The Economist Intelligence Unit

A report from The Economist Intelligence Unit

PART OF THE GROWTH CROSSINGS SERIES

No more excuses

Responsible supply chains in a globalised world

Commissioned by

Standard Chartered

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FOREWORD I. COUNTING THE COSTS OF GLOBALISATION

Contributed by Michael Spence, professor, New York University and 2001 winner of the Nobel Prize for Economic Sciences

Powerful forces are increasing in the global economy, threatening fragmentation, loss of accessibility for smaller poorer countries, lower potential growth and stalled progress on a range of economic and social issues: gender equality, health and safety, and the transition to environmentally-sustainable growth patterns.

No more excuses: responsible supply chains in a globalised world arrives at a critical moment in the evolution of the global economy. More than at any time since the current architecture was created after the second world war, people are questioning the balance of benefits and costs of increasing integration in the global economy, for goods and services that trade internationally and for cross-border investments. Developed economies have struggled to adapt to the impact of global integration and digital technologies on middle- and lower-middle-class jobs, opportunities, and incomes. Wide variances in working conditions and environmental policies across countries have introduced tensions and contributed to a growing anti-globalisation sentiment.

The recently-elected administration in the US has declared its lack of support for multilateral frameworks, preferring instead a bilateral approach based on the search for mutually beneficial relationships. For large countries and economies, such an approach may help rebalance growth patterns. But a world of bilateral and regional frameworks (a process well underway) will be a much more complex environment for multinational companies to navigate, and a difficult one for smaller countries to engage with. The Trump administration has also issued negative signals with respect to the US commitment to the climate change agenda, and hence to the sustainability of a rapidly-growing global economy.

Multinational firms are the architects of global supply chains. As such they must deal with the shifting economic, technological, political and social forces and pressures operating on their supply chains, employees, customers and regulators. It is not much of an exaggeration to say that their ability to navigate and respond will be one (perhaps the) decisive factor for the future of a reasonably integrated and sustainable global economy.

No more excuses: responsible supply chains in a globalised world is both timely and extremely interesting. It is a report card on the engagement and commitment of multinational companies (and others in global supply chains) in the mega-challenge of aligning corporate goals and incentives with important economic, social and ethical standards and objectives. It is an honest and objective look, based on a vast amount of survey information across eight economies (China, Germany, Hong Kong, Italy, Japan, Singapore, South Korea and the US), each of which has a key role in global supply chains. It is designed to get at the perceptions of corporate leaders, their commitments and achievements to date. And it paints a clear picture of important areas where progress is lagging, or in a few cases, in reversal.

For me, a number of things stand out. One is that the variance in several dimensions of supply chain responsibility across companies and economies is very high—clearly this is a work in progress with leaders and laggards, too.

Second, progress is greater in areas where measurement of impact is easier—perhaps not surprising but still important. And it appears to be greater in areas where there is a clear threat to brand image—as in the case of highly visible and horrific failures in the area of worker safety.

Third, some important dimensions in creating shared value via new business models are being neglected, among them gender equality, child labour and, prominently, sustainability.

This progress report from The Economist Intelligence Unit is rich in detail and insight. It is relevant to today's mounting challenges and it paints a clear picture of where multinationals are in supply chain responsibility in multiple dimensions.

FOREWORD II. PERILS ALONG THE CHAIN

Contributed by Richard M Locke, provost and professor of political science and international and public affairs, Brown University

We live in a world shaped by supply chains that link thousands of firms, large and small, across cultural and political boundaries. The diffusion of supply chains in an array of different industries has provided developing countries with much-needed investment, employment, technology and access to international markets. The integration of developing-country producers into supply chains is having a transformative effect on local economies, allowing poor countries to develop. At the same time, however, the social and environmental consequences of this particular pattern of development have provoked significant controversies over the role of global brands and their local suppliers, often seen as exploiting developing countries' low wages and weak social and environmental regulations to produce low-cost goods at the expense of local workers' welfare. Child labour, hazardous working conditions, excessive working hours and poor wages plague many workplaces in the developing world, creating embarrassment for the global companies that source from these factories and farms.

To get a better sense of this industry and corporate context, let's take a closer look at the dynamics behind the production and distribution of mobile electronic devices, which are used by millions of people every day. These products come with substantial costs to workers and the environment, involving a complex flow of materials and products around the world. The working conditions at the suppliers involved in these different stages of production have come under intense scrutiny in recent years. In order to meet the high consumer demand for these products, employees in these factories often work long days with mandatory overtime and forgo their rest days. Conditions in these factories are harsh; workers are not rotated, but rather specialize in narrow tasks and therefore suffer from repetitive stress injuries. Workers are also exposed to hazardous chemicals and unsafe conditions in the workplace.

To redress these conditions, global buyers have carried out internal audits of their suppliers and engaged with external groups to investigate the working conditions among their lead suppliers. Thousands of facilities have been audited and hundreds of corrective action plans have been developed. Yet even after many years of intense auditing, corrective action plans and training/capacity building among their suppliers, incidents of non-compliance have persisted. This situation is not the exception but rather is the norm across global supply chains operating across different industries and geographies.

No more excuses: responsible supply chains in a globalised world documents these mixed results. Drawing on a survey of 800 executives in major industrial economies, this study is innovative in the depth of its empirical results as well as the breadth of the corporate leaders it surveyed. The survey is also informed by frequent interactions with outside experts and experienced practitioners. The findings of this study are fascinating. On the one hand, the survey of corporate leaders suggests that more firms are valuing responsible environmental and social practices and integrating them into the core functions of their operations. On the other hand, the survey reveals that a significant proportion of firms have allowed supply chain responsibility to slide as a corporate priority in recent years. This apparent contradiction can be understood by examining more carefully the divergent internal management and supplier engagement practices across the surveyed firms.

Most importantly, however, this report identifies several “best practices” that can be diffused across firms and industries to promote truly responsible supply chains. As such, this study is both a wakeup call to those of us who are concerned about responsible supply chains and also a note of encouragement, a positive roadmap for how best to achieve this goal.

EXECUTIVE SUMMARY

A moral and practical imperative

Globalisation has vastly increased the length and complexity of supply chains over the past few decades. At the same time as drawing more communities into the global economy and playing a role in development, it has dispersed the negative impacts of business activities on people and the environment to nearly every corner of the world. Those countries which underwent their industrial revolutions in the 18th and 19th centuries have had centuries to build regulatory and social norms in response to excesses, ensuring that most businesses behave in a relatively responsible manner. However, globalisation has rushed in an era of industrialisation in many emerging markets at a pace that has made it hard for local governments, businesses and civil society to adjust to while adequately protecting local communities.

This phenomenon places a moral responsibility onto multinational firms, to ensure that standards viewed as acceptable in advanced economies are applied in the markets from which they source. And from a pragmatic point of view, the globalisation of communications and media means that people across the globe have real-time access to stories coming out of the developing-world communities which produce their clothes, smart phone components, food and so on. Preventable disasters like the Rana Plaza factory collapse in 2013 can hit a brand's bottom line (and that of its shareholders) hard. Positive stories, such as where a firm empowers the women in its supply chain to grow their businesses, can give a brand a reputational boost while improving supply chain resilience. There are also very rational business continuity reasons for responsible conduct, such as the threat to agricultural production in some regions from climate change, and growing competition for skills or labour in certain sectors.

Governments and international organisations have exerted increasing pressure on businesses to be responsible over the past decade. Sustainability reporting has become an industry in itself: the number of mandatory and voluntary reporting instruments has risen from 60 in 2006 to 383 in 2016, with the number of countries covered rising from 19 to 71.[1] Some advanced-economy regulators are also extending the applicability of their regulations onto a global scale—with regulations such as the Conflict Minerals Rule (Dodd-Frank Act, Section 1502) in the US and the Modern Slavery Act in the UK generating a worldwide ripple effect. New compliance risks are constantly emerging as NGOs and activists highlight scandals and governments attempt to close loopholes—but a reactive approach is not good enough. Firms need to get out ahead of the regulatory wave and show leadership in improving supply chain transparency and management. Those who do will find it does not just mitigate risks, but also generates opportunities. Consumers and

1 Bartels, W, Fogelberg, T, Hoballah, A and van der Lugt, T. 2016. "Carrots and sticks: Global trends in sustainability reporting regulation and policy". KPMG International, GRI, United Nations Environment Programme (UNEP) and The Centre for Corporate Governance in Africa (at the University of Stellenbosch Business School).

business customers are paying attention: in every market we surveyed, customers were cited by firms as one of the top influences driving them to make their supply chains responsible, with a greater perceived impact than even regulators.

The first step is to admit you have a problem

This study confirms that corporate responsibility over supply chains is becoming more prominent on the radars of business leaders. More firms are integrating it into their core operations, as senior executives and boards come to see the value to their business of a more responsible approach.

Recognising a corporate responsibility towards the social and environmental impact of supply chains is an important first step, but the complexity of today's global supply chains makes this challenging. We spoke to firms that had thousands, and in one case millions, of suppliers. Even small firms are much more likely to have cross-border value chains than was the case a generation ago. Large multinational businesses face a bewildering array of constantly-evolving regulatory and reputational risks. Dealing with these requires sophisticated systems with appropriate internal structures, well-designed supplier management systems and in many cases, outside support.

The scale of the challenge is not yet well recognised. In section one, "confidence and complacency", we present survey findings showing that executives had unwarranted confidence about how responsible their supply chains were. A significant minority of businesses had also allowed supply chain responsibility to slide as a priority in the past five years. There was a bias towards issues connected to more "obvious" material business risks and opportunities, while topics which were harder to quantify or which only affected sub-sets of the population were often neglected.

Time to stop pointing fingers

In our discussions with representatives of corporations, financial stakeholders, regulators, international organisations and NGOs, it was striking how often each blamed the others for constraining, or failing to adequately support, their efforts to be responsible. Company executives also pointed to the difficulties of fully understanding and monitoring their supply chains—something which some experts from academia and consultancy disputed, given the possibilities presented by digital technologies and outside specialists.

Companies seeking credibility need to stop making excuses and get out ahead of this issue.

Companies seeking credibility with an increasingly well-informed and critical consumer base need to stop making excuses and get out ahead of this issue. They must recognise that in the digital era, they can neither control the agenda, nor who can access information on their supply chains. Pressure on them for transparency and responsibility will only increase.

But the responsibility does not lie on the corporate sector alone. Corporations are best-placed to understand and take action on their supply chains, to mitigate both financial and ethical risks. They must therefore play the biggest role, but the other parties involved in setting, monitoring and enforcing standards must also consider how best to incentivise and support companies along this path. This report outlines key elements of best practice, illustrated with real-life case studies, to guide all stakeholders on this evolving journey.

A blueprint for better supply chains: understanding motivations and introducing best practice

Section two, "cultivating a responsible corporate culture", looks at what influences and motivates businesses to uphold social and environmental standards, identifying the levers held by regulators, multilateral organisations, financial stakeholders, business customers, consumers and civil society watchdogs—as well as how these influences interact. We also ask which firms fall through the gaps, and how a responsible business culture can be motivated in such cases.

Defining best practice on responsible supply chains is not easy, and there is inevitably nuance across industries and even from firm to firm. Yet lessons can be learned from the experience of leading firms and from experts on the subject. In section three, "more than words", we identify some key elements of best practice with regard to internal management, supplier engagement and working with third parties.

There is still plenty of disagreement over what role corporations and other stakeholders should play in ensuring responsible supply chains, and where the obstacles lie. In this white paper, we attempt to cut through the noise. Our argument is that there should be "no more excuses": in a world in which 69 of the world's 100 largest economic entities are corporations rather than countries, responsible supply chains are a moral imperative. In the context of a growing backlash against globalisation, rising consumer expectations and the rising economic impact of climate change, they are increasingly a business imperative. The millennials being recruited into corporations understand this and look for responsible behaviour in their employers; but it is down to today's corporate leaders to act on it.

No more excuses. It is time to embrace the necessity of, and business opportunities presented by, responsible supply chains.

Research highlights: key problems and recommendations

CHALLENGES	RECOMMENDATIONS
Complacency is evident and progress has stalled in some economies. Four in five respondents described their firms as having responsible supply chains, yet under a quarter addressed some of the key issues such as climate change or child labour. While a small majority of firms had made supply chain responsibility a higher priority in the last five years, a full 30% had decreased their focus on this over the same period. In some economies, progress had stalled.	• Progress on ensuring firms prioritise responsible supply chain risks is driven by soft and hard regulations. Momentum of multilateral initiatives and domestic regulations must be maintained to avoid a slide-back. • Brands and other large buyers hold significant influence over their supply chains and should do more to exert this influence. • Consumer and civil society pressure can drive progress on both the above points. Civil society watchdogs play an important role in disseminating information and shaping societal expectations, particularly with the tools of social media in hand.
Issues for which the impacts are harder to measure or forecast are not as well addressed. Issues for which it was relatively straightforward to demonstrate quantifiable short-term risks and benefits/opportunities received more attention from firms than less tangible or longer-term issues. For instance, firms were more likely to address health and safety risks (illustrated in disasters such as the Rana Plaza factory collapse) and recycling (which can generate revenue) than climate change.	• Corporate social responsibility (CSR) professionals need to translate social and environmental issues from moral imperatives into risks and opportunities relevant to business leaders. This entails working closely alongside strategy and operations to improve communication, and hiring staff with business experience in addition to those with technical/scientific expertise. • Business leaders and board members need to play a similar role in translating issues to financial stakeholders. • Given the complexity of quantification for some issues, third-party experts can play an important role in developing measurement and forecasting systems.

Issues that only affect a sub-set of the population are falling through the gaps. For instance, issues which disproportionately affect women and children appear to be side-lined compared to general labour issues. This could be a result of prioritisation methods used by firms to direct the focus of responsible supply chain efforts, achieving maximum overall impact but missing certain groups.	• Prioritisation systems should take into account the seriousness of an issue as well as how widespread its impact is. • Financial institutions can play a role in providing targeted incentives for inclusion of groups facing discrimination, and this can be commercially beneficial rather than altruistic. For instance, women and minority groups face discrimination in access to finance in many areas, and supplier finance programmes in partnership with buyers can drive financial inclusion while growing business for the financial institution or bank.
Financial stakeholders are missing opportunities to positively influence supply chain responsibility. Just 27% of executives cited banks or financial institutions as a key influence on their responsible supply chain policy, and just 20% cited stock exchanges. Yet interviews revealed that financial stakeholders have a good deal of potential to support, incentivise or hamper responsible conduct.	• More could be done to promote non-financial reporting and to move towards a broader, longer-term definition of fiduciary duty. Both regulators and financial stakeholders can play a role in this. • Financial stakeholders and corporate leaders need to improve communication and agree on systems that are better at taking social and environmental risks and opportunities into account. This will involve new measurement systems on the one hand, and greater acceptance of qualitative analysis on the other.
Some suppliers are less subject to positive influences. For instance, a) where a supplier is too small or anonymous to face much reputational risk, and is not subject to pressure from business customers, financial institutions or consumers (for example, a small or medium-sized enterprise [SME] in a developing country which is not listed and only supplies local firms), and b) when a supplier is so large that the brands buying its products have limited influence over it.	• Government regulation is especially important where suppliers are not subject to much influence from business customers, consumers or civil society watchdogs. Regulators should set and enforce an acceptable baseline to cover the firms which fall through the gaps. • In jurisdictions where regulatory or enforcement capacity is limited, as in many emerging markets, the most effective temporary measure may

be to develop the positive business case for responsible conduct, presenting the issue as an opportunity for individual businesses as well as the local economy.

- Where the supplier is bigger than the brands buying from it, cooperation among competitor brands on setting acceptable standards is one means of redressing the balance of power.

Supply chain complexity is the number one hurdle to responsibility, cited by 49% of executives. Most companies have a long way to go in tackling this challenge, with a majority enforcing their responsible supply chain standards among direct suppliers only—leaving themselves open to risks further down the chain.

- To cope with the complexity of modern global supply chains, the role of the supply chain leader needs to expand in scope to incorporate responsibility, and rise in influence within a firm to impact business decisions beyond sourcing.

- Reducing the supplier base, where feasible, simplifies the problem. As well as reducing the burden of risk assessment and monitoring, it enables firms to know their suppliers better and engage more closely with them on raising standards.

- Digital technologies should be better utilised for supply chain mapping and monitoring.

- Third parties can reduce the burden on firms.

- The challenge of complexity underlines the need for a solid baseline of government regulation.

ABOUT THIS REPORT

The Economist Intelligence Unit (EIU) has conducted a landmark study aiming to identify solutions to some of the barriers that are preventing companies from holding their supply chains to high or even acceptable social and environmental standards. For the purposes of this study, we define responsible supply chains as those in which standards are set and enforced by companies with regard to five main aspects: environment, health and safety, labour standards, gender equality, and business ethics.

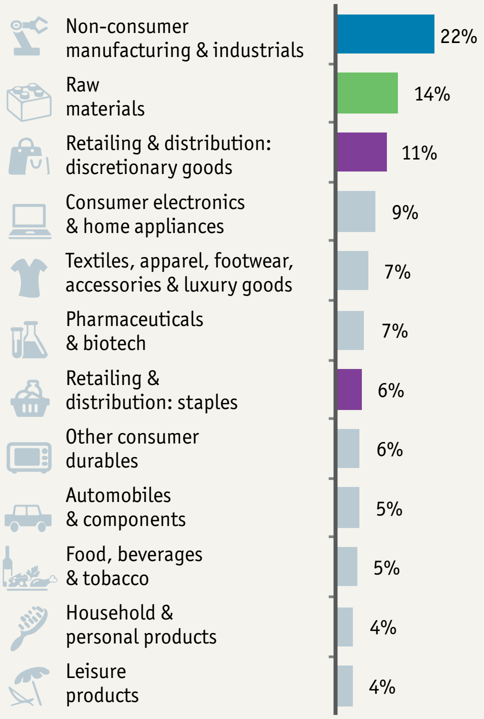
The research project, which was commissioned by Standard Chartered Bank, featured a survey of 800 executives in key industrial economies, to understand which responsible supply chain issues they address; what motivates and influences them to raise standards; how they structure their internal management of this issue; and how they engage with suppliers.

