ILO GLOBAL BUSINESS NETWORK ON FORCED LABOUR

Putting SMEs first:
why small- and medium-sized enterprises are crucial in the responsible business conduct conversation

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INTRODUCTION

Judging by the quantity and quality of standards, guidelines and instruments available, the field of responsible business conduct (RBC) has come a very long way in recent decades.[1] There is no shortage of guidance intended to support employers, workers and governments in making social and economic progress. These cover issues as wide ranging as fundamental principles and rights at work, broader human rights, responsible investment, social responsibility and sustainability. As a result of policy measures to improve transparency including regulation, reporting on RBC by large enterprises is on the rise. Commitment among business leaders ensures that resources and talent are directed to enable reporting against standards, in support of good due diligence, risk mitigation and reputation management.

Nevertheless, engagement with the various RBC standards is not universal across business. One noticeably largely absent group is the vast small- and medium-sized enterprise (SME) community. The UN Guiding Principles on Business and Human Rights outlines that the responsibility to respect human rights applies to all businesses, regardless of size, sector, geography or ownership. Today, SMEs, together with micro enterprises and the self-employed, make up approximately 70 per cent of global employment.[2] Yet, they are excluded from most activities and initiatives, either by accident, circumstance or design.

While this briefing note lays out the importance of engaging SMEs in the RBC conversation, it is important to acknowledge that SMEs come in all shapes and sizes and can vary considerably within the SME categorization. Local and sectoral contexts also remain of primary importance. Therefore, the briefing note does not prescribe a one-size fits all approach but instead highlights the need for change in the design, implementation, and measurement of RBC standards.

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Key points

1. Government and corporate commitment to RBC has grown, but this has not translated into commensurate change in practice.

2. Global standards are, de facto, designed for and about large enterprises. They are unsuitable for the SMEs that make up over 90 per cent of the private sector globally.[3]

3. When measured by metrics designed for large enterprises (high quality reporting on RBC standards), SMEs are found inadequate. However, such measures are unsuitable for SMEs and do not take their circumstances into account.

4. SMEs are unable to engage in the formation and voluntary implementation of standards for a range of reasons including resource availability and capacity limitations.

5. Standards are unsuitable drivers of RBC. Compliance is relatively expensive, profit maximization is not the singular motivator for SMEs, and they lack expertise in the topic and formal reporting practices. In addition, SMEs, often informally run, are driven by personal relationships and, crucially, the values of the owner-manager.

6. Notwithstanding some improvements globally, research suggests that, in some cases, the imposition of RBC standards on SME suppliers might result in: the withdrawal of otherwise qualified suppliers from contract competition; poor compliance processes that don't reflect practice; creative solutions to fake compliance; a negative effect on social performance; and undermining of the authenticity, identity and values of the SME.[4]

Research shows that successful progress in RBC is local context specific and requires a willingness to listen, collaborate and integrate approaches to RBC with SMEs and other non-corporate stakeholders. Meaningful contributions require an understanding of achieving scale and a willingness to work in partnership.

THE RESPONSIBLE BUSINESS CONDUCT LANDSCAPE

Labour exploitation still exists despite good intentions and progress to achieve the 2030 Sustainable Development Goals has been disappointing.[5] The assumption that the application of standards and compliance auditing will resolve poor RBC, particularly through top-down approaches, does not stand up to scrutiny.

The reasons for limited progress are multiple and complex. One important element is the relatively weak understanding of the perspective of businesses other than the large multinational enterprises that lead or implement private governance initiatives and dominate the business voice in the formation of standards and global governance instruments. This dominance speaks against the idea of shared responsibility as outlined in the UN Guiding Principles on Business and Human Rights, with all actors having important roles to play. SMEs in particular are commonly under-represented and misunderstood in global standard setting processes, requiring substantial re-interpretation and support in order to make standards meaningful for them.[6] Unsurprisingly SME engagement in voluntary global standards (such as ISO 26000 Social Responsibility) implementation is, proportionally speaking, extremely weak.[7] Table 1 summarizes some of the reasons why small- and

> ◢ SMEs in particular are commonly under-represented and misunderstood in global standard setting processes, requiring substantial re-interpretation and support in order to make standards meaningful for them.

medium-sized enterprises tend not to engage with global standards. This mismatch in participation is also true in other arenas where barriers persist to the SME voice penetrating high-level, multi-stakeholder discussions that lead to the creation of standards.[8]

1

POOR AWARENESS.

The first barrier is that SMEs need to be in a position to know that there is an issue under discussion to which they might contribute.

2

ASSUMPTION OF (IR)RELEVANCE.

Many discussions are inaccurately framed as being corporate in nature ('corporate' social responsibility, 'corporate' citizenship), SMEs may self-select out of a conversation, or assume that they are not of interest or invited to join. Language is important and should be inclusive.

3

LIMITED CAPACITY AND RESOURCES.

Engaging in multi-stakeholder dialogue is likely to be outside the core business of SMEs. It requires spare capacity and resources to provide input to the discussion.

