in their decarbonization practices. The remaining seven (32 per cent) say they intend to work with their suppliers to find more efficient methods to reduce scope 3 emissions but they're still trying to figure out the best way to go about that.

Ten of the 22 companies are committed to the Science Based Target initiative (SBTi), five European companies are starting the SBTi certification process, and seven haven't decided whether to align with SBTi or not. The SBTi is a partnership between the CDP, a global non-profit that runs the world's environmental disclosure system, the United Nations Global Compact, World Resources Institute (WRI) and the World Wide Fund for Nature (WWF). It defines and promotes best practice in science-based target setting for private sector companies.

As well, 10 companies – primarily in the U.S. and the U.K. - have performed the Task Force on Climate-related Financial Disclosures (TCFD) analysis and developed climate strategies based on the identified risks and opportunities. Seven have signed up for TCFD principles and five have not made any disclosures.

New standards

Of note, the release of the International Sustainability Standards Board's (ISSB) first two IFRS Sustainability Disclosure Standards in June marks a significant step toward a global baseline for investor-focused sustainability reporting that local jurisdictions can build upon.[3]

The IFRS S1 *General Requirements for Disclosure of Sustainability-related Financial Information and IFRS S2 Climate-related Disclosures* are effective from January 1, 2024. Individual jurisdictions, including Canada, will decide whether and when to adopt the ISSB standards, although some companies may choose to adopt them voluntarily. The final U.S. Securities and Exchange Commission rules are expected to be released in October.

The call to action

The way forward is to implement an integrated approach based on three key pillars: building a climate-aware corporate culture, aligning decarbonization goals with enterprise strategy, and developing a plan for the next 25 years.

Where does responsibility for decarbonization and ESG reside within your organization? At the board level? Within the executive ranks? Delegated to a staff level? Or a combination of these? If organizations are serious about making climate change a priority, then it must start with an action-focused tone at the top which is then cascaded down within the organization to create buy-in. It requires a fundamental shift in how people are incentivized, how the governance model is set up, and how policies are designed to build a climate-aware culture within the organization.

It is important to establish a baseline. This includes assessing the opportunities and risks from the impact of climate change on the organization and stakeholder demands for decarbonization. The initial assessment must be thoroughly vetted and validated.

Decisions will then need to be made, including redesigning policies and processes, governance systems, staffing and human resources, investment cases, and potentially establishing alliances with other members of the industry, and considering mergers and acquisitions.

It's not easy to plan five years ahead, let alone 25 years. Transforming on multiple tracks simultaneously is challenging but possible. Decarbonization strategies will need to be continuously assessed to maintain the necessary pace of change and stay aligned with the mission.

Grant McDonald is the Global Aerospace and Defence Industry Sector Leader at KPMG International. For more information, visit, www.kpmg.ca. The views expressed here are his own and do not necessarily reflect a CDR editorial position.

1 *KPMG International, "Sustainability in the Aerospace & Defense Industry", July 2023*

2 *Ibid*

3 *The International Financial Reporting Standards Foundation, "ISSB issues inaugural global sustainability disclosure standards", June 26, 2023, and KPMG Global IFRS Institute*

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