Australian Centre for Corporate Social Responsibility

FIVE FIRST STEPS TO A SUSTAINABLE SUPPLY CHAIN

The top 'Five Buts' you'll meet along the way
and how to give buts the boot

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Supply chains in the spotlight

> *"Research has shown up to 20% falls in share prices for firms that suffer serious supply chain shocks, taking up to two years for share prices to recover."*

How much value does your company place on its supply chain? Is that value at risk from blind spots or practises that could make you the next poster-child for corporate irresponsibility? Will your Chief Procurement Officer be taking the rap for a reputational disaster for your brand of potentially epic proportions?

Companies' sustainability and CSR supply chain credentials are in the spotlight as never before thanks to the new fourth generation (G4) Global Reporting Initiative (GRI) guidelines, introduced in 2013.

The GRI Guidelines are backed by the United Nations through its UN Global Compact program (the world's biggest corporate responsibility program) and are supported by the Australian government.[1]

Within the next two years, major firms reporting on their CSR activities will increasingly adopt the new G4 reporting guidelines – including many firms listed on the ASX in Australia. This marks a significant shift in reporting boundary, focus and outlook for organisations that must now come to grips with the sustainability of their supply chains.

Many may be reluctant to use G4, putting it in the too-hard basket. But I will argue here that the 'Five Buts', or reasons to dismiss supply chain sustainability reporting, can be easily addressed through five easy steps.

After all, as high profile supply chain incidents from the Nike sweat shop scandal of the 1990s to the Rana Plaza factory collapse in 2013 attest, stakeholders increasingly expect that goods and services are produced and provided in an ethical way.

Examples of sustainable supply chain practices and CSR activities

- Green procurement policies – minimising environmental impacts of procured products and services
- Use of independently verified certification standards such as Fairtrade, Forest Stewardship Council, RSPO
- Incorporating sustainability criteria into tender requirements and terms of trade agreements
- Supplier assessments and auditing on labour practices, environmental impacts, social impacts and human rights
- Committing a proportion of procurement to diverse suppliers based on various categories such as ethnic group, gender, location
- Setting ambitious sustainable supply chain goals such as "100% responsibly sourced cotton" or reducing a product's lifecycle water use.

1 Through funding for the GRI Focal Point and representation on the Focal Point's Advisory Group

Stakeholders are increasingly making it clear that they want a clean conscience and greater governance standards over supply chains to protect customers, suppliers and employees, as well as the natural environment. Greater supply chain governance is also used to protect their brand reputation and the scale of their investment. The high profile supply chain failures of recent times have inflicted heavy reputational damage on some leading global brands, and investors want to insure against such a risk.

But, crucially, and most importantly perhaps, the consumer is demanding greater social responsibility and higher sustainability standards from the goods and services they buy.

There are several very high profile examples of major global brands suffering significant supply chain shocks which have dramatically upset their normal business.

The most compelling of recent times was the collapse of the clothing factory in Bangladesh on 24th April 2013 which killed 1,129 people. The factory was a major supplier to some big brands including Wal-Mart. It also supplied cheap clothing stores in the UK nicknamed £1 stores. People in the UK, including even the owners of such businesses, were outraged at the idea of such a disaster being 'caused' by market demand for ultra-cheap garments.

Some other high profile and compelling examples of major supply chain shocks include:

- Australian football icon Sherrin being exposed in September 2012 for paying child labourers as little as 12 cents per hour to stitch new footballs. Interestingly, this is exactly the same 'crime' which Nike was castigated for back in 2000 and for which it continues to incur lasting brand damage
- Apple being criticised for allegedly condoning poor labour management practices at Foxconn City in China where many iPhone and Apple products are made - resulting in abnormally high reported suicide rates
- Fashion retailer Zara having a primary supplier that used a number of slaves in their factory in Brazil to manufacture their garments
- Sanlua baby powder, unwittingly distributed by Fonterra, containing melamine which is toxic to infants

Each of these examples highlights dramatic instances of supply chain failure that impact on all stakeholders in the supply chain. Research has even shown up to 20% falls in share prices for firms that suffer serious supply chain shocks, taking up to two years for share prices to recover.[2]