4

LIMITED CAPABILITY AND LACK OF EXPERIENCE.

Those leading SMEs tend to be experts in the product or service they deliver, with less opportunity to develop the wider skills necessary to speak on a national or international stage.

5

HETEROGENEITY.

Given individual impact is likely to be limited for an SME, collective voice is desirable. However, while SMEs have some common characteristics that differentiate them from large enterprises, they are heterogeneous in nature. One size does not fit all.

6

RELATIVELY LOW LEVELS OF LEVERAGE.

Rarely can an individual SMEs leverage their influence or enforce their own perspective upstream or downstream in a domestic or international supply chain.

Despite these barriers, research shows a mixed picture of RBC among SMEs, with instances of good practice as well as poorer examples.[9]

WHY IS THE COMPLIANCE APPROACH LIMITED?

No type of enterprise has a monopoly on responsible, or irresponsible, business conduct. There are leaders and laggards in all categories. Measuring SME RBC by their success on metrics designed for large enterprises does not, however, work effectively in the vast majority of cases. Table 2 summarizes some of the reasons why

TABLE 2. LIMITATIONS OF RESPONSIBLE BUSINESS CONDUCT STANDARDS FOR SMES[10]

Expectation	SME reality
Affordability	SMEs are often financially vulnerable with cash flow challenges, subject to late payment by their customers, and lacking reserves to buffer them. The relative cost of diverting resources to organizing and reporting on standards is high for SMEs. Given most SMEs will supply multiple customers, the demands for compliance may be varied, creating further challenges.
Profit-maximization as a driver	While SMEs need to ensure the economic survival of their business, the assumption that they will be motivated by business case arguments is misguided. SME owner-managers are not driven purely by profit-maximization. Factors such as cost reduction, long-term stability, employee retention and independence are important. Since SMEs are commonly owner-managed, the leader of the enterprise is not beholden to shareholders to maximize return on investment. Instead, SMEs often engage with their stakeholders directly on a day-to-day basis.
Expertise	Small and micro enterprises are likely to have minimal demarcation of managerial functions, with individuals having multiple responsibilities. For example, smaller enterprises would often not have the capacity to employ a lawyer, an accountant, or an HR professional. As a result, it is unlikely an SME will have the dedicated expertise and experience in formal process implementation necessary to perform well according to RBC standards.
Formality	Smaller enterprises lack the structure of their larger counterparts. Bureaucratic structures are costly and, up to a certain size, they encumber rather than facilitate business. SMEs tend to have a flat structure and informal management style. Relationships tend to be at the heart of SMEs as opposed to formal arrangements. Indeed the majority of enterprises are family businesses. Overall, family-run or not, SMEs are heavily reliant on personal relationships and social capital rather than compliance, formal systems and structures.
Reporting processes	Smaller enterprises are often not required to provide public financial reports. Therefore, their first publicly facing report may be about RBC. This is a disproportionate challenge when they lack knowledge and experience of gathering and presenting data externally. Formal communication practices will be limited in the smaller enterprise, favouring informal, personal approaches.
Values and relevance	SMEs tend to be driven by the values of the owner-manager. In most cases, the primary stakeholders (beyond family) are the workers and the community of geographic operation. These are pertinent to day-to-day business and do not necessarily fit the usual global orientation of standards.

As Table 2 illustrates, SME compliance with global standards requires overcoming of multiple challenges. Compliance tends to indicate a larger SME capable of specialization or formalization, and/or an enterprise that has some in-house expertise, or is sufficiently successful to fund the resource investment. There are examples of enterprises for which RBC is their core business, such as social entrepreneurs. Other enterprises may be ambitious to grow and eager to mimic large enterprise practices. Often though, SMEs, which are otherwise competent and responsible, lack the resources to report formally

and may opt out of the contracting process, report poorly on compliance, or creatively manipulate their reporting.[11] Unfortunately, some are negatively affected in terms of their own social performance by the requirement to comply with externally imposed standards that negate their authenticity, identity and values.[12]

◢ Meaningful progress across all business types cannot be achieved without SMEs.

Meaningful progress across all business types cannot be achieved without SMEs. Research and practice suggest that a different approach is needed.

RESPONSIBLE BUSINESS CONDUCT FROM AN SME PERSPECTIVE: WHAT WORKS?

The heterogeneity of SMEs makes it challenging to come up with a 'how to guide' on engaging them in RBC. Nevertheless, there are commonalities identified by research that can help to formulate approaches that are more likely to have a positive impact. The pointers of what works for SMEs to enhance RBC shown in Table 3 could be useful for corporates, standards setters, non-governmental organizations and policy makers. Important underlying perspectives are the imperative to listen, collaborate and integrate RBC with SME perspectives.

