



## ESG VIEWPOINT

### Drivers of Deforestation: how we are working to put the brakes on deforestation in automotive supply chains



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#### At a glance

- Automotive supply chains have a significant but underappreciated impact on global deforestation through their use of leather and natural rubber
- Deforestation links generate regulatory and reputational risks for the automotive industry
- The deforestation risk management in automotive supply chains is beginning to progress, but needs to accelerate
- We have engaged with twenty automotive companies in 2022 on deforestation and convened a group of institutional investors to hasten the sector's progress

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## Overview

When you purchase a new car, you may not realise that the leather on your seats may be driving deforestation in the Amazon, or the rubber in your tyres could be forcing orangutans closer to extinction.

The deforestation risks of automotive supply chains have taken a back seat in public consciousness, and as a result rubber and leather have sat close to the bottom of the automotive industry's Environmental, Social and Governance (ESG) to-do list. However, there are signs that with increasing regulation

and public awareness these issues are gaining traction. At Columbia Threadneedle Investments we have been engaging with car seat manufacturers, tyre companies and automobile manufacturers to drive progress on deforestation.

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[Why automotive supply chains are exposed to deforestation risk](#)



[Progress on managing deforestation risks is slow](#)



[Learn about our engagement with the automotive industry](#)



## Automotive supply chains are exposed to deforestation risk commodities

Automotive companies are exposed to two primary commodities which are linked to deforestation risks: natural rubber and leather.

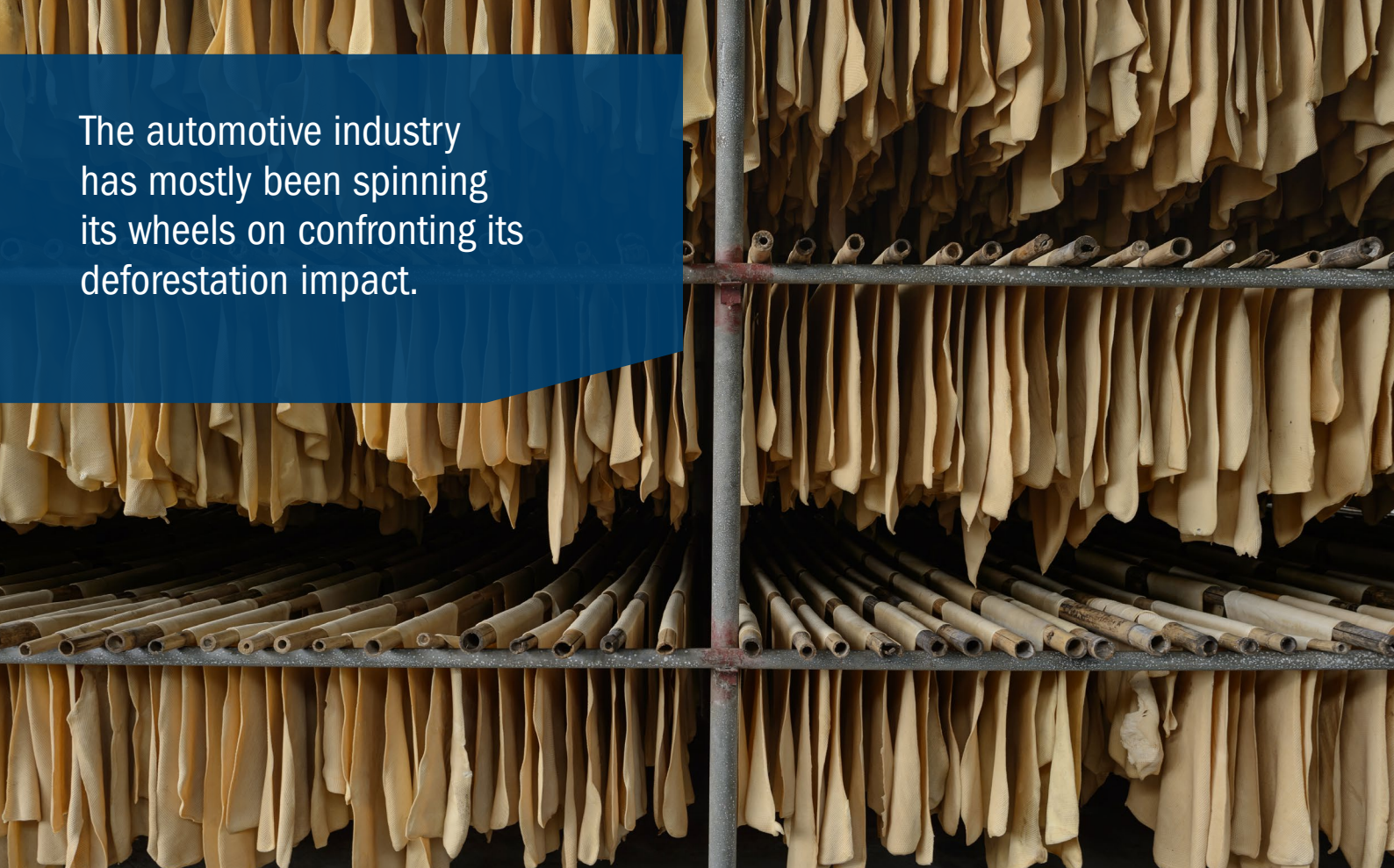
Natural rubber production is undisputedly linked to deforestation. Over **five million hectares** of tropical forests were cleared across Southeast Asia and sub-Saharan Africa for rubber plantations between 2003 and 2017. Particular hotspots were in Cambodia, where forest clearance for rubber from 2001-2015 accounted for **23% of total forest loss**, and west and central Africa where industrial rubber plantations are **driving deforestation** and **repressing local communities** through harassment and intimidation of whistle-blowers. Automotive demand is the primary driver of rubber production – nearly **three quarters** of global rubber production is used to produce tyres. With **rubber yields flatlining** and global demand set to **jump by a third** by 2030, future demand is likely to be met by further forest conversion. Industry estimates suggest an additional land area the **size of Switzerland** will be required to meet rising demand by 2027, exacerbating the extinction risk for over **70 extinction-threatened species**.

