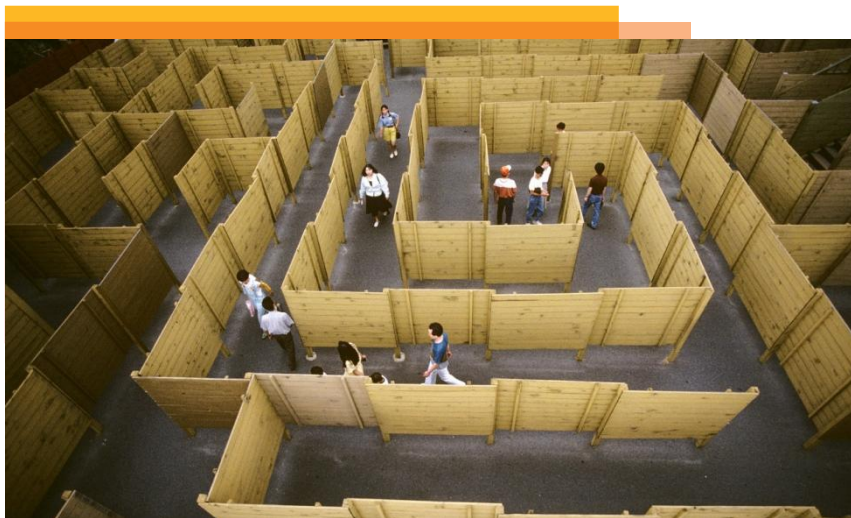


The New Face of Risk

Uncovering the Hidden Risks



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Can you answer these questions from your stakeholders ?

- Employee

“What should I do when people say our suppliers exploit labour?”

- Investor

“Does your company have a sustainability strategy?”

- Buyer

“Does your company have a sustainable sourcing policy?”



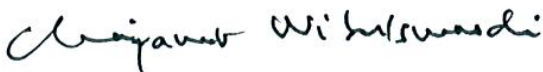
Foreword

Thai business leaders often think that corporate social responsibility (CSR) is something that is “nice to have” but is not really necessary for their company’s sustainability – forgetting that CSR is fast becoming a “must-have” in today’s highly competitive, increasingly globalized environment.

This booklet highlights the imperative for developing a rigorous sense of CSR because of its direct, immediate and significant effect on corporate profits and other matters of vital interests to stakeholders, using real-life examples, many of which are from Thailand or other parts of Asia. Readers will gain insight into why CSR is “everyone’s responsibility” – not just that of staff in the CSR, human resource, public relations, or corporate communications units. Top management, in particular, should show their determination and commitment to drive their company towards the goal of corporate sustainable development.

Corporate Social Responsibility Institute (CSRI), as a part of The Stock Exchange of Thailand, has been advocating enterprise-wide CSR practices and shared value creation. Our goal is to promote sustainable development of Thai businesses – ultimately leading to a sustainable society.

Hence, it is my pleasure to see strong collaboration between the CSRI and PricewaterhouseCoopers FAS Ltd to promote a better understanding of sustainability through this publication. Executives, especially those at the top, will find this booklet useful for corporate risk management and strategy planning, to boost corporate performance not only along financial but environmental, social and governance dimensions as well. This will benefit not only the firms themselves but Thai society as a whole in a sustainable manner.



Dr. Chaiyawat Wibulswasdi

Chairman, Executive Board
Corporate Social Responsibility Institute
The Stock Exchange of Thailand

Preface

Over the past few years, we have seen a gradual shift in the way that companies in Thailand view responsible – and, therefore, sustainable, business. Thai corporate leaders are increasingly seeing good business as going beyond ad hoc philanthropic “CSR” activities, toward being able to recognise and respond to the complex risks and opportunities that emerging global megatrends – like climate change, population growth, ecosystem degradation and resource scarcity – are presenting to businesses around the world today.

In part, this has been driven by an intensifying demand for transparency from stakeholders: social and environmental issues – whether the health concerns of Map Ta Phut, ethical labour issues in the shrimp industry, or severe floods linked to deforestation – are now putting pressure on businesses to look beyond their own operations and bottom line, to their broader supply chain and stakeholders.

