Strategic Insights for Procurement: PLAN for ESG in 2023 & Beyond

How to tackle ESG risk in your Supply chain and Procurement Processes

Our collective reality

Today, enterprises understand the value of making a positive impact on the world and incorporating a social purpose beyond profit making. While many businesses do so with an altruistic motive, they have the added 'motivation' in the form of increasing pressure from various sources including customers, financial institutions, governments, and international entities to reduce greenhouse gas emissions and prevent environmental degradation and ethical misconduct. This pressure not only impacts their own operations, but also their direct & n-tier suppliers and subcontractors across their supply chains.

The bottom line? Organisations must prioritize supply chain optimization and evaluate the environmental, social, and governance (ESG) standards of their suppliers.

Help your team identify opportunities to improve supply chain sustainability and mitigate ESG risk with this practical guide on what's the Procurement Leadership Agenda and Narratives (PLAN) for ESG in 2023 & beyond.

What is ESG Risk?

ESG risks are the risks of any negative financial impact on an institution stemming from the current or prospective impacts of ESG factors. The causes of impact can range from environmental pollution and waste generation to labor exploitation and corruption. The impact of ESG risks can manifest in reputational damage, regulatory penalties, and financial losses.

Why is ESG Risk Relevant to Supply Chain Management?

Supply chain management is the process of planning, coordinating, and controlling the flow of goods, services, and information from raw material suppliers to end customers. As a result, supply chain activities can significantly impact ESG factors.

Greenhouse gas emissions, such as carbon dioxide (CO_2) emissions are a common sustainability key performance indicator (KPI) that organizations track to measure their environmental impact. However, there is another measure called “scope 3” emissions that goes beyond an organization’s own direct emissions to include the indirect emissions produced by its supply chain and other activities.

Therefore, managing ESG risks in the supply chain is essential for protecting the environment, promoting ethical business practices, and ensuring the long-term sustainability of an organization's operations.

How to Mitigate ESG Risk in Your Supply Chain?

As per Greenhouse gas (GHG) protocol Corporate Value Chain Accounting Reporting Standard, GHG emissions can be classified into 3 "scopes":

Scope 1

emissions are those that are directly emitted by a organization's own and controlled sources, such as production facilities and transportation vehicles.

Scope 2

emissions are indirect emissions, coming from energy-providing facilities that are purchased and used by the organization.

Scope 3

emissions are those that originate outside the organization, including those from other organizations in the supply chain or end-users.

While Scope 1 and Scope 2 are straightforward to measure and are a clearly defined requirement for GHG reporting, Scope 3 emissions are more flexible in their reporting. CDP estimates that Scope 3 emissions on average account for 75% of an organization's total emissions and involve tracking the entire value chain from suppliers to end users making it a relatively difficult task for tracking.

With that being the case, it is where procurement has the greatest chance to influence GHG reductions and achieve organizational objectives. Here is how organizations can reduce ESG risk in their supply chain:

1

Understand the ESG legislation landscape

The first step in preparing for expanding ESG legislation is to have a thorough understanding of the current landscape. This includes familiarizing oneself with the various ESG laws and regulations that are already in place, as well as any upcoming or proposed legislation.

Some key pieces of ESG legislation in Europe include Germany's new Supply Chain Due Diligence Act (SCDDA), European Union's Green Deal and its Action Plan on Sustainable Finance, the Non-Financial Reporting Directive, and the Sustainable Corporate Governance Code. It is also important to stay up-to-date on national level legislations, such as the UK's Climate Change Act and the French Energy Transition for Green Growth Act.

2

Conduct a comprehensive ESG risk assessment

Conducting a comprehensive ESG risk assessment is the next step in identifying and managing ESG risks in your supply chain. The objective is to identify potential risks related to an organization's handling of ESG issues. This is done by utilizing specialized knowledge and expertise specific to the industry and organization in question. By identifying such anomalies and irregularities early on, enterprises can take appropriate actions to mitigate the potential risks.

In conducting an effective risk assessment, an organization's current and potential future strategy plays a pivotal role. Based on the identified risks, management may need to implement risk mitigation measures or make significant changes to business practices. The success of the assessment depends on the timeliness and thoroughness of the process, allowing the organization to respond effectively to potential risks.

