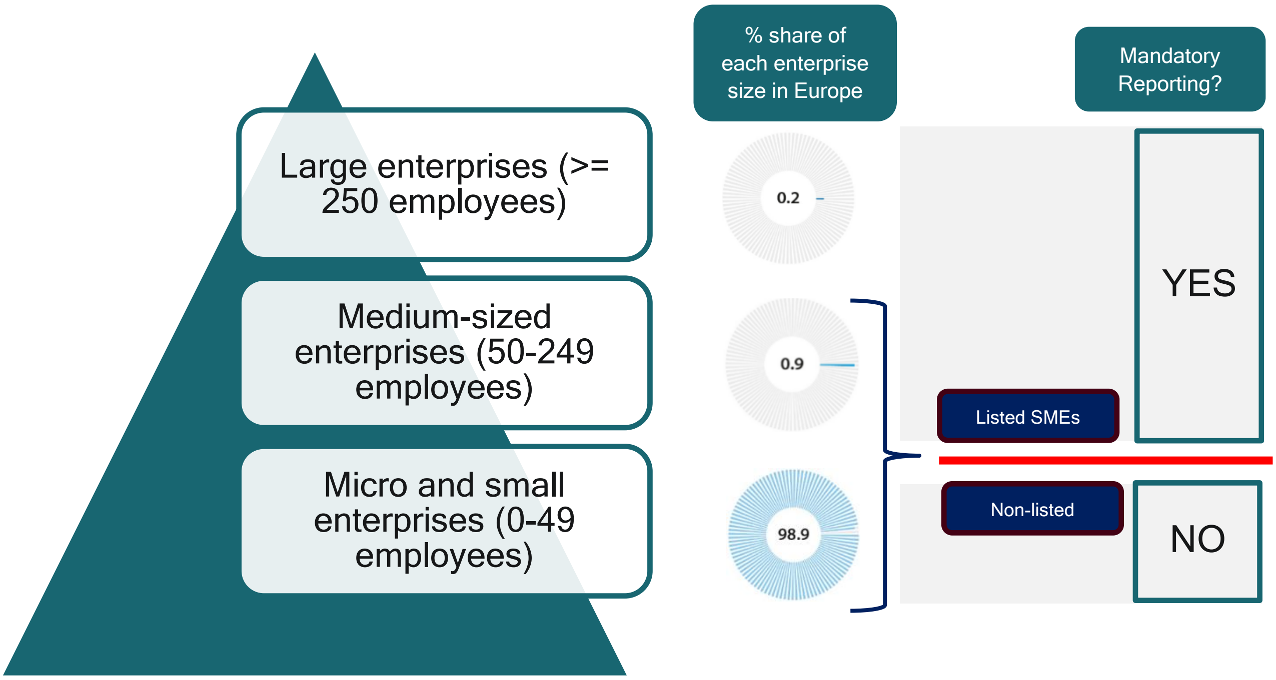
SUSTAINABILITY REPORTING FOR SMES:

Is your Business at an Upstream or Downstream Control Point?

Contents

Regulatory Context

Sustainability regulation is evolving rapidly across many jurisdictions, taking the shape of a pyramid across entire industry structures as illustrated below:



% share of each enterprise size in Europe data compiled from Eurostat.