RESPONDENT PROFILES

Location of business headquarters
100 respondents from each of the following markets: China, Germany, Hong Kong, Italy, Japan, Singapore, South Korea, US

Markets were selected based on the criteria GDP>US$1trn and manufacturing>12% of GDP

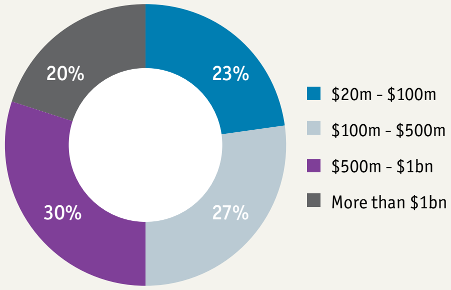
Primary industry



Level of seniority
C-suite/board member: 39%
Senior manager/managing director: 26%
Other manager: 35%

Job function
Overall leadership: 26%
Supply chain management/operations: 34%
Finance or risk: 35%
Other: 5%

Annual revenues in US$



Acknowledgements
This has been a highly consultative study, involving frequent interaction with outside experts and experienced practitioners: 53 people were interviewed in depth or consulted in roundtable discussions. A variety of perspectives have been taken into account, covering a range of industries, non-governmental organisations (NGOs) charged with setting the direction of the debate and developing best practice, government agencies, consultancies, industry associations and independent certification schemes, and academia. We are very grateful to each person who contributed their time and in so doing, enriched the analysis in this white paper. Their names and roles in the research project are outlined below.

THE STEERING COMMITTEE

The steering committee was involved at the outset of the research project. Its role was to inform the survey design and help us to identify the main elements of best practice in responsible supply chain management.

(Alphabetically, by surname)

Steven Beck, head of trade finance, Asian Development Bank (ADB)

Ynse de Boer, managing director, Accenture Strategy & Sustainability (Asia-Pacific)

Tim Carroll, vice-president, global supply chain, enterprise business group, Lenovo

Tom Delay, chief executive, The Carbon Trust

Lila Karbassi, chief of environment and member of the executive management committee, United Nations Global Compact

Sandra MacQuillan, chief supply chain officer, Kimberly-Clark

Sérgio Pimenta, director for manufacturing, agribusiness and services, International Finance Corp (IFC)

Mark Reuss, executive vice-president, global product development, purchasing and supply chain, General Motors

Andrew Voysey, director, finance sector platforms, Cambridge Institute for Sustainability Leadership, University of Cambridge

THE ADVISORY BOARDS

Once the survey had been completed, we convened three advisory board meetings in Hong Kong, London and Washington, DC to analyse possible reasons for, and implications of, the survey results. The Chatham House Rule applied, enabling frank discussion of sensitive topics.

LONDON

Chris Brown, vice-president, corporate responsibility and sustainability, Olam International

Dennis Cheong, vice-president, global supply chain, lubricants, Shell

Rajesh Garg, group chief financial officer, Landmark Group

Jonathan Ivelaw-Chapman, chief executive officer, Sedex

Amy Jackson, head, membership services, Ethical Trading Initiative

Christine M McGrath, chief sustainability, well-being, and public and government affairs officer, Mondelēz International

Tony Roy, head, supplier excellence, BT Group Procurement

Aleyn Smith-Gillespie, associate director, business services, The Carbon Trust

Cristina Tébar Less, head, Responsible Business Conduct Unit, Organisation for Economic Cooperation and Development (OECD)

Anna Turrell, senior public affairs manager, sustainability, Nestlé

HONG KONG

Gareth Brooks, managing director, VF Asia Limited

Matthew Friedman, chief executive officer, The Mekong Club

Frank Haunert, vice-president, direct procurement, APAC, BASF

Paul Lim, founder and president, Supply Chain Asia

Kim-See Lim, portfolio manager, IFC

John O'Callaghan, head, corporate communications and sustainability, Sateri

Sally Peng, member, Asia Pacific practice leader, Sandler, Travis & Rosenberg

Tey Wei Lin, chief executive officer, Sateri

Richard Welford, chairman, CSR Asia

WASHINGTON, DC

Carlos Busquets, director, public policy, Electronic Industry Citizenship Coalition (EICC)

Tim Carroll, vice-president, global supply chain, Lenovo

Judy Gearhart, executive director, International Labor Rights Forum

Bruce Harsh, director, office of supply chain, US Department of Commerce

David Hayer, president, Gap Foundation, and senior vice-president, global sustainability, Gap

Rob Lederer, executive director, EICC

Marissa Pagnani, group vice-president, corporate responsibility, PVH Corp

Anna Patrick, public affairs specialist, US Department of State

Melissa Powell, chief of staff, UN Global Compact

Rachel Rigby, deputy chief, division of research and policy, Office of Child Labor, Forced Labor, and Human Trafficking, Bureau of International Labor Affairs, US Department of Labor

Laura Rundlet, senior coordinator, public engagement, US Department of State

Maureen Smith, deputy assistant secretary, industry and analysis, US Department of Commerce

INTERVIEWS

The following experts and senior practitioners were interviewed during the preparation of this white paper, sharing their own perspectives on and experiences of managing responsible supply chains.

Kenneth Amaeshi, chair, business and sustainable development and director, Sustainable Business Initiative, University of Edinburgh

Tanya Bolden, programme development manager, corporate responsibility, Automotive Industry Action Group (AIAG)

Jürgen Braunstetter, senior vice-president, supply chain management, automotive, Continental

Stephen Cawley, head of sustainability and responsible sourcing, John Lewis

Dennis Cheong, vice-president, global supply chain, lubricants, Shell

Tom Delay, chief executive, The Carbon Trust

Han de Groot, executive director, UTZ

David Hayer, president, Gap Foundation, and senior vice-president, global sustainability, Gap

Richard Howitt, chief executive officer, IIRC

Samson Hu, chief operating officer, ASUS

Jonathan Ivelaw-Chapman, chief executive officer, Sedex

Mary Ellen Iskenderian, president and chief executive officer, Women's World Banking

Richard Locke, provost and professor, Brown University

Sandra MacQuillan, chief supply chain officer, Kimberly-Clark

Gerard A Manley, chief executive officer, Olam Cocoa

Kathleen McLaughlin, senior vice-president and chief sustainability officer, Walmart and president, the Walmart Foundation

Cristina Tébar Less, head, Responsible Business Conduct Unit, Organisation for Economic Cooperation and Development (OECD)

Frank Waechter, senior head, treasury and insurance, Puma

Sarah Watt, head, emission control technologies (ECT) divisional sustainability, Johnson Matthey

This report was written by Susan Evans, and was edited by Kevin Plumberg and Michael Gold. The EIU bears sole responsibility for the content of this report. The findings do not necessarily reflect the views of the sponsor.

1 CONFIDENCE AND COMPLACENCY

The survey revealed a worrying degree of complacency. Most executives felt confident that their companies' supply chains were responsibly managed—despite evidence that insufficient attention was being given to some key issues, such as child labour, climate change and gender equality. On top of this weak performance, a sizeable proportion of businesses had actually allowed supply chain responsibility to slide as a priority in the past five years. Economies in which policies and regulations have recently become more supportive of responsible business behaviour showed a more positive trend. Issues for which it is more straightforward to demonstrate a material business risk or opportunity received more attention than those for which quantification or prediction is more complex. Issues affecting a sub-set of the population, such as women and children, received less attention than those affecting all workers.

We're good

Business executives feel confident that their supply chains are responsible and compliant. Four in five respondents agreed or strongly agreed that their company's supply chain was responsible, and just 2% disagreed. The vast majority of respondents stated that their firms' responsible supply chain standards were compliant with, or even more stringent than, government regulations and industry standards (94% and 97%, respectively). The closer a firm was to its suppliers (physically), the more likely the respondent was to agree that it had responsible supply chains.

Issues slip through the cracks

However, some key issues are receiving little attention from companies. Just 22% address child labour, 23% address climate change and carbon footprint, and 28% address gender equality.

These results are concerning, given the severity of these issues and their relevance to Asia, where a majority of the companies surveyed are based. UNICEF estimates there are currently 150m children engaged in child labour globally, with the highest levels in Africa, but the problem is also significant in developing Asian countries.[2] Some of the most prominent exposés of child labour have been related to mining, and so it is disappointing to see that raw materials firms were the worst-performing industrial group in terms of addressing this issue (just 20% of firms).

The OECD's projections of the economic impact of climate change to 2060 anticipate the greatest negative effects in Africa and Asia, costing between 1.5% and 6.5% of GDP in most countries.[3] Here too, the sectoral results were disappointing: a paltry 12% of retail and

2 UNICEF. 2016. "Child labour: current status and progress". [https://data.unicef.org/topic/child-protection/child-labour/]; regional and country data downloaded from same page. 3 OECD. 2015. "The Economic Consequences of Climate Change: Policy Highlights". [https://issuu.com/oecd.publishing/docs/economic_consequences_of_climate_ch_21bcb6d97fe6a8].

Figure 1. Taking responsibility
(% of firms agreeing with the statement "my company has a responsible supply chain")

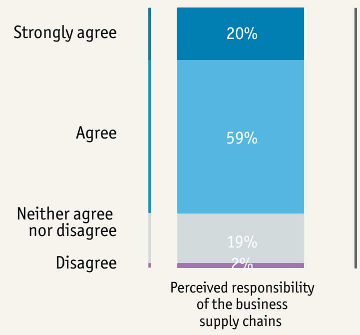


Figure 2. Compare and contrast
(% of firms giving the following answers when asked to evaluate their companies' standards vs government regulations and industry certification schemes)

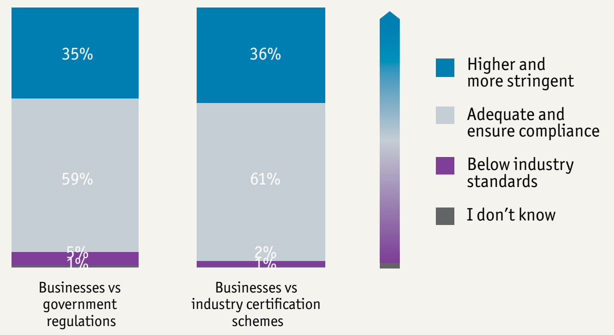


Figure 3. Long-distance relationship
(% of firms agreeing with the statement "my company has a responsible supply chain", correlated against distance between suppliers' base and customers' base)

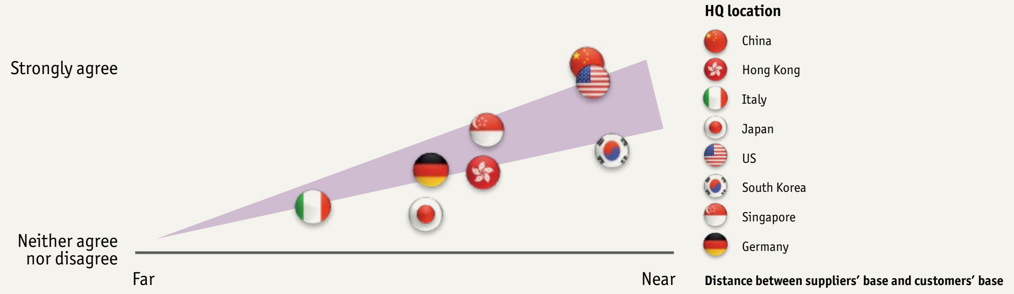
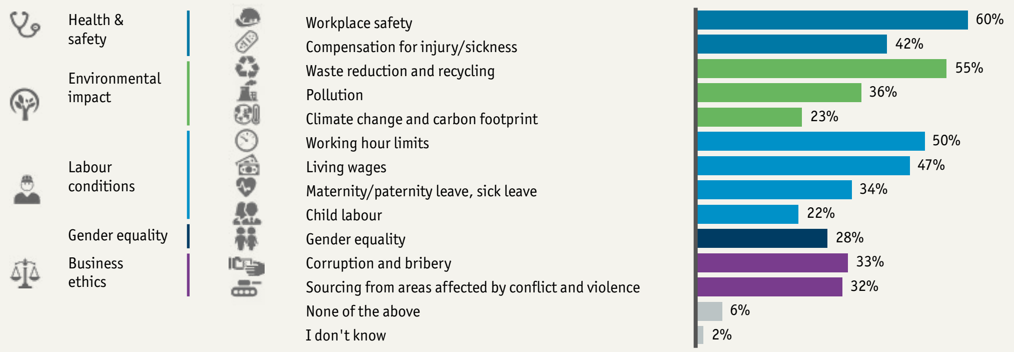


Figure 4. Supply of problems
(% of firms saying they address the following issues in their supply chains)



distribution firms were addressing the carbon footprint of the logistics and delivery firms which facilitate their business.

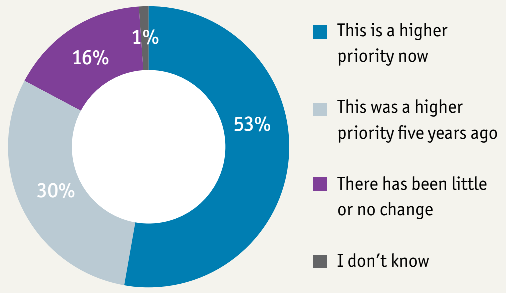
In failing to ensure the equal participation, reimbursement and empowerment of women in supply chains, economies are losing opportunities for economic development and companies are missing out on potential talent. According to the World Economic Forum's Global Gender Gap Report, even the best-performing region, Western Europe, has a 25% gender gap in access to resources and opportunities; North America has a gap of 28%, while the figure stands at 32% in East Asia and the Pacific. (Japan and South Korea perform particularly poorly on gender equality, below most Sub-Saharan African countries.) With the gap at over 30% in most regions of the world and progress slow, the problem is endemic and a drag on global development.[4]

Even for a relatively well-established topic like health and safety, which is addressed by the highest share of firms (60%), there is a huge distance from the ideal situation in which 100% of firms would ensure strong standards in their supply chains.

So five years ago

While a small majority of firms have made supply chain responsibility a higher priority in the last five years, a full 30% have decreased their focus on this over the same period. Some countries show a more positive trend than others. Responsible supply chain management has moved up on the agenda of most firms in China, Germany, South Korea and the US.

Figure 5. Shifting priorities
(% of firms giving the following answers when asked to evaluate how much importance their companies place on ensuring responsible supply chains)



In China, where two-thirds of firms reported an increased focus on this, the shift in government policy under the Xi Jinping administration may offer one explanation. The 12th five-year plan (2011-2015), which heralded a shift towards a more consumption-driven economy, brought in a higher emphasis on social well-being, environmental protection and energy efficiency (continuing now under the 13th plan). The fact that more Chinese companies are listing on stock markets and investing internationally has also increased the degree of scrutiny that they face.

In the US, there has been a trend in the last five years towards greater requirements for supply chain transparency, risk assessment and accountability, which could partially explain the rise in awareness of the risks among US-based firms. The year 2012 saw the introduction of both the California Transparency in Supply Chains Act and Rule 1502 of the Dodd-Frank Act, which addresses sourcing of conflict minerals. This trend now risks being reversed under the Trump administration.[5]

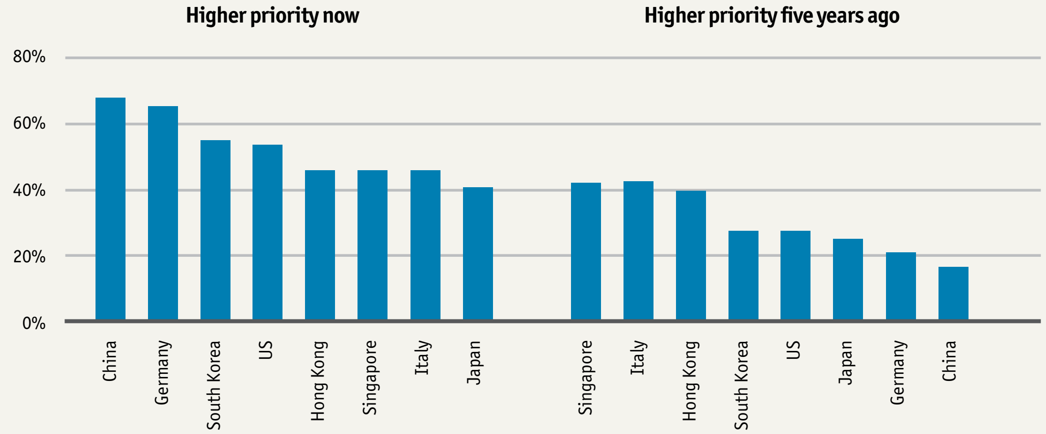
4 Data from: World Economic Forum. 2016. "The Global Gender Gap Report 2016: Performance by region and country". [http://reports.weforum.org/global-gender-gap-report-2016/performance-by-region-and-country/]; for further evidence on the link between women's economic empowerment and economic growth, see: UN Women. 2015. "Facts and figures: economic empowerment". [http://www.unwomen.org/en/what-we-do/economic-empowerment/facts-and-figures]. 5 Thompson, N. 2017. "Trump administration looks to weaken rules on conflict minerals". *Financial Times/This is Africa*, 7 Mar 2017. [http://www.thisisafricaonline.com/News/Trump-administration-looks-to-weaken-rules-on-conflict-minerals].

Yet in other markets, such as Hong Kong, Singapore and Italy, progress is stagnant because nearly as many firms have reduced their focus on responsible supply chains as have increased it. The result for Italy is surprising, given that it is exposed to the same EU regulations as Germany. The EU is in the process of introducing new regulations relating to conflict minerals, and new rules on sustainability reporting have come into force in 2017.[6] This indicates that the direction of policies and regulations alone is not enough to bring about widespread improvement in awareness and action. Weak economic growth (Italy was in recession as recently as 2013, and has yet to exceed 1% growth since) and political instability may explain the lack of focus on responsibility among firms and consumers. Italian firms were least likely to say that customer expectations influenced their approach to supply chain responsibility—at just 26% of respondents, compared to an average of 43%.

Taken together, the results point to two conclusions. First, neither industry standards nor government regulations adequately cover the full range of key social and environmental topics identified by the United Nations' corporate sustainability initiative, the UN Global Compact, and so even full compliance is unlikely to bring corporations up to a standard of behaviour that the average person on the street would consider to be "responsible".

Second, they reveal a worrying degree of complacency on the part of businesses. Given that many key issues are being overlooked in supply chains, it would have been a more positive result if a higher proportion of executives had declared that their firms did not yet have responsible supply chains. The more an executive understands about their own supply chain risks and what is required to address them, the more negatively they are likely to feel about their firm's performance—which may prompt action. A failure to acknowledge the risks is not a positive result.

Figure 6. A lifetime in five years
(% of firms saying responsible supply chains are a higher priority now vs five years ago, by market)



6 European Commission. 2017. "The EU's new Conflict Minerals Regulation". Mar 2017. [http://trade.ec.europa.eu/doclib/docs/2017/march/tradoc_155423.pdf]; The European Parliament and Council of the European Union. 2014. "Directive 2014/95/EU". 22 Oct 2014. [http://eur-lex.europa.eu/legal-content/en/TXT/?uri=CELEX%3A32014L0095].

A closer look at the issues

Taking a closer look at businesses' approaches to each of our key responsible supply chain issues can offer further clues as to why there is complacency with regard to some and relatively high awareness of others.

