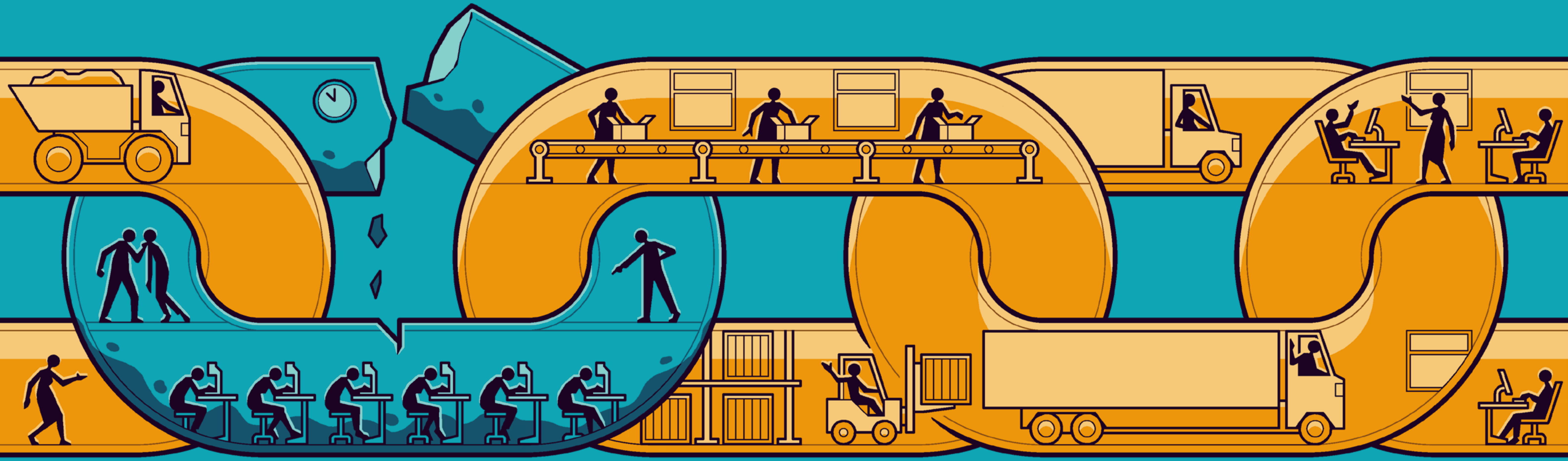
Moral Money Forum

FT FINANCIAL TIMES

So you think you know your supply chain?



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'In the absence of effective regulation, businesses must work with their peers and other stakeholders to create "soft law" and self-regulatory standards and guidelines so that complex issues can be managed in an integrated way'

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'While investors cannot be expected to do the job of regulators and law enforcement agencies, we can ask the tough questions and take the "vote with your wallet" concept to new heights'

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WHITE & CASE

'While some governments continue to publish voluntary soft law instruments, the direction of travel points sharply towards governments introducing mandatory obligations to eradicate risks in corporate supply chains'

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Foreword

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For all the sophistication of today's international supply chains, a grave and ugly problem lurks in their darkest corners. As this report details, forced labour and other forms of worker abuse remain a shockingly common feature of the global economy.

The persistence of the problem, decades after multinational companies came under pressure to eliminate it from their supply chains, is a harsh reflection of their failure to do so. But other stakeholders have a powerful role to play, too.

Investors are starting to apply a welcome whip hand to corporate leaders who fail to take this issue seriously. Tough new laws and regulations have been coming into force — and some national authorities are becoming increasingly energetic when it comes to enforcing them.

Consumers, too, have shown greater awareness — even if, for many, it doesn't yet affect their purchasing decisions. Even for the most enlightened shopper — or investor — a dire lack of reliable information can make it hard to know what action to take. But a new crop of start-ups is devising high-tech ways to shed light on this murky issue, building on years of valuable research by academics and non-profit groups.

As the data deficit begins to shrink, it will prove increasingly difficult for abusers of workers — and the companies they supply — to dodge the consequences.

Simon Mundy
Moral Money Editor
Financial Times

Illustration: Matt Kenyon

So you think you know your supply chain?

With greater scrutiny by investors and new regulations, the issue of worker exploitation and abuse is more in the public eye than ever, writes *Sarah Murray*

In 2018 the Responsible Sourcing Network presented an alarming figure: twice as many people worldwide were in forced labour as had been taken to the Americas during the 300 years of the transatlantic slave trade.

In the five years since that statement by RSN, a US non-profit organisation that combats human rights and labour abuses in raw materials sourcing, the upending of supply chains caused by the Covid-19 pandemic has put millions more workers at risk of this kind of abuse.

Statistics on forced labour and human rights violations make for grim reading, not least because efforts to end such abuse have been going on for decades.

Bennett Freeman, a corporate responsibility adviser and vice-chair of RSN, remembers the birth of organisations such as the Clean Clothes Campaign in the Netherlands (1989), the Ethical Trading Initiative in the UK (1998) and the Fair Labor Association in the US (1999).

"This agenda emerged in the early to mid-90s and the moving parts were visible and working by the end of the 90s," says Freeman, a US state department human rights and labour official at the time. "We're talking about a quarter of a century of focus, effort, initiatives, successes and failures, and frankly there's a big question to be asked about how much progress we've made."

He is not alone in wondering. Alison Taylor, a specialist in ethical business at the Stern School of Business, New York University, likens the situation to a game of Whac-a-Mole.

"There will be a revelation of some horrible abuse and collective action from the companies in question," she says. "Some of that will be quite effective but then another problem will pop up somewhere else. It's all very reactive."

But with continuing scrutiny from consumers, activists and the media – and growing interest from investors – companies are now under more pressure than ever to meet obligations over responsible sourcing.

When we asked FT Moral Money readers to point to the biggest risks posed by unethical labour practices in supply chains, most picked reputational damage while others cited consumer boycotts and legal challenges.

