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How **ESG, Sustainability** & **Supply Chain Risk Management Strategies** Are Growing Together

Executive Summary

Environmental, social and governance (ESG) criteria and sustainability play a crucial role in mature supply chain risk management programs.

Traditionally, supply chain risk management has focused on factors such as operational disruptions, financial stability and regulatory compliance. However, concerns about environmental and social issues are growing. These include emissions generated throughout the supply chain, as well as social concerns such as conflict minerals, which can finance armed groups or forced labor. Therefore, businesses are beginning to recognize the need to incorporate ESG and sustainability considerations into their supply chain risk management strategies.

The ESG framework takes the environmental, social and governance factors of a company's operations into consideration. These can be described as follows:

→ **Environmental factors** involve assessing the impact of a company's activities on the environment, air, land and water, as well as its management of waste produced.

→ **Social factors** encompass the effects on people—including communities, societies and the company's employees and customers.

→ **Governance factors** pertain to the company's internal processes and risk management practices, such as transparency and ethical conduct.

Regulators, investors and the public are putting more pressure on companies to implement ESG measures and to establish sustainable operations globally. At the same time, achieving greater sustainability throughout the entire supply chain is becoming even more important. Through stricter supply chain laws and reporting requirements, organizations are increasingly being held accountable for illegal or unethical conduct of their supply chain partners.

As a result, companies need to be ready to disclose information about their sourcing practices and supply networks. Enterprises need to comply with requirements from regulators and investors, as well as meet the demand of enterprise buyers and consumers who are looking to buy more sustainable and ethical products.

As ESG and supply chain risk management strategies grow together, supply chains will become more resilient and sustainable in return.

Understanding ESG Issues

In recent years, ESG and sustainability issues in supply chains have gained significant attention and have become more tightly regulated. Examples of typical ESG and sustainability issues that can arise in supply chains are given here.

Environmental

The "**E**" in ESG covers the impact of a business and its supply chain on the planet.

Relevant climate and environmental issues include:

- **Carbon emissions:** High levels of greenhouse gas emissions from transportation, manufacturing processes or energy consumption.
- **Deforestation:** Unsustainable logging practices for sourcing timber or agricultural commodities such as palm oil.
- **Water scarcity:** Excessive water usage or pollution of water sources due to inefficient processes or inadequate wastewater management.
- **Waste management:** Improper handling of waste materials, leading to pollution or landfill accumulation.

Social

The "**S**" in ESG encompasses policies and practices that affect people along the entire supply chain. This includes employees of the organization, the company's suppliers and logistics providers and the communities where the company operates or sells its goods.

Social issues involve matters such as:

- **Labor rights:** Poor working conditions, low wages, forced labor, child labor or lack of worker protection measures.
- **Health and safety:** Unsafe working environments, inadequate safety protocols or exposure to hazardous substances.
- **Human rights:** Violations of human rights, such as discrimination, harassment or exploitation of vulnerable populations.
- **Supply chain transparency:** Lack of visibility into supplier practices, which makes it difficult to identify and address social issues.

Governance

The "G" in ESG pertains to the governance framework used for directing enterprises—including transparent risk management—to prevent illegal and unethical practices.

For supply chains, particular areas of concern include:

- **Sourcing:** Unethical sourcing of materials from regions with political instability, conflicts or human rights abuses.
- **Business dealings:** Engaging in unethical practices—such as corruption or bribery—to secure contracts or gain preferential treatment.
- **Supplier relationships:** Unfair or exploitative relationships with suppliers, such as imposing excessive pricing pressure or engaging in anti-competitive practices.
- **Regulatory compliance:** Non-compliance with relevant laws and regulations, such as environmental protection, labor rights or product safety standards.

ESG and Sustainability Risks in the Supply Chain

Why do these supply chain issues matter for your business? The following examples illustrate how ESG and sustainability issues can arise across various industries—and some of the consequences that might follow if these issues aren't handled properly:

→ **Environmental:**
An apparel company sources cotton from areas where water is scarce. By using irrigation, the company's water consumption is excessive. As a result, environmentally conscious consumers switch to other brands, revenue is lost and profit margins erode. Attracting new talent becomes more difficult given the employer's damaged reputation.

→ **Social:**
A technology company's suppliers utilize child labor in the extraction of rare earth minerals needed for electronic components. Governments ban certain products from the company. In Germany, regulators could fine the business with a penalty worth up to eight million euros or up to 2% of annual global turnover of the company's revenue, as is stipulated in the German Supply Chain Act. Enterprise customers claim compensation as products don't get shipped and consumers cancel their orders. Investments in communication are needed to rebuild the company's brand and the trust of its customers.

