

6 STEPS

FOR PROCUREMENT
TO DRIVE ESG EXCELLENCE
FOR THE ENTERPRISE



6 STEPS FOR PROCUREMENT TO DRIVE ESG EXCELLENCE FOR THE ENTERPRISE



Introduction

Changing consumer trends, the rise of activist investors, and tightening of government regulations have made sustainability a top priority for many organizations across the world. And if ambitious corporate sustainability targets are to be met on time, all parts of the business will need to transform their operations, including the procurement function.

Indeed, procurement teams are uniquely positioned to respond to the challenges and opportunities in this shift towards sustainability, sitting as they do at the intersection of all arms of the business and its suppliers.

As such, procurement shouldn't simply keep pace with the demands of the business when it comes to sustainability but act as a catalyst to drive change and exceed targets. In order to do so, chief financial officers and chief procurement officers need to equip their teams with the right methodologies and expertise.

While procurement's efforts have traditionally been centered around costs, adopting a holistic framework with environmental, social, and governance (ESG) aspects will support sustainable decision-making and unlock benefits in terms of company value and growth, ecological footprint, and social equity.

Reimagining cost to focus on ESG-based value empowers procurement to drive the sustainability agenda and maximize value for the wider business. This is pivotal in today's world, where companies that act quickly gain competitive advantage and are seen favorably by consumers, investors, and policymakers.



Figure 1: The 8 holistic benefits of ESG improvements in organizations

Source: GEP

DEVELOPING AN ESG FRAMEWORK FOR PROCUREMENT

In many organizations, C-suite's sustainability goals and procurement's ways of working are out of sync. Recent years have seen multinationals across industries establish or expand functions tasked with strengthening the business's wider sustainability credentials.¹

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These functions commonly adopt a holistic understanding of sustainability, encompassing ESG aspects.

However, this clarity of purpose towards ESG norms has permeated to relatively few procurement functions. Indeed, business pressures due to the COVID-19 pandemic again made cost savings a top priority for procurement and sourcing professionals in 2021.ⁱⁱ

To drive and enable ESG optimization, procurement needs to engage all parts of the business to redesign their processes and methodologies and recalibrate their target-setting. Procurement also needs an ESG focus into the full scope of its responsibilities.

From strategy to execution to operational processes, procurement teams and systems need to be enabled with the right ESG insights to consistently make decisions in line with company goals.