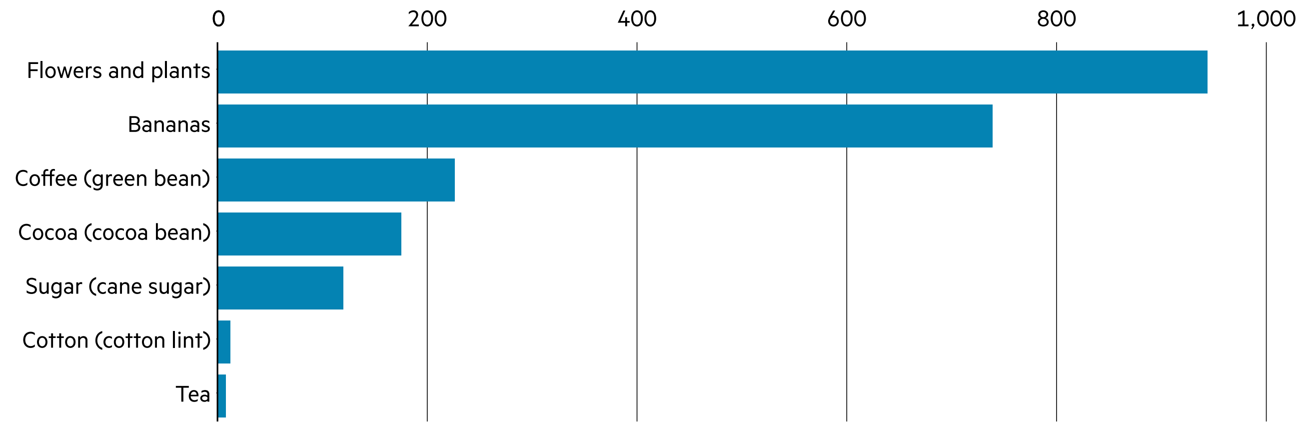
No silver-bullet solution has appeared since human and labour rights abuse emerged as a corporate risk in the 1990s. Thirty years on, companies are still not prioritising action in this area. Asked how important ethical supply chain practices are to their organisation, most readers of FT Moral Money ranked them the same as other sustainability challenges.

Nevertheless, in sectors such as apparel and footwear, which have faced particular scrutiny, the years of effort have begun to pay off. At the same time, innovators have developed technologies that can track products back to individual factories, fisheries and plantations.

Alongside emerging legislation that imposes financial penalties for non-compliance, this has led to cautious optimism about the emergence of a new era – one in which fewer iPhones and sneakers are made by children or exploited workers.

Fairtrade-branded products are concentrated in a few key commodities

Estimated sales volume of products sold under the Fairtrade International scheme in 2020 ('000 tonnes)



Source: Fairtrade International

Not an out-there problem

At the heart of the challenge is the length and complexity of the journeys that products take as raw materials become finished goods. Many pass through the hands of thousands of workers in enterprises that range from huge factories to agricultural co-operatives, micro businesses or farms of just a few hectares.

Even the sourcing of raw materials – where Patricia Jurewicz, chief executive of RSN, sees some of the worst abuses – is fraught with complexity. "There is a huge web of so many different actors, of transportation of materials, of the different processing and blending," she says. "It is really hard to peel all that back."

Disruptions such as the pandemic, inflation and currency fluctuation exacerbate the problems that face workers, as do geopolitical upheavals. LRQA, a global assurance firm, formerly part of Lloyd's Register, recently reviewed its 2022 audits – nearly 20,000 of them. It concluded that violence and macroeconomic volatility increased the risk of child labour in 18 production markets.

Purchasers' buying practices can also create problems. In 2017 and 2018, Mark Anner, a professor and an expert in pricing practices at Pennsylvania State University, studied 340 Indian factories making clothing for export. He found that price pressures and shortened lead times led most suppliers to raise production quotas for workers, maintain below-subsistence wages and make overtime obligatory.

Anner's analysis also revealed a greater reliance on female and migrant workers, the imposition of short work contracts to avoid paying benefits, and outsourcing to unregistered factories. Workers who failed to meet production targets were verbally and even physically abused.

