

**Sustainable sourcing
and procurement**

Sourcing and procurement as driving forces for sustainable business

by Helen van Hoeven,
Lean & Green



**dutch sustainable
trade initiative**

Foreword

President Obama recently said that there are only two kinds of car companies: those that sell hybrid cars and those that will sell hybrid cars in the near future. The same is true for sustainability in supply chains. There are companies that source and sell more sustainable products and there are those that will do so in the near future. With a world soon populated by nine billion people and over two billion new middle-class citizens, traditional sourcing and selling will simply be a no. You are either on the pathway to sustainable development or you are out of business.

The challenge of sustainability is reshaping the relationship between business and society. Industry needs to better manage natural resources and significantly lower its global ecological footprint. And companies need to engage much better with suppliers and workers in the emerging and developing economies.

The mission of the Dutch Sustainable Trade Initiative (IDH) is to upscale and accelerate the mainstreaming of sustainability in international commodity chains. IDH joins the forces of business, non-governmental organisations, labour unions and governments. We bring diverse stakeholders together in focused and result-oriented sectoral coalitions that implement ambitious improvement programmes. These programmes tackle social, ecological and economical bottlenecks in the countries of origin of raw materials, while at the same time creating value for more sustainable products in developed countries.

IDH acts as a knowledge broker, capturing and sharing best practices in sustainable business. This will help frontrunners to move even faster, while supporting others to overcome thresholds. To mark its first-year anniversary, IDH is publishing a series of six booklets on current practices in sustainability in mainstream business:

- **Sustainable Marketing: The positioning of sustainable products in mainstream markets, with cases of Lipton (tea), FSC (timber) and Nespresso (coffee).**
- **Sustainable Sourcing: Advanced strategies and cutting-edge practices in sustainable procurement, with case studies of AkzoNobel (chemicals), Mars (cocoa) and IKEA (cotton).**
- **Sustainable Trading: Why and how traders have become key agents for sustainability in the coffee supply chain and how this is being replicated in cocoa, with case studies of Ecom (coffee) and Olam (cocoa).**
- **Sustainable SMEs: Best practices in sustainable sourcing among small and medium-sized enterprises, with case studies of Wijma (timber), Fair Wear Foundation (garments), and RMP Grafmonumenten (natural stone).**
- **Sustainable Retail: Why and how retailers incorporate sustainability into their business strategy, with case studies of Ahold, Asda/Wal-Mart, and Carrefour.**
- **Labour Standards beyond Auditing: Best practices in going beyond auditing to achieve genuine social impact, and the business case for doing so, with a dozen cases in the garments, electronics, and sportswear industries.**

We hope you enjoy reading these booklets and that they may inspire you with actionable ideas to further embed sustainability within your own organisation.

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Chapter 1

Introduction: Setting the scene

‘How much can sustainability really contribute to the bottom line?’

Chief Procurement Officers who adopt sustainable approaches can support corporate social responsibility goals and potentially reduce operating costs.

Procurement is uniquely positioned to lead organisations through these turbulent times in which both the environment, society and economies are being challenged: firstly by managing the demand within the company, secondly by sourcing from sustainable sources and thirdly by motivating suppliers to use less resources. Rising to the environmental and ethical challenge can only boost the procurement profile and improve business' access to future opportunities.

Sustainability and corporate social responsibility are buzz words, with support for their implementation gathering pace for some years now. In the current economic climate companies must now ask how much sustainability can really contribute to the bottom line. In challenging times, cutting costs is the name of the game.

Indeed, a survey of procurement directors conducted in 2009 by HEC-Ecovadis¹ identified cost reduction on direct and indirect spend as an overwhelming priority, with over 94% ranking it as either their highest priority or a high priority. Such a response does not immediately lend itself to supporting sustainability policies which often involve investments and sourcing from more expensive suppliers.

Paradoxically, in the same survey, sustainable procurement is still the number three priority, with 90% of respondents labelling the issue as critical or important. How do companies deal with this paradox? How can we protect operating profit margins and at the same time drive sustainability?

This booklet presents the best practices of three companies – AkzoNobel, Mars and IKEA – that have successfully integrated margin and sustainability concerns into innovative sourcing policies, where sustainability is used as a source of competitive advantage. The best practices are instructive as a source of inspiration to improve sustainable sourcing in your organisation, so you can capture that competitive edge!

1.1 Sustainability as a source of competitive advantage

2009 is a crucial year for the sustainability agenda, forcing companies to ruthlessly assess which policies and sourcing decisions actually deliver shareholder value and which benefit the bottom line. When companies analyse their potential for social responsibility using the same frameworks that guide their core business choices, they will discover that sustainability can be much more than a cost or a constraint – it can actually be a source of opportunity, innovation and even competitive advantage.²

¹ Bruel, Menuet and Thaler, 'Sustainable procurement: a crucial lever to end the crises?' HEC-Ecovadis, 2009.

² Porter and Kramer, 'Strategy and Society', Harvard Business Review, December 2006.

Up to recently, most companies active in the field of sustainability use the following four arguments to justify their activities:

- the felt moral obligation to 'do the right thing'
- the notion of the 'license to operate' – companies need tacit or explicit permission from their stakeholders to do business
- corporate reputation
- continuity – companies should operate in ways that secure long-term economic performance by avoiding short-term actions that are socially detrimental or environmentally wasteful

All of these arguments focus on the (potential) tension between business, the environment and society, rather than on their interdependence. The mutual dependence of corporations, the environment and society means that business decisions and social and environmental policies must follow the principle of 'shared value'. Choices must benefit both sides in order to support the long term prosperity of both.

Box 1. Mapping Social Opportunities

Porter and Kramer¹ developed an interesting framework to analyse the interdependence between business, environment and society. This framework helps companies to set their sustainability agenda in line with their core business choices, and analyses the potential of sustainability activities from two perspectives:

1. The value chain – depicts all the activities a company engages in while doing business, and is used to identify the positive and negative impacts of those activities. By doing this, the company creates an inventory of problems and opportunities—mostly operational issues— that need to be investigated, prioritised and addressed. Sustainable sourcing will often appear as a tool to decrease the companies' negative impacts and will prove to offer opportunities for strategic distinction.