Some of these new regulations carry stiff penalties in case of non-compliance. For instance, the consequences of violating Germany's new Supply Chain Due Diligence Act (SCDDA) include fines of up to 2% of a company's annual global revenue, highlighting just how important it is for organizations to adhere to these new regulatory mandates.

3

Develop an ESG policy

Developing an ESG policy is an important way to communicate your commitment to ESG principles and provide guidance for managing ESG risks in your supply chain. This policy should outline your organization's approach to ESG issues and specify the standards and expectations for your suppliers. It is important to demonstrate a commitment to sustainability and responsible business practices, which can improve a organization's reputation and attract customers who value these principles. ESG policies can also help reduce an organization's environmental impact and improve its social and governance practices, which can help reduce operational costs and risks. This can help in improving the organization's long-term financial performance. Lastly, ESG policies can help align an organization's practices with broader sustainability goals, such as reducing greenhouse gas emissions and promoting social justice.

ESG is expected to gain widespread popularity soon. This can be attributed to investor demands, shareholder pressure, the need to remain competitive or expanding ESG legislation landscape. Some of these new regulations will carry stiff penalties: for instance, the consequences of violating Germany's new Supply Chain Due Diligence Act includes fines of up to 2% of a company's annual global revenue, highlighting just how important it is for executives to adhere to these new rules. Needless to say, implementing an ESG policy is crucial for business sustainability.

4

Engage with your suppliers

Germany's supply chain act is not the only legislation to emerge that will push companies to reassess their global supply chains. There is also the Modern Slavery Act in Australia; the US Securities and Exchange Commission (SEC) is considering ESG reporting rules and requirements on climate disclosure; and in February 2022, the European Commission adopted a proposal for new rules on corporate sustainability due diligence. There is a clear trend of expanding legislation which will make compliance more challenging.

One of the best ways to avoid the risk of non-compliance and penalties from such regulations is to implement a supplier due-diligence program and to include terms in supplier contracts to require proper procedures and controls for sustainable, ethical operations. Incorporating sustainability into supplier vetting and contracting practices can help prevent delays and omissions. Using third-party risk management and contract management can assist in implementing these practices without disruption to compliance or legal teams. Such practices can provide protections in several areas, including:

- Identifying high-risk vendors to comply with anti-bribery and anti-corruption legislation
- Ensuring compliance with data privacy and information security standards and mandates
- Maintaining ethical practices in line with your organization's supplier code of conduct
- Meeting your organization's ESG policies and standards.

5

Implement an ESG management system

Implementing an ESG management system is a structured approach to managing ESG risks in your supply chain. This system should include processes for identifying, assessing, and mitigating ESG risks and monitoring and reporting on your ESG performance. Data that was formerly collected using spreadsheets and then manually consolidated for analysis can now be automatically collected and analyzed as a part of the sourcing process. This change opens the door to inclusion of many more criteria, such as diversity and green status, minimizing CO2 emissions, and much more. Organizations should make sustainability a default criterion in their sourcing process.

Zycus' Scope 3 Carbon Analyzer is deeply rooted in spend-based methods, in line with what GHG protocol advises. Right from automated data retrieval and reviewing and auditing to Scope 3 emission estimation, it enables organizations to come one step closer to responsible procurement.

