CASE STUDY

"Beyond Compliance: The 5 Pillars Of Sustainable Procurement Value Creation"

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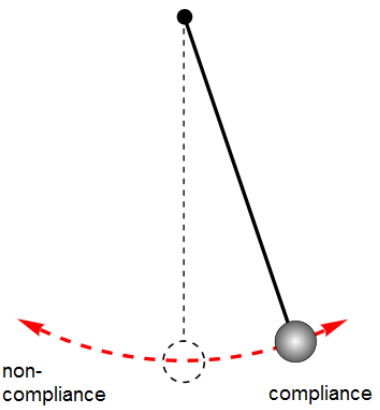
Introduction

Procurement organizations in most industries have been investing "supplier compliance" in CSR/ESG/sustainability, regulatory and other risk related issues. However, once they get several years into a responsible procurement program, many find they are passing the point of diminishing returns with a "compliance" based approach. Risk management devolves into an ever-expanding tactical exercise of re-evaluating the same risks. It can be like a revolving door.

This paper examines the best practices of procurement organizations who have turned the corner toward value creation by rethinking their sustainable procurement programs entirely. Five key elements emerge that have enabled these leaders to shift the focus of their programs to a performance mindset that engages suppliers in long term value. Starting with the first "strategy alignment" phase and continuing through to phase five, "innovating together", these companies are reaping the rewards not only in risk reduction, brand enhancement and new revenue growth, but also in improving their total impact on the planet and the communities they touch.

EXCEEDING THE LIMITS OF THE OLD APPROACH

Risk management is part of the job, but companies embarking on Sustainable Supply Chain are realizing that the compliance approach often doesn't address the root causes, thus problems keep re-occurring. They typically spend a lot of money on auditing and chasing under-performing suppliers. They have a hard time measuring the impact on the bottom line or seeing lasting progress taking place in the action plans. As Nike put it, ***"The suppliers 'yo-yo' in and out of compliance"***.



Apple's procurement team also echoes this experience: "We know audits and follow up on action plans aren't enough to fix systemic issues. As we go deeper into our supply chain to discover and correct problems, we [must] also tackle root causes … to bring about real change". *(Apple 2014 supplier progress report).*

A second factor is that economic growth is driving maturity in suppliers' markets. In China, for example, as it passes the so-called "Lewis point", demand for workers and consequently wages have risen, and with this working conditions have also improved. In many such cases, suppliers have advanced to the point where they already have the basic compliance issues in control (e.g. fire extinguishers, clean toilets, etc.). The concerns are shifting to more complex CSR risks and opportunities that require a management system in place.

The question is, what tools and strategies are companies using to break out beyond compliance? How can you go from supplier monitoring to motivating suppliers to embrace sustainability and innovate beyond the traditional factors of cost, on-time delivery and quality?

5 Pillars For Enabling Value Creation

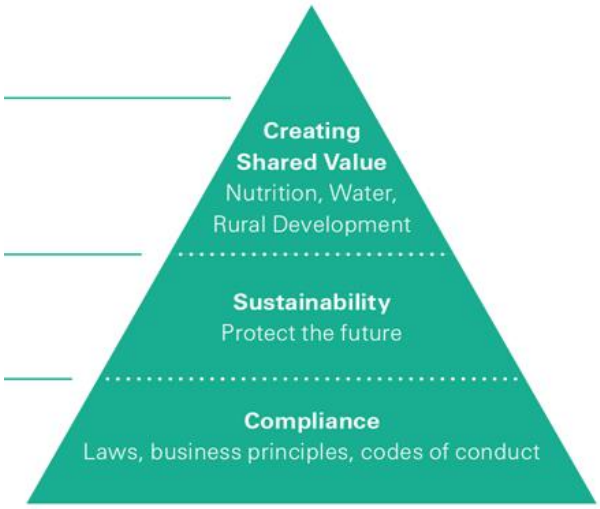
When examining sustainability leaders, five phases of the strategy emerge that enable them to realize value creation from their sustainable procurement programs.

Pillar 1: Aligning the strategy

The first element of a successful transition to value creation in a sustainability program is for the executive team to align the company strategy with this mission.

Nestlé Creating Shared Value

Nestlé is a good example, with their "Creating Shared Value" (CSV) long term corporate goal. As part of CSV, they publicly state 38 commitments in six themes, in which responsible sourcing and supply are firmly embedded such as Environment, Human Rights and Rural Development. This top down support sets a foundation on which functional leaders – such as those in procurement/supply chain and sustainability – can build and execute their strategies to carry out the mission.