Listen to SMEs

1 What are SMEs already doing in terms of responsible business conduct?

Without imposing categories that would make sense to large enterprises (do you have a code of conduct, is there a whistle-blower mechanism in place etc.), start to understand what RBC practices the SMEs are already doing, and what they see as important. From here, a checklist could be compiled, but this needs to be done in the words of the SME, or SME type. Priorities might be expressed as: "we always look after the family and the community first and there is no point being dishonest – everyone I do business with knows me and knows what we can do so it is important I am straight with them." Relationship building is important to understanding the SME

perspective particularly where SMEs are accustomed to telling their customers what they think they want to hear, so it will take patience to develop an open and honest dialogue.

2 Try to make sense of the heterogeneity of SMEs

While SMEs are very varied, some groupings can help to identify common characteristics. SME groupings may include those: working in the same geographical industrial cluster; in the same sector; of similar size, i.e. micros, small, medium; the same tier in the supply chain; and suppliers to a particular business. The reasons for these commonalities within groupings is that the enterprises face similar internal or external pressures.

Collaborate with SME representatives

3 Find who you can work with who really does represent a grouping of SMEs

A major challenge is to enable representation. Some formal clusters may have an existing structure. A valuable option is to seek collaboration with employer and business membership organizations or with the trade association for a particular context. Keeping in mind that some business representative organizations are more SME focused than others. Take the time to find the right, most representative group.

Integrate the SME perspective in responsible business conduct measurement

4 Change the way responsible business conduct is measured

Without taking action to change the approach to creating and measuring RBC standards, improvements across the business landscape will not be achieved. Leading businesses and business networks wanting to have an impact, need to work with SMEs to redesign the process. Governments have a role to play here, including at the local level. Sector and locally-owned approaches are important. Possible features might include those shown in Table 3.

TABLE 3. SMES AND RESPONSIBLE BUSINESS CONDUCT: WHAT WORKS?

1 **Embed an SME voice, champion or representative** in all stages of standard setting and implementation. SME orientation should be the dominant one with adjustments for large enterprises.

2 **A multi-stakeholder approach** in which the large enterprise customer is not the lead role, though may realistically need to finance the process.

3 **SMEs first:** SMEs need to be able to articulate their core purpose and core values. These should be an acknowledged part of the discussions.

4 **Bring workers into the conversation.** Without worker perspective and engagement, as a primary stakeholder for SMEs, progress will be limited.

5 **Governments have a role to play** in ensuring the effective communication of existing regulation and implementing it is a basic requirement. Effective legislation levels the playing field for SMEs.

6 **SMEs should not be under-estimated.** SMEs deserve respect for what they offer the economy and society. A readiness to learn, rather than just teach, is important.

7 **Language is important:** remove the word 'corporate' from the conversation. Terms like values, reputation, integrity, trust and responsibility may be more meaningful but this is context specific.

8 **Open and frank discussion about RBC is necessary.** Be ready to understand how corporates may negatively affect RBC in SMEs.

9 **Work towards supply chain responsibility rather than individual business responsibility.** Supply chain responsibility is characterised by a chain-wide commitment to RBC where all parties have a representative voice, forming a genuine partnership approach, and acknowledging differing approaches to ethics and responsible business conduct.

10 **Understand the key relationships for the SME** and work with those (workers, community, family) rather than assuming a narrow 'financial transaction' approach to business.

11 **Resist the temptation to make responsible business conduct formulaic.** Continuous dialogue rather than standards imposition and auditing should be the goal.

12 **Develop industry or sector-based approaches that suit all** and are not driven only by the needs of the large enterprise customer.

CHANGING THE STATE OF PLAY

Existing approaches to RBC are ill-designed for SMEs. Large enterprises, governments and non-governmental organizations that are committed to RBC need to put SMEs at the centre of their thinking. Those in a position to represent the SME voice need to be ready and able to engage at a high level on the meaning of RBC for SMEs. Without a shift from the current approach, the global project to enhance social progress through business will remain incomplete. New approaches are needed to go beyond the changes already accomplished.

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Endnotes

1   Standards come in many forms. Our focus is on voluntary responsible business, transnational standards which multinational enterprises (MNEs) (perhaps adapt and) apply to their supply chains, requiring compliance of their suppliers. In many instances, there is considerable crossover with national legal frameworks. This is the nature of standards but for the purposes of the discussion here, we treat standards as transnational, voluntary, soft regulation that have been applied through supply chains through the leadership of MNEs.

2   ILO, 2019.

3   WTO, 2016. There is no global standard definition of SMEs but the most common is that micro enterprises have fewer than 10 workers, small-sized enterprises fewer than 50 and medium-sized enterprises fewer than 250 workers.

4   Morsing and Spence, 2019.

5   Crane et al, 2019. UN, 2019.

6   ISO, 2012. Spence and McCarthy, 2017.

7   Perera, 2008.

8   ISO, 2012.

9   Soundararajan et al, 2018a.

10 (Drawing on Perera, 2008; Russo and Perrini, 2010; Soundararajan et al, 2018a; Spence, 2016; Spence and Rinaldi, 2014; Wickert et al, 2016).

11 Soundararajan et al, 2018b.

12 Baden et al, 2011; Morsing and Spence, 2019.

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