



Sustainable supply chains

Preparation check for the Supply Chain Due Diligence Act Information for SMEs

The Supply Chain Due Diligence Act (LkSG) requires large companies situated in Germany to comply with a number of due diligence and reporting obligations with regard to the observance of human rights along their supply chains. Companies that employ less than 1,000 people are not subject to the act. However, suppliers can expect to be bound to the new due diligence obligations in contracts concluded with companies that employ over 1,000 people, and be required to provide corresponding information.

Goal of the LkSG check for SMEs

Familiarising SMEs in particular, which are indirectly affected by the act as suppliers, with the requirements of the act and preparing them for the potential impact thereof on their company.

The following questions are at the core of this exercise:

- What does the LkSG imply?
- Which customer requirements should I, as an SME, expect to experience an increase in due to the LkSG?
- How can I best prepare and which support services and related information may offer help?

The first section covers the **key points of the LkSG**. Below, we will take a look at why SMEs, which aren't addressed directly in the act, nevertheless need to face the requirements.

The second section takes the **five key elements of human rights due diligence** the act requires large companies to implement in order to highlight the potential **implications** for SMEs along the supply chain. In addition, it also introduces a number of **practical courses of action** and **support services** for SMEs.

Note:

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1 Key points of the LkSG

The LkSG requires large companies situated in Germany to shoulder their responsibilities in global supply chains. Accordingly, companies need to review the extent to which their business activities negatively impact human rights, introduce suitable measures to prevent and remedy any negative impacts and regularly report on these activities. The act aims to improve the status of international human rights by defining requirements for the responsible management of supply chains at certain companies.

It enters into force on 1 January 2023, initially affecting companies in Germany that employ 3,000 employees or more domestically. One year later, its scope will increase to include companies with 1,000 employees or more.

Which requirements does the act subject companies to?

The act requires companies to **introduce a corporate due diligence process** related to the observance of human rights. **Environmental issues** are also included in the scope of the act if they result in human rights violations (e.g. through toxic water) or serve to protect human health.

The due diligence obligations pertain to a company's **own activities** and those of its **direct suppliers**. Indirect suppliers are subject to situational due diligence requirements, that is, companies need to act only in the case of substantiated indications of potential rights violations along the supply chain.

Notably, the due diligence requirements stipulated in the act are **obligations of means, not of result**. Accordingly, companies need to be able to verify that they have implemented the due diligence obligations stipulated in the act, which have been deemed feasible and adequate in the company's own individual case. In this sense: the stronger the ability of a company to exert influence, the more probable and severe the foreseeable violation of the protected legal position; and the greater the company's responsibility in this regard, the greater the efforts a company can be expected to make to avoid or end a violation.

How will the act be enforced?

The **Federal Office for Economic Affairs and Export Control (BAFA)** will be responsible for effectively enforcing the act. A lean reporting process is planned to ensure companies are effectively monitored. BAFA monitors company reports, pursues submitted grievances and levies sanctions and fines in the case of violations. Exclusion from public procurement for up to three years may also occur.

More rights will be granted to those affected by human rights violations, who will not only be able to assert their rights in German courts, but also file grievances with BAFA. German trade unions and NGOs will also continue to be able to provide assistance to the affected parties abroad by representing their rights in German courts (derivative action).

You can learn more about which implications/customer requirements you can expect to encounter from the act as a supplier in the next steps. A number of tools are referenced for individual points.

Please visit the BAFA website for more background information on the LkSG.

[Corporate Due Diligence Obligations in Supply Chains](#)

2 Implications for SMEs

To what extent are SMEs affected by the act?

SMEs may not be directly affected by the act, but they can nevertheless expect to be subject to due diligence requirements passed on from further up the supply chain and to provide large companies with corresponding information and agreements from their supplier companies.

They can also anticipate a changed contractual framework along with new or revised codes of conduct and increased customer requirements with regard to human rights and sustainability issues within their company or supply chain. In addition, SMEs may be required to (contractually) pass on the new requirements to their upstream supply chain.

As a result, all companies are advised to address the requirements from the Supply Chain Due Diligence Act, even though they only directly apply to large companies. New customer requirements may likewise arise within the scope of customer-supplier relations.

The five key elements of human rights due diligence:

The main priority of the LkSG is determining human rights due diligence obligations for large companies. This centres around the implementation of the five key elements of human rights due diligence:

- **Adopting a mission statement** to respect human rights
- **Conducting a risk analysis** to determine negative impacts on human rights
- **Introducing preventative and remedial measures** to avoid any negative impacts on human rights
- **Establishing a grievance mechanism**
- **Ensuring documentation and reporting**

The following section explores the individual aspects of due diligence obligations. These summaries will then be used to outline the implications of the requirements for suppliers and suggest potential preparations that can be made.

