Reaching the 95%

Engaging SMEs to scale responsible business practices in the global garment & footwear supply chain

This note was prepared by Libby Annat, independent expert, and does not necessarily reflect the views of the OECD.

Objectives of the session

- Create more awareness of the SME footprint in the global value chain, and why SMEs are critical for uptake of due diligence practices in the global garment and footwear industry.
- Highlight due diligence approaches SMEs are taking and the related outcomes, opportunities and challenges.
- Tackle some of the myths around SMEs. For example, perceived lack of leverage and smaller resources means SMEs brands are less likely to exercise due diligence.
- Discuss what support is available for SMEs, what else needs to be done to scale the support, and what tools and resources are needed.

Background

Small and medium-sized enterprises (SMEs) are vital to delivering sustainable and inclusive economic growth. SMEs represent 99.8% of all enterprises in the EU-28, and 99% of all enterprises in the garment and footwear sector are SMEs, employing 99% of the workforce[1]. See box for information on the classification of SMEs. Beyond providing significant employment, SMEs also provide value add. SMEs account for the majority of the increase in value add in the EU (60%) in 2018/2019. Within the garment and footwear sector, SMEs can include brands, retailers, exporters, manufacturers and agents, and there is increasing fluidity in the sector (as noted by McKinsey[2]) with manufacturers moving out of the traditional business to business (B2B) role and selling directly to the consumer through their own branded e-commerce channels.

Research from the International Trade Centre (ITC)[3] concludes that SMEs have tremendous potential to make an impact on the SDGs through the employment they generate, the business practices they choose to adopt, the sectors in which they operate and their impact on innovation and diversification in the

1 EU Annual Report on SMEs, Accessed at https://ec.europa.eu/growth/smes/business-friendly-environment/performance-review_en ; and Euratex
2 The State of Fashion 2020 McKinsey & Company, Accessed at https://www.mckinsey.com/~/media/McKinsey/Industries/Retail/Our%20Insights/The%20state%20of%20fashion%202020%20Navigating%20uncertainty/The-State-of-Fashion-2020-vF.ashx p.73
3 ITC SME Competitiveness Outlook 2019 Big Money for Small Business, Accessed at http://www.intracen.org/SMEOutlook/

economy. Clearly, engaging and providing the support that SMEs require is imperative if we are to accelerate and embed responsible business conduct throughout the entire value chain.

To date, focus on due diligence has been weighted towards larger enterprises. Frameworks on due diligence and responsible business practice have been largely developed for multi-national enterprises. Furthermore, legislative efforts are often referenced as setting a level playing field but exclude many SMEs from mandatory reporting by establishing minimum thresholds based on financial turnover.

A number of assumptions related to SMEs capability to carry out due diligence exist, and may require further research to determine their validity. For example, SMEs are generally assumed to hold lower leverage with suppliers but greater degrees of flexibility in applying due diligence due to more nimble management systems. Understanding how the structure of SMEs can enable them to pursue their own approaches to applying due diligence, rather than trying to apply models made for larger companies, could be valuable.

This session seeks to explore how SMEs are approaching and implementing due diligence, tackle some of the myths that only large companies can do due diligence and look at what support is available and what more needs to be done.

Classification of SMEs

Number of employees

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 in 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

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 (less 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, respectively.

Source: OECD Glossary of Statistical Terms, Small and Medium-Sized Enterprises, https://stats.oecd.org/glossary/detail.asp?ID=3123

Discussion questions

- **How are SMEs approaching due diligence and responsible business conduct?** Is it easier to create management and board level buy-in in smaller enterprises? If you are an SME, how important are policies and guidelines versus implementation through procurement decisions and action on the ground? What external tools and resources do SMEs need to support them, and are these different tools and resources than those developed by and for larger companies?
- **Do SMEs have more or less leverage than large companies when it comes to applying risk-based decision making based on due diligence?** It is often assumed that leverage of challenging issues requires larger companies to step up to the plate, but can SMEs exercise leverage, and if so how? Does the duration and nature of the business relationship matter more than the financial implications? Does being smaller allow SMEs to be nimbler and more proactive in addressing social and environmental impacts?
- **What are the opportunities for SMEs in applying due diligence?** A positive sign that SMEs are embracing due diligence is the growing number of start-up SMEs that are social entrepreneurs through initiatives such as Impact Hub and B-Corp. How does due diligence drive long-term value creation for SMEs, and how can SMEs at both the B2C and B2B level use due diligence to enhance their competitiveness? Financial institutions and investors are also increasingly seeking to invest in companies that perform well in ESG and responsible business conduct, and SMEs can use better ESG governance as a core proposition for investors.
- **Supporting institutions** What support exists through multi-stakeholder infinitives, business associations? How are these organisations set up to deal with SMEs and how are they ensuring they are relevant and valuable? What are their learnings? What do their members tell them they need more support on? Do we need to incentivise organisations and institutions to support SMEs? To this end, what role should governments and the OECD play?

About Libby Annat

Libby Annat, independent expert, has 19 years' experience of building and delivering sustainability strategies for both large and small-medium sized companies, with deep cross-sector knowledge of social and environmental sustainability. She works and partners with companies, governments and organisations to build networks and trust across the multiverse of stakeholders, including shareholders & investors, government and supranational bodies, suppliers, trade unions, companies, consumers, influencers, academia, media and campaigners.