



**University of
Zurich^{UZH}**

Text No. 18
Human Rights
Prof. Dr. Christine Kaufmann

BSR Discussion Paper on Responsible Supply Chain Management

30 June 2010



10th OECD ROUNDTABLE ON CORPORATE RESPONSIBILITY
Launching an update of the OECD Guidelines for Multinational Enterprises
30 June – 1 July 2010, OECD Conference Centre, Paris, France

**“SUPPLY CHAINS AND THE OECD GUIDELINES FOR
MULTINATIONAL ENTERPRISES”**
**BSR DISCUSSION PAPER ON RESPONSIBLE SUPPLY CHAIN
MANAGEMENT**

*Cody Sisco, Blythe Chorn, Peder Michael Pruzan-Jorgensen,
Jeremy Prepscius, and Veronica Booth
Business for Social Responsibility (BSR)*

This paper on “Supply Chains and the OECD Guidelines for Multinational Enterprises” was commissioned from the corporate responsibility and consulting firm Business for Social Responsibility (BSR) as background information for the 2010 Corporate Responsibility Roundtable’s session on supply chains, which will be held at the OECD Conference Centre on 30 June (morning).

The views contained in the BSR paper do not necessarily represent those of the OECD or its member governments. For further information or clarification on any of the issues covered in this paper please contact: Cody Sisco, csisco@bsr.org.

OECD ROUNDTABLE ON CORPORATE RESPONSIBILITY

“Supply Chains and the OECD Guidelines for Multinational Enterprises”

BSR Discussion Paper on Responsible Supply Chain Management

OECD Headquarters, Paris, 30 June 2010

BSR, a leader in corporate responsibility since 1992, works with its global network of more than 250 member companies to develop sustainable business strategies and solutions through consulting, research, and cross-sector collaboration. This paper was prepared by Cody Sisco, Blythe Chorn, Peder Michael Pruzan-Jorgensen, Jeremy Prepscius, and Veronica Booth at BSR. Please contact Cody Sisco at csisco@bsr.org.

Table of Contents

- I. Introduction**
- II. Supply Chain Opportunities and Challenges and Multinational Enterprise Responses**
 - A. The Value of Supply Chain Relationships for MNEs
 - B. Key Actors and Types of Supply Chain Relationships
 - C. The Macroeconomic Impacts of Supply Chain Relationships
 - D. Responsible Business Conduct Challenges in Supply Chain Relationships
 - E. Current MNE Approaches for Responsible Supply Chain Management
 - F. Challenges in Responsible Supply Chain Management
- III. Translating Multinational Enterprise Responses into Broader Operational Principles and Standards for Responsible Supply Chain Management**
 - A. Opportunities for Defining Responsible Supply Chain Management
 - B. Investment Nexus
 - C. Sphere of Influence
 - D. Impact
 - E. Due Diligence
 - F. Materiality
 - G. Continuous Improvement
 - H. Towards a Comprehensive Framework for Responsible Supply Chain Management
- IV. Developing Guidance on the Application of the OECD Guidelines to Supply Chain Relationships**
 - A. Current Guidance on Responsible Supply Chain Management in the OECD Guidelines
 - B. The Imperative for Revisions to the Guidelines on Responsible Supply Chain Management
 - C. Opportunities to Provide Additional Clarity and Guidance on Responsible Supply Chain Management
 - D. Considerations for the Role of the National Contact Points
- V. Conclusion**

I. Introduction

1. BSR (Business for Social Responsibility) is pleased to submit this discussion paper on the application of the Organisation for Economic Co-operation and Development (OECD) Guidelines for Multinational Enterprises to supply chains to the OECD in support of the Annual Meeting of the National Contact Points on 30 June 2010.

2. The purpose of this paper is to provide context and recommendations for discussion at the roundtable on corporate responsibility. This seminar will help clarify and develop appropriate guidance on the application of the OECD Guidelines for Multinational Enterprises (the Guidelines) to supply chain relationships in the context of the update that adhering governments have agreed to undertake in 2010-2011.

Definition of Supply Chain

There are multiple definitions of the term supply chain.

For the purposes of this paper, the term “supply chain” is used to refer to the network of organizations that cooperate to transform raw materials into finished goods and services for consumers.

Other definitions conceive of supply chains as flows of materials that are processed, transported, and otherwise transformed by a series of organizations into higher value products.

Supply chain and value chain are related but distinct concepts.

The value chain concept was first described and popularized by Michael Porter as a series of activities undertaken by a company that generate and add value to products. These activities include inbound logistics, operations, outbound logistics, marketing and sales, and services, and they are supported by activities including firm infrastructure, human resources management, technology development and procurement. A company's value chain is part of a larger value system that includes the value chains of upstream suppliers and downstream channels and customers.

(See Michael Porter, *Competitive Advantage: Creating and Sustaining Superior Performance*. New York: Free Press, 1980.)

II. Supply Chain Opportunities and Challenges and Multinational Enterprise Responses

3. The scale and pace of growth in global supply chains is unprecedented. Trade liberalization, decreased restrictions on capital movement, and technology advances which have sharply lowered transportation and communication costs have enabled geographically fragmented production processes, trade in services, and foreign direct investment by multinational enterprises (MNEs).¹

A. The Value of Supply Chain Relationships for MNEs

4. Supply chain relationships generally create significant value for MNEs. As growing competition in domestic and international markets forces MNEs to become more efficient and to lower costs, sourcing inputs from more efficient producers, either domestically or internationally, can be an opportunity to improve margins. This enhanced efficiency can stem from a number of sources, including lower labor costs, greater access to raw materials, and more advanced manufacturing and service provision processes, among others.

5. Another major motivation for building supply chains is the opportunity for entry into new markets. Demographic shifts and rapid growth in developing economies present tremendous growth opportunities for MNEs. Developing supply chain relationships in these economies allows MNEs to build a local presence in order to build brand awareness, gain market insights, and reduce costs associated with delivering final products and services to local customers.

6. MNEs also build supply chain relationships to gain access to strategic assets, which include skilled workers, technological expertise, and the presence of competitors and suppliers with valuable knowledge or experience. Access to these assets can improve product and service quality and support innovation. For example, access to foreign knowledge is a key element in shifting research and development (R&D) activities to the supply chain.²

B. Key Actors and Types of Supply Chain Relationships

7. To maximize these opportunities and to create efficiencies in manufacturing and service provision, MNEs have developed a variety of forms of supply chain relationships. In any one supply chain relationship, there are likely to be a number of unique actors:

- » *MNE*: The MNE is the large, global company that is the buyer of a product or service in the supply chain relationship. It may or may not be the ultimate retailer and so may face procurement and sustainability standards required by other MNEs.
- » *Supplier*: The supplier is the company, which could be a large, global enterprise or a small or medium-sized business based in one region or

¹ World Trade Organization, “World trade developments,” in *World Trade Statistics 2009*, (2009), www.wto.org/english/res_e/statistics_e/its2009_e/section1_e/its09_highlights1_e.pdf.

OECD, *Moving up the Value Chain: Staying Competitive in the Global Economy*, (2007), www.oecd.org/dataoecd/24/35/38558080.pdf.

² Wendy Tate, Lisa Ellram, Lydia Bals, and Evi Hartmann, “Offshore Outsourcing of Services: An Evolutionary Perspective,” *International Journal of Production Economics*, 120, (2009): 512-524. Peter Maskell, Torben Pedersen, Brent Petersen, and Jens Dick-Nielsen, “Learning Paths to Offshore Outsourcing - From Cost Reduction to Knowledge Seeking,” DRUID Working Paper 05-17, Danish Research Unit for Industrial Dynamics, Copenhagen Business School, (2007), www3.druid.dk/wp/20050017.pdf.

locale, which sells goods (including raw materials, semi-finished, component, and intermediary products) or provides services to a MNE. Suppliers that sell directly to a MNE are known as first-tier or direct suppliers.³ Suppliers that sell to other suppliers are known as sub-tier suppliers; they may be several times removed from the MNE but provide a good or service that is an element of the good or service that is ultimately sold to the MNE.

- » *Licensee*: Licensees purchase the rights to use MNEs' brands, usually to produce goods that bear MNEs' intellectual property or to provide services on behalf of MNEs. Licensees may perform the production or service provision in-house or further outsource to a supplier.
- » *Agent*: Agents identify and negotiate with suppliers and licensees on behalf of MNEs. Agents typically act fairly independently of MNEs, although each relationship is unique.
- » *Trader*: Traders typically make markets for goods and services by purchasing and reselling them, often across geographical boundaries. They typically are not involved in product development, manufacturing, or marketing to consumers.

