**ESG Compliance in the Supply Chain**

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00:00:12.520 --> 00:00:15.930

From the nation's leading supply chain university program.

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00:00:16.020 --> 00:00:22.020

We welcome you to the Penn State Supply Chain podcast brought to you by the Center for Supply Chain Research.

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00:00:22.190 --> 00:00:23.340

Here are your hosts,

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00:00:23.350 --> 00:00:25.340

Steve Tracy and Irv Grossman.

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00:00:30.059 --> 00:00:30.379

Well,

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00:00:30.389 --> 00:00:34.529

hello everyone and welcome to the Penn State Supply Chain podcast.

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00:00:34.540 --> 00:00:39.209

And we're joined by a special guest who has a bit of a long Penn State pedigree.

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00:00:39.220 --> 00:00:42.159

I'll get to her in a second and today's topic,

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00:00:42.169 --> 00:00:46.650

we're doing a deep dive into a topic that is the intersection of business ethics,

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00:00:47.479 --> 00:00:49.689

the environment and social responsibility.

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00:00:49.759 --> 00:00:54.029

You hear the term out there often these days ESG or environmental,

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00:00:54.040 --> 00:00:55.340

social and governance.

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00:00:55.349 --> 00:00:56.819

And it's really important in supply chain,

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00:00:56.830 --> 00:01:03.299

especially in today's globalized world where the supply chains are the lifeblood of our business operations and connecting,

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00:01:03.310 --> 00:01:03.400

you know,

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00:01:03.409 --> 00:01:07.099

products and services to customers and consumers worldwide.

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00:01:07.800 --> 00:01:19.050

But the real question we're asking today is how can businesses ensure that their supply chains not only deliver shareholder value but can also uphold their ethical environmental responsibilities?

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00:01:19.059 --> 00:01:24.059

And so we're joined today by I would consider a friend and a former colleague,

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00:01:24.069 --> 00:01:25.849

maybe a colleague again in the future,

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00:01:25.860 --> 00:01:26.650

Sophia Schuster,

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00:01:26.660 --> 00:01:32.819

Sophia holds both an MB A and a master's degree in supply chain management from the Penn State's Meal College of Business.

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00:01:32.830 --> 00:01:42.569

She has a background in the retail and education sector and her education so far is propelled by a desire to understand the impact of the way we communicate,

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00:01:42.580 --> 00:01:45.959

combined with her personal interest in sustainability topics.

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00:01:46.360 --> 00:01:46.739

So,

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00:01:46.750 --> 00:01:48.730

uh we're pleased to have her with us here today.

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00:01:48.739 --> 00:01:49.120

Sophia.

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00:01:49.129 --> 00:01:51.169

Welcome to the Penn State Supply Chain Podcast.

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00:01:51.180 --> 00:01:52.480

Thanks so much for having me,

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00:01:52.489 --> 00:01:52.879

Steve.

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00:01:52.889 --> 00:01:53.839

I really appreciate it.

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00:01:54.059 --> 00:01:59.230

So let's start with uh you can you share a bit about your personal background,

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00:01:59.239 --> 00:02:06.720

how ESG became part of your research interest and uh then we'll talk a little bit about your own research and,

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00:02:06.730 --> 00:02:09.100

and what you um what you know today.

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00:02:09.360 --> 00:02:09.559

Yeah,

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00:02:09.570 --> 00:02:10.190

sure.

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00:02:10.199 --> 00:02:10.750

So,

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00:02:10.919 --> 00:02:11.830

um like you said,

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00:02:11.839 --> 00:02:20.419

my background is really in the retail and education sector and something that really stuck with me when I was working in retail,

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00:02:20.429 --> 00:02:32.190

I had a manager who really stressed that the way that we communicate with our customers impacts their opinion of us and how they approach us every day.

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00:02:32.199 --> 00:02:35.550

And I think that that was something that really resonated with me.

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00:02:36.119 --> 00:02:43.169

And as I looked into some of the ESG literature or just the sustainability literature that exists within the business world,

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00:02:43.179 --> 00:03:00.220

a lot of the emphasis is focused on what sustainability means to consumers and how businesses are kind of conveying their own ethics to those consumers and how that kind of propels purchasing decisions and so on and so forth and even investing decisions.

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00:03:00.809 --> 00:03:08.720

And so that's kind of what got me really interested in ESG because ESG environmental social governance standards are,

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00:03:08.729 --> 00:03:10.710

I think we'll get into that a bit later.

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00:03:10.720 --> 00:03:20.229

But the way that that kind of harmonizes with corporate social responsibility is a really key component for modern business ethics.

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00:03:20.929 --> 00:03:23.240

And so that's how I kind of got into that.

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00:03:23.639 --> 00:03:26.080

So let's let's talk about the landscape a bit,

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00:03:26.089 --> 00:03:26.449

right?

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00:03:26.460 --> 00:03:28.679

So you've mentioned the three key aspects,

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00:03:28.690 --> 00:03:29.029

right,

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00:03:29.039 --> 00:03:30.080

of environmental,

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00:03:30.089 --> 00:03:30.929

social governance.

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00:03:30.940 --> 00:03:34.990

But when we think about compliance in the supply chain,

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00:03:35.000 --> 00:03:48.550

can you explain the distinction between what is maybe mandatory that firms have to do and what is voluntary and maybe some examples of how businesses think about those things differently?

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00:03:49.070 --> 00:03:49.479

Mhm.

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00:03:49.490 --> 00:03:50.190

Sure.

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00:03:50.199 --> 00:03:52.919

So when we talk about compliance,

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00:03:52.929 --> 00:03:53.610

that's really,

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00:03:53.619 --> 00:03:53.809

I mean,

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00:03:53.820 --> 00:03:58.850

compliance means that there's some kind of repercussions to failure.

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00:03:58.860 --> 00:04:02.009

And so compliance is really mandatory.

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00:04:02.179 --> 00:04:06.300

That's anything coming from government bodies regulations.

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00:04:06.309 --> 00:04:06.669

This,

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00:04:06.679 --> 00:04:07.949

that would be mandatory.

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00:04:07.960 --> 00:04:08.479

Like I said,

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00:04:08.490 --> 00:04:17.489

we in failure to comply has some kind of defined consequence that's set forth by the agency or group that's defining it.

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00:04:18.118 --> 00:04:27.639

An example that I'm kind of familiar with is a more recent piece of legislation out of California called A B 1200 A B 1200.

