GIVV US A SNAPSHOT

How to Drive Supplier Action on Sustainability

4 ways to start incentivising suppliers to take action in line with your sustainability & ESG targets

Businesses all around the world are setting sustainability and ESG (Environmental, Social and Governance) targets.

These include targets to reduce greenhouse gas emissions by a set year, reach a percentage spend with diverse suppliers, take action to address risks of modern slavery in the supply chain, generate positive social and community impact, divert waste from landfill - and more.

This is driven by commercial decisions. Research by environmental consultancy, South Pole (2021), shows that industry leadership, consumer pressure and future-proofing operations are the top reasons companies pursue an ESG agenda. Business leaders now recognize it is imperative to remain competitive.

Almost all of the world's largest companies now issue a sustainability report and have set goals. More than 2,000 companies have set a science-based emissions reduction target, and about one-third of Europe's large public companies have pledged to reach net zero by 2050 (HBR, 2021).

However, despite the number of companies setting targets, one thing is clear: commitment does not equate to actual action. A 2021 report by the Energy & Climate Intelligence unit warned that "[w]hile setting targets is the first step, there will need to be detailed plans on how the reductions will be achieved" - and **time is running out**.

Broadly speaking, up until now, companies have taken an incremental, project-based approach to sustainability – looking internally where change is more visible, and where the business has the greatest control to execute (HBR, 2021).

Companies are now recognizing the greatest opportunity lies in their value chain, in particular their supply chain. Suppliers will be critical in reaching net zero goals, with supply chain emissions 11.4 times higher (on average) than operational emissions (HBR 2022).

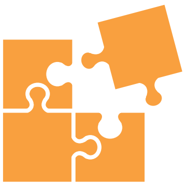
A strategic, systemic approach – from top to tail, large to small, first to lower tiers – is needed to drive supplier action and set companies on a genuine path to meeting their sustainability and ESG targets (HBR, 2021).

As the world's largest investment manager, Blackrock, put it:

"[C]ompanies not quickly preparing themselves will see their businesses and valuations suffer."
(Blackrock, 2021)

With more companies linking sustainability targets to executive remuneration and corporate scorecards, sustainability and procurement functions can expect increasing focus on policies and practices that drive positive outcomes (ACSI, 2021).

This is compounded by regulators – in Europe, Asia, the US and elsewhere – requiring companies to have credible plans to back their forward-looking targets or risk misleading and deceptive conduct and/or breaching disclosure requirements.



Challenge

How do you mobilize a supply chain to align with your targets?

For many suppliers, the process to quote, tender and onboard to a corporate or government customer is already onerous, particularly for SMEs.

Sustainability requirements have added to this, and current approaches transfer risk to suppliers or, in the case of surveys or questionnaires, duplicate enquiry and capture self-reported supplier information that quickly dates in what is an inherently conflicted process.

Solution

However, there are now several ways that businesses can overcome these challenges and set suppliers on a sustainability journey aligned to their own.

It requires a blend of **1 - Data, 2 - Practice, 3 - Incentives** and **4 -Education.**

Set out below are 4 ways companies can drive supplier action without significantly disrupting their existing procurement process or burdening suppliers with onerous requirements (i.e. cost or time) – while also giving companies timely data and insights needed to track and report progress with ease.

STEP 1 - DATA
Identify actions your suppliers are already taking

The Covid-19 pandemic has been a powerful ESG catalyst, but there is a sense that events have moved so fast that many companies are playing catch-up (EY, 2021). Access to more sophisticated data will be key to companies coming up the curve to meet the intensifying focus on ESG performance (EY, 2021).

There are now hundreds of third party administered programs and initiatives recognizing and supporting supplier action on sustainability and ESG (known as 'credentials').

These include:

1. Certifications, accreditations and standards
2. Rating, scores and assessments
3. Memberships, initiatives and other

While they each vary in scope, depth of enquiry, verification, transparency and accountability – they're effective at flagging the nature of an action a supplier is taking and the E, S and/or G focus areas of that action, while avoiding duplicating enquiry or effort with surveys and questionnaires.

On Climate Action, suppliers with science-based net zero targets are required to set near-term targets to put them on the trajectory to achieving their long-term 2040 or 2050 target (SBTi).

On Supplier Diversity, suppliers that are Femeconomy approved are certified as being at least 50% female owned or having at least 30% women on the Board of Directors.

These credentials are reportable evidence to support progress towards a company's own net zero (Scope 3) target or supplier diversity goal.