2.1 Adopting a mission statement

Due diligence obligations for affected companies: *Adopting a mission statement*

Large companies need to adopt a mission statement for their human rights strategy. The mission statement must include the company's strategy for ensuring compliance with human rights and environmental due diligence obligations along the supply chain, specify the concrete risks and communicate the company's expectations for its employees and suppliers with regard to human rights and the environment.

Potential implications and courses of action for suppliers

First and foremost, this kind of mission statement acts as a public acknowledgement of the observance of human rights that enables a company to communicate its expectations for its employees and business partners. A mission statement is typically based on previously existing principles on topics such as the environment and occupational health and safety. It's important that the mission statement addresses human rights reference documents, which may be uncharted territory for some companies.

Information on mission statements in the LkSG can also provide guidance when it comes to modifying existing supplier agreements. It states, among other information, that large companies need to implement preventative measures that contain contractual assurances from direct suppliers that they comply

with and adequately address the human rights and environmental obligations stipulated by the company's management team, both within their own company and along the supply chain (Section 6 (4) LkSG).

What can I do to prepare as a supplier?

- Familiarise yourself with international reference documents so you can communicate with your customers on equal footing. Reference documents for human rights include:
 - The Universal Declaration of Human Rights
 - The UN Human Rights Learning Package
 - International Labour Standards drawn up by the International Labour Organisation (ILO)
- Check your existing company mission statements and modify them where necessary. When modifying mission statements, make sure that you are familiar with the requirements for mission statements stipulated in the LkSG to ensure consistent content and ambitiousness.

Further information: The [Starter Kit toolkit](#) (stage 1) provides an overview on how to create a strong mission statement along with further information.

2.2 Risk analysis

Due diligence obligations for affected companies: *Risk Analysis*

The LkSG requires large companies to conduct a risk analysis. They first need to take a look at their own activities and those of their direct suppliers to identify whether any particularly high risks can be found in terms of human rights and the environment. A risk analysis regarding indirect suppliers is only necessary if a large company has real evidence that a violation of human rights or environmental requirements may possibly occur.

Potential implications and courses of action for suppliers

In several industries, particularly the production industry, human rights and environmental risks primarily occur in the upstream value chain. As a result, suppliers play a key role in providing information to increase transparency along the supply chain and facilitate the introduction of suitable measures to prevent and remedy risks.

Once your company has gained clarity on human rights and environmental risks within its operations and supply chain, it will be well-equipped to prepare for potential customer demands in this regard and improve customer relations.

What can I do to prepare for this as a supplier?

- Adopt a systematic approach and start by focusing on your core business activities, for example. In this vein, we recommend looking at available sources of information – risk analyses for environmental and human rights issues are available for a wide range of industries, products, services and countries.
- When it comes to customer demands for information, it can often be helpful to prepare an overview of issues relevant to your company (and, by association, your customers).
- Addressing the sustainability standards commonplace in your industry (certifications, labels, etc.) can also provide information on key risks and make it easier to communicate with your customers (e.g. as part of a self-assessment).

Further information: The [Starter Kit](#) toolkit (stage 2 onwards) provides information on pragmatically establishing and structuring a risk analysis along with further sources of information.

2.3 Introducing preventative and remedial measures

Due diligence obligations for affected companies: *Introducing preventative and remedial measures*

Companies affected by the LkSG need to introduce preventative and remedial measures based on the risk analysis. This pertains to several activities, including selecting and evaluating suppliers, creating codes of conduct, conducting training and drawing up contracts.

Potential implications and courses of action for suppliers

If corresponding risks are identified in a supply chain during a risk analysis, large companies need to introduce measures to prevent them. These measures generally involve direct suppliers, but can also affect the entire supply chain, e.g.

- Modifying contractual terms with suppliers (through renegotiations, for example) whereby suppliers are required to comply with corresponding due diligence requirements, including human rights, employee matters and environmental standards. Contractual penalties like cancellation rights, rights to indemnification and claims for compensation may also be governed.
- Introducing/revising a 'Supplier Code of Conduct', which allows the company to communicate its expectations for partnerships with suppliers.
- Requiring suppliers to apply the human rights standards, including in the upstream supply chain.
- Introducing control rights and regularly implementing risk-based control measures.
- Providing qualifications or training courses for supplier employees.

What can I do to prepare for this as a supplier?

