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ESG (ENVIRONMENTAL, SOCIAL & GOVERNANCE) FACTORS INFLUENCE ON SUPPLY CHAIN PROCESSES IN INDIA - CHALLENGES FACED AND WAY FORWARD

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Abstract

The intense focus on ESG to create a sustainable world has led to emergence of frameworks to define ESG, to rate ESG compliance and to rank business firms on ESG maturity levels.

In the field of Supply Chain Management, this aspect is even more profound due to the high impact of environmental and social factors that exist today.

This has led to businesses in the Supply Chain space working hard to define their sustainability goals, working towards being compliant to various ESG frameworks, etc. and be in the good books of both investors and consumers. This however, comes at an investment and cost for business firms who have to remodel their business to achieve sustainability goals.

This paper analyses the challenges faced by supply chain businesses in India in achieving their sustainability goals, the need to create a consistent and universal ESG rating framework that is relevant for India and how the government and industry bodies can help smoothen this transition to a fully ESG compliant industry.

Keywords: ESG, Environment, Sustainability, Environmental, Social, Governance, Supply Chain, Supply Chain Management, ESG Rating, ESG Framework, ESG Standards, Supply Chain Processes in India

Introduction

ESG and supply chain are intimately linked. Having a full view of all the factors influencing ESG within the Supply Chain network and working towards improving those is an important obligation of organizations that are high on ethics.

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These days' investors increasingly measure ESG factors and sustainability ratings of an organization before investing in them. In fact, there have been researches to create mathematical models for investors considering ESG factors before investing in a firm. 1 The end-consumers too are more environment and socially conscious and prefer buying from businesses which adhere to environment and social best practices. It is therefore; morally imperative for organizations and businesses to maintain high levels of sustainability and report their ESG maturity levels which indirectly talk about their concern for people and the planet.

However, this also introduces additional overhead costs for an organization and sometimes complexity in the business operations.

This paper throws light on whether sustainability efforts of organizations are impeding business growth or bringing benefits to the Supply Chain business in India and tries to find a way forward for sustainable supply chain businesses.

ESG and its relevance to Supply Chain Management

Supply chain sustainability is a key component of a business's ESG strategy. Through supplier engagement, supplier recognition, and sustainable procurement, a business can continue to improve its business practices and operations to manage risk while increasing productivity and efficiency within the supply chain.2

In essence, the majority of companies' environment and carbon footprint is rooted in its supply chain. Modern enterprise's supply chain is interracially woven network of material suppliers, assemblers, manufactures, and distribution centers and logistics providers. If an organization can understand where the materials are coming from, where it is sourced, how it is procured, how it is stored, where and how it is transported, then it can work on reducing the carbon footprint.

Why is ESG necessary for the future of Supply Chain Management?

Pressure to support sustainability in supply chains is coming from multiple sources, including investors, government, and international bodies; with all of them also being the key drivers pushing companies to embed ESG focused business models and encourage ESG transparency and disclosures.3

a) Government Regulations: With vigorous campaigns to take strict measures to reverse the impacts of climate change, various governments have started to frame rules and regulations to remove unsustainable habits by industries and businesses. High levels of sustainability measures are soon going to become mandatory for business to have an ESG policy and have benchmark ESG ratings.

b) Ecosystem Assimilation: For any organization to survive when the eco-system around is changing the organization also has to innovate and find newer sustainable strategies to survive.

c) Investors Preference: Attracting investments will be greatly driven by ESG ratings of a business. The reporting on ESGs allows investors to measure whether companies are meeting their commitments in terms of ESG issues that are relevant in their supply chain and creating a positive impact for the environment. ESG-oriented investing has experienced a meteoric rise. Global sustainable investment now tops $30 trillion.4

d) Consumer Conscience: The end consumer is a very important stakeholder of ESG. It gives them confidence that the company they may be buying from is socially responsible. If a company is doing sketchy things, consumers can vote with their wallets.

e) Environment Protection: This is an obvious one and the sole objective. ESG has also driven economic growth by creating more than 90% fewer carbon emissions per unit GDP across 25 OECD countries over the past 40 years, compared with those that had no or limited implementation of ESG practices. 5

Challenges with ESG initiatives that Supply Chain Businesses in India face

1. Lack of Supply Chain visibility and transparency: Supply Chain operations are traditionally opaque, and firms often do not have visibility beyond their immediate suppliers. Removing this opacity can enable firms to reduce supply chain risks and improve supply chain efficiency6

2. Goals not embedded in every business process of the organization: Sustainability goals are often soloed and set apart from business processes, with ESG reporting being looked at as a ticking a check-box exercise and don’t really embed it in the true sense.

3. Lack of structured data: A proper and structured data is needed to understand a company’s global value chain across different mechanisms. This data and insights generated must be available across the organization to anticipate and manage the impact of operational processes on ESG goals.

