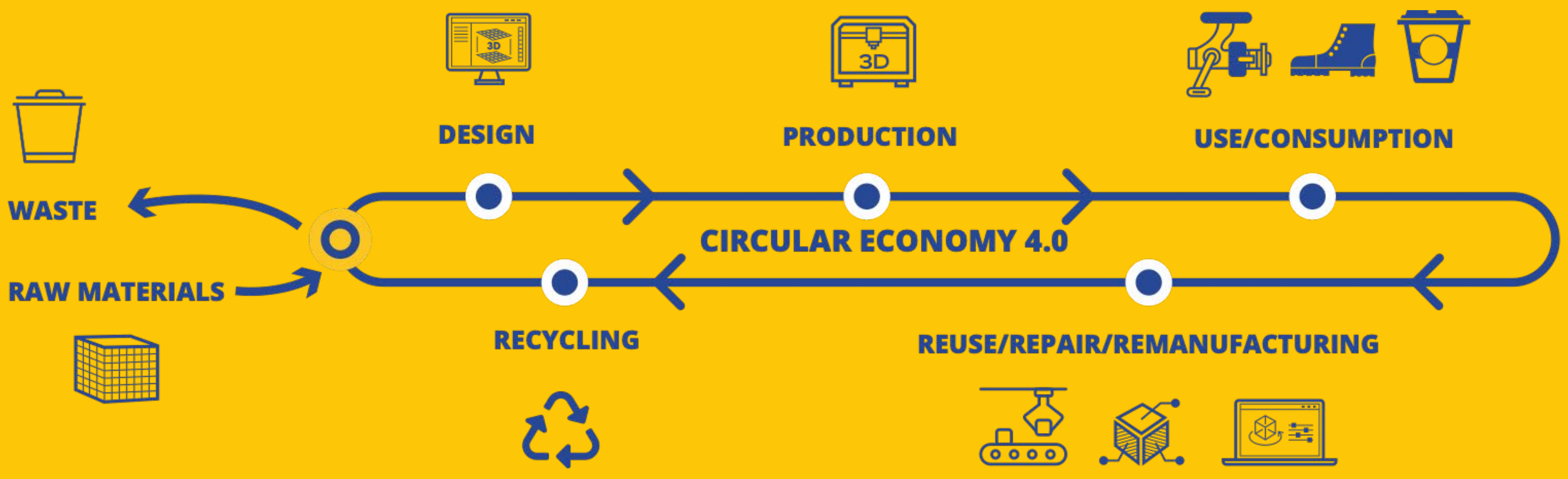
Financiranje krožnih poslovnih modelov v Sloveniji in v Območju Alp



Četrtek, 10.6.2021,
13.00 – 17.00, virtualno

dr. Slaven Mićković

Interreg Alpine Space Circular4.0
EUROPEAN UNION
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CIRCULAR 4.0

Kako banki predstaviti prednosti svojega krožnega modela pri obvladovanju tveganj?

How to present the advantages of our circular model to the bank and to it‘s risk management?

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The circular economy and sustainable finance are two mutually enabling policies

Our aim:

1. To promote and accelerate the transition to the circular economy.
2. To inspire circular economy practitioners to engage in the enhancement of frameworks for sustainable finance, and to motivate sustainable finance actors to integrate circular economy issues into the sustainable finance agenda.

EU Taxonomy

Environmental Objectives

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How the Circular Economy helps tackle Climate Change

Source: Ellen MacArthur Foundation, Material Economics, Completing the Picture: how the circular economy tackles climate change (2019)

A Circular Finance Problem

A well structured circular business case encountering problems obtaining finance (equity and/or debt) required from a third party[1].

This definition of a circular finance problem isolates circular characteristics as the problem for obtaining funding:

1. changing nature of cash flows,
2. increasing working capital needs and
3. a mismatch with current financial decision-making processes.

[1] Retrived from https://www.circle-economy.com/resources/10-step-guide-to-creating-a-financeable-circular-business

Major challenge

The cost of financing the transition to the circular economy - current risk assessment methodologies are insufficiently developed for circular/ sustainable businesses/projects:

1. For the linear industry, they do not always identify the risks of remaining in the linear model (e.g. climate, societal, regulatory, tax, etc.).
2. Existing models insufficiently capture the specific financial profile of circular business models (e.g. asset ownership, cash flow dynamics, depreciation) and fail to value the benefits/risk mitigants of circularity.

Major challenge (con‘t)

Traditionally, externalities have been largely excluded from company’s risk profiles and the measurements of corporate value or income statements:

1. This means that investors and companies have not been fully rewarded for the positive environmental or societal impacts they created through externalities, like creating jobs, using proven net-positive circular products or providing education and healthcare to workers or communities.
2. Conversely, investors and companies have also not been penalised for negative societal impacts, like generating or incinerating waste, depletion of scarce resources, noise and air pollution, or degrading ecosystems.

Major challenge (con‘t)

Circularity-related risks can potentially endanger the stability of the financial sector and they are only marginally addressed by Basel capital requirements:

1. Basel Agreement gives a more rigorous prudential treatment to long-term loans. This characteristic can then negatively impact the lending to circular projects which are by nature mid to long-term projects.
2. The Basel Agreement can be adverse to circular financing!

