

The new EU corporate sustainability due diligence directive is only limited understood

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Published in:
DILF Aktuelt

Publication date:
2023

Document version:
Final published version

Document license:
Unspecified

Citation for pulished version (APA):
Stentoft, J., & Mikkelsen, O. S. (2023). The new EU corporate sustainability due diligence directive is only limited understood. *DILF Aktuelt*, (21), 4-14.

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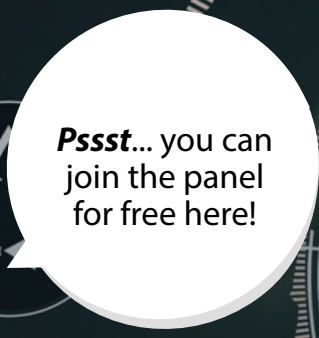
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THE NEW EU CORPORATE SUSTAINABILITY DUE DILIGENCE DIRECTIVE IS ONLY LIMITED UNDERSTOOD

DILF and researchers from the Department of Entrepreneurship and Relationship Management at SDU in Kolding conduct several mini surveys each year focusing on different supply chain management issues. Respondents to these mini surveys are voluntary senior managers from various Danish companies represented as the Danish Supply Chain Panel.

This article presents the results of a mini survey dealing with the new EU corporate sustainability due diligence and adjacent topic areas.



Pssst... you can join the panel for free here!



By Jan Stentoft, Professor at Department of Entrepreneurship and Relationship Management, University of Southern Denmark and Ole Stegmann Mikkelsen, Associate Professor at Department of Entrepreneurship and Relationship Management, University of Southern Denmark



DANSK RESUMÉ:

Hvert år udfører DILF, i samarbejde med forskere fra SDU, en række mindre surveys, som bliver besvaret af Det Danske Supply Chain Panel. Disse surveys tager udgangspunkt i forskellige problemstillinger inden for supply chain management.

Denne artikel, skrevet af Jan Stentoft og Ole Stegmann fra SDU, viser resultaterne af et survey omhandlende den nye EU Corporate Sustainability Due Diligence samt andre nærtliggende emner.

1. Introduction

The EU-Commission has proposed a new directive that contains requirements for large companies in EU to avoid violation of human rights (such as child labor and exploitation of workers), and to prevent, end, or mitigate adverse impact of their activities on the environment (such as pollution and biodiversity loss).

Two groups of companies are the targets for the directive: 1) companies with more than 500 employees and a global net turnover of more than EUR 150 million, and 2) companies with more than 250 employees and a global net turnover of more than EUR 40 million, with activities within high-risk sectors such as manufacturing of textiles, leather, agriculture, extraction of mineral resources, fishing, food production, and manufacturing of basic metal products. The directive is called "Corporate Sustainability Due Diligence". The purpose is to strengthen companies' obligations to a sustainable transition towards constraining global warming to a maximum of 1.5 °C cf. the Paris Agreement and the Glasgow Climate Pact.

The directive builds upon voluntary international standards for responsible business ethics, such as UN’s Guiding Principles on Business and Human Rights and OECD’s guidelines for multinational enterprises. To comply with the new directive, the companies must:

- Develop due diligence politics
- Identify actual and potential unfavorable human rights and environmental impacts
- Prevent and mitigate potential impact
- Stop or minimize the actual impact
- Establish and maintain a complaint procedure
- Monitor the politics and the targets effectiveness
- Communicate public about due diligence

What is interesting with the new directive, is how this will also affect small and medium sized enterprises (SMEs). The directive informs, that the directive is not directly affecting SMEs, however, most SMEs are players in international and global supply chains, where their customers may be large European companies, which are covered by the directive. Thus, SMEs will be affected indirectly. However, it is important to consider such a directive as not only an economic burden but also as a mean to strengthen competitiveness, such as improved reputation, trust towards customers, and risk management. Furthermore, the directive may contribute to creating a more attractive labor market in a time with a lack of qualified workforce (Stentoft, 2022).

At a conference on December 8, 2022, at SDU in Kolding, organized by The Ministry of Foreign Affairs – The Trade Council, University of Southern Denmark and Danish Industry (DI), LINAK A/S presented the requirements they meet from their customers in terms of Corporate Sustainability. More specifically, they presented a case from a major German customer that asked what LINAK will do to comply with the German version of the new EU directive with the idiomatic German name “Lieferkettensorgfaltspflichtengesetz” (LkSG). Despite the customer, due to their size, is not directly covered by LkSG, they have decided to comply with LkSG for ethical reasons. LINAK A/S is the largest supplier of the customer, who request LINAK to sign for LkSG. On January 1st, 2023, LINAK implemented LkSG.

2. Perceptions of the influence of the new directive

The first thing to investigate is to what degree the respondents are familiar with the new directive (see Figure 1). Despite the directive being very close to enforcement, and more countries already having enforced local legislation in alignment with the directive, Figure 1 shows that the respondents only to some degree are familiar with the directive with an average of 3.13 on a five-point Likert scale (where 1 = to a very low degree and 5 = to a very high degree).