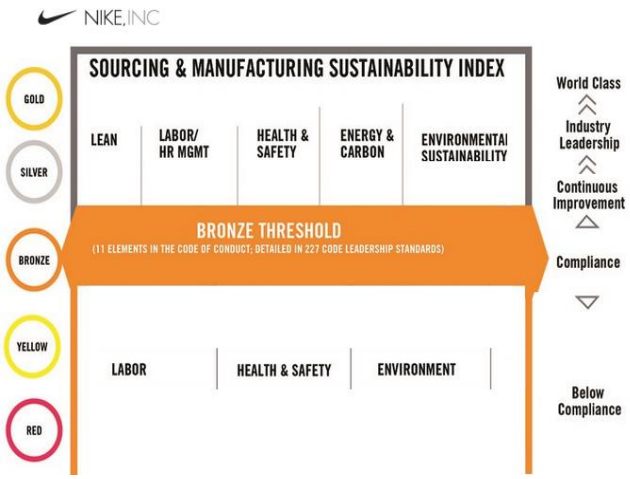
Nike"Rewire"

Nike is another great example of how you can move from compliance management to what they call "impact management". They have transformed their program from chasing compliance to a proactive approach, dealing with problems before they arise. Nike's initiative, named "rewire" (discussed in this Stanford GSB case study) required a fundamental change in organizational structure to create "Integrated Accountability." Nike changed to a matrix organizational structure in which managers report to multiple departments, and each department is accountable for sustainability performance. Also they integrate sustainability into business decisions much earlier in the design process. It is essential to note that top company management has driven the transformation with initiatives being led, and accountability shouldered, by top management.

Pillar 2: New Tools To Measure & Engage Suppliers

Many compliance programs use a 'binary' or narrow range of Pass/Fail criteria which is limited to avoiding risk, but such systems have core limitations: They cannot identify or incentivize suppliers to strive for great performance. Suppliers end up aiming for the minimum required to comply, because there's no mechanism to be recognized for doing more.

Thus, the second element needed is the integration of new tools for measuring and monitoring supplier sustainability performance. By implementing a 'rich' scoring system it not only assures supplier compliance, it gives suppliers a performance mindset. It gives procurement teams a way to rank and benchmark suppliers, so they can identify the top-performers.



Key features of these tools are:

1) A rich scale that provides meaningful targets and room for rewards, and

2) A measurement approach that is adapted to the supplier's business and profile.

Nike Manufacturing Index

As part of the Rewire program, Nike implemented the Manufacturing Index (M.I.) in 2011. The index is used to monitor, measure and reward suppliers on quality, on-time delivery, cost and sustainability performance. The sustainability dimensions of the index covers environmental, social, lean implementation and health and safety issues. Based on performance in each category, each supplier is given a score between 0 and 100, with ranges defined for gold, silver, bronze, yellow or red.

Coca Cola Enterprises uses a Supplier Relationship Management (SRM) system to build the relationship with their key suppliers. In it they track EcoVadis scorecards, with overall and per-theme sustainability scores on a 1-100 scale (see sidebar) along with other supplier performance criteria.

EcoVadis Best practice

EcoVadis provides a 100-point rating scale to evaluate suppliers in four areas: environmental, social, ethical and supply chain management. Suppliers are recognized with Gold, Silver, and Bronze badges for being in the top 5%, 30% and 60% respectively.

It also provides detailed feedback on the maturity of the CSR management.

Pillar 3: Push Ownership Upstream To Buyers and Suppliers

The third step in going beyond compliance is to get suppliers to take ownership of their own share of the goals and mission.

Nike uses its MI index to promote supplier ownership of responsible practices. The essential factor is that it is not a typical "push" model, where you invest in trying to improve suppliers that are frequently underperforming and not complying with minimum standards. They focus instead on a "pull" model which incentivizes suppliers to achieve the **highest performance possible**, in order to benefit from the MI program incentives. With each of the top three achievement levels on the MI scale (**Gold, Silver, Bronze,** Yellow, Red) Nike has defined a set of rewards. The higher the score, the more rewards for the supplier.

The Coca Cola Enterprises (CCE) team has set an ambitious goal for their suppliers to achieve a minimum EcoVadis overall score of 50, and a minimum per-theme score of 25.

Outstanding performance is recognized annually at a "supplier of the year award". If a supplier's score is below expectations, the CCE buyer helps the supplier develop an action plan to improve the score.

EcoVadis best practice:

The EcoVadis scorecard includes a comparative **benchmark**: A supplier's Overall and per-Theme scores (Environment, Labor, Ethic, Supply) can be compared to peers in their industry and/or country of operation. This sets a clear competitive motivation for suppliers to make sustainability improvements and boost their scores.

