The Business Case for Supply Chain Sustainability

A Brief for Business Leaders

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About this Report

This report was written by Blythe Chorn, Cody Sisco, and Peder Michael Pruzan-Jorgensen of BSR's Advisory Services team with the support of BSR's Beyond Monitoring Working Group. BSR's Beyond Monitoring Working Group is a company forum for defining and developing tools for the next phase of supply chain sustainability. Through engagement with a diverse set of companies and supply chain experts, members identify and develop new approaches to implement within their businesses and with suppliers. In addition, the group contributes to stakeholder understanding of supply chain challenges and solutions. We would like to thank the members of the Beyond Monitoring Working Group for their insight and advice: A.P. Moller-Maersk A/S, Bestseller, Burberry Ltd., Dell Inc., Electrolux AB, Ford Motor Company, Gap Inc., H & M Hennes & Mauritz AB, Hallmark Cards, Inc., Li & Fung Limited, Marks and Spencer, plc, Nordstrom, Inc., Novo Nordisk A/S, Starbucks Coffee Company, and Varner Group.

Any errors or inaccuracies that remain are those of the authors alone. For further information or clarification on any of the issues covered in this paper please contact Blythe Chorn at bchorn@bsr.org.

ABOUT BSR
A leader in corporate responsibility since 1992, BSR works with its global network of more than 250 member companies to develop sustainable business strategies and solutions through consulting, research, and cross-sector collaboration. With offices in Asia, Europe, and North America, BSR uses its expertise in the environment, human rights, economic development, and governance and accountability to guide global companies toward creating a just and sustainable world. Visit www.bsr.org for more information.

Introduction

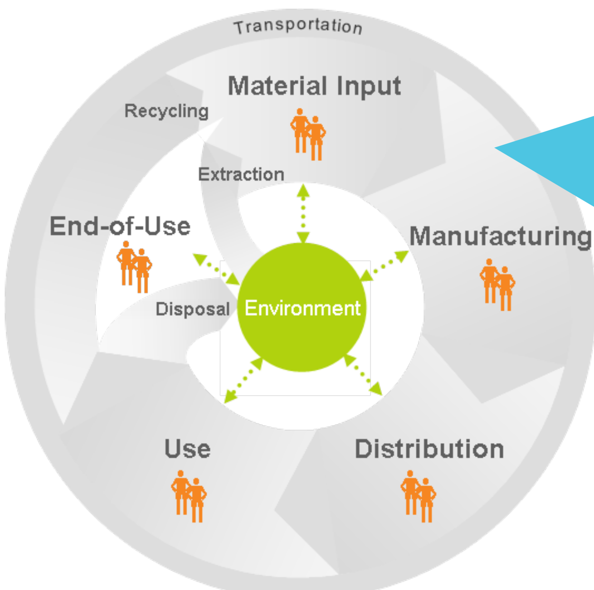
Supply chain sustainability is increasingly recognized as a key generator of business value and an important element of strong corporate responsibility performance.

Since the 1990's, when major consumer brands in the West faced scandals and campaigns highlighting poor working conditions in their supply chains, companies have begun to establish programs to address supply chain sustainability. As the field has grown, leading companies have increasingly recognized that these programs do more than deflect negative stakeholder attention—*supply chain sustainability can create business value.*

SUPPLY CHAIN SUSTAINABILITY AND BUSINESS VALUE

Supply chain sustainability is the management of environmental, social and economic impacts, and the encouragement of good governance practices, throughout the lifecycles of goods and services.* The objective of supply chain sustainability is to create, protect, and grow long-term environmental, social and economic value for all stakeholders involved in bringing products and services to market.

Figure 1: Environmental, Social, and Governance Impacts in the Supply Chain.

