

The cumulative effect of due diligence EU legislation on SMEs



Authors:

Aoife HANLEY, Finn Ole SEMRAU, Frauke STEGLICH and Rainer THIELE
(Kiel Institute for the World Economy, Germany)

European Parliament Coordinator:

Policy Department for External Relations
Directorate General for External Policies of the Union
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ABSTRACT

This study addresses the expected impact of the EU's Corporate Sustainable Due Diligence Directive (CS3D) on small and medium-sized enterprises (SMEs). It takes the German supply chain act (Lieferkettengesetz) as an example that may hold lessons for EU due diligence legislation. Against the background of a review of the existing literature on the impact of sustainability regulations, we conducted expert interviews with German business associations, German foreign chambers of commerce in emerging economies, as well as German supporting agencies. The objective was to identify key challenges SMEs in the EU and third countries face when dealing with the requirements of the supply chain act, and to discuss support measures that SMEs need or are already using. Based on the results of this analysis, we provide recommendations as to how the EU can help ease the burden for SMEs when implementing the proposed CS3D. These include targeted capacity-building measures for SME suppliers in developing countries, who mostly know little about European due diligence legislation, and simplifications in the reporting requirements for SMEs in Europe.

AUTHOR(S)

- Aoife HANLEY, Senior Researcher, Kiel Institute for the World Economy, Germany;
- Finn Ole SEMRAU, Researcher, Kiel Institute for the World Economy, Germany;
- Frauke STEGLICH, Researcher, Kiel Institute for the World Economy, Germany;
- Rainer THIELE, Deputy Director Research Centre International Development, Kiel Institute for the World Economy, Germany

PROJECT COORDINATOR (CONTRACTOR)

- Daniel MAYER, Bruegel

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CONTACTS IN THE EUROPEAN PARLIAMENT

Coordination: Wolfgang IGLER, Policy Department for External Relations

Feedback is welcome. Please write to wolfgang.igler@europarl.europa.eu

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1 Introduction

Participation in global supply chains (GSCs) is widely associated with economic benefits, such as higher productivity and employment growth (World Bank, 2020). Further, involvement in GSCs is generally beneficial for companies and their employees as, for instance, exporting can have a positive impact on working conditions (Tanaka, 2020), or the adoption of environmental innovations (Hanley & Semrau, 2022). However, the sustainability of production in global supply chains is increasingly contested. Reports of negative social and environmental externalities fuel the rejection of globalisation all over the world. Concerns about negative social and environmental impacts of large multinational enterprises (MNEs), especially in developing and emerging economies, are widespread. Companies are therefore increasingly under pressure to ensure certain minimum standards in their own production, but also by suppliers along their supply chains (Herkenhoff et al., 2021). Since the impact of voluntary approaches is ambiguous and can be ineffective, mandatory regulations have been introduced recently in many European countries, including France and Germany.

This study addresses the Corporate Sustainable Due Diligence Directive (CS3D) of the European Commission, the European Parliament and the European Council. The study proceeds in several steps. First, it discusses the expected impact of CS3D on small and medium-sized enterprises (SMEs) in EU and non-EU countries. Second, the study examines measures and tools that can support SMEs. Overall, we aim to gain insights into the purchasing practices of larger EU companies towards their suppliers and identify good practice examples of support measures for SMEs. Finally, based on the previous analysis, the study discusses how the EU can mitigate possible negative impacts and support SMEs to assist them comply with future due diligence expectations from the companies they do business with as part of the implementation measures when the future CS3D rules are in place.

To gain insights into the possible impacts of the CS3D on SMEs, we first systematically review evidence on related regulations targeting single products/sectors (see, e.g., Leipold (2017) for an analysis of the EU timber regulation) or human rights elements such as slave labour (Schaper and Pollach, 2021), and from the broader literature on standards or Corporate Social Responsibility (CSR) reporting in global value chains (Fiechter, Hitz and Lehmann, 2018; Lafarre and Rombouts, 2022). This overview guides the classification of potential benefits and challenges, especially for SMEs. We then apply the German supply chain act as a case study, on the intuition that its ongoing implementation might provide useful lessons for the proposed CS3D. We should bear in mind, however, that the German supply chain act is less comprehensive than the CS3D, limiting its scope to immediate, Tier 1 suppliers, while the CS3D envisages the entire value chain. Furthermore, the German supply chain act neglects environmental aspects. Nevertheless, the German supply chain act can help to illustrate which aspects work well and which prove more challenging. To this end, we conduct expert interviews with representatives of German business associations, German foreign chambers of commerce in emerging economies, as well as German supporting agencies. The expert interviews do not only point to the opportunities and challenges SMEs face when implementing sustainability regulations, but also explore the type of support offered to SMEs and its usefulness.

In all steps of the analysis, we take the differences between SMEs in the EU and third countries into consideration. Integrating the perspective of third countries – in particular developing and emerging economies – is essential because the proposed CS3D ultimately aims at improving the social and environmental situation in these countries and therefore explicitly pursues development goals.

The study is structured as follows: Chapter 2 gives an overview of existing EU due diligence legislation and discusses their potential impacts on SMEs based on key findings of the previous academic literature. Chapter 3 provides a deeper analysis of EU due diligence legislation relevant for SMEs and the expected impact of the Directive on Corporate Sustainable Due Diligence on SMEs in EU and non-EU countries. Based on the challenges identified in the interviews, Chapter 4 provides an overview of supporting tools that

companies are already familiar with and discusses additional support that would be needed. The supporting role that development cooperation can potentially play for SMEs in developing countries is also briefly mentioned. Chapter 5 sheds light on how the EU can help ease the burden for SMEs when implementing the proposed CS3D. Chapter 6 concludes.

2 Overview of EU due diligence legislation affecting SMEs

To look at the implications of due diligence legislation on SMEs, we need to step back in time, examining the raft of legislation touching on this theme. Over the past, the EU has proposed or implemented several regulations to improve the sustainability of global production and to consider any changes in the obligations of European businesses in response to a tightening in the rules (for an overview, cf. Verbrugge, 2022). One such legal tightening relates to how production can be carried out more responsibly. In line with Article 6 of the Treaty of the European Union, the Paris Agreement and the EU Green Deal, social and environmental aspects of a firm's production are considered. Other regulations pertain to specific industries, as is the case with the Conflict Minerals and the Deforestation Regulations, respectively. Alternatively, regulations can opt to take a more stringent line on labour abuses, the purpose of the Forced Labour Regulation. Other measures are more comprehensive. Adopting a broader angle, regulations are not limited to specific sectors or aspects of business activity. A case in point is the Corporate Sustainability Reporting Directive, the Regulation Concerning Batteries and Waste Batteries, the EU Taxonomy Regulation, or the CS3D.

While most of these regulations target larger firms, SMEs are often indirectly affected when they do business with larger companies in the EU to whom the rules apply. So far, the extent to which SMEs are already impacted (or will be affected in future periods) in response to changes in the diligence rules is unclear. In this chapter, we provide an overview of the relevant due diligence regulations and how they address SMEs (Chapter 2.1). This overview includes an assessment of the existing EU due diligence regulations, recent EU trade and investment agreements containing provisions on sustainability and due diligence as well as international standards. Additionally, we discuss potential impacts of such regulations, particularly on SMEs. Our assessment is based on evidence from existing studies. We also identify the sectors that are particularly vulnerable to human rights and environmental violations (Chapter 2.2).

2.1 Existing sustainability legislations

2.1.1 EU due diligence regulations

Our starting point in this chapter is to provide a snapshot of existing EU due diligence regulations which touch on the responsibilities and activities of SMEs. Our list of relevant regulations comprises both the EU Conflicts Minerals Regulation and the EU Corporate Sustainability Due Diligence Directive. Additionally, we look at the Forced Labour Regulation, Deforestation Regulation, the EU Corporate Sustainability Reporting Directive and the EU Taxonomy Regulation. One regulation we dropped from the list is the EU Regulation Concerning Batteries and Waste Batteries, as these rules do not pertain specifically to SMEs. Additionally, there is a raft of trade- and investment-specific rules, picking up on issues of sustainability and due diligence in the internationalisation activities of businesses, where the activities of SMEs are directly affected. Accordingly, we discuss such agreements, a representative case being the EU-New Zealand Trade and Investment Agreement. Apart from rules on labour, deforestation and trade, there is also a separate category which considers international standards – similarly critical for the activities of SMEs. Table 1 provides a summary, which gives the reader an overview of the scope of these regulations and directives.

Table 1: Overview of EU due diligence regulations, recent trade agreements, and international standards and their SME coverage

Regulations	Coverage	Actions taken	Support measures	SME excluded
EU Conflict Minerals Regulation	aims for non-binding guidelines	review effectiveness every 3 years	technical assistance; benefit from Competitiveness of Enterprises SMEs (COSME) program	
EU Corporate Sustainability Due Diligence Directive (CS3D)	lays down measures to limit the passing on of the burden to the smaller suppliers in the value chain	implementation of investments that prevent adverse impacts; joint stakeholder initiatives; EU development cooperation instruments	support in fulfilling the due diligence requirements; guidance on model contractual clauses; websites, portals or platforms for informational purposes; financial support of SMEs	SMEs are not included in the scope of this Directive
EU Forced Labour Regulations	guidelines on due diligence	publicly available guidelines; situation of SMEs is to be addressed through the design of the measure	providing a registry of penalised and banned entities and products	exception of SMEs is not seen a viable option
EU Deforestation Regulation	Attenuated requirements for SMEs	collect record of suppliers and customers; inform the competent authorities if new information becomes available regarding the non-compliance of their commodities and products	technical and other assistance and guidance to operators	
EU Corporate Sustainability Reporting Directive (CSRD)	sustainability reporting	SMEs should be allowed to report	SMEs are given time to prepare; assessment of impact	
EU Taxonomy Regulation	guidelines on non-financial reporting	SMEs may report	voluntary requirement for SMEs	
EU-Chile Advanced Framework Agreement	measures to enhance benefit for SMEs	SMEs specific website; SMEs contact points		

Regulations	Coverage	Actions taken	Support measures	SME excluded
EU-UK Trade and Cooperation Agreement 2021	measures to enhance benefit for SMEs	SMEs specific website; SMEs contact points	predictable regulatory environment; impact analysis of regulation	
EU-Vietnam Free Trade Agreement 2020	measures to reduce costs for SMEs	simplified custom procedures	possible subsidies in favour of SMEs	
EU-New Zealand Trade Agreement	measures to enhance benefit for SMEs	SME specific website; SME contact points; cooperation between Union and Maori-owned enterprises; support transparent and factual sustainability schemes	considering the effects of this regulation on SMEs	
OECD Due Diligence Guidance for Multinational Enterprises on Responsible Business Conduct	encourages SMEs to observe the recommendations	develop internal control, ethic and compliance programmes according to the size of the enterprise	co-operation with other stakeholders, personnel training, capacity building	
OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas	recommendations for SMES	building partnerships; building capacity for suppliers		

Source: Own compilation based on existing documentation of regulations.

EU Conflict Minerals Regulation

One major step forward for corporate due diligence was the introduction of the EU Conflict Minerals Regulation. This regulation, which was adopted and entered into force in 2017 and applied to EU importers from January 1, 2021, aims for mandatory requirements for importers of tin, tantalum, tungsten, and gold (3TG) coming from conflict-affected and high-risk areas (CAHRAs). In order to facilitate the implementation and identification of CAHRAs, particularly for SMEs, this regulation laid the foundation for a list of CAHRAs, which is regularly updated.

This review envisages an independent assessment of the share of total downstream firms – firms positioned close to final consumption along a supply chain – with 3TG in their supply chain, with due diligence schemes in place. In addition, the review shall assess the adequacy and implementation of these due diligence schemes and the impact of the rules for upstream firms – firms positioned close to the raw product in a supply chain – in conflict areas. Based on information gleaned from these regular reviews of the regulation and its efficacy, the reviewers can consider further legislative tweaks to the proposals, introducing additional obligations for firms.

Because it is comparatively time- and resource-consuming for SME importers to verify the alignment of their 3TG suppliers with the regulation, the Commission is mindful of the need for smaller firms to have access to adequate technical assistance. Additionally, there may sometimes be a need to liaise with a team of experts when implementing this regulation within their firm. To access this form of support, smaller EU importers of 3TG can refer to the Program for the Competitiveness of Enterprises and Small and Medium-sized Enterprises (COSME). The latter, which helps level the playing field for smaller firms, was established under EU Regulation No 1287/2013 of the European Parliament and of the Council. Another example for a supporting measure is the Due Diligence Ready! portal¹. This portal provides tools and training resources specifically designed to assist small and medium-sized EU companies in conducting due diligence on their minerals and metals supply chains, ensuring compliance with regulatory requirements, including Responsible Mining Regulation. The portal's main objectives are to help companies to (i) understand the advantages they can gain from conducting due diligence on their supply chains; (ii) assess and mitigate risks and impacts in their supply chains; and (iii) comprehend and implement the OECD due diligence guidance for responsible supply chains of minerals from conflict-affected and high-risk areas.

EU Corporate Sustainability Due Diligence Directive Proposal

We now turn to the instrument lying at the core of our analysis – the EU CS3D currently under discussion. In February 2022, the European Commission proposed the CS3D and in June 2023 the European Parliament adopted its amendments to this proposal. Under the provisions of the proposal, regulators aim to limit the reporting burden of smaller EU suppliers within the supply chain, in the hope that larger companies can absorb some of this reporting burden. Because of the onerousness of reporting, it is important to highlight that SMEs are under the Commission's proposal not directly included in the scope of this directive, being excluded from their due diligence duty. For smaller firms, the financial and administrative burden of setting up and implementing a due diligence process is relatively high. For the most part, they do not have pre-existing due diligence mechanisms in place. Additionally, they are more likely lacking experience and expertise with due diligence. They are also more likely to lack specialised personnel (e.g., an in-house legal team). For this reason, the cost of complying with due diligence rules impacts small firms disproportionately. Nevertheless, despite excluding small firms from the provisions of the regulation, SMEs are indirectly affected, to the extent that some – to avoid losing contracts with their larger customers – invest time and resources in ensuring regulatory compliance of their suppliers. In this sense, despite being excluded from the provision, SMEs are not exempt from the burden of reporting.

