MIDDLE EAST

TRANSFORM TO TRANSITION: STRENGTHENING SUPPLY CHAINS AND PROCUREMENT FOR SUSTAINABLE DEVELOPMENT

Green and conscious consumer demand is rising, but there is growing scepticism about the accuracy and completeness of sustainability claims.[1]

Awareness of terms such as greenwashing, greenwishing, and greenhushing is increasing, along with criticism of claims about carbon neutrality and the integrity of carbon credits. To gain credibility with consumers, regulators, and investors, companies are urged to make genuine and verifiable improvements in their sustainability practices. Overstating progress or making unrealistic forecasts that may not be achieved economically can be risky in today's environment.

UNDERSTANDING KEY SUSTAINABILITY TERMS

Greenwashing:
Making misleading or false claims about a company's climate actions including setting clear long-term goals without concrete plans to achieve them.

Greenwishing:
When a company expresses a desire or undertakes an initiative to be climate-friendly but fails to demonstrate a credible impact.

Greenhushing:
The refusal to voluntarily report on Environmental, Social, and Governance (ESG) metrics.

Regulatory focus is increasingly on Scope 3 emissions — indirect emissions from a company's value chain. As a result, companies face the challenge of decarbonizing their value chains cost-effectively while considering social and other factors.[2]

Around 70 percent of companies in the Net Zero Tracker data, representing almost USD 41 trillion in income, have made climate commitments.

35%
have committed to achieving Net Zero.

35%
have set other climate-related goals.

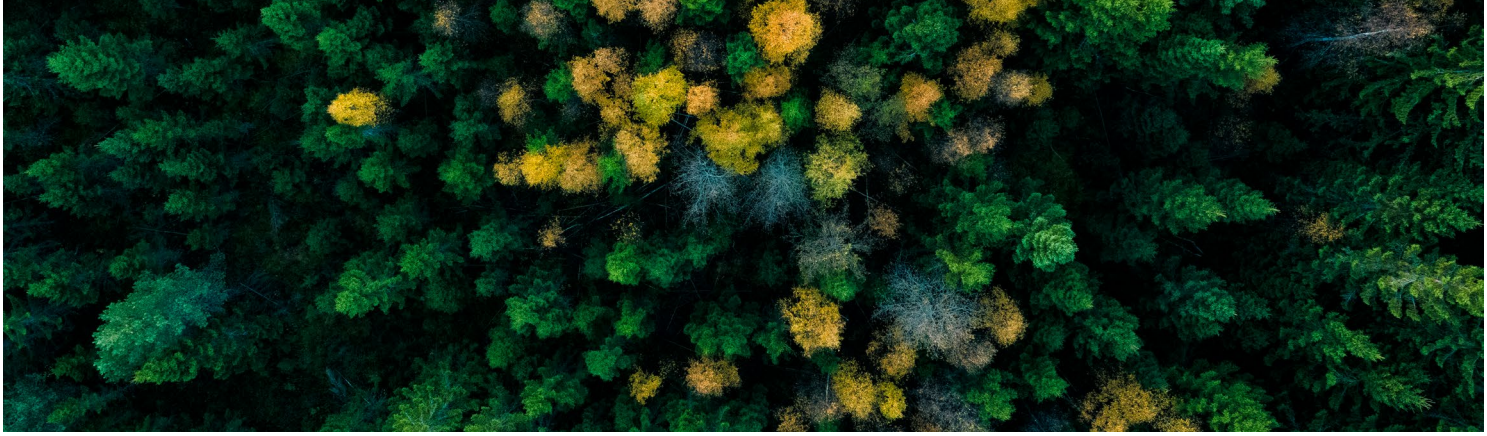
ADAPTING SUPPLY CHAINS FOR A LOW-CARBON FUTURE

AN OVERVIEW OF CURRENT SUPPLY CHAIN DYNAMICS

Today's supply chains are shaped by historical decisions and assumptions aimed at minimizing total costs and ensuring resilience. Key factors include:

- Proximity to raw materials
- Key suppliers
- Energy and other infrastructure
- Transportation options
- Warehousing and distribution
- Mergers and Acquisitions
- Legacy assets
- Incentives, taxes and tariffs

