

# SUSTAINABLE SOURCING



global  sources

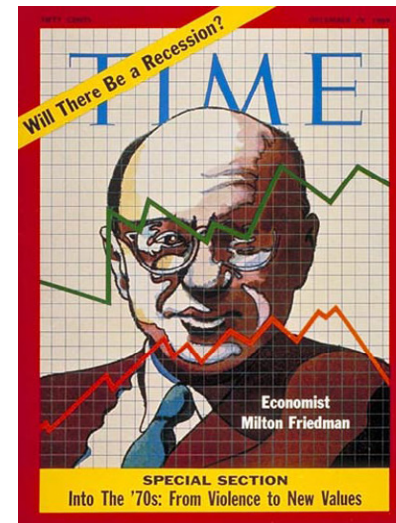
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# Introduction



It seems to have taken a convergence of social movements and public crises over the past few years to put sustainability front and center of the global economy. From global warming to growing alarm over plastic waste suffocating our oceans, from the #MeToo movement to glaring gaps in terms of diversity and inclusion in corporate and political hierarchies, from Black Lives Matter to concerns over unfettered materialism and consumption - these urgent issues have galvanized governments, NGOs, ordinary citizens, celebrities and, critically, young activists. Finally, like an existential über-emergency, COVID-19 has left entrepreneurs, investors, bosses and bankers questioning entrenched business models, production systems and, particularly, supply chains.



"It may well be in the long-run interest of a corporation to devote resources to providing amenities to [its] community or to improving its government. That may make it easier to attract desirable employees, it may reduce the wage bill ... or have other worthwhile effects."

- Milton Friedman, *New York Times Magazine*,  
13 September 1970

# About This E-book

*Sustainable Sourcing* is a deep dive into the challenges, opportunities and practicalities of building sustainability into your supply chain. Written exclusively for Global Sources, this e-book draws on the latest research and analysis from some of the world's leading business and sustainability experts to discuss everything from the business case for sustainable sourcing and the factors driving demands for it, to how you can benchmark, track and prove your company's green credentials, and reap the business benefits.





## Sustainability Issue Goes Viral

"The COVID-19 pandemic has driven home the importance of making our global supply chains more resilient," Ecovadis stated at the conclusion of its Sustain 2021 online conference in March 2021. "As factories scrambled to ramp up production despite staff shortages and government lockdown measures, supply chains were exposed to even greater risks associated with workers' rights, child labor and modern slavery," added the Paris-based provider of business sustainability ratings covering more than 75,000 companies in over 160 countries.

Ecovadis noted the start of the supply shock in February 2020, with China feeling the pinch first, followed by the demand shock triggered by the global economic shutdown. Caught off-guard, governments responded with temporary travel and trade restrictions, stoking public panic amid shortages of critical goods such as food, pharmaceuticals, and medical supplies.

"Now, over a year later, many of these problems have not been resolved," says an Ecovadis.com report from April 2021. "Many companies are still reporting shortages of nearly everything, saying the COVID-19 pandemic has caused supply chain breakdowns."

## Temporary Crisis, Permanent Change

While there were breakdowns in the supply chain, there has been a remarkable shift in the importance key players give to sustainable sourcing. Indeed, a survey by management consultants Bain & Company in late 2020 pointed to a growing consensus among executives regarding the importance of sustainability amid the pandemic disruptions.

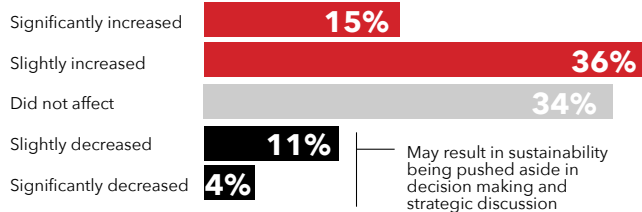
"COVID-19 has increased the importance of sustainability for nearly half of those executives surveyed, with 75% expecting sustainability initiatives to deliver permanent change," writes Jenny Davis-Peccoud and Clare Tovey in their report "Sustainability Efforts Accelerating Despite COVID-19 Disruption", published on bain.com on November 19, 2020.



"The crisis exposed weaknesses in existing operations and opened the door for companies to shorten supply chains and make them more transparent, socially conscious and environmentally friendly. So it wasn't surprising to learn that 43% of executives plan to improve sustainability-related processes," according to the Bain & Company analysts.

### Half of all companies say Covid-19 has increased the importance of sustainability

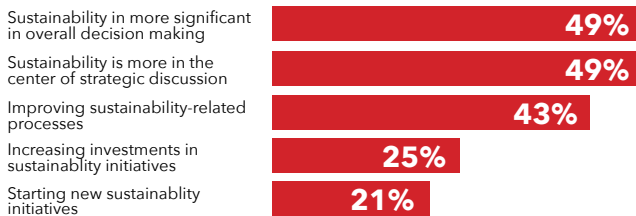
Did recent Covid-19 events affect the importance of sustainability for your company?



Source: Bain survey of global food supply chain executive, August 2020 (n=146)

### Sustainability's rising importance is being felt in different ways

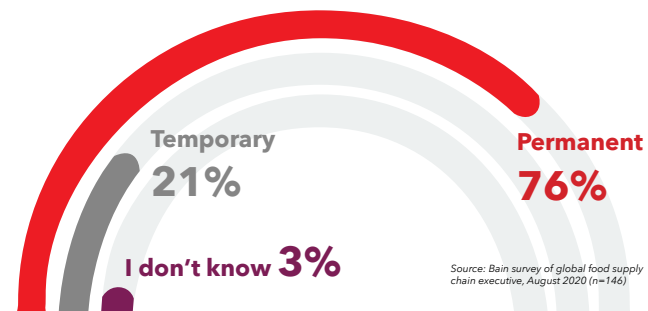
How has the change in sustainability's importance come into effect?



Note: Up to two answers permitted  
Source: Bain survey of global food supply chain executive, August 2020 (n=146)

### Most companies say sustainability will remain important

You expect that effect on the importance of sustainability for your company to be...



Source: Bain survey of global food supply chain executive, August 2020 (n=146)



## The Exceptional Rise of ESG

So what's behind this growing commitment to sustainable sourcing amid the COVID-19 pandemic? Simply put, it makes business sense. "Companies that commit to sustainability during the COVID crisis will come out stronger, with more solid customer and supplier relationships, enhanced corporate reputations, and improved employee loyalty and productivity," according to Davis-Peccoud and Tovey.

Another management consultancy giant, McKinsey & Company, echoes this conclusion, highlighting the importance of sustainable supply chains under the banner of ESG - investing and doing business guided by good Environmental, Social and Governance principles.

"Shareholders and stakeholders do not compete in a zero-sum game. Quite the opposite: building a strong connection with broad elements of society creates value, not least because it builds resilience into the business model," McKinsey

noted in its November 14, 2019 report, “Five ways that ESG creates value”.

“Compromising your connections with stakeholders simply to make earnings targets, on the other hand, destroys value. It’s the essence of short-termism, measurably and overwhelmingly harmful to most shareholders’ economic interests,” McKinsey adds. “Businesses need to satisfy the needs of their customers, employees, and communities – these days, often a global community – in order to maximize value creation. Thriving businesses concerned with long-term horizons fuel a virtuous cycle. They create jobs, increase tax revenue, and raise standards of living. ESG helps generate wealth, and wealth is not a fixed pie.”

Before slicing into that pie, it may help to backtrack a little and define sustainable sourcing as a business and production model.