¹ See https://single-market-economy.ec.europa.eu/sectors/raw-materials/due-diligence-ready_en.

To prevent adverse impacts, the CS3D envisions support for SMEs. Additionally, it seeks to facilitate joint stakeholder initiatives, a move further strengthened by initiatives to foster EU development cooperation. Ultimately, the regulation provides for SMEs to build essential financial and operational capacity, cushioning them against any regulatory fallout from the new rules. Companies whose business partner is an SME are obliged to support their smaller partner, assisting them in fulfilling the due diligence requirements. Where the viability of the SME is jeopardised by the larger firm's compliance obligations, the latter is to negotiate with its SME partner, in a manner which is fair, reasonable, non-discriminatory and proportionate. In this way, the new directive proposes measures which restrict the extent to which large companies can shift the reporting burden to their smaller, upstream SME partner. In addition, the Commission aims to provide guidance on the formulation of contractual clauses, which would limit the extent to which the burden can be shifted from larger companies to their smaller SME partners.

Moving from firms to the jurisdictions in which these firms operate (EU member states), the directive envisages a strong and supportive platform for underpinning the implementation of the new regulation. Either individually or jointly, member states can set up dedicated websites, portals or platforms to inform firms of the new diligence rules. In this way, SMEs are further supported in their response to the rules.

EU Forced Labour Regulation Proposal

The proposal of an EU Forced Labour Regulation, put forward by the European Commission in September 2022, foresees that the Commission should issue guidelines on due diligence concerning forced labour, in such a way that takes into consideration the size and economic resources of the businesses to whom the rules apply. It is acknowledged that SMEs are equipped with limited skills and resources to ensure that their products have not been produced using forced labour. The imposition of additional reporting burdens on SMEs should be avoided.

To support this goal, the guidelines envisage making risk indicators relating to forced labour publicly available to SMEs. This initiative is meant to complement gaps in other regulations, for example, the exemption of SMEs from the proposed CS3D. Contrary to the CS3D, this regulation does not exclude SMEs from the provisions because exempting SMEs would affect the effectiveness of the overall proposal, creating uncertainty. The regulation stipulates that the challenges facing SMEs should be mitigated through the design of this risk indicator, the provision of risk-based enforcement, and the provision of support tools.

As already mentioned, this measure is designed to cater for differences in the size and resourcing of firms falling within the provision of the new rules, in the knowledge that smaller businesses lack equivalent resources for auditing their supply chains. Likewise, the measure takes account of the number of products affected by the rules, as well as the extent of suspected forced labour used in the provision of these products. In terms of support measures, it is suggested that public authorities provide a registry of penalised and banned entities and products. Such a registry of excluded businesses is especially helpful for SMEs, helping them to navigate the pool of available suppliers. A further source of support by the Commission is the provision of guidelines or templates, all of which help to reduce the cost of auditing and reporting abuses concerning forced labour.

EU Deforestation Regulation

The EU Deforestation Regulation states that SMEs are required to collect a record of their suppliers and customers. This record is to be kept for at least five years and the information made available to the relevant authorities upon request. This requirement is estimated to involve only negligible costs, as such information is routinely collected by businesses as part of their day-to-day operations. If an SME receives new information, which includes substantiated concerns about the compliance of their products with the requirements of this regulation, they must immediately inform the authorities. Member states may provide technical and other assistance or guidance to businesses falling under the provisions of the regulation.

Additionally, the regulation takes into consideration the special status of SMEs and their need for additional help in complying with the requirements.

EU Corporate Sustainability Reporting Directive

The EU Corporate Sustainability Reporting Directive stipulates that SMEs should be allowed to report under the sustainability reporting standards for SMEs. In addition, all undertakings that are parent undertakings of large groups should prepare sustainability reporting at the group level. This is meant to assist to ensure that financial market participants can include smaller undertakings in investment portfolios, on the basis that they report the sustainability information that financial market participants need. Additionally, this directive is said to enhance the access of SMEs to financial capital and avoid discrimination. Ensuring that financial market participants have the information they need from investee undertakings to be able to comply with their sustainability disclosure requirements is important for achieving this goal. Therefore, SMEs should be given the possibility of reporting under standards that are proportionate to their capacities and resources. SMEs whose securities are not admitted to trading on a regulated market in the Union should also have the possibility of choosing to use such proportionate standards voluntarily. SMEs are meant to be given sufficient time to prepare for the application of sustainability reporting regulations. Therefore, January of 2026 is set as the beginning of the implementation for SMEs. From then on, an SME has two years to opt out from sustainability reporting requirements laid down in this Directive.

The Directive also suggests that third-country enterprises, which generate a net turnover of more than 150 million euros in the Union and which have a subsidiary undertaking or a branch on the territory of the Union should be subject to Union sustainability reporting requirements. A threshold is set to ensure the proportionality and enforceability of such a requirement. This threshold distinguishes between large companies and SMEs (except micro undertakings).

The assessment of the impact of national transposition measures on SMEs is free to be carried out by the member states to ensure that SMEs are not disproportionately affected. Member States should consider introducing measures to support SMEs in applying sustainability reporting standards. These standards should also consider the difficulties that undertakings may encounter in gathering information from actors throughout their value chain, especially from suppliers that are SMEs. In addition, reporting standards should not specify disclosures that would require undertakings to obtain information from SMEs in their value chain that exceeds information to be disclosed under the sustainability reporting standards for SMEs. The Commission is meant to review those sustainability reporting standards for SMEs every three years and submit a report to the European Parliament and to the Council on the implementation of this amending Directive, including an assessment of the number of SMEs that use sustainability reporting measures voluntarily and of whether the requirements for SMEs should be further extended. All in all, this Directive aims to adopt sustainability reporting standards for SMEs that are proportionate and relevant to the capacities and characteristics of SMEs.

EU Taxonomy Regulation

Under the provisions of the EU Taxonomy Regulation, small companies are mentioned only once. The motivation for referring to SMEs relates to existing guidelines on non-financial reporting – specifically, the reporting of climate-related information from 2019. While the regulation stipulates that large companies are required to submit annual information on key climate-related performance indicators, smaller companies may face a disproportionate burden due to such requirements. For this reason, there is a waiver clause for smaller businesses, who may choose to submit such information, but voluntarily.

2.1.2 EU trade agreements

Given the complexity of trade arrangements between partner firms from domestic and foreign markets (each regulated by varying jurisdictions), it is no surprise there exists a range of bilateral and multilateral

trade agreements stipulating the obligation of trade partners. Specifically, we focus on Regional Trade Agreements (RTAs), highlighting how these regulations are tailored to accommodate SMEs.

Our discussion begins with RTAs negotiated between 1) the EU and Chile and 2) the UK, Vietnam and New Zealand. Over the last few decades, bilateral trade agreements have gained momentum, a consequence of the failure to achieve consensus within the 2001 Doha Round (the most recent round of these trade negotiations). According to the single-undertaking rule of the WTO, nothing is agreed until everything is agreed. Hence, negotiating countries cannot pick out individual items from the package as a subject for negotiation. As a consequence of the failures of Doha, RTAs gained in popularity, a move encouraged by the EU in its steps towards advancing its agenda for social and environmental sustainability.

Brandi et al. (2020) analyse the effects of environmental provisions on the sustainability of exports from developing countries. They find that the coverage of environmental provisions reduces dirty exports and increases green exports from developing countries. From this finding, they infer that the inclusion of environmental provisions represents an appropriate policy tool for promoting green transformation. Next, we discuss how SMEs are regarded in different European bilateral trade agreements covering aspects related to due diligence.

EU-Chile Advanced Framework Agreement

Under the provisions of the EU-Chile Agreement, an entire chapter is dedicated specifically to SMEs to highlight the importance of SMEs in bilateral trade and investment. Specifically, there are provisions relating to the sharing of information as well as the proposed provision and maintenance of a publicly accessible SME-specific website. Each negotiating party is obliged to contribute internet links to the framework agreement, such that SMEs from both partner countries are adequately provided for in terms of support. The website also envisages the inclusion of internet links which connect to an electronically searchable database, the latter relying on tariff nomenclature codes to deliver information relating to the conditions of market access. The information relating to tariffs on bilateral transactions is very detailed. Reference is made to tariff measures and nomenclature, respectively. Information is also supplied about non-tariff measures. The provisions of the framework envisage that the information can be regularly updated and presented in a user-friendly manner to SMEs. Additionally, information access is free.

Moreover, each party is obliged to communicate to the other its designated institutions (SME Contact Points) for liaising with SMEs, ensuring that the needs of SMEs are considered in the implementation of this agreement. In this way, SMEs from both sides can take equal advantage of opportunities arising from the RTA. These SME Contact Points are aimed to ensure that the information that is shared via the designated websites is updated and tailored to SMEs. A further function of the Contact Points is to examine matters relevant to SMEs, including the exchange of information to assist the Trade Committee provided for under the agreement as well as other agencies working within the agreement (committees, Contact Points and working groups). The SME Contact Points are expected to meet at appropriate intervals. Among other things, the purpose of these meetings is to decide on appropriate communication channels and to seek cooperation with experts and external organisations.

EU-UK Trade and Cooperation Agreement

This agreement between the EU and the UK includes a chapter dedicated solely to SMEs – its primary purpose is to enhance the ability of SMEs to benefit from the Agreement. To begin with, the Agreement refers to the necessity for information sharing, and the provision and maintenance of a publicly accessible website to summarise all information pertaining to SMEs. Additional information included on the website, for example, refers to custom laws, regulations governing intellectual property rights, technical laws, regulations on public procurement and company registration procedures. Finally, the information also summarises the laws on sanitary and phytosanitary measures. Each party is expected to amend the text to include internet links to information websites and the website of authorities from which these dedicated

SME websites source their information. The website should also include internet links to an electronically searchable database, which relies on tariff nomenclature codes, providing information about market access. Information provided relates to tariff measures, tariff nomenclature as well as non-tariff measures. This Agreement envisions that information can be regularly updated and presented in a user-friendly manner to SMEs. Additionally, information access is free. Lastly, as in the Chile agreement, no fee applies for SMEs accessing the information of any party.

Moreover, SME Contact Points seek to provide help to SMEs operating within the Agreement and ensure that SMEs of both parties can benefit equally from the Agreement. Contact Points have further tasks – namely the examination of matters which touch on the activities of SMEs and providing regular feedback on their activities, and that information delivered via the websites is regularly maintained and updated.

Additionally, a key aspiration of the Agreement is to work as transparently as possible. A further goal of the Agreement is to maintain stability for SMEs – where stability means creating a predictable regulatory environment within which smaller firms can operate. Internal coordination is a further goal of the Contact Points, such that smaller firms are better able to navigate the rules and procedures. There is also provision for an impact analysis, whereby SMEs can explore the potential social, economic and environmental impact of choices they may make, including the impact of the Agreement on international trade and investment. Information is also provided for firms wanting to make comparisons by looking back in time (i.e., retrospective evaluations). When conducting such a retrospective evaluation, each firm shall consider whether there are opportunities to more effectively achieve its public policy objectives and to reduce unnecessary regulatory burdens on SMEs. When it comes to the subject of prohibited subsidies an economic actor or its owner, creditor or new investor, except for SMEs, shall contribute significant funds or assets to the cost of restructuring.

The Agreement also provides for the creation of so-called Authorised Economic Operators (AEO). Under the provisions of these AEOs, firms fulfilling certain conditions are afforded this privileged trading status. Care is taken that when awarding the status of AEO, firms meeting the same criteria have an equal opportunity of receiving the status. In this way, any discriminatory bias is kept at a minimum.

EU-New Zealand Trade Agreement

The EU-New Zealand Agreement includes a chapter dedicated to SMEs that is analogous to the EU-UK and EU-Chile Agreements. This Agreement similarly highlights the importance of information sharing (including websites and links) and contact points. There is also a non-application-of dispute-settlement article that states that dispute settlement does not apply to this chapter.

Reference is also made to digital trade and the challenge it imposes for SMEs in the use of electronic commerce. Parties to the Agreement are obliged to exchange information pertaining to the rules for digital trade. Furthermore, the Parties must agree on rules for the protection and enforcement of intellectual property rights, where there is public-private collaboration involving SMEs. There is also the issue of collaboration between EU and Māori-owned enterprises, such that they can access and benefit equally from the trade and investment opportunities created by this Agreement.

A final aspect are the proposed rules on trade and investment to support sustainable development, where SMEs are involved. Each Party to the Agreement is obliged to promote and facilitate activities that include encouraging the uptake of transparent, factual and non-misleading sustainability schemes, especially for SMEs.

EU-Vietnam Trade and Investment Agreement

The EU-Vietnam Agreement mentions SMEs in the context of simplified custom procedures and implies that each Party should provide transparent and efficient custom procedures. These are meant to reduce

costs and increase predictability for SMEs. Subsidies which favour SMEs are defined in the respective legislation of both Parties to the Agreement.

With respect to the issue of transparency, there are two paragraphs that apply to SMEs. They specify a reduced reporting burden for smaller firms, whereby information relating to ownership, enterprise voting structure and the annual revenue or total assets are not included in the list of required information. Both Parties to the Agreement also recognise the impact that regulatory environment and procedures may have on trade and investment. Each Party is expected to promote a predictable regulatory environment and efficient procedures for businesses covered by the Agreement, especially SMEs.

2.1.3 International standards

International Labour Organization

The business and human rights agenda, in relation to labour rights, is built upon the framework of international labour standards and the International Labour Organization's (ILO) pivotal role as the UN's standard-setting organization for matters concerning the world of work. Among others, the ILO resolved measures that are related to labour rights in global supply chains. The ILO Declaration on Fundamental Principles and Rights at Work and its Follow-up (adopted in 1998, amended in 2022) serves as basis for the debate on business and human rights. The Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy (MNE Declaration) provides guidance to large enterprises on social policy and inclusive, responsible and sustainable workplace practices. Recently, the ILO has published its strategy on decent work in supply chains². This strategy only mentions SMEs once – namely, that ILO coordination for development cooperation requires strengthening. More precisely, all tiers of supply chains, including SMEs and relationships between buyers and suppliers are deemed important.

OECD Guidance

The following paragraphs are intended to reflect relevant OECD guidelines concerning SMEs.