1 Your Customers Prefer Sustainable Products - businessnewsdaily.com
2 Using a Circular Economy to Slash Supply Chain Emissions | Cutter Consortium



In a low-carbon economy, supply chain strategies must now also focus on reducing Greenhouse Gas (GHG) emissions alongside traditional considerations of costs, risks, and time. It is becoming increasingly difficult to be part of a supply chain that is not taking climate action, even without regulatory pressure. Key drivers for this shift include:

Regulation[3]:

Governments and regulatory bodies are driving ESG initiatives with economic conditions and consequences for failing to achieve decarbonization. Key examples include the European Union (EU) Corporate Sustainability Reporting Directive (CSRD); and the proposed US Securities and Exchange Commission (SEC) rules covering disclosure of GHG emissions, both of which cover major markets. Potential carbon border taxes strive to achieve trade-based parity for in-market providers based on GHG emissions and are intended to prevent leakage of emissions to other jurisdictions. Practically, these taxes offer an incentive for trading partners to reduce emissions in their extended supply chain.

Finance flows:

- Global, regional, and national banks are committing to decarbonization by:
  - Considering their share of financed emissions among their clients.
  - Engaging in programmes to educate and finance climate action.
  - Redesigning products based on performance measures, including incentives and price adjustments.
- Finance and insurance organizations are increasingly incorporating climate-risks (regulatory, physical, and transition), climate action and decarbonization plans in their pricing models.
- Activist investors are also critically evaluating and holding CEOs and boards accountable for the costs and risks of climate action. They balance today's business performance against future prospects seeking appropriate uses of capital.
- Sources of net-zero funding have diversified, with increased investments from philanthropic organizations, governments, and the private sector.
- Private equity investors are increasingly measuring ESG credentials, particularly relating to GHG emissions and ethical working practices, during buy-side due diligence. This helps manage reputational risk and ensures that the cost of correcting underperformance is factored into the deal.

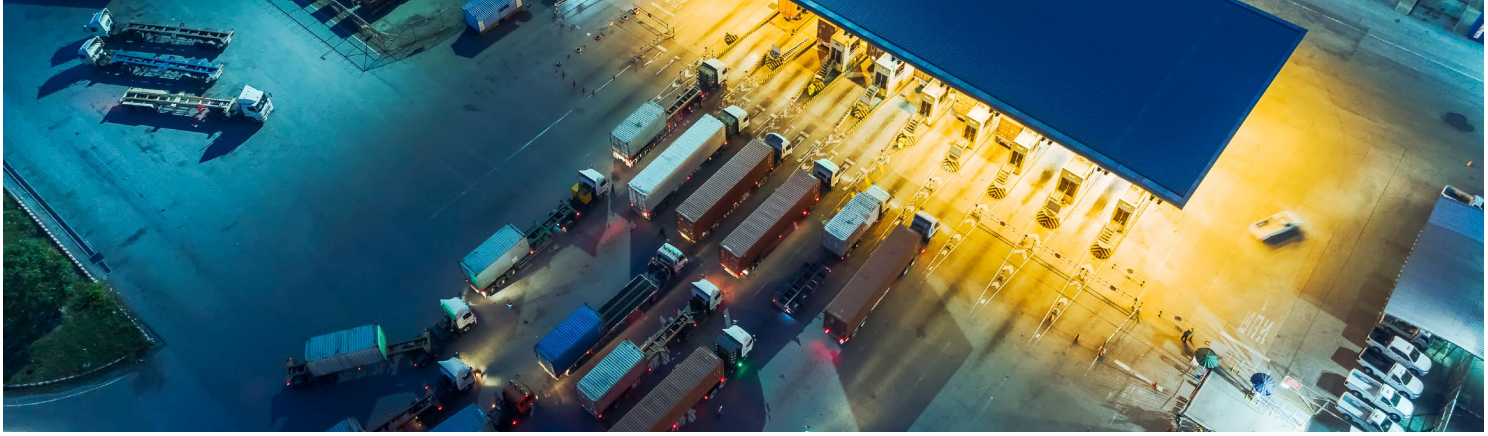
Corporate responsibility:

Companies have made voluntary commitments, independent of regulation, that align with consumer preferences or a sense of corporate responsibility. These commitments range from being 'climate positive' to 'carbon negative' across various emissions scopes and timeframes.

