Ramping up sustainable supply-chain finance

Asian SME's need to transition fast to a green world – which spells opportunities for a new asset class to emerge. By GIRIJA PANDE

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SUSTAINABLE transition finance is a phrase now in vogue to describe the multi-trillion-dollar efforts to massively decarbonize the world's fossil fuels-based energy systems within a few decades. At the COP28 climate summit in Dubai, this was a major focus and large sums were committed to it-the first time "transit toning out of fossil fuels" was set as a global goal.

Energy alternatives such as hydroelectric, geothermal, green hydrogen or safe nuclear are some of the substitutes being developed in a hurry. Carbon capture and storage (CCS) and geoengineering are among emerging technologies that are seen as an outside hope. There is no doubt that energy transition will prove to be technologically challenging, if not an existential issue facing the world. Apart from the requisite trillions of dollars of sustainable transition financing, many innovative pathways will have to be found to achieve this within a rapidly narrowing time horizon to 2050. A combination of new tech and innovative financing on an unprecedented scale will clearly be required.

Greening the global supply chains - challenges and risks

Supply chains - which account for more than 80 per cent of greenhouse gas (GIG) emissions and over 90 per cent of the impact on air, land, water, biodiversity and geological resources—are a critical part of any business' climate strategy. Globally, supply chains today are tiered, dispersed, and mostly owned and operated by small and medium-sized enterprises (SMEs) that form the backbone (in terms of employment) of any economy. Hence, the successful restructuring of SMEs is critical for Asian economies to move to greening supply chains. Moreover, supply chain diversification is now seen as essential due to inherent geopolitical risks or public health emergencies — a development that will require SMEs to restructure themselves or their business models for resilience.

Large corporations that have set ambitious targets for their net-zero journey to 2050 or sooner may not yet have fully focused on this issue - especially if they are still grappling with the financing required to reduce their own carbon or GHG footprint from the scopes 1 and 2 carbon emissions related, respectively, to their own activities and their use of purchased energy. They now need to figure out their exposure to the much larger Scope 3 emissions lurking in their supply chains.

Current Scope 3 emissions, which include the companies' value chain emissions both upstream and downstream, usually are a multiple of scopes 1 and 2 emissions. The disclosure regime for companies currently focuses largely on the control of scopes 1 and 2 emissions. The International Financial Reporting Standards-certified ISSB (International Sustain-ability Standards Board) regime- effectively a global disclosure standard - has allowed companies to delay their disclosure of their Scope 3 emissions to 2025 and beyond to give time for them to minimize emissions from their restructured value chains.

What will restructuring of supply chains entail?

SMEs that run tiered supply chains for global customers face three key obstacles in their green journey:

- The need to invest for the long term in new processes and technologies to reduce emissions considerably while keeping costs affordable. Like their buyers, they also need to create clear plans for net-zero transition. This will require considerable capital expenditure for newer plants and machinery, procuring new and sustainable technologies to lower emissions, and to invest in training staff in new ways of working. With thousands of SMEs across Asia being affected by this massive restructuring, the need for a vast amount of long-term capital infusion for this sector becomes clear.

Restructuring the supply chains of SMEs globally will need a vast amount of long-term capital infusion

- With the implementation of ISSB disclosure standards, along with a rash of other regulations announced by major jurisdictions such as the United States and the European Union, the impact on "unprepared" suppliers will be considerable, including possibly the loss of business. The new EU cross-border carbon tax will have an impact on Asian exporters to EU adversely, as will the EU corporate sustainability due diligence directive, which will require companies to meet due diligence obligations on sustainability and human rights across their value chain.

- Geopolitical risks and public health emergencies are driving suppliers to diversify to achieve friendshoring. But setting up in new geographies, finding local partners, and reinventing logistics and manpower are not easy for smaller firms, which will need considerable hand-holding by their long-term buyers and host governments.

Creating a separate asset class for green supply chains

As much as energy transition has an impact on large global corporations, the restructuring of SMEs' supply chains globally is much more challenging. Their transition finance needs - both long-term capital expenditure and working capital - will be considerable and varied. They are often seen to be at a lower credit standing by banks, which are currently struggling to understand the risks inherent in this restructuring journey. Moreover, banks tend to focus on short-term working capital and are hesitant to provide the long-term finance needed for newer and often untried energy-efficient equipment, novel technologies and intangibles such as software or training.

Given this challenge, there is an urgent need to create a new sustainability-linked asset class whose participants could extend well beyond banks.

This asset class - termed sustainable financing of supply chains for SMEs — will need to bring participants such as global funding institutions (the World Bank and its affiliates), national development financing institutions, impact investment funds and, typically, venture capital funding in newer tech areas.

Major buyers themselves and their outsourced global procurement companies which play a big role today in purchasing decisions linked to responsible supply chains-can play a role by providing credits or guarantees for customers they know well to prospective financiers. Moreover, wealth managers too can look to bring philanthropic capital as many high-net-worth clients would like to participate in such a sustainable purpose-driven asset class.

