Professional Perspective

Assessing ESG Risks for Businesses in the Covid-19 Era

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Covid-19 disrupted business operations, supply chains, and economies around the globe. In response, businesses had to respond to multiple crises throughout their operations. Companies sought to make good choices concerning procurement, logistics, HR, and go-forward strategies.

Looking ahead, the precise trajectory of the pandemic has yet to become clear, but in the past, public opinion harshly judged employers that took compliance short-cuts and prioritized short-term gains over longer-term social and environmental values.

Companies—particularly those that may have adopted a light touch in the compliance area—need to get ahead of the issue. They must honestly assess or reassess the compatibility of their environmental, social, and governance (ESG) goals with their real-world operations.

Covid-19 Impact on Supply Chains

Covid-19 affected even the simplest supply chains. Labor shortages disrupted the gathering of raw materials from mines, fields, rivers, and oceans. Even where raw materials were available, many initial or primary processing and manufacturing facilities reduced or shut down their operations. Logistical challenges for the limited amount of goods coming from those facilities included downsized warehousing capacity, trucking shortages resulting in less product transported to seaports, and smaller port operations resulting in fewer exports.

And for those goods that make it onto ships, the logistical issues upon arrival include an inability of port operations to off load ships, less trucks to transport product to warehouses, less warehouse capacity, and lessened distribution center activity. For more complex supply chains—where products such as electronics and automobiles involve many tiers and thousands of suppliers—the challenges have been exponential with multiple component shortages.

The world's economies are interdependent—raw materials are sourced globally, transformed in various countries, and transported around the world. In response to stakeholders' increased understanding of the myriad of issues associated with global supply chains, companies increased their focus on ESG concerns before the pandemic to include sustainability, climate change, human rights, community involvement, anti-corruption, and corporate governance.

Supply Chain Pressures & Compliance

Even companies deeply committed to ESG objectives made hurried decisions during the pandemic. Companies prioritized business-sustaining measures over business-enhancing measures. They may have inadvertently allowed forced labor or corruption into their supply chains when procuring products without the standard pre-pandemic supplier vetting. With border closings and Covid-19 precautions, social auditors were not deployed with normal frequency and potential problems remain undetected.

Covid-19 Compliance Compromises

As the pandemic struck workers extracting raw materials, it affected enforcers, regulators, inspectors, and others tasked with protecting natural resources and human rights. With less oversight, well-publicized reports of deforestation arose in the Brazilian Amazon and in Asia. Bad actors can more easily engage in illegal poaching, fishing, mining, and logging.

It is easy to imagine how these raw materials may flow into products previously shielded by supply chain compliance measures—and even less-nefarious activities have negative environmental impacts. For example, the pandemic has produced more litter and waste through increased single-use personal safety equipment such as gloves and face masks. The massive increase in cleansing products and disinfectants has similarly put a strain on the environment.

Millions of workers lost their jobs due to the pandemic and the loss of income pushed many households into poverty. School closures and the transition to income earners impacted many children. Covid-19 increased the demand for cheap labor as companies up and down supply chains faced shrinking revenue and felt compelled to reduce wages to make even a small profit. Rather than paying fair wages, companies employed forced and child labor to lower costs.

Practical Compliance Steps

Companies should pause and recommit to their ESG goals. Below are eight practical actions businesses can consider to jumpstart their ESG programs:

- **Engage in Robust Messaging**. Company leaders, including top management, should emphasize the importance of the company's ESG goals. With the shock of the pandemic waning, now is a good time for these leaders to speak out and influence the organization, stakeholders, and business partners. However, follow-through is important and these leaders should continue to champion their company policies.

- **Align Company Documents With Goals**. Create, revisit, or revise the following documents to specifically and pragmatically address the company's various ESG goals:

  - **Code of Conduct**. Guidelines for employees and management to clarify and make decisions that are consistent with the company's mission statement, core values, and policies.

  - **Policies**. Specific rules that support the guidelines.

  - **Procedures**. Acts or means to comply with a company's policies.

  For example, examine whether the fight against Covid-19 changed your operations through the increased use of personal protective equipment and harmful disinfectants. Tackle the potential environmental harm caused by discarded single-use masks, gloves, and the runoff of sanitizing agents. If you qualify but do not have the required California Transparency in Supply Chains Act or UK Modern Slavery Act disclosures in place, you should retain experienced counsel to help you do so.

- **Honestly Evaluate Your Risk Profile**. Verify your company's supply chains to evaluate risks of environmental harm, human rights violations, corruption, and other ESG risks. Implement measures to eliminate any risks that may exist. This is not a one-time act but an activity that you should continually repeat.

- **Make Sure Your Suppliers Understand Your Expectations**. Partner with suppliers and their employees to ensure they are complying with your company's requirements concerning sustainability, child labor, human trafficking, anti-corruption, etc. Supply agreements should require compliance with relevant laws and regulations and incorporate the company's code of conduct and audit rights.

- **Verify Through Targeted Audits**. Commit to a practical, risk-based supplier auditing program whereby you evaluate supplier compliance with company standards regarding ESG concerns. Social audits should be tailored to address the topics that your company prioritizes. The auditing program should first focus on those suppliers that pose the most risk to your company.

- **Train to Ensure Understanding**. Train company employees responsible for supply chain management and internal operations that touch on ESG issues. Focus on identifying and mitigating risks within your supply chains and operations that pose increased risk. Note that many nonprofit organizations, vendors, and even attorneys offer such training and can provide industry-specific presentations. Emphasize the importance of identifying such issues and reporting to management and your legal department.

- **Ensure Confidential Reporting Options**. Establish a toll-free hotline where employees, suppliers, and other stakeholders can confidentially report violations of your company's policies. Publish the hotline with assurances that callers, including supplier employees, need not fear retaliation.

- **Publish What You Are Doing—Without Over or Understating**. If your compliance program has achieved the appropriate level of maturity, commit to publishing a robust annual report summarizing all your company's ESG efforts with objective measurements of achievements and successes. You should take care to ensure that the report is accurate and aspirational rather than overpromising and guaranteeing absolutes.

Conclusion

The pandemic upended much of our lives, and decisionmakers have been forced to quickly resolve issues without the normal time to thoroughly scrutinize new suppliers or business partners. Procuring products outside of the normal, fully vetted sources may be completely reasonable but does come with risks.

Social auditors are becoming more available and should be deployed. New suppliers and business partners can now be thoroughly evaluated through due diligence, and any new-found risks must be addressed. Businesses reemerging from the pandemic should mitigate possible missteps and strengthen their ESG efforts.

