UNIQUE OPPORTUNITY TO CREATE LONG-TERM THINKING IN BUSINESSES

Tekstilrevolutionens input on the European Commission's draft bill on Due Diligence Duty

The European Commission is drafting a bill that is intended to hold companies to account for any environmental harm or human rights violations caused by their operations. This bill has an enormous potential for the environment, our climate, and for the people working at the lower end of supply chains. It is, however, crucial that we get the details of the enforcement right, as this will determine the impact and effectiveness of the legislation. It is key to create a shift from short term to long term thinking. This can be done by, amongst other things, requiring directors to balance the stakeholder interests of a company's operation with those of the shareholders, and by creating incentives to measure sustainability over short term financial performance.

WHY IS THIS IMPORTANT?

We live in a world where the system that companies operate by, and base their decisions on, is fundamentally flawed. The system is constructed in a way that rewards financial growth, and disregards the impact operations have on people and the environment.
Although we are conscious that we are on a trajectory to surpass many of the planetary boundaries, we still make decisions that benefit us financially and existentially in the short rather than the long term. Clearly, we need to create incentives that will accelerate a change to long-term thinking. This is essentially the purpose of a draft bill that will soon be processed in the European Commission - and with it there is a real opportunity to create a positive impact for both people and the planet. Which is why it is of utmost importance that stakeholders are consulted, so as to avoid loopholes and weak enforcement. This will reduce the risk of it becoming merely an administrative burden with little or no positive impact; the nuances and details in the enforcement are crucial for its success.

THE PROPOSAL

The European Commission is working on a bill that will require companies to work structurally with human rights due diligence. The legislation compels them to ensure that no human rights violations are taking place in their supply chain, and that they are taking into consideration the needs of stakeholders such as the environment, employees, and people affected by their business operations. It is common for companies to report on their CSR, but action is voluntary and has proven inefficient. A law that would hold businesses accountable would make a real difference.

Tekstilrevolutionen has therefore elaborated on four thematic areas, we believe are necessary to get right, in order for the proposal to become effective.

WHAT IS NEEDED

Directors should be obliged to protect the environment and people
Shareholders - the people or corporations that have invested in the company - are vital for the financial performance of a business and thus for its financial success. This means that the short term interest of the company is to cater to these shareholders. Meanwhile, stakeholders, defined here as the people and environments affected directly or indirectly by a company's operations - have little or no say in the company's business strategy. This results in companies' financial growth coming at the expense of environmental degradation and the exploitative working conditions.
The COVID-19 crisis has again reminded us about the need to build resilience in our complex and interconnected world. We therefore urge the European Commission to ensure that stakeholders are included in directors' *duty of care*, as voluntary approaches to drive positive changes have largely been ineffective. We therefore urge the EU to enforce inclusion of stakeholders in the director's duty of care, as this could bring about a dramatic shift from short to long term decision making.

DUTY OF CARE

Directors in companies have a duty of care for the interests of the company. They are required to put themselves aside and act in the interest of the company. In many cases this means to act in the interest of the shareholders. In turn, this leads to short-termism.

Measure companies on their sustainability performance
Another way of inspiring a more long term strategy, is to link the director's salary to the company's sustainability level. Right now, financial growth is rewarded with financial gain, with little incentive to focus on sustainability - which often results in it being sidetracked as a consequence.
We therefore welcome the idea of a compulsory inclusion of sustainability metrics in the variable remuneration of company directors. This will incentivise a shared, and thus more balanced, focus on both financial growth and sustainability.

Less stringent requirements in risk zones are not a viable solution
A central question posed in this proposal is whether there should be fewer or lesser requirements for companies to comply with environmental and social and/or human rights regulations in risk zones[1]. One argument for less stringency, is that due to the increased cost of operations, caused by complying with the law, companies would leave the area. This would leave the local population with a lower tax income and without jobs.

1 *Referring to Conflict-Affected areas and zones with high risk of operations causing environmental damage or violations of human rights.*

We agree that companies moving their operations abruptly can have grave consequences. Large scale operations can destroy the surrounding environment and social structures by depleting and/or polluting local resources, making the local community dependent on the factory jobs. This is precisely why operations must be a benefit to the local community - and

we believe a due diligence law that encompasses all stakeholders would reduce harm to the environment, and correct the unhealthy power dynamic.

Therefore, new operations should comply with a set of requirements for businesses to put systems in place that protect and regenerate local resources, protect human rights, and that make space for local business activities. Lastly, all stakeholders should benefit from the operations both in the long and short term. These requirements might reduce the risk of companies exploiting the local population by making use of child- or indentured/slave labour in vulnerable areas.

Enhancing sustainability expertise in the board of directors

Directors have a powerful position in leading a company; they are responsible for both operations and their impact on the environment, as well as the people in the entire supply chain. Therefore, it is crucial that these decision-makers have the relevant expertise in environmental, social and/or human rights matters.
As the current level of the expertise of boards of directors does to date not fully support a shift towards sustainability, enhancing directors' competence in

DUE DILIGENCE

In simple terms, due diligence is how a business understands, manages and communicates about risk. This includes the risks it generates for others, and the risks it encounters through its strategic and operational decisions and actions.

this area should be addressed. In order to ensure that this shift takes place, it is crucial that companies (except SMEs) are required to have a certain number/percentage of directors with relevant environmental, social or human rights expertise.

Start-ups and SMEs should not be disadvantaged by the law

In designing the law, it is worth considering which companies should be affected by the law. In the context of due diligence, we believe that the bigger the company, the greater its administrative reach. Smaller companies should not to the same extent be burdened with the administrative tasks of documenting and monitoring their supply chain, and including stakeholders' interests. Adjustments should be made to ensure that smaller companies should not be disadvantaged because of their size. We propose that micro-enterprises (less than 10 people employed) be exempt. To lighten the administrative burden for SMEs, we recommend capacity building and funding opportunities, as well as help desks that can translate due diligence criteria into business practice.

CONCLUSION

The European Commission is processing a draft bill that has the potential to require companies to balance their shareholders interests with those of the stakeholders in their operations. This would mean that we could see a shift from a short-term focus on financial growth to a focus on long term resilience in the environment and in communities. If the enforcement of the law is effective, it could have an enormously positive impact for the environment and for people working in the industry.

However, it is important to make sure that the law does not contain any loopholes, thus making it less of a game changer and more of an administrative burden.

To get it right, we need to make sure that corporate directors are incentivised financially to care for the environment and for the people affected by the company's operations. We also have to make sure that directors are responsible for harm caused - and we must not lower the threshold in risk zones.

Lastly, it is important that the level of expertise on boards of directors is raised significantly, so as to fully support a shift towards sustainability; knowledge of environmental and social matters should play a central role in the nomination and selection of directors.

TEKSTILREVOLUTIONEN

Tekstilpolitisk tænketank