Competitive pressures:

Business-to-business organizations are working to achieve meaningful decarbonization goals, even without consumer interest. They should understand the impacts created by their supply chains and the companies to which they are a supplier or end-user. Important considerations include the links between supply chain and food systems, the demand for raw material extraction, value addition and consumption, and the need for no- and low-carbon transport and logistics.

3 A note on scope: This article focuses on greenhouse gas emissions and reductions. The requirements of global sustainability-related regulation are considerably broader. Topical issues ranging from biodiversity to PFAS ("forever chemicals") to labour relations and the impacts of effective governce practices are also important but outside scope.



Accelerating towards a low-carbon economy requires rethinking the supply chain from a high-level perspective to capitalize on strategic levers of change and challenge assumptions. Strategic sourcing will play a key role in driving the production of decarbonized electricity, fuel, and other energy sources. This will directly impact a company's Scope 1 and 2 emissions (direct and indirect emissions from purchased energy respectively).

Other operational aspects will also need strategic consideration. The costs, risks, and benefits of Power Purchasing Agreements (PPAs), virtual PPAs, renewable energy certificates and similar instruments require careful consideration and communication to be credible or to meet the certification requirements for emerging low carbon products, such as hydrogen and its derivatives.

Green power: PPAs and emission reduction

Lower Scope 2 Emissions

- PPAs can help reduce emissions from purchased heating, cooling, and electricity if sourced from low-emission sources.

Focus on Scope 1 and Scope 2

- Reducing Scope 1 emissions should be a core priority.
- The purchasing power associated with Scope 2 emissions sends a powerful market demand signal, encouraging investment in renewable energy.

Support Energy Transition

- Direct PPAs, Virtual PPAs (VPPAs), and well-designed Renewable Energy Certificates (RECs) can substantiate a company's energy transition efforts.
- Drives further investment into renewable energy development.

Carbon Operating Model: Re-evaluating business decisions for a low-carbon future

- **Make vs. buy:** Reconsider choices between making products in-house or buying them from suppliers.
- **Insourcing vs. outsourcing:** Evaluate activities to determine if they should be performed internally or by external partners.
- **Integration strategies:** Assess the benefits of horizontal or vertical integration.
- **Technology adoption:** Explore how various technologies can enhance operating efficiencies.

Focus: Every decision should aim to reduce carbon impact and evolve towards a low-carbon operating model.

Reviews of the 'carbon operating model' should align with traditional economic and quality-based supply chain analyses. Different sectors and geographies will present varying opportunities, with some unlocking more potential than others. High-energy and high-carbon intensity sectors—such as traditional fossil fuels, heavy transport and shipping, cement, aviation, iron and steel, chemicals, and aluminium—will need specific attention.

These industries will need to make key assumptions about future innovations and adjustments to cost models based on decarbonization capital expenditures (capex) and operating expenditures (opex) being integrated into the value chain. Many of these sectors are strongly advised to undergo fundamental transformations to reduce their carbon footprints. For example, road transportation companies will need to invest in low-emission fleets and develop infrastructure (in many cases in conjunction with government and third-party investments), such as charging stations or hydrogen distribution ecosystems, to support electric vehicles (EVs) and hydrogen-powered transportation.

Opportunities to consolidate spending, optimize transportation, logistics and distribution may emerge from a fresh, carbon-focused view of the supply chain. Developing the right skillsets, decision-making capacity at various organizational levels, and the ability to rethink historical assumptions from a new baseline and set of trade-offs will be the hallmarks of a successful supply chain transition towards a low carbon future. This shift may necessitate difficult reassessments of current strategic supplier relationships, asset lifespans, and valuations. It may also reveal the challenges involved in transforming to a low-carbon future.

Hubs of Opportunity: Development of clean energy, low-carbon hydrogen, and carbon capture hubs

Global development stages

- Consolidated purchasing, waste and recycling are being developed worldwide.

Opportunities for carbon-intensive industries

- These hubs offer carbon-intensive industries the chance to concentrate economic activity at scale, justifying investments in new technologies and infrastructure.

Strategic considerations

- Participation in relevant hubs requires a high-level view to assess advantages and challenges.
- Re-evaluate supply chain assumptions and integrate incentives and efficiencies into planning scenarios.

