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BRIEFING PAPER

NAVIGATING MODERN SUPPLY CHAINS

How ESG is reshaping the way forward for procurement and distribution

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OVERVIEW

As the demand for sustainable business practices reaches fever pitch, organisations around the world are increasingly faced with the need to reassess the environmental, social and governance (ESG) impacts of their supply chains.

This demand is coming from multiple sources. Some of it is from end-users, who have grown more conscious of the impact of their purchases. Internally, workers are putting pressure on their employers to act. Meanwhile, investors and financiers are reshaping the ecosystem by pursuing more ethical portfolios and influencing positive societal change. The bottom-line is that companies that adopt ESG standards are regarded as more conscientious, less risky and more likely to succeed in the long run.

Consultants EY estimate that supply chains account for 50-70 per cent of businesses' operating costs, and more than 90 per cent of their greenhouse gas emissions. Thus, incorporating greater efficiency in supply chains is crucial if organisations are to realise their ESG goals. However, the inherent complexity of supply chains can make it challenging for industries to overhaul age-old practices and adopt new ways of procurement.

ESG IN SUPPLY CHAINS

Recent years have massively exposed the fragility of supply chain. In 2020, the Covid-19 pandemic sent shockwaves across the world, bringing economies to a grinding halt. The supply of semiconductors dipped, while container rates skyrocketed following lockdown restrictions, with events including Brexit and the Suez Canal incident adding to the strain. More recently, the Russia-Ukraine war and China's zero-Covid policy have hammered distribution and logistics networks globally.

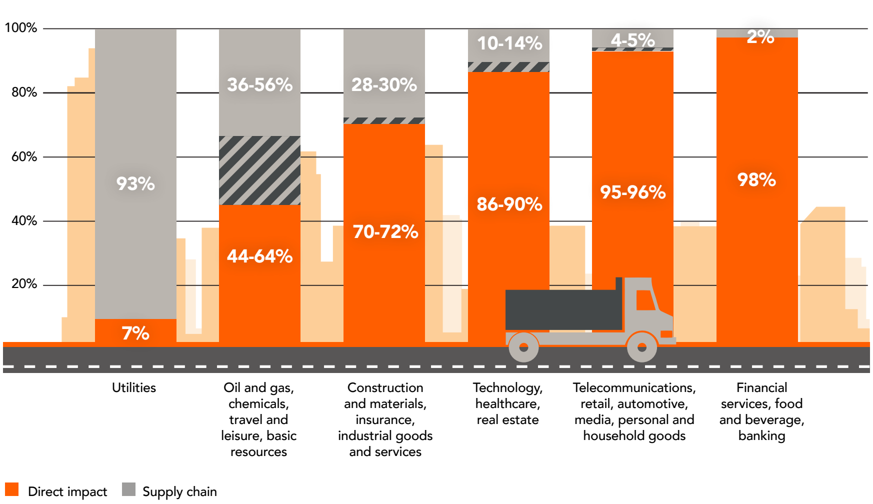
Amidst all of this, supply chains are facing pressing and long-term threats such as climate change and social issues. Experts highlight that climate-related disruptions caused by rising temperatures and extreme weather events are set to intensify in the coming years. Meanwhile, social and human rights challenges have been exacerbated by the pandemic. Data from credit analyst Moody's highlights that social controversies in global supply chains, such as decent wages and forced labour, increased by 237 per cent between 2020 and 2021. If not managed in a timely fashion, these risks could cause irreversible financial and reputational damage.

Identifying and measuring ESG-related issues should thus become an urgent priority for supply chain stakeholders. Several issues, however, need to be overcome first.

This includes the lack of understanding on what issues pose the greatest challenge to supply chains, and how these must be rectified across the network. Further, the singular emphasis on environment while neglecting social and governance factors could limit the extent to which an organisation and its suppliers can achieve compliance.

Another risk is the delayed pace of action. Recent corporate sentiment polls by research analysts GlobalData find that ESG has been deprioritised as companies focus on more pressing macro-issues such as the Russia-Ukraine war. Ultimately, the lack of a uniform, global standard for ESG reporting makes it onerous to define, quantify and resolve risks.