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00:04:27.648 --> 00:04:37.979

Is it in an effort to moderate the chemicals that are being used on cookware has been part of the California legislature,

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00:04:37.989 --> 00:04:48.070

it was just implemented in 2020 and it's basically asking large companies to show what chemicals are being used on their cookware.

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00:04:48.470 --> 00:04:50.500

Uh and so failure to comply,

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00:04:50.510 --> 00:04:57.369

failure to report their suppliers and what is going into their products has some kind of consequence.

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00:04:57.640 --> 00:04:59.459

We might also see,

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00:04:59.470 --> 00:04:59.910

um,

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00:05:00.230 --> 00:05:00.470

you know,

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00:05:00.480 --> 00:05:06.140

disclosure standards that are enforced by organizations like the SEC,

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00:05:06.149 --> 00:05:09.809

which I want to go into a bit later when we talk about the silver lining.

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00:05:09.820 --> 00:05:12.250

But those are the types of mandatory compliance.

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00:05:12.989 --> 00:05:19.450

A lot of the work that I did when it came to the research was looking at voluntary reporting.

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00:05:19.459 --> 00:05:21.799

Anything that the company is putting out,

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00:05:21.809 --> 00:05:25.600

maybe it's an ESG report annual or semi annual,

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00:05:25.920 --> 00:05:32.049

you might also have uh press releases where a company is announcing something that it's being,

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00:05:32.059 --> 00:05:34.440

that's being done that this probably proud of.

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00:05:34.450 --> 00:05:36.670

So you're assuming it's going to be very positive,

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00:05:36.679 --> 00:05:38.959

same thing with those ESG reports.

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00:05:39.709 --> 00:05:56.809

And then what we also see has been the emergence of these ESG ratings indices where uh companies will use these ratings to kind of bolster themselves among their peers and they get a grade for their ESG efforts.

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00:05:57.040 --> 00:06:02.730

Uh So that's kind of where we see the difference between what is mandatory and what is voluntary.

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00:06:02.859 --> 00:06:08.260

I think one of the biggest differences when we talk about this is what's mandatory is it's,

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00:06:08.269 --> 00:06:08.480

it,

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00:06:08.489 --> 00:06:10.179

there's no bias to it.

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00:06:10.190 --> 00:06:11.649

It's what you disclose.

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00:06:11.660 --> 00:06:13.600

It's what you're required to disclose.

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00:06:13.609 --> 00:06:14.940

Whereas voluntary,

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00:06:15.730 --> 00:06:17.029

it's gonna be positive.

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00:06:17.040 --> 00:06:19.260

You're not really going to be all that.

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00:06:19.320 --> 00:06:19.390

I mean,

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00:06:19.399 --> 00:06:32.070

businesses aren't going to be all that interested in highlighting what they're doing wrong or if they are doing something wrong they'll be able to spin it in a way that says we're going to address it in such,

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00:06:32.079 --> 00:06:33.230

in such a fashion.

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00:06:33.739 --> 00:06:33.950

So,

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00:06:33.959 --> 00:06:37.029

I guess the way a take on that would be if it's,

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00:06:37.179 --> 00:06:38.510

if it's mandatory,

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00:06:38.769 --> 00:06:40.399

um you're,

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00:06:40.410 --> 00:06:41.459

it's a binary choice,

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00:06:41.470 --> 00:06:42.630

you either do it or you don't.

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00:06:42.640 --> 00:06:43.459

If you don't do it,

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00:06:43.470 --> 00:06:45.660

there's repercussions and if you do do it,

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00:06:45.670 --> 00:06:46.730

you better do it right?

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00:06:46.739 --> 00:06:47.970

Or there's repercussions,

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00:06:47.980 --> 00:06:48.250

right?

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00:06:48.260 --> 00:06:50.049

So in both cases now,

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00:06:50.059 --> 00:06:51.480

on the voluntary side,

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00:06:51.489 --> 00:06:59.730

and I got the impression both from your research as well as from other conversations that we have that the voluntary portion really dominates today,

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00:06:59.739 --> 00:07:00.029

right?

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00:07:00.040 --> 00:07:06.670

There's way more voluntary reporting notification and information than there is a mandatory.

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00:07:06.679 --> 00:07:07.690

Is that a true statement?

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00:07:07.989 --> 00:07:08.369

Yeah,

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00:07:08.380 --> 00:07:17.200

I I would definitely agree with that and that's largely driven by consumer or I guess external stakeholder expectations.

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00:07:17.209 --> 00:07:19.519

And when I say external stakeholders,

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00:07:19.529 --> 00:07:22.450

I really want to focus on the consumer and the investor,

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00:07:22.459 --> 00:07:27.799

not necessarily the government bodies because that again gets into the mandatory side of things.

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00:07:28.239 --> 00:07:29.059

But I mean,

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00:07:29.070 --> 00:07:30.220

for consumers,

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00:07:30.230 --> 00:07:37.619

there have been multiple studies published indicating that consumers are willing to spend more money on sustainably made products,

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00:07:37.630 --> 00:07:41.079

green products for whatever that means And again,

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00:07:41.089 --> 00:07:43.079

that's a whole other can of worms,

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00:07:43.089 --> 00:07:47.420

but uh same thing for investors and for investors,

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00:07:47.429 --> 00:08:05.630

it's a particularly interesting note because not only are they interested in maybe making investments that are with organizations that are good or beneficial to the environment or that they can consider are doing the right thing by ESG standards.

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00:08:05.929 --> 00:08:08.329

Um But that they're also low risk.

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00:08:08.470 --> 00:08:13.829

Uh So by addressing some of these ESG issues that modern firms are facing,

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00:08:14.019 --> 00:08:18.410

they might be at a lower risk level than a firm that's not.

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00:08:18.640 --> 00:08:19.690

And so those,

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00:08:19.700 --> 00:08:26.809

those external stakeholders have a huge influence on the way that businesses do business today.

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00:08:27.140 --> 00:08:31.970

So before we get into the minutia or as you refer to it as opening some cans of worms,

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00:08:31.980 --> 00:08:35.289

so I'm guessing there's gonna be a few worms squirming around here in a minute or two.

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00:08:35.739 --> 00:08:41.369

What is so complicated about evaluating a supply chain or,

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00:08:41.380 --> 00:08:43.030

or an industry and,

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00:08:43.039 --> 00:08:47.349

and their supply chains when it comes to these ESG?

