SUPPLY CHAINS & THE ESG JOURNEY

SMES HAVE CONSIDERABLE ESG ISSUES TO ADDRESS, WITH SCANT RESOURCES COMPARED TO THEIR LARGER CUSTOMERS. **JONAS PERSSON** LOOKS AT THE UK SITUATION AND SUGGESTS THREE MAJOR THEMES FOR TREASURERS

According to figures from the Federation of Small Businesses, there are nearly 6 million SMEs in the UK. These are the businesses that in many ways will be the most important to the UK's green transition – the ones working at the front line to deliver national projects. They hold the specialist skills that large corporates need.

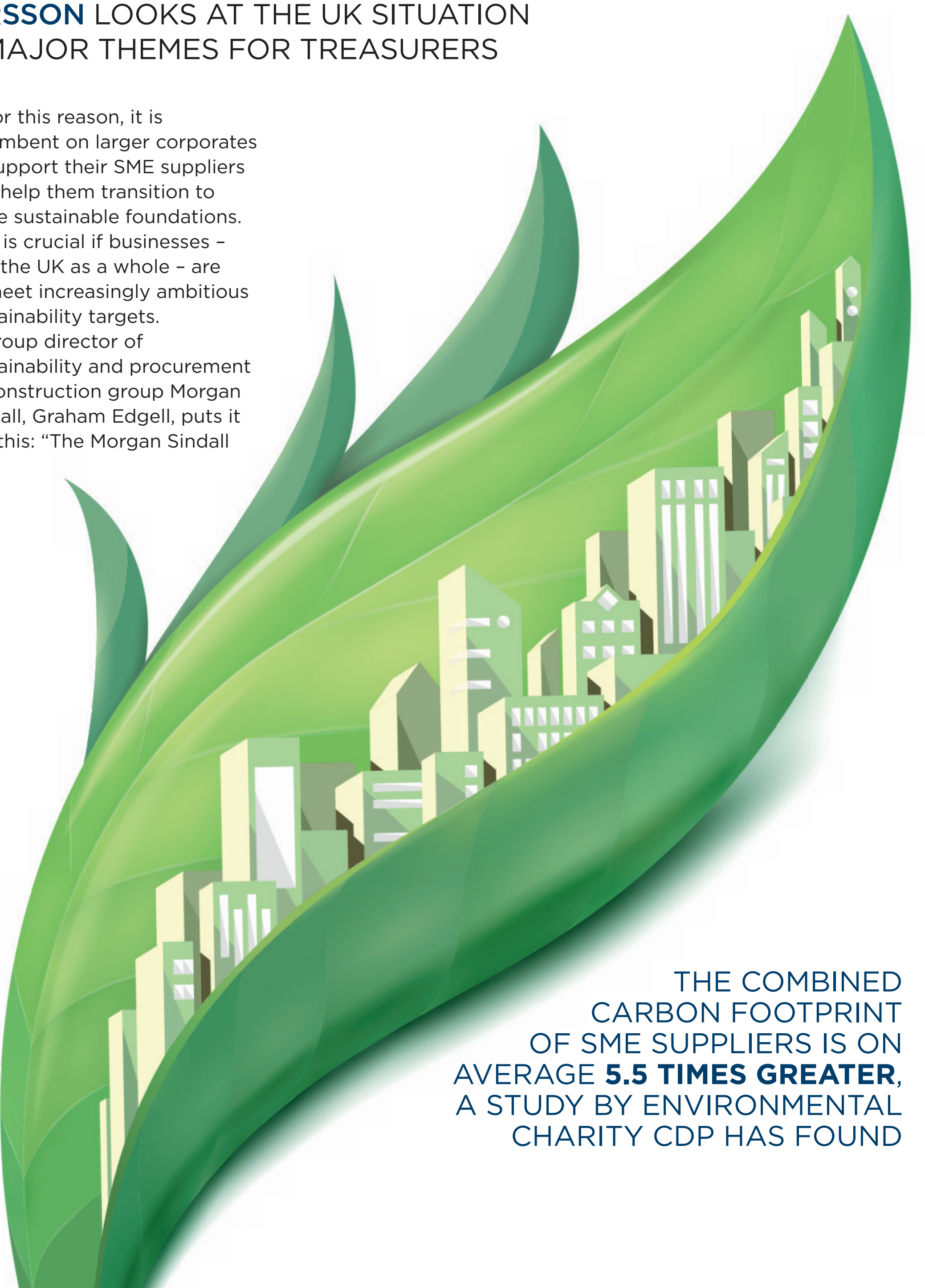
However, they are also the firms that often have the least resource to invest in transitioning to a more sustainable footing, and this paradox poses a major challenge to the UK's progress towards net zero.