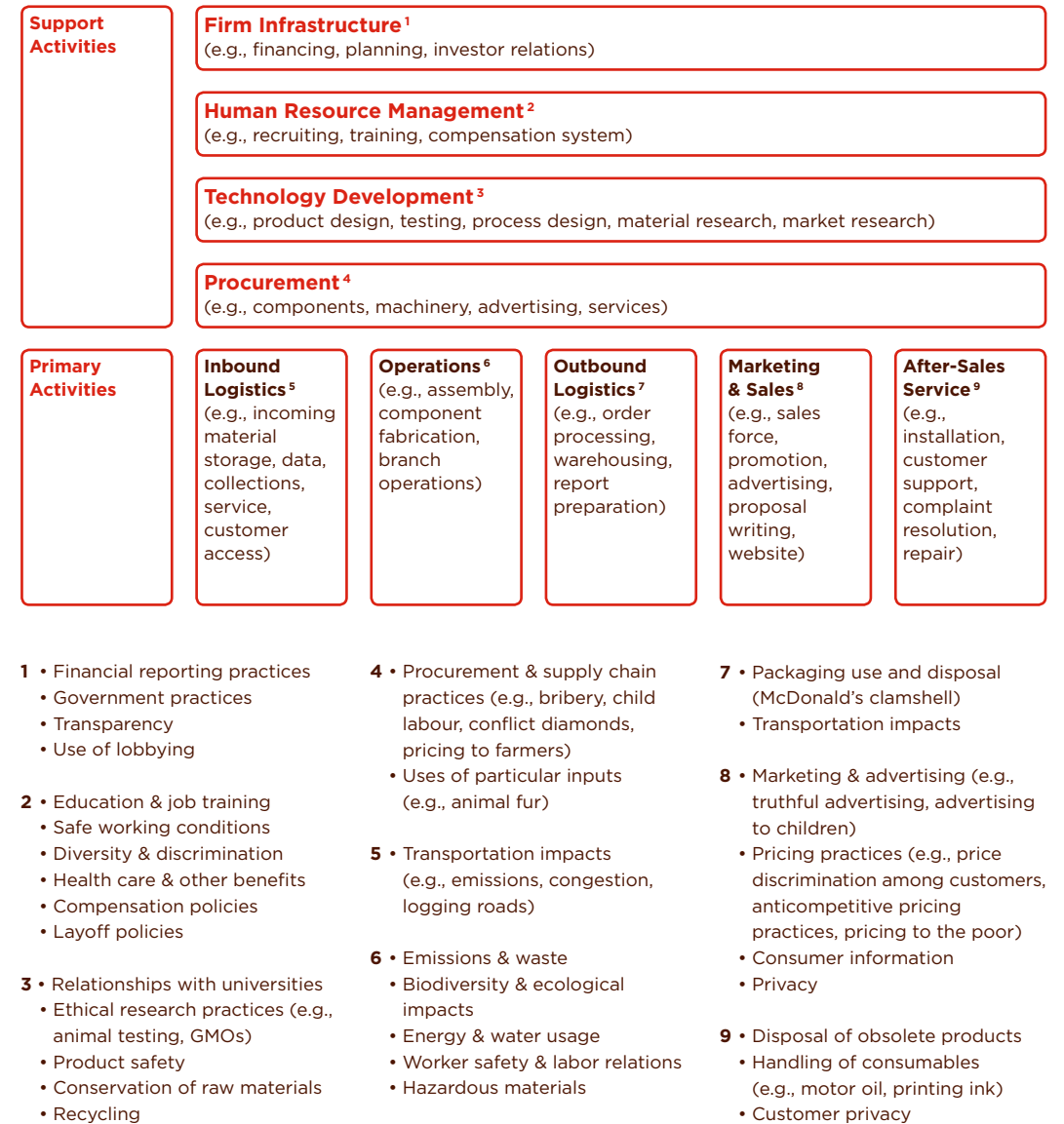
2. The company's competitive context – shows how the conditions at a company's locations affect its ability to compete. The competitive context can be divided in four areas:

- the quantity and quality of available business inputs, such as human resources or transportation
- the rules and incentives that govern competition, such as policies that ensure transparency
- the size and sophistication of local demand, which is influenced by consumer rights and fairness in government purchasing
- the availability of supporting industries such as service providers and machinery producers. These aspects can be opportunities for sustainability initiatives and serve as a framework for sustainable sourcing

Figure 1. Looking Inside Out: Mapping the Social impact of the Value Chain

the value chain depicts all the activities a company engages in while doing business. It can be used as a framework to identify the positive and negative social impact of those

activities. These 'inside-out' linkages may range from hiring and layoff politicise to greenhouse gas emissions, as the partial list of examples illustrated here demonstrates.



Source: Michael E. Porter, *The Competitive Advantage: Creating and Sustaining Superior Performance*, 1985

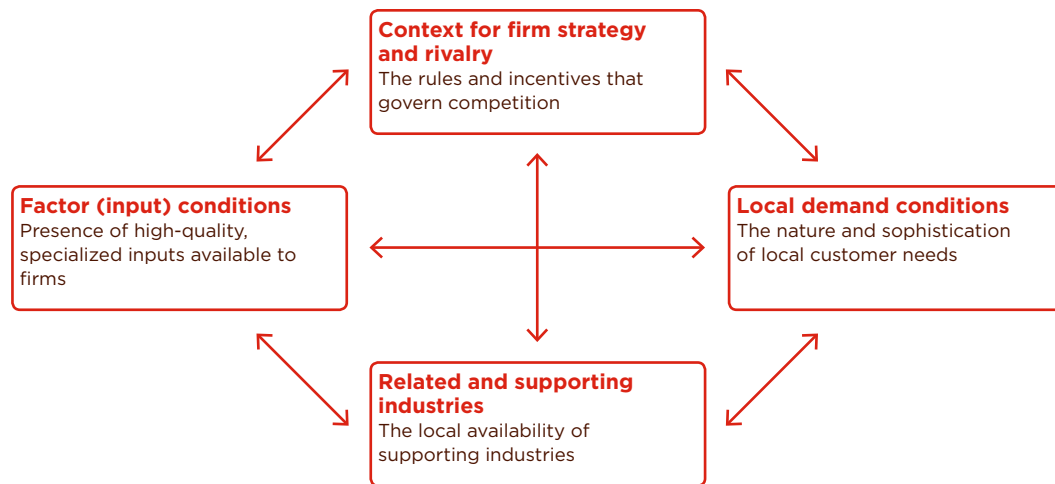
Figure 2. Looking Inside Out: Mapping the Social impact of the Value Chain

In addition to understanding the social ramifications of the value chain, effective CSR requires an understanding of the social dimensions of the company's competitive context – the 'outside-in' linkages that affect its ability to improve productivity and execute strategy.

These can be understood using the diamond framework, which shows how the conditions at a company's locations (such as transportation infrastructure and honestly enforced regulatory policy) affect its ability to complete.

