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How To Mitigate ESG Risk In Your Supply Chain

Businesses worldwide seek more transparency in ESG data, according to new Coupa study

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INTRODUCTION

Businesses today recognize the importance of having a positive impact on the world and embracing a social purpose beyond simply generating profits. Not only is it the right thing to do, but they face increasing pressure from multiple sources to make greater commitments and improved progress towards their environmental, social, and corporate governance (ESG) objectives.

This pressure is coming from both customers and financial institutions who now often judge companies according to their performance on ESG measures in addition to their product quality and financial metrics. As a result, ESG is now an important element of brand messaging and investor relations.

Also, we are starting to see increased legislative pressure from governments and international entities pushing businesses to act on reducing greenhouse gas (GHG) emissions and preventing environmental degradation or ethical misconduct, not only within their own operations but with their direct and n-tier suppliers and subcontractors throughout their supply chain.

Some of these new regulations will carry stiff penalties: for instance, the consequences of violating Germany's new Supply Chain Due Diligence Act includes fines of up to **2%** of a company's annual global revenue, highlighting just how important it is for executives to adhere to these new rules. **Read more here** to find out the four best practices to adopt and ensure compliance.

But these legal requirements, including the German supply chain act, also underline an important fact: for those businesses who are serious about improving their ESG credentials, optimizing their supply chain and relationships with their suppliers represents **one of the biggest opportunities to escalate a positive impact on the world.** For example, while high standards for the ethical treatment and behavior of employees are well established in many large western companies already, they are not as well enforced throughout their supply chain. Meanwhile, as highlighted by **Boston Consulting Group**, so-called scope 3 greenhouse gas emissions made by a company's supply chain are in most cases far greater than direct emissions from its own operations.

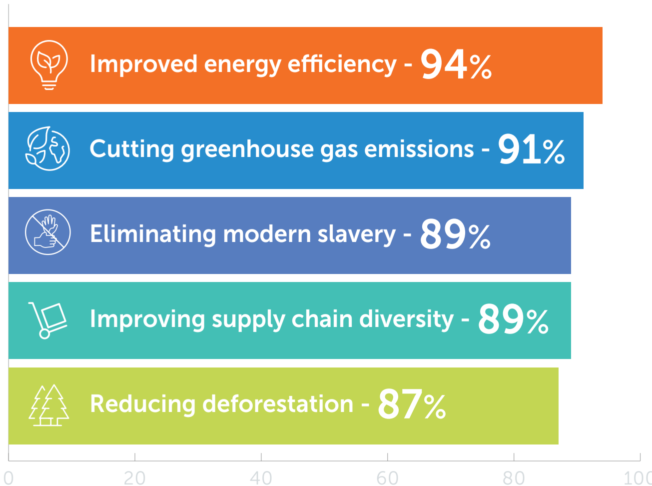
As such, in order to reduce emissions and prevent human rights violations (and avoid the risk of penalties represented in global regulations across countries), businesses must make supply chain optimization and assessing the ESG standards of their suppliers a priority.

But how seriously are companies taking this supply chain risk, and what can be done to address it? To find out, Coupa conducted a survey of 800 business leaders in organizations with over 1,000 employees across Australia, France, Germany, Singapore, UK and the US.

Supply Chain Due Diligence

Starting January 2023, companies operating in Germany with 3,000+ employees must fulfill due diligence obligations by monitoring supply chains for human rights violations and compliance with environmental standards. By 2024, the law will extend to companies with 1,000+ employees.

MORAL MATTERS: WHAT ARE THE TOP ESG PRIORITIES?



Reassuringly, the research showed that almost all large enterprises care about ESG concerns and are committed to achieving several major objectives across many areas.

Furthermore, many companies are "putting their money where their mouths are" when it comes to these issues, and not merely paying lip service to these ideals. Many are actively investing in their operations to help them achieve their ESG goals and ensure compliance with new regulations, such as by buying or building new technology **(64%)**, improving and expanding their legal and compliance capabilities **(62%)** or acquiring new tools for measurement and analysis **(59%)**.

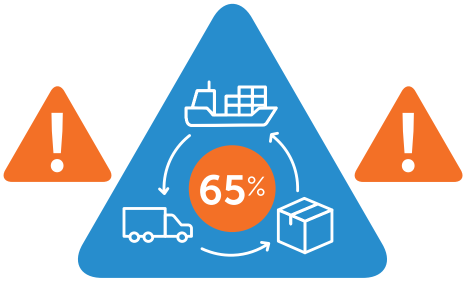
94% of businesses stated that improving energy efficiency was important to them

ARE BUSINESSES DOING ENOUGH?

While the survey showed that large businesses are concerned about ESG and compliance with legislation, it also indicated that they could be doing much more. A majority are **suffering from major blindspots** in their supply chains that mean it is impossible for them to make real progress on their ESG objectives.