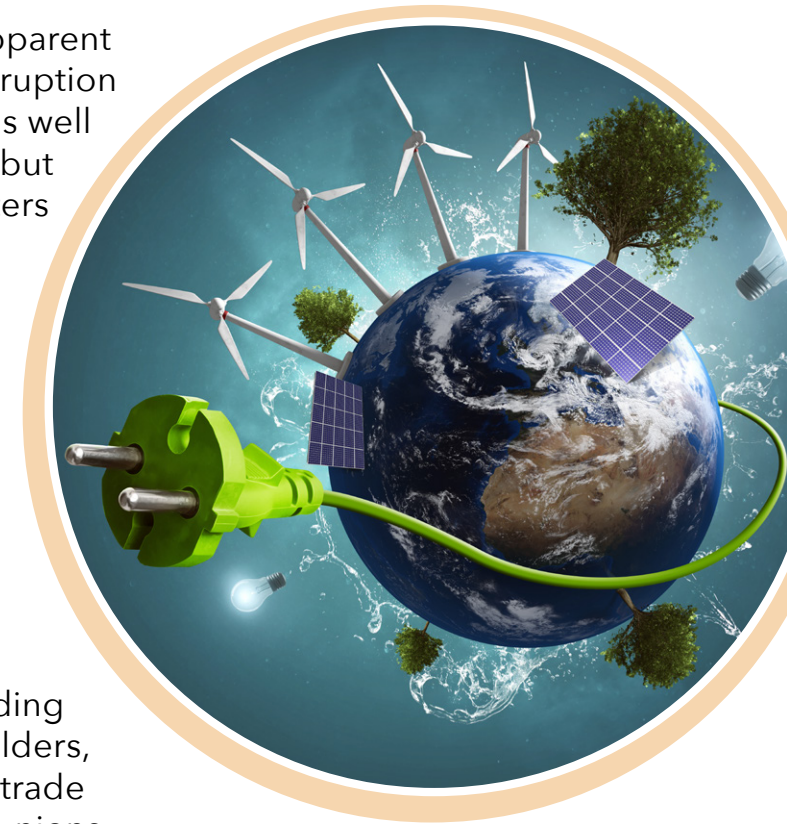
## What is Sustainable Sourcing?

Ecovadis gives a very straightforward definition: “Sustainable sourcing is the integration of social, ethical and environmental performance factors into the process of selecting suppliers.”

Although stated rather differently, these three factors still echo the ESG parameters highlighted by McKinsey. According to Ecovadis, sustainable sourcing has become even more important as companies – looking to cut costs and boost production – include developing countries in their supply chains, especially for food and clothing. In these nascent economies, non-local companies could be exposed to various

risks, such as the apparent issues of supply disruption and cost volatility, as well as the less obvious but equally crucial matters of compliance with local laws and regulations, and other potential pitfalls that could hurt their brand reputation.

“Companies must meet the growing expectations of stakeholders (including customers, shareholders, employees, NGOs, trade associations, labor unions, government observers) to take responsibility for their supplier’s environmental, social and ethical practices,” Ecovadis explains. “The ultimate goal of sustainable sourcing is to build strong, long-term relationships with suppliers. Improving performance in environmental, social and ethical issues is becoming a major part of the overall process. Working toward this has become an extension of the company’s commitment to corporate responsibility and as such becomes a part of the overall business structure and model.”





## Focusing on

Digging down deeper, Ecovadis zeroes in on sustainable procurement, where corporate social responsibility (CSR) principles are integrated into procurement processes and decisions, without ignoring the requirements of the company and its stakeholders.

“Sustainable procurement is not simply about not using child labor or illegal chemicals that can damage the environment and peoples’ health,” Ecovadis clarifies. “Commitment in sustainable procurement ensures values which are core to the business are integrated through a company’s supply chain into the life cycle of its products and services... Policies and strategies for sustainable procurement developed by companies are based on the need to future-proof themselves primarily around scarcity in supply and ability to cope with the demand of emerging markets, cost

pressures, and ability to reduce this through reductions in energy consumption and waste reduction.”

Crucially, outsourcing companies that take sustainable procurement seriously can protect their brand reputation through detailed risk management and by fixing weak areas that could fuel scandals and bad publicity. If done properly, sustainable procurement can help companies rise above the competition through the development of innovative products and services that are also relevant to their markets and customers. If done wrong, it can prove disastrous, because “as much as 90% of a company’s environmental impact may be caused by the supply chain, putting people, communities, and brand reputation at risk,” according to an Ecovadis.com report in April 2021.

## Back To The Essence of ESG

As far as McKinsey is concerned, sustainable sourcing and sustainable procurement are part and parcel of the ESG-driven business model. For the purpose of this report, ESG and sustainable sourcing are used interchangeably, given the near universal overlap of the two concepts.

The environmental criteria cover energy usage, waste discharge, use of other resources for production, and the overall impact not just on humanity but on every living creature. "The Environmental criteria encompasses carbon emissions and climate change," McKinsey adds. "Every company uses energy and resources; every company affects, and is affected by, the environment."



According to McKinsey, the social criteria cover the relationships and the reputation a company has with the public and the institutions in its host community. "This includes labor relations and diversity and inclusion. Every company operates within a broader, diverse society," McKinsey adds.

Finally, McKinsey defines governance as "the internal system of practices, controls, and procedures your company adopts to govern itself, make effective decisions, comply with the law, and meet the needs of stakeholders." In short, as a legal entity, every company requires good governance.



## The Value of Sustainable Sourcing

So why is ESG so important to 21st century businesses? In August 2019, the highly influential US Business Roundtable strongly affirmed the business sector’s commitment to its various stakeholders, including customers, employees, suppliers, communities, and, of course, shareholders - the very parties that the ESG model aims to satisfy.

“Of a piece with that emerging zeitgeist, ESG-oriented investing has experienced a meteoric rise,” McKinsey reports. “Global sustainable investment now tops US\$30 trillion - up 68% since 2014 and tenfold since 2004. The acceleration has been driven by heightened social, governmental, and consumer attention on the broader impact of corporations, as

well as by the investors and executives who realize that a strong ESG proposition can safeguard a company’s long-term success. The magnitude of investment flow suggests that ESG is much more than a fad or a feel-good exercise.”

Contrary to most expectations, companies that adopt ESG principles are not hampered in their value-creation drive. In fact, according to McKinsey, the opposite is true, based on accumulated research. “A strong ESG proposition correlates with higher equity returns... Better performance in ESG also corresponds with a reduction in downside risk, as evidenced, among other ways, by lower loan and credit default swap spreads and higher credit ratings,” it says.



### **ESG Can Help Boost Cash Flow**

Many people might assume that compliance with ESG principles could be costly. While that may be true in the initial stages of ESG adoption, the long-term benefits to cash flow are undeniable. In a 14 November 2019

report in the McKinsey Quarterly, the consulting giant says ESG can have five virtuous effects on cash flow by boosting top-line growth, cutting costs, minimizing regulatory and legal interventions, improving employee productivity, and ensuring that investment and capex are optimized.

“Each of these five levers should be part of a [business] leader’s mental checklist when approaching ESG opportunities,” McKinsey says. “The five links are a way to think of ESG systematically... Some are more likely to arise in certain industries or sectors; others will be more frequent in given geographies. Still, all five should be considered regardless of a company’s business model or location. The potential for value creation is too great to leave any of them unexplored.”



### **Good for Gatekeepers, Customers & Costs**

Good corporate reputation engendered by ESG adoption can also be a key tool in expanding businesses in situ or tapping into new markets. “When governing authorities trust corporate actors, they are more likely

to award them the access, approvals and licenses that afford fresh opportunities for growth,” McKinsey says.

