

MISSING LINK: FALLOUT FROM A SUPPLY CHAIN LAPSE

Link Strategy creates value from thinking systemically about supply chain risks.

By DR ALICE WOODHEAD



Mattel, Nike, Coca-Cola. All three needed major interventions to manage the consumer fallout from supply chain failures. Mattel recalled about 9 million toys because of lead paint and tiny magnets that could be swallowed. In the 1990s Nike was targeted for child labour in the production of footballs. Coca-Cola has been under attack by students at several universities who are not satisfied with the company's environmental and ethical performance. This year the infant deaths and shocking succession of events that followed the milk scandal in China once again signaled a massive leadership failure across the supply chain landscape. Executives at these manufacturing firms may have ignored or failed to see the level of risk their companies were taking on in their attempts to reduce production costs and enhance profit.

Companies frequently undervalue their corporate brand by failing to assess supply chain risks. Sometimes it is because they have no direct control over these companies, or assessment is considered too expensive and

time consuming, or they have no confidence in their ability to gain compliance from offshore manufacturing companies. In effect, they allow their reputations and their brand's credibility to potentially be tarnished through product withdrawals, negative publicity and ill-focused supply chain management.

The chain gang

This type of supply chain failure dates to the 1980s when companies began to focus on low-cost production in developing countries. An excessive focus on the financial bottom line at the expense of quality control is at the core of leadership 'blind spots' that have caused these problems. Not surprisingly there is a lot more focus within the food sector on product recall insurance. According to Greg Malcolm, a quality assurance manager at Manildra Harwood Sugar, it is becoming increasingly difficult to operate without the appropriate certification and you would be unlikely to get insurance without certification systems. Every aspect of the supply chain must have a systematic approach, which leads to a whole of supply chain approach. As sustainability best practices become better defined, they will increasingly become incorporated into assurances required by insurers for due diligence.

Missing opportunities

Notwithstanding the growing market for 'green' and 'ethical' products, profit maximisation may cease to be the paramount objective of listed companies as shareholders become more discerning about the

sustainability values of the companies they invest in and more attuned to 'green wash'. The social boundaries have shifted. Concerns about being socially responsible and sustainable are changing the way consumers view companies and their products. A company's responsibility no longer stops at the factory door. Companies must show leadership and manage their local and far-flung manufacturing factories to the same environmental and social standards.

Suppressing uncertainty can lead to calamitous mistakes, while admitting doubts and working with management teams to understand the complexity of the supply chain systems reduces the risk of being blindsided. Companies tend to underestimate the opportunities that exist in value adding through effective risk reduction and knowledge management. Whilst reducing production costs will remain a key factor, focusing on the intangible value, beyond compliance reporting, and moving towards sound social and environmental supply chain management is where companies can find value and innovation opportunities that provide the competitive edge.

GPT (ASX: GPT) unit Voyages Hotels & Resorts Group wanted to get a snapshot of corporate responsibility (CR) uptake. Mark Ireland, a corporate responsibility manager with Voyages, says that they were pleasantly surprised with the results of a survey of CR uptake from their suppliers at one resort. Ireland says the survey results will be used to set minimum CR standards that in time all suppliers will be required to meet. Lessons learnt from those suppliers who exceeded

Four steps that Link Strategy recommends companies consider when reviewing the sustainability credentials of their local and international supply chains:

1. Walk the supply chain. Talk to the management and the staff on the factory floor.
2. Map the entire supply chain. Find out where commodities are sourced and assess the social and environmental impacts at each stage of the supply chain.
3. Develop procurement policies and contracts that include social and environmental performance standards.
4. Audit the contractors and sub-contractors, visit the sites regularly and ensure that they are complying with the contractual conditions.

expectations will be shared with those who don't, with the overall aim of increasing awareness of CR across the entire supply chain.

Carbon joins risk list

Ethical funds assess companies on a range of risk issues around sustainability, including capacity to comply with emerging carbon regulation. Nick Edgerton, a research analyst at Sustainable Alpha Funds, AMP Capital Investors, says debt levels might be taking front stage at the moment but pushing down the supply chain on sustainability issues will only increase. He says AMP's Sustainable Alpha Fund's criteria are now driven by assessing the carbon footprint as well as brand and reputation management risks.

AMP (ASX: AMP) also assesses companies based on potential growth and distribution of costs. Supply chain sustainability can affect both the viability and value of acquisitions. Edgerton says discerning buyers in a tight market are making purchasing choices based on green traits, not glamour. Tenants need to reduce their carbon footprint by leasing low-energy buildings. Consequently, tenancy premiums for green buildings are rising as reputational risks, plus the need to offset their operations by having energy efficient buildings, increase.

While tenants are partly responsible for creating this demand, there is increasing emphasis on the importance of reducing the carbon footprint and energy efficiency from government departments that is driving a broader awareness of the opportunities in supply chains to improve resource efficiency and logistics in operations.

In a recent focus group with the concrete supply chain (convened by the Australian Research Institute in Education for Sustainability, supported by Macquarie University), developers identified that reducing the levels of embodied energy in both the production of concrete and the use of concrete in buildings, were key drivers for developers to form closer relationships with suppliers (see Box). However, while the choice of materials does affect operational performance, the link is not always linear or precise. For example, two buildings

with apparently similar materials can have substantially different operational performance depending on design, fit-out and construction methods.

Send in the team

Supply chains are very complex systems with multiple social interactions occurring. One best practice approach to assess the complexity of the process is to conduct a critical systems analysis. The interactions between supply chain systems and sub-systems are mapped and the sustainability risks and opportunities identified with multi-disciplinary supply chain teams.

Companies are increasingly realising that multi-disciplinary sustainability teams, consisting of marketing, customer relations, supply chain managers, technical experts as well as the sustainability managers, are essential for addressing the complexity of embedding sustainability best practices into supply chain management and understanding the diversity of perspectives. A broad decision-base not only enables a more systemic and collaborative approach to procurement policies and specifications. It also reduces the risk of being blindsided. Assumptions about design, use of materials and logistics often need to be challenged for

products and buildings to achieve the most sustainable outcomes.

Emphasis to-date has tended to be on assessing the risk up the supply chain. However, some small and medium-sized enterprises (SMEs) now find their role is to educate buyers down the supply chain about the sustainability value in their products and services. Sustainability criteria on commodities may not have a price differentiation but it is being used for market access and for establishing collaborative research and development relationships. Clusters of regional or sectoral SMEs are evolving that actively support businesses who demonstrate their commitment to sustainable products and services.

In today's global markets, companies that have addressed their supply chain risks are likely to be rewarded for their efforts. Those that don't assess their supply chains and don't take some responsibility for their purchasing choices can expect to see their story on the front cover of newspapers and their insurance premiums moving upwards. 

Dr Alice Woodhead is director of Link Strategy, a sustainability policy and strategy consultancy. Dr Woodhead will be speaking at the Ethical Investor Sustainable Supply Chain Forum in Melbourne on 25 February.

Systemic thinking is required at multiple stages in a construction supply chain to ensure the most sustainable outcomes.

