Corporate & Investment Banking

Sustainable Finance & Advisory

Sustainable supply chains: Financial strategies for a greener outcome

Executive summary

- Regulators, investors, and other stakeholders are focused more than ever on social and environmental impacts within supply chains and demanding that corporates and suppliers take more responsibility for activity that occurs within their supply chain and reduce value chain greenhouse gas (GHG) emissions
- Supply chain sustainability platforms such as EcoVadis, Sedex, and CDP Supply Chain have enhanced their tools and expanded their user base to streamline the process for suppliers to report and for corporates to receive sustainability data
- Corporates with more advanced supply chain sustainability programs have established supplier sustainability engagement programs and collaborated with peers who may share the same suppliers to accelerate progress
- Corporates are increasingly exploring sustainable finance solutions such as sustainability-linked loans and sustainable supply chain finance programs to help improve supply chain sustainability outcomes

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Financial tools to incentivize supplier sustainability

While more than 55% of the S&P 500 disclose GHG emissions* from sources that they own and control, such as vehicles and boilers (scope 1 GHG emissions) and from the electricity that they purchase (scope 2 GHG emissions), focus is shifting to GHG emissions generated by their suppliers and from consumers using and disposing of their finished products (scope 3 GHG emissions).[1] Currently, only 5% of U.S. companies are reporting scope 3 GHG emissions even though it comprises, on average, 80% or more of a company's carbon footprint.[2] Some corporates have deployed financial tools and incentives, sometimes with financial services partners, to help expand scope 3 GHG emissions disclosure, enhance the economics of sustainability improvements at the supplier level, and drive further progress.

Co-investing

The most direct approach is for corporates to co-invest with suppliers to enable energy efficiency improvements or the transition to renewable energy. Apple has raised more than $4.7 billion in green bonds to invest in more than 16.5 GW of renewable energy and enable more than 320 suppliers operating in 28 countries to commit to using renewable energy for all Apple products by 2030. This represents more than 95% of the company's direct manufacturing spend.[3]

In the apparel space, corporates like H&M, Lululemon, Target, and PVH are partnering together on a $250 million Fashion Climate Fund. The Fund works to connect suppliers with technical assistance to evaluate their needs, strategize the path that suppliers must take to meet their climate goals, identify proven and promising tools and solutions, and then use a blended capital approach to lower interest rates and create more incentivized finance.[4]

Enhancing contract terms

Corporates may choose to purchase more goods or enter longer-term contracts with suppliers who demonstrate sustainability leadership or improvement in sustainability progress. The economics of a supplier's investment in renewable energy or more efficient equipment or a farmer adopting more sustainable farming practices can be more easily justified in the context of a long-term contract. As an example, PwC recognizes that sustainability is a key area for making procurement decisions, and the firm is integrating enhanced sustainability clauses into key suppliers' contracts at renewal.[5]

Sustainable supply chain finance

Corporates like Coca-Cola, PVH, Henkel, Bridgestone, and Walmart have all established sustainable supply chain finance programs to incentivize further sustainable development in their supply chain. A traditional supply chain finance program allows suppliers to elect to receive advanced payment for goods sold by delivering an approved invoice to the financial services provider which is discounted to account for the immediate delivery of funds to the supplier. Sustainable supply chain finance can allow suppliers that achieve certain sustainability criteria or demonstrate sustainability improvement to receive a better rate for each invoice paid under the program.

Sustainability-linked loans, letters of credit

Sustainability-linked loans (SLLs) are increasingly prevalent, and several transactions have featured supply chain sustainability metrics prominently. Hewlett Packard Enterprise (HPE), Johnson Controls, IMTT, CBRE, Moody's, and Evergy have all tied the margin in their revolving credit facilities (RCFs) with supplier sustainability-related metrics. While sustainable supply chain finance programs utilize pricing incentives to encourage suppliers to pursue sustainable outcomes, sustainability-linked performance letters of credit (LCs) or RCFs can provide margin relief to corporates for achieving their own sustainability goals. These tools tie the margin for outstanding borrowings under an RCF or a performance LC to environmental or social key performance indicators (KPIs). Adjustments usually also apply to the standby fee or commitment fee, creating a deeper incentive for achievement of the selected KPIs. KPIs can focus on supply chain engagement, such as suppliers setting their own emissions reduction targets or overall reduction in corporate scope 3 GHG emissions.

Green bonds, loans

Green bonds can support investments that corporates make in upstream supplier sustainability capacity building, while green loans can support green financing needs at the supplier level. All these structures can provide increased transparency into how companies are spending the money that they are borrowing on sustainability initiatives and the environmental impact of those expenditures, which can attract incremental investors and lenders.

* Greenhouse gases include carbon dioxide, methane, nitrous oxide, and fluorinated gases.

Regulator, investor, and stakeholder pressures

Regulatory requirements are increasingly targeting corporate supply chains. Although the SEC's Enhancement and Standardization of Climate-Related Disclosures rule announced in March 2024, currently stayed in court, excludes scope 3 GHG emissions reporting requirements, U.S. companies with operations in the European Union (EU) and doing businesses in California will still have to comply with some level of scope 3 GHG emissions reporting.

