



OECD Centre for Responsible Business Conduct

Building back better with SMEs: Regulatory Developments on Due Diligence for Responsible Business Conduct

Background

Recent developments in environmental and human rights due diligence legislation have led to discussions around the extent to which SMEs should be subject to the same requirements as larger companies, how to ensure proportionality and reasonableness in the design of regulations, as well as implications for competitiveness, market access, costs and enforcement. As a consequence, a wide variety of approaches and perspectives are being taken in response to these issues.

These discussions coincide with the growing recognition that sustainability and inclusiveness are essential objectives of SME and Entrepreneurship (SMEE) policy.¹ Furthermore, they are taking place against the background of the COVID-19 pandemic, which has severely affected SMEs, including in their inclusion in global value chains (GVCs), and through the development of policies to support SMEs to “build back better”.²

Governments face complex challenges in fostering SME observation of responsible business conduct (RBC) standards, while also strengthening the competitiveness and participation of SMEs in GVCs in a post COVID-19 environment. Whereas these two objectives seem well aligned, their instrumentation may also include potential trade-offs which has led to important questions. This note seeks to outline some of these questions and where possible, raises key considerations policy-makers can take into account while designing due diligence legislation.

SMEs and RBC: Challenges and Opportunities

SMEs play a central role in global economies

Through their collective weight, SMEs are highly important to achieving objectives related to inclusiveness, sustainability and RBC. SMEs are the predominant form of enterprise globally, accounting for approximately 99% of all firms in OECD countries.³ They also provide the main source of employment, accounting for about 60% of jobs on average. SMEs are major contributors to value creation, generating between 50% and 60% of value added on average among OECD countries.⁴ SMEs participate in international trade, not just in direct imports and exports, but also indirectly through global value chains, and hence contribute to jobs and

growth globally. SMEs are therefore an important source of employment, social mobility and innovation.

Data on how SMEs conform to RBC standards is limited. At a macro level, given their proportion of the business population and share of value added, SMEs can play an important role in addressing RBC risks and impacts. For example, collectively, SMEs may account for up to 60-70% of GHG emissions⁵ and industrial waste.⁶

At a firm level, surveys suggest that RBC practices amongst SMEs are slightly less established than in larger companies.⁷ ILO research has found that work environments tend to be more hazardous in small enterprises than in larger ones.⁸ In regards to industrial relations, trade union membership appears to be low and collective bargaining is often non-existent in smaller enterprises.⁹

In this respect, a broad scope of application with respect to RBC standards is important for society at large. It can also provide value for SMEs. Implementing RBC standards may open up new markets or enable better prices for products and services. It may help in acquiring or retaining staff and finance. Similarly, it may prove pivotal in retaining or gaining access to global markets and integrating into supply chains as buyers or other actors upstream mandate RBC due diligence practices.

SMEs face specific challenges and opportunities in implementing RBC standards...

SMEs may face greater challenges than larger firms in screening the regulatory environment and dealing with RBC norms.¹⁰ SMEs are often aware of RBC due diligence standards, yet lack knowledge about concrete obligations and find it difficult to translate policy commitments into relevant operational procedures.¹¹ SMEs often lack leverage vis-a-vis actors in their supply chains, making implementation of certain aspects of due diligence more challenging (e.g. identifying impacts and encouraging business relationships to prevent and mitigate impacts), especially if their supply chain extends internationally.¹²

SMEs may also lack access to the resources needed to adopt RBC recommendations due to the lack of financial liquidity and small margins. Much of the costs related to due diligence should be commensurate to firm size and risk exposure. In many instances, due diligence actions will be covered by existing processes (such as health and safety compliance systems or labour relations management)¹³ and thus may not represent additional costs. However, in other cases, SME's may face disproportionate costs associated with due diligence relative to larger firms.

For example, large companies may benefit from economies of scale in implementing aspects of due diligence and may have more specialized resources in place to support implementation (for example, existing staff specialised in value chain management, technological solutions, etc.).¹⁴ Additionally, other due diligence related costs such as membership fees for participation in industry schemes or multi-stakeholder initiatives, or subscription to proprietary databases, may not be proportionate to the size of the enterprise.

Larger companies are also more likely to see greater financial benefits from reputational enhancements afforded through RBC relative to SMEs, which are often less consumer facing.¹⁵ However, in instances in which RBC standards are a legal or market requirement,¹⁶ RBC implementation can allow SMEs to participate in new markets and integrate into global supply

chains. Stronger participation by SMEs in global markets can enhance technology spill-over, managerial know-how, skill-set development and productivity.¹⁷

...However some characteristics of SMEs may facilitate implementation of RBC expectations

Certain characteristics of SMEs may also facilitate more effective implementation of RBC standards. For example, SMEs generally have more informal processes and management structures in comparison to larger companies.¹⁸ In this respect, they may have a more agile and adaptive organisational culture, as well as greater cohesion and sense of collective purpose.¹⁹ SMEs may be able to align and coordinate various decision-making functions across the company to support RBC and due diligence engagement with business partners more efficiently.

