How voluntary disclosures can make supply chains more sustainable

Even as climate regulations weaken, voluntary disclosure requests from companies can encourage suppliers to share environmental data — and cut emissions.

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With countries rolling back regulations on climate-related disclosures along the supply chain, companies may be less legally obligated to report on the environmental performance of all their suppliers. But there may still be a way to get the information: asking for it.

For many companies, the supply chain is among the most complex and yet important pieces of the sustainability puzzle. Corporations, especially multinationals, may have little control over the climate performance of their far-flung networks of suppliers. Yet ignoring supply chains may be ignoring where companies do the most environmental damage. According to a report by consultancy BCG, supply chain emissions are 26 times greater than emissions from direct operations.

With ESG disclosure becoming increasingly political, it can be useful to approach the issue from a pragmatic lens of supply and demand of information.

A working paper by Pietro Bonetti, Yang (Ellen) En, Igor Kadach and Gaizka Ormazabal looks at what happens when companies ask for climate-related information from their suppliers. Companies may be prompted to do so for a number of reasons: they may believe that suppliers' climate performance will affect their future cash flows; their sustainability objectives may extend to the supply chain; or their environmental reporting may incorporate suppliers.

Suppliers, in many cases, are not legally required to answer. It also may be too costly for them to provide the information, or the company asking for it may not be an important enough customer for the supplier to go the extra mile of disclosing environmental information.

Will suppliers offer the information? Or will they simply ignore the request? And will disclosure play a role in climate-related corporate decision-making?

Analyzing data from the CDP reporting platform, the research finds that not only did suppliers tend to provide the information when requested, but they also subsequently reduced their own carbon emissions. When companies asked for environmental information, suppliers complied 52% of the time. Following that disclosure, greenhouse gas emissions by suppliers declined approximately 2.5%. The research used the CDP because it is a voluntary platform, meaning that suppliers were not bound by regulations to disclose.

Some companies were also prepared to walk the sustainability talk, cutting off relationships with suppliers that were unwilling to provide information. Specifically, the probability of terminating a business relationship with an unresponsive supplier increased by 1.4% following a customer's request for information. Companies were also more likely to continue relationships with less contaminating companies and sever ties with high emitters.

All of these trends were more pronounced when the companies were likely to face greater scrutiny from shareholders or other stakeholders — for example, among companies with more institutional shareholders, with operations that could suffer an environmental mishap or that operated in carbon-intensive sectors.

These findings are important as countries and regions, such as the European Union, simplify and soften sustainability regulations. Beyond laws, contractual relationships — like those between companies and their suppliers — can also serve as an incentive to disclose, with subsequent improvement in the environment.

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