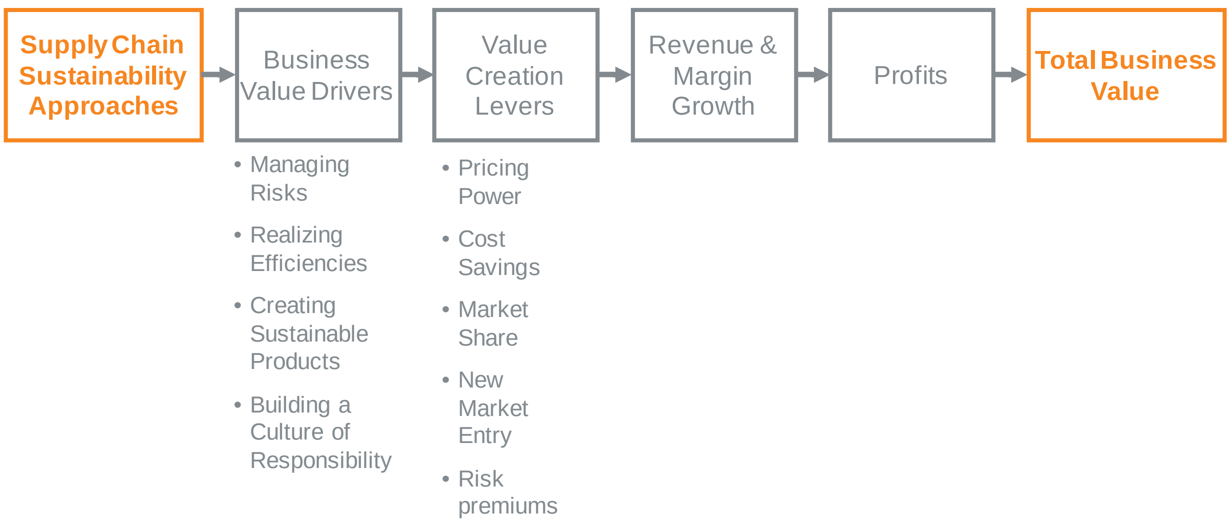


At every stage in the life-cycle of specific products there are social and environmental impacts, or externalities, on the environment and on people. In addition, governance, or the accountability of organizations to their stakeholders for their conduct, is important at every stage and throughout the supply chain.

* From *Supply Chain Sustainability: A Practical Guide for Continuous Improvement* by the United Nations Global Compact and BSR. http://www.unglobalcompact.org/Issues/supply_chain/guidance_material.html.

There are many compelling business reasons to take action to improve social and environmental impacts throughout the supply chain. Often though, at a first glance, the connection between supply chain sustainability—generally perceived as a cost center in companies—and the total value of the business can seem weak. However, as depicted in Figure 2, it makes sense to understand the value of supply chain sustainability approaches through the impact they can have on value creation levers such as pricing power, cost savings, and market share. Such impacts may be significant. Further, while the business benefits that suppliers accrue through improved sustainability performance often aren't passed directly to buyers, buyers may benefit through increased stability of supply and quality.

Figure 2: The Link between Supply Chain Sustainability and Total Business Value.

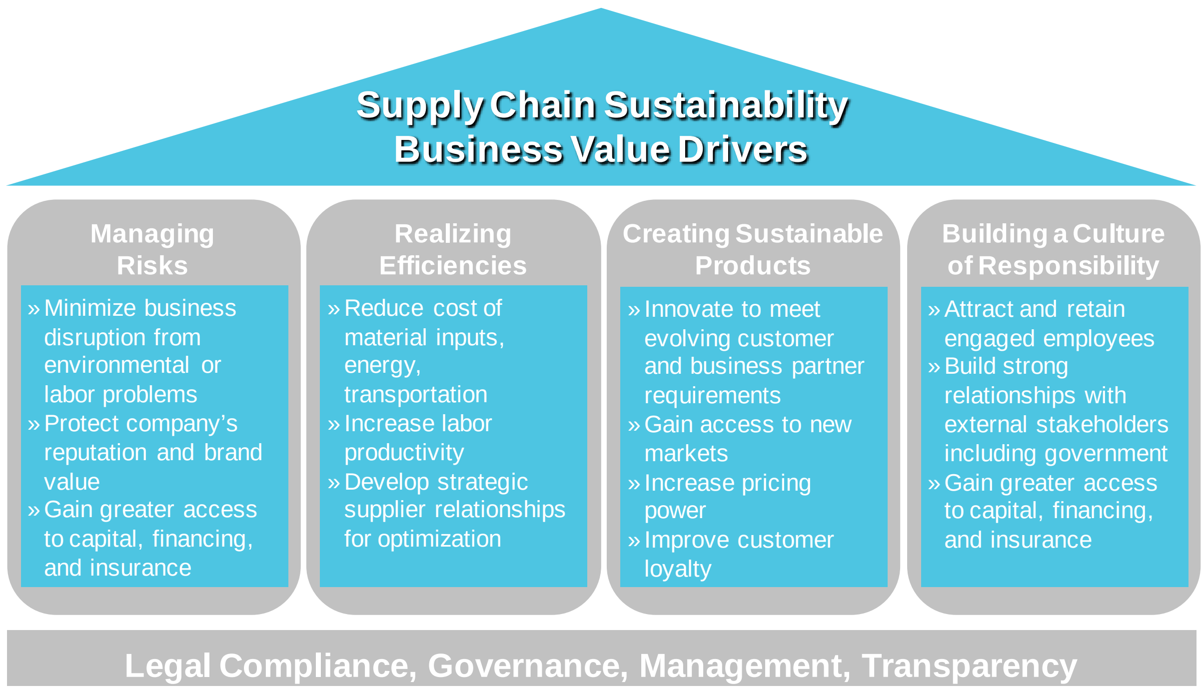


The Business Case for Supply Chain Sustainability

The business case for supply chain sustainability for a particular company depends on a variety of issues including industry sector, region of operation, stakeholder expectations, business strategy, organizational culture, and past performance.