Before policies can be set and practices implemented – it is important to understand the baseline of the company's existing supply chain. The highly fragmented nature of supplier credentials makes it difficult to capture this data on even 50 to 100 suppliers, let alone high volumes – hence the role of technology solutions.

givvable helps companies infill this data and keep it up-to-date without having to manage certificates internally or issue supplier requests for information. Each credential is tagged by sustainability category, target, ESG theme, SDG and nature of action – making it easier for companies to understand relevance to their own objectives.

The other important insight is inaction – where no sustainability credentials indicating action can be independently verified for a supplier. For businesses with 100s and 1,000s of suppliers, this instantly narrows the focus on potentially at-risk suppliers or categories of spend.

STEP 2 - PRACTICE
Set preferred or mandatory sustainability credentials

Businesses have started to implement requirements for suppliers to hold sustainability and ESG credentials – for some companies, it is mandatory.

For example, from July 2022, a major European bank will require every new or extended contract of a certain size to have an external vendor rating by Ecovadis or another eligible rating agency, such as MSCI ESG, Sustainalytics, ISS ESG, S&P Global and CDP (DB, 2022). Even where the requirement applies above a certain spend threshold, it ultimately filters though the value chain as first tier suppliers must themselves engage suppliers taking action in order to attain the requisite rating.

For companies considering this type of approach, set out below are 4 important considerations.

1 **Map preferred or mandatory supplier credentials to your targets.** The increasing number of sustainability and ESG credentials means that it is now possible to set preferred or mandatory requirements and maintain an acceptable level of supply. It is, however, difficult for companies to know what each credential means. givvable has automated mapping of over 750+ local and global credentials to help companies identify preferred or mandatory credentials aligned to their targets.

2 **Don't exclude SMEs.** Given that 90% of businesses are SMEs and MSMEs represent 97% of sustainable and ethical suppliers (McKinsey 2018), it is important to include credentials that are affordable and accessible to SMEs who may not have the financial or human resources to attain costly or time-intensive credentials.

3 **Don't exclude 'S' & 'G'.** Cover credentials directly and indirectly advancing your targets. Businesses addressing the full range of ESG issues outperform in the long run.

If your company has Ethical, Social, Diversity and/or Community (e.g., local buying) targets, it is even more important to ensure your preferred or mandatory credentials include those referred to in (2) and (3) above to not put those targets at risk.

4 **Track progress.** Set your baseline by screening existing suppliers for your preferred or mandatory credentials.

Research has found that vetting criteria of procurement functions typically do not include environmental and social considerations – particularly for SME, tail or lower-tier suppliers – risking the credibility and impact of the company's overall sustainability effort (HBR, 2020).

givvable has developed a **Quick Search Tool** that companies and suppliers can use at any point in the procurement process (e.g., quote, tender and contract renewal) to continuously grow pools of credentialed suppliers. Integrations and APIs are also available for high volumes of suppliers.

STEP 3 - INCENTIVES
Reward action with a supplier sustainability-linked benefits program

One of the best ways to drive supplier action is to offer incentives, such as sustainability-linked benefits programs.

Risk-based approaches typically translate into punitive measures or penalties. Action required by a supplier is often negatively framed, and compliance is often a 'tick the box' exercise.

It can also include a disproportionate transfer of risk in supplier contracts, particularly for SMEs. Examples exist of companies 'asking' suppliers to set science-based target or risk paying a fine (HBR, 2021).

Companies also cannot continue to operate on a "if it's not bad, it's good" basis. They must incentivise positive action or risk falling short of their targets.

The challenge with sustainability is that the action companies are asking suppliers to take may initially be cost and time intensive and/or require substantial changes in the operation of the supplier's businesses. For SME suppliers who typically don't have their own ESG or sustainability departments, they also don't know where to start. This is why incentives are key.

The role of sustainable finance

The financial sector is serious about supporting sustainable development – at COP26, the Glasgow Financial Alliance for Net Zero, with members representing more than US$130 trillion in assets under management or advice, was formed. Members of the Alliance are committed to reducing emissions across all scopes in line with the Paris Agreement, with transparent action plans and robust near-term targets.

With respect to supply chain finance, there are an estimated US$2 trillion in financeable secure payables globally (McKinsey, 2015), and an estimated trade finance gap of US$1.7 trillion (ADB, 2020). SMEs are disproportionately represented (40% of trade finance rejections, while representing 23% of trade finance demand), with women-owned firms even more so (70% partially or fully rejected).

Sustainable supply chain finance, which can incentivize sustainable behaviours in global supply chains, is expected to represent at least one third of the market – $660 billion (BSR, 2018).