- Availability of human resources (Marriot's job training)
- Access to research institutions and universities (Microsoft's working connections)
- Efficient physical infrastructure
- Availability of scientific and technological infrastructure (Nestlé's knowledge transfer to milk farmers)
- Sustainable natural resources (GrupoNueva's water conservation)
- Efficient access to capital

- Fair and open local competition (e.g., the absence of trade barriers, fair regulations)
- Intellectual property protection
- Transparency (e.g., financial reporting, corruption: Extractive Transparency Initiative)
- Rule of law (e.g., security, protection of property, legal system)
- Meritocratic incentive systems (e.g., antidiscrimination)



- Availability of local suppliers (Sysco's locally grown produce; Nestlé's milk collection dairies)
- Access to firms in related fields
- Presence of clusters instead of isolated industries

- Sophistication of local demand (e.g., appeal of social value propositions: Whole Food's customers)
- Demanding regulatory standards (California auto emission & mileage standards)
- Unusual local needs that can be served nationally and globally (Urbi's housing financing, Unilever's 'bottom of the pyramid' strategy)

Source: Michael E. Porter, *The Competitive Advantage of Nations*, 1990

The analysis based on the model of Porter and Kramer (see Figures 1 and 2) gives a valuable insight into the opportunities for shared value. The challenge is to choose the correct sustainability issues to address i.e. those which present an opportunity to create shared value by being meaningful to the company, the society and the environment. In this case, the sustainable initiative chosen can help a company to grow revenues, reduce costs, manage risks and build intangible assets.

1.2 Sustainable sourcing

Companies can't be leading edge in sustainability if they are not leading edge in sourcing and procurement. Sustainable sourcing is a process of buying goods and services that takes into account the long term impact on people, profits and the planet. Organisations that excel in sustainable sourcing typically have an integrated business model, which recognises the integral connection between sustainability and the supply chain. Sustainable sourcing considers how products are made, where and from whom they (and their components) come from, how they are transported, and how they are disposed of. In most cases, sustainable sourcing will require calculation of 'total cost of ownership' (the costs to the company starting at the source until the product or service is disposed of). This is a much broader perspective than the traditional sourcing policies which focus on quantity, quality, price, lead times and vendors. Sustainable sourcing demands full transparency of the supply chain, insights into the sustainable competences of the vendors, knowledge of the commodities used, and often co-operation with other companies, governments and NGOs to secure the supply of sustainable commodities. Sourcing with those insights in mind will increase the sustainability of the company in the long-term, and still be on top of the margins.

The best practices in sustainable sourcing and procurement of AkzoNobel, Mars and IKEA, described in this booklet, will illustrate this. These companies understand that all business functions, including sourcing, contribute to shareholder value. So their sole mission in sourcing and procurement is not cost-cutting. Instead, they chose to drive a comprehensive sustainability agenda, which helped them to maintain and win market share and revenues, even in an overall declining market.

The case for sustainability in sourcing is even stronger in times of economic recession than at other times. First, any reduction in the company's demand for commodities, such as energy, transport, waste disposal and packaging, will lead to direct contributions to the bottom line results. In addition, a focus on sustainable sourcing usually leads to transparency in the supply chain. Transparency will enable you to further optimize your supply chain and to secure it in the long run, both in terms of volume and quality.

Procurement professionals should be championing sustainability at the board level to help their companies survive and thrive. Because whether you like it or not- sustainability is here to stay!

Chapter 2

Best Practice AkzoNobel:

Delivering tomorrow's answers today

‘Sustainability is still a differentiator at present, but will be your license to operate in the future’

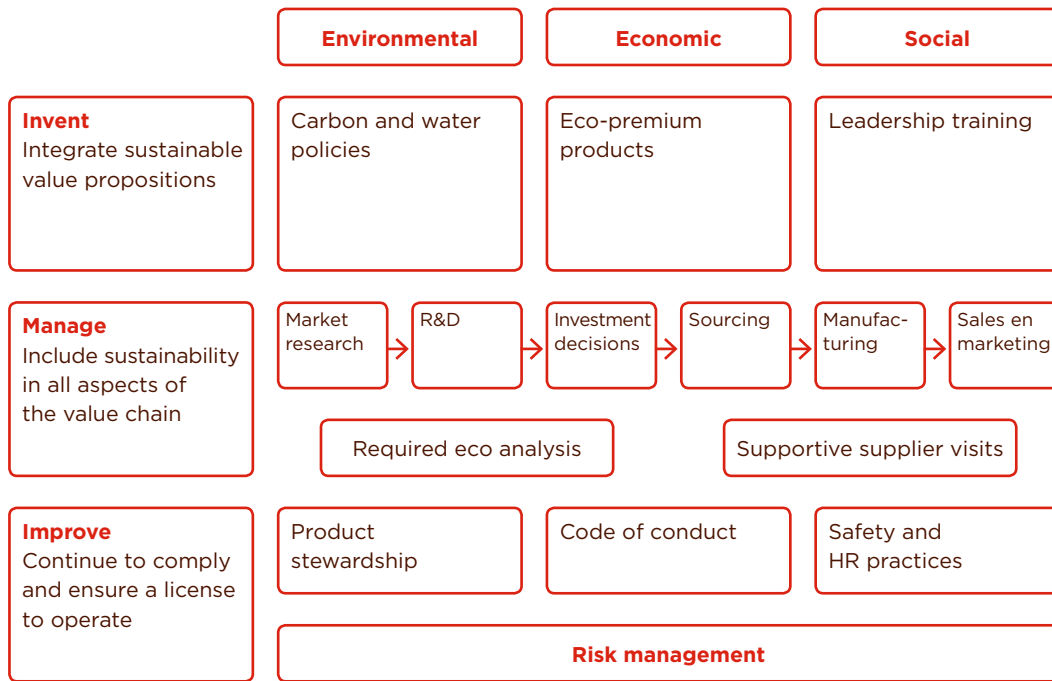
AkzoNobel thinks about the future, but acts in the present. They are passionate about introducing new ideas and developing sustainable answers for their customers. That's why their 59,000 employees – who are based in more than 80 countries – are committed to excellence and delivering their long-term strategy of sustainable value creation: ‘tomorrow's answers today’.

AkzoNobel is proud to be one of the world's leading industrial companies. Based in Amsterdam, the Netherlands, they manufacture and supply a wide range of paints, coatings and specialty chemicals – 2008 revenue totalled 15.4 billion euros. In fact, AkzoNobel is the largest global paints and coatings company in the world. With a total buying volume of around 8 billion euros, mostly spend on raw materials (75%), AkzoNobel is an important player in the sector. As a major producer of specialty chemicals they supply industries worldwide with quality ingredients for items we all use every day, from ice cream to asphalt, soup to soap, and plastics to paper.