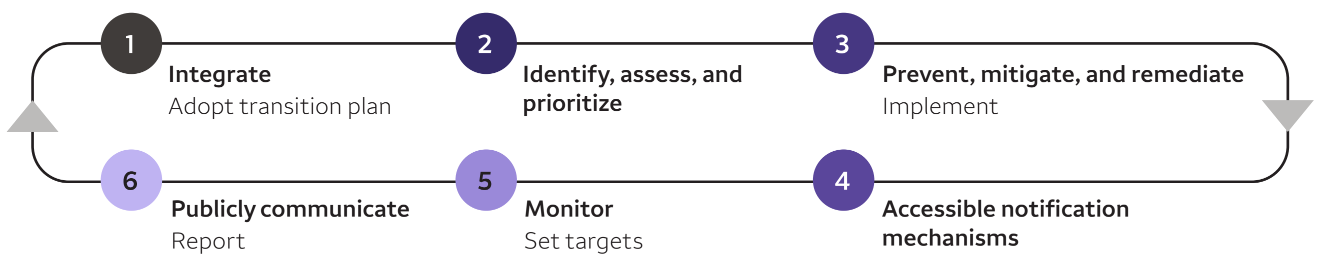
The State of California Senate Bill 253 (SB 253), which was signed into law in October 2023, will require scope 1, 2, and 3 GHG emissions reporting for any U.S. entity with global revenues of more than $1.0 billion that does business in California.[6] By 2030, all this data will also need to have limited assurance. It is estimated that more than 5,300 companies will be in scope of SB 253, as it applies uniformly to public and private enterprises.[7]

Any U.S. company with more than €150 million in annual revenues within the EU and at least one branch or subsidiary in the EU is in scope for the Corporate Sustainability Reporting Directive (CSRD). Among other sustainability data, the CSRD requires companies in scope to report material scope 3 GHG emissions.[8]

The Corporate Sustainability Due Diligence Directive (CSDDD or CS3D), formally adopted by the European Parliament in April 2024, will introduce comprehensive mandatory human rights and environmental due diligence obligations, with significant financial penalties and civil liability for companies that do not fully comply.[9]

EU companies with more than 1,000 employees and global revenues exceeding €450 million are in scope. Non-EU companies with more than €450 million in annual revenues in the EU are also in scope, with no employee threshold – meaning even if there are no employees operating in Europe, having substantial revenues from the EU is sufficient to qualify. CS3D's impact affects a company's own operations as well as upstream and downstream activities.

Figure 1: Corporate Sustainability Due Diligence Directive requirements



Source: ERM

Major investors are making commitments to reduce their portfolio emissions – their share of GHG emissions from the companies in which they invest or finance. Obtaining high quality scope 3 GHG emissions data is critical to understanding and setting targets to reduce an investor's portfolio emissions, particularly for industries in which scope 3 comprises the majority of GHG emissions. A survey of investors completed by the Task Force on Climate-Related Financial Disclosures (TCFD) highlights that 95% of respondents find disclosure of scope 3 GHG emissions data useful. A further 87% responded that disclosure of a scope 3 GHG reduction target is useful.[10] Investor pressure to increase disclosure has contributed to some of the previously mentioned regulatory developments.

Reputational risk arising from breaches of supply chain ethics is greater than ever before, with campaigns from the media and NGOs targeting failures in supply chain governance such as the Rana Plaza factory collapse in the fashion industry,[11] forced labor in Thailand supporting seafood supply chains,[12] and deforestation in Malaysia and Indonesia.[13] These events highlight the disastrous consequences that weak supply chain oversight and disclosure can have on both humanity and brand value. This pushes many corporates to invest in tools, technologies, and procedures to enhance supply chain governance and incentivize positive environmental and social behavior across their supply chains, from raw materials to finished goods.

Tools to enhance supply chain governance

The first step many organizations take in improving supply chain governance is developing a supplier code of conduct and requiring compliance across the value chain. The code of conduct frequently details compliance requirements across labor and human rights, health and safety, environmental protection, and integrity & compliance (e.g., anti-bribery, whistleblower procedures). While essential to effective supply chain governance, a code of conduct on its own is limited in its ability to ensure effective supplier compliance. Routine supplier audits are an important tool to improve supply chain performance. Industry collaboration among companies that share suppliers is also critical to provide a uniform approach to responsible supply chain management and engagement. Two industry collaboration examples include the Responsible Business Alliance (RBA) and Worldwide Responsible Accredited Production (WRAP).