Figure 1 - Share of a sector's environmental impact located in the supply chain



Source: United Nations – Principles for Responsible Investment

KEY ESG MILESTONES

- **1948** The UN adopts the Universal Declaration of Human Rights
- **1967** The Environmental Defence Fund is formed to pursue legal actions against environmental damage
- **1971** Non-governmental environmental organisation Greenpeace is founded
- **1990** The International Institute for Sustainable Development (IISD) is created
- **1993** First meeting of the UN Commission on Sustainable Development takes place
- **1997** The Global Reporting Initiative is founded in Boston
- **1999** The Dow Jones Sustainability Index is launched
- **2000** UN launches Millennium Development Goals. The UN Global Compact is introduced
- **2002** The World Summit on Sustainable Development in held in South Africa
- **2005** The Kyoto Protocol comes into force. The term 'ESG' is coined by UN Global Compact
- **2006** The United Nations' Principles for Responsible Investment (UNPRI) reporting framework is launched
- **2011** The Sustainability Accounting Standards Board (SASB) is launched
- **2015** The Paris agreement is signed at Cop21 in Paris
- **2016** The UN launches its 17 Sustainable Development Goals
- **2021** The Cop26 summit takes place in Glasgow, Scotland
- **2022** The Cop27 summit takes place in Sharm el-Shaikh, Egypt
- **2023** The UAE to host the Cop28 summit in Expo City Dubai
- **2050** The UAE and Oman's goal for net-zero emissions
- **2060** Saudi Arabia, Kuwait and Bahrain's goal for net-zero emissions

SECTORAL IMPACT

Analysing how ESG principles are shaping select industries

APPAREL AND RETAIL

Numerous social and environmental problems exist within apparel and retail supply chains, attributed to rapid growth, penetration of e-commerce and the dependency on raw materials and services sourced from abroad. Estimates from the World Bank show that the fashion industry was responsible for 10 per cent of annual global carbon emissions in 2019, necessitating the need for action.

Despite the macroeconomic challenges, companies are actively investing in improving their ESG compliance – although largely environment-focused. Retail giants such as Unilever, Amazon, Inditex and Ikea have committed to switching to shipping vessels that use zero-carbon fuels by 2040.

Retailers are also turning to circular economy practices, for instance the use of recycled polyester in clothing. Meanwhile, digital technologies such as blockchain and virtual certification are helping manufacturers and retailers trace the lifecycle of products from the manufacturing stage all the way to the end of its lifespan.

As an outcome of the pandemic, trends including on-shoring or nearshoring, adapting to changing consumer behaviour, shortening the supply chain and taking a digital-first approach have all become commonplace in the retail and apparel sectors. However, issues such as higher consumer products costs and unreliable product data are hampering sustainable buying behaviours. This is prompting retailers to try innovative ways to instill green habits.

For example, UAE-based retailer Spinneys recently partnered with water and waste management firm Veolia's RECAPP recycling solution. Together, the firms are offering shoppers points at Spinneys stores as a reward for returning their plastic bottles, metal cans and tins.

Many consumers are aware of the concept of greenwashing, so it is of utmost importance that retailers truthfully fulfil their ESG targets and goals. Retailers that fail to do so will likely receive backlash from consumers.

CONSTRUCTION

The construction and real estate sector is notorious for its environmental impact through various project related activities, accounting for 34 per cent of global energy consumption and 37 per cent of CO_2 emissions in 2021, according to the Global Status Report for Buildings and Construction released at Cop27.

The industry continues to be challenged by narrow margins, low return on investment and a lack of top-down incentives, which can make it challenging to adopt sustainable practices. But at the same time, it must evolve to meet changing consumer demand.

The 2022 sustainability report by the Royal Institution of Chartered Surveyors (RICS) reports a growing demand for green and sustainable buildings by both occupiers and investors. It also suggests that the industry is calling for consistent standards, relevant skills and trusted information on low-carbon products.

Ensuring greater on-site worker safety, use of modular construction techniques and improved energy efficiency on existing and upcoming buildings are all steps in the right direction. But further efforts are required when it comes to reducing emissions and recycling materials. Digital technology can be further leveraged to enable monitoring and assessment of the environmental impact, carbon emissions and social progress on construction projects.

Essential to achieving carbon neutrality is ensuring the principles trickle down the value chain. Larger firms will have to support smaller business (that make up a sizeable portion of the industry) in attaining goals, to ensure no one is left behind.

CONSUMER GOODS

Fast-moving consumer goods (FMCG) companies have a significant impact on the environment, given their lengthy supply chains and agricultural sourcing.

These companies also heavily contribute to landfills and waste, both during manufacturing and packaging stages. FMCG companies are further susceptible to social issues such as labour exploitation and corruption due to the vast number of stakeholders involved, such as smaller suppliers responsible for raw materials.

GlobalData's Q1 2022 global consumer survey found that almost two thirds (63 per cent) of consumers' purchasing choices are influenced by more ethical or environmentally-friendly products.

Supply chain transparency is the most important initiative an FMCG company can take to avoid environmental or social risks. Transparency translates to good governance, creating a clear overview of product lifecycles and revealing environmental or social issues, such as child labour, deforestation, and product defects or safety.

Digital technologies have an important role to play here too, enabling the sharing of data between manufacturers and supermarkets to measure ESG progress.