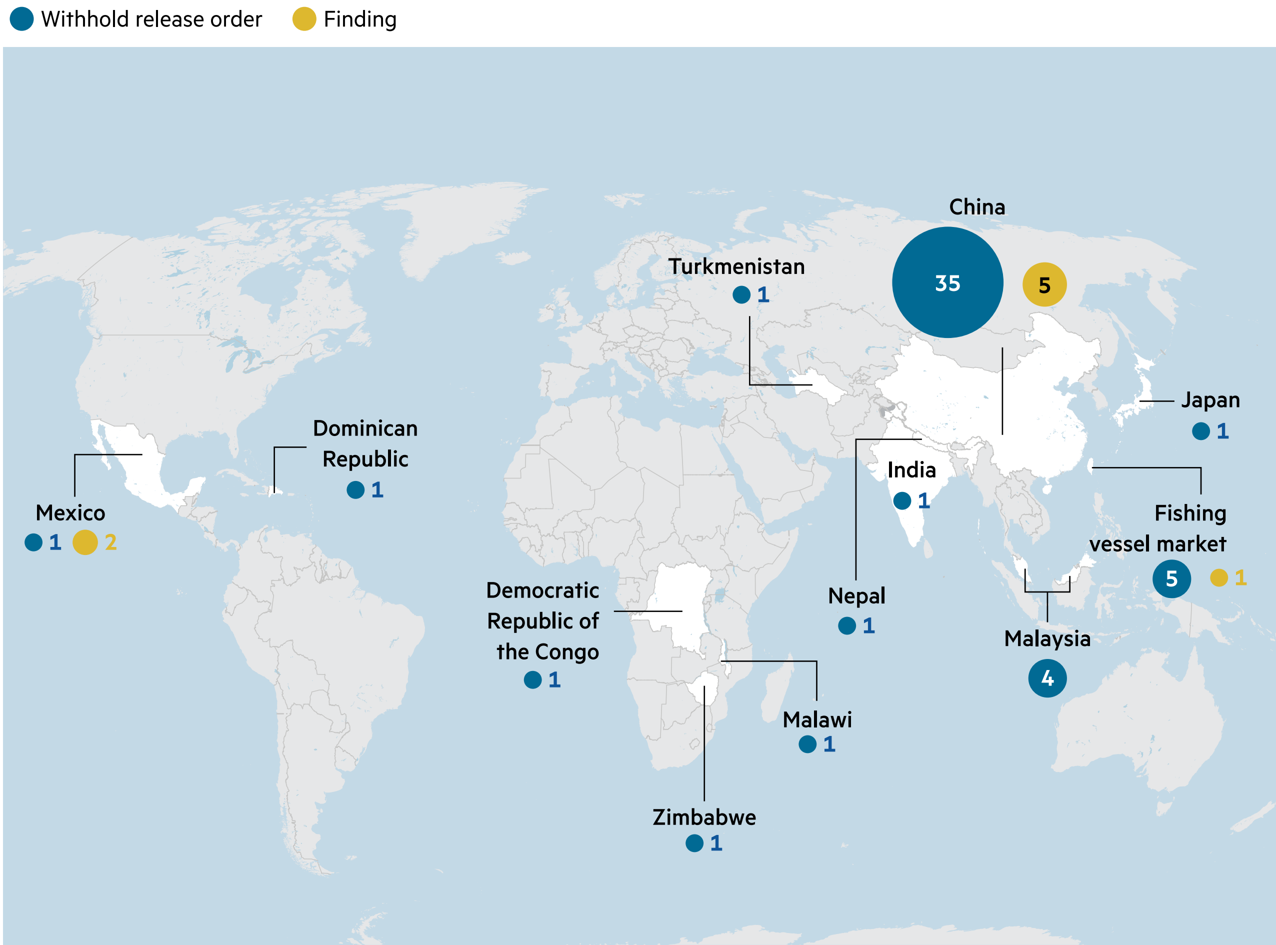
"It's not just an out-there problem," says Caroline Rees, president of Shift, a non-profit organisation that is a centre of expertise on the UN guiding principles on business and human rights. She argues that when buyers push down prices, particularly at a time of rising input costs, suppliers' struggle to survive will always win out over codes of conduct.

"There's been too much externalising the problem then coming in behind to say, 'let's be part of the solution,'" she says. "[This never questions] how much internal practices or the business model itself is creating the context for that problem."

As procurement decisions make their way through the supply chain, it is workers who suffer most. "Those at the top of the supply chain have incredible power and resources," argues worker rights advocate Cathy Feingold, director of the international department at AFL-CIO, the US's largest trade union federation. "They should be responsible for assisting suppliers in having a supply chain that upholds their commitments to good worker and human rights."

China accounts for the bulk of forced-labour action by US trade authorities

Active withhold release orders and findings issued by US authorities over forced labour concerns



Source: US Customs and Border Protection

Scrutiny finds a new home

As a student in 2001 Jonah Peretti, who went on to co-found the Huffington Post and BuzzFeed news outlets, took up an offer by Nike to personalise his trainers. He asked for the word "sweatshop" to be stitched into them — and his email exchanges with the company were broadcast globally. The age of online consumer activism had arrived.

What followed was a wave of interest from consumers in knowing that what they were buying was not made by children or underpaid workers in dangerous or sweatshop conditions.

Shoppers began to vote with their wallets. Between 2004 and 2016, Statista estimates that retail sales of products certified by Fairtrade International rose by nearly 10 times, from €830mn to €7.9bn. At the same time, new digital tools emerged to help consumers make more ethical choices, including QR codes, mobile apps and interactive websites.

In the end, it may not be shoppers pushing companies hardest. The Statista research, published in 2021, found that only 26 per cent of US consumers would pay a premium for fairly traded food and drink.

"It's hard to engage consumers," says Rees. "I feel there's a ceiling on the percentage of consumers for whom that will tip the balance."

Consumer pressure can only go so far, says Shawn MacDonald, chief executive of Verité, a non-profit organisation that highlights and remedies supply chain violations. "It's not fair to expect consumers to hold companies accountable."

The investment community, meanwhile, is increasingly a force to be reckoned with. "I have [sustainability executives] frequently tell me that when investors call, that is when I can get the C-suite's attention," says MacDonald.

Yann Wyss, global head of social impact and human rights at Nestlé, knows how this works in practice. He has seen a sharp rise in interest from investors since joining the company 12 years ago. "Back then I would attend maybe a call a month with investors," he says. "These days it's more like a call every two days."

The questions investors ask vary. According to FT Moral Money readers, they range from the origins of the materials that companies use to the nature of local labour practices.

Finding answers can be tough for investors. "Getting a baseline understanding of these issues is incredibly hard," says Dan Hochman, head of sustainability research at Bridgewater Associates, the asset manager.

He compares data on supply chains with that now available for carbon emissions. "We're so much earlier in the data evolution," he says.

"Almost by definition some of the worst parts of the supply chain happen in the shadows."

For investors, this means looking beyond compliance or audit data, or whether companies have a supplier code of conduct or a human rights policy.

At Wellington Management, due diligence in its Global Stewards fund covers everything from whether a company is meeting its legal obligations to how it holds suppliers to account on issues such as fair wages and working conditions, as well as what it is doing on the ground and through third-party assurance firms to verify all this.