- Address the customer's (new) Code of Conduct or self-assessment and check whether you are able to satisfy the sustainability issues and requirements listed therein (e.g. prohibition of any form of child or forced labour; compliance with key occupational health and safety measures; adherence to environmental standards).
- Suppliers can also expect to be involved in the customer's due diligence management processes and preventative measures as part of the checks conducted (through self-assessments or audits). Consider whether customers tend to rely on industry solutions or cross-sectoral supplier platforms for supplier evaluations and familiarise yourself with them if so. The CSR Practitioner Days website, a project co-financed by the [German Federal Ministry of Labour and Social Affairs](#), provides an overview of solutions and platforms. Achilles, Business Social Compliance Initiative (BSCI), EcoVadis, NQC and Sedex Global are all platforms that customers may use.
- Make sure that employees at your company are adequately able to process customer queries and customer communications are carried out to the customer's satisfaction.
- Proof of adherence to management system codes and certifications can improve your company's credibility. Audits should be prepared with a corresponding lead time. Preparations include stating the audit process, rights and requirements when surveying employees and potential implications for companies. In this context, it can also be worth considering which audit rights you can handle as a supplier.

- When it comes to customer demands for information, it can often be helpful to prepare an overview of issues relevant to your company (and, by association, your customers).
- Addressing the sustainability standards commonplace in your industry (certifications, labels, etc.) can also provide information on key risks and make it easier to communicate with your customers (e.g. as part of a self-assessment).

Further information: Learn more about the aspect of procurement in sustainable supply chain management in particular. Consult the [Procurement in Focus](#) guide for more information. The [Starter Kit](#) toolkit provides information on identifying key fields of action and defining concrete measures.

It's also important to think about communications with your suppliers, as you may be required to pass on sustainability requirements along your supply chain by customers (particularly if you're a direct supplier). [Supplier evaluations – recommended guidelines](#) and the [Supplier Code of Conduct – Template](#) offer more information on this topic.

2.4 Grievance Mechanism

Due diligence obligations for affected companies: *Grievance Mechanism*

Companies affected by the LkSG are required to establish, implement and publish a grievance mechanism in writing that (potentially) affected individuals and people who have information on potential violations can use to alert the companies to human rights risks and violations in the supply chain.

Accordingly, it's important that companies in the supply chain understand that the grievance mechanism needs to be set up in a way that also enables people to inform companies of human rights or environmental risks along with violations of human rights or environmental requirements caused by the business activities not just of direct suppliers, but also of indirect suppliers.

Potential implications and courses of action for suppliers

Grievances may be filed by customers, other business partners or potentially directly affected individuals. Many companies have already established formal or informal grievance mechanisms, particularly for their own employees. They should therefore identify existing grievance channels, check their effectiveness and target group orientation, and modify them if necessary.

What can I do to prepare for this as a supplier?

- Communications with groups of people associated with a company often take place directly or informally, particularly in small companies. Set up a dedicated email address or phone number to receive information on the negative impacts of business activities with regard to human rights and publish this information on your website. Make sure to include a notice stating that all grievances will be treated as confidential and people who assert their legal right to use the grievance mechanism will not be disadvantaged in any way.
- Establishing grievance mechanisms is increasingly discussed at industry level. Get in touch with your industry association before you develop new solutions. It can also be useful to communicate directly with customers to see whether your grievance system can be linked to theirs.
- If your company is found to have caused or contributed to negative human rights impacts, you will need to introduce measures to remedy the situation or assist with the introduction of measures.

Further information: The [Starter Kit toolkit](#) (stage 1) offers pointers on how to establish a grievance mechanism along with further information.

2.5 Ensuring documentation and reporting

Due diligence obligations for affected companies: *Ensuring documentation and reporting*

Large companies need to document their fulfilment of human rights due diligence obligations. This involves publishing an annual report on the issue and submitting it to the competent authority, i.e. the Federal Office for Economic Affairs and Export Control.

Courses of action for suppliers

Many large companies require targeted information on supplier supply chains as part of their sustainability reporting. These reporting requirements will further increase as a result of the LkSG. For this reason, it can also be a good idea for SMEs to familiarise themselves with reporting requirements at this point. Suppliers likewise need to account for the fact that customers may enquire about targeted KPIs, which they can incorporate in their sustainability reporting.

What can I do to prepare for this as a supplier?

- Pool information and prepare it in KPIs as a basis for your company's own reporting and to disclose information to customers. Relevant data is generally already available, for instance data on in-house training or supplier audits.
- It can be useful to formulate your KPIs on the basis of industry-standard KPIs and sustainability standards.
- Various guidelines and initiatives can assist with external communications, including the German Sustainability Code, which is particularly useful for getting started.

Further information: Further information on this topic can be found in the [Starter Kit](#) (stage 4) and the toolkit **‘Proactively shaping sustainability communications as a supplier’**.



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