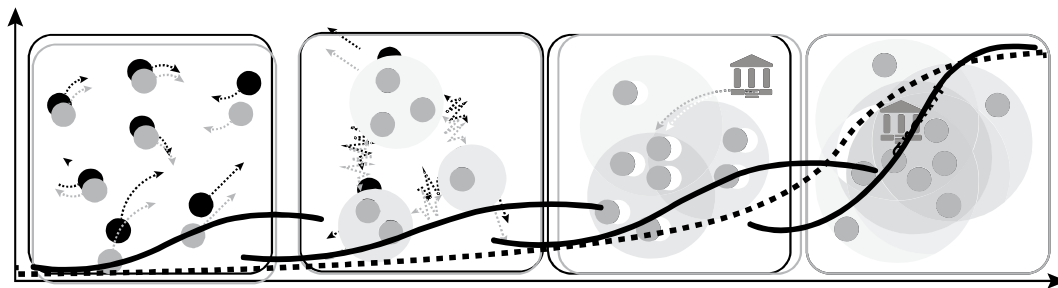


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# INTERNATIONAL RBC MEASURES IN MARKET TRANSFORMATION PERSPECTIVE

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The role of the government in the application of the OECD  
Guidelines and UN Guiding Principles from a market  
transformation perspective

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## Management summary

*“The challenge we are facing today is to manage an evolution towards higher levels of sustainability yet unknown in relation to a broad and expanding list of topics and with an increasingly wide range of stakeholders”*

Nigel Roome

### **Due diligence in market transformation perspective**

This study focuses on companies' compliance with OECD guidelines from the perspective of market transformation. The base assumption for market transformation is that the dynamics, in which companies find themselves around collective issues, develop in a predetermined order. This process, which focuses on applying due diligence with regard to the OECD guidelines by companies, evolves through four phases. The market transformation model assumes that (ir)responsible behaviour is the logical outcome of the way in which a system is organised. When different market actors interact with each other, it becomes a system that starts behaving in a certain way.

This occurs because in a system all actors influence each other's behaviour. They respond to each other. These feedback loops, or system loops, can exert a reinforcing or balancing effect within a system. Collectively, these loops lead to collective behaviour - as a logical outcome of the system - that determines whether or not the process of due diligence is effectively applied by Dutch companies. Noteworthy here is that process and content in transformations are inextricably linked because they are subject to the same system dynamics.

In this study, the following dynamics regarding due diligence are observed per phase:

- *Phase 0 – Due diligence as a non-issue* – Companies are not aware of due diligence with regard to the OECD guidelines, or have the impression that it does not matter for their business interests, whether they pursue an active policy on the matter;
- *Phase 1 – Learning how to apply due diligence* - interventions that use the loop to develop alternatives to current behaviour, which better meet the application of the principle of due diligence;
- *Phase 2 – Rewarding the application of due diligence* - interventions that address the market dynamics loop, as actors learn how to incorporate the application of the due diligence principle into mutual business transactions;
- *Phase 3 – Cooperation on due diligence* - interventions that impact the enabling environment loop in which the parties jointly draw up concrete strategies and policies aimed at scaling up the application of due diligence to the entire market;

- *Phase 4 – Enforcing due diligence* - interventions that affect the externalities loop, because the policy is institutionalised; actors that are not complying, will experience the consequences thereof.

Based on the market transformation model, it can be determined which categories of interventions - based on the Integral Assessment Framework for policy and regulation - are effective, because they affect the dynamics of a particular phase. The interventions, appropriate to a phase, change a system loop that has to be addressed in that specific phase; collectively, the (adapted) system loops lead to appropriate collective behaviour.

The results are shown in the following table:

System loops	Categories of policy instruments
<b>Alternatives loop</b> (addressed in <b>Phase 1</b> )	<ul style="list-style-type: none"> <li>• B.1 behavioural instruments</li> <li>• B.6 Rules stimulating innovation or creating space for execution</li> <li>• B.9 Arranging the execution of a government task</li> </ul>
<b>Market Dynamics Loop</b> (addressed in <b>Phase 2</b> )	<ul style="list-style-type: none"> <li>• B.3 Financial steering</li> <li>• B.8 Steering of the execution</li> </ul>
<b>Enabling Environment Loop</b> (addressed in <b>Phase 3</b> )	<ul style="list-style-type: none"> <li>• B.2 Acquiring support or knowledge</li> <li>• B.4 Social steering</li> <li>• B.5 Co-regulation and self-regulation</li> <li>• B.11 Ex-ante evaluation</li> </ul>
<b>Externalities Loop</b> (addressed in <b>Phase 4</b> )	<ul style="list-style-type: none"> <li>• B.7 Balance between new legislation or amendment law and the existing legal situation</li> <li>• B.10 Compliance and enforcement</li> <li>• B.12 Dispute resolution</li> <li>• B.13 Monitoring policy</li> </ul>

