

# Supply Chain (Mis)management - Key Challenges and Constraints

## A Critical Analysis

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# Introduction

Supply chain management (SCM) on internationally financed infrastructure projects is a complex and underestimated area of risk involving child and forced labour, dangerous working conditions and environmental degradation in places such as factories and mines. As revealed through exposés by NGOs and corporate watchdogs, human rights risks are intertwined within the global economy's supply chains, particularly at the lower ends. The renewable energy (RE) industry, generally perceived to be the more sustainable path for energy production, is also increasingly receiving attention for the human rights risks identified throughout its supply chains.

International financial institutions' standards aim to protect people and the environment in supply chains from harm through the impact assessment, due diligence and monitoring processes, but this has not always been effective due to several factors.

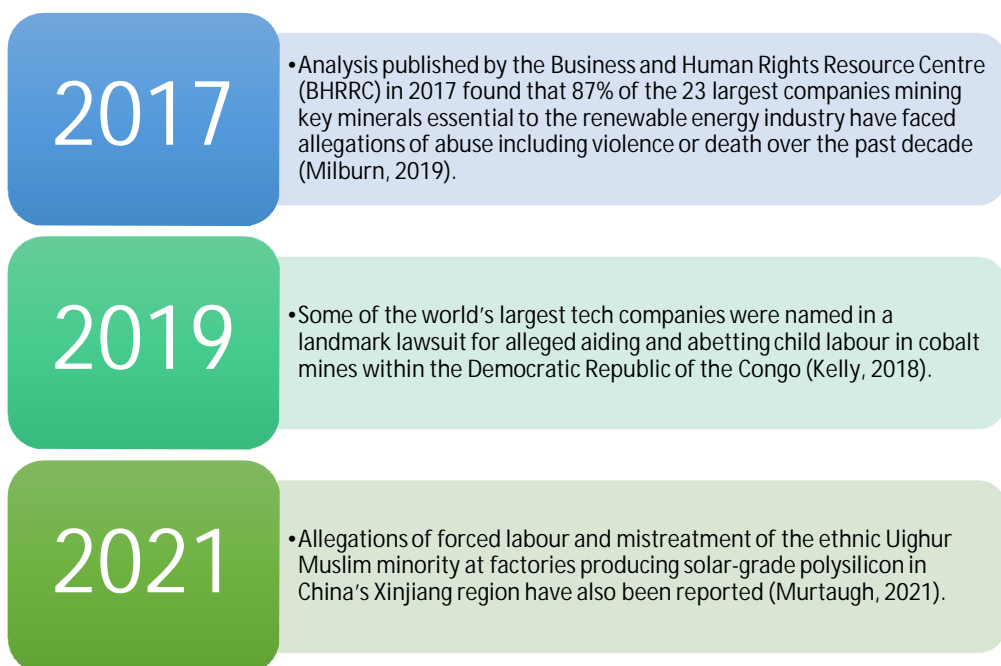
The authors aim to add to the existing body of literature by providing a social impact assessment (SIA) practitioner's perspective, drawing on past experience of conducting impact and due diligence assessments and monitoring against international environmental and labour standards. This paper explores the challenges to SCM on international infrastructure projects focusing on labour risks within the RE sector. It elaborates on the specific risks faced by the sector, the various factors that have led to ineffective implementation of SCM processes, and proposed approaches to enhance SCM within environmental and labour compliance planning and monitoring.

# Context and Literature Review

## Labour risks in global supply chains

In 2013, the Rana Plaza factory building in Bangladesh collapsed, causing the death of 1,300 garment workers who were manufacturing items for major international fashion brands. This tragedy served as a catalyst for greater scrutiny of poor working conditions and treatment of labourers throughout global supply chains, particularly for major brands in textile, electronics and agricultural industries.

