



Transparency in the supply chain

An article prepared by Joris Wiemer, Intern SMEs, in the context of the GRI/GTZ Transparency in the supply chain project, in cooperation with Leontien Plugge, Coordinator SME program. The findings are based on desk research and interviews with a dozen European MNEs, including the project participants, about their sustainable supply chain management systems.

"My experience over the last decade and also the feedback from [direct] suppliers worldwide have led me to the conviction that systematic and trustful communication between the two parties is an essential key to a successful cooperation (...) this is not a one way street but should also encourage the buyers to have a more open and frequent communication with their partners, the suppliers. Setting up a reporting system will contribute to raising awareness on the supplier' side and deepen the mutual understanding." - Maren Böhm, CSR Representative for Asia, Otto Group

To date, sustainability in the supply chain has been a top-down driven effort. Most companies are only now engaging their direct suppliers, with plans to extend beyond that. However, there is a growing realization that the control a company has over the sustainability aspects of its supply chain - which expands almost exponentially between tiers - is ultimately limited. There is currently a necessity for site visiting and auditing to obtain reliable information, and this will probably remain so for the foreseeable future, especially with regard to suppliers in weak enforcement environments. Alternatively, the development that can be pursued throughout the supply chain is the spread of the realization of a shared responsibility and the merits of transparency and especially reporting in the chain. By involving all tiers it will become much easier to gain meaningful insights and inputs from the entire supply chain.

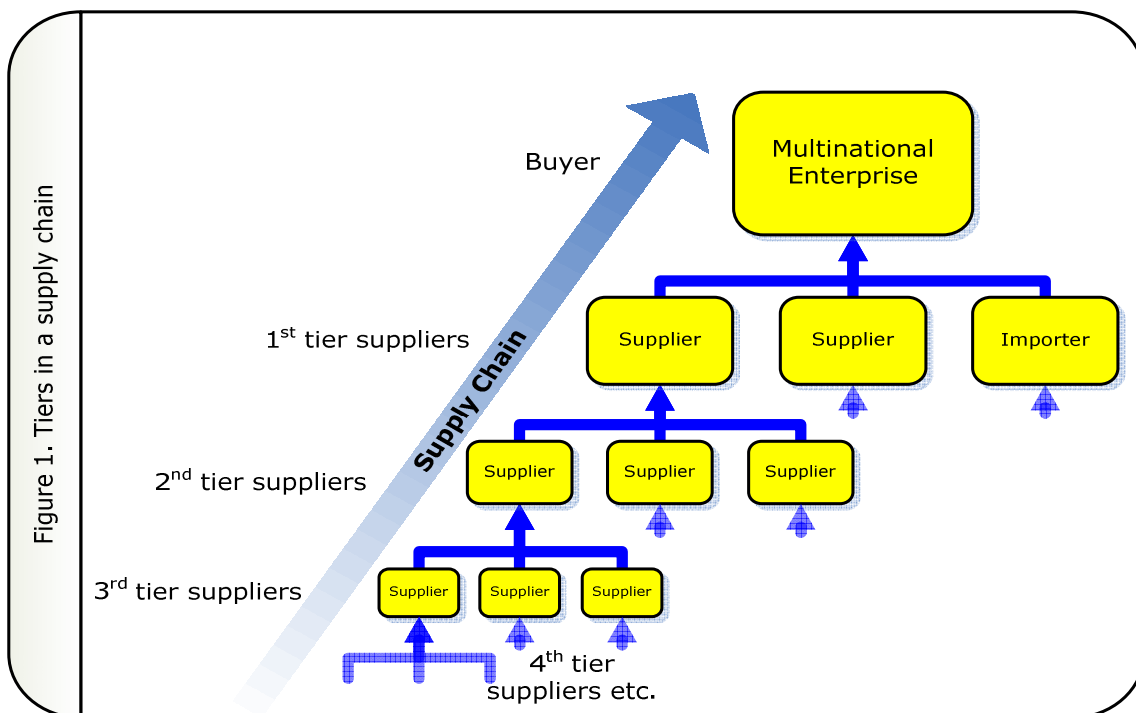
In order to deal with supply chain issues more effectively, many companies are now moving to proactively improve the sustainability of their supply chains, focusing predominantly on their direct suppliers. Traditionally, Multinational Enterprises (MNEs) have defended their sustainability by policing their supply chains with codes of conduct and audits in a somewhat reactive way. Mimicking the move from face to face transactions of supplies towards process reengineering, MNEs are increasingly working *together* with their suppliers to deal with sustainability issues. Using incentives over regulation and partnership rather than policing supports companies as they move towards more transparent and sustainable supply chains. This was reflected in the interviews which highlighted companies' view that their contribution to sustainable development was a work in progress rather than a steady state of affairs.

The "problem" with sustainability is that is not intrinsic to a product. It is not something added or assembled by one supplier as a component or a mark of quality measured in the finished product. Rather, it is a quality of a

product pertaining to the impact its creation, use and disposal has had on environmental, social and economic systems. For a company, significant value is gained from having a sustainable supply chain. Minimizing impact on the environment and ensuring proper social and working conditions are obviously desirable from a sustainability perspective. In addition, a business' brand value can be enhanced if a company can communicate its performance in reaching sustainability goals in their supply chain.

