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# Staying alert to ESG risks and opportunities in global supply chain

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Few days pass without a new, high-profile news story relating to the issues that fall within the broad concept of Environmental, Social and Governance, or ESG. So prominent has ESG become, in the corporate, political and economic agendas, as well as in the public conscience, over the past two years that companies, financial institutions, and professional service providers ignore the trend at their peril.

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There are many, often interrelated and overlapping, elements of ESG; indeed the concept is, and is likely to remain, a fluid one. But, we are writing this series of articles from the belief that the recent focus on the common themes of sustainability, responsibility and accountability will continue, and increase.

A noteworthy feature of the rapidly growing importance of ESG is the breadth of contexts in which it applies. It is no longer sufficient for a business to consider, and address, ESG issues within its owned and controlled enterprise. Instead, businesses are increasingly expected to account for performance, and shortcomings, of associated undertakings, notably those operating within its supply chain. A global brand or companies may have most of its ESG impact in its supply chain.

In this series of articles, we will consider the ESG-related risks and opportunities specifically in the context of complex global supply chains, including in relation to security and resilience, and potential exposures in different jurisdictions that may arise, such as litigation and regulatory risks; political and trade-related risks; financial and operational risks; and, of course, market and reputational risks.

Supply chains have always been a fundamental important aspect of business; their importance was, however, thrown into stark focus by the COVID-19 pandemic. It quickly became apparent that traditional — often inflexible — supply chain structures, particularly those that involved markets and jurisdictions that were less stringently regulated than others, were, or could become, vulnerable, in many ways. Some of those vulnerabilities and issues were directly attributable to the pandemic and associated lock-downs and restrictions, while others were long-standing features of some supply chains, but had not previously received the level of attention and scrutiny that emerged.

In any event, the significance of ensuring that supply chains are flexible, resilient, and transparent, and that they meet the increasingly exacting standards required by lawmakers, regulators and society at large, is now widely recognized. While ensuring robust supply chains has traditionally focused, somewhat narrowly, on cost and quality of the product, and the costs, speed, and reliability of delivery, it is ever-more important to factor in a far broader range of ESG-related factors including, for example, the well-being of, and workplace protections for, workforces; any "red flags" suggestive of bribery or corruption; environmentally damaging practices of upstream producers; and the impact of those producers' activities on the local populations and societies.

The aims of ESG — sustainability, responsibility and accountability — are laudable, and should be celebrated in their own right, but the further good news is that it is already becoming apparent that those businesses that proactively embrace this approach are, anecdotally at least, starting to enjoy greater operational performance. Conversely, those that are perceived as falling short in this regard may, and increasingly do, find the consequences to be severe, whether they involve operational difficulties, regulatory penalties, corporate criminal liability, shareholder and securities litigation risks as a result of sharp share price drops, or very significant brand and reputational damage.

Achieving sustainable, responsible, and ethical supply chains will be difficult. It may require lengthy processes involving, for example, multiple risk and exposure assessments to be carried out in the various jurisdictions involved in the particular supply chain, followed by diligencing current and potential suppliers within those



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jurisdictions to assess their ESG credentials, as well as reviewing current corporate governance frameworks, and implementing measures specifically focused on ensuring ESG-compliant behaviors and practices throughout the supply chain. These are not straightforward undertakings, but they can be crucial.

A critical first step to identifying, and addressing, emerging supply chain risks is ensuring an awareness, and appreciation of, the impacts of the rapidly evolving legislative and regulatory frameworks, in relevant jurisdictions. As reporting obligations, customs, tariffs and other trade regulations promote ESG considerations, anticipating and reacting to those developments is important.

This is a fast-moving area. Significantly, recent weeks have seen the European Commission's final proposal for a regulation establishing a European Union Carbon Border Adjustment Mechanism (CBAM), as part of the broader European Green Deal, by which it intends to regulate greenhouse gas emissions embedded in "*covered products*" (including cement, and certain iron, steel and aluminium products) imported into the EU. It also addresses due diligence guidance on forced labor risks in supply chains, while the German Parliament passed, in June, the "Law on corporate due diligence in supply chains" (*Lieferkettensorgfaltspflichtengesetz*). In the United States, the U.S. Customs and Border Protection (CBP) has increasingly issued "withhold release orders" to exclude merchandise under Section 307 of the Tariff Act of 1930, which prohibits import of merchandise mined, produced or manufactured by forced or indentured labor.

Regardless of the sector, or jurisdictions, in which a particular business operates, procurement and sourcing strategies should incorporate, and focus intently on, ESG criteria. This will likely include developing robust, effective, and measurable corporate policies and business processes around governance, and engaging closely with suppliers through multiple tiers in the supply chain, to develop common goals and unified objectives.

Establishing effective oversight and audit protocols will become increasingly important, as monitoring performance and behaviors within supply chains develop as a central consideration for improving organizations' ESG credentials, and commensurately reducing the associated risks and exposures.

The rise of ESG, and the corresponding emergence of ESG factors featuring significantly in supply chain management, is a trend that will continue apace over the coming months and years. This undoubtedly presents challenges to businesses that rely on complex global supply chains, but it also presents exciting opportunities for those businesses to review, and improve, their policies and arrangements, and to develop best in class practices that will contribute to increased resilience and versatility, and reduced legal, regulatory and reputational exposures.

We will focus on these issues in more detail in subsequent articles in this series.

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