8. There are also a number of different supply management models, each of which has varying levels of visibility and control over direct and sub-tier supply chain relationships. While supply management approaches vary widely between industries, MNEs, and even among product or service categories within one MNE, models can be generally grouped into four approaches:

- » *Transactional*: Generally the shortest of supply chain relationships, transactional supply management models are often characterized by a lack of contact between the MNE and supplier. Rather, products and services are sold through auctions, wholesalers, etc. This model is often used for commodities, one-time buys, and seasonal sourcing.
- » *External Management*: Although these supply chain relationships may be more durable than transactional relationships, an external management approach is similarly characterized by the lack of direct interaction between the MNE and supplier. Rather, the MNE provides general specifications and requirements and receives shipment, but a third party manages the entire procurement activity including selecting and managing suppliers. External management approaches are often typical of licensing relationships, where the agent acts as the third party.
- » *Supplier Selection*: The most common supply management model, supplier selection is typified by MNEs which directly approach suppliers, often through a request for quotation (RFQ), and select suppliers based on subsequent analysis and negotiations. Suppliers are often responsible for sourcing materials and services they require to deliver product to the MNE; the MNE typically does not interact with any sub-tier suppliers.
- » *Strategic Management*: Generally used with only the most durable, long-term supply chain relationships, a strategic management approach to supply management involves MNEs sourcing from and strategically managing direct, first-tier suppliers. Strategic management can involve making direct investments in suppliers to improve quality through providing training, assigning MNE staff to provide on-site support, and making joint

³ In some industries, the term "direct" supplier has a different and distinct meaning: a supplier of goods that are incorporated into the finished goods that are provided to consumers. This is distinct from "indirect" suppliers, which are technically first tier suppliers, but that provide goods which do not become part of products to consumers, for example, suppliers of office equipment, information technology services and catering would be considered "indirect" suppliers.

asset investments. MNEs using a strategic management approach often engage with sub-tier suppliers as well to improve production processes, lower costs, and ensure supply continuity.

9. Also, depending on a MNE's internal structure, supply management may be a centralized function or spread across many different product lines and business units. Interactions with suppliers therefore can take many forms, and any one supplier or other supply chain actor may have multiple points of contact within a MNE.

C. The Macroeconomic Impacts of Supply Chain Relationships

10. The emergence of global supply chains has had significant effects on national economies and has resulted in changes in comparative advantage and export specialization. Global supply chains also have significant impacts on employment, productivity, prices, wages, and terms of trade, and these impacts vary across regions and social groups.

11. **Developed economies.** In developed economies, globalization of supply chains may lead to short-term employment losses. While the number of jobs may be large in absolute terms, direct employment impacts are considered to be relatively small in comparison to overall turnover in the labor market due to technological development, changing consumer demands, etc.⁴ However, supply chain relationships can create greater opportunities for expansion and growth of domestic firms. Global supply chain relationships may allow firms to focus on their core activities and may enable them to expand employment in other areas.

12. Global supply chains also have positive impacts on productivity and may thus increase access to better, cheaper, and more varied goods and services. Supply chain relationships can also lead to increased inflows of foreign direct investment (FDI) to developed economies.

13. **Developing economies.** For developing economies, supply chain relationships can create numerous opportunities for growth. The expansion of global supply chains is clearly linked to the increasing integration of emerging countries into the global economy. Strong growth in manufacturing production has occurred in East Asia and in China, as well as in South Asia and the Middle East. Between 1996 and 2004, for example, Brazil, Russia, India, and China (known as the BRICs) together reported annual growth of 14.1% in manufactured exports, compared to 5.8% for the OECD as a whole. Exports of services are also increasing. Exports have grown more strongly than imports in the BRICs, resulting in an improvement of their trade surpluses.⁵

14. Also, trade data indicates that the BRICs have also become more active in higher-technology industries. Starting from a low base, their trade in high and medium-high-technology industries has risen faster than their trade in total manufacturing. In 2004 for example, average imports and exports in higher-technology industries, such as pharmaceuticals, scientific instruments, aircraft and spacecraft, motor vehicles, chemicals, and machinery and equipment, made

⁴ M.N. Baily and D. Farrel, *Exploding the Myth about Offshoring*, San Francisco: McKinsey Global Institute, 2004.

Sharon Brown and James Spletzer (2005), "Labour Market Dynamics Associated with the Movement of Work Overseas", (paper presented at OECD Workshop on the Globalisation of Production: Impacts on Employment, Productivity and Economic Growth, Paris, 15-16 November 2005).

⁵ OECD, *Moving up the Value Chain: Staying Competitive in the Global Economy*, (2007), www.oecd.org/dataoecd/24/35/38558080.pdf.

up almost 60% of the BRICs' total trade. This evolution will support larger inflows of FDI, increased innovation, and more sophisticated industrial structures.

15. **Small and medium-sized enterprises.** At the enterprise level, participation in global supply chains seems to bring stability to small and medium-sized enterprises (SMEs) in both developed and developing economies. Small firms that succeed in gaining access to a supply chain, and are able to retain their position in a supply chain despite competition, typically have more “staying power” than their peers.⁶

16. The development of global supply chains also offers SMEs new opportunities to expand their business across borders. The fragmentation of production also creates new entrepreneurial possibilities for SMEs that can move quickly and flexibly to fill emerging niches for the supply of novel products and services.⁷

17. Finally, through their supply chain relationships with MNEs, some SMEs have gained access to capital, experience, and expertise to enable them to develop into large MNEs themselves.⁸ The same trends enabling MNEs to develop supply chain relationships are also expanding SMEs' opportunities to realize efficiencies through supply chains. Similarly to MNEs, SMEs in developing economies are increasingly externalizing activities for production rationalization and resource optimization.⁹

D. Responsible Business Conduct Challenges in Supply Chain Relationships

18. Despite the clear opportunities, supply chain relationships can also create significant responsible business conduct challenges for MNEs. Beyond the business complexities of managing inventory, quality, etc., supply chain relationships introduce risks related to responsible business conduct as defined by the OECD Guidelines.

19. **Disclosure.** The complexity of supply chain relationships described above, and the challenges associated with visibility and traceability beyond the first tier of suppliers, creates challenges in knowledge of and disclosure of material information. In particular, MNEs sometimes struggle to identify and communicate foreseeable risk factors in their supply chain relationships.

20. Also, MNEs' disclosure of any impacts in their supply chains related to responsible business conduct issues are largely dependent on the accurate disclosure of impacts by suppliers and other actors in supply chain relationships. Historically, it has been challenging for MNEs to capture high-quality data on environmental impacts, labor conditions, and other responsible business conduct issues within the supply chain because often suppliers either do not track or do not want to disclose this information to MNEs.

21. **Employment and industrial relations.** Labor conditions in global supply chains, particularly those that extend into developing countries, often fail to meet international standards and national regulatory requirements and can lead to serious human rights abuses. These abuses may include denial of the freedom

⁶ OECD, (2007).

⁷ OECD, *SME and Entrepreneurship Outlook 2005*, Paris: OECD, 2005.

⁸ Dilek Ayut and Andrea Goldstein, “Developing Country Multinationals: South-South Investment Comes of Age,” In *Industrial Development for the 21st century: Sustainable Development Perspectives*, (New York: UN Department of Economic and Social Affairs, 2007), 85-116.

⁹ OECD, (2007).

of association and collective bargaining, the use of child and forced labor, employee discrimination, excessive work hours, degrading treatment by employers, inadequate health and safety protections, improperly paid wages, and inhibited movement. The causes are numerous—pressures to keep prices low and to meet MNE expectations for short production and delivery schedules, as well as poor enforcement of local and national regulations and low understanding among suppliers and other actors of labor rights standards—and can all create challenges for MNEs in supporting good employment and industrial relations. Additionally, workers' often lack the means to improve their situations, either due to poverty and the lack of other opportunities, or due to their limited understanding of labor rights or limited access to grievance mechanisms or union representation.

22. Poor labor conditions create significant business challenges for MNEs. Low productivity and worker strikes can impact product and service prices and delivery. Negative non-governmental organization (NGO) campaigns and media coverage damage brands and reputations, threaten employee engagement and retention, and can lead to customer boycotts which directly impact profitability.