That's because nearly two thirds **(65%)** of businesses cannot tell if their closest supply chain partners are meeting any kind of ESG standards. Worse still, **57%** admit they do not have an effective risk management system in place to ensure the ESG integrity of their supply chains. This is a major problem, especially for companies with operations in Germany, as the country's Supply Chain Due Diligence Act comes into force from January 2023 and will require companies to monitor their supply chains for human rights violations and compliance with certain environmental standards.

This lack of insight is compounded by a lack of agility when it comes to replacing a supply chain partner that is not meeting ESG standards. Despite the vast majority of businesses surveyed **(95%)** agreeing that it is important to quickly find new partners that align with their ESG values, **42%** admitted that replacing a supplier would take them a couple of months or more, if they were able to do it at all, compared to just **16%** who said they could adapt in a couple of days.



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This inertia suggests a lack of supply chain resiliency among many large enterprises, which could be addressed through better supply chain design and planning. Tools including artificial intelligence can be used to model and analyze a company's supply chain to identify gaps, flag risky suppliers and plan for scenarios to mitigate hazards. Read more about **how to outsmart supply chain disruption**. Any capability gaps identified as part of the design process will need to be bridged either through capacity expansion with existing suppliers or **creating sourcing events** with minimal to no latency.

PREPARE FOR EXPANDING ESG LEGISLATION

Germany's supply chain act is not the only piece of legislation to emerge that will push companies to reassess their global supply chains. There is also the Modern Slavery Act in Australia; the US Securities and Exchange Commission is considering **ESG reporting rules and requirements on climate disclosure**; and in February 2022, the European Commission adopted a proposal for **new rules on corporate sustainability due diligence**. There is a clear trend of expanding legislation which will make compliance challenges more acute.

Companies understand that compliance is non-optional: **97%** of decision-makers recognize that it is important to be able to accurately assess the ESG risk and compliance of supply chain partners in order to comply with any future rules.

However, **their current solutions are unable to handle the job.** While **95%** of companies surveyed have a risk management solution in place to perform this assessment, nearly two thirds **(65%)** thought their current compliance solution was insufficient. This indicates that more investment is needed in the people, processes, and technology required to guarantee businesses have the agility and flexibility to address new regulatory requirements efficiently.

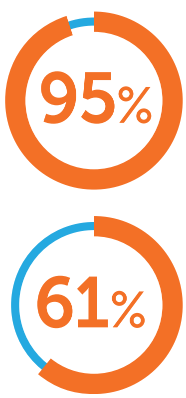
Also, the majority of businesses **(89%)** believe any ESG regulations will place a financial burden on them. This will compound the problem facing the **40%** of companies who said a lack of funds is the biggest issue preventing them from being able to assess their supply chain's ESG standards.

THE NEED FOR DATA SHARING & INTEGRATED BSM

Faced with the combination of stricter ESG requirements and insufficient solutions, companies need to think outside the box.

Decision-makers realize that their own companies and their peers all need information on suppliers' ESG credentials.

In fact...



Of survey respondents said that this data is important

Have already invested in collecting this data

Instead of keeping this data to themselves, greater industry-wide collaboration and data sharing would reduce this duplication of effort in data collection by magnitudes. Almost all of the surveyed businesses **(99%)** recognized that more open and transparent data sharing would help them to accurately assess the ESG risk and compliance of their supply chain partners across the globe. The current lack of data sharing is the top factor preventing nearly half **(48%)** of businesses from accurately assessing the ESG standards of supply chain partners.

Data sharing among the business community would address two important issues: first, it would ensure data is collected in a scalable way that can be optimized by **community intelligence**; and second, it would get data into the hands of decision-makers more quickly across a company, so that they can better collaborate to take action on improving their supply chain.

Coupa is already moving boldly in this direction. Our community-based approach to data sharing and using the power of spend has been proven, for instance by helping companies share diversity, equity, and inclusion data on suppliers to ensure supply chain diversification. This approach has amassed one of the largest **databases** of diverse suppliers and empowered companies to make progress on their DEI commitments.

TOP 3 BARRIERS TO ASSESSING ESG RISK OF SUPPLY CHAIN PARTNERS

48%
Lack of data on suppliers' ESG credentials

40%
Limited financial resources

36%
Reliance on technology not designed for complying with ESG standards

Looking forward, a community-based approach could help businesses to scale their ESG commitments by providing insights on how to optimize their supply chain design to reduce CO2 emissions, get leading indicators of supplier performance issues, as well as assess ESG risks of their suppliers using automation. This will help to ensure businesses can adopt the processes and capabilities necessary for compliance with current and future legislation by global governments that mandates greater corporate oversight into global supply chains.

Find out more about how Coupa's business spend management (BSM) approach to digital transformation in the supply chain can ensure that this data gets to the right decision makers without the need for years-long, complex IT engagements by **clicking here**.

Coupa is the cloud-based Business Spend Management (BSM) platform that unifies processes across supply chain, procurement, and finance functions. Coupa empowers organizations around the world to maximize value and operationalize purpose through their business spend. To learn more about Coupa, visit **coupa.com** or follow us on **LinkedIn** or **Twitter**.