The links between cattle and tropical deforestation are more widely understood than the deforestation risks associated with rubber production. Cattle ranching in the Brazilian Amazon is the **primary global driver of deforestation** and is growing, with rates of forest loss reaching a **15-year high** in 2021. However, the leather industry often attempts to avoid its share of responsibility by claiming it

is merely a by-product of beef production. This claim does not stand up to scrutiny as leather sales underpin meatpackers' profit margins. Meatpackers would suffer a **3.2% loss with only beef sales**, rather than a 4.2-13.8% profit when leather and other products are included. Deforestation-linked Brazilian meatpackers export around 80% of the leather they produce, around **half of which** ends up in automobiles. All the top five European car manufacturers source leather from clients of Brazilian companies linked to at least a **million hectares of recent deforestation**. "As a major end user of Brazilian leather, the automotive industry has both the leverage and the responsibility to ensure that its supply chain is free from deforestation, but it is not yet taking the necessary steps to do so" says Tim Steinweg, responsible finance adviser at Rainforest Foundation Norway.

**Deforestation links are spawning financial risks for the automotive industry, yet progress on managing deforestation remains slow**

This exposure to deforestation risk creates material financial risks for automotive manufacturers, component manufacturers and their investors through several routes. There are proposals tabled in the UK, EU and US to mandate due diligence and reporting on forest-



The automotive industry has mostly been spinning its wheels on confronting its deforestation impact.

risk commodities. While the scope of commodities and likelihood of enactment varies between the proposed regulations, it is likely that parts of the automotive industry will be covered by a regulatory imperative in the short term, especially in the EU where both natural rubber and leather are in scope of the regulation which recently [passed through the EU Parliament](#). Links to deforestation also pose a growing reputational risk for automotive companies, as stories are increasingly picked up by mainstream media outlets such as the New York Times, Time magazine and The Guardian.