23. **Environment.** Environmental impacts in supply chains can be severe, particularly where environmental regulations are lax, price pressures are significant, and natural resources are (or are perceived to be) abundant. These impacts can include toxic waste, water pollution, and hazardous air emissions as well as high energy use and greenhouse gas emissions. The impacts may start at the very beginning of a product or service lifecycle, with the extraction of basic material inputs, but often continue through to the end-of-life when use and disposal also create waste.

24. For MNEs, the challenges associated with negative environmental impacts in supply chains are significant. The potential costs of supplier non-compliance with local and national regulations, including fines and operating interruptions, can create volatility in the price of goods and services and threaten business continuity. And NGO, government, and customer attention to environmental impacts lead to some of the same challenges with negative brand and reputational impacts as are created by poor labor conditions.

25. **Bribery and competition.** Significant bribery and competition risks can exist in supply chain relationships including procurement fraud between MNEs and suppliers who engage in corrupt practices involving governments and other supply chain actors.

26. The direct costs to MNEs of bribery and anti-competitive behavior are considerable, including diminished product quality, but are often dwarfed by indirect costs related to management time and resources spent dealing with issues such as legal liability and damage to a MNE's reputation.

27. **Consumer interests.** Supply chain relationships can also create significant challenges for MNEs in protecting consumer interests. Less direct oversight of product manufacturing and service provision means that MNEs have less ability to effectively influence product content, data protection, and accurate disclosures to consumers.

28. The risks for MNEs in protecting consumer interests are extensive given the potential costs, both directly and to a MNE's reputation, of a product recall or fine for non-compliance with consumer protection regulations.

Prevalence of Responsible Supply Chain Management Approaches

Because disclosure of MNEs practices related responsible supply chain management is based on an uneven landscape of legal requirements and voluntary standards, there are no comprehensive and authoritative statistics on the prevalence of responsible supply chain management practices. However, there are a few recent research results and survey findings that provide some indication of the extent to which MNEs are applying these approaches.

For example, using an ASSET4 database of environmental, social and governance data on 2,508 global corporations, the Harvard Law School benchmarked public labor and human rights policies relating to global supply chains. Their findings revealed that a significant minority of companies (28 percent) has broadly stated policies in this area, but far fewer have detailed standards or follow-up procedures. However, less than 6 percent of MNEs endorse specific labor standards such as the eight core conventions of the International Labor Organization. Only 6 percent say they monitor suppliers for policy or code compliance or set improvement targets; and only 7 percent describe enforcement procedures.

(See Aaron Bernstein and Christopher Greenwald, "Benchmarking Corporate Policies on Labor and Human Rights in Global Supply Chains," Capital Matters Occasional Paper Series No. 5, Pensions and Capital Stewardship Project, Labor and Worklife Program, Harvard Law School, (November, 2009), <http://www.law.harvard.edu/programs/lwp/pensions/publications/occpapers/occasionalpapers5.pdf>).

29. **Science and technology.** While intellectual property (IP) and technology transfer offer important opportunities to advance supply chain relationships and support economic development, the widespread lack of stringent IP protection practices in global supply chains can create real risks for MNEs. IP infringement can lead to direct financial loss and stifle innovation.

E. Current MNE Approaches for Responsible Supply Chain Management

30. At present, there is no universal standard that defines responsible supply chain management for MNEs across all the responsible business conduct issues articulated in the Guidelines. As a result the scope and boundaries of MNE accountabilities for responsible business conduct issues in supply chains are not clearly defined. Instead, a baseline expectation has emerged, primarily driven by stakeholders including international organizations, governments, civil society, and labor groups, that MNEs should seek to uphold a number of legal and voluntary standards in their supply chain relationships including:

- » International covenants, declarations, and frameworks that define individuals' rights such as the Universal Declaration on Human Rights, the International Covenant on Economic, Social and Cultural Rights, and The International Labour Organization's Declaration on Fundamental Principles and Rights at Work
- » International frameworks and standards that define responsible business conduct such as the OECD Guidelines, the UN Global Compact, and the UN Protect, Respect, Remedy Framework
- » National and local regulations

31. To meet this expectation, MNEs, often in partnership with governments, NGOs, and other international institutions, have developed a number of different tools and approaches to assess and influence responsible business conduct in their supply chains.

32. Responsible supply chain management programs are generally based on four primary approaches—setting expectations, monitoring and audits, remediation and capability building, and partnership—each of which is implemented using a variety of tools.



33. **Setting expectations.** To set clear expectations with suppliers for responsible business conduct, MNEs use codes of supplier conduct which provide guidelines and direction to suppliers on how the MNE views responsible business conduct and what will be expected of suppliers in the course of the relationship. Codes of supplier conduct typically reference the three types of law and voluntary frameworks described above, and at present, this is the primary application of the OECD Guidelines to supply chain relationships.

34. The consequences for non-compliance with codes can vary significantly—from limited or no action taken by the MNE to requirements to participate in some

of the activities described below, such as monitoring or remediation, to consequences for the business relationship, such as suspension of new orders or contract cancellation.

35. **Monitoring and audits.** To assess suppliers' performance against responsible business conduct expectations, MNEs may ask suppliers to complete self-assessments or accept on-site audits. On-site audits may be performed at the facility level or at a supplier's headquarters (if the supplier has multiple facilities) and may be conducted by staff from the MNE or a third-party auditing firm. The scope, length, and frequency of audits vary considerably.

36. **Remediation and capability building.** MNEs use remediation and capability building to address specific areas of non-compliance discovered during the monitoring process and to promote continuous improvement of responsible business conduct.

37. Remediation can include a number of activities including working with suppliers to create a corrective action plan to achieve compliance, defining a roadmap for gradually increasing standards and expectations, and terminating supplier relationships when serious shortcomings on "zero-tolerance" issues are not remedied in spite of repeated notifications.

38. Capability building goes beyond fixing particular non-compliance issues to develop suppliers' overall ability to improve performance on specific responsible business conduct issues over time through an increased understanding of issues and access to resources. Capability building includes a variety of efforts, such as training for supplier personnel and establishment of supplier learning networks.

39. **Partnership.** To build more lasting responsible business conduct in the supply chain, some MNEs are trying to build supplier ownership of responsible business conduct expectations through partnership. Partnership approaches to responsible supply chain management employ many of the tools described, but rather than focusing solely on compliance with a code, partnership emphasizes the development of supplier management systems and creating shared incentives and value through responsible business conduct.

40. For example, some MNEs have begun incorporating evaluation of management systems into their audits and are providing training and consulting for suppliers on management system design. MNEs are also instituting improvement ladders which emphasize a continuous improvement approach to management systems development and provide increased incentives as responsible business conduct is demonstrated, such as recognition of improved performance, preferred supplier status, and reduced frequency of auditing.

41. Partnership approaches to responsible supply chain management are indicative of a significant mindset shift from a focus on basic risk management—value protection—to value creation for MNEs and suppliers. However, they are not yet widely applied by MNEs, even among those that have otherwise strong responsible supply chain management programs.

42. **Implementation.** As alluded to above, the approaches MNEs employ vary tremendously. Most MNEs, at least initially, build responsible supply chain management programs to manage the risks associated with responsible business conduct issues in their supply chains, including negative stakeholder attention and impacts on business continuity. Consequently, the approaches and tools employed, as well as the scope of their application through different tiers of

the supply chain, are a function of how MNEs perceive risks in their supply chain relationships rather than a normative decision.

43. To determine which responsible supply management approaches to apply with which suppliers, many MNEs begin by segmenting their supply base based on level of risk to their business. Some MNEs will also consider the level of risk to society and their opportunity to influence or impact suppliers' responsible business conduct based on the type of relationship with each supplier.

44. Most MNEs designing a new responsible supply chain management program focus on setting expectations, and to an extent, monitoring. Even advanced MNEs use these tools as the basis for understanding the extent of responsible business conduct issues in their supply chains, and to engage with their first-tier and sub-tier suppliers. Capability building and management systems tools are used more exclusively with suppliers that are considered more "strategic" by MNEs. These approaches are mainly the province of advanced MNEs who have a more sophisticated understanding of their supply chains, including where the biggest risks and opportunities are, and where investments will create long-term benefits for the buyer as well as the supplier and society.¹⁰



E. Challenges in Responsible Supply Chain Management

45. While the approaches described above are relatively common and well-established, there are still many complex and deeply rooted challenges that MNEs face in responsible supply chain management.