2.1 Sustainability at AkzoNobel

In 2008, AkzoNobel, was the first company in the world to combine their annual report and their sustainability report into one publication. In this way they proved sustainability to be a business case, a novelty for most companies. The company's strategic agenda for 2009 consists of seven aims, listing the aims on profitable growth and margins, but also the aim to strive for world class sustainability and safety. AkzoNobel is already ranked on the Dow Jones Sustainability Index as one of the leading companies, and the aim is to remain in the top three in 2009.

Clearly, sustainability is embedded in overall company strategy. Sustainability is managed in an integrated way across the business and it is reviewed on the basis of a balanced score card. To map out their sustainability journey, AkzoNobel has developed a framework to demonstrate all environmental, economical and social aspects of their operations. This framework has three levels: ‘Invent’, ‘Manage’ and ‘Improve’.



Invent

With the growing global emphasis on better management of natural resources and a lower ecological footprint in all areas of industry, the focus of AkzoNobel is increasingly on identifying and managing areas which will provide long-term and sustainable opportunities for the business. The long term opportunities for AkzoNobel are to:

- work in partnership with customers and suppliers to deliver eco-premium solutions
- manage long-term resource and environmental issues
- develop their people to lead and deliver innovative solutions
- increasingly work in partnership with a range of stakeholders to achieve transformational change

Manage

AkzoNobel continues to focus on incorporating a strong sustainability component throughout the entire value chain, from market research through to sales and marketing:

- research, development & innovation: groups focus on product design for eco-efficiency
- source: working in partnership with suppliers to ensure business integrity, and to help deliver sustainable value to the customers
- manufacture: optimising processes, improving yields, and improving energy efficiency
- sales and marketing: work with customers to develop eco-premium solutions

Currently, close to a fifth of the revenue of AkzoNobel comes from products which are more eco-efficient than rival products. By 2015, AkzoNobel aspires to increase this figure to 30% of the revenue.

Improve

AkzoNobel is working to continuously improve in several compliance areas. The foundation of this lies in the AkzoNobel business principles, as included in their code of conduct. The principles define how AkzoNobel operates as a company: their commitments and responsibilities to shareholders, employees and customers, as well as to suppliers and other business partners, the communities in which they operate and the environment. The main focus is on:

- Integrity management. The code of conduct outlines the requirements for employees and for the company to operate with integrity. There is a compliance procedure, a corporate compliance committee and business compliance officers in place to manage these issues. A global complaints procedure also allows employees to report any violations which they may encounter.
- Health, safety, environment and security management. HSE&S management systems are based on international and internal company standards. Implementation is carried out by trained experienced employees, actions are driven by objectives and verification is achieved through internal and external audits.
- Product stewardship. Management systems and processes are in place to control the safety of the products and to ensure compliance with international and local regulations, e.g. REACH in Europe.
- Employment practices. HR systems are set up to meet business and local needs, within the framework of the global HR policy, which outlines the principles for development, education and training, and compensation and benefits of staff members.

Each of these areas includes directives and standards, management systems, objectives to drive improvement, training and auditing. They are underpinned by AkzoNobel's risk management process, which integrates environmental, social and governance issues. AkzoNobel develops position papers and an improvement plan by corporate staff members for particular sustainability issues which might be of concern to stakeholders.

2.2 Sustainable procurement

AkzoNobel is working to incorporate sustainability throughout its entire value chain. This would not be possible without a progressive sourcing and procurement policy in which it works in partnership with suppliers to ensure business integrity and to help AkzoNobel to deliver sustainable value to its customers.

The current organisational changes in procurement will without doubt support the aim of integrating sustainability in procurement. The organisation of procurement has gone through a major change resulting in the growth of the centrally coordinated budget, from 0.5 billion euros in 2007 to 6.5 billion euros in 2008. In fact, the procurement function was recognised for its wide-ranging, value-focused sustainability programme with the prestigious European ProcureCon award for sustainability.

Ton Geurts led the organisation through these changes and was awarded CPO of the year in 2008. According to Ton Geurts, sustainability in procurement is 'not about philanthropy, it is about cost reduction, risk reduction, building new opportunities and building stakeholder support'. The company has identified the following four important areas for sustainable procurement:

1. Supplier assurance & development

The AkzoNobel vendor policy outlines the expected environmental and social standards for their suppliers. The target is to have 85% of the budget for raw materials committed through signed agreements that comply with the vendor policy.

The vendor policy is complemented by support visits to suppliers in emerging markets. Over 150 suppliers have been visited in 2008 and 50 more are planned in 2009. They help their suppliers to support AkzoNobel to meet the demand of the customers and to outperform their competitors. Sustainability in procurement is taken seriously. If a supplier proves to be unfit to work with AkzoNobel as a sustainable partner, volumes will be shifted towards a sustainable competitor.

Another element is the key supplier management programme which involves co-operation with key suppliers to enhance eco-premium solutions for customers. An eco-premium solution provides the same or better functionality for the customer, but has a clear eco-efficiency benefit over mainstream products in the marketplace. For example, AkzoNobel together with BSF has developed a sunroof paint which keeps out the heat and contributes to lowering the energy use of air conditioning. Eco-efficiency is about creating more value with less environmental impact. AkzoNobel aims to increase the turnover in eco-premium solutions, from 18% to 30% by 2015. This can only be done through close co-operation with the suppliers. Research on more environmentally friendly products is increasingly common, especially in the chemical industry, and this expertise is now being used to serve the customers in a better way.

2. Logistics & travel

The procurement group has achieved significant savings through efficient use of hauliers in China and they are currently planning a second project in Latin America. Furthermore, new communication technologies such as video conference tools are being used to decrease the business travel footprint. In lease cars, AkzoNobel has set the ambitious target of a weighted average of 130 g/km CO₂ measured over the total fleet by 2013. For comparison, the average in Europe is 150 g/km CO₂.

3. Waste management

The procurement group works on a country-wide basis to identify opportunities for material and cost saving. Individual sites are identifying ways to reduce waste at the source and to increase beneficial uses and recycling. Good waste management can be very beneficial. For instance, Alox which is a by-product of H₂O₂ production is now being used as a raw material for cement production, leading to a recurring benefit of several thousands of euros annually. Another striking example is the use of plant waste as an alternative fuel in the cement industry, leading to huge environmental benefits, due to the reduction in landfill costs and leading to a recurring benefit of several thousand euros per year.

4. Packaging

Savings are being achieved through standardisation, material reduction and ecological improvement due to recycled material content, end-of-life recycling and carbon efficient sourcing. For instance, inbound steel drums are used for packing products for consumers, resulting in a reduction of up to 50% in the use of new drums in the US. This way of working has been expanded to Europe and China. Another clear win-win situation in this field is the fact that water-borne paints now use plastic, not tin packaging. This has resulted in considerable cost savings and a more environmentally friendly solution.