However, while the level of awareness of sustainability and its relevance to business is increasing rapidly, truly integrating social and environmental considerations into the heart of corporate strategy is a practice still limited to a minority of companies.

As a start, this booklet will help you to uncover some of the “hidden risks” related to social and environmental business impacts and dependencies. The inability to detect and address these hidden risks could lead to production disruption and loss of public trust. Part I describes “The New Risk Landscape”, which reaches far beyond a company’s own operations; Part II, “The Hidden Risks”, highlights risks relating to key stakeholders; and Part III, “Managing Uncovered Risks”, provides a quick checklist to assess your risk exposure, as well as some examples of Thai companies leading the way in uncovering today’s risk.

Uncover the Hidden Risks in 3 steps

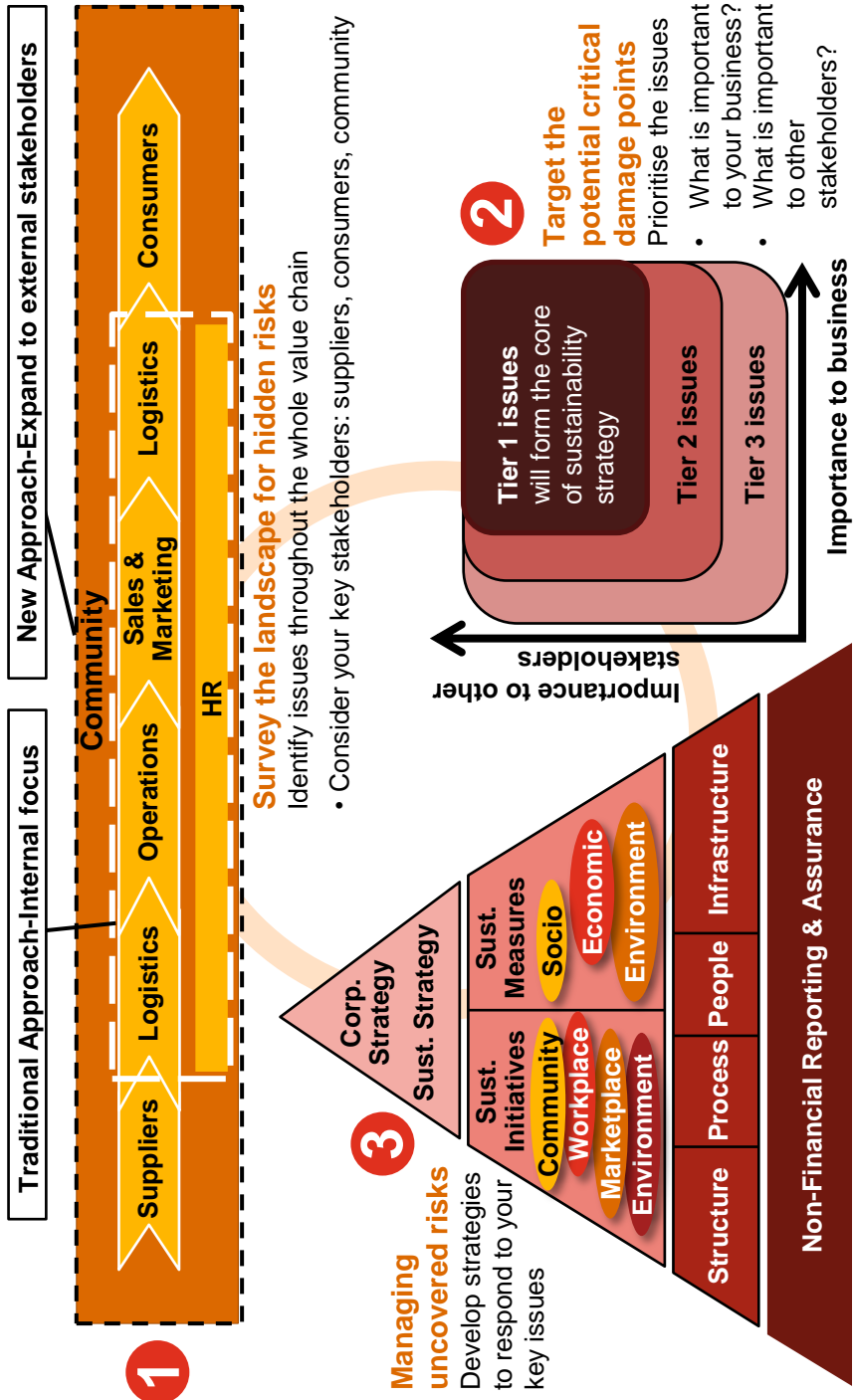


Figure 1. 3 steps to uncovering the hidden risks.

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Part I: The New Risk Landscape



Surveying the landscape

You are as strong as your weakest link

In a globalised world, facing intensifying challenges from megatrends which are: population growth and resource scarcity, technological change, and climate change, it is clear that the scope of risk assessment today must necessarily expand far beyond a business' internal operations. Companies need to be able to assess their entire value chains – along with their associated stakeholders – in order to truly understand the risks to their business, and effectively mitigate them.

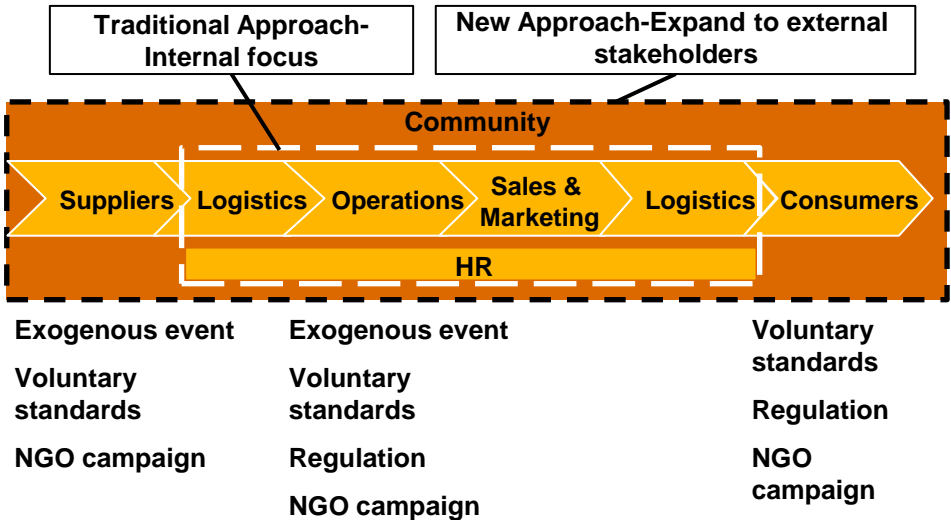


Figure 2. Look beyond yourself. A company interacts with many stakeholders along its value chain. Stakeholders themselves may be subject to disruptions, e.g. a company's supplier may suffer from a natural disaster, such as a flood – or face protests from an NGO due to perceived poor labour conditions. These disruptions will eventually affect the company itself.

Surveying the landscape

Megatrends - What are they?

Population growth and resource scarcity

Businesses rely heavily on raw materials and intensive energy consumption, and are sensitive to shortages and disruptions. At the same time, continued population growth means ever-intensifying and changing expectations and demands.

Technological change

Social media and the advancement of information and communication technologies mean that a business conduct – both good and not so good – can be quickly and easily exposed to the world.

Climate change

The changing environmental conditions mean changing resources, changing expectations, and even changing requirements for businesses and all stakeholders involved.

Assessing critical damage points

In this booklet, we discuss 3 key stakeholders that can pose serious threats to business if not understood or managed effectively. The changes influencing each type of stakeholder are different, which in turn present different challenges to business. However, all can affect the business bottom line.

Suppliers can be a weak link, if not well understood. Some are beginning to cause severe supply chain disruptions due to increasing social and environmental complexities.

Consumers do not only consume. They are active advocates and are casting their votes for a better world with their money.