46. **Defining responsibility.** First and foremost is the challenge noted earlier in this section of defining the responsibility of MNEs for ensuring responsible business conduct in their supply chains. While guidelines such as the UN Protect, Respect, Remedy Framework have made great strides in beginning to clarify the roles of business and government in upholding international legal standards, these advancements have so far focused only on specific aspects of responsible business conduct such as human rights and build on discrete sources of international law and voluntary standards. While the UN Protect, Respect, Remedy Framework clearly applies to supply chain relationships, the implications for what this means in practice is still being defined. In addition, MNE responsibilities related to responsible business conduct issues beyond human rights are also unclear.

47. As a result, the responsible supply chain management efforts described above have been, for the most part, the result of on-going, informal, and ad hoc

¹⁰ Aaron Bernstein, and Christopher Greenwald, "Benchmarking Corporate Policies on Labor and Human Rights in Global Supply Chains," *Capital Matters Occasional Papers*, 5, (2009), www.law.harvard.edu/programs/lwp/pensions/publications/occpapers/occasionalpapers5.pdf.

UN Global Compact, "Supply Chain Sustainability: A Practical Guide for Continuous Improvement," *The United Nations Global Compact*, (2010).

interactions between MNEs and multiple stakeholders, often in reaction to negative events. At present, there is no overarching standard to help MNEs define and manage their responsibilities for all aspects of responsible business conduct—including human rights, labor rights, environmental protection, and good governance—in their supply chains. Thus, current approaches have been developed in the absence of a comprehensive standard, mainly in response to business risks, and based on evolving definitions of good practice.

48. Additionally, as understanding of the complexity of responsible supply chain management has grown over the last twenty years since some of the first responsible business conduct challenges in supply chains came to light, a number of systemic challenges have become evident including weak government enforcement of regulations, the lack of visibility in supply chains, the transactional nature of many supply chain relationships, the lack of bargaining power, poor MNE internal alignment, and weak or perverse incentives for suppliers, among others. While the partnership approach to responsible supply chain management has evolved partly in response to these challenges, there are still considerable barriers to MNE efforts to promote responsible business conduct in supply chains.

49. **Weak government enforcement of regulations.** Although national and local laws are one of the foundations of current responsible supply chain management efforts, they are often a shaky foundation. In many geographies, government policy is poorly enforced, either because governance structures are weak, resources are inadequate, corruption is endemic, or enforcement of responsible business conduct regulation is perceived to be disadvantageous to economic development. For MNEs, this creates complex challenges related to the boundaries between government and MNE responsibility for responsible business conduct and can put MNEs in the tenuous situation of acting as regulator or police officer.

50. **Lack of visibility.** As described above, many MNEs have little visibility into their supply chains because they have minimal direct interaction with the first tier of their supply chains and with sub-tiers. Even where MNEs take a more hands-on approach to managing their supply chain relationships, it is often challenging for MNEs to get a complete and accurate understanding of the sub-tiers of their supply chains. This lack of visibility makes it difficult for MNEs to identify responsible business conduct challenges and engage with supply chain actors to appropriately address them.

51. **Transactional nature of supply chains.** Similarly, many supply chain relationships are characterized by their transitory nature. In short-term relationships focused on a one-time delivery, possibly of a product that has already been manufactured, there is little opportunity for even well-resourced and highly committed MNEs to assess and address responsible business conduct issues with specific suppliers.

52. **Lack of bargaining power.** Even in longer-term supply chain relationships based on supplier selection or strategic management supply management models, MNEs struggle with a lack of bargaining power to require responsible business conduct in the supply chain. The threat of lost business generally is not a strong deterrent for irresponsible business conduct by suppliers who can often find another buyer with less stringent requirements. Also, MNEs are often hesitant to withdraw business based on irresponsible business conduct because there are significant costs associated with switching suppliers, and in the worst case, a supplier closure has significant negative repercussions for workers and local economies. MNEs may also be unable to offer positive incentives such as

preferred contracts or higher prices for responsible business conduct to suppliers.

53. **Poor MNE internal alignment.** There is often an unresolved tension within MNEs between commercial and responsible supply chain management objectives, particularly for purchasing and supply management staff. This tension can be further aggravated by product design that does not account for responsible business conduct issues, such as setting product specifications that require the use of highly toxic chemicals, and logistics complications that create significant time pressures and lead to worker overtime requirements or insufficient rest breaks. Until responsible business conduct issues in the supply chain become a priority for all functions within MNEs, responsible supply chain management efforts may be unintentionally circumscribed by supplier requirements from other parts of the business.

54. **Weak or perverse incentives for suppliers.** The lack of internal alignment can create competing incentives for suppliers as described above. This is exacerbated by many of the responsible supply chain management approaches currently employed by MNEs which focus on negative consequences for non-compliance rather than incentives for improved or consistent performance. In these situations, it is often easier for suppliers to fake compliance using double sets of books, forged certifications, etc. Competing incentives are also introduced by governments—for example, suppliers sometimes use double sets of books to demonstrate a smaller staff and therefore decrease their tax burden or other social contribution requirements.

III. Translating Multinational Enterprise Responses into Broader Operational Principles and Standards for Responsible Supply Chain Management Conduct

A. Opportunities for Defining Responsible Supply Chain Management

55. While the approaches to responsible supply chain management described above generally represent well-intentioned efforts by MNEs and other stakeholders to address emerging and evolving challenges in responsible business conduct in the supply chain, they are limited by the deficit in understanding of what defines MNE responsibility for responsible business conduct in supply chains.

56. MNEs should seek first and foremost to meet international, national, and local laws relevant to legal business conduct in the practices of their supply chains. To clearly define MNEs' responsibilities in responsible supply chain management though, an overarching framework is also needed to define MNEs responsibilities.

57. To effectively promote responsible business conduct throughout supply chains, and to help MNEs to understand how to direct their efforts in order to meet their responsibilities, such a framework needs to take into account the complexity of supply chain relationships, the evolving nature of responsible business conduct issues, and the complicated and overlapping web of international legal and voluntary standards and national and local laws. Therefore, it is limiting to strictly define MNE responsibilities in terms of a particular type of supply chain relationship or supplier tier. For example, some of the most serious responsible business conduct issues, such as forced labor in mines in conflict-affected areas, arise in the sub-tiers of MNEs' supply chains, and a definition of responsibility and responsible supply chain management that is limited to only to the first tier of suppliers would overlook these issues.¹¹

58. Rather, what is needed is a framework that describes how MNEs themselves should define and manage their responsibilities for responsible business conduct in the supply chain based on their unique supply chain relationships and the responsible business conduct issues that may arise in the context of those relationships. The framework should provide guidance on:

- » *Assessment*: how MNEs should identify and understand the full universe of potential responsible business conduct issues in their supply chains.
- » *Prioritization*: how MNEs should prioritize these issues to determine what issues, and therefore suppliers, to engage with.
- » *Management*: how MNEs should manage prioritized issues.

59. Additionally, such a framework should emphasize that, due the evolving and emerging nature of responsible business conduct issues in the supply chain, responsible supply chain management requires an ongoing, iterative approach to assessment, prioritization, and management of issues.

¹¹ The UN Protect, Respect, Remedy Framework pointed out similar challenges with trying to identify a limited set of rights for which they may bear responsibility and concluded that there are few if any internationally recognized rights business cannot impact - or be perceived to impact - in some manner. See John Ruggie, *Protect, Respect and Remedy: a Framework for Business and Human Rights*, Human Rights Council, (2008), www.reports-and-materials.org/Ruggie-report-7-Apr-2008.pdf.

60. A framework for defining responsible supply chain management should also specify the two types of responsible business conduct issues that MNEs should assess, prioritize, and manage:

- » *Risks to society*: potential outcomes that would have a detrimental effect on human rights, labor rights, consumer interests, the environment, economic development and inclusion, and good governance as defined in international legal and voluntary standards.
- » *Risks to business*: potential outcomes that would have a detrimental effect on achieving business success including realizing business strategies, meeting financial targets, ensuring business continuity, containing costs, protecting reputation and brand equity, meeting customer and investor expectations, and other sources of business value.

61. As described in Part II, some leading MNEs are also making positive contributions to create value through responsible supply chain management. These MNEs use assessment of responsible business conduct issues in the supply chain to identify present, emerging, and potential risks as well as opportunities for value creation. They prioritize those issues that are important to stakeholders and that have an influence on business success, and engage with suppliers to realize opportunities. While it is important to recognize that responsible supply chain management can make a positive contribution to create value for society as well as for MNEs and suppliers, the assessment, prioritization, and management of opportunities for positive contribution is beyond the scope of MNE baseline responsibility for responsible supply chain management.

