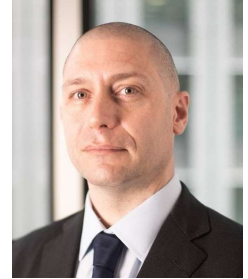


# Business Elements of ESG for Supply Chain Management in Asia

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The ESG agenda has been pushing companies to address environmental and social impact in supply chains. It is no longer acceptable to profit from damage to the planet or to the societies we operate in and in the scramble to brand our operations as ESG friendly there is also increased scrutiny to prove our commitment and verify there is meaningful intention and implementation behind the rhetoric. Rapidly evolving regulations coming into play are bringing new forms of pressure to respond and be accountable for the environmental and social impact of operations.

So what are the key issues that need to be addressed and how do we go about doing this?

## 1. What are our Objectives

Prior to discussing the embedding of ESG objectives and commitments it is essential to understand where these sit in a company's overall objectives and purpose. Many are currently going through a revisioning process to address corporate vision, mission, and purpose in light of the expectations for environmental and social contribution. One company cannot undertake all aspects of this, but it can focus on where it can make a meaningful contribution for effective change, where its value chain exists and where it holds responsibility for the impact it has. Key to this process is also to define who will be responsible for ensuring our ESG commitments are efficiently realized, communicated, and implemented and what decision-making power do they have? Do we have the correct structure to successfully engage with our supply chain?

## 2. Understanding our Supply Chains

The complexity of our supply chains creates a formidable challenge to try to understand, down to raw materials and specific component or ingredients, where the entire supply chain actually exists and how it operates. Working with key tier 1 suppliers can assist in mapping out the lower tiers of a supply chain, but given the complexity of components, raw materials and human capital, a company will need to prioritize high-risk suppliers examining risk by country, commodity, revenues, number of employees, employee social groups, volume of supply and supplier category risk, with a focus on stakeholders.

## 3. Identifying and Addressing Key ESG Risk

Companies must examine their supply chains with a mindset of fact-finding. Risk-mapping should ask: Are we making money anywhere out of some kind of damage? Where can we make positive change? Where do we need support? Transparency is a major challenge especially considering the complexity of supply chains operating across multiple jurisdictions and economies.

The main criticisms levelled at companies in relation to supply chains by NGOs include:

- Profits from environmental/ social harm
- Conflict of brand policy against activities
- Conflict of interest
- Non-engagement
- Engagement but with limited transparency or accountability
- Gap between commitment and implementation

- Deference to local labour laws that fall short of standards
- Non-transparent dialogue with suppliers
- Lack of engagement with communities, unions, or workers
- Lack of resolution
- Are our expectations realistic for procurement divisions to execute?
- Will suppliers actively participate and contribute? How do we ensure buy-in?
- Do our expectations make sense for our business and how are we managing / passing on costs?

**4. Procurement, Scorecards and KPIs**

In order to ensure a meaningful response to ESG expectations suppliers will need to be convinced of the value to them. Communication and active dialogue on objectives are key to making sure we are not seeking to achieve the impossible. Initially it will be important to work with high-priority suppliers in order to build commitment and work out how performance can be measured against objectives, how the reporting mechanism will work and what incentives or sanctions may be awarded or incurred.

There are many generic tools available that can be applied but for them to work effectively, be meaningful and adhered to them again need to be carefully considered.

- Does what we are asking our suppliers reflect the overall ESG objectives of our company?
- Are we adequately structured and aligned to support these expectations?

Procurement criteria should be clear on accountabilities and an audit and monitoring process should also be embedded as a way to partner with suppliers rather than police them. For environmental goals it is recommended by the UN to link to baseline and target dates – e.g. We will decrease CO2 emissions from our supply chain by 50% between 2021-2025.

Social measures will likely need to consider qualitative information and measure impact – i.e., before we engaged and after we engaged. This again will largely depend on a companies’ overall social objectives and commitment to their value chain in terms of where the focus will be, but there are some fundamental issues such as fair wages, adequate facilities and health and safety provisions which will be the baseline.

The table below is an overview of some of the critical areas to consider with supplier engagement.

