FINANCIAL SERVICES INDUSTRY GROUP

Sustainable Supply Chain Finance
Unlocking the Potential for Banks

Introduction

In an era of rapid economic and geopolitical change, public and private sector entities alike have experienced a significant shift towards Environmental, Social and Governance (ESG) initiatives. However, this movement is not merely a response to immediate challenges — it is a strategic endeavour to fortify businesses and foster resilience.

Leading the trend, regulators worldwide are continually introducing new guidelines and regulations, requiring companies to comply with specific ESG disclosure requirements. Companies globally, including those in the Middle East, are increasingly formulating green and sustainable strategies, integrating them into their overarching business strategies and reporting, and establishing associated sustainability commitments. They are not only aligning their financing mechanisms with these sustainability plans, but also beginning to incorporate sustainability into their supply chains by applying relevant criteria in supplier and distributor selection processes. This strategic move not only mitigates operational risks along the value chain but also helps improve profitability while enhancing brand value.

Financial institutions play a crucial role in this paradigm shift by directing funding towards sustainable supply chains. With adequate funding and a robust understanding of ESG practices, suppliers and buyers can fortify their business operations and improve their competitive standing. Sustainable Supply Chain Finance (SCF) has emerged as a prominent trend in global banking, presenting a lucrative business opportunity for financial institutions.

In this article, we examine the concept of sustainable SCF, its implications for financial institutions and the key drivers for its growth globally and in the Middle East.

Sustainable finance – growth beyond compliance

Sustainable finance has garnered increasing attention within financial institutions. Banks are under pressure both from a regulatory and public point of view to demonstrate ESG compliance via public commitments, products, client offerings and ESG reporting. At the same time, multiple secular themes and megatrends are creating urgency to accelerate the ESG agenda:

- **Climate change and extreme weather events are becoming more prevalent;**
- **Geopolitical pressures, climate change and demand for clean commodities forcing shifts in supply chains;**
- **Energy and industrial dependent nations are being forced to transform their economies and core infrastructures;**
- **Green technologies are proliferating and reaching a tipping point on the scale curve.**

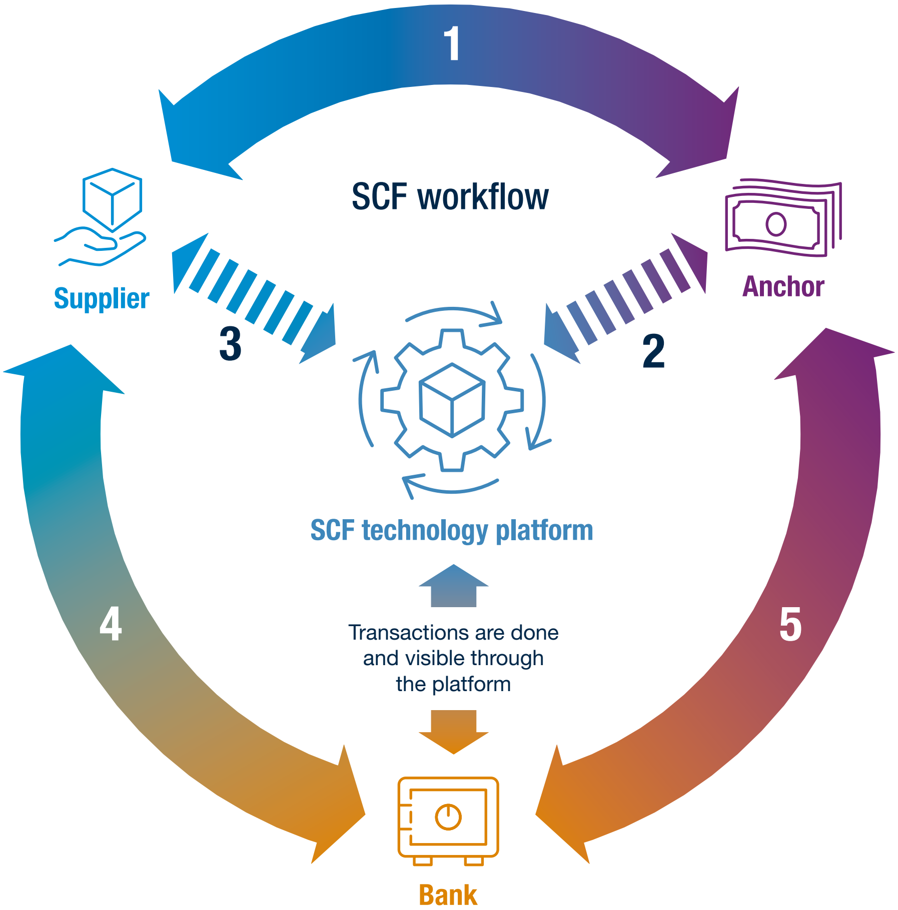
A large amount of capital committed to the transition is still not channeled to the real economies due to a lack of viable or bankable projects. As a result, the focus has shifted from mere regulatory compliance to strategic initiatives aimed at leveraging sustainability as a business opportunity for long-term growth. Companies are starting to focus more on how ESG impacts their core business and seek to link ESG performance to financial returns e.g., ESG-linked enterprise value/EBITDA. They also face new cost pressures in the form of tariffs like the Carbon Border Adjustment Mechanism (CBAM). This is driving demand for low-carbon commodities and alternative fuels, shifting traditional supply chain dynamics. In Europe, the Corporate Sustainability Due Diligence Directive (CSDDD) requires companies to account for adverse environmental and human rights impacts in their operations and value chains.