Example: hydrogen production

- Placing hydrogen production close to consumption points can reduce costs, risks, and distribution complications.
- Proper development is essential to prevent value loss.

Leading the supply chain with climate priorities: strategies for a sustainable future

Driving climate action change through procurement: Tools developed by the Science-Based Targets Initiative (SBTI)[4] should be considered as part of the supply chain review and implemented alongside a clear carbon reduction plan and enabling policies.

Engaging with suppliers: This involves having a strong internal view of GHG emissions targets, conducting lifecycle analyses, and being willing to explore the 'realm of the possible'. It is a strategic activity that should command executive attention. However, it is not as straightforward and must be carefully managed to send the right messages, signals, and intentions.

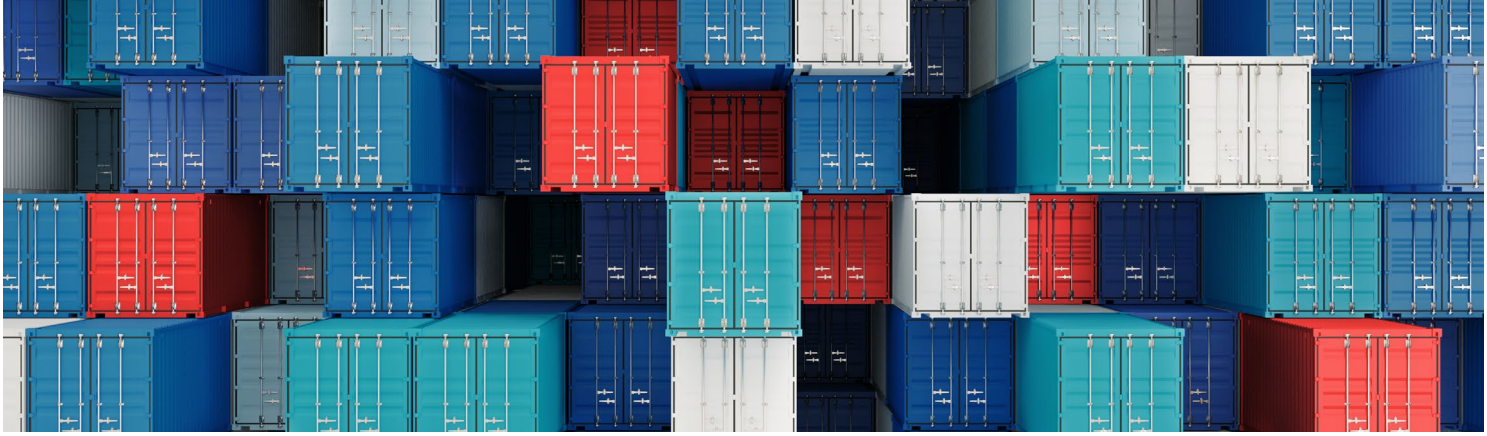
Varying levels of preparedness: While some procurement teams are making efforts to change how suppliers are evaluated and involved in decarbonization, there is clear evidence of varying levels of preparedness across organizations, largely influenced by local regulatory conditions. Some companies, including their extended supply chains and raw material providers, may not be aware of how carbon border taxes and international regulations could impact their business relationships and financial performance.

National climate policies and incentives: In some cases, countries are starting to define their own climate policy, incentives, and initiatives to preserve or grow in-country economic activity and GDP, rather than having their industries make tax payments to other jurisdictions. These trade dynamics represent one of the 'moving parts' that makes international procurement strategy challenging when it comes to a low carbon economy. Companies will need to identify and capture incentives that offer short-term benefits as a trade off against longer-term uncertainties.

Retail and consumer-facing partnerships: Retailers and agency holders in business-to-consumer transactions may not be prepared for the evolving expectations within their role in the value chain. An increase in circular product principles —encouraging consumers to repair, reuse and recycle products, rather than following linear 'use to waste' systems —will shift activity, cost, and performance obligations among partners around concepts of responsibility.

Reconsidering partnerships: Retail and other consumer-facing distribution and agency agreements may be reconsidered or have their terms reset by partners further up the supply chain as part of operating model reviews based on carbon and related factors. For instance, a major manufacturer setting demanding decarbonization goals may only achieve them by imposing these obligations on to their supply chain. Being alert to these evolving expectations and aligning towards a low carbon economy would be good practice.