Even though the respondents only report “to some degree” of familiarity with the coming EU directive, they respond to a higher degree that

FIGURE 1. Knowledge about the new EU directive and perceptions about its influence

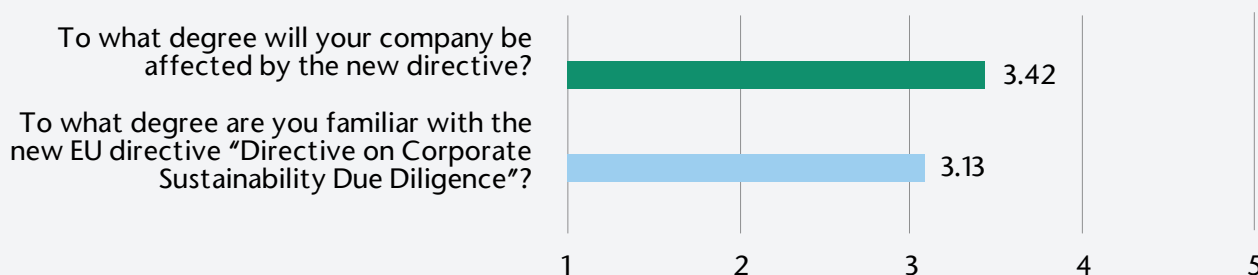
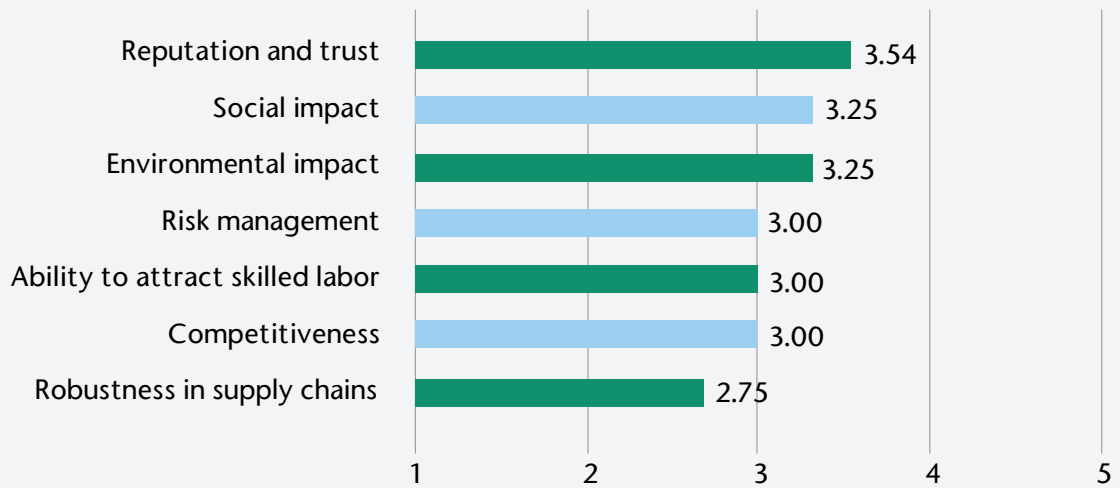


FIGURE 2. Perceptions of how the directive will improve business practices



their supply chains will be affected by the new directive with 3.42 on the five-point Likert scale. Enforcement of new governmental initiatives is often perceived as extra work and cost, however, we found it of interest if the companies perceive business improvements in implementing the new EU corporate sustainability due diligence directive. The respondents' answers to this are included in Figure 2. In surveys like this, average scores above 3.50 are perceived as significant. Hence, as seen in Figure 2, the Danish Supply Chain Panel report that the new EU directive will improve reputation and trust, with an average of 3.54 on the five-point Likert scale. After reputation and trust, we find the respondents pointing at social impact and environmental impact as perceived to be improved to some degree with 3.25 respectively.

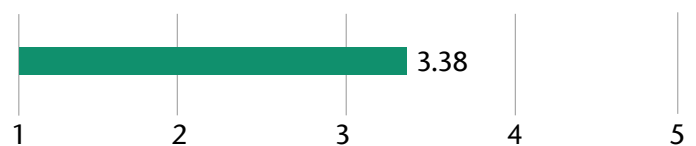
With an average of 3.00, we find answers of risk management, the ability to attract skilled labor and competitiveness being improved by implementing the new EU corporate sustainability due diligence directive. Lastly, the respondents point at robustness in supply chains to be improved with only 2.75 on the Likert scale. Thus, this result indicates a perception that they are more concerned with responsibility and not directly with practices of developing supply chain resilient capabilities, such as redun-

dancy, agility (velocity, visibility, flexibility), and adaptability.