There are structural impediments to managing deforestation risk in automotive supply chains. Rubber supply chains are typically complex and long, there can be up to eight tiers separating automotive manufacturer end-users from producers. In addition, around [85% of rubber is produced by smallholders](#) which adds complexity to traceability and due diligence efforts. Tracing leather products to their point of origin is also difficult due to the number of facilities involved in the production process, with cattle often moved between multiple breeding, rearing and fattening farms. This has resulted in widespread instances of “[cattle laundering](#)”, where cattle are reared on illegally deforested areas before being passed through legitimate farms to authenticate their products.

The automotive industry has mostly been spinning its wheels on confronting its deforestation impact, but there are signs the rubber is starting to hit the road. The Global Platform for Sustainable Natural Rubber is coordinating supply chain actors and stakeholders to halt deforestation and adverse impacts on the environment and improve respect for human rights. However, while most large tyre companies are involved, major automakers such as **Ford, Stellantis and Hyundai** are not members. Furthermore, while most automakers and tyre companies have adopted GPSNR-aligned high level commitments on responsible sourcing of natural rubber, few have committed to a zero deforestation targets and progress on traceability remains low. “To mitigate conversion pressure on tropical ecosystems, buyers and manufacturers of natural rubber products must map their supply chains and build capacity among smallholder producers so they can increase yields and household incomes” says Sam Ginger, SPOTT Natural Rubber Analyst at the Zoological Society of London (ZSL).

While automotive progress on deforestation-linked rubber is stalling, work on deforestation-linked leather has barely started. Very few car seat manufacturers or automobile manufacturers are members of the Leather Working Group (LWG) or require LWG certification from suppliers. Traceability of automotive leather sourcing down to



the farm level remains vanishingly low, and supplier engagement and due diligence efforts are largely non-existent. Some of the better performers we have spoken with are **BMW** and **Volkswagen**, who have better certification and supplier due diligence efforts. **Mercedes** has robust expectations of suppliers, and car seat manufacturers **Lear** and **Adient** are conducting deforestation risk assessments. In general, the automotive sector needs to shift gears on its management of deforestation risk.

### Engagement to accelerate action to tackle the issue

As a responsible investor with a strong legacy of active ownership, we engage with our internal funds' and **reo**<sup>®</sup> clients' holding companies in the automotive industry to accelerate action on deforestation. We have prioritised the automotive companies we engage on deforestation by drawing on the analysis and expertise of the NGOs **Rainforest Foundation Norway** and **ZSL SPOTT**, and augmented this by piloting a proprietary tool which combines data from several sources to grade corporate exposure to and manage of deforestation risk. We also identified car seat makers as a pinch point in the supply chain which we can target to drive change throughout the supply chain. In 2022 we have engaged with eight automobile manufacturers, five car seat manufacturers and seven tyre companies to encourage them to step up their efforts. We have convened a group of institutional investors to coordinate engagements and present a unified set of asks on this topic. We will also look to strengthen our coordination with GPSNR and the Leather Working Group moving forward.

### Our engagement is focused on a core set of high-level asks:

- > Publicly commit to a zero-deforestation supply chain and adopt responsible sourcing policies

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- > Set clear public expectations for your suppliers on their deforestation-risk management systems and disclosures

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- > Trace the leather and natural rubber supply chain beyond direct suppliers and provide transparency about the origin of leather and natural rubber products

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- > Systematically assess deforestation and other sustainability risks in supply origins

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- > Engage direct and indirect suppliers that face high deforestation risks and/or are non-compliant with sourcing policies

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- > Publicly disclose sufficient detail on deforestation risk management to CDP Forests or corporate reporting

We appreciate that deforestation is a new issue for many automotive companies and will look to support them to identify an appropriate way forward to deliver on our expectations. With many sectors stepping up their ambitions in advance of the pivotal **COP15 biodiversity conference** in December 2022, now is the time for the automotive sector to shift up a gear on managing its deforestation risk commodities.


## Get to know the author



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Joe joined the Responsible Investment team in 2021 and is focusing on climate change and biodiversity. Before joining us, Joe worked as a sustainability consultant with a range of private and public sector clients. Outside work he enjoys playing sport, hiking and birdwatching.

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