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Human rights and environmental due diligence

FAQ on what it means and how to do it

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1 What does due diligence mean?

Due diligence is a process that gives companies guidance on how to identify risks of significant negative impacts in their own operations and their business relationships throughout the value chains. It also helps them choose the appropriate approach to prevent and address the identified issues, taking into account:

- the company's contribution to their emergence
- the company's ability to influence the business relationships in which the impacts occur

Value chain due diligence in a nutshell:

> When a company operates in high-risk value chains, it needs to know the origin of products or raw materials, assess new suppliers and work together with them.
>
> For example, if a company sources palm oil from a supplier that does not verify that the oil does not come from illegal plantations and is therefore not linked to deforestation, it will not meet due diligence.
>
> Companies guarantee the safety and quality of their products and therefore address quality standards and precise delivery times with their suppliers. Human rights due diligence can be built into these processes and taken into account in contract negotiations.
>
> Note: Supply chain refers only to the company's suppliers in relation to e.g. production, resource extraction, etc. (i.e. "upstream"); value chain covers both "upstream" and "downstream", i.e. also the sale, use and disposal of products.

2 Has due diligence been regulated?

In response to demands from investors[1] and companies[2], the European Commission presented a proposal for a Corporate Sustainability Due Diligence Directive (CSDDD) in February 2022. The Directive is also a response to France, Germany and Norway adopting legislation on due diligence and attempts to harmonize and introduce one European standard of responsible business conduct.

The draft due diligence legislation is based on international UN and OECD standards, which have been endorsed by all EU countries. In particular:

- United Nations Guiding Principles on Business and Human Rights
- OECD Guidelines for Multinational Enterprises
- OECD Due Diligence Guidance for Responsible Business Conduct

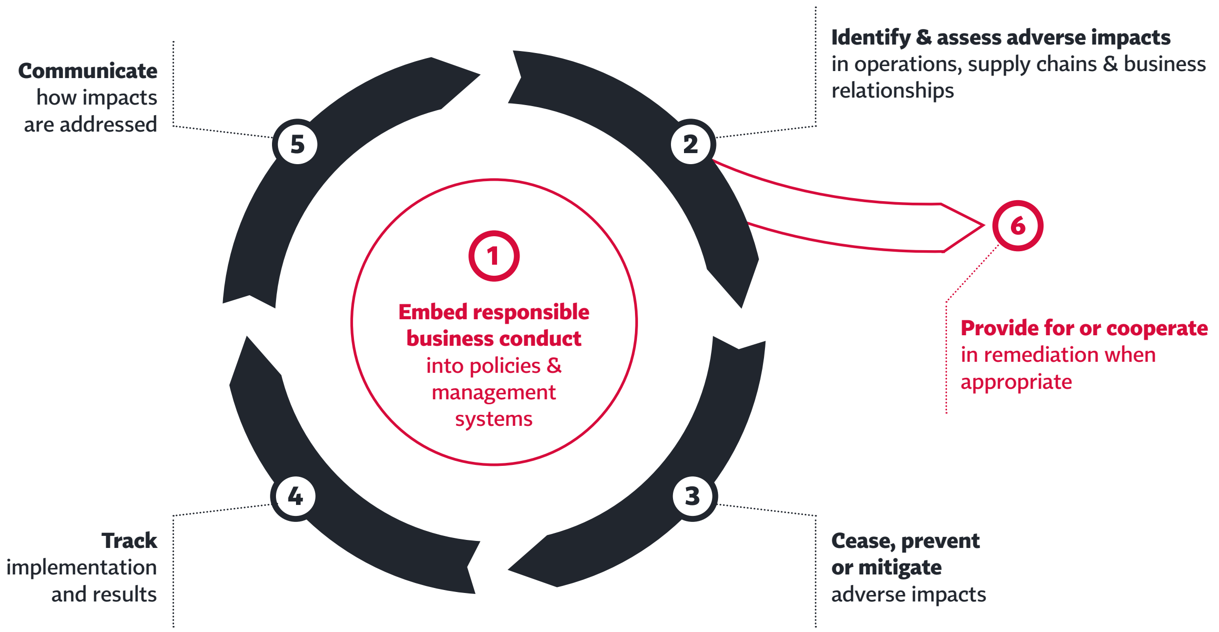
Due diligence is already a condition for access to sustainable finance under the EU Taxonomy. The proposed Directive clarifies what companies need to comply with in this respect.