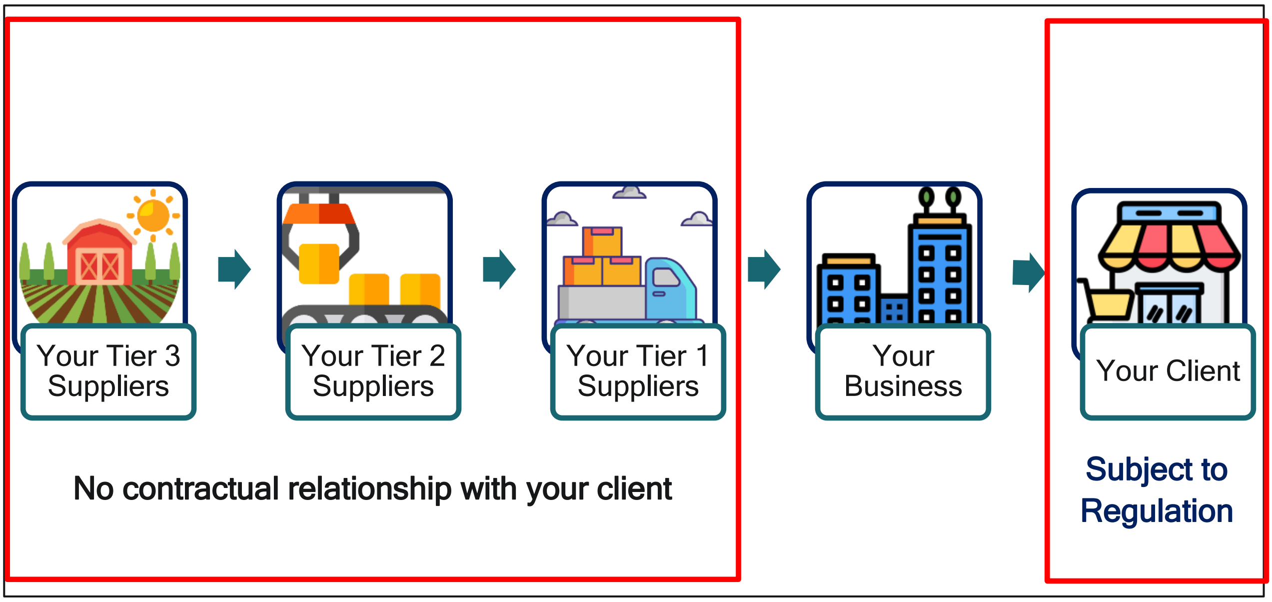
Sustainability regulation has effectively started at from the top of the pyramid, and for the 98.9% of micro and small enterprises, and non-listed SMEs, regulation may appear far away. As a result, there appear to be no impetus for SMEs to engage in the management of material sustainability topics.

This article explains the reason why even SMEs should engage with the management and reporting of their sustainability risk and opportunities.

Starting from the top of the pyramid, regulators need not to extend regulation further down. They should monitor the trickle-down effect that the current regulatory regime has on SMEs over time.

Supply chain relationships and "control points"

As an SME, your larger business partners (clients, suppliers and banks) who are subject to sustainability reporting regulation need to report on sustainability risks and opportunities across their entire value chain. One particular challenge that they face is to effectively assess the risks and opportunities derived from businesses with whom they do not have contractual relationships. In order words, assessing the risks and opportunities of your suppliers (Tier 1), or your suppliers' suppliers (Tier 2).



The longer the upstream supply chain, the less visibility your clients have over your Tier 3 suppliers for example. Your business might be an ideal **control point** for your client.

"'Control point enterprises' will likely have greater visibility and/or leverage over their own suppliers and business relationships further up the supply chain than enterprises closer towards consumers or end-users."