Figure 2: Supply chain industry group examples

Industry group	Overview
Responsible Business Alliance (RBA)[14]	• Nonprofit comprised of more than 500 electronics, retail, auto, and toy companies committed to supporting the rights and well-being of workers and communities worldwide affected by global supply chains • Members commit and are held accountable to a common Code of Conduct and utilize a range of RBA training and assessment tools, including the Responsible Minerals Initiative, Responsible Labor Initiative, Responsible Factory Initiative, and the Responsible Environmental Initiative • RBA Validated Assessment Program is a leading standard for onsite compliance verification and assessments conducted by independent, third-party firms
Worldwide Responsible Accredited Production (WRAP)[15]	• Promotes safe, lawful, humane, and ethical manufacturing around the world in the apparel industry through a comprehensive audit and certification program • Certifies facilities for compliance with the 12 WRAP Principles which encompass human resources management, health and safety, environmental practices, and legal compliance – including imports, exports, customs compliance, and security standards • WRAP certification affirms a production unit consistently abides by all applicable laws and best practices, and there are more than 3.25 million workers employed in WRAP certified facilities

Supply chain data collection and aggregation

Even with regular audits of supplier sites and universal application of a code of conduct, collection of performance data for key performance indicators is a challenge. Many suppliers lack the software and technology required to accurately track important environmental data, leaving corporates little choice but to estimate upstream scope 3 GHG emissions. Platforms such as the Higg Index, which is focused on the apparel industry, and EcoVadis, Sedex, and CDP Supply Chain, which apply across industries, allow suppliers to input data in one format.

Figure 3: Supply chain data platforms

Platform	Overview
Higg Index[16]	• Has released Facility Tools focusing on environmental and social labor topics, Product Tools to provide information about the impact of materials used in apparel, footwear, and home textiles, and a Brand & Retail Tool to help brands and retailers measure the environmental, social, and governance impact of their business operations • Supplier data and scoring can be audited • 40,000 organizations use Higg Index tools[17]
EcoVadis[18]	• Performs a sustainability assessment of a supplier based on information submitted to a sector-specific questionnaire and assigns a rating based on the supplier's sustainability performance, labor considerations, and governance • Process begins at the request of a corporate – the corporate and the supplier pay a fee • Suppliers are assigned a rating from 0-100 and can use their rating from EcoVadis to satisfy reporting demands of other corporates • More than 130,000 companies rated since 2007
Sedex[19]	• Sedex Self-Assessment Questionnaire allows suppliers to share information about their business with customers by completing a set of questions based on labor, health & safety, environment, and business ethics standards • Sedex Members Ethical Trade Audit helps a company understand performance on those standards in its own operations or at a supplier site and is accompanied by a corrective action plan to improve performance • 75,000 members are on the Sedex platform
CDP Supply Chain[20]	• Membership allows corporates to gather scope 3 GHG emissions data from their suppliers which can be used to help corporates set and achieve their GHG emissions, zero-deforestation, and water security targets • Questionnaire submissions are assigned a rating of A-F based on the quality of the disclosure • More than 330 corporates, with $6.4 trillion in purchasing power, submitted more than 50,000 supplier requests in 2023

Corporate engagement with supply chains

Corporates that have taken steps to ensure compliance throughout their supply chain and have insight into their supplier-related scope 3 GHG emissions can begin to mandate GHG emissions reporting, require suppliers to provide decarbonization plans, or require GHG emissions reduction targets.

For example, T-Mobile requires that all suppliers either have established Science-Based Targets initiative (SBTi)-verified emissions reduction targets or submit a letter to SBTi within 90 days of signing any contract with T-Mobile committing to set such Science-Based Targets (SBTs).[21] HPE and Deloitte have also set their own targets to engage with their top suppliers by spend and a requirement to set SBTs.

Some corporates are strategically engaging with their supply chains to provide the resources they need to adopt sustainable practices and meet reporting and target requirements. Apple offers a suite of free e-learning resources and live trainings through its Clean Energy Program. It also works closely with its suppliers and local partners to identify effective solutions for renewable energy and carbon removal.[22]

Unilever, which sources products and services from 54,000 suppliers, launched the Unilever Climate Programme to work closely with core suppliers and offer hands-on guidance and access to tools and resources to help them measure, report, and reduce their emissions.[23] Salesforce has a commitment[24] that by 2024, suppliers representing 60% of applicable scope 3 GHG emissions will set SBTs. Salesforce developed and fully funded a six-month accelerator program for select suppliers with virtual workshops, self-guided resources, and a comprehensive supplier GHG emissions inventory.

Firms like Salesforce and Unilever provide an example of best-in-class supplier engagement that other firms can work towards as they raise the bar on sustainability for their suppliers and provide resources to help them improve on their sustainability performance.

Figure 4: Case studies on supply chain engagement

T Mobile		Unilever	salesforce
Requires suppliers to set or commit to SBTi-verified emissions reduction targets	Provides training and local partnerships to identify local renewable energy and carbon removals	Offers hands-on guidance to measure, report, and reduce emissions	Provides accelerator program for suppliers to complete GHG inventory

Conclusion

As corporates seek to address mounting pressure from regulators, investors, and stakeholders to act on the global supply chain sustainability imperative, they may consider the myriad of solutions available in the marketplace. These solutions include industry collaborations, supply chain sustainability platforms, and innovative sustainable finance structures. Wells Fargo's Sustainable Finance & Advisory team is prepared to engage with clients around best practices in supply chain sustainability and explore how sustainable finance can support their sustainability strategies and implementation.

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