VACCINE INEQUITY AT THE HEART OF TWO-TIERED GLOBAL RECOVERY
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Armida Salsiah Alisjahbana is the Executive Secretary of the United Nations Economic and Social Commission for Asia and the Pacific. Prior to joining ESCAP in 2018, Ms. Alisjahbana was Professor of Economics at Universitas Padjadjaran in Bandung, Indonesia, Minister of National Development Planning and Head of the National Development Planning Agency in Indonesia.

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Nada Shousha is currently a Director on five regional and international companies’ boards as well as Vice Chair of the Egyptian-American Enterprise Fund. She is also an Advisor to the International Finance Corporation’s program Banking on Women. Until 2016, she was Regional Manager for Egypt, Libya and Yemen in the Middle East and North Africa Department of the IFC.

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Nick Maan has been the CEO of Spectrum for the past three years. Prior to his current post, he worked as a Senior Legal Counsel at IG Group. Nicky’s vision for Spectrum over the next five years is for it to be the most important and trusted venue for financial institutions and their retail investors.

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Companies are being impacted by new disruptive and complex societal trends, such as climate change, energy transition and social inequality. Still, only a few companies have begun to invent strategies focused on creating long-term value, not just for shareholders but for all stakeholders.

Introduction
This article summarises a new strategy model to support companies in creating long-term value. This model is helpful to understand the process of transition, which is differentiated across sectors and individual companies, and can be used as part of the strategic-planning process. It also enables assessments of the transition preparedness of individual companies and business units across sectors—and identifies frontrunners and laggards.

Banks can use the model to assess how futureproof their lending portfolios are. This assessment starts with a review of the transition preparedness of their clients. Banks can accelerate the transition toward a sustainable economy by including social and environmental factors in their loan criteria: banking for impact.

Strategy for transition
Leading companies develop strategies to capture societal trends that are relevant for their products and services portfolios. We created a strategy model to aid the strategy process (Kurznack, Schoenmaker and Schramade, 2021). The first step is to identify the relevant trends for a particular industry. In the example of the car industry, the key trend is the transition from combustion engines to electric cars due to the need to reduce carbon emissions. Figure 1 shows this transition. The solid line illustrates the transition curve, starting in 2010 with no demand for electric cars to 2030 with only electric cars.

The second step is to assess the capabilities of individual companies to execute the strategy. Do they have the required capabilities—in the form of intellectual capital, manufactured capital (machine park), human capital and financial capital—to switch in a timely manner towards the new product demand? Figure 1 indicates that Tesla is at the transition curve and thus able to cater to the demand for electric cars. By contrast, Volkswagen is behind and can meet the demand for electric cars only halfway. The difference in capabilities is summarised in the Bloomberg article entitled “VW’s Boss Warns the Troops: We Don’t Want to End Up Like Nokia”: “Volkswagen is at a critical juncture. It has weathered the pandemic relatively well but is fretting about cases going up again. It has electric cars rolling out but is well behind Tesla. And it has a massive manufacturing scale but desperately needs to rethink its vehicles as rolling software devices. It is this last issue that CEO Herbert drives home with VW’s more than 635,000 employees. The transition in competencies from industrial might to software prowess will be an immense challenge for automakers that are vast, deliberate and, as some say, ripe for disruption. Car companies that get it wrong risk ending up like Nokia—failed hardware makers doomed by more nimble and technologically adept upstarts.” (Rauwald, Patel and Thomas, 2020).

The third and final step is to examine the value implications. Tesla is ahead of its competitors in the transition towards electric driving, adding to its valuation. Volkswagen is behind, which reduces its valuation. In our model, we provide a more detailed approach to assess the relative valuations of companies in a sector based on their transition preparedness. The business-as-usual (BAU) scenario of continuing to produce only combustion-engine cars becomes increasingly obsolete, as the demand for these cars is rapidly replaced by electric cars. Traditional car manufacturers become stranded assets if they don’t change their strategies in time.

Is your loan portfolio sustainable?
How can banks use the insights from our strategy model? At the company level, sustainable lenders are looking for their borrowers to adopt long-term value creation. The closer a borrowing company is to the optimal transition curve, the higher the valuation and the lower the risk. This justifies a lower cost of capital (i.e., lower credit spread) for more sustainable companies. Banks can accelerate the transition toward a sustainable economy by including social and environmental factors in their loan criteria.

At the portfolio level, banks can position their clients in relation to their respective sectoral transition curves. They thus construct a transition diagram for each sector, which shows how advanced their borrowing companies are in that particular sector, identifying frontrunners and laggards. This information can, in turn, be used to analyse the credit risks and valuations of those companies. Laggards will receive accordingly higher interest rates and lower valuations, as discussed before. At the portfolio level, banks can use this information to adjust the sectoral and country allocations in their lending portfolios.

An important insight from our model is that banks should not only focus on the frontrunners but also the laggards. In the energy transition, for example, banks, like other financial institutions, are proudly...
announcing their increased lending to renewable-energy companies. However, a full picture emerges only when banks give also insight into the reduction of fossil-fuel-related lending. A typical bank may have 5 percent renewable companies and 15 percent fossil-fuel companies in its portfolio. The long-term value potential of the renewables is then outweighed by the fossil-fuel holdings. The recipe here is building up the new sustainable portfolio and reducing the old unsustainable portfolio at the same time. Leading banks have already announced their intentions to stop financing coal.

The bank’s chief financial officer (CFO) can use this transition analysis to examine which activities contribute to the bank’s earnings and which assets are eroding. The bank can accordingly engage with its clients on transition management and strategy. With clients that make insufficient progress, the bank can end the relationships.

**Impact reporting**

Just like companies, banks also have stakeholders who want to know how their banks are performing. A consortium comprising Harvard Business School and Impact Institute has proposed a new impact-reporting system to measure the environmental and social effects of all banking activities. Four international banks, ABN AMRO, Danske Bank, DBS Bank and UBS, are spearheading this banking-for-impact initiative. These banks believe that they can accelerate the transition toward a sustainable economy by adopting new impact-reporting standards that account for social and environmental factors. They can thus provide a well-rounded picture of how they create long-term value.

Not only bank customers and NGOs (non-governmental organisations) are interested in banks’ impacts, but also bank supervisors. Supervisors can use the transition analysis and the related impact reporting to assess how futureproof a bank’s business model is. In the current low-interest environment with eroding interest margins, supervisors are keen to learn how futureproof a bank’s lending portfolio is.

The European Central Bank (ECB) and the People’s Bank of China (PBoC) are already preparing climate stress tests of their banking system, while the US Federal Reserve Board is still contemplating its strategy. With increasing global warming, biodiversity losses and social inequalities (both within countries and across countries), attention to sustainability efforts is also increasing. Banks had better prepare themselves for a sustainable future.

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