Then there’s consumer preference. According to McKinsey, research has shown that customers are willing to pay to

“go green”, with more than 70% consumers surveyed (with confirmed purchases in multiple industries such as the automotive, building, electronics, and packaging categories) saying they are willing to pay a 5% premium for a green product that meets the same performance standards as a non-green alternative.

Indeed, as reported by Sustainable Brands, 85% of consumers are more likely to buy from a company with a reputation for sustainability than from a neutral company.

ESG adoption can also slash operating costs, such as those for raw materials and the true cost of water or carbon – which can affect operating profits by as much as 60%, according to McKinsey research. The consultancy cites the case of US conglomerate 3M, which has confirmed savings of US\$2.2 billion since introducing its “pollution prevention pays” (3Ps) program, in 1975. The scheme involves reformulating products, improving manufacturing processes, redesigning equipment, and recycling and reusing waste from production. Another case is FedEx, which has already reduced its fuel consumption by more than 50 million gallons – simply by converting 20% of its 35,000-vehicle fleet to electric or hybrid engines. More savings are expected as FedEx aims for full conversion.



### **Inspiring Employees and Partners**

On a much more intangible level, strong adherence to ESG principles can boost a company’s ability to “attract and retain quality employees, enhance employee motivation by instilling a sense of purpose, and increase productivity overall,” says McKinsey, pointing to

the positive correlation between employee satisfaction and shareholder returns.

“Just as a sense of higher purpose can inspire your employees to perform better, a weaker ESG proposition can drag productivity down,” McKinsey warns. “The most glaring examples are strikes, worker slowdowns, and other labor actions within your organization.”

Companies with inadequate ESG commitment also face various risks if they fail to check on their primary suppliers, purchasing agents and subcontractors. As some of these third-party players down the supply chain can be managed loosely, companies that source from them can be tainted with the same scandalous brush, such as cases involving the neglect of workers’ health and safety.

McKinsey shares that, to avoid potential damage to their brand reputation, some companies have adopted mechanisms to ensure that their suppliers strictly comply with their ESG pledge. For instance, Walmart monitors the working conditions at their suppliers and subcontractors, including those in China, using a proprietary “scorecard”.



### **Creating Value and the Art of Repurposing**

According to McKinsey, companies can enhance investment returns by adopting ESG principles. This can entail the smart allocation of capital or the reassessment and re-channeling of “stranded” investments. The former can mean assigning capital to opportunities proven to be sustainable, such as renewables, waste reduction and scrubbers. In contrast, the latter can mean re-balancing assets,

such as the gradual pull-out from oil-tanker or fossil-fuel investments, as these may not pay off because of longer-term environmental and regulatory issues.

“When it comes to ESG, it’s important to bear in mind that a do-nothing approach is usually an eroding line, not a straight line,” McKinsey says. “Continuing to rely on energy-hungry plants and equipment, for example, can drain cash going forward. While the investments required to update your operations may be substantial, choosing to wait it out can be the most expensive option of all.”

But creating value via ESG adoption need not involve new initiatives. “One way to get ahead of the future curve is to consider repurposing assets right now - for instance, converting failing parking garages into uses with higher demand, such as residences or day-care facilities, a trend we’re beginning to see in reviving cities,” McKinsey adds.

This “future-proofing” can be an insurance against adverse social reactions that can damage a company’s reputation. McKinsey estimates that negative publicity can mean double-digit declines in market capitalization in the short to medium-term following an unfavorable incident. “These days, the tail events can seem to come out of nowhere, even from a single tweet. Playing fast and loose with ESG is playing to lose, and failure to confront downside risk forthrightly can be disastrous,” it says.



## A strong environmental, social, and governance (ESG) proposition links to value creation in essential ways.

|                                    | Strong ESG proposition (examples)  | Weak ESG proposition (examples)   |
|------------------------------------|--|---|
| Top-line growth                    | Attract B2B and B2C customers with more sustainable products<br><br>Achieve better access to resources through stronger community and government relations   | Loose customers through poor sustainability practices (eg, human rights, supply chain) or a perception of unsustainable/unsafe products<br><br>Lose access to resources (including from operational shutdown) as a result of poor community and labor relations |
| Cost reduction                     | Lower energy consumption<br>Reduce water intake  | Generate unnecessary waste and pay correspondingly higher waste-disposal costs<br>Expand more in packaging costs  |
| Regulatory and legal interventions | Achieve greater strategic freedom through deregulation<br><br>Earn subsidies and government support  | Suffer restrictions on advertising and point of sale<br><br>Incur fines, penalties, and enforcement actions   |
| Productivity uplift                | Boost employee motivation<br><br>Attract talent through greater social credibility   | Deal with "social stigma," which restricts talent pool<br><br>Lose talent as a result of weak purpose   |
| Investment and asset optimization  | Enhance investment returns by better allocating capital for the long term (eg, more sustainable plant and equipment)<br><br>Avoid investments that may not pay off because of longer-term environmental issues | Suffer stranded assets as a result of premature write-downs<br><br>Fall behind competitors that have invested to be less "energy hungry"  |

McKinsey  
& Company

## The Business Case for Sustainable Sourcing

According to Ecovadis, ESG or sustainable sourcing/procurement is driven by three key business priorities: cost reduction, insurance against risks, and revenue growth. The first driver means cuts in total cost of ownership linked to reductions in energy costs, over-specification, consumption, as well as social and environmental compliance costs. Among other factors, Ecovadis says, sound sustainability standards can lower the cost of capital, according to 90% of studies on this theme as collated by Oxford/Arabesque.

Meanwhile, the second driver - risk management - can minimize adverse effects in two areas: financial impact on brand value from bad supplier practices (such as child labor and local pollution); and the economic cost of sourcing disruptions (such as non-compliance with environmental

regulations). Citing the World Economic Forum's "Beyond Sustainable Procurement" report, Ecovadis says sustainable sourcing practices can boost brand value by 15% to 30%.

Finally, Ecovadis concludes that sustainable sourcing can help boost revenues through new income streams from innovative and eco-friendly products and services, price



premium, and income from recycling programs. Indeed, in its report on the 'circular economy' (which goes beyond mere recycling), McKinsey points out: "In 2015, we demonstrated that [adoption of a circular economy] could boost Europe's resource productivity by 3% by 2030, generating cost savings of €600 billion a year and €1.8 trillion more in other economic benefits." (This McKinsey report is discussed in detail in the "IN FOCUS: The Circular Economy" section of this report.)

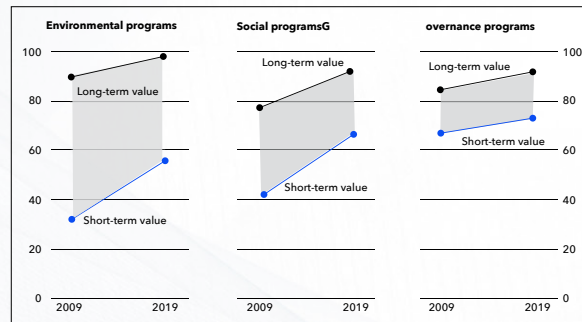
In summary, Ecovadis cites the various benefits of sustainable procurement as follows: minimized risk in business practices; compliance with environmental and social legislation; enhanced consumer perception; control of costs by adopting a wider approach to whole product-life costing; creating markets for new products and services; reduced waste and improved resource efficiency; bolstered competitive advantage; facilitation of access to capital; and increased valuation.

# A Boon for Shareholder Value

ESG's positive impact on shareholder value is confirmed by a McKinsey Global Survey ("The ESG Premium: New Perspectives on Value and Performance", 12 February 2020, McKinsey Sustainability, www.mckinsey.com). The survey found that 83% of C-suite leaders and investment professionals expect ESG programs to contribute more shareholder value within five years.