Health and safety

Health and safety in supply chains is the issue which is most commonly addressed by firms. Three in five ask their suppliers to meet certain standards on workplace safety, though interestingly just 42% call for compensation to be made available to injured parties—a more concrete measure which can provide a useful performance incentive.

Why does this topic get more attention than others? Calamitous events such as the factory collapse at Rana Plaza, Bangladesh in 2013 have no doubt raised the public profile of health and safety, pushing it up the agenda as a reputational (and therefore financial) risk to firms. The relatively high visibility of health and safety—whether fire exits are in place or workers are provided with appropriate protective gear, for instance—makes it at once more of a target for third parties such as NGOs, media or concerned citizens, and also more straightforward for companies themselves to set requirements for and monitor. It is also an issue on which there is legislation in most industrialised countries, though enforcement varies greatly.

Risk perception among the survey respondents could also be a big factor. Supply chain, finance and risk executives are more likely to acknowledge health and safety as material to them than more "hidden" issues such as child labour, less obviously risky issues such as gender equality, or issues that are harder to assess such as a supply chain's carbon footprint.

MATERIALITY

We are living in a material world

The CSR function is well-known for its use of jargon. Among sustainability officials, “materiality”, a term commonly used in financial auditing, has taken on a new meaning. It refers to the extent to which a given social or environmental issue has a real business impact, in the sense of financial risk or opportunity.

> For an issue to be taken seriously, top decision makers within a firm must understand its impact on their own targets.

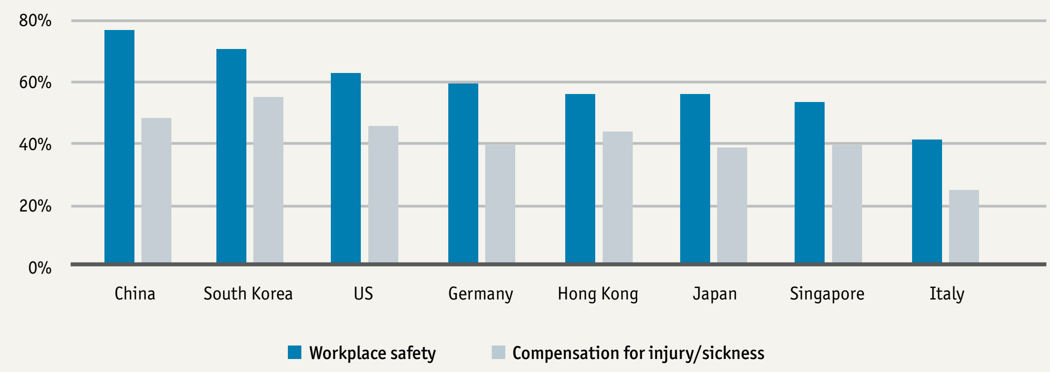
Different stakeholders may consider different topics to be “material” to them,[7] and this makes targeted communication crucial. Samson Hu, chief operating officer of consumer electronics company ASUS, explains that his firm carries out engagement with its various stakeholders, internal and external, in order to identify key topics relevant to each. This guides not just what is reported, but which issues are tackled. For an issue to be taken seriously, top decision makers within a firm, as well as shareholders and investors in some cases, must understand its impact on their own targets. As a result, the role of a CSR professional is increasingly that of interpreter: explaining how neglecting a social or environmental issue will affect the bottom line, or how tackling it could create a quantifiable opportunity.

Professor Kenneth Amaeshi, director of the Sustainable Business Initiative at the University of Edinburgh, explains how materiality directs the focus of responsible supply chain initiatives in Africa. “[Efforts to make supply chains more responsible are] happening more in areas where there are significant risks to the companies themselves. For example, British-American Tobacco understands the impact of deforestation and desertification. They want to ensure that the sources of their raw materials are protected, so there’s a strategic interest. You’re seeing what I call ‘strategic CSR’, where something of value is at risk if it is not done.”

This focus on materiality and therefore quantification helps to explain why some issues are neglected. For topics where quantification of risks and opportunities is tricky, or where the time frame is longer (and uncertainties greater), the interpretation challenge is a stumbling block that can take years to overcome and may need the involvement of expert third parties.

7 See for example: Global Reporting Initiative and RobecoSAM. 2015. “Defining materiality: What matters to reporters and investors”. [https://www.globalreporting.org/resourcelibrary/Defining-Materiality-What-Matters-to-Reporters-and-Investors.pdf].

Figure 7. Safe and sound
(% of firms addressing each issue, by market)



Health and safety in supply chains receives most attention from China-based firms (76%). This could owe to a sense among Chinese firms that they face high scrutiny from domestic and international media, given that worker deaths in mining and other industries have repeatedly featured in the news. There has also been a tightening of regulations, including a blacklist of companies with poor safety records since 2014.[8]

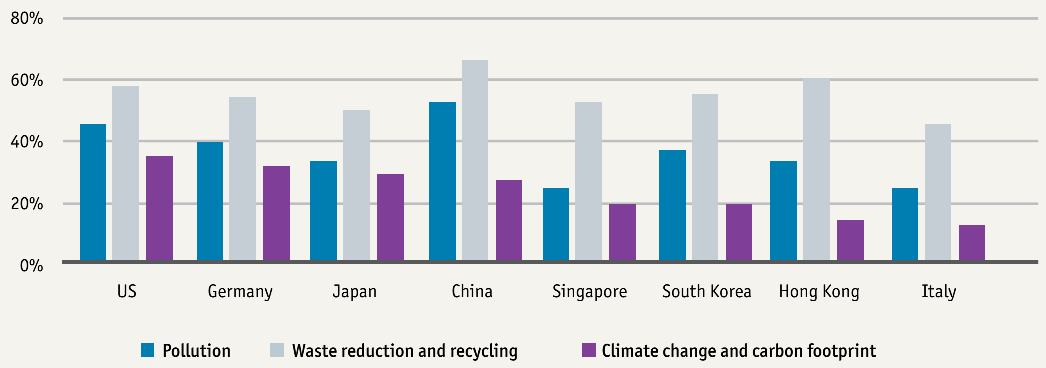
Environmental impact

A materiality bias can be seen in the extent to which different environmental issues are addressed. Waste reduction and recycling, which can reduce disposal costs and in some cases increase revenue,[9] are addressed by significantly more firms in every market than either pollution or carbon emissions. Firms in China are most likely to address these material issues in their supply chains (66% of respondents).

When it comes to the less tangible issue of carbon footprints, this is most commonly addressed by firms from the US (35%) and Germany (31%). Italian firms lag on managing all three environmental issues, with a mere 12% setting any supplier requirements related to carbon emissions. Tom Delay, chief executive of the UK-based Carbon Trust, attributes the weak focus in all markets on suppliers' carbon footprints in part to a lack of regulation, and in part to the relative newness of the topic—methods for measuring and tackling carbon emissions are complex and still relatively unknown. They are, however, becoming available.

8 UK Foreign and Commonwealth Office. 2016. "Overseas business risk: China". [https://www.gov.uk/government/publications/overseas-business-risk-china/overseas-business-risk-china]. 9 GM, for instance, generated $2.5bn in revenue from recycling activities from 2007-2010. See: GM. "The business case for zero waste". [https://www.gm.com/content/dam/gm/en_us/english/Group3/sustainability/sustainabilitypdf/GMs_Landfill-free_Blueprint.pdf]. For other case studies showing the economic benefits of recycling and waste reduction, see: New Jersey Wastewise Business Network. 2013. "The economic benefits of recycling and waste reduction: Wastewise case studies from the public and private sectors". [http://www.nj.gov/dep/dshw/recycling/wastewise/njwwcasestudy.pdf].

Figure 8. Clean and green
(% of firms addressing each issue, by market)



Labour conditions

Overall, firms are more likely to address working-hour limits and living wages in their supply chains than other labour issues, such as parental and sick leave or child labour. Access to parental and sick leave is a gender issue: women are more likely to request both types of leave, often using their own sick leave to care for unwell children. These findings could stem from the way in which firms prioritise. David Hayer, president of the Gap Foundation and senior vice-president, global sustainability at Gap, explains that a key step in the formulation of a responsible supply chain strategy is to ask what the firm can influence most, and what impacts the firm most—and use this information to prioritise. One unfortunate result of this may be to side-line topics that affect sub-sets of the labour force, such as women and children.

Where labour shortages are becoming more of a challenge, as in North-east Asia's aging societies, a larger proportion of firms require their suppliers to provide maternity and sick leave. ASUS, based in Taiwan, has a number of provisions related to pregnant women and new mothers in the workforce. "We ask all suppliers to conduct occupational risk assessments for pregnant labourers, who must be transferred to maternity-friendly tasks if any risks are identified," says Mr Hu. The firm's suppliers cannot ask pregnant or breastfeeding women to work overtime or night shifts.

Figure 9. Out of office
(% of firms addressing maternity, paternity and sick leave, by market)

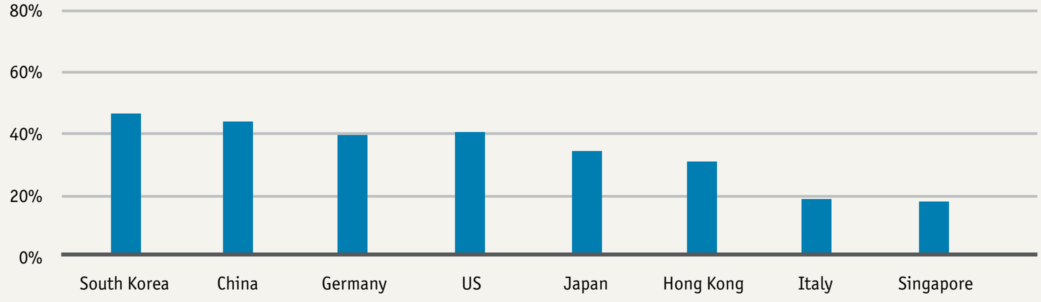
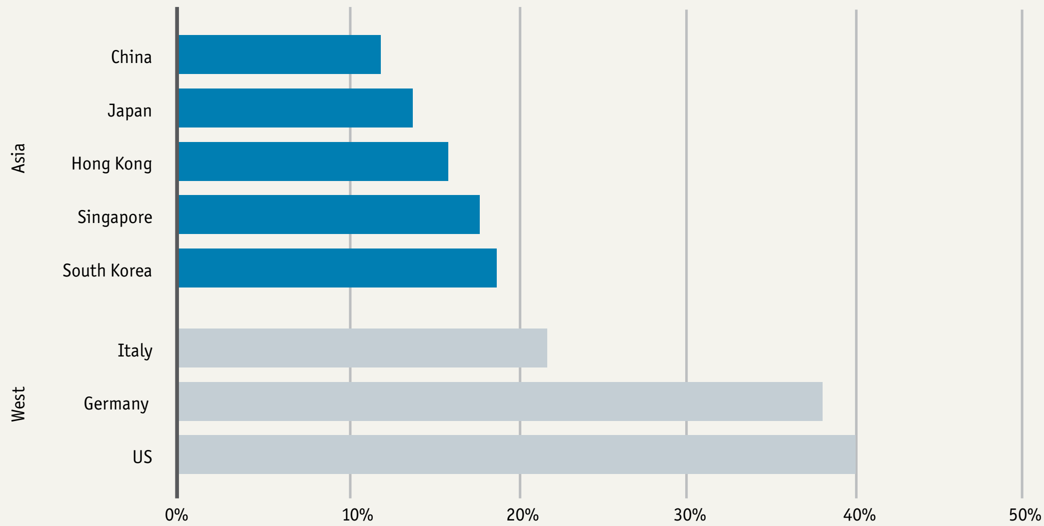


Figure 10. Save the children
(% of firms addressing child labour, by market)



Child labour usually exists among suppliers which are geographically far from the head office and insulated by multiple layers of intermediary firms, and this makes it harder to detect. This is also the case with the inter-related issues of forced labour, trafficking and modern slavery—which disproportionately affect children.[10] The International Labour Organization (ILO) estimated that in 2012 there were 21m victims of forced labour globally, with over half in the Asia-Pacific region, but also affecting advanced economies, with 1.5m in North America.[11]

US- and Germany-based firms are most likely to have policies aimed at eliminating child labour

10 The ILO estimates that around half of the people affected by forced labour are children. See: ILO. 2011. "Hard to see, harder to count: survey guidelines to estimate forced labour of adults and children". 7 Dec 2011. [http://www.ilo.org/global/topics/forced-labour/statistics/WCMS_182084/lang--en/index.htm]. 11 ILO. "Statistics on forced labour, modern slavery and human trafficking". [http://www.ilo.org/global/topics/forced-labour/statistics/lang--en/index.htm].

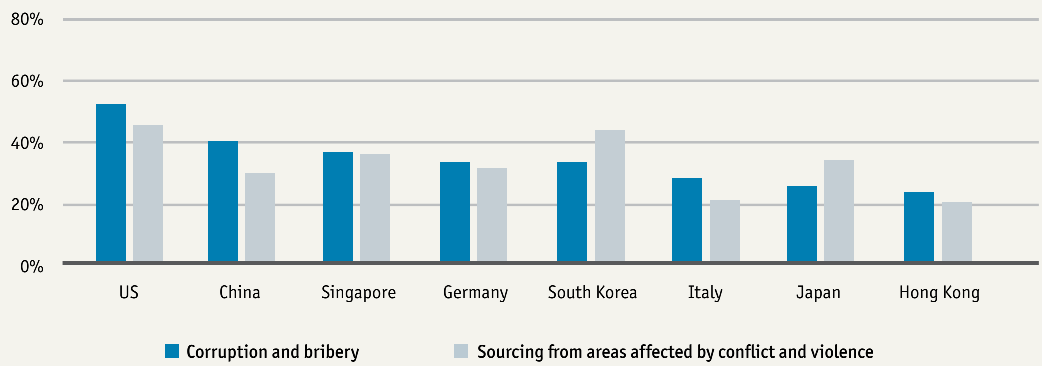
from their supply chains. US firms may have been influenced by regulatory developments, which accelerated after 2009 when the Department of Labor started issuing a list of goods believed to be produced by forced labour or child labour. (As of 2016, the list stood at 139 products from 75 countries.[12]) The Trade Facilitation and Trade Enforcement Act 2015 prohibits the import of any product made by forced or indentured child labour,[13] while the California Transparency in Supply Chains Act 2010 requires firms with over $100m in global revenues to disclose their efforts to eradicate trafficking and slavery, including details of supplier audits.[14] The German government has also been active in developing a national implementation plan for the UN's Guiding Principles on Business and Human Rights, addressing similar issues.[15]

Another explanation for the relatively high focus on child labour by US and German firms may be the history of scandals affecting well-known domestic brands. US and German firms in sectors ranging from agriculture and food production to clothing, footwear and electronics have featured in media scandals over the past few decades, and they are now ahead of the curve in developing mechanisms to avoid future humiliations.

Business ethics

US firms lead the way in addressing business ethics in their supply chains, with 52% addressing corruption and bribery, and 45% addressing sourcing from conflict areas. The Foreign Corrupt Practices Act has been in place as a check on bribery in the global supply chains of US companies since 1977, but its application has been more vigorous since a new enforcement unit was introduced in 2010. There were 26 enforcement actions taken in 2016, and the annual average since 2010 is significantly higher than 2000-2009.[16] Rule 1502 of the Dodd-

Figure 11. Worst of the worst
(% of firms addressing each issue, by market)



12 US Department of Labor. 2016. "List of goods produced by child labor or forced labor". [https://www.dol.gov/ilab/reports/child-labor/list-of-goods/]. 13 US Customs and Border Protection. 2016. "Trade Facilitation and Trade Enforcement Act 2015 - Overview". [https://www.cbp.gov/sites/default/files/assets/documents/2016-Oct/Trade%20Facilitation%20and%20Trade%20Enforcement%20Act%20of%202015%20-%20Overview.pdf].
14 California Senate Bill No. 657, Chapter 556. "Human trafficking". 30 Sep 2010. [http://www.leginfo.ca.gov/pub/09-10/bill/sen/sb_0651-0700/sb_657_bill_20100930_chaptered.pdf]. 15 Business and Human Rights Resource Centre. 2016. "Germany adopts National Action Plan on Business and Human Rights". [https://business-humanrights.org/en/germany-launches-development-of-national-action-plan-on-business-human-rights].
16 US Securities and Exchange Commission. 2017. "SEC enforcement actions: FCPA cases". [https://www.sec.gov/spotlight/fcpa/fcpa-cases.shtml].

Frank Act, which addresses sourcing of conflict minerals, was also introduced in 2012.

South Korean firms are second-most likely (43%) to tackle sourcing from conflict areas—despite a lack of national regulations on conflict minerals. This could be explained by the importance of electronics and automotive manufacturing to the South Korean economy, with a large proportion of exports going to advanced markets such as the US and UK which do have relevant regulations in place. South Korean giant Samsung has also been exposed to reputational risk after being named in an Amnesty International report on conflict minerals in the Democratic Republic of Congo. These factors cannot fully explain the results, however, given that Japanese and Singaporean exports have a rather similar profile and Japanese conglomerate Sony was also named by Amnesty.

Some firms may not address these issues because they are not very relevant to them. This helps to explain the low results for Italy, as only 5% of respondent firms were in raw materials, with the largest cohort in retail and distribution.

Overall, a disappointing 28% of firms address gender equality among their suppliers.

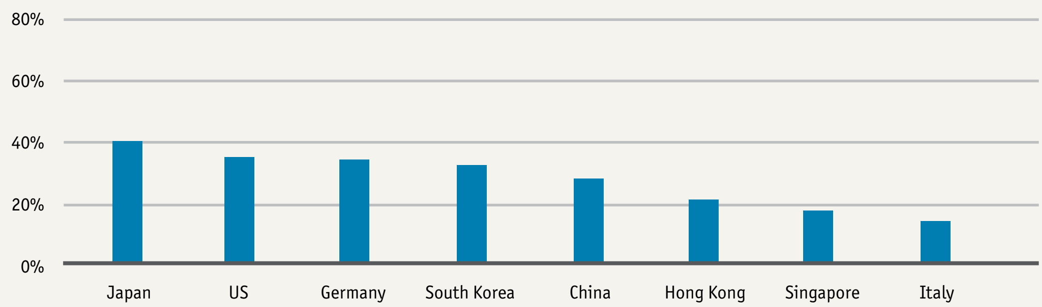
Gender equality in supply chains

Overall, a disappointing 28% of firms address gender equality among their suppliers. Interestingly, the best- and worst-performing economies on this issue are two countries with reputations for a lack of female empowerment: Japan (40%) and Italy (14%). Each ranks among the lowest-scoring in its respective region in the WEF's Global Gender Gap Index. It may be that Japan's growing labour shortage has prompted its firms to take a more active approach to the inclusion and fair treatment of women in their supply chains.

