In light of current market movement on climate-related disclosures, this research note presents two studies that examine the impact of disclosure through the CDP (formerly the Carbon Disclosure Project) and the SEC (U.S. Securities and Exchange Commission) on a firm’s access to capital. Study 1 found that between 2012 and 2016, firms that disclosed through the CDP ranked 19 percentiles better than the average firm in their ability to access capital, while firms that disclosed through the SEC ranked 4 percentiles worse than the average. Study 2 found that investors favoured CDP because: i) comprehensive voluntary disclosures signal high-quality management teams, with enhanced awareness of material threats and opportunities posed by climate change; and ii) comprehensive voluntary disclosures enable dialogue between firms and investors that consider climate change as material to their business. As a result, investors are more likely to provide capital to firms that disclose through the CDP.
The Role of CDP Disclosure to Improve Access to Capital
October 2019

Introduction

According to the World Economic Forum’s 2019 Global Risks Report1, climate change has been considered to be among the top five global risks in terms of likelihood and impact since 2011. In response to this global challenge, standard setters and framework providers have developed a variety of tools for firms and investors to discuss climate change risks and opportunities, strategies for response, and information on greenhouse gas emissions. Securities regulators such as the U.S. Securities and Exchange Commission (SEC) and the Ontario Securities Commission (OSC), as well as non-governmental actors such as the CDP (formerly the Carbon Disclosure Project), the Global Reporting Initiative (GRI), and the Sustainability Accounting Standards Board (SASB) - to name a few - have provided numerous frameworks on how to disclose climate-related information.

Given the rising importance of climate change to actors in the financial system, many issuers, investors and academics are exploring if and how disclosures on climate-related information should be made2 3 4 5. Do climate-related disclosures lead to better financial performance, or are they merely a symbolic measure to improve public reputation, without materially affecting the firm’s performance? Are capital allocation decisions affected by climate-related disclosures? Does disclosing climate-related information create value and does it justify the costs? If so, where should firms disclose climate-related information given the proliferation of rules, guidelines and standards on sustainability? To help answer some of these complex questions, this research note examines one dimension in which climate-related disclosures could affect firm performance: access to capital.

STUDY 1 – STATISTICAL ANALYSIS METHODOLOGY

Study 1 focused on statistically comparing access to capital of firms that didn’t disclose climate-related information against firms that disclosed through at least one of two channels: i) the CDP (formerly the Carbon Disclosure Project, a voluntary disclosure channel for climate-related information); ii) the SEC regulatory filings (a mandatory but weakly enforced channel for climate-related information). The total population of firms in the study dataset included 5,195 unique U.S. and Canadians firms between 2012 and 2016. Within this population, an annual average of:

• 180 firms (about 5% of the population) disclosed climate-related information through both the CDP and the SEC,
• 80 firms (about 2% of the population) disclosed climate-related information only through the CDP,
• 1,335 firms (about 33% of the population) disclosed climate-related information only through the SEC, and
• 2,350 firms (about 59% of the population) did not disclose climate-related information through either the SEC or the CDP.

Climate-Related Disclosures and Access to Capital

“Access to capital” is a measurement of a firm’s ability to fund desirable investments. Firm-level access to capital may be affected by credit constraints, inability to borrow, inability to issue equity, overdependence on bank loans, or asset illiquidity6. Academic research has found that access to capital is important for strategic decision-making because it affects major investment decisions7, the firm’s capital structure choices8, and subsequent stock market performance. Moreover, better access to capital has been shown to be linked to higher ESG (environmental, social and governance) ratings because it reflects a firm’s strength in transparency and stakeholder engagement9.

The Analytical Approach

Two studies were conducted to understand if and why climate-related disclosures affect access to capital. The first study involved a statistical analysis of publicly traded firms in U.S. and Canada. The second study was based on one-on-one interviews with twenty-one professionals working for issuers that disclosed climate-related information and/or analyzed disclosures as asset managers and analysts. Together, the studies provided both a macro and micro perspective on if and why climate-related disclosures affect access to capital. A brief overview of each study, and the implications of their findings is provided in the following pages.
A sectoral breakdown of climate-related disclosures by channel is provided in Exhibit 1. Manufacturers are the most prolific disclosers of climate-related information through both the CDP and SEC. Firms in mining and construction are more likely to disclose through the SEC than through the CDP. The financial sector was excluded from the analysis due to methodological limitations. The statistical models controlled for firm performance, size, industry, year, and pooled effects. Additional analysis with matching techniques were conducted to build support for causality of findings.

Exhibit 1 – Disclosure through CDP and SEC by sector

Study 1 - The Statistical Link

Study 1 focused on examining statistically significant links between a firm’s disclosure channel and their access to capital. The key finding of this study, as seen in Exhibit 2, is that firms that disclosed only through the CDP rank 19 percentiles better on their ability to access capital as compared to the average ranking. On the other hand, firms that disclosed only through the SEC ranked 4 percentiles worse than the average ranking. Firms that disclosed through both the CDP and the SEC rank 2 percentiles better than the average ranking, suggesting that firms that disclose climate-related information through the SEC offset their loss of access to capital when also disclosing through the CDP.

