

# A Powerful ESG Tool: Supply Chain Localization



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### Author **Shaun Doherty**

is a supply chain adviser for Chevron who is seconded as Kazakhstani content managing adviser at the Tengizchevroil joint venture in Atyrau, Kazakhstan.

The power of creating a purpose-driven company — one focused on the bottom line and a sustainable social impact — has never been more evident. Investors and boardrooms recognize this and are pushing company leadership for improved environmental, social and governance (ESG) performance results.

One effective ESG strategy is localization of supply chains in the countries and communities of operation. This requires significant change management, persistence and patience, but companies that sustainably localize their supply chain can enjoy not only the benefits of better ESG performance, but also those of improved quality, delivery and service.

### **Sustainability Frameworks as a Guide**

Localization strategies are largely driven by a company's products and global supply chain.

Consider the extractive industry: Mining and oil and gas companies have been executing localization — also called local content — programs for decades in response to governmental regulations, and also to ensure their social license to operate. Whether classified as local content development, supplier diversity, community development or Indigenous participation, such programs focus on identifying, developing and including local goods and services into a company's supply chain.

In the extractive industry, local content has typically been defined as the value that an extraction project brings to a local economy through hiring local labor and procuring local goods and services. However, this concept has evolved and become more visible through such sustainability frameworks as:

### **Creating shared value (CSV).**

An early model, popularized by Michael Porter of Harvard Business School, CSV is an evolution of corporate social responsibility (CSR); it is a collaboration-based model to drive positive social and economic outcomes.

**The United Nations Sustainable Development Goals (SDGs).** These 17 SDGs were adopted in 2015; local content is a key contributor to the eighth goal: decent work and economic growth.

**ESG.** In ESG-focused businesses strategies, local content is a key component of the “S” or social performance; it pertains to a company’s reputation and relationships with individuals and institutions in the communities where it does business.

That stakeholders and rating agencies are increasingly asking extractive industry companies to report their progress against these frameworks provides strong incentive for improvement.

However, extractive companies have typically focused on short-term, year-to-year compliance targets and/or activities that reduce social risk, infrequently prioritizing competitive, long-term local content.

## **Creating a Case for Change**

Since strong localization programs boost a company’s reputation and improve its social license to operate, the risks associated with social unrest and work stoppages are reduced. While these outcomes overlap with ESG outcomes, they are not the same.

Strong ESG performance can offer significant benefits. As noted in an article by McKinsey & Company, *Five Ways That ESG Creates Value*, companies that score well on ESG metrics are better able to

anticipate future risks and opportunities — and engage in longer-term strategic thinking and long-term value creation.

Additionally, research shows that companies with a strong ESG strategy can lower costs while increasing profits and productivity. They also are more likely to be considered as partners of choice to local governments and gain access to funding on more favorable terms.

As companies face more global competition from organizations that don’t embrace a shared-value strategy, ESG business strategies and local content development can be key differentiators in the race for increased market share, employee retention, access to lower-cost capital and better governmental relations. To be truly effective, companies need to look for long-term, competitive and business-driven localization.

## **Developing a Strategy**

When including localization in their ESG programs, companies can choose leader, follower or incremental approaches. Arguably, the most impactful is the leader strategy, in which a company (1) creates a compelling value-based vision, (2) builds internal alignment and (3) develops processes and tactics to incorporate ESG into company DNA. Such an approach will lead to “winning” in ESG and local content.

Additionally, companies must embrace this shift in social or local content strategy and employ sub-strategies to provide durable and sustainable results. These include:

**An operations-led local content program** features a strong understanding of the global, regional and local business, as well as knowledge of how to interact with and influence operational leadership and technical subject matter experts. To be effective, stakeholders from the operations, leadership and supply chain functions must be involved. By creating a logical, competitive and realistic plan with the “on-the-ground” operations team, companies can build impactful, sustainable local content

initiatives that lead to improved results and positive reputational impact.

In a **collaboration-driven model**, the company focuses on high-value, complementary stakeholders like government, associations, finance organizations, development firms and business partners that can help drive localization programs. Such a strategy drives greater business opportunities and system-wide growth, but establishing a good organizational, professional and cultural fit can be difficult. It’s important to conduct extensive market investigation and due diligence, as well as align priorities and values.

**A communication-enhanced localization plan** requires results not only be achieved, but also measured and communicated. Often, technical teams, suppliers and supply chain professionals engage in localization work, but no one hears about it. While results are necessary, it is just as critical to effectively communicate them to key stakeholders to achieve full reputational benefit. Such internal and external promotion also will help create a culture where employees, suppliers and stakeholders are recognized for their contributions — and encouraged to provide more.

## **Commitment is Critical**

A strategy is vital but only the beginning. Implementation is the true path to success and is determined by having effective localization tactics in product design, category management, supplier development and other competencies.

For many companies, building a purpose-driven culture and implementing a localization program will need a high-level commitment of time and resources. It will require company leadership to passionately communicate the benefits, build a compelling strategy and to drive work significant change. However, those that do can reap the business benefits associated with higher ESG performance. **ISM**

