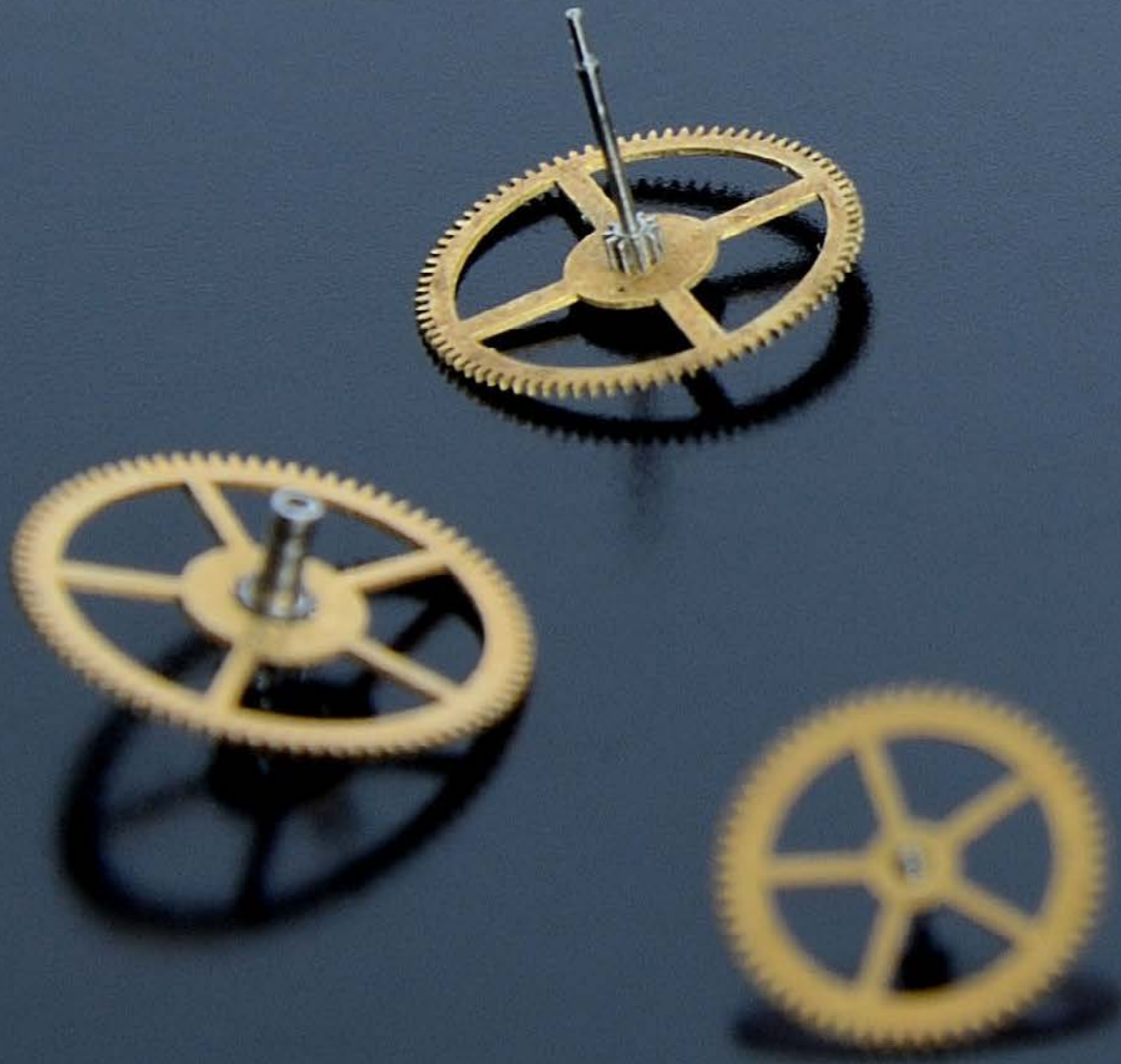


# The German Supply Chain Act is here!

How can it have an impact and how should companies react?



## How Germany intends to meet its responsibility with its Supply Chain Act

On June 11, the German Bundestag passed the Supply Chain Due Diligence Act, which as of January 2023 is intended to create a more level playing field among German companies through due diligence in favor of human rights and environmental protection (Deutscher Bundestag 2021a, Deutscher Bundestag 2021b).

With the Supply Chain Act, the German government is contributing to the development of a more resilient and sustainable economic system. This builds upon national sustainability strategies such as the German Sustainability Strategy (Die Bundesregierung 2021), European level actions such as the EU-wide supply chain law (endorsed by the European Parliament in March) and the European Green Deal, and international agreements such as the Agenda 2030 and the Paris Climate Agreement.

