HIGHLIGHTS

# Introductory paper on SMEs and Responsible Business Conduct in the Garment and Footwear Sector

## SURVEY RESULTS AND KEY CONSIDERATIONS

OECD

Draft for consultation

# Introductory paper on SMEs and Responsible Business Conduct in the Garment and Footwear Sector

Survey results and key considerations: Highlights

**Draft for consultation**

OECD

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Introductory paper on SMEs and Responsible Business Conduct in the Garment and Footwear Sector: Survey results and key considerations

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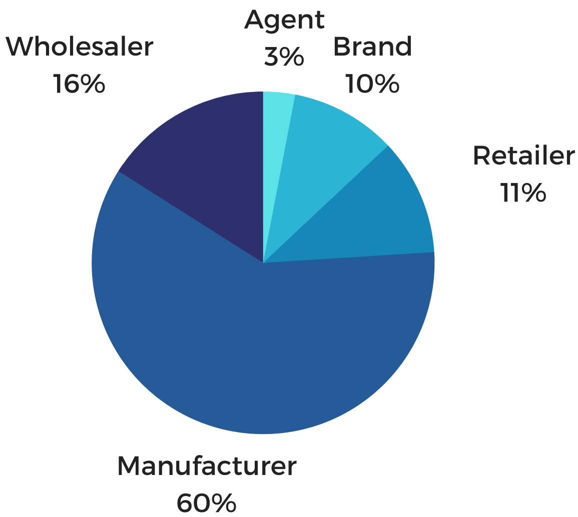
This draft paper was prepared by Julia Del Valle under the direction of Dorothy Lovell from the OECD Centre for Responsible Business Conduct in the Directorate for Financial and Enterprise Affairs. We would like to acknowledge those who completed the survey and provided input or reviewed the report. This report will now be open for further review, and we will update this acknowledgement in the final version of the report.

# RESULTS OF THE OECD SURVEY ON SMEs' SOURCING PRACTICES & DUE DILIGENCE IN THE GARMENT & FOOTWEAR SECTOR

## OVERVIEW OF THE SAMPLE

### PRIMARY BUSINESS ACTIVITY

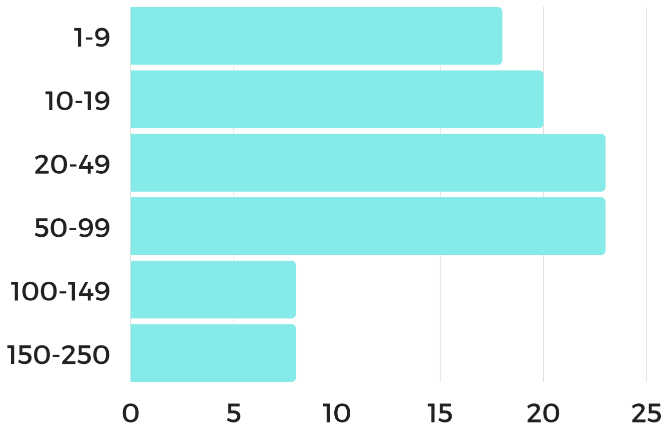



Manufacturers' activities in the sample are mainly part of tier 1, which involves final stages of manufacturing

**80%**

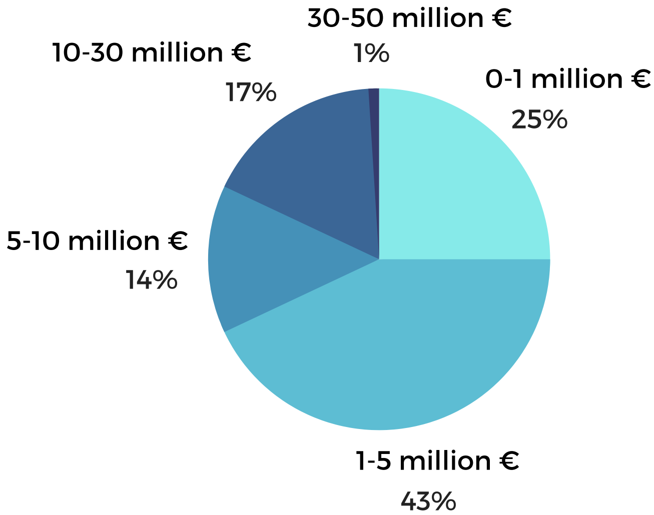
of respondents have been in operation for over 20 years

