



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

SURVEY RESULTS AND KEY CONSIDERATIONS



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Survey results and key considerations

Draft for consultation



Please cite this publication as:

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.

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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

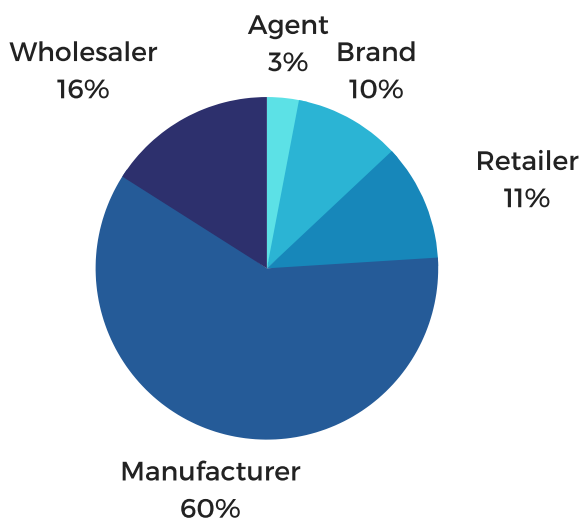
Besides the information provided in the Guidance and tools that can be particularly useful for SMEs, the paper recognises the important role of larger businesses and governments in contributing to a level playing field in which these characteristics are taken into consideration. The support of government 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.

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

OVERVIEW OF THE SAMPLE

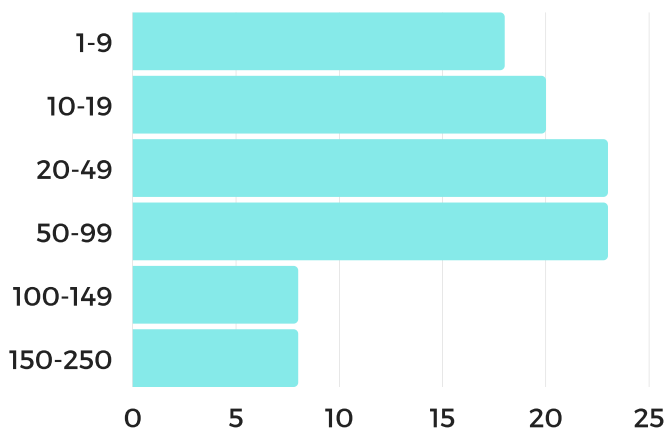
PRIMARY BUSINESS ACTIVITY



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

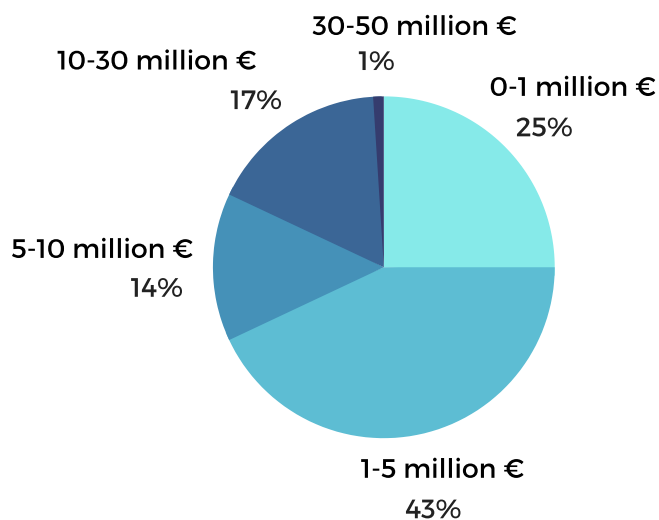
80%
of respondents
have been
in operation
for over 20 years

NUMBER OF EMPLOYEES

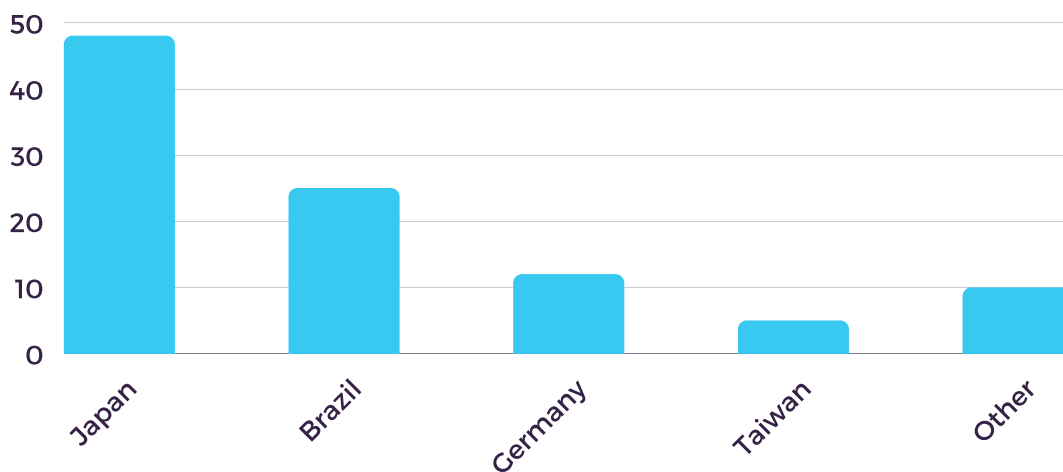


Nearly 90% of respondents are small and medium enterprises. SME respondents have on average 50 employees and a turnover of 3 million €

ANNUAL TURNOVER

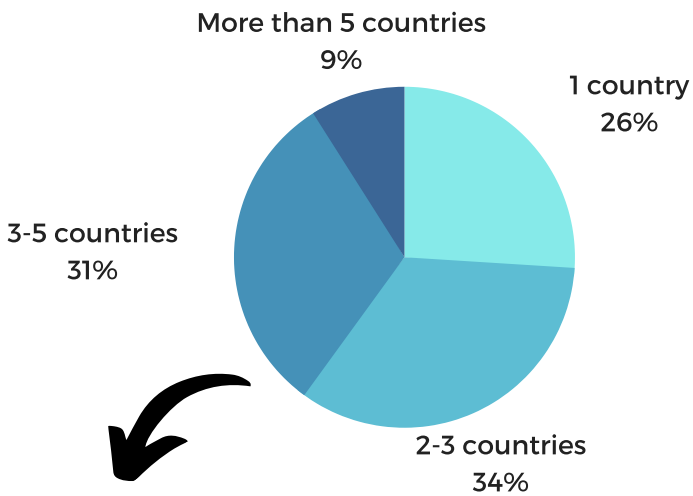


HEADQUARTERS LOCATION



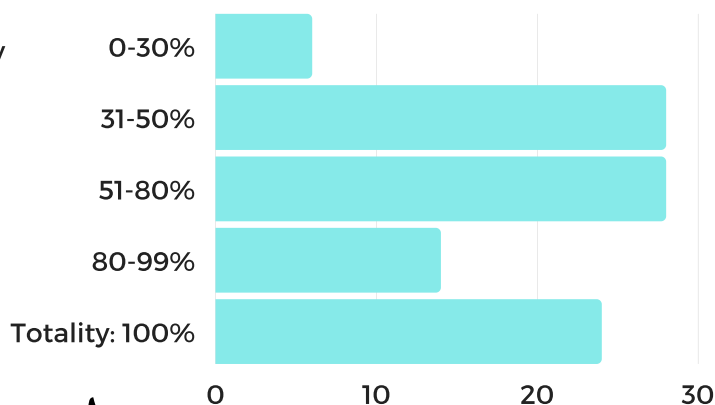
SMEs' SOURCING PRACTICES

NUMBER OF COUNTRIES INVOLVED IN THE SUPPLY CHAIN

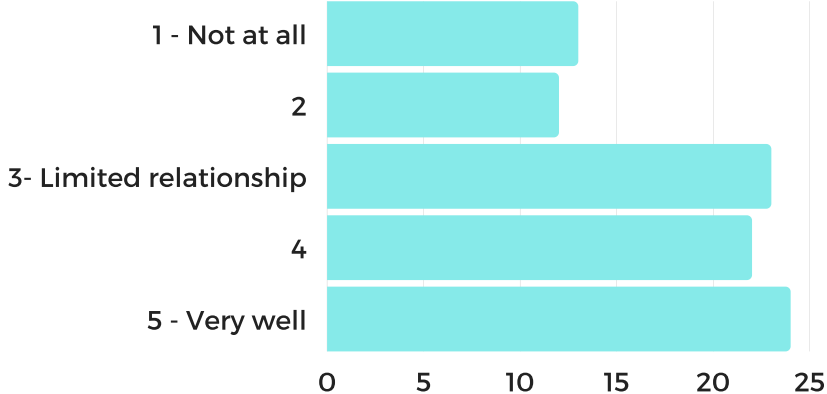


SME respondents source on average from 1 to 3 different countries

% 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

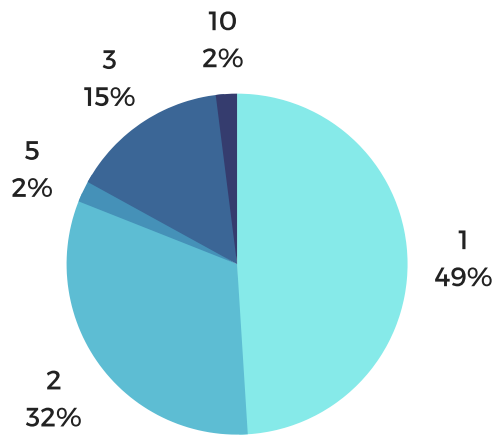


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1. Introduction

1.1. Introduction to the OECD Due Diligence Guidance for Responsible Supply Chains in the Garment and Footwear Sector

The OECD Guidelines for Multinational Enterprises (the Guidelines) reflect the expectation from governments to businesses on responsible business conduct (RBC). They acknowledge and encourage the positive contribution that business can make to economic, environmental and social development, and also recognise that human rights and labour abuses, harm to the environment and corruption by businesses are prevalent across global supply chains. The Guidelines specifically recommend that companies carry out supply chain due diligence to identify and address such adverse impacts associated with their operations, their supply chains and other business relationships. The Guidelines are an international legal instrument, adopted by all OECD members and open for adherence to interested non-OECD members (to date, a total of 48 governments have adhered to the Guidelines) and endorsed by a multi-stakeholder advisory group comprised of governments, business, trade unions and civil society

In order to promote the effective observance of the Guidelines, the OECD has developed sectoral guidance which helps enterprises identify and address risks to people, the environment and society associated with business operations, products or services in particular sectors.

The OECD Due Diligence Guidance for Responsible Supply Chains in the Garment and Footwear Sector (the Garment Guidance) sets a common framework to help companies identify, prevent, mitigate and address adverse impacts in their own operations and their supply chain. It is not an audit standard but rather provides a set of processes that can be tailored to an enterprise's size and sourcing context to promote responsible sourcing. It provides enterprises with the flexibility to adapt the characteristics, specific measures and processes of due diligence to their own circumstances. Enterprises should use it as a framework for developing and strengthening their own tailored due diligence systems and processes, and then seek out additional resources for further in-depth learning as needed¹, making the OECD framework a practical framework for SMEs.

Due diligence risks covered by the Garment Guidance include human rights, social and environmental risks that are prevalent in the garment and footwear sector globally across product lines and geographies. Regarding human rights and social risks, the Garment Guidance covers child labour, sexual harassment and sexual and gender-based violence in the workplace, forced labour, working time, occupational health and safety (OHS), trade unions and collective bargaining, and wages. Regarding the environment, it takes into account a number of critical environmental matters, including hazardous chemicals, greenhouse gas (GHG) emissions and wastewater. It recognises the important role of the industry in addressing environmental challenges and encourages enterprises to consider the environmental impacts of a product across its full life cycle to the extent possible – thereby integrating circular economy considerations but with a risk-based approach, as companies may prioritise the most severe risks. It also considers others risks related to bribery and corruption, and responsible sourcing from homeworkers

¹ OECD (2018), OECD Due Diligence Guidance for Responsible Business Conduct, <http://mneguidelines.oecd.org/OECD-Due-Diligence-Guidance-for-Responsible-Business-Conduct.pdf>

1.2. Key characteristics of the Garment and Footwear sector and implications for company due diligence

Due diligence is the process through which enterprises can identify, prevent, mitigate and account for how they address their actual and potential adverse impacts. Due diligence is conducted against the OECD Guidelines regarding specific adverse impacts (i.e. harm). An enterprise is expected to conduct due diligence on its own activities and on its suppliers across its supply chain and other business relationships, regardless of its size. Due diligence is an ongoing exercise, recognising that risks of harm may change over time as the enterprise's operations and operating context evolve.

The OECD Garment Guidance recognises that there are a number of factors, specific to the nature of the garment and footwear supply chain, that may affect the nature and extent of the steps taken to conduct due diligence:

- *Product risk factors*: Some products hold a higher risk of impact than others due to the processes used to make them. For example, cotton products may hold a higher risk of hazardous insecticides such as Parathion, Aldicarb and Methamidophos, whereas polyester products may hold a higher risk of contributing to greenhouse gas emissions.
- *Country risk factors*: Country risk factors are conditions in a particular country or production cluster, or within the industry within a particular country, which may make the above sector risks more likely. These generally include governance, socio-economic and industry factors. For example, high rates of migrant labour is a risk factor for child labour, forced labour, non-compliance with wage legislation and sexual harassment. Other examples include high levels of corruption or low levels of law enforcement.
- *Business model*: The enterprise's business model, such as the number and diversity of product lines that it sells and how often those product lines are changed (i.e. seasons per year), or the extent of an enterprise's foreign operations, may amplify the level of risk of harm in the enterprise's supply chain. This is particularly relevant for retailers and brands but may also be true for manufacturers that produce a wide variety of finished goods.
- *Sourcing-model risk factors*: Similarly, the enterprise's sourcing models – whether it sources from a large range of suppliers, whether they are operating in or sourcing from many countries, the nature and length of its contractual relationships and whether sourcing is direct or indirect – may increase (or decrease) the risks of harm in its supply chain.

1.2.1. SMEs in the OECD Due Diligence Guidance for Responsible Supply Chains in the Garment and Footwear sector

The Guidance acknowledges that SMEs may face unique challenges in conducting due diligence, such as having constrained access to financial, human and knowledge resources. These constraints make it more challenging for these smaller enterprises to implement due diligence compared to larger enterprises. At the same time, SMEs often have smaller operations and fewer suppliers, which can reduce the complexity of their supply chain.

The Guidance seeks to highlight instances in which an SME may choose to use different mechanisms to apply due diligence in light of its resources, position in the supply chain and leverage, in order to support greater uptake of due diligence among SMEs.

Although size is not the only factor in determining the nature and extent of due diligence for an enterprise, as due diligence should be risk-based², the Guidance does recognise the size of the enterprise as one of the main factors that can affect the nature and extent of due diligence.

1.3. Research background: SMEs in the Garment and Footwear sector and supply chain due diligence

1.3.1. SME Definition

Small and medium-sized enterprises (SMEs) are non-subsidiary, independent firms, which employ fewer than a given number of employees. This number varies across countries. The most frequent upper limit designating an SME is 250 employees, as is used by the European Union. However, some countries set the limit at 200 employees, while the United States considers SMEs to include firms with fewer than 500 employees. Small firms are generally those with fewer than 50 employees, while micro-enterprises have at most 10 or, in some cases, 5 workers.

Financial assets are also used to define SMEs. In the European Union, the turnover of medium-sized enterprises (50-249 employees) should not exceed EUR 50 million; that of small enterprises (10-49 employees) should not exceed EUR 10 million, while that of micro firms (fewer than 10 employees) should not exceed EUR 2 million. Alternatively, balance sheets for medium, small and micro enterprises should not exceed EUR 43 million, EUR 10 million and EUR 2 million, respectively³.

The ILO uses another definition of SMEs, with three different firm size classes. Small enterprises are defined as having up to 20 employees, while medium enterprises have as many as 99 employees. Large enterprises are those with 100 or more employees. This is important to note as the research contains ILO references.

For the purposes of this study, the OECD uses the definition proposed by the European Commission, classifying medium-sized enterprises with 50-249 employees and not exceeding a turnover of EUR 50 million, small enterprises with 10-49 employees and a turnover not exceeding EUR 10 million, and micro firms with fewer than 10 employees and a turnover not exceeding EUR 2 million.

1.3.2. SMEs in the Garment and Footwear sector

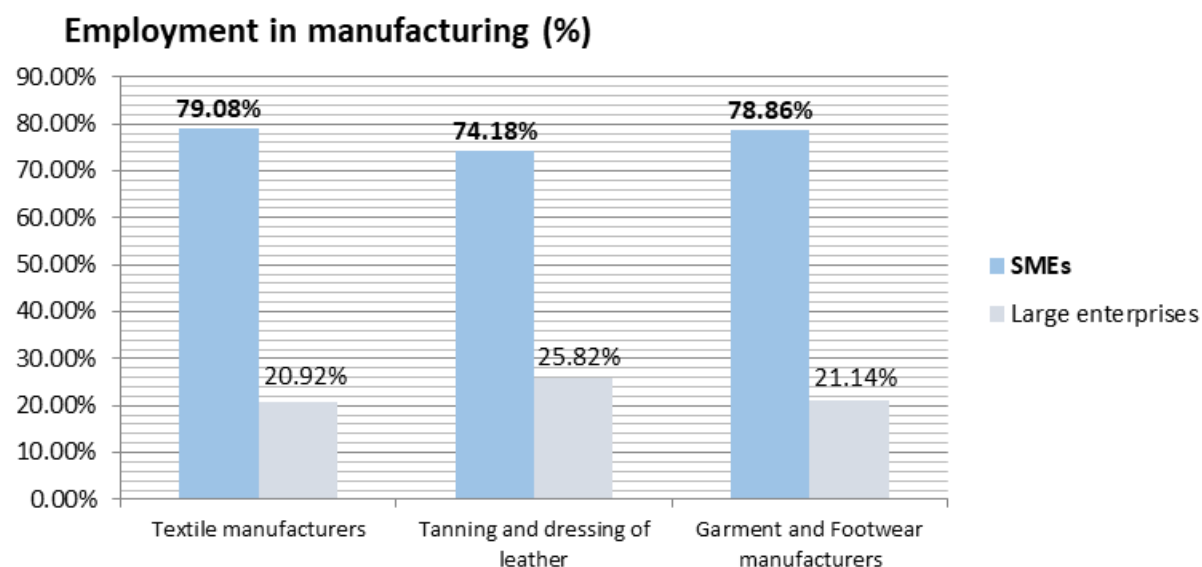
In the EU, the textile and clothing sector remains an SME-based industry. 77% of all workers in the textile, garment and footwear manufacturing sector are employed in SMEs. In 2015, across twelve OECD countries, the share of SME merchandise exports in textile and apparel represented respectively 66% and 64% of the total⁴.

² The measures that an enterprise takes to conduct due diligence should be commensurate to the likelihood and severity of the harm.

³ OECD (2005), OECD SME and Entrepreneurship Outlook: 2005, OECD Paris, page 17, <https://stats.oecd.org/glossary/detail.asp?ID=3123>

⁴ 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>

Figure 1.1. Employment size in the garment and footwear sector, EU-28



Source: Eurostat (SBS) 2014

In order to better understand the enterprises involved in the garment and footwear supply chain, Table 2.1 and Table 2.2 present employment data and enterprise numbers for different enterprise sizes in four stages of the supply chain in the EU.

Table 1.1. Employment indicators in the garment and footwear supply chain, EU-28, 2014

	Textile manufacturers	Tanning and dressing of leather	Garment and Footwear manufacturers	Retail stores	Total
Micro enterprises	113 657	29 935	260 799	--	--
Small enterprises	163 432	44 703	359 045	--	--
Medium-sized enterprises	205 028	36 872	377 808	--	--
SMEs	482 117	111 510	997 652	--	--
Large enterprises	127 529	38 820	267 431	--	--
Total	609 646	150 330	1 265 083	3 027 977	5 053 036

Source: Eurostat (SBS)

Table 1.2. Number of enterprises in the garment and footwear supply chain, EU-28, 2014

	Textile manufacturers	Tanning and dressing of leather	Garment and Footwear manufacturers	Retail stores	Total
Micro enterprises	51 500	28 732	123 083	--	--
Small enterprises	7 541	6 897	17 059	--	--
Medium-sized enterprises	1 958	1 330	3 691	--	--
SMEs	60 999	36 959	143 833	--	--
Large enterprises	301 ^(e)	160	566 ^(e)	--	--
Total	61 300	37 119	144 399	592 204	835 022

Source: Eurostat (SBS)

Furthermore, the EU footwear subsector consists mainly of SMEs, employing 10-15 persons on average. Similar trends are seen in the leather industry, where tanneries are typically family-owned SMEs⁵.

Despite this, in many OECD countries, the number of SMEs is currently declining in the sector. Textiles is one sector that has been particularly transformed by global value chains in the last twenty years. This is largely because manufacturing jobs in the sector have been provided as entry-level employment with the employer taking care of the training, and such activities were easily transferred to countries with large pools of low-skilled workers, indicating that the assembly of clothing at the end of the value chain remains a labour-intensive task. At least for now, assembly has not been greatly affected by automation, with firms in the sector in developed economies specialising in design, often fabric design and high-quality assembly, and firms in lower-income countries specialising in assembly⁶.

