Ethical Supply Chain

Bringing to life the ethical and sustainable vision of a business

June 2020

Executive summary

The supply chain brings to life the Ethical and Sustainable vision of a business. Business continuity relies on us thinking about the impact of the value chain on our people and planet

In summary:

- Increasing pressure from customers, regulators, and investors makes ethical and environmental supply chain management a strategic priority. The impact of the recent COVID-19 pandemic only increases the urgency.
- Ethical supply chains underpin resilience. Supply chain transparency and authentic support for third parties can keep your business relevant in a market of stakeholder rather than shareholder capitalism.
- Cost optimising and asset minimising supply chains, that sourced and served in a predictable world, have been left opaque, inflexible and vulnerable in global disruption.
- The key to business continuity during disruption is a resilient, digitally-enabled value chain; a multi-modal network that promotes collaboration with suppliers, enhances operational performance, and reinforces the ethical and sustainable reputation of the business.
- KPMG are here to support your journey in bringing to life your ethical and sustainable vision, and drive value through your business. We aim to provide a truly connected offering with the ability to mobilise globally at pace and provide digitally-enabled solutions.
- There are five steps to building an ethically and environmentally resilient supply chain:
  1. **Visibility:** achieve real-time, end-to-end tracking and traceability of suppliers of products.
  2. **Measurement:** complete due diligence screening of third party ethical compliance, and quantify the true environmental impact of movement of products.
  3. **Prioritisation:** identify and sequence the risks and solutions that have the greatest positive impact on your business.
  4. **Optimisation:** enhance the ethical and environmental footprint of the value chain to improve performance, mitigate risk and promote an affirmative reputation.
  5. **Proactive management:** use external data to enable predictive risk mitigation, and educate and influence third party behaviour through shared ethical and sustainability goals.
- An ethical and connected network means embracing the digital platforms that enable visibility and collaboration, educating and supporting vulnerable third parties, and taking bold steps in empowering consumers to make informed buying decisions.

“**A company’s supply chain typically accounts for 80% of greenhouse-gas emissions and >90% of the impact on air, land, water, biodiversity and geological resources[a]**”

Note: (a) https://www.mckinsey.com/business-functions/sustainability/our-insights/starting-at-the-source-sustainability-in-supply-chains.

Introduction

"Unprecedented" – a word used to describe the devastating fires in Australia, flooding in Yorkshire, and the COVID-19 pandemic. Astute businesses are already reconciling the impact of this global shift on their future footprint. Environmental, Social and Governance (ESG) principles applied across the value chain deliver resilience to weather shocks. This means embracing the digital platforms that enable visibility and collaboration, educating and supporting vulnerable third parties, and taking bold steps in empowering consumers to make informed buying decisions.

Global crises are industry agnostic. In the last 20 years, we have seen rapid geographic and structural diversification of customers, suppliers, products, and communications as a result of globalisation. In turn, we expect increased revenue and operational performance. And yet, the basic model that underlies most core operations predates globalisation.

Supply chains are strategically critical, but vulnerable to risk. Globalisation means supply chains have become complex, dispersed, opaque and inflexible. Traditional cost optimising and asset minimising models sourced and served adequately in a predictable world. Faced with the unexpected, however, a minimalistic approach without visibility over where inventory is located, knowledge of nodal constraints, and impending risk, exposes your business to disruption and ethical violation.

If businesses can't see to respond to operational change, it is concerning to think what is happening to the people and planet across supply chains spanning less mature and unregulated markets, exposed to slavery, forced labour, dangerous working conditions, information security lapses, quality issues, environmental waste, pollution and much more.

The key to business continuity is resilience, and at the core of resilience is an ethical and sustainability operating model. KPMG can help you to become agile, flexible and influential in a new world of stakeholder capitalism. A multi-model network with diverse upstream and downstream locations, driven by real-time, predictive intelligence means you are able to react quickly and effectively in a crisis, predict and mitigate future risk, promote stakeholder loyalty and ensure regulatory compliance.

Profitability and shareholder returns are always going to be a priority, but investors and consumers are making it clear that social purpose and environmental stewardship are critical to business success, creditability and relevance. The supply chain is the platform to evidence the ethical and sustainable vision of your business, but demonstrating that, requires action, innovation, collaboration, and transparency.

Why we need to act now

“ESG is a must have, not a nice to have. Every client will require it.
– Top-30 UK Asset Manager”

40 million people are victims of modern slavery worldwide,

71% of these are women and girls[b]

£116bn is the global profit[c]

Today’s market is of stakeholder capitalism rather than shareholder capitalism. In a borrow-and-share network, stakeholder credibility is essential to ensure your business remains relevant.