→ **Governance:**
A food company fails to address deforestation in sensitive ecosystems caused by its suppliers clearing land for soybean cultivation. The company will no longer be allowed to sell its soy products in the EU. Until the offending suppliers can be replaced, the shelves in the supermarkets remain empty. Related revenue loss exceeds 5% of overall turnover. The procurement department is blamed for having made the sourcing decision and the chief procurement officer is replaced.

Reputational issues in the supply chain can seriously damage a company's brand and disrupt business. Gain visibility across the supply network to mitigate or avoid such risks.

Five Key Benefits of ESG and Sustainability

Incorporating ESG and sustainability factors into supply chain risk management programs does more than help organizations avoid penalties or damage to their image. Socially and environmentally responsible practices, embedded in good governance, offer significant benefits, **especially in the areas of:**

1. Risk identification and mitigation.

Integrating ESG and sustainability into supply chain risk management strategies helps identify and mitigate potential risks more effectively. It allows businesses to assess the vulnerability of their supply chains to disruptions caused by environmental issues and social impacts. Examples include labor issues, regulatory changes, resource scarcity or weather extremes caused by climate change.

By proactively addressing such risks, companies can build more resilient operations and foster sustainable supply chains that contribute to a better world. Sustainable procurement and supply chain functions deliver value in the form of cost savings as well. Through ongoing, proactive risk management and preventative measures, companies are better equipped to avoid disruption.

2. Reputation and brand protection.

ESG and sustainability have become significant drivers of brand value and reputation. Consumers, investors and other stakeholders are increasingly expecting companies to operate in an environmentally and socially responsible manner. Failure to meet these expectations can result in reputational damage, fewer financing opportunities and, ultimately, financial losses.

Incorporating ESG and sustainability practices in supply chain risk management helps protect a company's brand by ensuring ethical sourcing, responsible manufacturing and sustainable operations throughout the entire supply chain. Leveraging such factors extends well beyond the organization's own four walls. The company's actions affect the communities where raw materials are obtained and go all the way to the consumers and how they use and dispose of the products.

3. Regulatory compliance.

ESG and sustainability are increasingly promoted through regulations by governments worldwide. Two relevant examples are the U.S. Uyghur Forced Labor Prevention Act and the German Supply Chain Act. These demonstrate the increasing pressure from regulators on companies to improve ESG performance and to strive for sustainability within supply networks. Integrating these aspects into supply chain risk management programs enables companies to ensure compliance with relevant laws and regulations.

Technology-based supply chain risk management helps companies identify potential legal and compliance risks associated with environmental impacts, worker safety, human rights and other social issues across the supply network. Users receive alerts of potential risk events and can react quickly to prevent or mitigate the consequences. By staying ahead of regulatory requirements, businesses can avoid penalties tied to the company's revenue (such as those stipulated in the German Supply Chain Act).

Organizations can also avoid legal disputes with NGOs, which can represent labor grievances when workers are not treated according to U.N. Human Rights standards. Violations are accompanied by negative press coverage and scathing social media sentiment.