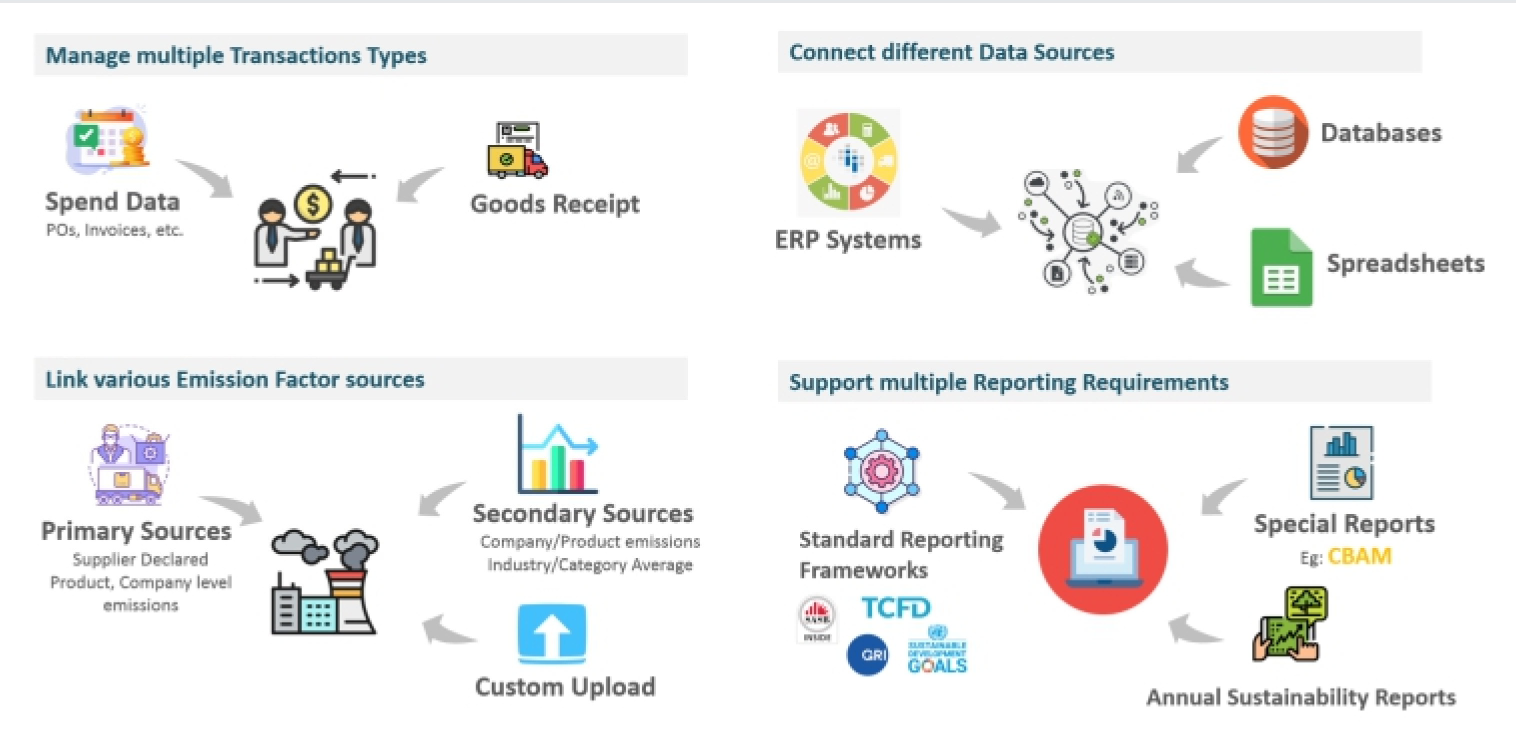

Fig. 1: Scope 3 Carbon Analyzer- Key Highlights (Source: Zycus)

One of the benefits of Zycus' Scope 3 carbon analyzer is the 'green supplier portal' where suppliers can take ESG assessments and declare carbon emissions for products using the Product Data Exchange. Even for the Accounts Payable (AP) functions, they can use a single system and process to manage every invoice. Invoices are validated and approved automatically, and then they can be paid digitally using electronic transfers or virtual cards. This end-to-end digital process cuts out the substantial amounts of paper typically seen in all but the most strategic supplier relationships—invoices, paper checks, and otherwise--saving trees as well as freeing up valuable employee time.

Each Zycus customer gets a Scope 3 emissions dashboard that monitors and quantifies these benefits—showing exactly how many trees and how much waste from energy, fuel & carbon have been saved by going paperless. These metrics can be included in your ESG annual reports.