It can be challenging to balance the triple bottom line. Driving ethical and sustainable business practices adds economic and social value across the supply chain.

1. **Stakeholder expectation:**
Consumers, employees and investors are demanding more visibility over the sourcing and manufacturing of products. Consumer purchasing decisions are increasingly focused on businesses who follow ethical best practice. Stakeholder loyalty dictates your license to operate. If withdrawn, revenue and profit margins suffer.

2. **Competitive advantage:**
Leading by example in ethical stewardship can be considered a ‘differentiator’ in a competitive market. Evidence of ethical and environmental practice can prompt the same purchase intent as product promotion. Businesses have the opportunity not just to be able to react to demand or supply shifts, but to influence the nature of those shifts in their third parties.

3. **Reputation:**
Authenticity in your ethical purpose and action will mitigate the risk of reputational damage, as well as attract and retain talent. When an ethical breach, violation or climate disaster occurs, it is not typically the supplier that receives the negative press, it is the company that uses their services. Underpaying suppliers can result in liquidation, a forced reset of customer expectations, and damaged credibility.

4. **Regulatory compliance:**
Businesses need to ensure they align with government regulation. Failure to do so may result in fines reaching into the billions, sanctions or investor withdrawal. In 2022, the Task Force on Climate Disclosures are likely to become mandatory, and the plastic-packaging tax will come into force on all goods imported and manufactured in the UK containing 30% or more single-use plastic.

5. **Supplier risk:**
Supply chains are opaque, complex, and inflexible. Single-sourcing or reliance on third parties to manage the extended supply chain exposes your business to the risk of regulatory fines and operational inefficiency. Collaborative value networks are crucial to business continuity in response to logistics restrictions, ethical violation, and mass workforce absenteeism.

6. **Operational efficiency:**
Waste reduction and streamlining processes allows companies to simultaneously reduce costs and practice environmental stewardship. Fair payment and ethical treatment of third parties yields greater output due to higher quality and cultivated input. Underpaying suppliers will result in either liquidation or demotion from “Customer of Choice” when stock is limited.

Notes: (b) https://www.un.org/press/en/2018/gashc4244.doc.htm.
(c) https://www.ilo.org/global/topics/forced-labour/statistics/lang--en/index.htm.

Disruption heightens the urgency

Disruption presents a unique supply chain challenge and opportunity. Those businesses we've seen able to respond effectively to COVID-19 are those with ESG embedded in their operating model. As investors, employees, and consumers continue to find a safe haven in those businesses, they'll be well placed to capitalise in the new normal.

The financial crisis impacted demand. Fires and floods impacted supply. COVID-19 has impacted both. As the pandemic spread, every node of the supply chain was squeezed, resulting in scarce materials, inability to match workforce demand to supply, travel restrictions, logistics confinement, closure of administration centres and retail hubs, and shifts in customer buying patterns.

Meanwhile, the businesses who performed effectively swiftly examined their operations; testing critical choke points, reviewing contracts with critical suppliers, financially and ethically enforcing the safety of their workforce, and initiating new ways of working, such as freight consolidation, remote working, and multi-sourcing key commodities. Each of these businesses had the following characteristics:

— Diverse value chains and multi-sourced key commodities

— Authority to agree new led times which protected workers in low/middle income countries, and provide financial stability to those without national economic safety nets

— Inventory buffers

— Strong relationships with upstream and downstream third parties

— End-to-end tracking and traceability of products and services

— Worked agile production and distribution centres.

Once remedied, business continuity relies on resilience.

Firstly, resilience means sensing your "new" demand profile and generating scenario plans for how the downstream post-COVID-19 customer behaves. Resilience also means going deeper into the supply side; supporting critical and vulnerable suppliers, moving away from single source procurement, and rethinking Just-In-Time inventory management. And finally, resilience means creating a new footprint and systematically restructuring your target operating model to adapt to a new global market.

Restructuring the target operating model is like moving house; You don't do it often, and when you do it is an endeavour, but yields significant results. Touching on performance, technology, people and structure, transformation provides an opportunity to combine technological innovation, ESG compliance, and operational excellence into a single, cohesive model.

