

# Sustainable Supply Chain Finance

TRANSFORMATION GUIDE

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# Introduction

Transform to Net Zero is a cross-sector initiative to accelerate the transition to an inclusive net zero global economy. The initiative includes companies that are climate leaders in their industries – Danone, GSK, HSBC, Mercedes-Benz, Microsoft, Nike, Inc., Starbucks, and Wipro – plus Environmental Defense Fund as a founding NGO member, and BSR as Secretariat.

To support companies in meeting targets backed up by transformation plans to achieve net zero no later than 2050, Transform to Net Zero is publishing a series of Transformation Guides. Each Transformation Guide shares experiences and lessons learned by Transform to Net Zero members when addressing a challenging issue in net zero implementation. A Transformation Guide does not prescribe a single way to tackle net zero implementation but instead invites readers to choose between and combine different approaches depending on which is best suited to their circumstances.

The Sustainable Supply Chain Finance Transformation Guide is the eighth in the series and outlines how sustainable supply chain finance programs can be leveraged to accelerate net zero transformation.

## Acknowledgments

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# The Problem

Many companies find the majority of their emissions footprint in upstream supply chains. A [2020 CDP Report](#) found that supply chain emissions make up 11.4x more emissions than those generated by operations, on average. To successfully transition to a net zero economy, companies are looking for opportunities to engage and support their suppliers to reduce their operational emissions. However, suppliers still cite resource limitations, both in terms of internal capacity and access to capital, and lack of aligned incentives from buyers, as significant barriers to successful implementation of decarbonization actions.

Tier 1 suppliers, defined as suppliers that a buyer does business with directly, often have low margins and little capital to invest in emissions reductions, and smaller or earlier stage suppliers face comparatively higher cost of capital due to lower credit ratings that prevent access to preferable credit lines.

Buyers adopt a common set of approaches to engage suppliers on emissions reductions, including trainings, resources, and non-financial recognition. While helpful, these offerings limit the impact that any one buyer can have on a supplier. There is a pressing need to increase adoption of stronger incentive and support mechanisms for suppliers. Buyers and suppliers need offerings that can support the financial health of the suppliers' operations while allowing the buyer to establish and enforce climate action standards. Sustainable supply chain finance is one tool in the toolbox of supplier incentivization schemes that can advance supply chain decarbonization and enable a net zero transformation.

# The Solution

Supply chain finance (SCF) is a set of financial solutions designed to leverage a buyer's credit to their suppliers. Sustainable supply chain finance (SSCF) adopts this same concept but ties access to SCF to achievement of certain sustainability metrics. Through SSCF, suppliers receive improved access to working capital—usually in the form of early payment terms or lower interest rates—for demonstrated progress on a set of sustainability criteria. These programs can either focus on climate impact and decarbonization specifically or on sustainability more broadly. Using [HSBC's design](#) as an example, these programs typically either:

1. Increase the working capital of suppliers with strong ESG performance by advancing against the purchase order and/or extending financing up to the expected shipment date (Supplier Sustainable Pre-shipment financing); or
2. Enable suppliers with good performance on climate/environmental/sustainability to access capital at lower cost (Supplier Sustainable Post-Shipment financing).

IFC, a member of the World Bank Group and the largest global development institution focused exclusively on the private sector in developing countries, also has extensive programs providing short and long-term financing directly to suppliers, as well as programs that provide lending to suppliers via local financial institution partners. Both HSBC's and IFC's programs are focused on suppliers in emerging markets. For example, IFC's **Global Trade Supplier Finance (GTFS) Program**, a \$1 billion short-term lending facility, was the first SCF Program to incorporate sustainability-linked pricing (2014), providing an incentive for suppliers to improve on sustainability metrics. IFC's GTFS Program purchases and discounts invoices accepted for payment by pre-approved participating buyers to the respective supplier network. Various other banks also provide similar SSCF programs, as noted in [Table 1](#).



# Research Insights

## Research Approach

Transform to Net Zero (TONZ) conducted research via three channels:

- 1. Landscape assessment:** TONZ researched nine SSCF programs using publicly available information to understand similarities and differences in the design of programs and explore the benefits for buyers and suppliers.
- 2. Survey:** TONZ issued separate surveys to a group of buyers and suppliers\* that either a), previously participated or are currently participating in a SSCF program, or b), considered a program but decided not to participate.
- 3. Interviews:** TONZ interviewed buyers who have engaged in SSCF programs to gather additional information on their experiences.

