Our approach to engagement on natural capital

Investment Stewardship

BlackRock Investment Stewardship (BIS) encourages companies to have sound corporate governance and business practices that support the long-term, durable value creation that our clients depend on to achieve their financial goals. As part of our fiduciary responsibilities as an asset manager to act in our clients’ best interests, we assess a range of risks and opportunities that can affect the financial performance of the companies in which we invest on their behalf. We engage companies to understand their approach to the material drivers of risk and value in their business models, provide feedback and raise any concerns. We may signal continuing concerns through our voting, where clients have authorized us to vote on their behalf. We vote to advance the long-term financial interests of our clients as shareholders.

The management of nature-related risks and opportunities is a component of the ability to generate long-term financial returns for companies whose strategies or supply chains are materially reliant on natural capital. For these companies, we look for disclosures to assess risk oversight and to understand how nature-related impacts and dependencies are considered within the company’s strategy.

Natural capital as an Investment Issue

Natural capital refers to the living and nonliving components of ecosystems that contribute to the provision of goods and services to people. Some forms of natural capital have market value, including natural resource stocks, such as oil and gas, minerals, and timber. More than half of global gross domestic product (GDP) — an estimated USD $44 trillion — is moderately or highly dependent on nature. This figure likely underestimates the economic value of natural capital as it does not account for ecosystem services and natural processes, such as nutrient cycling and water filtration, which are not financially priced in the market. Estimates suggest that ecosystem services from biodiversity are worth an estimated USD $150 trillion annually.

While natural capital is a broad term, we focus on three key components — land use, water, and biodiversity — which we believe can affect the long-term financial returns of companies with material exposure to nature-related impacts and dependencies.

**Land use.** Given the growing pressures on the land and forests from which many companies depend for their products and other services, companies with material impacts and dependances on land and forests may face financial risks associated with the depletion of these resources. For example, governments may impose tariffs or import bans on consumer goods and agricultural products that are not certified as sustainably-sourced. Conversely, there could be material business opportunities in demonstrating responsible and regenerative practices.

**Water.** A number of economic sectors — such as agriculture, pharmaceuticals, manufacturing, technology, apparel, food and beverage production — are heavily dependent on fresh water. Companies for whom water is essential to their business operations may need to demonstrate that they use this scarce natural resource efficiently.
Overexploitation, increased demand, pollution, drought, or other factors may result in governmental regulations that restrict water availability and usage. For companies with material dependencies on water, this may impact their ability to deliver long-term financial performance.

**Biodiversity.** Biodiversity refers to the variety and abundance of life on earth and it is essential to a healthy ecosystem and the services it provides. Biodiversity loss is a potential risk to the future financial performance of companies in certain sectors as biodiversity is a critical component of ecosystem health, which is required to allow for sustainable use of natural capital inputs. While some companies flag this risk, at many others which would potentially be impacted awareness is nascent, although we expect this to change near-term given the considerable work being undertaken to build understanding of the ramifications to companies’ business models from biodiversity loss.

Natural capital-related risks and opportunities to companies can manifest in several different ways, such as:

**Operational challenges.** Companies that rely on raw materials as a basic input of production may face risks if key ecosystems are degraded or the supply of natural capital is decreased or depleted. For example, poor soil health could lead to lower yields, greater nutrient runoff, and the need for increased fertilizer and/or pesticide application—all of which can increase costs and lower production for agriculture businesses. These operational challenges can also be exacerbated when companies depend on complex supply chains.

**Reduced inputs.** The challenge of producing more goods with fewer inputs—land, water, minerals, etc.—can also provide opportunities for companies. For example, companies may consider operational techniques that take into account nature-based solutions and the re-use of materials throughout production processes, such as farming practices that sequester more carbon naturally and enrich the soil, or cooling systems that allow for better water circulation, re-use, and return. These practices might decrease costs, mitigate risks, and/or improve reputation among consumers and other key stakeholders.