The range of issues affecting women in supply chains is broad, and varies by location and

Figure 12. Ladies first

(% of firms addressing gender equality, by market)



industry. There are simple matters of equality such as equal pay and the introduction of flexible working practices that enable women, who tend to have more household and caring responsibilities outside of work, to remain in the workforce. In some areas there is a particular need to guard against various forms of abuse, including forced labour and trafficking, which disproportionately affect women. There were some encouraging signs from the survey results, with 43% of firms saying they educate suppliers on the business benefits of gender equality.

Gender equality is not just about protecting vulnerable women, but also empowering ambitious women to play a greater role in global supply chains. This is a topic close to the heart of Mary Ellen Iskenderian, chief executive officer of Women's World Banking, an NGO focused on improving access to finance for women-owned SMEs. For any start-up wishing to scale up in order to sell to a multinational, finance is crucial. According to Ms Iskenderian, women in emerging markets are often excluded from formal financial services. One reason is that they are much less likely than men to have collateral, which is narrowly defined in many emerging markets as fixed property.

"The importance of finance to building gender equality in supply chains cannot be overestimated. It is the number one constraint that women-led companies cite in terms of the barriers to growth, and diversifying off-take," says Ms Iskenderian. Buyers can support these companies through programmes aimed at increasing the number of women-owned suppliers, and by working with financial institutions to improve their access to finance, as Walmart has done in recent years (see box). These measures are not common by any means. Just 18% of firms supported women by sourcing from women-led organisations, and 27% helped their suppliers to access finance, the survey showed.

If it can't be measured, it won't get done. This mantra regularly came up in interviews as the attitude toward supply chain challenges. Statistics on sourcing from women, equality of pay and other indicators are in theory straightforward to collect—but few firms are collecting them. Under a quarter of firms require their suppliers to provide gender-disaggregated data. While the benefits of gender equality at the macro-economic level are quite clear, the argument does not seem to have been as well-made at the micro level of individual businesses.

There remain unanswered questions with regard to why certain issues receive more attention by firms, and why certain economies have clearly raised their level of focus on responsible supply chain risks in recent years, while others have stalled. When we asked executives what influenced their firm's approach to responsible supply chains, the top answer—cited by half of respondents—was "company culture". Given the degree of complacency that our survey has revealed, it is fair to ask exactly how a strong company culture of responsibility can be nurtured. The next section looks at the factors which can influence and motivate companies to hold their suppliers to higher standards, and asks what can be done where some or all of these factors are absent.

An empowering change: a case study of Walmart

In recent years, more of the corporate world has come to recognise the benefits to the bottom line, as well as to reputation, of helping women play an equal role within businesses. While studies touting the benefits of greater female representation on boards and in the C-suite abound, getting a greater share of women into supply chains is an equally crucial, but as our study shows, oft-neglected, task. Where do women sit in the dialogue surrounding ethical supply chains? Why should companies prioritise sourcing from women-owned businesses (WOBs)?

These questions were front of mind for executives at Walmart, the world's largest private employer, when they launched the Global Women's Economic Empowerment Initiative in 2011. Among other goals, the Initiative aims to increase Walmart's sourcing from WOBs and empower women through market access, career opportunities, job training and education.

Give the customers what they want

According to Kathleen McLaughlin, Walmart's senior vice-president and chief sustainability officer, the firm saw a business opportunity in the concept of products designed or produced by women, for women, who comprise the "vast majority" of Walmart's customer base. "We did that because we believed sourcing from WOBs would give us exciting, innovative products that customers said were of higher quality," she says. "It's really about driving growth and pleasing our customers."

Benefits would multiply as the Initiative's effects rippled throughout its target communities, Ms McLaughlin says, due to women's central role in enhancing local resilience and growth, particularly in emerging markets. "We were intrigued by the notion that our purchase orders could be used as a form of development capital," she says.

Walmart and the Walmart Foundation also committed to support training as a key aspect of the Initiative which set a goal to educate 1m women around the world, according to Ms McLaughlin. More than half of those would hail from agriculture, 60,000 from factories and several hundred thousand from retail or adjacent sectors in emerging markets, with the latter specifically targeting women entering their first job. "For example, in Kenya we gave grants to train women to be coders for e-commerce businesses, while in China we gave women support to run an eBay-style e-commerce business from home," she says.

The training incorporates a range of issues, from broad aspects of management and leadership, to more narrow issues like logistics, audits and quality control.

"We found that women entrepreneurs may need assistance with how to run a good business, or [simply] how do you supply to a major retailer?" says Ms McLaughlin.

Scalable solutions

Another pillar of Walmart's efforts involves integrating more WOBs into global supply chain financing, a major issue for women trying to bring a business model to life or scale-up their pre-existing operations. To tackle these barriers, Walmart engaged the financial institutions directly, spurring them to use the promise of Walmart business as justification for a loan. Ms McLaughlin says that programmes aimed at enhancing the role of women often end up being equally applicable to suppliers from other minority groups, or even to all small suppliers. One such program is the Supplier Alliance Program, which allows qualified suppliers to leverage Walmart's credit in order to have cash on their invoices earlier than they normally would while at a cheaper rate than other financing mechanisms.

"We worked with banking service providers, and got them agree that if they have a Walmart invoice, they can access capital allowing them to scale up their service," Ms McLaughlin says. "That was a big unblock for many of the women suppliers." There are currently more than 250 suppliers in the programme, accounting for approximately $9.5bn in purchase orders.

Walmart has also leveraged its position as one of the world's biggest downstream purchasers of goods to convince consumer brands like Coca-Cola and Mondelēz to publicly report aggregated spending on WOBs in the US through the Women's Business Enterprise National Council, the largest third-party certifier of businesses owned, controlled and operated by women in the US. "We'd like to shine a spotlight on sourcing from WOBs as an opportunity, and make it more of a movement," says Ms McLaughlin. This initiative, launched in March, comes as Walmart makes a similar push with other companies through a WEConnect initiative to source a total of $15bn from WOBs in the US and internationally over the next five years, on top of the $20bn already sourced by Walmart through the Global Women's Economic Empowerment Initiative.

Ms McLaughlin says the effects of its enhanced focus on sourcing from WOBs have been felt as strongly within the company, where women comprise approximately 30% of its corporate officers. "For women at Walmart it's pretty inspiring," she says. "I have associates who say they're excited and find it really affirming." She also emphasises the role of men in making the Initiative a success. "The men have been as strong advocates for the programme as the women," she says. "It just so happens that women are leading it."

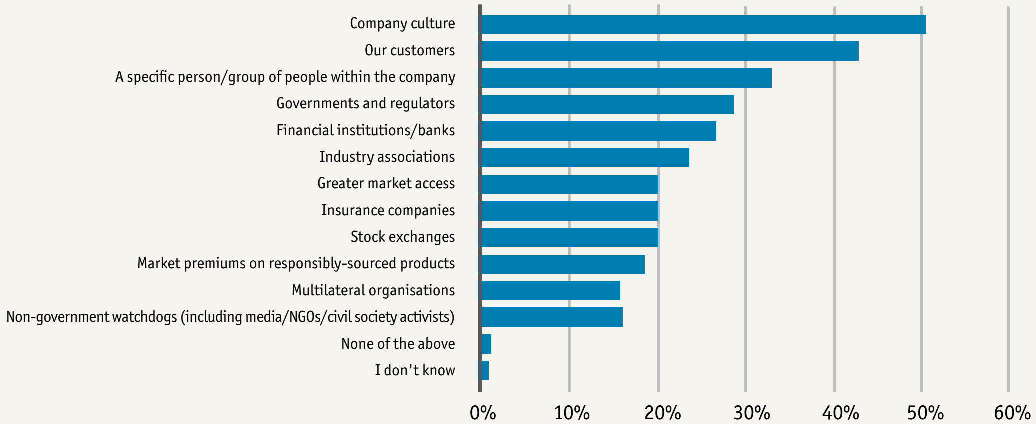
2 CULTIVATING A RESPONSIBLE CORPORATE CULTURE: MOTIVATIONS AND INFLUENCES

There has been little research to date on which factors are most effective at motivating and influencing companies to take greater responsibility for social and environmental standards in their supply chains. Survey respondents tended to point to corporate culture as the main impetus behind improvements in supply chain responsibility; but it is important to look beyond, to what creates the context for corporations to develop a culture of responsibility.

The respondents downplayed the impact of regulators, multilateral organisations and civil society watchdogs; yet this was contradicted by other survey findings and expert testimonies. For instance, customers, whether consumers or B2B buyers, were found to be a top influence. Customer expectations are moulded by the agendas set by other stakeholders (notably multilateral organisations and NGOs), as well as the extent to which information on irresponsible supply chain practices is made available to them. NGOs and activists play an undeniably important role in highlighting bad practice and bringing certain issues to the fore in the public consciousness.

As well as examining influences and motivations, it is important to consider what happens in

Figure 13. Feeling the pressure
(% of firms identifying each factor as an influence on its approach to responsible supply chains)



their absence. Firms which are less influenced by reputational considerations (whether of their own, of their customers, or of their financial backers) may fall through the cracks, demonstrating the need for an adequate baseline of regulation and enforcement.

Culture club

Asked what has a significant influence on their company's approach to responsible supply chains, executives were most likely to state the positive influence of company culture (50% of respondents). A corporate culture of responsibility was the top-ranked factor for each geography covered, and its importance was underlined by a number of the supply chain leaders we interviewed.

However, corporate culture does not develop out of the blue. It is shaped by the societal expectations which are established by the regulatory climate, multilateral organisations (notably the UN and the OECD), industry bodies and independent certification schemes, as well as awareness-raising work by NGOs, the media and other civil society watchdogs (increasingly including citizen activists on social media).

These social expectations also exist within firms, particularly among the younger generation. A responsible business culture can be a draw for new recruits, as Sarah Watt, head of ECT divisional sustainability at Johnson Matthey, a UK-based chemicals firm, illustrates: "When we ask graduates why they chose JM, they say quite frequently that it's because our products are quite green, innovative and exciting, and producing environmental solutions—so being authentic as an organisation is not just providing good solutions but how we do that, and relationships with suppliers is an important part of that."

Sometimes, key individuals within a firm, as opposed to a corporate function, department or initiative, can drive progress on responsible supply chains beyond of what is required for compliance. A third of survey respondents cited this as a key influence, and many of the experts we spoke to emphasised the importance of leadership. Mr Hayer gives much of the credit for the evolution of responsibility policies and practices at Gap to the influence of the founding family, the Fishers, who maintain an active interest in the company.

The customer is king

Consumer expectations represent an important influence on large, well-known brands; while B2B customers hold leverage over less well-known firms. Keeping customers happy was reported by executives to be the second-highest influence on responsibility: 43% of firms said that customers—including B2B customers and consumers—influenced their approach to responsible supply chains. Few would dispute the important role of the customer in determining how businesses manage their supply chains, and which issues they focus on.

For consumer-facing firms, this is a matter of brand reputation and the financial cost of a scandal is a very tangible incentive. Where there is a brand to protect, the role of NGOs, media

Forest for the trees: a case study of Kimberly-Clark

It is easy to overlook the complexity of a product as ostensibly simple as a tissue. The labour, natural resources and processing required to produce a single sheet entail long and complex supply chains, stretching from wilderness to manufacturing plants, to points of sale and finally the consumer. At each stage, rising consumer expectations make a responsible supply chain strategy a necessary component of business.

For US-based consumer goods firm Kimberly-Clark, gaining and maintaining transparency over its 35,000 suppliers is an exercise in both brand building and risk-management, according to chief supply chain officer Sandra MacQuillan. Ms MacQuillan leads a team focused on holistic supply chain management, overseeing all aspects of procurement and manufacturing from quality to regulatory, safety and sustainability. "Having a seat at the [executive leadership] table is huge," she says. When her position was created in 2015, "there was a shift in the conversation. Now we talk about transparency in the supply chain as an enabler of business development and growth."

For a consumer-facing brand, there are clear and tangible business benefits to having responsible supply chains. Kleenex, one of Kimberly-Clark's brands, has become synonymous with tissue products the world over. Kimberly-Clark's leading position in this market means that its moves toward greater sustainability resonate throughout the industry. After launching an initiative to procure more wood pulp from sources certified as sustainable by the Forest Stewardship Council, an independent NGO, it increased its share of such raw material from 6% in 2006 to 75% in 2015.

Reasons for responsibility

According to Ms MacQuillan, the company's supply chain responsibility initiatives are at once a manifestation of the company's longstanding culture and are driven by external demand. "Our customers and consumers are looking for this kind of transparency in the supply chain," says Ms MacQuillan. The need to acquire and retain top-quality talent, particularly young workers, is another reason she cites for the firm's supply chain transparency and responsibility practices.

However, consumer requirements and employee preferences are only part of the equation. "Consumers do have an influence, but don't drive a company to become sustainable unless the company wants to go there," she says.

In order to put culture into practice, Kimberly-Clark employs key tools and processes. "You need to look at how the [company] talks about its values and then how to translate those into reality," she says. One of these methods is adherence to the Global Reporting Initiative, an independent organisation that helps companies understand and communicate the impact of businesses on such issues as climate change, human rights and corruption. "We're very proud of what we do in terms of fully complying with the Initiative, which in our industry is one of the most severe and demanding asks for transparency and data," Ms MacQuillan says.

The company has created and retained a sustainability advisory board (SAB) for the past few years, which Ms MacQuillan says is aimed at helping the company translate sustainability into business opportunities. This SAB includes external partners and thought leaders in sustainability, in addition to Kimberly-Clark employees. Kimberly-Clark also benchmarks performance against meeting sustainability targets such as greenhouse gas emissions. "Metrics are crucial to deliver your strategy, so ensuring you have simple, clear metrics to drive the performance and results you want is an essential element of doing business," Ms MacQuillan says.

Supplier relationships

At the heart of the firm's sustainable supply chain mission is its relationships with its vast network of suppliers. "We aim to be a customer of choice for our suppliers and ask them in return to be the supplier of choice for us," says Ms MacQuillan. She outlines three tiers of suppliers that work with Kimberly-Clark: basic, core and strategic, and all are asked to support the firm's mission of sustainability. "Our basic suppliers we expect to be transactional in nature," she says. "Our core suppliers are essential for continued mutual success and play a key role for us in growing and developing our business." Top tier strategic suppliers collaborate with the firm across a variety of business deliverables, of which sustainability is fundamental. "The firm encourages suppliers at all levels to operate sustainably, with more active partnership and collaboration for driving sustainable solutions occurring at the higher tiered levels," she notes.

Collaboration and intellectual property (IP) risk remain delicate areas for any firm attempting to raise its supply chain standards, and Kimberly-Clark is no exception. Ms MacQuillan says that it is possible to strike a balance between transparency and IP protection. "In Kimberly-Clark we've found a way of using the right language and the right metrics to still be as transparent as we need to be, without giving away our intellectual property, trade secrets, or the key strategies that are going to make the difference. I don't think it has to be a barrier to transparency, if you find the right language and the right metrics."

For firms which are concerned about giving too much away to competitors about their supply chains, working with partners like FSC can be a useful means of taking part in industry-wide initiatives to raise standards beyond one's own supply chain, without directly working with competitors.

and increasingly social media is influential. They provide customers with an understanding of where and how social and environmental abuses are occurring and in so doing, offering an incentive for responsibility that is keenly felt by businesses. They also influence the direction of soft and hard regulations being developed by multilateral organisations, governments and stock exchanges. Cristina Tébar Less, head of the OECD's Responsible Business Conduct Unit, points out that the OECD's voluntary guidance on responsible sourcing of minerals, which has influenced regulation in the US and EU, "was heavily demand-driven through political, civil society and regulatory pressure".

But supply chain executives do not readily acknowledge this: we found that just 16% of firms viewed civil society watchdogs as a key influence on their approach to responsible supply chains.[17] Our in-depth discussions with supply chain leaders revealed a much higher degree of concern, particularly with regard to social media. As one advisory board member put it: "Everyone's a whistle-blower now." The scale and pace of supply chain scandals (and financial repercussions) has grown hand-in-hand with globalisation.

For firms mainly supplying other businesses, raising standards can bring access to new corporate customers. "We want to be a partner of choice," says Gerard Manley, chief executive officer of the cocoa business division for agricultural trader Olam International, referring to both supplier and customer relationships. "Because we know that if we're that partner of choice, then our business will become more effective, and our position—our competitive advantage—will actually gain much greater traction." The influence of corporate customers is an important lever, particularly for raising standards among firms which are small or anonymous enough to fall under the radar of civil society watchdogs. For the last few years, Walmart has actively encouraged its major suppliers to include women and minorities on the teams that service Walmart and Sam's Club accounts. The firm has gathered data on the impact of this initiative, which shows a trend towards greater diversity on supplier teams since 2014—with over half of reporting suppliers' executives now being female.

Money talks, but needs to positively influence

Financial stakeholders could do more to support and incentivise supply chain responsibility, and transparency and communication are key. Financial stakeholders hold various levers to compel, support or incentivise companies and their suppliers to ensure responsible conduct. Their potential influence is high but is not yet being fully realised: 27% of survey respondents cited financial institutions/banks as a key influence, and just 20% cited stock exchanges.

Publicly-listed companies are pushed for greater transparency, but still have their hands tied by fiduciary duty and financial short-termism.

These figures respectively rise to 30% and 25% for publicly-listed companies, which

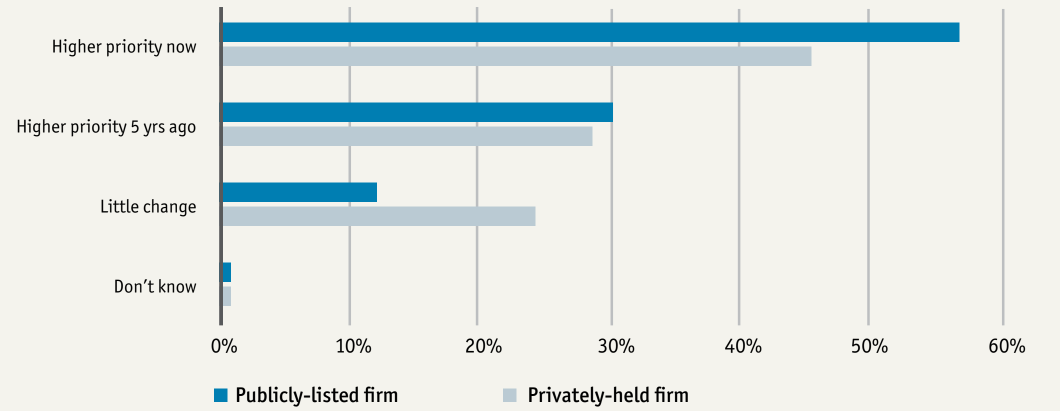
17 This finding was not a result of the bias towards firms based in Asia, where the NGO sector is less developed and media freedom faces more challenges, as the figure was below average for the US and Germany, and above average for China and Singapore.

feel the influence of financial stakeholders more keenly. Reporting and transparency requirements are determined by stock market rules, financial regulations, institutional investors and other shareholders, as well as the intermediaries who gather and share information. This pressure appears to have had some positive effect over the past five years: 57% of listed firms report that responsible supply chains are now a higher priority, compared to 46% of private firms.