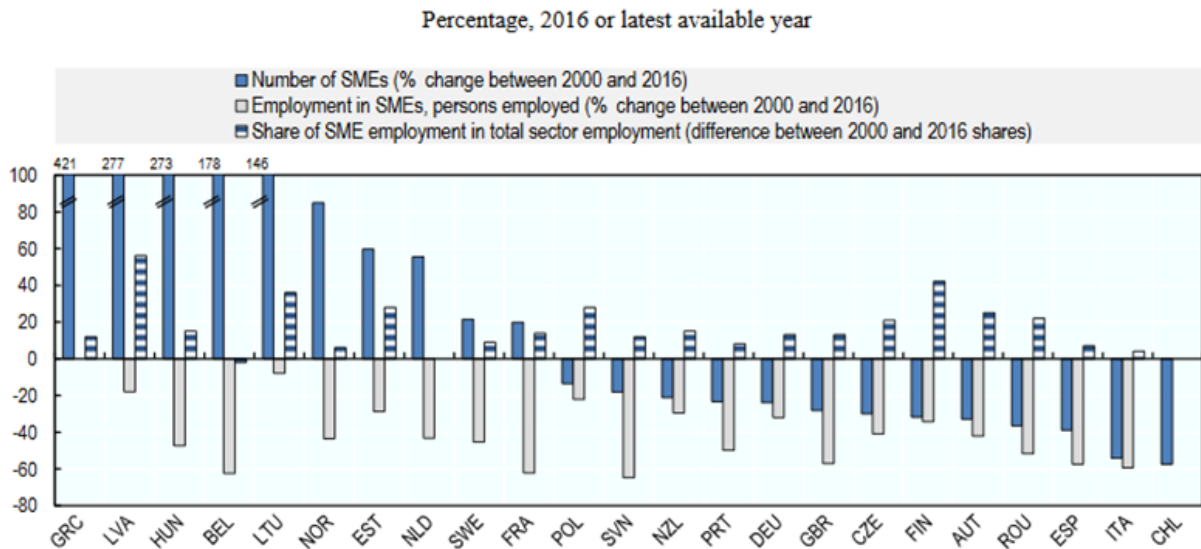
This factor has seen the number of SMEs in the sector decline considerably in many OECD countries in recent years, especially in Italy, Spain, Denmark and Chile with even more severe contractions in employment. See Figure 2.2 below representing SMEs in the manufacturing textile sector⁷:

⁵ European Commission, Internal Market, Industry, Entrepreneurship and SMEs, The EU Footwear Industry, https://ec.europa.eu/growth/sectors/fashion/footwear/eu-industry_en

⁶ OECD (2019), OECD SME and Entrepreneurship Outlook 2019, OECD Publishing, Paris, <https://doi.org/10.1787/34907e9c-en>

⁷ OECD (2019), OECD SME and Entrepreneurship Outlook 2019, OECD Publishing, Paris, <https://doi.org/10.1787/34907e9c-en>.

Figure 1.2. SMEs in the manufacturing textile sector



Source: OECD Structural and Demographic Business statistics Database, 2018 <http://dx.doi.org/10.1787/sdbs-data-en>.

The number of SMEs in the sector has declined yet their domestic market share has increased across all countries. As a result, many SMEs focus on niche activities of higher value or have adapted their activities in other ways to withstand the competition from cheaper imports, such as capitalising on cheaper intermediate imports of textile products⁸.

As mentioned in the first chapter, SMEs are mainly informal and constitute the largest proportion of employment, and the garment and footwear sector is no exception. Informalisation is a tool businesses use to cut costs while remaining competitive in the global market; garment production makes wide use of the informal economy. Production is being increasingly decentralised through diverse forms of subcontracting, in which orders are often fulfilled through informal subcontracting arrangements⁹. Currently, the most readily available data are on SMEs in the formal sector and, while there are data on the informal economy in general, information is limited in the sector.

1.3.3. SMEs in the economy

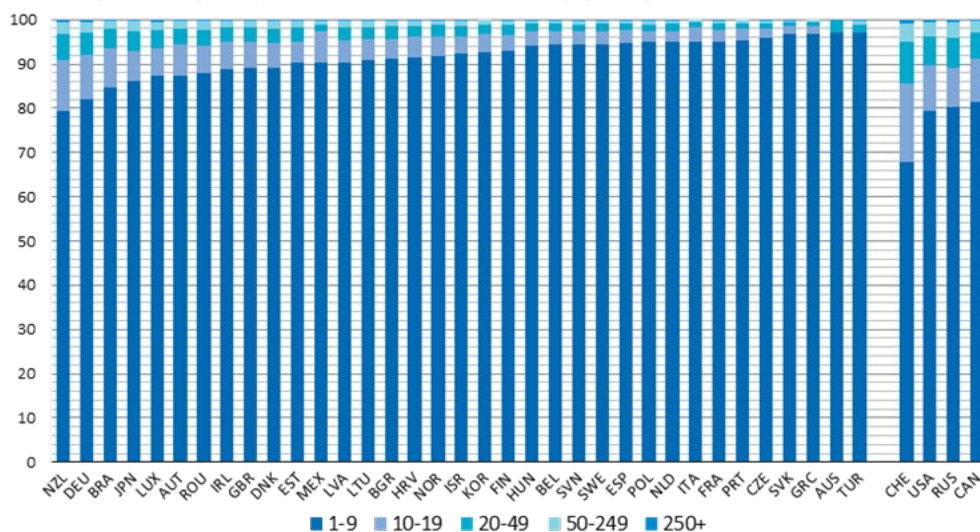
SMEs are estimated to represent 99% of all enterprises in countries of the OECD, generating about 60% of employment and totalling between 50% and 60% of value added in the OECD area¹⁰. In most OECD countries, SMEs contribute to more than 50% of GDP.

⁸ OECD (2019), OECD SME and Entrepreneurship Outlook 2019, OECD Publishing, Paris, <https://doi.org/10.1787/34907e9c-en>.

⁹ Ascoly N. (2004), The Global Garment Industry and the Informal Economy: Critical Issues for Labour Rights Advocates, IRENE/CCC Discussion Paper https://ecommons.cornell.edu/bitstream/handle/1813/99409/CCC_04_09_informal_labour_seminar_discussion_paper_CCC.pdf?sequence=1

¹⁰ OECD (2019), OECD SME and Entrepreneurship Outlook 2019, OECD Publishing, Paris, <https://doi.org/10.1787/34907e9c-en>.

Figure 1.3. Enterprises by size, total business economy (in %), OECD countries



Source: OECD SDBS database 2013

According to the International Council for Small Business (ICSB), globally formal and informal SMEs make up over 90% of all firms and account, on average, for 70% of total employment (80-90% of total employment in the developing world¹¹) and 50% of GDP¹². Between 2003 and 2016, the number of total full-time employees in SMEs nearly doubled, rising from 79 million to 156 million¹³.

The ILO has estimated that there are between 420 and 510 million SMEs globally, of which 9% are formal SMEs¹⁴ and an estimated 80-95% are in low- and middle-income countries¹⁵. While in high-income countries, 58% of total employment is in SMEs, in low- and middle-income countries, the proportion is

¹¹ International Labour Organization (2016), Procurement practices and SMEs in global supply chains: what do we know so far? : A literature review, Lizbeth Navas-Aleman, Tamara Guerrero; International Labour Office, Enterprises Department. Geneva, http://www.oit.org/wcmsp5/groups/public/---ed_emp/---emp_ent/---ifp_seed/documents/publication/wcms_486227.pdf

¹² United Nations (2020), Micro-, Small and Medium Sized Enterprises Day 27 June, Supporting small businesses through the COVID-19 crisis <https://www.un.org/en/observances/micro-small-medium-businesses-day>

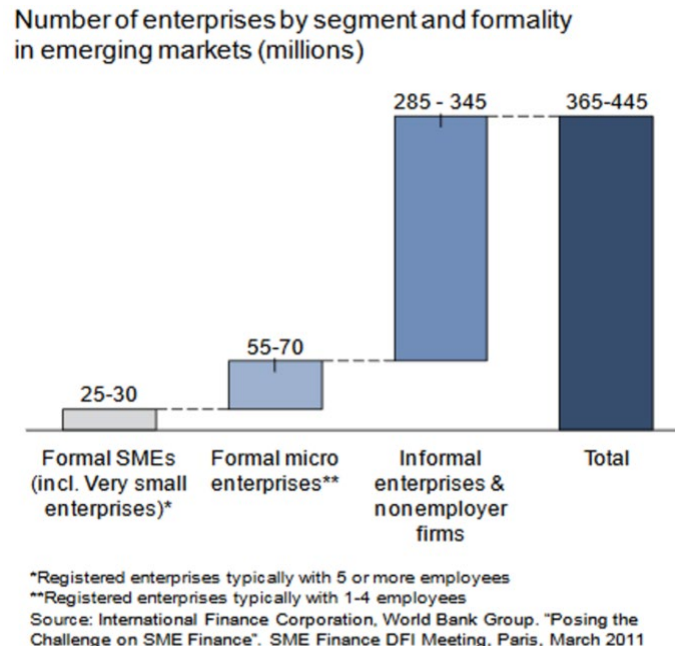
¹³ United Nations Department of Economic and Social Affairs (X), Micro-, Small, and medium-sized Enterprises (MSMEs) and their role in achieving the Sustainable Development Goals, https://sustainabledevelopment.un.org/content/documents/25851MSMEs_and_SDGs_Final3120.pdf

¹⁴ Excluding micro-enterprises. International Labour Organization (2016), Procurement practices and SMEs in global supply chains: what do we know so far? : A literature review, Lizbeth Navas-Aleman, Tamara Guerrero; International Labour Office, Enterprises Department. Geneva, http://www.oit.org/wcmsp5/groups/public/---ed_emp/---emp_ent/---ifp_seed/documents/publication/wcms_486227.pdf (p. 5, ILO, 2015).

¹⁵ International Labour Organization (2015), Small and medium-sized enterprises and decent and productive employment creation, Report IV, International Labour Conference 104th Session, Geneva, https://www.ilo.org/wcmsp5/groups/public/---ed_norm/---relconf/documents/meetingdocument/wcms_358294.pdf

considerably higher. In countries with the lowest income levels, the proportion of employment in small economic units is almost 100%¹⁶.

Figure 1.4. Number of SMEs by segment and formality



Source: https://www.eib.org/attachments/dalberg_sme-briefing-paper.pdf

Among formal SMEs (9%), the evidence indicates that they have difficulty accessing the financial products and services critical to their growth. According to the IFC and McKinsey study, almost 45 to 55% (11 to 17 million) of the formally classified SMEs in emerging markets do not have access to formal institutional loans or other financial products that could help them to grow or become more financially stable¹⁷. Credit constraints are especially severe in mid-and low-income countries, where funding gaps are often the main barrier to formalisation and SME development¹⁸.

On the other hand, relatively few SMEs export, either directly or indirectly (compared to large firms), and they account for a relatively small fraction of overall exports¹⁹. It is acknowledged that inclusive

¹⁶ International Labour Organization (2019), "Small Businesses and self-employed provide most jobs worldwide, new ILO report says", ILO News, https://www.ilo.org/global/about-the-ilo/newsroom/news/WCMS_723409/lang-en/index.htm

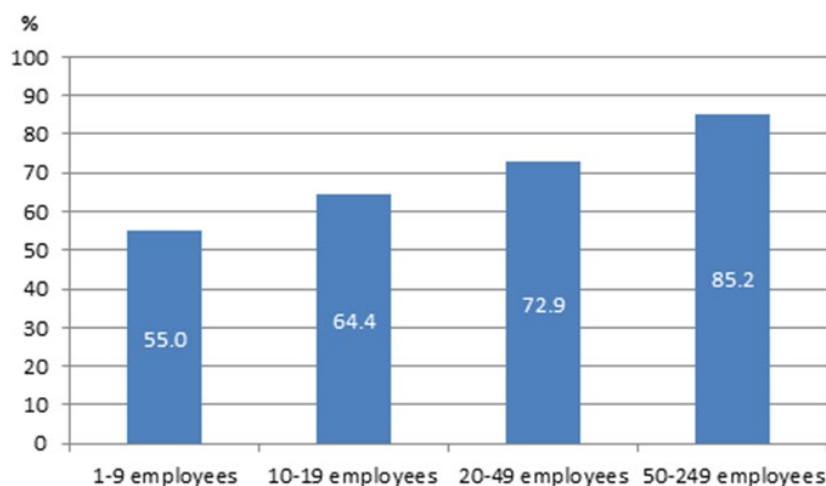
¹⁷ The European Centre for Development Policy Management (2019), Sewing the pieces together: Towards an EU strategy for fair and sustainable textiles, Nadia Ashraf and Jeske van Seters, <https://wfto-europe.org/wp-content/uploads/2019/12/Sewing-Pieces-Together-Towards-EU-Strategy-Fair-Sustainable-Textiles-ECDPM-Discussion-Paper-264.pdf> International Finance Corporation (2010), Scaling-Up SME access to Financial Services in the Developing World, Financial Inclusion Experts Group, SME Finance Sub-Group, g20 Seoul Summit 2010, https://www.gpfi.org/sites/gpfi/files/documents/G20_Stocktaking_Report_0.pdf

¹⁸ International Trade Centre (2019), SME Competitiveness Outlook: Big money for small business- Financing the sustainable Development Goals <https://www.intracen.org/uploadedFiles/intracenorg/Content/Publications/SMECO2019.pdf>

¹⁹ World Trade Organization (2016), Levelling the trading field for SMEs, World Trade Report 2016, https://www.wto.org/english/res_e/booksp_e/world_trade_report16_e.pdf

participation in international trade can bring several benefits, such as improving a firm's productivity and innovation. Stronger participation by SMEs in global markets can help to strengthen their contributions to social well-being, it can be source of knowledge and technology spill-overs and managerial know-how, developing the skill-set, and enhancing productivity²⁰. To become suppliers to large multinationals, 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 impact²¹.

Figure 1.5. Average productivity gaps between SMEs and large firms in the OECD area



Note: Labour productivity of SMEs (by size band) relative to large enterprises (250+ employees), Percentage values - Values are unweighted averages of the gaps in productivity between SMEs and large enterprises in 24 OECD countries

Source: <https://oecd-development-matters.org/2017/04/03/unlocking-the-potential-of-smes-for-the-sdgs/>

1.3.4. SMEs and due diligence

Due diligence practices among SMEs appears to be slightly less established than in larger companies (with over 1,000 employees)²². An ILO report has shown that enterprises with up to 100 employees have more labour-intensive production processes than larger companies²³ and working conditions in small

²⁰ 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>

²¹ World Trade Organization (2016), Levelling the trading field for SMEs, World Trade Report 2016, https://www.wto.org/english/res_e/booksp_e/world_trade_report16_e.pdf

²² 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.clearygotlieb.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> :

²³ M. Morsing, F. Perrino (2009), CSR in SMEs: do SMEs matter for the CSR agenda?, Business Ethics: A European Review, Volume 18, Number 1, <https://onlinelibrary.wiley.com/doi/epdf/10.1111/j.1467-8608.2009.01544.x>

enterprises are generally less favourable compared to larger enterprises²⁴. As represented below, an ILO study shows that wages in small enterprises are 20-30% lower than the national average.

Figure 1.6. Wage index



Note: The wages of small enterprises have been indexed to 100 to allow for comparison. Wages are averages of country medians and are calculated as total annual labour costs divided by the number of full-time permanent employees. Please note that the ILO uses the definition of medium enterprises being up to 100 employees.

Source: https://www.ilo.org/wcmsp5/groups/public/---dgreports/---dcomm/---publ/documents/publication/wcms_723282.pdf

The ILO research also finds that work environments are more hazardous in small enterprises than in large ones. In Europe, 82% of all occupational injuries and 90% of all fatal accidents occur in enterprises with up to 100 employees. Regarding industrial relations and collective bargaining, trade union membership appears to be low and collective bargaining is often non-existent²⁵.

It is recognised that SMEs usually face bigger challenges than large firms in screening the regulatory environment and dealing with norms²⁶. Studies have shown that SMEs, while aware of due diligence standards, recognise that they lack knowledge about their obligations, find it difficult to translate policy commitments into relevant operational procedures and would like additional information on what is expected of them²⁷ and the potential benefits of due diligence implementation. Additionally, many SMEs

²⁴ 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

²⁵ 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

²⁶ 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>

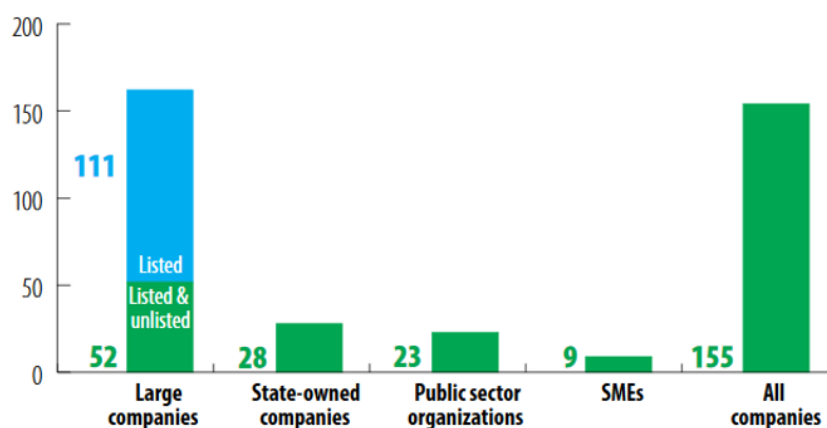
²⁷ International Organization of Employers and International Labour Organization (2016), SMEs and Human Rights: What is the current state of play, what are the opportunities and challenges, what kind of support is needed? https://www.ilo.org/wcmsp5/groups/public/---ed_emp/---emp_ent/---ifp_seed/documents/publication/wcms_535220.pdf; A joint IOE/ILO 2016 survey⁴ of more than 250 SMEs from 32 countries.

fear that they may not be able to meet the social and environmental requirements without losing their competitive edge in national and international markets²⁸.

For instance, environmentally sustainable improvements in SMEs are often held back by perceived technical complexities, burdens and costs, as well as lack of awareness about financially attractive opportunities. SMEs tend to be more risk averse and less willing to invest in new technologies compared to larger firms due to resource constraints and lack of appropriate skills and expertise²⁹.

In 2015, SMEs accounted for just 10% of sustainability reports in the GRI Sustainability Disclosure Database³⁰. Here it is important to emphasise that around 40% of sustainability reporting instruments apply either to all companies (without distinction by size, listing or sector) or to all companies except state-owned companies³¹. In many countries, reporting instruments focus initially on large companies, state-owned enterprises, the largest companies in the stock exchange and companies operating in high-impact sectors. Regulators commonly focus on these companies to ensure that the targeted enterprises have the financial and human resources required to manage reporting and may already have experience in doing so, while smaller companies often lack the capacity to report³².

Figure 1.7. Organisations covered by instruments



Source:

https://wedocs.unep.org/bitstream/handle/20.500.11822/9435/-Evaluating_national_public_policies_on_corporate_sustainable_reporting_-_2015evaluating.pd.pdf?sequence=3&isAllowed=y

²⁸ M. Morsing, F. Perrino (2009), CSR in SMEs: do SMEs matter for the CSR agenda?, *Business Ethics: A European Review*, Volume 18, Number 1, <https://onlinelibrary.wiley.com/doi/epdf/10.1111/j.1467-8608.2009.01544.x>

²⁹ OECD (2017), Enhancing the contributions of SMEs in a global and digitalised economy, Meeting at the OECD Council at Ministerial Level, Paris, <https://www.oecd.org/industry/C-MIN-2017-8-EN.pdf>

³⁰ Global Reporting Initiative (2016), Sustainability Disclosure Database, <http://database.globalreporting.org/>

³¹ <https://assets.kpmg/content/dam/kpmg/pdf/2016/05/carrots-and-sticks-may-2016.pdf>

³² UNEP & Group of Friends of Paragraph 47 (2015), Evaluating National Policies on Corporate Sustainability Reporting, https://wedocs.unep.org/bitstream/handle/20.500.11822/9435/-Evaluating_national_public_policies_on_corporate_sustainable_reporting_-_2015evaluating.pd.pdf?sequence=3&isAllowed=y

SME engagement in voluntary global standards implementation is therefore extremely weak. This lack of participation can also be explained by their absence in high-level multi-stakeholder discussions that lead to the creation of standards³³.

SMEs are particularly relevant in the achievement of supply chain due diligence. For example their environmental impact, while individual footprint may be low, their aggregate impacts can exceed that of large companies, particularly in the manufacturing sector, which accounts for a large part of the world's consumption of resources, air and water pollution and generation of waste³⁴.

While SMEs might face different types of obstacles when implementing due diligence, they can also have a competitive edge due to their greater flexibility, greater ability to integrate new instructions, more agile and adaptive organisational culture, as well as greater cohesion and sense of collective purpose. SMEs likely have fewer suppliers and long-lasting business relationships with them, which can help them meet expectations to provide due diligence information in public reporting and when requested by business partners. Given SMEs' smaller size, individuals often have multiple overlapping functions in the firm, which also enables easier functional alignment and coordination on due diligence processes and decision-making.

SMEs therefore play a key role in shifting innovation models towards sustainable pathways, adapting supply and processes to different contexts or user needs. Effectively preventing and mitigating adverse impacts may in turn also help a company to maximise positive contributions to society, improve stakeholder relationships and protect its reputation. It may also help with cost reduction, strengthening the management of company-specific business and operational risks, and decreasing exposure to systemic risks or litigation. The benefits for SMEs of offering better jobs can be manifold and extensive. First, upskilling their workforce can help them to close the productivity-wage gap with large firms, and attract more highly skilled workers. It can also help them to strengthen their position in global value chains (GVCs) and integration into higher value-added segments of GVCs.

1.3.5. Role of governments to enable SME due diligence

Governments are a key driver for RBC and there is widespread recognition that RBC cannot be achieved without governments taking part in these efforts. Governments' role includes creating an enabling policy environment to support and promote responsible business practices. This is particularly important to ensure a level playing field where SMEs remain competitive while implementing due diligence.

