



FINANCIAL MARKETS SUSTAINABILITY SUSTAINABLE FINANCE OPPORTUNITIES

Sustainable Supply Chain Finance

What is a sustainable supply chain?

Sustainable supply chain management has become an increasing area of focus for large companies (purchasers) as they address competitive pressures arising from new environmental regulations, rising energy costs, workplace standards, and other consumer and government demands. This has led many companies to incorporate eligibility requirements, based on sustainability standards, into contractual relationships with suppliers. By explicitly factoring social, environmental, and governance criteria upstream, where raw materials are processed, and downstream to the consumer, purchasers and their suppliers can reduce operational risks, maintain profitability, and meet the growing demand for organic, certified and sustainably-produced goods.

Closing the financing gap to suppliers

Suppliers able to meet purchasers' eligibility requirements are likely to enjoy business growth. However, many are small and medium enterprises (SMEs) that lack the necessary finance and technical skills to improve social and environmental management and operating performance. In the absence of other lending, some purchasers and brokers have stepped in to provide short-term and pre-export financing to their suppliers. Instead, local financial institutions (FIs) can close this loop and share in this profitable market niche. With IFC's assistance, FIs can offer financing packages designed to improve supplier business performance and credit risk, while generating attractive portfolio returns from an untapped market.

What are opportunities for financial institutions (FIs)?

- **Large market with good growth potential:** Supplier finance opportunities exist in multiple sectors, including: timber, cotton, sugar, coffee, cocoa, fruit, vegetables, and flowers. Purchasers may vary from international retailers to domestic supermarket chains.
- **Improved credit risk:** Supporting suppliers to implement best practice environmental, social and governance standards enhances risk management, operational efficiency, and increased profitability, reducing financial liabilities for FIs.
- **Attractive financing niche:** Supplier demand for finance is already there and the involvement of purchasers reduces collateral risk, which further enhances the attractiveness of these deals, with simple paybacks in the 7 year range.
- **Improved client service:** Finance is essential to help suppliers produce a better quality product that meets purchaser eligibility requirements, often involving

Sustainable supply chain: a strategic asset



The business case

A sustainable supply chain allows purchasers to strengthen their supply base through improved risk management, production efficiency and increased brand value. High performance standards are a strategic asset as poor environmental, labor and governance standards increase the risk of regulatory sanctions and reduce shareholder value.

What companies are addressing sustainability in the supply chain?

Major market players have adopted sustainability standards in supply chains, including: Home Depot, Gap, Hewlett Packard, IKEA, Nike, Nokia, Michelin, Starbucks, Sony, Volvo, and many others. Some adhere to voluntary codes, such as ISO 14001 and UN Global Compact, while others have chosen to adopt corporate-level sustainability policies. In some cases, these standards even exceed domestic regulations.

What does "greening" involve?

Supply chain greening may include improving health and safety awareness; curbing emissions; ensuring good working conditions; improving energy efficiency, water use, and waste recycling; and raising product quality to meet certification requirements. Such initiatives generate broad financial, social and environmental benefits and demonstrate a commitment to good corporate governance.

What are the implications for suppliers?

With the right financing and technical support, suppliers can differentiate their business through sustainability and benefit by reinforcing existing partnerships and competing for new business. Suppliers falling short of rising industry standards risk losing competitiveness, especially in import markets.

certification. Benefits for FIs come from building competitive supplier businesses, which add to portfolio returns.

- **Market differentiation:** FIs well-acquainted with the specificities of the sustainable supplier market and offering value-adding financial services in this area, can extend their market reach in a highly competitive SME market.
- **Increased brand value:** FIs can enjoy the reputational benefits of supporting businesses with high operating standards among policymakers, investors, and customers.

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What are the key issues—questions to ask?

- **Portfolio profile:** What is the profile and quality of the FI's existing portfolio?; What suppliers and which sectors could be eligible for financing?; What is the potential for market sizing?
- **Supplier capacity:** Do some suppliers already meet purchaser eligibility requirements?; What are the nature of the eligibility requirements (e.g. labor standards, environmental due diligence, product quality)?; What is the supplier's level of awareness and capacity to implement sustainability improvements?; What technical assistance is needed, and in what areas?
- **FI products and processes:** What internal resources exist to support performance-based lending?; What is the availability of medium-to long-term financing to SMEs, and at what terms?; How would loan size, pricing, segmenting, and structure vary for this type of lending?; Is assistance needed in developing programs to support deal flow and supplier delivery?
- **Monitoring and evaluation:** What is the FI's internal capacity to monitor supplier sustainability performance?; Is technical assistance needed to build institutional capacity in this area?; What methods will be used to evaluate performance-based lending, and over what timeframe?; What actions will be taken in case of default or non-improvement in sustainability performance by a supplier?

How can IFC help?

IFC's Global Financial Markets department provides risk-sharing financial instruments and technical assistance grant funding to FIs interested in leveraging the sustainable supplier market for profit. IFC's offering includes:

Market Assessment:

- IFC works with local FIs and purchasers to assess regional potential for an initial pipeline of bankable projects and the eligibility of suppliers in the supply chain.

Flexible Financing and Risk Sharing:

- IFC provides structured finance and portfolio guarantees, or credit lines with a performance bonus, in some cases, which is paid to the FI at the end of the guarantee period based on the supplier portfolio performance.
- Performance targets reflect socio-environmental improvements, loan volume, and portfolio quality. The risk sharing and performance bonus can also be structured to lower the FI's costs.

Technical Assistance Grant Funding:

- Technical assistance is designed strengthen the FI's credit scoring and due diligence tools through staff training and systems enhancement, including social and environmental compliance.
- IFC can develop programs with the FI to support cash flow-based (against supplier contracts) lending, deal flow, deal preparation, and mentoring to support supply chain development.
- IFC supports capacity building for suppliers through a technical assistance provider to improve social and environmental management and operating standards to enable suppliers to meet purchaser eligibility or certification requirements.

Sample Project: Finance for Organic Coffee Growers

Purpose	IFC extends a sustainability finance package to local FI to support on-lending to coffee growers. Package supports technical assistance to help growers meet the certification standards of international buyers
Borrower	Local FIs
Sponsor	Coffee traders/brokers; purchasers
Beneficiaries	Individual coffee growers, or coffee farming cooperatives
IFC role	Medium-to long-term credit line; short term trade finance; TA through third party specialist; and insurance
Simple Payback	Up to 7 years
Sustainable Impact	Improved long term supplier capacity and product quality; reliable supply of organic coffee to purchasers; reputational value for all project participants; replication potential for FI and access to an untapped market.

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