Non-financial reporting, prompted in part by the evolving regulatory environment and rising investor interest in sustainability, is driving this positive effect. According to Mr Hu, ASUS's supplier code of conduct has been influenced by a desire for inclusion in key sustainability indices. Among his firm's achievements, he notes: "We've made it to the list of the MSCI Global Sustainability Index for three consecutive years, and were included in the FTSE Emerging Market Sustainability Index in 2016." Investor demand for sustainability reporting is far from being mainstream, however. Johnson Matthey regularly receives questionnaires on its sourcing activities because its product range places it in a category of green investment options, not because mainstream investors are interested.

Not all influence from financial stakeholders is positive. Listed firms also face shareholder pressure to maximise returns on investment over short periods of time, and this can make it a challenge to explain long-term investments required to raise standards of responsible conduct. In a traditional business planning cycle, explains Mr Delay of the Carbon Trust, the longest-term investors such as the extractive industries may consider a five-year horizon. The planning period is more typically one to three years. Some advisory board members expressed frustration at the constraints which financial short-termism imposed, with some describing short-termism as the enemy of responsibility.

Figure 14. Public perception
(% of firms saying responsible supply chains are a higher priority now vs five years ago, by company type)



A key principle driving short-termism is the board's fiduciary duty to shareholders. Richard Howitt, chief executive officer of the International Integrated Reporting Council, an organisation which promotes integrated reporting (incorporating broader disclosure, such as sustainability and governance information, into traditional financial reporting), argues that redefining fiduciary duty is key to enabling more responsible business conduct. "We don't challenge the notion of shareholder primacy," he says. "We are part of a debate challenging the interpretation of fiduciary duty. We accept investor reporting, but aim to redefine it to take a more long-term approach." Given the uncertainties and difficulties of quantifying and predicting the impact of issues such as climate change, or indeed forecasting any numbers beyond a five-year horizon, developing a strong narrative—and persuading financial stakeholders to accept a combination of qualitative and quantitative reporting—is an important aspect of this. Just as sustainability professionals must convince their firms' internal decision-makers of the materiality of responsible supply chain issues, board members face the challenge of making these issues material to financial analysts and investors.

Innovative supplier finance can enable and incentivise responsible conduct.

The financial and non-financial institutions that provide finance to suppliers, many of which are SMEs, can play a significant role in encouraging them to raise standards of responsibility. The International Finance Corporation (IFC) partners with multinationals sourcing from developing countries to do just this. In an innovative programme run by the IFC and sports apparel firm Puma, suppliers are offered more or less expensive finance according to the extent to which they comply with a social, environmental and safety code of conduct. This has had three main impacts on standards: first, Puma's own code of conduct was harmonised with IFC standards. Second, suppliers receive ongoing incentives to do better on responsibility. And third, suppliers benefitted from improved access to finance, which is a key challenge for many SMEs. This can stabilise cash flow, not only for practical purposes such as paying employees on time, but also to survive and develop longer-term partnerships with buyers.

The use of supplier finance as a lever to improve responsible sourcing originated in the international development finance sector, but could be applied much more widely. "What makes us special is that we are the first to do this in Europe," says Frank Waechter, senior head of treasury and insurance for Puma and programme pioneer. "Others only run these programmes in countries where the IFC operates—emerging markets which are not so well-banked. We're the first to extend the programme worldwide, so we brought in a publicly-listed bank which has agreed to use the same system as the IFC." Any financial programmes in support of suppliers must be fast-moving to be of use, Mr Waechter argues. "We can't give a guarantee that each supplier will be doing business with us in five years' time; we need this supply chain finance to be implemented quickly to provide finance and leverage."

As we saw earlier with the case of Walmart, supplier finance can also be targeted at other social goals, such as the empowerment of female entrepreneurs. As with Puma's scheme, this requires innovative thinking, but can make financial sense.

The rules do matter

Firms play down the influence of hard and soft regulations, but the evidence suggests otherwise. Under a third (29%) of firms cited "hard" government regulations as a key influence on their responsible supply chain policies, and a mere 16% credited multilateral organisations, which help set the agenda through "soft" regulations. This finding was sharply questioned by some advisory board members and contradicted by the testimonies of the supply chain leaders we interviewed, many of who mentioned the direct impact of recent regulations and initiatives by bodies such as the ILO, OECD and UN on their supplier codes of conduct.

There was country variation in the results: Chinese firms were most likely to acknowledge government influence (47%), which is unsurprising given the high prevalence of state-owned enterprises in China. Many US firms (36%) also chose this as key influence. By contrast, just 12% of Italian firms viewed government regulation as influential; which may help to explain why Italian firms were also less likely to address most of the responsibility issues posed in the survey.

Hard regulations set by government bodies and stock market regulators, as well as soft regulations (such as voluntary codes and guidance) developed by multilateral entities do exert an important influence, but supply chain executives do not always perceive it. When sustainability and compliance professionals are doing their job well, they pre-empt forthcoming regulations. Mr Hayer of Gap speaks on behalf of switched-on sustainability teams: "If we're waiting for a regulation, we didn't do our job."

Global influence

Regulations and multilateral initiatives in influential consumer economies can have an impact well beyond their home markets, for several reasons. First, a growing number of regulations in Western economies apply to the entire global supply chain of companies operating within their jurisdiction. This trend is likely to accelerate among EU and OECD countries in particular, as the UN's Guiding Principles on Business and Human Rights are incorporated into national legislation. Second, the codes of conduct set by large multinationals—which are influenced by present and anticipated future regulations—are usually applicable throughout their global supply chains.

Even where a Western firm isn't involved, international brands may voluntarily adopt the standards established by Western regulations, in order to enhance their reputation and gain market access. ASUS illustrates this point well. According to Mr Hu, the Taiwanese electronics brand's code of conduct sets targets for reducing the use of conflict minerals (mirroring legislation in the US and EU); specifically confirms that its suppliers do not use child or forced labour (ensuring no prohibitions on imports into the US); and restricts the use of hazardous substances (going above and beyond the EU's relevant directive[18]).

Where little other external pressure exists, regulation (and implementation) comes to the forefront.

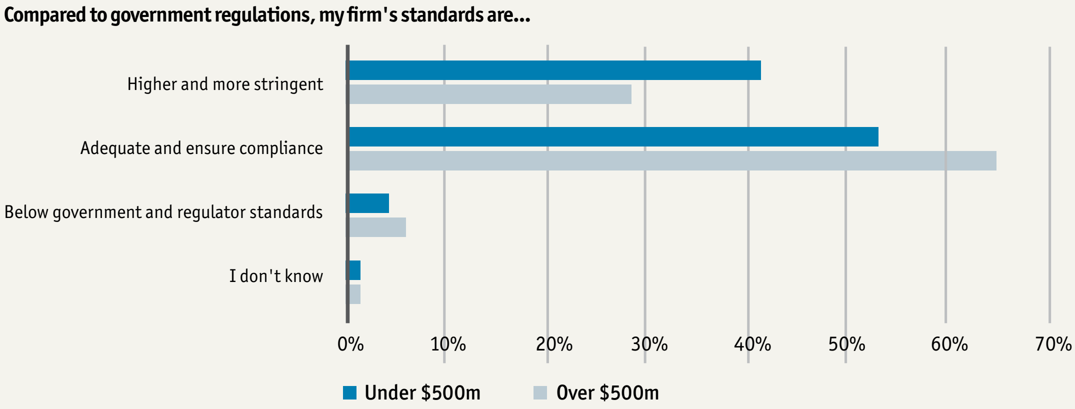
Corporate executives tend to express scepticism about hard regulation, preferring guidance and voluntary industry or company codes. A cynical view is that this is simply because they have to make more effort to raise standards where regulation exists, and our survey does support this view to a degree. But there is a serious argument in favour of persuading and encouraging, rather than forcing. In the view of Mr Delay of the Carbon Trust, regulations work best when they are not overly complex and are aligned with business interests. If companies do not see any benefit in complying, they are likely to respond by paying lip-service or ignoring them altogether. If you rely only on the stick, the burden of enforcement is often too great for governments to cope with (particularly in emerging markets).

In the long term, if a shift towards longer-term financial and strategic planning can be achieved, many large and/or well-run firms may voluntarily act more responsibly. But many firms will always fall through the gaps, and this is where regulation needs to play a role.

Small fry and big fish

Who falls through the gaps? In short, the firms which are less subject to the previously discussed influences. They are not affected by reputational risk related to their own brands, or to the brands of any B2B customers or investors. They are considered too "small fry" for NGOs to divert their limited campaign resources. The most likely example is an SME which is either not plugged into the supply

Figure 15. Regulatory burden
(% of firms giving each answer, by company annual revenue)



18 The European Parliament and the Council of the European Union. 2011. The Restriction of the Use of Certain Hazardous Substances (RoHS) in Electrical and Electronic Equipment Directive (2011/65/EU). 8 Jun 2011. [http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2011:174:0088:0110:EN:PDF].

chain of any multinational, or operates far enough down the chain to avoid scrutiny. Another scenario is a supplier that is so large that the brands buying its products have limited influence over it.

In countries with strong governance, regulations can provide a baseline of acceptable social and environmental standards for these firms. “We do need regulation as well, to keep the laggards in line,” argues Han de Groot, executive director of certification scheme UTZ. “Raising the bar is difficult through legislation, but to ban really bad practice, governments need to take responsibility.” Taking the UK’s Health and Safety at Work Act as an example, from the introduction of the Act in 1974 to 2016, fatal injuries to employees fell by 85%—equating to hundreds of lives saved each year.[19] It is likely that much of this improvement came from smaller companies—local construction outfits, for instance—rather than the market leaders, who were probably consulted on the standards. Our survey supports the view that smaller firms are more likely to do the minimum necessary for compliance than larger firms. Even among larger firms with annual revenues over $500m, the majority opt for compliance rather than going above and beyond.

Where all external influences are weak, there is little alternative to persuasion.

Kenneth Amaeshi of the University of Edinburgh conducts research into how a responsible business culture can be developed among SMEs in Africa. In many of the continent’s economies, weak governance means that even where governments and central banks are starting to address corporate responsibility, as is happening in Nigeria, carrots tend to be more effective than sticks. With more international businesses investing in Africa, awareness of the social and environmental expectations of developed-country consumers and firms is rising. But some domestic firms and governments resent these as externally-imposed values, which threaten economic growth by raising barriers to global value chains. There is also the problem of how to motivate the majority of firms that only serve the local market.

Mr Amaeshi believes that a shift in mindset is needed, and works to persuade local business leaders of the opportunities presented to their own firms and the local economy by responsible business. The concept of socially- and environmentally-responsible business he endorses, dubbed “Africapitalism”, is posited as African companies prioritising African needs, tapping into sentiments of economic nationalism. “If you’re an entrepreneur, [it’s about considering] how can you make money in a way that doesn’t disadvantage Africa?” He also sees an important role for civil society in the absence of hard regulation. “There’s the dimension beyond regulators, those informal governance mechanisms from other actors like NGOs and social media, that companies respond to on a daily basis. That’s made it much harder for companies—anyone can take a picture and upload it, and it becomes a reputational risk.”

19 Health and Safety Executive. 2016. “Historical picture”. [http://www.hse.gov.uk/statistics/history/index.htm].

3 MORE THAN WORDS: IMPLEMENTATION AND MONITORING

This section outlines best practice in three areas of responsible supply chain management: i) internal organisation and management; ii) engaging with suppliers; and iii) engaging with third parties. While there is no one single model that works best across all industries and company types, we draw out some common elements that are widely applicable.

i. Internal organisation and management

> "The power structure of the company can shift the overall culture."
>
> *Advisory board member (anonymous)*

Where a core business executive is in charge of supply chain responsibility, more gets done. Where the person with ultimate responsibility for environmental and social standards was in overall leadership, operations, finance or risk, firms were more likely to address each key social and environmental issue than where a CSR, marketing/public relations or legal executive was in charge. They were also more likely to have recently increased the priority level of supply chain responsibility, and to have concrete measures in place to ensure suppliers complied with their requirements.

It is by no means always a weakness to have a sustainability or legal professional in charge of overseeing supply chain responsibility, though CSR has developed an unfortunate association with "greenwashing". The important point is the degree of influence they have over business decisions—which relates both to their capacity to speak the language of business risks and benefits, and to their level of seniority compared to key decision-makers.

It is encouraging that core business executives are in charge of responsible supply chains in a majority (62%) of firms. Yet 16% of firms still place this vital issue in the marketing or PR function, implying a superficial approach. The economy with the strongest profile is the US, where a full 45% give top company leaders this responsibility, 33% assign it to supply chain or operations managers, and just 5% put it under marketing or PR.

Summary

LEADERS	LAGGARDS
The person in charge of the supply chain: • Has an influence on business strategy, reporting directly to the C-suite/board. • Is personally accountable (through KPIs) for social and environmental standards in the supply chain. • Focuses on value creation and brand protection. • Can communicate the link between social and environmental issues and financial risks/opportunities. • Acts as a bridge between different business functions. • Can impact operational decisions beyond their own function.	**The person in charge of supply chains:** • Is a mid-level manager, with little influence on overall business strategy. • Has KPIs limited to transactional matters such as cost, quality and time. • Takes a transactional approach to procurement. • Views CSR as a separate function and a cost centre. • Has little impact on product development, manufacturing or commercialisation decisions.
The responsibility function: • Is embedded into, or has frequent contact with, other business functions. • Is staffed by people with a mix of sustainability and business expertise—who understand the concerns of different stakeholders and can make social and environmental issues material to each.	**The responsibility function:** • Acts as a cottage industry, and communication with/ability to impact other business functions is weak. • Is staffed by people who understand sustainability well but cannot translate this into business risks and opportunities.

Figure 16. Tough job
(% of firms addressing each issue, by function of person with ultimate responsibility for social & environmental standards in supply chains)

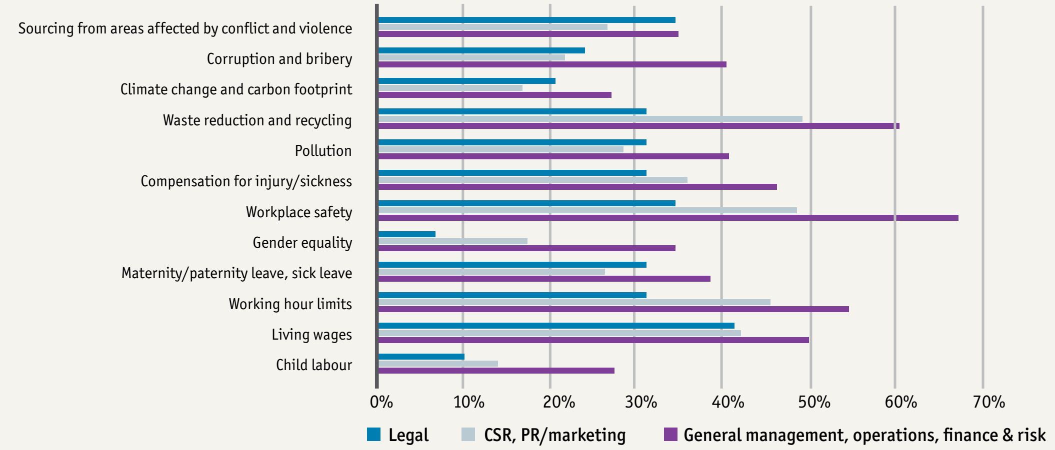


Figure 17. Position of power
(% of firms giving each answer, by function of person with ultimate responsibility for social & environmental standards in supply chains)

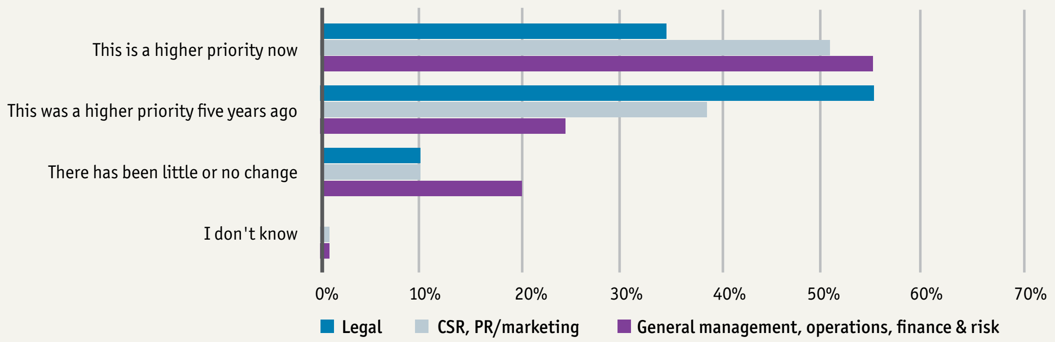
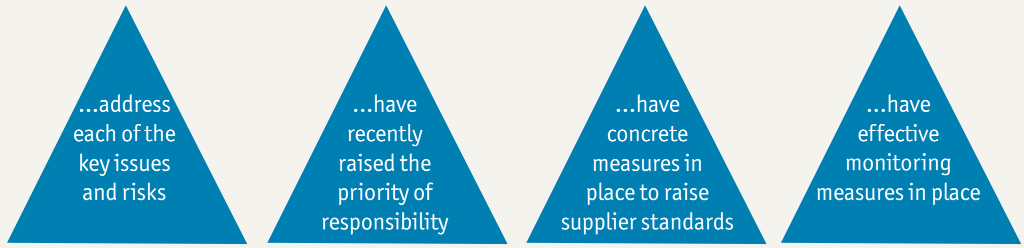
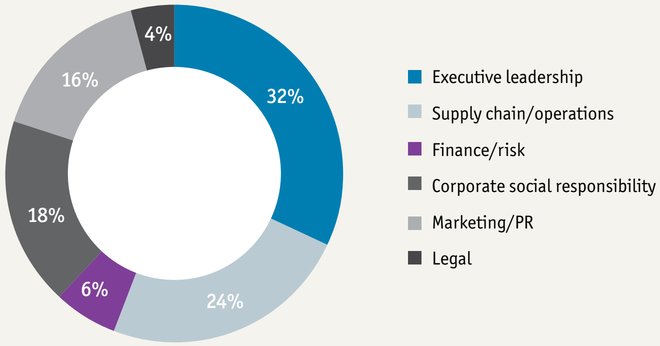


Figure 18. Where a core business executive is in charge of responsible supply chains, a firm is more likely to...