2 Georgia Tech study 2005 www.mgt.gatech.edu

The G4 supply chain reporting imperative

The thrust of the new GRI-G4 guidelines is that major business understands and reports on its own, directly managed, CSR impacts, but also for those along its supply chain. This involves understanding where impacts occur along the supply chain, even if it may be two or three tiers down the line, without much direct control. This reflects an understanding that often first tier suppliers that are within direct control and oversight of a company are not where the greatest risks lie. A company that can report on the latent threats will have greater visibility of its supply chain and while they may not have sole responsibility or direct control over these suppliers, they are able to create responsible management strategies to deal with potential shocks.

Putting the value and significance of the framework to one side, there are five principal problems immediately apparent to a company that wants to embrace supply chain reporting using the G4 framework - and all organisations serious about using the G4 guidelines must address them at some point – and sooner rather than later.

These 'Five Buts' will likely be the essence of your average procurement manager's barriers to delivering accurate supply chain reporting that meets G4 requirements.

The Five Buts

If business has found it difficult to produce reliable and accurate reports on their CSR performance, wait until they try it for their supply chain. It is not quite as easy as it sounds. And as a problem it cannot even be reliably delegated to hapless suppliers.

Alas, even the most compelling logic and the most willing commitment might not make it any easier in the immediate term. The saving grace is probably that there are some easy and simple things organisations can do to at least get started (see the five-easy-steps section below).

To imagine the full difficulty, one needs to bear in mind that most large companies have in the region of 15,000 suppliers globally. I will next outline the 'Five Buts' you are likely to encounter and then present solutions to these obstacles.

1. Your average procurement manager says: BUT definition is difficult …

When counting your suppliers it is, at the outset, very difficult to get an accurate figure. Most large enterprises have multiple purchase ledger driven systems – often geographically, often by product line or business unit - each keeping their own list of suppliers. Those same suppliers can also appear in multiple formats and in multiple countries. The scope for repetition is huge.

For example, British Telecom (as it is most widely known in the UK) repeated on one corporate database some 18 times. Variants included: BT, Brit Telecom, British Telecommunications PLC, British Telecom Ltd, British Telecom (Europe) Ltd, BT Gmbh, and so on … So, just how many suppliers do you have again?

In any list of suppliers, especially global lists of 15,000 suppliers, we need definitions and segmentation to make it manageable. So in our listing for CSR reporting do we include suppliers of services, for instance, or just suppliers of physical goods as well?

Moreover, when is a supplier a supplier? When you use them just once for a minor purchase? When you use them repeatedly, surely.

But what about the suppliers to your suppliers? How far down the supply chain do you reach? How many tiers can you aim to influence? Is the benefit worth the cost? Why are you paying a margin to the prime contractor in the first place?

Genuine due diligence and supplier appraisal is time-consuming. Sifting through reports and accounts, checking corporate registrations, testing samples, checking labour practices, production standards, contractual terms, regulatory compliance, insurance policies, planning, quality standards, processes; the list is almost endless. The productivity required from the Procurement Department for full due diligence on a material supplier is very rarely available.

So, in any CSR reporting program, which suppliers (and their contractors) do you actually include? Including all of them is unrealistic. So where do you draw the line? Top 80%? The top 20% more likely? Or just the top 20 suppliers? Or maybe just the top five to get started.

There is often a natural 80/20 rule to most corporate supply chains. If the top 20 cover 80% of the total expenditure of the organisation (or more likely, over 40% of the spend) then that is a natural logical starting point.

"In any CSR reporting program, which suppliers do you actually include? Including all of them is unrealistic. So where do you draw the line?"

It might also go some way to determining a companies' material impacts, as defined by G4 . Materiality is a key principle within the G4 guidelines for determining what CSR impacts to report on. Materiality is defined as issues that are of significant or strategic importance to both the organisation itself and its stakeholders.

The top 20 spend lines are most likely to be those material to the business – the strategic ones too – including raw materials usually, or plant and machinery and productive capacity. These are also the most likely target areas for meaningful and relevant CSR activity. Certainly brand associated CSR activity.