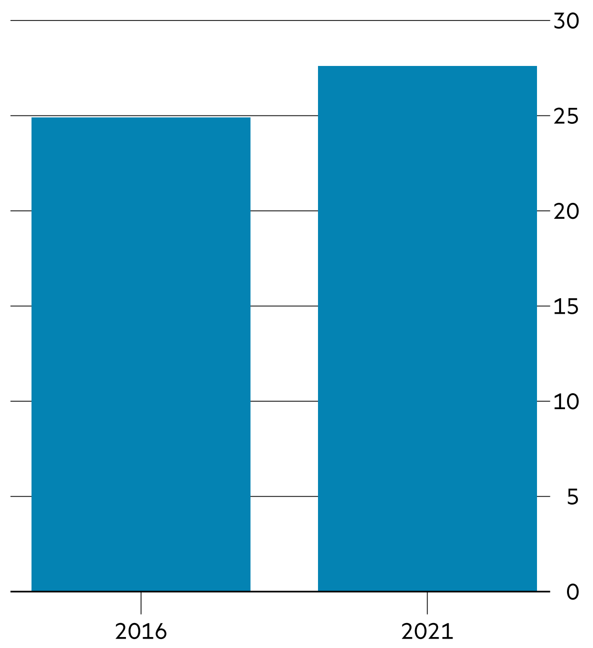
In 2021, for example, concern about the use of forced labour in China's Xinjiang province prompted Wellington to seek an assurance that Inditex, which owns Zara, the fast-fashion retailer, did not source its cotton from the region — which it was able to confirm.

"You get them on the phone and you unravel how they work, how their supply chain is overseen and how they have confidence that they aren't involved in that region," says Yolanda Courtines, an equity portfolio manager at Wellington.

Needless to say, this is harder than verifying reductions in carbon emissions. "You can say we want to reach net zero and that's a pretty common standard," she says. "But how you roll up all the different issues around modern slavery — that is much more complex."

Forced labour has been on the rise

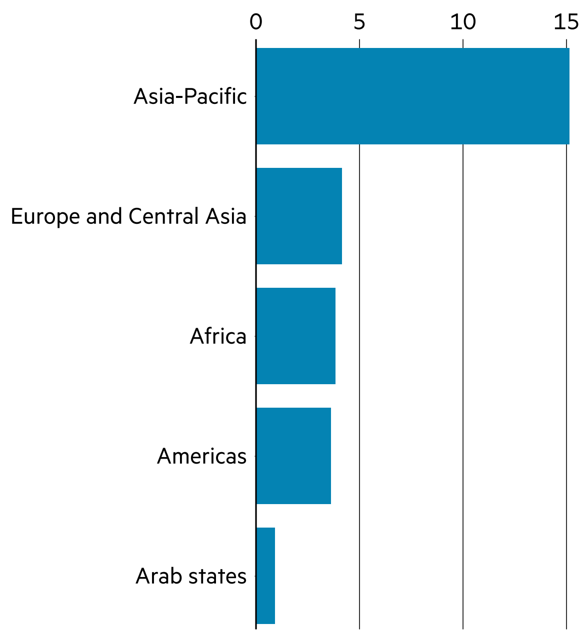
Global number of people subject to forced labour (mn)



Source: ILO/Walk Free/IOM

Most victims of forced labour are in the Asia-Pacific region

Number of people subject to forced labour (mn)



Source: ILO

Regulators show their teeth

In March 2022 at the port of Baltimore, Maryland, customs officers seized four shipments from Malaysia with a combined value of almost $2.5mn. These were not narcotics, counterfeit products or goods from embargoed countries. They were palm oil products destined for a processing facility in Delaware.

The cargo was seized because of the alleged use of forced labour. Officials can use a withhold release order, or WRO, to detain goods until they are re-exported or until the importer can show that no forced labour was used in their production. If neither happens, the goods can be destroyed.

It is not the only ban importers now need to worry about. Since June, the US has used the Uyghur Forced Labor Prevention Act to prohibit imports from the Xinjiang region of China, where there have been allegations of human rights violations that include forced labour.

These are not regulators' first efforts to combat forced labour. Issuance of WROs falls under a more than 90-year-old law: the Tariff Act of 1930.

In recent years forced labour has been targeted with laws including the California Transparency in Supply Chains Act of 2012 and the Modern Slavery Act 2015 in the UK. Some critics say this legislation lacks teeth, however.

The Californian law only requires companies to report publicly on efforts to eradicate human trafficking and slavery, even if this is insufficient; it does not mandate new measures. Similarly the emphasis of the UK's law is on reporting.

Its lack of financial penalties in 2021 for non-compliance prompted a parliamentary committee to call for tougher enforcement.

"These were well-intentioned but fairly limited, given the lack of back-up beyond what was expected to be disclosed," says Eric Biel, senior adviser at the Fair Labor Association in the US.

He says the nature of legislation now emerging is markedly different. "With the Uyghur Forced Labour Prevention Act and the use of WROs, it is no longer a choice," he says. "That is where government engagement has been a game-changer."

Rees, of Shift, agrees that WROs are an effective tool for change. "It is mission-critical — companies cannot get their goods into the country."

At one time, the main risk to a company found to be using forced or child labour was to its reputation. "Now it's costing millions of dollars. The financial hit is real," says MacDonald of Verité.

Import bans are not the only sticks regulators can wield. The EU is working on a directive to require large businesses to disclose and manage environmental and human rights standards along their supply chains. Germany has such a law in place already.

Debates are taking place on whether the best way forward is an import ban, which the EU is also considering, or due diligence. "For the EU legislation, so much is going to depend on the enforcement and enforceability," says Rees.

She warns against legislation that permits a tick-box approach, or one in which companies pass responsibility for compliance back to suppliers that are not equipped or cannot afford to handle it.

The discussion will continue, alongside calls from those who would like to see rules made consistent internationally.

Most agree, however, that regulations on forced labour have entered a new era, one in which companies failing to provide assurances that their goods have been responsibly sourced will be deemed negligent.

In other words, ignorance is no longer bliss.

Behind the story: NBIM and Unicef

UN agencies often work with global buyers to tackle problems such as child labour. In one such initiative, however, the partner was not a company but an investor.

In 2017, the Norwegian arm of Unicef, the UN agency for children, joined forces with Norges Bank Investment Management, which manages Norway's sovereign wealth fund, to establish a children's rights network.

The idea was to bring together companies in NBIM's portfolio, which includes Adidas, H&M and VF Corporation, to develop a practical guide that could help shape business practices to protect children.

NBIM is no stranger to the issue. "Over the years we've addressed a number of child and human rights risks as part of our ownership work," says Caroline Eriksen, its head of social initiatives.