Furthermore, the share of respondents who say that ESG programs create value has also grown from 10 years ago - and this finding is consistent across various industries (see following graphics).

**Among respondents who say ESG programs create value, the share seeing short- and long-term value has grown.**  
Share of respondents who say given program creates value, %

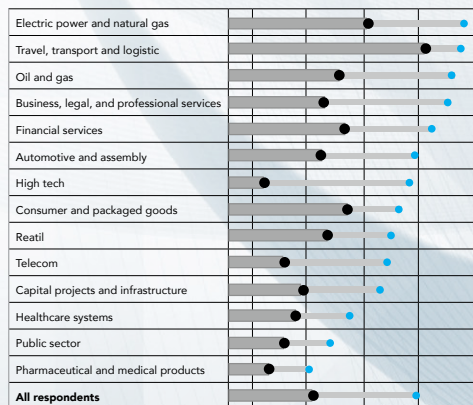


\*Question was asked only of respondents who said environmental, social, and governance programs increase shareholder value. Respondents who said "sustainability negative," or "no effect" are not shown; total n=136 in 2009 and n=342 in 2019.

McKinsey & Company

## Forty percent of respondents expect company sustainability programs to generate value in the next five years—nearly double the current share.

Share of respondents who report or expect "modest" or "significant" value created from sustainability programs, by industry, %



\*Total 7 answer choices presented "significant cost," "modest cost," "minimal to no cost or value," and "don't know;" n=2,421. Only industries that received meaningful numbers of responses are shown.

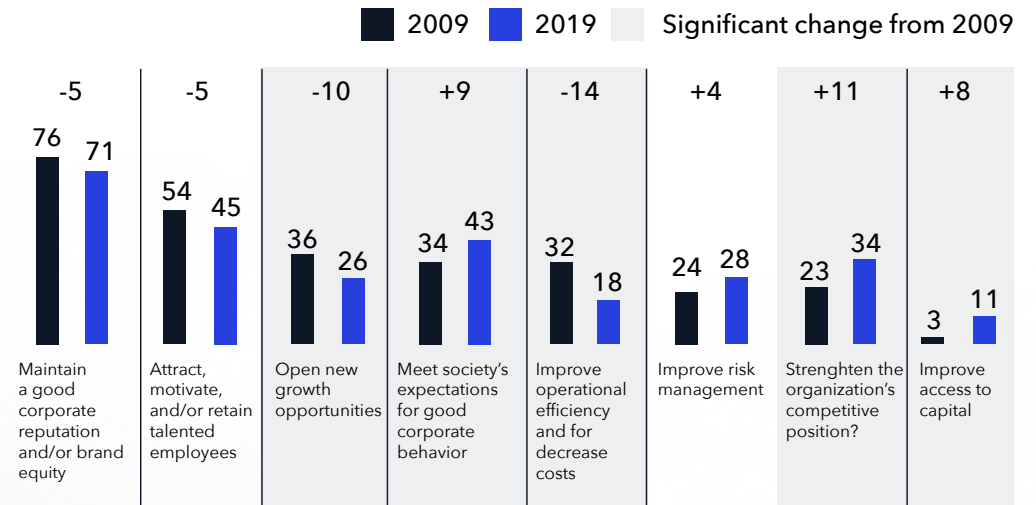
McKinsey & Company

There's also a direct correlation between ESG programs and best-practice management, McKinsey says. "Maintaining a good corporate reputation and attracting and retaining talent continue to be cited most often as ways that ESG programs improve financial performance," it says, adding that ESG's other intangible benefits "include strengthening the

organization's competitive position and meeting society's expectations for good corporate behavior".

## Perceptions have shifted in the past decade around how ESG programs contribute to financial performance.

**Top ways that ESG programs improve financial performance, % of respondents'**



"Question was asked only of respondents who said environmental, social, and governance programs increase shareholder value. Executives were asked which ways ESG programs improve their organizations' financial performance. Respondents who said "other" or "don't know" are not shown: total n=136 in 2009 and n=342 in 2009.

\*Not statistically significant when controlling for the different roles included in the 2009 and 2019 survey samples.

McKinsey & Company

Interestingly, the C-suite leaders and investment professionals surveyed by McKinsey said they would pay as much as a 10% median premium to acquire a company with a positive ESG record over another with a negative one. "That's true even of executives who say ESG programs have no effect on shareholder value," McKinsey reports.



## Identifying the Good ESG Manager

Given the premium placed on companies with positive ESG record, how does one identify a good ESG business leader? McKinsey offers some tips from its McKinsey Global Survey published on [mckinsey.com](https://www.mckinsey.com) on April 28, 2021. According to the consultancy giant, companies that are able to use their sustainability programs to generate value adhere to a unique set of management practices.

- First, they tend to prioritize sustainability as a business strategy, complete with detailed aspirations and targets. In effect, ESG or sustainable sourcing becomes an essential part of the company's mission and vision statements.
- Second, they are known to integrate sustainability into their corporate culture, making sure it is instilled by training their employees on how to make sustainability principles

an essential part of their work ethics and daily practice.

- Third, effective ESG managers work with their customers and suppliers in tackling sustainability issues and in calibrating their product portfolios to make sure they comply with ESG standards. One way of doing this is to use a sustainability guide when selecting and assessing suppliers.
- Finally, compared to other companies with weak or no ESG programs in place, these ESG advocates are much more likely to monitor their facilities and transportation networks to make sure they strictly follow with ESG principles.

"Sustainability endeavors often make good business sense, promising to deliver revenue gains, cost savings, and other benefits that lift enterprise value," McKinsey concludes.



## **Sustainable Sourcing: Laying the Groundwork**

Notwithstanding the preceding steps to ensure suppliers comply with sustainable sourcing principles, there's no replacing having actual boots on the ground – that is, fieldwork and face-to-face meetings with suppliers, stakeholders and other relevant parties.

Ecovadis suggests the following front-line actions to guarantee strict compliance with ESG or sustainable sourcing principles, particularly in the area of regulatory requirements:

- Check the fine print of the social and environmental legislation in the countries of production of prospective suppliers
- To assess and mitigate against production risks, determine the level of regulatory enforcement in these countries
- Check whether prospective suppliers qualify for independent certification of conformity with recognized social and environmental standards
- Clearly define your expectations to your suppliers – make clear that compliance with all applicable laws is a minimum
- Explore potential risk areas with suppliers, agree on the desired level of performance and incorporate these in the contract. If necessary, use a supplier code of conduct as a benchmark
- Regularly assess the facilities and practices of your suppliers, preferably via independent monitoring, or by organizing random or scheduled on-site visits and worker interviews
- Find out about sectoral initiatives on assessments, and those that can help provide information and training to suppliers on responsible business practices. For instance, suppliers can be asked to provide CSR assessment scores, or industry certificates such as for ISO 26000
- Raise awareness among your purchasing officers of the impact that their buying practices might have on production at the factory level



## Matching Sustainable Sourcing and Suppliers

Zeroing in on the important role of suppliers in ensuring that companies stick to their sustainability pledge, Ecovadis offers some tips on how to ascertain that supply chains are sustainable.

First, Ecovadis advises companies to make sure that sustainability principles are properly defined and integrated into their supplier screening processes. "Typically, the procurement leadership develops a vision that aligns with the company's Responsible Business policy, and then adapts their procurement policies to include Responsible Business in the various processes and criteria for supplier selection and management," it explains.

Second, companies must ensure expectations are clearly set and communicated for suppliers to avoid conflicts of interest and regulatory issues. Ecovadis suggests including such expectations in contracts and in a code of conduct, and the constant underscoring of such requirements in all supplier interactions and communications.