3. Geopolitical issues

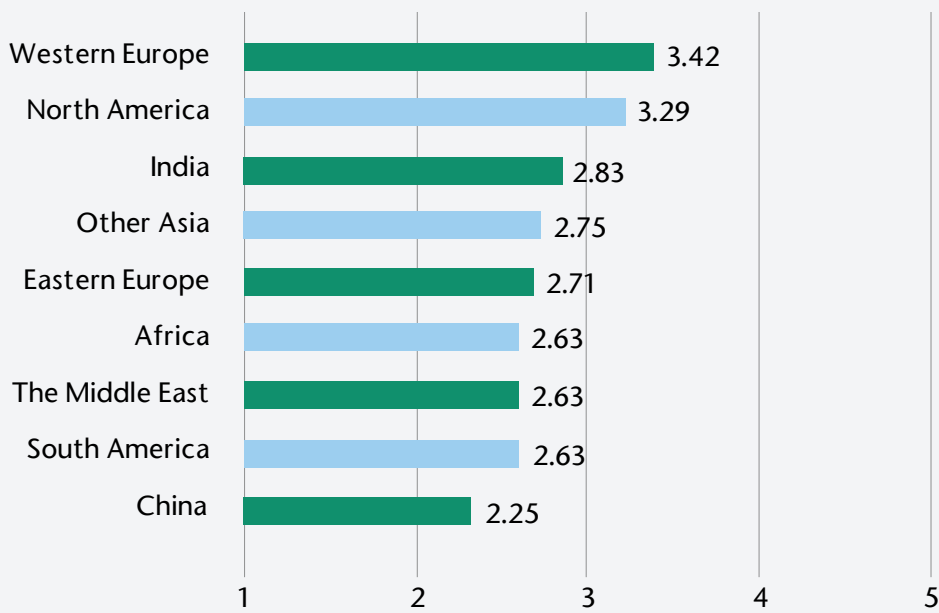
Lately, we have witnessed more geopolitical issues, such as wars and political tensions. Therefore, we find it important to understand, to what degree such geopolitical issues are considered to affect the supply chains of the Danish Supply Chain Panel. Even though we in the media often read and hear that the supply chains are highly affected by the terrible war in Ukraine, the USA-China trade war, the sanctioning of Russia, etc., Figure 3 indicates that the supply chains of the respondents only to some degree are impacted with an average of 3.38.

FIGURE 3. Geopolitical issues affecting the supply chains



Following the previous question on supply chain impact from geopolitical issues, we find it interesting if these current geopolitical issues affect companies' investment activities in different

FIGURE 4. Investment activities affected by geopolitical issues



markets. Hence, we have asked the respondents about this using a five-point scale, in which 1 = we will invest much less, 3 = same as now, and 5 = we will invest much more. As it appears from Figure 4, the companies report slightly increased investments in Western Europe and North America (3.42 and 3.29 respectively), due to the current geopolitical issues. On the other end, and most significantly, we find that the companies plan to invest less in China (2.75).

One explanation could be that China, until recently, has had a zero-tolerance policy for COVID-19 and forcefully closed cities, regions, and harbors with the slightest outburst. This has created turmoil in the global supply chains. Hence, the slight investment increase in Western Europe and North America will shorten the supply chains. Surprisingly, we do not see increases in expected investment in Eastern Europe but slightly lowered investment expectations. We expected more investments in Eastern Europe at the expense of especially China. Eastern Europe is still more cost-effective than Western Europe and simultaneously much closer than China/Asia.

Likewise, in one of our previous studies, we found

indications that Danish companies look more toward Eastern Europe when it comes to the future location of their supplier base (Stentoft & Mikkelsen, 2022a). However, we do not argue that changes in investments due to current geopolitical issues are the same as changes in supply base locations, but we expected the two to point in the same direction.

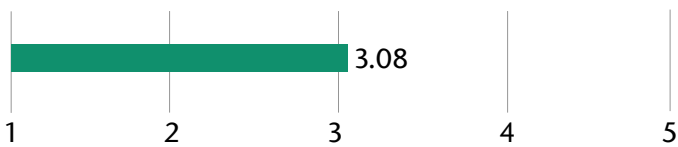
For the other regions in Figure 4, we see slightly less expected investments in the future.

“Friendshoring”, a newer term proposed by the US Treasury Secretary Janet Yellen, is a concept derived from onshoring and nearshoring, but it goes beyond these by limiting supply chain networks to allies and friendly countries. In this context, partnerships should be established only between nations based on the same set of values. Therefore, nations that e.g., do not respect human rights, and in which there is political instability or adversarial regimes, should be avoided.

We find it of interest to investigate if the members of the Danish Supply Chain Panel find it realistic to pursue such friendshoring strategies. As it appears from Figure 5, the panel finds it

to some degree (3.08) realistic to pursue such strategies. However, friendshoring might also be viewed as a source of creating a new block among democratic countries. It may restrict free and fair trade that can exclude poor nations, who are dependent on global trade. Global economies are filtered together, why, in theory, it may be easier to cut away trade connections with some countries than to make it a reality.

