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Industry Insights

Going local isn't just a supply chain fix – it could reduce the risk of environmentally-driven D&O claims

Wayne Imrie • April 27, 2023

For many companies, the COVID-19 pandemic presented not only a challenge to 'business as usual', but a growing existential threat as supply chains were put under severe pressure and, in some cases, ground to a halt. Now, three years on, these pressures have not been alleviated. In our recent Risk & Resilience research undertaken earlier this year, 20% of business executives ranked supply chain instability as their top business risk concern in 2023, and 21% of leaders expect it to remain a top concern in 12 months' time. Even when stalled production lines sputtered back into life, many companies were forced to seek alternative suppliers after the networks they had spent years developing proved too challenging and expensive to re-establish.

As part of this move to re-configure supply chains via more reliable and less exposed routes, an increasing number of businesses have sought to bring them 'onshore', re-orienting their purchasing towards suppliers much closer to home – either in the same country or region.

In combination with the long-lasting effects of the pandemic, fractious US-Chinese trade relations, a growing climate emergency, and rising inflation, one widely anticipated outcome of the Russia-Ukraine war is a greater emphasis on localisation as companies seek to build resilience against future shocks. Shorter supply chains are not only less vulnerable to trade and geopolitical disruptions but also have the benefit of lower freight and insurance costs.

In addition to building resilience and reducing costs in an era of rising commodity prices, supply chain localisation could also help to shield senior executives from some of the increasingly vociferous debate on the negative environmental impact of more complex arrangements.

Growing environmental risk concerns

In 2021 our Risk & Resilience research indicated that environmental risks were the leading category for only 12% of the businesses we surveyed, but this has doubled over the past two years to 24%. At the same time, perceived resilience has fallen across all the risks in our environmental risk category, as firms wake up to the growing disconnect between stakeholder expectations and corporate risk management priorities. Our 2023 research reveals that perceived resilience to climate change (33%), pandemic (34%) and energy transition (33%) risk dropped by two percentage points against our 2022 research, and greenhouse emissions resilience fell to 32% in 2023 from 35% last year.

With companies anticipating the introduction of new and potentially onerous accounting standards on climate-related and general sustainability disclosure requirements, they are also facing an increase in climate-related litigation, with the number of cases brought by non-governmental organisations and individuals on the rise.

Companies that are slow to align their operational practices with environmental concerns could face a triple whammy of significant interconnected legal, reputational, and regulatory risks in future.

More localised supply chains are likely to reduce companies' exposure to greenhouse gas emission risk as their carbon footprint shrinks, and could also make the energy transition less challenging as industries reduce their reliance on carbon-intensive transport, such as air and sea freight. Companies could also reduce their exposure to supply chains linked to environmental damage or loss of biodiversity, as suppliers operating in more highly-regulated economies are likely to have more binding commitments to reducing or removing harmful practices from their production and supply methods. This would be a welcome strategy for the 61% of companies who placed greenhouse gas emissions in their top 3 environmental risks in our 2023 Risk & Resilience survey.

Supply chain risk: the D&O danger

The exposure is real and already resulting in litigation. As one court filing last year highlights, reducing reliance on producers located in catastrophe-prone areas, where climate change could drive natural catastrophe events, could potentially reduce supply chain disruption – along with the impact on a company's Directors' & Officers' liability (D&O) policy.

In a Minnesota District Court case last year, a US manufacturer was the subject of a securities class action for allegedly having failed to meet customer demand (and thus, revenue targets) due to supply chain issues caused by severe weather - even after the company assured investors of the "flexibility and resilience" of its supply chain strategy.

What's notable about the case is that it illustrates how catastrophe events, which have arguably been exacerbated by climate change (in this case, the impact of Winter Storm Uri on Texan industrial facilities), can impact supply chains, resulting in D&O claims being made against companies whose operations and profitability are impacted by the disruption.

If business leaders adopt a strategic approach to onshoring supply chains, the process could have a positive impact in terms of reducing many of the factors that contribute towards their environmental risk exposures, and reduce the risk of related claims being made against their D&O coverage.

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