When it comes to the RE sector, social issues in supply chains have often been underestimated or overlooked, with a general perception of the sector as representing the greener path for energy production, and therefore more socially conscious. However, similar issues have started to emerge in the public spotlight:



These reveal the complex web of components involved in producing materials needed to build solar parks and wind farms, including mines for mineral extraction, factories producing base materials, and quarries for aggregate material excavation. They also suggest that calls for companies to be held accountable for workers' rights and well-being within supply chains will only continue to increase.

Accordingly, industry and governmental actors have started to step up:

## Governments

- Binding EU law requires companies to conduct human rights due diligence along the full value chain (2021) (Morrison & Foerster LLP, 2021)
- Netherlands: Child labour due diligence law requires companies to assess the issue in supply chains (approved in 2019) (Allen & Overy, 2020)
- UK: Modern Slavery Act (2015) requires certain businesses to publish a statement on steps taken to minimise slavery in supply chains (UK Home Office, 2020)

## Industry

- Group of 175 solar companies pledge to commit to ensuring supply chains are free from forced labour (Solar Energy Industries Association, 2021)
- Global Battery Alliance: 70 organisations' platform for sustainable battery value chain (World Economic Forum, 2017)
- Responsible Minerals Initiative: Resources for 400 member companies to support responsible mineral sourcing (Responsible Minerals Initiative, 2008)

### International conventions and lender standards on supply chains

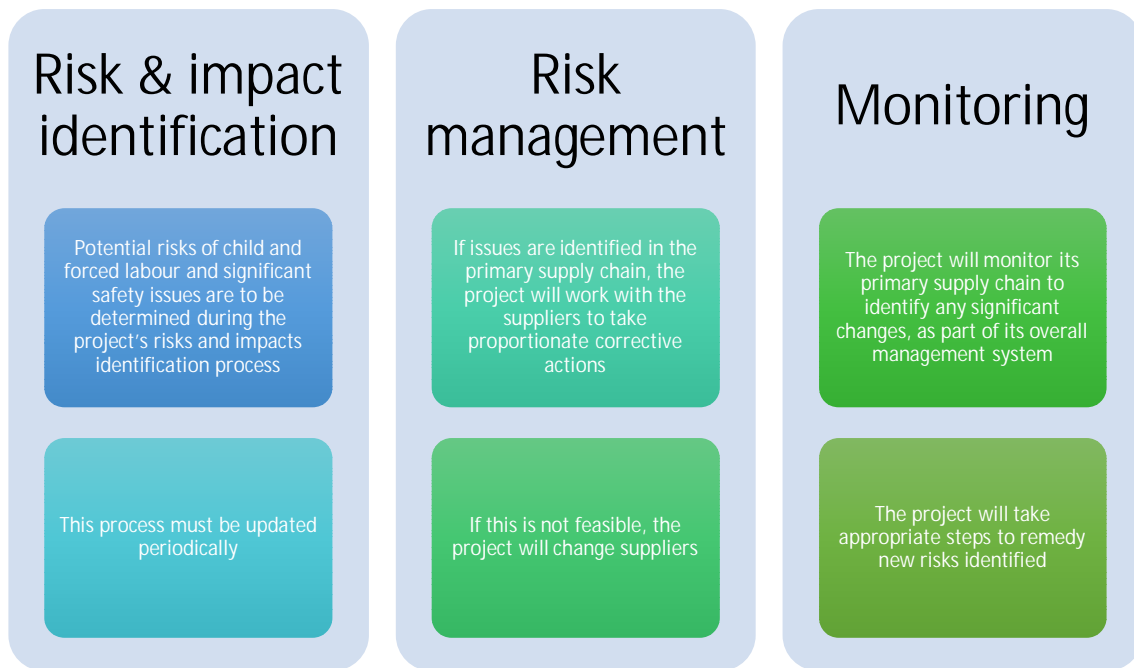
International standards also exist that establish best practice principles for identifying, assessing and mitigating labour and human rights risks within supply chains, including various International Labour Organization (ILO) conventions and resolutions.<sup>1</sup>

In particular, the International Finance Corporation (IFC) Performance Standards (PS) establish requirements for assessing and managing projects' relationships with primary suppliers,<sup>2</sup> primarily through PS2 on Labour and Working Conditions. The requirements for each project phase are listed below.