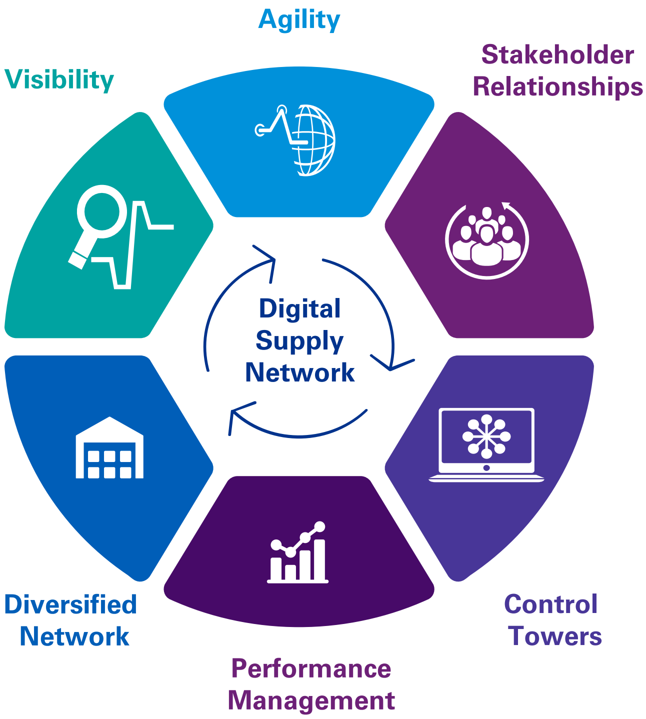
In a post COVID-19 world, it will no longer be acceptable for business to be unprepared for the unexpected. We have demonstrated that ESG principles underpin rapid stabilisation techniques. We have collaborated at scale and at pace to achieve social purpose. We have promoted the importance of people, health and wellbeing, alongside operational logistics.

Act now: Authentic action is needed to preserve finite resources, align strategic performance metrics to incoming ESG reporting frameworks, and optimise the value chain to enable traceability, technological and product innovation, and collaborative networking. Resilience means that, together, we take care of people and our planet.

What good looks like

A resilient value chain is a multi-model, digitally-enabled network that promotes collaboration with suppliers, enhances operational performance, and reinforces the ethical and sustainable reputation of the business.

All industries face ethical and sustainable risk; from avoiding corruption to tracing products; using water responsibly to ending child labour; coupled with the complexity and scale of a typical value chain. A strategic change in operational management needs to consider the entire value chain, and as you transform, they need to follow your lead.



Demand intelligence and network synergy enables **agility** and resilience. This means being able to respond at pace to inefficiencies or crises, including regulatory change and climate-related weather disasters.	Our new global markets are those of borrowing and sharing. **Collaborative relationships** with third parties promote regulatory compliance and ethical behaviour, and generate synergies towards shared sustainability goals.
Real time visibility over the value chain is critical to operational excellence; reducing waste and costs, ensuring workforce safety, and improving third party regulatory compliance.	**AI and predictive analytics** can accurately forecast demand, shifts in global climate and economic risk profiles, and improve production and distribution scheduling and monitoring.
A **multi-sourced, diverse network** enables flexibility at pace. Collaborative and ethical third party relationships underpin the resilience of the network and business continuity.	An **integrated set of KPIs** provides insight into the ethical and sustainable performance of the value chain, and how this interacts with other strategic business objectives.

“Of the world’s 300 largest pharma, energy, CML, & tech companies, those with more ethical operations had higher profits”

79%

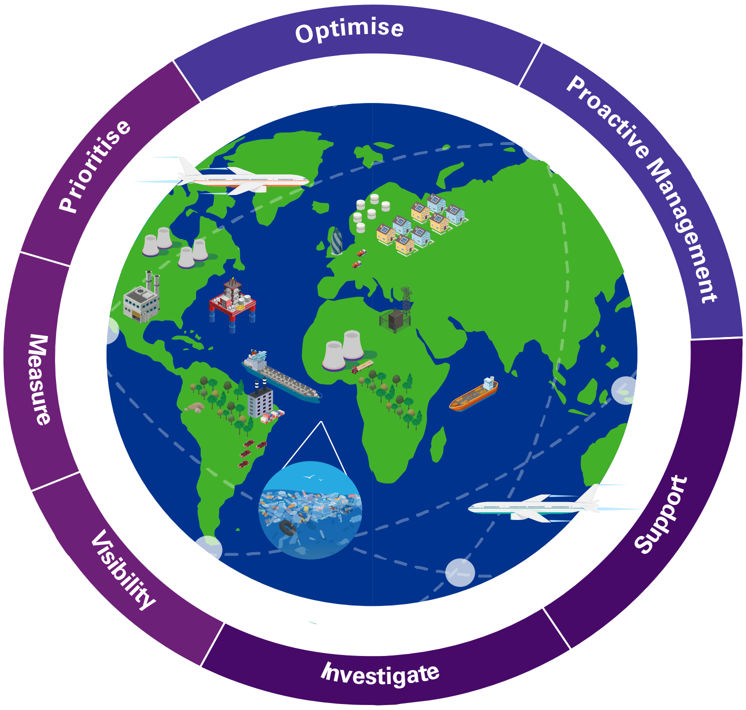
of fund asset managers say their organisations consider ESG in investment decisions[g]