In GCC countries the regulators imposed mandatory or voluntary ESG reporting for the listed companies, and more regulation will likely follow.

To complement their clients' needs, banks are transitioning from a product-centric approach to a client-oriented strategy that integrates comprehensive solutions, insights and transition execution. This evolution underscores a move towards aligning bank strategies with ESG principles, with a particular emphasis on environmental considerations. Sustainable SCF emerges as a transformative trend in banking – with banks fulfilling their own ESG commitments while simultaneously facilitating their clients' and trade partners' journeys towards sustainability.

Sustainable SCF and opportunities for financial institutions

SCF refers to the use of financing and risk mitigation practices to optimize the management of working capital and liquidity invested in supply chains (see chart below).



1
Supplier delivers goods, anchor accepts invoices

2
Anchor sends invoices to be financed

3
Supplier selects invoices to be financed

4
Bank accepts the assignment or sale of receivables and credits the supplier account

5
At maturity the bank debits the anchor's account through the platform

A technology platform can enable finance providers to see the underlying trade flows, which is an essential element of such financing arrangements.

The sustainability principles of SCF, which extend to suppliers, buyers and underlying transactions, evolve around the following areas:[1]

Environmental
Supporting climate change mitigation, as well as the sustainability of local environments and ecosystems;

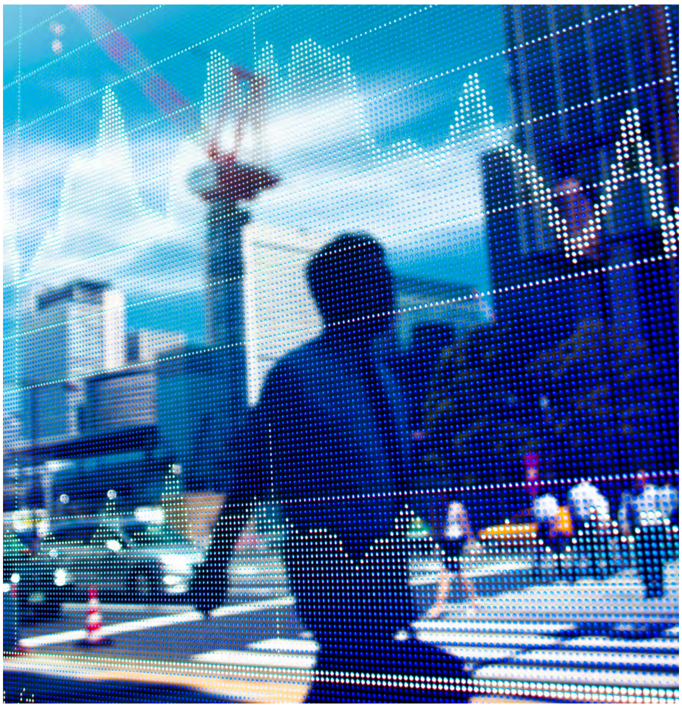
Social
Supporting human and social rights, sustainable economic development as well as addressing and alleviating complex poverty issues and promoting peaceful and inclusive societies; and

Governance
Establishing corporate practices that facilitate effective risk management, compliance and business continuity as well as ethical business conduct related to procurement and distribution.