Findings from Study 1 were statistically significant (p<0.001) even after controlling for firm size, financial performance, and ESG ratings. Exhibit 3 shows that capital constraint advantage for disclosure through the CDP is more or less independent of size. Similarly, the access to capital disadvantage of firms that disclose climate-related information through the SEC only is also independent of firm size.

While Study 1 provides statistically compelling conclusions on the effect of climate-related disclosures on access to capital, it does not provide explanations on the mechanisms underlying this phenomenon. To help address this shortcoming of Study 1, a second interview-based study was conducted to help confirm and identify mechanisms linking access to capital and climate-related disclosures.
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Study 2 - The Market Perspective

Study 2 was focused on interviewing investors and corporate sustainability professionals about the role of climate-related disclosures in the organization, and in particular, its effects on firms’ performance. Twenty out of the twenty-one interviewees that participated in Study 2 cited specific examples in which capital transactions were affected by disclosure of climate-related information. Critically, disclosure through the CDP positively affected capital allocation decisions for two reasons:

1. Comprehensive and voluntary disclosures signaled to a subset of investors that the firm has a strong management team and is capable of managing the risks and opportunities of complex issues such as climate change;

2. Comprehensive and voluntary climate disclosures enabled dialogue between investors and firms concerned about the financial consequences of climate change, which helped establish new channels between the two parties to discuss various issues considered material to the business.

For these two reasons, investors seemed to provide more capital resources to this subset of companies.

Exhibit 4 – Interviewee Sample Quotes

“People care more about: ‘Are you reporting to the CDP?’ They don’t care how we do on the CDP, they care that we report (...). Whether [the request comes from] RFPs, investors, analysts, the CDP itself... They don’t care how we do, they just want us to report. Kind of like the U.S. Government would like me to report my taxes.”
- Corporate Employee

“In the common everyday discourse on the street, people think ‘when you report you are probably more transparent and you are more sophisticated, and able to manage harder things’. If you’re managing that intangible information then you are good at managing other stuff, and you are also able to attract top talent. I believe that it’s a perception thing...”
- Bank Employee

STUDY 2 – MARKET PERSPECTIVE METHODOLOGY

Insights were sought from the market by interviewing twenty-one issuers, analysts and other market participants. All interviewees worked for or provided capital for organizations that are publicly traded on U.S. stock markets (and therefore regulated by the U.S. federal government’s Securities and Exchange Commission). The interviews took place between November 2018 and January 2019. Each interview was guided by a sequence of questions designed to understand the interviewee’s role, the role of climate-related disclosures in their work, what they believe drove climate disclosures, and what they believe was the effect of climate disclosures on companies. The interviews were analyzed based on parameters considered to be relevant to the link between climate-related disclosures and access to capital.

Patterns, themes, and concepts were identified to help determine if and why capital allocation decisions were affected by disclosure of climate-related information, as suggested by the statistical analysis of Study 1. The goal was to capture insights from interviewees that reflected their thoughts on climate-related disclosures with respect to their work, while being guided by the principle of mutually exclusive and collectively exhaustive categorization.

It is also important to consider what interviewees didn’t talk about. In particular, neither investors nor issuers referenced climate-related disclosure through the SEC as a valuable source of information, indicating that the information in this channel did not provide the signals or dialogue that the CDP generates. This makes sense, as regulatory disclosures are biased towards disclosing risk-related information and therefore unlikely to broker trust between investors and the firm without the mention of positive opportunities associated with climate change. Moreover, disclosure on ESG issues to the SEC has largely remained boilerplate language and has increased threefold over the last 10 years. Additionally, it is possible that consumers of SEC disclosures are less specialized in the issue of climate change, prompting neutral or negative reactions to climate-related information from capital markets.

11. As mentioned by SEC Commissioner Robert J. Jackson Jr. at the 2019 PRI in Person conference held in Paris on September 10, during the panel discussion titled “What global policy developments mean for responsible investors”.

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Study 2 found that firms that disclosed climate-related information had the following characteristics:

- ESG issues integrated into management processes;
- Proactive investor relations management;
- Typically larger in size;
- Proactive in engaging political, regulatory and industry bodies; and
- Climate-related disclosures used as a tool by the management team to both bring visibility into the firm’s internal operations and manage risks.

Similarly, the subset of investors that rewarded comprehensive and voluntary disclosure on climate-related information had the following characteristics:

- Dedicated employees and teams for ESG analysis and Responsible Investment (RI);
- Smaller asset managers had limited resources to analyze climate-related disclosures;
- Larger asset managers had difficulty finding enough investment opportunities while also accounting for climate-related disclosures;
- Were active long-term investors; and
- Considered the issue of climate change as financially material to their investment returns.