### NUMBER OF EMPLOYEES

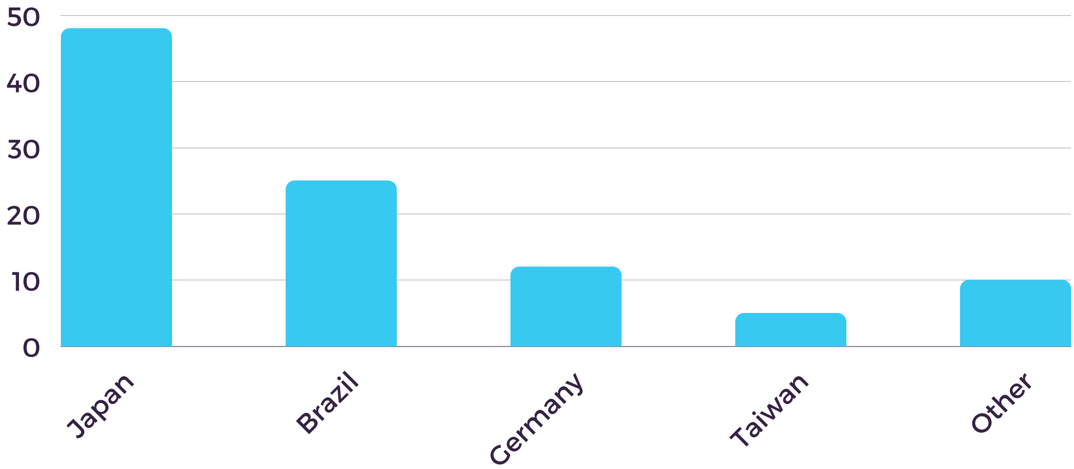



Nearly 90% of respondents are small and medium enterprises. SME respondents have on average 50 employees and a turnover of 3 million €