Key questions:

- How can we and our suppliers benefit from G4 reporting?
- When is a supplier a supplier?
- How far down the supply chain do we reach?
- Who justifies the costs of such diligence?
- Which suppliers are significant and which impacts are material?

2. Your average procurement manager says: BUT reporting is not easy ...

Accurate and timely reporting from just a few suppliers is hard enough, from many it is a daunting task. It is also difficult when few truly measurable KPIs are established at the outset, or with no frame of reference or when benchmark control data describing the past situation does not really exist or was not collected – preventing real and ready comparison with any improved state.

Establishing data collection systems for sustainability reporting is an ongoing challenge. For supply chain reporting, additional issues arise, namely that supplier and customer systems are rarely compatible, even today, despite portal programs that bridge data passing from system to system such as Excel or text formats or html or consolidation software.

Reporting periods also vary by country, by financial year, by system, by product, by everything. Getting a common frame of reference can be difficult, though G4 does help with defining report scope.

Grappling with data privacy might also be an issue, certainly where customer data is needed – and is often made more complicated when working across different countries or jurisdictions.

Ultimately, supply chain reporting from data sources will need much manual intervention and expensive human productivity to produce reliable reports early. It is also likely to need bespoke software development which cost time, money and effort. It also distracts from the core business of any enterprise.

Key questions:

- How can you access all the data that is needed and ensure systems compatibility?
- How can you manage data privacy issues?
- How can you be sure of data integrity and accuracy?
- What report formats and comparisons are truly needed and why?

3. Your average procurement manager says: BUT compliance is not easy to confirm ...

Suppliers are most likely to be motivated to support any CSR efforts to continue business relationships with important clients. Assuming suppliers do help and enthusiastically commit to reporting core CSR data and activities, how do you know that they are truly complying with agreed protocols? Do you question their integrity openly? Or include a testing or audit regime at more cost? Is trust in their qualitative reports enough?

Moreover, with often stringent compliance requirements to be enforced, how can suppliers and their socially responsible clients justify significant resources to CSR programs, when so much needs doing to support and verify the core business?

Key questions:

- Self-commitment is often not measured; how can you ensure true commitment from a supplier for a second-hand commitment made by their customer?
- Self-declaration has limitations ... so how do you verify without compromising trust?
- Audits are clumsy, expensive and not infallible ... are they the best way to ensure supplier support of CSR programs?
- Sample testing test only samples ... how do you truly know what you are buying is what you are getting?

4. Your average procurement manager says: BUT corporate decision making becomes more complex ...

With CSR becoming so prevalent, is it becoming part of the basis for future corporate decision making? Is it a valid basis for deciding from whom to source?

The principal difficulty is we want so much. The best/fastest/cheapest option - always. And the most flexible, sustainable, conscionable and the nearest solution too. And now the most socially responsible as well.

Which is the most important criteria, and when?

How do we decide between all the variables? Who makes that choice?

Who decides whether this order goes to the cheapest vendor, or the most socially responsible one? And why?

"Global volatility in climate, markets and human behaviour all directly affect supply, risk, confidence and then markets. These factors disrupt corporate decision making, but also benefit from viewing through a sustainability lens."

What weight do we allocate to any given factor in deciding on a source of supply – including, of course, CSR contribution as a factor? How important is that compared to other factors that might more obviously drive core business such as price and quality?

Ultimately these questions challenge what the company sees as value.

Key questions:

- Are we to buy the cheapest, fastest or best quality?
- Or do we buy from the most local suppliers, and maybe pay more?
- Or source from low-cost countries, run reputational risks, and ship goods incurring carbon costs too?
- Or do we buy from the firms with the most minorities' involvement? Or the best CSR reports?
- What value do we place upon a good CSR outcome? Is it worth more?

5. Your average procurement manager says: BUT proactive action becomes more onerous ...

Global volatility in climate, markets and human behaviour all directly affect supply, risk, confidence and then markets. These factors disrupt corporate decision making, but also benefit from viewing through a sustainability lens. Volatility affecting supply can be more readily identified and addressed through G4 reporting.