...than when this is the remit of an executive from CSR or legal.

Figure 19. Right to the top
(% of firms saying the following functions hold ultimate responsibility for responsible supply chains)



The role of the supply chain leader in large firms has expanded in scope and risen in prominence in tandem with the growing complexity—and risks—of global supply chains. There has been an ongoing transition in the role of a supply chain leader over the past few years. This is reflected in the shift in terminology among leading firms, from "supply chains" to "value chains" and "brand protection", according to Jonathan Ivelaw-Chapman, chief executive officer of Sedex. When a supply chain leader becomes responsible not just for sourcing but for mitigating risks and creating opportunities related to environmental and social issues, their role is elevated. This shift has occurred recently in several of the multinational firms we spoke to. Jürgen Braunstetter, senior vice-president of automotive supply chain management for Continental, was the first supply chain manager to report directly to the CEO when he took up the position in 2011. Likewise, Sandra MacQuillan was the first person to take up the C-suite role of chief supply chain officer in Kimberly-Clark. Our survey found that in two-thirds of firms, the person in charge of supply chain responsibility reported directly to the C-suite or board—an encouraging sign that this shift is happening.

A rebalancing of power is often necessary to raise the impact of supply chain and sustainability professionals on core business decisions. Leading firms have taken moves to equalise the influence on business strategy and operational decisions of the functions traditionally viewed as the heart of the business, and functions formerly viewed as serving the core business such as procurement, legal and sustainability. In retail, for instance, merchandising, design and marketing are typically viewed as the most important functions, but must increasingly communicate directly with, and take into account the concerns of, those in the organisation who understand supply chain risks and opportunities. "We're continuing to improve the integration of sustainability work deeper into the business, particularly to where product decisions are made," says Mr Hayer of Gap. Chemicals firm Johnson Matthey has undergone a similar shift (see box).

The science of sustainability: a case study of Johnson Matthey

The chemicals industry does not usually fall into the public spotlight when it comes to supply chain issues. While firms in industries like apparel and fast-moving consumer goods have stepped up their public-relations efforts to address supply chain slip-ups, chemicals companies still largely operate behind the scenes.

Nevertheless, the challenges that chemicals companies face are myriad, ranging from the sourcing of raw materials which can be potentially risky in their extraction processes; the handling of materials during processing and manufacturing; and the potential impact on the environment and public health of those materials when used in finished goods.

Giving procurement a seat at the table

Britain's Johnson Matthey, which produces a range of products from automotive catalysts to active pharmaceutical ingredients, has been taking multiple steps to address these challenges. It is viewed as an organisation which not only enhances the sustainability aspects of its customers, but also effectively controls for environmental social and ethical risks in its own supply chains. Rather than just paying lip-service to sustainability and social responsibility, the company has altered the way its teams are organised, how they interact and their performance criteria to ensure that sustainable supply chain issues are given due consideration.

The company now actively attempts to integrate a mindset around sustainability more deeply into company processes. That began with engaging the scientists that hold much of the decision-making power around product development at Johnson Matthey. The relationship between the supply chain and product development functions has changed, with the former moving from an advisory capacity to being an active participator in the product development process. Scientists are advised of high-risk raw materials from a sustainable supply chain perspective. If the risks are significant, alternative materials and options are sought. The role of supply chain is not to interfere with the scientific process, but to act as partners to ensure all raw material risks are considered.

Another significant change in structure entailed the risk and sustainability function reporting directly to supply chain, rather than just to manufacturing—meaning that risk and sustainability professionals now scrutinise external suppliers in addition to internal operations.

Integrating supply chain responsibility into product development

A key aspect of the work of Sarah Watt, Johnson Matthey's risk and sustainability manager, is looking at the risks in the supply chain around labour, health, safety and environmental issues. Sustainability considerations are embedded into early discussions both internally and with potential new suppliers. This gives a wider view of supply chain risk, meaning that the cheapest raw material is not always the right option in terms of doing the right thing and ensuring supply chain security.

In order to assess a supplier's sustainability credentials, Johnson Matthey applies an internally-developed set of criteria. These differ from those formulated by third parties, which are often more tailored to other industries, according to Ms Watt. "That can sometimes be quite hard to explain because it's not under a badge which is well-known," she says.

Working closely with suppliers

Managing the risks in the firm's supply chain means focussing on a dynamic environment where the risks are constantly changing. This is a challenge because the issues are sometimes hidden. "We cannot just focus on cost, quality and delivery. The plethora of risk is much broader than that, and we need to ensure that we do the right thing in terms of identifying and managing these risks," Ms Watt says.

Suppliers that fall short may be ousted, though Ms Watt notes that it can be difficult to find an effective replacement. "Our initial approach is to work with our supply chain partners to help them improve, however from time to time this may not be possible. The challenge for Johnson Matthey and our scientists is that there are only a small number of companies globally that make the materials that we're interested in," she says.

This leads to a collaborative approach, including learning from outstanding suppliers as well as working with underperforming suppliers to improve performance. New suppliers are subject to audits, a process that Ms Watt says has recently become more thorough. "Four years ago, we did this type of work in a very light-touch way, and we recognised that we needed to make improvements," she says. When problems are discovered, they are reported up the chain as far as is necessary to resolve them. A special committee deals with major issues, and the chief executive officer and board become involved in the most serious cases.

Despite these improvements, there are still a number of challenges. Although this programme has been very successful in one sector, the next challenge is to roll this out across the group. This means that increased governance and more robust data management systems are needed to ensure continued effectiveness. Another change is more intrinsic to the chemical industry itself—how to balance the demand for closer collaboration on supply chain issues, while effectively managing the audit burden on suppliers, costs of audit and the intellectual property considerations when speaking across industry on common areas of concern.

The CSR function must "infiltrate" core business departments. The changing role of the supply chain leader is part of a dispersal of the corporate responsibility function into other business functions. There will always be a role for experts who can dedicate time and resources to understanding the social and environmental risks a firm faces—but CSR should not be a cottage industry. The professionals in this role must work alongside, understand the concerns of, and speak the language of operational and financial business functions. Recognising this, some leading firms are diversifying the candidates they recruit into responsibility roles, so that existing cohorts of natural and social scientists are being joined by people with business and financial experience.

People developing and manufacturing products need to understand the impact of their decisions on the people and environments affected by their supply chains. Richard Locke of Brown University explains that there is often not enough awareness of the social and environmental consequences of the decisions made at corporate headquarters. The choice of materials used in a product's design and decisions on required lead times, for instance, can make it significantly easier or harder to maintain responsible supply chains.

ii. Engaging with suppliers

Supplier standards should be cascaded throughout a supply chain, but a majority of firms only apply standards to their direct suppliers. Slightly over half of firms require social and environmental standards of their direct suppliers only, whereas 42% try to enforce them beyond the first tier. The challenges of setting and enforcing standards end-to-end in a supply chain are great, particularly in the case of very large multinational firms. Olam sources from around 4m smallholder farms, for instance.

Steps can be taken to cascade expectations down the chain, however. Suppliers at each level can be made responsible for writing standards into the contracts of their own suppliers, and be required to monitor them. Stephen Cawley, head of sustainability and responsible sourcing for UK retailer John Lewis, describes his firm's approach: "Suppliers are required to establish management systems for implementing the Responsible Sourcing Code of Practice and maintain records demonstrating compliance. It is important that their workers and those in their supply chains understand their rights."

Systems are always more effective when all participants can see their value, so another measure some firms take is to educate their suppliers in the benefits to productivity and staff retention of more responsible management practices. Third parties can also assist firms with end-to-end supply chains standards and monitoring.

Firms must be willing to penalise under-performing suppliers—though positive incentives are more popular. Nearly three in ten firms reward suppliers who comply with their code of conduct or show improvement; fewer (21%) take steps to penalise suppliers who continuously or seriously under-perform.

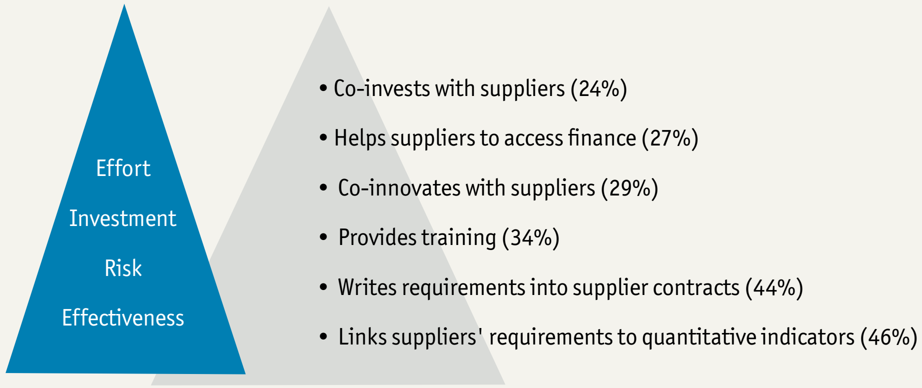
Supplier codes of conduct: communication, support and incentives

LEADERS	LAGGARDS
A supplier code of conduct applies to all tiers of the supply chain, with responsibilities cascaded down the chain.	There is no supplier code of conduct, or it only applies to direct suppliers.
Expectations of responsible supplier conduct are quantified, communicated clearly and written into contracts.	Expectations are vague and not legally binding.
Various forms of support are provided to help suppliers progress towards and exceed social and environmental targets.	No support is offered to suppliers.
Suppliers are rewarded according to their performance on social and environmental targets.	There is no incentive for suppliers to raise standards.
Suppliers are penalised for failing to comply, and let go if failures are serious or ongoing.	There is no penalty for non-compliance.

One reason for this is the negative impact on operations of cutting an under-performing supplier. Some firms have little choice of suppliers; others are smaller than their suppliers and can exert relatively little influence on them. But many firms also take the attitude that there is little benefit to communities or the environment in simply avoiding suppliers who are struggling to meet social and environmental standards, so suppliers should instead be persuaded and supported to up their game. This makes engagement with and commitment to suppliers key elements of best practice.

To build responsible supply chains, longer-term partnerships involving closer engagement are preferable—but still less common than a transactional approach. The infographic below shows the degree to which businesses engage with suppliers with a view to building responsible supply chains. Move up the pyramid, you reach more sophisticated measures used by market leaders—unsurprisingly, fewer firms have adopted these measures. Some leading firms use incentive systems, under which firms which demonstrate better compliance gain access to benefits such as co-investment and a deeper, more committed partnership.

Figure 20. Works well with others
(% of firms doing each of the following)



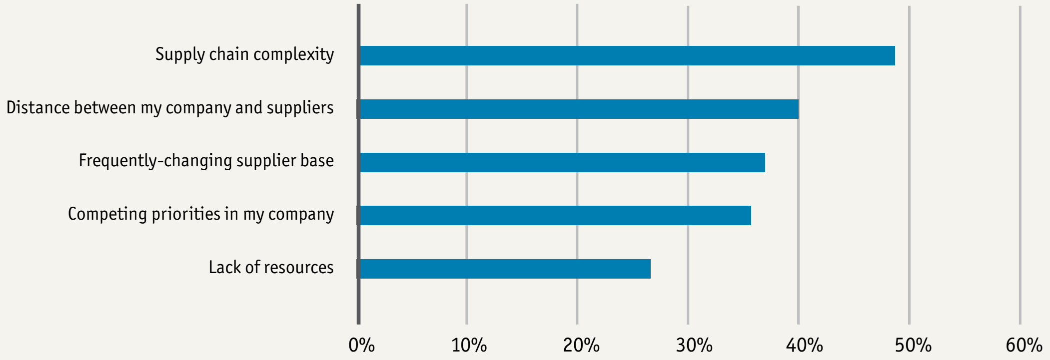
Monitoring suppliers

Leaders	Laggards
There is a system of regular auditing, including unannounced audits.	There are no/infrequent on-site audits, and audits are all announced in advance.
Suppliers are viewed as partners, and long-term relationships are preferred (where practical).	The supplier-buyer relationship is purely transactional and often short-term.
The supplier base is rationalised—seeking stronger relationships with fewer suppliers.	As there is minimal engagement with or investment in suppliers, the number of suppliers is immaterial.

Only half of firms carry out regular on-site audits of their suppliers. The figure is slightly higher for the raw materials sector (54%) and manufacturing (51%) than for retail and distribution (43%), indicating that responsibility for inspections tends to be pushed further down the value chain. China-based firms were most likely to carry out audits (68%).

Know your partners: a smaller supplier base allows for greater engagement and easier monitoring. Supply chain complexity was the top

Figure 21. Excuses, excuses
(% of firms naming each of the following as the main challenge to monitoring supply chains)



problem affecting monitoring, according to the survey. Following a period of fragmentation and dispersal of global supply chains in the pursuit of lower prices, some leading firms are now reversing this trend with a view to increased responsibility. Both Gap and Continental have introduced supplier rationalisation programmes. "We've reduced the total number of factories we work with from over 2,000 six years ago to less than 900 today," says Gap's Mr Hayer. "We think that's incredibly important when any firm is trying to improve partnerships between buyer and supplier." Mr Braunstetter of Continental emphasises the efficiency gains that also come from reducing the supplier base. "Fewer suppliers means less effort in supplier handling," he says. With fewer suppliers, it is more feasible for firms to engage more closely with each, gaining a better understanding of risks and opportunities.

iii. Engaging with third parties

"Supply chains are very complex, and there are many inter-related issues in making them sustainable and successful. So we have to make sure that we do this through alliances."

Gerard A Manley, Olam

"The butcher checking his own meat is probably less credible."

Han de Groot, UTZ

Figure 22. Share and share alike
(% firms doing each of the following)

Third-party support for responsible supply chains

Who?

- **Industry bodies**, such as the Electronic Industry Citizenship Coalition (EICC) and the Automotive Industry Action Group (AIAG), based on consensus among leading industry players.
- **Independent certification schemes**, such as FSC, Fairtrade and UTZ, the standards of which are set with varying degrees of independence from and consultation with industry.
- **Programmes under multilateral organisations**, such as the Better Work Programme run in partnership between the IFC and the ILO.

Why use a third-party programme?

- **Raise standards more broadly in the supplier base** without working directly with competitors.
- **Bring in external expertise** and avoid re-inventing the wheel.
- **Share the burden** of keeping up with evolving expectations, supply chain mapping and monitoring.
- **Reduce risk of a scandal** by working with the watchdogs.
- **Gain credibility** from an objective external partner.

One firm alone—even a very large one—has a limited effect on the overall supplier base. Working with third parties holds more potential to make responsible supply chains mainstream. "It's not just individual supply chains but the whole sector that has a sustainability problem," says Mr de Groot of UTZ. "Whether you're big or small you can't resolve this on your own, as some things are so endemic that you really need to work together to bring about change." Many firms change suppliers frequently (around four in ten cite this as a key problem for monitoring), meaning that if efforts towards improving standards are only directed towards existing suppliers, the work may need to start all over again each time there is a change. Cooperation among industry participants can ensure that certain basic standards are exempt from the battle to gain a cost advantage, making it less of a commercial risk for individual firms to enforce a responsible code of conduct.

With most firms reluctant to cooperate directly with other firms on supplier standards, third parties can act as brokers. Just 27% of firms are willing to cooperate with non-competitor firms, and even fewer (23%) are willing to cooperate with competitors to share the task of raising supplier standards. Many firms are nervous about the transparency required for external partnerships, particularly where they consider there to be a risk to their competitive advantage and intellectual property. Ms MacQuillan of Kimberly-Clark expresses cautious support for transparency. "Declaring how you make a product can give away a secret to success. Particularly in some parts of the world, we have to carefully guard our IP. Where that's not an issue, you should be as transparent as you can."

This is where third parties can play a useful role, creating systems for industry-wide standards without requiring direct information-sharing among competitors. A much higher proportion of firms (42%) participates in third-party certification schemes.

Third parties can reduce the difficulties presented by supply chain complexity. Supply chain standards are a moving target, and it can be resource-intensive for a firm to stay up-to-date with the risks and requirements of multiple sourcing locations. It makes sense to share this workload with specialist third parties, perhaps also dividing the cost between industry participants. "One of the dreams of the supply chain and sustainability departments is to get an industry standard, so each company doesn't have to do the work again and again," says Frank Waechter of Puma. John Lewis has joined the Fast Forward programme, which supports UK retailers on various labour rights issues including compliance with the Modern Slavery Act. Expert third parties can also ensure better outcomes: Gap has found that factories monitored by the Better Work Programme (run by the ILO and IFC) were 50% more likely to show improved auditing scores over a two-year period than those which were not.

Collaboration between competitors over standards can address power imbalances where suppliers are larger than buyers. Firms at the top of the supply chain tend to have more public brands than the companies from which they source, and as previously discussed they can have an important impact on their suppliers' responsible conduct. But in some industries, such as certain types of electronic goods and textiles, the suppliers can be too large for the buyers to influence individually. Collaboration among competitors is one way to tip the balance of power in favour of the brands, allowing them to assert control over reputational risks.

External monitoring should support, not replace, internal checks. When it comes to deciding between in-house and external monitoring of suppliers, there is no infallible system. "It tends to be the case that in markets where risk is highest, it's harder to find a reputable third party," says Dennis Cheong, vice-president of lubricants global supply chain at Shell. "So we do a lot of due diligence and assessment ourselves." In-house audits can have benefits in a complex or niche industry, and can also be a useful way of getting to know your suppliers.

The UTZ certification scheme requires both internal and external monitoring. "Internal monitoring is in part to support the external monitoring," says Mr de Groot, "but I can't stress enough that it is also very important to improvements on the farm. This is a continuous process of improvement: doing more with less, doing smart farming, being more sustainable; and training people in management practices of continuous improvement. The internal monitoring system is very important to bringing about real change."

CONCLUSION: GOING MAINSTREAM? BUILDING THE BUSINESS CASE FOR RESPONSIBLE SUPPLY CHAINS

The corporate world is a long way yet from treating responsible supply chains as a mainstream way of doing business, but that is the aim. Some sectors and issues will get there faster, driven by undeniable imperatives such as potential loss of crops to climate change. Where the change must be driven by consumer expectations and government regulations, progress may take longer—especially where civil society is less free and active in highlighting issues—and will suffer setbacks when economies are struggling. A cultural shift in the financial sector to broader and longer-term interpretations of risk and fiduciary duty could accelerate progress significantly. Two things could drive this: either government regulations, or the emergence of robust data showing that firms which adopt more holistic and long-term definitions of value creation and risk also perform better on traditional financial indicators.