### ANNUAL TURNOVER

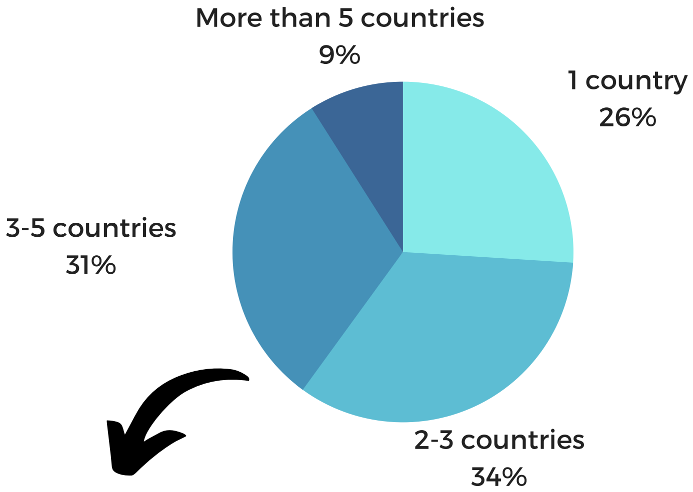



### HEADQUARTERS LOCATION



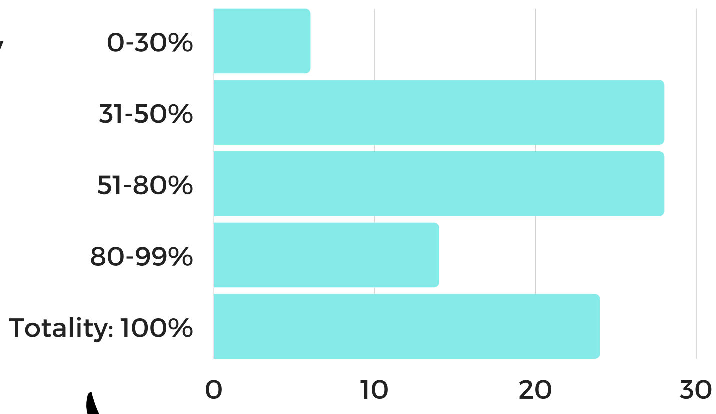
# SMEs' SOURCING PRACTICES

## NUMBER OF COUNTRIES INVOLVED IN THE SUPPLY CHAIN

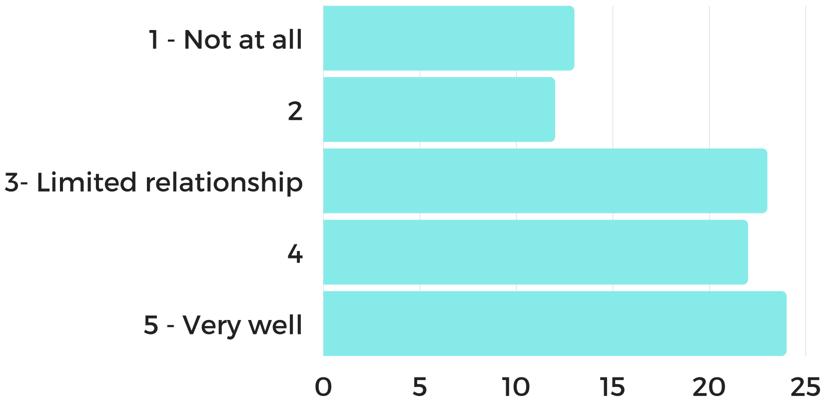



SME respondents source on average from 1 to 3 different countries

## % OF SOURCING THAT COMES FROM TOP SOURCING COUNTRY




For the majority, they mostly source from 1 country




**80%**

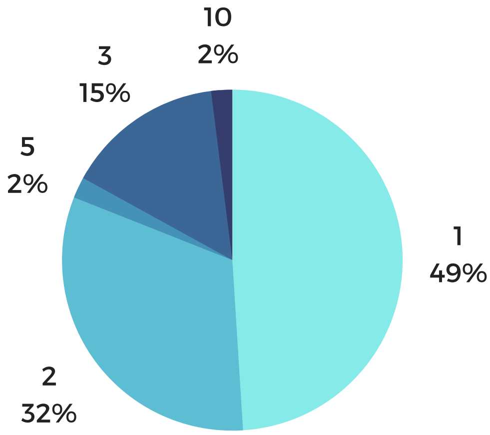
of respondents consider themselves to be smaller or significantly smaller than their suppliers

When sourcing directly, SMEs have on average

**2-10**

direct suppliers in a year

## INDIRECT SOURCING: NUMBER OF INTERMEDIARIES BETWEEN THE ENTERPRISE AND THEIR SUPPLIERS



# Executive Summary

SMEs are predominant actors in the global garment and footwear sector, where they are prevalent across the whole supply chain. They provide around 80% of jobs and account for 60-70% of industry turnover in Europe. They are essential drivers of economic and social well-being, as they contribute to economic growth, foster innovation and economic diversification and create jobs. At the same time, they are often an important source of employment for groups who are particularly vulnerable to social and economic deprivation, including women, older persons and less-skilled workers. While they constitute the backbone of the sector, their resources, knowledge and capacity to implement due diligence tend to be more limited compared to larger multinationals.

SMEs may find it harder to fulfil compliance requirements for example, meeting the costs of conducting due diligence or understanding how to concretely translate policy commitments into relevant operational due diligence procedures. Other factors such as their business and sourcing models can also largely affect the way that these companies carry out due diligence. However, SMEs often have greater flexibility, greater ability to integrate new instructions as well as smaller operations and fewer suppliers, which can reduce the complexity of their due diligence process. Clearly, understanding how due diligence may differ for SMEs from larger companies, and engaging SMEs and their relevant stakeholders on these issues is imperative if we are to accelerate and embed responsible business conduct throughout the entire value chain.

This paper identifies and examines in which ways the structure and sourcing practices of SMEs can impede or enhance to their capacity to implement meaningful due diligence.

Based on the results of a survey about the nature of their business and sourcing models and due diligence practices conducted with SMEs across six months in multiple languages, this report shares observations on key characteristics of SMEs, their link to SME due diligence practices, and makes 4 key findings about the challenges faced by SMEs in conducting due diligence.

## Context of the sample

Most SMEs in the survey data represent tier 1 suppliers in the supply chain, as the primary business activity for most respondents is manufacturing (60%). The overall results therefore reflect the experience of manufacturers and their position in the supply chain versus other types of companies: raw material producers, spinners, millers and traders. The regional breakdown of the respondents is as follows: 48% of respondents were Japanese companies, 25% Brazilian and 12% German, with 15% from other countries. Despite this, in preliminary consultations with stakeholders, the findings were found to be of broad application across the supply chain.