The procurement group is also working closely together with AkzoNobel's energy efficiency centre of excellence, which provides energy reduction plans for sites and plants. A conservative estimate is that this programme will lead to energy efficiency savings of 35 million euros annually by 2012.

2.3 Lessons and advice

Ton Geurts' vision of sustainability is that it is a core competence for successful entrepreneurs. It represents a unique opportunity to innovate your supply chain from the perspective of sustainability and to implement more profitable value chains. In his view, sustainability is still a differentiator at present, but will be your license to operate in the future.

He strongly believes that each company needs a carbon strategy because climate change is one of the biggest issues that society has to face today. In fact, a sound carbon strategy will prove to be a driver of business, will give companies a competitive edge and will be used as a sales argument in terms of the 'carbon' advantage. AkzoNobel is ready for future legislation and requests for information on CO₂, and can even be audited on CO₂ emissions.

Ton Geurt's advice to procurement organisations on sustainability is fourfold:

1. **Strategy:** Set up a sustainability strategy in line with the company strategy, for each commodity or spend category. Translate the strategy into plans and targets. Award with an extra performance rating. Celebrate successes and give the buyers the opportunity to demonstrate their success to the board, (for instance through a sustainability council with board members).
2. **Control:** Ensure that the function of control is embedded in the sustainability projects and targets. Be prepared to be audited at all times. Manage your risks but also let sustainability lead. For instance, within AkzoNobel, the quality manager, instead of the buyer, approves the suppliers, to prevent the risk of a short-term focus on costs, as a trade-off against sustainable quality.
3. **Share:** Share best practices and successes in a competence centre, preferably supported by an intranet portal.
4. **Change:** Sustainability is a change management programme. You must evaluate the value chains and adapt your business model and organisation accordingly. Changes will not happen overnight, but need time to be accepted by the organisation.

Chapter 3

Best Practice Mars: The five principles

‘How can we grow profitably, celebrate our community, and enhance the health of the planet?’

Mars recognises that their long-term economic growth is intrinsically linked to their ability to determine how they address sustainability in the context of their businesses, product ranges and impact on the planet. They believe that their commitment to sustainability depends on their long-standing ethical commitment to the individual and to the larger community, expressed and captured via the five principles.

Mars Nederland B.V. is part of the family owned Mars, Incorporated group, founded in 1911. Mars, Incorporated is one of the largest private companies in the world, generating an annual revenue of over 30 billion dollars from their operations in six business segments: Chocolate, Petcare, Wrigley Gum and Confectionary, Food, Drinks and Symbioscience. Amongst their billion dollar brands are M&Ms®, Snickers®, Dove®, Mars®, Estra®, Orbit®, Pedigree®, Royal Canin® and Whiskas®. This success is due to the company’s constant creativity and sharp instinct for trends that have continually brought Mars forward, step-by-step, after almost a century of business

3.1 Sustainability at Mars

Rather than simply trying to minimize the effects of unsustainable activities, Mars envisions growing their businesses in a manner that is mutually beneficial to the social, environmental and economic areas that they impact on. Sustainability is viewed by Mars as a source of innovation and as an emerging business opportunity. It will enable Mars to gain competitive advantage, increase revenue, add long-term value, whilst also making the world a better place by making a difference. Their goal, albeit aspirational, is to manage and grow their businesses asking themselves, ‘How can we grow profitably, celebrate our community, and enhance the health of the planet?’

3.2 The five principles of Mars

The five principles guide Mars in the choices they make daily and the manner in which they do business. The essential values that they embody define the company’s philosophy and approach to how they operate. Sustainability flows naturally and directly from their principles and will continue to shape how they think and act.

1. **Quality.** The quality principle states, ‘The consumer is our boss, quality is our work and value for money is our goal.’ Beyond the traditional aspects that still matter greatly, such as price and value for money, consumers around the world are expanding their definition of quality to include stewardship of the environment.
2. **Responsibility.** Mars seeks to make responsibility a personal endeavour, holding themselves accountable for their individual and collective actions. Viewed in the context of sustainability, this means upholding social, economic and environmental standards, not only on behalf of their business, but also for the larger community to which they belong and the planet at large.

3. **Mutuality.** Mars seeks to achieve mutual benefit of all parties involved with their business. Mars believes that ‘a mutual benefit is a shared benefit: a shared benefit will endure’. Sharing success is what they aim to do. In terms of sustainability, they recognise that the independence they enjoy as a privately held business is based on their interdependence with others, and successful partnerships are the foundation of sustainability. Their goal is to consider the social, environmental and economic impacts of their business decisions, from the local to the global level.
4. **Efficiency.** Efficiency, while being an indispensable part of implementing sustainable strategies such as lean manufacturing, cannot achieve sustainability on its own. Mars’ long-term success depends on ‘doing the right things’ as well as on ‘doing things right’. When they use highly efficient processes in the service of effective practices, they can create commercially profitable, socially beneficial and ecologically intelligent products and services that form the basis of robust, sustainable, long-term growth.
5. **Freedom.** Profitability enables Mars to preserve their freedom to operate. Their company’s unique qualities and ways of doing business provide the opportunity to approach sustainability as both a significant business opportunity and a common goal. Sustainability can help drive self-sustaining cycles of innovation and profitability.

In summary, Mars believes that the five principles and their approach to sustainability in the context of their businesses will drive innovation and enhance their competitive advantage, long-term growth and the value of their brands. By embracing both change and profitability, sustainability at Mars provides a lasting bond with their traditions and a bridge to their future success.

3.3 Sustainable sourcing at Mars

There is a lot more to Mars than chocolate. The main commodities sourced by Mars are cocoa, fish, meat, palm oil, peanuts and sugar. In every category in which they operate, they strive to make a difference. Mars’ actions and initiatives on these commodities range from commitment to the round table on sustainable palm oil to co-operation with the tropical agricultural research institute in India to improve the sustainability of peanut production. They focus on the production of sustainable commodities, as well as reducing the environmental impact of their company processes through initiatives which aim to decrease waste, packaging, use of water, use of energy and CO₂ emissions.

The cocoa commitment

Mars takes a leading position on cocoa. Together with Nestlé, Mars buys about 20% of the available cocoa on the global market. This means that Mars can take a leading role in motivating the market towards sustainable growth of cocoa. And that is unquestionably what Mars has been doing. In April 2009, Mars announced their ambitious intention to source 100% sustainable and certified cocoa ingredients by 2020. This commitment places Mars as an industry leader in the pursuit of socially responsible cocoa production. To illustrate this, in 2020, Mars expects to source about 400,000 tonnes of certified sustainable cocoa ingredients. Currently, only 2%-3% of the cocoa market can be labelled as sustainable. Mars’ aim for sustainable sourcing will undoubtedly impact on the cocoa market, their competitors and their supply chain. A budget of about twelve million euros has so far been allocated to the sustainable cocoa project.

