

# Gaining Competitive Advantage via Ethical Manufacturing Sourcing

by Thomas Wrobleski and Kaush Oza

Sustainability, Corporate Social Responsibility, Green Supply Chain, Carbon Footprint – these are a few of the many buzzwords currently being used by companies as they attempt to differentiate themselves in the marketplace by forging new solutions and attempting to reshape the expectations of their customers.

Ethical Manufacturing Sourcing is a critical component of Corporate Social Responsibility. The goal is to use suppliers that

incorporate principles of morality in manufacturing conditions, including proactively trying to reduce harm to and/or exploitation of labor and the environment. Addressed correctly, ethical manufacturing sourcing minimizes the risk of failure within the supply chain. Some industry sectors are more impacted than others. Not surprisingly, the retail and consumer product industries garner the most public attention as the customer experience of tangible products and their ethical-sourced supply chain are integrally woven.



### Perception Issues for Ethical Sourcing

Several industry initiatives abound to address this global ethical sourcing challenge. The challenge many companies face is justifying the need for suppliers that adhere to ethical sourcing standards. The traditional supply chain concept is leveraging low cost suppliers that are effective in meeting prescribed material parameters and service/product requirements. A common misconception is that suppliers that actively embrace and invest in recycled materials, energy conservation and other sustainability efforts, or choose not to leverage “sweat shop” labor and/or conditions have higher prices due to non-standard processes and lack of economies of scale. In fact, companies that embrace key sustainability solutions, including ethical sourcing, are more prone to adapt and succeed over the long term as they can pass on savings and/or branding (e.g., certified coffee producers) to their buyers and end consumers.

### Barriers to Ethical Sourcing

Before embarking on the ethical sourcing journey and changing any of the existing Supplier Relationship Management processes or framework certain steps need to be taken, including reducing barriers to sourcing:

**Stakeholder Pushback** – A move from incumbent suppliers or changes to the sourcing strategy may spur internal and external pushback. This is typical for industries where quality of the product or perceived value, such as in manufacturing and some retail sectors, is at stake. More often than not the internal stakeholders are the ones that need to be convinced.

**Lack of Alignment with Business Objectives** – Another barrier to embracing ethical sourcing is not linking business objectives to strategic sourcing. For instance, an organization may

have ethical sourcing goals but are those goals clearly articulated through execution of daily sourcing activities (e.g., commodity analysis, supplier assessments etc.)? Failing to link strategic business goals with operational execution can derail the best intentions in pursuit of a differentiating sourcing program.

### Absence of a Structured

**Assessment Process** – Due to the significance and critical nature of the supplier assessment process, many suppliers push back on the information required and length of time it takes to be certified. What they fail to see is the opportunity to leverage this capability to get on the preferred supplier list of other companies.

Whether faced with public outcry based on published reports of the use of child labor or internally determining that corporate social responsibility must be a core company value, multiple companies have taken the lead in driving ethical sourcing. **Levi's** (Better Cotton Initiative), **Starbucks** (Coffee and Farmer's Equity or C.A.F.E program), **Patagonia** and **Nike** are just a few of the large multinational companies that embraced ethical sourcing, set the standard, and are leading the way for other companies to follow. They have found that ethical sourcing can not only enhance their corporate image but can also improve sales within their specific brands.

### Enablers of Ethical Sourcing

There are five key enablers for ethical sourcing that will drive and create a competitive advantage, not to mention a market enhancing image for a company that addresses ethical sourcing correctly as shown in Figure 1:

**1. Reach out to Suppliers as Partners** – A multi-partner strategy where the company uses not only its internal assessment, but also external sources in evaluating its supply chain partners is desirable.

This is especially true for countries where initial production is the beginning of the sourcing process – no company wants bad publicity to smear its image. The United Nations, Non-Governmental Organizations, and human/environmental rights activist organizations can play an important role and provide contextual information. However, nothing replaces a partnership approach where a company can continually evaluate and support its supplier base in the form of joint development activities and assistance in prototyping a desired product line to specifications.