### Problem analysis focused on the dynamics of due diligence

Before investigating which roles are effective when, this study has conducted a problem analysis. Why is the application of due diligence sometimes difficult for Dutch companies? In system dynamics, in which due diligence does not fit – a situation now obsolete for Dutch companies - prescribing due diligence will at most lead to complying ‘on paper’ or excluding parts of a value chain, if risks are too high. Such system dynamics are characterised by:

- Market dynamics, in which suppliers receive orders based on costs, product quality and delivery times, responsibility for violations can easily be transferred to others;
- an environment, in which Dutch companies individually have little leverage because they are only one of many customers or suppliers - and both companies and governments have a keen interest in international trade growth;

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- c. a context, in which the conditions for change are absent because companies have no direct, or only superficial, contact with links further up (or down) a value chain - or do not even know which companies are active there, and;
  - d. an environment, in which the consequences of violations are hardly felt by those who cause them. This occurs because the people - and in the case of environmental violations, areas - affected are far away in a value chain, or unable to demonstrate liability of Dutch companies.

### **Applied interventions based on desk research**

The desk research focused on the analysis of four documents and ten International Responsible Business Conduct (RBC) sector agreements. Both theoretical and desk research conducted in this study confirmed that the market transformation model can be applied to compliance by Dutch companies with the OECD guidelines and the UN Guiding Principles. On the basis of the specific documents in our desk research however, it has not been possible to indicate in which phase of the market transformation model the Dutch market and/or sectors currently are. The documents studied did not provide enough specific information to ascertain this. The study did however map out which roles the government currently conducts and which it *may* fulfil to stimulate compliance by Dutch companies with the OECD guidelines and the UN Guiding Principles. Main results of the desk research are that two categories of policy instruments are used remarkably often, i.e. social steering and co-regulation. Many multi-actor interventions are taking place and the focus is on cooperation. The government is very active and uses a wide range of policy instruments (with a preference for co-regulation and social steering). On the basis of the reports studied, companies are less active and mainly use the co-regulation / cooperation instrument. It also appeared that more interventions are taking place in certain sectors than in others, namely financial institutions, garment & textile and, to a lesser extent, the food sector. These coincide with sectors that participate in sector agreements.

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### **Consequences for Dutch companies, government and civil society**

From a market transformation perspective, effective government policies address all four system loops, each of which is changed in a particular market transformation phase. In view of appropriate roles per phase, an effective portfolio strategy can be developed, as stipulated under recommendation 2) of this summary. This also implies an important consequence of the market transformation perspective, i.e. the relationship of government policy with other systemic influences on the collective behaviour of companies.

Government measures can strengthen or weaken the existing system dynamics. In order to strengthen current dynamics in further reducing violations, it is appropriate to consider measures in this context and, where appropriate, link them to the regular, traditional business risks (and opportunities), such as reputation, damage claims, security of supply, etc. It is also important that market incentives take into

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account the varying degrees of due diligence adoption by companies (from front runners to laggards). Moreover, the role of civil society shifts during a sustainable market transformation from a "driver" to an "expert" who provides information and monitors the process - in collaboration with government and the industry. In this study, the roles of Dutch companies, government and civil society have been summarized in a matrix (attached to this summary) that indicates who should do what and when. The matrix provides guidance for each of these actors to consider how they can put into practice the appropriate roles per phase in institutionalising the application of due diligence.

## Recommendations

Based on these findings, this study proposes the following recommendations:

1. Apply a **systemic perspective** in policy development focused on due diligence. The reason why implementing due diligence is difficult for some Dutch companies is due to the fact various actors influence each other - through action and reaction. A one-sided focus on interventions by the Dutch government entails the risk of unintended side effects, such as only complying with due diligence on paper, withdrawing from high-risk areas without improving the situation and undermining any joint actions that have already been initiated in various value chains.
2. From a market transformation perspective, effective government policies address all four system loops that are changed in different phases. This advocates a **portfolio strategy** that for each phase, examines how the existing interventions have already changed the underlying system loops and what is still needed (appropriate roles). Since this study concludes that there are still points for improvement in each phase in order to further stimulate due diligence, this study recommends such a portfolio strategy:
  - in **phase 1**, this mainly concerns developing *alternative methods* for applying due diligence, and where possible, increasing transparency;
  - in **phase 2**, a broader set of instruments to *reward companies* that properly apply due diligence;
  - in **phase 3**, *sector strategies* must be developed more broadly and deeply, focusing on *upscaling* the application of due diligence to the entire market, and;
  - in **phase 4**, measures aimed at institutionalisation should focus on participation in collective behaviour, as ascertained in the sector strategy, rather than on individual company behaviour. This is further elaborated in the following recommendations.
3. Cherish what has already been achieved in creating alternatives. Companies looking for alternative ways of applying due diligence are able to get support in various ways. It is important to **maintain access to such alternatives**. No indications have been found that expansion is necessary. However, there is still a lack of **transparency** in value chains. As a result, some Dutch companies still have

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insufficient insight to determine which risks occur in their chain. It is recommended that this lack of transparency will be tackled jointly, as part of a sector strategy (phase 3).