OECD Due Diligence Guidance for Responsible Business Conduct

The scope of this OECD due diligence guidance for responsible business conduct includes SMEs in the list of enterprises that are of importance. A further goal of the guidance is that due diligence must be tailored to an enterprise's underlying circumstances. Therefore, the size of the business, the context of its operations, its business model, its position in supply chains, and the nature of its products or services are relevant to how the business responds to regulations. However, the size or resource capacity does not change its responsibility to conduct due diligence commensurate with the risk. Enterprises with resource constraints may 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. Large enterprises with expanded operations and many products or services may need more formalised and extensive systems than smaller enterprises with a limited range of products or services to effectively identify and manage risks. Enterprises may also face practical and legal limitations on how they can influence or affect business relationships to cease, prevent or mitigate adverse impacts on RBC issues or remedy them. Enterprises, in particular SMEs, may not have the market power to influence their business relationships by themselves.

To be able to identify and assess actual and potential adverse impacts associated with the enterprise's operations, products or services, a broad scoping exercise in areas where responsible business conduct

² See https://www.ilo.org/wcmsp5/groups/public/---ed_norm/---relconf/documents/meetingdocument/wcms_869573.pdf

risks are most likely to be present is envisaged. For smaller enterprises, a scoping exercise may not be necessary before moving to the stage of identifying and prioritising specific impacts.

The latest update of the guideline sheds new light on the support measures for SMEs. Engaging with and supporting SMEs is cited as an important aspect of the general policy that enterprises should follow. Additional support measures include industry-wide collaboration efforts, information-sharing, personnel training, and capacity building. Regarding anti-bribery recommendations, there is a stipulation to develop internal controls, ethics and compliance programmes for the purpose of preventing bribery. For SMEs these measures are expected to be adjusted to their individual circumstances.

OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas

This guidance includes specific recommendations for all downstream or upstream companies. SMEs are mentioned in the paragraph relating to downstream companies, whereby SMEs are encouraged to join or build partnerships with industry organisations, which participate and support the independent third-party audit of the refiner's due diligence practices.

SMEs are only explicitly mentioned on one more occasion, in reference to supply chain policy in the context of bribery and fraudulent misrepresentation of the origin of extracted minerals. Upstream companies may cooperate through associations, assessment teams or other suitable means to build supplier capacity to conduct due diligence for responsible supply chains of minerals from conflict-affected and high-risk areas.

2.2 Impact of sustainability legislation

Most of the above presented due diligence regulations in Europe are relatively new, which is why evidence on their impacts is still scarce. Nevertheless, some expectations on the impacts can be formed based on evidence from regulations that have been in place for some years and the academic literature on the impacts of standards, buyer requirements, or stakeholder pressure on corporate governance in global supply chains in the broad sense. We organise the discussion along three aspects that also feature prominently in the expert interviews which we analyse below: (i) the relevance of company size; (ii) the potential benefits of due diligence regulations; and (iii) the role of buyer-supplier relations. To better understand the potential impacts on SMEs, this chapter also provides an overview of the industries that are most prone to human rights and environmental violations, like agriculture, textiles and apparel, and mining industries.

Constraints for SMEs to implement corporate responsibility

Several differences exist between large companies and SMEs that determine the way how corporate responsibility is implemented (Spence, 2016). First, SMEs are disadvantaged due to their relative sensitivity towards the higher imposed costs and their lower capability to implement standards (Carrigan et al., 2017; Álvarez Jaramillo, Sossa and Orozco Mendoza, 2019; Sfakianaki, 2020). In a literature review, Álvarez Jaramillo, Sossa, and Orozco Mendoza (2019) reveal that SMEs lack sufficient human resources and expertise to deal with regulation. Additionally, they have trouble shouldering the cost burden of the new regulations. More specifically, Carrigan et al. (2017), in their descriptive study for SMEs engaged in the high-value jewellery sector, suggest that for supply chains to become more responsible, regulation must be accompanied by concrete ways to improve the visibility of supply chains. These ways include less costly certification routes for small firms, the harmonisation of industry standards (to reduce certification overlap) and the utilisation of track and trace schemes for highly sensitive inputs (precious gems in the high-value jewellery sector). Carrigan et al. (2017) also mention a widely neglected issue, namely how increased supply-chain transparency goes hand in hand with an SME's prerogative to protect its trade secrets. SMEs which have worked hard to source unique inputs or negotiate exclusive deals with suppliers are now forced to reveal these competitive secrets under the new reporting requirements. A review of the Non-Financial

Reporting Directive by the European Commission conducted in 2020, reveals that SMEs often lack necessary resources and technical expertise to prepare reports under given standards. Furthermore, the likelihood of financial institutions requesting certain non-financial information increases. If SMEs fail to provide this type of information, they may face negative consequences on commercial opportunities as suppliers to larger companies. In addition, access to capital and the opportunity to benefit from new sustainable investments may also be negatively affected (European Commission, 2021a).

Second, owing to their restricted scale, SMEs face a shortage of human resources, which necessitates the multi-faceted utilisation of employees. As a result, there is limited time available for tasks that extend beyond the pre-established routine of daily activities (Granly and Welo, 2014). Managers of SMEs do not have the capacity of delegating tasks to a team of specialised employees (e.g., a specialised compliance team). And compliance absorbs a lot of a manager's time – days of business downtime while 'boxes are ticked' and supplier audits are performed. The ITC (2016) report shares this pessimistic view. Here, the compliance costs for SMEs are estimated at double those for larger firms. Moreover, since the most problematic suppliers are located in export markets, due diligence laws exert a disproportionate impact on the trade of SMEs with their foreign intermediaries and customers. The conclusion of the ITC report is to call on policy makers to make compliance easier for SMEs. In contrast, SMEs usually have flat organisational structures with lean decision-making processes, the manager is often the owner, and they face less pressure from the market to focus on short-term goals, which gives them more flexibility to implement corporate responsibility (von Weltzien and Shankar, 2011).

Beyond the relatively tighter constraints of SMEs compared to large companies to meet due diligence regulation, there is also a generally pessimistic view on the effects of tightened regulation on SMEs (Cral, 2005; Sfakianaki, 2020; Graafland and Smid, 2017). The argumentation goes that since SMEs pay excessive attention to compliance (not to the adoption of voluntary standards that might benefit their business), they view due diligence regulations as just another cost to be minimised. In this sense, the cost is likely to outweigh any benefit. A more profit-maximising approach to the due diligence rules would encourage the SME to overhaul its production methods – something that requires substantial investment. And since SMEs have comparative difficulty in attracting investment – compared to larger firms – they are not only unwilling but also unable to extract economic value from voluntary adoption of standards or compliance. This reluctance of SMEs to view due diligence from a profit-maximising perspective is not necessarily an optimal business strategy. According to Ackroyd et al (2008), firms with reduced environmental impacts are indeed more sustainable, profitable, valuable or competitive.

Benefits for SMEs of implementing due diligence

However, there is also a more positive view on the effects of SMEs to engage in due diligence. Several studies discuss the benefits of new due diligence regulations for SMEs. It may, for instance, improve reputation, which is a primary objective for SMEs to engage in corporate responsibility (Sen and Cowley, 2013). Further, due diligence is associated with improved employer branding, which facilitates, among other things, access to a talented workforce (von Weltzien and Shankar, 2011). Moreover, corporate responsibility can improve competitiveness, provide opportunities to supply big enterprises and win public procurement contracts, and it can save costs in the long run (von Weltzien and Shankar, 2011). The Environment Agency (2003) claims that the smallest businesses have a strong incentive to respond to any public concerns about the labour and environmental impacts of their operations, regardless of legislative pressures. Upgrading their processes makes strong business sense, not only to avoid sanction but because a good corporate image impacts positively their business. Enhanced reporting requirements can open new avenues for smaller firms in leveraging finance from banks and investors. Since SMEs are expected to invest considerable time, energy and money in reporting their non-financial activities, it seems reasonable that they should also benefit from improved supply-chain transparency.

Giacomelli (2022) documents the possibilities for extending the reporting requirements for SMEs to consider the environmental sustainability of their actions. It is expected that in the upcoming years, incorporating ESG (Environmental, Social, and Governance) information will become standard practice, serving as a foundation for various transactions, including bank loans, and will witness growing demand from customers. SMEs will be obliged to report on their sources of supply, production practices, how they distribute products and services and the sustainability of their logistics. In turn, it should become easier for these small firms to gain access to finance. This is because successful compliance with the new ESG rules has a positive effect on their financial credit rating (Giacomelli, 2022). And because the capital requirements of bank loans are impacted by the sustainability of the projects financed, banks will favour SME applicants who meet the new reporting requirements (Giacomelli, 2022). However, the author sees enormous potential to simplify the reporting requirement for SMEs, making it less time-consuming to complete. The idea is that because banks are already collecting this reporting information using tailored software reporting tools, it would make sense to elicit this additional reporting information on the same integrated platform as that used for financial reporting. In this way, there is less doubling-up of compliance effort. We next turn to a deeper discussion on the role of buyer-supplier relationships in companies' consideration of social and environmental standards.

The role of buyer-supplier relationships

Overall, involvement in global supply chains is beneficial for companies and their employees. For instance, exporting can have a positive impact on working conditions (Tanaka, 2020) or the adoption of environmental innovations (Hanley & Semrau, 2022). The implementation of responsible sourcing requirements by multinational enterprises, which establishes minimum criteria for worker compensation, benefits, working conditions, and other production practices across their global supplier network, can lead to enhanced domestic welfare benefiting particularly low-wage workers (Alfaro-Ureña et al., 2022). What is more, exporting and importing activities positively link to firms' corporate social responsibility initiatives (Newman et al., 2018). Consequently, the extent of a firm's activity in international supply chain relationships appears to have a significantly positive impact on its CSR endeavours (Newman et al., 2018).

Mandatory due diligence requirements for large lead firms might be transmitted to their (larger) suppliers in the value chain. Schiller (2018) examines the impact of corporate environmental and social policies on supplier behaviour within the value chain, utilising data limited to prominent publicly listed companies. By analysing the relationship between these policies and firm performance, he presents compelling evidence supporting the notion that firms can influence their suppliers' CSR decisions to some degree. This is not necessarily true for the smallest and most upstream suppliers – suppliers further away from final consumption along the supply chain – because of the nature of supply chains. If production occurs within developing countries, supply chains often function within environments where complete contracts are unattainable due to various challenges, such as quality assessment and unforeseen disruptions (Boudreau, Cajal-Grossi, and Macchiavello, 2023). Buyer-supplier relations pose a key challenge for policymakers seeking to improve worker welfare and environmental impacts in supply chains.

Enforcement along supply chains

In general, binding corporate responsibility agreements between lead firms and their suppliers are hard to enforce. The enduring and significant problems related to adherence to labour and environmental standards across the value chains of numerous companies highlight the challenges that firms face in enforcing standards on their global suppliers. For instance, the implementation of legally binding codes of conduct proves to be a complex endeavour (Locke, 2013a, Locke, 2013b). What is more, corporate responsibility agreements between lead firms and their suppliers are usually characterised by incomplete contracts between firms and suppliers, which results in more upstream firms having lower CSR expenditures (Herkenhoff et al., 2021). However, human rights abuses and environmental pollution occur primarily at the beginning of global supply chains. The success of enforcement depends, among others,

on anchoring CSR measures on the ground. For example, for the textiles sector, Boudreau (2022) shows that compliance with workers' safety increases due to strengthening occupational safety and health committees in factories. Overall, the challenges for implementing corporate responsibility are higher for small firms in upstream industries like, for instance, mining (Eslava, 2018).

SMEs with suppliers in developing countries face particularly difficult challenges (Ciliberti et al., 2008). SMEs cannot easily compel their developing country suppliers to align their work practices to CSR requirements. Using a multiple case-study approach for five Italian socially responsible SMEs, Ciliberti et al. (2008) reveal that SMEs from the Global North face enormous challenges in getting their partners in the Global South to introduce more responsible work or production practices. The smaller size of a company frequently leads to reduced bargaining power. Larger companies possess greater influence to promote socially responsible behaviour among their supply chain partners. The implementation of corporate social responsibility practices and their dissemination throughout the supply chain can pose challenges for SMEs, partly due to the associated costs in terms of required resources and expertise. For instance, SMEs often find it necessary to depend on external entities such as NGOs or multinational companies to monitor their suppliers (Ciliberti et al., 2008). However, SMEs might face challenges in incorporating information regarding their supply chains. Furthermore, while larger firms may possess superior bargaining power, smaller firms are not completely powerless, as suggested by Ciliberti et al. (2008). Although nudging suppliers towards regulatory compliance can be costly for SMEs and may risk straining trading relationships, the study reveals that SMEs adopt a highly differentiated approach towards corporate social responsibility. Serious violations such as human rights abuses, including the use of child labour, are viewed with utmost severity, prompting SMEs to adopt a zero-tolerance stance towards such irresponsible practices (Ciliberti et al., 2008). However, other shortcomings are treated with relatively less severity and considered negotiable. By employing a differentiated approach to supplier compliance, SMEs prioritise addressing significant issues within the supply chain, effectively allocating their limited resources of time and money towards what they perceive as the most critical abuses (Ciliberti et al., 2008).

Certain common factors help to stimulate supplier compliance. First, SMEs are more likely to engage in capacity building with their developing country suppliers where managers are personally committed to CSR objectives (e.g., managers are philanthropists) (Ciliberti et al., 2008). Another key factor is market characteristics, e.g., a market is characterised as a niche market. Niche markets offer higher scope for capacity building. Although the literature does not shed light on the reasons for this pattern, we argue that narrower, more specialised markets allow for deeper and more enduring buyer-supplier relationships. Generally, niche markets are potentially more transparent, less complex (fewer products) and involve fewer participants (Ciliberti et al., 2008). Finally, capacity building is more likely to take place where supply-chain participants can derive profit from any positive action taken. Here, the ability to advertise the changes to customers is important. In the same way, NGOs can also raise the visibility of positive action (Ciliberti et al., 2008).