Community is empowered. The increasing availability of platforms for connectivity is giving communities, and society at large, a powerful amplifier. News travels fast – especially, bad news.

Figure 3. 3 key stakeholders: Potential critical damage points.

Part II: The Hidden Risks





*Suppliers:
Increasing
complexity*

Suppliers - Trends

Companies' sourcing standards currently tend to be based on economic criteria, such as price, quality, and timely delivery of raw materials or products.

However, the business world is becoming more complex and awareness of social and environmental issues more sophisticated.

Can companies use conventional sourcing criteria to survive or achieve growth?

From 2009 to 2012, the Business Continuity Institute (BCI) conducted annual surveys on supply chain activity. Key findings from the survey were as follows:

(1) The majority of companies experience disruption in their supply chain:

In 2012, 70% of the respondents experienced at least one disruption in their supply chain. This high level is consistent with the trend-line over the past 4 years.

(2) Product quality, business ethics, and environmental incidents are gaining higher significance as causes of disruption. Also, energy scarcity is a rising issue:

Throughout the 4 years of the survey, the 2 causes of disruptions which consistently gained the top spot were unplanned outages of IT/telecoms and adverse weather. However, from 2011 to 2012, there were notable new entrants, including incidents relating to product quality, business ethics, and the environment. Energy scarcity also gained significant traction in 2012 compared to the 2011 survey.

Suppliers - Trends



(3) Disruptions can originate deep in the supply chain:

While approximately 60% of disruptions originated with immediate suppliers (1st tier), 30% occurred at 2nd tier suppliers, and 10% from 3rd tier suppliers. This illustrates the potential deep-rooted nature of disruption.

(4) Higher damage per incident is being reported:

The percentage of respondents experiencing more than €1 million damage in a single incident increased significantly, from 3.4% in 2010 to 21% in 2012.

(5) Impacts from product recall and brand reputation damage are increasing:

The most common impacts were loss of productivity, increased cost of working, loss of revenue, and customer complaints received. Incidents forcing a product recall or withdrawal also increased from just 5% in 2011 to 11% in 2012. As identified in 2011, longer term impacts are being experienced more frequently with damage to brand reputation increasing from 17% to 24% in the 2012 survey.

Suppliers - Cases

Failure to address suppliers' social and environmental risks can be costly.

Are you the next in line?

World's leading fast food brand hit by misconduct of suppliers¹

KFC, China's biggest fast-food chain with 5,300 outlets, was hit hard when state television reported in December 2012 that some suppliers were using excessive amounts of antibiotics. Sales in the first quarter 2013 plunged 20%. The company later promised to test meat for banned drugs, and strengthen oversight of farmers. It said more than 1,000 small producers used by its 25 poultry suppliers have been eliminated from its network.

The sustainability of a business is not only based on a company's own operations, but also those of its suppliers. A supplier's failure to meet sourcing standards can bring about negative impacts on the sourcing company.

Global toy manufacturer attacked by NGO for unsustainable sourcing²

In 2011, Mattel was attacked by Greenpeace for sourcing its packaging from Asia Pulp & Paper (APP), which allegedly procured raw materials through deforestation. Mattel later pledged to create a sustainable procurement policy and directed suppliers to put a freeze on purchases from Asia Pulp & Paper (APP).

To avoid reputational damage, a company may have to go beyond legal requirements.

1 "Yum's Q1 China Sales Drop 20% On KFC Chicken Probe; Shares Surge," Forbes, March 2013.

2 "Mattel to pay out 12 mln dollars over Chinese-made toxic toys," AFP, December 2008.

Suppliers - Cases



Thai shrimp business facing plummeting US sales – and the prospect of being classified with North Korea and Iran on labour abuses by the US³

The Thai shrimp industry faces being classified as a tier-3 watch list nation by the US government. This would likely result in some large buyers in the US shifting purchasing away from Thailand. Though the Thai Frozen Foods Association (TFFA) actively defends its members, stating that they each go through labour audits, allegations of labour abuse in some small processing plants still persist.

Issues in smaller parts of a supply chain can eventually result in severe repercussions to both larger companies – and countries. Sustainable sourcing policies can go some way to mitigate the risks from these issues.