4. **Reward frontrunners** in applying due diligence through socially responsible procurement by government organisations, in addition to continuing to apply due diligence as a selection criterion for the three implementing organisations that manage private-sector instruments funded by the Dutch government (FMO, Atradius DSB and RVO). Encourage the integral inclusion of environmental, social and governance (ESG) criteria in credit allocations by financial institutions. Making visible which companies do - and which do not - properly apply due diligence, for example in the form of **benchmarks** - also strengthens the dynamics in phase 2.
5. Assess value chains for the development of - and commitment to - a **sector strategy** in phase 3. In order to meet limited capacity, the principle of proportionality can be upheld, by focusing primarily on chains and sectors with the largest risks. This assessment should not be a one-off process, since monitoring the effects of such strategies - and making continuous adjustments based on results - is crucial.
6. Focus in policy development on sector strategies to which companies **collectively commit**. Interventions from companies have increased leverage in international value chains if they are deployed together - and involve the **roles of companies, governments and civil society**. In this way, actions by the various stakeholders reinforce each other. It is recommended that policies for each high-risk sector encourage the development of a sector strategy, with at least a shared vision on the future of the sector, a coherent action plan to get there and indicators to check whether the implementation of the strategy is realising the desired effect.
7. In addition to sector agreements, include **other forms of multi-stakeholder initiatives** (MSIs) in policy development, such as frontrunner coalitions and roundtable meetings. Otherwise, a wrong image will arise of the way in which due diligence is applied by companies. An example is the agricultural sector, which is lagging behind in the development of a sector agreement, but is actually front-running in drawing up a sector strategy for international value chains. Examples of the latter approach are the vision and accompanying strategic action plan, such as developed for horticulture in the RBC programme of CSR Netherlands and the Roadmaps for e.g. coffee and tea, as facilitated by IDH.
8. Focus policy development on preventing violations and implementing the Sustainable Development Goals. This increases the efficiency of existing instruments because several goals can be achieved.

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This is also emphasized in a recent SER advice: “An international RBC risk analysis provides companies with insight into the (possible) negative consequences of their core activities and the positive contribution to the SDGs if the most important risks are effectively addressed”. Therefore, support in sector strategies, the development of new business models that **integrally address risks and opportunities**.

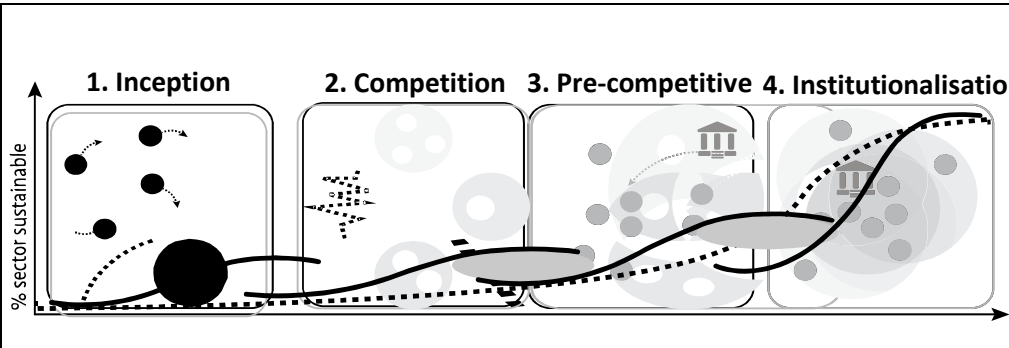
9. **Broaden the discussion on legislation** from the question "whether mandatory legislation should be introduced" to "**what measures should be taken to ensure that laggards in a sector experience the disadvantages of not complying.**" This can be done through self-regulation (such as in the Responsible Care programme in the chemical industry) and through government regulation (e.g. the Carbon Tax or when phasing out single-use plastics). **Transparency measures** such as the further introduction of *True Price* also ensure that laggards will experience disadvantages from not conforming to what the frontrunners advocate. The measures aimed at institutionalisation in phase 4 should support a shared sector strategy. This is to ensure that companies that do not yet cooperate in the implementation of that strategy will experience disadvantages.
10. **Create an ex-ante test** that every **sector strategy** must meet, focusing on: “A successful transition with different stakeholders requires that a shared, clear vision is translated into an action-oriented strategy, whereby a viable business case for all stakeholders is sought after, roles and responsibilities are clear and progress is monitored and evaluated collectively. ” This promotes transparency - and with it the necessary confidence - on how the various value chains and sectors are developing, in terms of a shared sector strategy. Institutionalisation (phase 4) is currently still too early for many value chains and sectors because there is not yet a joint sector strategy. Or the collective activities that already exist are insufficiently transparent. Research into the results of a strategy - and making these transparent - provides more certainty that the institutionalisation of those activities will in effect lead to the effective application of due diligence.
11. The **main added value** of this study is that it provides **insight into the appropriate roles of government in the various phases of market transformation**. Based on the research material, it has not been established *in which phase of market transformation the Dutch market* is. To get a more complete picture of government interventions in each of the phases of market transformation, it is recommended to map this out through expert interviews. Moreover, it is recommended not to do this per sector, but across sectors. In this way it will be possible to map how - and to what extent - the appropriate roles, as described in this study, are applied. Such an investigation may also provide guidance on how the government can fulfil these appropriate roles.