Notes: (f) https://www.bcg.com/publications/2017/total-societal-impact-new-lens-strategy.aspx.
(g) http://securities.bnpparibas.com/files/live/sites/web/files/private/surv_esg_en_2017-07-07.pdf.

Where to start

KPMG can help you transform the environmental, social, and governance foundations that make up your business. We help you to shape a value chain that mitigates risks associated with climate disasters, complies with incoming regulation, and looks after the people and the planet.

This approach can improve the overall efficiency of your operations and contributes to reducing the wider global risk of continued ethical or environmental catastrophes.



Understanding the Supply Chain

Enabling you to empower your stakeholders to make informed buying and investing decisions.

1. Achieve real-time **visibility** over suppliers and operations through AI-enabled technology to provide tracking and traceability
2. **Measure** the compliance of suppliers, portfolio companies, acquisition targets and strategic partners through ESG due diligence:
   - Internal reviews of ESG certifications, policies and documents
   - Outside-in reviews of ESG track record and integrity profile through independent sources
   - Quantify the true impact of products/services on the environment through analysis of the value chain at a granular level.
3. **Prioritise** key ESG risks through interactive risk identification considering key criteria; severity, likelihood, velocity and interconnectivity.

Transforming the Supply Chain

Driving a step change in your ethical and sustainable footprint through flexibility, resilience, collaboration and control across the value chain.

1. Support you to **optimise** the value chain to enhance performance, mitigate risk and increase reputation, by;
   - Identifying and prioritising, at pace, solutions based on tolerance to value levers
   - Align ESG optimisation to the wider operating model across performance setting, digitalised operations, organisational structure, and workforce and talent enhancement
2. **Proactively** mitigate risks using external data to enable predictive risk management, influence consumers through product segmentation, and influence suppliers by implementing a new compliance framework to plan, execute, monitor and assess shared sustainability goals.

Remediation & Incident Management

Responding and embedding a culture able to respond to unprecedented ESG breaches at pace through effective remediation

1. Investigate incidents or breaches at pace, and respond with the design and implementation of a detailed remediation plan
2. Support in the execution of ongoing incident response management, by identifying high risk scenarios and designing a strategy which includes;
   - The design and implementation of scenario "playbooks" to build a crisis-ready culture
   - Embedding robust ongoing ethical practices; third party supplier audits, due diligence, and managed services

Our technology

Supported through AI, the value chain provides operational agility and resilience, process visibility over the real-time movement of products, suppliers and services, and uses predictive intelligence to mitigate against regulatory or climate risk. At the core of the model are collaborative third parties relationships, embedded on trust and shared strategic goals.

1 KPMG Third Party Risk Intelligent Diligence (K-3PID)

K-3PID is a technology-enabled cognitive computing solution that has the ability to perform due diligence, auto-discount false positives and generate a full audit trail.

Scalable and flexible, it reproduces the cognitive and investigative processes of due diligence researchers through natural language processing to return results more efficiently, without the constraints of human-based research.

2 Dynamic Risk Assessment

An interactive risk identification process that uses the application of key criteria; severity, likelihood, velocity and interconnectedness, to identify high risk nodes across the value chain by;

- conducting interviews with key stakeholders to identify the risks most pertinent to their role in the value chain
- producing graphic analysis of risk clusters, risk-to-outcome relationships, pervasive risk emitters, and the interconnected velocity of risks.