4. Lack of proper integration with data sources: Finding quality data continues to be a top challenge, where a lack of credible sources of truth compounds the problem. Data must be integrated from different sources like the organizations ERP systems. It must be enriched with data from carbon accounting platforms, supplier rating data and a host of other external data sources. Only then the reporting can be done to meet the various industry standards such as CDP, SAS, GRI and Science based Targets initiative (SBTi), all to achieve compliance and adherence to regulatory standards. 7

5. Lack of a common ESG definition and standards: The lack of a common ESG reporting standard has afforded companies different ways to measure and report their data. There is lack of global standards on various ESG specific attributes to be captured/collected, standards for storing and standards for exchange of data/information between systems or between two different organizations

6. Far too many ESG rating agencies mushrooming up each having a different methodology and criteria of measurement. E.g., ISO, CDP, MSCI, Bloomberg, FTSE GRI, Russells, IPCC, ISS,

S&P Global, Nabers, SASB, Moody's, etc. These rating agencies mostly use corporate statements to generate their ESG ratings. Every agency employs its analysts and algorithms to evaluate ESG metrics in the form of disclosure and focusing on the quantity of information rather than quality. 89. Same firms ESG ratings can be highly inconsistent across different rating agencies. None of the agencies have an India specific framework.

7. Manipulation of data to avoid attention: Many organizations are seen manipulating the system just to avoid reporting several non-sustainable practices. This manipulation can cause a great damage to the environment, as well as the social life of people.10

8. Lack of collaboration between cross functional teams: To craft a good ESG procurement strategy that limits suppliers to the best benchmarks, cross functional teams need to come together and collaborate, but that is missing.

9. Lack of proper strategy that optimizes business processes while exploring the opportunity for moving forward towards ESG success, including for example extending the life of the business asset to reduce waste, or reducing carbon footprint by automating customer services through virtual bots

Impact on Financial performance of businesses when implementing ESG measures

Given the challenges that industries face with regards to sustainability goals, there is clearly a good investment that firms would have to do initially. This could include:

a. Reinventing their core supply chain operations

b. Reimagining their core supply chain business processes

c. Reworking the entire supply chain to improve sustainability goals

d. Improving their technology capabilities

e. Remodeling employee diversity policies, etc

These points obviously at the outset would need investments to be made and cost to be incurred by businesses. However, given the push from governments all over the world to improve sustainability ratings as well as the sustainability commitments already made by top business houses in the world, it is no longer a means for firms to evaluate these investments. It is now a matter of survival and firms have to plunge into it.

Way Forward

a. Governments can consider coming up with an incentivization mechanism for Supply Chain Businesses that meet specific ESG and Sustainability goals. This can be in terms of tax breaks, etc as an example to encourage this move. In a paper, Klimkiewicz (2017) has analyzed extensively the role of compensation system for assuring and promoting the environment policies across the supply chain that are directly linked to sustainability, corporate, social and environmental performance 11. Narayanan et al. (2004) in a review says that cooperation between partners is regulated by the performance scheme that specifies payment conditions including what performance metric should be applied to each individual manager or employee. Thus, even small changes in incentive schemes can transform the whole supply chain 12

a. Create Global standards and framework for collection, storing and transfer/exchange of ESG data across organizations. Today the lack of this is creating data collection, storage and exchange with multiple different formats which in future could become a big impediment for firms to operate. Once structured date with all the right attributes is available, this itself can trigger multiple optimization initiatives and further improve the supply chain.

b. Create India specific Standards to integrate ESG measures in Supply Chain.

c. Regulate multiple ESG ratings by different rating agencies and consolidate into few ratings to rank businesses on sustainability goals that are relevant to India. This would help firms to focus on one set of criteria rather than confusing and overlapping criteria by various rating agencies

a. Large firms and Small/Medium firms would need to have some distinction in the way they are measured on sustainability goals. Today criteria are same for all. If there are financial benefits associated with moving toward sustainability, then more firms will adopt sustainable supply chain practices. 13

Conclusion:

There is absolutely no doubt that ESG is resulting in a more sustainable society and an improved environment. It is helping to lower carbon emissions across major economies, reduce deforestation and water waste through better irrigation practices, improve energy efficiency within companies, and create a circular economy.

The Indian industry, however, is going through a ESG transition phase currently and this transition phase would seem chaotic. Firms clearly have to do an initial investment in reinventing their operations, their business processes, the technology upgrades, etc. to meet the sustainability goals.

At the same, Government and industry bodies have to enable this transition smoothly through incentivization, creating standard definitions, rating framework, and data collection/storage/transfer frameworks, etc.

While ESG investing is gaining a lot of traction, inconsistent and complex ESG reporting and standards have created problems for not just the supply chain firms but even for investment bodies. Further, ESG measures associated with a firms supply chain operations have not been fully captured which can induce firms to shift dirty and unsustainable practices to their partners down in the supply chain network.

To conclude, ESG would not just become a means for business growth but also of survival.

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