62. There are a number of different concepts that MNEs have used for defining and managing baseline responsible business conduct in the supply chain and which may prove useful for establishing a comprehensive framework:

- » *Investment nexus*: the practical ability of MNEs to influence the conduct of their business partners with whom they have an investment-like relationship.
- » *Sphere of influence*: the scope of power and influence that a MNE has over the decisions and activities of suppliers.
- » *Impact*: the positive or negative change resulting from MNEs' decisions and activities.
- » *Due diligence*: the process of evaluating (and managing) the risk involved in doing business with an entity prior to establishing and during a relationship.
- » *Materiality*: the assessment of the relative importance of an issue based on its impact on MNEs' business strategy as well as its impact on society.
- » *Continuous improvement*: the process of identifying and realizing opportunities for performance improvement.

63. Below, each of these concepts is explored in detail and analyzed for usefulness in assessing, prioritizing, and managing responsible business conduct opportunities and risks to business and society.

B. Investment Nexus

64. The concept of investment nexus has been the foundation for guidance developed by the OECD Committee on International Investment and

Multinational Enterprises (CIME) on how the Guidelines are intended to apply to supply chains.¹²

65. The investment nexus concept is broadly defined as the idea that MNEs' practical ability to influence the conduct of their business partners is based on the extent to which they have an investment-like relationship. Some National Contact Points have given a broad interpretation to the concept of investment nexus, and accepted cases on supply chains and contractual relationships, while others have given the investment nexus a much more narrow interpretation, and therefore excluded similar cases.

66. At present, the OECD is the only international institution that uses the concept of investment nexus. In the OECD CIME statement on the scope of the Guidelines issued in 2003, the concept is used to provide guidance to MNEs on the scope of the applicability of the Guidelines to supply chain relationships. No other international standard or guidance references the concept.

67. There is an obvious connection between the investment nexus concept and responsible supply chain management. In particular, the concept suggests that MNEs assess and prioritize the responsible business conduct issues that arise in their supply chains based on where they have strong, investment-like relationships.

68. However, the concept is weak in three key ways. First, it does not advise on how to determine if a supply chain relationship is investment-like. The CIME statement on the scope of the Guidelines recommends a "case by case approach...that takes into all factors relevant to the nature of the relationship and the degree of influence," which leaves the meaning of investment nexus and investment-like relationships subject to interpretation.¹³

69. Second, the concept does not provide any guidance on what responsible business conduct issues MNEs should assess, prioritize, and manage. Specifically, it does not distinguish between responsible business conduct risks to society or to business. Third, the investment nexus concept lacks recommendations for MNEs on managing responsible business conduct.

70. Consequently, the concept of investment nexus is too flexible and open to interpretation to be applied as a framework for responsible supply chain management.

C. Sphere of Influence

71. The concept of sphere of influence is currently the predominant paradigm for responsible supply chain management.

72. While it is difficult to establish the exact meaning of the sphere of influence concept, it is generally used to refer to the scope and extent of power and influence that a MNE has over the decisions and activities of other entities.

73. The concept of sphere of influence is quite prevalent in international principles and standards. For example, the concept of sphere of influence will be included in the final ISO26000 standard in some form, although there are ongoing discussions by the drafting group about how the standard can be aligned with the UN Protect, Respect, Remedy Framework. The ISO26000 drafting group

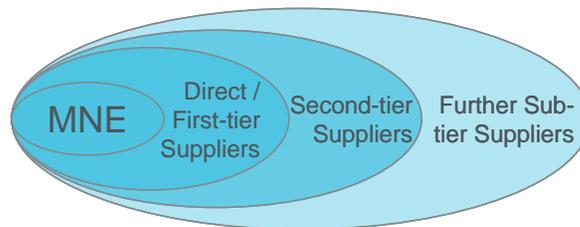
¹² OECD, "Statement by the Committee," *Scope of the Guidelines and the Investment Nexus*, (2003), www.oecd.org/document/3/0,3343,en_2649_34889_37356074_1_1_1_1.00.html.

¹³ Ibid.

discussed in May 2010 the following definition of sphere of influence: “range/extent of political, contractual, economic or other relationships through which an organization has the ability to affect the decisions or activities of individuals or organizations.”¹⁴ In addition, the drafting group recommends that the standard clarify that:

“An organization does not always have a responsibility to exercise influence purely because it has the ability to do so. For instance, it cannot be held responsible for the impacts of other organizations over which it may have some influence if the impact is not a result of its activities. However, there will be situations where an organization will have a responsibility to exercise influence. These situations will be determined by the extent to which the organization’s relationship is contributing to negative impacts.”¹⁵

74. Additionally, the UN Global Compact refers to sphere of influence to establish the scope of MNE responsibilities for application of the principles contained therein. In this context, sphere of influence was intended as a spatial metaphor: the “sphere” was expressed in concentric circles with MNE operations at the core, moving outward to suppliers, the community, and beyond, with the assumption that the “influence”—and thus presumably the responsibility—of the MNE declines from one circle to the next.¹⁶ The criteria for determine which suppliers fit into which circles was a loose paradigm based on the suppliers’ proximity to the MNE in terms of contractual relationship. However, the Global Compact’s practical guide on supply chain sustainability does not use the concept of sphere of influence.



75. While the link between the concept of sphere of influence and responsible supply chain management is clear, and can in practice be useful for identifying opportunities for positive contributions to responsible business conduct in the supply chain, there is a growing recognition that the concept is flawed both in theory and in practice.

76. First, despite its prevalence, there is still considerable lack of clarity as to the meaning of the concept. Its exact meaning in practice is highly specific to individual MNEs based on a holistic view of the business, its partnerships and relationships with other entities and governmental agencies, its legal structure and organization, as well as its physical property and operations.¹⁷ The vague use of the concept has left it overly flexible and malleable.

¹⁴ ISO, *Copenhagen Discussion Document: Copenhagen Key Topics (CKTs) – 4 May 2010*, (2010), <http://isotc.iso.org/livelink/livelink?func=ll&objId=9180193&objAction=Open>.

¹⁵ Ibid.

¹⁶ John Ruggie, *Protect, Respect and Remedy: a Framework for Business and Human Rights*, Human Rights Council, (2008), www.reports-and-materials.org/Ruggie-report-7-Apr-2008.pdf.

¹⁷ Urs Gasser, post on “Corporate Social Responsibility: What is the Meaning of ‘Sphere of Influence’?” *Law and Information Blog*, entry posted October 25, 2006, <http://blogs.law.harvard.edu/ugasser/2006/10/25/corporate-social-responsibility-what-is-the-meaning-of-sphere-of-in/>.

77. Further, according to the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, John Ruggie, “sphere of influence conflates two very different meanings of influence: one is impact, where the MNE’s activities or relationships are causing human rights harm; the other is whatever leverage a MNE may have over actors that are causing harm. The first falls squarely within the responsibility to respect; the second may only do so in particular circumstances.”¹⁸ The representative goes on to explain that “anchoring corporate responsibility in the second meaning of influence requires assuming, in moral philosophy terms, that ‘can implies ought’. But MNEs cannot be held responsible for the human rights impacts of every entity over which they may have some influence, because this would include cases in which they were not a causal agent, direct or indirect, of the harm in question. Nor is it desirable to have MNEs act whenever they have influence, particularly over governments.”¹⁹

78. As a foundation for responsible supply chain management, application of the concept of sphere of influence does not sufficiently distinguish between risks and MNEs’ capacity to exert influence. It could lead MNEs to miss considerable risks in sub-tiers of supply chains. For example, the most serious responsible business conduct issues in supply chains, e.g. child labor, forced labor, and serious violations of health and safety, often exist in sub-tiers of MNEs supply chains, precisely where influence is weak, but where significant risks may still exist. Consequently, MNE responsible supply chain management programs based on sphere of influence may not prioritize issues that are critical risks to society nor to the business itself.

79. Since the concept of sphere of influence does not provide useful guidance on assessing, prioritizing or managing responsible business conduct risks in the supply chain, and has been largely discredited in the international community, it is insufficient as a framework for responsible supply chain management.

D. Impact

80. The concept of impact is also increasingly referenced as a foundational concept for MNEs’ responsible supply chain management programs.

