Are companies ready for the EU supply chain law?

What our Social Benchmark tells us about the state of corporate readiness to enact mandatory due diligence legislation

July 2024

What is the Corporate Sustainability Due Diligence Directive (CSDDD)?

What is purpose and basis of CSDDD?

The European Union Corporate Sustainability Due Diligence Directive[1] (CSDDD) is a significant legislative initiative aimed at promoting sustainable and responsible business practices both within the EU market and globally. The directive attempts to address the adverse impacts of corporate activities on human rights and the environment, focusing on creating a legal framework to ensure that companies operate responsibly throughout their own operations and entire supply chains.

The impetus behind the CSDDD stems from growing recognition of the urgent need to tackle environmental degradation and human rights abuses linked to corporate supply chains. In recent years, there has been increasing pressure from civil society, consumers, and even investors, for companies to adopt more sustainable practices. The European Green Deal and the EU's commitment to the UN Sustainable Development Goals (SDGs) further underscore the necessity for robust legislation to enforce corporate accountability.

CSDDD is in itself not a new or original concept, but rather builds on existing international standards on responsible business conduct which specify that companies should protect human rights and set out how they should address the protection of the environment across their operations and value chains. The UN Guiding Principles on Business and Human Rights[2] (UNGPs) recognised the responsibility of companies to exercise human rights due diligence by identifying, preventing and mitigating the adverse impacts of their operations on human rights and by accounting for how they address those impacts. The concept of human rights due diligence was specified and further developed in the OECD Guidelines for Multinational Enterprises[3] which extended the application of due diligence to environmental and governance topics. Furthermore, the OECD Due Diligence Guidance for Responsible Business Conduct[4] and sectoral guidance[5] are internationally recognised frameworks setting out practical due diligence steps to help companies identify, prevent, mitigate and account for how they address actual and potential impacts in their operations, supply chains and other business relationships.

While the CSDDD represents a crucial step towards more sustainable business practices, its implementation poses several challenges. Companies will need to invest in developing robust due diligence systems, which may require significant resources and expertise. These efforts will be needed to ensure effective supply chain mapping and stakeholder engagement, particularly for complex global supply chains.

What companies will be directly impacted by CSDDD?

CSDDD will apply to the largest EU and non-EU companies operating within the EU single market. Specifically, the scope of the directive will be companies that fall under the following criteria:

1) For companies headquartered in the EU:
    a. Companies with than 1,000 employees on average and with a net worldwide turnover of more than EUR 450 million in the last financial year

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[1] Corporate sustainability due diligence - European Commission (europa.eu)
[2] guidingprinciplesbusinesshr_en.pdf (ohchr.org)
[3] OECD Guidelines for Multinational Enterprises on Responsible Business Conduct | OECD iLibrary (oecd-ilibrary.org)
[4] Guidelines for MNEs - Organisation for Economic Co-operation and Development (oecd.org)
[5] Due Diligence - Organisation for Economic Co-operation and Development (oecd.org)

    b. Companies that do not reach the above thresholds but is the ultimate parent company of a group that reached those thresholds in the last financial year
2) For those companies not headquartered in the EU but active in the EU market:
    a. Companies that generate a net turnover of more than EUR 450 million in the EU.

Based on the latest ongoing calculations[6] it is currently envisaged that there will be approximately 5,400 companies directly in the scope of CSDDD.

What is the timeline for CSDDD application?

The EU co-legislators signed-off on the final Corporate Sustainability Due Diligence Directive (CSDDD) in May this year meaning that the final legal act is expected to be published in the Official Journal[7] by Q3 2024. This should result in the directive will coming into force in 2027 and it will have a phased-in approach on which size of companies will fall directly under scope as follows:

1. **2027**: First wave starts with largest companies in scope, i.e. those companies with 5000 employees on average and a net worldwide turnover of more than EUR 1500 million. This includes companies both head quartered in and outside the EU.
2. **2028**: Next wave of companies with 3000 employees on average and a net worldwide turnover of more than EUR 900 million
3. **2029**: Final wave of companies with 1000 employees on average and net worldwide turnover of more than EUR 450 million

What percentage of SDG2000 companies will be impacted by CSDDD?

The World Benchmarking Alliance (WBA) has published an updated list[8] of the world's 2,000 most influential companies. The analysis, refreshed at the start of each year and known as the SDG2000[9], details 2,000 companies that hold dominant positions in their respective industries, headquartered across 86 economies and with operations and supply chains spanning the globe. They provide the vital food, energy, housing, internet, transportation and financial systems our societies depend on, and have collective revenues of USD 45 trillion, equivalent to 42% of global GDP.

Give the impact of the SDG2000, WBA has begun mapping these companies to understand what percentage will be directly subject to key EU sustainability legislation, namely the Corporate Sustainability Due Diligence Directive (CSDDD).

