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Fortna Thought Leadership Series

Environmental, Social and Governance in the Supply Chain: Driving Value

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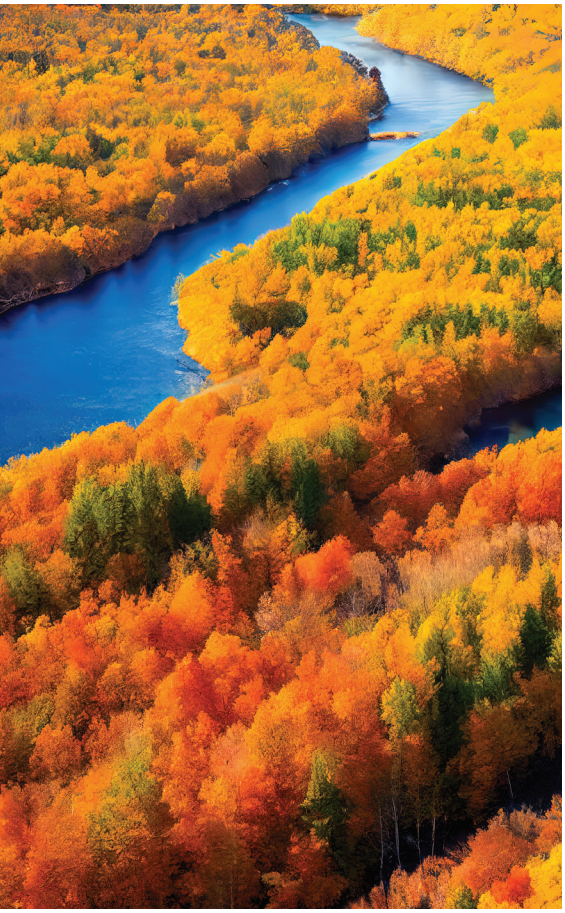


ENVIRONMENTAL, SOCIAL AND GOVERNANCE IN THE SUPPLY CHAIN: DRIVING VALUE

Any major investment a company makes has an expected return within a specified period. What makes Environmental, Social and Governance (ESG) difficult for businesses to adopt is a clear line or understanding of when the return will be and how it can be measured. Many executives could easily view ESG as an unnecessary expense that could impact revenue and disrupt operations.

In the first installment of Fortna's ESG in the Supply Chain series, we review what ESG is and how it affects the supply chain. In the second installment, we examine ESG best practices. In our third and final installment, we explore how an integrated ESG program can drive value and ROI in the short and long term.

ESG DRIVING VALUE

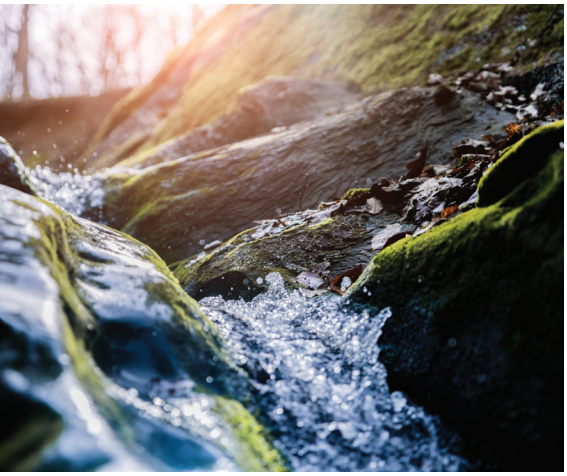
While regulations have yet to be introduced that enforce ESG practices and reporting, many companies have already been proactive in incorporating ESG into their culture and day-to-day work life. These early adopters have seen positive results not only with ROI, but also in brand reputation and value. Consider some of the statistics below:

- 59% of companies in a Deloitte survey[1] reported positive top-line impact from operational ESG investments and more than half of the companies noted a positive effect of sustainability improvements on profitability
- Accenture found in a study[2] of 140 US companies that organizations taking the lead in diversity hiring, employment and inclusion averaged 28% higher revenue, higher net income and 30% higher profit margins
- Bloomberg[3] reports that global ESG assets and investments are estimated to exceed $50 trillion dollars by 2025

[1] https://www.brightest.io/esg-roi-benefits
[2] https://www.accenture.com/_acnmedia/pdf-89/accenture-disability-inclusion-research-report.pdf
[3] https://www.bloomberg.com/company/press/esg-assets-rising-to-50-trillion-will-reshape-140-5-trillion-of-global-aum-by-2025-finds-bloomberg-intelligence/

ESG AND ROI

While some may argue that a company would need to sacrifice profits for ESG, this notion has been disputed as companies with ESG programs not only achieve their overarching goals, but also deliver value and ROI. Below are five areas within an organization that can see increased value with ESG.



