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Thought Leadership Series

Environmental, Social and Governance in the Supply Chain: Top Priorities and Best Practices

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A company's ongoing commitment to creating a positive impact on the environment, as well as social issues, has created a new lens in which companies are measured and perceived. Environmental, Social and Governance (ESG) has become a key indicator for investors to evaluate a company's health and overall attractiveness. Harvard Business Review[1] recently interviewed 70 senior executives at 43 global institutional investing firms, including the world's three largest asset managers (BlackRock, Vanguard, and State Street). This research found that almost universally, ESG was top of mind for each of these executives.

1 https://hbr.org/2019/05/the-investor-revolution

> "ESG issues have become much more important for us as long-term investors," Cyrus Taraporevala, President and CEO of State Street Global Advisors said. "We seek to analyze material issues such as climate risk, board quality, or cybersecurity in terms of how they impact financial value in a positive or a negative way. That's the integrative approach we are increasingly taking for all of our investments."

Another take away from these interviews was corporate leaders will soon be held accountable by shareholders for ESG performance. Some organizations have already linked compensation to ESG targets. Nike and Chipotle have both tied executive compensation to their environmental and social goals[2]. This is backed up by another survey conducted by PwC[3]; the survey found that 68% of investors felt that ESG performance measures and targets should be included in executive pay.

A key component of ESG focus is the supply chain. In a study done by McKinsey & Company[4], supply chains are responsible for up to 90% of consumer companies' emission and environmental impact. According to the Environmental Protection Agency (EPA)[5] supply chains are responsible for more than three quarters of greenhouse gas emissions for several industry sectors.

2 https://sustainablebrands.com/read/walking-the-talk/trending-nike-chipotle-tie-exec-compensation-to-diversity-sustainability-metrics
3 https://www.pwc.com/gx/en/services/audit-assurance/corporate-reporting/esg-investor-survey.html#exhibit-4
4 https://www.mckinsey.com/business-functions/sustainability/our-insights/starting-at-the-source-sustainability-in-supply-chains
5 https://www.epa.gov/sites/default/files/2015-07/documents/managing_supplychain_ghg.pdf

Top ESG Issues in the Supply Chain

In a recent survey[6] on ESG and the supply chain, the top priorities for companies were:

- Improved energy efficiency
- Cutting greenhouse gas emissions
- Eliminating modern slavery
- Improving supply chain diversity
- Reducing deforestation

Other top of mind ESG issues included:

- Worker health and safety
- Data security and privacy risks
- Addressing human rights in the supply chain

6 https://get.coupa.com/22_ESG-Risk-Supply-Chains_Report-Request-Eng.html

The Blind Spot for ESG in the Supply Chain

The biggest roadblock to ESG success is not just a company's primary supply chain practices, but the practices of their supply chain in its entirety. In a recent survey of businesses with global supply chains[7], 65% of the businesses could not tell if their closest supply chain partner was meeting any kind of ESG standards. Companies that have multiple suppliers, vendors and partners which are all interconnected and interdependent create a complex network that can be difficult to understand and manage. The larger the organization, the larger the supply chain, which carries more risk. The business landscape is littered with many cases where a larger overall organization was held publicly and financially responsible for a vendor's unethical practices.

> "It takes many good deeds to build a good reputation, and only one bad deed to lose it."
>
> **Ben Franklin**

boohoo: Lessons Learned

The UK-based company boohoo, an ultra-fast fashion company, had seen continued and record growth before and through the pandemic – until a Sunday Times article[8] published their findings of an investigation into one of boohoo's vendor's labor practices. The report revealed workers were being paid well below minimum or the established living wage and they did not have access to needed personal protection equipment. The report went on to find that the vendor was using mostly South Asian immigrants as their labor force, seemingly taking advantage of their status and need to work.

After the report, boohoo stated[9] that the supplier was not a direct supplier, but a secondary one and that they would immediately discontinue their relationship with them and launch an investigation into all its suppliers.

However, the damage was done and within two days boohoo's market value plunged 1.89 billion dollars, losing over a third of its value. Large retailers like Amazon, Next and Zalando also pulled all of boohoo's clothing from its sites. Much of boohoo's image and reputation had been carefully built online through influencers and social media. After the report, many of these influencers turned their back on boohoo and spoke out against the company.

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7 https://get.coupa.com/22_ESG-Risk-Supply-Chains_Report-Request-Eng.html
8 https://www.thetimes.co.uk/article/boohoo-fashion-giant-faces-slavery-investigation-57s3hxcth
9 https://www.nytimes.com/2020/07/08/fashion/boohoo-labor-influencer-crisis.html

4 Best Practices for ESG in the Supply Chain

1. **Buy-in from all levels of leadership and a unified ESG message.**
C-suite and senior leaders need to understand the importance of ESG efforts and the managing of the associated risks. Centralizing efforts can help deliver a consistent message and address the company's most important ESG issues. Also, adding a Chief Sustainability Officer (CSO) to the leadership team can help organize and begin to measure a company's activities toward reaching their goals.

2. **Vetting vendors early in the selection and sourcing process.**
Third-party risk management has become one of the largest ESG issues for supply chains. The risk might not be with the vendor that a business has enjoyed a long and fruitful relationship with, rather with the vendors they use that are not visible to the primary company. Requiring vendors to vet their own suppliers as vigorously as they were vetted can help minimize risk. Additionally, adding ESG language and incentives to contracts and agreements can go a long way to communicating compliance expectations and possible punishments if not adhered to.

3. **Set short and long term ESG goals and communicate across the organization and beyond.**
Use a purpose driven, actionable plan to rally employees to support, work and take ownership of ESG efforts. Creating incentives to reach short term goals can help push ESG acceptance within a supply chain and lead to quick wins and an overall changed outlook toward sustainability.

4. **Digitize and report ESG efforts.**
Adjusting a company's current enterprise resource planning (ERP) or standalone ESG software to measure and report on ESG efforts will be a needed requirement. These software programs can create visibility into a company's ESG goals and progress. From executive dashboards to company level announcements and reporting, ESG data will need to be transparent and accessible companywide as well as with vendors and related third-party organizations.

Funding and Investing in ESG

Investing and funding in ESG programs have become a hot topic for many boards and executives. But there are barriers that have kept many organizations from adopting and funding an ESG plan. A survey of supply chain professionals[10] found the following:

- 48% lacked data of any sort on suppliers' ESG credentials
- 40% reported they had limited financial resources for ESG efforts
- 36% were reliant on technology not designed to comply with ESG standards

In the same survey, the top three categories of investing for an ESG program were found to be:

- Buying or building new technology
- Improving legal and compliance capabilities
- Acquiring new measurement tools for analysis

With any new regulation or governance, there will be companies that resist reporting or complying with the new ESG standards as they believe it will place too large a financial burden on them. However, an inactive or poor ESG performance record can lead to far worse repercussions. According to Bank of America[11], US companies in 2019 lost more than $500 billion in market value over the prior five years due to controversies related to corruption, data privacy, sexual harassment and more.

10 https://get.coupa.com/22_ESG-Risk-Supply-Chains_Report-Request-Eng.html
11 https://www.avetta.com/blog/supply-chain-sustainability-and-its-role-companys-esg-program

Summary

ESG, for the most part, is still largely voluntary; however, a broad set of stakeholders are now demanding visibility into an organization's ESG efforts, risks and future plans. Addressing these issues now and not waiting for a governmental mandate can improve a company's resiliency, accountability and reputation.

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.

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FORTNA CAN HELP

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.

Contact us today at **www.FORTNA.com**