Governments have a range of tools at their disposal to advance company due diligence, including providing incentives through procurement policies or licensing processes that are favourable to businesses with strong due diligence approaches, providing resources and guidance to companies to conduct due diligence, and introducing regulations with respect to RBC due diligence³⁵. Some governments have already put in place mechanisms to support SMEs in this process, by offering financial incentives to proactive business, increased market opportunities and informational measures in place to raise awareness and build capacity in SMEs. These can be powerful levers for governments to guide corporate behaviour

³³ ILO Global Business Network on Forced Labour, L. J. Spence, Puttins SMEs first: why small and medium-sized enterprises are crucial in the responsible business conduct conversation, https://flbusiness.network/wp-content/uploads/ILO_GBNFL_SMEs-and-RBC_Final.pdf

³⁴ OECD (2017), Enhancing the contributions of SMEs in a global and digitalised economy, Meeting at the OECD Council at Ministerial Level, Paris, <https://www.oecd.org/industry/C-MIN-2017-8-EN.pdf>

³⁵ OECD (2018), Promoting due diligence: The role of government, Global Forum on Responsible Business Conduct, Session Note, Paris <https://mneguidelines.oecd.org/global-forum/2018-GFRBC-Session-note-Role-of-Government-for-DD.pdf>

and support best practices in RBC, including due diligence. National Action Plans on Business and Human Rights from several countries include stimulus programmes to avoid a disproportionate administrative burden for SMEs³⁶. Some governments have also developed guidance directed at SMEs and offer comprehensive access to available documents to increase awareness and capabilities of practical action within SMEs.

In efforts to push supply chain due diligence further, some governments have also turned to regulation to mandate company due diligence. In most cases, SMEs have been exempted under these laws³⁷. The extent to which SMEs should be subject to due diligence expectations and how to ensure proportionality and reasonableness is one of the most discussed issues surrounding legislation design. While the Garment Guidance expectation of due diligence is applicable to all enterprises regardless of their size, due diligence regulation should take into account the specificities of SMEs to ensure proportionality. A recent European Commission (EC) study on due diligence requirements across the supply chain considers the impact of including SMEs in the scope of due diligence regulations. Key questions relate to the relative administrative burden of SMEs, generally greater than for larger companies, competitive disadvantage vis-à-vis larger companies and tighter contractual obligations imposed by their large corporate clients. SMEs also appear to lack the sufficient leverage to extract the necessary information from their supply chain partners, especially if their supply chain extends to foreign countries³⁸.

³⁶ Change in Context, commissioned by Ministry of Foreign Affairs of the Netherlands (2018), Government policy to stimulate international responsible business conduct, <https://media.business-humanrights.org/media/documents/files/government-policy-to-stimulate-international-responsible-business-conduct.pdf>

³⁷ M. R. Pearl S. Suilt (2019), Applicability of Supply Chain Laws to SMEs: A Critique of the Laws of the United States, the United Kingdom and the European Union, Central European University, https://www.google.com/url?sa=t&rct=j&q=&esrc=s&source=web&cd=&cad=rja&uact=8&ved=2ahUKEWjk8KKGyrXuAhUJmRoKHeuQADsQFjADegQIBBAC&url=http%3A%2F%2Fwww.etd.ceu.edu%2F2019%2Fsuilt_ricca-pearl.pdf&usq=AOvVaw2Tg-K9G1W8f1Lf33_ys4JX

³⁸ 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> :

2. Characteristics of SMEs operating in the Garment and Footwear sector

2.1. Objective

The business and sourcing models for SMEs in the garment and footwear sector affects the way that these companies carry out due diligence. Acknowledging the dearth of information on factors relevant to due diligence implementation, the OECD Centre for RBC sought to collect additional information to better identify gaps in the Garment and Footwear sector in order to enhance the quality and extent of due diligence implementation among SMEs.

Any approach to due diligence implementation considerations must take into account SMEs' potential challenges, including their limited access to financing, limited market share, predominantly informal economy status (in many, but not all jurisdictions), and type of relationships with other entities³⁹. SMEs are heterogeneous, and developing one-size-fits-all tools will not provide effective guidelines for SMEs. Collecting information about sourcing models, the size of an SME's supply base and the level of visibility SMEs have over their supply chain can help to identify the extent to which these characteristics influence their due diligence implementation. The final objective is to highlight instances in which an SME may choose to use different mechanisms to apply due diligence in light of its resources, position in the supply chain and leverage, and instances in which due diligence can be tailored to their reality.

2.2. Methodology

This paper is based on data collected from SMEs via an online survey, available in nine languages and accessible online for six months (December 2019-May 2020). The survey focuses on sourcing practices prevalent in SMEs working in the global garment and textile supply chains. Survey findings are further supported by analysis and context provided by previous research in the field conducted by the OECD. This paper analyses the sourcing practices of a limited sample of SMEs (just over 200 companies) and current due diligence practices in their operations and supply chains. The SMEs who responded to the survey are from 11 countries overall.

Throughout this paper, the term "Tier 1" indicates the final garment and components manufacturers and will not refer to direct suppliers in general. The terms "suppliers" and "producers" will be used interchangeably.

The survey questionnaire includes 19 questions divided into two parts:

1. Companies' type of sourcing models and characteristics of the supplier base

³⁹ United Nations Office of the High Commissioner for Human Rights (2017), Report of the Working Group on the issue of human rights and transnational corporations and other business enterprises, A/HRC/35/32, https://ap.ohchr.org/documents/dpage_e.aspx?si=A/HRC/35/32

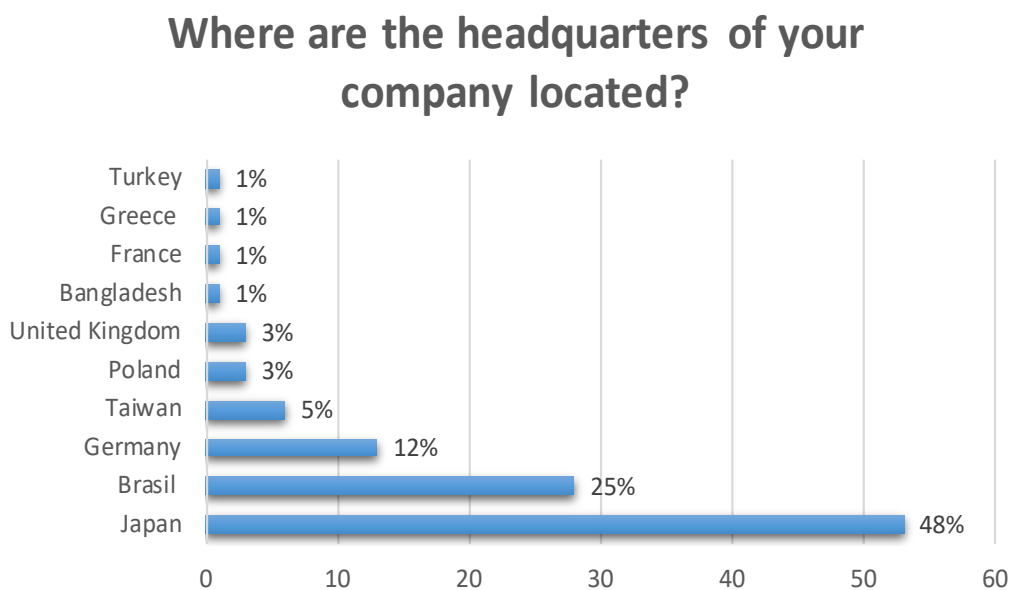
2. Challenges that companies face in addressing the social and environmental issues.

A total of 204 companies undertook the survey, however, not all companies responded to every question. The sample size of companies per question has been indicated throughout this paper.

All types of companies were invited to take the survey. Among the respondents, 90% are SMEs, of which 18% are micro enterprises (<10 employees), 43% small enterprises (10 to <50 employees) and 39% are medium-sized enterprises (50 to <250 employees). Of all respondents, 10% are characterised as large companies with more than 250 employees or a turnover of more than 50 million Euro. Data from the responses of these larger companies (non-SMEs) have been extracted and analysed separately so that the analysis focuses primarily on SME responses and where relevant and possible is compared to non-SME data as a control.

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.

Figure 2.1. Location of Headquarters



Note: 54% responded - 110 responses

Limitations of the study

There are certain limitations that need to be taken into account. The scope of the study is focused on identification of several SME characteristics of their structure and supply chain giving rise to due diligence implementation challenges. The study is built on the results from the survey and respondents to surveys may not always be willing or able to give an exact answer to all the questions. Further, the study is limited by the regional imbalance of available data, as 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. Given the regional breakdown, the limitations of the study in terms of representativeness are taken into consideration. This study does not seek to draw conclusions on regional differences owing to the variation of available data by country. This study notes that there could be some bias to the results due to this imbalance.

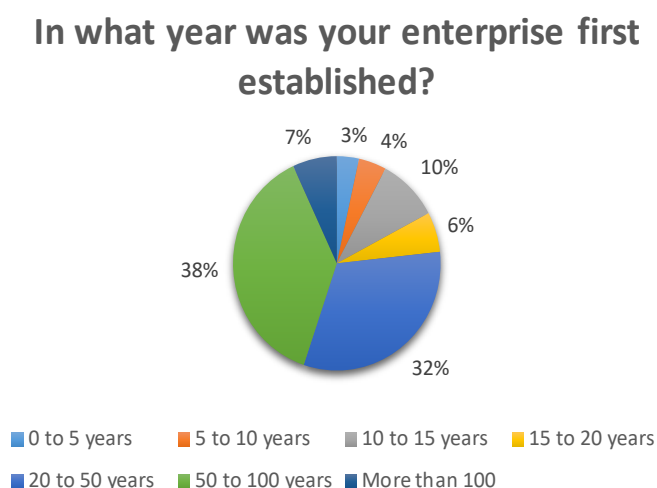
However, the available data from the responses do allow this study to explore broad challenges and opportunities related to due diligence, which are specifically experienced by a business because it is an SME. While available online, the majority of responses to the survey were generated by dissemination via an informal OECD Manufacturers Network, this can explain the uneven regional uptake and the subsequent over-representation of Japan and Brazil in the results. 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 segments of the supply chain. In addition, this study doesn't seek to draw conclusions as to which solutions are particularly well adapted to support SMEs in their due diligence, and further analysis of real life examples would be a very practical follow up to this study.

2.3. Main characteristics of SME survey respondents

This section will present several data points showing the main characteristics of the survey respondents.

2.3.1. Operation period

Figure 2.2. SMEs: Operation period



Note: 57% responded – 116 responses

Nearly 80% of SME respondents have been in operation for over 20 years. Around 40% of respondents have been in operation between 50 and 100 years, and a third between 20 and 50 years. 7% have been in operation for more than 100 years⁴⁰. Among those older than 50 years old (45%), it is important to note that 70% are Japanese.

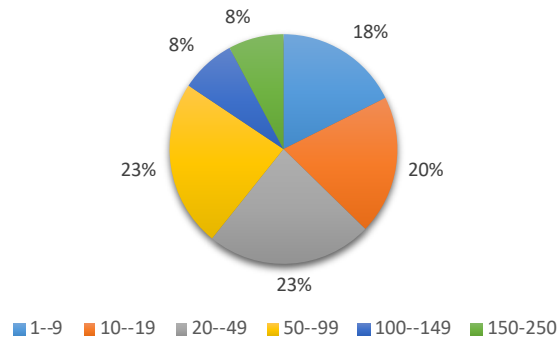
The median value of the sample is 50 years. Larger companies' responses range mostly between 20 to 50 years old (66%), with 10% of them older than 100 years old.

⁴⁰ Here it is important to highlight regional differences, since Japan is home to some of the oldest companies in the world. K. Gittleston, Can a company live forever?, BBC News. NewYork <https://www.bbc.com/news/business-16611040>

2.3.2. Size

Figure 2.3. SMEs: Number of employees

How many employees does your company have?



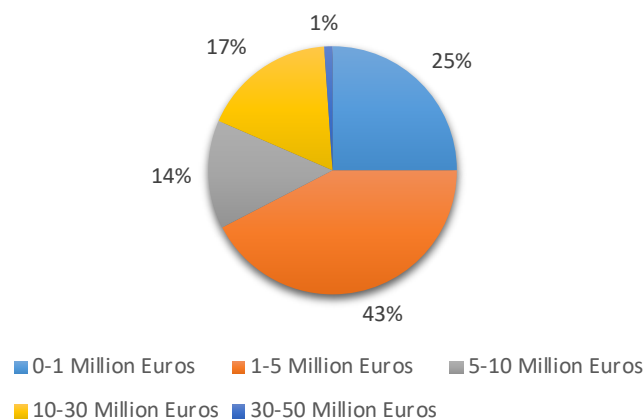
Note: 50% responded – 103 responses

The number of employees for most SME respondents ranges between 1 and 49 (61%). Although the median of the data sample is 30 employees, the average response and mode value is 50. On the basis of this data, 43% of SME respondents are small enterprises, 39% are medium-sized enterprises and 18% are micro enterprises. Among SME respondents, 82% of respondents are small and medium enterprises. Overall, 11% are non-SMEs.

2.3.3. Annual turnover

Figure 2.4. SMEs: Annual turnover

What is your company's annual turnover?



Note: 50% responded - 103 responses

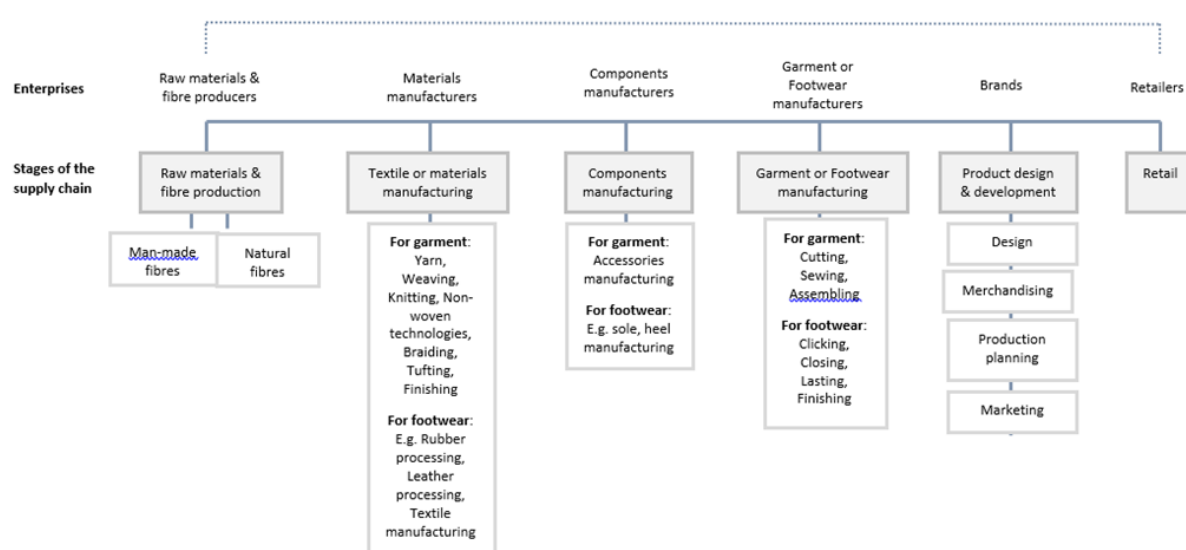
The annual turnover for nearly two-thirds of SME respondents ranges between 0 and 5 million Euros. The median of the data set of SMEs' annual turnover is EUR 3 000 000. However, a significant number of respondents (25%) fall into the EUR 0-1 million turnover bracket.

For the most part, non-SMEs' (according to the number of employees) annual turnover represents more than EUR 50 million (60%). 27% of them have an annual turnover of more than EUR 100 million.

2.3.4. Position in the supply chain

Textile, garment and footwear production involves numerous operations that take place at different stages in the supply chain, including the transformation of raw materials (fibres), spinning, weaving (or knitting), dyeing, clothing/footwear manufacture (cutting, sewing, trimming, embroidery, printing, washing), packaging and transport. For the purposes of this study, the various stages of the supply chain can be simplified into six main stages⁴¹:

Figure 2.5. Simplified Garment and Footwear supply chain



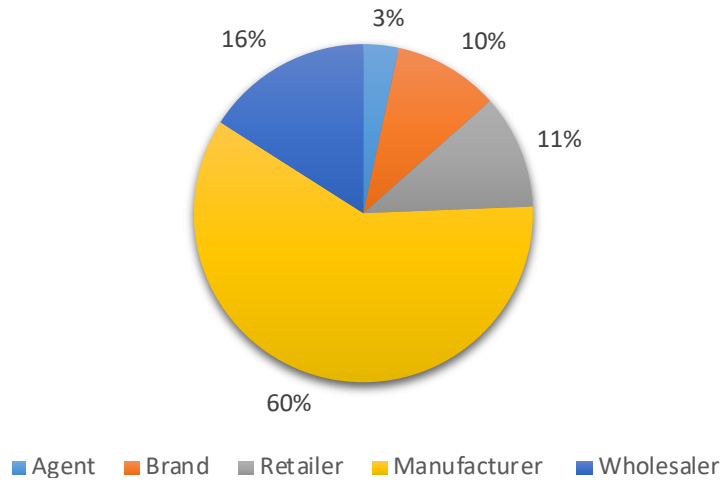
Note: Intermediaries are present throughout the supply chain

Source: OECD

⁴¹ Intermediaries operate throughout the supply chain

Figure 2.6. SMEs: Primary business activity

What is your primary business activity?



Note: 55% responded – 113 responses

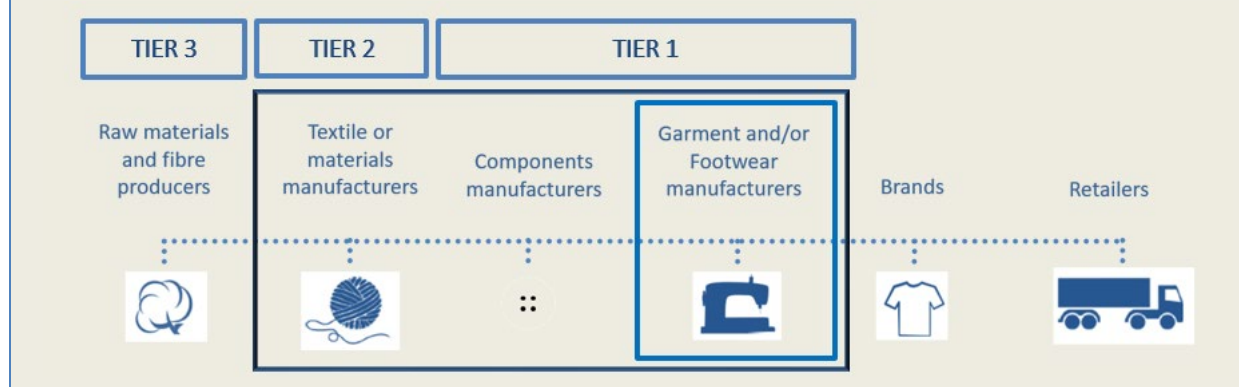
The primary business activity of 60% of the respondents is manufacturing. The overall results therefore reflect more the experience of manufacturers and their position in the supply chain. Brand and agent respondents make up a very small percentage (13%) of the respondents that answered this question.

Box 2.1. Manufacturers' position in the supply chain

Manufacturers are positioned in the downstream part of the supply chain. They can be textile or material manufacturers, component manufacturers or garment and/or footwear manufacturers.

60% of the survey respondents are manufacturers, of which 69% work in tier 1 activities, such as:

- Manufacture of other materials such as component accessories (e.g. zips, buckles, shoe laces)
- Manufacture of finished garments
- Manufacture of sportswear
- Manufacture of leather garments
- Manufacture of articles containing fur
- Manufacturer of knitted garments
- Shoe manufacturer
- Tanning of leather and leather finishing
- Dressing and finishing of fur
- Manufacture of luxury garments



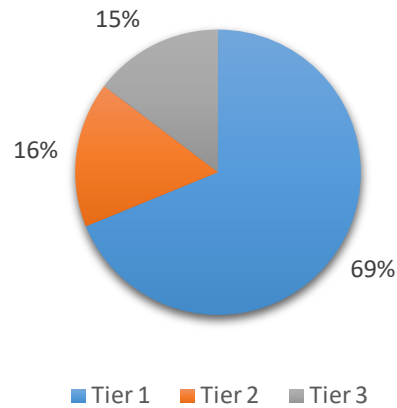
The manufacturers' types of activities have been categorised into tier 1, tier 2 and tier 3 to make the respondents' position in the supply chain easily visible. Manufacturers' activities in the sample are mainly part of tier 1, which involves the final stages of manufacturing. The most common responses concern manufacturers of knitted garments and finished garments. Non-SME activities in our sample are mainly concentrated in tier 2 (textile processing and textile finishing).

Table 2.1. Garment and Footwear supply chain

Tier 3	Raw material processing (Preparation and refinement of textile fibres)
Tier 2	Material production (textile processing and finishing)
Tier 1	Finished production assembly (garment and components manufacturers)

Figure 2.7. SMEs: Type of manufacturing activities

What manufacturing activities is your company involved in?



Note: 97% responded - (out of manufacturers) 69 responses

2.4. Sourcing practices and supply chain structure of SME survey respondents

This section will present key data points collected through the survey on the sourcing practices of SMEs and the type of supply chain structure.

2.4.1. Sourcing concentration and number of countries involved in the supply chain

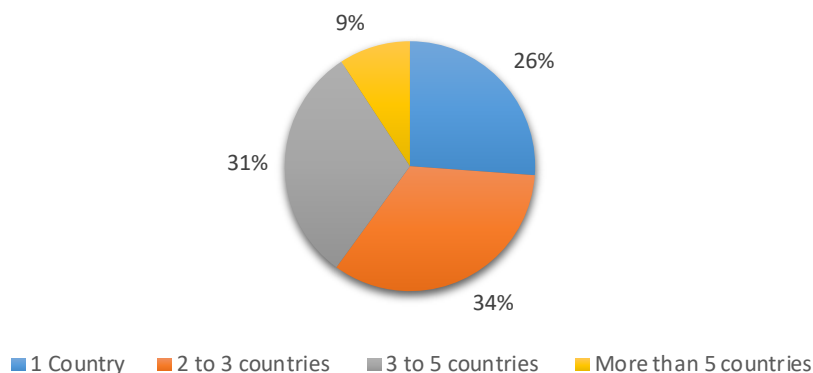
The survey sought to identify sourcing concentration and the number of countries involved in the supply chain. Companies were asked the number of different countries they source from, and what percentage of their total sourcing the countries represented.