This Mars investment has three important drivers:

- The company and its owners are strongly committed to the five principles in which responsibility and mutuality are clearly signalled. As Mars is family owned, it can plan even twenty years ahead.
- The consumer is buying the tasty, healthy drinks and snacks that Mars is producing in a sustainable way, in record breaking volumes. It is expected that the consumers will increasingly demand the same standards for all chocolate-based snacks.
- More sustainable production can help to diminish the supply chain risks which currently endanger the cocoa value chain. Presently, aging trees, outdated farming techniques and plant disease reduce annual crop yields by more than 50% of their potential. Overcoming these problems is essential, not only for the supply chain of cocoa processing industries, but also for the economic wellbeing of the sector and for the sustainability of rural livelihoods.

Securing the supply chain

Small family farms are at the heart of the cocoa industry, with 5 to 6 million farmers providing more than 90% of the world’s cocoa crop. Mars has developed the following policies in order to integrate smallholder farmers in the cocoa industry in a sustainable way:

1. **Farmer training:** Mars aims to train hundreds of thousands farmers, mostly located in the Ivory Coast, in increasing the productivity of their land and trees without causing ecological damage. They do this by building capacity within institutions and NGOs who can reach many farmers. For example, Mars is working together with UTZ and The Rainforest Alliance to help farmers to produce more cocoa from fewer trees and to diversify their production so they can balance their income across the seasons. By training farmers in a structured way to increase their productivity through better agricultural practices, it is estimated that productivity and incomes can double, and reduce poverty in the process.
2. **Stable prices:** For Mars as well as for smallholder farmers, stability in the price of cocoa is important. If the price of cocoa drops too much, the farmer may decide to switch to growing other crops and hence start a spiralling effect of reduced supply – increased demand. If the cocoa price increases to the extent that the price of chocolate increases, the consumer may choose to buy an alternative, cheaper snack food. Stimulating competitors to buy sustainable cocoa is an important part of Mars’ view on mainstream certification, as it leads to less price disadvantages. With higher demand, the competitive disadvantage of premium prices will decrease and ultimately through volumes, prices will leverage.

3. **Certification:** Mars strongly believes that certifying systems, such as UTZ and The Rainforest Alliance, will drive sustainability, where a premium is paid to the farmer groups and in exchange they are assured of a more stable supply of high quality cocoa. Working together with UTZ and The Rainforest Alliance helps Mars to enable farmers to have access to certified, sustainable and traceable cocoa. Peter van Grinsven, Cocoa Sustainability Field Research Manager for Mars, is convinced that certification can make a difference, because farmers receive the training and support they need to improve their productivity and run more profitable cocoa farms.

While Mars has supported farmers and the sustainable development of the cocoa crop for many years, it is now focusing its attention on a foundation called 'Putting farmers first'. Resources will be directed towards working with certifying partners, cocoa farming communities, cocoa sector governments and national institutes to effect real change in sustainable farming practices and certification of cocoa. By investing in 'farmers first', Mars has demonstrated that it is serious about helping cocoa buyers to source sustainably grown cocoa.

This initiative is similar to Mars' genome project where the entire cocoa genome is being analysed. Mars will share the genome information with the industry. Unlocking the genome will enable farmers to plant better cocoa varieties and create healthier, stronger cocoa crops with increased yields, pest and disease resistance, and improved water and nutrient use efficiency.

3.4 Lessons and advice

Peter van Grinsven and his team have been responsible for steering Mars' aims in relation to the cocoa industry for several years. His previous commercial experience in analysing supply and demand is an asset in his current job. Having gained a lot of experience, it is interesting to note the most important lessons he has learned in the past years:

- **Contribution:** *Know why* you want to work on sustainability and on *what issues* you can have major impact on. Find out *how* you can contribute – is it expertise or buying power or something else? Always make sure that you contribute in line with the long-term goals of the company.
- **Sourcing:** Implementing sustainability in sourcing is important in building a secure and sustainable supply chain. The best route to follow is to source certified commodities or services. This helps to create standardisation, volume and leverage.
- **Share:** Don't try to do it all by yourself but organise the sector. Accept the fact that competitors will benefit from shared knowledge and initiatives.
- **Persistence:** Most projects will need time to show success, and it takes time for the sustainability approach to be accepted by the organisation. Be prepared to invest the necessary time.

Chapter 4

Best Practice IKEA:

Low price – but not at any price

‘Taking responsibility for people and the environment is a prerequisite for doing good business’

For IKEA, sustainability is an opportunity to optimise the current way of thinking and handling. Sustainability projects are always labelled as business projects because they need to serve the planet, the people and the profit, meaning that environmental, social and economical criteria are connected to create a better business.

The IKEA story began in 1943 in the small village of Agunnaryd in Sweden, when the founder, Ingvar Kamprad was just 17. Since then, the IKEA Group has grown into a major retail experience with around 128,000 co-workers and 253 stores in 24 countries, generating annual sales of more than 21.1 billion euros. The IKEA group has 41 trading service offices in 30 countries to support their worldwide sourcing. Their supplier base covers 1,769 suppliers in 54 countries.

IKEA’s vision is to create a better everyday life for many people. Their business idea supports this vision by offering a wide range of well-designed, functional home furnishing products at prices so low that as many people as possible will be able to afford them. To make good products at low prices, you need to develop methods that are both cost-effective and innovative.

4.1 Low price – but not at any price

Low prices are the cornerstone of the IKEA vision and their business idea – low prices, but not at any price. At IKEA, their belief is that taking responsibility for people and the environment is a prerequisite for doing good business. The IKEA culture is a good example of how a responsible conduct is being integrated throughout the organisation. All business units of IKEA have integrated sustainability in their business plans, leading to sustainable targets and Key Performance Indicators (KPIs) for all managers. In effect, all IKEA managers are responsible for achieving the sustainability targets in their daily work.

To support business, there are a number of social and environmental specialists covering a wide range of areas, such as chemical experts, forestry specialists, energy experts, code of conduct developers and auditors. All IKEA stores and distribution centres have social and environmental co-ordinators who work in the areas of training, working conditions, safety, waste management, water and energy conservation.

4.2 Sustainability

IKEA has a very active approach to sustainability. To illustrate this, these are some of the highlights:

- IKEA puts considerable effort in their ‘IKEA goes renewable’ programme which aims to have all of their products recyclable within the next two years.
- IKEA has identified potential energy efficiency improvements in existing stores. New energy efficient features will be included (including use of renewable energy for heating) in the 20 new stores being constructed.
- IKEA has estimated their entire carbon footprint to identify the full extent of their climate impact – from the extraction of raw materials to customer transportation and the use of products. The result showed that 60% of the footprint is related to raw materials.

