



Briefing note

Sustainability standards in global supply and value chains

The background

There is growing pressure to turn global, regional and national supply chains into more sustainable business and consumer linkages. Standard systems are a major instrument to manage supply chains, including companies from various sectors, different size and countries. Standard systems are being shaped by government policies and legislation but also very much by the market forces.

Sustainability standards fulfil several functions, i.e. regulation, quality management, risk management and communication.

Regulation function: Pressured by consumers, civil society activist groups and the legislating bodies of the consuming countries, more and more companies are forced to consider sustainability aspects as part of their core business activities. As efficient and transparent supply chains are in the self-interest of companies, standard systems are considered a useful instrument. Also governments are increasingly using standard systems for the purpose of government regulations. Sustainability standard criteria are usually following those stipulated in global agreements and conventions.

Quality management function: When supplying goods and services, business operators and companies use standard systems as operational guidance to integrate sustainability into their management systems. With their principles, criteria and indicators, standard systems offer a guide for concrete and measurable steps to implement sustainable production. Sustainability standards serve to regulate production methods and processes for commodities or services.

Risk management function: Globally acting companies face an increasing reputational risk with regard to potential environmental damage and socially harmful practices associated with their business operations and those of their suppliers. The traceability mechanisms and control systems, integrated into the standards system, support and enforce compliance with sustainability standards among suppliers.

Communication function: Market participants increasingly require information about the sustainability of the production methods and processes. What possibilities do suppliers have to demonstrate the parameter of their sustainable production? How can companies and consumers purchase sustainably produced commodities and services if they are not able to verify whether the product has been produced sustainably or not? Communication along global supply chains creates transparency about the sustainability of the production process. Sustainability reports and labels are important communication elements for companies. Also the standard system itself fulfills a communication function as it enables companies to demonstrate sustainable production along the supply both towards business clients (B2B) as well as towards consumers (B2C).

The quality and credibility of a standard system depends on several factors: The *governance* of the standard system determines how the rules of the game are set and who can change them. This includes mechanisms to settle conflict of interests and complaint mechanisms.

The credibility and attractiveness of a standard system also depends on the *transparency* of the decision-making structure and the *integration* of different stakeholder. Often, there are significant differences between multi-

stakeholder initiatives and schemes dominated by private sector.

The *governance* structure determines content and composition of the system which consists of several elements:

The standard itself is the relevant document determining the principles of sustainable production or processes. These requirements are translated into operational steps by criteria and indicators. However, a standard system comprises further elements. Through conformity assessments different parties assess if and how the standard is successfully implemented. If the result is to be communicated to the general public compliance with the sustainability standard requirements is often certified by external third party auditors. Standard systems also regulate who is allowed to trade with sustainably produced commodities and how this is to be documented and communicated. The chain of custody requirements of a standard determine the form of conformity assessments along the supply chain, communication and labeling. That way it can be excluded that e.g. ten kilo of sustainably produced coffee at the beginning of the supply chain turn into twenty kilo of allegedly sustainably produced coffee at the end of the supply chain.

Standard systems with solely private sector participants run the risk of being accused of *greenwashing*. Credibility is then questioned due to the restricted participation of civil society representatives during the development process and because of the sole private control of the auditing. Therefore, standard systems are increasingly developed in **multi-stakeholder** processes including processing and trading companies, producers, government representatives, investors, academia and the civil society. The conformity assessment is conducted mostly by third party auditors.

Providing training to producers and other qualification measures is a crucial instrument for the successful implementation of a standard system. Small businesses as well as manager and employees of medium- and large sized companies are only able to implement measures and standard requirements if they are extensively trained and if they develop ownership for the whole process.

Maintenance of a standard system implies costs, e.g. for administration, qualification measures or *marketing*. Possible sources of finance are membership fees or charges for the use of labels. A standard system is a learning system which should be regularly adjusted e.g. by revising its standard document. A standard initiative has to benchmark itself regularly against its targets

and expected impacts and reflect how the system as such can be improved.

The demand for sustainably produced commodities and services is rapidly increasing. The most important products and sectors are coffee, cocoa, cotton, palm oil, fisheries and aquaculture, biofuels, timber and forestry, the natural stone sector as well as the textile industry and other areas of industrial manufacturing. In most of these sectors, the share of certified products in global production lies between five and twenty percent. Meanwhile, retailers and consumer goods manufacturers realize that integrating sustainability aspects into their supply chains is critical for their competitive position in the market, for the management of reputational risks as well as a risk mitigation strategy. They increasingly issue quantitative commitments by when they intend to solely procure sustainably produced goods. Therefore, verification of sustainable production of commodities and services has become an important competitive element in company strategies. In the meantime, the complexity of the systems is increasing. No longer is the primary production considered, e.g. the forest management, but the entire value chain, i.e. the whole wooden chair. Thus the systems need to serve not only the single product but more complex value chains.