Note however, that a supply chain is not really a chain as much as a pyramid, with suppliers having many suppliers of their own, making the number of entities to be controlled increase almost exponentially throughout the chain as illustrated in figure 1. Nevertheless, MNEs' brand value forces them to be seen to be accountable for almost all parts of the chain. End-users do not have the power to check the entire chain, but they do have the power to influence MNEs to do so.

As MNEs like Shell and Nike have experienced (and acted upon!) we are moving from a "trust me" world to a "show me" world. In the "trust me" model, whatever is done with regard to sustainability of supply chains is based on what MNEs have required their supply chains to do. Value is added when customers have sufficient faith in a company and how it manages sustainability in its own operations and those of its suppliers. The "show me" world is one where people want to see the facts for themselves.¹



¹ SustainAbility and UNEP Trust Us: The Global Reporters 2002 Survey of Corporate Sustainability Reporting No. 2 in the *Global Reporters Series* (2002) pp. 11

As a way of demonstrating how they are managing sustainability and relationships with suppliers, MNEs turn to codes of conduct and audits. Whilst this may be a useful starting point, it is also a somewhat reactive and ponderous way to work towards sustainable solutions. The interviews conducted for this article showed that codes of conduct are common amongst MNEs. Such codes generally outline how the buying company will behave vis-à-vis suppliers and how it expects suppliers to behave, including the circumstances under which its products are produced. The codes typically covered any combination of health and safety, human rights, labor, social rights and environmental impacts. The Universal Declaration of Human Rights, ILO conventions, the UN Global Compact principles and ISO14000 are commonly referenced. Codes of conduct often restate or refer to local environmental and social legislation. Many MNEs contractually bind the supplier to sustainability measures, thus making violation possible grounds for terminating the commercial relationship.

All the MNEs interviewed are now monitoring or auditing adherence to codes of conduct. This is especially relevant in perceived "high risk countries", such as emerging economies where production sites are low-cost and environmental and social standards potentially lax. Monitoring can range from supplier generated information, e.g. through reviews or self-assessment questionnaires, to full audits and scheduled or unscheduled site visits by the MNE or a certified auditor to verify the adherence to the code of conduct.

The talks with the MNEs showed that there are some problems with the current efforts. Major issues identified were:

- 1) Limited control: Companies can police their direct suppliers and sometimes even the tier beyond that, but cannot see the base of their supply "pyramid".
- 2) Third party procurement: Importers often refuse insight into their supply chains because they compete with the MNEs themselves.
- 3) Too many codes: Suppliers are overwhelmed by various codes. Though roughly similar, the certification processes themselves are a burden.²
- 4) Limited knowledge: Suppliers in developing countries are often simply unfamiliar with sustainability.
- 5) Supplier skepticism: Codes are seen as an attempt to set demands and externalize costs; this view is strengthened by occasions where there is a discrepancy in priorities between the MNEs' different departments.³

To meet some of these challenges several of the interviewed MNEs are now adopting a more integrated, partnership based approach to sustainable

² Jørgensen, H.B., P.M. Pruzan Jørgensen, M. Jungk, A. Cramer, *Strengthening Implementation of Corporate Social Responsibility in Global Supply Chains*; World Bank (October 2003) pp. 24

³ Ibid. pp. 10

supply chain management. After a self-assessment or initial visit of their direct supplier, an improvement program is set up in which the supplier is expected to actively and sincerely engage the requirements. Inadequacies in sustainability are seen as a starting point for improvement rather than a reason to instantly terminate a relationship. The MNE clarifies its needs to the supplier and supports the supplier in fulfilling its requirements through guidance. This approach helps suppliers by not just externalizing costs of audits to them, but also helping them to meet their customers' needs. Naturally, if the supplier remains persistently unengaged, the contract may be terminated.

To make such a relationship successful a certain amount of transparency is required. Transparency e.g. through sustainability reporting fulfills a concrete information need. The OECD recognizes the power of sustainability reporting by MNEs, citing research that transparency is better than certification in gaining the trust of consumers. However, it also highlights how reporting is strenuous for MNEs with global supply chains.⁴

Rather than continually stretching the boundaries of an MNE's reporting responsibility, making it strenuous and ultimately an unrealistic option, the "sharing out" of reporting sustainability performance to the tiers of the supply chain can create the desired transparency while sharing the challenges. The mutual understanding and awareness of partner needs is another benefit. Reporting can become part of the "improvement package" buyers require from their suppliers.

It seems a good first step for suppliers and the MNE to become more transparent. The proactive nature of reporting would greatly facilitate the information gathering of larger companies, making the supplier more attractive. Rather than being the subject that is asked to implement certain regulations, transparency through reporting can give a supplier the opportunity to demonstrate their contribution to sustainable management systems and potential increased efficiencies. It also gives suppliers a chance to explain their failures and hopefully, their successes, something which an audit does not do very well.

Nurturing transparency will help create bottom-up efforts for sustainability rather than relying purely on top-down monitoring, which after all is also an expensive proposition. By convincing suppliers to be transparent it becomes possible to look further down the supply chain and understand its challenges better. In getting more and more actors in the supply chain to speak for themselves through reports mapping sustainability in such a vast network of organizations can become easier.

⁴ Fliess, B., H. Lee O.L. Dubreuil and O. Agatiello *CSR and Trade: Informing Consumer about Social and Environmental Conditions of Globalised Production* OECD Trade Policy Paper No. 47 -Part 1 (January 10th 2007) pp. 31