LGC ASSURE

Why ESG reporting is every organisation's responsibility

AXIO PROFICIENCY TESTING

BRCGS

SPORTS AND SPECIALISED ANALYTICAL SERVICES

Safefood 360°

lgcassure.com

February 2022

In 2011, less than 20 per cent of companies in the S&P 500 index published an annual sustainability report. By 2019 that proportion had grown to 90 per cent[1]. In this white paper we look at what's driving companies to disclose detailed information about their emissions, use of resources and labour practices.

We consider the implications for supply chains, in particular second and third tier suppliers who may not yet be under pressure to report their performance, but who can see the day approaching when that will change.

We also consider solutions for small and medium sized enterprises who need help along the pathway to reporting and disclosure.

Introduction – why your business is coming into scope

It is easy to think of ESG (Environment, Social and Governance) reporting as something that only large enterprises need to concern themselves with. After all, while institutional investors are laser focused on disclosure, performance and ratings, investors in small and medium sized enterprises (SMEs) seldom demand anything like the same levels of transparency.

But that thinking is faulty. ESG reporting for any organisation is only as good as the data coming out of its supply chain. That's why more and more corporations are setting targets not only for their own operations but also for their suppliers.

It would be no exaggeration to say that big business is outsourcing a significant proportion of its environmental responsibilities. If that sounds like a criticism, it is not meant to. A large company is simply the terminus point for a global supply chain that may involve hundreds, thousands or even tens of thousands of smaller enterprises.

It is not just materials, products and services that flow through supply chains, so do a multitude of environmental and social impacts.

The emissions associated with growing, picking and packing green beans in Africa, for example, will, at some point, show up in the environmental reporting of the supermarket in Europe that sells them.

That's why, when it comes to ESG disclosure, the supplier's problem is the customer's problem and the customer's problem is the supplier's problem.

[1] Governance Accounting Institute

So what happens when a supplier is unable to provide environmental and social performance data to their customer? What happens when they cannot commit to targets and show progress towards those goals? What happens if they can't show evidence of systems and processes that will bring about improvements?

The answer will depend in part on where they sit in the supply chain. When large companies first commit to ESG targets, their focus generally extends only to first tier suppliers and wholly owned facilities. The indirect impacts attributed to distant or disconnected second and third tier suppliers are left out of the calculations. These are part of so-called "Scope 3 emissions".

Scope 1 emissions are those that a company makes directly, for example from running its boilers and vehicles. Scope 2 covers indirect emissions such as the electricity or energy it buys for heating and cooling buildings.

Scope 3 covers all the emissions up and down a company's value chain. For example, from buying products from its suppliers, and from its products when customers use them.

Typically Scope 3 accounts for the largest contribution to a company's environmental footprint which is why customers, investors, business partners and shareholders expect this data to be part of a company's ESG disclosure.

According to MSCI – one of the leading ESG ratings agencies – as of March 2020, 18% of the companies in its principal ESG index reported Scope 3 emissions[2], but that proportion will inevitably grow as companies become ever more sophisticated and ever more scrutinised.

For those sitting further back in the supply chain, who perhaps until now have not been under pressure to collect and report environmental and social impact data, the message is clear. Reporting responsibilities are heading your way and if you're not ready to participate there are likely to be others who will.

Regulation – why disclosure is no longer voluntary

ESG reporting to a prescribed formula is becoming a mandatory requirement for more and more businesses in more and more jurisdictions.

This year, for example, the Corporate Sustainability Reporting Directive (CSRD)[3] will come into force in the EU. CSRD extends the scope of reporting obligations to all companies with more than 250 employees and requires the audited assurance of reported information.

[2] MSCI
[3] European Commission corporate sustainability reporting

It also introduces more detailed reporting requirements than the previous standard, and a requirement to report according to mandatory EU sustainability reporting standards.

This year will also see the introduction of the EU Taxonomy[4], a classification system designed to establish a list of environmentally sustainable economic activities. The taxonomy is designed to provide companies, investors and policymakers with definitions of which economic activities can be considered environmentally sustainable, and direct investment and policy accordingly.

Why do regulators feel the need to be so prescriptive? The lack of standardised definitions and reporting frameworks leaves room for what could charitably be referred to as creative interpretation and is less kindly described as greenwashing.

Countless companies have been called out for making environmental claims that cannot be substantiated or are misleading. Companies that claim 'net zero carbon emissions' by purchasing carbon offsets have come in for particular criticism. Carbon credits may have a legitimate role to play in achieving climate goals but experts agree that the number one priority for every business is to reduce emissions in their value chain.

In the UK, the Competition and Markets Authority has established a Green Claims Code designed to stamp out misleading green marketing.

Companies are being enjoined not only to commit to specific targets for emissions, waste, water and land use, they are also being encouraged to sign up to Science Based Targets, an initiative designed to provide companies with a clearly-defined path to reduce emissions in line with the Paris Agreement goals.

All this means that there is mounting pressure on enterprises to standardise their reporting practices, deepen the level of transparency through their supply chains, and commit to meaningful improvements.

Pressure at the top of the pyramid will inevitably trickle down through the first, second and third tiers of supply chains, meaning that those suppliers able to help their customers discharge their obligations will inevitably enjoy a competitive advantage over those that cannot.