Benefits to such finance providers abound—from assisting a national priority to create green supply chains to providing larger volumes of financing to this new asset class, which will be profitable to boot.

This market, of course, needs to be well-regulated, structured as a separate asset class — parts of which could be securitized with carbon credits and offsets. Innovative financing options and encouragement from regulators will give buyers the confidence to support their supply chain partners instead of dumping them as they hurriedly traverse on their own net-zero transition plans.

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Having over three decades of experience in senior positions in Banking and Financial Services and having served on multiple Boards of government bodies as well as non-profit organizations, Mr. Pande is currently the Chairman of Chain IQ's ESG (Environmental, Social and Governance) Advisory Board. He also serves on the Advisory Board of a Global ESG Fund and on High Level Advisory Board of Brussels based Digital Goes Green Foundation working on sustainability issues of digitalization.

Mr. Pande holds an engineering degree and an MBA. He has extensive experience throughout Asia, and has held senior postings in Korea, Hong Kong, Bahrain and India. He has co-authored a successful book on building business in China and India 'The Silk Road Rediscovered' published by John Wiley.

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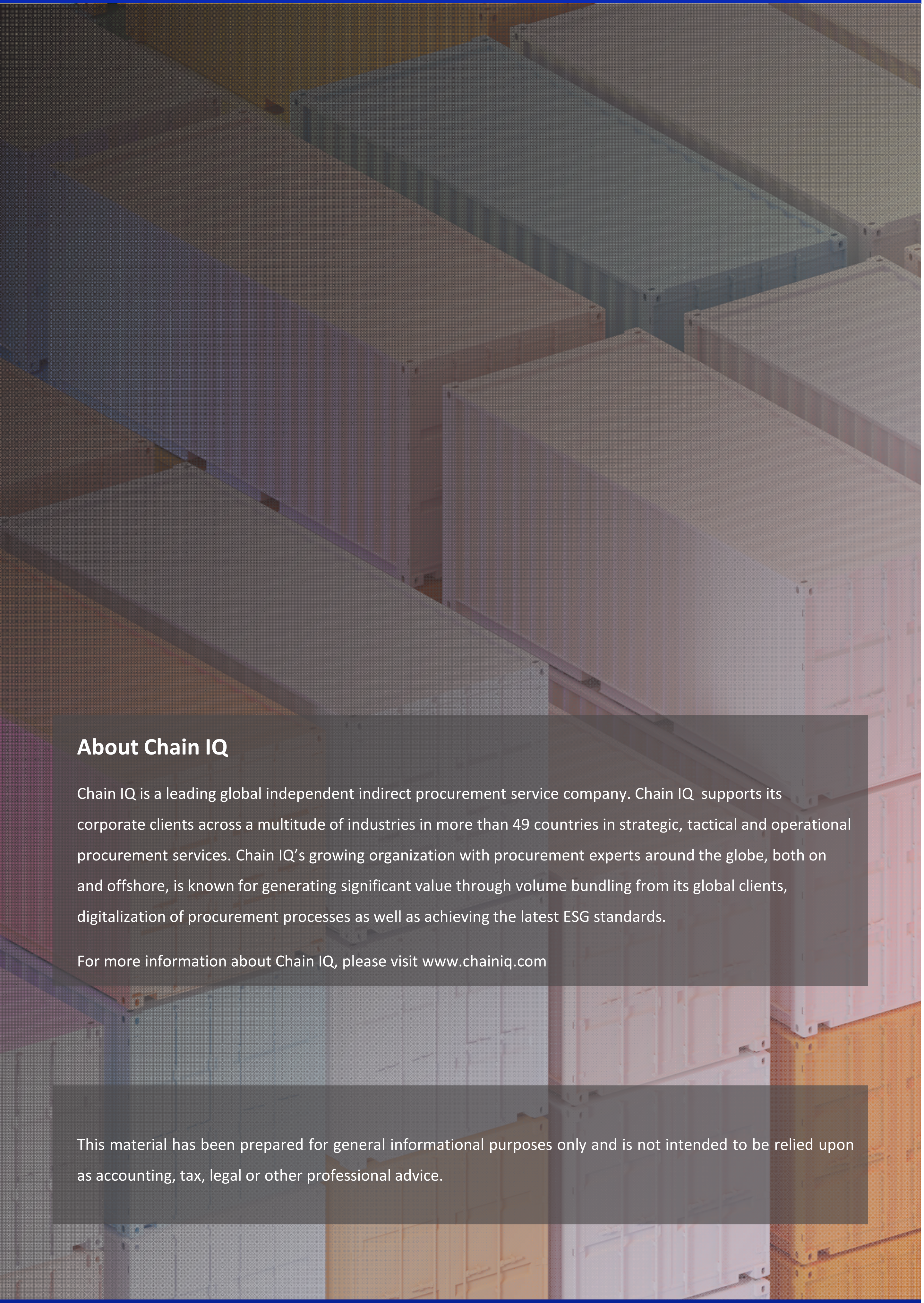

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