**Changes to policy and consumer preferences.** In addition to operational risks and opportunities, policy changes will likely play a role in determining availability, cost, and access to natural capital. Although policy actions will likely be uneven globally, we anticipate increased measures that encourage more efficient use of resources, such as a price or tax on the externalities from which many companies benefit, or increased prices for natural resources. Other key constituents in companies’ value chains—consumers, employees, community members—are, like investors, increasingly taking into consideration the sustainability and impacts of the companies or products with which they interact. These trends have the potential over time to have significant economic outcomes for companies.

**Community impacts.** For some companies, support of key community stakeholders is necessary to be able to operate in certain areas. It can help reinforce that company’s reputation, ability to operate in certain areas, minimize the risk of disruptions to business operations, which can undermine a company’s long-term financial success. For example, for companies whose operations impact Indigenous Peoples’ lands and legal rights, a failure to obtain, in advance and on an on-going basis, free, prior and informed consent (FPIC) from those Peoples may expose companies to increased legal, reputational or regulatory risk, in light of various local and international laws and norms governing these relationships.

**Reporting on natural capital impacts and dependencies**

Where natural capital is material to the long-term strategy of companies, we look for disclosures to assess risk oversight and to understand how nature-related impacts and dependencies are managed. We find it helpful when these disclosures include a discussion of material natural capital risks and opportunities in the context of a company’s governance, strategy, risk management, and metrics and targets. This information could be augmented with an evaluation of the business impacts of potential, or unpredictable, changes in the availability of critical natural resources. It is also helpful to hear from companies about how they manage natural capital dependencies and impacts in the context of their value chains.

While nature-related disclosures have historically been limited and difficult to compare across companies, private-sector initiatives, such as the Taskforce on Nature-related Financial Disclosures (TNFD), are working on frameworks to guide disclosure on material, nature-related impacts and dependencies, alongside associated risks and opportunities. We recognize that some companies may report using different standards, which may be required by regulation. In addition, some industry groups have developed their own nature-related disclosure standards, which may be useful for certain sectors.

When we engage with companies on natural capital, we seek the following disclosures, when appropriate:

- The natural capital-related risks, opportunities, impacts, and dependencies that management has identified as financially material to the company’s business model, and how these have been evaluated in anticipation of increasing levels of stress on essential natural capital factors
- The board’s role in overseeing material natural capital risks and opportunities
• Whether and how the company sets short-, medium-, and long-term targets for managing material natural capital factors, and how the company monitors progress against stated goals, and how these efforts might contribute to process and resource efficiencies

• Whether the company has corporate policies or codes of conduct addressing natural capital practices, including whistleblower protections, and mechanisms to oversee compliance and remedy breaches

• The company’s supply chain due diligence processes, including how the company is working with key stakeholders or participating in industry-specific initiatives, and how the company identifies and protects against adverse impacts across the supply chain

• Any material investments in strategic initiatives or research and development to develop products and/or enhance operations to reduce natural capital dependencies and impacts, including contributions to programs that protect natural capital and/or participation, as appropriate, in industry collaborations aligned with addressing pervasive issues

• Efforts to engage with local communities directly impacted by company operations and use of natural capital

• Any independent third-party assessments of the data and/or approach taken to manage natural capital-related risks including the benchmarking of policies, practices, and performance
Endnotes

1. This commentary should be read in conjunction with BIS’ Global Principles and market-specific voting guidelines. Other materials on the BlackRock website might also provide useful context.


3. For additional information on ecosystem services research, see the United States Environmental Protection Agency, “Ecosystem Services Research”, last updated on 14 September 2022.


5. For example, see World Bank, “Water in Agriculture”, last updated on 5 October 2022.

6. The Convention for Biological Diversity (CBD) defines biodiversity as the variability among living organisms from all sources including, inter alia, terrestrial, marine and other aquatic ecosystems, and the ecological complexes of which they are part; this includes diversity within species, between species, and of ecosystems.

7. For example, please reference the University of Cambridge, “Dasgupta Review: Nature’s value must be at the heart of economics,” February 2021.

8. Nature-based solutions are commonly defined as conservation, restoration, and improved land management practices that increase carbon storage and/or avoid greenhouse gas emissions across global forests, wetlands, grasslands, and agricultural lands.


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