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00:08:47.359 --> 00:08:49.179

And I'm putting air quotes around its standards,

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00:08:49.190 --> 00:08:51.070

what's what makes it so complicated?

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00:08:51.400 --> 00:08:51.640

Well,

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00:08:51.650 --> 00:08:56.349

just the fact that supply chain isn't really an accurate way to look at it anymore.

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00:08:56.359 --> 00:08:56.510

I mean,

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00:08:56.520 --> 00:09:10.609

it's really supply network and modern supply networks are not characterized by a single multinational corporation with their major first tier suppliers and that's pretty much it.

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00:09:11.080 --> 00:09:24.599

Now you have major MN CS with their first tier suppliers who then subcontract out to other lower tier suppliers and those lower tier suppliers are not held to any,

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00:09:24.609 --> 00:09:26.099

if many,

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00:09:26.109 --> 00:09:27.780

if any standards.

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00:09:28.340 --> 00:09:38.400

Um And that's really where we run into issues in terms of setting standards within an organization and within an industry because you,

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00:09:38.719 --> 00:09:39.020

you know,

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00:09:39.030 --> 00:09:45.559

essentially if there's no way to moderate what's going on at those lower levels,

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00:09:45.570 --> 00:09:53.340

it's really hard for MN CS to really take any kind of responsibility or understand what's going on in their own supply networks.

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00:09:53.349 --> 00:09:56.200

So that's really what makes it incredibly difficult.

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00:09:57.270 --> 00:09:57.770

So,

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00:09:57.780 --> 00:09:58.280

you know,

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00:09:58.289 --> 00:10:00.479

you talked about supply networks being,

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00:10:00.489 --> 00:10:00.650

you know,

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00:10:00.659 --> 00:10:01.809

so pervasive.

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00:10:01.820 --> 00:10:13.409

Have you seen any companies or any organizations or industries associations that have been successful at kind of mapping and measuring that entire network?

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00:10:13.869 --> 00:10:14.330

Yes,

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00:10:14.340 --> 00:10:15.330

definitely.

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00:10:15.340 --> 00:10:15.429

I,

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00:10:15.440 --> 00:10:18.530

I hate to be kind of um get up on the,

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00:10:18.539 --> 00:10:20.030

the Patagonia soapbox,

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00:10:20.039 --> 00:10:26.700

but they actually done a fantastic job at tracing their entire supply chain and being very transparent about it.

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00:10:26.710 --> 00:10:30.559

That's kind of in that same or on that track.

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00:10:30.570 --> 00:10:39.719

I suppose there is a very common misconception that by a multinational corporation having this good behavior,

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00:10:39.729 --> 00:10:48.469

this good ESG behavior or having something that's very well laid out within the corporate network that that is automatically going to,

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00:10:48.479 --> 00:10:56.429

it's like the trickle down effect that it's going to go down to your first tier suppliers who are going to integrate it with their 2nd and 3rd tier suppliers.

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There's been a lot of evidence to show that that's not necessarily true.

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00:11:00.239 --> 00:11:04.150

There was a great paper by Doctor Joy and Doctor Vienna,

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00:11:04.559 --> 00:11:11.940

both who were associated with Penn State in 2020 where they showed that that was not true.

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00:11:11.950 --> 00:11:20.729

And they kind of highlighted these nine multinational corporations or MN CS that have been kind of leaders in their particular industry.

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00:11:20.929 --> 00:11:25.590

And still there were a lot of inconsistencies along the supply network.

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00:11:25.599 --> 00:11:28.510

And so just that alone,

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00:11:28.539 --> 00:11:30.309

I think kind of tackles,

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00:11:30.320 --> 00:11:34.590

uh an assumption that a lot of Mn CS rest on uh for,

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00:11:34.599 --> 00:11:46.549

for ESG what uh Vienna and Joya actually laid out then was that there's kind of this hope that you can integrate a lot of different types of practices,

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00:11:46.559 --> 00:11:49.609

what they classify as a direct,

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00:11:49.619 --> 00:11:52.489

indirect collective and global.

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00:11:52.590 --> 00:12:01.380

So a direct practice might be anything that the buyer firm is sort of putting into place specifically with their supplier.

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00:12:01.780 --> 00:12:10.400

Um Those might be audits and those audits might be done with that particular MNC or it could also be done in a collaborative way,

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00:12:10.409 --> 00:12:12.700

which is then a collective mechanism.

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00:12:12.710 --> 00:12:15.049

So the lines are very blurred.

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00:12:15.539 --> 00:12:16.869

And when I say collaborative,

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00:12:16.880 --> 00:12:17.549

I mean,

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00:12:17.559 --> 00:12:29.219

um the MNC might be working with other organizations within their same industry who will sort of monitor those same suppliers that they are working with together that they share.

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00:12:29.229 --> 00:12:36.950

And any punishment that comes from the audit can either come from one MNC or from the collective whole.

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00:12:37.039 --> 00:12:39.909

So it sort of depends on how they might have that structure.

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00:12:40.500 --> 00:12:42.960

Um You also have indirect,

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00:12:43.099 --> 00:12:43.919

like I said,

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00:12:43.929 --> 00:12:44.979

where that's kind of,

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00:12:44.989 --> 00:12:56.710

that is sort of integrates the whole trickle down effect idea where you would have expectations in place for your first tier suppliers and how they are doing business with their,

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00:12:57.059 --> 00:12:58.440

their suppliers,

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00:12:58.450 --> 00:13:01.119

their lower tier subcontracted suppliers.

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00:13:01.130 --> 00:13:23.080

We also have kind of these global opportunities where we're working with organizations like the sustainability consortia or the WWF where they have different mechanisms to help organizations trace their supply chain and understand what the risks are that are inherent in those supply chains.

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00:13:23.659 --> 00:13:26.239

So I know that is a very long winded answer.

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00:13:26.250 --> 00:13:28.840

But those are kind of some of the key techniques.

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00:13:29.179 --> 00:13:39.760

All of that comes back to the imperative nature of having a transparent and traceable supply chain.