Around 65% of SME respondents selected that they sourced from one to three countries, with around 25% sourcing from one country. The median is three different countries and the mode value is one, as a high number of respondents source from only one country, and this can be directly linked to a high sourcing concentration. As a point of comparison, a major part of our non-SME sample sources from at least five or more countries (44%).

While 14% of SME respondents answered, “Don’t know”, indicating a lack of knowledge of their sourcing origins, 13% indicated that the question was non-applicable. It can be noted that a high number of SMEs might not collect this type of information from their suppliers and lack visibility over their supply chain. This is particularly true for SMEs using agents or subcontracting a high number of their orders.

Figure 2.8. SMEs: Number of countries involved in the supply chain

From approximately how many countries did your company source raw materials, fabrics and semi-finished fabrics or finished goods in the past year ?

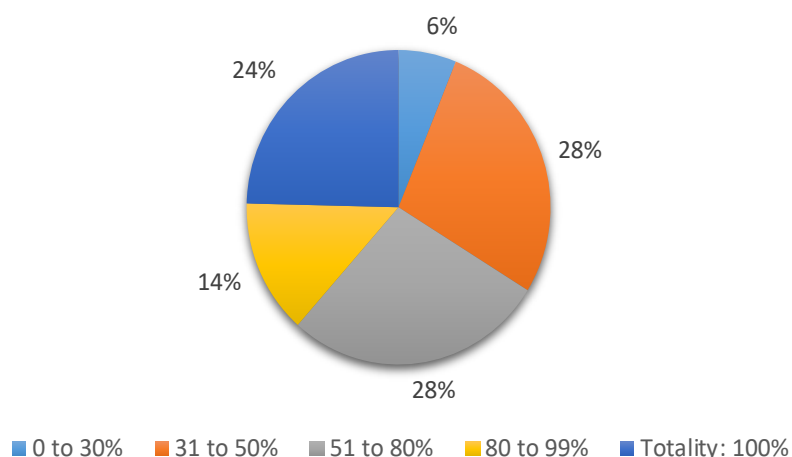


Note: 44% responded - 90 responses, the graph only represents 65 respondents that answered with quantitative data

The country from which they source the most represents a high percentage of their total sourcing, with an average of 69% of the total sourcing, meaning on average respondents concentrate most of their sourcing in one country. This is the case for 65% of respondents. While the median is 60%, the mode value is 100%; this reflects the high number of respondents that source all their materials from one country (24%).

Figure 2.9. SMEs: Sourcing concentration

What percentage of your total sourcing (in terms of volume) does this country represent?

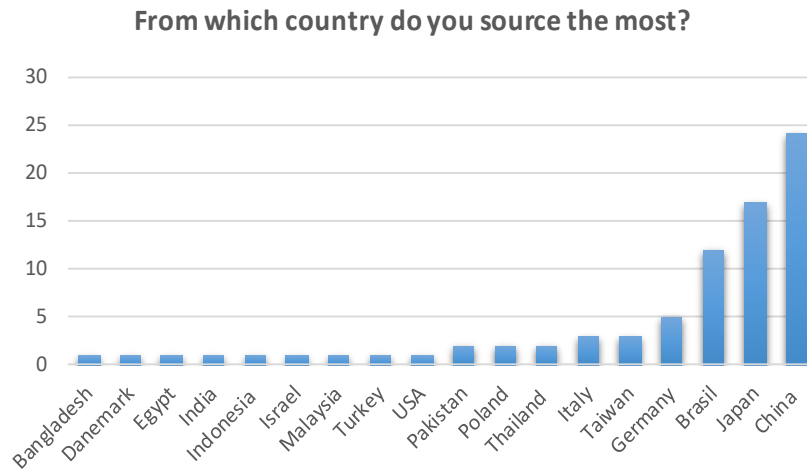


Note: 33% responded - 68 responses

Enterprises that are operating in or sourcing from many countries – relative to their size – may have an increased exposure to risks and therefore may find preventing and mitigating potential or actual harm more challenging. This sample reflects low exposure of SMEs with regard to their sourcing practices as they tend to source from a low number of countries and concentrate a large part of their sourcing in one country. A high sourcing concentration can be considered an SME characteristic that can facilitate the scoping

exercise on country risk factors. Country risk factors are conditions in a particular country or production cluster, or within the industry within a particular country, which may make sector risks more likely.

Figure 2.10. Main sourcing country



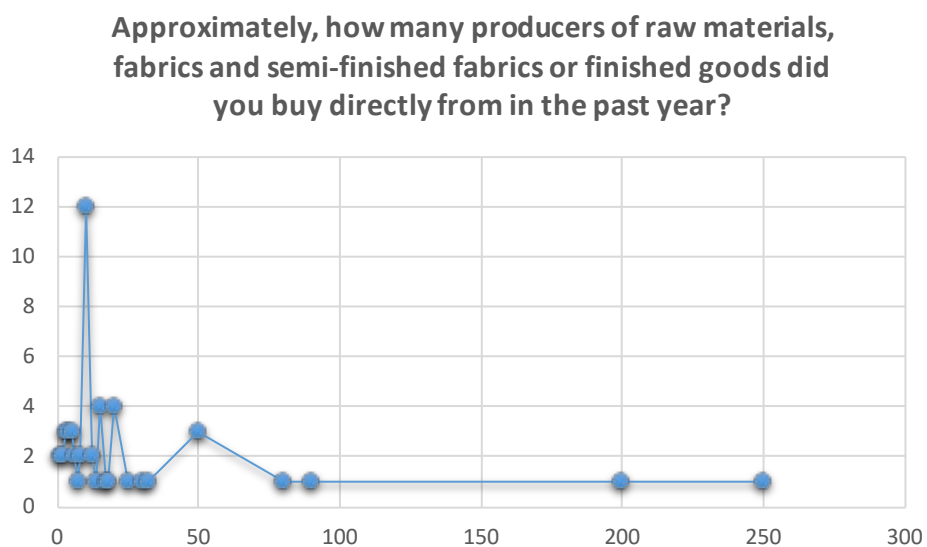
The main sourcing country data cannot be analysed due to the responses' regional imbalance.

2.4.2. Direct suppliers

The survey sought to identify direct sourcing intensity and questioned SMEs about how many direct suppliers they interact with on average within a year. For nearly 60% of SME respondents, the number of direct suppliers is less than ten. The median and mode is ten suppliers. A majority of SMEs buy from approximately 2 to 10 direct suppliers in a year on average.

Therefore, for the majority of respondents, the number of direct suppliers is low compared to larger companies: in the case of our non-SME sample, most companies (60%) have more than 20 suppliers, of which 20% have more than 100. A third of all respondents either did not know or the question was not applicable (for 13%).

Figure 2.11. SMEs: Number of direct suppliers



Note: 36% responded - 74 responses, the graph only represents quantitative data (53 responses)

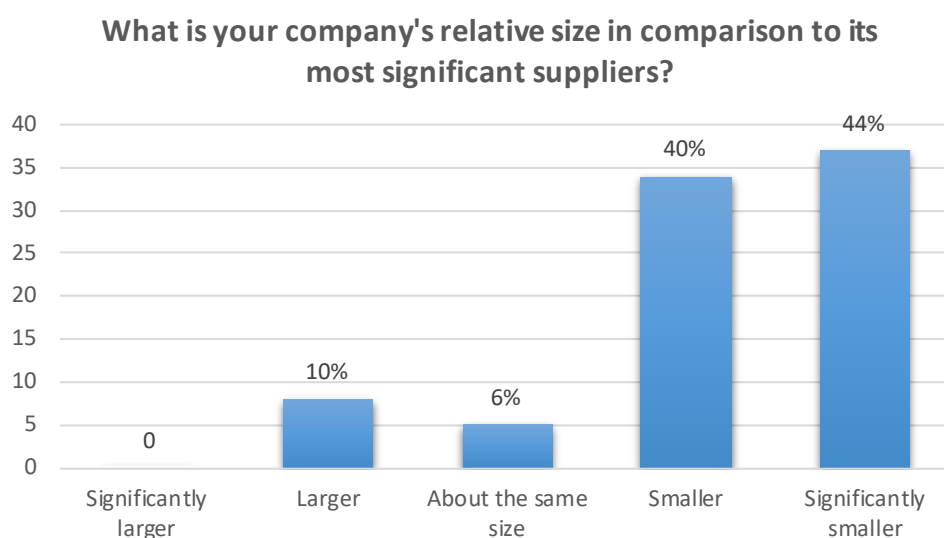
Having a large numbers of suppliers may increase the exposure to harm in the enterprise's supply chain. A large number of suppliers in relation to the size of the enterprise and its resources dedicated to supply chain due diligence can be more difficult to control.

2.4.3. Relative size

The survey questioned companies on their size in comparison to their main suppliers. Most respondents consider themselves to be smaller or significantly smaller (80% of respondents) than their suppliers. Only 10% are larger and no SME declared itself to be significantly larger.

This could be closely connected to the most significant challenge they reported, namely verifying that suppliers meet standards, as their orders represent a small portion of the suppliers' total (37%).

Figure 2.12. SMEs: Relative size



Note: 41% responded - 84 responses

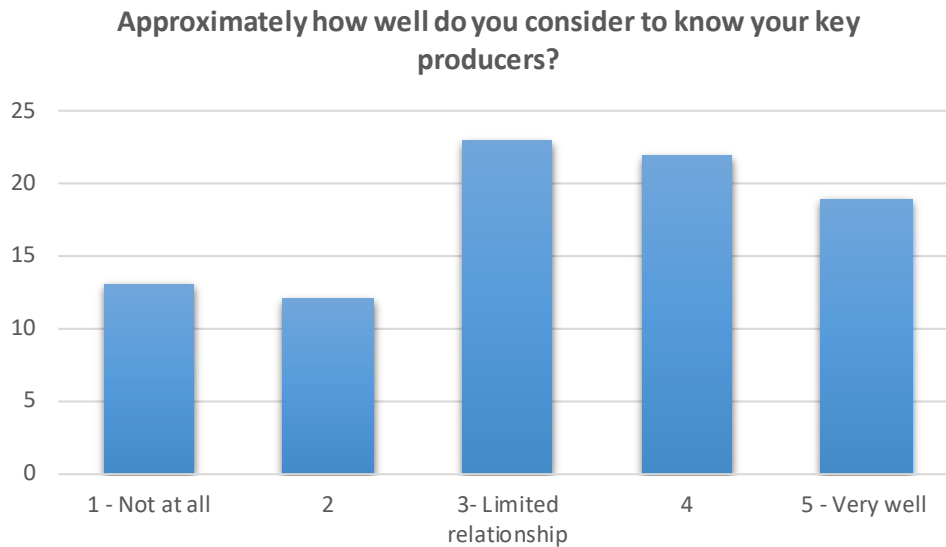
The size of the enterprise can affect the leverage that the enterprise has with its suppliers, which may be diminished due to its small size or its relatively insignificant buying power, if the buyer represents a small proportion of business for the supplier. Leverage is an important tool that can be used to impact the suppliers' decisions.

2.4.4. Type of relationship

The survey questioned SMEs about how well they consider they know their key suppliers. Half of SME respondents consider that they know their key suppliers well or very well. One in four have a limited relationship with their suppliers. This can be linked to data previously shown, as the SME respondents also have a low number of direct suppliers. It can also be correlated with the average operation period length for the enterprises in our sample, which is 50 years. Knowledge of suppliers can also be correlated with the number of orders via agents and the number of orders subcontracted out.

The non-SME respondents also appear to have a good knowledge of their suppliers, as nearly 70% state that they know their suppliers well or very well and only 6% not at all. Long-term buyer-supplier relationships can help to increase visibility and control over the enterprise's supply chain.

Figure 2.13. SMEs: Knowledge of suppliers



Note: 41% responded – 84 responses

The volatility of an enterprise's relationship with its suppliers may affect its ability to identify, prevent or mitigate harm in its supply chain. It may also mean that the enterprise lacks leverage with the supplier to prevent or mitigate any impacts that have been identified. Enterprises that have longer-term relationships with their suppliers and understand the local operating context are more likely to understand the risks in their supply chain and be able to support their suppliers in pursuing outcome-oriented solutions.

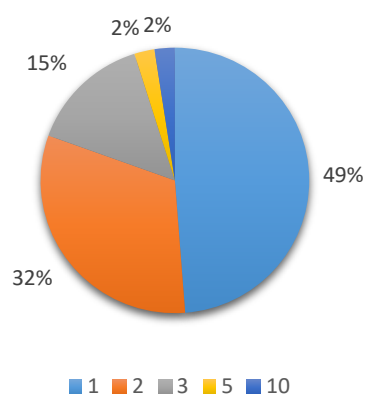
Indirect sourcing intensity

This survey question sought to identify SMEs' indirect sourcing intensity and asked for the average number of intermediaries between the enterprise and suppliers and the percentage of orders that are placed via agents. One-third of SME respondents either stated that they source directly or that the question was not applicable.

For the remaining SMEs that declared intermediaries, the number of intermediaries used varies, although the average remains limited to two, with most (81%) using between one and two intermediaries. Overall, 21% of them did not know. It can be considered that respondents that do not know have reduced visibility over their supply chain and the actors present beyond tier 1. This can also be linked to the predominant use of buying agents and subcontracting.

Figure 2.14. SMEs: Average number of intermediaries in the supply chain

On average, how many intermediaries are there between your enterprise and your producers of raw materials, fabrics, and semi-finished fabrics or finished goods ?



Note: 43% responded – 87 responses (the graph represents SMEs that have at least one intermediary (41))

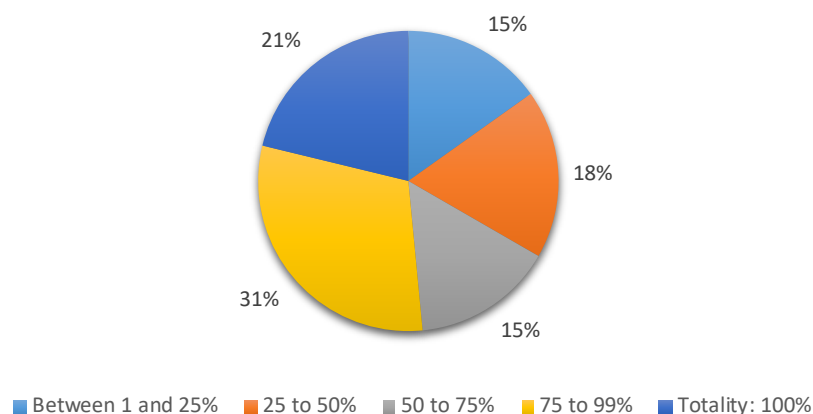
Having a low number of intermediaries can potentially increase the visibility and control over suppliers, as it is easier to implement control measures in some cases. The term “intermediaries” here may include buying agents, logistics providers and global commodities merchandisers (traders) and processors, among others.

Buying agents:

For respondents placing orders via agents, the proportion of their total orders via agents differs widely. While 17% of SME respondents declared that they do not place any orders via agents (out of those who responded), most SME respondents using buying agents as intermediaries (out of those who answered quantitatively) place a high percentage of their orders: 67% of our sample companies place more than 50% of their orders via agents. One in five place all their orders via agents. On the other hand, a majority of non-SMEs place less than 50% of their orders via agents.

Figure 2.15. Number of orders placed via agents

What percentage of your orders were placed via agents?



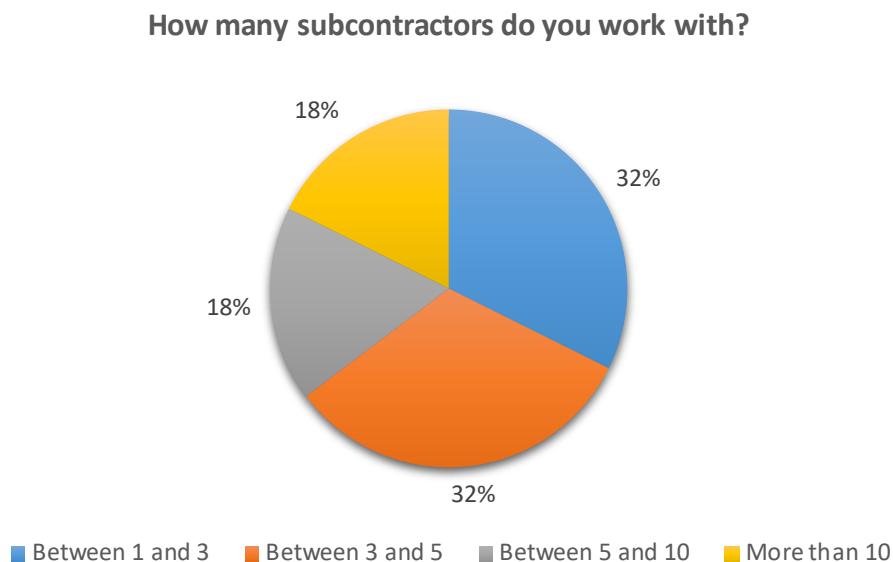
Note: 42% responded - 86 responses (graph represents only quantitative data – 83 responses)

While SMEs that place the majority of their orders via agents might interact with a lower number of business partners (the agent could represent a control point, depending on the type of relationship), this can also reduce the visibility across the supply chain. The relationship between the SME and the buying agent might be largely influenced by the type of leverage that the SME can exert over its buying agents. The use of agents to place orders can also be correlated with their lack of knowledge of suppliers and influence their lack of leverage. This shows how collaboration with buying agents in terms of due diligence can be a useful tool for SMEs, as it can contribute to the increased traceability and transparency of the supply chain as well as enhance collaboration between SMEs buying via a common buying agent with regard to due diligence data, which in turn would help to pool their leverage.

Subcontracting

The survey asked SMEs how many subcontractors they work with. Half of SME respondents answered none or that the question was not applicable. The majority of those that do work with subcontractors (64%) work with between one and five subcontractors and the median is three. 10% did not know.

Figure 2.16. SMEs: Number of subcontractors



Note: 41% responded – 83 in total (declared quantitative information - 47 responses)

Subcontracting orders to third parties is a fairly common practice at many stages of the garment and footwear supply chain. Subcontracting can enable the SME to respond quickly to short lead times and changes in orders, specialise in certain tasks such as design, or outsource specialised tasks that are not performed in-house such as screen printing. Outsourcing can decrease transparency in the supply chain and has been demonstrated to increase the risk of human rights and labour abuses and environmental impacts in higher-risk contexts. When operating in higher-risk contexts and where there is a high likelihood of subcontracting, the due diligence measures that an SME should take to mitigate these risks should therefore be increased.

2.5. Summary: Key findings

The main characteristics of our sample are:

- Around 80% of respondents are either small or medium enterprises, SME respondents have on average 50 employees and a turnover of EUR 3 million. Most respondents are manufacturers (60%), of which nearly 70% work in tier 1 of the supply chain as garment, footwear and/or component manufacturers, which involves the final stages of manufacturing.
- A high sourcing concentration was identified as most of their sourcing comes from one country (60 to 100%), but on average they source from one to three different countries. This sample reflects low exposure of SMEs with regard to their sourcing practices, as they tend to source from a low number of countries and concentrate a large part of their sourcing in one country. A high sourcing concentration can be considered as an SME characteristic that can facilitate the scoping exercise on country risk factors.
- When sourcing directly, their direct suppliers range on average between 2 to 10 within a year. A third of all respondents did not know and the question was not applicable for 13%. A large number of suppliers in relation to the size of the enterprise and its resources dedicated to the supply chain can rapidly complicate due diligence implementation across the supply chain and reduce visibility.
- Most respondents consider themselves to be smaller or significantly smaller (80% of respondents) than their suppliers and half of SME respondents consider that they know their key suppliers well or very well. One in four have a limited relationship with their suppliers. This can be linked to the low number of direct suppliers they interact with and with high sourcing intensity. It can also be correlated with the average operation period length of the enterprises in our sample, which is 50 years.
- When sourcing indirectly, they have on average between 1 and 2 intermediaries. One-third declared that they either source directly or that the question was not applicable and, overall, 21% of them did not know. It can be considered that respondents that do not know have reduced visibility over their supply chain and the actors present beyond tier 1. This can also be linked to the predominant use of buying agents and subcontracting.
- 18% do not place orders via agents. When they do, they place the majority of their orders: nearly 70% of them place more than 50% of their orders via agents, and one in five place all their orders via agents. Depending on the type of relationship they have with buying agents, high reliance on buying agents can reduce supply chain visibility.
- Regarding subcontracting, half of SME respondents answered none or that the question was not applicable. For those working with subcontractors, the majority (64%) work with between 1 and 5 subcontractors with an average of 3.

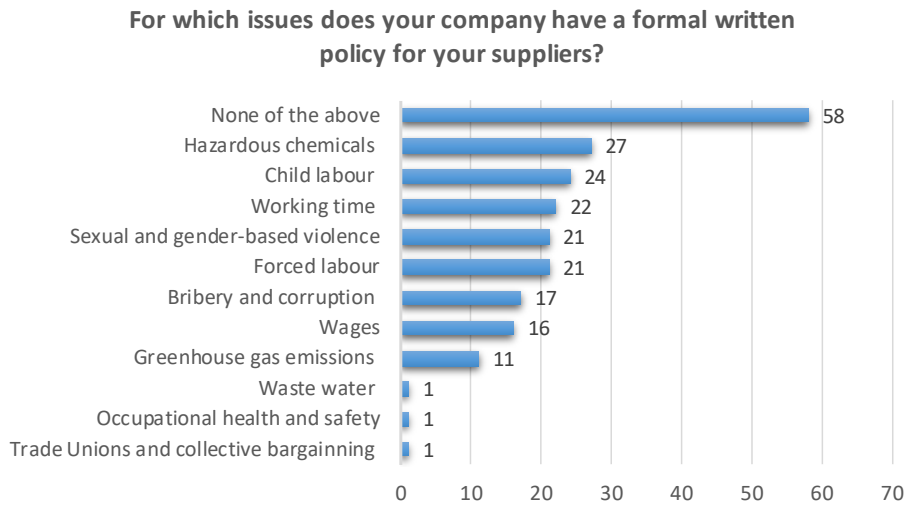
2.6. Due diligence practices of SMEs operating in the Garment and Footwear sector

2.6.1. Company due diligence policies

As an initial step under a due diligence process, companies are expected to adopt a policy that articulates their commitments on responsible business conduct in their operations and supply chain. Companies are also expected to embed those policies into their oversight and management systems so that they are implemented as a part of regular business processes.