Third, companies should integrate Sustainable Sourcing principles into actual buying practices by providing buyers

the proper vision, training and tools to guide their work and procurement decisions. "This may include new software, training in CSR and responsible business, and a complete change management plan," Ecovadis says, adding that companies should also promote cooperation between corporate buyers, supplier sales team and units of production when planning schedules of production.

Fourth, Ecovadis advises companies to support and instruct suppliers on how to set their own ESG-compliant business standards and to self-assess their performance. "Educate suppliers on the business and community benefits of practicing responsible business," Ecovadis says. "This may include productivity, quality, community support and engagement, and improved recruiting, employee turnover and renewal of contracts."

Fifth, companies should assess and audit the CSR performance of suppliers by enlisting the help of stakeholders for a fair and comprehensive monitoring done over time. Ecovadis suggests that companies within the same industry sector can work together on such assessments to save on costs and ensure efficient implementation of their monitoring programs.

Finally, Ecovadis says companies should manage the expectations of their shareholders and promptly report on their work with suppliers as part of good management practice and to enhance their reputation. "Transparency is the final step to building and maintaining stakeholder trust," Ecovadis says. "The program should produce supplier performance information that can be adapted to include in an annual CSR reporting."



To enhance teamwork and corporate reputation, companies are enjoined to publish progress reports internally and externally over periods of time, such as on the company's website, along with the relevant performance benchmarks. "Companies, governments and public institutions are seeking tools they can use to evaluate sustainability performance and to recognize and reward best practices," Ecovadis says. "Benchmarks and indices provide frameworks and outline best practices for organizations to follow."

Ecovadis suggests using the UN Sustainable Development Goals (SDGs), Global Reporting Initiative (GRI) or the Dow Jones Sustainability Index (SDJI). "But it is also important to benchmark yourself against your peers. This is what really helps you understand where the market is going and what you need to do to retain the cutting edge," Ecovadis concludes.

## Benchmarking and Securing a Buy-in

On the last point stated above, Ecovadis further suggests some best practices on how to formulate and achieve sustainable procurement goals, this time for the company's internal players, particularly those involved in procurement.

Ecovadis suggests that such goals should be clear, easy to implement and measurable. "Show the big picture: how sustainable procurement goals are part of bigger sustainability goals, and how defined results add up to impact," it adds.

Next, for easy and fast buy-in, Ecovadis says goals and key performance indices (KPIs) could be broken down based on program initiatives, such as "People, Planet and Profit", with associated KPIs or departmental initiatives.





## Maximizing the ESG Benefits

On the macro level, McKinsey suggests some guidelines on how executives can focus their companies' sustainability efforts and maximize value creation.

First, it says executives should approach sustainability issues as business opportunities. "Leading companies develop business cases for their sustainability programs based on the value that they stand to create (or protect) through their handling of sustainability issues," McKinsey says. "They set tangible, concrete aspirations for their sustainability programs and convert those aspirations into quantitative performance targets, which reflect their competitive position, their consumers' expectations, and their investors' demands."

Second, to avoid duplication, overreach and sprawl, McKinsey says executives should set up accountability systems across their organizations. This could be centered around business unit that usually generate most of the company's sustainability impacts, such as product-focused teams, or functions-based groups such as supply-chain management, or even geographic departments.

"Unlike the central sustainability team, these departments also have the authority to change day-to-day operations," McKinsey says. "Recognizing this, savvy executives assign responsibility for sustainability initiatives to heads of functions and divisions and give them performance targets. In this way, executives can hold senior managers to account for the company's sustainability achievements."



Finally, McKinsey urges collaboration for maximum impact, since ESG challenges can span industries or regions. The consultancy cites the case of plastic waste, which affects the entire chemicals industry, not just one company. "To address these systemic difficulties, companies might form coalitions with industry peers and work together on setting standards, promoting technological innovation, or advocating for policy shifts," it says. "Since value chains produce the majority of a company's environmental impact, most will also benefit from working closely with their value-chain partners."

## The Push and Pull of Sustainability

At the opening of the “Sustain 2021” virtual conference organized by Ecovadis in March, former US vice-president Al Gore – also the founder-chairman of The Climate Reality Project, a nonprofit devoted to solving the climate crisis – boldly declared: “The sustainability revolution is now well underway.”

Gore noted that sustainability imperatives were already starting to reshape the world, transforming relations between and among people, governments, businesses and the environment. For example, electric vehicles are overhauling transportation and humanity’s historic dependence on fossil fuels, regenerative farming approaches are shaking up agriculture, while renewables are rewiring energy consumption. Similar revolutionary shifts are happening in innovation, corporate governance, investment decisions, consumer behavior and legislation, all reshaped by – and in return reshaping – sustainable sourcing.



### ON THE ENVIRONMENT

The environmental roots and seeds of ESG have been well-explored in this report, but it probably pays to reiterate that the supply chain accounts for as much as 90% of a company’s environmental impact, which means that a weak ESG program can hurt people, communities and brand reputation. The risks entailed are not lost to executives, investors and customers, so much so that, in an April 2021 online article, Ecovadis pointed out that business leaders like Bill Gates and Larry Fink – the billionaire chairman and CEO of BlackRock, an American multinational investment management corporation – have kept climate action on top of their corporations’ agendas. This issue has become even more urgent, what with the 26th United Nations Climate Change Conference, or COP26, just on the horizon, where the Paris Agreement will be renewed.



### ON INNOVATION

Ecovadis also noted that the business case for sustainability has moved beyond business-as-usual factors such as cost saving, reputation, risk management and resource efficiency. “This old-fashioned approach is not enough to address the sustainability challenges we are facing today,” it says. “Innovation is now widely regarded as a core engine for long-term growth, differentiation and competitive advantage. And companies are looking to leverage collaboration with suppliers as a massive lever to scale innovation.” To support its claim, Ecovadis cites the 2018 Global 100 Most Sustainable Corporations in the World index, which found that “the most successful companies see sustainability innovation as a key strategic and tactical advantage.”



### ON ACCOUNTABILITY

In a March 2021 article, Ecovadis.com blogger Pia Pinkawa wrote: “As sustainability becomes an increasingly core issue for companies, stakeholders are demanding greater accountability from companies in terms of their social and environmental actions and the impact of their products and business activities.” Pinkawa noted a record increase both in number and scope of corporations committing to ambitious sustainability and climate neutrality targets in 2020. “More than 10,000 companies now report their data to [the Carbon Disclosure Project], with which over 500 major investors are affiliated,” according to Pinkawa. She cited Mercedes, which includes climate neutrality in its contract terms under its Ambition 2039 strategy. Mercedes’ so-called Ambition Letter has now become a key criterion for awarding contracts to suppliers.



## ON INVESTMENT DECISIONS

In an Ecovadis.com report on December 10, 2020, Matteo Berger noted that investors managing climate-related risks and their financial impacts have been scrutinizing the carbon reduction strategies of target companies before making any investment commitments. "Initiatives such as the Task Force on Climate-Related Financial Disclosures (TCFD) have shown that financial stakeholders are starting to demand more comprehensive greenhouse gas (GHG) emissions data and action from corporate supply chains," he says. Berger adds that investors, lenders, insurance underwriters and other stakeholders of climate-related disclosures are keen on understanding how businesses tackle climate-related issues, as well as management's role in assessing them.



## ON CONSUMER BEHAVIOR

In an August 2020 report on its survey, the Boston Consulting Group (BGC) found that 90% of consumer respondents said they were equally or more concerned about environmental issues after the Covid19 outbreak, while about 95% believed their actions could help reduce waste, tackle climate change, and protect wildlife and biodiversity - with nearly 30% noting that the pandemic had strengthened this belief. "Responsible manufacturing will be a new and potent loyalty driver as consumers become more determined to take control of their impact on climate change," said the authors of the BGC report.