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00:13:40.010 --> 00:13:42.640

Because the more information that you have,

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00:13:43.280 --> 00:13:57.320

the more knowledge that you have and you know how to address those issues and we've seen time and time again in history where not having that understanding has come back to bite companies many times now,

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00:13:57.330 --> 00:13:57.690

Sophia,

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00:13:57.700 --> 00:14:01.650

I have uh firsthand knowledge because full disclosure here,

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00:14:01.659 --> 00:14:04.679

Sophie and I worked together for better part of six months.

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00:14:04.690 --> 00:14:09.559

I was one of her paper advisors for her master's paper in this area.

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00:14:09.690 --> 00:14:13.159

So I got to read some really cool research in this space.

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00:14:13.669 --> 00:14:15.650

You talked earlier about rating,

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00:14:15.659 --> 00:14:24.250

you just get finished talking about what companies should do and other research associated with how they should work toward both mandatory and voluntary compliance.

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00:14:24.700 --> 00:14:27.330

But then there's these ratings out there,

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00:14:27.340 --> 00:14:27.890

right,

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00:14:27.900 --> 00:14:35.409

that are offered by agencies that I think have the intent of trying to create a level playing field.

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00:14:35.419 --> 00:14:44.719

But when you looked into these ratings you saw there was kind of a difference between what the ratings agencies were doing and maybe what best practice was.

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00:14:44.729 --> 00:14:46.489

Can you talk a little bit about that?

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00:14:46.900 --> 00:14:47.539

Yeah,

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00:14:47.549 --> 00:14:48.359

absolutely.

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00:14:48.369 --> 00:14:48.679

Well,

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00:14:48.690 --> 00:14:54.260

so I think there are two important things to know about these ratings agencies.

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00:14:54.270 --> 00:14:54.880

First of all,

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00:14:54.890 --> 00:15:04.109

there are 600 more than 600 ratings indices that exist in today's business world.

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00:15:04.119 --> 00:15:08.460

And essentially they all suggest,

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00:15:08.530 --> 00:15:08.590

uh,

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00:15:08.599 --> 00:15:10.549

that they are measuring the same thing.

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00:15:11.030 --> 00:15:15.489

And so you would think that because of that if they're measuring the same thing,

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00:15:15.599 --> 00:15:16.270

ultimately,

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00:15:16.280 --> 00:15:18.489

they're going to be getting similar results.

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00:15:19.179 --> 00:15:19.890

Another,

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00:15:19.900 --> 00:15:19.909

uh,

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00:15:19.919 --> 00:15:35.630

key thing to note then is that except for a select few Ftse Russell and I believe it's sus analytics are two of the indices that have access to information provided by the MNC.

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00:15:35.950 --> 00:15:36.900

Otherwise,

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00:15:36.909 --> 00:15:41.679

a lot of these ratings indices are dependent on publicly available data.

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00:15:41.929 --> 00:15:46.840

And so that in itself is going to be very limited again,

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00:15:46.849 --> 00:15:53.840

based on something that a company might want you to see that's gonna be coming from those ESG reports and those,

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00:15:53.849 --> 00:15:55.669

those news reports as well.

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00:15:56.359 --> 00:15:56.609

Yeah.

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00:15:56.619 --> 00:15:59.229

And we've already established that most of that is voluntary.

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00:15:59.239 --> 00:15:59.609

Right?

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00:15:59.700 --> 00:16:00.039

Most,

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00:16:00.049 --> 00:16:03.049

most of it is not mandatory or compliance related.

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00:16:03.440 --> 00:16:04.320

Exactly.

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00:16:05.059 --> 00:16:12.330

And so what we're seeing then is that there's this disconnect between what we just said,

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00:16:12.340 --> 00:16:13.140

those direct,

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00:16:13.150 --> 00:16:27.880

indirect collective and global efforts that are really imperative in um procurement and just in supply networks in general that make a difference in improving the transparency and traceability of a supply network.

240

00:16:28.690 --> 00:16:36.590

Those things are not necessarily being measured though in a lot of those ratings indices and why is that?

241

00:16:36.599 --> 00:16:37.150

Well,

242

00:16:37.159 --> 00:16:40.880

a lot of them are focused on environmental,

243

00:16:40.890 --> 00:16:41.950

social and governance.

244

00:16:41.960 --> 00:16:46.830

But what is easily measured is the social and governance aspects,

245

00:16:46.840 --> 00:16:48.590

the diversity of a board,

246

00:16:48.599 --> 00:16:51.549

the uh equal pay ratio,

247

00:16:51.559 --> 00:16:54.469

any kind of association with risk.

248

00:16:54.479 --> 00:16:55.109

For example,

249

00:16:55.119 --> 00:16:57.390

when you talk about coffee beans,

250

00:16:57.400 --> 00:17:11.030

uh a Starbucks might have some more social risk factors because of the type of workers that they employ uh and maybe not giving a fair wage to those workers.

251

00:17:11.040 --> 00:17:14.030

So those types of things are easily measurable.

252

00:17:14.489 --> 00:17:24.989

Those generally speaking across all ratings indices are considered the key or mandatory things that are being measured.

253

00:17:25.729 --> 00:17:31.270

The optional things that are being measured is the environmental pillar.

254

00:17:31.500 --> 00:17:38.260

And that is particularly problematic when you think about what these ESG ratings are,

255

00:17:38.380 --> 00:17:44.630

telling consumers and telling investors or at least what their assumptions are about what they mean.

256

00:17:45.180 --> 00:17:53.849

Uh And so I think a huge issue is that disconnect because if what gets measured gets done,

257

00:17:53.859 --> 00:17:54.459

you know,

258

00:17:54.489 --> 00:17:57.010

old adage in the business world,

259

00:17:57.020 --> 00:17:59.170

if what gets measured gets done,

260

00:17:59.469 --> 00:18:08.489

we are not rewarding firms in those ratings agencies or ratings indices to do what is necessary on the environmental side.

261

00:18:09.500 --> 00:18:12.510

So I guess I struggle a little bit because,

262

00:18:12.520 --> 00:18:12.790

you know,

263

00:18:12.800 --> 00:18:16.150

I think about the measurements of things like other rules that,

264

00:18:16.160 --> 00:18:19.189

that talk about child labor that's being measured,

265

00:18:19.199 --> 00:18:19.530

you know,

266

00:18:19.540 --> 00:18:22.369

o other things about using uighur labor in,

267

00:18:22.380 --> 00:18:22.790

in,

268

00:18:22.800 --> 00:18:22.910

uh,

269

00:18:22.920 --> 00:18:23.170

in,

270

00:18:23.180 --> 00:18:23.420

in,

271

00:18:23.989 --> 00:18:25.449

they're being measured right now.