81. The draft ISO26000 standard defines impact as the “positive or negative change to society, economy or the environment, wholly or partially resulting from an organization’s past and present decisions and activities”.²⁰

82. Beyond the draft ISO26000 standard, impact is used in many other international standards including the UN Global Compact and the International Finance Corporation’s Policy on Social and Environmental Sustainability. In the current debate, impact is often used in place of the idea of influence—the UN Protect, Respect, Remedy Framework suggests that one meaning of influence is the concept of impact, where the MNE’s activities or relationships are causing harm. The UN Protect, Respect, Remedy Framework also uses the concept of impact to explain that the scope of corporate responsibility to respect human rights is defined by the actual and potential human rights impacts resulting from a MNE’s business activities and the relationships connected to those activities.²¹

¹⁸ Ruggie, (2008).

¹⁹ Ruggie, (2008).

²⁰ ISO, *Draft International Standard ISO/DIS26000: Guidance on Social Responsibility*, Geneva: ISO, (2009), http://isotc.iso.org/livelink/livelink/fetch/-8929321/8929339/8929348/3935837/ISO_DIS_26000_Guidance_on_Social_Responsibility.pdf?no_deid=8385026&vernum=-2.

²¹ Ruggie, (2008).

83. The concept of impact has useful links to responsible supply chain management. As a framework, it is a helpful concept for MNEs to employ in evaluating opportunities for positive contributions to responsible business conduct in the supply chain. And unlike sphere of influence, it does not presuppose any geographic or spatial formula.

84. However, based on the current use of the term in international standards and principles, it is unclear if the term is limited to risks to society or if it also encompasses risks to business. While critical to assessing and understanding where MNEs might have a negative impact on society, the former interpretation would leave a gap in guidance on how MNEs should prioritize investments and engagement with suppliers to mitigate these risks based on their potential impact on the business.

85. In practice, the use of impact as a foundational framework for responsible supply chain management may result in MNEs prioritizing engagement on high societal risk issues and overlooking issues that are perceived as lower risk to society but that present serious business risk.

86. Impact is a useful framework for understanding how to prioritize engagement with responsible business conduct issues and suppliers. However, as an independent framework for responsible supply chain management, impact is not an adequate foundation for management.

E. Due Diligence

87. The concept of due diligence is often an implicit starting point for MNEs seeking to build responsible supply chain management programs.

88. Although definitions vary to some extent, the ISO26000 drafting group discussed in May 2010 the following definition of due diligence: a “comprehensive, proactive process to identify the actual and potential negative social, environmental and economic impacts of an organization’s decisions and activities, with the aim of avoiding and mitigating those impacts.”²² There are differing conceptions of due diligence as a management process versus an assessment approach that should be part of a larger, more robust management system.

89. Due diligence is currently referenced in a number of international standards and principles. In addition to ISO26000, the UN Global Compact references due diligence in its guidance on the responsibility of business to respect human rights.²³ Further, the OECD Pilot Project in the Mining and Minerals Sector is developing “draft due diligence guidance” as a framework for MNEs to manage risks related to the supply chains of minerals sourced from conflicted-affected and high-risk areas.²⁴ The UN Protect, Respect, Remedy Framework states that to discharge the responsibility to respect human rights requires due diligence and defines the core elements of human rights due diligence as:

1. Having a human rights policy;

²² ISO, *Copenhagen Discussion Document: Copenhagen Key Topics (CKTs) – 4 May 2010*, (2010), <http://isotc.iso.org/livelink/livelink?func=ll&objId=9180193&objAction=Open>.

²³ UN Global Compact, “The Ten Principles: Principle One,” *The United Nations Global Compact*, (2000), www.unglobalcompact.org/AboutTheGC/TheTenPrinciples/principle1.html<http://www.unglobalcompact.org/AboutTheGC/TheTenPrinciples/principle1.html>.

²⁴ OECD, *Draft Due Diligence Guidance, Pilot Project in the Mining and Minerals Sector: Corporate Due Diligence for Responsible Supply Chain Management of Minerals from Conflict-Affected and High-Risk Areas*, (forthcoming).

2. Assessing human rights risks and impacts;
3. Integrating human rights throughout a company;
4. Having a mechanism to handle grievances; and
5. Tracking and reporting performance.²⁵

90. The concept of due diligence has obvious links to responsible supply chain management. As a conceptual framework, it is useful for helping MNEs assess the issues and consequently which suppliers to engage with on responsible business conduct. Further, the concept as defined by the UN Protect, Respect, Remedy Framework, which has gained considerable traction among MNEs, international organizations, and other stakeholders, also provides guidance on managing human rights issues. Because the UN Protect, Respect, Remedy Framework includes both a definition of responsibility, i.e. “do no harm,” as well as more operational guidance in the form of due diligence, it could be a key component of responsible supply chain management.

91. In view of the diversity of responsible business conduct issues covered by the Guidelines, however, the UN Protect, Respect, Remedy Framework concept of due diligence would require further elaboration with regard to providing guidance on other issues beyond human rights, such as the forthcoming guide on due diligence in minerals supply chains from the OECD.²⁶ Additionally, the concept could be further augmented with practical guidance on the balanced prioritization of risk mitigation efforts. That additional practical guidance should consider both risks to business and to society and should recognize that some environmental or social issues do not necessarily represent an equal risk to business and to society.

92. In practice, due diligence provides guidance to MNEs on the identification and management of risks to both society and business. Additional guidance on prioritization would help companies ensure a balanced mitigation of the broad range of risks related to responsible business conduct.

93. In sum, due diligence is a robust, near-comprehensive approach for assessing and managing responsible business conduct risks, and with some further adjustments, could be the core of an overarching framework for supply chain management.

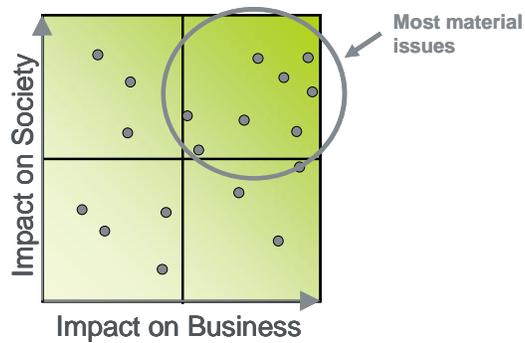
F. Materiality

94. The concept of materiality is a separate, additional interpretation of the concept of impact that considers both the effects of a responsible business conduct risk on society as well as on a MNE.

95. Materiality is generally defined as the assessment of the relative importance of an issue based on its impact on a MNE’s business strategy as well as its impact on society. Originally, the concept pertained to the reporting of business risk to regulators and investors, but has been expanded within the field of responsible business and corporate responsibility to encompass risks to business and society as well as opportunities for value creation. A responsible business materiality assessment begins by identifying all of the possible issues that could arise in the supply chain and then evaluating the potential impact of each issue on a MNE’s business success as well as its potential impact on society (using the issue’s importance to stakeholders as a proxy) to determine which issues are most material for the MNE and society.

²⁵ Ruggie, (2008).

²⁶ Ruggie, (2008).



96. The concept of materiality is not yet prevalent in international principles or standards but is increasingly used as a foundation by MNEs in responsible business reporting and strategy. For example, it is a key principle of the Global Reporting Initiative Sustainability Reporting Framework.

97. Although it is still a nascent concept in this field, materiality has clear links to responsible supply chain management. As a framework, it provides strong guidance to MNEs on the evaluation of risks to society and business as well as opportunities.

98. However, materiality does not offer a comprehensive management process for the issues that MNEs determine should be high priority. Accordingly, materiality is inadequate as a comprehensive framework for responsible supply chain management and is most useful for assessment and prioritization.

G. Continuous Improvement

99. Finally, the concept of continuous improvement, while less prevalent in international principles, is also increasingly cited as a basis for MNE responsible supply chain management programs. The UN Industrial Development Organization defines continuous improvement as “a process that identifies opportunities for performance improvement and facilitates their realization through the use of metrics, process development methodologies/approaches, project management principles, and reporting tools that support strategic and business plans”.²⁷

100. At present, continuous improvement is only included in a small number of international standards, although the UN Protect, Respect, Remedy Framework references the idea, and emphasizes an iterative approach to due diligence.²⁸ However, continuous improvement is a widely applied business concept embedded in the management systems approach and has been applied to supply chains to address quality concerns. Many MNEs have also begun to use the concept as a basis for aspects of their responsible supply chain management programs, particularly supplier capability building and management systems development.