To support and accelerate the financing the transition to the circular economy in an economy where more than 70% of finance comes from banks, it is necessary to keep working on the recognition of the beneficial nature of these transition.

Drivers of the circular economy[2]

1. Resource constraints: With global resource demand growing quickly, there is increasing concern about looming shortages of critical raw materials, arable land and water. It is thus becoming imperative to rethink our resource use.
2. Technological development: The introduction of new technologies, notably the internet of things and big data tools, is enabling the development and introduction of new circular economy business models, often based on sharing and leasing but also reuse and remanufacturing.

[2] Retrived from https://www.eib.org/de/publications/the-eib-in-the-circular-economy-guide.htm

Drivers of the circular economy

3. Socio-economic development: Currently, about half the world's population lives in cities, and this will rise to six in ten by 2030, according to World Health Organization estimates. Increasing urbanisation supports the development of circular models since urban areas can easily host cost-effective collection and return systems for goods, materials and other resources and thus promote the closing of circular loops, as well as asset-sharing schemes and systems for product reuse.

Opportunities for companies in the European Union

1. De-risk/hedge future commodity supply uncertainty and price volatility: The circular economy offers the means to increase resilience and hedge risks related to uncertain future commodity supply and price volatility.
2. Reducing manufacturing costs: Design for reuse, disassembly and recycling with a view to facilitating remanufacturing and reintroducing the products is often less expensive than producing new parts from virgin materials.

Opportunities for companies in the European Union

3. Avoided costs and new revenue streams: Companies realise the rationale of evaluating their production chains to identify by-product and waste streams that could be avoided, reused or recycled. As a consequence, companies turn to resource management or reverse logistics partners rather than rely on waste management in order to identify potential uses for their by products and waste approach that cuts costs and increases efficiency while reducing resource consumption and environmental impact.
4. New business opportunities and new markets: The ability to increase the life and revenues from a given asset through repair and refurbishment schemes enables new service-based business models and strengthens the customer relationship.

How to create a financeable Circular Business Model

To attract financiers to invest:

1. Secure stable cash flows through a robust contract
2. Mitigate debtor risk
3. Match asset value, payback period and contract duration

Implicitly, it means that corporates:

1. involve their supply chain when choosing their circular strategy and
2. smartly shift their business strategy

How to create a financeable Circular Business Model – PSS example

Circular product-service or product service systems, (PSS) business models:

1. provide control over the products while at the same time incentivizing optimal use and circular design,
2. provide products in the form of services while retaining ownership instead of transferring ownership to users,
3. have a potential for long-term customer relationships and recurring cash flows.

1. Secure stable cash flows through a robust contract

Circular PSS models are generally structured as performance contracts since this provides maximum control over the assets while creating opportunities for increased sustainability:

1. a product and services purchasing strategy used to achieve measurable supplier performance,
2. focuses on developing strategic performance metrics and directly relating contracting payment to performance against these metrics where common metrics include availability, reliability, maintainability, supportability and total cost of ownership.

1. Secure stable cash flows through a robust contract

- It is important to structure a robust contract that clearly states the responsibilities of both the service provider and the customer - clearly stating the service providers' responsibilities like installation, maintenance, repair, reverse logistics and disassembly will create a mutual understanding of what the user pays for and what the service provider delivers,
- In order to entice customers into longterm contracts, they can be structured in a way that facilitates easy extention once it has reached its initial completion period:
  1. discounts for contract renewals can further stimulate this,
  2. reward for returning the product, depending on its state, can incentivize the proper use of products.

1. Secure stable cash flows through a robust contract

- Flexibility and trust are important factors, which are not increased by more stringent contracting - balancing contractual agreements and flexibility is therefore a challenge both with customers and throughout the supply chain!

2. Mitigate debtor risk

- Debtor risk is one of the main hurdles for financing PSS business models (a onetime sales transaction has no such risk):
  1. a PSS with on going transactions creates the risk of customers defaulting on their obligation to pay for the service,
  2. easy access to the collateral in case of default is hindered since assets are being used by the customer.

2. Mitigate debtor risk

- Debtor risk is one of the main hurdles for financing PSS business models (a onetime sales transaction has no such risk):
  1. service new customers (that have not yet proven their payment behaviour) with second cycle assets,
  2. collaborating with a party already involved in credit checks and payment structures,
  3. ‘red button’ that the service provider can use to disable the service if the customer fails to pay the service fee,
  4. ask for a deposit or an upfront payment for the first couple of months of the contract term,
  5. social networks can also be used as a means for decreasing risks.

3. Match asset value, payback period and contract duration

- Low asset value imposes a risk to the financing party, which can be reduced by shortening the payback period:
  1. harmonize the payback period with the contract duration,
  2. charging higher fees in the first year(s) of a service contract,
  3. ‘red button’ that the service provider can use to disable the service if the customer fails to pay the service fee,
  4. ask for a deposit or an upfront payment for the first couple of months of the contract term,
  5. social networks can also be used as a means for decreasing risks.

4. Measure environmental impact on financial performance

- Make a company's environmental impact and level of circularity a core part of its operations:
  1. showing numerical evidence can convince financiers to consider these factors alongside the traditional financial factors when making decisions,
  2. when investments in environmental initiatives do not yield positive results this potentially uncovers (normally hidden) externalities and can be an input for policymakers in pricing these externalities.

Thank you

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