This preliminary study is shared for a broader consultation and findings will be tested as further research would be necessary to explore in greater depth the extent to which the indicative findings from this study apply in different Garment and Footwear industry sectors, countries and position in the supply chain.

## SME Characteristics

Most SMEs in the sample are manufacturers working in tier 1 of the supply chain as garment, footwear and/or component manufacturers, which involves the final stages of manufacturing. They are on average smaller than their suppliers that they consider to know well. A high sourcing concentration was identified as well as a low number of countries involved in the supply chain. They appear to have less complex supply chains with a low number of direct suppliers and a low number of intermediaries when sourcing indirectly. When they place orders via buying agents, there is high reliance on them. A low number of SMEs declared subcontracting.

## Due Diligence Practices

Policy, risk identification and assessment and monitoring: One third declared that they didn't have any kind of RBC policy or tool in place to set expectations and assess RBC performance. The most used tools are certification, contract terms and requirements and supplier self-assessment. They appear to have restricted access to other tools such as trainings, membership of collaborative initiatives and supplier factory audits. A low number collected RBC information, or even basic information about supplier's production sites. They mainly obtain RBC information from peer companies and business associations, reflecting that they rely on existing partnerships and use available information and existing practices, also showing a very low reliance on government, trade unions and civil society information.

## Findings:

### *Key challenges faced by SMEs*

SMEs tend to have a lower level of leverage due to their size and their orders generally represent a small amount of their suppliers' total production. Given their size and position in the supply chain, SMEs also lack leverage over their customers to influence their decisions and are more likely to be impacted by poor purchasing practices. On the other side, leverage is also affected by their sourcing model and the type of relationship the enterprise have with their suppliers and based on these criteria, SMEs present several advantages.

SMEs' due diligence costs tend to be higher given their position in the supply chain, low leverage over their suppliers and lack of financial liquidity and small margins. SMEs often face finance-related barriers to doing business, complying with complex and changing regulatory frameworks or implementing standards. At the same time, they often have greater flexibility in policy making and implementation and may have fewer impacts or suppliers to manage compared to larger enterprises. While costs can represent a significant burden for SMEs, their knowledge of business partners may allow them to reduce it. It should also be noted that they can also often engage in more direct ways with their suppliers and may need less complex impact assessments.

SMEs reported a lack of visibility over their suppliers as another main challenge. This is closely linked to the enterprise's level of leverage, since in cases where leverage is low, the enterprise is more likely to experience difficulty gathering information from the supplier. This can also be linked to the need for financial and human resources and the technical capacity for traceability. SMEs reported concerns in implementing supply chain transparency through disclosure of information, raising the competitive disadvantage of disclosing supplier factories and anti-competition behaviour. A lower number of actors and countries involved in the supply chain and direct interactions can reduce the cost of traceability.

SMEs are in general less informed and aware about due diligence. Technical content and terminology can represent a barrier to accessibility of relevant information, there is low level of formalisation of RBC processes through technical language among SMEs. Due to their flat structure and informal management, SMEs are heavily reliant on personal relationships and social capital rather than compliance, formal systems and structures. Lack of harmonisation of standards has also been reported by SMEs as an obstacle to due diligence.

### *Opportunities for SMEs according to the OECD Garment and Footwear Guidance*

While SMEs might face different types of obstacles when implementing due diligence, they also present characteristics that can enable them to facilitate their due diligence process and can use these to their advantage. Their management structure, greater flexibility, lower number of business partners, direct interactions and less complex supply chain can help implement their due diligence process rapidly and more effectively than larger multinationals. The OECD Garment and Footwear Guidance offers some pointers explaining how due diligence can be implemented in these types of situations. It provides guidance that may suit situations where companies have low leverage, while reducing costs and increasing the efficiency of the due diligence process.

The Guidance particularly encourages SMEs to collaborate and engage in industry initiatives to pool leverage, reduce the costs of due diligence and facilitate access to and harmonisation of information on RBC risks. For instance, taking into consideration how their sourcing practices influence their due diligence capacity and engage accordingly, SMEs are encouraged to develop a more intensive supplier selection process, consolidate (where feasible) their supplier base and limit the number of intermediaries, as well as actively seek out similarly sized suppliers, will help reduce the cost and complexity of supplier assessments. Restricting the number of countries involved in the supply chain is also recommended, as well as seeking common buying agents. This will also facilitate supply chain mapping and traceability and reduce country risk factors. SMEs are also encouraged to use existing sources of information from CSO, governments and Industry associations to help develop their due diligence processes, as well as stakeholders are encouraged to develop and facilitate accessibility to RBC information.