These SMEs are part of a bigger ecosystem. If larger corporates want to operate sustainably, they require the buy-in of their whole supply chain, not just the tier 1 contractors with a direct commercial relationship with the client.

While we see corporate organisations starting to get their environmental, social and governance (ESG) plans in order, the combined carbon footprint of SME suppliers is on average 5.5 times greater, a study by environmental charity CDP has found. This will ultimately have an impact on the metrics that large organisations report.

For this reason, it is incumbent on larger corporates to support their SME suppliers and help them transition to more sustainable foundations. This is crucial if businesses – and the UK as a whole – are to meet increasingly ambitious sustainability targets.

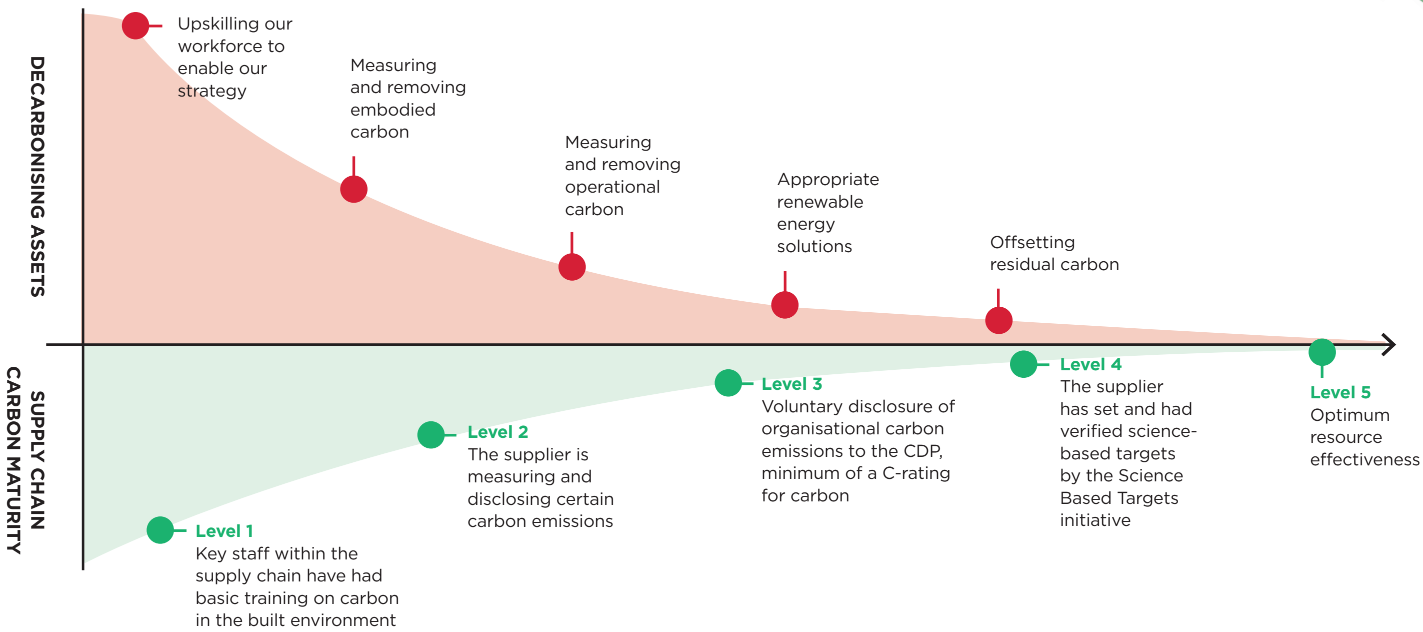
Group director of sustainability and procurement at construction group Morgan Sindall, Graham Edgell, puts it like this: "The Morgan Sindall



THE COMBINED CARBON FOOTPRINT OF SME SUPPLIERS IS ON AVERAGE **5.5 TIMES GREATER**, A STUDY BY ENVIRONMENTAL CHARITY CDP HAS FOUND

Working in parallel with a supply chain

Morgan Sindall Group: As part of its decarbonising communities strategy, Morgan Sindall Construction aims to take SMEs alongside them on a journey towards minimising carbon



Group has been acting on climate change for many years, recognising its responsibility in a sector that can have an immense impact on the environment.