- **Competitive Advantages** – Companies that have strong ESG practices will have a decided advantage over competing organizations that do not. A business that can prove its commitment to environmental and social issues can show that they are more stable, dependable and a reliable choice for investors and partners. JP Morgan[4] stated that there was growing evidence of a positive correlation between ESG and financial performance. Another study[5] found that for every one extra point in ESG score cumulative excess returned, they realized an 8% increase.
- **Labor and Productivity** – Over the past 10 years in almost every survey of the material handling industry, the number one challenge has revolved around the scarcity of labor. Companies that inspire employees to act in tandem toward a positive, prosocial goal can encourage them to perform at higher levels while creating loyalty toward the company. A business devoid of ESG initiatives can be viewed to only care about profits; and if an organization doesn't care, why should its employees? With Millennials and Gen Z moving into the dominant labor demographic, multiple reports and studies have shown that a company's positive or negative approach to ESG will greatly affect a prospective employee's decision to work for the company.
- **Long-Term Capital Investments in Sustainability** – Many operations will come to a crossroads when less efficient and less sustainable equipment reaches the end of its useful life. Some might choose to travel the inexpensive route with equipment that does nothing to reduce an operation's carbon footprint or emissions instead of choosing ESG-friendly equipment which could have a higher upfront cost but will realize more savings long-term. Companies

[4] https://www.jpmorgan.com/insights/research/build-back-better-esg-investing#:~:text=During%202020%20there%20was%20growing,for%20investing%20in%20ESG%20strategies
[5] https://www.mindshareworld.com/news/good-growth-and-esg-deliver-financial-value

could find themselves behind the curve when new regulations come into play. By starting the process now, operations can start to realize the benefits and advantages of using clean and efficient equipment and energy.

- **Operational Cost Reductions** – By creating ESG plans and projects that target savings in energy consumption and reduction of waste, a company can see significant cost savings across the board. Owens Corning[6] believes that they will achieve $1.6 million annually in cost savings contributed to 31 sustainability projects that have a 1 to 3-year ROI. Some of the projects they are currently engaged in are:
  - Efficient lighting
  - Compressed air efficiency
  - Efficiency upgrades for pumps, motors and infrastructure
  - Operational improvements with automation and process optimization
  - HVAC efficiency
- **Reduced Dependency on Fossil Fuels** – Market fluctuations, geopolitical conflicts, as well as other factors can all unexpectedly drive-up fuel costs and availability. This volatility can take a significant bite out of margins and increase operational costs. Investing in clean, renewable, zero emissions energy like solar, wind, hydro and geothermal can lessen an operation's dependency on fuel costs that they cannot control. Electric vehicles both inside and outside the warehouse can also create a cleaner and safer environment for employees and customers.

"The SEC is well equipped to lead and facilitate a discussion on when and how ESG risks and data must be disclosed, and how to create and maintain an effective ESG-disclosure system that would promote the disclosure of decision-useful, reliable and, where appropriate, globally comparable ESG information."

—John Coates, SEC Acting Director of Corporate Finance

[6] https://www.corning.com/media/worldwide/global/documents/2021_Sustainability_Report_Corning_Incorporated.pdf

ESG PROGRAMS IN ACTION

UPS and ORION – As one of the leaders in ESG engagement, UPS made the commitment to dramatically cut down miles traveled by its delivery trucks which in turn would reduce emissions. Creating new efficiency programs that optimize the capacity inside of their trucks as well as calculating optimal travel routes while traffic conditions, pickup commitments and delivery orders change throughout the day. The UPS flagship ESG program, ORION[7], has saved an estimated 100 million miles and 10 million gallons of fuel each year.