### *Role of larger businesses, government, industry associations and multi-stakeholder initiatives*

Besides the information provided in the Guidance and tools that can be particularly useful for SMEs, the paper recognises the important role of larger businesses and governments in contributing to a level playing field in which these characteristics are taken into consideration. The support of government and larger businesses is needed to ensure that SMEs implement due diligence in a favourable environment. Particularly government’s role will be crucial to develop a level playing field and ensure SMEs remain competitive while implementing due diligence. Given the particular characteristics of SMEs, governments can generate a great deal of value by creating an enabling environment to promote supply chain due diligence among SMEs. Multi-stakeholder initiatives, industry associations and CSOs have also an important function in ensuring that the development of communication and learning tools are reasonably accessible for SMEs to learn about the standards and tools for implementing due diligence.

Effective collaboration and due diligence implementation may in turn help a company to maximise positive contributions to society, improve stakeholder relationships, protect its reputation and perform better in the long term. It may also help with cost reduction, strengthening the management of company-specific business and operational risks, increase productivity and decreasing exposure to systemic risks or litigation. This paper is a contribution to a broader effort to understand and promote SME due diligence practice in the sector and these findings should be treated as insights that would merit further development, while additional research is needed for their quantitative verification.

# Conclusions and key considerations

## Conclusions

Given the primordial role to be played by SMEs in the garment and footwear sector, this paper considers persisting challenges and barriers to SME due diligence implementation in the sector as well as specific opportunities based on their characteristics. After identifying key characteristics of the sample and current due diligence practices, the paper reflects on the perceived obstacles faced by SMEs in terms of due diligence implementation and what type of mechanisms appear to be more adapted to their situation.

The key challenges identified in our sample relate to leverage, financial resources, supply chain visibility and due diligence awareness. All of the challenges are transversal.

- SMEs tend to have a lower level of leverage due to their size and their orders generally represent a small amount of their suppliers' total production. They are also more likely to be impacted by poor purchasing practices.
- SMEs' due diligence costs tend to be higher given their position in the supply chain, low leverage over their suppliers and lack of financial liquidity and small margins. They may lack the human resources to oversee due diligence implementation.
- All these factors also contribute to a lower level of visibility over their supply chain. SMEs have capacity, leverage and resource constraints in implementing traceability and predominantly lack visibility beyond tier 1.
- SMEs appear to lack access to and understanding of RBC information and the technical capacity to implement due diligence. They have also reported increased due diligence costs due to the lack of harmonisation of standards and assessment methods.

To address these challenges, the Guidance particularly encourages SMEs to use collaborative approaches and engage in industry initiatives to pool leverage, reduce the costs of due diligence and facilitate access to and harmonisation of information on RBC risks. They should take into account the extent to which their sourcing practices influence their due diligence capacity and engage accordingly, developing a more intensive supplier selection process, consolidating (where feasible) their supplier base and limiting the number of intermediaries, as well as actively seeking out similarly sized suppliers to help to reduce the complexity of the process. Restricting the number of countries involved in the supply chain is also recommended, as well as seeking common buying agents. This will also facilitate supply chain mapping and traceability. They are also encourage to use existing sources of information from CSO, governments and Industry associations to help develop their due diligence processes

SMEs are also encouraged to prioritise and address the most significant risks in their supply chain. Besides the information provided in the Guidance and tools that can be particularly useful for SMEs, the paper recognises the important role of larger businesses and governments in contributing to a level playing field in which these characteristics are taken into consideration. The support of government and larger businesses is needed to ensure that SMEs implement due diligence in a favourable environment. In turn, due diligence implementation may also help with cost reduction, strengthening management of company-specific business and operational risks, and decreasing exposure to systemic risks or litigation. It can also help them to strengthen their position in global value chains (GVCs) by accessing new markets.

This paper is a contribution to a broader effort to understand and promote SME due diligence practice in the sector and these findings should be treated as interesting insights that would merit further development, while additional research is needed for their quantitative verification.

