

# ESG In Supply Chain: Creating a Sustainable Value Chain



We all know just how valuable the supply chain is. And if there's anything the COVID-19 pandemic has taught us, it has been just how fragile they can be as well, given all the shortages we've dealt with across global supply chains thanks to various supply chain disruptions.

As we become more aware of climate change and how it can affect the supply chain, environmental, social, and corporate governance, better known as ESG practices are now more important than ever.

They have transitioned from something that is nice to have to something that is necessary for everyone to work toward and achieve as soon as possible.

There are many reasons for companies to focus on ESG issues. You may want to satisfy customers who are increasingly shifting towards brands with strong ESG credentials even if that means higher price tags.

Or, they made you may be trying to stay ahead of increasingly strict regulations. It's also possible you're motivated by pressure from investors and banks, seek to boost employee engagement, or wish to attract and retain better talent.

For most companies, the answer is a combination of these factors which add up to

needing to understand and manage environmental impact across every part of your business, working toward supply chain sustainability.

Beyond that, it's about social responsibility, not just to your local community, but to the world in general.

Leading organizations are already reaping the benefits from their efforts. The top ESG performers experience faster growth and higher valuations than competitors in their sectors by 10 to 20% in every case.

Strong and sturdy credentials drive down costs by as much as 10% since these companies are focusing on operational efficiency and waste reduction.

Excelling in DSG reduces transition risk by helping organizations stay ahead of changes in regulation and stakeholder sentiment.

## **Getting Started with Environmental, Social and Governance Practices**

ESG leadership begins with the top but it can't stay there if you want to make a real impact.

That's where procurement's role becomes so crucial. Many organizations are already running incredibly successful initiatives to optimize resource consumption within their operations and engage with their local communities.

But, the social and environmental footprint of a business goes well beyond your walls. For most products, 80 to 90% of greenhouse gas emissions are Scope 3 which are indirect emissions that occur across a company's value chain such as embedded in missions in purchased goods and services, employee commutes, and how products sold are treated at the end of their lives.

Of all these emissions, 2/3 of them usually come from the upstream supply chain. These suppliers are more difficult to monitor which increases the risk that import labor or environmental practices remain unnoticed.

The procurement function is the primary interface with your upstream supply chain so it has a decisive role in shaping your ESG footprint directly through purchase decisions and indirectly by its influence on product design.

Speaking with chief procurement officers (CPOs), we found that they clearly understand how significant their permission position is, but many companies are still struggling to transform that understanding into a clear vision of a sustainability strategy that procurement can actually use.

## **Survey Says: The State of Current ESG Affairs**

According to a recent survey of 20 CPOs at large European companies, 60% know where they wanted to be, but didn't have an aligned sustainability strategy.

Only 20% said their organizations use sustainability measures as primary criteria and sourcing decisions and supplier reviews. And less than 10% said sustainability was part of category strategies.

When asked why the CPOs hadn't built the ESG strategy into the organization's sourcing processes, it was clear that many felt they lacked the tools, skills, and information required. 70% of the CPOs said their organizations didn't understand where scope 3 emissions came from in their value chain.

90% said they had a hard time identifying the correct actions necessary to move the needle and nearly 75% of them said they didn't even know what ESG targets to set in the first place.

## **Creating an ESG Strategy Across the Entire Supply Chain**

CPOs know and accept that there is a significant amount of work required to create the sustainable procurement function that needs.

What many fail to realize however is that many organizations, especially those with mature and established procurement capabilities, already have the foundation's in place that they need.

The procurement function already has access to rich data on its upstream value chain. They know exactly how much a company buys, where it comes from, and who makes it.

Your organization can build on these foundations by using a holistic approach to develop new ESG-focused data, capabilities, and processes.

It requires three basic steps which together make sustainability and ESG in general, part of the way the company operates, starting with what if it's yours and ending with how it sells and supports customers.

## **Step One: How Good Could We Be?**

It's impossible to know how to get where you're going without first establishing where you are and exactly where you want to go. For procurement organizations, you can address these questions in multiple ways.

To understand your supply base ESG footprint, use an internal approach to ask suppliers to provide detailed information about their own ESG impact. Consider it overall as well as by category.

If suppliers aren't willing to provide this information, you can also use external data sources provided by ESG analysis and rating companies.

