VOL. 28, NO. 2 | MAY 2024

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2024 ENVIRONMENTAL SOCIAL GOVERNANCE SPECIAL ISSUE

Supply Chains Know No Borders When It Comes to New Climate Disclosure Regulations

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Analyst Insight: Companies need to accurately calculate their global supply chain emissions, comply with the new sweeping climate disclosure regulations, and create a supportive ecosystem for sharing climate information..

Regulators across the globe, including the Securities and Exchange Commission (SEC), the European Union (EU), and the State of California, have called for sweeping and mandatory disclosures of material risks posed by climate change to a company's business operations and financial statements. While most of the regulatory schemes are focused on the greenhouse gas emissions directly attributable to the companies, it is increasingly clear that emissions from their supply chains will also need to be disclosed.

The Carbon Border Adjustment Mechanism (CBAM), a framework explicitly designed to account for product-based emissions, and dissuade companies from offshoring their manufacturing and other carbon intensive activities to places without carbon regulation, has come online in the EU. These regulations, when fully implemented over the next 10 years, will require companies to accurately account for greenhouse gas emissions for products that they import into the EU. Ultimately, products that are manufactured in a location that does not have carbon-focused regulations in place, will have a "carbon tax" levied, to level the playing field with products manufactured in locations that are subject to more rigorous rules. There are even rumors of a CBAM-like ruleset being discussed in Washington, D.C.

Many large companies are already well along in their carbon reduction journeys, and are independently looking to reduce their emissions, including those that originate in their supply chain. In these cases, what can be challenging is that the requestors of this information sometimes have bespoke demands and methodologies for how they want their data compiled. The recipient of these requests is then confronted with a situation where they need to respond in a "one-off"

manner, consuming limited human and technical resources.

In other words, global supply chains are in the crosshairs, particularly when it comes to greenhouse gas emissions. In addition, accounting for supply chain-related greenhouse gas emissions present some significant challenges including the following:

Gathering data. Gathering data about specific products from multiple tiers of suppliers, to accurately account for each of their respective impacts is a difficult exercise in record keeping regarding materials, manufacturing processes, activities of second- and third-tier suppliers, and overall data governance and quality. And that is before any actual calculations are even performed.

Calculating methodology. Next, once you have data of decent quality, you must select a calculation methodology that reflects the realities of raw material sourcing, product manufacturing, transportation and distribution, and other life-cycle impacts that may affect reported greenhouse gas totals. Lifecycle analysis is a highly technical exercise that requires detailed knowledge of methodologies and information about the products you are providing. This is not something that every company is capable of doing, or willing to invest in.

Assessing supplier relationships. These exercises can strain relationships with suppliers. Almost everyone in your supply chain will claim a dearth of resources, lack of expertise, no available time, and other reasons why these requests are unreasonable. Ultimately, your suppliers want to maintain good relationships with their customers, much as you do. The question is how each participant in a supply chain can provide relevant, timely, and quality information that can be used to comply with either regulatory frameworks or support each other in achieving their climate-related goals.

Here is a three-step strategy for how you can begin to address some of these climate-related requests for information, and build a mutually supportive ecosystem of information exchange that moves the collective needle towards more climate-aware and friendly practices.

Assessing and understanding supply chain materials. One of the key elements in understanding the climate impacts of a particular product is to document the basic "ingredients" of that product: amounts of materials, and a description of the processes used to manufacture the product. These data points can then be used by you or by your customer to build a basic model of the climate impacts of the products you provide to your customers. Much of this information exists already in many companies in the form of a Bill of Materials (BOM). These documents outline, in relatively straightforward terms, what materials are in each product and their corresponding amounts. When you have this information, plus a description of manufacturing processes, you have the basic dataset needed by those with knowledge of life-cycle analysis to calculate the greenhouse gas impacts of a particular product.

Assessing the climate impact of suppliers. Second, a key data point is the greenhouse gas emissions of your suppliers. So-called Scope 1 and Scope 2 emissions — those resulting from the combustion of fuels and the usage of electricity – are basic pieces of information that allow you to estimate a significant component of your supply chain emissions. So, we advise companies of all sizes to understand and calculate their Scope 1 and 2 emissions so they can readily provide that information to anyone who asks.

Engage and collaborate with suppliers. Lastly, we encourage companies to approach this new regime of climate awareness with an open and collaborative mindset. Requests for information are only going to increase over time, and the level of technical sophistication required to accommodate these requests will also increase. By constructively engaging with your suppliers, and engaging with your customers who are asking these types of questions, you can build a culture of collaboration and mutual support that will ultimately strengthen relationships, and solidify them for the long-term. In our experience, one of the best questions a supplier can ask a customer is, "how can we help you achieve your sustainability goals?"

The climate reporting and regulatory space is rapidly evolving. Companies need to keep their ear to the ground and make quick decisions about where, when and how much to invest in complying with regulatory requirements, as well as requests from customers. With smart thinking about costs and benefits, aligning efforts to deliver the greatest bang-for-the-buck, companies can demonstrate their commitments to climate change mitigation, and build a clearer picture of the risks and opportunities in their supply chains. ■