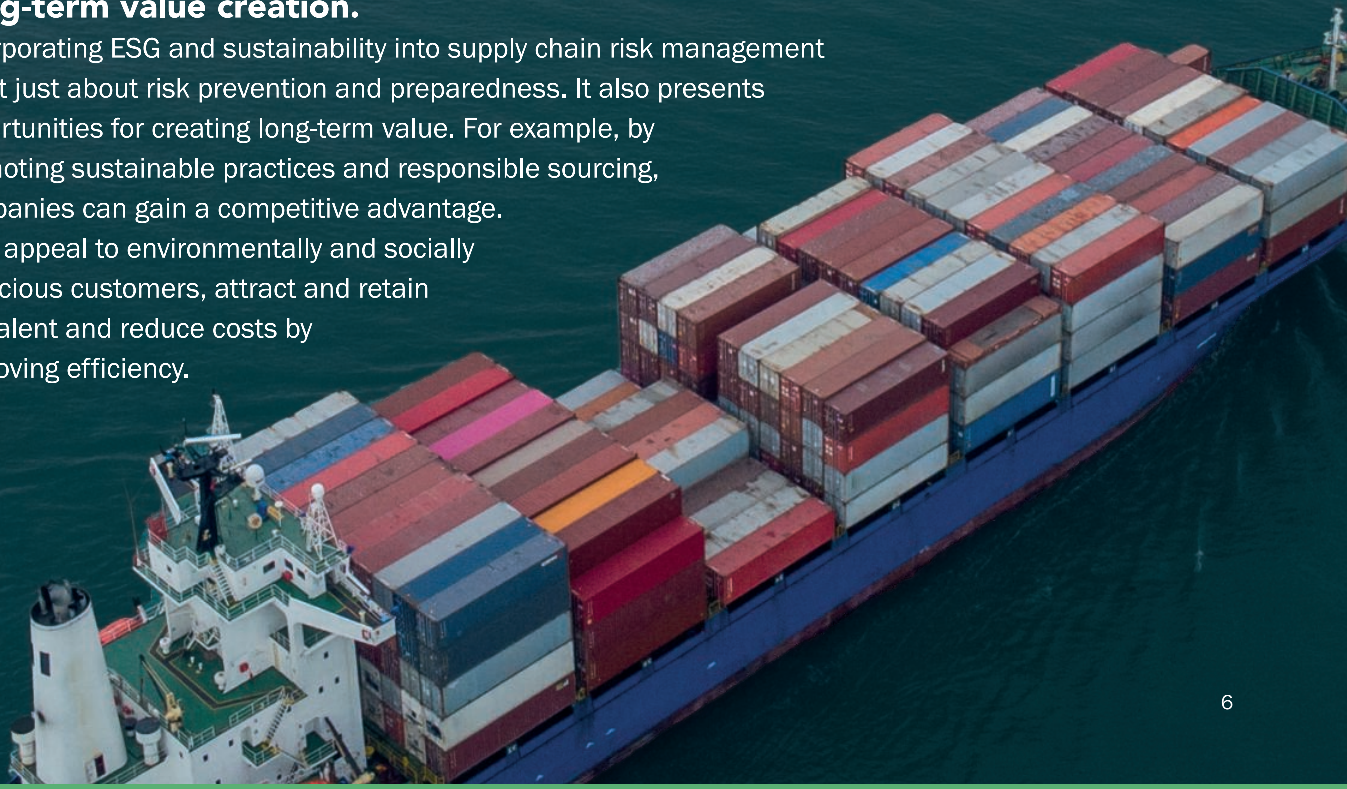
4. Stakeholder engagement and collaboration.

ESG and sustainability practices encourage greater collaboration and engagement with supply chain partners, stakeholders and communities. Supply chain risk management that is focused on ESG factors involves working closely with suppliers, conducting audits and promoting transparency in the supply chain.

Collaboration with stakeholders also helps companies foster innovation, share best practices and build stronger relationships, leading to more innovation, increased resilience and greater sustainability.

5. Long-term value creation.

Incorporating ESG and sustainability into supply chain risk management is not just about risk prevention and preparedness. It also presents opportunities for creating long-term value. For example, by promoting sustainable practices and responsible sourcing, companies can gain a competitive advantage. They appeal to environmentally and socially conscious customers, attract and retain top talent and reduce costs by improving efficiency.



The Convergence of ESG, Sustainability and Supply Chain Risk Management

ESG and sustainability factors play a crucial role in shaping impactful supply chain risk management programs. Supply chain risk management has become a truly cross-functional discipline.

Stakeholders from many departments, such as compliance, finance or quality management take ownership of risk prevention and crisis response to protect the business. They influence the monitoring, identification, assessment and mitigation of risks within supply chains. Such activities contribute to the organization's overall sustainability and responsible practices – for a better world.
In short, the convergence of ESG, sustainability and supply chain risk management adds real value to the enterprise. Overall, businesses cultivate innovation and build resilience in their end-to-end supply networks. With strong ESG and sustainability strategies, companies can comply with laws and regulations, maintain stability and integrity, build trust and protect their reputation.
Leading organizations embrace comprehensive supply chain risk management programs and consider ESG and sustainability risks as important as the traditional risk factors that cause supply chain disruptions. Instead of merely applying a "band-aid" for selected ESG and sustainability regulations, leaders seek a holistic supply chain risk management approach.

Are you interested in learning more?

Learn how to get started with a recent session from Sphera's Virtual ESG Summit,

"Recipe for Success: Building Resilient Supply Chains That Foster ESG and Sustainability"

Sphera [formerly riskmethods] can help your company incorporate ESG and sustainability factors into a holistic supply chain risk management program.

Contact us to learn more about Sphera Supply Chain Risk Management.

Request a demo today!

About Sphera

Sphera is the leading provider of environmental, social and governance (ESG) performance and risk management software, data and consulting services focusing on Environment, Health, Safety & Sustainability (EHS&S), Operational Risk Management (ORM), Product Stewardship and Supply Chain Risk Management (SCRM).

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