101. The link between the concept of continuous improvement and responsible supply chain management is therefore apparent. The advantage of continuous improvement is that it provides guidance on applying an iterative approach to assessing, prioritizing, and managing responsible business conduct issues in the supply chain.

²⁷ UNIDO, *SPX Expert Corner: Supply Chain Management Glossary*, www.unido.org/index.php?id=o51310.

²⁸ Ruggie, (2008).

102. The concept is limited though because, like sphere of influence, continuous improvement may lead MNEs to focus more on the “can” than on the “ought”—on what they are more easily able to do rather than difficult issues for which they may have responsibility. It also does not offer any clarity on the types of issues—risks to society or risks to business—that should be identified and addressed.

103. In practice, a MNE responsible supply chain program based exclusively on the concept of continuous improvement might over-emphasize “quick wins” and fail to make investments in high-risk responsible business conduct issues and suppliers based on a perception of low likelihood of improvement. The continuous improvement framework applied on its own would also emphasize capability building and management systems development over (more widespread) monitoring, leaving MNEs potentially unaware of risks in unmonitored parts of their supply chains.

104. Although useful as a concept to guide implementation of a responsible supply chain management framework, continuous improvement does not provide clarity on the elements of assessment, prioritization, or management of risks to business and society. Therefore, the concept of continuous improvement is deficient as a comprehensive framework for responsible supply chain management.

H. Towards a Comprehensive Framework for Responsible Supply Chain Management

105. MNE responsible supply chain management should be based on a framework that promotes a strong understanding of where risks to the business and to society exist. Such a framework should also provide guidance on the elements of a robust management system which includes not only assessment of responsible business conduct issues in the supply chain but also processes for appropriately prioritizing and managing those issues.

106. Of the concepts reviewed, the concept of due diligence as defined by the UN Protect, Respect, Remedy Framework provides the strongest foundation for a comprehensive framework for assessing and managing responsible business conduct issues in the supply chain. Due diligence can usefully be augmented with concepts of materiality and continuous improvement that provide additional guidance on the prioritization of responsible supply chain issues, clearly specify the necessity of prioritization based on risks to business and to society, and applying a continuous improvement approach to responsible business conduct in the supply chain.

107. The three concepts illustrated below—due diligence, materiality, and continuous improvement—would together create a comprehensive framework.²⁹ As an overarching framework for responsible supply chain management, due diligence describes the steps MNEs must take to assess, prioritize, and manage responsible business conduct issues in the supply chain. Materiality offers



²⁹ See the OECD, Draft Due Diligence Guidance, Pilot Project in the Mining and Minerals Sector: Corporate Due Diligence for Responsible Supply Chain Management of Minerals from Conflict-Affected and High-Risk Areas, (forthcoming)

additional guidance specifically on the assessment and prioritization elements of due diligence to ensure that all potential impacts—risks to society as well as to business—are evaluated and prioritized. Continuous improvement provides guidance on implementation of the framework to ensure that MNEs assess, prioritize, and manage evolving and emerging risks.

IV. Developing Guidance on the Application of the OECD Guidelines to Supply Chain Relationships

A. Current Guidance on Responsible Supply Chain Management in the OECD Guidelines

108. At present, the OECD Guidelines for Multinational Enterprises offer limited guidance related to responsible supply chain management. References to suppliers are limited to the General Policies and associated Commentary, the Commentary on Disclosure, the Commentary on Environment, and the Guidance on Competition.

- » *General Policies*: MNEs are prompted to “encourage, where practicable, business partners, including suppliers and sub-contractors, to apply principles of corporate conduct compatible with the Guidelines” in the General Policies. The Commentary on this General Policy focuses on why this encouragement is important to meeting the objectives of the Guidelines and on the limitations MNEs face in actually doing so. Very little is offered in terms of guidance on how to apply this Policy.
- » *Commentary on Disclosure*: Suppliers are also referenced in the Commentary on Disclosure, specifically in relation to social, environmental, and risk reporting.
- » *Commentary on Environment*: Additionally, the Commentary on Environment references the importance of engaging with suppliers (among other stakeholders) to build trust in MNEs and “understanding on environmental issues of mutual interest.”
- » *Guidance on Competition*: The Guidance on Competition encourages MNEs to “refrain from entering into or carrying out anti-competitive agreements among competitors ... to share or divide markets by allocating customers, suppliers, territories or lines of commerce.”

109. The Guidelines do not provide any definition of supplier or supply chain.

110. Additionally, the Guidelines currently make little use of the concepts described above:

- » *Investment nexus*: Investment nexus is currently not referenced at all.
- » *Sphere of influence*: The Commentary on the General Policies does refer to influence and scope of influence, which though not defined are presumed to be related to the concept of sphere of influence. The Commentary acknowledges the variation in the extent and the scope of influence that MNEs have, and also specifies that “Established or direct business relationships are the major object of this recommendation rather than all individual or ad hoc contracts or transactions that are based solely on open market operations or client relationships.” However, the Commentary does not provide any guidance on how MNEs can determine what influence they have with suppliers or on responsible business

conduct issues. It also does not offer any advice on how MNEs should use their influence in responsible supply chain management.

- » *Impact*: The concept of impact is referenced but not in regard to supply chain relationships.
- » *Due diligence*: Due diligence is currently not referenced at all.
- » *Materiality*: The concept of materiality is referenced but not in regard to supply chain relationships.
- » *Continuous Improvement*: The concept of continuous improvement is referenced but not in regard to supply chain relationships.

B. The Imperative for Revisions to the Guidelines on Responsible Supply Chain Management

111. There is clearly an opportunity for the OECD to significantly strengthen the guidance on responsible supply chain management provided by the Guidelines. There is also an obvious imperative to do so.

112. As discussed throughout this paper, there is no universal standard that defines the responsibilities of MNEs for the responsible business conduct issues in supply chains described above, with the exception of the UN Protect, Respect, Remedy Framework which defines responsibilities related to human rights. Not only does this create challenges for MNEs which seek direction for their well-intentioned efforts on responsible supply chain management, it also inhibits accountability for MNEs that have not proactively engaged with responsible business conduct issues in the supply chain. The OECD Guidelines are an appropriate instrument to use to clarify responsible supply chain management for four primary reasons: current relevance to MNEs and stakeholders, comprehensiveness, structure, and implementation mechanism.

113. **Current relevance.** First, as described in Part II, the Guidelines are currently used by MNEs and other stakeholders as a reference point for the baseline expectations of MNEs in responsible supply chain management. Rather than creating a new instrument for responsible business conduct in supply chains, it is more useful to integrate responsible supply chain management into existing instruments.

114. **Comprehensiveness.** The OECD Guidelines are the most comprehensive multilaterally-agreed corporate responsibility instrument currently in existence. The only other similarly comprehensive standard for responsible business conduct, the UN Global Compact, is designed for business rather than government adherence. Other international government standards are limited to specific issues in responsible business conduct.

115. **Structure.** The OECD Guidelines are also structured in a way that facilitates further guidance and clarification on responsible supply chain management, for example through Commentary. Unlike other international standards, which have little room for adjustment and no established regular method for revision, the structure of the Guidelines allow detailed guidance to be added through regular updates.

116. **Implementation mechanism.** Finally, the OECD Guidelines also have a unique implementation mechanism that can be leveraged to help further realization of any additional guidance on responsible supply chain management. Through their “specific instances” facility, National Contact Points (NCPs) offer support for resolving disputes between MNEs and stakeholders arising from

alleged non-observance of the Guidelines. Further considerations for the role of NCPs in relation to responsible supply chain management are examined below.

C. Opportunities to Provide Additional Clarity and Guidance on Responsible Supply Chain Management

117. To provide maximum guidance and clarity on how MNEs should apply the Guidelines in their supply chain relationships, the Guidelines should describe and encourage MNEs to implement a comprehensive framework that outlines how MNEs can assess, prioritize, and manage responsible business conduct issues in the supply chain. As described in Part 2, the three concepts of due diligence, materiality, and continuous improvement could be integrated to create a complete framework.

118. Based on the above analysis of the use of these concepts, it will be critical to clearly define each of these concepts in the Guidelines and to explain how they are intended to complement each other.

119. Additionally, any revision of the Guidelines should include an explanation of what is meant by suppliers and supply chain relationships. This could be included in the Concepts and Principles, where the definition of MNEs is currently addressed, or as part of any of the options described below.