"We have changed our processes, our materials and our mindset to bring carbon impact to the forefront of decision-making right across the businesses and beyond it, along our supply chain."

Here, we look at three key issues for corporate treasurers who are working to help their supply chains along their sustainability journey.

1 LISTEN AND LEARN: ENGAGE AND INCENTIVISE SUPPLIERS

Larger firms must listen to their suppliers to understand the complexities and challenges they face in greening their operations. It is especially important in the current environment, where many smaller businesses are under great pressure. Some are even fighting for survival.

Emphasise the strong commercial incentives for them to transition, from reputational benefits to business continuity. The business case for sustainability should be well understood.

Suppliers that fulfil ESG requirements may well become preferred suppliers and benefit from securing long-term contracts. Not only that, the absence of a sustainable strategy and action on this front potentially poses a threat to their existence in the medium and long term.

> "We have changed our processes, our materials and our mindset to bring carbon impact to the forefront of decision-making"

Treasurers must ensure they know and understand the businesses in the supply chain, given how important they are to their company's own success and – as we have seen – given how fragile supply chains can be. The focus should be on getting to grips with their challenges and the solutions they have put forward, which will identify where the larger business can support and incentivise progress.

Sharing best practice will help inform suppliers' transition, but financial support may also be needed. If there is supply chain financing available, this can provide much-needed liquidity for smaller firms, so they have the capital to transition.

There are also circumstances where direct financial incentives for making positive changes are appropriate. For example, on many big building projects, contracts will include incentives to reduce waste. This creates an environment where conversations between tier 1 contractors and their supplier around agreed targets and rewards can take place.

2 STAY ON TARGET: SET CLEAR AND MEASURABLE GOALS

Larger businesses should help suppliers to set measurable, achievable and relevant key performance indicators. Smaller firms lack the resources of many corporates but, as mentioned earlier, their role in helping to meet ambitious emissions targets is crucial.

We have seen firms set lofty targets, sometimes far into the future. However, the key is to find a balance. Stakeholders must be able to look at a company's strategy and see it has committed to metrics that are realistic and timely. Some commitments are not tangible, so the focus must be on contributory factors that are in the control of management teams.

For example, we set two main sustainability targets back in 2018. The first was a funding target for financing renewable projects. The second was to reduce the carbon footprint of our own operations by making office space more energy efficient. In both cases, these were targets that could be easily benchmarked against previous performance, so progress could be clearly quantified.

Targets may change over time and sustainability journeys are unlikely to be linear. Larger businesses and their supply chains must be prepared to recognise when strategies and actions are not working well and act to rectify them quickly.

By the same token, when targets are met, there is an opportunity to share the good news and set new, more ambitious goals.

3 DON'T UNDERESTIMATE THE 'G' IN ESG

It is truly heartening to see how ESG has risen up the boardroom agenda in recent years. In the past there has been criticism that corporates treated ESG, and its forerunner corporate and social responsibility, as a box-ticking exercise to give the impression of progress being made. Now, driven by key stakeholders including investors, customers and suppliers, as well as legislation, it has become a strategic priority and key differentiator.

Many stakeholders are no longer satisfied by simply understanding a firm's ESG aspirations. Rather, they want to see a defined strategy aimed at achieving hard targets. To that end, businesses are fundamentally changing their operations and bringing ESG strategies into their capital structures.

This shows a real commitment to change. If businesses don't meet their targets, stakeholders have a mandate to ask searching questions and potentially take action to further focus the minds of boards. It raises the question of what steps businesses – with corporate treasurers playing a key role – can take to avoid such pitfalls.

This is where the 'G' in ESG comes in – governance. Any organisation that fails to meet its ESG targets or is perceived to be failing to address the issue with sufficient urgency risks being perceived as having substandard governance. In that eventuality, businesses may be judged to be inadequate, with consequences for their relationships with key stakeholders, including investors.

On the other hand, there is huge reward on offer for those businesses with a clear ESG strategy and targets. Here, treasurers have an important role to play, whether in their own organisation or in supporting those in their supply chain.

There is no question that transitioning can be a very complex process and the expertise to do it effectively may not be found in-house.

Lloyds Bank's newly created Sustainability and ESG Finance team is a natural extension of the group's mission to help Britain recover from the pandemic crisis in a sustainable way, supporting clients of all sizes as they transition their businesses to become more sustainable.

With COP26, the UN's Climate Change Conference taking place later this year in the UK, now is the right time for corporate treasurers to hold these conversations. The stakes have rarely been higher.

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