These analyses will be incomplete, but provide a top-down evaluation of your supplier base to help procurement take the lead in finding the most significant risks and Improvement opportunities throughout the value chain.

To get started, determine your baseline benchmarks and how far you want to go. Understand and quantify your organization's current ESG footprint.

Find the most significant risk areas and look for chances to improve. Prioritize things based on what matters most in the context of your company's overall ESG agenda. Set ESG goals and targets for sustainable procurement.

*Start small and make adjustments based on data. Trying to tackle too much at once will harm your ESG efforts.*

Some areas to focus on could be:

### **Human Rights**

Making an effort to improve working conditions not just at your company, but in the factories where your raw materials come from. More than that, will you work

to expand workplace diversity, hiring more individuals of color and from other marginalized groups?

## **Environmental**

Will you work to reduce emissions, not just by transitioning to LED lightbulbs, but by engaging with suppliers that also use sustainable manufacturing processes so that you truly have a sustainable supply chain?

As you choose the areas to focus on, use data to support your decision-making. Consider the costs, reputational risk, supply chain risks, etc. of each focus area.

It's also a good idea to benchmark your ESG performance against your competitors and major players and other Industries. This can help you find where your current ESG strengths are and show you where you need to improve to either match or outperform the industry norm.

If your company is serious about building sustainable procurement practices, it's a good idea to take a deep dive into the ESG performance of your most important value chains.

Work with case studies to conduct an ESG teardown of your supply chain looking at the environmental and social impact of activity through each Supply chain change here.

Companies are also building upon evolving practices that they're already using with data and analytics. Procurement experts have been familiar with using a clean sheet analysis of components in raw material cost.

Using resource clean sheets builds on that foundation to create a granular assessment of the monetary cost and the carbon footprint of every component in the manufacturing step involved in making a product.

Over time, this approach creates a common language that engineering is sustainability organizations can use to quantify and evaluate materials and Technology against the cost of admission trade-offs.

These kinds of exercises require good sources of data and skilled analysts, but they are an incredible way to pinpoint major sources of greenhouse gas emissions.

## Step Two: How Do We Get There?

After you understand your ESG footprint, you can start to implement new practices that address risk and create value. You can integrate many of these practices into your standard sourcing and supplier management processes. The main thing is to consistently reinforce the DSG always matters and should be priority.

A consumer products company for instance, decided to take action when it found out that an overseas component supplier used unfair labor practices.

These practices representative represent reputational risk to the company and also threaten the stability of its supply chain because switching to an alternative supplier resulted in significant delivery delays.

In response, the company introduced a new requirement that all potential suppliers provide documentation of their EST practices as part of its standard RFX (request for x) process.

The first time they ran the exercise, only seven of 12 candidates suppliers were able to submit the information. Since the cost of mitigating risks are regular supplier checks an audit outweighs any potential savings suppliers without strong East G practices provide, the company included the presence of the systems and its primary supplier qualification criteria for all future sourcing projects.

Regardless of what your priority initiatives are, you could consider including them as part of the RFX process and why suppliers accordingly in addition to other criteria such as delivery performance, cost, and quality.

Establish your core initiatives and the ones that will drive value creation.

Define the ESG metrics and policies that you will integrate into your standard supply selection, procurement, and supply chain management processes.

Choose a number of ESG themes to focus on and address them with in-depth cross-functional Improvement and innovation initiatives. For example, consider collaborating with value chain partners to reduce carbon emissions in the intensive areas of your supply chain.

What ESG criteria will you use as you work on supply chain optimization for risk mitigation and social impact?

Will you start donating a percentage of your profits to your local community (or the local communities affected by your business operations?) Will you offer incentives to your employees who perform volunteer work in the community to give back?

## **Step Three: Making it Happen**

Make the organizational shift. Scale-up and roll out successful initiatives. Integrate sustainable purchasing practices in your organization and continuously train your procurement team on sustainable procurement practices and how to use them.

Track your performance against your targets. then adjust, re-evaluate, and add additional initiatives so you have a consistent ESG strategy that works across the entire organization and makes a real difference.

Including sustainability as a practice along with other ESG initiatives is not an overnight thing. It will take time, and dedicated effort to bring to reality. However, the payoffs will easily justify continuing reinvestment in ESG initiatives.

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