120. There are a number of options to present this framework in the Guidelines:

- » *Option 1:* Revise the tenth General Policy and associated Commentary.
- » *Option 2:* Revise only the Commentary associated with the tenth General Policy.
- » *Option 3:* Revise the Commentary on Disclosure, Employment and Industrial Relations, Environment, Combating Bribery, Consumer Interests, and Science and Technology.
- » *Option 4:* Revise the Commentary on Disclosure, Employment and Industrial Relations, Environment, Combating Bribery, Consumer Interests, and Science and Technology in combination with Option 1 or 2.
- » *Option 5:* Add a special annex on the responsibilities of MNEs in applying the Guidelines to supply chain relationships.

121. Options should be considered based on their ability to provide complete guidance at a level of detail deemed appropriate by adhering governments. For example, edits to the text of the guidelines must be approved by the OECD Council, while the Commentaries are adopted at the level of the Investment Committee. Likely MNE perceptions of the level of importance of the guidance in relation to other elements of the Guidelines should also be considered. Each option is described in detail below.

122. **Option 1.** The most obvious option is to revise and expand on the tenth General Policy and Commentary that specifies that MNEs should encourage suppliers to apply principles of corporate conduct compatible with the Guidelines. This Policy could be considerably strengthened by recommending that MNEs apply the concept of due diligence to assess, prioritize, and manage material responsible business conduct impacts, as defined by the Guidelines, in their supply chain relationships.

123. The Commentary would need to be revised to explain the concept and each element of due diligence—assess, prioritize, and manage. The Commentary would also need to describe the concepts of materiality and

continuous improvement and how they should be applied by MNEs to implement the elements of due diligence.

124. The advantage of this option is that responsible supply chain management would be highlighted as a fundamental obligation of MNEs in meeting the OECD Guidelines. However, the links to specific Guidelines, such as Consumer Interests and Environment, might not be as clear.

125. **Option 2.** The Guidelines could be updated by revising only the Commentary related to the tenth General Policy without revising the Policy itself. The Commentary could be expanded as described above to present the framework of due diligence, materiality, and continuous improvement and describe responsibilities in responsible supply chain management.

126. This option, while somewhat clarifying and strengthening the Guidelines, would not send as strong of a message to MNEs about the necessity of responsible supply chain management as part of meeting the OECD Guidelines.

127. **Option 3.** Guidance on responsible supply chain management could be provided through the Commentary on Disclosure, Employment and Industrial Relations, Environment, Combating Bribery, Consumer Interests, and Science and Technology. This would necessitate a comprehensive explanation of the framework and descriptions of the concepts of due diligence, materiality, and continuous improvement throughout the Commentary of the Guidelines.

128. While the importance of responsible supply chain management would be emphasized by including it in so many places, the guidance would be somewhat difficult to access and may be perceived as a weak recommendation by MNEs. The guidance might also become repetitive, which would weaken the Guidelines overall by unnecessarily lengthening them.

129. **Option 4.** A revision of the tenth General Policy or the General Policies Commentary could be complemented by additional guidance through changes to the Commentary on Disclosure, Employment and Industrial Relations, Environment, Combating Bribery, Consumer Interests, and Science and Technology. Because the framework and concepts would be clearly explained in the tenth General Policy and Commentary, it would not be necessary to repeat that information. Rather, the expanded Commentaries could offer more detail on how MNEs should apply the framework specifically to the subject of each chapter.

130. This option would be helpful for providing more detailed guidance on responsible supply chain management and emphasizing its importance throughout the Guidelines. However, it would also disaggregate the guidance and potentially make it more difficult for MNEs to comprehensively identify responsibilities.

131. **Option 5.** Finally, the Guidelines could provide stronger and clearer guidance on responsible supply chain management by adding a special annex on the responsibilities of MNEs in applying the Guidelines to supply chain relationships.

132. Because this would be a new format for the Guidelines, the options for how this could be designed are numerous. In general, an annex could cover many of the topics described above—an overall framework for applying the Guidelines in supply chain relationships and an explanation of how the concepts of due diligence, materiality, and continuous improvement should be applied to

assessment, prioritization, and management of responsible business conduct for responsible supply chain management. An annex could also provide more detailed guidance on how MNEs can apply the framework to the specific topics covered by the Guidelines.

133. The advantage of this option, like the option of strengthening the tenth General Policy and the General Policies Commentary, is that all of the guidance would be captured in one place in the Guidelines and easily accessible. As described, a special annex would also be the most comprehensive of the options discussed. However, the lack of precedent for a special annex could create a challenge with regard to the perception by MNEs. On the one hand, a special annex could be perceived as emphasizing the importance of responsible supply chain management. However, by separating the guidance from the existing guidance and formatting it differently, responsible supply chain management could be interpreted as a topic not integral to the Guidelines. One alternative would be to create a “reference annex” that gathers together the Guidelines text and Commentary from various sections so that these are accessible in one place, though without any official status beyond being a collection of related text that has been approved by adhering governments.

D. Considerations for the Role of the National Contact Points

134. Finally, it is important to consider how revisions to the Guidelines to provide guidance on supply chain relationships might impact the role of the NCPs and whether any additional guidance is needed in Part II of the Guidelines. This implementation mechanism is unique among international responsible business conduct instruments and as such presents unique opportunities to further realization of the guidance provided on responsible supply chain management.

135. The terms of reference for the update of the Guidelines covers procedural provisions and institutional issues related to NCPs, including promotion of the Guidelines, implementation in specific instances, NCP co-operation, and peer learning. In practice, new guidance related to responsible business conduct in supply chains, if adopted by adhering governments, will also require careful consideration of how the NCP mechanism will be affected.

136. Currently, the Procedural Guidance and associated Commentary do not offer any guidance specifically related to MNEs’ application of the Guidelines in supply chain relations.

137. Specific instances of responsible business conduct issues in supply chains will be more difficult to resolve because supply chain relationships are complex and relationships can be unclear. Each specific instance will likely have particular complexities. For example, many suppliers in global MNE supply chains are based in non-adhering countries. The Commentary does however provide some direction on the role of NCPs in the event that Guidelines-related issues arise in a non-adhering country and this will be further expanded by the update process. However, it is important that each specific instance be carefully implemented with due caution and concern for all the parties involved, and in the spirit of shared learning and problem solving.

138. More specifically, NCPs will require information and guidance about responsible business conduct issues in supply chains, responsible supply chain management practices, and guidance in promoting this aspect of the Guidelines. They will also require guidance on implementing the specific instances facility—specifically on which instances to accept, procedures for further investigation, and guidance on mediation and adjudication, and how to pursue peer learning

opportunities. In addition, guidance related to third-party standing will be particularly important given that responsible business conduct issues in supply chains typically involve multiple parties who share responsibility in some way.

139. Given the options for revising the Guidelines described above, resolution of an issue either through mediation or adjudication could require confirmation that MNEs had implemented the responsible supply chain management framework to assess, prioritize, and manage responsible business conduct issues in the supply chain. Mediation and adjudication could center on demonstration of MNE efforts to implement the framework recommended in the Guidelines.

140. To offer further guidance, the Procedural Guidance and Commentary could be expanded to provide detail on which specific elements of the responsible supply chain management framework NCPs should take into account in making an initial assessment of whether the issue raised merits further examination and in crafting a statement and recommendations, if needed.

141. The Procedural Guidance and Commentary could also be revised to further clarify the need for full transparency. Because the issues associated with responsible business conduct in the supply chain continue to evolve, and the framework described above places the onus for defining and managing responsibilities on MNEs, there will be considerable learning opportunities that arise from issues brought to NCPs. Guidance on how to disseminate information on issues that have been raised would support MNE efforts to appropriately implement the responsible supply chain management framework.

V. Conclusion

142. At present, the Guidelines do not adequately reflect the challenges MNEs face in responsible supply chain management or provide appropriate guidance on MNE responsibilities to improve responsible business conduct in global supply chains.

143. The OECD has identified a critical opportunity to strengthen the OECD Multinational Guidelines on the application of the OECD Guidelines to supply chain relationships, which will not only improve the Guidelines themselves but advance the field of international standards and principles that MNEs rely on to improve responsible supply chain management.

144. Guidance should include clear definition of MNEs responsibilities related to responsible business conduct in supply chains and enable MNEs to assess, prioritize, and manage risks to society and risks to business.

145. This topic is rapidly evolving and will likely need more frequent updating and clarification in the future. The June 30th workshop is an important first step to ensuring the Guidelines reflect the latest thinking and practice in responsible supply chain management by MNEs.