The EU taxonomy uses performance criteria to demonstrate whether a company's economic activities make a significant contribution to the Green Deal. This directly encourages companies to transparently disclose sustainability information and help shape the transformation toward more sustainable value chains (EU Technical Expert Group on Sustainable Finance, 2021).

This approach is precisely what the Supply Chain Act is intended to contribute to. As a country poor in raw materials and a catalyst for global value creation processes, Germany and its economy bear a special social and ecological responsibility. However, the German Supply Chain Act will only meet this responsibility if it addresses the following areas of impact in the further revision of the adopted Supply Chain Act. These aspects would also have to be implemented at the European level:

- **Expansion of environment-related due diligence obligations**, as human rights, social and environmental impacts of economic activities are interdependent. Environmental concerns are not sufficiently addressed in the Supply Chain Act, as the law only refers to individual conventions, which mainly relate to human rights due diligence. Environmental degradation due to biodiversity loss is not addressed and the climate is not anchored as a protected good. To address this, a "damage and environment-related general clause" should be integrated (Initiative Supply Chain Act 2021, p.5).
- **Inclusion of indirect suppliers** in the scope of application (in addition to direct suppliers), as social and environmental risks usually lie deeper in the supply chain. Currently, indirect suppliers need only undergo a risk analysis if they have "substantiated knowledge" of possible human rights violations. In the development of the EU law, the scope should therefore be extended to include indirect suppliers through a proactive risk analysis (Initiative Supply Chain Act 2021, p.4).

- **Include SMEs from critical industries and business areas** (in addition to companies with more than 1,000 employees) and create incentives through appropriate government frameworks (Beckers et al. 2020, p.4; Deutscher Bundestag 2021, p.31).
- **Enabling civil liability** to achieve resilient steering effects in companies and supply chains (Initiative Lieferkettengesetz 2021, p.5). Furthermore, novel options to verify enforcement mechanisms should be discussed, such as monitoring by public bodies or non-governmental organizations (Beckers et al. 2020, p.5).

Taking these aspects into account, the German Supply Chain Act is compatible with the tightening of the European CSR reporting obligation and with an expected more far-reaching European supply chain law (Lenzen 2021; Hewartz and Koch 2021).

The Supply Chain Act provides further impetus to the emergence of sustainable supply chains as a whole and, in particular, the actions and strategic positioning of companies. Companies can and should prepare for the act in order to take maximum advantage of the opportunities it presents. In addition to the regulatory provisions and research impulses in the above-mentioned areas, it makes sense for companies to examine their own supply chain for the potential of increased sustainability at an early stage and to find points of contact with the political objectives of the legislative and investment initiatives in close coordination within the supplier network (European Commission 2021).

The publication “Future Impulse ‘Sustainable Value Chains’” (“[Zukunftsimpuls ‘Nachhaltige Lieferketten’](#)”, published by the Wuppertal Institute, 2020) lays out four starting points for measures that complement and extend existing approaches in a consistent and integrative way:

- Orientation towards a model of globally cooperative regional economies (globalize competencies and cooperation, regionalize material flows)
- Mandatory alignment of supply chains with sustainability (acting with shared responsibility)
- Establish supply chain resilience through cooperation and digital management systems
- Establish sustainable public procurement as a role model.

Below interested companies can find strategies that link to the starting points already discussed and illustrate the relevance for strategic purchasing and comprehensive supply chain management.

# The Supply Chain Act as an impulse for companies: Opening up new markets sustainably with collaborative value chain management

## 1. Collaborative solutions

Pivotal for the supply chain management is the communication of compliant standards along the supply chain. In complex supply chains, the challenge of enforcing supplier obligations increases with rising vertical depth. The increasing complexity and differentiation of this network is often accompanied by a certain lack of transparency and fragility (Engelhardt-Nowitzki et al. 2010). Active involvement and a dialog-oriented, long-term supplier relationship with mutual development potential is part of effective resilience management, which offers companies a decisive advantage in crises.