H&M Closing the Gap – Using the concept of a circular economy where a company uses waste and refuse as their raw materials for production, H&M has engaged with consumers to recycle or repair existing H&M purchases. The "Lets Close the Gap" project collects and categorizes discarded clothing from its customers to either restore or recycle into new materials. In 2019[8], 57% of H&M's raw materials were sustainable and the company hopes to be at 100% by 2030.

Nike Ties Compensation to ESG Goals – The sportswear and shoe giant recently took the bold step toward accomplishing its environmental and social goals by tying executive compensation to them[9]. Nike CEO John Donahoe recently stated, "We are redefining what responsible leadership looks like. For the first time, we will tie executive compensation to Nike's progress in deepening diversity and inclusion, protecting the planet, and advancing ethical manufacturing."

Nike also reported an over $50 million[10] improvement to their profit margin by replacing materials in their shoes with more sustainable materials.

IKEA IWAY – In the mid 90's, IKEA created their supplier code of conduct called IWAY[11]. This code requires suppliers to meet certain ESG benchmarks to either gain entry as or remain a supplier for the retail giant. IWAY is currently in its sixth version, as IKEA continually monitors and updates the program.

[7] https://www.bloomberg.com/press-releases/2020-01-29/ups-ups-to-enhance-orion-with-continuous-delivery-route-optimization
[8] https://thestrategystory.com/2020/11/15/hnm-apparel-industry-circular-economy/
[9] https://sustainablebrands.com/read/walking-the-talk/trending-nike-chipotle-tie-exec-compensation-to-diversity-sustainability-metrics
[10] https://www.brightest.io/esg-roi-benefits
[11] https://research.aimultiple.com/sustainability-case-studies

SUSTAINABILITY INVESTING AND FUTURE REGULATIONS WILL DRIVE ADOPTION

Over the past five years, there has been a stronger belief from the investment community that ESG performance will be a prime indicator of overall performance and value. In a 2018 survey[1,2], 32% of investors conducted an ESG performance review of potential organizations to invest in; by 2020 that number increased to 72%.

Pressure to adopt ESG practices will also come from governmental regulations and financial organizations. The Securities & Exchange Commission (SEC) is investigating an effective ESG disclosure system compelling publicly traded businesses to indicate their ESG programs and risks.

The SEC acting Director of Corporate Finance, John Coates, recently said, "The SEC is well equipped to lead and facilitate a discussion on when and how ESG risks and data must be disclosed, and how to create and maintain an effective ESG-disclosure system that would promote the disclosure of decision-useful, reliable and, where appropriate, globally comparable ESG information."

Companies that adopt a "do nothing until forced to" strategy could find themselves facing challenges not only from an ESG reporting perspective, but also from a reputational and customer loyalty standpoint.

POSITIVE ESG AND BRAND PERCEPTION

Businesses that are committed to taking care of the environment and its people will not only be prepared for upcoming regulations and reporting but could have a decided competitive edge. Most studies have shown higher consumer engagement on ESG issues, and it is believed that these consumers will eventually become the main driving force behind ESG adoption and reporting.

Not too far in the future, ESG performance will become part of a company's overall brand and reputation. Brand success, retaining and acquiring talent, positive organizational culture, risk management and investment potential will be tied in some way to ESG.

[1,2] https://www.globaltrademag.com/supply-chains-the-esg-imperative-the-buck-stops-with-the-c-suite/

FORTNA CAN HELP

Reducing carbon emissions, utilizing sustainable packaging and employing green building strategies are just a few of the ESG considerations that are top of mind for many companies today. Fortna assists companies along the ESG journey by partnering with clients to identify ESG goals and considerations and incorporating them into an operational design that not only ensures ESG standards are kept and maintainable, but also meet and exceed an operation's financial and customer expectation goals.

Learn more about how Fortna can help meet and exceed your ESG goals Click here to get started.

Visit www.fortna.com to request assistance today.

THE DISTRIBUTION EXPERTS™

Fortna partners with the world's leading brands to transform their distribution operations to keep pace with digital disruption and growth objectives. Known world-wide as the Distribution Experts, we design and deliver intelligent solutions, powered by FortnaWES™ software, to optimize fast, accurate and cost-effective order fulfillment. Our people, innovative approach and proprietary algorithms and tools, ensure optimal operations design and material and information flow. We deliver exceptional value every day to our clients with comprehensive services including network strategy, distribution center operations, material handling automation, supply chain systems and warehouse software design and implementation.

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