When it comes to corporate behaviour, some positive signs emerged from our research. Overall, a small majority of firms have increased their focus on supply chain responsibility in the past five years. Two-thirds of firms now place ultimate responsibility for this topic in the hands of someone either on, or reporting directly to, the board, and leading firms anecdotally appear to be doing more to ensure that those in charge of supply chain responsibility have more impact on company strategy and operations. Nearly half of firms have begun writing requirements into supplier contracts and setting quantitative KPIs related to responsibility, even if fewer offer active support such as training or access to investment, and half conduct regular on-site audits of their suppliers.

It is also encouraging that progress is not confined to advanced Western economies. Chinese firms reported the greatest increase in the degree of priority attached to responsible supply chains in the last five years, and the impact of evolving societal expectations is illustrated by the finding that 70% of firms in China view customers as a top influence on their approach to responsible supply chains. Government policy and regulations—driven by rising middle-class expectations of corporate behaviour—are also having an impact in China.

Rapid globalisation over the past few decades has generated extremely long and dispersed supply chains, and risks have proliferated hand-in-hand with their complexity. But some of the solutions can also be found in globalisation. Firms which are subject to well-developed regulatory frameworks in advanced economies increasingly carry standards around the world to less-developed jurisdictions. As more countries implement the UN Guiding Principles on Business and Human Rights, for instance, it should become easier for victims of irresponsible corporate conduct anywhere in the world to seek legal redress in the corporation's home jurisdiction. Leading firms in East Asia, a region which is tightly bound into global supply chains, are already adapting their own supplier codes of conduct to mirror regulatory requirements in Western markets, to safeguard their market access.

Nonetheless, some leading firms are now acknowledging that it makes sense to rationalise the supplier base in order to make it a less daunting task to understand and address social and environmental risks. Digital technologies will make supply chain mapping and risk assessment on scale easier in the future, but there is no substitute for boots on the ground—and leaders on this topic are going beyond monitoring, to supporting and co-investing with suppliers.

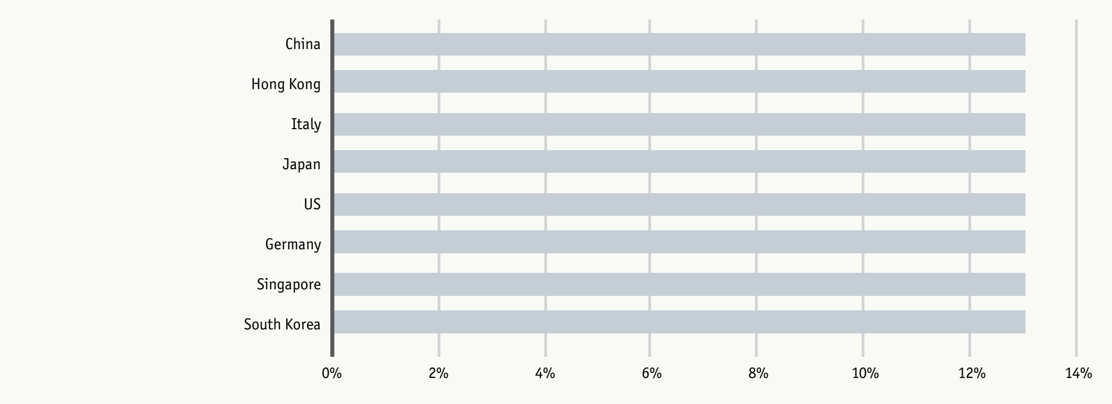
This is a critical juncture in the history of globalisation. Firms from leading advanced economies such as the US and UK have been among the greatest beneficiaries of globalisation, and have until recently pushed their governments to be among its most ardent advocates. Yet now, with advanced economies struggling to regain momentum in the decade since the global financial crisis, anti-globalisation sentiment is rising on both the left and right of the political spectrum—and not just in the Anglo-Saxon economies, but more widely in Europe and other parts of the world. In some Asian markets, anti-globalisation sentiment is dovetailing with political movements concerned with class and generational disparities. Seeking relative advantage is a sound business strategy, but if this is achieved by a race to the bottom for social and environmental standards, the young people missing out on jobs in locations where standards are acceptable—precisely because firms do not want to pay for acceptable standards—will continue to vent their discontent through more extreme political choices.

The onus is on businesses to demonstrate that they can be responsible global citizens. People are more connected than ever before, and capable of instantly undermining a finely-worded sustainability report with a damning video posted on social media. Even without a media scandal, excessive resource depletion and climate change impact will financially damage a growing number of firms in coming decades. Some will need to entirely re-think their business model in order to achieve sustainability—and would do well to pre-empt, rather than react to, this eventuality. “If you look at the best companies that have survived over many decades, at some point they will have made some big bets [on necessary change],” says Mr Delay of the Carbon Trust. In the coming years, more firms will need to consider whether their current business models are aligned with the needs of the societies and environments in which they operate. The financial sector must support, not obstruct, the shift to a responsible business culture.

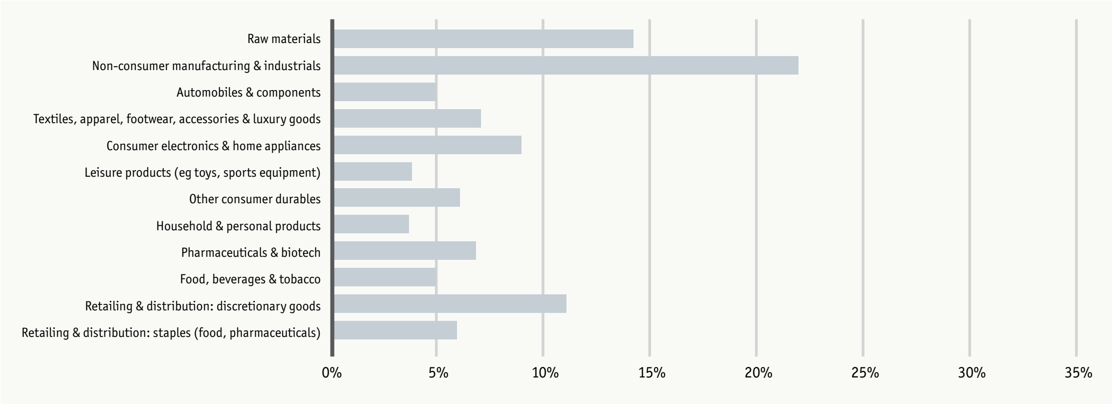
A generational shift may be needed to make responsible supply chains mainstream. “I think awareness is growing, but not as fast as you’d want it to be,” observes Mr Amaeshi. “This is typical of large-scale social change. [Today’s business leaders] went to business school or were socialised in an era where sustainability issues were not at the forefront, so they have learnt a particular way of doing things, and it’ll take time for that to change.” Most experts believe that businesses will continue to move in the right direction, however. Mr de Groot sums up the sentiment: “This is not a matter of choice any more: consumers expect it. It is a matter of not being left behind.”

APPENDIX: SURVEY RESULTS

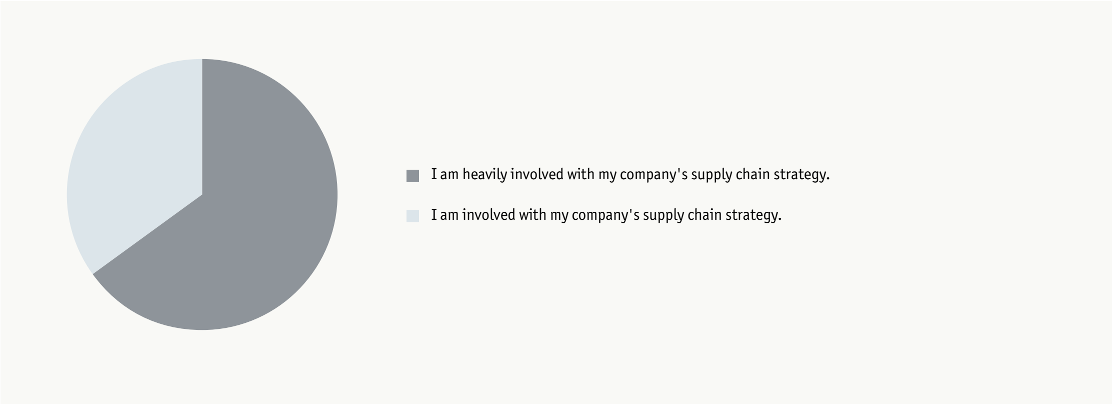
A1. Where is your organisation headquartered?



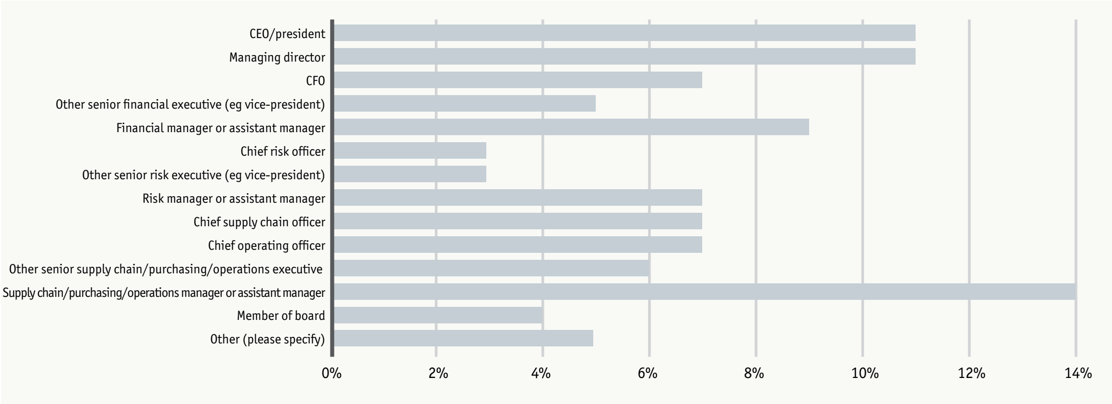
A2. What is your primary industry?



A3. How involved are you with your company’s overall supply chain strategy?



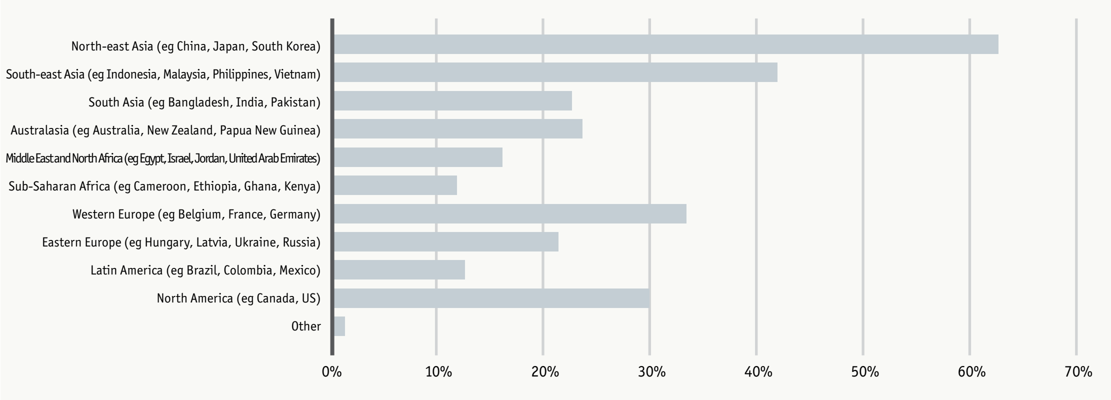
A4. Which of the following best describes your title?



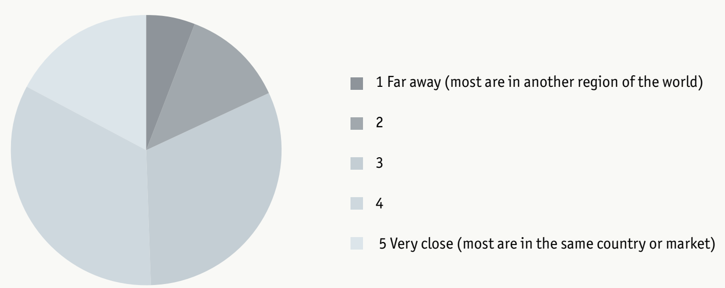
A5. What are your organisation's global annual revenues in US dollars?

A6. Which of the following best describes your business?

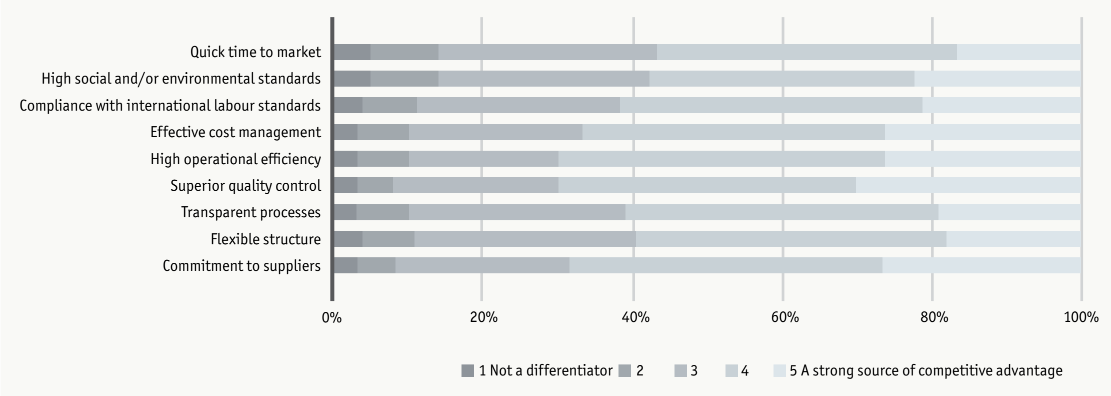
A7. In which of the following regions are your suppliers located?



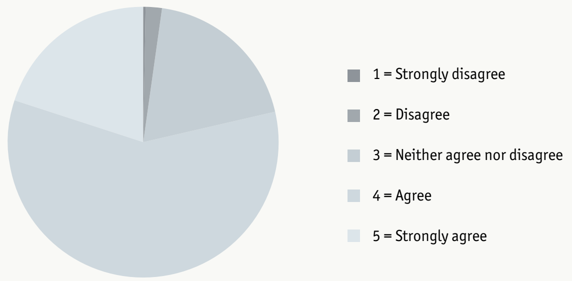
A8. Thinking of where your suppliers are based and where your customers are based, how close are your suppliers to your customers?



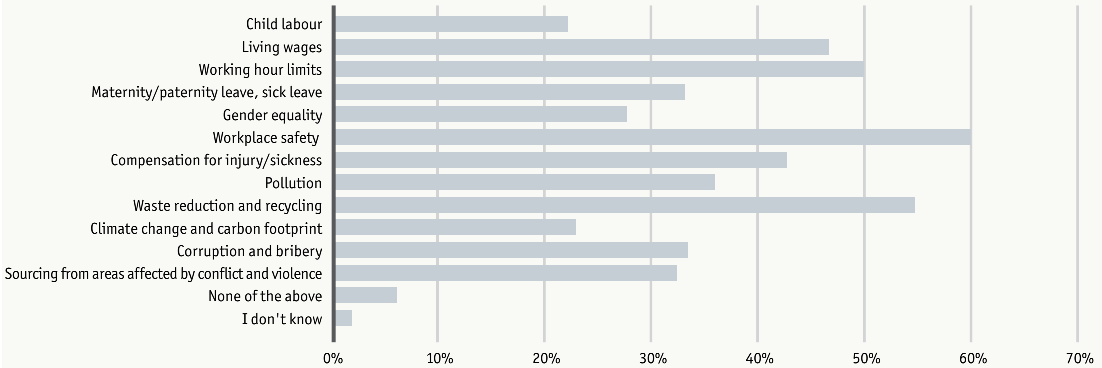
A9. Thinking of what differentiates your supply chains from those of your competitors: please rate on a scale of 1 to 5, where 1 = Not a differentiator and 5 = A strong source of competitive advantage



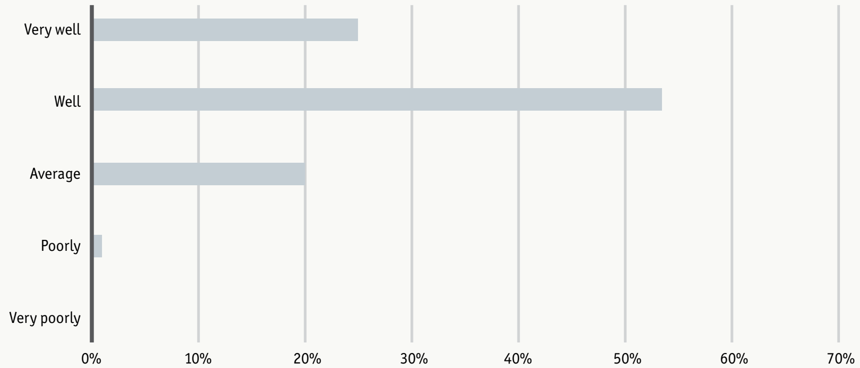
B1. To what extent do you agree with the following statement: my company has a responsible supply chain



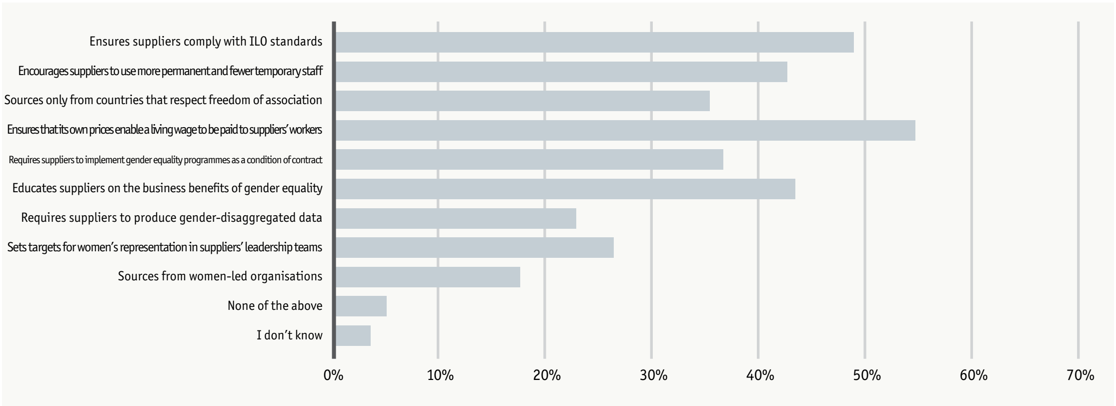
B2. Which of the following issues does your company address in its supply chain management?