4 https://sciencebasedtargets.org/blog/new-supplier-engagement-guidance-unlocking-the-power-of-supply-chains-for-decarbonization



Expectations from suppliers: sustainable sourcing of raw materials

Traditionally, suppliers have been expected to provide quality input material at the lowest cost and with a short lead time. However, non-financial factors are now gaining attention, specifically sustainable sourcing and resilience.

Creating successful relationships with suppliers to achieve these goals may require a more flexible and partner-based relationship. Shifting from a transactional 'procure at lowest cost' approach to a knowledge-based relationship, where emissions and efficiency opportunities are integral, will demand resources from both supplier and purchaser. Balancing these priorities will be crucial on both sides of the relationship.

Procurement teams can consider multiple dimensions of sustainability to realize successful supply chain transformation. This includes changing how they engage with suppliers by:

- Choosing suppliers willing to collaborate on reducing risks
- Consolidating the supplier base to actively engage in value engineering
- Focusing on sustainable product development and sourcing
- Reducing the ESG risks of the supply chain

By adopting these practices, procurement teams can foster more sustainable and resilient supply chains.

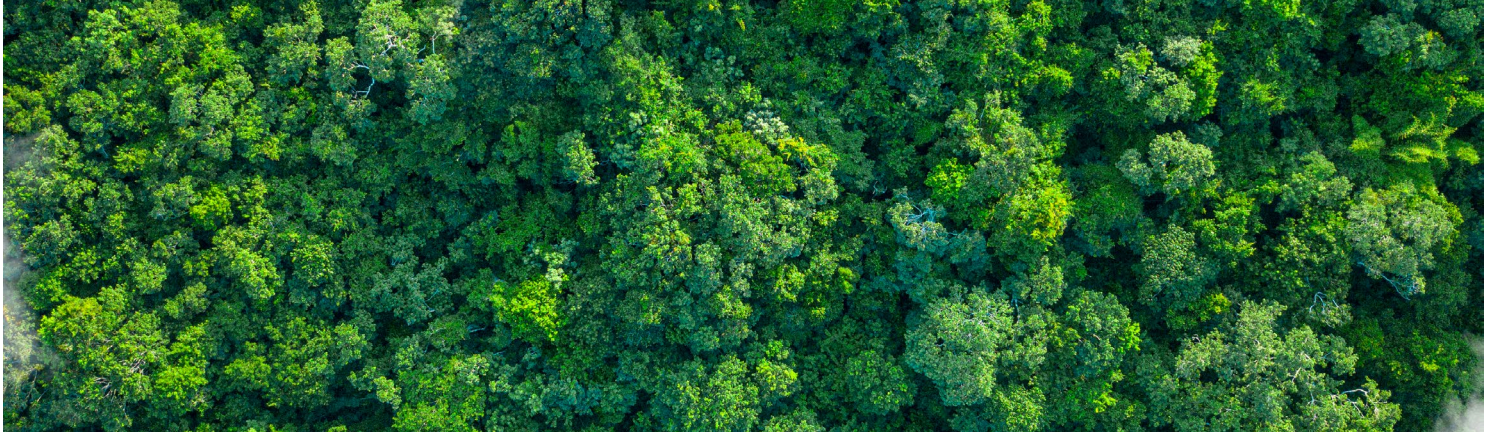
Embracing circular systems: advancing beyond linear supply chains for sustainability

Along with changes in supply chains and procurement, product and service configurations can also be reimagined. Scope 3 embraces a holistic view of product GHG emissions in use, at end of life, or as a waste stream. There may be radical opportunities and regulatory pressure towards supplier responsibility for emissions. Lifecycle emissions and economics are expected to shift from 'cradle to grave' to 'cradle to cradle' in a low carbon world, better aligning responsibilities in product development and procurement organizations. This may create increased focus on surplus inventories, secondary markets and consolidated buying and waste management in some categories.

"Cradle to grave" vs "cradle to cradle"

Cradle to grave: Describes the life of a material or product up to the point of disposal. For example, a plastic bottle that is not recycled goes from the cradle (creation) to the grave (disposal).