Within the sample of companies answering the survey, one key finding shows that almost one-third do not have any type of due diligence policy (32%). The companies that do cover special issues. The main risks covered in companies' policies include "hazardous chemicals" with 13%, "child labour" and "working time", representing 10% and 9% respectively. Some of the less-covered risks appear to be "occupational health and safety", "trade unions and collective bargaining" and "greenhouse gas emissions".

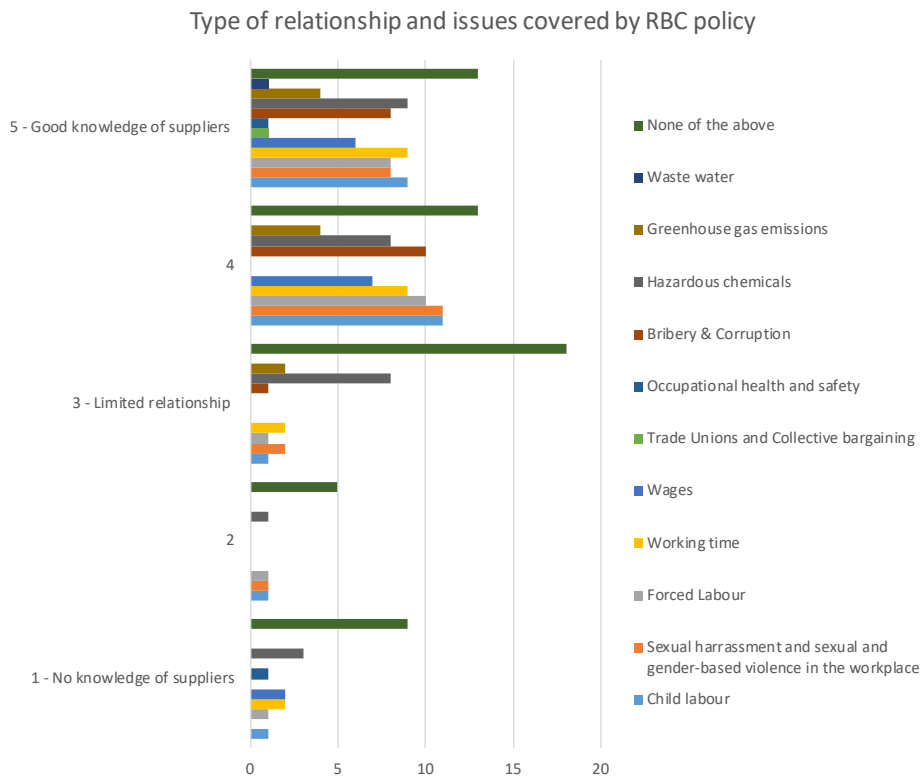
Figure 2.17. Issues covered by RBC policy



Note: 48% responded – 97 responses

As previously mentioned, while 26% of SME respondents do not have any policies on RBC issues, this is particularly high compared to our non-SME sample, where only 9% do not have an RBC policy. This intuitively reflects a low level of awareness among SMEs compared to their counterparts. Those who have a better knowledge of their suppliers tend to have more diversified due diligence policies in place, as the graphic below shows, correlating level of knowledge of suppliers with issues covered by the policies in place.

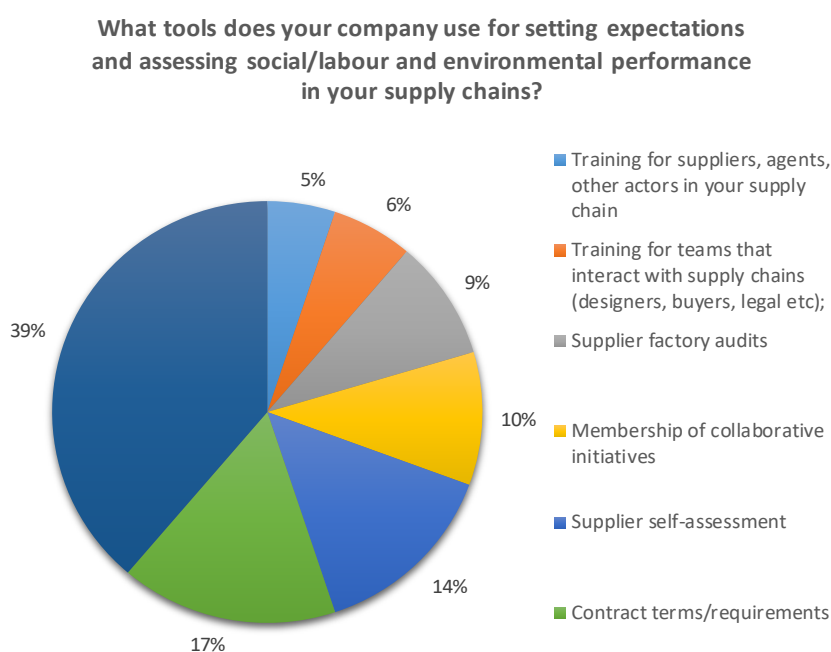
Figure 2.18. Type of relationship and issues covered by RBC policy



2.6.2. Setting expectations and assessing performance

To identify potential and actual harm in the enterprise supply chain, the enterprise should set expectations to assess suppliers' due diligence implementation; enterprises must take steps to communicate expectations. This will facilitate the assessment of suppliers with higher risks at the site level and the enterprise's relationship to the impact.

Figure 2.19. SMEs: RBC tools

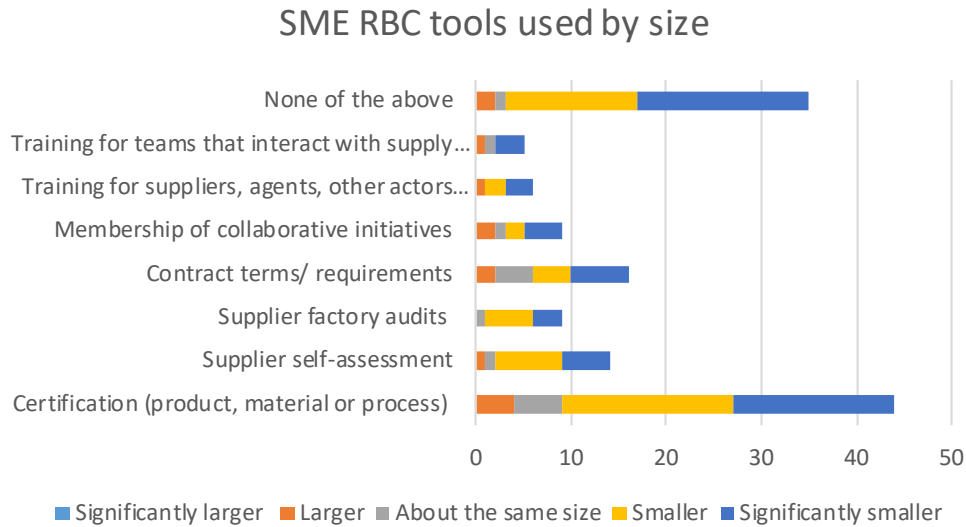


Note: 42% responded – 86 responses

A significant finding is that more than one-third of the respondents do not use any tools to communicate expectations and assess RBC performance in their supply chains (28%). However, of the tools used by SMEs, there is a considerable reliance on certification (39%). Other tools that SMEs mostly use include contract terms and requirements (17%), supplier self-assessment (14%), membership of collaborative initiatives (10%) and factory audits (9%). The type of tools that are least used by SMEs are training for suppliers, intermediaries (6%) and teams that interact with the supply chain (5%).

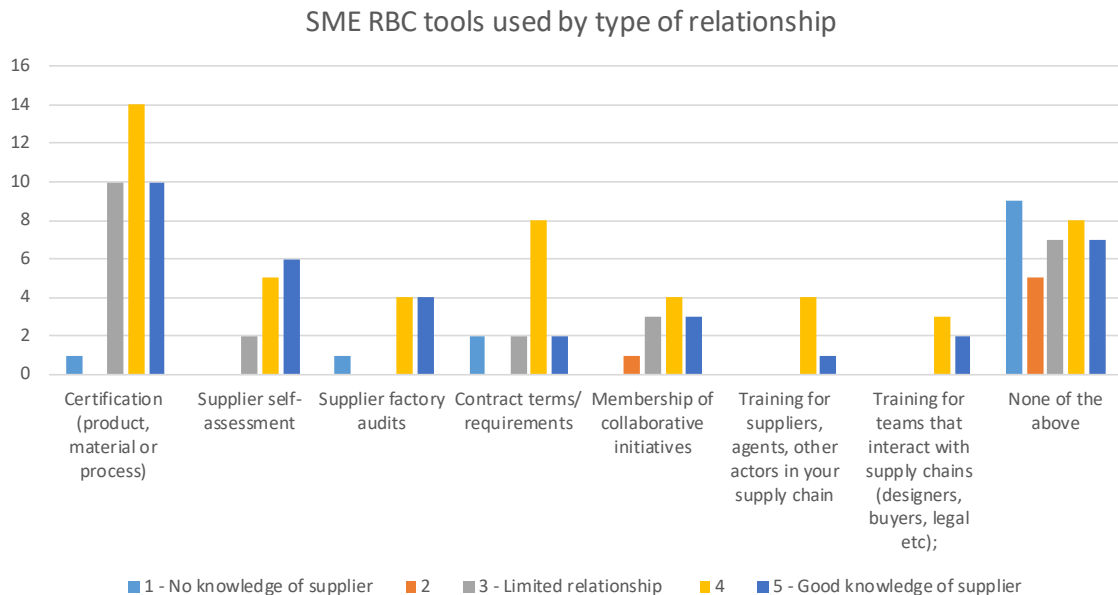
Since the non-SMEs that responded use training, membership of collaborative initiatives and supplier factory audits more than the SMEs, it could indicate that these tools are less accessible to SMEs owing to their size and available resources. Below is a graph representing the most-used tools per size of respondent, showing that larger enterprises tend to use more training and supplier audits and supplier self-assessment compared to smaller respondents. 20% of non-SMEs do not use any type of tools. Non-SMEs also use a high number of contract terms and requirements (17%) and supplier self-assessments (10%).

Figure 2.20. Size and RBC tools in place



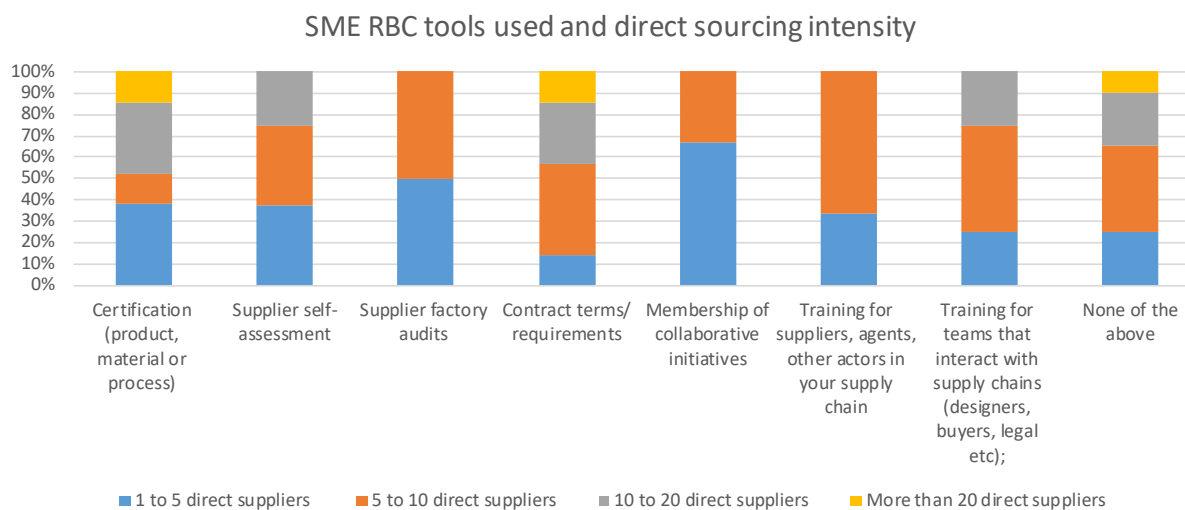
It is shown that enterprises smaller than their supplier tend not to use any type of RBC tool to set expectations and assess performance but when they do, they mainly use certification. With suppliers of the same size, the most-used tools appear to be certification and contract terms and requirements. We can also see a higher presence of training and membership of collaborative initiatives among larger SMEs, indicating the cost and availability of these tools.

Figure 2.21. Type of relationship and RBC tools in place



The graph above shows a correlation between the level of knowledge of suppliers and the type of tools used to set expectations and assess RBC performance. While any type of tool is used in all cases, enterprises that have a good knowledge of their supplier tend to use more supplier factory audits, membership of collaborative initiatives and training than the other enterprises. This shows that the accessibility of these tools also depends on the type of business relationship and level of leverage to put them in place.

Figure 2.22. Direct sourcing intensity and RBC tools in place



Once again, we can see the abovementioned correlation, in which enterprises with a low number of direct suppliers tend to use more tools such as membership of collaborative initiatives, training and supplier factory audits, compared to their counterparts. This indicates that a low number of suppliers, and therefore the possibility of having more visibility and control over them, as well as better knowledge of them, is a more suitable supply chain structure for these tools. Tools that appear to be used irrespective of the type of sourcing intensity are certification, contract terms and requirements and supplier self-assessments.

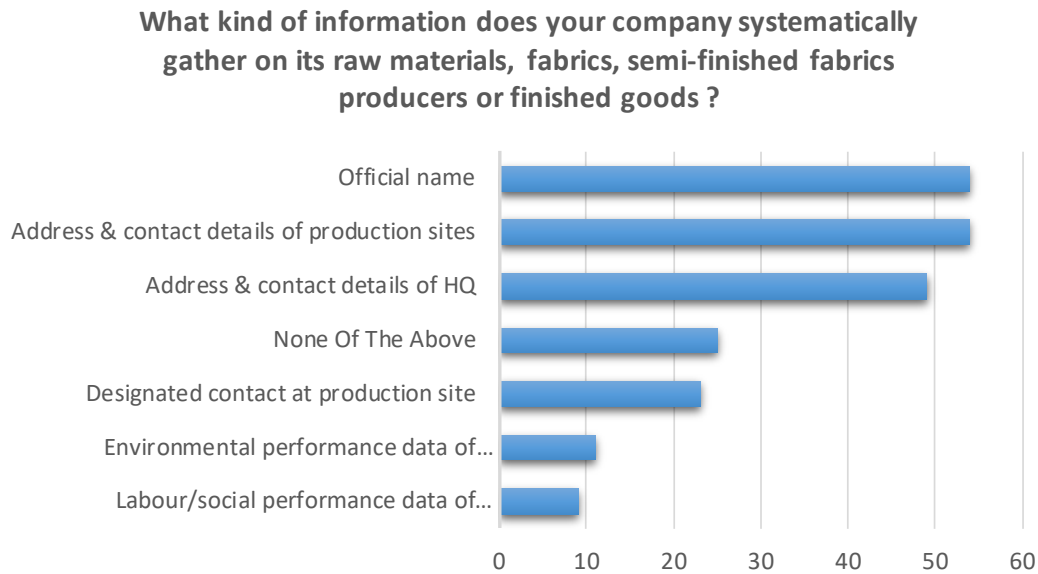
2.6.3. Type of due diligence information required from suppliers

As part of the due diligence process, the enterprise may collect information on whether their suppliers conduct due diligence and the extent of that due diligence. The lack of sufficient and accurate data remains a challenge in understanding the nature, scale and scope of the risks in the sector.

Very few respondents collect information on suppliers' labour and environmental performance. While most respondents collect basic supplier information such as the official name, address, contact details of HQ and production sites, very few (4 to 5%) collect more advanced information, such as due diligence data: environmental and labour social data performance from their suppliers (as compared to nearly 10% of respondents from the non-SME sample).

While 27% of respondents collect just the name, 51% in total collect the name, address and contact details of their suppliers' HQ. A few collect the same information about suppliers' production sites (27%). The majority would therefore be unable to map their supply chain. Difficulty gathering information can also be linked to a lack of leverage: in such cases, the enterprise can find it more difficult to identify and prioritise risks.

Figure 2.23. Information collected



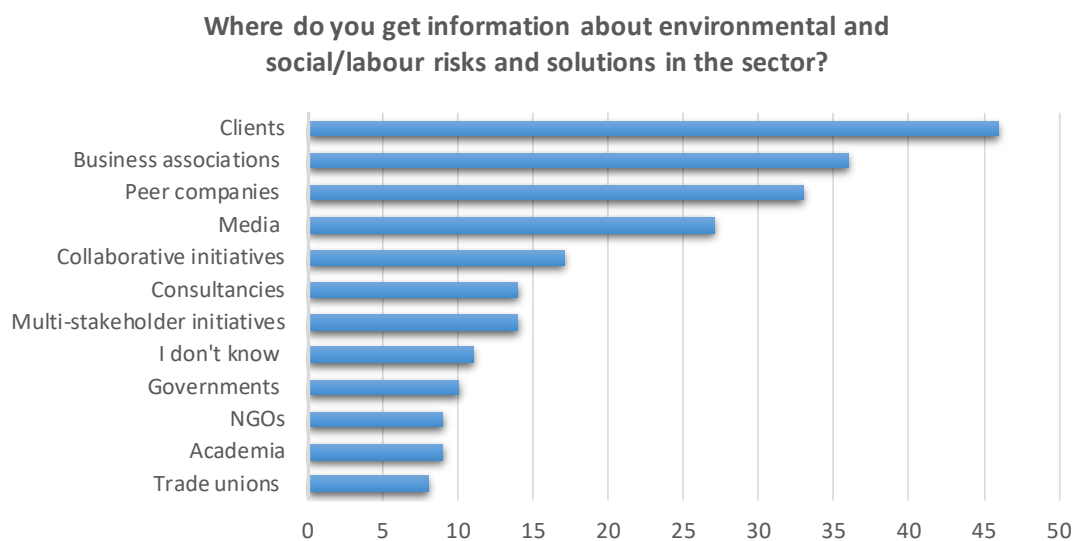
Note: 42% responded - 86 responses

2.6.4. Circulation of information in the sector

SMEs predominantly obtain information about the main risks in the sector via their clients, business associations and peer companies. 20% of respondents obtain information through clients and 15% via business associations and peer companies, with lower reliance on government, trade unions and civil society for information. 12% obtain information via the media.

We can see that SMEs mainly use information from peer companies and business associations, reflecting that they rely on existing partnerships and use available information and existing practices. The lower reliance on government, trade unions and civil society (3 to 5%) reflects a lack of access to or understanding of this type of communication. This will lead to further discussion on the accessibility and language of RBC information for SMEs. Non-SMEs rely primarily on business associations, clients, the media and peer companies.

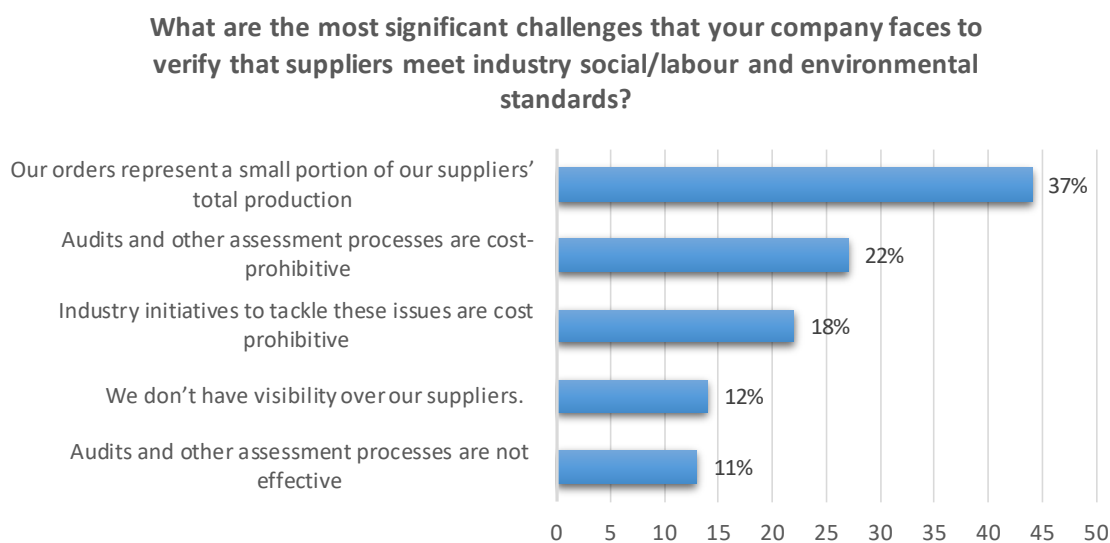
Figure 2.24. Reported sources used to obtain RBC information



Note: 42% responded – 86 responses

2.6.5. Key challenges in verifying due diligence implementation

Figure 2.25. Challenges faced in implementing due diligence



Note: 40% responded - 81 responses

SME respondents identified various challenges in verifying that suppliers meet industry social and environmental standards. For 37% of respondents, their orders represent a small amount of suppliers' total production. Almost one in five respondents find the cost of audits and participation in industry initiatives prohibitive and 11% lack visibility.