12. The starting point for market transformation is the **dynamics between the various system loops**. This advocates to further reduce non-compliance by companies with the OECD guidelines, to also consider government measures in the context of *regular, traditional business risks (and opportunities)*. Such external influences only arose in this study to a limited extent. In follow-up research, it is recommended to pay more attention to the impact of regular business risks on the application of due diligence, according to the OECD guidelines.

13. As indicated above, the application of the appropriate roles per phase has consequences for Dutch companies, the government and civil society. When summarised in a matrix, the entire market transformation curve - also known as the S-curve - can be represented in one image.

The **appropriate actions per stakeholder per phase** are shown in the next **matrix**.

The matrix provides a practical overview of *who should do what, when*, depending on the transformation phase in which the application of due diligence in a market or sector is residing:



	1. Inception	2. Competition	3. Pre-competitive	4. Institutionalisation
	<b>Phase 1 - Learning to apply due diligence</b> interventions that address the loop to develop alternatives to current behaviour, which better meet the application of the principle of due diligence	<b>Phase 2 – Rewarding the application of due diligence</b> interventions that affect the market dynamics loop because actors experience how they can incorporate the application of the principle of due diligence in mutual transactions	<b>Phase 3 - Working together on due diligence</b> interventions that apply to the enabling environment loop, in which actors jointly develop concrete strategies and policies aimed at scaling up due diligence to the entire market	<b>Phase 4 - Enforcing due diligence</b> interventions that affect the externalities loop, because the policy is institutionalised and actors, who still do not comply, will experience the consequences thereof
<b>Dutch companies</b>	Stop ignoring due diligence	Realise the importance of applying due diligence in international chains	Realise that effective risk management depends in part on what others do	Lobby for the shared sector strategy
	Experiment and learn what alternatives are	Differentiate the approach and try to	Work with other parties in developing	Encourage compliance and



	possible in applying this principle	outperform competitors	a sector strategy to apply due diligence scalably and efficiently	enforcement of the sector strategy
	Learn to report on the results of the current approach of due diligence	Involve customers and suppliers in the value chain in the approach	Increase transparency in the chain through a joint approach to audits and knowledge sharing	Respect independent and cross-company institutionalisation
<b>Government</b>	Realise that Dutch companies are in a system dynamic, in which many actors play a role	Increase transparency on the performance of individual companies	Provide financial and public support to multi-stakeholder platforms and coalitions	Dialogue with frontrunners and civil society about the right incentives for institutionalisation, given the system dynamics of a chain
	Provide guidance on what is required with regard to due diligence	Link measures to socially responsible procurement (act as 'launching customer') and to regular, traditional business risks and opportunities	Provide realistic information about the state of affairs with regard to due diligence	Create synergy by aligning Dutch government interventions to other (international) incentives so that those left behind experience negative consequences
	Create space for experiments and subsidise projects that stimulate due diligence	Influence other parties to also take on their appropriate role	Determine policy goals and indicators	Measure the impact of the new policy, based on the agreed policy goals and indicators
<b>Civil Society</b>	Put issues in international value chains on the agenda by highlighting what goes wrong	Study best practices and lessons learned around the application of due diligence	Participate and support multi-stakeholder initiatives to collaboratively develop a sector strategy	Lobby to government and companies in order to develop incentives for forcing laggards to conform to the sector strategy
	Hold Dutch companies and the government accountable for applying and/or encouraging due diligence	Enter into partnerships with companies that take measures in their chain to identify and mitigate risks	Bring in expertise with regard to the impact of the choices of Dutch companies in other parts of international chains	In case of violations, assist those directly affected to hold parties legally liable

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	Participate in projects with companies to learn how to apply due diligence	Define agendas that can uplift the entire market	Monitor which companies – and which not – are actively participating in a sector strategy	Identify and put on the agenda the subsequent problems in a value chain, which the current sector strategy does not yet address
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