The purpose of this mapping is to provide an overview for national & regional governments as to whether CSDDD will bring about significant change in corporate due diligence practices and the level of preparedness ahead of the final application. It is also intended to empower supervisory bodies to leverage the most impactful companies to help deliver on the SDG commitments.

Based on the current assessments of key benchmarks[10], WBA assess that approximately over 50% of the SDG2000 will fall under the scope of the CSDDD. This allows for WBA to give a snapshot of the current trends of the world's most influential companies and the level of preparedness to comply with CSDDD.

[6] SOMO, with some data from Orbis and Eurostat
[7] Access the Official Journal - EUR-Lex (europa.eu)
[8] https://www.worldbenchmarkingalliance.org/news/world-benchmarking-alliance-identifies-2000-most-influential-companies-globally-who-can-help-or-hinder-achieving-the-sdgs/
[9] SDG2000 | World Benchmarking Alliance
[10] Corporate Human Rights Benchmark, Nature Benchmark, Food & Agriculture Benchmark

What does our Social Benchmark tell us about the current state of corporate preparedness for CSDDD?

What are the key obligations under CSDDD?

While CSDDD will not legally become binding until 2027, the European Commission is still mandated to produce further guidance to provide support companies and EU member state authorities on how companies should fulfil their supply chain due diligence obligations. However, in order to begin to draft this guidance, and as member states begin to transpose CSDDD into national law, there is a need to understand the current state of adherence to international due diligence requirements. Through this we can understand how much upskilling and pressure is needed to bring companies in line with CSDDD before the initial date of application in 2027.

While the CSDDD introduces broad obligations on how companies must conduct due diligence, develop climate transition plans and the sanctions/liability implications for non-compliance, this assessment looks at the key obligations that companies will have to implement effectively supply chain due measures, namely:

1. Conducting meaningful due diligence (Article 5, 6, 7, 8, 9, 10, 11)
2. Conducting meaningful engagement with stakeholders (Article 13)
3. Ensuring access to complaints & grievance mechanisms (Art 14)

While the European Commission acknowledged the role of the financial sector in its CSDDD proposal, the final political agreement has significantly limited the scope of financial institutions' inclusion and exempted the sector from key obligations, preventing them from conducting meaningful human rights and environmental due diligence. This briefing also takes a sector specific look at the current performance of the financial sector ahead of the further development of how the sector will be brought in line with CSDDD.

How does the Social Benchmark findings compare to the CSDDD obligations?

By reviewing the findings of the Social Benchmark[11] through the lens of the impending CSDDD application, it is possible to deliver a snapshot on the current state of preparedness for companies to implement mandatory supply chain due diligence legislation. In doing this we can see the key gaps that companies and governments need to focus on to ensure meaning full implementation.

This assessment is explained in the findings outlined in the next section, and which can be summarised below as follows:

CSDDD requirements	Social Benchmark measurement	Current status of CSDDD readiness
Conducting due diligence (Article 5, 6, 7, 8, 9, 10, 11)	• Carry out human rights due diligence • Identifying human rights risks and impacts • Assessing human rights risks and impacts	**80% of companies scored zero on the initial steps of HRDD implementation**

[11] https://www.worldbenchmarkingalliance.org/publication/social/

	• Integrating and acting on human rights risks and impacts	
Conducting meaningful engagement with stakeholders (Article 13)	• Engaging with affected and potentially affected stakeholder	• **Only 9% of companies demonstrate any evidence they engage with affected or potentially affected stakeholders**
Complaints & grievance mechanisms (Art 14)	• Grievance mechanisms for workers • Grievance mechanisms for external individuals and communities	• **While majority of companies have a grievance mechanism, only minority ensure rightsholder involvement in the mechanism's design.**
Future full Financial Sector inclusion in downstream due diligence (Article 36)	• Sub sector analysis based on the above human rights due diligence indicators	• **On average 87% of the financial sector demonstrate ZERO evidence of implementing HRDD.**