In the context of capacity building, SMEs sourcing products and services from developing country suppliers can provide these suppliers with advice, assistance and technology know-how, on the understanding that the suppliers will upgrade their processes. Alternatively, SMEs might shy away from capacity building, regarding the supply-chain regulations as a superficial 'box-ticking' exercise. In this case, SMEs would avoid (rather than invest in) suppliers who fail to meet the CSR requirements (Kolev and Neligan, 2022).

Cost pass through/ burden shifting

There is a risk that the burden of compliance is shifted from the large companies to their SME partners. Indeed, policymakers at the European Commission have recently alluded to this concern.

"The Commission is very much aware of the importance of limiting the shift of the compliance burden to business partners, in particular to small and medium-sized enterprises (SMEs)".

(P2, European Commission and Trade and Technology Council, 2023. Roundtable Report)

In a study on the Non-Financial Reporting Directive (NFRD) by the European Commission, 212 companies were questioned about the effects of the NFRD (European Commission, 2021). The results show that additional information from suppliers and/or clients was requested by more than one-third of the surveyed companies. This includes information concerning human rights, environmental aspects and enhanced procedures. As a consequence of the NFRD, SMEs are generally affected by a rise in prices (European Commission, 2021b). On the other hand, the EU Commission states that corporate resilience increases due to a greater awareness of sustainable risks and an improvement in risk management.

Exclusion from business relations

Failure to comply with the new due diligence laws is expected to affect firms' overall eligibility to participate in its supply chain. Improvements in social and environmental aspects along supply chains are largely expected to arise from capacity building, where companies actively invest in their suppliers. The dilemma between investing in a business relationship to comply with standards or to divest depends on the type of buyer-supplier relationship, the substitution options, and the industry. Firms that are part of supply chains but engage in economically unsustainable practices or that cannot comply with the requirements face the potential of losing their customers (Felbermayr et al., 2022). This is because larger companies, which are directly affected by a regulation, will be compelled to establish sustainable supply chains and will prefer suppliers whose business models already incorporate sustainability characteristics (Giacomelli, 2022). Although surveys reveal that firms intend to leave markets with weak governance structures in response to due diligence regulations (Kolev and Neligan, 2022), this has not yet happened across the board. One reason for this is that changing suppliers is costly and, thus, buyer-supplier relationships are often characterised by stickiness (Martin, Mejean, and Parenti, 2020). Whether relationships are sticky depends, among other things, on the industry. For French firms, Martin, Mejean, and Parenti (2020) show that specialty chemicals or customised parts and accessories have high stickiness, while motor vehicles or suits exhibit low stickiness. Moreover, particularly in developing countries, buyer-supplier relationships are often characterised by long-term relationships to overcome contracting constraints (Boudreau, Cajal-Grossi, and Macchiavello, 2023). In contrast, the likelihood of switching suppliers is higher the easier it is to substitute, and thus probably more likely for suppliers producing homogenous products or for informal suppliers.

Role of the position in global supply chains

Firms' position in supply chains determines the extent to which due diligence requirements can be enforced and reap benefits for firms. Fiechter et al (2022) empirically examine – but on larger, listed firms – the European Union directive on corporate social responsibility, and the characteristics of firms which responded most comprehensively to the new regulation. The most compliant firms were closest to end-customers or operating in industries with the highest perceived impact (e.g., mining and extractive industries). Similarly, an empirical study by Koenig and Poncet (2019) confirms the argument that proximity to end-customers matters. In this study, demand for imports from Bangladesh fell significantly, following the Rana Plaza disaster, as end-customers decided to boycott sales from this region. Herkenhoff et al. (2021) show that upstream firms have lower CSR expenditures compared to downstream firms.

The arguments spelt out here largely apply to larger firms that represented the focus of the empirical studies. However, we can apply similar reasoning to SMEs – where smaller firms which are closest to end-customers (or most likely to suffer adverse reputation effects from shoddy supplier practices), would be most willing to comply with any new due diligence regulations.

Having examined the characteristics of SMEs most likely to respond positively to due diligence laws, can we expect – more generally – a positive welfare and environmental effect from the introduction of these laws? Unfortunately, the answer is so far not very clear. Our review of the available literature hints at a

worrying possibility. Regulation frequently results in buyers and their suppliers acting in ways which counteract the purpose of the legislation. A case in point is the recent study by Abman et al (2023). Applying data from 101 developing countries (harmonised survey microdata), they examine Regional Trade Agreements to arrive at their empirical predictions. Imposing a ban on child labour had the unintended effect of *increasing* underage workers (14-17-year-olds) and decreasing school enrolment for children. In other words, the regulation attempting to ban the practice of child labour worked in a counter-productive way.

Industry characteristics

In addition to the aspects mentioned so far, the specifics of the industries also play a role. It is well known that certain industries are more vulnerable to human rights violations or environmental pollution than others. For instance, labour-intensive industries like agriculture, textiles or mining are particularly prone to worker rights abuses or slavery. These industry-specific issues are captured by many industry-specific standards and supporting measures.

To illustrate the most vulnerable industries from the perspective of the EU, we combine trade data with a measure of sustainability. First, we rely on trade data by firm size from Eurostat³ and calculate the import share by industries and firm size categories (less than 10 employees, 10-49 employees, 50-249 employees and more than 250 employees). Second, to assess industries' vulnerability, we utilise the Environmental, Social, and Governance (ESG) scores provided by the Refinitiv ESG database⁴. The Refinitiv ESG score comprises ten components. This score is assigned on a numerical scale ranging from 0 (poor performance) to 100 (good performance). It is derived from various sources, such as publicly available information, company disclosures, media reports, stock exchange filings, and non-governmental organization (NGO) websites (Refinitiv, 2021). While it is acknowledged that utilising ESG data may not be ideal due to the lack of standardisation and moderate correlations between scores from different providers, it remains the most feasible approach to measure corporate human rights performance across a significant number of companies. Various studies have indicated that, despite the limitations, using data from large index providers is the most reliable method currently available for assessing corporate human rights performance on a broad scale (Lafarre and Rombouts, 2022). For this study, we take averages of the ESG scores by industries and regions (Europe and non-Europe).

Table 2 presents the results of this exercise. Overall, it illustrates that larger firms – those with more than 250 employees – account for the majority of imports from non-EU countries (panel A) across all industries. However, SMEs account for a considerable share of imports in selected industries: the primary industries of agriculture, forestry, and fisheries, as well as the manufacturing industries of textiles, wearing apparel, wood, rubber and plastic products, non-metallic mineral products and fabricated metal products. For instance, 20.6 % of imports from non-EU countries in the agricultural, forestry, and fishery industry are attributable to European firms with less than 10 employees. This picture is even stronger for intra-EU trade, where the smallest firms account for 44.9 % of imports in the agricultural, forestry, and fishery industry. As expected, the average ESG scores are overall higher within the EU compared to non-EU countries. For non-EU countries, the median ESG score is 43.2, for EU member states it is 54.5. For some industries, on which SMEs' imports depend relatively strongly, the ESG score is lower than the median score, like in agriculture, forestry, and fishery, wearing apparel, or fabricated metal products. For other industries, the measure for sustainability is above the median, like in the textile industry. Overall, this highlights the heterogeneity of import dependence among firms of different sizes and the resulting differences in vulnerability to social and environmental risks.

³ Statistics on trade by NACE Rev. 2 activity and enterprise size class, EXT_TEC01, are provided by Eurostat. Last accessed 2 June 2023, <https://ec.europa.eu/eurostat/web/international-trade-in-goods/database>.

⁴ Last accessed 10 November 2022.

Table 2: ESG scores and imports shares (%) of the EU by firm size, industry and geographic region

Industry	Panel A: Extra EU					Panel B: Intra EU				
	<10	10-49	50-249	>250	ESG	<10	10-49	50-249	>250	ESG
Agriculture, forestry and fishing	20.6	19.7	22.9	25.7	37.63	44.9	28.2	17.7	11.7	40.22
Mining and quarrying	0.3	5.7	7.0	88.5	39.90	3.8	9.2	22.4	48.0	50.02
Manufacture of food products	3.3	10.1	32.1	53.8	43.10	2.6	10.0	28.0	57.1	58.50
Manufacture of beverages	1.2	8.8	16.1	47.1	43.09	1.6	5.2	16.5	78.6	58.06
Manufacture of tobacco products	0.2	0.8	8.5	85.4	57.36	3.8	0.7	2.7	79.2	73.00
Manufacture of textiles	7.5	24.4	31.1	21.1	46.76	5.8	17.0	32.8	29.5	42.89
Manufacture of wearing apparel	5.8	16.9	27.7	46.0	43.14	7.9	17.9	33.3	35.8	58.48
Manufacture of wood	9.1	25.1	28.6	28.8	47.99	8.2	18.4	29.0	31.7	36.24
Manufacture of paper and paper products	2.8	7.0	26.3	60.9	47.13	2.7	8.5	32.9	62.0	59.65
Manufacture of coke and refined petroleum products	0.1	0.3	3.0	73.9	49.36	1.1	0.8	2.9	71.5	60.54
Manufacture of chemicals and chemical products	1.4	5.4	17.7	73.9	39.88	2.6	8.0	27.6	60.9	54.13
Manufacture of basic pharmaceutical products	0.6	0.9	6.4	81.5	39.88	1.4	1.1	8.6	80.9	54.13
Manufacture of rubber and plastic products	2.4	9.8	27.5	58.2	46.16	2.0	10.2	34.3	51.7	51.75
Manufacture of other non-metallic mineral products	3.5	10.8	25.3	55.4	48.30	3.5	9.3	28.4	53.3	60.66
Manufacture of basic metals	2.1	4.7	17.3	75.6	46.17	1.3	3.8	24.5	73.6	61.18
Manufacture of fabricated metal products	3.6	13.8	30.1	37.6	42.56	3.7	15.2	32.0	39.2	59.19
Manufacture of computer, electronic and optical products	2.2	3.3	12.9	75.9	47.76	2.9	4.6	17.6	68.8	42.30
Manufacture of electrical equipment	1.9	4.9	13.0	78.0	43.13	1.6	3.9	16.1	75.2	47.98
Manufacture of machinery and equipment n.e.c.	1.7	4.9	14.2	73.2	34.31	2.0	6.0	16.1	67.1	54.48
Manufacture of motor vehicles	0.4	0.7	3.3	94.8	44.81	0.4	0.6	3.1	94.3	55.81
Manufacture of other transport equipment	0.9	2.0	12.3	83.0	44.50	1.4	2.5	7.2	84.8	58.68
Other manufacturing	5.3	10.1	23.7	58.0	45.52	4.9	7.6	24.1	58.5	45.77
Repair and installation of machinery and equipment	3.1	14.1	20.2	54.7	22.13	11.1	15.3	24.8	39.8	59.38
Construction	31.5	21.4	21.0	22.7	42.69	30.9	26.7	17.4	25.4	53.75
Wholesale and retail trade	17.3	23.9	25.1	32.6	41.9	17.3	20.9	23.5	34.8	49.93
Total	10.1	13.9	20.0	55.5		11.7	14.8	21.5	51.0	

Note: Share of imports by firm size, industry and partner region over total imports per industry and partner region. Import data refer to year 2020.

Source: Authors' calculation based on Eurostat (2023) – Trade by partner country and enterprise size class, EXT_TEC01, and Refinitiv ESG scores (Refinitiv, 2021) following Lay et al. (2021).

3 Analysis of EU due diligence legislation relevant for SMEs

3.1 Interview methods

In this study, we opted for a qualitative approach as an overarching methodology to better understand and differentiate the views of SMEs, by using expert interviews as a means to gather information. Expert knowledge comprises unique and exclusive integrated knowledge and is frequently tied to a profession (Döringer, 2021; Meuser & Nagel, 2010). Our research approach can be considered inductive and explorative, meaning that this study aims to find patterns through specific observations since there is yet limited existing research on the perspectives of SMEs towards the new German supply chain act.

A multi-case study approach was applied as a research design. Case studies are detailed analyses of one or more units that enable a thorough comprehension of the context (Merriam & Tisdell, 2015; Yin, 2018). Since we aimed to compare several perspectives to find overarching themes, we opted for a multi-case study, following Miles, Huberman, and Saldaña (2014), who point out that a larger number of cases offer more convincing interpretations: "By looking at a range of similar and contrasting cases, we can understand a single-case finding, grounding it by specifying how and where and, if possible, why it carries on as it does. We can strengthen the precision, the validity, and the stability of the findings" (p. 29). In this study, three main cases could be differentiated: Business associations located in Germany, business associations located in sourcing countries, and politicians and agencies to support countries to understand legal requirements. These three cases entailed multiple interviewees, so called with-in cases, who represent single entities, yet could be expected to share common traits within their groups.

In this study we applied non-random sampling or non-probability sampling, implying that cases were not drawn arbitrarily. This approach is frequently used in qualitative research (Merriam & Tisdell, 2015). Specifically, this study made use of purposive sampling, which requires specific inclusion criteria based on the researcher's expertise. Subsequently, the chosen sample should be the most appropriate in line with the research purpose (Merriam & Tisdell, 2015). Due to the limited number of interviewees and non-random sampling procedures under a specific background, solely analytical generalisations can be drawn.

The criteria for interviewees' inclusion included:

1. The interviewee needs to have a good understanding of the sourcing decisions of German companies and in particular SMEs.
2. The interviewee should understand the third-country perspective in the sourcing country.
3. The interviewees should be diversified in terms of region.
4. The interviewees should be diversified in terms of sectors.
5. The interviewees should not follow the interest of single companies and rather have a general view on issues related to due diligence.

First, interviewees meeting the criteria above were collected independently by the research team based on their own expertise and additional desk research. Second, the research team discussed the eligibility of possible interview partners. Third, the interview partners were contacted with a standardised e-mail. The e-mail included short information about the research team and the mission of the study. Ultimately, 11 interviews have been conducted. Due to the sensitivity of the topic for some interviewees as well as to create a favourable atmosphere for getting detailed information on the constraints and benefits for SMEs, we are not revealing the respective interviewees. What is assured is that the interviewees represent different sectors and world regions as well as provide a national perspective from the governmental point of view on the challenges related to fulfilling the German legal requirements.