All survey and interview findings are anonymized.

### NOTE:

While TONZ issued a survey to a group of suppliers, no supplier completed the survey in full. TONZ recognizes the importance of obtaining the supplier perspective to understand whether and how these programs have benefited suppliers, how successful they are at advancing climate action, and how they can be improved. The lack of supplier responses points at limited supplier bandwidth to dedicate to stakeholder requests on climate-related initiatives.

## Research Findings

SSCF programs are still relatively nascent and limited in scope. However, TONZ captured four key program design and implementation themes, as well as three common implementation challenges:

PROGRAM DESIGN AND IMPLEMENTATION THEMES	IMPLEMENTATION CHALLENGES
<ul style="list-style-type: none"><li>• Programs consider multiple sustainability / ESG topics</li><li>• Programs are tailored to sector and buyer priorities</li><li>• Programs rarely set constraints regarding supplier use of capital</li><li>• Programs strengthen buyer-supplier relationships</li></ul>	<ul style="list-style-type: none"><li>• Limited bandwidth to establish programs</li><li>• Low supplier uptake</li><li>• Does not provide the levels of long-term finance needed for deeper decarbonization interventions</li><li>• Ensuring impact</li></ul>

## Program Design and Implementation Themes

### 1. PROGRAMS CONSIDER MULTIPLE SUSTAINABILITY/ESG TOPICS

Seven of the nine programs researched consider a range of sustainability-related efforts that integrate human rights, environmental, and social metrics as part of supplier assessments. Only Tesco and Walmart developed programs focused exclusively on environmental achievements.

Survey and interview insights support this finding, as buyers noted that establishing a SSCF program provides an opportunity to increase adherence to core sustainability expectations as outlined in buyer policies and Codes of Conduct (CoC) or otherwise communicated to suppliers via engagement.

### 2. PROGRAMS ARE TAILORED TO SECTOR AND BUYER PRIORITIES

While SSCF programs share the ultimate objective of incentivizing progress on sustainability, program design and implementation can vary greatly. In most cases, buyers and banks co-design a program that aligns participation criteria and rating mechanisms with the buyers' over-arching sustainability objectives. Common approaches to design identified through the landscape assessment include:

#### Participation criteria:

- Geography (e.g., suppliers in emerging markets)
- Demonstrated sustainability score or performance (e.g., minimum EcoVadis or CDP score, compliance with Supplier CoC, minimum score on company-specific scorecard/rating system)
- Specific KPIs (e.g., public science-based target, commit to 100% renewable energy, measure emissions data)

#### Financing model:

- Early payment terms
- Lower interest rates
- Tiered pricing premiums/discounts based on supplier performance

#### Rating mechanisms:

- Existing ESG ratings (e.g., EcoVadis or CDP scores)
- Industry-specific tools (e.g., Cascale's (formerly Sustainable Apparel Coalition) **Higg Facility Environmental Module** (Higg FEM))
- Company-specific criteria (e.g., performance against Supplier CoC or sustainability standards)

All buyers surveyed were involved in the design of the SSCF programs, metrics and reporting requirements, and assessing supplier performance and program scope. Buyers surveyed indicated a varied approach to supplier recruitment. While many suppliers may meet the SSCF participation requirements, buyers indicated they tend to

focus on suppliers with highest spend/emissions and where they have existing strong relationships. In line with findings from the landscape assessment, surveyed and interviewed buyers indicated they require suppliers to either:

- Demonstrate existing sustainability- or climate - related efforts (e.g., have emissions reduction targets, implement renewable energy projects)
- Demonstrate compliance with existing vendor or supplier requirements

TONZ was not able to determine from the research to what degree suppliers are commonly involved in the co-design process of the program\*, but generally this practice is likely more ad hoc and dependent on the specific buyer-bank partnership rather than standard practice. There is a strong opportunity to engage suppliers at the design stage to understand what financing model is of most benefit, as well as throughout the duration of the program to evaluate whether the program is meeting supplier needs and how the buyer might begin to increase participation criteria.

#### NOTE:

Tailoring SSCF program design to buyer goals is the typical approach to program development. However, aligning program objectives with buyer sustainability priorities can also create drawbacks tied to a lack of standardization of ESG/sustainability ratings to qualify and determine pricing tiers across buyer programs. Program-specific participation criteria and rating frameworks may have the undesired effect of overwhelming suppliers with different sustainability expectations from buyers, a challenge that suppliers already struggle with.

