Ceres

Opportunities for Action in Agricultural Supply Chains

ENGAGE *the* CHAIN

engagethechain.org

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The profitability of the world's largest food and agribusiness companies depends on secure access to a reliable supply of commodities, but this secure supply base is increasingly in jeopardy due to issues such as climate change, water scarcity, and deforestation. Assessing and minimizing the material risks due to these supply chain issues is an imperative for investors. This document guides investors through steps to evaluate these material risks in their portfolios.

STEPS TO EVALUATE MATERIAL RISKS IN INVESTOR PORTFOLIOS

STEP 1	STEP 2	STEP 3	STEP 4	STEP 5
Build understanding of agricultural supply chain risks	Analyze the risks of individual companies in their portfolio	Assess company plans to mitigate supply chain risks	Collaborate with other investors on company engagement	Engage directly with select companies on supply chain risks

STEP 1

Build understanding of agricultural supply chain risks

Engage the Chain outlines seven environmental and social issues that drive financial risk in the agricultural supply chains of consumer product companies: climate change, deforestation, land rights, land use & biodiversity, livelihoods, water use & pollution, and working conditions. Understanding these issues is fundamental for investors who seek to identify priorities and suggest improvements to a company's policies and procedures.

Avenues for building understanding of supply chain risks include:

- Reviewing background material on social and environmental issues that drive supply chain risks;
- Reviewing issue-specific reports and sources for agricultural supply chain indicators; (See Box below)
- Attending investor webinars or educational meetings on supply chain risks.

AGRICULTURAL WATER RISKS: FEEDING OURSELVES THIRSTY

In Feeding Ourselves Thirsty, *Ceres takes a closer look at how the food sector is managing water risk. The report evaluates publicly available information on the water use, stewardship and policies of more than 35 major food sector companies in four industries: packaged food, beverage, meat and agricultural products. The report examines how water risks affect the profitability and competitive positioning of these companies, ranking company performance on a zero to 100 point basis. The report provides recommendations for how investment analysts can more effectively evaluate food sector companies on their water risk exposure and management practices. It also provides recommendations for how companies in the food sector can improve water efficiency and water quality across their operations and supply chains to reduce risks and protect water resources.*

STEP 2

Analyze the risks of individual companies in their portfolio

As a starting point, Ceres summarized for investors the environmental and social impacts and related risks for eight of the commodities most commonly sourced by food and beverage companies operating in the U.S. (i.e., beef, corn, dairy, fiber-based packaging, palm oil, soybeans, sugarcane, and wheat), along with a table showing company exposure to each of those commodities. Investors can use the commodity information and suggested third-party data resources in Engage the Chain to analyze potential issues in corporate supply chains.

Within a particular commodity, the level of environmental and social risk is largely a function of the geographic context and agricultural production conditions and practices.

- **Where is the production taking place?**

  The geographic context of primary production influences the level of risk stemming from poor labor and human rights conditions, changing climate conditions, soil health and natural resource constraints, and the vulnerability of local ecosystems. Third-party tools and resources are available for assessing whether a commodity is grown in areas of high water risk or stress (WWF/DEG's Water Risk Filter, WRI's Aqueduct) or with the possibility of child or forced labor (U.S. Department of Labor's *List of Good Produced by Child Labor or Forced Labor*).

- **What are the farming practices and production systems?**

  Farming practices that can affect risks include soil management techniques, irrigation practices, and fertilizer or pesticide management. Investors should also consider the way that companies source agricultural inputs—directly from farmers, through co-ops and wholesalers, or through multiple levels of intermediaries or commodities market—as this affects a company's ability to manage risk.

- **Under what labor conditions is the commodity produced?**

  Production conditions that pose material risks include unsafe working conditions, lack of land tenure for smallholder farmers and food security issues.

> ***If a company cannot trace its supply chain, it is far more exposed to unknown risks than a company that understands the complexities of where its products are grown and sourced.***
>
> —Hillary Marshall, Senior Research Associate, Responsible Investment Research, Domini

Industries with long, opaque supply chains are more likely to be a risk for human trafficking than ones with short, transparent supply chains. Companies cannot achieve no-deforestation commitments without being able to trace commodities back to the location of primary production. Yet in many instances, companies view supply chain relationships as propriatery information to be closely guarded. In addition, agricultural supply chains are highly complex and significant traceability challenges can make it difficult to idenfity the geographic origin of a particular commodity and the intermediaries through which it passes.

STEP 3

Assess corporate plans to counter and proactively deal with these supply chain risks

Investors should assess whether companies have policies for sustainable sourcing of agricultural commodities. These policies should be incorporated into procurement strategies and processes, and include time-bound, measurable goals against which progress is regularly monitored and disclosed.