"Companies can have an impact on children through their operations, supply chains and the use of their goods and services," she says. "That can entail a risk to companies and to us as an investor, both from a financial perspective and a responsible business conduct perspective."

The result was a guidance tool and a compendium of case studies. The benefit is being felt at Fung Group, the Hong Kong sourcing group, where staff use the company's WorkerApp to find out about parenting, nutrition, health, finance and hygiene.

Meanwhile, the UK clothing brand Next set up a team to make sure that its policy on child labour would be implemented consistently, especially in places where local norms might differ from international standards.

Both Unicef and NBIM were keen to highlight practical approaches. "It was important for us that the guidance tool focused on what companies can do, and what are the best practices out there to inspire others," says Eriksen. "It's going beyond the policies to seeing what's working."

Digital detective work

If regulators are pressing companies to disclose their products' provenance and how they were made, tracking and tracing technologies — from satellite imaging to the isotopic fingerprints on foods and textiles — are making it harder to claim ignorance.

At Verité, MacDonald has watched with interest as science has enabled the work needed to find out whether goods are made by children or bonded workers. "I've been doing this work for a long time," he says. "Five years ago I never would have thought of something like isotope tracing."

Through a project called Streams (supply chain tracing and engagement methodologies), Verité is working with the RSN and others to identify the most effective approaches and which to apply more broadly.

Technology is even shining a light on one of the murkiest supply chains: that for seafood. Evidence has emerged of workers being forcibly held on unregistered "ghost ships" on the seas around south-east Asia and other regions. Many are forced to work 20-hour shifts and have been beaten or killed.

Until now, such vessels have been hard to track since they often disable the automatic identification system (AIS), which provides location and other data to other ships and to coastal authorities.

However, Global Fishing Watch — a partnership between conservation organisation Oceana, digital mapping watchdog SkyTruth and Google — is using machine learning to flag up when boats' location beacons are intentionally turned off, suggesting unregulated fishing activity.

GFW makes this data freely available on its platform. "We are working with port authorities to help them identify which vessels they should inspect," says David Kroodsma, the director of research and innovation at the organisation.

Mission-driven investors take a keen interest in these kinds of technologies. Working Capital is among them. An early-stage venture fund, it was incubated at Humanity United, part of the Omidyar Group.

Its investments include OpenSC, which uses data science and machine learning to verify ethical production claims, and internet of things technologies to trace products across the supply chain. Another is Kenzen, whose wearable device for industrial workers can detect risks such as heat stress and fatigue that could lead to injuries.

Still, Ed Marcum, the fund's managing director, believes that responsible sourcing technology has some way to go. "There's demand for information," he says. "The problem remains that the quality and scale is limited, especially when it comes to labour rights."

One investment by Working Capital achieving scale is Altana AI, a New York-based start-up whose clients include US Customs and Border Protection, BMW, Merck and Maersk. Altana has an ambitious goal: to build what Evan Smith, its chief executive and co-founder, calls "Google Maps for the supply chain".

As well as using public data, Altana applies machine learning to non-public data, such as shipment bookings, purchase orders and bills of materials, to build a picture of what is happening across supply chain networks. This allows customers to identify risks such as worker exploitation, whether in regions, manufacturing facilities or raw materials.

"We're connecting the dots across product flows, physical shipment locations, value-added manufacturing and then end-use and distribution," says Smith. "We take the thumbprint of the data, which benefits the entire network, but sensitive data elements and raw data stay private."

Smith believes this approach underpins something he sees as essential in managing supply chains: a change in mindset that treats them not as outsourced buyer-supplier relationships but as multi-tiered networks. "That's the key," he says.

Case study: The Responsible Contracting Project

Sometimes responsible sourcing solutions lie close to home: including in contracting practices and the way procurement teams draw up legal agreements with suppliers.

Until recently, says Sarah Dadush, a professor at Rutgers Law School, New Jersey, the focus of contracts has been to manage only the buyer's risks — risks related to delivery delays, product defects and so on.

"Contracts are part of a smart mix of interventions but they're really important. Until now they haven't been designed in a way that supports human rights," says Dadush, the project's founding director.

The Responsible Contracting Project, of which Dadush is a director, plans to change this. Originally an initiative of the American Bar Association, the project is developing a model contract that sets out new obligations.

In it, buyers and suppliers must each conduct human rights due diligence before and during the term of the contract. Both parties must also adhere to responsible sourcing and purchasing practices.

The model contract also sets out processes through which buyers must provide proportional remediation in cases where purchasing practices, such as last-minute changes or short lead times, lead to problems such as human or labour rights violations.

"Contracts are the legal links of the supply chain," says Dadush. "So if you want to change the supply chain, one of the places to look is the contract."

All together now...

Advocates for responsible sourcing practices are the first to point out that while data is a critical tool, it cannot tackle labour abuses alone. "You can have the fanciest technology but in the end we need to make sure workers feel their companies respect their right to a collective voice," says Feingold of the AFL-CIO. "They're the ones who can tell you what is happening in their workplaces."

When she was leading Unilever's social impact work, responsible and sustainable business expert Marcela Manubens learnt the importance of including suppliers and their employees in decision making processes. "When you think about the progress made, in many instances it is because we listened to workers, to management and to communities," she says.

In 2007, to equip female workers to play a bigger role in decision making — both at work and in their communities — Gap, the clothing company, launched Pace, a voluntary programme that delivered life skills and technical training to women in the factories that made its garments.

Yet when other brands began similar initiatives, this created a problem: multiple sessions were being delivered in the same facility. "Workers would be going through similar training, depending on which buyers were sourcing from that factory," says Daniel Fibiger, head of responsible sourcing at Gap.

To fix this, four organisations — Better Work, an International Labour Organization initiative, Gap's Pace programme, humanitarian agency Care and advisory BSR's HERproject — came together to launch Reimagining Industry to Support Equality, or Rise, to give workplace training to increase women's wellbeing and skills.