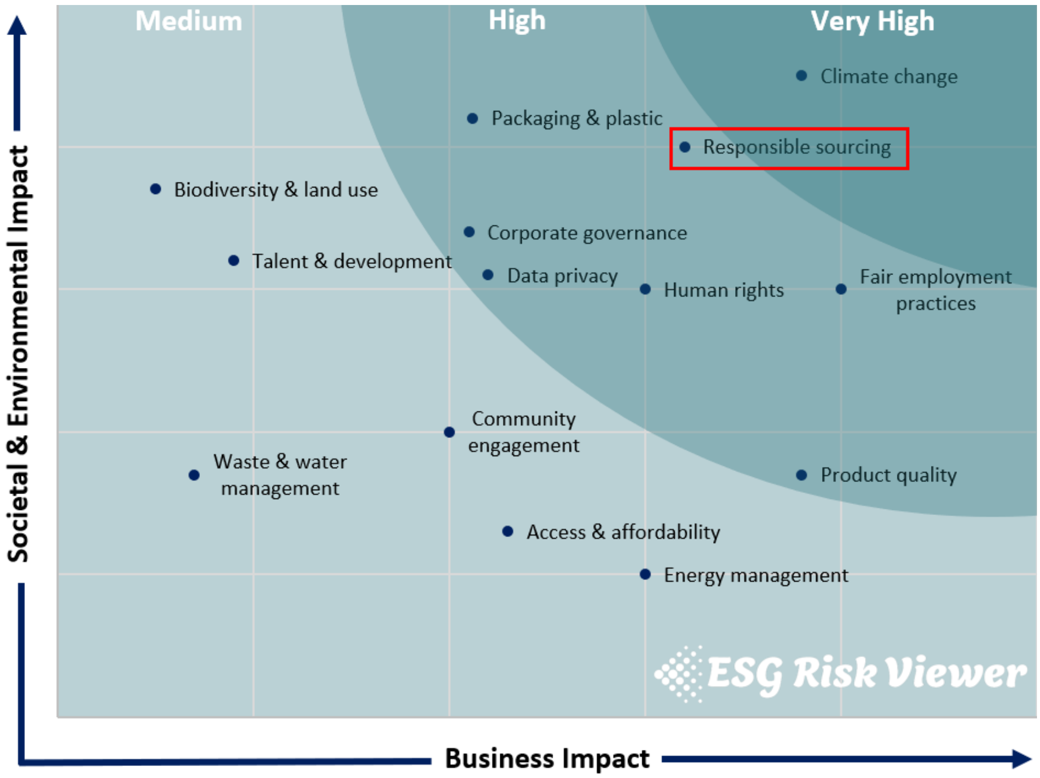
(OECD Due Diligence Guidance for Responsible Business Conduct, 2018, p. 69)

Reasons why your business might be at a downstream or upstream "control point"

Your business might be an ideal **control point** for your corporate clients and lenders; and they are likely to assess the due diligence process you have in place to control your suppliers and sub-contractors. This is because you have greater visibility and/or leverage over your own suppliers and business relationships further up the supply chain.

Conducting due diligence on your business to determine whether you are in turn conducting due diligence on your suppliers provides some comfort that the risks of adverse impacts directly linked to suppliers have been identified, prevented and mitigated.

Consider for example the following double materiality matrix of your typical corporate client, a larger multinational retailer:



Source: *ESG Risk Viewer*

"*Responsible sourcing*" has been identified as a material sustainability topic by your corporate client. Your client needs to report using the specific requirements in applicable frameworks such as

- Environmental & Social Impacts of Ingredient Supply Chain *(ISSB/SASB - FB-AG-430a.1, 2 and 3)*
- Workers in the value chain (*ESRS S2*)
- Supplier Environmental Assessment 2016 *(GRI 308)*
- Supplier Social Assessment 2016 *(GRI 414)*

As an example, ESRS 2, stated that

" *19. The undertaking shall disclose whether and how its policies with regard to workers in the value chain are aligned with internationally recognised standards relevant to value chain workers … The undertaking shall also disclose the extent to which violations in relation to … the OECD Guidelines for Multinational Enterprises that involve workers in the value chain have been reported in its upstream and downstream value chain and, if applicable, an indication of the nature of these."*

The OECD Guidelines for Multinational Enterprises clearly specify the need for multinational enterprises to carry out due diligence beyond Tier 1 suppliers, across the entire value chain, and your business is potentially the ideal **control point** for such due diligence.

Concluding thoughts

SMEs should become "see-through" business partners for their corporate clients and lenders.

Supply chain visibility leads to supply chain resilience. SMEs should proactively engage with sustainability reporting and effectively become "see-through" business partners for their corporate clients and lenders.

SMEs are increasingly receiving requests for sustainability-related information from banks and corporate clients, who in turn need this information to manage their sustainability profiles for aspects that arise from their business relationships.

Voluntary sustainability reporting can also be a source of competitive advantage as the decision of an actual or potential corporate client may rest on the **opacity** or **clarity** that your business brings in the management of its sustainability profile.

ESG Risk Viewer