The Case for Comprehensive Climate-Related Disclosure Through the CDP

Together, the studies demonstrate that comprehensive and voluntary disclosure channels such as the CDP can broker trust between firms and investors that see a material link between climate change and their investments’ return, leading to improved access to capital. On the other hand, disclosure through regulatory channels - at least through the SEC – provides incomplete information, focussed exclusively on the most important risks, which not only fails to gain investor trust, but can even undermine it, leading to diminished access to capital.

More fundamentally, the findings presented in this research note seem to be rooted in a deeper phenomenon in which investors favour firms that can demonstrate their ability to handle complex and uncertain issues. The issue of climate change is certainly not the only complex issue that affects businesses, but its global scope and multi-faceted nature provides a unique opportunity for firms to demonstrate their risk management capabilities and their ability to tap into the rising climate-related opportunities. It is fitting, therefore, that many interviewees also viewed comprehensive climate-related disclosures as an essential part of a good risk management process.

Based on the findings of the studies presented in this research note, there is a strong case for corporate issuers that are contemplating where to disclose climate-related information to consider the historically positive benefits of climate-related disclosure through the CDP. The results from both studies suggest that comprehensive disclosure through the CDP helps firms attract capital from investors that look to the long-established CDP brand as a comprehensive and voluntary disclosure framework of climate-related information. Moreover, disclosure through the CDP can help offset the diminished access to capital associated with limited disclosure of climate-related information through the SEC.

By the same token, investors could utilize findings presented in this research note by looking to comprehensive disclosure through the CDP as a proxy for well-managed and well-funded companies. Academic research shows that firms with better access to capital will have more opportunities to undertake strategic investments that help the firm grow, gain competitive advantage, and generate better financial returns over the long run. Companies that disclose climate-related information through the CDP can therefore be expected to provide more favorable financial returns over time as compared to companies that fail to disclose material climate-related information through voluntary channels.

The Future of Climate-Related Disclosures

Considering the increasing endorsement by issuers and investors of the recommendations by the Task Force on Climate-Related Financial Disclosure (TCFD) and that the CDP evolved to include disclosure in accordance with TCFD recommendations, this initiative has the potential to shape the future of climate-related disclosure. Given the results that we found with this research, the CDP could be a great mechanism to meet the recommendations of the TCFD. As issuers and investors increasingly recognize the importance of integrating material ESG issues in the conduct of their business to better manage risks and find opportunities, and in the context of increasing demand from stakeholders for transparency and disclosure, it would be interesting to see

whether the correlation between comprehensive and voluntary disclosure and access to capital applies to other ESG issues, beyond climate change.

In addition to disclosure, engagement is being recognized as a key mechanism by investors to influence corporate behavior. Considering the impact that Millani Inc.\textsuperscript{18} sees from the Canadian Expert Panel on Sustainable Finance’s final recommendations, companies should expect not only increased demand for disclosure, but also increased pressure from investors to engage in a constructive dialogue on climate change.

Another issue on the horizon is the systemic risk of abrupt policy change. In September 2019, the UNPRI published The Inevitable Policy Response\textsuperscript{19} report (IPR), which delivers a clear statement on the emergency of addressing climate change. According to this report, and in the context of the Paris Agreement’s fifth anniversary, there is recognition that government action has so far been “highly insufficient to address climate change and achieve the commitments made under the Paris Agreement...”\textsuperscript{20}. In this context, the report forecasts that governments’ response will be “forceful, abrupt, and disorderly because of the delay”\textsuperscript{21}. The report also states that market participants have not yet recognized that significant changes in regulation will happen, leaving them exposed to increasing risks, potentially causing instability to their investment portfolios and in the financial system.

In Canada, the Federal Government has put forward the Pan-Canadian Framework for Clean Growth and Climate Change\textsuperscript{22}, a plan to transition to a low-carbon economy. While this initiative is a good first step, more action can be expected from the government to address this systemic issue. As we move towards a highly regulated environment, companies from all sectors can expect increased pressure for transparency around climate change.

In this context, how is Canada positioned? How can market participants adjust to the upcoming landscape of increased regulation leading to a low-carbon economy? As investors act to protect and enhance the value of their assets, companies need to be proactive and to strategically prepare, disclose and engage in an economy where increased climate-related regulation will prevail.

ABOUT THE AUTHORS

This research note is the result of a collaboration between Amir Nosrat, PhD Candidate at McGill University’s Desautels Faculty of Management, and Millani Inc., a Canadian-based ESG consulting firm who serves investors, public companies and capital market participants. Millani partnered with Amir Nosrat to examine the following research question: “If and why disclosure channels affect firm-level access to capital”, a question that is also of great interest to Millani’s clientele. In an effort to maximize the usefulness of the research for issuers and investors, we are presenting here the most timely, market-relevant results. While the results are produced by Amir Nosrat as part of his doctoral thesis, McGill University policies prevent the University from officially endorsing or refuting any opinions or conclusions above.

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