### *Guiding vision on globally cooperative regional economies*

*The model of globally cooperative regional economies describes an economic and social system that fundamentally reduces worldwide inequalities in development opportunities and quality of life, while at the same time permanently preserving the natural foundations of life. For this purpose, transformative cooperation networks between regions are established globally, with the goal of globalizing competencies and cooperation and leading material flows into regional cycles as far as possible and reasonable. Successive establishment of these cooperation networks enables effective resilience management, which is based on humane, sustainable and transparent supply chains and ensures security of supply for basic needs in the cooperation network even in the event of sudden changes in the framework conditions and in times of crisis. The prerequisite for resilience management is not national borders, but the functional interlocking and mutual support of the cooperation networks. Global problems can only be solved globally, as the pandemic resoundingly demonstrates. Basic conditions are created by sustainable supply and value chains in which all companies involved fulfill their human rights and environmental due diligence obligations and social and environmental standards are developed step-by-step. Sustainability is thus firmly anchored in corporate strategies and practices, and negative social and environmental effects are priced into business decisions. Product, process and business model innovations aimed at the SDGs enable increased value creation in economically less advantaged regions.*

*As a result, globally cooperative regional economies ensure that worldwide development of prosperity is made possible and decoupled from ecological stress. This is a prerequisite for climate change and population growth.*

To achieve resilience<sup>1</sup> the requirement is to know the supply chain beyond the direct suppliers all the way to the extraction of the raw materials. The supply chains must therefore be as transparent as possible (Sustainabill GmbH 2019). The publication “Future Impulse ‘Sustainable Value Chains’” (“Zukunftsimpuls ‘Nachhaltige Lieferketten’, Wuppertal Institute, 2020) recommends globalizing competencies and cooperation and regionalizing material flows along the lines of globally cooperative regional economies (see guiding vision).

For an improved exchange of competences and knowledge between globally cooperative regional economies, a detailed knowledge of the local potentials and problems for workers, suppliers and communities is first necessary in order to address them in a targeted manner. The supply chain law should legislate that the interests of potentially affected parties must be included in the risk analysis, the definition of preventive and remedial measures, as well as complaint handling. However, the act leaves it to the companies' judgment to what extent employees, works councils, local contact persons such as state authorities and municipalities, and NGOs are directly consulted (Deutscher Bundestag 2021a, p.44 on §4; Initiative Lieferkettengesetz, 2021, p.5). Going beyond the legal requirement to maintain proactive supplier management at eye level with the parties involved may be resource-intensive to carry out, but the benefits gained in crisis situations and in increasingly sustainability-oriented competition outweighs any disadvantages. Beyond the regional orientation of supplier management, companies can seek coordinated cooperation with competitors to improve product and production standards in the industry (see examples).

**Examples of industry-wide collaboration to raise supply chain standards**

Chemical sector: Together for Sustainability (Together for Sustainability 2021)

The global initiative of chemical companies is based on the UN Global Compact and Responsible Care Principles and develops assessments and audits through the peer-to-peer network, with the results being shared with all member organizations.

Textile sector: ABVTEX program (Brazilian Association of Textile Retail ABVTEX 2021)

The supplier program of Brazilian textile manufacturers enables audits even for interested companies that do not yet have a business relationship with the initiators. The mandatory compliance rules are evaluated and adapted in a continuous process.

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<sup>1</sup> The goal of resilient supply chains "should be people-centered, sustainable and transparent supply chains that can ensure the security of supply to meet basic needs and services of general interest even in the event of sudden changes in framework conditions and crises. (...) Regional-global cooperation networks of politics, business and municipalities jointly build/establish value creation, innovation, research and development, education and competence networks that support each other in their development and also during times of crisis. They develop the capacity to respond jointly to social, environmental and economic crisis situations (e.g. pandemics, political conflicts and wars, natural and environmental disasters, financial crises). They form an organizational learning and management unit with high innovation competence. Joint development affects community functions, such as social, health, education, environmental, and governance systems, as well as the political and economic systems as a whole." (Liedtke et al. 2020a, p. 5, translation by the authors).

## **2. Establish public procurement as an important role model and purchaser of sustainable products and services**

The design of the Supply Chain Act provides possibilities for the exclusion of companies from the granting of public contracts and fines if the companies violate due diligence obligations (Deutscher Bundestag 2021 a und b §22-24). Public procurement organizations are strengthened with the new legal regulation to demand compliance with environmental and social standards in public tenders. The annual order volume of the public sector, estimated at 2 trillion euros at the EU level (European Commission 2019) and up to 500 billion euros at the federal level (BMWi 2020), offers enormous potential for the purchase of sustainable products and services, some of which has not been exploited to date due to bureaucratic hurdles and competence and communication deficits (Brauer et al. 2021). In addition to a need to develop a concerted federal-state-municipality procurement strategy, municipal procurement initiatives at the regional level offer the opportunity to initiate stable circular-oriented value chain systems. In particular, regional procurement cooperation (e.g. buyer associations) offer opportunities for local companies to find new business partners regionally, and to keep the bureaucratic effort low through harmonized requirements. Through more sustainability-oriented public procurement bidding companies with transparent, sustainable supply chains enjoy a competitive advantage.