OIL AND GAS

Climate change is expected to fundamentally alter the oil and gas industry, as the world pivots to adopting sustainable hydrocarbon-alternatives. Although the demand for fossil fuels is expected to grow in the near term, the International Energy Agency estimates that demand for oil will drop to around 24 million barrels a day (mb/d) and demand for natural gas to 1,750 billion cubic metres (bcm) annually by 2050, versus around 100 mb/d and 4,100bcm respectively today.

In the GCC, national oil companies (NOCs) are directing investments into carbon capture and storage (CCS), and hydrogen production to counter the carbon intensity of their activities, guided by the concrete net-zero goals set by their governments.

NOCs are also digitalising to improve efficiency. For instance, in November 2022, Abu Dhabi National Oil Company (Adnoc) and Germany's Siemens Energy announced a joint pilot blockchain technology that would help certify the carbon intensity of Adnoc's products throughout the supply chain, improving transparency for stakeholders.

PACKAGING

Regulatory and public concerns surrounding single-use plastic – made from petrochemicals – have prompted the packaging sector to rethink its processes and materials. A closed-loop supply chain is seen as an effective solution for the industry, to build a governed system of recyclable and reusable packaging across industries. Consumer goods brands including Cola-Cola, PepsiCo, Unilever, Danone and Nestle, have committed to providing 100 per cent recycled plastic in their packaging and introduce reusable or recyclable packaging – accelerating the shift towards a circular economy.

Technologies such as blockchain and artificial intelligence, as well as trends around advanced materials and smart packaging have a crucial role to play in enabling the transition to more sustainable sector.

INCORPORATING ESG ACROSS SUPPLY CHAINS

- Adopt ESG framework and set formal targets with clear KPIs
- Conduct water, energy and waste audits
- Work with employees and external stakeholders to align needs
- Utilise digital technologies such as blockchain, artificial intelligence and digital twins
- Invest in clean fuels and energy sources where possible to reduce emissions from production and transport processes
- Prioritise welfare of workers and stakeholders across the supply chain
- Revisit management processes to ensure proper governance to tackle bribery, corruption and unfair wage practices
- Work with authorities to develop industry codes and standards
- Collaborate with specialied service providers and third-party certifiers to improve ESG compliance

INDUSTRY SPECIFIC PRACTICES

Apparel and retail

- Improve buying practices, adopt ethical sourcing, fairly price contracts
- Adopt circularity and avoid direct-to-landfill practices
- Avoid the use of hazardous chemicals and materials
- Encourage customers to make better choices

Construction

- Embed ESG into project planning phase
- Require contractors and suppliers to demonstrate ESG credentials
- Emphasise both physical and mental wellbeing of workers
- Use more sustainable building materials and limit waste to landfill

Fast-moving consumer goods

- Improve buying practices, adopt ethical sourcing, fairly price contracts
- Adopt circularity and avoid direct-to-landfill practices
- Decrease freshwater usage and improve water recycling
- Shared data platforms for stakeholders to measure ESG initiatives
- Offset emissions by undertaking programmes such as reforestation

Oil and gas

- Decrease freshwater usage and improve water recycling
- Scale up investments in clean fuels such as hydrogen and biofuels
- Offset emissions by undertaking programmes such as reforestation
- Cut methane emissions by utilising technology and safety systems

Packaging

- Adopt circularity and avoid direct-to-landfill practices
- Decrease total packaging weight where possible
- Explore the use of bioplastics and other compostable packaging materials, while reducing use of virgin plastic

UNDERSTANDING THE ESG FRAMEWORK

Environmental

Climate change

Contributing factors
- Greenhouse gas emissions

Mitigating actions
- Set science-based emissions reduction targets
- Invest in low-carbon technologies
- Invest in carbon capture and storage technologies
- Commit to credible carbon offset projects
- Invest in energy-efficiency projects
- Set an internal price on carbon

Pollution

Contributing factors
- Air pollutants
- Water pollutants
- Land pollutants
- Space pollutants

Mitigating actions
- Invest in clean energy sources and conduct air quality assessments
- Invest in advanced waste management techniques
- Incorporate principles of the circular economy into product design and operations
- Invest in space debris removal and tracking technologies

Biodiversity

Contributing factors
- Deforestation
- Pollution
- Agriculture
- Construction
- Trade in endangered species
- Overfishing

Mitigating actions
- Invest in reforestation projects and sustainable forest management
- Invest in clean energy and waste management techniques
- Invest in precision agriculture technologies using safe pesticides and fertilisers
- Build on brownfield sites and incorporate living structures in architecture and planning
- Implement recovery programmes for endangered species
- Implement responsible fishing and invest in breeding programmes

Natural resources

Contributing factors
- Overuse of fossil fuels
- Overuse of metals and minerals
- Overuse of water
- Overfishing
- Land mismanagement