CCE also is also pursuing topic-specific supplier ownership initiatives such as its "Carbon Challenge". With 65% of their carbon footprint coming from their supply chain, CCE is heavily dependent on their suppliers to move ahead on their sustainability journey. "Carbon Challenge" sets carbon emissions goals for each supplier, where they are responsible for measuring, managing and reporting on their carbon footprint. Depending on the commodity or service the supplier provides, they are given a low, medium or high impact score. Next, they develop carbon improvement plans and finally, share their carbon information. Suppliers are engaged, as they are setting goals and focused on improving performance.

The **GeSI industry initiative** in the ICT sector provides another example, with the ICT Leadership Index which each year recognizes top suppliers with outstanding sustainability performance, based on their CSR performance rating.

Pillar 4: Integration in Procurement Processes

The fourth element for driving results beyond compliance requires integration with the processes and systems: Connecting the dots from the supplier scoring system to the procurement decisions and behavior. This includes both process integration, by setting targets and business rules linked to performance, as well as technical integration by connecting software systems to drive internal adoption.

EcoVadis best practice:

Societe Generale, a leading French bank, gives EcoVadis sustainability scores a 15% weighting among other criteria such as price, delivery, quality, etc., in the RFP selection process for awarding new projects to suppliers.

In Nike's case, sustainability receives a **25% weighting,** equal to each of other three categories of supplier evaluation. Moreover, rewards are scaled by performance: Suppliers must achieve a level of bronze or better to be eligible for priority consideration for new orders. High-performing suppliers gain access to Nike leadership and training on issues such as waste and energy management, and the implementation of lean practices.

At Coca-Cola Enterprises, the supplier's EcoVadis score is integrated into the SRM (Supplier Relationship Management) system. The sustainability score receives **equal weighting** as other SRM criteria when evaluating suppliers. When buyers use the system to evaluate and select suppliers, sustainability performance is truly built-in to their decisions and behavior.

This connection of business decisions to sustainability performance drives behavior change, and higher performance from both buyers and suppliers alike.

Pillar 5: Collaborate to Drive Improvements and Innovation

In order to achieve Nike's long-term vision for sustainability, it recognizes that collaboration with other firms and stakeholders is vital. Nike focuses innovation on proactively "designing out" problems in the supply chain in both products and processes. As Hannah Jones, Sustainability Officer at Nike says:

> *"Only innovation will make the difference because these issues are simply too big and complex for Nike or any one business to address on its own. We need coalition to drive systemic change at scale".*

The integration of 'Lean Principles' that are aligned with sustainability best practices such as reducing resource use and waste, valuing the workforce and reducing downtime is part of the continuous improvement program. Nike provides lean manufacturing training to their subcontractors to build workers skills and improve efficiency. Moreover, they developed a new supplier incentive scheme and began promoting innovation to engage all relevant stakeholders in creating the environment needed for a systemic change to take place.

At CCE their Carbon Challenge program enabled them reduced the carbon footprint of their drinks by 18% in the last three years and collaboration with their suppliers has been critical in achieving this. For example is their collaboration with bottle supplier Ardagh to reuse waste heat in an internal process.

Apple's "SEED" program, Supplier Employee Education and Development, is going beyond performance targets to "empower workers through education", by making direct investments in their supplier's employee development.

> *Apple is committed to providing and expanding educational opportunities for workers in our supply chain. Since 2008, more than 861,000 workers have taken advantage of our Supplier Employee Education and Development (SEED) program, which offers free courses ranging from economics to English. Now SEED is expanding beyond the traditional classroom setting to include more cutting-edge tools, including a new iPad-based learning program. (Apple 2014 supplier progress report)*

The result of this is a supply base with a better-educated workforce, who are better prepared to use their own voice to ensure fair labor practices are present and implemented in those suppliers.

Conclusion

These examples illustrate five key elements that leaders have taken -- some subtle, and some more systemic -- to transform sustainability performance into value creation in their supply chains. Transition from a traditional compliance-based "push" model of pass/fail, to a "pull" model of measuring, rewarding and integrating great performance results in higher ROI by investing in the most motivated suppliers, and creates a more holistic approach to creating value deeper in the supply chain.

Best of all, suppliers may benefit greatly from the approach: By offering suppliers incentives, and measuring performance on a balanced scorecard, these "pull" approaches help to develop suppliers who are committed to growing their business using social and environmental performance as a source of competitive advantage.

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About EcoVadis

www.ecovadis.com

EcoVadis operates the 1st collaborative platform allowing companies to assess the environmental, social and ethical performance of their suppliers on a global basis. Combining technology and CSR expertise, EcoVadis helps businesses reduce risk and drive performance and innovation in their supply chains.

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