Environmental	Social	Governance
GHG Emissions	Human Rights	Business Ethics and Policy
Air Quality	Community Relations	Legal and Regulatory Environment
Energy Efficiency	Data Security	Risk Management
Water Efficiency	Access and Affordability	Systems
Waste Management	Product Quality	Procurement
Hazardous materials	Customer Welfare	Business Model Resilience
Impact of climate change	Employee Welfare	Supply Chain Management
Ecological impact	Labour practices	Marketing and Sales Practices
Raw Material Sourcing	Health and Safety	Customer Welfare
Critical Incident Risk	Diversity and Inclusion	Oversight and Audit Processes

## 5. Human Rights

The move towards Human Rights in supply chains has gathered pace in recent years since the introduction of SDGs and national frameworks being put in place around the United Nations Guiding Principles on Business and Human Rights. The framework includes not only state duties for human rights but the corporate responsibility to protect human rights and engage in remedial solutions. Legislation moving quickly in Europe and the US around mandatory human rights due diligence (HRDD) are increasing awareness of the need to be prepared for the implications on our global business footprints.

HRDD will stem from the embedding of responsible conduct into policies and compliance systems. There are of course many forms of due diligence, and many are familiar with M&A due diligence, KYC and third-party due diligence which has largely been established as a vital component of compliance. For our supply chains it will be important to take a risk-based approach and where needed to have an understanding of the following:

- Who are the people we are doing business with? How do they operate and what are their activities?
- Who controls their operations? Who else do they work for? Where do their staff come from?
- What are their hiring practices? How do they treat their staff? How do they ensure compliance?
- Do they adhere to local regulations? Have they had previous issues?
- Any labour issues/ human rights issues? Are there local unions? Any local industry bodies or NGOs who know them? How are they viewed in the community?

This information is often not available in the public domain and can be difficult to collect and verify through questionnaires and interviews. For high-risk suppliers operating in countries where information is vague, unreliable, or non-existent, it is often necessary to cover the above through both public domain research and human inquiries on the ground with people who know the communities, the suppliers, their operations, their working methods, and their workforce. When processes

have been appropriately established the onboarding of new suppliers should build efficiencies into this HRDD process.

## 6. Remediation

Where issues are found remedial action is required to address and seek to make changes. Many issues are relevant to the economies where materials are being sourced, the lack of access to alternative lifestyles, poor wages, lack of educational opportunities and are deeply entrenched over years requiring the development of specific measures to address these problems. Each situation needs to be addressed according to an understanding of where we need to make changes - what can we feasibly change - where do we need to collaborate to effect change.

There are often options for ESG / CSR initiatives which can contribute to change, options such as ensuring fair wages, product differentiation to offer pricing policies for ethically sources products, consumer education and awareness, outreach to local communities, industry peer groups and local government agencies. Fundamentally, better supplier relationship management can create incremental changes which can transform perception and outlook for all stakeholders, and in doing so elevate a company in terms of actively demonstrating the standards it is aspiring to, setting benchmarks and in turn encouraging other industry players to collaborate and define positive actions for social change.

## 7. Reporting

ESG reporting often focuses on quantitative data that can be easily configured and presented – recycling, emission reductions, energy efficiency, with reporting on human capital mainly linked to overtime and diversity figures and work/ life balance. Reporting on ESG in relation to supply chain requires careful thought and in most cases qualitative input and forward thinking as opposed to focusing on historical data. Admitting that there are issues that need to be addressed and that there are no short-term fixes but rather a longer-term strategic approach to issues is a challenge to portray to stakeholders. The focus here should be on how to demonstrate the positive impact a company has made

to the communities and society its supply chains operate in. Are we able to show a difference to the welfare and lifestyle of the labour force, what positive attributes have been seen since we engaged? What is the commitment we are making and the results of that commitment?

## 8. Conclusion

From the above, the business elements in ESG supply chain management in Asia can be summarized as follows.

- Start with high level objectives and ensure these are supported with the appropriate senior management commitment and internal infrastructure to successfully engage with suppliers on what is effectively a major change management implementation.
- Know your supply chain. Where are your priorities? Where is your risk exposure?
- Create a road map. This will be a long-term initiative. A road map will show where we are today and where we intend to land and be available to communicate to all stakeholders.
- Focus on priorities and realistic goals. Collaborate and partner with suppliers to agree and implement objectives with a clear idea of the ‘what’ and the ‘why’ along with incentives. They need to know the value they will receive.

Through implementing strong ESG policies and procedures in supply chains companies will reduce exposure to regulatory issues, litigation, sanctions, negative publicity, and reputational damage.

Taking the initiative to build an ethical supply chain also provides opportunities – being attractive to investors, attracting talent, new business opportunities and essentially business resilience and ultimately profitability.

