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HOW PROCUREMENT CAN DRIVE ESG GOALS FOR THE ENTERPRISE

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There is increasing pressure from investors, consumers and government legislation for organizations to transform their procurement practices based on ESG requirements. Aside from emissions reduction, these mandates often include waste management, ethical sourcing of materials and labor, and an overarching evaluation of environmental and social impacts across the value chain.

Consumers increasingly prefer sustainable products that help the environment — about 23% wish to reduce waste from production, and around 22% would like to reduce their carbon footprint.[1] A report by Nielsen Insights suggests that 73% of customers are willing to change how they consume to mitigate environmental impacts.[2] Additionally, 25% have a zero-tolerance policy toward companies that embrace questionable practices.[3]

ESG is becoming increasingly crucial for investors as well: 73% of investors state that efforts to improve the environment and society contribute to their investment decisions, and 22% have a zero-tolerance policy toward unethical company practices.[4]

Today, many investors have strict reporting requirements for companies. These are being bolstered by regulations such as the SEC's new proposed rules for climate-related disclosures, which would require public companies to report business exposure to climate-related risks and greenhouse gas emissions to help investors make informed decisions based on consistent and reliable data.[5,6] Across the globe, government legislation such as the German Supply Chain Act, the EU Corporate Sustainability Due Diligence Directive and the United Kingdom's Modern Slavery Act are helping move the needle.

Enterprises must evaluate ESG performance across their entire value and supply chains to meet such demands. An enterprise's environmental and social impact includes the raw materials they source, how they run operations, and how goods are packaged and delivered. Therefore, it's critical to address supplier spend when striving to achieve ESG targets.

For example, supplier spend directly impacts Scope 3 emissions, representing between 80% and 97% of an enterprise's overall emissions,[7] and therefore must be addressed to achieve net-zero goals. When companies do not extend their ESG strategies to their suppliers, they may be scrutinized for "greenwashing." For example, enterprises may be criticized for not requiring suppliers to set specific targets under the Science Based Targets initiative (SBTi), which is necessary for an enterprise to achieve its own SBTi targets.

The value chain also represents the largest gap in ESG performance. This presents a key opportunity for sustainability action and improvement.

One issue: The average maturity on most sustainability topics is relatively low among suppliers/value chain partners compared to most MNCs, particularly for small- and mid-sized companies, which comprise 70% of most supply chains. On average, less than 20% of suppliers report carbon/GHG emissions, which is less than 15% for small- and medium-sized enterprises.

Based on these statistics, procurement is positioned to help organizations make their ESG goals actionable. Through sustainable procurement, companies can structure commercial relationships and purchasing decisions to make a substantial positive ESG impact. From ensuring that materials are sourced responsibly to safeguarding human rights across the supply chain, procurement can drive ESG outcomes through its lever of influence over purchasing spend and supplier relationships. In fact, about 54% of CPOs believe that the function will play a significant role in securing a sustainable future by 2025.[8]

Why Procurement Needs To Evolve To Drive ESG Outcomes

While procurement has traditionally focused on driving cost savings, it is increasingly playing a more strategic role in operations. Procurement drives value by ensuring quality, reducing lead times and optimizing production by collaborating closely with suppliers and across business functions.

Procurement can leverage these enhanced responsibilities to help drive ESG outcomes as enterprises face rising pressure throughout their operational footprint. This can be done by embedding ESG into existing processes and driving targeted and strategic action to improve supplier ESG performance.

The first of these methods focuses on how everyday procurement practices can integrate ESG. For example, ESG criteria can be embedded in RFx evaluations, ESG clauses can be added to contracts when they are up for renewal and ESG information can be integrated into guided buying. These changes to current processes can help push the entire supply base toward better ESG outcomes.

This type of strategy is well suited for an ESG goal such as advancing human rights across the value chain because it translates them into specific procurement goals — for example, ensuring that 80% of suppliers have been assessed or audited against labor rights or have labor rights certifications by 2025.

The second of these methods — driving targeted actions — involves identifying hotspots in the value and supply chain that procurement can focus on to help achieve ESG goals. This effort evaluates the supplier base to determine which suppliers to target with procurement levers to drive ESG outcomes.

This method is critical for achieving ESG goals such as achieving net zero by 2030 due to their higher level of complexity and the need for prioritization to meet timelines. Procurement can prioritize suppliers that have high emissions, have a higher level of ESG maturity, are in countries with stricter regulations, or with whom they have strong existing relationships — and employ levers best suited for each supplier.

Change management will be essential to successfully applying these strategies. This includes investing in people: developing internal training to build expertise and awareness, embedding the ESG vision into the procurement organization and communicating changes across business functions and category teams.

Technology is also vital, whether it's integrating ESG into existing tools or selecting and integrating any additional tools into the technology ecosystem and processes. These tools are essential for collecting and centralizing data and tracking and reporting progress.