In general though, there are a number of opportunities to use supply chain sustainability activities to enhance business value. While not mutually exclusive, the most commonly cited business value drivers impacted by supply chain sustainability are depicted in Figure 2 and explained below.

Figure 2: Building the Case for Supply Chain Sustainability.



Examples of Creating Business Value through Supply Chain Sustainability Activities

Managing Risks

Partnering with suppliers to improve human resources management practices, such as minimum hiring age, contracts with workers, and health and safety conditions, to reduce the risk of poor quality or production disruptions.

Realizing Efficiencies

Setting targets with suppliers to reduce energy use and costs through training on identifying energy-saving opportunities, building systems for energy management, and emulating best practices.

Creating Sustainable Products

Sourcing raw materials with social and environmental impacts explicitly considered, such as biologically based plastics that emit relatively fewer greenhouse gases throughout their lifecycle.

Building a Culture of Responsibility

Setting objectives for supply management professionals related to supply chain sustainability—such as sourcing a certain percentage of total spend from suppliers that have participated in sustainability trainings—to encourage employees to take ownership for the positive impacts of the company.

Proactive v. Reactive Approaches to Supply Chain Risk Management

Management of risk in the supply chain generally takes two forms:

1. Proactive management, or risk mitigation, to avoid potential risk events from occurring, and
2. Reactive management to respond to risk events that have already occurred to address consequences

In regards to supply chain sustainability efforts, risk mitigation activities may include providing suppliers with training on sustainability issues, developing worker empowerment programs, or partnering with suppliers to develop sustainability management systems.

Conversely, reactive risk management, or contingency strategies, typically focus on identifying and responding to risk events that have occurred, often through auditing suppliers' sustainability performance and partnering with suppliers on corrective action plans to address audit findings. Contingency strategies are also useful for actively responding to sustainability events that are external to companies and their suppliers—such as new sustainability-related regulations or general labor unrest in a geography—but that shape the sustainability requirements for companies.

MANAGING RISK

By mitigating and responding to sustainability risks in the supply chain, companies can control costs, protect their market share, and reduce risk premiums.

Companies can protect themselves from potential supply chain interruptions or delays associated with suppliers' environmental, social or governance challenges by ensuring suppliers have robust management systems and regulatory compliance programs. For companies who have a single source for key inputs, reducing social and environmental risks is even more critical to ensuring access to those resources. For example, a supplier with ongoing labor challenges could create delivery delays due to labor stoppages or poor productivity. Similarly, a supplier with poor water management practices could face unexpected shortages and cause delays in sourcing. Managing these risks helps companies meet the demands of their customer bases, thereby protecting their market share, and control their costs.

Some companies are also using sustainable procurement practices to ensure that their suppliers can adapt to anticipated changes in environmental regulations and extended product responsibility legislation and to reduce potential future liability. Companies and their suppliers are facing more sustainability related regulations increase around the world —including REACH (Registration, Evaluation, Authorisation and Restriction of Chemicals) and the Illegal Timber Law in the EU and new regulations in the U.S. related to conflict minerals and human rights in the supply chain. Knowing the scope of their supply chains and potential exposures will help companies position themselves to respond to these and other regulations.

In addition, strong management of social and environmental issues can help companies address reputational risks that could impact their market share. Companies that demonstrate a strong understanding and ability to manage potential risks in their supply chains—including social, environmental, and governance risks—may also have easier access to capital at a lower cost and to financing and insurance.