- IKEA co-operates with companies, trade unions, NGOs and organisations to develop and strengthen the impact of their work within the social and environmental field. For example, IKEA works in partnership with UNICEF and Save the Children to improve children's rights and with the global conservation organisation WWF on forestry, cotton and climate change projects.
- IKEA has taken some steps to engage in water conservation projects and raise the awareness of their suppliers. Over the next few years IKEA will work to adopt a more systematic and comprehensive approach to water.

Another important step forward is the update of *IWAY*, the IKEA code of conduct, which describes minimum requirements for social and working conditions, together with environmental norms. The code of conduct has been established in order to make the IKEA position clear to suppliers and their co-workers, as well as any other parties. It is based on the eight core conventions defined in the Fundamental Principles and Rights at Work, ILO declaration June 1998 and the Rio Declaration on Environment and Development 1992. Further, IKEA recognises the fundamental principles of human rights as described in the Universal Declaration of Human Rights (United Nations 1948). IKEA has also adopted a long-term sustainability direction, stating that the IKEA business shall have an overall positive impact on people and the environment. Improved routines enables IKEA to focus more on supporting suppliers to take responsibility and ownership themselves, while continuing to build long-term relations with suppliers who share the IKEA values. New suppliers will be selected based on start-up requirements with a special focus on working conditions.

4.3 Sourcing

IKEA sources globally, with the top five countries being China (21%), Poland (17 %), Italy (8 %), Sweden (6 %) and Germany (6 %). Overall IKEA sources mostly in Europe (67 %) and Asia (30 %). IKEA has two important focus points, increasing the sustainability of their supplier base and increasing the use of sustainable raw materials.

Increasing the sustainability of the IKEA suppliers

IKEA strives to build long-term relationships with suppliers that share their values and who want to grow and develop together with IKEA. Their focus is to motivate and support suppliers in such a way that developments become sustainable and independent of IKEA presence. Suppliers are motivated to become compliant in order to stay in business with IKEA. All suppliers have to commit to develop to 100 % compliance to the IKEA code of conduct *IWAY*. New suppliers are selected based on start-up requirements and they are obliged to commit to a 2- to 3-year plan in which they will reach 100% compliance.

IKEA has identified four major groups of suppliers: Home Furnishing suppliers (13,800), FOOD suppliers (76), Catalogue suppliers (50) and Transport service providers (263).

For all suppliers the IKEA *IWAY* code of conduct is applicable. Additional requirements are outlined depending on the category of the supplier.

- For instance, the *IKEA Food Quality and Environmental Requirements* is a supplement to *IWAY*, which consists of specific requirements on food quality and environmental issues which are not covered by *IWAY*.
- IKEA requires catalogue suppliers to set environmental targets focusing on the reduction of energy consumption and CO₂ emissions and to document their water consumption.

- There are also specific requirements on improving the efficiency of transportation, for example their supplier of sea freight is requested to use a specific AKZO Nobel coating which leads to 6% reduction in fuel use. All transport service providers must measure their carbon dioxide emissions and set a three year target to reduce these emissions. This shows that IKEA has a firm grip on sustainability issues in their supply chain.

IKEA auditors regularly visit suppliers to ensure that *IWAY* criteria are met. These visits can be both announced and unannounced and each supplier is audited at least every second year. The IKEA auditors help to set up action plans when there is non-compliance and conduct follow-up visits to review progress.

The compliance and monitoring group (CMG) is responsible for ensuring that the same audit criteria are followed worldwide. CMG works to fine-tune and calibrate audits by training and supporting IKEA auditors in order to create a common standard of auditing. Third party auditors such as KPMG, Intertek Testing Services and PricewaterhouseCoopers participate to verify IKEA working methods and audit results. These third party auditors also carry out their own audits at IKEA suppliers.

Obviously, IKEA puts in enormous effort to motivate their suppliers to become 100 % compliant with *IWAY*. In 2008 the number of *IWAY*-approved suppliers continued to increase in Europe and the Americas in particular to 80 % and 91 %, respectively. Progress can be detected in Asia (now 34 %), though the development towards *IWAY*-approval in China continues to be slow.

Only a few Chinese suppliers have been fully approved. Since the introduction of *IWAY* in 2000, there has been some positive developments amongst IKEA's Chinese suppliers and in 2008 the *IWAY* fulfilment rate for China improved significantly, from 4 % to 7 %. There are major challenges with regard to the social and environmental conditions in China. The most difficult labour related challenges are related to wages, working hours, overtime compensation, lack of unions and social insurance. These issues are not unique to IKEA but relate to all multinational companies who are doing business in China. IKEA is approaching these issues in two different ways.

- IKEA participates in the business for social responsibility (BSR) project 'One voice – beyond monitoring.' The aim of the project is to facilitate IKEA to build relationships with other multinational companies doing business in China, and to work jointly with them to find solutions to corporate social responsibility challenges. During the financial year 2008/2009 there has been an active dialogue with Chinese authorities and academia to promote issues on both a national and local level.
- Audit rates have been increased in China (and in some other countries) and specially appointed *IWAY*-developers offer support and training to actively contribute to improvements among suppliers.

During the financial year 2008/2009 IKEA updated *IWAY*. IKEA wants to shift focus from an audit-driven process, and work together with suppliers beyond monitoring. Rather than detailing how suppliers can comply with *IWAY*, they focus on increasing understanding for what they need to comply with. IKEA supports their suppliers to improve their operations and practices using a network of trading service offices. IKEA believes in maintaining relationship with its suppliers and does not break off relations simply because of non-compliance. IKEA will continue to work with these suppliers as long as they show a willingness to improve in the right direction with an agreed plan of action to comply with the IKEA requirements within an agreed timeframe.

Increasing the use of sustainable raw materials

Efficient use of raw materials is one way IKEA manages to keep its costs down. IKEA is striving to increase the sustainability of their major commodities and still keep their prices low. To be ahead of competition, they are taking up leadership in stewardship of sustainable wood and cotton, and they are adapting their procurement and sourcing function accordingly:

Wood

Wood is one of the most important raw materials for IKEA. As wood is both renewable and recyclable, it is a sound environmental choice, provided it comes from responsibly managed forests. Suppliers of wood used in IKEA products must be able to document the origin of their wood in an annual questionnaire, which is used as the basis for a wood supply chain audit. Information from the questionnaire and a risk assessment are used to choose a number of wood supply chain audits for closer evaluation. The Rainforest Alliance smart wood programme, a third party auditor, complements the IKEA auditing system by conducting a limited number of wood supply chain audits for IKEA.