With the introduction of the EU taxonomy, not only public sources of financing but also private investments are guided along sustainability criteria. In order to take advantage of financing opportunities, it is of critical importance for companies to comply with the minimum protection provisions of the "OECD Guidelines for Multinational Enterprises and UN Guiding Principles on Business and Human Rights" (EU Technical Expert Group on Sustainable Finance) in their economic activities. These frameworks can mean significantly stricter requirements than those required by the current Supply Chain Act. In addition to a more far-reaching supply chain law at the EU level, the EU Sustainable Finance Strategy is also expected to extend CSR reporting requirements to large, non-capital market-oriented companies and capital market-oriented SMEs (European Commission 2021; Lenzen 2021). Comprehensive monitoring of environmental impacts, compliance with human rights and fulfilment of production standards in the supply chain from the very first stage will continue to gain importance in the future. Proactive management of all companies - whether they are affected by the current legislation or not - is therefore indispensable in the view of the authors.

### **3. Risk Radar for raw materials – developing international competencies to counter risks early on**

A key criticism of the design of the current Supply Chain Act is the restriction of comprehensive due diligence only to direct suppliers (Deutscher Bundestag 2021 a,b). Since for many products or entire industries a large number of the problems in the supply chain can be located at previous stages (Villena and Gioia 2020), applying due diligence only to direct suppliers would hardly address existing deficits. Regardless of legal regulations on how far down the supply chain due diligence obligations must be fulfilled, it is advantageous for companies to also risk assess raw materials. From human rights violations to climate change, many risks in the supply chain are associated with the raw materials used. If the raw materials in the purchased products are known, then purchasing should prioritise those raw materials that are sustainably and ethically sourced. Typically, the expenses can be included as weighting factors. An example in the field of electromobility is cobalt. The metal is often mined under harsh working conditions in the Congo, involves risks of child labor, and causes conflicts (Köllner 2018). In the case of minerals, the focus is on raw materials such as mica, which is used for paints and varnishes as well as cosmetic products (Baranzelli 2020). Once the corresponding risks have been identified, suitable measures must be developed. This requires appropriate competencies in the company, specifically in purchasing. Especially if risks are located in emerging and developing countries, these should be overcome through demand-oriented development projects. Investments in the supply chain should be seen as a win-win, especially since in the end both the supplier and all companies that directly or indirectly purchase the products of the supplier in question benefit. If, for example, efficient technologies are made possible through investments or know-how, the energy saved reduces the carbon footprint of the material produced but also of all downstream products in the supply chain that use this material as an input. In addition, with regard to climate change, the principle of "think globally, act locally" applies: those who invest in local climate adaptation ensure that they will also be able to guarantee the availability of their own products and raw materials tomorrow and beyond. Excluding suppliers due to social and ecological risks in emerging and developing countries should therefore be the option of last resort for companies.



#### **4. Procurers in transition – evolving from efficiency optimizers to product and business model designers**

Collaborative value chain management requires strategic purchasing. The aim is to expand the efficiency focus of procurement to include sustainability criteria and to develop sustainable innovations and business models through new forms of cooperation between product development, end users, suppliers and procurement. Specifically, this means: during product development, in addition to internal company actors (designers, product and innovation managers, etc.), other stakeholders - in the sense of the LivingLab approach (Liedtke et al. 2012, Baedeker et al. 2020) - are involved, in particular, end users and suppliers. Procurers thus play a key strategic role as the interface between companies and their stakeholder landscape, so that sustainable purchasing conditions can be taken as the starting point for product design (Liedtke et al. 2020b). In addition to efficient, cost-effective and reliable purchasing, procurers can act as drivers for SDG business models and new forms of economic activity (e.g., prosumption models). Companies are already recognizing the potential of procurement as a driver of sustainability and innovation management and are increasingly adapting their competence profiles and job descriptions: from efficient procurers to change agents. In the future, operational processes in procurement will be controlled by automation processes and new digital management tools, thus creating room for strategic procurement.

At the same time, purchasing in many companies is under strong time pressure, which leaves little room for change. In order to be able to take sustainability into account in purchasing decisions alongside price and quality, it is necessary on the one hand to build up know-how in the own company and on the other hand to create the corresponding capacities in purchasing. Furthermore, sustainability offers the purchasing unit the opportunity to strengthen its position in the company as purchasing has a unique role in implementing sustainable practices at the company-wide level.



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