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OPINION

ESG standards crucial for automakers

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While a sweeping, industry-specific deadline to meet emissions standards does not exist, automakers have a little time to build environmental, social and governance, or ESG, standards into the cost of doing business — but not much.

In the global Race to Zero efforts, the United Nations calls for emissions to be reduced by 45 percent by 2030 and reach net zero by 2050.

Ford, General Motors, Toyota, Nissan, Volvo and other automakers are among more than 90 companies who have joined the U.S. Department of Energy's Better Climate Challenge to reduce portfoliowide greenhouse gas emissions by at least 50 percent within 10 years.

As automakers prioritize environmental, social and governance, it increases pressure on manufacturers and suppliers to document, codify and comply with new standards to remain competitive. Downstream suppliers are facing requests from customers for disclosures and data that may be new and not readily available. However, this evolution within the industry also presents opportunities for differentiation by implementing sustainable practices and demonstrating a real, impactful commitment to ESG.

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ESG's ubiquity

Initially, many businesses focused on the environmental aspect of the framework, but now they are analyzing the social, economic and data-driven impacts they have on the world and the people around them.

For the automotive industry, the impact on the environment is still a primary focus. The EPA reports transportation accounts for about 27 percent of greenhouse gas emissions in the U.S., and governments, consumers and automakers want to cap and minimize those numbers to combat climate change.

Auto manufacturers and zero-emission vehicle states are making commitments to change production, vehicle emissions and other standards to achieve carbon neutrality. Due to issues with capacity, infrastructure, and access to raw materials like lithium, the target date range is broad for now but narrows every day.

The U.S. does not have environmental, social and governance reporting standards, but that is changing. The International Financial Reporting Standards in the European Union created the International Sustainability Standards Board. Through mergers and partnerships with groups such as the Task Force on Climate-Related Financial Disclosures, the International Sustainability Standards Board is helping to establish a global baseline for ESG standardization, globalization and reporting that manufacturers and downstream suppliers will have to understand.

The investor community is also a driving force for such standardization, and 89 percent of investors consider environmental, social and governance issues in some form as part of their investment approach. Financial statements and disclosures alone are no longer sufficient to indicate organizational or investment risk. Investors want to know what is being done to integrate ESG efforts. Additionally, younger generations are more values-driven.

They want to work for, buy from and invest in companies that align with their goals and values, further pressuring automakers to keep up and prioritize sustainability measures.

Manufacturers will continue nudging suppliers with increasing urgency to prioritize environmental, social and governance through quantifiable metrics, rating and disclosure systems, performance commitments and progress toward goals.

Costs and hurdles

At many suppliers, changing operations and constant budget pressure have resulted in limited resource availability to manage various aspects of ESG reporting.

However, considering the level of scrutiny and significance to the industry, the inability to meet reporting demands is not going to cut it with customers. Soon, there could be repercussions throughout supply chains if ESG and Scope 3 reports are not streamlined, organized parts of doing business; it will be a requirement just to sit at the table. Establishing specific functional ownership of the reporting is likely to be required, along with the costs associated with gathering data and disclosure that suppliers will need to take into account.

On the heels of reporting, the expectation from auto manufacturing customers will likely be a proactive plan to reduce overall greenhouse gas emissions. While this will have cost implications, smart suppliers will look to analyze the new data to find opportunities to reduce production costs or recover costs through pricing.

Proactive approach

The world is watching as environ mental, social and governance shapes the auto industry's future. Reducing emissions is a customer-driven demand, and automakers and downstream suppliers cannot afford to turn a blind eye. With any industry transformation there will be increased costs and a significant learning curve. However, these situations also present latitude to grow, innovate and ultimately see cost savings through sustainability and production efficiencies.

Now is the time to experiment and seize opportunities — or risk getting left behind chasing competitors that do.