Meanwhile, in a January 2021 article for Ecovadis, Divya Demato - CEO and co-founder of GoodOps, a supply chain sustainability consultancy based in San Francisco - stressed that: "Brands that continue to invest in their sustainability practices will reap the rewards as consumers become savvier and demand evidence against marketing claims. Companies

who have truly incorporated sustainable procurement practices into their product lines will be far ahead of the curve, not only in terms of risk mitigation, but in building consumer confidence."



## ON LEGISLATION

In her March 2021 piece, Pia Pinkawa said: "Financial markets and investors are already driving issues such as sustainability, human rights and decarbonization at an ever-increasing pace around the world, demanding proven performance from companies. However, pressure on companies is also increasing from the legislative side."

In fact, ESG-related legislation also covers the executive actions of governments. As cited by Al Gore at the Sustain 2021 online conference, the US has already rejoined the Paris Agreement while newly elected US President Joe Biden has vowed to budget US\$2 trillion to help shift the US to a clean-energy future. Gore pointed out that China, Japan and South Korea have also made commitments to go carbon neutral within the next few decades.

And at the European Union, the EU Green Deal is awaiting the green light. Using a carbon border adjustment mechanism, this will screen countries with weak climate policy "to prevent carbon leakage and to protect economic competitiveness". According to Gore, this will speed up the "decarbonization" of countries doing trade with the EU. Also, EU member states have endorsed a target to cut their greenhouse gas emissions by at least 55% from 1990 levels by 2030. And human rights due diligence will soon be mandatory for all companies in the EU, thanks to a law that the European Commission plans to introduce this year. Such legislative moves are expected to have global ramifications, especially among companies doing business with the EU.



and is on the path to 100% renewable energy by 2025.”

So how do businesses navigate in this brave new world of Sustainability? The basic step is to come up with or search for an established “risk mapping” of global suppliers, similar to Bridgestone’s Global Sustainable Procurement Policy.

Ecovadis also suggests the formulation of a Supplier Sustainability Program (SSP) strategy along the lines of L’Occitane Group’s #NotJustSuppliers Program, which adheres to the guidelines enumerated in this report’s “Matching Sustainable Sourcing and Suppliers” section.

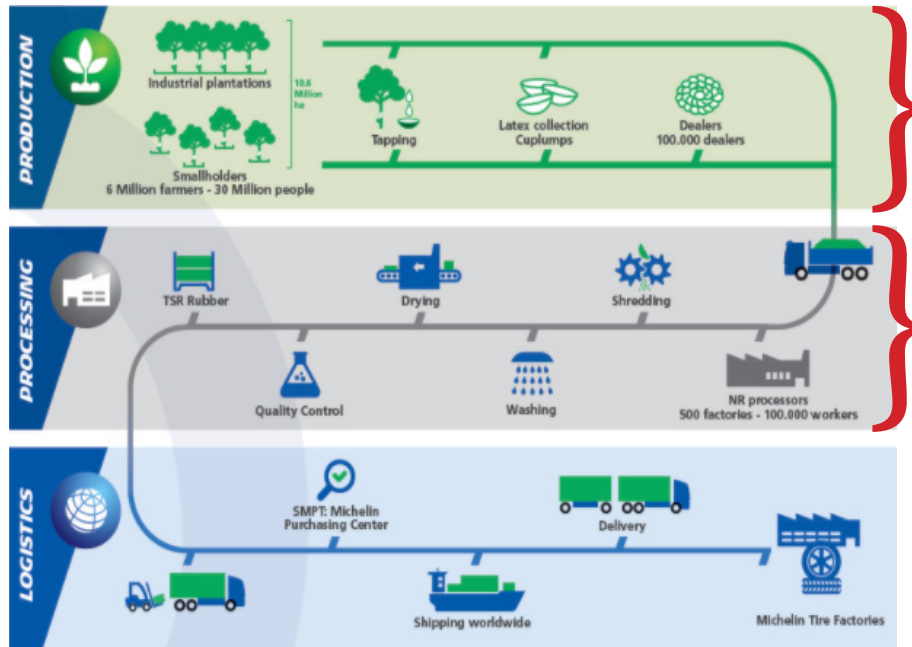
To ensure effective management buy-in, sustainable procurement programs

### **Tips on Securing Sustainable Credentials**

The global trend for sustainable sourcing is undeniable. For instance, in an April 2021 report, Ecovadis noted that companies around the world are tapping into renewables. “Only this week, Amazon announced nine new utility-scale wind and solar energy projects in the US, Canada, Spain, Sweden and the UK,” Ecovadis reported. “The company now has 206 renewable energy projects globally, generating 8.5GW... With this week’s announcement, Amazon is now the largest corporate purchaser of renewable energy in Europe

should be actively supported by the Chief Purchasing Officer and Chief Sustainability Officer, backed by at least one other C-Level officer, such as the CEO or the CFO. For efficient operations, Ecovadis suggest a fully staffed sustainable procurement office, led by the procurement manager, which has the authority to override decisions involving risky suppliers. For oversight, a cross-functional steering committee should meet regularly to review program goals and build strategy. There should also be involvement from the board of directors and even the stockholders for effective governance.

## Natural Rubber Value Chain Monitoring



### STEP 2

#### FARM TO PROCESSOR MAPPING

*Rubberway assesses natural rubber supplies back to the farm*

### STEP 1

#### NR PROCESSOR ASSESSMENTS

*From 2013, major tire makers have started to assess their immediate natural rubber suppliers through independent third parties, such as EvoVadis.*

## Sustainability Tools and Tracking

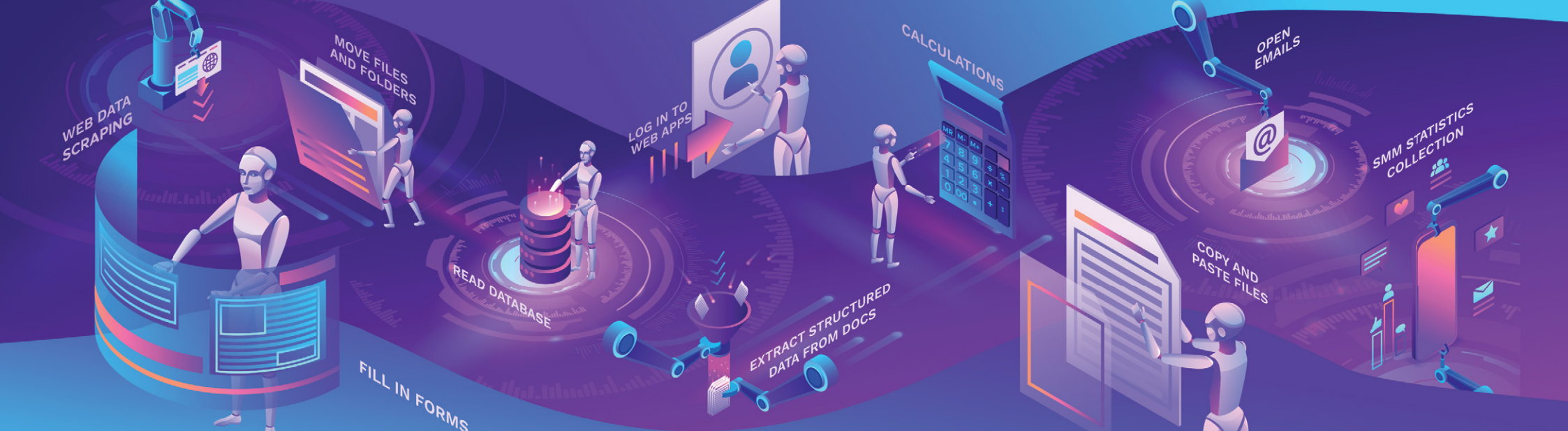
Once engaged, supply aggregators and contractors should be monitored using a tracking system that covers even the smallest of suppliers down the chain. This tracking system can also be used to help reform or reduce the number of suppliers identified as medium and high-risk.