Why responsibility for sustainability improvements is cascading down supply chains

For most organisations, the vast majority of emissions are classified as Scope 3. In other words, they occur in the value chain rather than in their own operations.

In 2019, the Co-op – a UK grocery retailer – reported that 92% of its total emissions would be classed as Scope 3, with 71% from sourcing ingredients, 8% from manufacturing and 10% from packaging and transporting products[5].

Carrefour assessed its Scope 3 emissions at 98 per cent of the total and has committed itself to achieving a 29% reduction in emissions by 2030 (versus a 2019 baseline).[6]

Companies that already report Scope 3 emissions include Mars, Coca Cola, General Mills, Danone, Kellogg, Kraft Heinz, Nestle, PepsiCo and Unilever.[7]

One large UK retailer has pledged to engage with 67% of its suppliers (ranked by emissions) with the objective of them having Science-Based Targets by the start of 2026, while a global building materials manufacturer has committed to a 50 per cent reduction in product CO_2 intensity from its primary supply partners by 2030.

Historically retailers have focused on reducing Scope 1 and Scope 2 emissions, but as the pressure grows to report on Scope 3 emissions – and to set Science Based reduction targets – pressure is cascading down the supply chain.

The message is clear: suppliers at every step of the value chain need to be ready to report and prepared to improve.

[4] EU taxonomy for sustainable activities
[5] The Grocer
[6] Carrefour
[7] Ceres

Could food be the new oil?

It seems peculiar to suggest that something as economically fundamental as the food industry could one day be considered toxic – an industry that struggles to attract talent and investment; an industry that is easy for politicians to criticise; an industry that citizens are eager to see regulated.

Perhaps food will never be the new oil or the new tobacco, but unless the industry is seen to be taking purposive action to reduce food and packaging waste, drive down emissions, use land and water responsibly, eliminate poor labour practices, and maintain high standards of animal welfare, it may well see its social licence to operate start to diminish.

Industries that, historically, have never really struggled for social acceptance – like aerospace and fashion – are currently experiencing a reversal of fortune with audiences from young consumers to veteran institutional investors asking increasingly uncomfortable questions.

Ratings, benchmarks and indices

The ESG landscape is littered with acronyms and jargon and it can be hard to differentiate between ratings agencies, reporting frameworks and indices. They are all part of the ESG ecosystem.

Ratings agencies such as Sustainalytics and MSCI attribute a risk rating to corporations based, primarily, on the data and information the companies themselves disclose.

Essentially they tell investors how likely it is that the company will face financial and regulatory risks associated with their ESG performance, targets and processes.

ESG frameworks, meanwhile, are blueprints designed to help companies report their targets and achievements; the best known are GRI (Global Reporting Imitative) and CDP (formerly Carbon Disclosure Project), but there are many others.

Indices such the Dow Jones Sustainability Index and FTSE4Good operate both as a benchmark and a tradable index, allowing investors to buy into businesses with a strong ESG profile.

There is a growing interest in Green Finance - bonds, loans and other financial instruments designed to fund climate friendly projects and businesses.

The term is rather loosely defined which is why there are a number of initiatives in place to help investors determine what is and is not a green investment. These include the EU Taxonomy (see page 1) and a new ISO standard (ISO/TC 322) which is designed is to establish a framework under which new standards can be developed to define and guide sustainable finance activities.

Major corporations have the resources to navigate their way through the complexities of ESG data gathering and disclosure. The same applies to their first tier suppliers. But those responsibilities and obligations are working their way through supply chains, meaning that second and third tier suppliers will come under increasing pressure to collect data, set targets for improvement and put in place management processes to deliver on their commitments.

Introducing ESG LEAD

LGC ASSURE, a global leader in supply chain assurance, has partnered with Ecodesk to create ESG LEAD, a platform that allows businesses to measure their ESG performance, identify best practice and generate actionable insights to drive improvements.

Ecodesk has been supporting some of the most forward-thinking and influential brands to reduce their ESG impact, while LGC ASSURE with brands such as BRCGS is well established as the world's leading assurance standard in food safety, storage & distribution, and ethical trade and responsible sourcing.

Together they have created ESG LEAD, an online assessment platform where any business can rate its ESG performance against best practices that have been tailored for the food and drink sector, and using those best practices to drive improvement.

The platform is designed to bridge the ESG gap in the food and drink sector by providing a tool that can be quickly and easily deployed to enable the measurement of ESG impact across the entire supply chain.

ESGLEAD
LEARN | EVALUATE | ADVANCE | DISCLOSE

ESG LEAD provides critical insight, enabling users to influence change and optimise their supply chains to mitigate their ESG impact. It is a solution oriented towards meaningful and verified improvement, rather than simply a rating.

It also allows users to share their performance with customers in the same way that they can with their safety audit information.

It therefore provides a multi-dimensional view of compliance and performance on a single platform. It pushes sites beyond compliance through in-built continuous learning to ensure that they are an ever lower risk for the customers and brands they serve.

For more information about what ESG LEAD can do for your organisation, contact us at contactus@lgcassure.com.

LGC ASSURE
Queens Road
Teddington
Middlesex
TW11 0LY
contactus@LGCASSURE.com
www.lgcstandards.com/LGCASSURE