Managing risks through supply chain sustainability is particularly important in companies that:

- Serve customers (business and/or consumers) that attribute value to sustainability in their supply chain
- Have very short go-to-market or lead times for delivering products and services to customers
- Create products or services that are highly dependent on specialized inputs (rather than commodities) that are only available from a small number of suppliers
- Are structured with high volume, low margin business models that offer little ability to absorb significant, unexpected costs
- Operate in an industry generally perceived by the financial community to be high risk, such as oil and gas, mining, or pharmaceuticals
- Derive a significant part of their pricing power and market positioning from brand recognition and reputational trust
- Are consolidating and beginning to rationalize their supply chains

The ROI of Efficiency

Studies such as BSR's Investing in Women have demonstrated that by investing in women's health education and care suppliers, and hence buyers, can achieve savings through increased productivity and reduced absenteeism. For example, in a 2006 study in one Bangladesh factory, Extending Service Delivery found a US$3 to US$1 return on investment (ROI) for their women's health education and clinic services improvement program. The ROI was in the form of reduced turnover and absenteeism tracked over 18 months.

Similarly, investments in worker empowerment can improve employee engagement on the factory floor—leading to reduced turnover, improved productivity, and reductions in excessive overtime. In a case study explored in BSR's Moving the Needle report for example, one factory its average reduced turnover rate by 3%. The factory's "Worker Initiative Program", a contest run in partnership with a local NGO where workers submitted ideas on improving factory processes, also improved the buyer's confidence in the accuracy of the factory's worker compensation and hours reports.

REALIZING EFFICIENCIES

Through many supply chain sustainability activities, companies can create efficiencies in their supply chains and reduce sourcing costs.

Responsible management of operational inputs, such as energy, water, natural and synthetic materials can greatly reduce companies' procurement costs while simultaneously reducing the environmental footprint and impact on worker health of supply chains. Taking the time to understand these operational inputs frequently results in an increased understanding of supply chain functions, reductions in unnecessary purchasing of inputs, and improved risk management of potential disruptions (including those caused by environmental problems with suppliers). A number of leading companies offer suppliers technical assistance to implement energy and material use efficiency improvements that help them cut their costs and avoid price increases. Similarly, companies sourcing agricultural products can improve resource and cost efficiency by working with suppliers to adopt more sustainable farming practices—sustainable cotton growing for example reduces water consumption and pesticides that make up 30-40% of costs. Efforts to improve resource efficiency now may also help companies prepare for future carbon intensity product labeling.

Strong labor and health and safety practices are also a key driver of cost efficiency. Many companies have created cost efficiencies by undertaking efforts to reduce accidents. Additionally, health promotion activities can improve productivity and reduce absenteeism and turnover and associated costs. Strong labor and health and safety practices can also help make suppliers employers of choice in regions experiencing labor shortages, such as China, thereby reducing turnover and keeping labor costs steady. Even when these savings aren't passed on to buyers directly, companies can realize savings through more stable and often higher quality supply over time.

Applying supply chain sustainability approaches to realize efficiency is particularly important in companies that:

» Have products or services that are highly dependent on natural resource inputs (whether specialized or not) and therefore vulnerable to price fluctuations or scarcity in resources

» Operate with low margins and must constantly innovate to stay cost competitive

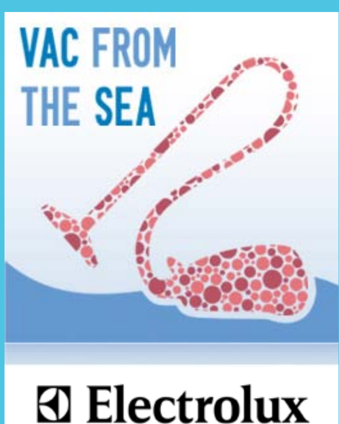
» Rely on skilled or semi-skilled labor in the supply chain, or have significant elements of their supply chains located in regions experiencing labor shortages

» Have supply chain labor characterized by high turnover and low productivity

» See downstream business value in developing more resource efficient upstream supply chains, e.g. more carbon-efficient products

Meeting and Making the Market

Many of the members of the Beyond Monitoring Working Group have begun partnering with suppliers to develop products with specific sustainability characteristics:



CREATING SUSTAINABLE PRODUCTS

Collaboration with suppliers on sustainability issues can also foster product innovation to meet (or create) market demand.

With the rising awareness of environmental impacts of manufacturing such as greenhouse gas emissions and product toxicity, and the radical growth in transparency brought about by the internet, customers of all types are increasingly demanding more products created from more sustainable materials, processes, and working conditions.

In response, companies are collaborating with suppliers to add new features and performance characteristics to existing products and even to generate new products. For example, sustainable products may be produced using fewer natural resource inputs, such as using dyes that require less water use for washing in fabric mills; with inputs that more environmentally and socially sustainable, such as using metals that are mined in conflict-free regions; or through processes that are less harmful for workers, such as growing agricultural products with organic pesticides. Sustainable products can also be designed to result in fewer reduced environmental impacts through their use than traditional products or to have improved end of life collection and disposal options.