### 3. PROGRAMS RARELY SET CONSTRAINTS REGARDING SUPPLIER USE OF CAPITAL

In most cases, programs do not specify how suppliers use capital obtained through the SSCF program. The sustainability incentive is at the front end, where suppliers must illustrate sustainability achievements to qualify for funding. Once the supplier obtains the financing, they have discretion on how it may be used, whether that be towards sustainability improvements to qualify for higher pricing tiers or towards non-sustainability related needs.

#### NOTE:

The limited ability to earmark funding from early payment terms and lower interest rates remains a central challenge to SSCF programs. There is an opportunity for collaboration and innovation among buyers and banks to develop better tracking systems and enforcement mechanisms to increase adoption of emissions reduction initiatives as a direct result of the program. Green loans and bonds and sustainability capital funds may provide examples of other sustainable financing mechanisms that do implement requirements on use of capital. (See Ensuring Impact in Implementation Challenges).

\*See note in Research Methodology on supplier survey responses.

#### 4. PROGRAMS STRENGTHEN BUYER-SUPPLIER RELATIONSHIPS

Buyers who participated in the survey cited stronger relationships with suppliers as the primary benefit of SSCF programs. Buyers have opportunities to interface with suppliers throughout various stages of the program, starting from the development stage where buyers may involve suppliers in the design to identify how the program can best fit their needs through to implementation with suppliers. In addition to enhanced relationships between buyers and suppliers, buyers point to reputational benefits and better supplier adherence to sustainability standards established by the programs. Overall, buyers who have implemented SSCF programs plan to continue them and are exploring ways to expand to additional suppliers. **Table 1 (below)** provides an overview of programs considered in the landscape assessment, highlighting examples of the key findings outlined above.

BANK(S)	BUYER	CRITERIA/RATINGS FOR DETERMINING RATES	CRITERIA FOR SUPPLIER PARTICIPATION	STIPULATIONS ON USE OF FINANCING
HSBC	<u>Levi's</u>	<ul style="list-style-type: none"> <li>Environmental and social standards outlined in Levi's <b>Supplier CoC</b></li> </ul>	Not disclosed	No
IFC	<u>Levi's</u>	<ul style="list-style-type: none"> <li>Score on Levi's evaluation for labor, health, safety and environmental performance.</li> <li>Adherence to Levi's <b>Supplier CoC</b>.</li> <li>Demonstrated progress on implementing agreed upon low-carbon investment plans.</li> </ul>	Suppliers in emerging markets	No
IFC, Citigroup, World Bank	<u>McCormick</u>	<ul style="list-style-type: none"> <li>ESG performance (assessment mechanism not disclosed)</li> </ul>	Suppliers in Vietnam, Indonesia, Brazil and Madagascar	No
IFC, HSBC, BNP Paribas, Standard Chartered	<u>Puma</u>	<ul style="list-style-type: none"> <li>PUMA's social and environmental standards</li> </ul>	Suppliers in emerging markets; Achieve SAFE A, B+ or B- rating on PUMA's auditing process	Improve environmental, health and safety, and social standards
HSBC, DBS, Standard Chartered, IFC	<u>PVH</u>	<ul style="list-style-type: none"> <li><b>Social &amp; Labor Convergence Program (SLPC)</b></li> <li>Cascale's (formerly Sustainable Apparel Coalition) <b>Higg Facility Environmental Module</b> (Higg FEM)</li> </ul>	Not disclosed	No
HSBC	<u>Walmart</u>	<ul style="list-style-type: none"> <li><b>Project Gigaton</b>, CDP score</li> </ul>	Set SBT through Project Gigaton or achieve a score threshold from CDP	No
Santander	<u>Sonae</u>	<ul style="list-style-type: none"> <li>EcoVadis</li> </ul>	Minimum EcoVadis score (not disclosed)	Address ESG impacts from operations and operational risks
Santander	<u>Tesco</u>	<ul style="list-style-type: none"> <li>Carbon data disclosure</li> <li>Emissions reduction targets</li> <li>Progress against targets</li> <li>(Anthesis helps verify and assess data for participation)</li> </ul>	Suppliers to Tesco UK and Ireland, with a focus on SMEs	No
Rabobank	<u>Coca-Cola Europacific Partners</u>	<ul style="list-style-type: none"> <li>Ecovadis score &gt;50</li> <li>Set and validate SBT</li> <li>Deliver 100% RE</li> </ul>	Minimum EcoVadis score of 50	No



## SSCF Implementation Challenges

### 1. LIMITED BANDWIDTH TO ESTABLISH PROGRAMS

Limited capacity to dedicate to climate action is not unique to suppliers. In surveys and interviews, buyers cited limited bandwidth as the primary barrier to developing and implementing SSCF programs. One interviewee that has considered, but ultimately not implemented, a SSCF program noted that they were unable to gather sufficient internal buy-in to identify and assign responsibility for development, oversight, and management of the program.