CSR is currently a marginal task for too many companies. Corporate motivation is sometimes only as thin as profits allow.

Some companies clearly deliver on CSR as they have recognised sustainable business is good business. Others are yet to be convinced, and have to climb the motivational hierarchy (see Figure 1).

Motivational Heirarchy

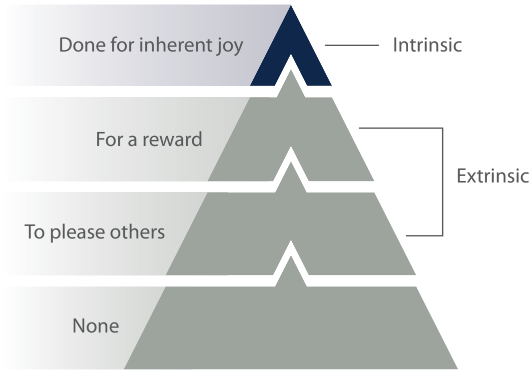

Figure 1: *Companies need to climb the motivational hierarchy for CSR*

Interestingly, it often seems the cases, that when firms start meaningful CSR work, it does grow as the benefits often become more obvious, and sceptics evolve into advocates.

Similarly, as corporate decision making becomes more complex (see point 4 above) so we do less. And to sustain the proactive CSR agenda, we must be rigorous, but this demands more resources and tests commitment. It demands we grab opportunities to move off the corporate problem-solving agenda.

The better we plan, the more stakeholders expect of our plans. There are few easy wins in the modern business world where managing volatility and complexity are commonplace.

With stakeholders including governments, Boards and shareholders, let alone consumers, demanding greater supply chain visibility and traceability, some firms may be dissuaded from even starting genuine CSR projects.

Reporting is only the beginning. Action on those reports comes next. And then the big question – how much is it worth to the company, to be able to report a clean, sound and socially responsible supply chain?

Key questions:

- If so much is so difficult, should we still expect the unexpected?
- How can we better manage supply chain risks from a volatile world?
- Will social responsibility diminish as burdens are easily shelved – as professional standards fall, will firms be dissuaded from starting projects?

An easy action plan for dumbfounded companies

There are no easy answers to the five substantial dilemmas listed above. Time, money and effort – all precious resources – need to be mobilised.

Even then, before starting, it is vital to have a clear understanding of objectives: what exactly are we trying to achieve by reporting on supply side CSR initiatives? Hard results? Or just a warm feeling that it's the right thing to do?

Fortunately, for the junior procurement executive burdened with collating supply side CSR data from suppliers, there are a number of 'easy-wins' to get the ball rolling.

Five easy steps:

1. Get your own house in order

Supply chain reporting is compromised without good internal data, designed to your needs or those of your customer. Start with the few top suppliers first. Getting your own data right first sets the benchmark. It also leads by example.

2. Review your supplier appraisal processes immediately

Incorporate the G4 Aspects of Supplier assessment for labour practices, human rights, impacts on society and environmental assessment into your ideal supplier appraisal process. Ask suppliers and sub-contractors to sign up to principles for social responsibility like the ten United Nations Global Compact Principles[3] as part of your terms of trade agreement. Be prepared to look at established work flows or activities using a CSR lens. Maybe they are already acting responsibly and the initial challenge is only reporting and validating the effort against the results.

3. Define critical supply lines as material

Start with your top 10 suppliers, or the top 10% of your spend, or your most strategic suppliers, or the suppliers with whom you have the best relationships already. Define materiality in your own terms as the most appropriate way for your organisation. Aim for areas of high reputational risk first as these often have clearer business cases to justify new effort.

3 www.unglobalcompact.org.au

4. Review your preferred procurement policies for the suppliers

Work with stakeholders to define your preferred corporate supply policies relevant to CSR and write them down. Align your new policies with your stated corporate values; and focus these supply policies on value creation. Now ask which are your most important and/or risky suppliers?