Figure 2.26. Key challenges and relative size

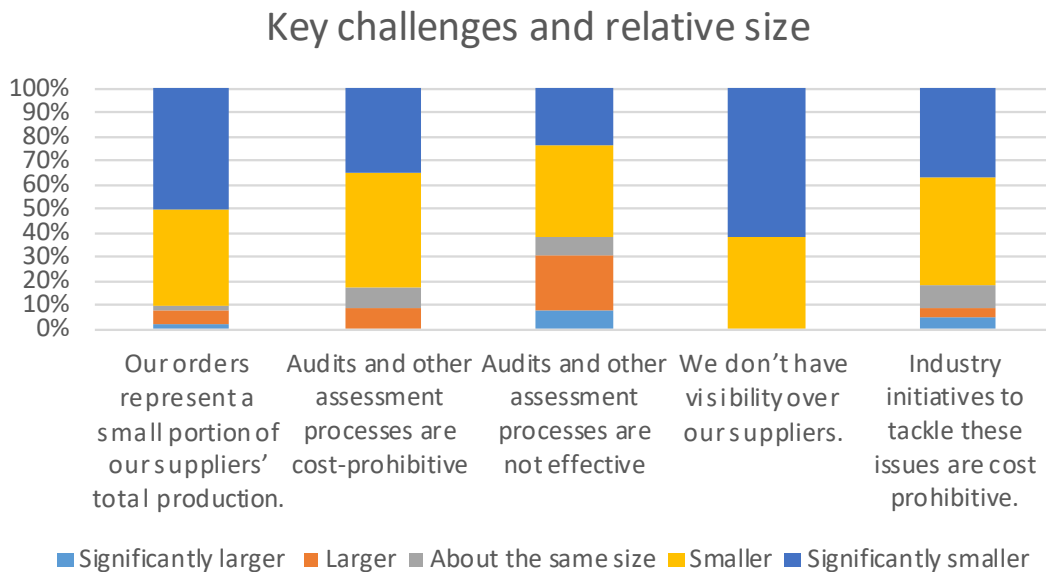


Figure 2.27. Key challenges and relative size

The figure shows that smaller SMEs tend to face challenges such as a lack of visibility and lack of leverage because they represent a small share of their suppliers' overall production, along with a lack of resources, more than their larger counterparts. Larger companies identified the lack of effectiveness of the audits and other assessment processes as the main challenge. This shows that SMEs' main challenges are linked to leverage, visibility, financial resources and the accessibility of the tools.

Lack of leverage over their supplier, lack of financial resources, lack of visibility of their supply chain and lack of awareness are the three main challenges to identifying, preventing and mitigating harmful impacts associated with a supplier. In light of SMEs' characteristics and the sourcing practice information collected during the survey, several hypotheses can be developed on how SME structure and sourcing models can affect the nature and extent of their due diligence practices.

This chapter considers the main obstacles to carrying out due diligence for SMEs and presents avenues to address them. The following sections flag what information the Garment Guidance provides to tackle each of these challenges and highlights where extra effort might be needed to develop additional tools tailored to SMEs' due diligence.

3. Key challenges for SMEs in supply chain due diligence implementation and avenues to address them

3.1. Leverage

The lack of leverage over their suppliers is one of the main obstacles SMEs face in implementing due diligence. In the Garment Guidance, leverage refers to the ability of an enterprise to influence another enterprise. An enterprise's leverage with its suppliers is important when identifying, preventing and mitigating harmful impacts associated with a supplier. The Due Diligence Guidance for RBC considers that leverage exists "*where the enterprise has the ability to effect change in the wrongful practices of the entity that causes the harm*". An appropriate approach to using leverage will depend on the impact in question, the degree of leverage an enterprise possesses with its business relationship, and other characteristics specific to the sector and/or nature of the business relationship. Enterprises may also pursue a combination of approaches in applying leverage⁴².

The extent of leverage can be affected by a number of factors, such as the proportion of business that the enterprise represents for the supplier, whether the enterprise is directly sourcing from the supplier or sourcing through a buying agent, and whether sourcing agreements are short-term or long-term. In these cases, the SME's scope of action is limited, as the extent of its decisions may not impact the supplier's decision.

3.1.1. Leverage towards suppliers

In the case of the survey SME sample, the main reasons for the respondents' lack of leverage appear to be their size, as they are generally smaller than their suppliers⁴³ and consequently represent a small proportion of business for the supplier, and their indirect sourcing intensity. There is high reliance on intermediaries when present, as most placed all or the majority of their orders via the intermediary.

Leverage is affected by their sourcing model (direct or indirect sourcing) and the type of relationship the enterprise has with their suppliers (long-term or short-term and typical length of business contract). Based on these criteria, within the sample companies, SMEs present several advantages when it comes to conducting due diligence on their suppliers: they mainly source directly, concentrate sourcing in a low number of countries and, when sourcing indirectly, a low number of intermediaries are involved⁴⁴. For

⁴² OECD (2018), OECD Due Diligence Guidance for Responsible Business Conduct, <http://mneguidelines.oecd.org/OECD-Due-Diligence-Guidance-for-Responsible-Business-Conduct.pdf>

⁴³ Ref to section 2.2.2

⁴⁴ Ref to section 2.3

example, when sourcing via agents, a high number of them source the majority of their production via one agent, which considerably lowers the number of actors that the SME would need to engage with in order to ensure implementation of their due diligence policies, scope its supply chain and identify and prioritise risks. High reliance on intermediaries can also reduce leverage over the supply chain depending on the type of relationship with the intermediary. With regard to the type of relationship, they appear to have long-term relationships with their business partners, as most of those surveyed declared that they knew their suppliers well or very well. Bearing in mind their resource and capacity constraints, SME sourcing practices have the potential to facilitate some aspects of the due diligence process.

The guidance explains how due diligence can be implemented in these types of situations. The following solutions may suit situations where companies have low leverage, while reducing costs and increasing the efficiency of the due diligence process:

- Increase its leverage with its supplier, such as increasing orders, moving towards longer-term contracts, publicising the supplier's corrective action plans, etc. (where feasible).
- Pool leverage with other buyers sourcing from the same supplier, for example by aligning on activities, timelines and follow-up measures included in the supplier's corrective action plan.
- Over time, only prequalify and engage with suppliers that are willing to undergo assessments. The enterprise may also direct sourcing towards suppliers that have been assessed by credible sector or multi-stakeholder initiatives.

i. Supplier assessment prequalification process: What the Garment Guidance says

Box 3.1. When sourcing directly

Adopt a policy on responsible business conduct that articulates the enterprise's commitments to responsible business conduct in its own operations and in its supply chain

The enterprise policy on responsible business conduct (hereafter RBC policy):

- Should include commitments regarding its own activities and should articulate the enterprise's expectations of its business partners – including suppliers, licensees and intermediaries – across the full length of its supply chain.
- Should cover matters covered by the OECD Guidelines. The enterprise RBC policy should also commit to upholding international standards on sector risks and sub-sector risks relevant to the enterprise and make explicit reference to relevant international standards.
- Should include commitments to conduct due diligence on the enterprise's most significant risks in its own operations and in its supply chain.
- (Retailers, brands and other buyers) should include a commitment to responsible sourcing practices, meaning that the enterprise commits to seeking to prevent its contribution to harmful impacts through its sourcing practices.
- Should stipulate the enterprise's expectations regarding the use of subcontractors by direct suppliers, when relevant, including a definition of "subcontract" and distinctions in subcontracted work if they exist.
- Should put forth the enterprise's expectations regarding the outsourcing to homeworkers and the use of handwork, where relevant to the enterprise's business models.
- Should include a commitment to meaningful engagement with affected stakeholders through the course of due diligence. See Introduction to due diligence under the OECD Guidelines.

- Is encouraged to include a commitment to hear and address all complaints against the enterprise regarding its own operations regardless of how they are raised; and include a commitment to hear and address measured and substantiated complaints that the enterprise has caused or contributed to harms in its supply chain that are raised through legitimate processes.

Prequalification of suppliers

The SME may focus primarily on a robust prequalification process for suppliers so that fewer resources are necessary to prevent impacts once a supplier has been engaged. Over time, the SME may also choose to consolidate the number of suppliers with which it engages.

Consolidating the total number of suppliers can help to increase an enterprise's control over its supply chain and therefore concentrate its resources to prevent impacts with a limited number of suppliers. Having a low number of direct suppliers can facilitate the enterprise's task of gathering information from the supplier, accessing the supplier's facilities or convincing its supplier to participate in a facility assessment.

The enterprise and supplier should consider the cost and resources necessary to effectively prevent or mitigate future harms. In cases in which the supplier does not have the resources to take the agreed action to adequately address identified risks, the enterprise should consider whether it will contribute financing. If funding is not available, the enterprise should consider the severity of the harm and whether to continue the relationship.

Beyond tier 1, the enterprise may lack leverage with suppliers with which it does not have a contractual relationship. In such cases, the enterprise may experience difficulty gathering information from the supplier, accessing the supplier's facilities or convincing the supplier to participate in a facility assessment. The enterprise may require its direct supplier (e.g. tier 1) to assess its suppliers (e.g. tier 2) and disclose the findings. The enterprise is encouraged to support this process. For example, a brand may partner with its cut-make-trim (CMT) supplier to assess spinning mills. The sector may also pool its leverage within a sourcing region (e.g. export processing zone or production cluster) to assess suppliers.

SMEs who have very few suppliers may find it harder to disengage from suppliers and onboard new suppliers in situations where the supplier has not taken adequate steps to address and prevent risks given appropriate notice and warning. However, in cases in which the supplier is not able to demonstrate its own ongoing efforts to mitigate impacts and does not take appropriate action in light of the inability to address significant risks, continuing the connection could bring the SME into legal, reputational or financial risk.

Box 3.2. When sourcing indirectly

Prequalification of intermediaries

Enterprises that source indirectly (e.g. through buying agents) and do not have an adequate selection process for these intermediaries have limited visibility and control over their suppliers. The enterprise may require that its buying agents assess the suppliers from which they source. In this case, the intermediary may include the cost of assessing suppliers in its pricing framework.

The prequalification process may assess the intermediary's capability to conduct due diligence on its suppliers. The enterprise may seek to understand the following during the prequalification process:

- that the intermediary is a legitimate company with a proper licence
- whether or not the intermediary fulfils the contract or whether it outsources to another company
- the total number of suppliers that the intermediary sources from and the geographic location of its suppliers
- the frequency with which the intermediary visits suppliers and the functions of staff members that visit suppliers
- the average length of time the intermediary holds a relationship with its suppliers
- measures that the intermediary has in place to prequalify the suppliers from which it sources
- the intermediary's track record for performance related to risk management, including client references
- disclosure of family relations with any suppliers.

Additional control measures may be applied to prequalified intermediaries:

Integrate expectations of intermediaries in line with the enterprise's RBC policy into supplier contracts. Intermediaries should apply a prequalification process to their direct suppliers and intermediaries.

- The enterprise should be able to know at any time where its orders are currently located. Intermediaries should be prepared to disclose the following:
 - selection of pre-approved suppliers
 - up-to-date information on suppliers
 - the results of the most recent supplier assessment and corresponding prevention measures.
- Intermediaries should alert the enterprise immediately when actual or potential severe harms are identified.
- Where feasible, intermediaries should establish long-term relationships with their direct suppliers to support the ongoing identification and effective prevention or mitigation of harm.
- The enterprise conducts assessments on a random sample of preapproved suppliers.

The enterprise may provide its support to its buying agents to assess suppliers, for example, by facilitating introduction to sector-wide or multi-stakeholder initiatives that assess suppliers

Box 3.3. When subcontracting

Prequalification of subcontractors

If the enterprise permits subcontracting, it should conduct due diligence on the subcontractors in its supply chain or ensure that its supplier has done so. In practice, this means that all steps of the due diligence process – including measures such as developing and monitoring corrective action plans, as appropriate – should be carried out on subcontractors. The enterprise is encouraged to establish clear requirements on transparency and the selection of subcontractors.

Subcontractors should be prequalified through similarly rigorous processes to those used for direct contractors. It is recommended that this is a systematic process where suppliers apply to be on a preapproved subcontractor list. Approved subcontracts may be reviewed on a semi-regular (e.g. annual) basis to remain approved. Workers of those subcontractors should have access to grievance mechanisms, similar to those of direct contractors.

In summary, when leverage is low, enterprises may:

- When sourcing directly, consolidate and focus on robust prequalification assessments.
- In the case of indirect sourcing, build due diligence expectations into direct supplier contracts (e.g. intermediaries). In this case, ensure that intermediaries are conducting due diligence.
- Support training and capacity building, facility upgrading and strengthening of management systems, as appropriate.
- Collaborate through multi-stakeholder initiatives to prevent and mitigate adverse impacts where leverage is insufficient.
- Use leverage with government where appropriate to address systemic risks.
- Work towards continuous improvement on the above and account for progress.
- Consider disengagement.

ii. Leverage through collaboration: What the Garment Guidance says

Box 3.4. Collaboration to increase leverage

Enterprises are encouraged to pool their leverage. Enterprises sourcing from the same supplier may use their combined leverage to encourage the shared suppliers to implement effective corrective action measures with due consideration for competition law. For example, a group of enterprises sourcing from the same supplier may:

- Use their combined leverage to encourage the supplier to prevent impacts.
- Pool their leverage by setting joint timelines for corrective action in partnership with shared suppliers.
- Choose to jointly publish supplier assessments, corrective action plans and progress against those plans, which can likewise increase leverage.
- Enterprises may also choose to jointly publish supplier assessments, corrective action plans and progress against those plans, which can likewise increase leverage.

- Work on a broader sector-wide scale at either a global or regional level to place pressure on suppliers that are larger than any individual supplier and/or to place pressure on suppliers that operate at common choke points in the sector supply chain.
- Pool their leverage (at sectoral level) to place pressure on global commodities traders to address risks linked to upstream raw material production.

Enterprises are encouraged to collaborate to harmonise the assessment methodology and support recognition, provided that the assessments conform to high standards. Enterprises are likewise encouraged to collaborate on the assessment of suppliers when sourcing from the same region and supplier base, to the extent feasible. However, the rigour of the assessments should not be compromised to support increased uptake.

Enterprises sourcing from the same supplier may develop and share a common set of RBC requirements of the supplier. SMEs are encouraged to work towards a common approach to identifying suppliers (e.g. common supplier ID codes) in order to facilitate the sharing of information on common suppliers with due regard for competition law. Collaboration does not alter the individual enterprise's responsibility to identify, prevent or mitigate harm.

3.1.2. SME customer purchasing practices and supplier leverage

A majority of SME survey respondents are manufacturers working in tier 1 of the supply chain. The manufacturers' types of activities have been categorised into tier 1, tier 2 and tier 3 to make the respondents' position in the supply chain easily visible. Manufacturers' activities in the sample are mainly part of tier 1, which involves the final stages of manufacturing in the downstream part of the supply chain.

It is therefore important to consider to what extent they are influenced and face difficulties in due diligence based on their customers' buying practices. Given their size and position in the supply chain, SMEs generally lack leverage over their customers to influence their decisions.

The purchasing practices of retailers, brands and their buying intermediaries have been demonstrated to contribute to harmful impacts – such as excessive and forced overtime and low wages – in some cases. This is most notably the case when orders are changed, cancelled, placed late, rushed (particularly during peak times or holidays) or when lead times are set shorter than feasible. Late or delayed payment for products may also contribute to suppliers delaying payment of wages to their workers. An enterprise's price negotiations may contribute to cost-cutting and therefore labour, human rights or environmental impacts.

The Garment Guidance incorporates the expectation that companies address their purchasing practices as part of their due diligence. This is particularly relevant for SME buyers.

3.1.3. Responsible purchasing practices: What the Garment Guidance says

Box 3.5. Prevent contribution to harm through responsible purchasing practices

The enterprise is encouraged to engage with its supplier to understand if and how its purchasing practices may be contributing to harm. Recognising that suppliers may be reluctant to provide such feedback candidly, the enterprise may seek to collect information from its suppliers anonymously (e.g. annual survey) or partner with a third party that aggregates the data and presents findings.

The enterprise should track relevant indicators of actions that lead to harm. Examples include: percentage of orders placed late, percentage of orders changed after order is placed, number of days between the last change and shipment. Systems should be established to track such information on an ongoing basis.

If the enterprise identifies through its tracking that the above practices (e.g. changes in orders) are common, it should seek to identify why. Team members responsible for the placement of orders should be included in the analysis.

Control measures to prevent contribution to harm

- The enterprise should develop pricing models that account for the cost of wages, benefits and investments in decent work. The above considerations should be reflected in freight on board (FOB) prices together with traditional pricing considerations such as quantities being purchased, cost of materials, skill requirements, etc.

Implement control measures to reduce the likelihood of contributing to poor labour outcomes such as:

- Set final order placement dates with the supplier.
- Communicate the deadlines to everyone in the purchasing teams.
- Share the purchasing plan with suppliers and communicate updates in a timely manner.
- Improve forecasting alignment, which involves coordination across geographies, categories and product designs to get the right information and decisions made at the right time.
- Optimise the sourcing base to handle fluctuations in capacity and to adopt and implement the technologies needed to respond to the demand for emerging styles and products.

Red flag systems

Develop procedures for purchasing teams to follow in instances in which practices could contribute to harm. For example, in instances in which orders are changed after order placement or orders are placed late, the enterprise may mitigate risks by a) paying for rushed order delivery b) changing the delivery date or c) providing a list of prequalified subcontracts to fill a portion of the order.

3.1.4. Functional alignment: What the Garment Guidance says

Box 3.6. Functional alignment between business units

To ensure responsible purchasing practices, there must be alignment across teams and business units, particularly between buying units and business units overseeing supplier human rights, labour and environmental performance.

The RBC policy will be relevant across several internal departments (e.g. sourcing, design, etc.). As such, the enterprise is encouraged to establish alignment across teams and business units, particularly when the incentives of one business unit do not align with the RBC policy. Some examples of how an enterprise might promote functional alignment include:

- Facilitate feedback and learning on due diligence and the RBC policy between business units.
- Ensure that information related to due diligence is provided to relevant decision makers and is adequate and appropriate.
- Include multiple business units in making a decision that may increase the risk of harm in the enterprise's own operations or in its supply chain (e.g. sourcing from a new, higher-risk country).

For example, in the garment and footwear sector, the incentives of buying units may not align with the incentives of the business units overseeing supplier human rights, labour and environmental performance. In light of this, it is recommended that buying units have access to ongoing and updated information such as: suppliers that are prequalified for sourcing, subcontractors that are prequalified for sourcing (if relevant), and supplier order capacity.

3.1.5. Further considerations: how purchasing practices impact SMEs' ability to implement due diligence

Given the characteristics of SMEs, they are particularly vulnerable to poor purchasing practices. Bearing in mind their constrained access to financial resources and more generally lack of financial liquidity and small margins, they often lack the resources to make the financial investments that are frequently needed in the context of due diligence. Their ability to provide good working conditions and wages is therefore more likely to be impacted by buyers' type of purchasing practices.

It has been reported that detailed manufacturing contracts are especially lacking between SMEs and brands⁴⁵. Besides reducing their rights, the lack of a formalised written agreement with even basic terms such as price, delivery date and product types can lead to poor purchasing practices. This section will show how these practices increase the challenges SMEs face when implementing due diligence, along with examples of best practices for buyers to support SMEs through their purchasing practices.

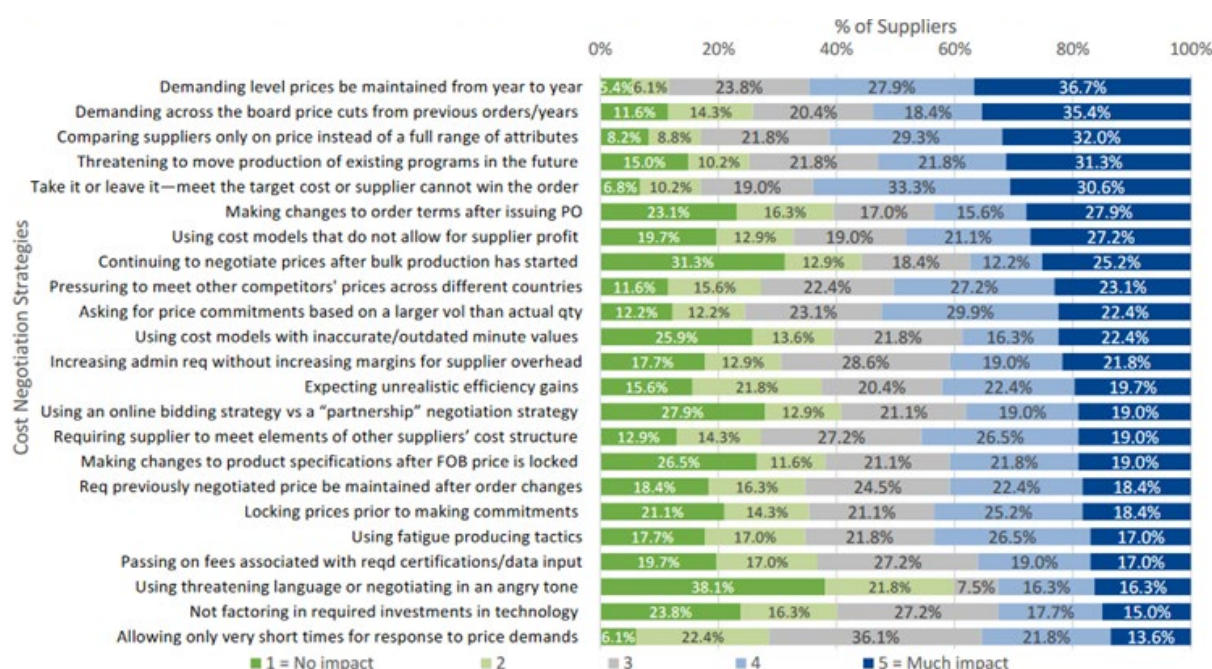
A 2020 Better Buying report examining the varied ways that suppliers are pressured through purchasing practices showed how improvements in purchasing practices, especially related to planning and forecasting, created benefits in terms of efficiency in the production process and reduced financial pressure on manufacturers, helped suppliers to maintain a more stable workforce and decrease their reliance on

⁴⁵ Human Rights Watch (2019), "Paying For a Bus Ticket and Expecting to Fly": How Apparel Brands Purchasing Practices Drive Labor Abuses, United States of America, <https://media.business-humanrights.org/media/documents/files/documents/wrd0419.pdf>

temporary labour or excessive overtime to adapt their production capacity⁴⁶. These improvements also provided suppliers with the visibility they needed to plan production responsibly. This has also been shown in a study of Brazilian, Indian and South African SMEs, where increased planning certainty mitigates risks and due diligence implementation therefore becomes more feasible. Outcomes of inaccurate forecasting can lead to unutilised capacity and excess materials, for which retailers and brands usually take no responsibility. It can also lead to suppliers accepting last-minute, low-price orders to fill capacity⁴⁷.

