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The imperative of sustainability

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The ITFA's 47th Annual Conference from the 6th – 8th October has at its heart sustainability and digital technologies for enabling trade finance. In the wake of the pandemic, the burning questions for the industry centre around harnessing these two areas: to use the power of data and analytics alongside the power of digital technologies to simplify access to trade finance, use digital instruments to enable more effective working capital and to meet regulatory requirements for Anti-Money Laundering and KYC.

Above all though, the biggest challenge at present is to meet the sustainability imperatives that are coming from regulators, governments and clients alike. The conference is an exciting platform for discussing so many of these issues.

For example, sustainable trade regulations will come on tap globally faster than banks can recruit compliance officers. By the end of 2021, S&P estimates that around $3tn of business from outside of the EU could be affected by the Sustainable Finance Disclosure Regulation.[1] While this is largely investment fund money at present, the consequences for the trade finance sector are substantial and it's vital that the sector takes the lead on how it applies to the financing of trade generally, and supply chain finance in particular.

There are three, clear, issues at stake for banks as they attempt to navigate the minefield of sustainability.

The first is simply the imperative to avoid greenwash. Sustainability is about saving the planet from itself, not just about climate change. Effectively it is the business and financial equivalent of the Hypocratic Oath: do no harm. This includes effective governance and transparency, creating high quality jobs with decent pay and conditions as well as delivering "social responsibility programmes that encourage learning and help communities around the business to grow. Climate change is to ESG what Pandas are to the conservation movement - the "charismatic megafauna" that gets all the attention but that only represents a fraction of what needs to be done.

Second, a comprehensive view of ESG like this potentially means collecting, analysing and actioning so much data that the attempt to standardise fees to many like boiling the ocean. The ocean is, unfortunately, doing a good job of boiling itself so the challenge for trade finance providers is to step back and identify the means by which this complexity can be simplified. Unless we can agree on standard processes, we won't avoid greenwash.

Without wanting to sound overly reductionist, there are ways of doing this by focusing on the product that underpins a transaction, rather than focusing on the transaction itself. This would be a welcome move to increase transparency anyway, but we can all agree that it is the product and the production process that pollutes, so a move towards "Know Your Goods" and how they are associated with Sustainable Development Goals and the EU Taxonomy enables the level of granularity that a trade finance provider needs.

Finally, because we can take everything down to the product level, this means that we can effectively price for sustainability. It would be possible to integrate preferential terms for transactions or contracts that are sustainable by virtue of the products or services intrinsic to them. Many banks want to move towards a process of more favourable terms for sustainable supply chains – the product or service level approach enables the real time data to do this.

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[1] https://www.spglobal.com/esg/insights/more-than-3t-of-companies-outside-the-eu-could-be-on-the-hook-for-europe-s-sustainable-finance-disclosure-regulation

Many years ago I was involved with productivity research that looked at the management of “intangibles” in business. “Intangibles” are, broadly speaking, the things that drive ESG management: effective governance, decent work practices, training, Corporate Responsibility programmes, environmental impact management and innovation. The startling finding of that research was that companies that managed their intangibles well were statistically signficantly more productive than those who did not, by a margin of around 10%. More recent research[2] has corroborated these findings.

The question, then, is why has this got caught within the compliance function? Why is it seen as a regulatory push that is driving the momentum for change, when identifying and measuring a business’s ESG status might lead to better credit terms for better businesses? The imperative of sustainability is a commercial imperative – not just a planetary one. This may well be the moment in time where everyone can genuinely “do well by doing good."

[2] https://workofthefuture.mit.edu/wp-content/uploads/2020/11/2020-Research-Brief-Brynjolfsson-Benzell-Rock.pdf