[1] Investor Alliance for Human Rights, 2021: https://investorsforhumanrights.org/sites/default/files/attachments/2021-10/Investor%20Statement%20mHREDD%20FINAL%206%20October%202021.pdf

[2] Business and Human Rights Resource Centre, 2022: More than 100 companies and investors call for effective EU corporate accountability legislation: https://www.business-humanrights.org/en/latest-news/eu-mandatory-due-diligence-2022/

3 How should due diligence be implemented?

Due diligence can be divided into six main steps:



Graphic by Frank Bold based on the original from OECD, more at mneguidelines.oecd.org

- → For details on the practical actions that each of the six steps imply, see: OECD Due Diligence Guidance for Responsible Business Conduct.
- → Compare also the introduction on the corporate responsibility to respect human rights compiled by Shift.

4 How can a company identify and assess negative impacts?

In the first step, companies should carry out an initial analysis of potential exposure to impacts commonly associated with their sector, products or geographical locations. When assessing risks, a company can draw on the impacts mapped within existing voluntary standards and assess whether they are relevant with respect to the company's core activities, supply chain for key products and reached countries.

Stakeholder engagement is a key element of the due diligence process and – if done in a meaningful way – leads to more informed and preventive actions.

- In most industries, human rights and environmental risks are predictable, making it easier for companies to determine whether or not they are exposed to typical risks of serious impacts.
- Companies operating in different countries are advised to address country-specific risks, see this map.
- Companies may also find helpful the examples of business model risks in "Business Model Red Flags" by Shift.
- Companies that want to start managing their risks may also use this online tool from Dutch organisation MVO.
- The Corporate Human Rights Benchmark by the World Benchmarking Alliance can also serve as a guide for companies.
- See also 10 practical tips by the German government for implementing human rights due diligence.

Companies need to assess risks affecting vulnerable people

- For example, migrant workers can be particularly vulnerable to exploitation, including forced labour. Child labour is most often a risk in harvesting of cocoa, or other agricultural products, but also in raw material mining, certain commodities or products, such as in the making of footballs or carpets.
- Women may be particularly at risk of abuse in low wage, low skill roles or affected by sexual violence.
- Indigenous peoples may be particularly at risk where their rights, especially land rights, are not legally recognized or enforced.

In a first step, companies should focus on the adverse impacts that are most severe or likely to occur:

For example, after looking across its product lines, an enterprise operating in the footwear sector may identify its leather footwear as being associated with significant risks in light of labour and environmental risks linked to the tanning process. The enterprise may then map specific business relationships (e.g. tanneries) linked to the production of its leather products in order to prioritise individual suppliers operating in higher-risk geographies for further assessment.

5 How can a company cease, prevent or mitigate impacts?

If companies identify significant negative impacts, they should try to cease, prevent or mitigate these impacts, monitor and report on the results of their actions, and communicate them to those who are affected. If the initial analysis shows that companies are not exposed to risks, they do not need to take further action. However, risks must be monitored and evaluated on **an ongoing basis**, especially when starting a new business or changing suppliers.

The measures taken should be appropriate to the size of the company: **Smaller and medium-sized companies** can find special guidance to first steps of due diligence here. Smaller companies can also use due diligence to ensure reliable and long-term supplier relationships.

Specific measures depend on the involvement of the company in the adverse impacts:

Companies should prioritise addressing the most severe impacts, regardless of whether they caused them. However, the nature of the measures depends on the company's **leverage** – the ability to influence the impacts:

1) Where the company **causes** or **contributes** to the impact, it should cease or prevent the impact and remedy the harm caused.

2) Where there is no contribution by the company, but the impact is **directly linked to its operations, products or services by a business relationship**, the undertaking should use its **leverage** with third parties (e.g. through contractual terms or other means where contractual terms cannot be applied) to seek to prevent or mitigate the impact. The more complex or systemic the issue, or the more remote in an undertaking's value chain, the more likely that exercising leverage will require some form of collaboration with others, whether industry peers or other public, private, international or civil society organisations.

3) Where an undertaking cannot create or use the leverage necessary to achieve change, it needs to consider ending the business relationship(s) concerned. In most cases, due diligence does not require companies to end the problematic business relationship, but rather seeks ways to influence the problem proportionate to their leverage.

Taking appropriate action

IF A COMPANY...	Has **caused or may cause** an impact	Has **contributed or may contribute** to an impact	Has or may have its operations **linked** to an impact through its relationships with other entities
THEN IT SHOULD...	**Prevent or mitigate** the impact	**Prevent or mitigate** its contribution to the impact + **Use or increase its leverage** with other responsible par ties to prevent or mitigate the impact	**Use or increase its leverage** with responsible parties to **seek to** prevent or mitigate the impact + Consider **using its leverage** with responsible parties to **enable remedy**
AND...	**Remediate** the harm if the impact has occurred	**Contribute to remediating** the harm if the impact has occurred, to the extent of its contribution	**Not required itself to re mediate** the harm but may take a role in remedy