High-pressure cost negotiation strategies involving pressuring suppliers through price competition have also been reported to have the highest impact on suppliers' business profitability. The Better Buying survey results show that 55% of suppliers reported that their business profitability has a high impact on their ability to provide good working conditions and wages, while 44% reported a high impact on their company's environmental performance⁴⁸. Due diligence practices can be facilitated by buyers' decreasing use of high-pressure cost negotiation and improved timing of payments. The latter is particularly relevant as its impact is likely to be higher on SMEs since it is directly linked to cash flow and financial liquidity.

Figure 3.1. Suppliers' priorities for minimally acceptable costing practices



Source: <https://betterbuying.org/wp-content/uploads/2020/07/Better-Buying-Special-Report-Cost-Cost-Negotiation-the-Need-of-New-Practices.pdf>

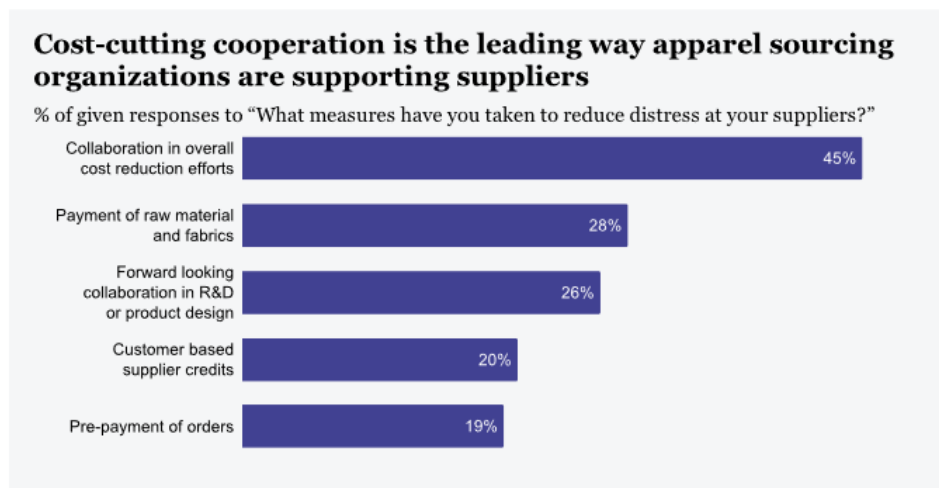
⁴⁶ Duncanson, Kelly, Dickson, Marsha A., & Bhatt, Dipti (2020). Better Buying Index Report 2020: Purchasing Practices Performance in Apparel, Footwear, and Household Textile Supply Chains, <https://betterbuying.org/wp-content/uploads/2020/10/2020-Better-Buying-Index-Report.pdf>

⁴⁷ Dickson, Marsha A. (2019). Better BuyingTM Index Report 2019: Purchasing Practices Performance in Apparel, Footwear, and Household Textile Supply Chains, https://betterbuying.org/wp-content/uploads/2019/09/4523_better_buying_report_summer2019_final.pdf

⁴⁸ Duncanson, Kelly, Dickson, Marsha A., & Bhatt, Dipti (2020). Better Buying Index Report 2020: Purchasing Practices Performance in Apparel, Footwear, and Household Textile Supply Chains, <https://betterbuying.org/wp-content/uploads/2020/10/2020-Better-Buying-Index-Report.pdf>

Examples of best practices reported include providing long-range buying plans, taking suppliers' suggestions for altering product specifications to reduce costs, providing accurate forecasts in advance and meeting minimum order quantities when placing orders⁴⁹. Another example in an ILO report shows Japanese buyers training their suppliers in order to ensure quality, specifying not only the design and materials but also the technologies to be used in their sourcing countries and also investing in skills training for local SME workers⁵⁰. In the figure below, you can find examples of best practices that have been reported during the COVID-19 crisis to reduce distress at suppliers.

Figure 3.2. Examples of good purchasing practices



Emma Cosgrove / Supply Chain Dive, data from McKinsey

Source: <https://www.supplychaindive.com/news/coronavirus-apparel-fashion-sourcing-suppliers/578403/>

3.2. Financial resources

Due diligence involves human and financial resource implications. One of the most reported challenges in the SME survey results is the cost of audits and other assessment processes and industry initiatives that address RBC issues. This was identified as the most significant obstacle by 40% of respondents. It therefore represents one of the most important challenges to discuss and address.

SMEs often face finance-related barriers to doing business, complying with complex and changing regulatory frameworks or implementing standards. For example, there may be a cost barrier to employing dedicated staff to oversee due diligence, accessing certification, training or making improvements to implement their own due diligence or meet the expectations of their customers' due diligence plan. 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. Enterprises with resource constraints may

⁴⁹ Dickson, Marsha A. (2019). Better Buying™ Index Report 2019: Purchasing Practices Performance in Apparel, Footwear, and Household Textile Supply Chains, https://betterbuying.org/wp-content/uploads/2019/09/4523_better_buying_report_summer2019_final.pdf

⁵⁰ International Labour Organization (2016), Procurement practices and SMEs in global supply chains: what do we know so far? : A literature review, Lizbeth Navas-Aleman, Tamara Guerrero; International Labour Office, Enterprises Department. Geneva, http://www.oit.org/wcmsp5/groups/public/---ed_emp/---emp_ent/---ifp_seed/documents/publication/wcms_486227.pdf

rely more heavily on collaborative approaches in carrying out due diligence and may have to make more careful decisions in the context of prioritisation. They may also take advantage of existing resources such as model policies or public information on risks in certain supply chains and seek technical assistance from industry associations of which they are members.

3.2.1. Reduce costs through collaboration: What the Garment Guidance says

Box 3.7. Collaboration to reduce costs

The garment and footwear sector includes numerous sector initiatives, trade-union agreements and multi-stakeholder initiatives that have developed policies or codes of conduct for their members. Enterprises are encouraged to adopt or align their policies with such existing commitments in order to facilitate sector collaboration on assessments against those policies.

For instance, to measure GHG emissions, collaboration is particularly relevant for SMEs that may lack the resources to adequately measure GHG emissions across the full length of their products or supply chain. They are encouraged to collaborate in measuring, reducing, monitoring and reporting GHG emissions. Example forms of collaboration include:

- developing sector-wide tools for measuring and tracking GHG emissions on particular fibres, products and production processes
- sharing good practices for reducing GHG emissions
- requesting a clear road map from governments on climate change.

To address OSH risks, enterprises are encouraged to collaborate – for example, within a production cluster – to exchange information among workers and management overseeing ongoing corrective action measures. For example, this could include joint visits or regional safety committees.

3.2.2. Scoping and prioritisation of RBC risks: What the Garment Guidance says

Box 3.8. Identify the enterprise's most significant risks of harm

The enterprise is encouraged to draw from known sector and sub-sector risks to determine the likelihood of risks and severity of harm in its own operations and in its supply chain based on the countries that the enterprise operates in or sources from, the products that the enterprise produces or sells and its business and sourcing practices. Based on all known information, the enterprise should determine which risks of harm are (or are likely to be) the most significant risks in its own operations and in its supply chain. Factors such as the number of product lines the enterprise has, the number of countries it sources from, etc. may affect how the enterprise scopes the risks of harm in its supply chain.

The enterprise may prioritise the order in which it takes action based on the likelihood and severity of harm. This step will be particularly relevant for SMEs as prioritisation will be necessary where it is not feasible for enterprises to identify and respond to all adverse impacts associated with their activities and business relationships immediately.

Based on all known information, the enterprise should determine which risks of harm are most significant – in relation to likelihood and severity of harm – in its own operations and in its supply chain and prioritise those risks for action first. Severity of harm is judged on scale, scope and irremediable character.

- “Scale” refers to the gravity of the adverse impact.
- “Scope” concerns the number of individuals that are or will be affected.
- “Irremediable character” means any limits on the ability to restore those affected to a situation at least the same as, or equivalent to, their situation before the adverse impact.

Given the complexity and diversity of issues within the garment and footwear sector, determining the most significant risks of harm in the enterprise’s own operations and in its supply chain is likely to entail some judgement on the part of the enterprise. The enterprise is encouraged to engage with stakeholders and experts in this process. In all cases, the enterprise should be prepared to justify how it determined and prioritised risks.

Prioritisation of significant risks or impacts will be relevant when enterprises identify impacts, as well as when they seek to prevent and mitigate impacts and communicate. Impacts that are prioritised for prevention and mitigation will also be those that should be tracked to ensure that they are addressed. The OECD Guidelines state that in the case of human rights, severity is a greater factor than likelihood in considering prioritisation. Thus where prioritisation is necessary, enterprises should begin with those human rights impacts that would be most severe, recognising that a delayed response may affect remediability.

3.2.3. Further considerations: cost and benefit of due diligence for SMEs

SMEs are often on the receiving end of the due diligence procedures of large multinational companies and might be subject to greater due diligence costs given their size and position in the supply chain. Several reasons can explain this.

Large companies benefit from economies of scale in various respects: a wide range of existing due diligence activities, existing manpower specialised in value chain management and existing technological solutions not available to SMEs. Given their size, large companies are more likely to remain competitive as the additional cost burden accounts for a much smaller relative share in these companies’ total costs. It is also possible that large companies benefit from a reputation-induced increase in sales volumes, which is less likely for SMEs⁵¹.

The EC study on due diligence requirements through the supply chain shows that any increase in financial costs for carrying out due diligence in the supply chain would remain relatively low compared to the company’s revenue: for SMEs, the additional recurrent company-level costs would be around 0.14% of their revenue, and, for larger companies, only around 0.009%. While this would amount to an additional cost of EUR 740/year for companies with a revenue under EUR 1 000 000, compared to large companies, the cost-revenue ratio is 15 times higher for SMEs for mandatory due diligence⁵².

Another factor observed is the burden of due diligence cascaded to the lowest tiers of the supply chain⁵³. This is the case for certification costs. The use of certification as a tool to assess due diligence

⁵¹ 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> :

⁵² Covington (2020), European Union Justice Commissioner Commits to Regulation on Corporate Human Rights and Environmental Due Diligence, Business and Human Rights, <https://www.cov.com/-/media/files/corporate/publications/2020/05/covington-alert-european-union-justice-commissioner-commits-to-regulation-on-corporate-human-rights-and-environmental-due-diligence.pdf>

⁵³ Covington (2020), European Union Justice Commissioner Commits to Regulation on Corporate Human Rights and Environmental Due Diligence, Business and Human Rights, <https://www.cov.com/>

implementation relies on the supplier financing the certificate and its participation in the scheme. In this way, cost participation can easily outweigh potential due diligence benefits⁵⁴. Additionally, certification costs due to documentation requirements as well as the costs of third-party verification must be regularly renewed⁵⁵.

Certification validation often requires multiple social audits throughout the year to comply with several buyers⁵⁶. In some cases, this has resulted in companies adopting due diligence practices without being officially certified, with downstream and smaller supply chain actors facing increased due diligence costs⁵⁷.⁵⁸For example in France, SMEs reported that MNEs often delegate to their direct suppliers (Tier 1) the task of disseminating RBC requirements to their own suppliers (Tier 2)⁵⁹ under the French Duty of Care, while reporting a lack of support in implementing due diligence. 6% stated that they receive financial aid, 13% training and 39% a due diligence plan⁶⁰. Hence in some cases, while responsibilities are cascaded, the support provided is not proportional and creates disproportionate burden related to the cost of due diligence for SMEs.

Furthermore, regulatory uncertainty, complexity and inconsistency affect SMEs disproportionately. SMEs are typically less efficient than large firms in screening the regulatory environment and dealing with relevant norms. Since they might lack information or expertise in house, the cost and complexity of regulatory procedures and conditions for regulatory compliance are especially important for SMEs⁶¹.

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 due to the implementation of efficient due diligence

[/media/files/corporate/publications/2020/05/covington-alert-european-union-justice-commissioner-commits-to-regulation-on-corporate-human-rights-and-environmental-due-diligence.pdf](#)

⁵⁴ 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>

⁵⁵ Global Partnership for Financial Inclusion, World Bank Group, Federal Ministry for Economic Cooperation and Development (2017), Financing SMEs in Sustainable Global Value Chains, G20 Germany 2017, https://www.gpfi.org/sites/gpfi/files/documents/GVC%20paper_highres_0.pdf

⁵⁶ United Nations Conference on Trade and Development (2012), Corporate Social Responsibility in Global Value Chains: Evaluation and monitoring challenges for small and medium sized suppliers in developing countries, New York and Geneva, https://unctad.org/system/files/official-document/diaeed2012d3_en.pdf

⁵⁷ OECD, Columbia SIPA School of International and Public affairs (2016), Quantifying the costs, Benefits and Risks of Due diligence for Responsible Business Conduct: Framework and Assessment Tool for Companies, <https://mneguidelines.oecd.org/Quantifying-the-Cost-Benefits-Risks-of-Due-Diligence-for-RBC.pdf>

⁵⁸ Tran, Angie and Jeppesen, Søren, (2015), SMEs in their Own Right: The Views of Managers and Workers in Vietnamese Textiles, Garment, and Footwear Companies, SBGS Faculty Publications and Presentations, California State University, Monterey Bay, <https://core.ac.uk/reader/229542050>

⁵⁹ BPI France, Observatoire de la responsabilité sociétale des entreprises (2020), Résultats de l'enquête "RSE : La parole aux fournisseurs! », » https://www.novethic.fr/fileadmin/user_upload/tx_ausynovethicarticles/BH/AD_Enqu%C3%AAte_BPI_France_ORSE_2019_Web.pdf

⁶⁰ B. Héraud (2020), Novethic, Devoir de vigilance : Les PME en première ligne, sans être assez accompagné par les donneurs d'ordre, News, <https://www.novethic.fr/actualite/entreprise-responsable/isr-rse/rse-et-devoir-de-vigilance-les-pme-en-premiere-ligne-sans-avoir-toujours-les-moyens-adequats-148094.html>

⁶¹ SMEs often incur in other indirect costs, paying for external advisors' expertise or investing in specific training of staff to comply with new obligations. 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>

procedures, some SMEs may actually face lower relative costs compared to large companies⁶². SMEs often have more flexibility than larger companies, which means that they can potentially respond quicker and more effectively to change due to their size and informal culture⁶³. They can also often engage in more direct ways with their suppliers and may need less complex impact assessments. As SMEs are likely to have more informal processes and management structures than larger companies, their respective policies and processes will take on different forms. With fewer employees, communication appears to be less formalised, and internal systems and oversight functions are therefore less complex⁶⁴.

This can lead to further discussion questions and considerations in terms of cost sharing of due diligence implementation across the supply chain and the potential risk associated with disproportional requirements of due diligence implementation on SMEs. When businesses require due diligence practices, the cost and benefits of the process should be shared by all parties. This can be done, for example, through cost-sharing schemes for certification costs. In addition, technical and financial support for suppliers in the implementation and certification process is in the best interests of lead firms as it guarantees the quality of the supply chain product and secures sourcing through more stable relationships with suppliers⁶⁵.

Government RBC policy should take the limited human, financial and knowledge resources of SMEs into account in its design and implementation. For instance, taking into account that SMEs might take longer to fulfil requirements, the development of certification processes that verify and reward first steps in the transition to full compliance would allow due diligence benefits during the transition period and raise feasibility⁶⁶. When developing regulations, adapting the type of procedures and fees to SMEs' actual capacity will be crucial to their effective implementation.

Several governments have put in place different mechanisms to address the financial challenges faced by SMEs in their due diligence implementation, taking their characteristics into account. For instance, in Indonesia the government grants SMEs tax reductions and exemptions for pollution control equipment and the cost of water treatment. In Brazil, public institutions are bound by law to purchase products and services with minimal adverse effects on the environment and public procurement rewards sustainable practices: in 2013, SMEs earned 57% of the 40 billion Brazilian real (about USD 22 billion) spent on public procurement⁶⁷. In the Netherlands, considerations under review to improve the Child Labour Due Diligence

⁶² 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> :

⁶³ I. 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>

⁶⁴ 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

⁶⁵ C. Sommer (2017), German Development Institute, Drivers and Constrains for Adopting Sustainability Standards in Small and Medium Sized Enterprises (SMEs), Discussion Paper 21/2017, Bonn, https://www.die-gdi.de/uploads/media/DP_21.2017.pdf

⁶⁶ C. Sommer (2017), German Development Institute, Drivers and Constrains for Adopting Sustainability Standards in Small and Medium Sized Enterprises (SMEs), Discussion Paper 21/2017, Bonn, https://www.die-gdi.de/uploads/media/DP_21.2017.pdf

⁶⁷ Global Partnership for Financial Inclusion, World Bank Group, Federal Ministry for Economic Cooperation and Development (2017), Financing SMEs in Sustainable Global Value Chains, G20 Germany 2017, https://www.gpfi.org/sites/gpfi/files/documents/GVC%20paper_highres_0.pdf

Act include an option in the context of the RBC Agreements to increase the financial capacity of SMEs by means of subsidies or tax breaks⁶⁸.

The Greening SMEs toolkit developed by the OECD gives recommendations to governments such as introducing tax privileges (accelerated amortisation, reduced property or corporate taxes) and favourable loan policies through public financial institutions to SMEs willing to invest in green technologies; encouraging private banks and insurance companies to provide incentives for good environmental performance of small businesses; directing subsidies and free technical assistance to SMEs to help to increase their awareness and secure their initial engagement in green practices⁶⁹.

3.3. Visibility across the supply chain

SMEs reported a lack of visibility over their suppliers as another main challenge. This has also been reflected in a particularly high level of “don’t know” responses in questions related to information beyond direct suppliers. It can be deduced that SMEs have a low level of visibility beyond their immediate business relationships. 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.

Due to a lack of visibility and leverage, it may be difficult for an enterprise to identify and assess individual suppliers operating upstream, for example at the raw materials stage. Enterprises are encouraged to establish mechanisms that are fit for purpose. Establishing traceability systems and/or assessing “choke points” are two examples of mechanisms that may be used to evaluate whether risks linked to harms upstream in an enterprise’s supply chain are being identified, prevented or mitigated. This is an area where collaborative approaches may be appropriate, particularly for SMEs.

3.3.1. Traceability: What the Garment Guidance says

Box 3.9. Traceability

Traceability is the process by which enterprises track materials and/or products and the conditions under which they were produced (in relation to matters covered by the OECD Guidelines) through the supply chain. It is important to note that traceability as a tool may help an enterprise to gain information on upstream actors; however, an enterprise cannot stop at traceability.

⁶⁸ E. R. Van Rhijn, NautaDutilh, Evaluation of Dutch RBC Agreements in the lights of the Child Labour Due Diligence Act, Lexology, <https://www.lexology.com/library/detail.aspx?g=1f618e89-521d-4971-9ce6-1a0d609d9c15>

⁶⁹ OECD, EaPGreen Partnership for Environment and Growth (2015), Environmental Policy Toolkit for Greening SMEs in the EU Eastern Partnership countries, First Edition, <https://www.oecd.org/environment/outreach/Greening-SMEs-policy-manual-eng.pdf>

3.3.2. Assessment of choke points: What the Garment Guidance says

Box 3.10. Direct assessment of choke points

Another measure to reduce the costs of supplier assessment is the identification and direct assessment of choke points (also to establish traceability). The enterprise could choose to trace to choke points, as they would have greater visibility on their own suppliers and business relationships and seek to understand how they are doing due diligence upstream.

This can be done via sector-level collaboration or via approved certification schemes. “Choke points” include:

- key points of transformation in the supply chain
- stages in the supply chain that generally include relatively few actors that process a majority of the commodity
- stages in the supply chain with visibility and control over the circumstances of production and trade upstream.

Example choke points in the garment and footwear supply chain may include:

- global commodities merchandisers (e.g. for cotton and rubber)
- exporters, processors, wholesalers (e.g. for fragmented supply chains)
- chemical plants (e.g. for synthetic fibres).

The following are example steps that an enterprise or initiative may take to assess enterprises operating at choke points in the supply chain:

- identification of actual or likely choke points in the supply chain
- traceability to enterprises operating at choke points
- verification (e.g. through management audits and unannounced site checks) that enterprises operating at choke points are applying due diligence on their upstream suppliers in accordance with the recommendations in this Guidance
- directing sourcing towards enterprises operating at choke points in the supply chain that are applying due diligence in accordance with this Guidance.

This will help to increase visibility over their supply chain. If an enterprise can reasonably determine that enterprises operating at choke points in its supply chain are conducting due diligence on their upstream suppliers, then the enterprise can likewise reasonably determine that risks of adverse impact linked to its own upstream suppliers have been identified, prevented and mitigated. Enterprises are encouraged to collaborate at a sector level on the auditing control points.

In general, however, enterprises are encouraged to avoid duplicating assessments and prioritise resources for prevention and mitigation. Resources should first be allocated to where the intervention will have the greatest effect.