5. Map your supply chain

Draw a map of your supply chain to the fifth tier suppliers and from fifth to the originating source if possible; whether this is from raw materials or an originating equipment manufacturer (OEM). Now look for the pressure-points as these may be the seemingly poor CSR areas for improvement. Are these the most material priorities? Consider what measures would reflect good CSR in these areas.

Suppliers too must make the justification journey for genuine CSR work. Forced compliance often awakens an awareness that realises risk. Risk management often breeds opportunity; which can easily create value when mined with investment. Many organisations have already undertaken this journey (see Figure 2). Procurement teams in major organisations can facilitate this journey – all they need is a brief.

***Figure 2:** As procurement matures it can drive value from CSR activity*

Potential CSR measures and KPIs

The best measures of CSR activities are those that portray the most accurate representation of value being added through proactive action. Crucially, these efforts need to be relevant to the supply chain and brand, so they are most compelling and most effective. This will then offer synergistic value for the contributing supply chain partners.

But base measures (admittedly more towards the compliance end of the pyramid rather than the value apex) might be easier to compile manually than first imagined. Smaller suppliers can surely count afresh their most important ratios. Large suppliers should have the data somewhere – it is just a case of compiling – see the second 'but', above.

Some examples of CSR reporting quotas that might just be more readily available in your supply base are:

- Worker ratios by diversity category (e.g., ethnicity, race, age, gender, disability)
- Average wage rates by supplier to worker ratio
- Percentage signed commitment to the UN Global Compact (or other principles-based frameworks)
- Total safety checks and commitments in place
- Percentage of supplier appraisals completed
- Contractual commitments in place to support your aligned policies
- Local CSR policies and programs in place

Once reporting templates have been developed then the responsibility for completion can rest with participating suppliers. However, it is important to ensure that ultimately there is something in it for them. It might be added value to the brand being produced, the removal of risk or a condition of continuing to do business.

Conclusion

CSR has clearly reached the business mainstream. Most significant businesses recognise at some level that positive CSR is good for business.

However, many struggle to weigh the costs with loose short term benefits. Or they struggle to justify the proactive use of precious resources for what they perceive to be non-core business activities. The 'Five Buts' only describe five obvious impediments to reporting on the supply side of the business. Yet, ultimately, they are just symbols of waste in the supply process. That is the disconnected, complex and volatile network that constitutes the modern supply chain.

There is much work to be done within all supply chains to balance cost and benefits, risk and rewards. CSR is just one aspect of the work required to rebalance supply chains, however it has the potential to streamline the process and create value for the business.

There are real weak links in most supply chains, usually found where buyers and sellers interact. Those buyers and sellers could work more as a team against their common enemy – waste and inefficiencies.

In the immediate term, many organisations will need to continue reporting on their sustainability impacts and performance. For those established GRI reporters, the supply chain reporting requirements may prove to be a stumbling block with limited time and resources.

But, there are easy ways to get started. Which begs the ultimate question – how badly do you want a sanitised supply chain. How much value do you place on that?

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About the author

Jonathan Dutton is a non-executive director of leading corporate social responsibility consulting firm, the Australian Centre for Corporate Social Responsibility (ACCSR).

Jonathan is the former head of the global peak body for procurement in this region, The Chartered Institute of Purchasing & Supply (CIPSA), which he led for over eight years as the founding managing director in Australasia from 2004 until earlier this year. He is also a fellow of CIPS in his own right.

In addition to his eight years leading CIPSA, Jonathan has worked in both procurement and sales for British Airways & Qantas and been marketing director of two public companies – Chubb and Regus. He has a degree in economics, is a fully qualified procurement professional, has the AICD diploma in corporate governance, and is a fellow of four institutes including the Royal Society of Arts, Manufacturing & Commerce [RSA].

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- **Learn what's involved**
  - Attend a workshop to understand changing expectations, reporting compliance requirements and how to measure sustainability impact (check website for dates or book an in-house workshop)
- **Plan and act**
  - Sustainable supply chain strategy
  - Sustainable procurement
  - Value chain analysis
  - Product sustainability analysis and planning
  - G4 and reporting your supply chain

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