Infographics by Shift, more at shiftproject.org

6 What are examples of good and bad practice?

Good practice	Bad practice
Workforce (on-site)	
→ Require contractors to ensure that all workers involved in the activity have guaranteed appropriate level of protection	→ Using subcontractors that hire foreign workers and pay less than national minimum wage
High-risk supply chains	
→ Know your chain → Assess new suppliers → Engage with high-risk suppliers	→ Trading in a high-risk commodity and taking no precautions (e.g. cotton and child labour, palm oil and deforestation, conflict minerals) → Sourcing from high-risk geographies and failing to screen suppliers
Direct investments	
→ Carry out environmental and human rights impact assessments	→ Failing to engage local and indigenous communities → Harmful operations in national parks
Finance	
→ Implement system to identify heightened risk of potential human rights violations in screening of companies for potential investment	→ Financing land grabbing activities → Financing palm oil companies linked to deforestation and not exercising leverage → Investing in companies which systematically abuse labour rights

7 What are the costs of implementing due diligence?

- For large companies, the cost of implementing due diligence is estimated at an average of 0.005 percent of their profits, and for small and medium-sized companies at 0.07 percent.[3]
- According to the experience of companies[4], the costs invested in identifying risks and taking preventive and mitigation measures pays off financially and leads to savings. This conclusion was also reached by an OECD study that examined the costs of implementing several due diligence regulations and found that the costs of implementation are offset by various economic benefits for companies.[5]
- The more companies apply due diligence in their supply chains, the lower the costs for individual companies.[6]
- Overall, the costs of implementing due diligence are manageable.

8 Are there additional costs for customers?

- The impact on prices for end-users depends on whether and to what extent companies reflect the costs of due diligence in their products and/or services. However, the additional costs for companies are considered to be sufficiently low that the risk of an increase in prices is low as well.
- For example, of the average price of chocolate bars (1 Euro in Germany in 2020), between four and five cents currently go as wages to cocoa farmers in Ghana and the Ivory Coast.[7] If the wage were raised to a living wage level, a milk chocolate bar would be about five cents more expensive for consumers.[8]
- In 2017, the magazine WirtschaftsWoche estimated that for a mid-range car with a purchase price of 25,000 Euros, the additional costs for fair raw materials (especially steel, copper, aluminium and platinum) total about 200 euros.[9] That is, less than one percent.
- Sustainability and due diligence-conscious apparel manufacturer Purnaa breaks down the costs of $20 t-shirts for both a regular and their fair trade product.[10]

[3] British Institute of International and Comparative Law, Civic Consulting und London School of Economics 2020: Study on due diligence requirements through the supply chain, p. 427: https://op.europa.eu/de/publication-detail/-/publication/8ba0a8fd-4c83-11ea-b8b7-01aa75ed71a1

[4] Danish Institute for Human Rights 2020: Doing well by doing right? Exploring the potentials and limitations of a business case for human rights, Research Report: https://www.humanrights.dk/sites/humanrights.dk/files/media/document/Rapport_DoingWell_tilg%C3%A6ngelig.pdf.
See also: Friede, G., Busch, T. & Bassen, A. 2015: ESG and financial performance: aggregated evidence from more than 2000 empirical studies. Journal of Sustainable Finance & Investment, 5:4, 210–233: https://www.tandfonline.com/doi/full/10.1080/20430795.2015.1118917;
Milberg, W. 2011: Economic and social upgrading in global value chains: http://www.capturingthegains.org/pdf/ctg-wp-2011-6.pdf

[5] OECD 2016: Quantifying the Costs, Benefits and Risks of Due Diligence for Responsible Business Conduct, p. 59 ff: https://mneguidelines.oecd.org/Quantifying-the-Cost-Benefits-Risks-of-Due-Diligence-for-RBC.pdf

[6] Minimum impact on the environment – yes. Minimum wage for workers – no., https://www.kingsofindigo.com/blogs/news/minimum-impact-on-the-environment-yes-minimum-wage-for-workers-no

[7] Fairtrade Foundation 2022: Cocoa Farmers: https://www.fairtrade.org.uk/farmers-and-workers/cocoa/

[8] Cocoa Barometer, 2020: Cocoa Barometer: https://voicenetwork.cc/wp-content/uploads/2021/03/2020-Cocoa-Barometer-EN.pdf

[9] Bergermann 2017: Das dunkle Geheimnis der Autoindustrie, WirtschaftsWoche 45 / 27. 10. 2017: https://basflonmin.com/home/wp-content/uploads/2017/01/WirtschaftsWoche_45_10_2017_Blutauto.pdf

[10] The Purnaa Team, What is the True Cost of a T-Shirt? https://www.purnaa.com/post/what-is-the-true-cost-of-a-t-shirt

The real price[11] of a $20 t-shirt

The cost differences are mainly related to the salaries of the producers, as Purnaa employees earn more than the living wage, and also to the materials, which are produced in an environmentally friendly way. Purnaa, on the other hand, operates on a lower margin and sells its products directly. The focus on sustainability helps Purnaa to attract customers. The higher administrative costs of the 'industry-average' t-shirt, including shipping costs and import taxes, are due to production taking place in Nepal.