To bolster this finding, most buyers surveyed indicated that they primarily learned about SSCF programs through outreach from banks or from existing partnerships with banks offering SSCF, pointing to a lack of internal capacity to proactively explore and pursue establishment of SSCF programs.

Involving additional relevant functions, notably finance, is one way to address this challenge. One buyer who has successfully launched and maintained a long-standing program noted the original impetus behind the program came from their treasury department, who maintains ownership. This engagement from financial teams has proven to be a key enabler to program success.

### 2. LOW SUPPLIER UPTAKE

Through the survey, buyers indicated that about 20% of suppliers approached ultimately participate in SSCF programs. Buyers speculate that low program uptake could be due to lack of supplier capacity, misalignment between immediate supplier needs and program benefits, and/or the interest rates offered through the program not being sufficiently competitive. Buyers also noted tension between setting stringent standards and establishing programs that would be accessible to many of their suppliers. For example, increasing standards for participation over time could eliminate suppliers from qualifying. At the same time, maintaining the same standards hinders ambition.

As noted above, involving suppliers in program design can help address these challenges and ensure the program terms are meeting suppliers where they are. For example, tiered pricing qualifications can be designed to meet the needs of suppliers with very low and very high climate maturity.

### 3. DOES NOT PROVIDE THE LEVELS OF LONG-TERM FINANCE NEEDED FOR DEEPER DECARBONIZATION INTERVENTIONS

Major decarbonization efforts such as energy efficiency upgrades, on-site renewable energy, fleet electrification, and other initiatives, often involve larger investments that require longer term financing which SSCF programs may not provide. As such, SSCF programs can and should be paired with other financial solutions such as green loans to address supplier financial needs holistically, considering those both in the short- and long-term.



### 4. ENSURING IMPACT

Measuring the impact of SSCF programs remains a key challenge for both buyers and financial institutions. As noted above, there is no straightforward mechanism to track whether capital obtained through early payment terms or lower interest rates is then re-invested directly into sustainability improvements. As such, buyers cannot draw a direct correlation between the implementation of SSCF and measurable, attributable emissions reductions (e.g., whether capital received from early payments was used to finance a decarbonization initiative, such as on-site renewable energy). Insights gathered from the landscape assessment indicate that the most common impact metrics focus on total dollar amount received by suppliers, total dollar amount of early payments made, number of days from order of payment relative to typical payment timeframes, and total number of suppliers participating.

However, based on survey findings, strengthened relationships between suppliers and buyers that come from SSCF programs do increase opportunities to align climate targets and action through continuous engagement.



# Case Studies

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**TONZ selected two case studies from the landscape assessment to provide real world examples of existing SSCF programs. Information included for each case study is only from publicly available information and as such may not reflect all design details or impact metrics.**

### HSBC / IFC - PUMA →

In 2015, PUMA launched its 10FOR20 Targets, linking PUMA's sustainability targets to the UN SDGs. In 2016, PUMA launched the Forever Better Vendor Financing Program to progress on targets through supply chain initiatives in regions where PUMA operates and where its products are manufactured. The program offers financial incentives to suppliers for improvements in environmental, health and safety, and social standards.

Through the program, financial partners (HSBC and IFC) provide tiered pricing of short-term working capital through early payments and offer lower interest rates for suppliers that achieve high scores in PUMA's supplier rating system. Suppliers can access interest rates through PUMA's credit rating while maintaining their own lines of credit. For example, suppliers can "sell" their PUMA invoices to one of the financial partners and receive payment within 5 days. Supplier scores are assigned based on adherence to PUMA's social and environmental standards, monitored through PUMA's auditing process. Financing terms for transactions improve based on supplier sustainability scores.

The program has expanded year over year since its inception. It was initially launched with IFC in Bangladesh, Cambodia, China, Indonesia, Pakistan and Vietnam. In 2019, it expanded to include HSBC and BNP Paribas, and then Standard Chartered Bank in 2020. In 2021, PUMA involved insurance partner Chubb to include better terms for product liability insurance: suppliers with good sustainability scores are responsible for no or minimal product claims and have lower insurance premiums.