Our position

Against this background GIZ holds the following positions:

1. Improvement process is key

Sustainability standards serve as a framework for the improvement of social, ecological and economic factors in local production areas and global supply chains.

For producers, the main challenge lies not necessarily in the need to comply with the standard, but rather to establish internal management instruments for continuous improvement. Lack of information, resources, information, and best practice experience as well as a weak infrastructure are major obstacles for producers and other market participants in developing countries when aiming to comply with sustainability standards and enter high-value markets.

2. Standardization pays off

In the long run, standardization reduces transaction costs in supply and value chains and is a precondition for the widespread implementation of sustainability requirements across sector and regions. Many examples show that despite the necessary investments at the beginning, the introduction of ecologically and socially sound practices produce financial and economic returns in the long run.

If market participants in the entire sector agree on rules of the game, namely sustainability standards, the transaction costs can be drastically reduced and the credibility and transparency can be increased. Particularly small- and medium sized companies and smallholder farmers can benefit from the standard initiatives since they offer access to standardised and practice-approved solutions for productivity improvement, efficiency gains, cost reduction and adoption of new technologies.

3. Lack of transparency

There is an urgent need to increase the transparency of standard systems' characteristics and to facilitate comparison between the individual standard systems' claims. In many areas, standards have proliferated to a degree that the benefit of the systems, namely the standardization, is put at risk. However not the variety of the systems as such poses problems but rather the fact that users may get confused as there is a lack of transparency related to the claims. If benchmarking would be introduced producers could, among others, avoid multiple audits, companies would set priorities as needed and the competition between the systems would generate innovation.

4. Standard requirements should not be set too high

The details of a standard system decide whether it encourages sustainable development or it rather becomes a trade obstacle. If the standard requirements are set too high or the instruments of the standard system are not suitable for smallholder farmers and other small enterprises, many actors in developing countries and emerging economies will be systematically excluded from standard application and thereby from access to global supply chains.

A gradual approach like continuous improvement towards the targets set in the standard is more likely to lead to widespread adoption among developing country producers and inclusion of small production units. This means that producers and companies do not have to accomplish the highest requirements from one day to another but get more time to adapt, i.e. a period of two years. A further element is group certification to provide for easier access especially for small and medium-sized companies and smallholders. Additionally, the standard requirements need to be adjusted to the local conditions.

5. Qualification of actors in the supply chain is more efficient than auditing

Experience shows that investments in training and other qualification measures are far more effective than investments into improved surveillance, control and auditing. Significant investments in improved production techniques and systems and especially in human capital are necessary to bring sustainable production into mainstream operations.

Often, major challenges are access to finance for the conversion of a business and access to supply chain-specific knowledge and information. Sustainable development is not only the objective of standard initiatives but also part of government policies, e.g. in sustainable resource management or enforcement of workers' rights. Cooperation with government institutions, research institutions and universities are needed when implementing training and capacity building initiatives.

6. Standard systems are only one of many instruments

A standard systems itself cannot guarantee sustainability. It is one of many instruments that may lead to more sustainability. They are usually limited to the improvement of single production units. Their contribution, e.g. to the protection of biodiversity or of water catchment areas is therefore limited. Nevertheless they can be helpful in broadly based approaches such as land use planning.



Our recommendations for action

In the view of GIZ these are the most important recommendations for action:

1. Development of guidelines for effective standard systems

This is not only about demanding requirements but also about optimized standard system performance. Effective standard systems are a complex instrument. As there is broad experience on sustainability standards in many economic sectors available, guidance for improved quality management is needed.

2. Alignment of systems to mainstream supply chain requirements

In most of the value and supply chains, sustainability standards still cover only a minor share of the global production and trade.

However, the demand for commodities and products produced in line with sustainability standards will be further increasing. Therefore elements of the standard systems and their interaction need to be adjusted to efficiently serve larger market shares. As one example, auditing processes should become more flexible on the basis of risk indicators. Besides, standard systems should consider enlarging their units of verification from farm to regional or landscape level. Such indicators may be e.g. the previous *performance*, *satellite monitoring*, and the extent of corruption within a country or the existence of an internal control system on the production site.