[11] Based on the infographics "The real cost of a $ 20 t-shirt" and simplified, original: https://www.purnaa.com/post/what-is-the-true-cost-of-a-t-shirt

9 What are further benefits of conducting due diligence?

Positive impact on financial performance

- Companies that exercise due diligence in their supply chains are more competitive. They have significantly lower employee fluctuation and often several times higher labour productivity. Other benefits include better strategic risk management, and improved reputation.[12]
- The coronavirus pandemic has shown how vulnerable global supply chains are. OECD studies indicate that responsible companies have coped better with the coronavirus crisis in the short term and have better prospects of overcoming the crisis in the medium and long term.[13]

Bettina Roth,
Head of Quality Management
& CSR Supply Chain, apparel company Vaude

"Even in the pandemic, we had stable supply chains and we could find solutions with our suppliers when they struggled with the covid-19 impacts. We can clearly show that sustainability leads to economic success."

Better access to investment

- The EU's green economic transformation will require €500 billion a year from investors and banks.[14] Companies wishing to access this funding will have to meet due diligence criteria.
- Investors and banks are increasingly demanding information on sustainability and due diligence. Examples include the members of the Investor Alliance for Human Rights[15], which manages USD 6.3 trillion in assets, supporting the draft EU legislation, as well as more than 100 other companies and investors, including Danone, Ericsson, IKEA, Aviva and Robeco.[16]

Théo Jaekel,
Corporate Responsibility Expert,
telecommunications company Ericsson

"Many times we have experienced direct questions from investors on our due diligence. By being prepared, and by having due diligence frameworks, we have seen quite positive reactions from them. We also have regular engagements with our investors to update them on the situation in specific high-risk countries and that has been really appreciated by them."

12 European Parliamentary Research Service 2020: European Added Value Assessment on Corporate due diligence and corporate accountability: https://www.europarl.europa.eu/RegData/etudes/STUD/2020/654191/EPRS_STU(2020)654191_EN.pdf

13 OECD 2020: COVID-19 and responsible business conduct: http://www.oecd.org/coronavirus/policy-responses/covid-19-and-responsible-business-conduct-02150b06; Ding, W., Levine, R., Lin, C. and Xie, W. 2020: Corporate Immunity to the COVID-19 Pandemic. NBER Working Paper No. 27055, https://www.nber.org/system/files/working_papers/w27055/w27055.pdf

14 Speech by Commissioner McGuinness at the Launch of the Platform on Sustainable Finance: https://ec.europa.eu/commission/commissioners/2019-2024/mcguinness/announcements/speech-commissioner--mcguinness-launch-platform-sustainable-finance_en

15 Investor Alliance for Human Rights, 2021: https://investorsforhumanrights.org/sites/default/files/attachments/2021-10/Investor%20Statement%20mHREDD%20FINAL%206%20October%202021.pdf

16 Business and Human Rights Resource Centre, 2022: More than 100 companies and investors call for effective EU corporate accountability legislation: https://www.business-humanrights.org/en/latest-news/eu-mandatory-due-diligence-2022/

Better decision-making in times of armed conflict

- The Russian war in Ukraine has, in addition to the COVID-19 global pandemic, once again highlighted the need for corporate human rights and environmental due diligence. Future private sector preparedness in the face of such crises requires a harmonised standard of responsible business conduct in order to help direct corporate behaviour and to ensure companies do not contribute to armed conflict, or otherwise exacerbate crises.
- Situations of crisis, such as armed conflicts or global pandemics, demand rapid and comprehensive decision-making and action on behalf of the private sector as well as governments. Embodying a standard of responsible business conduct and effective decision-making enable companies to respond appropriately to situations of significantly heightened risk, in order to safeguard human rights (including the right to life) and the environment. With such procedures and processes in place, companies are better prepared to take decisive and protective action when it matters most.

A level playing field for domestic producers

- Companies producing in the EU have higher costs than their competitors using manufacturing outside of Europe, where labour and environmental standards are not the same. Introducing due diligence obligations would alleviate this disadvantage. This is the case, for e.g. companies in the apparel and outdoor equipment sectors, or in European steel production.

Frank Bold

Frank Bold Society is a public interest law organisation working on human rights, climate change litigation and anti-corruption advocacy, and strengthening grassroots civil society. As a Board member of the European Coalition for Corporate Justice (ECCJ), Frank Bold Society is active in the area of business and human rights as well as on the role and accountability of corporations.

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