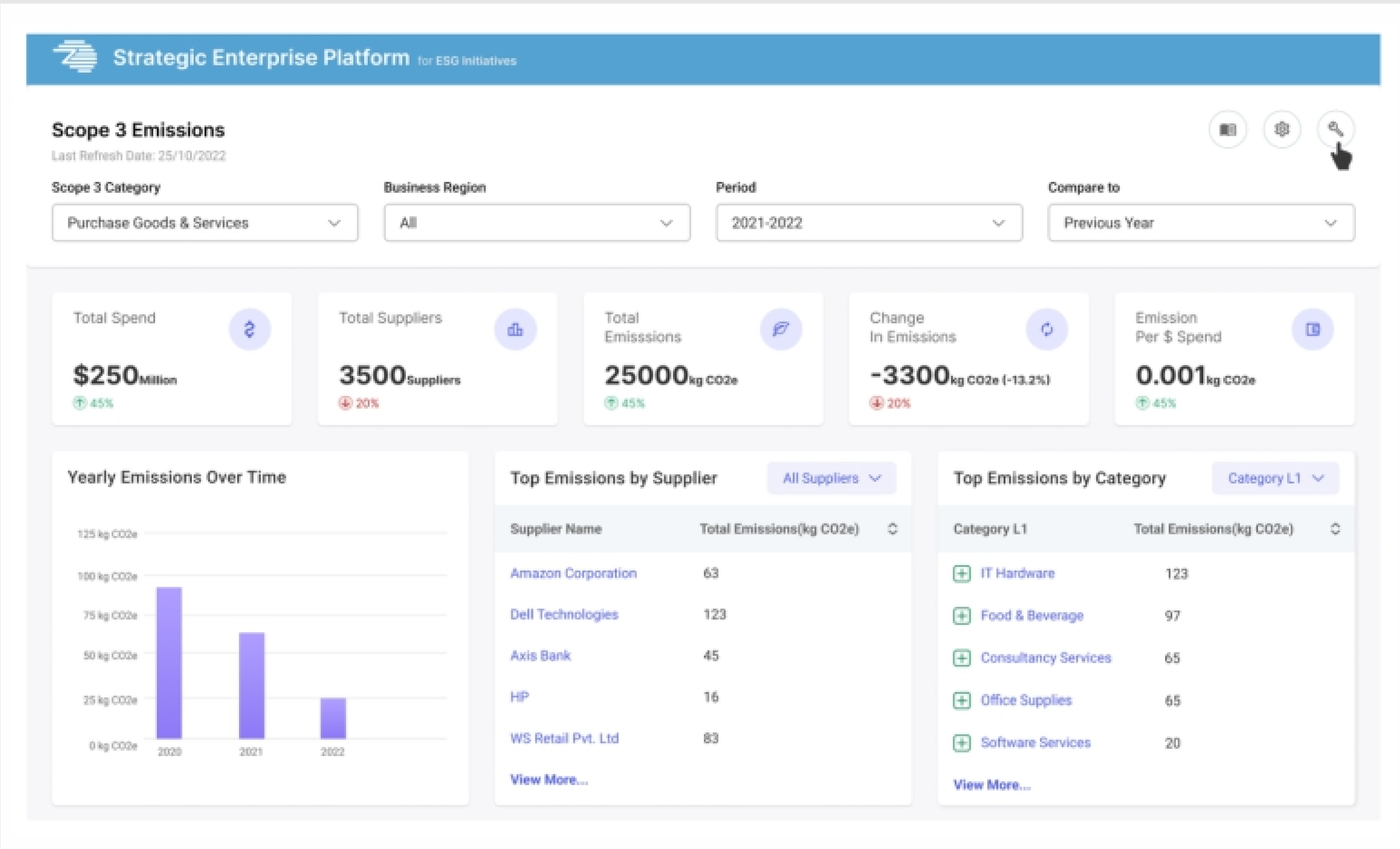

Fig. 2: Scope 3 emissions dashboard (source: Zycus)

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Communicate your ESG performance

Communicating your ESG performance is an important way to demonstrate your commitment to ESG principles and build trust with stakeholders. This can include publishing annual ESG reports, participating in industry initiatives, and engaging with stakeholders on ESG issues. Many procurement organisations miss opportunities to show the impact of their sustainability initiatives. The key is to have metrics that represent the program benefits, supplier, and program performance (Figure 03).