FIGURE 5. Friendshoring



4. Internal integration

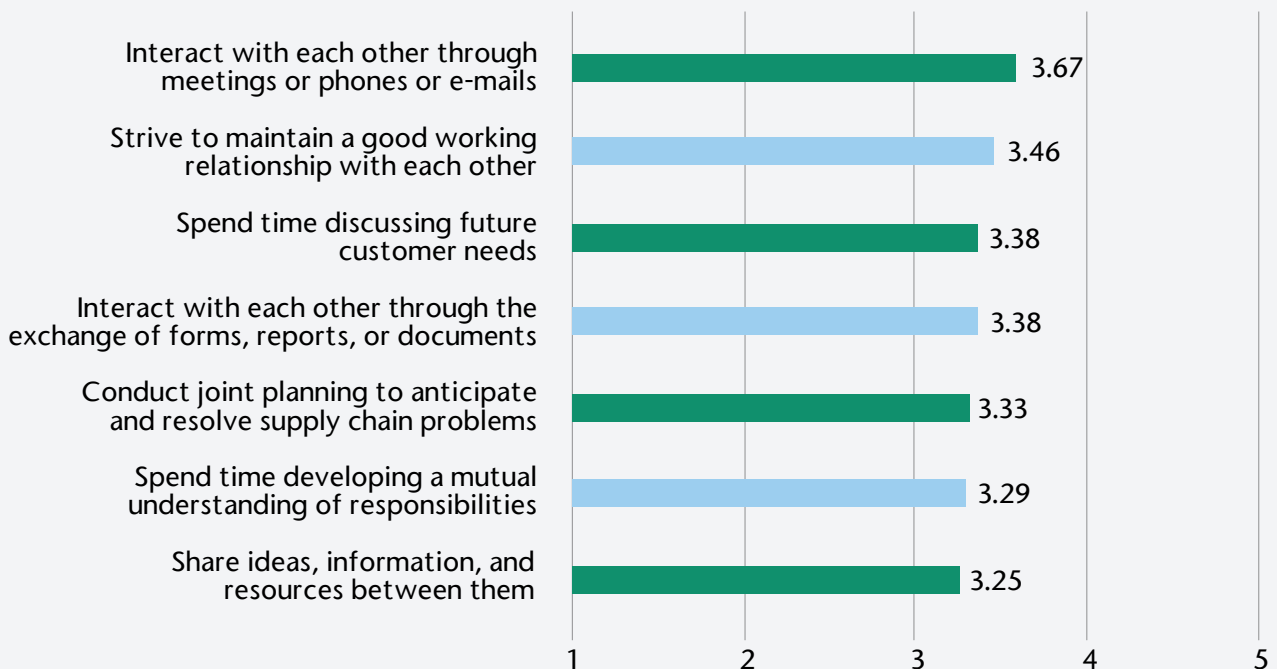
The respondents have also been asked about their internal integration efforts across functions. The questions target three different areas of internal integration: Communication, Coordination, and Affective Relationships. The answers are depicted in Figures 6, 7, and 8, respectively.

As depicted in Figure 6 on communication, the answers are all above an average of 3.00 (to

some degree) on the five-point Likert scale. However, it is only “interacting with each other through meetings, phones, or e-mails”, that with an average of 3.67 is significant (above 3,50). Hence, communication mainly takes place through everyday means. At the bottom, we find that companies to some degree (with an average of 3.25) share ideas, information, and resources between functions. Interestingly, companies do not mark it higher than an average of 3.38 when it comes to spending time on discussions across the functions about future customer needs. Basically, the customers are the *raison d’être* for the companies’ existence and their current and future needs are topics that always should be on main focus and continuously discussed and aligned across functions.

In Figure 7, the answers to coordination are shown. Again, most answers are above an average of 3.00 (to some degree) revolving around 3.30. Lowest, however, with an average of 3.13, we find “synchronize activities with each other”. This, linked with fact that companies only to some degree (3.25) consult each other before making decisions affecting other departments, indicates that the so-called silo mental-

FIGURE 6. Communication



ity is still very much alive. Such a silo mentality may result in functions working in different directions, and even stimulates counterproductivity, thus limiting performance levels.

Thus, there seems to be an opportunity for improvement here. In our research with SMEs, we often observe the “magic” of prioritizing time to sit down and talk, and inform each other of the issues in the company. Such meetings often resolve many day-to-day issues on the spot (Stentoft & Mikkelsen, 2023).

The last theme is affective relationships. As seen in Figure 8, all answers revolve around an average of 3.60, with “get along with each other” at an average of 3.63, “accessibility” at an average of 3.58, and “sharing the same vision” with an average of 3.54. As mentioned earlier, in surveys like this, averages above 3.50 are perceived as significant. Hence, on average the companies seem to get along, are accessible, and share the same vision.

