

# The challenge of sustainable supply chains

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Modern production is global, and globalization persists through pandemics, war, xenophobia, and trade wars. It persists because global supply chains enhance product quality while reducing costs.

Globalization continues because the technology of communication, information, and even transportation keeps advancing while becoming relatively less expensive.

The [sustainability](#) issue for those that make or sell goods and services is how does a company ensure that what they are making or selling is not built with components that destroy the environment or use child or slave labor during production? Out of sight cannot be out of mind, and that is the heart of the challenge of sustainable supply chains.

One of the issues still under debate in the proposed U.S. Securities and Exchange Commission carbon disclosure rule is how should the SEC address "scope 3" emissions, those outside the control of the organization but within their [supply chain](#).

Scope 1 emissions are those created directly during production, and scope 2 are those caused indirectly through the use of whatever is produced. Those are relatively easy to identify and measure. Nevertheless, governments seeking to regulate the reporting of greenhouse gasses recognize that supply chains must also be regulated.

As Dieter Holger recently observed in the *Wall Street Journal*:

"A host of supply-chain regulations went into effect in recent years and more are on the way, exposing companies to potential penalties and public criticism if found to be negligent, lawyers said. The rules come as businesses, especially small and midsize companies, have a limited view of their supply chains and are struggling to broaden their oversight, sustainability analysts say."

"One of the biggest pieces of legislation on the horizon is the European Union's Corporate Sustainability Due Diligence Directive. The proposal published last February would require larger companies operating in the EU to identify, prevent and remedy risks to human rights and the environment in their supply chains, such as minimum age requirements, worker safety, pollution and biodiversity loss."

Supply chain relationships are not random encounters but are contractual and formal inter-organizational interactions. The quality of a product or service is agreed to, and payment is exchanged. Companies purchasing supplies will need to add elements of environmental and social sustainability to the definition of quality and develop methods for ensuring quality control.

There will always be unscrupulous suppliers that cut corners and cheat on contracts or purchase orders, but there are long-standing methods for detecting such practices, and they will simply need to be extended to cover these new elements of quality. We have seen this in other areas of regulation, such as auto safety. Recalls of defective airbags are perhaps the best-known example of ensuring that quality control principles are applied to ensure regulatory compliance.

The image of a supply chain is overly simplistic because organizations often rely on multiple suppliers for the same supply, and their suppliers are serviced by suppliers as well. It may be more sensible to speak of supply webs rather than chains and replace the linear image of a chain with the more complex, multidimensional image of a network.

In a 2020 piece in the *Harvard Business Review*, Verónica H. Villena and Dennis A. Gioia reported on their study of the sustainability practices of multi-national corporations (MNCs) and their suppliers and found that:

"In recent years a rising number of multinational corporations have pledged to work only with suppliers that adhere to social and environmental standards. Typically, these MNCs expect their first-tier suppliers to comply with those standards, and they ask that those suppliers in turn ask for compliance from their suppliers—who ideally ask the same from their suppliers."

"It's an admirable idea, but it's been hard to realize in practice. Many of the MNCs that have committed to it have faced scandals brought about by suppliers that, despite being aware of sustainability standards, have nevertheless gone on to violate them... What's more, all those scandals involved first-tier suppliers. The practices of lower-tier suppliers are almost always worse, increasing companies' exposure to serious financial, social, and environmental risks."

The method they propose to improve the performance of multinational corporate supply chains is to train their own procurement staff or purchasing agents to understand that the definition of a quality supply is not simply its technical requirements but extends to the supply's environmental and social sustainability. Villena and Gioia conclude that the senior management of multinational corporations should make it:

"...clear to their procurement officials and create incentives for them to pursue not only economic goals but also environmental and social goals. Those officials should take a hands-on approach to collecting data about suppliers' capacity, monitoring indicators of their sustainability performance, and engaging with them in continuous improvement projects."

The challenge of supply chain sustainability is no different than the overall challenge of sustainability management. The goal is more thoughtful, careful management. The focus is on precision.

What resources must be used to produce this good or service, and how do we ensure that the production process is efficient and does not create more waste or environmental impact than needed? Similarly, are the people involved in producing the good or service treated well? Our goal is that workers remain in [good health](#) so they can remain engaged in production as their lives, skills, and the organization's productive capacity are all enhanced.

In a supply chain or supply web environment, this requires communication and effort at relationship building between suppliers and customers. Rather than sitting back and expecting an automatic delivery of sustainable supplies, engage with suppliers and identify their obstacles to sustainability.

In one notable effort in this direction, Walmart has a program where they work with the HSBC bank to reward sustainable suppliers with faster payment on invoices and access to capital. Some suppliers may require technical assistance to ensure compliance with sustainability quality criteria. Procurement officers could help them gain access to that assistance.

The formalization of sustainability requirements through regulation will help ensure that these factors are taken more seriously by senior management. Anticipation of the emergence of regulation in Europe and the United States is already having an impact. The major accounting firms are trying to add sustainability experts to their auditing staff, and corporations are starting to realize that sustainability is more than public relations.

General Counsel Offices are adding environmental lawyers or having experienced legal analysts carefully review environmental and employment statutes and regulations. While conservatives who find regulation inherently anti-business will likely seek to impede these practices, it would be more useful if they could focus on ensuring that the rules facilitate rather than impede organizational productivity and effectiveness.

More enlightened labor practices can result in more motivated and productive workers. Production that creates less waste and uses less energy and water will reduce costs. This is simply good management, and at its best, regulation can encourage best management practices.

Sustainability management and the careful use of people and natural resources will be how we continue economic growth without destroying the planet. The old management philosophy that you must break some eggs to make an omelet is just that—old and out of date. Relatively [free markets](#) are the best way to create the wealth we all rely on, but let's end this delusion that there has ever been a totally free, unregulated market.

Rules and regulations are needed and have always been around—try "thou shall not steal," for example. The rule of law has never been as important as it is today in this crowded, interdependent world. We can meet the challenge of supply chain sustainability, a process that has already begun.

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