An interview guide with questions was formulated beforehand, which involved a thorough pre-analysis of the respective literature, and constituted the more structured section of the interview, while follow-up questions were posed flexibly in correspondence with the interview progress, following a semi-structured interview approach (Kallio et al., 2016; Merriam & Tisdell, 2015). A draft of the interview guide was sent to the study participants before the interview (please see the interview guide in the appendix).

The interviews were realised in May 2023 and June 2023 via the videoconferencing software Microsoft Teams and were recorded as agreed upon by the participants. Also using Microsoft Teams, the interview transcripts were prepared while conducting the interviews using the speech-to-text transcription function of Microsoft Teams. The interviews were carried out by the research team together and in most cases with a single interviewee. The approximate duration was one hour. Even though the interviews were recorded and transcribed, notes were taken simultaneously to capture highlights. The transcripts were subsequently coded and analysed, using the qualitative content analysis approach, as described by Kuckartz (2018). In particular, the textual, content-related and structural sub-form was chosen, which allows for a systematic description and topic-wise resumptive and compressing analysis of the interviews and is commonly referred to as thematic analysis outside of Europe (Kuckartz, 2019). This method was chosen as it appeared to be most promising for coming up with overarching themes leading to applied conclusions.

3.2 Practical implications for SMEs

The interviews discussed in this section all refer to experiences with the German supply chain act. The German supply chain act aims to ensure compliance with fundamental human rights and key environmental standards (BMZ, 2023). The law applies to companies with more than 3 000 employees as of 2023 and to companies with more than 1 000 employees as of 2024. Branches of foreign companies in Germany are also included if the company has more than 3 000 employees (2023) or 1 000 employees (2024). The requirements differ depending on the nature and scope of the business activity, the company's power of influence, the anticipated risk of non-compliance of foreign suppliers with the act, and the type of perpetrator contribution. With direct suppliers and in their own business area, companies are obliged to adopt a policy on respecting human rights, carry out risk analyses, take preventive and remedial measures and act transparently.

The interviews provide insights into the practical challenges and chances of the German supply chain act, which serves as an example for the EU due diligence regulations although the latter differs in several aspects. The expert interviews reveal several practical implications for companies in general and SMEs in particular. The results from the interviews are presented by overarching themes. For each of the themes, we first describe the answers from the interviews referring to the German case, embed these findings in the literature outlined in Chapter 2.2 and then discuss implications for the EU CS3D where applicable.

We start the discussion of the key results of the expert interviews by highlighting potential opportunities created by the legislation mentioned by interviewees.

3.2.1 Opportunities

Whether the supply chain act is perceived as an opportunity depends on the corporate culture, existing resources, and type of supply chain. These factors play a decisive role in shaping a company's response to the regulation. A company's corporate culture and resources serve as the foundation for successfully adapting to new regulations. If sustainability and responsible practices are already ingrained in a company's business model, the supply chain act is seen as an opportunity rather than a burden. Such companies are more likely to embrace the regulation, as it aligns with their existing values and strategies, and they can leverage their established resources to comply with the requirements effectively. As another opportunity interviewees mentioned that by incorporating sustainability into their corporate culture and business model, companies not only enhance their chances of complying with the supply chain law but

also strengthen their brand, attract new customers, and potentially achieve cost savings through improved efficiency and resource utilisation.

Over the last years, supplier development has evolved beyond monetary aspects to include sustainability considerations. Supplier development is no longer solely driven by financial factors but has expanded to include sustainability considerations. This shift is observed across sectors like chemicals, textiles, and mechanical engineering, emphasising the cross-sectoral nature of the change. The rethinking of supply chain management practices simplifies the implementation of a regulation such as the supply chain act.

For suppliers in developing countries, the implementation is easier when operating in sectors that are traditionally subject to standards, like the agricultural sector in which the EU has set strict sanitary and phytosanitary standards to protect consumers. Local suppliers in the agricultural sector have experience in implementing various requirements via labels, such as Fairtrade, dictated by external buyers. The introduction of a supply chain act may be new in form, but the local suppliers' familiarity with adapting to sustainability requirements gives them an advantage. Their ability to provide information and implement local solutions adds further value. For example, local communities can find innovative solutions to address issues like child labour even without significant funding. For instance, forming cooperatives, involving village elders in child supervision, and establishing libraries can be effective measures.

Capturing and understanding supply chains is important to better manage disruptions and risks.

When companies take the time to thoroughly capture and familiarise themselves with their supply chain, they are better equipped to handle any disruptions that may arise. By gaining a comprehensive understanding of their suppliers, companies can proactively identify potential risks, establish alternative sourcing options, and develop contingency plans. This knowledge enables them to respond swiftly and effectively to any disruptions, minimising their impact on the overall supply chain. Moreover, a deep understanding of suppliers allows companies to build stronger relationships and establish trust, fostering better collaboration and communication. This, in turn, enhances the company's ability to balance and mitigate supply chain disruptions more efficiently. Overall, by capturing and knowing their supply chains, companies can navigate any disruptions more effectively, maintain operational continuity, and ensure a more resilient and robust supply chain.

The supply chain act can help certain companies to develop new consumer groups. The supply chain act presents opportunities for companies to expand their customer base by catering to the growing demand for sustainable and ethically sourced products. This is particularly true for those companies that directly interact with final customers who are more downstream in the supply chain. Those companies have greater responsibility and incentive to ensure ethical and sustainable practices throughout the supply chain. Further, it depends on whether companies can pass on the higher costs associated with compliance to consumers without adversely affecting demand (demand elasticity).

The supply chain act has indirect advantages. Companies that comply with the supply chain act may enjoy indirect benefits, such as being invited to participate in ministerial trips or events. These opportunities can create business opportunities and enhance a company's reputation and visibility. Further, compliance facilitates participation in public procurement.

The implementation of a supply chain act at the EU level can create a level playing field. It ensures that all companies operating within the EU adhere to similar standards, thereby promoting fair competition. Especially companies with an established culture of dealing with sustainability-related topics see opportunities to improve competitiveness because other companies have to improve the monitoring of social and environmental standards, which requires financial and personal effort. Regarding general impacts on competitiveness of European firms, some interviewees mentioned the fear that European firms are put at a disadvantage particularly vis-à-vis countries like the US. If firms from third-party countries are able to serve the EU market with regard to fulfilling quality standards, they are also able to serve the US

market and might be tempted to withdraw from the EU market if requirements are becoming too complicated.

New opportunities to enter supply chains emerge. The supply chain act provides an opportunity for companies, countries and regions that were previously excluded or overlooked to enter the supply chain. This can foster diversity and inclusion within supply networks.

Positive impacts in production countries. All respondents indicated that German businesses should respect human rights and avoid environmental distortion. Accordingly, they hope the law would bring improvements. So far, however, the effects on environmental and social standards along the value chain are still unclear.

The opportunities mentioned during the interviews are also reflected in the literature. Several studies highlight the advantages of new due diligence regulations for SMEs, including improved reputation and employer branding, enhanced competitiveness, access to big enterprises and public procurement contracts, long-term cost savings, and access to finance (von Weltzien and Shankar, 2011; Sen and Cowley, 2013; Giacomelli, 2022).

3.2.2 Challenges

Uncertainty regarding the legal requirements is seen as the most important obstacle. Huge uncertainty exists concerning the legal requirements of the German supply chain act. For many companies, it is not clear what they are obliged to do to be regarded as compliant. Uncertainty exists regarding how risk analysis should be conducted, and there are questions about the suitability of the law's implementation for small and medium-sized enterprises. Standards and questionnaires from larger buyers often reach SMEs, potentially leading to exclusion if they cannot guarantee compliance.

This led to buyer companies applying the same questionnaires to all suppliers regardless of location or industry, which is seen as independent of UN guidelines that emphasise risk-based and appropriateness principles. This approach raises concerns about the lack of risk prioritisation and alignment with international standards, indicating a need for greater clarity and a more nuanced implementation strategy. This poses challenges for suppliers who may be unfamiliar with such detailed requirements.

In the case of Germany, part of the uncertainty can be explained by the relatively recent implementation along with the prospect of fines. So far, no good or bad practices exist that could serve as examples. Good examples would be information about companies which passed the assessment by the supervisory authority, in the German case the Federal Office for Economic Affairs and Export Control (BAFA). However, also information about bad practices would help companies because it reveals red lines and respective consequences. The possible consequences are perceived as rigorous. However, the de facto implementation remains vague.

The extent of the bureaucratic burden depends on the companies' size but also on the industry and supply chain organisation. Amidst ongoing crises, such as skilled labour shortages, economic worries, energy price fluctuations, and disrupted supply chains, the supply chain law adds an extra layer of complexity. Companies aspire to uphold an honourable merchant status by respecting human rights and avoiding negative reputational impacts. However, there are worries about the potential burden of excessive bureaucracy and the simultaneous introduction of additional regulations, causing concerns about the practicality and feasibility of complying with the supply chain law. For example, the textile industry already faces sustainability requirements imposed by the EU, leading to resistance towards additional requirements imposed by the supply chain law. Although it is generally seen as an advantage if standards already exist because companies have already addressed issues of sustainability and incorporated them in their business model, additional regulations are viewed critically. Market power imbalances and increased documentation requirements compared to other certifications or seals can

result in a loss of confidence in suppliers and an added bureaucratic burden. The many different regulations, like the supply chain act, the EU deforestation-free supply chain act and the like create uncertainty as it is unclear how they interact. The fact that SMEs are not directly covered by the act makes little difference. As suppliers to directly affected companies, SMEs are often indirectly affected.

Compliance with the supply chain law may require additional financial and personal resources, potentially diverting attention from other important tasks within a company. Whether companies have the human resources to employ staff for managing the requirements from the supply chain act crucially depends on the companies' size. Only large companies have the capacity of in-house compliance departments or sustainability managers. In SMEs, these tasks are usually taken over by existing employees. Depending on the industry and position in supply chains, it is often the management or those responsible for customs and export issues, sales, purchasing, or human resources (HR). For example, if a company buys a lot of products and has a rather small location and is only in Germany, then the topic is also more likely to be in the purchasing department; for companies that provide services in Germany, it is then also more likely to be in the HR department.

Overloading of the supervisory authority. There are concerns about the capacity of the supervisory authority to effectively implement the supply chain act because it is perceived as being already overloaded with tasks such as export controls. Accordingly, the responsible institution mandated to control the observance of the supply chain act needs to have sufficient capacity to meet new related tasks while not delaying other tasks.

Actors in the partner countries often lack awareness of the supply chain act and related planned regulations at the EU-level. The supply chain act and its implications are generally unknown or seen as burdensome by many suppliers. It was emphasised that suppliers outside of Europe prefer focusing on delivering products and receiving payment rather than engaging in additional compliance work.

The differences between large companies and SMEs in implementing corporate responsibility are also reflected in the literature. SMEs face disadvantages, such as higher costs and limited capabilities to meet standards (Carrigan et al., 2017; Álvarez Jaramillo, Sossa and Orozco Mendoza, 2019; Sfakianaki, 2020). They often lack the resources and expertise to handle regulations (Álvarez Jaramillo, Sossa, and Orozco Mendoza, 2019), struggle with the financial burden of new regulations (Carrigan et al., 2017), and face challenges in maintaining supply chain visibility (Carrigan et al., 2017). The example from the German supply chain act illustrates that the exclusion of SMEs does not necessarily protect SMEs because they can indirectly be affected, above all as suppliers for firms covered by the supply chain act. The anchoring of support offers for SMEs, as presented in the current CS3D proposals, appears to be meaningful here.

3.2.3 Buyer-supplier relationship

There is a risk of pass through of costs of compliance from larger buyer companies to suppliers/SMEs. This risk depends on the clarity of duties. Overcompliance by large companies due to uncertainty about what "compliance" really means may lead to unrealistic and excessive requests passed on to suppliers. Further, the extent to which costs of compliance are passed on along the supply chain depends on market power, the business model and the position in the supply chain. For instance, if an industry is characterised by a few large buyers and many intermediate SMEs, it is more likely that requirements are passed on along the supply chain. A highly specialised SME supplier has more bargaining power than a supplier producing relatively easy-to-substitute components. SMEs in mid-level supply chain positions that source from many different countries, and especially from developing countries, face greater challenges in assessing their suppliers' requirements than SMEs that source primarily from Europe.

The cooperation with direct suppliers works relatively well (supplier training and development) but not necessarily further along the supply chain. The impact of supply chain regulations depends on whether the supplier is located within or outside the EU. Suppliers outside the EU appear to have limited

knowledge about these regulations. Local partners are also poorly involved in the process. However, suppliers in industries with existing high standards, such as agriculture, demonstrate awareness of the regulations. Effective communication is essential to bridge the information gap and ensure compliance. Standardisation of requirements is crucial, emphasising the need for consistent guidelines rather than buyer-specific standards. While companies have evaluation mechanisms in place to assess suppliers, primarily for quality management purposes, there is a lack of substantial support concerning compliance requirements. Although answers can be obtained when questions are asked, concrete support in this regard is not readily available.

In the realm of SMEs, maintaining strong relationships with buyers often takes precedence over meticulous examination of agreements. Due to limited resources and time constraints, SMEs sometimes find themselves signing contracts "blindly" to avoid damaging these critical connections. As a result, the dominance of business relationships can inadvertently expose businesses to increased levels of risk. However, in situations where potential consequences are not readily foreseeable, SMEs may be more inclined to accept established codes of conduct as a safeguard against unexpected pitfalls. This delicate balance between maintaining relationships and mitigating business risk highlights the challenges faced by SMEs in navigating complex contractual landscapes.

So far, termination of business relationships is perceived as unlikely; however, the risk is expected to increase. Buyer-supplier relationships are often long-term and built on trust, making it unlikely for buyers to switch suppliers easily. The decision to continue the relationship depends on market power and the structure of the supply chain. For example, a large supplier with market power from a non-EU country may choose not to sell to a SME from the EU if the quantities purchased are small and the reporting burden is seen as too high.

From the perspective of German companies operating in countries known to be prone to human rights violations or weak institutions, there is a trade-off between investing in supplier relationships or exiting specific markets. Often, this decision is based on a regional or country risk assessment rather than dealing with individual suppliers, highlighting the disadvantages of country risk assessment and the consideration of substitutability.