5. Cross-functional understanding of supply chain vulnerabilities

During the last three years, we have witnessed a plethora of unforeseen causes of disruptions in the global supply chains, e.g., COVID-19, the

stranding of a vessel in the Suez Canal, and the war in Ukraine. These disruptions have surfaced embedded vulnerabilities in the supply chains of companies. Therefore, we found it of interest to investigate to what degree these supply chain vulnerabilities are understood in the companies.

As it appears from Figure 9, the respondents report that top management is conscious about supply chain vulnerabilities close to a high degree, while the cross-functional understanding of supply chain vulnerabilities is at a lesser level with an average of 3.63.

In a similar survey, it was found that cross-functional understanding of supply chain vulnerabilities was at a level of 3.00 (Stentoft & Mikkelsen, 2022b). However, even though an average of 3.63 in the current survey indicates a progress, the level implies a potential for further cross-functional understanding and alignment of the possible top vulnerabilities to be addressed in the companies’ supply chains. A tool for this is under development in a current project on supply chain resilience in SMEs, funded by the Danish Industry Foundation (www.scr-smv.dk).

In our research with SMEs, we have observed an extensive list of challenges in the supply chains

FIGURE 7. Coordination

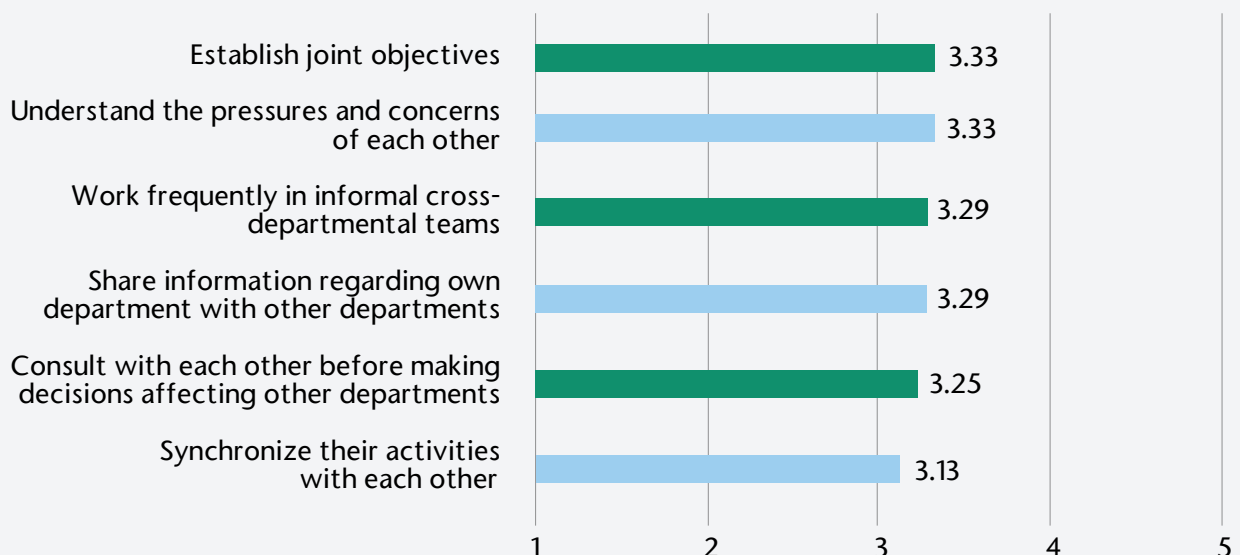


FIGURE 8. Affective relationships

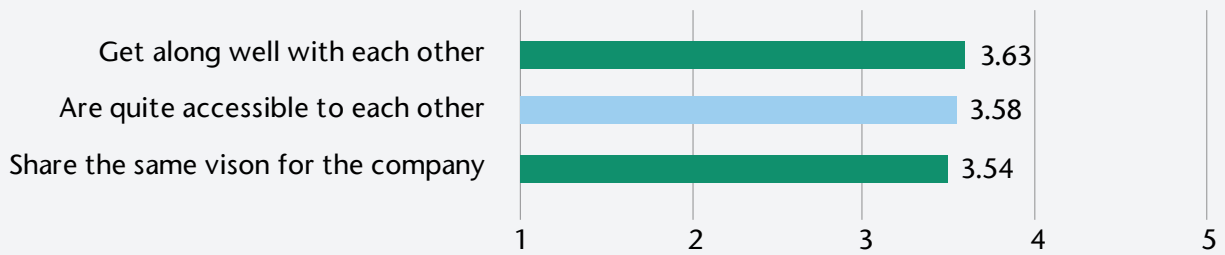
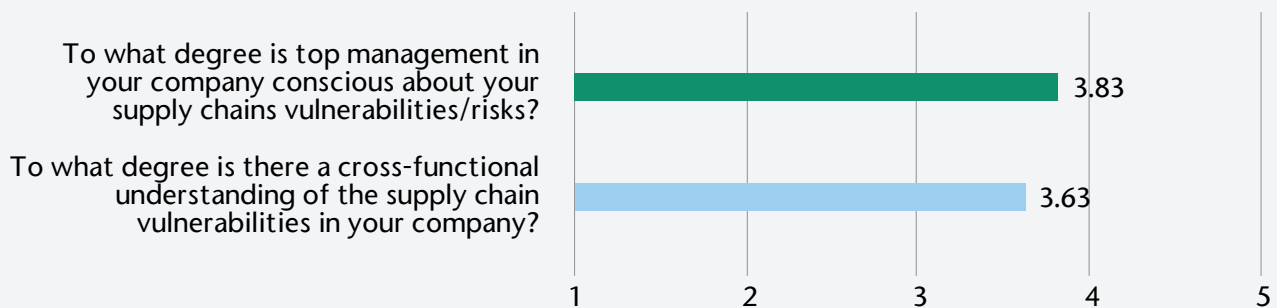