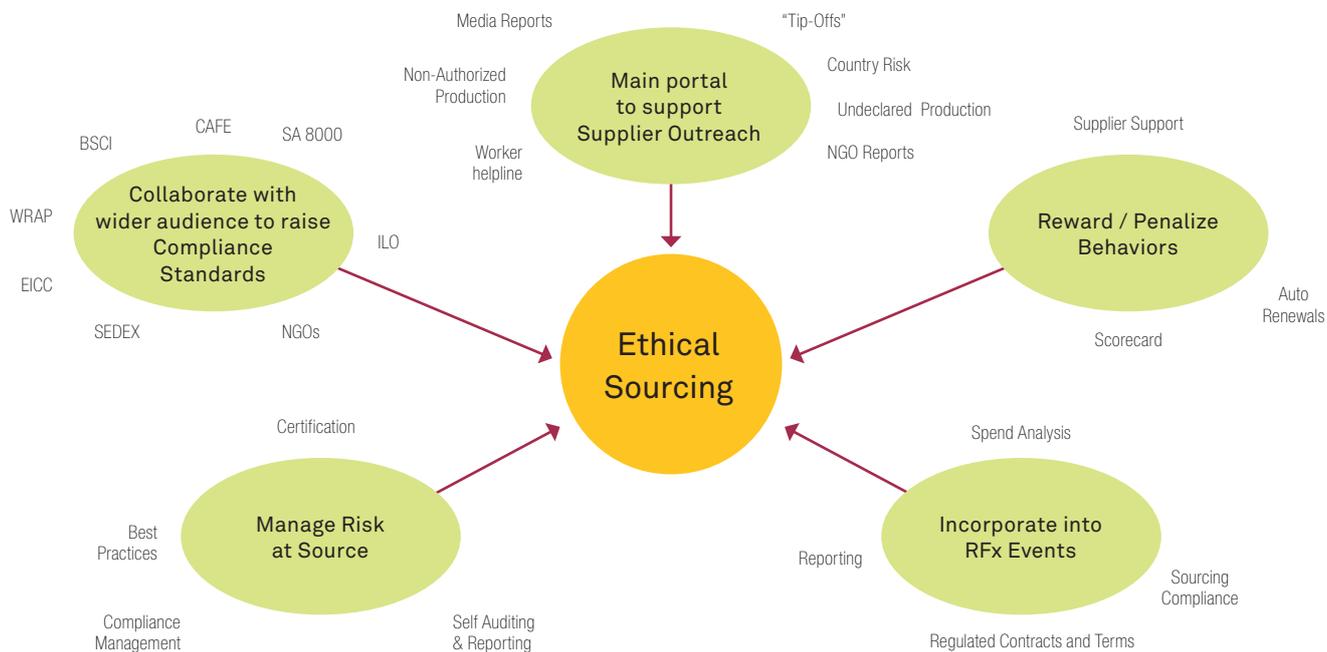
### 2. Reward/Penalize Behaviors

– A solid Supplier Relationship Management Scorecard should incorporate a metrics driven structure that can quantify and qualify supplier ability to sustain their ethical manufacturing commitment. This structure should reward suppliers who are consistently delivering on their promises in the form of repeat and increased business. This does not mean volume commitments, but a partnership approach to utilize dependable services and products. It is important to have clear objectives and metrics, and equally important for the suppliers to be aware of the company's program and expectations.

### 3. Incorporate Ethical Sourcing Language into RFx Events

– Contractual language should be well crafted to deter any major deviation from the norm. By providing clear Terms and Conditions for sourcing via electronic or manual bid processes a standardized structure should be implemented. For companies with global business units it is imperative that a uniform process drive the bid process. This can be done by involving legal, marketing, and finance teams in the sourcing discussions during the pre-bid process.