Similarly, many companies are beginning to respond to customer demand for more "local" products by shifting their supply chains to buy from suppliers who are located closer to the point of sale. This shift can reduce the environmental impacts of transporting products while meeting customer demands for agricultural products that are fresher and consumer products that support their local economies.

By partnering with suppliers to improve the sustainability of the inputs and processes used to create goods, companies are maintaining market share—including existing customer loyalty and pricing power—and gaining access to new markets.

Creating sustainable products through supply chain sustainability is particularly important in companies that:

» Operate in mature or highly saturated markets in which differentiation from competitors is critical to the business model
» Aspire to serve market niches that can carry a price premium for more sustainable products
» Seek to enter or expand in emerging economies, where employees in the supply chain are increasingly brand customers
» Sell to other businesses and governments, which are increasingly including sustainability criteria in their requests for proposals and contracts
» Have marketing and other channels to communicate to customers about the attributes of products
» Seek to leverage the knowledge of their supply chain partners in finding, developing, or commercializing products, materials, or components

Corporate Social Responsibility Instills Pride among Employees

According to the Towers Perrin 2007-2008 Workforce Study, an organization's reputation for social responsibility* was the third most influential driver of employee engagement, behind senior management's concern for employee well-being and the company's investment in skills-enhancement of its employees.

The results of a 2010 study by the Center for Creative Leadership confirm the link: employees' perceptions of their organizations' concern for community and environment is linked to their level of organizational commitment. In fact, the higher an employee rates their organization's corporate citizenship, the more committed they are to the organization.

** As defined by the respondent but presumably including supply chain sustainability.*

BUILDING A CULTURE OF RESPONSIBILITY

Finally, many companies have found that supply chain sustainability can create business value by contributing to a culture of responsibility.

As issues like climate change and child labor have become more pervasive in mainstream society, employees are often keen to find opportunities to bring issues they are personally passionate about into their job responsibilities. Supply chain sustainability gives employees that opportunity and can improve employee engagement and reduce the costs associated with recruitment and turnover. Leading companies are making their employees aware of their efforts in supply chain sustainability and also seeking to involve employees from a variety of functions that affect suppliers' sustainability performance—such as procurement, product design, merchandising, and logistics—in supply chain sustainability strategy. These efforts, along with supporting supply chain sustainability objectives, can also improve the attractiveness of companies as employers.

As a critical element of many companies' overall corporate responsibility, supply chain sustainability can also help companies build trust and credibility with external stakeholders—including governments, nongovernmental organizations, activist groups, and investors. These relationships can in turn provide companies with crucial information about emerging regulatory trends, market forces, and other external influencers that could impact business. They also enhance companies' abilities to secure business friendly outcomes from stakeholder decisions.

Finally, companies that use their efforts in supply chain sustainability to demonstrate strong management, awareness of the importance of external trends, and focus on good governance can build a more positive perception of the company's brand and gain easier access and better rates for capital, financing, and insurance.

Applying supply chain sustainability approaches to build a culture of responsibility is particularly important in companies that:

- Rely on skilled labor that has flexibility in choice of employer
- Operate in a highly regulated or scrutinized industry that is vulnerable to rapid shifts in government policy or activist campaigns
- Operate in an industry or in regions perceived by the financial community to be at risk for poor governance or corruption
- Have significant equity tied up in brand or other intangible assets that are subject to both risk and changing consumer appetites

Conclusion

As more companies build efforts in supply chain sustainability, our understanding of the business value of these efforts is expanding greatly. While the benefits described above are often overlapping and difficult to measure, there is growing evidence that supply chain sustainability contributions to business value are significant and multi-faceted. Why, after all, would the majority of the world's leading business invest in improving the sustainability performance of their supply chains? Arguing that supply chain sustainability is just a 'feel good' exercise, doesn't make sense anymore.

Still, in order to make supply chain sustainability a more broadly adopted and more thoroughly implemented business practice, we need to continue our efforts to build a better understanding of the business value created, Alongside continued implementation of supply chain sustainability practices, companies should look for opportunities to assess direct savings and model avoided costs associated with their supply chain sustainability efforts to advance practices that create value for their businesses as well as for society.

BSR and the Beyond Monitoring Working Group will continue to look for opportunities to advance the dialogue on identifying and tracking the business value of supply chain sustainability efforts. And we will welcome opportunities to work with businesses to build a measurable business case.

For comments on this report, or to get involved in future initiatives, please contact Blythe Chorn at bchorn@bsr.org.