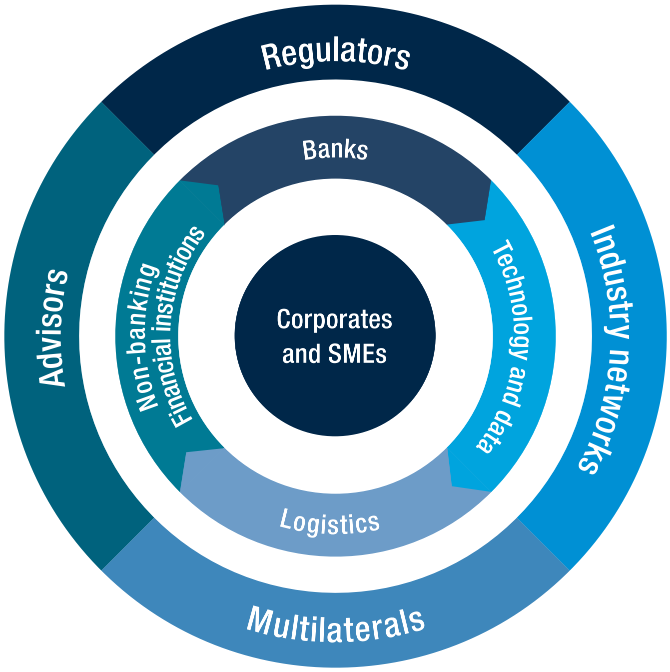
While businesses (corporates and Small and Medium Enterprises (SMEs)) are the ultimate beneficiaries, SCF brings together various players from across the ecosystem (see chart on the right): funders, technology vendors, data providers and logistics companies. Further, regulators play a crucial role in policy provision and control, multilaterals and development of financial institutions – in funding and expertise, industry networks – in common standard setting, advisors – in provision of knowledge.

Global supply chains facilitate the movement of over USD 22 trillion worth of goods annually, contributing to approximately 80% of the world economy's carbon emissions.2 Consequently, trade and SCF wield considerable influence in expediting the decarbonization of the global economy. Integrating sustainability principles into supply chains can significantly accelerate this process. Estimates suggest that global supply chains will need USD 100 trillion in investments by 2050 to achieve net-zero emissions, with up to 50% required by SMEs.3 Thus, banks have a sizeable opportunity to drive the transition towards ESG compliance by offering ESG-linked SCF solutions and incentivizing sustainable practices among corporate clients and their trade counterparts.

The global sustainable SCF market was valued at USD 1.3 billion in 2023 and is estimated to surpass USD 5.7 billion by 2032.[4]



SCF ecosystem



1 ICC Principles for Sustainable Trade, 2023
2 Bridging the gap in sustainable trade & finance, Trade Finance Global, 2024
3 Delivering Net Zero Supply Chains, HSBC, 2021

Tapping into this growing market will provide numerous benefits for banks, such as:

Market differentiation

By developing robust sustainable SCF propositions, banks can distinguish themselves from competitors — many banks have yet to develop sustainable SCF propositions;

Expansion opportunities

Banks can tap into the underserved SME financing segment at a comparatively lower acquisition cost by extending SCF to suppliers and distributors, particularly through deep-tiered SCF;

Credit risk mitigation

Enhanced visibility of supply chain operations and adherence to ESG standards enables banks to improve credit risk management;

Relationship building

SCF initiatives often foster stronger relationships with corporate clients, leading to additional funded and non-funded business opportunities;

Reputation enhancement

By aligning with sustainable finance goals and providing ESG-linked solutions, banks can enhance their brand value and reputation;

Client support

Banks play a pivotal role in assisting clients in achieving their own sustainability objectives through tailored SCF solutions.