³ “News Alert: Know Your Supplier Continued: Eliminating Child and Forced Labor from the Shrimp Supply Chain,” Shrimp Alliance, September 2012.

Suppliers - Response from Thai businesses



Product Traceability – the beginning of sustainable sourcing

Modern technology allows products to be traced, which helps companies to ensure total quality and safety. Thai poultry and meat exporters such as *Charoen Pokphand Foods*, *GFPT* and *Betagro* currently employ traceability standards and measures in their sourcing.

Recently, there has been a trend towards also ensuring traceability in the seafood sector – and Thai seafood exporters, such as *Thai Union Frozen Products*, are taking a lead in ensuring the traceability of their shrimp raw materials.

Traceability from a quality and safety perspective is a starting point for sustainable sourcing. In coming years, we will likely see its evolution into sustainable sourcing policies and practices, i.e. traceability that encompasses social and environmental considerations.



*Consumers:
Transforming
behaviour*

Consumers - Trends

Consumers' purchasing behaviour is becoming "greener" at the same time that consumers are actively sharing their views with peers.

Can companies stay relevant with their existing products and business model?

(1) Appetite for sustainable consumption in emerging markets is growing⁴

A recent National Geographic survey suggested that consumers in emerging markets are increasingly inclined to buy environmentally friendly goods. When prompted about global issues, consumers in emerging economies tend to be concerned about environmental problems such as climate change, water pollution, air pollution, shortages of fresh water, and loss of species and habitat.

(2) The emerging of online platforms for collective consumer action

An example of such consumer-based platforms is carrotmob.org. The website is a new way to influence businesses, showing how consumers and business can collaborate in a positive direction. Consumers spend money as a group, and in return forward-thinking businesses take socially-responsible actions that consumers care about.

⁴ "National Geographic Explores the World of Green Consumers: Worldwide, Consumers Who Feel Most Guilty About Their Environmental Impact Are Least to Blame," National Geographic, July 2012.

Consumers - Trends

(3) Consumers are becoming advocates⁵



The Millennials – people born during 1980 to 2000 – are becoming major market force. A World Economic Forum study published in January 2013 suggests that about 80% of Millennials believe in their power to be agents of change. They have shared brand experiences, and frequently join online brand communities and post product reviews. Through their words and actions, Millennials can shape the behaviour of other people and consumer markets. And, as Millennials become parents, they will influence the next generation of consumers.

⁵ “Engaging Tomorrow’s Consumer,” World Economic Forum, January 2013.

Consumers - Cases

Consumer movement is speeding the overlooked sustainability concern to become real issue.

Are you the next in line?

Revolutionising the fashion industry⁶

Zara, the world's largest clothing retailer, was under intense public pressure for 9 days in 2012, both online and offline, for the use of toxic chemicals in its cloth production. Zara finally joined Nike, Adidas, Puma, H&M, M&S, C&A, Li-Ning, Mango, Esprit, Levi's, Uniqlo, Benetton, Victoria's Secret, G-Star Raw and Valentino in a commitment to stop the use of toxic chemicals. Over 300,000 supporters across the world, and more than 700 Greenpeace volunteers in 80 cities, staged actions outside Zara stores to demand that it eliminate the use of all hazardous chemicals throughout its supply chain.

In an age of instant connectivity, causes can gain fast support, working like a domino effect. Once one company makes a commitment, other leading companies are indirectly forced to follow suit.

⁶ "Greenpeace Claims Success as Zara Bows to Detox Campaign," Brandchannel, November 2012.

Consumers - Cases



PepsiCo replacing Gatorade ingredient after online petition⁷

Small quantities of brominated vegetable oil (BVO), which is found in fire retardants, are used legally in some citrus-flavored drinks in the United States to keep flavours evenly distributed. Sarah Kavanagh, a 15-year-old girl from Hattiesburg, Mississippi, noticed BVO in the ingredients of Gatorade and started a petition on change.org to ask PepsiCo to remove it. It received more than 200,000 signatures. The company later announced the removal of BVO, though denied the connection between the removal of the chemical and the girl's petition.