3.3.3. Increase transparency through collaboration: What the Garment Guidance says

Box 3.11. Collaboration to increase transparency

Implementing traceability and engagement with choke points requires financial resources. To reduce costs, the Guidance recommends that enterprises build into supplier contracts an obligation to support supply chain due diligence of risks linked to upstream production where appropriate (e.g. obligation to direct sourcing towards choke points that have demonstrated effective due diligence mechanisms).

Collaboration can also help to facilitate the disclosure of aggregate information, for example, on supplier assessments, corrective action taken and measured improvements, and therefore broadly increase the transparency of the sector. This will help to avoid duplication of supplier assessments and programming (e.g. training initiatives) that creates an unnecessary burden on suppliers, and particularly on SMEs, without necessarily increasing the quality of information collected or disseminated or the capacity of suppliers.

In this way, collaborative initiatives that focus on harmonising assessment methodology and support recognition of such harmonised assessments could reduce the burden placed on suppliers as well as increase the quality of assessment, provided harmonised assessments conform to high standards. Collaborative initiatives can play a role in scaling up solutions (e.g. policy, training, capacity building, etc.) that have been demonstrated to be effective as well as avoid duplications in programming. However, the Garment Guidance does not recommend that enterprises mandate that suppliers engage in specific initiatives unless the enterprise is willing to support the cost of the supplier's participation and any associated premiums. Rather, enterprises should recognise a range of collaborative due diligence initiatives, tools, etc. that conform with the Garment Guidance.

Collaboration can also support enterprises across the sector to identify gaps in data collection and work towards improved coordination and collection of information, to simplify the due diligence process. Where information does not exist, the enterprise is encouraged to collaborate with other enterprises sourcing from the same region to conduct an assessment.

The enterprise may also encourage its industry association to commission an assessment. If the enterprise is unable to gather information through any of the above means, it is encouraged to either reduce its cost of due diligence (e.g. by consolidating its suppliers) or direct sourcing to countries that hold lower risk until it is able to gather adequate information to source responsibly.

3.3.4. Further considerations: Transparency and traceability

Transparency can be used as a means to gain visibility or traceability across a supply chain. Collaboration might require disclosure of information to be effective. SMEs reported concerns in implementing supply chain transparency through disclosure of information, raising the competitive disadvantage of disclosing supplier factories and anti-competition behaviour⁷⁰.

⁷⁰ Human Rights Watch (2019), *Fashions Next Trend: Accelerating Supply Chain Transparency in the Apparel and Footwear Industry*, https://www.hrw.org/report/2019/12/18/fashions-next-trend/accelerating-supply-chain-transparency-apparel-and-footwear#_ftn68

For example, the German Partnership for Sustainable Textiles (PST) has raised both these concerns. The PST wrote that they found that smaller companies were reluctant to publish supply chain information because these companies feared that by naming their suppliers, “they might lose reliable and long-term business partners to larger competitors.

Enterprises' best practices involve engagement with traceability schemes to strengthen traceability throughout the supply chain. For example, the Leather Working Group (LWG) traceability system only sources apparel and footwear leather from LWG Silver or Gold-rated tanneries. LWG provides information on the origin of the hides within the supply chain and ensures the environmental compliance of SME suppliers by placing them on a rating system⁷¹. As an example of best practices in information disclosure among SMEs, the Worker Rights Consortium (WRC)⁷² has published an online database of the supplier factories of companies licensed by WRC's affiliate universities and colleges in the US and Canada to market products bearing these schools' names and insignia. The UN Global Compact has developed a guide to support SMEs in their traceability process that shows different types of best practices⁷³.

3.4. Due diligence awareness among SMEs

As it has been shown in the survey results, one-third of SME respondents do not have any kind of RBC policy or RBC tool in place, gather an extremely limited level of information from suppliers (50% basic information and nearly 5% RBC information) and, while there is low reliance on CSOs, trade unions or governments to obtain RBC information in the sector, they appear to rely on existing partnerships to exchange RBC information. One of the respondents was unable to identify their key challenge and answered, "I don't know how to check". It can be deduced that SMEs have a low level of awareness of due diligence and a low level of either access to or understanding of the available RBC information.

3.4.1. Increase awareness through collaboration: What the Garment Guidance says

Box 3.12. Collaboration to increase due diligence awareness

Enterprises are encouraged to prevent RBC risks in their supply chain by increasing supplier awareness on what constitutes the different types of risks and building the capacity of their SME suppliers. SME buyers are particularly encouraged to do so.

For instance, to prevent forced labour in the supply chain, recommendations include:

- Building suppliers' awareness of forced labour, including what constitutes forced labour.
- Supporting suppliers to implement a corrective action plan.

The PST also wrote that agents or business partners to larger brands feared that disclosing suppliers may lead "brands to eventually choose to start direct business relations with them."

⁷¹ United Nations Global Compact (2016), A Guide to traceability for SMEs: The drivers, opportunities, challenges and implementation steps for Small and Medium sized enterprises (SMEs) looking to adopt traceability in the supply chains, https://d306pr3pise04h.cloudfront.net/docs/issues_doc%2Fsupply_chain%2FA-Guide-to-Traceability-for-SMEs-2016.pdf

⁷² Worker Rights Consortium, Factories Disclosure Database, <https://factories.workersrights.org/factory-database-search/>

⁷³ United Nations Global Compact (2016), A Guide to traceability for SMEs: The drivers, opportunities, challenges and implementation steps for Small and Medium sized enterprises (SMEs) looking to adopt traceability in the supply chains, https://d306pr3pise04h.cloudfront.net/docs/issues_doc%2Fsupply_chain%2FA-Guide-to-Traceability-for-SMEs-2016.pdf

- Supporting suppliers in improving production efficiency and, in doing so, addressing the business driver for cheap labour.
- If the enterprise identifies that forced labour may in some way be linked to their final product (and may or may not know how to prevent it), the enterprise is encouraged to raise awareness at a sector level and invite enterprises within the sector to jointly work towards preventing forced labour.
- Industry associations may seek to form organised consultations with trade unions and stakeholders to ensure a coordinated and holistic approach to tackling forced labour at a sector level.
- In recognition that forced labour, in some contexts, is prevalent across sectors, enterprises are encouraged to co-operate with other sectors operating in the same country or region to support a co-ordinated strategy. This also reduces the risk that forced labour is simply transferred from one sector to another.
- In recognition that, in some cases, forced labour requires a multi-stakeholder approach to adequately address impacts, the enterprise is encouraged to make aggregate data and high-level findings available to local and international human rights organisations and international organisations (as relevant). Enterprises should likewise seek to feed into existing effective initiatives to reduce the risk of duplication.
- In contexts in which forced labour is State-sponsored, for example through regulatory frameworks and/or in instances in which the state is not effectively upholding its duty to protect against forced labour, the enterprise should consider engaging with government either directly or through collaborative initiatives to communicate the enterprise's commitment to prevent forced labour in its supply chain.

Sharing information at a sectoral level can also help to raise awareness of specific risks. Many enterprises in the garment and footwear sector source from the same countries and suppliers. Sharing information can therefore help to increase the awareness of specific risks in the sector and bring attention to emerging risks more quickly than would be possible for most individual enterprises.

3.4.2. Further considerations: Language, applicability and harmonisation of RBC requirements for SMEs

Research shows that SMEs are in general less informed about due diligence practices⁷⁴. This can be due to several reasons.

Language

SMEs may not properly understand a standard due to the technical content and terminology with which they might not be familiar, the unavailability of a version in the national language, the abundance of references to other standards, or a lack of information on the context of the standard⁷⁵. For instance, an EC study on SMEs' due diligence practices under the Conflict Minerals Regulation and their preferred support system revealed they were most interested in practical information and tools like factsheets and

⁷⁴ Directorate-General for Internal Market, Industry, Entrepreneurship and SMEs (European Commission) , Levin Sources , RINA Consulting (2017), Study on the Support System for SME Supply Chain Due Diligence, Final Report, <https://op.europa.eu/en/publication-detail/-/publication/67a2c448-fb38-11e7-b8f5-01aa75ed71a1/language-en/format-PDF/source-67264534>

⁷⁵ ISO (2013), By H. J. de Vries, K. Blind, A. Mangelsdorf, H. Verheul & J. van der Zwan, New opportunities improving SME access to standards, News, <https://www.iso.org/news/2013/02/Ref1711.html>

checklists. They asked for practical information on what to do, when and what to keep on file, reflecting a need for information that is pared back and broken down to help them to implement due diligence⁷⁶.

Their informal management style supports further evidence in other studies that finds that few SMEs have formalised their values and embedded them into a code of conduct or a statement of good business practice⁷⁷. Informal communication is used to engage with their stakeholders, as SMEs often engage on a day-to-day basis with their business relationships⁷⁸. Due to their flat structure and informal management, SMEs are heavily reliant on personal relationships and social capital rather than compliance, formal systems and structures⁷⁹. This can also explain the low level of formalisation of RBC processes through technical language.

Applicability

Global standards might sometimes not be appropriated or applicable in the local context. These standards are used as benchmarks for RBC measurements that do not always take into account SME characteristics. It is acknowledged that SMEs are commonly under-represented and misunderstood in global standard setting processes⁸⁰. Several studies show how these frameworks can be inadequate and even counterproductive for SMEs: a study in the garment sector in India notably shows how standard implementation can be a source of involvement in “*evasion institutional work*”⁸¹: SMEs that lack the resources to report formally may opt out of the contracting process, report poorly on compliance or creatively manipulate their reporting⁸².

Harmonisation

Lack of harmonisation of standards has also been reported by SMEs as an obstacle to due diligence, as they face parallel procedures of implementation, documentation and multiple certifications if they sell to

⁷⁶ Directorate-General for Internal Market, Industry, Entrepreneurship and SMEs (European Commission), Levin Sources, RINA Consulting (2017), Study on the Support System for SME Supply Chain Due Diligence, Final Report, <https://op.europa.eu/en/publication-detail/-/publication/67a2c448-fb38-11e7-b8f5-01aa75ed71a1/language-en/format-PDF/source-67264534>

⁷⁷ D. Baden and I. A. Harwood, D. G. Woodward (2011), The effects of procurement policies on ‘downstream’ corporate social responsibility activity: Content-analytic insights into the views and actions of SME owner-managers, *International Small Business Journal*, <https://journals.sagepub.com/doi/pdf/10.1177/0266242610375770>

⁷⁸ Example of ISO 26000 not likely to serve as a management tool for SMEs, considered to be too broad spectrum and implicit to serve as a resource in operational challenges https://www.iisd.org/system/files/publications/how_material_iso_26000.pdf

⁷⁹ ILO Global Business Network on Forced Labour, L. J. Spence, Puttins SMEs first: why small and medium-sized enterprises are crucial in the responsible business conduct conversation, https://flbusiness.network/wp-content/uploads/ILO_GBNFL_SMEs-and-RBC_Final.pdf

⁸⁰ ILO Global Business Network on Forced Labour, L. J. Spence, Puttins SMEs first: why small and medium-sized enterprises are crucial in the responsible business conduct conversation, https://flbusiness.network/wp-content/uploads/ILO_GBNFL_SMEs-and-RBC_Final.pdf

⁸¹ V. Soundararajan, L.J Spence, C. Rees (2016), Small Business and Social Irresponsibility in Developing Countries: Working Conditions and “Evasion” Institutional Work, *Business and Society* <https://journals.sagepub.com/doi/10.1177/0007650316644261>

⁸² ILO Global Business Network on Forced Labour, L. J. Spence, Puttins SMEs first: why small and medium-sized enterprises are crucial in the responsible business conduct conversation, https://flbusiness.network/wp-content/uploads/ILO_GBNFL_SMEs-and-RBC_Final.pdf

more than one buyer, which greatly increases the costs of compliance⁸³. An EC study of SMEs in the mineral sector has also shown that getting documentation from suppliers and then verifying its validity (e.g. because of uncertainty over multiple industry certifications, not all of which certify the same minerals or to the same extent) constituted the greatest hurdles in conducting due diligence, and this was the case for all SMEs regardless of their different levels of due diligence implementation⁸⁴. Consequently, they identified guidance on what information to expect from suppliers and how to verify the information as being of value overall.

SMEs tend to be more dependent on external sources of knowledge, but they are also less well integrated into the local, national and global innovation networks that would help them to capture knowledge spillovers. It could, for instance, be more challenging for SMEs to find out supply chain risk information or implement policies such as requiring suppliers to pay a living wage or identifying and preventing forced labour by tracking risk indicators further upstream in their supply chain, and SMEs may gain leverage to effectively address these risks through collaboration⁸⁵.

Enterprises' best practice examples aimed at supporting and developing due diligence awareness among SMEs involve training and capacity building when buying from SMEs, mentoring first-tier suppliers on how to increase the capacities of their SME subcontractors, so as to have positive effects on production and working conditions at upstream levels⁸⁶. This can also help develop understanding of buyer's code of conduct.

Some governments have already developed tools to increase SMEs' due diligence awareness and understanding as well as their technical capacity to implement it. For instance, the EU has developed a programme under the conflict mineral regulation – “*EC SME Support Programme*”, with supporting materials including an educational platform, a due diligence toolbox, training modules, and educational webinars prepared as ready-to-use content⁸⁷. The platform, for instance, provides information on the benefits that companies can gain from performing due diligence on their supply chains, helping them to understand, assess and mitigate risks and impacts in their supply chains related to responsible sourcing⁸⁸. Here it is important to highlight the need for SMEs to understand the benefits of due diligence.

⁸³ Global Partnership for Financial Inclusion, World Bank Group, Federal Ministry for Economic Cooperation and Development (2017), Financing SMEs in Sustainable Global Value Chains, G20 Germany 2017, https://www.gpfi.org/sites/gpfi/files/documents/GVC%20paper_highres_0.pdf

⁸⁴ Directorate-General for Internal Market, Industry, Entrepreneurship and SMEs (European Commission) , Levin Sources , RINA Consulting (2017), Study on the Support System for SME Supply Chain Due Diligence, Final Report, <https://op.europa.eu/en/publication-detail/-/publication/67a2c448-fb38-11e7-b8f5-01aa75ed71a1/language-en/format-PDF/source-67264534>

⁸⁵ The guidance recommends that each company addresses its own responsibility with respect to adverse impacts. In cases where impacts are directly linked to an enterprise's operations, products or services, the enterprise should seek, to the extent possible, to use its leverage to effect change, individually or in collaboration with others.

⁸⁶ International Labour Organization (2016), Procurement practices and SMEs in global supply chains: what do we know so far? : A literature review, Lizbeth Navas-Aleman, Tamara Guerrero; International Labour Office, Enterprises Department. Geneva, http://www.oit.org/wcmsp5/groups/public/---ed_emp/---emp_ent/---ifp_seed/documents/publication/wcms_486227.pdf

⁸⁷ Directorate-General for Internal Market, Industry, Entrepreneurship and SMEs (European Commission) , Levin Sources , RINA Consulting (2017), Study on the Support System for SME Supply Chain Due Diligence, Final Report, <https://op.europa.eu/en/publication-detail/-/publication/67a2c448-fb38-11e7-b8f5-01aa75ed71a1/language-en/format-PDF/source-67264534>

⁸⁸ European Commission, Internal Market, Industry, Entrepreneurship and SMEs, Due diligence ready! <https://ec.europa.eu/growth/sectors/raw-materials/due-diligence-ready>

In Germany, key instruments have been developed to increase awareness and capabilities within SMEs. For instance, a guidance and coaching programme for SMEs on topics related to RBC; promotion of regional and national activities to share information and experience between larger companies and SMEs and/or their suppliers; improved advisory and guidance services provided to SMEs interested in doing business in developing countries⁸⁹. Canada developed the SME Sustainability Roadmap⁹⁰ to assist SMEs in achieving sustainability goals, offering many SME examples of sustainability in practice.

⁸⁹ Change in Context, commissioned by Ministry of Foreign Affairs of the Netherlands (2018), Government policy to stimulate international responsible business conduct, <https://media.business-humanrights.org/media/documents/files/government-policy-to-stimulate-international-responsible-business-conduct.pdf>

⁹⁰ Government of Canada, SME Sustainability Roadmap, https://www.ic.gc.ca/eic/site/csr-rse.nsf/eng/h_rs00174.html

4. Conclusions and key considerations

4.1. 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 encouraged 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.

4.2. Key considerations

4.2.1. 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.

4.2.2. 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 chain⁹¹, 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.

4.2.3. 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.

4.2.4. 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.

⁹¹ International Organisation of Employers, Shift (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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Annex A. OECD Survey Sourcing practices of SMEs operating in the garment and footwear sector supply chain

The OECD seeks to support SMEs in carrying out due diligence in-line with international expectations. Within this context, we are conducting a survey to better understand the structure and sourcing practices of SMEs operating in the garment and footwear sector. Our goal is to identify pragmatic approaches to implementing due diligence that are tailored to their size, resources, nature of business, and sourcing models. This survey targets agents, brands, licensees, manufacturers, retailers, and wholesalers and is divided into 3 sections: company characteristics; company sourcing practices; and due diligence.

Survey participants are not required to identify themselves or their organisation and all responses will be confidential.

The findings from the survey will only be reported in aggregate form or in a manner that does not allow individual responses to be identified. For the purpose of this survey the terms "agents" and "intermediaries" are used interchangeably to refer to third-parties that sell raw materials, fabrics and semi-finished fabrics that they have not produced themselves.

Please answer the questions to the best of your ability. Please answer all questions for your company and not for a parent company.

The OECD thanks you for your time.

A. COMPANY CHARACTERISTICS

1. In what year was your enterprise first established?
2. How many employees does your company have? Please include both full-time and part-time employees on the payroll as well as temporary and contract employees.
3. What is your company's annual turnover? Please use the value from the last fiscal year. Please write in the amount and currency (e.g. Euro 2 million).
4. What is your primary business activity?

Manufacturer

Agent

Wholesaler

Brand

Retailer

Other:

- 4.2 What manufacturing activities is your company involved in? (Select all that apply)

Preparation and refinement of textile fibres (natural fibres, eg. cotton, wool, silk)

Preparation and refinement of textile fibres (synthetic or cellulosic fibres, eg. polyester or viscose)

Textile processing (synthetic or cellulosic fibres, eg. polyester or viscose)

Textile finishing (synthetic or cellulosic fibres, eg. polyester or viscose)

Manufacture of other materials such as component accessories (eg. zips, buckles, shoe laces)

Manufacture of finished garments

Manufacture of sportswear

Manufacture of leather garments

Manufacture of articles containing fur

Manufacturer of knitted garments

Shoe manufacturer

Tanning of leather and leather finishing

Dressing and finishing of fur

Manufacture of luxury garments

Other:

5. Where are the headquarters of your company located?

Please indicate the country where the headquarters of your own company are located, and not of the larger group that your company may be a part of.

B. COMPANY SOURCING PRACTICES

6. From approximately how many countries did your company source raw materials, fabrics and semi-finished fabrics (for manufacturers) or finished goods (for brands) in the past year?

7. From which country do you source the most? What percentage of your total sourcing (in terms of volume) does this country represent?

8. Approximately, how many producers of raw materials, fabrics and semi-finished fabrics (for manufacturers) or finished goods (for brands) did you buy directly from in the past year?

9. What is your company's relative size in comparison to its most significant suppliers? In comparison to our suppliers, our company is...

Significantly larger

Larger

About the same size

Smaller

Significantly smaller

10. Approximately how well do you consider to know your key producers?

Not at all - (e.g: source via agents)

Limited relationship

Very well (e.g: visit their production site(s) regularly, engaged for over 5-10 years)

11. What percentage of your orders were placed via agents?
12. On average, how many intermediaries are there between your enterprise and your producers of raw materials, fabrics, and semi-finished fabrics (for manufacturers) or finished goods (for brands)? Please enter number or write NA if not applicable, or DK if you do not know.
13. How many subcontractors do you work with? Please enter number or write NA if not applicable or DK if you do not know.

13.2 Approximately what percentage of your orders is subcontracted out?

Please enter number or write NA if not applicable or DK if you do not know.

C. DUE DILIGENCE

14. For which issues does your company have a formal written policy for your suppliers? Select all that apply:

Child Labour

Sexual harassment and sexual and gender-based violence in the workplace

Forced Labour

Working time

Occupational Health and Safety

Trade Unions and Collective Bargaining

Wages

Hazardous Chemicals

Waste water

Greenhouse gas emissions

Bribery & Corruption

Subcontracting

Other:

None Of The Above

15. What kind of information does your company systematically gather on its raw materials, fabrics, semi-finished fabrics producers (for manufacturers) or finished goods (for brands)? Select all that apply:

Official name

Address & contact details of HQ

Address & contact details of production sites

Number of employees/workers at production site

Designated contact at production site

Environmental performance data of production sites e.g. audit data

Labour/social performance data of production sites e.g. audit data

Other:

None Of The Above

16. What tools does your company use for setting expectations and assessing social/labour and environmental performance in your supply chains? Select all that apply:

Contract terms/requirements

Training for teams that interact with supply chains (designers, buyers, legal etc);

Training for suppliers, agents, other actors in your supply chain

Supplier self-assessment

Supplier factory audits

Membership of collaborative initiatives

Certification (product, material or process)

Other:

None Of The Above

17. What are the most significant challenges that your company faces to verify that suppliers meet industry social/labour and environmental standards? Please select a maximum of 3:

Industry initiatives to tackle these issues are cost prohibitive.

We don't have visibility over our suppliers.

Our orders represent a small portion of our suppliers' total production.

Audits and other assessment processes are cost-prohibitive

Audits and other assessment processes are not effective

Other:

18. Where do you get information about environmental and social/labour risks and solutions in the sector?

Academia

Business associations

Consultancies

Governments

Collaborative initiatives

Multi-stakeholder initiatives

International organisations

NGOs

Peer companies

Clients

Trade unions

Media

I don't know

Other:

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

Survey results and key considerations

<https://mneguidelines.oecd.org>