## Key considerations

### *Considerations for governments*

Governments have a responsibility to enable RBC and promote policy coherence. Given the particular characteristics of SMEs, governments can generate a great deal of value by creating an enabling environment to promote supply chain due diligence among SMEs. In this respect, the following measures will be key:

a. *Regulation*

- Level the playing field: promote the development of an enabling economic and regulatory environment to encourage SMEs to implement supply chain due diligence and strengthen their capacities to remain competitive.
- Require due diligence implementation in public procurement processes and facilitate the competitiveness of SMEs in procurement bids by providing financial incentives (for example, tax privileges and favourable loan policies through public financial institutions, public procurement offers to SMEs implementing RBC) to SMEs that have implemented due diligence.

b. *Guidance*

- Raise the level of due diligence awareness by developing effective communication, practical tools and guidance adapted to build SMEs' capacity to recognise and act upon due diligence risks. Communication should be targeted at SME owner-managers.

c. *Incentives*

- Support collaboration by promoting the development of multi-stakeholder initiatives or collaborative initiatives in the sector.
- Support development and alignment of national certification schemes to international RBC standards.
- Encourage private banks and insurance companies to provide incentives for good RBC performance by SMEs.

### *Considerations for businesses*

SMEs are expected to implement supply chain due diligence to identify and address actual and potential adverse impacts in their supply chain. They may encounter challenges while doing this. This non-exhaustive list contains recommendations for business to ensure that they maximise their RBC capacities, bearing in mind their constraints in terms of knowledge and resources:
*Considerations for SMEs*

a. Formalise the due diligence process. Develop an RBC policy embedded in the enterprise policy that includes commitments regarding its own activities to build the enterprise's expectations of its business partners – including suppliers, licensees and intermediaries – across the full length of its supply chain.

b. Build leverage through partnering with suppliers. This can be more easily achieved with long-term suppliers. Drawing on trusted relationships, this would enable the company to develop a collaboration model. SMEs are recommended to develop a more intensive supplier selection process, to identify risks early, as well as to consolidate the number of suppliers. Actively seeking suppliers of a similar size could also be beneficial when trying to use leverage across the supply chain[1], as it might be easier to engage and relate to each other.

c. Use existing processes and avoid duplication. While individual company efforts are ongoing, they may identify, through industry schemes or collaborative initiatives, the suppliers that meet the Garment Guidance's recommendations. This will contribute to the harmonisation of assessment methodology and support recognition of assessments, which can reduce the burden placed on suppliers as well as increase the quality of assessment.

### *Considerations for SME buyers*

a. Provide suppliers with written agreements with clear terms of contract. Avoid putting additional pressure on suppliers and improve your capacity to ensure fair price negotiations, planning and forecasting, order placement and responsible disengagement. The type of purchasing practices that can reduce pressure in suppliers may include collaboration in cost-reduction efforts, payment of raw materials, pre-payment or payment of orders in full and in time, customer-based supplier credits and collaboration in production design.

b. Incorporate training and capacity building when buying from SMEs. This can increase their due diligence awareness as well as their understanding of SME buyers' policies and contract clauses. Mentoring first-tier suppliers on how to increase the capacities of their SME subcontractors will increase supply chain visibility and control.

c. Ensure communication between business units to avoid contradictory requirements to suppliers, such as consistency between due diligence requirements and cost of production. Ensure due diligence requirements are accompanied by technical and financial support for suppliers, for instance in the implementation and certification process, to avoid any disproportionate burden on suppliers.

### *Considerations for industry association and multi-stakeholder initiatives*

Multi-stakeholder initiatives, industry associations and CSOs should ensure that the development of communication and learning tools are reasonably accessible for SMEs to learn about the standards and tools for implementing due diligence.

Templates and tools could be developed to ensure that SMEs are accompanied at each step of the due diligence process (checklists, assessment grids, FAQs, self-assessment questionnaires, common audits). These can also be developed via peer learning systems within the sector and across sectors to share knowledge and experiences on due diligence implementation from the standpoint of an SME. They should be accessible to SMEs and applicable, taking their capacities into consideration.

[1] International Organisation of Employers, Shirft (2019), SMEs and the Responsibility to Respect Human Rights: A summary of a Workshop With SMEs And IOE Members On The UN Guiding Principles On Business And Human Rights,https://shiftproject.org/wp-content/uploads/2020/01/index.pdf

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**Survey results and key considerations: Highlights**

https://mneguidelines.oecd.org

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