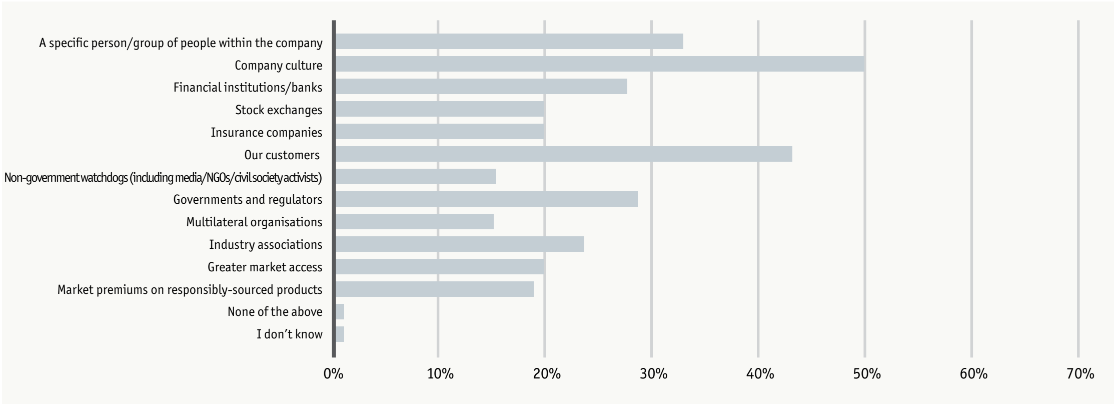
B3. In your view, how well does your company address these issues in its supply chain?



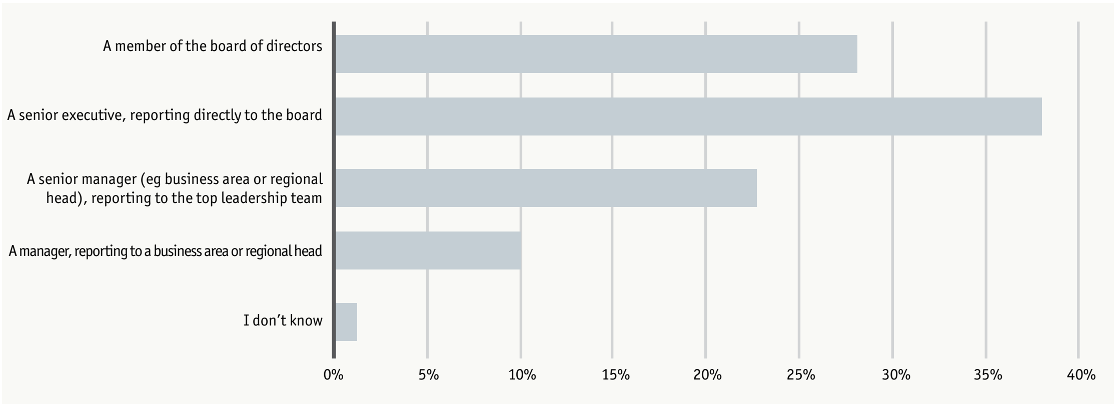
B3b. Which of the following does your company do to ensure gender equality in its supply chains?



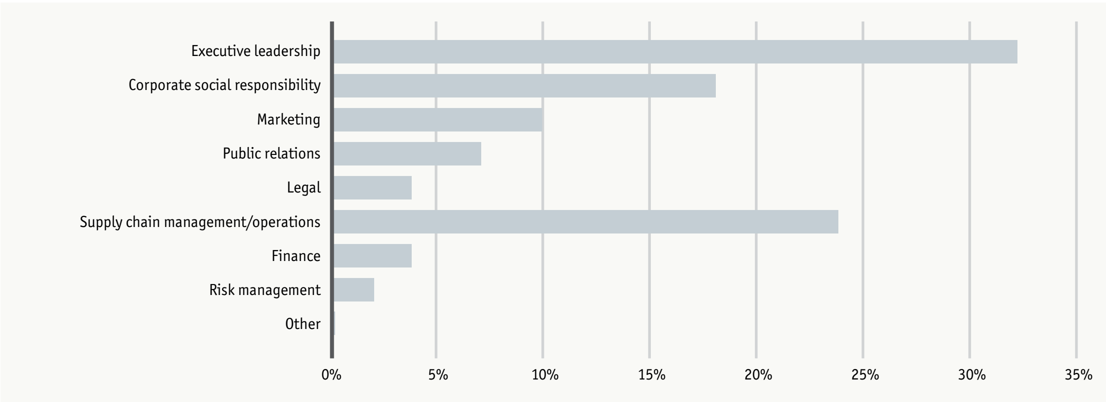
B4. Which of the factors below have a significant influence on your company's approach to responsible supply chains?



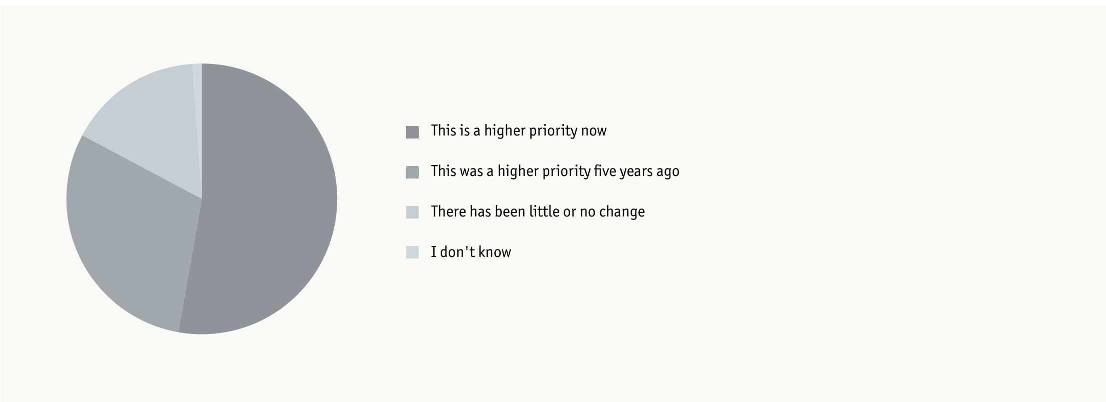
B5. Who in your company has ultimate responsibility for making sure that its supply chains are responsible? B5a. Please select one answer that best describes their level of seniority:



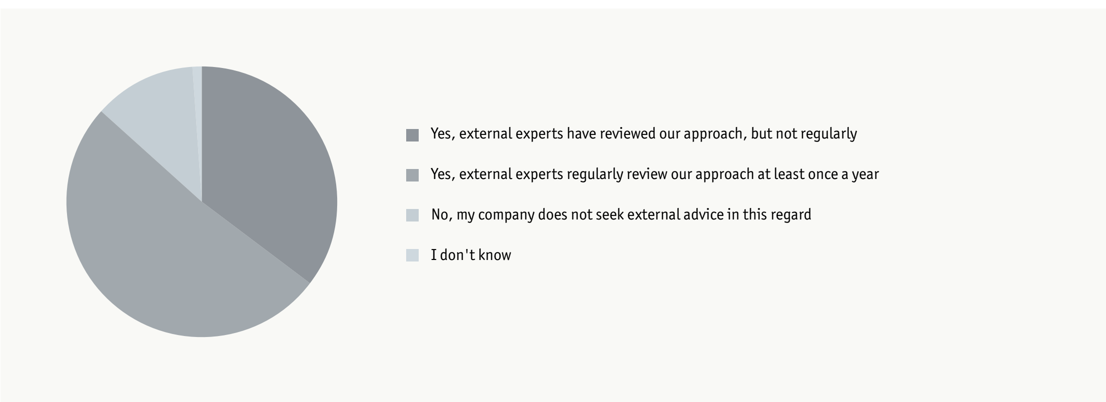
B5. Who in your company has ultimate responsibility for making sure that its supply chains are responsible? B5b. Please select one answer that best describes their job function:



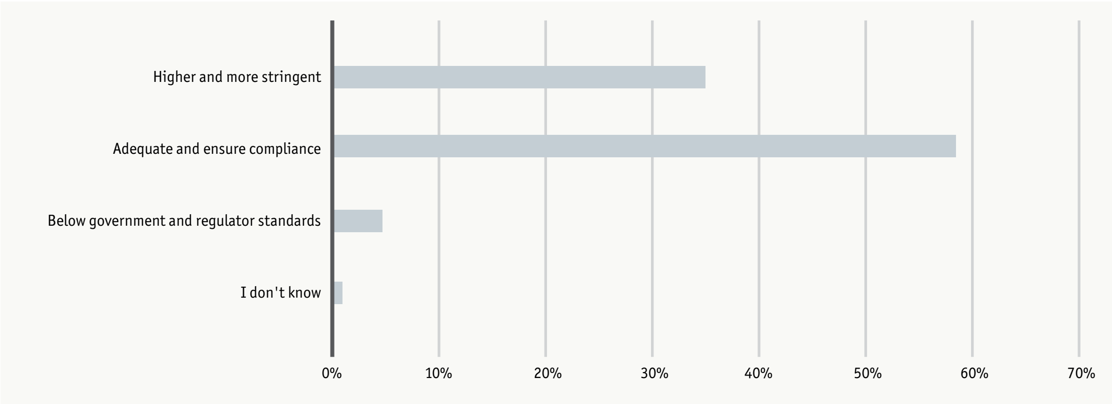
B6. Considering how much importance your company places on ensuring its supply chains are responsible now, how has this changed in the past five years?



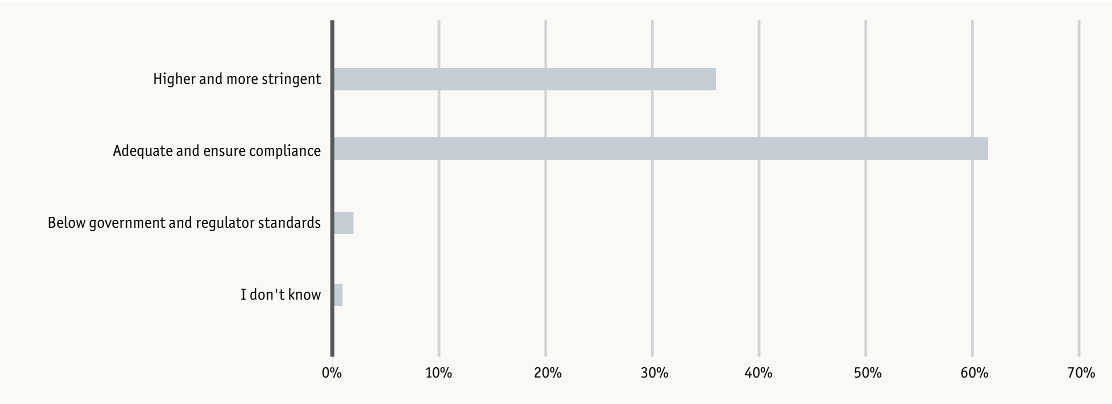
B7. Thinking of how your company forms and reviews its approach to responsible supply chains, does your company seek external advice?



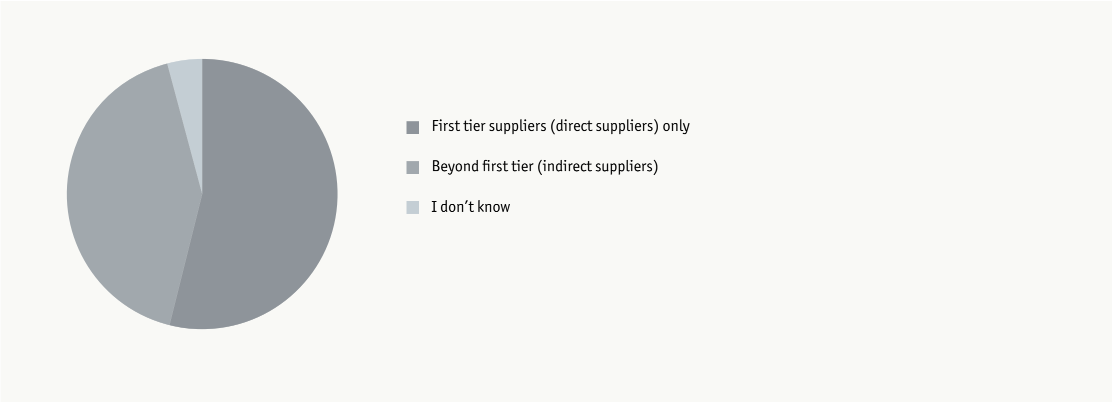
B8a. With regard to government regulations, my company's standards are:



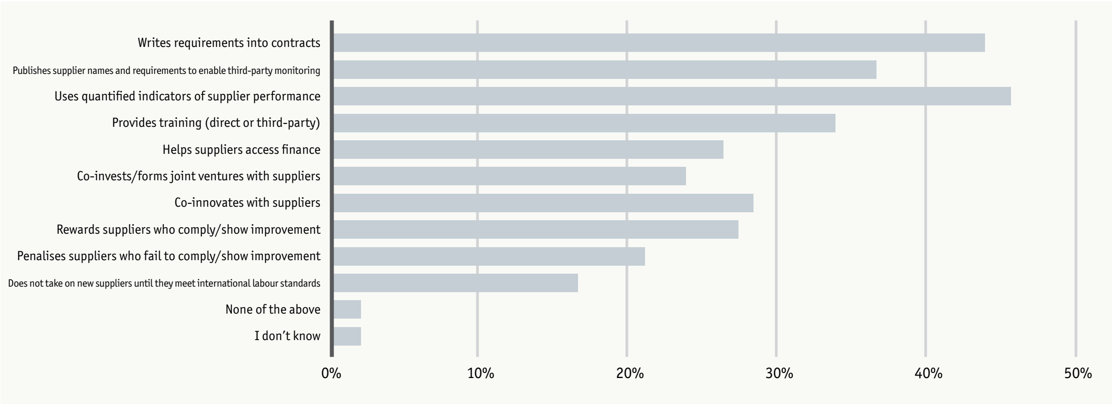
B8b. With regard to industry certification schemes, my company's standards are:



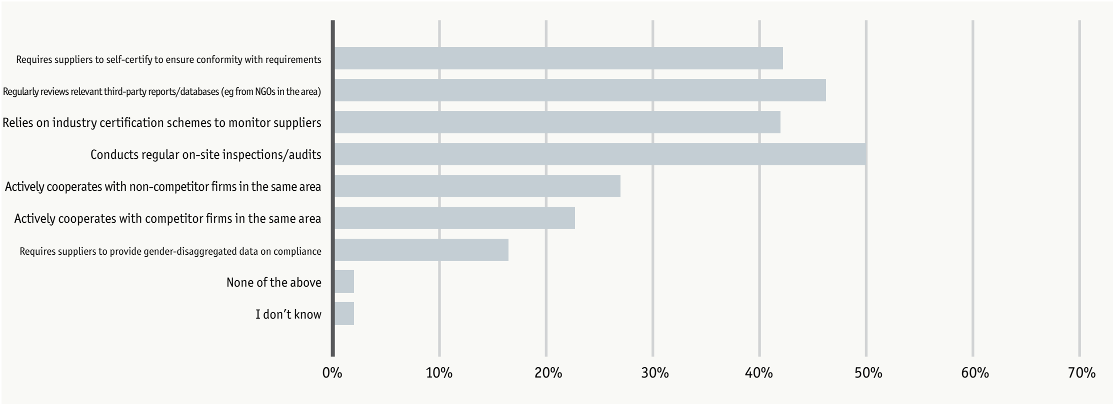
C1. Thinking of the responsible supply chain standards that your company sets, how far along the supply chain are these enforced?



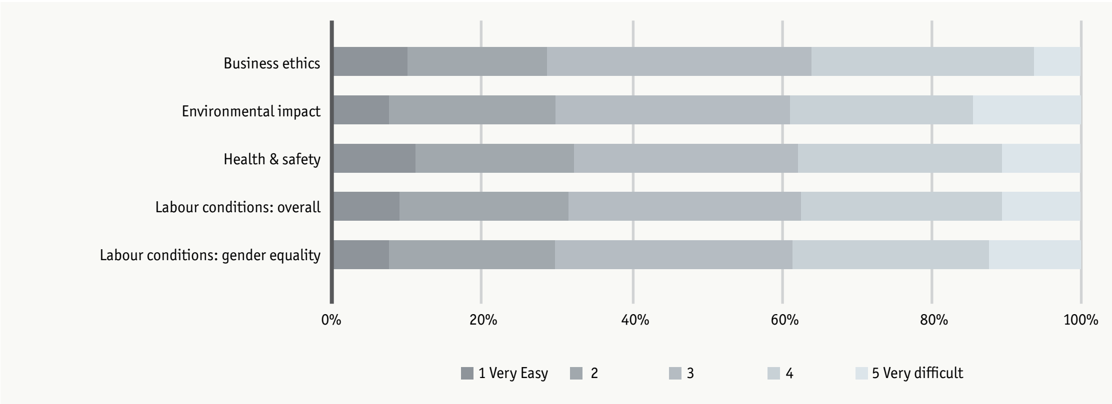
C2. Thinking of how your company engages with suppliers to ensure they comply with your responsible supply chain standards, which of the following does it do?



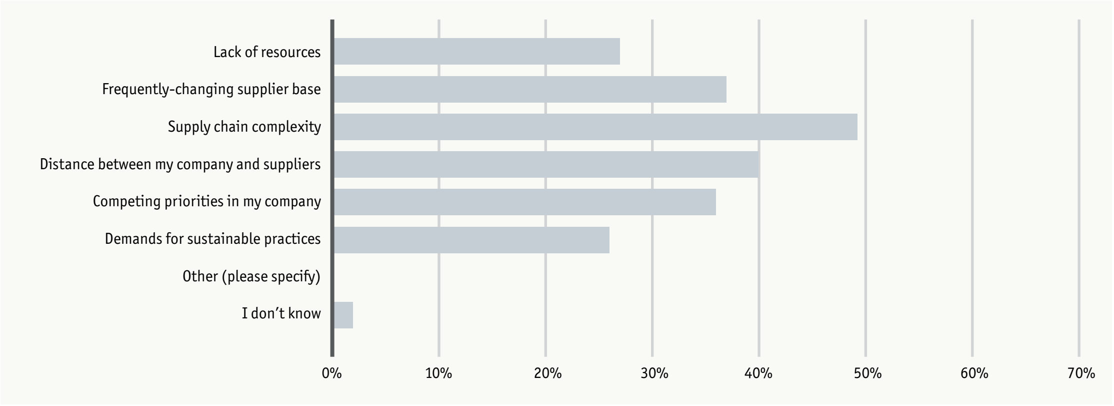
C3. With regard to supply chain monitoring, which of the following does your company do?



C4. With regard to the issues below, how difficult are they to monitor in your company's supply chain? Please rate each on a scale of 1-5, where 1 = Very easy and 5 = Very difficult:



C5. What are the main challenges your company faces in monitoring its supply chains?



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