Many issues might be overlooked or disregarded by companies. However, one customer might pick them up and spread the word – and damage a company's reputation.

⁷ "PepsiCo replacing Gatorade ingredient after online petition," Reuters, January 2013.

Consumers - Response from Thai businesses



Listening to consumers – the foundation for sustainable relationships

Since 2011, small and medium enterprise (SME) loans have been identified by Thai banks as a segment to watch in terms of both size and growth. Many players in retail banking had been competing in this saturated market with no real value differentiation. To be able to lead the market, KASIKORNBANK recognised that “listening” to its customers was the key. The bank decided to conduct a survey, and its results have led them to excel to date.

The survey showed that small business owners were lacking proper knowledge in the running of their businesses. More than 50% were using their “gut feeling” and employing a process of trial and error. This resulted in a shorter life span for SMEs which, in turn, implied poor performance for KASIKORNBANK and other retail banks.

To address this problem, KASIKORNBANK sought after what it believed would truly help sustain SME businesses. Interviews revealed that SMEs were seeking for partners or business consultants to help guide them with real business insights. KASIKORNBANK realised that “giving knowledge” was the key to this problem. Consequently, K-SME care was developed to address this problem, offering training classes, business solution centre and web-based knowledge sharing, among other initiatives.⁸

⁸ “SME is Bread and Butter,” BrandAge, February 2008.



*Community:
Amplifying
power*

Community - Trends

While companies are generally good at accurately assessing operational hazards, they often fail to prepare for social discontent.

Unlike operational and health risks, protests are often based on perception.

Many companies do not yet sufficiently understand their community; this condemns them to a reactive, versus proactive, stance vis-a-vis community concerns.

The community has long been considered an important stakeholder for businesses with a visible impact to their surroundings, such as mining and oil and gas. However, the situation has evolved over the years to encompass other sectors, as well. Moreover, companies must increasingly also gain acceptance from society at large – a *social licence to operate* – in order to prosper over the longer term.

(1) The need for a social licence to operate has expanded beyond extractive industries⁹:

As a result of consumer discontent in the banking sector, in recent years, Australian banks have had to absorb a series of costly and complex regulatory burdens, including laws on consumer credit, unfair contracts and responsible lending.

(2) Communities are empowered by the internet and social media:

Like consumers, communities are now easily finding a voice and gaining external support through social media.

Websites such as change.org, which has over 140 million joiners, and sumofus.org, which has over 900,000 members worldwide, are gathering like-minded people to ask for social justice and corporate responsibility.

⁹ "Banks look to boost their image," The Australian, April 2012.

Community - Cases

As gaining community as well as social acceptance is moving beyond extractive industries, companies need to address community and social sentiment in order to survive and achieve growth.

Are you the next in line?

Map Ta Phut¹⁰

Despite being a critical hub for Thai industry and the country, a rising number of industrial accidents and community protests over the last 10 years eventually led the Central Administrative Court to order the suspension of projects in the Map Ta Phut until proper health and environmental impact assessments could be completed and reviewed. Although all but 2 of the projects have since been given the go-ahead, the financial impact of the year-long stop was immense. The blocked projects accounted for well over US\$7 billion, and tens of thousands of jobs.

Companies should monitor and address issues in the early stages – before they become complex and uncontrollable.

Human fence app¹¹

This app was created to gather signatures for a petition demanding the Office of Natural Resources and Environmental Policy and Planning to declare Tha Sala and 3 neighbouring districts a “protected food-producing zone” under the 1992 Environment Protection Act. It is hoped that this move will stop the area being used for heavy industry.

By taking into account consumer and community empowerment through social media, companies can not only mitigate risks, but also discover new and better perspectives and collaborative solutions.

¹⁰ “บทเรียนจากมาบตาพุด,” *Thaipublica*, 2012.

¹¹ “When building fences beats taking offence,” *Bangkok Post*, February 2013.