Cradle to cradle: A way of designing and producing for next use, instead of end of life. Materials are productively re-incorporated into new production and use phases, such as upcycling and using them as raw materials in new products.



In its extreme form, this may look like a circular product system, where the designer and manufacturer retain responsibility for the product beyond its typical lifecycle. This can involve either a direct consumer relationship or a more holistic relationship with a retailer. These 'looped', or networked systems view by-products and waste generated in the production process as opportunities and materials that can be utilized by third parties. Companies may take back end-of-life products from consumers for repurposing or processing. Adopting these systems will demand new behaviours and decision-making as companies adjust their operating models to verify post-consumer materials, avoid landfills and waste, and shift logistics and distribution to lower emissions intensity.

Procurement teams will lead the transformation towards a more networked supply chain to reduce emissions and reduce the use of resources. They will need to shift from a transactional relationship focused on cost optimization to one of active engagement with suppliers. This new partnership approach will ensure a secure supply, drive efficiencies in the supply chain and enhance value engineering.

Some of the key parameters that are transforming from a company perspective include:

Parameter	Current state	Transformed state
Nature of supply chain	Linear	Looped, circular, or networked
Changing expectations from supplier	Cost effective and quality raw material	Sustainably sourced raw material with traceable or verified provenance, lifecycle analysis and potentially
Nature of relations with supplier	Transactional	Active engagement/partnership
Types of suppliers	Multiple suppliers	Select supplier partners ready to work on value engineering and holistic sustainability

Action plan for sustainable supply chain transformation

Transforming supply chains toward more sustainable models is essential for every company, though it comes with its challenges. Reducing the carbon footprint of a company's supply chain will become a central tenet of future transformations. Depending on the industry, this is likely to involve:

1. **Supplier segmentation:** Completing a detailed supplier segmentation to identify critical suppliers that account for 75 percent of third-party costs and/or Scope 3 emissions based on current strategic plans.
2. **Supplier self-assessment:** Ensuring all critical suppliers complete a detailed self-assessment to evaluate their sustainability risk and outline performance improvement areas, with an emphasis on GHG emissions
3. **Low-carbon planning:** Planning for a low-carbon operating model based on assumptions about future scenarios.
4. **Strategic decisions:** Making strategic decisions such as insourcing vs. outsourcing, and horizontal or vertical integration, based on operational, financial and emissions impacts of these decisions, including geographic plans and operational trade-offs.
5. **Sustainable supplier programme:** Partnering selectively with current and potential suppliers to understand how they can reduce emissions through a holistic sustainable supplier programme.
6. **Cost implications:** Understanding the cost implications of aligning the supply base into line, gaining executive approval for the investment, and commencing the corrective action programme.
7. **Technological integration:** Exploring whether additional technologies, such as blockchain and AI analytics, could be introduced to aid in emission reductions across the entire supply chain.
8. **Performance reassessment:** Reassessing performance every two years if for medium or low risk suppliers.
9. **High-risk supplier check-ins:** Conducting regular check-ins with any identified high-risk suppliers to review progress.
10. **Supplier Alternatives:** Making strategic decisions on finding alternate suppliers or excluding non-compliant suppliers from the process
11. **Emission offsets:** Exploring emission offsets in the short term by procuring carbon credits, particularly where suppliers are from hard-to-abate sectors and cleaner technologies are in the early commercialization stage.

HOW CAN WE HELP?

A&M is helping propel leading organizations in their energy transition journeys to achieve true transformation through leadership, action, and results.

A&M can help you navigate the energy transformation and prepare for evolving environmental regulations. When conventional approaches are not enough to create transformation and drive change, clients seek our deep expertise and practical solutions to their unique problems.

Our expertise includes:

- Creating value from transformations.
- Guiding companies through supply chain, procurement, and sustainability initiatives.
- Critically evaluating opportunities and future challenges.
- Preparing for public and supply chain disclosures.
- Assessing assets and financing risks.
- Unlocking value through innovation.
- Empowering our clients with proprietary data and insights.

A&M has a world class procurement advisory practice with more than 100 experienced consultants across all major geographies, and a mature ESG advisory practice with hubs in the US, South America, and Europe.

For more information or if you have any questions about this article, please contact our team of experts.

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