FIGURE 9. Cross-functional understanding of vulnerabilities



of the companies. Hence, we find it important to investigate to what degree varied factors affect the supply chains. Figure 10 provides an overview of the respondents' answers.

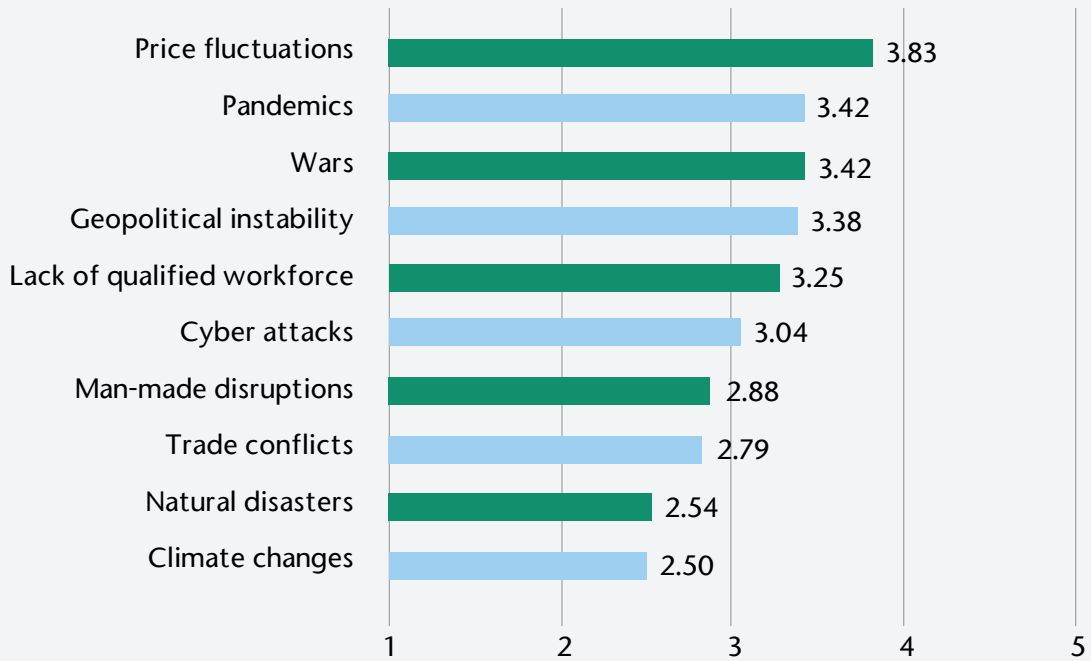
As it appears, especially price fluctuations affect the supply chains with an average of 3.83. In Stentoft & Mikkelsen (2022b) price fluctuations obtained an average of 3.56, indicating an increase of 0.27 point. On the other hand, pandemics and wars have fallen in significance from an average of 3.58 in Stentoft & Mikkelsen (2022b) to an average of 3.42 and from 3.67 to 3.42, respectively. In both surveys, however, these challenges are all in top three. Climate change is the factor perceived to have the least impact on the supply chains.

The respondents have had the opportunity to indicate other factors that they perceive to affect the supply chains. One respondent has mentioned that market trends and consumer behavior affect their supply chains.

Given the previous questions, it is of interest to understand what the members of the Danish Supply Chain Panel perceive as barriers to become more supply chain resilient. The answers to this question are shown in Figure 11. Even though the barriers revolve around an average of 3.00 (to some degree), some interesting insights can be revealed. "Lack of transparency" comes out as the highest perceived barrier with an average of 3.21. This is an increase of 0.28 (3.21 minus 2.93) compared to a similar question in Stentoft & Mikkelsen (2022b). "Lack of time" is often a top-scorer in these types of surveys, as daily operations often steal focus in the companies.