**Figure 1: Enablers of Ethical Sourcing**



Source: Capgemini

**4. Manage Risk at Source** – Periodic inspection and / or supplier outreach is another aspect of ensuring conformance to desired objectives. Failure to assess or support supplier programs can have undesired consequences for production cycles. Proactive monitoring of manufacturing conditions (e.g., labor standards, environmental conformance) tells the supplier that the company is serious in its intent to address the ethics challenge.

**5. Collaborate with a Wider Audience** – For any consumer product, retail, or manufacturing activity with a global footprint an alliance approach is critical. For instance, for a retailer or consumer product company that heavily uses labor meeting International Labor Organization (ILO) guidelines or for a toy company being integrally involved with International Council of Toy Industry (ICTI) should be a basic foundational capability. However, the dialogue and more importantly management of the company’s image should extend to a broader audience, including

consumers, workers, shareholders and sub-contractor networks. While retailers can be reluctant to work with their competitors, sharing common information about environmental or child labor transgression related to a supplier helps to weed out undesirable activities without anger from or harm to the end consumer. More importantly, it sends a message to suppliers that the industry means business.

**Benefits of Ethical Sourcing**

Early adopters of ethical sourcing have leveraged this capability for years. With technology capabilities allowing our globe to continually “shrink” and be more competitive, ethical sourcing is now gaining traction on a much larger scale. There are three benefits to pursuing ethical sourcing:

**1. Market Image** – Consumer perception and buying habits are often swayed by how a company conducts or does not conduct itself. The last thing a company wants is adverse publicity. A single

environmental or child labor issue can have a far reaching impact on a company’s image not to mention its market standing.

**2. Cost Avoidance** – Focus on product safety and improved process controls enables better contract handling and monitoring of supplier scorecards. This in turn provides companies with the ability to reduce suppliers and more importantly product / service failure rates while improving the overall cycle time. This is of utmost importance particularly during recessionary times or declining sales as CFOs are under pressure to reduce costs and improve margins.



**3. Bottom Line Impact** – Companies that pursue ethical sourcing reap the benefits of better supplier relationships, reduce risk exposure and improved cost structures. The reason is greater efforts are made by the companies in allocating time and resources to ensure suppliers are living up to higher moral standards and execution responsibilities.

Share price and profitability are higher for companies with significant

sustainability programs as shown by an Aberdeen Group study in Figure 2.

During tough economic times such as currently seen in the market, where sales are stagnant or declining, ethical sourcing can provide much needed margin improvement. As shown in the table above, those companies either best in class or even average in leveraging ethical sourcing see decreases in cost factors

that will drive down Costs of Goods Sold (COGS) thereby improving margins. On the flip side, all other factors being equal, having ethically sourced products would allow a company to charge higher prices, thus improving margins, as consumers have shown a willingness to pay more for socially responsible products.

Ethical manufacturing sourcing is not about a philosophy or a new fangled approach in this day and age – it is another potential channel that companies can implement across the organization’s buying habits to enhance their image and reduce waste.

Given the need for companies to continually find points of differentiation in the global marketplace, this differentiation is an ideal “game-changing” sourcing dynamic.

**Figure 2: Year-over-Year change in 6 Key Metrics**

Metric	Best in Class	Average	Laggard
Paper Costs	Decreased by 11%	Decreased by 7%	Increased by 13%
Facilities Costs	Decreased by 10%	Decreased by 1%	Increased by 15%
Energy Costs	Decreased by 9%	Decreased by 2%	Increased by 19%
Waste / Disposals Costs	Decreased by 8%	Remained the same	Increased by 7%
Pakaging	Decreased by 7%	Decreased by 1%	Increased by 1%
Transport / Logistics Costs	Decreased by 5%	Decreased by 2%	Increased by 125%

Source: Aberdeen 2009 Study Sustainability Matters: The Corporate Executives Strategic Agenda”



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