Mitigating actions
- Invest in renewable energy sources
- Incorporate principles of circular economy in operations using sustainable resources
- Invest in water conservation programmes and smart water initiatives
- Implement responsible fishing and investment in breeding programmes
- Prioritise greater use of brownfield rather than greenfield sites

Social

Human rights

Contributing factors
- Forced labour
- Child labour
- Marginalisation of indigenous people
- Personal data breaches
- Low wages
- Job insecurity

Mitigating actions
- Implement clear policies against forced labour
- Implement clear policies against child labour
- Work with indigenous people to uphold rights
- Implement clear policies on data privacy and data security
- Implement HR policies that ensure all workers are fairly paid
- Implement HR policies that ensure all workers have their rights protected

Diversity and inclusion

Contributing factors
- Gender discrimination
- Disability discrimination
- Religious or racial discrimination
- Ethnic minority discrimination
- Age discrimination
- Sexual orientation discrimination

Mitigating actions
- Implement strong and up-to-date diversity and inclusion policies
- Introduce policies and training to eliminate unconscious bias
- Implement formal processes to capture incidences of discrimination
- Implement mentorship programmes

Health and safety

Contributing factors
- Inadequate employee health and safety
- Inadequate customer health and safety
- Inadequate supplier health and safety
- Inadequate product health and safety

Mitigating actions
- Invest in employee health and safety training and management
- Invest in protocols and management systems that improve customer health and safety
- Police health & safety standards at suppliers
- Ensure products comply with health and safety standards

Contributing factors
- Community neglect
- Lack of charitable donations
- Displacement of communities

Mitigating actions
- Boost the local economy by consulting local stakeholders
- Donate to local community projects
- Construct homes for displaced communities

Governance

Corporate structure

Contributing factors
- Lack of board oversight
- Unjustified remuneration
- Avoidance of regulatory scrutiny
- Lack of adequate pension provision
- Lack of diversity at board level
- Lack of shareholder representation
- Share-based incentives

Mitigating actions
- Empower independent directors
- Introduce executive pay caps or pay ratios
- Ensure proper segregation of duties, especially in compliance departments
- Enhance powers for pension trustees
- Ensure broader representation at board level
- Introduce transparent share structure with equal voting rights
- Set remuneration policies based on ESG targets

Risk management

Contributing factors
- Lack of ESG disclosure
- Cybersecurity breaches
- Lack of stakeholder engagement
- Lack of employee engagement

Mitigating actions
- Develop a quantifiable and timebound ESG plan and provide updates on progress
- Hire a chief information security officer to implement an effective cybersecurity strategy
- Involve stakeholders in strategic decision making
- Implement employee development programmes and hold employee feedback sessions

Corruption and bribery

Contributing factors
- Political contributions
- Related party transactions
- Lobbying for unsustainable causes
- Money laundering
- Tax evasion

Mitigating actions
- Introduce a company-wide ban on political contributions
- Conduct an external audit of all related party transactions
- Introduce a company-wide ban on lobbying for unsustainable causes
- Implement employee-friendly whistle-blowing policies
- Introduce clear policies to punish tax evasion

Ethics

Contributing factors
- Auditor conflicts of interest
- Anti-competitive behaviour
- Lack of complaint handling system
- Aggressive tax avoidance
- Regulatory non-compliance
- Personal data sharing
- Union blocking

Mitigating actions
- Rotate auditors regularly and introduce a ban on hiring auditor for consulting or M&A advice
- Introduce a ban on unethical competitive practices
- Implement policies to ensure effective response to complaints
- Set up independent ethics committee to review tax policies
- Empower the compliance team
- Introduce robust data privacy policies
- Engage with unions

Source: GlobalData

About Mashreq

Mashreq is more than half century old bank, yet proudly thinks like a challenger, startup, and innovator. Mashreq pioneered key innovations and developments in banking, starting with entry-level digital-first customers, all the way to powering some of the region's most prominent corporations and wealth accounts.

The bank's mandate is to help customers find their way to Rise Every Day, partnering through the highs and lows to help them reach fulfillment, achieve financial goals, and unlock their vision of success.

Reassuringly present in major financial centers of the world, Mashreq's home and global HQ remains in the Middle East, offering services whenever and wherever opportunity takes its customers.

Find your way to Rise Every Day at Mashreq.com/RiseEveryDay

About MEED

MEED has been integral to delivering business information, news, intelligence and analysis on the Middle East economies and activities for over 60 years.

Attracting a key senior management audience through its content and activities, MEED is a media brand, publication and data business that covers a spectrum of services which inform, engage, connect and ultimately support our subscribers and partners in their business development and strategic growth.

Acquired by GlobalData Plc in December 2017, MEED is now part of one of the largest data and insights solution providers in the world with the capacity to build global communities for our clients.

Our purpose is to help the region's companies make better and more timely decisions through our innovative data solutions and grow through our comprehensive and world-class marketing solutions. To find out more email: info@meed.com