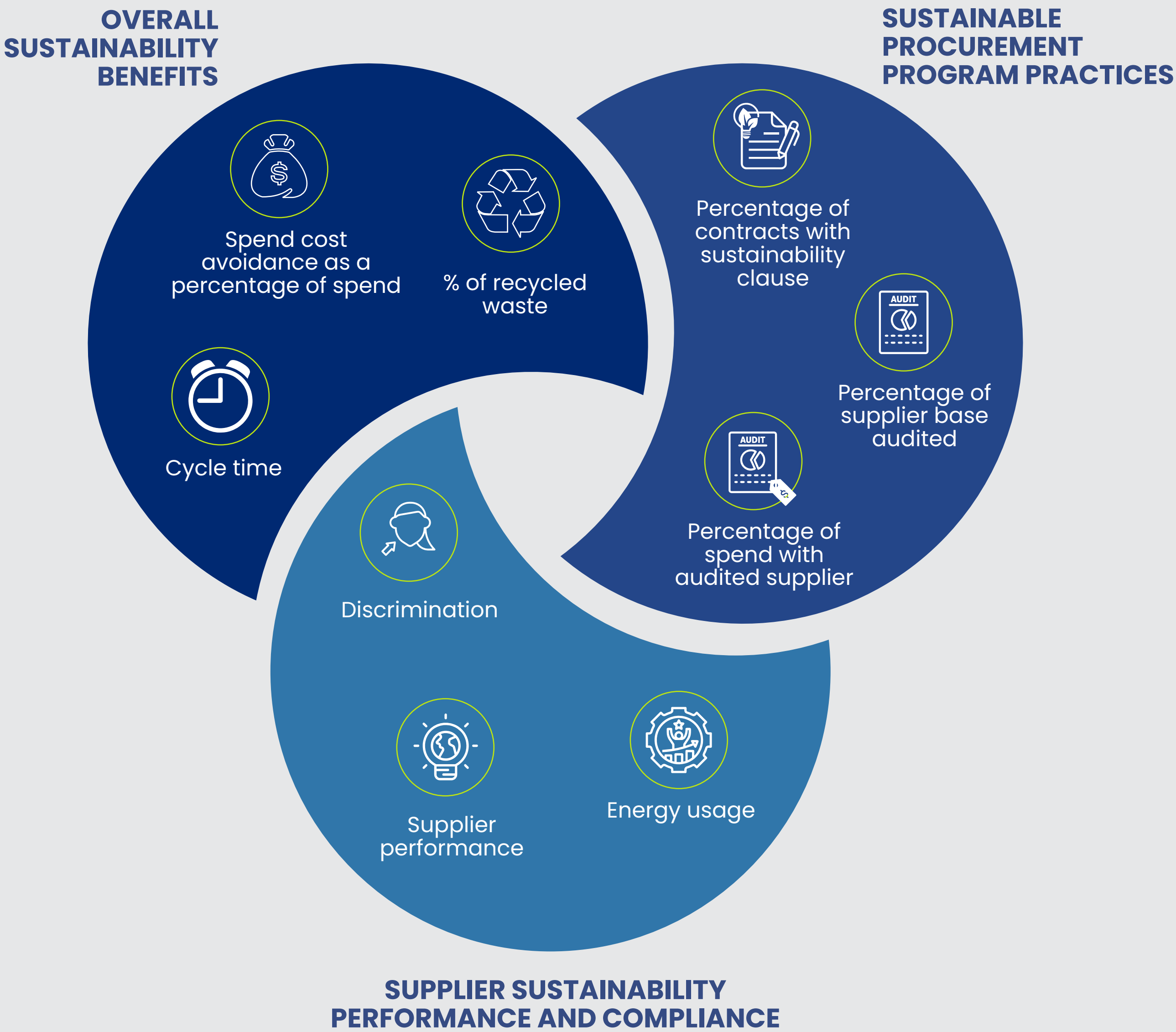

Fig. 3: Demonstrating the impact of sustainable procurement (source: Zycus)

Conclusion

Managing ESG risks in the supply chain is essential for protecting the environment, promoting ethical business practices, and ensuring the long-term sustainability of an organization's operations. By conducting an ESG risk assessment, developing an ESG policy, engaging with your suppliers, implementing an ESG management system, and communicating your ESG performance, organizations can effectively mitigate ESG risks in their supply chains.

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COGNITIVE PROCUREMENT

Zycus is the pioneer in Cognitive Procurement software and has been a trusted partner of choice for large global enterprises for two decades. Zycus has been consistently recognized by Gartner, Forrester, and other analysts for its Source to Pay integrated suite.

Zycus powers its S2P software with the revolutionary Merlin AI Suite. Merlin AI takes over the tactical tasks and empowers procurement and AP officers to focus on strategic projects; offers data-driven actionable insights for quicker and smarter decisions, and its conversational AI offers a B2C type user-experience to the end-users.

Zycus helps enterprises drive real savings, reduce risks, and boost compliance, and its seamless, intuitive, and easy-to-use user interface ensures high adoption and value across the organization.

Start your #CognitiveProcurement journey with us, as you are #MeantforMore.