3 Predictive Supply Chain Management (PSCM)

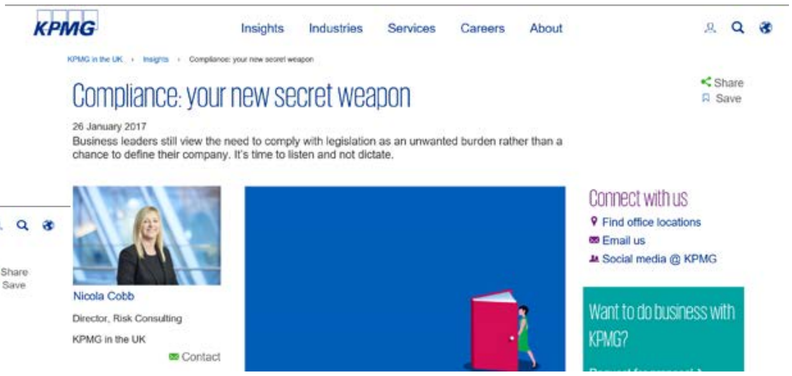
PSCM uses a real time digital platform with integrated and advanced predictive analytics to address risks, and provide visibility and control of the value chain.

The platform enhances operational and financial performance by applying insights from customers, suppliers, third party providers and other external data points. Proactive risk management further improves decision-making and interoperability, collaboration with Supply Chain partners through real-time connectivity, and automated reporting with predictive capabilities.

Note: (h) https://www.blumeglobal.com/blog/achieving-20-20-vision-into-your-supply-chain/.

Further Information

Click on the hyperlinks embed in the images to read further thought leadership on ethical and sustainable supply chains



Risk management must improve as some slavery reporting falls short

Companies must step up their risk management activities as reporting requirements around the new Modern Slavery Act come into force this year, with lobby groups claiming some of those already reporting are falling short.

Those companies reporting financial results from the end of March will have six months to issue statements under the new laws, which came into force last October and affect companies with more than £36m in group turnover and operations in the UK.

Some companies have already published statements voluntarily but analysis by one lobby group found many fell short.

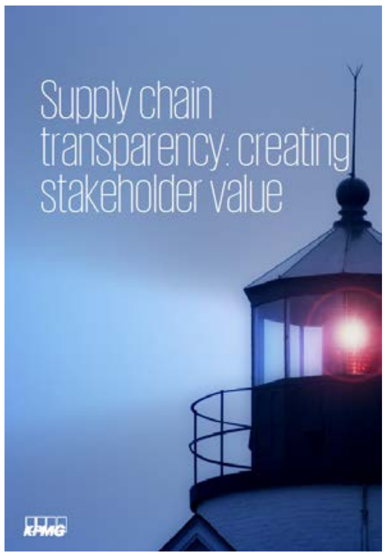
The Business and Human Rights Resource Centre analysis of the 75 statements it holds on its public registry found only 22 met the requirement to be both signed by a director and available from the company's website home page.

Marilyn Croser, director of corporate accountability group Core Coalition, said while it hopes its guidance will help address the problem, if a pattern of non-compliance emerged the government must take enforcement action against companies.

"While the companies that have published reports under the *Act* are to be commended as early movers, it's clear that there is widespread misunderstanding among business about what's required," Croser said.

Institute of Risk Management CEO Ian Livsey said it would take time for best practice to emerge but he was encouraging firms to avoid generalities and be specific about their risk management plans, then put those plans into action.

"They're quite brief at the minute but I'm not surprised at that, because these are the ones that are doing it on a voluntary basis," Livsey told *Post*.



Why KPMG?

Connected Consulting:

We are a cross-functional team with SMEs across our global member firms in Sustainability, Supply Chain, Procurement, Forensic, Corporate Intelligence and Compliance. We also regularly collaborate with Strategy, Climate Risk, Managed Services and People consulting, bringing the best insights and knowledge from across KPMG.

Our global coverage:

With an extensive network of KPMG member firm offices worldwide, we have the capability to mobilise at pace, and can deliver projects virtually and remotely as required.

We have teams to support you with challenges beyond the Supply Chain. We work closely with our experts in Climate Risk, Strategy, Climate Assurance and Sustainable Finance.

Our technology:

We utilise prebuilt software and proven methodologies; K3PID (AI supplier risk assessment), Diagnostic Risk Assessment (Operational risk analysis), and KPMG Predictive Supply Chain Management (decision support AI providing end-to-end traceability across the supply chain).

We bring a holistic advisory service that recognise the importance of people and performance through digital innovation.

Our expertise and track record:

We have worked on some of the highest profile supply chain projects globally, including the largest operating model transformation 'in a generation'.

We have extensive experience with both FTSE 350 and boutique businesses. We help our clients achieve end-to-end traceability across their supply chains, improved compliance and due diligence, and increased efficiency through digital enablement.

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