The group works with 50 of the world's largest apparel brands. "The integration does away with duplication. It brings this proven training to other factories that might not otherwise have been able to benefit," says Fibiger.

As the Rise initiative suggests, if companies have learnt one thing over decades of working on responsible sourcing it is that they cannot make progress on their own. Sometimes, this means building local capacity, as Walmart has done in Thailand. "They had laws against forced labour but there was an opportunity to enhance enforcement," says Kathleen McLaughlin, Walmart's head of sustainability.

Part of the challenge, she says, is that law enforcement officials sometimes lack the capacity to build cases against traffickers. In Thailand, this led the company to make a grant through its foundation to the International Justice Mission, a US-based non-governmental organisation. This enabled the IJM to open an office in Bangkok and to train police officers in how to build strong cases that have the best chance of securing convictions.

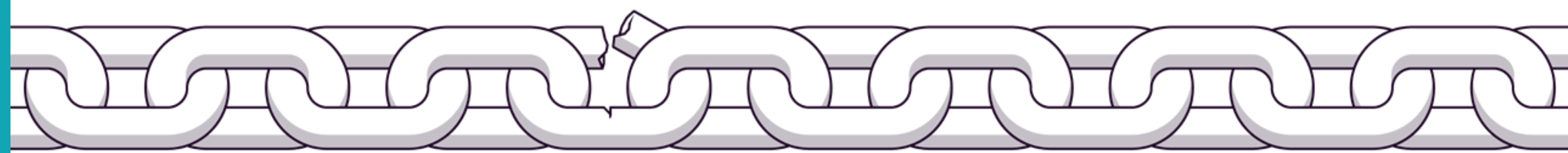
Building capacity can also involve bricks and mortar. In Ivory Coast, for example, the sustainability goals of Nestlé's income accelerator programme — which gives farmers direct payment incentives — include increased school enrolment to help prevent child labour. But in communities that have no schools, the company has sometimes needed to build them.

"You could argue it's not our job to build schools," says Wyss. "But sometimes the government has limited resources and other priorities. It's a combination of us stepping in but also engaging in discussions and making them aware of these gaps."

The Cotton Campaign is an example of what can be achieved by bringing together organisations from all sectors. In March 2022 the campaign, which sought to stop the systematic use of forced labour by the government of Uzbekistan, was able to announce the end of its 12-year boycott of Uzbek cotton.

The victory came as a result of years of efforts by Uzbek activists, international advocates, multinational companies, human rights organisations and others.

"From the beginning, this was a multi-stakeholder coalition that brought together not just the usual suspects but also big apparel brands and their trade associations," says Freeman, who co-founded the campaign. "That was the secret sauce."



A possible turning point

Battles to end worker exploitation or prevent child labour are far from over. In fact, geopolitical and economic upheavals, as well as the pandemic's long tail, have exacerbated these problems in many places.

Among the more worrying statistics, for example, is a 2022 ILO estimate that more than 27mn people worldwide — equivalent to the population of Shanghai — are working in situations of forced labour.

Yet in some places, years of work on the ground with governments and NGOs appear to be paying off. "One must look at the data at a national level and preferably even at the factory level," says Fibiger. "I've visited some of the same factories I visited 10 years ago and today they are completely different places to work."

New sources of pressure may help. While activists have long understood how to express disapproval of poor labour practices, investors are also making their voices heard. In 2021, for example, investors representing more than $6.3tn in assets sent a statement to the European Commission and the European parliament in support of mandated human rights and environmental due diligence.

Feingold cites the commitment she has seen from Norway's sovereign wealth fund to using its financial clout to drive better labour standards. "That could be huge if they take action," she says. "That's where I get excited."

In 2021, Just Capital, which monitors the effect of business on society, found that companies that explicitly mention human rights in their supplier code of conduct tended to outperform those whose code omits them.

For Jurewicz of the Cotton Campaign all this is a cause for optimism. "A lot of people ignored this for a long time," she says. "But something is finally happening."

What comes next may be a case of two steps forward, one step back. But the current combination of forces — collaborative, regulatory, financial, technological and legal — may just be enough to start laying the foundations for global supply chains that benefit, rather than abuse or exploit, the people who work in them.

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Advisory Partner

HIGH MEADOWS INSTITUTE

Why corporate leadership is critical to progress on sustainable supply chain management
Chris Pinney, president, High Meadows Institute

There is no question that a global framework of strong laws and regulations would be the best way to ensure sustainable supply chain practices. In a fractured global economy, however, with few worldwide or enforced sustainable supply chain standards, progress on better practices will continue to require corporate leadership backed by consumers and the public.

In the past few decades — in response to pressure from investors, consumers and, in some jurisdictions, regulators — most large firms have started to report on supply-chain sustainability. Challenges arise because the issues can be complex and interrelated.

Take, for instance, rare earth minerals. On the environmental side, concern centres on how mining can contaminate the environment and disrupt ecosystems. Wastewater ponds can fill with acids, heavy metals and radioactive material, which may pollute groundwater or poison workers. On the ethical labour front, such resources are often mined in conflict zones or in regions where there are significant human rights abuses and poor environmental protections for workers, such as the Democratic Republic of the Congo and China.

Another example is the fashion industry, where the production of commodities such as cotton, as well as the manufacturing process and its use of chemicals, are just a few of the environmental supply chain issues. Ethical labour practices are also of great concern, ranging from the use of child and forced labour to sweatshops and unsafe working conditions that kill thousands of people a year.

To effectively attend to the environmental issues in both examples, one has to consider how change will affect those who are currently employed. The target must be a just transition for all.

Addressing these issues comprehensively is beyond the capabilities of most individual companies. In the absence of effective regulation, businesses must work with their peers and other stakeholders to create "soft law" and self-regulatory standards and guidelines so that complex issues can be managed in an integrated way.

A good example in the rare earth minerals industry is the Responsible Minerals Initiative. Founded in 2008, its participants include more than 400 companies from 10 industries. RMI sets standards and offers reporting templates that cover a range of environmental and labour practices within supply chains, while also providing independent third-party assessment of smelter/refinery systems and sourcing practices.