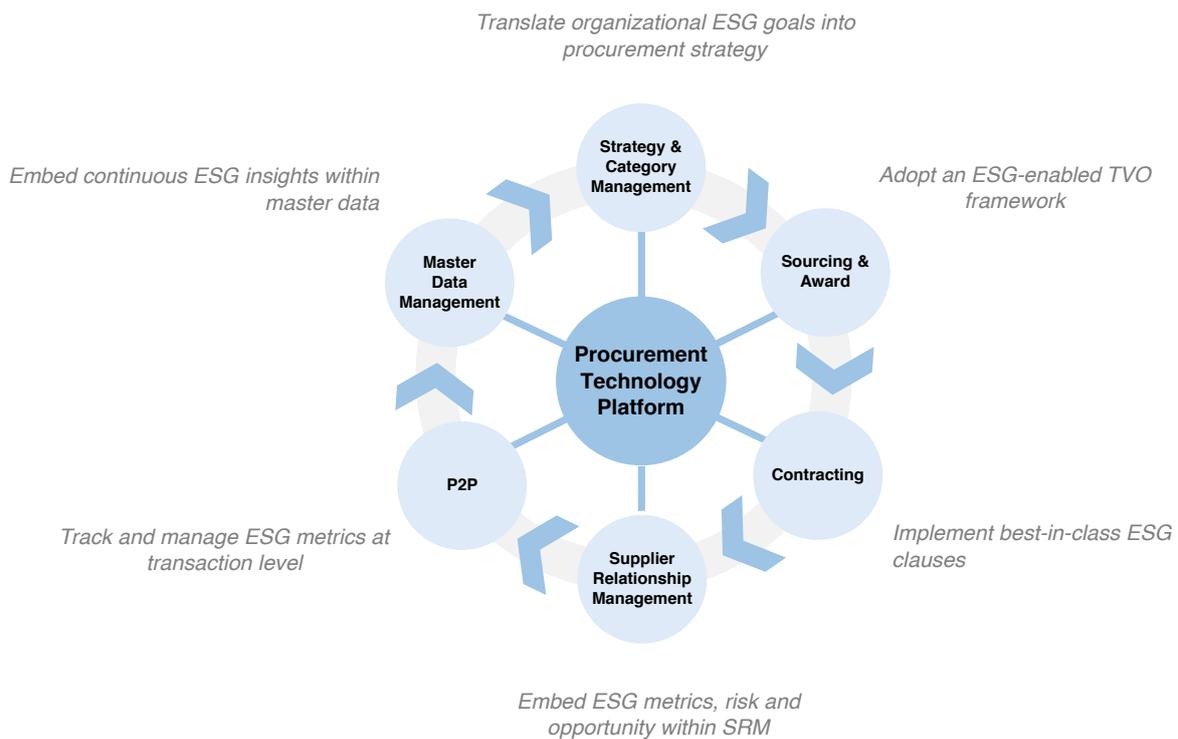


Figure 2: A simplified view of procurement’s service areas, responsibilities, and key actions. An ESG mindset should be embedded across the board to enable success.

Source: GEP

Each company’s ESG framework for procurement is unique to its maturity level, existing capabilities and technologies. Developing it through cross-functional collaboration ensures alignment with the company’s overall goals as well as with key stakeholders’ targets and aspirations.

Here are six steps to go about this:

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1. Translate organizational ESG goals into procurement strategy

Optimizing procurement activities for ESG performance starts with refreshing the procurement strategy to reflect the organization’s ESG goals. For this, organizations should implement a four-step approach.

- i. **Translate organizational ESG goals into procurement-specific and category-specific key performance indicators (KPIs).** This should be done in a way that procurement is mandated to monitor business ESG performance and is incentivized to identify and realize ESG opportunities. These KPIs are specific to organizations but some common examples can be:
 - o X% spend with local and/or diverse suppliers
 - o Total greenhouse gas emissions in carbon dioxide equivalent
 - o X% share of recycled materials in manufacturing or packaging
- ii. **Gather data at the category and supplier levels to identify ESG risks and opportunities across the supply chain.** A lack of supply chain visibility will jeopardize any effort to embed sustainability into the organization. Analyze spend and mark regions, sub-categories, and pipeline opportunities with the biggest ESG impact (for example, product innovation, carbon footprint, labor intensive, outsourcing, recycled content, supplier diversity, supplier’s diversity, and inclusion requirements, and local sourcing).