From the perspective of local suppliers, there is a trade-off between exporting to other markets or dealing with an additional bureaucratic burden to continue exporting to Europe. Suppliers that can fulfil the standards of both, the US and the European market, can choose which market to supply. Suppliers in industries that primarily export to Europe may be more willing to meet the required standards. Agricultural exports to the EU are a case in point.

Overall, in long-term relationships, the presence of trust acts as a mitigating factor, reducing the likelihood of abrupt breakdowns.

The challenges raised by the interview partners for the case of the German supply chain act mirror findings from the literature. While in surveys some firms express intentions to leave markets with weak governance, the overall impact, so far, has been limited due to the costs of supplier switching and the stickiness of buyer-supplier relationships. The likelihood of switching suppliers depends on factors such as industry, substitutability, and the presence of long-term relationships in developing countries. Further, the fear of burden shifting is documented for the NFRD (European Commission, 2021). In the case of the CS3D proposal under discussion at the EU level, the European Parliament's amendments aim at avoiding the possible negative effects mentioned during the expert interviews. As stated, for instance, in Amendment 46, contractual provisions should not shift the responsibility and liability for conducting due diligence, and they should be fair, reasonable, and non-discriminatory, reflecting the joint tasks of the parties involved. Companies should take appropriate measures to prevent or mitigate adverse impacts and consider

investments and support, such as financing and collaboration with SMEs, to help implement codes of conduct or prevention action plans⁵.

3.2.4 Cooperation with partner countries

It seems that only a few trading partner governments and local business partners know about the supply chain act. Some respondents claimed that the neglect to involve political actors, such as representatives of Ministries or ambassadors, as a diplomatic duty, has led to missed opportunities and a lack of information dissemination in the partner countries. Efforts by the political actors to raise awareness of the supply chain act are perceived as insufficient as a means of reaching local business partners. Some interviewees criticized that it is left to companies to pass on information about the supply chain act and that the extent to which support for companies is offered depends on the country and industry structure as a focal point like the helpdesk does not exist in many partner countries. One measure for bridging the gap between German companies and companies in developing countries was highlighted during the interviews: So-called 'business scouts' implemented at the interface between the private sector and development cooperation. Outside Germany, business scouts are either integrated into the German Chambers of Commerce Abroad, Delegations of German Industry and Commerce or German development cooperation offices. These state-sponsored multipliers facilitate access to information on doing business with German companies and, for instance, provide training or webinars on topics like the supply chain act.

If Germany and the EU are not perceived as major trading partners, they are not prioritised by partner country governments. Even if there were attempts to include the local government as a stakeholder in information events, there is a risk of lack of interest, particularly if there are divergent interests. For some industries, there are positive examples of information sharing before the supply chain act came into force. These are industries with traditionally high standards and experience in cooperation with NGOs and local actors. The limited market power of SMEs and the importance of their position in supply chains emphasises the need for collaboration with local partners rather than individual enforcement of sustainability.

In their policy report, Felbermayr et al. (2022) criticised the lack of coordination with governments in supplier countries. In the case of the German supply chain act, they argue that this regulation reflects political preferences in developed countries and makes labour in supplier countries more expensive. This not only worsens employment and skills problems but also has a protectionist effect, increasing production costs and reducing the real income of local consumers. Some scholars argue that the Western-style CSR agenda is not only protectionist but also a form of cultural imperialism (Khan & Lund-Thomsen, 2011). Concerning the introduction of an EU-wide regulation, the involvement of all European embassies and stakeholders in supplier countries, like business representatives, would be desirable. Also, from a geo-economic point of view, it is important that emerging and developing countries are involved in the discussion about the standards that apply in their countries and that they are proactively informed and involved from the European side. Given the importance of strengthening the cooperation with partner countries, the focus of the proposed CS3D on communication with partner countries is a very important step.

3.2.5 Cooperation within the European Union

There is uncertainty as to whether the European Directive will lead to harmonisation within the EU.

The majority of respondents stated that they would prefer harmonised standards within the European Union and that this would be crucial for the competitiveness of European companies. However, they fear that the implementation by EU governments will lead to different standards. They point to different firm

⁵ For an overview of the Amendments adopted by the European Parliament on 1 June 2023 on the proposal for a directive of the European Parliament and of the Council on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937 (COM(2022)0071 – C9-0050/2022 – 2022/0051(COD)), see https://www.europarl.europa.eu/doceo/document/TA-9-2023-0209_EN.html.

structures in the EU, with SMEs featuring prominently in some member states but not in others. The implementation of a European helpdesk is appreciated.

Some respondents claimed a lack of a “European voice” in the partner countries. They see coordination with diplomatic representations and European business representatives abroad as crucial. The perceived lack of coordination does not hold for all countries and contexts. Still, the outreach efforts by the EU in collaboration with Member States and business representatives appear to be an important element of due diligence legislation.

4 Fixing shortcomings

In this chapter, we first discuss the extent to which the current framework may not fully account for the unique characteristics and needs of SMEs. In so doing, we draw on the interviews and the literature presented in the previous chapters. Second, we discuss existing SME supporting tools and best practices highlighted during the expert interviews for the German case and discuss the applicability of existing or proposed supporting tools at the EU-level. It should be noted that the amendments to the European Commission’s CS3D proposal adopted by the European Parliament on 1 June 2023 already addresses several issues related to SMEs and potential adverse effects on SMEs.

Based on the findings of the previous chapters, the areas most relevant for SMEs can be summarised as follows:

Addressing regulatory challenges for SME suppliers outside the EU requires transparency, communication, access to information, and integrating local knowledge through regular reviews and a feedback mechanism. Suppliers located outside the EU often face challenges in anticipating new or additional regulations due to a lack of transparency and communication. There is often a dearth of centralised or local information platforms that provide comprehensive and up-to-date regulatory information. This lack of access to relevant information can put these SMEs at a disadvantage when it comes to compliance and adapting to changing requirements. Moreover, regional markets have their own distinct priorities, emergencies, and shortcomings. For instance, some countries may be grappling with issues related to child labour, while others might have different concerns. Such differences can be observable between different world regions as well as between countries within the same region. The respective markets cannot be simply compared, highlighting the need to consider the idiosyncrasies and specific context of each country. It is crucial to recognise and understand the unique challenges and circumstances present in each location, leveraging local knowledge to inform policy and decision-making processes. To address these complexities, it becomes essential to integrate local idiosyncrasies into legislation, perhaps through the establishment of a feedback mechanism. This feedback mechanism would allow for the systematic and periodic review of regulations, considering the experiences, perspectives, and insights of SMEs and other stakeholders operating in diverse regions. By incorporating this local knowledge and feedback, policymakers can refine and adapt regulations to better align with the realities and needs of different markets. Regular reviews and feedback mechanisms ensure that regulations remain relevant, effective, and responsive to changing circumstances. They provide an avenue for stakeholders to voice their concerns, suggest improvements, and share valuable insights gathered from on-the-ground experiences. This iterative approach allows for continuous learning, adjustment, and improvement of regulatory frameworks, enhancing their overall effectiveness and minimising unintended consequences. In summary, addressing the challenges faced by SME suppliers outside the EU requires improved transparency, communication, and access to information. Recognising the unique priorities and circumstances of regional markets, along with integrating local knowledge into legislation, can lead to more tailored and effective regulatory frameworks. Regular and systematic reviews, supported by a feedback mechanism, enable ongoing improvements and ensure that regulations remain relevant and responsive in an ever-evolving global landscape.

Even if SMEs are not directly obligated to comply with certain reporting requirements, they may still face pressure from extensive reporting requirements. The first experiences with the German supply chain act demonstrate that excluding SMEs does not necessarily protect them, as they can still be indirectly affected, particularly as suppliers to firms covered by the supply chain act. Therefore, it seems sensible to incorporate support measures specifically tailored to SMEs, as outlined in the current CS3D proposals. From the first experiences with the German act, the collaboration with direct suppliers is relatively effective, with training and development programs in place. However, this effectiveness may not extend further along the supply chain. The impact of supply chain regulations varies depending on whether the supplier is located within or outside the EU. Suppliers outside the EU seem to have limited knowledge about these regulations, and local partners are not adequately involved in the process. However, suppliers in industries with existing high standards, such as agriculture, demonstrate awareness of the regulations. What we learn from this first evaluation is that firms indirectly impacted by the CS3D need targeted support.

Enforcement along supply chains is difficult and requires anchoring in the local industry and country context. The current proposals for the CS3D initiative recognise the issue of burden shifting from large buyers to SMEs and offer recommendations on how buyers can support their suppliers, especially SMEs, in meeting compliance requirements. However, enforcing due diligence agreements between lead firms and suppliers in global supply chains proves to be a challenging task. Even legally binding contracts have shown limitations in ensuring adherence to labour and environmental standards throughout value chains. This highlights the complexities involved in enforcing standards on global suppliers. The implementation of codes of conduct that carry legal obligations is a multifaceted process, and incomplete contracts between firms and suppliers often lead to reduced corporate social responsibility investments by upstream firms. SMEs face unique challenges in this regard, as they lack the leverage to compel their suppliers in developing countries to align with CSR requirements.

SMEs would benefit from simplified reporting requirements. To effectively address the challenge of extensive reporting requirements faced by SMEs and firms indirectly affected by regulations, it is crucial to establish a simplified framework for reporting as is already envisaged in the CS3D. This framework should aim to eliminate duplications and redundancies, ensuring that businesses are not burdened with unnecessary reporting obligations. By streamlining the reporting process, SMEs can allocate their limited resources more efficiently, focusing on their core operations and strategic growth. One approach to achieving harmonisation is to leverage existing reporting standards as a foundation as proposed in the CS3D. These standards, which may already be in place for financial reporting or other regulatory purposes, provide a solid starting point. Incremental additions of specific standards relevant to the regulatory requirements can then be made, considering the unique characteristics of the industry or sector involved. This incremental approach allows for the integration of additional reporting elements without overwhelming businesses with a sudden and complex reporting overhaul. Promoting overall transparency in reporting is essential not only for regulatory compliance but also for enhancing access to finance. Transparent and accurate reporting practices build trust and confidence among potential investors and lenders. When businesses demonstrate a commitment to transparency by providing comprehensive and reliable information, it becomes easier for financial institutions to assess their creditworthiness and evaluate the potential risks and returns of investments. This increased transparency can open doors to funding opportunities, loans, and partnerships that contribute to the growth and sustainability of SMEs. Moreover, harmonising reporting requirements and promoting transparency have broader benefits beyond access to finance. It enables stakeholders, including consumers, employees, and regulatory bodies, to gain a clearer understanding of a company's operations, performance, and adherence to regulations. This transparency fosters accountability and encourages responsible business practices, leading to improved overall governance and sustainability. To ensure effective implementation of harmonised reporting requirements, regular monitoring and review processes should be established. These processes can help identify any gaps, ambiguities, or evolving needs in reporting standards, allowing for timely

updates and adjustments. Additionally, providing guidance and support to SMEs and firms on reporting best practices, such as through training programs or resource centres, can further facilitate compliance and enhance reporting quality. In conclusion, harmonising reporting requirements, considering existing standards as a starting point, and incrementally adding relevant standards can streamline the reporting process and alleviate the burden on SMEs. By promoting transparency in reporting, businesses can enhance their access to finance, foster trust, and accountability, and contribute to sustainable business practices. Regular monitoring and support mechanisms should be in place to ensure the effectiveness and continuous improvement of reporting frameworks.

Concrete examples and timely feedback foster regulatory compliance. In a context characterised by high uncertainty surrounding regulatory requirements, it becomes imperative to provide concrete examples of best practices. These examples serve as practical guidelines and reference points for businesses, especially small firms that may have limited access to legal resources. By offering clear and specific illustrations of how to meet the regulatory standards, these examples help bridge the gap between legal requirements and their implementation on the ground. Small firms often face challenges in understanding and complying with complex regulations due to their resource limitations. By presenting best practices in a clear and accessible manner, supervisory authorities and industry experts can empower small firms to navigate the compliance process more effectively. This can enhance their ability to meet legal obligations and contribute to a more sustainable and responsible business environment. Furthermore, the need for speed in delivering judgments and assessments is crucial. When firms receive timely feedback from regulators regarding their compliance status, it creates a sense of certainty and enables prompt corrective actions, if necessary. Swift and efficient assessment processes allow businesses to make informed decisions and adjust their practices accordingly, reducing the potential risks of non-compliance and associated penalties. The availability of concrete examples and expedited feedback mechanisms also serve as incentives for firms to comply with regulations. When businesses observe that regulatory processes are streamlined and feedback is provided in a timely manner, it creates confidence and motivates them to actively engage in compliance efforts. The prospect of receiving prompt validation or guidance from regulators can create a positive compliance culture, encouraging firms to proactively address any deficiencies and align their operations with the regulatory framework.

Demand for support

For the German case, the expert interviews revealed several supporting tools that companies find helpful or would welcome expanding. These supporting measures address the above raised shortcomings. In the following, we first present the results from the interviews and then discuss the applicability at the EU-level.

During the interviews, companies expressed concerns, particularly regarding the establishment of standards, uniform risk analysis methods, compliance achievement, and motivating suppliers for change, while also seeking advice on addressing customer expectations, contractual regulations, and making complaint procedures known throughout the supply chain. Several aspects were raised frequently, reflecting the concerns of companies grappling with supply chain issues. One common question was about the establishment of standards and a uniform method for conducting risk analysis. Companies sought clarity on the stages involved in this process and at what point a relationship with a supplier should be terminated. They also inquired about achieving compliance with appropriateness and effectiveness and sought guidance on the legal terms and requirements associated with substantiated knowledge. Furthermore, there was a keen interest in identifying risks within the deeper supply chain. Companies wanted to understand how to motivate suppliers to implement changes and how to effectively monitor and control their actions.

The interview partners also addressed the questions of indirectly affected companies, especially those with fewer than 1 000 employees. They sought advice on addressing customer expectations and understanding what obligated and non-obligated companies could regulate in their contracts. The mention of model

contract clauses highlighted the need for guidance on incorporating appropriate provisions. Additionally, there was a focus on the extent to which complaint procedures should be made known throughout the supply chain, particularly in the deeper tiers.