In the footwear and textile industry, the Sustainable Apparel Coalition is the leading alliance for sustainable production. Its goal is to empower fashion companies to make improvements that defend the welfare of factory workers, communities and the environment. The coalition has developed the Higg Index, a suite of tools that industry participants use to assess their environmental and social impacts.

These types of industry and civil society collaborations and "soft law" initiatives will play an increasingly important role in advancing sustainable supply chain management.

** High Meadows Institute's views are separate from other advisory partners, the FT and the FT Moral Money Forum*

Vontobel

Knowing your supply chain is crucial for investing in a new era

Christel Rendu de Lint, head of investments and member of the global executive board, Vontobel

For a single company, supply chain oversight can be complex. For professional investors with multiple companies in their portfolios, this task can be massive. Complexity, however, is not something to hide behind. As capital allocators, investment firms have a fiduciary duty to act in the best interests of investors. In the context of ESG expectations, regulations and best practice, this includes assessing and monitoring the supply chain activities of the companies in which they invest.

Can data be the game-changer?

Data and new technology are delivering new opportunities for increased visibility around ESG red flags, and we welcome them. One area where this is set to make a huge impact is the confirmation of on-site human rights audits. Here, regulatory and legislative trends play a crucial role in pushing things in the right direction. If regulators can compel companies to provide accurate and accessible data, a start can be made in eliminating the thorns in the "know your supply chain" process.

At the macroeconomic level, data-driven clarity over which companies adhere to requirements for ethical compliance, coupled with penalties for those that do not, should start to create an ecosystem that naturally promotes an ESG-compliant approach. This assumes even-handedness, however. If legislation and compliance requirements are not globally comparable, or universally applied, then those companies that undercut on price with cheap labour, for example, can skirt the pressure to change. In such instances, and from an economic theory point of view, where the cost of reputational risk does not exceed the benefits of cheaper inputs, intervention is needed. Where would this responsibility fall?

Who sets the rules for a new era?

While investors cannot be expected to do the job of regulators and law enforcement agencies, we can ask the tough questions and take the "vote with your wallet" concept to new heights. Our clients care about their legacies and the effects that their investments have on society. While it is not our job to tell clients what their legacies should be or what better futures they could help build, we have a fiduciary duty to incorporate all value drivers, including those for ESG, when advising them about opportunities and risks. Vontobel is committed to being a responsible citizen and we have four overarching ESG investment principles that we use in our actively managed investment processes to develop solutions that meet clients' needs.

Last year, I contributed a piece to this report where we tackled the topic of sustainability in emerging markets. A similar question arose: should investment houses stop engaging with companies and marketplaces that are not yet up to the desired standards? Or is the greater good derived from continued investment that is contingent on clearly communicated ESG expectations, producing a dynamic in which highly experienced companies pass on their expertise?

We live with these questions day to day in our boutiques. In our sustainable equities boutique, for example, our focus is on emerging markets, where ethical consumerism can lag significantly in comparison with the situation in developed markets. It is, however, gathering momentum in some places quite quickly, especially when aligned with a focus on quality and consumer safety. Our experience shows that companies domiciled in emerging markets are often very receptive to hearing our perspective on where they can improve on ESG matters and their disclosure of them. They are also open to our sharing of information on ESG market trends and their regulatory drivers.

Opportunity amid duty

A focus on improving supply chain management brings benefits on many fronts. This is immediately apparent for those involved in the supply chain itself, as the example of compliance requirements regarding human rights audits makes clear. It also brings opportunities for new products and services. Consider those that use the Fairtrade label: data shows that many consumers will pay the higher price this induces.

At Vontobel, we view responsible consumption as a strong trend that we seek to capture as part of our approach to impact investing. Indeed, our entire investment approach is governed by the belief that, over time, consideration of ESG in investing best enables our clients to achieve their investment objectives. This applies to all six boutiques that constitute our multi-boutique set-up.

Returning to the fiduciary duty of capital allocators to act in the best interest of investors, ESG has fundamentally changed the way we invest for our clients. At an industry level, where investors have multiple companies in their portfolios, supply chains are in the spotlight. The era of clear delineation of ownership of "problems" is over (whether it ever existed is a topic for debate). In the same way that "know your client" has become part of the banking furniture, it seems "know your supply chain" will follow suit.

** Vontobel's views are separate from other advisory partners, the FT and the FT Moral Money Forum*

WHITE & CASE

The fragility of supply chains is at the forefront of business thinking: heightened by disruption caused by global events and natural disasters exacerbated by climate-change. But responsible supply chain management is driven not only by an ethical imperative that warrants a place at the top of boards' agendas. There are legal and commercial risks for companies that fail to implement adequate due diligence processes.

According to the 2020 European Commission's "Study on due diligence requirements through the supply chain," the three primary incentives for businesses to take due diligence seriously are: "reputational risks; investors requiring a high standard; and consumers requiring a high standard."

From a legal and commercial perspective, these risks and pressures are reshaping the landscape for corporate governance and M&A, including private equity transactions. Buyers and investors are increasingly seeking that target companies provide detailed supply chain management and human rights impact assessments not only across a target's own business operations, but across the operations of its entire value chain, and to report on environmental impacts and modern slavery risk (regardless of whether such reporting is mandatory under applicable regulations).

In recent years, high-profile firms have been caught up in supply-chain related misconduct, across all sectors, ranging from fast fashion to household appliances, mining to supermarket chains, financial institutions and retail services. These companies have suffered reputational damage and financial loss when such scandals made the headlines; and in some cases led to major shareholders dumping stocks, auditors stepping down over reputational concerns, or boards of directors buying shares to stabilise the market price.