272

00:18:25.459 --> 00:18:27.219

There's laws being passed in,

273

00:18:27.229 --> 00:18:28.900

in those areas here,

274

00:18:28.910 --> 00:18:30.229

specifically in the US.

275

00:18:30.689 --> 00:18:31.150

I mean,

276

00:18:31.160 --> 00:18:32.469

I see those,

277

00:18:32.479 --> 00:18:35.790

the ability to measure the results in compliance somewhat similar.

278

00:18:35.800 --> 00:18:36.469

Am I wrong?

279

00:18:36.619 --> 00:18:36.630

Uh,

280

00:18:36.650 --> 00:18:37.030

no,

281

00:18:37.040 --> 00:18:38.069

you're not wrong.

282

00:18:38.079 --> 00:18:39.430

But that is,

283

00:18:39.439 --> 00:18:40.020

I mean,

284

00:18:40.040 --> 00:18:40.829

the,

285

00:18:40.839 --> 00:18:43.750

uh uighur label that is mandatory.

286

00:18:44.150 --> 00:18:48.310

And so what we're really focusing on right now is what is voluntary,

287

00:18:48.319 --> 00:18:52.790

what companies are actively openly reporting that they are doing.

288

00:18:53.329 --> 00:18:54.920

And so when you see,

289

00:18:54.930 --> 00:18:54.939

uh,

290

00:18:54.949 --> 00:18:56.069

the publicly of,

291

00:18:56.079 --> 00:18:56.930

of course,

292

00:18:56.939 --> 00:19:04.500

compliance with regulations is going to factor into or those mandatory regulations is going to factor into a score,

293

00:19:04.930 --> 00:19:04.939

uh,

294

00:19:04.969 --> 00:19:05.670

for,

295

00:19:05.680 --> 00:19:07.040

from the ratings index.

296

00:19:07.050 --> 00:19:07.310

Yeah.

297

00:19:07.890 --> 00:19:10.010

So then what about mandatory compliance?

298

00:19:10.020 --> 00:19:11.219

And when does that come into play?

299

00:19:11.270 --> 00:19:11.750

So,

300

00:19:11.760 --> 00:19:12.930

mandatory compliance,

301

00:19:12.939 --> 00:19:13.390

I mean,

302

00:19:13.400 --> 00:19:16.640

it comes into play always,

303

00:19:16.650 --> 00:19:17.160

I guess,

304

00:19:17.170 --> 00:19:17.670

but,

305

00:19:17.680 --> 00:19:17.959

you know,

306

00:19:17.969 --> 00:19:19.199

we have to think about that.

307

00:19:19.209 --> 00:19:20.469

There are certain,

308

00:19:20.569 --> 00:19:22.770

when you talk about mandatory compliance,

309

00:19:22.780 --> 00:19:24.750

there are going to be various levels of that.

310

00:19:25.280 --> 00:19:25.290

Uh,

311

00:19:25.300 --> 00:19:29.920

you might have local or state level regulations that uh,

312

00:19:29.930 --> 00:19:32.119

depending on what state it comes from,

313

00:19:32.130 --> 00:19:38.209

is going to have more teeth So let's actually return to that A B 1200 example that I mentioned before,

314

00:19:38.229 --> 00:19:38.520

you know,

315

00:19:38.530 --> 00:19:39.170

like I said there,

316

00:19:39.180 --> 00:19:47.170

that regulation was put into place for identifying the different toxins or chemicals that are being used in cookware.

317

00:19:47.180 --> 00:19:59.650

And there has actually been a lot of talk within restaurant supply company circles that suggest that maybe they just won't do business in California.

318

00:20:00.239 --> 00:20:03.780

And so there are ways to get around some of these regulations.

319

00:20:03.790 --> 00:20:04.479

It's actually,

320

00:20:04.489 --> 00:20:04.780

I mean,

321

00:20:04.790 --> 00:20:08.199

especially when you talk about state and local regulations that,

322

00:20:08.560 --> 00:20:09.140

you know,

323

00:20:09.260 --> 00:20:12.319

you can not deal with a local area.

324

00:20:12.329 --> 00:20:13.959

That's really not a big issue.

325

00:20:14.130 --> 00:20:16.859

When you talk about a state like California,

326

00:20:16.869 --> 00:20:20.280

I believe it's 100 $38.5 billion industry.

327

00:20:20.290 --> 00:20:24.380

The restaurant industry is 100 $38.5 billion industry.

328

00:20:24.859 --> 00:20:26.400

It accounts for maybe,

329

00:20:26.560 --> 00:20:30.640

uh I wanna say 10% of the employment in the state.

330

00:20:30.859 --> 00:20:33.560

That's a huge impact.

331

00:20:33.569 --> 00:20:36.689

And so even the fact that these com these companies,

332

00:20:36.699 --> 00:20:39.599

these organizations are talking about,

333

00:20:40.119 --> 00:20:41.989

we'll just forget California.

334

00:20:42.920 --> 00:20:50.020

That means that suggests to me that they're not necessarily willing to pay the price of compliance in that state.

335

00:20:50.030 --> 00:20:51.020

And that's big.

336

00:20:51.359 --> 00:20:52.020

Now,

337

00:20:52.030 --> 00:20:53.170

think about it,

338

00:20:53.319 --> 00:20:55.140

if it wasn't California,

339

00:20:55.150 --> 00:20:59.900

which obviously commands a huge amount of power in the American legislature,

340

00:21:00.310 --> 00:21:00.800

I mean,

341

00:21:00.810 --> 00:21:01.819

if you talk,

342

00:21:01.829 --> 00:21:02.089

if,

343

00:21:02.099 --> 00:21:03.319

if you said the same leg,

344

00:21:03.329 --> 00:21:07.260

if you said the same legislation was going to come out of South Dakota,

345

00:21:07.270 --> 00:21:07.780

any,

346

00:21:07.790 --> 00:21:10.650

any smaller state with a lower population.

347

00:21:10.979 --> 00:21:15.880

It's pretty easy to understand why companies would be able to just discard that regular,

348

00:21:15.890 --> 00:21:17.170

that compliance,

349

00:21:17.180 --> 00:21:20.170

that mandatory regulation right then and there.