Large enterprises with expansive operations and with many products or services may need more formalised and extensive systems to effectively identify and manage risks compared to smaller enterprises with a more limited range of products or services.²⁰ Furthermore, SMEs will likely have fewer suppliers than large companies and are more likely to have long-lasting business relationships.²¹ On aggregate, they also have fewer foreign operations than larger firms, and tend to focus mostly on countries close to their home market,²² which can reduce the complexity of supply chain due diligence.

Conclusion and further issues for consideration

In sum, the observance of RBC standards by SMEs can provide a number of positive externalities and benefits to SMEs, although additional support may be necessary to ensure that private investment in RBC is sufficient and actually delivers value for individual SMEs.

Policy and regulatory approaches should be designed to reflect the specific characteristics of enterprises, including enterprise size, but also taking into account business models, risk exposure, position in global value chains and the context of their operations.

In developing due diligence regulations, it is important to carefully consider the impacts on and perspectives of SMEs impacted by or associated with potential regulation. Governments should carefully consider issues specific to SMEs, including proportionality and complementary support in the design of regulation.

Beyond developments related to mandatory due diligence rules, the relationship between RBC and other SME policy objectives such as promoting SME participation in global value chains and harnessing SMEs to drive inclusiveness and sustainability also merit further discussion and inquiry. In this respect cross policy dialogue could be useful to identify how to realise “win-wins” between instruments supporting inclusive and sustainable SME participation in GVCs and those fostering of RBC. In the current context, considering how “build back better” COVID recovery packages can be used to support these related but varied policy goals will also be important.

RBC Standards & SMEs

Under OECD standards on responsible business conduct (RBC) Small and Medium-sized Enterprises (SMEs) are expected, like other businesses, to behave responsibly and carry out due diligence to identify and respond to adverse environmental and social impacts they may be involved in.

The OECD Guidelines for Multinational Enterprises (MNE Guidelines) provide that “Governments wish to encourage the widest possible observance of the Guidelines. While it is acknowledged that small- and medium-sized enterprises may not have the same capacities as larger enterprises, governments adhering to the Guidelines nevertheless encourage them to observe the Guidelines’ recommendations to the fullest extent possible.” (Chapter I, para 6)

However they also recognise that “the nature and extent of due diligence, such as the specific steps to be taken, appropriate to a particular situation will be affected by factors such as *the size of the enterprise*, context of its operations, the specific recommendations in the Guidelines, and the severity of its adverse impacts.” (Chapter II, Commentary para 15)

The OECD Due Diligence Guidance for Responsible Business Conduct (Due Diligence Guidance) also acknowledges the specific circumstances and challenges many SMEs may face in implementing due diligence. In particular it notes that “while resource constraints may be a challenge for all enterprises, small enterprises particularly may have fewer personnel and financial resources to carry out due diligence [...] [a]t the same time, they often have greater flexibility on policy-making and implementation and may have fewer impacts or suppliers to manage as compared to larger enterprises.” (Annex, Q6)

The Due Diligence Guidance also recognizes that while the size and resource capacity of an enterprise (among other factors) do not change its responsibility to conduct due diligence and act responsibly, it may affect *how* an enterprise carries out due diligence and responds to certain risks. (Annex, Q6)

In this respect the RBC risk-based due diligence approach puts an emphasis on proportionality to help to ensure that due diligence processes can be tailored as appropriate to an enterprises’ circumstances, including its size, but also the context of its operations, its business model, positions in supply chains, and the nature of its products or services. (See Due Diligence Guidance, Key Characteristics).

Notes

¹ As documented in the 2018 OECD SME Ministerial Conference Declaration adopted in Mexico.

<https://www.oecd.org/cfe/smes/ministerial/SME-Ministerial-Declaration-ENG.pdf>

² See for example OECD (2021) One year of SME and entrepreneurship policy responses to COVID-19: Lessons learned to “build back better” <https://www.oecd.org/coronavirus/policy-responses/one-year-of-sme-and-entrepreneurship-policy-responses-to-covid-19-lessons-learned-to-build-back-better-9a230220/>

³ OECD (2017), Enhancing the contributions of SMEs in a global and digitalised economy, Meeting at the OECD Council at Ministerial Level, <https://www.oecd.org/industry/C-MIN-2017-8-EN.pdf>

⁴ OECD (2019), OECD SME and Entrepreneurship Outlook 2019, OECD Publishing, Paris, <https://doi.org/10.1787/34907e9c-en>.