When launched in 2016, 19 suppliers from 11 countries joined, and the program financing totaled \$100 million USD. In 2017, twelve additional suppliers from six countries joined the program. In 2019, financing total doubled to \$200 million, then further increased to \$580 million by 2020, and totaled \$800 million for FY2022. By the end of 2023, 72 vendors were registered.

### RABOBANK - COCA-COLA EURO-PACIFIC PARTNERS →

In 2022, Coca-Cola Europacific Partners (CCEP) established a SSCF program in partnership with Rabobank to support the company's goal to reduce value chain GHG emissions 30% by 2030 and reach net zero by 2040. The program was designed to reward suppliers that improved ESG performance with discounted financing. Rabobank offers incremental discounts against initial funding rates to CCEP suppliers that deliver sustainability improvements.

CCEP and Rabobank consider a combination of Ecovadis scores and two custom KPIs—1, setting and validating an SBT, and 2, commit to using 100% renewable electricity across operations—to determine financing levels. Suppliers must have a minimum EcoVadis score of 50 to participate in the program, and achievements beyond that are rewarded with better financing terms:

- **Tier 1:** Ecovadis score > 50
- **Tier 2:** Ecovadis score > 50 and 1 KPI
- **Tier 3:** Ecovadis score > 50 and 2 KPIs
- **Tier 4:** Ecovadis score > 65 and 2 KPIs

The program was initially launched in Germany and set to expand to the rest of Europe, Australia, and New Zealand. The original objective was to grow financing to €600m, however, there are no updates publicly available on the geographical expansion nor total financing offered.



# Key Takeaways and Opportunities for Action

Sustainable supply chain finance programs have significant potential to help companies reduce their scope 3 emissions and cascade climate action up the supply chain. They are designed to address two key challenges: i) enforcement of sustainability and climate-related expectations on the side of the buyer, and ii) increase access to capital on the side of the supplier. These programs present an example of one of various forms of financial incentives which will become increasingly important as buyers exhaust initial supplier engagement tactics (e.g., education, training, resources).

## Buyers should consider several factors when exploring an SSCF program and evaluating the possible benefits:

- Buyers new to supplier engagement and financing may consider SSCF programs as a resource to strengthen relationships with suppliers, align supplier engagement efforts with existing ESG programs, and increase enforcement of sustainability expectations. These benefits are in addition to the primary program objective to provide financial benefits to suppliers that improve their ESG standards.
- Buyers focused on climate action can select participation criteria and rating mechanisms aligned with existing climate-specific goals and initiatives (e.g., measure emissions, set an SBT, commit to 100% renewable energy). When designing programs, buyers should confirm with suppliers whether they are already participating in similar programs with other buyers in order to align requirements and expectations.
- Buyers may consider focusing on suppliers that produce high-emission materials to engage suppliers that contribute a large percentage to their scope 3 profile.

## Buyers and banks may consider several best practices to strengthen impact:

- Buyers and/or banks may explore opportunities to increase supplier participation in the program design process, with a view towards standardizing the practice. This can ensure offerings address the needs of suppliers and in turn maximize uptake.
- Buyers and banks may explore opportunities for knowledge sharing and collaboration to improve impact measurement and tracking and look towards standardizing ESG/sustainability ratings frameworks and metrics to evaluate supplier performance. In a varied buyer-supplier landscape, aligning on common expectations of suppliers can streamline efforts and ensure suppliers are receiving a unified message.
- SSCF programs implement early payment terms and lower interest rates as the primary financing mechanisms. As programs evolve, buyers and banks may consider exploring different forms of financing that can meet the needs of maturing suppliers (e.g., longer term financing for larger investments).

## Suppliers may explore how they can be involved in the establishment of a SSCF program:

- As suppliers continue to receive different incentive and support schemes from buyers, they should consider whether and how an SSCF program might meet their needs.
- Suppliers can approach their buyer and/or bank to identify opportunities to institute a program or adapt an existing one, suggesting what requirements would enable their participation or what financial mechanisms would meet their needs.
- If implemented, suppliers should prioritize identifying how to direct capital received from the program to finance decarbonization initiatives, and in turn qualify for better terms.

# Resources

Companies are invited to reference previous Transformation Guides to explore other key levers for net zero transformation.

[Transform To Net Zero Resources](#) →



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