Several reporting frameworks have developed agricultural supply chain indicators that are relevant to this type of analysis, including:

- Global Reporting Initiative (GRI)—Food Processing Sector Disclosure
- Sustainable Accounting Standards Board (SASB)—Consumption I Standard

In addition, investors may find that these issue specific data sources are helpful references:

- CDP's climate, water and forest product reports
- Benchmarking results from Ceres' *Feeding Ourselves Thirsty* report
- Oxfam's *Behind the Brands* company scorecard
- Forest Trends's data tracking deforestation commitments at Supply-change.org
- KnowTheChain's benchmarks on labor standards and workers rights

Although a company's specific policies and goals will vary based on the nature of its purchases and sourcing model, effective risk management requires that companies:

- Set policies that are relevant to the risks and impacts associated with their key commodities and goals that are time-bound for sustainable sourcing;
- Communicate clear expectations to suppliers through policies;
- Evaluate participation in multi-stakeholder initiatives;
- Provide incentives to suppliers to encourage improved production practices;
- Make investments and support policies that reduce shared agricultural risks;
- Incentivize the procurement function to ensure alignment between sustainability policies and goals and internal sourcing decisions;
- Publicly report, using meaningful indicators, on progress towards goals.

REPORTING GUIDANCE FOR RESPONSIBLE PALM

To improve transparency and help all stakeholders understand the gaps in palm oil implementation, a diverse group of 20 nonprofit organizations and investor groups, convened by Ceres, developed common reporting guidance for companies. The **Reporting Guidance for Responsible Palm** *is a set of shared expectations for corporate reporting on company commitments towards responsible palm oil sourcing and production.*

Although supply chain risk indicators will vary based on the nature of the commodity and sourcing model, below are some sample indicators from the **Reporting Guidance for Responsible Palm***, which encourages companies to:*

- *Report the percentage of agricultural procurement volume that is traceable to its geographic origin (traceable mills or estates);*
- *Report the percentage of producers in the supply chain that provide labor-related information according to the Free and Fair Labor Principles;*
- *Report the percentage that is certified in accordance with credible, internationally-recognized responsible production standards.*

STEP 4

Join collaborative investor efforts focused on agricultural supply chain risk

Leverage existing collaborative investor efforts that engage companies on agricultural supply chain topics, such as Ceres' Investor Network, the United Nations-supported Principles for Responsible Investment's (UNPRI) and the Interfaith Center for Corporate Responsibility (ICCR).

Issue-focused working groups enable investors to engage and collaborate on environmental, social, and governance issues, and to advance investment practices and peer-to-peer idea sharing to improve investment decision-making and efficient engagement. (See Box below)

Currently, Ceres helps to coordinate two investor working groups focused on agricultural supply chain risk. To learn more, please contact Nathalie Wallace at Ceres: wallace@ceres.org

CERES INVESTOR NETWORK'S WATER HUB

A working group of Ceres' Investor Network, the Water Hub, undertakes activities that help drive greater consideration of water in investment decision-making. The "Hub" serves as a collective action forum that develops more effective research methods to assess water risks and offers peer-to-peer sharing of leading water integration and engagement practices. The Hub is open to asset owners and asset managers interested in the topic of water risk integration in investment decision-making. The Hub engages actively with affiliated investment, NGO and water experts. The group meets quarterly via conference call and hosts investor-led peer learning sessions throughout the year. For more information contact Monika Freyman: freyman@ceres.org

STEP 5

Engage directly with select companies for improved management of supply chain risks

Investors can deploy a range of actions to engage with companies directly to incorporate environmental and social risks into their investment decisions.

- **Review proxy-voting guidelines**
  Asset managers can review their institution's proxy-voting guidelines and policies to ensure support for relevant shareholder resolutions on agricultural supply chain risk. Asset owners should engage their fund managers to ensure such guidelines are in place and are acted upon.

- **Solicit improved risk disclosure**
  Investors can support efforts to increase and standardize disclosure on agricultural supply chain risks. To encourage this, investors can employ a range of approaches, from engaging directly with portfolio companies, to joining relevant investor working groups and dialogues, to supporting market-level disclosure platforms such as CDP's Climate, Water and Forests questionnaires and Know the Chain's evolving human rights benchmarks.

- **Engage directly with the management of underperforming companies**
  If a company has poor risk disclosure, investors can engage directly with company management to request information on potential risks or to improve risk mitigation. Sending a letter or filing a shareholder resolution, either individually or with other investors, are other engagement tools used to try to influence corporate behavior. As a last resort, investors may consider reducing their exposure to companies that are not managing risk effectively.