350

00:21:20.500 --> 00:21:21.040

Ok.

351

00:21:21.050 --> 00:21:22.790

So that's great.

352

00:21:22.890 --> 00:21:26.910

California obviously passed something that has quite a bit of teeth.

353

00:21:27.199 --> 00:21:29.819

They're able to be more specific,

354

00:21:30.030 --> 00:21:32.530

the further out you go,

355

00:21:32.540 --> 00:21:36.390

the more power that you get behind legislation,

356

00:21:36.550 --> 00:21:41.989

they might have to in an effort to get more people from both sides of the aisle on board.

357

00:21:42.000 --> 00:21:46.630

You have to kind of make concessions on what is and is not acceptable.

358

00:21:47.040 --> 00:21:54.469

And so even though you have maybe regulations like the uighur uh forced labor prevention,

359

00:21:55.420 --> 00:22:01.089

there might have been more concessions made in that regulation.

360

00:22:01.099 --> 00:22:01.479

I'm not,

361

00:22:01.489 --> 00:22:01.680

I,

362

00:22:01.689 --> 00:22:06.079

I can't speak to it very directly aside from just general knowledge of it,

363

00:22:06.459 --> 00:22:14.640

but there might have been more opportunities to go deeper at a state level than is possible at a federal level.

364

00:22:14.989 --> 00:22:16.349

The way I like to think about this,

365

00:22:16.359 --> 00:22:18.089

Sophia correct me if I'm wrong is that?

366

00:22:18.189 --> 00:22:20.209

And you sort of established this earlier,

367

00:22:20.219 --> 00:22:21.380

we've got two buckets,

368

00:22:21.390 --> 00:22:29.060

we've got this compliance mandatory part that firms sort of have an inherent incentive either to,

369

00:22:29.069 --> 00:22:30.270

as you've already said,

370

00:22:31.160 --> 00:22:36.219

I'm not going to play in that space so they can self select out or if I am gonna play in that space,

371

00:22:36.599 --> 00:22:38.810

I'm pretty much obligated to comply.

372

00:22:38.949 --> 00:22:42.459

Otherwise I'm gonna get a big old black guy one way or the other.

373

00:22:43.180 --> 00:22:45.140

So that part is kind of straightforward.

374

00:22:45.810 --> 00:22:49.420

But then you also said there are hundreds,

375

00:22:49.430 --> 00:22:52.430

I think you said 600 ratings agencies,

376

00:22:53.699 --> 00:23:04.550

more than 600 who are publishing data about firms that tell a story about how this firm is doing for environmental social governance.

377

00:23:05.819 --> 00:23:08.510

But that is not a compliance issue.

378

00:23:08.540 --> 00:23:10.160

It's not a regulatory issue,

379

00:23:10.170 --> 00:23:11.869

it's not mandated by any.

380

00:23:11.880 --> 00:23:12.750

As far as I'm aware,

381

00:23:12.760 --> 00:23:14.109

industry standards,

382

00:23:14.119 --> 00:23:17.359

maybe there are sort of industry,

383

00:23:17.800 --> 00:23:18.469

I don't know,

384

00:23:18.520 --> 00:23:20.589

social norms that they follow.

385

00:23:20.660 --> 00:23:24.329

How do I segue from the very structured,

386

00:23:24.680 --> 00:23:31.410

mandatory compliance reporting stuff over into this world of 600 plus ratings.

387

00:23:31.420 --> 00:23:38.770

How do I even make any sense of that stuff to say whether it's uh I don't want to say truthful because that would probably be a misnomer but whether it's usable,

388

00:23:38.780 --> 00:23:39.130

right?

389

00:23:39.140 --> 00:23:40.939

Whether I can interpret anything from it.

390

00:23:41.209 --> 00:23:41.650

Yeah.

391

00:23:41.660 --> 00:23:42.229

Uh I mean,

392

00:23:42.239 --> 00:23:45.130

I would like to say that there's an easy answer to that,

393

00:23:45.140 --> 00:23:47.810

especially because like I said before,

394

00:23:48.449 --> 00:23:59.579

you have these ratings indices that are basically they say that they are measuring the esg performance of firms and that in and of itself suggests,

395

00:23:59.589 --> 00:24:00.459

I think to the,

396

00:24:00.469 --> 00:24:03.969

to me and to the average consumer that,

397

00:24:04.500 --> 00:24:10.729

that score is indicative of whether they are doing the right thing.

398

00:24:11.020 --> 00:24:16.550

And if that's the case and if all of these organizations,

399

00:24:16.560 --> 00:24:20.719

these indices are getting data from publicly available sources,

400

00:24:20.729 --> 00:24:25.839

so they all have access to the same information you would think that.

401

00:24:25.849 --> 00:24:26.619

In fact,

402

00:24:26.630 --> 00:24:31.099

their scores are going to be really similar and that's not true.

403

00:24:31.150 --> 00:24:31.660

In fact,

404

00:24:31.670 --> 00:24:37.979

there was a really good paper in 2022 Larker Pomorskie Tyne and Watts.

405

00:24:37.989 --> 00:24:45.420

They found very low correlations across ESG ratings as well as the different individual E SS G components.

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00:24:45.430 --> 00:24:52.900

So not only was there low correlation across the ratings but what they classified as environmental was different,

407

00:24:52.910 --> 00:24:56.420

what they classified as social was different and same for governance.

408

00:24:57.459 --> 00:24:59.040

And so what could be causing that?

409

00:24:59.469 --> 00:25:03.680

Uh I think the natural inclination is to think it's the weights,

410

00:25:03.689 --> 00:25:06.069

it's the way that they are waiting their scores.

411

00:25:06.079 --> 00:25:14.199

And therefore that's going to skew the way that the data and that's going to skew the way that the score kind of comes out in the end.

412

00:25:14.339 --> 00:25:16.680

But in another study,

413

00:25:16.760 --> 00:25:26.180

they basically found that the measures and the measurements being employed accounted for about 56% of the divergence.

414

00:25:26.589 --> 00:25:32.300

And so if they're trying to measure the same thing and they have the same information,

415

00:25:33.150 --> 00:25:37.949

then you would think that the measurements would be the same and they're not.