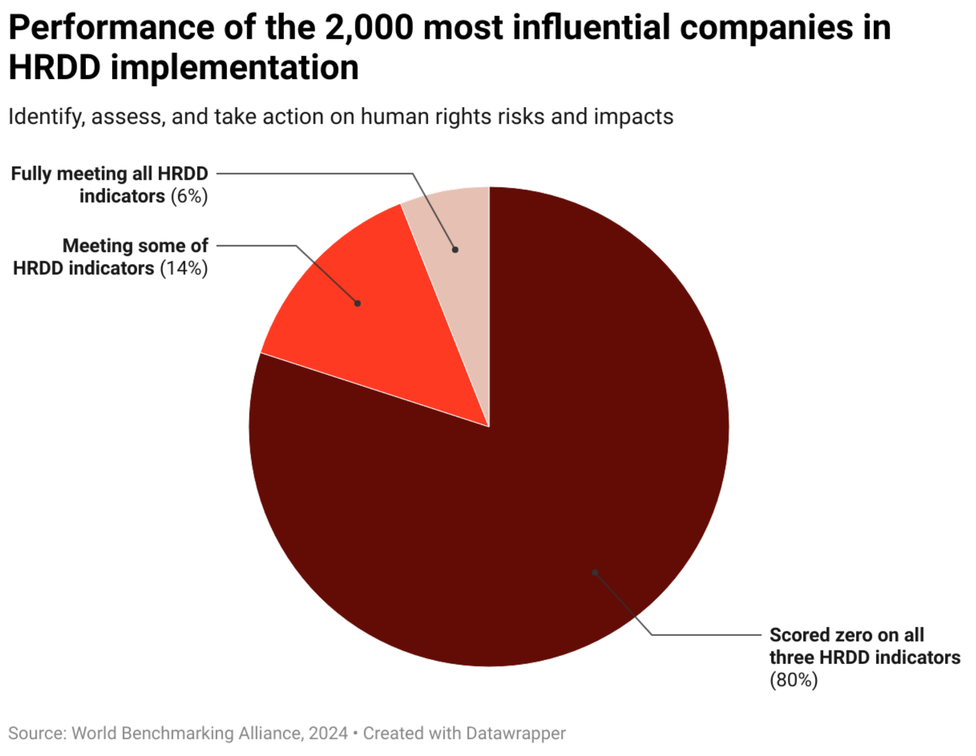
The Social Benchmark's key findings and the current state of CSDDD preparedness

1. Overwhelming majority of 2,000 companies are not ready to implement CSDDD as they currently fail to implement any key HRDD steps

- **80% of the 2,000 companies scored <u>zero</u> on the key steps of HRDD implementation, namely identifying, assessing and taking action on their human rights risks and impacts**.
- **Coupled with this, while 20% of companies implement some of the initial steps of HRDD, only 6% of companies have fully implemented them**.

Given the reach an impact of the 2,000 companies assessed in the Social Benchmark, this puts millions of workers and communities at risk and undermines global efforts to achieve the SDGs. In high-impact sectors alone, where adverse human rights impacts are more likely to occur – such as textiles and apparel, mineral extraction and agriculture[12] – their operations are estimated to impact at least 160 million workers[13]. By failing to identify and address their human rights risks, these companies are not yet ready to be CSDDD compliant and will continue to contribute to serious negative human rights impacts.

FIGURE 1



[12] High-impact sector as defined by the European Commission:
[13] This analysis was done by WBA to estimate the number of workers impacted by the operations of the assessed companies in the high impact sectors, 80% of whom are Tier 1 to Tier 4 workers in the supply chain.

2. Only minority of 2,000 companies currently engage with stakeholders

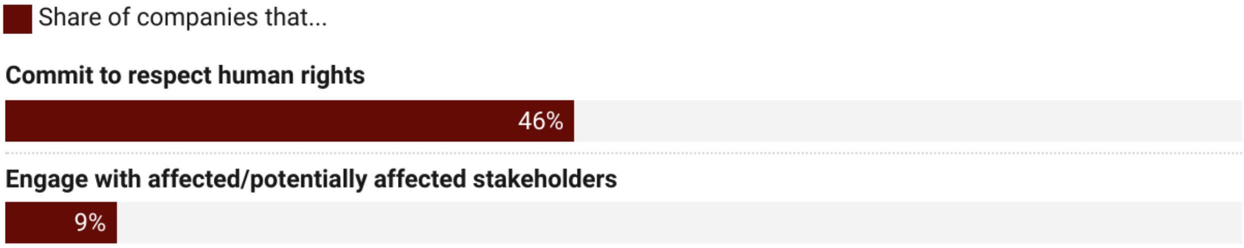
- **Only 9% of companies in the Social Benchmark demonstrate any evidence that they engage with affected or potentially affected stakeholders**
- **But companies that do engage with affected stakeholders perform better on average across every indicator in the benchmark, including commitments to respect human rights and human rights due diligence**

The 2030 Agenda recognises the importance of collaboration between all stakeholders to implement the SDGs and calls for the prioritisation of the voices of those who are often left behind. Moreover, both the UNGPs and the OECD's Due Diligence Guidance emphasise the responsibility of companies to meaningfully consult potentially affected stakeholders as part of their human rights due diligence. This commitment is reflected in the final CSDDD text which also mandates the engagement with stakeholders as part of the due diligence process. By engaging affected stakeholders in dialogue and decision-making processes, companies gain valuable insights into the social and cultural contexts in which they operate, leading to better identification of risks and more effective strategies for mitigation.