Sustainable SCF in the Middle East

The Middle East is uniquely positioned to develop its supply chains. The region lies at the heart of several global trade routes and by 2030, its trade volumes are projected to reach USD 2 trillion in exports and USD 1.7 trillion in imports.[5] East Asia is the largest trade destination, expected to grow 5.1% per annum until 2030, followed by Europe, which is forecast to grow at 7.3% per annum until 2030. South Asia is a valuable import partner, fueled by demand for various sectors including textile and apparel, machinery, metals, and mining.

Countries in the Middle East are looking to diversify beyond traditional oil and gas businesses, expanding into trade, transport, logistics, and technology. Concurrently, regulatory changes, infrastructure projects, and foreign direct investment in renewable energy are gaining momentum in major economies like the United Arab Emirates (UAE) and the Kingdom of Saudi Arabia (KSA). High-profile examples include Etihad Rail[6], Masdar[7] and NEOM[8]; the groundwork for a thriving and sustainable finance market is well underway. In addition, the UAE has earmarked USD 163 billion for the development of new renewable energy projects and has allocated extensive land areas for solar power generation. Similarly, KSA has committed to invest USD 266 billion towards achieving carbon neutrality by 2060 and is establishing itself as a leading exporter of clean hydrogen globally.[9]

With regional corporates emphasizing supply chain resilience, there is rising demand for sustainable SCF solutions, and therefore an opportunity for banks to expand their offerings in support of these growing supply chain ecosystems. Several banks in the region have recently introduced sustainable SCF products and services, with ample room for further expansion in the coming years. This trend not only contributes to national sustainability goals but also fosters trade promotion and economic diversification.

Banks already possess significant expertise and insight across multiple industries, sectors, and geographies. They can position themselves as catalysts for change, driving innovation and fostering partnerships to advance sustainable finance goals. For instance, the flourishing technological landscape in the Middle East provides a conducive environment for the rapid advancement of sustainable SCF. Banks can capitalize on this momentum by forging partnerships with digital SCF platforms and ESG data providers, thereby enhancing the efficiency and efficacy of their programs to meet the needs of their clientele.

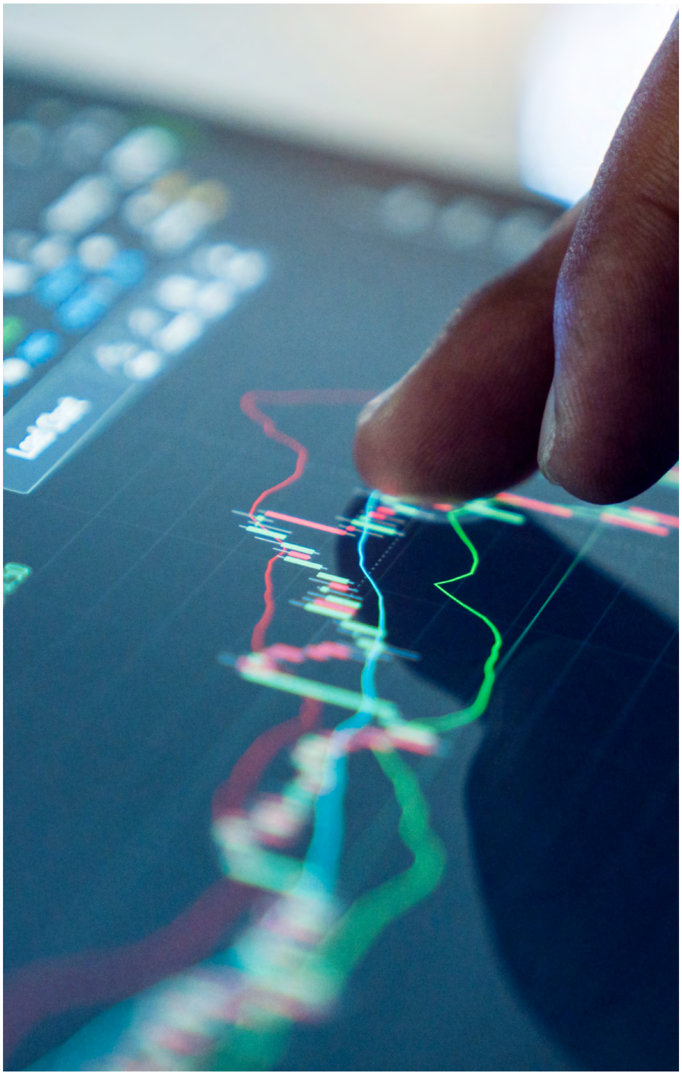
4 Supply Chain Finance market, Astute Analytica, 2024
5 Future of Trade, Standard Chartered, 2023
6 https://www.etihadrail.ae/
7 https://masdarcity.ae/
8 https://www.neom.com/en-us
9 Future of Trade, Standard Chartered, 2023