416

00:25:38.459 --> 00:25:43.989

And so if you have these different indices that are saying that they're measuring the same thing,

417

00:25:44.000 --> 00:25:46.689

but the way that they're measuring it is different,

418

00:25:46.699 --> 00:25:53.650

but an investor and a consumer doesn't know that it tells of it gives you kind of this very difficult,

419

00:25:54.280 --> 00:25:57.800

you can't really interpret them the same and it's,

420

00:25:58.599 --> 00:26:02.209

it gets messy and I don't really know that there's necessarily a,

421

00:26:02.219 --> 00:26:04.369

a great solution to it.

422

00:26:04.380 --> 00:26:06.619

At this current juncture,

423

00:26:06.910 --> 00:26:07.819

it leaves open,

424

00:26:07.829 --> 00:26:09.579

it leaves open for a lot of debate,

425

00:26:09.589 --> 00:26:10.380

that's for sure.

426

00:26:10.469 --> 00:26:11.900

Tons of debate.

427

00:26:11.910 --> 00:26:12.859

Absolutely.

428

00:26:12.869 --> 00:26:13.459

Because,

429

00:26:13.699 --> 00:26:14.540

and again,

430

00:26:15.030 --> 00:26:15.489

I,

431

00:26:15.829 --> 00:26:18.459

you can take this in so many different ways,

432

00:26:18.469 --> 00:26:18.780

but,

433

00:26:19.069 --> 00:26:19.290

you know,

434

00:26:19.300 --> 00:26:20.780

consumers and investors,

435

00:26:20.790 --> 00:26:24.339

especially if you think about the modern consumer,

436

00:26:24.349 --> 00:26:34.290

they have so many choices that they're facing every single day and if they want to be able to feel confident in the choices that they're making,

437

00:26:34.300 --> 00:26:41.199

and they're looking to these ratings and they assume that the rating is consistent across all circles.

438

00:26:41.209 --> 00:26:42.250

But it's not,

439

00:26:42.689 --> 00:26:43.010

I mean,

440

00:26:43.020 --> 00:26:43.569

how can,

441

00:26:43.579 --> 00:26:47.369

how can a consumer or an investor make an informed decision?

442

00:26:48.199 --> 00:26:48.979

And that's,

443

00:26:48.989 --> 00:26:51.119

I think that's the issue that I have,

444

00:26:51.130 --> 00:27:01.750

especially as a former retail employee who is told to always be honest and I don't know that firms are necessarily trying to be dishonest,

445

00:27:02.239 --> 00:27:07.780

but the fact that there is no consistency makes it very difficult to make a choice.

446

00:27:08.140 --> 00:27:09.560

Sophia is a consultant.

447

00:27:09.569 --> 00:27:13.900

I typically end up in debates with clients about how they measure forecast accuracy.

448

00:27:14.319 --> 00:27:14.939

So,

449

00:27:14.949 --> 00:27:15.430

I mean,

450

00:27:15.439 --> 00:27:19.099

that's when you're asking people a lot of self reporting and,

451

00:27:19.109 --> 00:27:19.420

and,

452

00:27:19.430 --> 00:27:20.739

and in these situations,

453

00:27:20.750 --> 00:27:22.099

you end up with a lot of debate.

454

00:27:22.670 --> 00:27:24.660

What's the path forward?

455

00:27:24.670 --> 00:27:25.219

Like,

456

00:27:25.599 --> 00:27:26.689

where do you think we go?

457

00:27:26.810 --> 00:27:28.680

You think these 600 organizations,

458

00:27:28.689 --> 00:27:31.589

some of them just die off and they merge and well,

459

00:27:31.599 --> 00:27:32.619

so actually,

460

00:27:32.630 --> 00:27:37.020

uh there was a recent MS C I which is the biggest rating.

461

00:27:37.030 --> 00:27:37.219

I mean,

462

00:27:37.229 --> 00:27:40.729

it's probably the most well known ratings index that's out there.

463

00:27:41.060 --> 00:27:44.010

They came to be as a result of a merger.

464

00:27:44.020 --> 00:27:54.459

And so I wouldn't be surprised if some of these organizations do start to move together because they're just competing against one another.

465

00:27:55.099 --> 00:27:57.160

But I think you bring up a good point.

466

00:27:57.170 --> 00:28:02.560

It's like a lot of uncertainty and doom and gloom that I'm talking about here.

467

00:28:02.569 --> 00:28:08.800

But there's actually been some really interesting movement forward just in the last couple of years.

468

00:28:08.810 --> 00:28:16.000

So one example in 2023 I think it was March 2023 early 2023.

469

00:28:16.010 --> 00:28:25.420

I know that the SEC announced new ESG disclosure requirements that are supposed to strengthen and standardize climate related disclosure.

470

00:28:25.430 --> 00:28:37.520

And Goldman Sachs was actually the Asset management group was fined for non compliant because they indicated that the way that the data,

471

00:28:37.530 --> 00:28:41.209

the research was done left those investors,

472

00:28:41.219 --> 00:28:41.280

oh,

473

00:28:41.290 --> 00:28:42.099

that they were,

474

00:28:42.109 --> 00:28:52.420

the investors were basically uh exposed to greenwashing and that uh they didn't have all the necessary information to make that informed decision.

475

00:28:52.430 --> 00:28:54.060

So right there,

476

00:28:54.209 --> 00:29:04.270

you have a standardized way of disclosure for climate related issues uh that is expected in financial reports.

477

00:29:04.489 --> 00:29:06.589

So that's kind of a we're talking,

478

00:29:06.599 --> 00:29:09.560

we're sort of talking about voluntary reporting.

479

00:29:09.910 --> 00:29:10.630

This is a,

480

00:29:10.640 --> 00:29:12.699

a mandatory report,

481

00:29:12.709 --> 00:29:13.579

of course.

482

00:29:13.900 --> 00:29:23.119

But I think that a lot of the ways that uh mandatory reporting exists is going to inform the voluntary reporting.

483

00:29:23.130 --> 00:29:30.390

And may I hope inform the way that ESG ratings indices approach their methods?

484

00:29:30.660 --> 00:29:35.849

Because if we're punishing companies for being non compliant in disclosure,

485

00:29:35.859 --> 00:29:46.900

we would hope that those ratings Andes become a little bit more consistent in the way that they're reporting or getting their information one quick.

486

00:29:46.910 --> 00:29:50.660

Uh I'll call say final technical question for you in your opinion on this.