Three main areas of concern were raised. Firstly, the importance of cooperation within the value chain was highlighted, emphasising the collective responsibility of the companies involved. Secondly, companies sought clarification on the level of individual responsibility they needed to assume. Lastly, methodological issues pertaining to risk analysis and complaint procedures were discussed. A key question was how to ensure accessibility of information and make grievance procedures known to potentially affected parties at indirect suppliers.

An important point that emerged during the interviews was the desire of companies to determine their compliance status. It was emphasised that there is no official "stamp" indicating compliance, highlighting the complexity of the matter. Moreover, the distinction between free advice and legal advice was noted, underscoring the limits of informal guidance from official supporting agencies in addressing the legal aspects of supply chain compliance.

In Germany, the helpdesk for business and human rights provides companies with individual, confidential and free advice, which is considered very helpful by company representatives. The materials and information provided there are used as a basis for industry-specific consulting services. Only one interviewee had not yet heard of this service. In addition to individual consulting, the helpdesk offers online services such as the SME Compass and risk checks. Even though the advisory service by the helpdesk is perceived as very helpful, its mandate is limited to guide firms in dealing with the supply chain act. It has not the mandate for legally binding advice. Such a mandate might be in the interest of some companies; however, it would also require an extensive advisory body that would be able to provide legally binding checks for all companies.

Against the background of these findings, the proposals by the EU to set up helpdesks in all EU member countries appear promising⁶.

There is still room for improvement in the provision and standardisation of industry-specific support services. To support member companies, many company associations have developed standards that are processed and made available free of charge to members. In addition to this, many associations organise events aimed at providing information and disseminating guidelines related to supply chain compliance. They have also created checklists to assist companies in ensuring their adherence to the required standards. Recognising the importance of industry-specific guidance, many associations offer tailored advice to address the unique challenges faced by different industries. Furthermore, they have compiled comprehensive guides that include background information on the law, best practices, and practical step-by-step guides for implementation. Establishing a strong online presence is considered crucial, as it facilitates the sharing of best practices and enables an exchange of experiences among companies. The associations understand that transitioning from abstract concepts to concrete actions is a significant challenge, and they are committed to providing practical resources and fostering a collaborative environment for knowledge sharing.

The demand for information sharing and harmonisation is supported by findings from the literature. In their study, Carrigan et al. (2017) suggest several approaches to improve corporate responsibility implementation for SMEs, including price adjusted certification routes, harmonisation of industry standards, and the use of track and trace schemes for sensitive inputs in the high-value jewellery sector. Giacomelli (2022) proposes simplifying reporting requirements for SMEs by integrating them into existing financial-reporting platforms used by banks. This would reduce compliance efforts and avoid duplication. According to a

⁶ Refer to https://www.europarl.europa.eu/doceo/document/TA-9-2023-0209_EN.html.

Summary Report by the European Commission (2020) on the review of the NFRD, there is strong support from SMEs for simplified standards, with 74 % of surveyed companies supporting the development of simplified standards for SMEs, 27 % favouring mandatory standards, and 64 % supporting voluntary standards (European Commission, 2020).

Helpdesks are to be set up in the production countries to serve as contact points for German/European companies and for local companies serving the European market. In doing so, it is important to make use of existing local structures, establishing a partnership approach involving development cooperation actors, chambers, business representations and embassies. For example, development cooperation actors have experience with social and environmental standards but lack access to and trust in the local business community. In the German case, so called business scouts for development are deployed, who act as an interface between development cooperation and business. These mediators have a very good understanding of supplier development and challenges for local suppliers as well as for buyers of intermediary products. Accordingly, they are perceived as very useful in bridging the gap between local suppliers who are doing or willing to do business with German firms.

Concerning the introduction of an EU-wide regulation, the involvement and coordination of all European embassies and local business representations would be desirable. Analogous to the helpdesks in European countries, contact points in supplier countries could be powerful. Among other things, these contacts points could increase awareness for due diligence and the respective regulation, avoid a patchwork of different expectations and interpretations of the European regulation for local suppliers, help to reveal regional specific challenges in meeting the demands, improving the possibility to find solutions to avoid that regions will drop out of a value chain due to country risks, and organise workshops as well as round tables of stakeholders. The OECD National Contact Points for Responsible Business Conduct can serve as an example. These contact points are established by those governments adhering to the OECD Guidelines and, among other things, foster the promotion of the OECD Guidelines. As discussed above, establishing contact points like this in developing countries would be useful. So far, many initiatives to support local suppliers and buyers on due diligence related aspects exist. Such guidelines, online tools, advisory services, online courses and platforms are provided by institutions such as the International Trade Centre (ITC), the Organization for Economic Co-operation and Development (OECD), the International Labour Organization (ILO) or the Gesellschaft für Internationale Zusammenarbeit (GIZ), the implementing agency of the German development cooperation. The European Union can take leadership in coordinating different initiatives bridging the European perspective with the partner country's perspective.

The role of private consultancies and software solutions is unclear. So far, the market for software solutions and data seems to be confusing. In the interviews, the concern that private consultancies have a self-interest in blowing up problems was emphasised. There is software for almost every due diligence step and the private market actors make big promises that cannot be kept, e.g., the promise to ensure compliance with regulations. The use of software tools appears difficult as the required inputs differ although similar aspects are covered by different regulations. Often software solutions are expensive and not affordable to SMEs. Beyond the pessimistic view on consultancy and software solutions, there is a huge potential of software in facilitating access to information about social and environmental issues along the supply chain. However, it seems as if there is no concrete assisting tool for a wide usage of SMEs available yet or known.

Several databases are currently being developed to trace supply chains and facilitate data collection, reporting, and communication. They are provided by both private and public actors. Centrally collected data can be tailored to provide industry-, project or country-specific risk-based information to businesses. To illustrate, the U.S. Department of Labor's List of Goods Produced by Child or Forced Labour helps to guide businesses in identifying products with the highest probability of violating human welfare regulations. Analogously, the EU has produced its own indicative and non-exhaustive list of conflict-

affected and high-risk zones (conflict-affected and high-risk areas (CAHRAs), which is publicly available and regularly updated⁷. However, a word of caution is appropriate. Not all data is equally sound. The information which bases on aggregate lists, indices or other performance metrics – identifying countries as ethical or less ethical, are generally disappointing when it comes to drawing conclusions about the ethical activities of their firms (Felbermayr et al, 2022). To illustrate the shortcomings of these aggregate data, Felbermayr et al (2022) have pointed to substantial discrepancies between e.g., a country's official stance on worker welfare and the e.g., actual toleration of worker unionisation, by firms. Typically, such data relies – among other things – on a country's track-record in signing up to conventions such as the eight ILO core conventions regulating worker protection (ILO, 2023). Adoption of an ILO convention and ratifying the convention such that it becomes enshrined into the domestic laws of the signatory country appears only weakly predictive of on-the-ground practices of firms. As such, data relying on official, aggregate statistics (e.g., whether a country has signed up to the ILO conventions on unionisation of labour) has limited power in helping firms to decide whether suppliers operating in these jurisdictions will be subjected to the expected governmental checks and balances.

The alternative to using such published data is for a firm to collect its own data – i.e., by directly auditing its suppliers. And while larger firms may have this option, the high volumes purchased from suppliers justifying the effort and expense of scrutinising more closely the actions of these suppliers, smaller firms rarely have this option (Felbermayr et al, 2022). It follows, that if small firms cannot justify the expense of collecting their own data on suppliers, they might be more inclined to use official and freely available data. And while such published data – at face value – might appear insightful, the reality may fall short. Of course, compiling 'on-the-ground' data directly from suppliers is arguably the best option. Moreover, collecting supplier-specific data makes economic sense, if the costs incurred in collecting and disseminating these data can be offset by improved decision making in small firms vs their developing country suppliers. Finally, where the collection cost can be defrayed by widening the availability to numerous small firm users, there is a further economic case for proposing a more targeted data collection effort. Good data does not come cheap. But applying poor data as a criterion for picking and choosing among suppliers is worse than relying on no data at all. More tellingly, the use of such data can work against the aspirations of the CS3D, encouraging a wholesale withdrawal from trading with partner firms in these countries.

To facilitate access to already existing databases and digital tools, it could be helpful to bundle them on an official website provided by the EU.

5 Improving due diligence practices for SMEs within supply chains

Based on the findings in the previous chapters, we provide policy recommendations for the EU intending to help SMEs comply with future due diligence expectations from the companies they do business with as part of the implementation measures when the future CS3D rules are in place. In so doing, we distinguish between SMEs in the EU and their SME peers in third countries. We specifically zoom into the situation of suppliers in third countries because the underlying goal of due diligence legislation arguably is to improve social and environmental conditions in developing and emerging economies, which implies that the main burden of adjustment rests with firms in non-EU partner countries that currently operate with standards supposedly violating EU standards. The following set of recommendations can be derived from our analysis above and broadly reflects many aspects covered by the European Commission's proposal for the CS3D and the amendments adopted by the European Parliament on 1 June 2023.

⁷ See <https://www.cahraslist.net/>.

5.1 Targeted capacity building for developing-country suppliers

For the case of the German supply chain act, our interviews pointed to some of the channels that offer the most promise in terms of capacity building – or where the capacity-building activities of existing agents could be improved. One case in point are business scouts – state-sponsored agencies helping support the foreign direct investment or export activities of their domestic firms from within the foreign destination country, but also helping local suppliers comply with regulatory requirements. At the EU-level, establishing a similar system of multipliers working at the interface between European companies and companies in developing countries would be a promising option. Such an effort could build on existing structures and knowledge within the EU, for example involving the EU Chambers of Commerce and the European Development Fund. The EU chambers of Commerce have already gathered considerable expertise in private business partnerships, which they can leverage when it comes to ensuring the sustainability of supply chains. The EU is also already a key player in supporting local private sector development in developing-country partners (European Commission, 2023).

By hosting information events or workshops, business scouts can liaise with supplier firms, discuss regulatory compliance and – depending on their mandate – help to mediate frictions arising in the supplier-buyer relationship from implementing the new regulations. From their extensive dealings with foreign suppliers, these multipliers are potentially also able to shed light on which suppliers completed training on the sustainability impacts of their operations, which could serve as a signal to buyers. There is a further incentive to encourage compliance of developing-country suppliers. This includes the prospect of introducing suppliers to further potential clients, thereby increasing their sales, if business scouts offer to act like matchmakers for the subset of suppliers who have shown commitment to working towards eliminating shoddy work practices and improving environmental outcomes. Importantly, while business scouts should be active around the globe, only developing-country locations are likely to necessitate such extensive capacity building efforts. Support is more critical in locations characterised by weaker consideration for worker welfare or environmental issues. Here, business scouts will need adequate resources if their activities are to include the list of support measures described above. The aim of such efforts should be to help prevent a race to the bottom, where developing countries get excluded from supply chains; rather they should be assisted in upgrading their social and environmental standards. Ideally, this kind of capacity building represents a possibility for ensuring that Global North buyers and Global South suppliers can work in regulatory compliance. Additionally, it can attenuate suspicions in developing countries that the new regulations simply constitute a new form of non-tariff protectionism.

5.2 Identification of complying firms in developing countries

A key concern is that risk-averse buyers completely turn away from countries with low social and environmental standards rather than assessing suppliers on an individual basis. One concrete possibility for making it easier to evaluate the worker welfare and environmental outcomes of individual suppliers from developing countries – and encourage capacity building – is to provide tangible examples of exemplary supplier behaviour. One idea raised during the interviews was to set up supplier databases in partner countries. These could be hosted by local contact points, which could be affiliated with, for instance, chambers of commerce, investment promotion agencies or the like and consist of suppliers who comply with standards given the country context. The decision on whether a supplier is compliant could for example be based on the completion of a training programme on due diligence with the local contact points. This would perform a signaling function, enabling peer-group firms from similar high-risk countries to demonstrate steps they have taken towards improved environmental and social standards.

A related idea to reduce the risk of transacting with partner firms focuses on the provision of centrally collected data and digital tools to facilitate risk assessment. So far, the landscape of publicly available data and private applications is diverse. It is not clear who will provide and certify data for risk assessment. In

general, such data can help buyers to navigate issues relating to the supply of ethically sourced intermediate inputs. With the consolidation of existing trade and custom data on the source of raw materials and other intermediates (products and services), beneficiaries of such data might be better able to reduce the cost of obtaining such information independently. Centrally collected data can be tailored to provide industry-, project or country-specific risk-based information to businesses. However, a word of caution is appropriate. The information based on aggregate lists, indices or other performance metrics – identifying countries as ethical or less ethical – is generally disappointing when it comes to drawing conclusions about the ethical activities of their firms. Compiling ‘on-the-ground’ data directly from suppliers is arguably the best option. Moreover, collecting supplier-specific data makes economic sense, if the costs incurred in collecting and disseminating these data can be offset by improved decision making in choosing developing country suppliers. Finally, where the collection cost can be defrayed by widening the availability to numerous users, there is a further economic case for proposing a more targeted data collection effort.

5.3 Dialogue with trading partners

To foster sustainable global trade, it is important to engage in constructive dialogue with trading partners' governments and effectively communicate regulatory objectives. Prioritising cooperation with developing countries is crucial, also concerning the presence of emerging market firms as potential replacements for EU companies withdrawing from a particular country. Enhancing information flow and involving partner governments fosters understanding and ownership. Various instruments can be employed to support third country governments and economic operators in addressing the underlying causes of adverse human rights and environmental impacts. As also highlighted in the EU proposals on the CS3D, these include neighbourhood policies, development initiatives, and Free Trade Agreements. By leveraging these instruments, efforts can be directed towards providing the necessary assistance and guidance to improve sustainability practices within partner countries. This collaborative approach necessitates active engagement with partner country governments, local private sectors, and other stakeholders to collectively tackle challenges and promote sustainable global trade.

A further outcome from our interviews with stakeholders in Germany and beyond was that due diligence priorities depend on the developing country and sector in question. The importance of addressing the specific challenges faced by smallholders and tailoring solutions to local contexts was highlighted. For instance, child labour is more ubiquitous in some countries, whereas the lack of workers' safety in factories might be more pressing in other locations. To counteract these different ‘burning points’, a differentiated strategy is advocated, focusing on the most urgent human rights and environmental issues on a country-to-country basis and in cooperation with local actors. This helps to target resources where they are most needed.