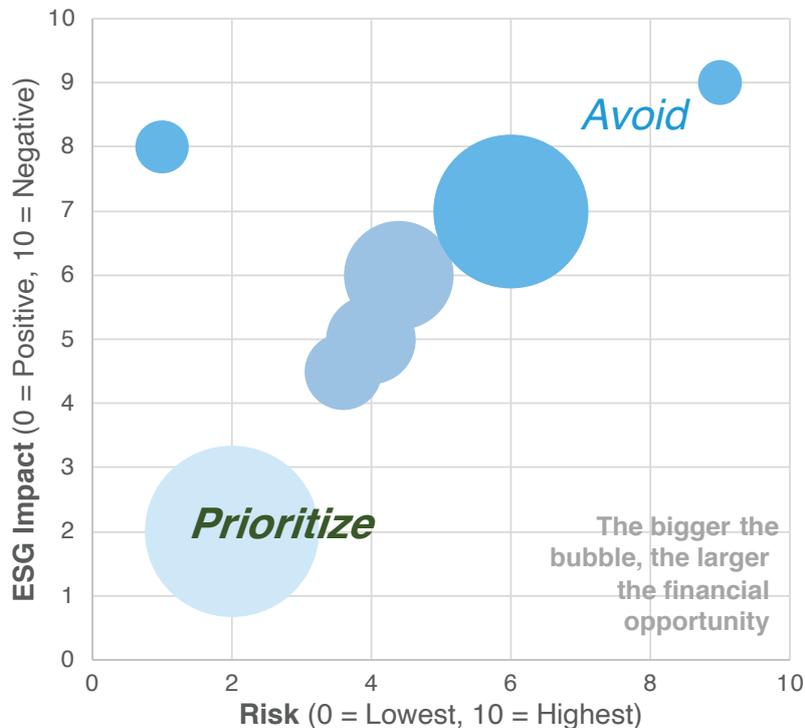


Figure 3: Illustrative output of a category-level ESG assessment

Source: GEP

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- iii. **Prioritize areas with highest risk and largest opportunity to achieve ESG KPIs and improve triple bottom line.** Create a cross-functional project plan with clear milestones, roles, and responsibilities.
- iv. **Continuously monitor ESG KPIs to measure progress.** Also, continue to tweak and optimize the total-value-of-ownership (TVO) framework.

2. Adopt an ESG-enabled TVO framework for strategic sourcing

Among early-adopter organizations that have started to embed sustainability criteria into supplier selection processes, there remain four common shortcomings that prevent procurement from operating as a true catalyst for ESG within the business. These are:

- i. **A narrow view of sustainability:** Many organizations have criteria that focus heavily on specific topics such as CO₂ emissions or modern slavery rather than on a holistic ESG definition of corporate sustainability.
- ii. **Checkbox exercise:** Forms and tools require binary answers and certifications. Any supplier meeting the criteria (often self-certified) passes and is judged overwhelmingly on price and service levels, with sustainability credentials holding little weight in decisions to award the contract.
- iii. **Cost-based targets:** Procurement's contribution to the business is measured in savings and cost reduction, and procurement teams are accordingly incentivized to focus their efforts on these two criteria.
- iv. **Cost over value:** Outgoing cost remains a key quantitative metric for supplier evaluation and comparison. An assessment of the universal value that a given project or supplier can bring to the business is rarely central to decision-making.

Organizations aspiring to avoid these shortcomings and embed best-in-class sustainability practices into procurement activities – and therefore into the broader supply chain and business operations – can do so by adopting a TVO methodology.

The TVO approach balances the benefits and costs of different outcomes to evaluate which one delivers the best overall value. This involves quantifying previously qualitative ESG factors, or linking other quantified ESG metrics to cost, and is typically best done by scoring benefits and costs.

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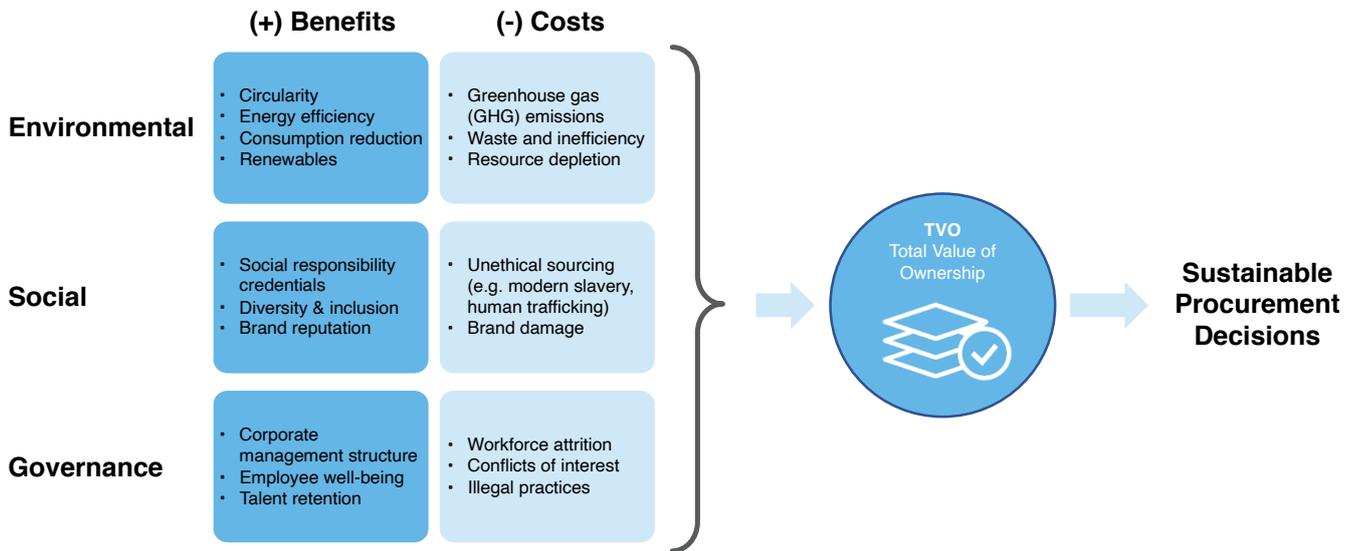