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<sup>1</sup> Including the 2016 resolution concerning decent work in global supply chains [http://www.ilo.ch/wcmsp5/groups/public/--ed\\_norm/--relconf/documents/meetingdocument/wcms\\_497555.pdf](http://www.ilo.ch/wcmsp5/groups/public/--ed_norm/--relconf/documents/meetingdocument/wcms_497555.pdf) and the eight ILO fundamental conventions that are also applicable for workers within supply chains: 1. Freedom of Association and Protection of the Right to Organise Convention, 1948 (No. 87) 2. Right to Organise and Collective Bargaining Convention, 1949 (No. 98) 3. Forced Labour Convention, 1930 (No. 29) (and its 2014 Protocol) 4. Abolition of Forced Labour Convention, 1957 (No. 105) 5. Minimum Age Convention, 1973 (No. 138) 6. Worst Forms of Child Labour Convention, 1999 (No. 182) 7. Equal Remuneration Convention, 1951 (No. 100) 8. Discrimination (Employment and Occupation) Convention, 1958 (No. 111)

<sup>2</sup> Defined as suppliers who are providing goods, and materials essential for the core business processes of the project



Importantly, these PS2 requirements do not apply to materials or components used in the construction phase of projects.

### What this means for the RE sector

The lack of applicability of supply chain oversight requirements for construction activities has meant that the components of RE supply chains where the most significant human rights risks lie have been left unaddressed. This lack of oversight has been compounded by the fact that guidance and analyses produced to date on supply chain environmental and social (E&S) risks have either been generic or focused on other, higher-profile industries.

The below section will elaborate on the issues encountered with regards to ineffective supply chain assessment and management and proposed approaches to address the gaps.

# Analysis and Discussion

Our experience from our due diligence and monitoring work indicates that the practice of applying SCM in the RE sector is more complex than it would seem. While project proponents and contractors are committed to project E&S compliance when it comes to SCM, their comments depict numerous uncertainties:

- Lack of awareness and understanding of actual working conditions at suppliers (“there are no risks in our supply chain / it is not our job to monitor suppliers’ labour compliance”)
- Perceptions that local labour compliance is all that is required (“suppliers must comply with national labour laws”)
- Perceptions that SCM requirements are too onerous (“we cannot check where every nut and bolt come from”)
- A relationship of internal (other departments are responsible) and external trust (between sponsor/contractor and supplier) exists (“we trust our supplier/suppliers are evaluated by the contracts team”)

We have grouped these challenges into three core areas: Focus, roles and process. These challenges are further discussed below.

## Focus

Much of the available SCM guidance is focused on the agricultural, retail and textile industries. RE is generally considered to have less impact and risk than these other industries, and as such, the focus has been lacking on how to apply SCM on RE projects.

IFC PS2 GN93 states the supply chain requirements do not apply to “material or components used in the project’s construction phase.” This could be misconstrued to be read that SMC only applies to the operations phase of the project when, in fact, there are often larger risks in the construction phase of large infrastructure projects.

## Roles

It is often unclear who is responsible for assessing and monitoring the supply chain: project developer or the contractor – and who within these entities. Procurement teams within developers/contractors typically apply only technical and financial requirements to appoint suppliers. Monitoring rarely is required from suppliers.

## Process

The contractual scope of SCM sometimes requires OHS compliance from suppliers but rarely is expanded to include labour rights, environmental compliance, or both. IFC PS2 scope also focuses only on primary suppliers, whereas exposés have indicated that gross human rights violations typically occur at the raw material extraction and primary processing areas, where end users rarely monitor. Costs associated with monitoring are typically considered prohibitive by sponsors/contractors.

Hence, it is clear that SCM in RE has a several gaps and grey areas around focus, roles and process that need clarification.

