

# Reputational risks due to environmental performance of supply chains on the rise in China

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During the 1990s and 2000s, many big international corporations found their reputations tarnished due to labour issues at manufacturing operations in China. In many cases, it was not due to their own actions in producing clothing, electronics and other goods, but those of their independent suppliers.

International Non-Governmental Organizations (NGOs) accused the name-brand corporations of profiting from child labour, underpaying workers and tolerating hazardous work environments in the supplier companies. For many multinationals and name brands, the word 'sweat-shop' became a PR nightmare.

Since then, many global companies have enacted and enforced strict employee health and safety standards, as well as good practice around issues like fair pay, forced and child labour, for their direct suppliers in China. These have helped improve working conditions for the employees who make their products.

Now, this pattern is repeating itself, with three important differences – the focus is on the environmental performance of supplier operations, much of the pressure is coming from local individuals and groups, and many of the affected people are not employees of the suppliers but are external to the companies in question.

With the rise of a civil society in China, an increasingly free news media and the growing power of the internet, people are expressing their concerns and taking action.

Sometimes it is groups of people living close to a factory that are affected by noise, odour, hazardous air emissions or water pollution, who will mount a protest or put pressure on authorities to take action. There have been cases of sabotage and violence.

Local NGOs have shown growing skill in causing media pressure to be placed on offenders, with the cause also sometimes picked up by international organisations and the news media. Even a small group can post images on its website, have a well-regarded blog, and issue news releases that get international attention.

As a result, there have been many instances in which polluting operations were forced to shut down and interrupt production, move operations, or make capital investments to reduce environmental impacts.

But most worrying for international corporations, some companies have found themselves listed on internet sites of Chinese NGOs such as the Institute of Public and Environmental Affairs. These sites publish lists, commonly referred to as 'blacklists', with the names and loca-

tions of companies which have been found to violate environmental permitting requirements. Foreign media coverage tends to focus on the international companies that are being accused of supporting bad environmental practice – just as it was the case with labour standards a decade ago. The big name multinationals have a higher risk of getting negative publicity simply because they are well known by the public and more newsworthy.

While the Chinese authorities move swiftly to stamp out criticism of the government itself, they appear more willing to allow criticism of companies, whether Chinese-based or international.

This trend is posing new, material risks on international corporations that are perhaps unknowingly dealing with companies whose operations are causing negative environmental impacts.

However, corporations that can demonstrate a diligent understanding of the environmental performance of their supply chains will have a point of competitive advantage in more reliable supplier networks and less reputational risk. In addition to production problems and reputational risks, corporations that fail to demonstrate adequate environmental performance in their suppliers could also risk their eligibility for investment by ethical or environmental funds and damage their chances of being included in lists such as the Dow Jones Sustainability Indexes.

## How can these risks be managed?

Experience from the management of labour issues in China can certainly be useful in managing environmental performance. Requirements for production facilities which currently focus on labour issues will need to be updated to ensure environmental performance standards are met. While many companies do currently include an environmental component in their supplier requirements, this component is often limited, does not consider the full range of potential environmental impacts and may not consider local issues.

Regular audits and environmental monitoring will also likely be needed. While keeping double sets of books and isolating disgruntled workers may be widespread tactics in China to pass labour audits, it can be more difficult to hide or falsify environmental performance, particularly as it is often external stakeholders that are affected.

Developing environmental requirements which ensure an adequate level of environmental performance while balancing the potential costs for compliance with these requirements can be challenging. Companies ►►

may need to consider agreeing to programs of continuous improvement over time with their suppliers in order to manage investment requirements.

Many international companies will look first to the local and national regulations that pertain to the operations of their suppliers down the chain. Perhaps accustomed to regulatory and legal environments in which environmental standards are clearly laid out and generally enforced, they may find that operating in China becomes a learning experience. This is particularly the case in terms of environmental standards.

The Chinese environmental impact assessment regulatory framework and standards often focus on a limited range of pollutants and the assessments also often miss or underestimate the impacts from some activities.

Therefore companies need to look more towards international best practice to establish environmental requirements rather than relying on Chinese regulations and standards alone. Using industry standards such as the Electronics Industry Citizenship Council Code of Conduct or referring to guidance in the European Union's Best Available Techniques documents are ways in which international best practice can be determined. Consultants with international reach may also help.

#### **Need to reach out beyond the factory gate**

One of the best ways to manage reputational risk from environmental

performance is through reaching out to the people who may be affected by the suppliers' operations. This includes talking with residents, local and international NGOs, local government officials and others to find out what complaints and concerns they have, through a structured community consultation program. Then, it is a case of developing and implementing a plan to reduce the negative environmental effects.

Public access to information on company environmental performance is still limited in China. Requiring suppliers to report data on environmental emissions could help enlist civil society in enforcing environmental requirements. Some companies have also started improving supply chain transparency by publishing the names and locations of supplier facilities.

Furthermore, it may be necessary for companies to get serious about suppliers who do not satisfy the requirements by reducing or stopping orders. If they understand that environmental standards are also part of a continued contractual relationship with the international company, and they are convinced that investments to come up to standard are encouraged, there is more chance that they will make the necessary changes.

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