The IKEA wood procurement group works to secure future price reductions and access to wood from sustainable sources. The group supports selected suppliers to purchase raw materials and they initiate and handle IKEA investments in forestry sawmills and component production. Next to that, the IKEA wood procurement group has established co-operation with the pulp and paper industry and has long-term agreements with governments, forest owners, and forestry-related associations. Suppliers of wood are expected to be at least compliant with the IKEA minimum requirements and preferably be certified by the Forest Stewardship Council (FSC), including the Forest Management (FM) and Chain of Custody (CoC) standards.

Cotton

Cotton is another important raw material for IKEA, using nearly 1% of the world capacity of cotton. IKEA is at the end of a long cotton production process. In many countries the supply chain for cotton is complex and has several tiers. Lasting change can only be achieved through co-operation with many parties including other international companies, NGOs, governments and authorities. The long-term goal is for all cotton used in IKEA products to be 'better cotton'. The availability of sufficient volumes of 'better cotton' will affect how quickly IKEA can reach their goal.

IKEA is one of the founding members of the Better cotton initiative (BCI). This global multi-stakeholder organisation aims to make global cotton production better for the people who produce it, better for the environment it grows in and better for the future of this sector. Leading participants are international companies such as GAP and Adidas, NGOs and the United Nations Environment Programme. Key criteria for sustainable cotton are reduction of the use of water and reduction of chemicals by at least 50%.

Since 2005, IKEA and WWF have field projects in Pakistan and India, testing improved working methods for cotton cultivation and processing. These projects use 'better management practices' (BMP) which enable farmers to reduce their environmental impact, improve efficiency, maintain cotton crop yields and increase their gross margins. To illustrate the reduction of environmental impact: currently 80% less pesticide, 50% less water and 30% less chemical fertiliser is being used by farmers working with BMP. Another benefit is that the farmers earn a better income: on average 42% more. Some 2,000 farmers in Pakistan and 500 in India are participating through farmer field schools.

Of course the question always arises as to what the impact of all this will have on the price of cotton. Guido Verijke, Deputy Business Area Manager and Business Leader (Home textiles), explains that IKEA aims to source at the same price as conventional cotton. IKEA is trying to create capacities which are far beyond the need of IKEA and as such, will help to leverage the price.

Organic cotton can be produced at lower costs but still a premium price is asked in the market. IKEA is not in favour of that because it is slowing the progress of sustainable sources. Organic cotton has many advantages but also disadvantages such as price and the small available capacities. Better cotton which IKEA wants to use for all of its products can be produced in higher volumes.

Guido Verijke expects that nearly 30% of IKEA's cotton needs for 2010 are already available. By 2015, he expects to be able to source 100% 'Better Cotton' needed for their products. IKEA is working in close partnership with their suppliers because they partly control the use of 'Better Cotton'.

In sourcing from sustainable sources, Guido says that it is very important to take the 'total cost of ownership' into account. This leads to opportunities to further optimise the supply chain by reducing middlemen, to select fewer suppliers who work in the preferred sustainable way and to directly link them to sustainable sources of cotton.

4.4

Lessons and advice

IKEA is open to sharing their experiences with others. Guido has even organised meetings with competitors to discuss sustainability issues. In his view, this is not about competition but about solving a problem together. His most important lessons working for IKEA on sustainability are:

- **Integrate:** sustainability at the very beginning of your process, keeping the total cost of ownership in mind.
- **Work together:** If you are small, get your sector organised to create volume and impact. Look at initiatives that you can join. Work together with NGOs because they will provide you with a lot of expertise. Work in partner-ships with your suppliers.
- **No compromise:** Put your demand to the market and do not compromise.
- **Internal commitment:** Working in a more sustainable way, will mean considerable changes in traditional thinking. To get the internal commitment, you must do your homework well and know the facts about the impact that your company can have. Work out a sustainability strategy to reduce environmental impact and seize the competitive chances.

Chapter 5 Conclusion

‘There’s no sustainable development if there’s no sustainable profitability.’

Jean Martin, president of the
Confederation of the Food & Drink
Industries of the EU

The best practices described in this book are from three companies who have successfully integrated sustainability into their core processes, overall strategy and in their value proposition. These companies are striving to get a competitive edge based on proven progress in sustainability.

They are frontrunners when it comes to aligning the sustainable sourcing and procurement function to their business objectives. They are in close contact and communicate fully and openly with all of their stakeholders and they have developed comprehensive approaches to defining and calculating cost of ownership. They keep a firm grip on their progress and measure their results. Most importantly, these companies are the ones who have put their sustainable demand out there in the market, outpacing those that may follow.

If you are planning to take the necessary steps to convince the wider business world of the potential and competitive opportunities that sustainable procurement and sourcing offers, I propose that now, of all times, is the time. No company is the same. The ecological impact will be different depending on the size of the company, the core business, the volumes of raw materials, the number of suppliers and consumers, the transport needed, among others. Nevertheless, there seem to be some shared lessons to be learned from the three companies described in this booklet. In summary:

1. **Integrate sustainability in the overall strategy of your company:**
 - a. Analyse the ecological impact of your processes, list the opportunities to reduce the ecological footprint and map these opportunities in terms of benefits for the company, the society and the environment
 - b. Select the sustainability opportunities which have the best shared value
 - c. Translate those into plans, targets, KPIs and (optional) incentive schemes
2. **Integrate sustainability in your sourcing strategy:**
 - a. Define a sourcing strategy for each commodity and spend category and include a focus on the use of certified raw materials.
 - b. Calculate based on total costs of ownership and optimise your supply chain
 - c. Request your suppliers to read and accept your code of conduct and encourage your suppliers to become compliant
 - d. Place your demand firmly in the marketplace and do not compromise
 - e. Measure your results using financial and ecological indicators

3. **Share volumes, knowledge, resources and practises:**
 - a. If buying volumes are small, get more organised
 - b. If buying volumes are considerable, consider becoming the leader in stewardship of the relevant sustainable commodity
 - c. Work together with NGOs, government, companies, customers and suppliers to find the innovations that will lead to sustainable profit
 - d. Communicate your progress

4. **Choose a change management approach:**
 - a. Sustainable sourcing will require some fundamental changes. Be prepared to take time and get a long-term commitment from the board
 - b. Involve the internal organisation whenever possible in the successes and regularly update the internal organisation on progress

Sustainability is here to stay, global recession or not, and it is up to you to seize or further explore the opportunities. The message is simple. Those that prepare early will not only be ahead of the game but will also be in the best position to attract clients, secure their supply chain, grow their business and to make a difference to the people and planet. Make sure that you are one of them!

Acknowledgements

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