Figure 4: High-level TVO decision-making methodology, considering ESG factors

Source: GEP

Procurement can apply this TVO lens to help the business reimagine costs. That is, the concept of cost to the business – and procurement’s role in reducing it – is recalibrated to better balance holistic returns on investments as well as incorporate intangible costs and benefits. This is part of the effort to drive a mindset shift in how the organization approaches spending and is key to achieving the organization’s ESG goals and creating net value.

3. Implement best-in-class ESG contract clauses

The contracting stage of a new or incumbent supplier relationship is key to supporting ESG efforts. Without robust sustainability clauses built into contract templates as a standard, procurement and the wider business cannot maintain visibility on ESG compliance and progress, nor can they identify issues and hold suppliers to account.

EcoVadis, a global provider of business sustainability ratings, proposes a frameworkⁱⁱⁱ for assessing the maturity and effectiveness of ESG clauses in commercial contracts. The framework is a qualitative scorecard against six criteria:

- i. **Precision**
- ii. **Verifiability**
- iii. **Enforceability**
- iv. **Coverage depth**
- v. **Contextualization**
- vi. **Consistency**

It is imperative that procurement teams work with the legal team to optimize both standard and bespoke ESG clauses

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to be used across the board. Once equipped with best-in-class contractual templates, procurement needs to be proactive in training teams to use and adapt these for specific circumstances and suppliers.

Too often, such clauses are seen by buyers and suppliers alike as mere boilerplate checkbox exercises. Procurement has a role in promoting active negotiations around these clauses so that these are well understood and suited to the situations these are applied to.

4. Embed ESG metrics, risk, and opportunity within supplier relationship management

ESG criteria should be a core element of any supplier segmentation within a mature supplier relationship management (SRM) program. Suppliers can be evaluated and scored on the basis of risk to organizational ESG goals and the opportunity to support ESG goals.