Consumer boycotts and grassroots action also present a significant risk. By way of example, in a victory for campaigners in March 2020, Mexico terminated construction permits held by a global beverage producer, which caused the company's stock to plummet by 11 per cent. The company had been granted access to the town of Mexicali's drinking-water supply for its planned $1.5bn brewery. This would have seen the company use up to 20mn cubic metres of water a year (20 per cent of the city's annual supply), but the scheme was defeated in a referendum. In a similar manner, consumer pressure is likely to grow against UK tea brands following the BBC Panorama documentary in February 2023 "Sex for Work: the True Cost of Our Tea."

Shareholder activists are increasing efforts to address supply chain-related risk by:

- Filing shareholder proposals. One example is the 15 proposals filed by Investor Alliance in January 2023 at three Big Tech companies. These relate to human rights risks in the tech sector and will be voted on by shareholders at the companies' annual meetings.
- Writing open letters to boards. In March 2023, Tulipshare, the activist investment platform, condemned a sports apparel giant for failing to act upon shareholders' concerns over potential human rights abuses in its supply chain.

Critically, regulatory and enforcement risk is also accelerating. According to the same 2020 Commission study, only 37 per cent of businesses conduct environmental and human rights due diligence based on voluntary international standards, and only 16 per cent cover the entire supply chain. For more than a decade, the UN Guiding Principles and the OECD Guidelines have informed the efforts of states and businesses to adopt best practices for effectively managing human rights/environmental risks in supply chains. While some governments are opting for voluntary instruments (for example, Japan's 2022 guidance on Respecting Human Rights in Responsible Supply Chains), the direction of travel points sharply towards mandatory obligations in corporate supply chains.

While global legislative initiatives vary in their scope, operation and goals, they fall within three camps:

- Disclosure requirements (for instance, the EU's Corporate Sustainability Reporting Directive, and the UK's Modern Slavery Act 2015 (a strengthened bill was announced in the Queen's Speech 2022)).
- Due diligence obligations (for example, the German Supply Chain Due Diligence Act (LkSG) and the European Commission's proposed Corporate Sustainability Due Diligence Directive (CSDDD)).
- Import bans (for instance, the US Uyghur Forced Labor Prevention Act and the Commission's proposal for a regulation prohibiting goods made with forced labour).

Legislative measures coexist on a sector-specific basis. Notable examples at the EU-level include the Conflict Minerals Regulation, the Deforestation Regulation and the Batteries Regulation. The proposed Critical Raw Materials Act seeks to promote responsible sourcing, requiring large companies to audit their supply chains and enhance strategies to prepare for supply disruptions. The UK's Critical Minerals Strategy has similar goals.

In terms of litigation risk, as these laws are new or still working their way through the legislative process, little jurisprudence is available to clarify how they will be interpreted and applied. Judgments will be instructive in the early legal actions filed. In February 2023, two cases were brought by NGOs against a financial institution before the French courts. These claims relate to alleged violations under the French Duty of Vigilance Law for failing to carry out adequate due diligence before agreeing to finance global corporations (such as beef producers or oil and gas companies) that contribute to human rights abuses and/or environmental harms. Claims have also been brought in the UK, US, EU and Canada on a range of grounds, including misleading consumer advertising and parent company duty of care.

Boards must stay tuned on pending decisions in these "world-first" cases, to evaluate the litigation risk they could face in connection with their supply chain responsibilities, alongside the growing regulatory pressures.

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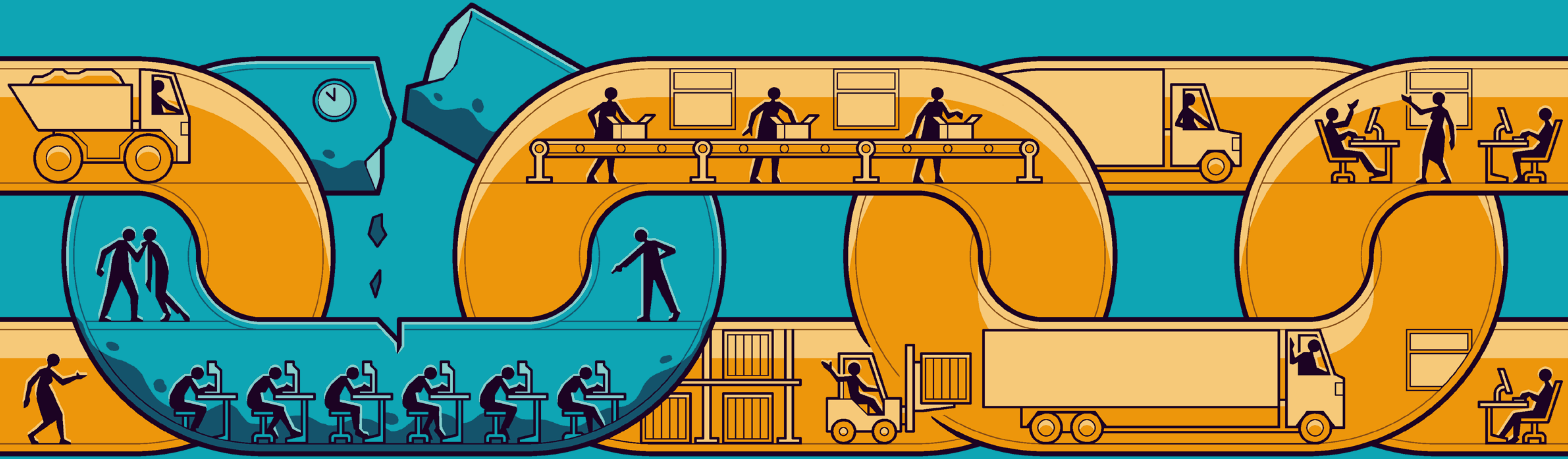

About the FT Moral Money Forum

The FT Moral Money Forum takes key issues from the ESG debate and explores them for FT Moral Money subscribers.

The forum highlights macro and philosophical questions and explores the experiences and solutions being proposed. We apply an editorial filter to these and present the most interesting ideas and experiences. We also engage our data visual team to find the best form of presentation.

The forum produces regular reports to highlight the ideas, policies and practices that are making a difference.

Find out how to take part in the FT Moral Money Forum by emailing **moralmoneyforum@ft.com**

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