How ESG Performance Insights Can Impact Procurement Decisions

Enterprises typically have thousands of suppliers, all at different maturity levels, with varying levels of impact on an enterprise's sustainability goals. This can make it challenging to narrow down the suppliers to focus on to maximize impact on these goals.

However, this challenge can be addressed by conducting a risk-mapping assessment of the value and supply chains. This assessment should leverage expert insights on intrinsic country and category sustainability factors to understand the risk landscape broadly across the supply base. These insights and factors can be combined with other data from procurement, such as spend, criticality, the strength of supplier relationships and others to determine the suppliers to engage in further due diligence.

For example, procurement can analyze data to conduct spend-to-emissions mapping to identify which spend areas have higher levels of emissions. Once these areas are identified, companies can target the suppliers to collect data from directly.

This additional due diligence on a targeted set of suppliers also needs to be strategic. For example, suppliers may not be able to provide the data, may provide it in different formats, use different methodologies or be uncooperative.

Enterprises also need to collect the right data types to effectively drive decision-making. They can develop key performance indicators and work with suppliers on measuring and reporting against these. This will facilitate benchmarking and tracking performance and help generate actionable insights on how to improve — and can be supported with expert insight and platforms that enable supplier collaboration, tracking, consolidation and data analysis.

The ESG-related indicators of suppliers' performance can be integrated into current procurement processes. This includes the RFx process that would embed sustainability scores as a weighted criterion as well as supplier relationship management activities requiring suppliers to commit to an annual assessment. The data can also be added to existing procurement tools such as buyer portals to ensure visibility throughout the procurement decision-making process.

How to Apply Targeted Procurement ESG Strategies

Once suppliers have been prioritized and a methodology to assess performance and collect data is finalized, procurement should evaluate strategies for achieving the desired ESG outcomes. Generally, when addressing existing suppliers and spend, it's preferable to implement strategies that help incumbents improve on ESG dimensions rather than to switch suppliers, as this can be costly and disruptive.

Depending on the supplier and situation, there are various strategies that can help them achieve ESG outcomes. For example, for a supplier with whom there is already a strong relationship, procurement can collaborate with them to review performance compared to benchmarks, provide them with improvement areas, set priorities and collaborate with them to advance their sustainability practices.

Additionally, procurement can incentivize suppliers by:

1. Motivating suppliers through consistent supplier engagement and being transparent about the weight sustainability carries in procurement decisions
2. Including KPIs and/or a bonus-malus structure in the contract; for example, by tying fees/penalties around supplier score improvement goals or decarbonization clauses
3. Rewarding progress financially through exclusivity, improved payment terms and co-branding

Some suppliers may require more support to improve their ESG performance. In these cases, procurement can employ several strategies, such as:

1. Investing in workshops and training on supply chain decarbonization, ethical labor practices or other ESG areas
2. Providing free audits and guidance from experts, which could apply to areas such as energy, carbon, waste and human rights
3. Instituting policies that encourage transparency and accountability across all suppliers and incentivize collaboration and communication on ESG outcomes
4. Setting up long-term relationships with suppliers so they can overcome expenditure barriers that impede progress on ESG goals

If these strategies do not work, enterprises can consider switching suppliers or reducing supplier spend. However, procurement can help to prevent this by continuously evolving its actions based on lessons learned, applying best practices and tailoring its approach based on the supplier situation.

Given the complexity of ESG transformation, it's fairly easy to lose momentum across the journey. Procurement can combat this by establishing a governance structure from the outset to ensure that progress is sustainable, consistently reevaluating strategy and setting new targets.

Similarly, by prioritizing data collection and reporting/monitoring, procurement can continuously prove its value and push forward results.

In Action: How GEP and EcoVadis Have Empowered Procurement To Advance ESG Goals

A global telecom giant had challenges. They had an outdated, highly proprietary legacy system. In addition, disparate global systems were capturing risk information from various sources, leading to inefficiencies in supplier risk/sustainability information.

To reduce inefficiencies, the telecom enterprise wanted to build risk analysis under a single umbrella and use a sustainability score as one of the critical parameters in the supplier onboarding and management process that was missing in their existing system.

Once the telecom company replaced their legacy system with GEP's unified end-to-end procurement software to transform their strategic sourcing processes, the telecom firm was able to implement a platform from EcoVadis, a provider of globally trusted business sustainability ratings, to achieve seamless integration with minimal configuration.

In addition, the firm wanted to build a validation process, which would make it possible to escalate any question or discrepancy based on their standards. (For example, concerns about the sustainability policy may require escalation to the responsible business area. This step can affect areas such as commercial, compliance, legal, sustainability and finance.)

By leveraging the capabilities of GEP and EcoVadis, the enterprise was able to add parameters such as environment, labor, ethics and sustainable procurement when onboarding suppliers. As a result, the telecom giant was empowered to maximize its procurement spend and supplier relationships in achieving its corporate sustainability commitments and goals.

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Business Sustainability Ratings

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100 Walnut Avenue, Clark, NJ 07066 | P 732.382.6565 | info@gep.com | www.gep.com

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