STEP 3 - INCENTIVES (cont'd)

The role of sustainable finance

Two key ways organizations can drive supplier action using sustainable finance include:

1 Set up a supply chain finance program to reward businesses with preferred or mandatory credentials with early payment of invoices.

For example, Walmart has implemented a supplier financing program with HSBC to incentivise SMEs (small to medium sized enterprises) to set validated science-based targets for emissions reductions and meet certain performance thresholds.

Under the program, Walmart suppliers must set at least three sustainability goals and work towards a 1.5 degree Celsius target to be eligible for financing. This means smaller suppliers can get paid earlier at preferred rates leveraging Walmart's credit rating.

A key benefit of this type of program is it allows organizations to set parameters that directly align to their own sustainability and ESG targets.

It is an approach that has been used by other companies, like Tesco, too.

2 In a similar model, but initiated by the supplier - suppliers with eligible sustainability credentials can get approved invoices paid in as little as 4 hours for amounts starting from $1,000.

In an Australian first, **givvable**, as sustainability partner, and Fifo Capital, as credit provider, have teamed up to provide suppliers with up to 25% off the cost of finance if they hold eligible sustainability credentials.

The more eligible credentials a supplier holds, the greater the potential discount - and, it is has been designed with the SME supplier in mind, ensuring that relevant SME credentials are covered and invoice amounts start from $1,000.

This type of program is accessible to any supplier and can operate independently of any corporate supply chain finance program. It also positively flags to companies that the supplier holds a sustainability or ESG credential that aligns with relevant institutional sustainability-linked or green financing principles.

Other incentives

Other incentives companies can employ to encourage suppliers to take action and cascade sustainability requirements into their own supply chain (and hence lower tier suppliers) include supplier sustainability awards, long term contracts, education and capacity building, and preferred status (HBR, 2020).

STEP 4 - EDUCATION
Educate and raise awareness among suppliers

For many businesses, particularly SME suppliers, sustainability can be daunting – *Where to start? What to do? How to do it? How much will it cost?*

Not all businesses can afford to engage sustainability consultants to guide them on this journey.

Research shows that SME and lower tier suppliers are least equipped to handle sustainability requirements. They often do not have the sustainability expertise or resources, and may be unaware of accepted environmental and social practices and regulations (HBR, 2020).

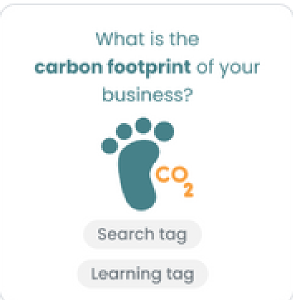
To be able to start and make informed decisions about what action makes sense for their business, suppliers first need to know:

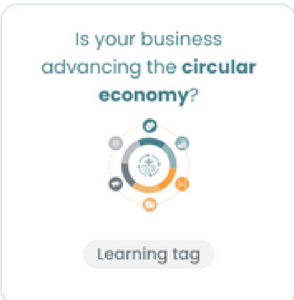
1. The impact of their business operations, from both an environmental and social perspective
2. Customer requirements on sustainability

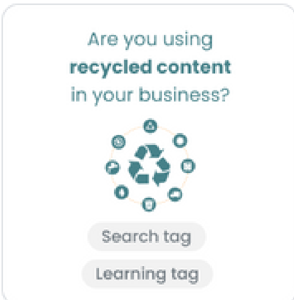
Companies can support suppliers on their sustainability journey by providing opportunities to learn about emerging customer requirements. Ideally, this is at their own pace, and content should be relevant to their business. If suppliers get recognition for learning beyond a single customer, they are much more likely to engage with the content.

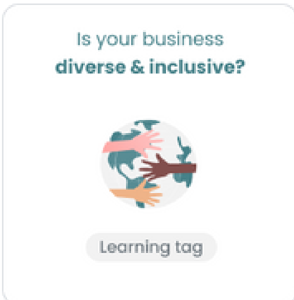
givvable makes available free learning modules *designed for suppliers* on carbon footprint, circular economy, recycled content, labour practices, ethical sourcing and supply chain. Once completed, suppliers earn a 'learning tag' visible to users of the platform – with different tags assigned for different levels of learning.

Examples of givvable learning modules









Conclusion

The rapid evolution of ESG over the last 2 years means companies now need to transition from internal, project-based approaches to sustainability and ESG, to a more strategic and systemic approach that activates the entire supply chain to take action aligned to their sustainability targets. Those that succeed will employ a blend of measures that include supplier **1 - Data, 2 - Practice, 3 - Incentives** and **4 - Education**.