Community - Cases



Electromagnetic radiation issues mean large costs for mobile-telecom carriers in Taiwan¹²

The operators of mobile-communication services in Taiwan were faced with public protests over existing base stations by neighbouring residents, due to fear of the potential hazards of electromagnetic radiation. Residents' objections were spontaneous in some cases and planned and led by local political figures in the others. According to The Taiwan Telecommunication Industry Development Association (TTIDA) statistics, about 2,700 of 49,000 existing base stations around Taiwan were under protest, and nearly 900 were subsequently demolished in 2005. Operators spent a total of more than US\$30.8 million in dealing with such issues. In 2006, the total cost incurred was expected to rise to US\$61.7 million.

Recognising the high potential but oftentimes overlooked risks from public protests will help avoid and mitigate the impact of the outcry. Obtaining the social license to operate before taking critical actions is key.

¹² "Electromagnetic radiation issues mean large costs for mobile-telecom carriers in Taiwan," Digitimes, March 2006.

Community - Response from Thai businesses



Community engagement – the starting point for long-term coexistence

There has been a long history of dispute between communities and the cement business, due to its visible impact on the environment and local stakeholders. Recognising this, in 2011, the Thai Cement Manufacturers Association, SCG Cement, and Siam City Cement initiated a project in Saraburi province called 'Cement Partnership'.

This partnership was set up to achieve 2 goals: green operations and community development. The Cement Partnership is based on 3 key strategies: (1) Co-operative Strategy – a collaboration between large companies in the same business which share the same goal (2) Partnership Strategy – expanding partnerships in the same industry which will promote knowledge and experience sharing (3) Community Engagement Strategy – listening to communities and acting to reduce operational impacts and improve people's lives.¹³

13 “โรงงานรักษ์ชุมชน – สมาคมอุตสาหกรรมปูนซีเมนต์ไทย, เอสซีจีซีเมนต์ และปูนซีเมนต์นครหลวง,” CSRI, 2012.

Part III: Managing Uncovered Risks





*Are you at
risk?*

Are you at risk?

Suppliers

- Yes No Do you have a code of conduct/standards of engagement for suppliers?
- Yes No Have you verified that all your suppliers in all tiers conform to your standards?
- Yes No Have you selected or dropped suppliers because of their environmental or ethical behaviour relating to chemicals/hazardous substances, animal welfare, labour standards, or other issues?
- Yes No Have you verified your suppliers' activities, e.g. relating to forestry, labour practices, chemicals usage, through independent third party assurance?

Consumers

- Yes No Have you assessed your current consumers' views on sustainability in relation to your products or services to identify potential opportunities or threats?
- Yes No Do you provide a platform for your consumers to voice their concern?
- Yes No Do you keep track of the activities held by activist groups in your industry or sector?
- Yes No Have you identified business opportunities to support millennials' preferences and their interest in sustainable consumption?

Are you at risk?

Community

Yes No

Do you fully understand the community's attitudes toward your business and your impacts on their community?

Yes No

Have you identified issues which could cause tension between your business and community?

Yes No

Do you have measures to prevent or mitigate those issues?

Yes No

Do you engage the community as a stakeholder in developing your business?



*Time to
rethink risk
assessment*

The time is NOW

Rethinking risk assessment

From presented trends and cases, when considering financial, strategic and operation risks, business has to reckon risks originated from its stakeholders: communities, consumers, suppliers, and beyond. Issues which can generate business risks can be categorised into 4 levels: latent, emerging, exploding, and regulated. Businesses usually wait until issues explode or turn into regulation. By strategically managing risks, businesses can minimise risks and discover new opportunities.



Categorising issues

Latent

- Some activists, communities, academics and NGOs are aware of issues
- Little business community awareness

Emerging

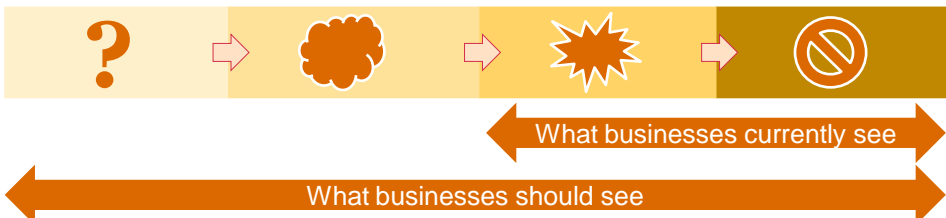
- Focus on NGO campaigning, political and media awareness
- Leading businesses experimenting with approaches