487

00:29:51.319 --> 00:29:58.300

So if I and our audience is gonna be primarily um supply chain or just business professionals in general,

488

00:29:58.859 --> 00:30:06.939

and they're listening to everything that you just said and they're trying to think about their own decision making process going forward.

489

00:30:07.920 --> 00:30:13.540

So what would be your advice to a business professional who wants to do the right thing?

490

00:30:14.349 --> 00:30:22.300

Knows that there are lots of choices out there as far to r as far as ratings agencies and differences in what they're going to get.

491

00:30:23.270 --> 00:30:25.449

What can they do to,

492

00:30:25.459 --> 00:30:27.250

to try to do the right thing,

493

00:30:27.260 --> 00:30:28.689

not just for their firm,

494

00:30:28.930 --> 00:30:34.650

but also uh in utilizing these ratings agencies to tell the right story about what they're actually doing.

495

00:30:35.640 --> 00:30:36.000

Yeah,

496

00:30:36.010 --> 00:30:37.310

and that's a great question,

497

00:30:37.319 --> 00:30:44.420

especially because um there was a study from KPMG that said that 75% of businesses,

498

00:30:44.430 --> 00:30:49.660

companies globally are not necessarily ready for these disclosure requirements.

499

00:30:49.670 --> 00:30:57.400

And so that's a huge indicator there that ESG data makes a lot of organizations nervous.

500

00:30:57.410 --> 00:31:01.290

And I think rightfully so because as we've discussed,

501

00:31:01.300 --> 00:31:07.489

it is a widely saturated and complex wild west out there.

502

00:31:07.500 --> 00:31:10.650

I think if I had to make any recommendations,

503

00:31:10.660 --> 00:31:16.130

I would really focus on from the procurement perspective because when,

504

00:31:16.140 --> 00:31:16.369

you know,

505

00:31:16.380 --> 00:31:17.569

procurement has,

506

00:31:17.579 --> 00:31:17.790

you know,

507

00:31:17.800 --> 00:31:20.270

interfaces at every level of the business,

508

00:31:20.280 --> 00:31:22.089

it's the deal maker,

509

00:31:22.099 --> 00:31:23.130

the designer,

510

00:31:23.140 --> 00:31:24.319

the you know,

511

00:31:24.329 --> 00:31:26.209

everything sourcing.

512

00:31:26.660 --> 00:31:31.329

I think that's one of the biggest areas that organizations can make an impact.

513

00:31:31.689 --> 00:31:32.780

And like I said,

514

00:31:32.790 --> 00:31:35.229

that can come in a variety of different ways.

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00:31:35.239 --> 00:31:40.280

But when you work with organizations like the sustainability consortia,

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00:31:40.290 --> 00:31:44.770

which has its own uh transparency traceability mechanism,

517

00:31:44.780 --> 00:31:54.170

it's called thesis where it helps organizations kind of map their supply chain and identify areas of risk.

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00:31:54.380 --> 00:32:00.199

I think that's a huge first step having that understanding of what exactly is going on,

519

00:32:00.209 --> 00:32:02.250

not only with your first tier suppliers,

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00:32:02.260 --> 00:32:09.520

but who they're doing business with is vital for doing the right thing and for protecting yourself from risk.

521

00:32:09.530 --> 00:32:29.939

And I think that a lot of that would then fall into improvement opportunities within the sustainability ratings indices because avoiding risk addressing any opportunity for risk is ultimately going to improve the social.

522

00:32:29.949 --> 00:32:34.239

It probably should improve the social and likely the environmental scores,

523

00:32:34.250 --> 00:32:36.979

but definitely the social because like we said,

524

00:32:37.160 --> 00:32:41.880

those are mandatory for a lot of those ESG ratings indices.

525

00:32:41.989 --> 00:32:45.170

And so that's going to give them a lift as well.

526

00:32:45.229 --> 00:32:46.489

And I,

527

00:32:46.560 --> 00:32:46.949

you know,

528

00:32:46.959 --> 00:32:48.739

I guess I'm a little bit biased,

529

00:32:48.750 --> 00:32:50.819

have more people on your team.

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00:32:50.829 --> 00:32:58.680

Who are well versed in ESG metrics and what you can do from a publicity,

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00:32:58.689 --> 00:33:02.300

but also from a back end standpoint is gonna be really crucial.

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00:33:02.910 --> 00:33:10.619

So it sounds like what you said is try to do the right thing and do the right thing and eventually the ratings will catch up with you and recognize what you're doing.

533

00:33:10.949 --> 00:33:11.349

Yeah,

534

00:33:11.359 --> 00:33:12.099

that's i,

535

00:33:12.109 --> 00:33:14.459

it's probably not the best answer,

536

00:33:14.469 --> 00:33:15.000

but yes,

537

00:33:15.010 --> 00:33:15.489

that's,

538

00:33:15.819 --> 00:33:17.619

it's the best I've got right now.

539

00:33:18.219 --> 00:33:18.479

Well,

540

00:33:18.489 --> 00:33:21.790

on behalf of the Smell College of Business here at Penn State University,

541

00:33:21.800 --> 00:33:25.520

the Department of Supply Chain Information Systems and the Center for Supply Chain Research.

542

00:33:25.530 --> 00:33:28.209

Both her Grossman and I want to thank our guests today,

543

00:33:28.229 --> 00:33:35.930

Miss Sophia Schuster MB A and master's degree from here in supply chain Management for talking to us about environmental social governance,

544

00:33:35.939 --> 00:33:36.900

the landscape,

545

00:33:36.959 --> 00:33:38.589

mandatory and voluntary reporting,

546

00:33:38.599 --> 00:33:44.739

the ratings agencies with a little bit of advice for all our professionals on how they can think about the environment.

547

00:33:44.939 --> 00:33:55.910

Uh not the environment literally but the environment of ESG and uh hopefully we can get her back here in a couple of years so she can talk about how it's changed and uh sounds like there's a lot of room for improvement again.

548

00:33:55.920 --> 00:33:57.469

Thanks Sophia for joining us today.

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00:33:57.630 --> 00:33:57.640

Oh,

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00:33:57.660 --> 00:33:58.869

thank you so much guys.

551

00:33:58.880 --> 00:33:59.810

I really appreciate it.

552

00:34:03.150 --> 00:34:12.580

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553

00:34:12.590 --> 00:34:15.510

research needs and professional development offerings.

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00:34:15.600 --> 00:34:21.429

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