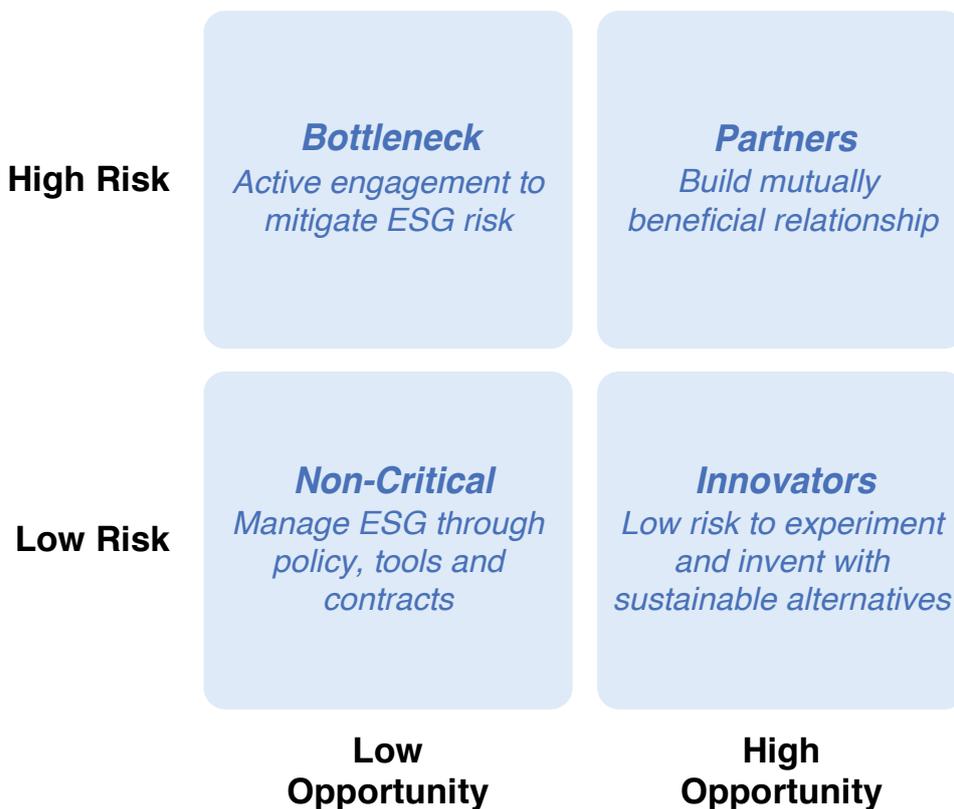


Figure 5: Basic supplier segmentation quadrant from ESG perspective

Source: GEP

A comprehensive SRM program will segment all suppliers in relation to ESG and manage them according to the three pillars depicted in Figure 6. To maximize value from ESG, strategy-focused category managers and business partners should put their focus and effort on maximizing spend through “innovator” suppliers.

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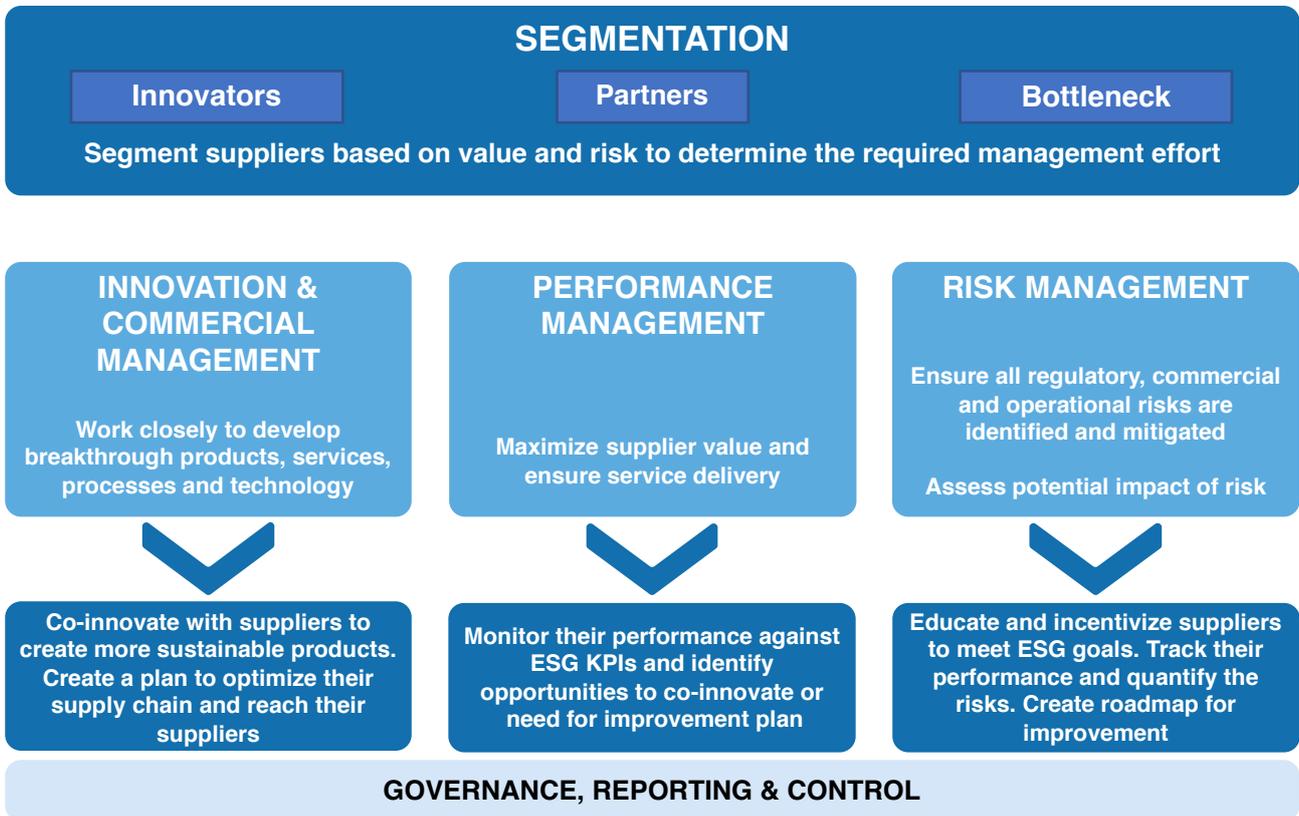