3. Integration of sustainability aspects into national certification

The integration of sustainability aspects into already existing national certification structures should be promoted. Hence, the certification effort can be reduced by utilizing economies of scale. National strategies will be amended to cover sustainability aspects which in turn will reinforce economic competitiveness of specific sectors.

4. Professionalization of standard initiatives

Standard initiatives need to be professionalised and the systems need to be adjusted to manage a rapidly growing demand and supply. For the quality, credibility and effectiveness of standard systems, participation of all relevant stakeholders is critical. It is important to help standard initiatives to shape their decision-making-structure to become more efficient. Furthermore, existing business practices should be optimized so that initiatives can perform in the market independently from donor support.

5. Create transparency and compatibility

The development of a global comparison framework, a so-called *benchmarking* for standard systems is essential in order to enable governments, companies and NGOs to compare and combine the complex systems. This is e.g. the basis for an internationally recognized comparison of audits to minimize the need for multiple audits of individual producers. On behalf of the Federal German government, GIZ launched in early 2015 the web portal www.siegelklarheit.de to promote consumer awareness and knowledge about sustainability standards.

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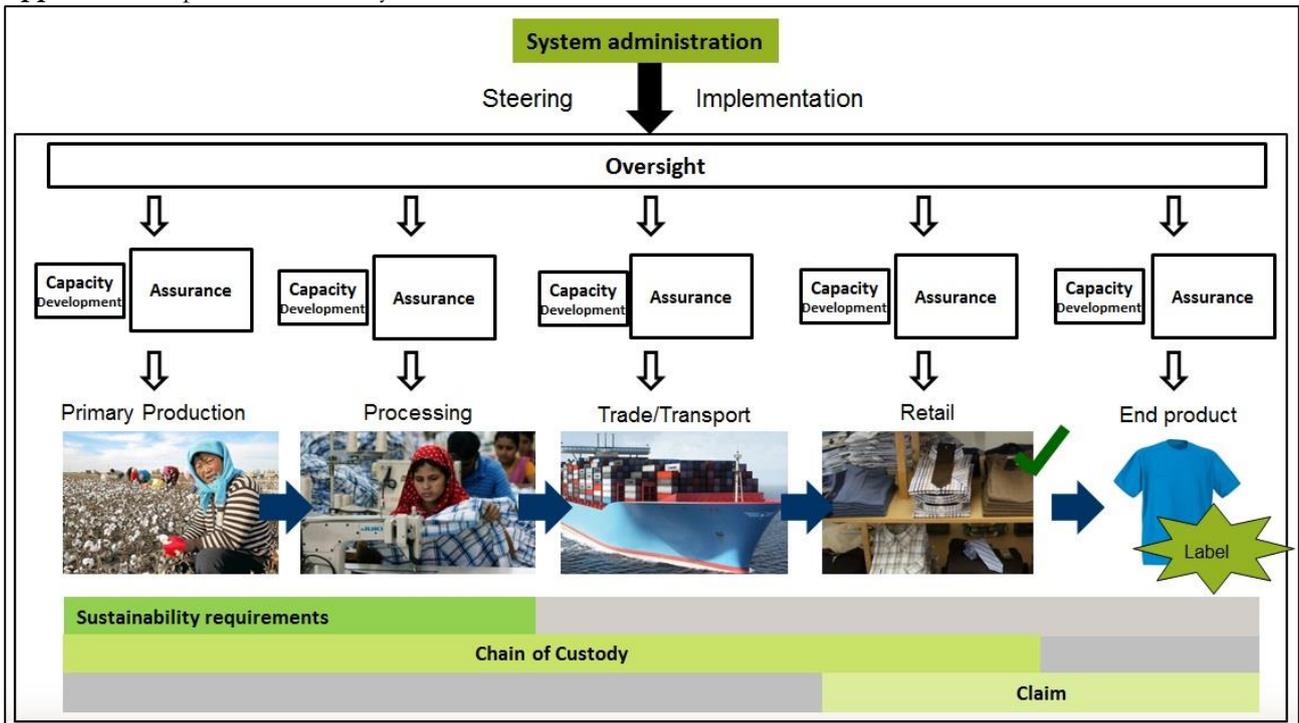
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Appendix: Graphics: Standard System



Source: GIZ Program Social and Environmental Standards, 2015.