Certain industries currently use standardized tracking systems for suppliers. One such tool is Rubberway, a mobile app developed by leading tire manufacturer Michelin in 2017, later joined by Continental AG. In a February 2021 report for Ecovadis, Veronique Seel explains that Rubberway aims to provide natural rubber buyers with a risk-mapping service for

the upstream supply chain, covering more than 36,000 players in the sector in seven countries as of September 2020.

“The vast majority of the world’s natural rubber comes from small rubber tree plantations sized between two to three hectares, operated by some six million farmers,” Seel says. “As a result, the industry is very prone to human rights violation, including modern slavery and child labor, with the farms being particularly exposed to risk.”

Rubberway works by requiring natural rubber processors to compel their managers and suppliers – down to the small family-owned farms – to use self-assessment tools to determine their ESG practices. The submitted reports are then audited, oftentimes with site visits, to ensure accuracy. Paired with third-party assessments in the downstream segments of the natural rubber manufacturing and logistics industry, Rubberway has been an effective tool in ensuring ESG compliance.



## What's Ahead: The Evolution of Supply Chains

At the March 2021 Ecovadis Scientific Committee annual meeting, several trends were identified that could further reshape and accelerate the evolution of the ESG reporting landscape – and one of these has an important implication for Asia.

Globally, ESG reporting is becoming even more sophisticated, requiring data-driven, high-quality KPIs. Partly due to the social-distancing imperatives of the Covid19 pandemic, digitalization and other new technologies are emerging to enable remote ESG auditing and assessment at scale. And several initiatives, such as the Better Alignment Project, are underway to harmonize the sprawl of existing ESG reporting standards and frameworks.

Crucially for Asia, CSR Works International managing director Rajesh Chhabara has noted a remarkable growth in ESG reporting by the region's businesses, thanks in large part to state regulators, as well as ESG-oriented multinational customers and investors.

Chhabara acknowledges that most Asian firms remain reluctant to go beyond ESG reporting compliance. However, more and more of them are producing integrated reports and are submitting to the Carbon Disclosure Project much more frequently, with 29% of global responses now coming from Asia. In fact, according to Chhabara, Asian companies have even surpassed their North American counterparts in several Task-Force on Climate-Related Financial Disclosures reporting categories.

“Supply chain assessment will be particularly relevant in markets like Singapore, which is home to a large number of multinational companies with complex supply chains and ambitious sustainability agendas. The Philippines, which is beginning to mandate ESG disclosure for certain companies, also represents an emerging growth market for assessment,” Chhabara says. “These developments, combined with the emergence of green bonds and carbon taxes, will continue to drive supply chain sustainability in the region.”

## Taking Ownership of Sustainability

Once Sustainability pledges, strategies and tools are in place, what's next? How can Sustainability be sustained in a corporate world where various priorities jostle for executive attention?

For McKinsey, the solution is simple enough. "Value creation should be the CEO's core message. Anything else could sound off-key. Managers, especially more senior ones, are usually assessed based on performance targets. Under those conditions, top-down ESG pronouncements can seem distracting or too vague - 'Save The Planet' won't cut it. To get everyone on board, make the case that your company's ESG priorities do link to value, and show leaders how - ideally with hard metrics that feed into the business model (for example, output per baseline electricity use, waste cost in a given plant or location per employee, or revenue per calorie for a food-and-beverage business)."

In a 12 May 2020 article for McKinsey Quarterly, CB Bhattacharya - author and the H. J. Zoffer Chair in Sustainability at the University of Pittsburgh's Katz Graduate School of Business - posits the idea of "ownership" as a critical step in institutionalizing ESG practices.

"Senior leaders making real progress on the sustainability front are those who tackle it with what organizational psychologists refer to as an ownership mentality. Simply put, they 'own' the problem and then extend and infuse the feelings

of ownership and connection across their organization and to the external world," Bhattacharya writes. "Challenged with the existential crisis of our times, corporate leaders must avoid inertia and take ownership of sustainability... When you take ownership of sustainability, you bring to life a new leadership mandate for you and your top team."

Bhattacharya continues: "Through a journey of personal transformation, many leaders today are re-imagining their company's corporate purpose and the role of business in society and reinforcing the sense of sustainability ownership through a course of action both internally and externally that benefits not only people and planet but also profit."





## Modest Actions, Huge Impact

Indeed, testimonials from some of the world's leading business leaders point to this sense of "personal transformation".

In a May 2020 interview with McKinsey Quarterly, former Coca-Cola Enterprises CEO John Brock describes his evolution of thinking, from simply focusing on "making good decisions for the future of the planet" to incorporating social issues such as gender and ethnic diversity, as well as community service and well-being. "Being responsible and relevant to the communities in which we operate. And working with them to help understand what we can do and they can do together," Brock says. "If you have the personal commitment but aren't willing to invest the time, money, and resources, it's not going to happen. And if you don't have the personal commitment, even if you invest the time, money and resources, it won't happen."

Simple but meaningful ESG-oriented actions are also key to Lotte Mastwijk, manager of communications and sustainability

at LC Packaging, maker and distributor of flexible packaging solutions. In a February 2021 guest blog post for Ecovadis, Mastwijk says: "Every year we understand more about our impact. All colleagues are involved now one way or another. By actively conducting our awareness training sessions. By helping local communities and initiating sustainable innovations. By selecting production partners who share our values. By helping us work in the cloud and communicate via Microsoft Teams so we do not have to jump on a plane as

much. By always paying our production partners on time and upfront if needed and by supporting them in difficult times. By explaining to our customer the importance of reusing and recycling our packaging. By speaking out against misconduct. By treating each other well and by turning off our screens when we go home."

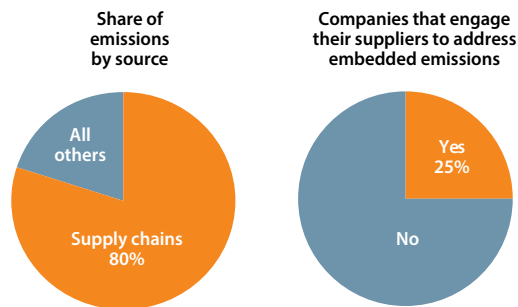
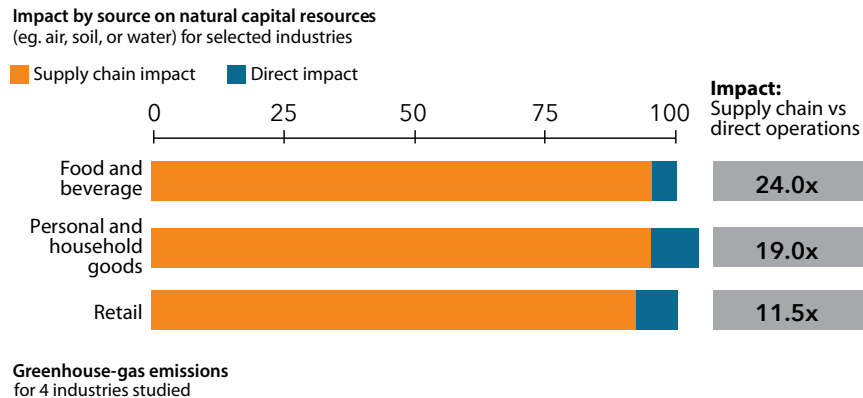
And Francesco Starace, chief executive of Enel, a company transformed under his leadership from a large, traditional electric utility into a renewable-energy powerhouse, tells McKinsey Quarterly in a May 2020 report: "It's not because we want to change things that we do it; we do it because it is the only thing we can do going forward - there is no other alternative."