Figure 6: High-level ESG engagement plan per supplier segment

Source: GEP

A key tenet of a successful SRM program is effective communication to suppliers of organizational and category-specific ESG goals. This incentivizes suppliers to support customers in achieving their goals, often by increasing focus on their own supply chains and the second- and third-tier suppliers who are not directly accessible to the customer, such that the whole supply chain benefits.

5. Build ESG into operational process excellence

The strategic ESG mindset from source-to-contract activities needs to also move downstream to activities within the procure-to-pay space. Large organizations typically have many processes, workflows, tools, and teams that require adaptation. This space is similarly a focus area for operational excellence, efficiency and digitalization. It is imperative that process owners do not neglect to include ESG opportunities in any such optimization effort.

For instance, there is often significant ESG opportunity in optimizing guided buying processes and tools to influence or mandate requisitioners to make purchase decisions in line with ESG strategies. This also applies to the upskilling of spot buy teams to systematically deploy ESG evaluations. Collaboration between strategic and downstream teams in these areas ensures tail spend is not forgotten in the drive towards sustainability.

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6. Secure continuous visibility of ESG metrics within master data

Data is key to successfully monitor and achieve ESG KPIs. Later in this series, we will delve deeper into traceability and visibility of ESG metrics across the supply chain. Data will be the first step in helping procurement and the rest of the organization understand their position today with ESG and how to prioritize moving forward.

Conclusion

Procurement departments are well positioned to realize the benefits of organizational pivots towards ESG excellence, and should indeed seize the opportunity to catalyze this shift.

Success in doing so hinges upon direction from top management, as procurement can act most effectively when benefiting from the structure of a consistent and holistic ESG framework that covers all of its activities.

Procurement and finance leaders who act quickly to develop and implement such an ESG framework can unlock competitive advantage for their organizations. To do so, they need to equip their teams with the right methodologies, expertise, and procurement technology to shine.

i https://infokf.kornferry.com/rs/494-VUC-482/images/Korn_Ferry-TheRiseOfTheChiefSustainabilityOfficer-web.pdf?aliId=eyJpIjoiWDc3UjBtNGVuSW1uc1ZXeClInQiOiJsVG9GU0oxSlwvbGpMNzErUXZkRXR6dz09In0%253D

ii <https://www.apqc.org/system/files/resource-file/2021-02/2021%20SCM%20Priorities%20Survey%20Report.pdf>

iii <https://resources.ecovadis.com/whitepapers/sustainability-clauses-commercial-contracts-key-corporate-responsibility>





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