Exploding

- High level of general awareness of issue amongst relevant business, civil society and public bodies

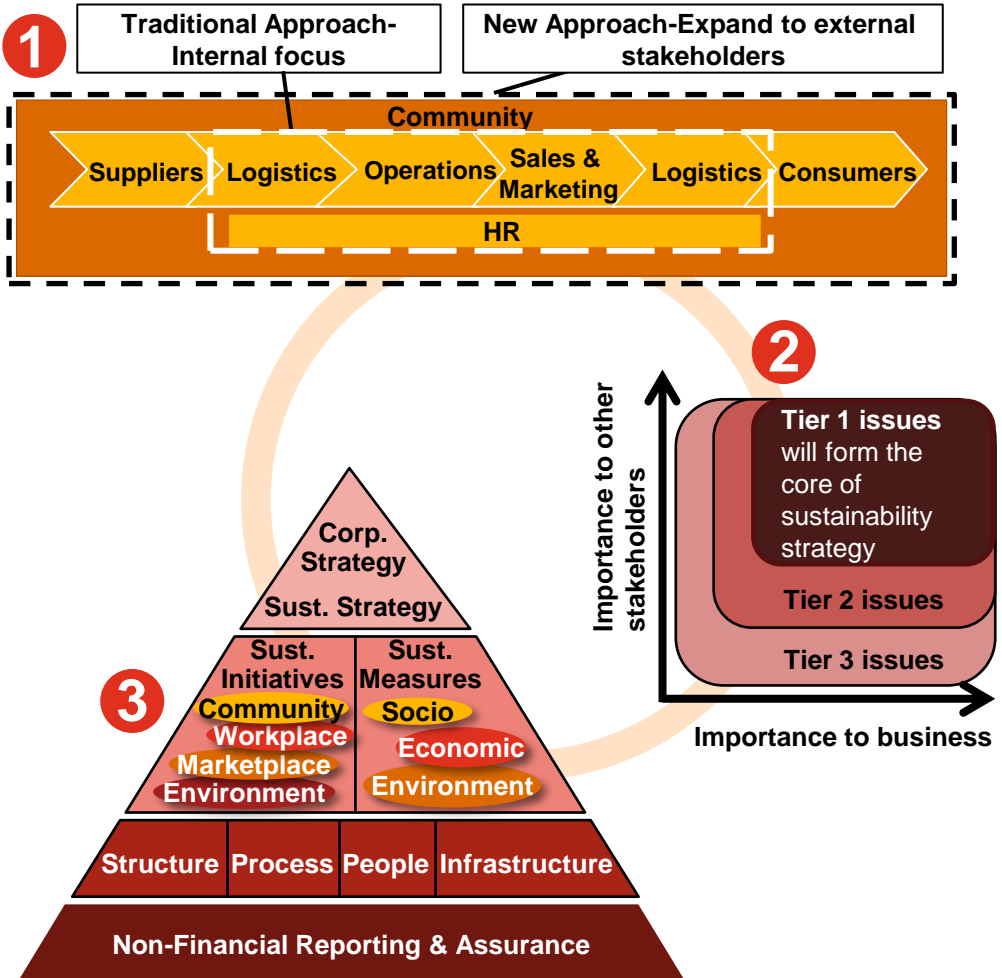
Regulated

- Normal part of a business-regulated by law



Start strategising

To strategically manage your risks, consider the following steps:



Start strategising

1

Survey the landscape for hidden risks

- Identify phases and group issues based on relevancy
- Assess the risks and opportunities and take into account megatrends

2

Target the potential critical damage points

- Assign tiers of priority to issues based on their importance to core business operations and importance to stakeholders

3

Manage uncovered risks

- Ensure the coherence of planning, policy formulation and implementation in the organisation components
- Develop and check against KPIs and set up effective communication systems

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