⁵ OECD (2019) An OECD Strategy for SMEs: Synthesis of SME related analysis on SMEs and the Environment [CFE/SME(2019)7/ANN1

⁶ Shashwat Koirala, OECD (2018) SMEs: Key Drivers of Green and Inclusive Growth https://www.oecd.org/greengrowth/GGSD_2018_SME%20Issue%20Paper_WEB.pdf

⁷ F. Snagg, C. Cibrario Assereto (2020), Human rights supply chain due diligence: new legislation on the horizon in the EU and UK, Butterworth Journal of International Banking and Financial Law, <https://www.clearygartlieb.com/-/media/files/human-rights-supply-chain-due-diligence.pdf>; Directorate-General for Justice and Consumers (European Commission) British Institute of International and Comparative Law, Civic Consulting, LSE (2020), Study on due diligence requirements through the supply chain, Final Report, United Kingdom, <https://op.europa.eu/en/publication-detail/-/publication/8ba0a8fd-4c83-11ea-b8b7-01aa75ed71a1/language-en> (hereinafter EC and LSE (2020))

⁸ In Europe, 82% of all occupational injuries and 90% of all fatal accidents occur in enterprises with up to 100 employees. See International Labour Organization (2019), Small Matter: Global evidence on the contribution to employment by the self-employed, micro enterprises and SMEs, Geneva, https://www.ilo.org/wcmsp5/groups/public/---dgreports/---dcomm/---publ/documents/publication/wcms_723282.pdf

⁹ Id.

¹⁰ OECD (2018), Fostering greater SME participation in a globally integrated economy, Discussion paper, Plenary session 3, SME Ministerial Conference, Mexico City, <https://www.oecd.org/cfe/smes/ministerial/documents/2018-SME-Ministerial-Conference-Plenary-Session-3.pdf>

¹¹ International Organization of Employers and International Labour Organization (2016), SMEs and Human Right's: What is the current state of play, what are the opportunities and challenges, what kind of support is needed? https://www.ilo.org/wcmsp5/groups/public/---ed_emp/---emp_ent/---ifp_seed/documents/publication/wcms_535220.pdf; A joint IOE/ILO 2016 survey of more than 250 SMEs from 32 countries.

¹² See EC and LSE (2020)

¹³ In some cases, SMEs have been found to incur lower additional costs, such as under the EU Non-Financial Reporting Directive, which finds that large companies' additional annual costs amount to 155,000 and 604,000 EUR, while SMEs additional cost are substantially lower, amounting to 8,000 and 25,000 EUR Directorate-General for Justice and Consumers (European Commission) British Institute of International and Comparative Law, Civic Consulting, LSE (2020), Study on due diligence requirements through the supply chain, Final Report, United Kingdom, <https://op.europa.eu/en/publication-detail/-/publication/8ba0a8fd-4c83-11ea-b8b7-01aa75ed71a1/language-en>

¹⁴ Directorate-General for Justice and Consumers (European Commission) British Institute of International and Comparative Law, Civic Consulting, LSE (2020), Study on due diligence requirements through the supply chain, Final Report, United Kingdom, <https://op.europa.eu/en/publication-detail/-/publication/8ba0a8fd-4c83-11ea-b8b7-01aa75ed71a1/language-en>

¹⁵ Directorate-General for Justice and Consumers (European Commission) British Institute of International and Comparative Law, Civic Consulting, LSE (2020), Study on due diligence requirements through the supply chain, Final Report, United Kingdom, <https://op.europa.eu/en/publication-detail/-/publication/8ba0a8fd-4c83-11ea-b8b7-01aa75ed71a1/language-en>

¹⁶ SMEs are increasingly required to adhere to codes of conduct and programmes for sustainable supply chain management, including best practices on issues such as health and safety, labour rights, human rights, anti-corruption practices and environmental impact.

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¹⁷ OECD (2017), Enhancing the contributions of SMEs in a global and digitalised economy, Meeting at the OECD Council at Ministerial Level, <https://www.oecd.org/industry/C-MIN-2017-8-EN.pdf>

¹⁸ O. Perera (2008), International Institute for Sustainable Development, How Material is ISO 26000 Social Responsibility to Small and Medium sized enterprises (SMEs)?,

https://www.iisd.org/sites/default/files/publications/how_material_iso_26000.pdf

¹⁹ Bergström, and J. Grunewald (2009), Corporate Social Responsibility in SMEs: A Case study of prerequisites for a small company to create value through the implementation of a code of conduct, Stockholm School of Economics, Stockholm <http://arc.hhs.se/download.aspx?MediumId=768>; Von Weltzien Heivik, H., & Shankar, D. (2011). How Can

SMEs in a Cluster Respond to Global Demands for Corporate Responsibility? *Journal of Business Ethics*, 101 (2), 175-195. Retrieved June 9, 2021, from <http://www.jstor.org/stable/41475974>

²⁰ OECD (2018), *OECD Due Diligence Guidance for Responsible Business Conduct*,

<http://mneguidelines.oecd.org/OECD-Due-Diligence-Guidance-for-Responsible-Business-Conduct.pdf>

²¹ Francis West for Shift, "SMEs and the Corporate Responsibility to Respect Human Rights Busting the Myth that Bigger is Always Better" May 2019, available at: <https://www.shiftproject.org/resources/viewpoints/busting-myth-smes-corporate-responsibility-respect-human-rights/>; <https://shiftproject.org/smes-and-the-corporate-responsibility-to-respect-human-rights/>;

https://www.standardizations.org/bulletin/?p=531&utm_content=bufferc1f28&utm_medium=social&utm_source=twitter.com&utm_campaign=buffer

²² OECD (2019), *OECD SME and Entrepreneurship Outlook 2019*, OECD Publishing, Paris, <https://doi.org/10.1787/34907e9c-en>.