5.4 Improving the information interface – User-friendly websites, portals and platforms

Frictions can arise between Global North buyers and their Global South suppliers, where information is asymmetric or otherwise lacking and deficient. One way of filling this information void is through the provision of user-friendly websites, portals or platforms, reducing the information wedge and easing the reporting burden on firms. A concrete request arising from conversations with stakeholders was for increased use of hard and fast rules for best practice. Many firms appear to struggle with the fundamental question ‘How do I know my firm is fully compliant with the regulations?’. Accordingly, the European Parliament Amendment 65 (recital 47) is timely, aiming as it does to mitigate the administrative and economic burden on firms. Although smaller firms will not be explicitly included under the remit of this proposal, those acting as subcontractors to larger firms might be advised to adopt this directive voluntarily, claiming support for tools to help their increased reporting requirement. Our interviews with stakeholders, in the context of the German supply chain act, revealed some preliminary success with these information

sites. However, there is scope for further improvement. Much of this improvement lies, however, less in the effectiveness of the platforms and tools used, but rather in the content of the reporting requirements (See next section). The helpdesk as a first point of contact is viewed as very helpful for obtaining information and preliminary guidance and should be available in all EU member states as already envisaged in the proposed CS3D.

5.5 Simplification of procedures for SMEs

Our discussions with stakeholders revealed a similar conclusion to that reported in the literature: whether SMEs are covered by the regulatory requirement or not, their integration into supply chains means they cannot evade the provisions. Accordingly, the upstream SMEs in the supply chain bear a heavy burden of complying with the regulations. Part of the problem could be avoided with clearer and more comprehensively written rules. A consensus emerging from the conversations with stakeholders was a call for 1) simplified reporting and 2) a harmonisation of any new reporting with information ‘already in the system’, that is information having been reported by the firm in response to similar requests from other third parties. Both issues would greatly reduce the reporting burden on the firm, reducing the scope for time-wasting redundancies and overlap. One suggestion is to devise a contract template and a tailored questionnaire template for each industry, where SMEs would be asked to respond to core questions, devised at the industry level and in conformance with existing reporting instruments. The questionnaire could also contain sections with supplementary, non-binding and non-obligatory questions. The latter would allow firms to signal instances where they have exceeded regulatory expectations. In addition, the EU CS3D proposal already stresses the importance of limiting the shift of the compliance burden to SMEs and providing practical tools and support for SMEs.

5.6 Graduated approach to legal requirements

Our interviews revealed that reducing uncertainty with respect to the reporting requirements was a key concern of firms. And much uncertainty surrounds the issue of worker rights and environmental stewardship. Are all violations and abuses equal in magnitude and severity? Or are some less severe and persistent than others? This concern chimes with the European Parliament Amendment 63, recital 46 recognising the need for support and practical tools on how companies should fulfil their due diligence obligations. Given the substantial time required to attain full compliance (a highly abstract concept), there must be some way of marking the gravity and severity of certain worker-right derelictions and environmental practices. A ‘risk-based’ approach does not mean that firms have to comply with everything everywhere. However, some firms had difficulties prioritising and the best-resourced firms – typically large firms – would rather tick every compliance box than be prosecuted after the fact. We suggest the adoption and communication of a clearly graduated approach to legal requirements for SMEs – what is mandatory, what is highly recommended and what exceeds expectations. This would also increase the incentive to comply with the legislation because small firms can then more readily identify the ‘burning points’ and channel resources towards quenching these.

5.7 Ensuring timely procedures

Our conversations with stakeholders in the context of the German supply chain act also revealed deficiencies in the timing of feedback to firms which had submitted worker welfare and environmental assessments for their supply chain, although it is still very early for a final verdict. There was a concern that supervisory authorities seemed to lack adequate resourcing in terms of personnel (skills and number of employees) and budget. Early starters among the companies submitted their notices months ago, but no feedback has been received yet, which may be due to the relatively new set-up. To improve the credibility of the due compliance reporting procedures of the CS3D, supervisory authorities must be adequately

equipped to deliver timely assessments from the very beginning. Otherwise, inertia enters the procedure and firms lose interest (and incentive) to improve outcomes in their supply chains.

6 Conclusive remarks

This study has addressed the expected impact of the EU's CS3D on SMEs. Throughout the study, we have taken the differences between SMEs in the EU and third (developing) countries into consideration. The German supply chain act has been considered as an example that could offer insights when it comes to implementing the EU due diligence legislation. Against the background of a review of the existing literature on the impact of sustainability regulations, we have conducted expert interviews with German business associations, German foreign chambers of commerce in emerging economies, as well as German supporting agencies. The objective has been to identify key challenges SMEs in the EU and third countries face when dealing with the requirements of the German supply chain act, and to discuss support measures that SMEs need or are already using. Based on the results of this analysis, we have derived recommendations as to how the EU can help ease the burden for SMEs when implementing the proposed CS3D.

Our literature review reveals that due diligence regulations are associated with considerable challenges for SMEs. Compared to larger firms, they are disadvantaged due to their relative sensitivity towards the higher imposed costs and their lower capability to implement standards. Most notably, SMEs often lack sufficient human resources to deal with specific regulations. There is a risk that the burden of compliance is shifted from large companies with market power to their SME suppliers. And firms may turn away from SMEs in countries with weak governance structures in response to due diligence regulations, even though this has not yet happened across the board as changing suppliers is costly. However, there is also a more positive view on the effects of SME's actions in due diligence. It may, for instance, improve reputation and is associated with improved employer branding, which facilitates, among other things, access to a talented workforce. Moreover, corporate responsibility can improve competitiveness, provide opportunities to supply big enterprises and win public procurement contracts.

Our interviews with German stakeholders corroborate that due diligence regulations present both opportunities and challenges for SMEs. The supply chain act, for instance, presents opportunities for companies to expand their customer base by catering to the growing demand for sustainable and ethically sourced products. Companies that comply with the supply chain act may also enjoy indirect benefits, such as gaining access to public procurement. Uncertainty regarding the legal requirements of the German supply chain act is seen as the most important obstacle. For many companies, it is not clear what they are obliged to do to be regarded as compliant. Another issue that was frequently raised in the interviews is the pass through of costs of compliance from larger buyer companies to smaller suppliers, which is regarded as a considerable burden by the SMEs. Interviewees also recurrently demanded a simplified framework for reporting, which aim to eliminate duplications and redundancies, ensuring that businesses are not subject to unnecessary reporting obligations. So far, termination of business relationships in response to due diligence requirements is perceived as unlikely, but the risk is expected to increase. SME suppliers in developing countries often completely lack awareness of the supply chain act and related planned regulations at the EU-level. They, therefore, face insurmountable hurdles in complying with due diligence regulations without further support.

As concerns the tools that may assist SMEs in complying with due diligence regulations, the German helpdesk for business and human rights provides companies with individual, confidential and free advice, which is considered very helpful by company representatives. The materials and information provided there are used as a basis for industry-specific consulting services. One measure for bridging the gap between German companies and companies in developing countries was highlighted during the interviews: So-called 'business scouts' implemented at the interface between the private sector and

development cooperation, which act as multipliers facilitating access to information on doing business with German companies for example by offering training related to the supply chain act.

The measures our analysis suggests for improving due diligence practices when the proposed EU CS3D is implemented fall into two categories: those that help suppliers from developing countries comply with due diligence regulations; and those that facilitate smooth and efficient reporting procedures for SMEs. As for the former, establishing a system of multipliers working to connect European companies and companies in developing countries along the lines of the German business scouts would be a promising option. Such an effort could build on existing structures and knowledge within the EU, for example involving the EU Chambers of Commerce and the European Development Fund. In developing countries that are characterised by very low overall social and environmental standards, options such as supplier databases that identify complying firms could be applied to avoid that risk-averse buyers turn away from these countries. Various instruments such as neighbourhood policies, development initiatives, and Free Trade Agreements can be employed to support third country governments and economic operators in addressing the underlying causes of adverse human rights and environmental impacts.

A first step towards improving due diligence procedures is the provision of appropriate information about reporting requirements. Helpdesks as a first point of contact should be available in all EU member states as already envisaged in the proposed EU CS3D. User-friendly websites, portals or platforms could further ease the reporting burden on firms. Increased information should be coupled with measures that reduce the uncertainty about what constitutes a violation of worker rights or environmental malpractice. One option would be to adopt a clearly graduated approach to legal requirements for SMEs, distinguishing what is mandatory, what is highly recommended and what exceeds expectations. In addition to having a clearer understanding of their obligations, SMEs would benefit from simplified reporting and harmonisation of any new reporting with information that has already been reported in response to similar requests from other third parties. Finally, to guarantee a smooth operation of the due diligence procedure, supervisory authorities must be adequately equipped (personally and financially) to deliver timely assessments of filed reports.

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Appendix

Expert interview guideline (in German)

Ziel der Interviews

Dieses Interview ist Teil einer Studie für das EU-Parlament (Directorate-General for External Policies of the Union, Committee on International Trade (INTA)) und zielt darauf ab, praktische Herausforderungen, welche für Unternehmen durch Sorgfaltspflichtengesetze entstehen, zu identifizieren. Der Fokus liegt dabei auf kleinen und mittleren Unternehmen (KMU/SMEs)⁸. Diese Herausforderungen können sich sowohl auf die Berichterstattung über die Sorgfaltspflicht als auch auf die Einkaufspraktiken größerer Käuferunternehmen beziehen. Des Weiteren soll die Studie mögliche Lösungen und den Nutzen von unterstützenden Instrumenten sowie positive Fallbeispiele identifizieren. Wir verwenden das deutsche Lieferkettengesetz als Fallstudie und führen zu diesem Zwecke Experteninterviews mit VertreterInnen von z.B. deutschen KMU- und Unternehmens-Verbänden und Fördereinrichtungen durch. Wir wenden uns auch an EU-VertreterInnen, die an dem Entwurf des Europäischen Lieferkettengesetzes (CS3D) beteiligt sind, um ein besseres Verständnis der möglichen Folgen für KMU zu erhalten. Aus diesen Gesprächen wollen wir Erkenntnisse über die Einkaufspraktiken größerer EU-Unternehmen gegenüber ihren Zulieferern und Beispiele bewährter Verfahren für Unterstützungsmaßnahmen für KMU gewinnen.

Ablauf des Interviews

- I. Kurze Vorstellungsrunde und Erläuterung der Ziele der Studie und der Rolle der Interviews
- II. Fragen

Chancen und Herausforderungen

1. Was sind Chancen und Herausforderungen deutscher Unternehmen bei der Umsetzung des (deutschen) Lieferkettengesetzes?
 - a. Aus Ihrer Erfahrung, was sind die größten Herausforderungen bzw. gibt es Erfahrungen/begründete Befürchtungen, wo es Probleme bei der Umsetzung gibt?
 - b. Einige Unternehmen setzen sich aktiv für die Einführung von Lieferkettengesetzen ein, da sie positive Auswirkungen erwarten, wie beispielsweise mehr Planungs- und Rechtssicherheit. Was sind Ihre Erfahrungen aus Gesprächen mit Unternehmen, gibt es positive Erfahrungen/Erwartungen von Unternehmen?
 - c. Ihrer Meinung nach, gibt es unterschiedliche Erfahrungen für kleine und große Unternehmen?

Praktische Aspekte der Umsetzung

2. Für eine erfolgreiche Umsetzung ist das Geschäftsmodell/ die Einkaufspraktiken entscheidend. Es wird beispielsweise befürchtet, dass Verantwortung die Lieferkette entlang gegeben wird und auf Unternehmen am Anfang von Lieferketten lastet bzw. auf kleineren Unternehmen oder es sogar zum Abbruch von Vertragsbeziehungen kommt. Auf der anderen Seite gibt es Berichte, dass beispielsweise enger Austausch mit Zulieferern die Umsetzung von Standards erleichtert. Können Sie best und/oder worst practice Beispiele für die Interaktion zwischen großen Unternehmen und KMU im Hinblick auf die Umsetzung von Standards nennen?

⁸ In Anlehnung an die Empfehlung (2003/361/EG) der Europäischen Kommission werden KMU wie folgt definiert: Kleinstunternehmen, kleine und mittlere Unternehmen mit bis zu 249 Beschäftigten und einem Jahresumsatz bis zu 50 Millionen Euro.

3. Welche praktischen Herausforderungen gibt es speziell für KMU?
4. Können Sie einschätzen, wie das Lieferkettengesetz die Beziehung zu Abnehmern und Zulieferern (in Deutschland und in Partnerländern) beeinflusst?
5. Wenn wir uns die aktuelle Diskussion auf EU-Ebene anschauen, werden KMU voraussichtlich ausgenommen. Was bedeutete das in der Praxis, da KMU indirekt, als Zulieferer, auch betroffen sein können?
6. Können Sie einschätzen, ob Prozesse innerhalb der Unternehmen zur Wahrung von Nachhaltigkeitsstandards überarbeitet wurden?
7. Können Sie einschätzen, ob es durch das Gesetz zu einem Personalmehraufwand in den Unternehmen gekommen ist? Wenn ja, wie wird dieser in der Regel getragen: neuer Personalbedarf vs. Mehrarbeit für bestehende Beschäftigte? Wer (welche Position im Unternehmen) ist in der Regel für die Umsetzung zuständig?
8. Haben Sie Erfahrung, inwiefern Multi-Stakeholder Initiativen eingebunden werden? Wie funktioniert der Austausch in der Praxis?

Unterstützungsmaßnahmen

9. Grade in Hinblick auf KMU wird oft davon gesprochen, dass es Unterstützungsangebote geben soll, damit sie nicht benachteiligt werden. Aus Ihrer Erfahrung, welche Unterstützungsangebote werden von Unternehmen am meisten angenommen bzw. zu welchen Aspekten fragen Unternehmen überwiegend Beratung an?
10. Welche Unterstützungsangeboten fehlen derzeit bzw. welche Angebote wünschen sich Unternehmen?
11. Können Sie einschätzen, inwiefern Online-Tools oder Software von Unternehmen verwendet werden, um die Nachhaltigkeit ihrer Lieferketten zu kontrollieren?

Sonstiges

12. Gibt es weitere Aspekte, die wir nicht besprochen haben, die Sie für wichtig erachten?

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