Building blocks for developing sustainable SCF

In contemporary banking, revenue streams in SCF are transitioning from product-centric to client-centric strategies. Consequently, the path to sustainable SCF success requires a comprehensive programmatic approach. From aligning business strategies with sustainability objectives to embracing technological innovations, banks must chart a course towards sustainable growth. By fostering collaboration, building expertise and leveraging data-driven insights, banks can pave the way for a more sustainable future.

Among the obstacles to integrating ESG factors into SCF is the absence of standardized and comprehensive data. According to a 2023 survey by the Asian Development Bank, progress on sustainability has been impeded by a "lack of harmonized standards and data collection"[10], as well as few reporting mechanisms to demonstrate compliance. To operationalize sustainable SCF, banks can set up partnerships with ESG data providers. Such collaboration can facilitate automation, drive innovation and develop new business, with third-party data providers offering technical expertise to strengthen the market analysis and product development essential for banks in this realm.

10 Trade Finance Gaps, Growth and Jobs Survey, ADB 2023



This entails a structured framework comprising six fundamental blocks:

1 Business strategy and model

Develop program objectives and a business plan, aligning sustainable SCF with broader bank-wide sustainability strategies and ensuring the allocation of relevant resources and processes.

2 Product

Design ESG-linked SCF products to enable companies to transition towards sustainable, low carbon activities that may include incentives in the form of preferential pricing for suppliers compliant with sustainability criteria.

3 Client focus and ESG awareness

Introduce a client selection and onboarding approach, devise ESG rating methodologies and develop account planning and sales KPI monitoring. Additionally, advise and train corporates and SMEs on ESG integration within their supply chains and possibilities to capitalize on sustainable business opportunities.

4 Risk management and operational processes

Integrate ESG factors in Know Your Customer (KYC) due diligence, risk assessment and underwriting. Additionally, integrate ESG into the operational workflows and reporting mechanisms and establish internal program monitoring procedures using transactional and ESG-related data.

5 Technology

Automate the onboarding and financing processes and ensure visibility of trade and financing transactions by utilizing specialized digital platforms dedicated to SCF. Alternatively, use internal platforms to enhance the efficiency of SCF operations.

6 Talent management

Recruit new talent that is passionate about sustainability, form a dedicated team responsible for managing sustainable SCF initiatives and grant this team a certain level of independence, and improve knowledge and performance through training, clear target setting and incentive schemes.

Collaboration for success

Collaboration among stakeholders is imperative for the success of sustainable SCF initiatives. Financial institutions, corporations, SMEs, technology firms, data providers, multilateral agencies and regulators share a common goal of achieving net-zero emissions and must embrace collaborative partnerships to attain success.

Banks carry a large responsibility for the successful shift towards a sustainable future by enabling financing, facilitating awareness and fostering digital innovation through well-structured sustainable SCF programs.

As global trade volumes surge so do concerns about carbon emissions and environmental degradation. Sustainable SCF is not just a moral imperative — it is an economic necessity. With trillions of dollars at stake and ambitious net-zero targets on the horizon, banks have a unique opportunity to influence the transition to a more sustainable economy by incentivizing sustainable behaviours and driving impactful change.

A&M's approach

A&M helps financial institutions develop and implement sustainable SCF solutions aimed at achieving sustainability objectives with greater speed and efficiency. We are working with banks, multilateral development agencies, infrastructure funds and insurance companies to identify new sustainable project opportunities for financing and delivery. In addition, we provide clients with clearly articulated, high impact ESG-related propositions which have direct links to enterprise value/EBITDA. Our hands-on, collaborative approach, combined with deep expertise in financial services, supply chain management and ESG, can enhance business resilience and drive profitability.

If you would like to learn more about our expertise in this area, please reach out to the below key contacts.

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