Indeed, as Ecovadis has noted in a May 2021 online article, sustainable sourcing has moved from an isolated procurement action to an organizational driver of brand protection, risk management, and innovation over the past two decades. "Sustainability is a marathon, not a sprint," it says.

## IN FOCUS: The Circular Economy

Oftentimes, when assessing their sustainability performance, most consumer companies focus on their own operations. In fact, according to a June 2017 report by McKinsey Quarterly, supply chains typically represent the largest opportunities for environmental improvement, accounting for 80% of a consumer business's greenhouse-gas emissions and more than 90% of its impact on air, land, water, and biodiversity.

### Most of the environmental impact associated with the consumer sector is embedded in supply chains.



Note: Supply chains are defined here as all organizations, including energy providers, involved in producing and distributing consumer goods. Greenhouse-gas-emissions data are for electronics and electrical equipment, food, manufacturing, and textile, apparel, and shoes.  
Source: Carnegie Mellon University; CDP (formerly the Carbon Disclosure Project); McKinsey analysis

“Using more sustainable methods may cost slightly more, but doing so can also spur innovation, guard against supply-chain shocks such as drought conditions, and enhance corporate reputations,” McKinsey says. “We estimate that more than half of the enterprise value of the top 50 consumer companies depends on their projected growth, which is vulnerable to issues such as drought, government limits on greenhouse-gas emissions, and reputational damage from insufficient attention to pollution and safety.”

One paramount way of mitigating against environmental scandals while realizing huge savings is by adopting what McKinsey calls the circular economy. The consultancy cites six key ideas:

- Regenerate: Shifting to renewable energy and materials
- Share: Promoting product sharing or prolonging product life spans via design and maintenance
- Optimize: Improving product efficiency and removing waste from supply chains
- Loop: Keeping components and materials in “closed loops” via remanufacturing and recycling
- Virtualize: Delivering goods and services virtually
- Exchange: Replacing old materials with renewables or applying new tech such as 3-D printing

As already cited in this report, a 2015 study by McKinsey and the Ellen MacArthur Foundation showed that adoption of a circular economy could boost Europe's resource productivity by 3% by 2030, for potential cost savings of €600 billion a year and another €1.8 trillion in other economic benefits.

## The Virtues of a Virtuous Circle

The circular economy can indeed deliver a virtuous circle of responsible production and consumption. In a November 2020 article for Ecovadis, Elizabeth Lo explains: "At the heart of our current economy lies a linear 'take, make, waste' model. This involves the extraction of non-renewable resources, production, manufacturing, followed by product use and disposal. In contrast, a circular economy looks beyond this linear model and is restorative or regenerative by intention and design... Waste and pollution are minimized, materials stay within the natural environment, and operational activities such as repair, refurbishing, remanufacturing and recycling keep materials in use indefinitely."

McKinsey flags the urgency of ideas such as the circular economy given the various critical pressures on the planet's resources, including the fact that about three billion consumers from developing countries will enter the middle class by 2030. "The unprecedented size and impact of this shift is squeezing companies between rising and less predictable commodity prices, on the one hand, and blistering competition and unpredictable demand, on the other hand," it adds.

Way back in 2014, in its "Remaking the Industrial Economy" report, McKinsey had already cited the concrete benefits of a circular economy:



### NET MATERIALS SAVINGS

McKinsey sees net savings from materials of around US\$1 trillion a year on a global scale by 2025. For the EU, annual savings of US\$630 billion could be realized for durable products with moderate lifespans. In terms of sectors, the

biggest benefits could be notched up in the automotive industry (US\$200 billion a year), followed by machinery and equipment.



### MITIGATED SUPPLY RISKS

Demand-driven volatility could also be reduced – such as for steel consumption in the automotive, machining and transport sectors, as a circular economy could mean global net materials savings of 110 million to 170 million metric tons of iron ore a year in 2025.



### INNOVATION POTENTIAL

The need to redesign materials, systems, and products under a circular economy can be a huge business and profit opportunity for companies, even for those involved in so-called traditional crafts, such as the carpet industry.



### JOB CREATION

McKinsey estimates that the remanufacturing and recycling industries already account for about one million jobs in Europe and the US. "We see signs that a circular economy would – under the right circumstances – increase local employment, especially in entry-level and semi-skilled jobs, thus addressing a serious issue facing many developed countries," it adds.

In the fast-moving consumer-goods industry, it is quite a shock to learn that about 80% of the US\$3.2 trillion worth of materials used each year is not recovered, as highlighted by McKinsey. "In addition to the implicit environmental benefits that a circular economy would bring, there is a significant economic impact," the consultancy giant says. "In fact, our research suggests that... under the right conditions, a circular economy could become a tangible driver of global industrial innovation, job creation, and growth for the 21st century."

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Connect authentic buyers and suppliers worldwide with tailored sourcing solutions and actionable market intelligence. Help them meet the rapidly changing dynamics of the global trade, source more effectively and seize new opportunities.

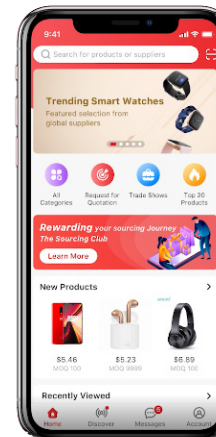
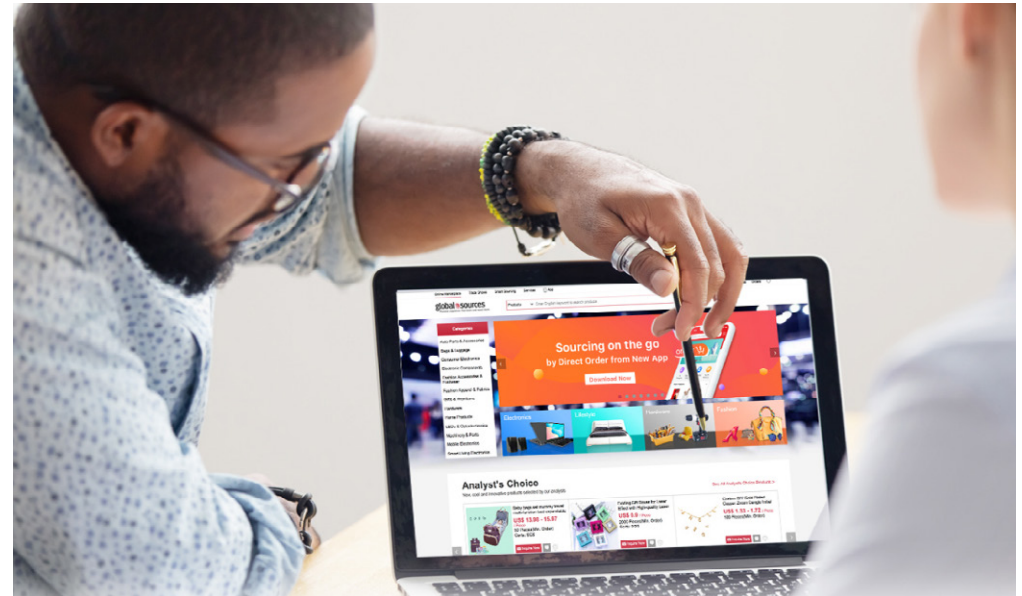
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