This is also the case in this survey, as lack of time obtains the second highest average of 3.17. This is a little lower than in the 2022 survey, in which lack of time was the highest scoring barrier with 3.26. However, in a comparable survey from 2021, lack of time was also among the top barriers, but with an average of 3.60 (Stentoft & Mikkelsen

FIGURE 10. Factors affecting the supply chains



en 2021). Hopefully, this indicates a trend, that lack of time becomes a less significant barrier. Hereafter, an array of barriers presents themselves closely around an average of 3.00 (to some degree).

These barriers are “too much supply chain complexity”, “lack of operational tools and approaches”, “lack of knowledge about supply chain resilience”, and “lack of capacity”. Lack of internal and external integration are, to the same de-

FIGURE 11. Barriers for creating better supply chain resilience

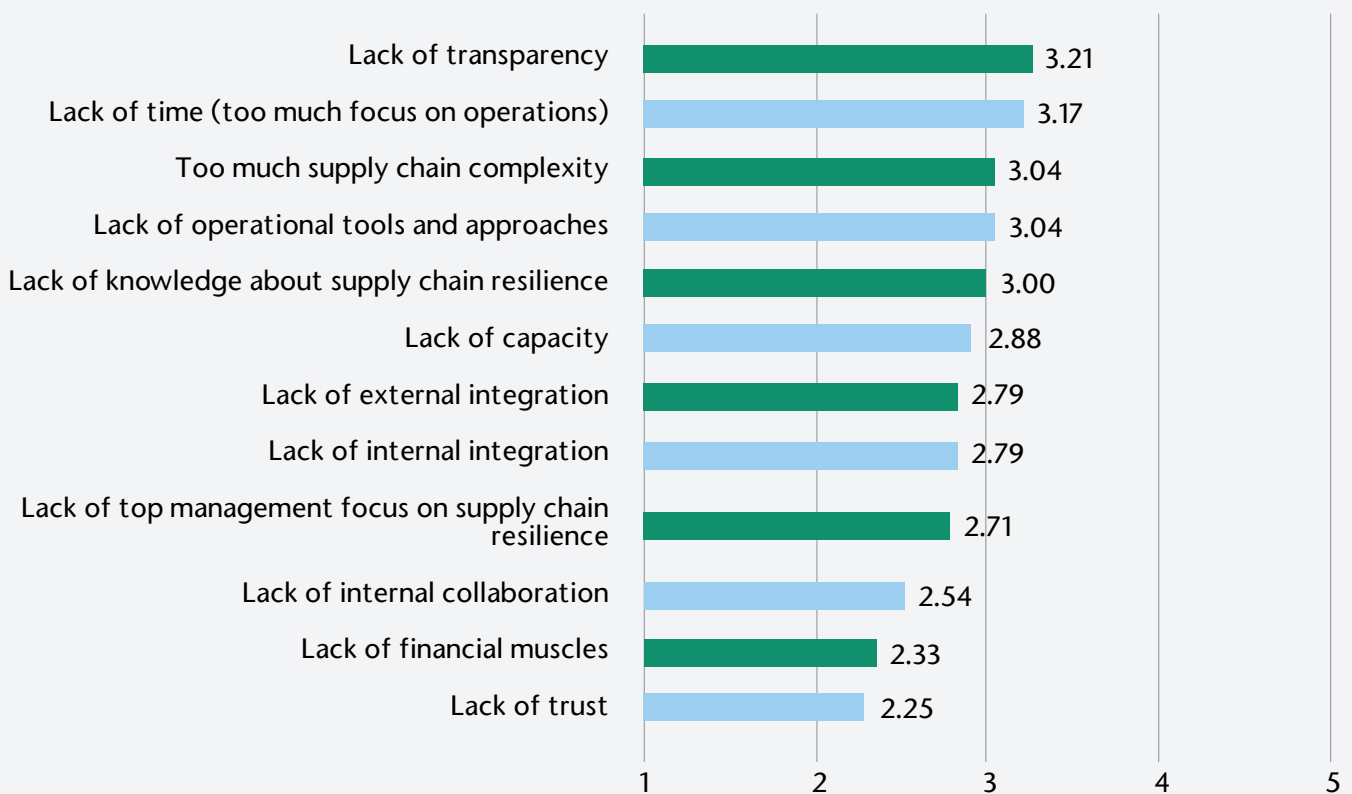
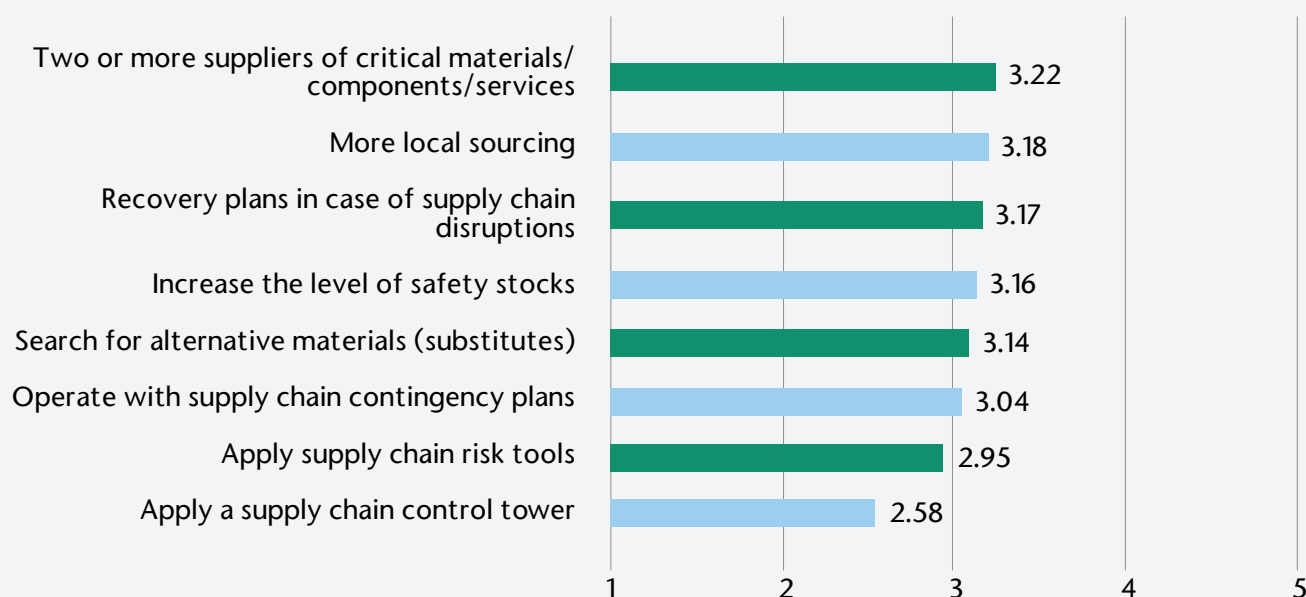