One recent project we have been monitoring has flagged SCM as a key issue and has developed best practice measures to address these risks:

- Contractual commitments that suppliers must adhere to
- Labour requirements are clearly specified and included in contracts: no child or forced labour, freedom of movement, right to resign, good OHS practice, grievance mechanism

- Environmental requirements are clearly specified and included in contracts: adherence to greenhouse gas, water, waste legislation/standards (etc.)
- Clear, detailed supplier questionnaires developed that require evidence of compliance, assessed by environmental, labour and procurement departments
- Risk levels are assigned to suppliers based on assessment, with associated corrective actions/termination triggers based on level of risk
- Monitoring mechanisms for compliance involve direct audits as well as other secondary sources such as media/lenders
- Monitoring frequency tailored to the level of risk (and is recurring)

These measures have started to address some of the gaps we have highlighted in this paper.

# Recommendation and Conclusion

We recommend that SCM is improved by following a model focussing on Guidelines, Education, Compliance and Oversight (GECO).

Guidelines and tools need to be further developed by international lender groups, governments and/or developers with a global presence who are keen to demonstrate best practice or consultant groupings such as IAIA. These can draw from best practice experience that is applied to individual projects. As part of this, roles must be clarified. Ultimately the project developer is responsible for monitoring the supply chain (even if this role is delegated to the contractor). The cost for this must be considered within project financing agreements. Multiple methods, approaches and sources for continuous monitoring of supply chain risks must become standard practice.

Renewable energy-specific guidelines must be created, and guiding examples of screening checklists developed that assess risks based on the country, industry and specific company. Completion of these checklists must require demonstrated evidence by the supplier. Questions must be included about who the *suppliers'* suppliers are to expand the current focus beyond the primary supply chain. Risk must then be assessed, and the minimum requirements for the monitoring type, the number of links in the supply chain to monitor, and the frequency of monitoring must be defined. Annual monitoring should be set as a minimum benchmark.

It should also be made explicitly clear that supply chain issues must be considered even prior to, and during construction. Discussions that we have had with international lenders indicated that they had provided project-by-project guidance on this, suggesting that during construction, any supplier who provides materials or services more than once to the project must be considered within the supply chain for monitoring. The practicality of this needs to be determined on a case-by-case basis, as many developers and contractors consider this requirement too onerous (especially if it has to be agreed after financing agreements have been signed).

Education on SCM is a crucial step in improving the practice. Sponsors have to understand, take ownership and act on the risks, rather than being reactive and responding to pressure coming from lenders, media or NGOs. Existing, complex supply chains need to slowly be amended to include contractual requirements that require environmental and labour compliance. This requires the education of sponsors and contractors, starting during the environmental and social impact assessment studies and continuing throughout project development. Consultants are often unskilled and unaware of the need and scope for supply chain assessment, and as the guidelines available are not always practical, there are wide ranging types of advice given and vastly differing methodologies and outcomes. Therefore, it is important that the expanded guidelines and tools are made practical as far as possible to create precise, minimum requirements for the RE industry.

Finally, it is critical that developers, lenders and lenders' consultants enforce the required guidelines. Too often, SCM requirements are disregarded to ensure that projects are financed, and the supply chain risks are considered "minor". Unfortunately, the reputational damage that companies and lenders face when external parties uncover supply chain abuses is significant. Contractors must be contractually bound to monitor their supply chains, and suppliers must be assisted in monitoring their own suppliers. We believe that initiatives at an industry level is required, and the recent signing of multiple solar project developers to abolish labour risks within their supply chains is a step in the correct direction.

SCM is important not only to protect people but also because it protects companies and investors' reputations, increases trust and reduces costs. As mentioned earlier, there is very recent emerging legislation that invokes supply chain responsibility as well as the recent EU vote to hold businesses accountable and liable when they harm or contribute to harming the environment, human rights and good governance. SCM is therefore



receiving significantly increased focus, and as social safeguard practitioners, we play a key part within continued improvements to safeguard the communities in which our projects are developed.

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