Moreover, stakeholder engagement fosters trust, transparency and accountability, thereby enhancing the company's reputation and credibility. Ultimately, robust stakeholder engagement on human rights is not only ethically imperative, but also critical for ensuring the long-term sustainability and success of companies in an increasingly complex and interconnected world.

FIGURE 2

Nearly half of the 2,000 companies commit to respect human rights, yet only 9% of them engage with stakeholders



Source: World Benchmarking Alliance, 2024 • Created with Datawrapper

3. Positive trend in introducing grievance mechanisms but further work needed to make these CSDDD-compliant

- **Majority of the 2,000 companies in the benchmark (58%) have a grievance mechanism available for either workers or external individuals to report negative impacts and seek remediation**
- **However, previous data form the Corporate Human Rights Benchmark[14] shows that of companies assessed only 5% demonstrate building rightsholder trust through providing predictability and transparency, and 10% ensure rightsholder ownership by involving users in the mechanism's design.**

The Social Benchmark shows that companies have been working on providing ways for workers and other people who might be affected by their actions to voice their concerns through grievance mechanisms. While it is encouraging to see improved access for rightsholders to company grievance mechanisms, companies fall short in demonstrating how they ensure rightsholders are meaningfully involved in remediation. Previous data form the Corporate Human Rights Benchmark shows that only 5% of companies disclose evidence of ensuring rightsholder trust and 10% disclose evidence of ensuring rightsholder ownership.

These mechanisms provide a way for rightsholders to raise issues and enable companies to spot key concerns, complementing their human rights due diligence process. However, one of the most important aspects of these mechanisms is allowing people to seek remedies when the company has caused them harm. Whether this works depends on how well the mechanism is set up. To make sure the process is fair and that companies are held accountable, it's vital that the people who have been harmed are involved along the way as their case is handled. Rightsholders' ability and willingness to use and engage with grievance mechanisms hinges on their sense of trust and ownership.

FIGURE 3: KEY FINDING FROM OUR 2023 CORPORATE HUMAN RIGHTS BENCHMARK

[14] Access to grievance mechanisms without trust and ownership hinders just remedies | World Benchmarking Alliance

4. Majority of financial sector score zero on implementing key HRDD steps

- **The financial sector is one of the worst the worst performing sectors assessed in the Social Benchmark with virtually no company fully meeting the HRDD requirements.**
- **While certain sub sectors in the financial system show some evidence of action on certain HRDD indicators, on average 87% of the sector has demonstrated zero evidence of implementing HRDD.**

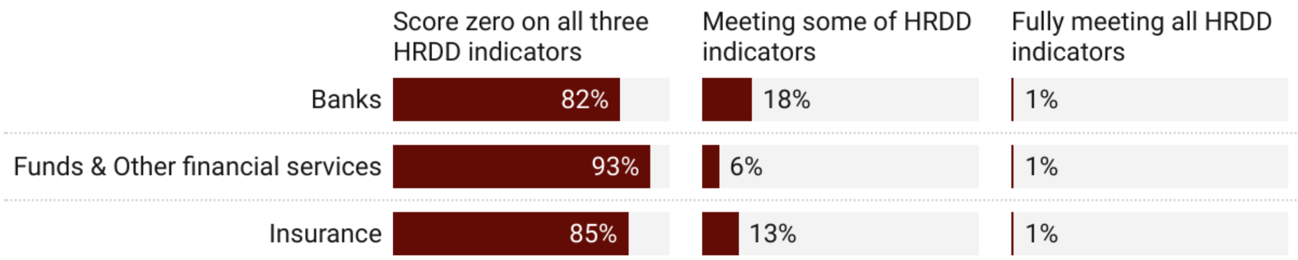
The lowest performing sectors in the Social Benchmark include Funds & Other Financial Services – which includes both Asset Owners and Asset Managers. However, it is worth noting that in the financial system, Banks and Insurance companies perform better than Asset Owners and Asset Managers. This may be due to the consumer-facing characteristics of Banks and Insurance companies. Funds & Other Financial Services are one step removed from consumer pressure and, therefore, may not consider the risks and impacts as material.

Nonetheless, to scale up the identification and mitigation of their human rights risks and impacts, governments should include financial institutions in the scope of human rights legislation, such as the EU's CSDDD. Therefore the review that the Commission will conduct on how to include the financial sector should focus on the urgency to introduce mandatory due diligence requirements before the sector begins to further lag behind.

FIGURE 4

The majority of financial sector entities have not implemented the initial steps of HRDD

Identify, assess, and take action on human rights risks and impacts



The percentages may not always add up to 100% due to rounding.

Source: World Benchmarking Alliance, 2024 • Created with Datawrapper

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