FIGURE 12. Planned activities



gree, not seen as barriers with averages of 2.79. It also seems that supply chain management and supply chain resilience have managed to get top management focus since this barrier only reach an average of 2.71. “Lack of trust” is the lowest perceived barrier with an average of 2.25.

Given the questions and discussions above, we also find it of interest to investigate what activities are planned to improve supply chain resilience (see Figure 12). The questionnaire offers the option to state if the activity is already installed. Such answers are eliminated from the analysis, and hence, we only report on the companies that have not yet installed the practices analyzed. As seen in Figure 12, we again observe that the companies on average revolve around 3.00 (to some degree), with applying dual/multiple sourcing for critical materials/components and services with an average of 3.22.

Based on the turmoil in the global supply chains, and the challenges of acquiring materials in the right amount and at the right time and cost, we expected this to be somewhat higher. One explanation could be that the situation is starting

to improve, and that the challenges are not so present as they have been.

Further planned activities are to pursue more local sourcing (3.18), develop recovery plans (3.17), increase of safety stocks (3.16), and search for alternative materials – substitutes (3.14). It is interesting, though, that applying supply chain risk tools are only at an average of 2.95. Given the challenges in the supply chains of material shortages, postponed deliveries, price increases, inflation, etc., we expected companies to be much keener on applying supply chain risk tools. Lastly, with an average of 2.58 comes applying a supply chain control tower. There seems to be an improvement area to create a hub of technology, people, and processes that captures and uses supply chain data to enable short- and long-term decision making (Sheffi, 2017, p. 209).

6. Conclusion

This article has set out to present the results of a mini survey from the Danish Supply Chain Panel, concerning the new EU corporate sustainability due diligence directive and adjacent topic areas. Data reveal that the respondents only

to some degree are familiar with the directive, but that they, however, to a higher degree find that their supply chains will be affected by the new directive. The main areas, where the directive will improve their business, are found to be related to reputation and trust, social impact, and environmental impact.

The respondents find that the current geopolitical issues affect their supply chains to some degree, which will increase investment activities in Europe and North America and decrease such activities in China. The term friendshoring is only to some degree perceived as being a factor that will affect their supply chains. Concerning internal integration, co-communication through meetings, phones, or e-mails is very well applied. Regarding cross-functional coordination among the functions, this seems to exist only to some degree, which points to the existence of some silo culture. Affective relationships obtain the highest averages concerning internal integration.

There seems to be a decent cross-functional understanding of supply chain vulnerabilities, which is also the case for top management. The supply chains are currently most affected by price fluctuations, pandemics, and the war in Ukraine.

The data does not reveal any impactful barriers to creating supply chain resilience with the highest average scores around "to some degree" being lack of transparency and lack of time.

Finally, current activities to improve supply chain resilience is concerned with applying dual/multiple sourcing for critical materials/components and services, to pursue more local sourcing, developing recovery plans, increasing safety stocks, and searching for alternative materials (substitutes). We hope these results can stimulate discussions in your companies about your current status and needs for further developments./

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