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Corporate due diligence and corporate accountability

European added value assessment

STUDY

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There is evidence of human rights violations and negative environmental impacts related to business activities, including of EU companies. Several actions have been taken at both international and EU level to promote responsible business conduct and to prevent such violations. While being important steps forward, these initiatives suffer from several limitations, as they are either voluntary, sector-specific, or limited to reporting obligations. The EU is committed to upholding human rights and environmental protection, and has the competence to harmonise national company law to ensure the proper functioning of the single market. This study analyses the European added value of a potential measure requiring companies to carry out due diligence on possible social and environmental risks in their operations and supply chains. It analyses why action should be taken at the EU level and points to its potential impacts from the perspective of both EU companies and society at large.

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Executive summary

European added value assessments (EAVAs) provide support in the form of research-based evidence to European Parliament reports on legislative-initiative proposals drafted under Article 225 TFEU. This EAVA accompanies the legislative-initiative report of the European Parliament's Committee on Legal Affairs (JURI) on Corporate due diligence and corporate accountability (2020/2129(INL)).

EAVAs try to explore the potential impact of an EU action in a certain field, by analysing the gaps existing in the status quo and identifying the potential European added value of the proposed intervention.

One of the points of departure in the debate around the need for companies to apply due diligence with respect to human rights violations and negative environmental impacts is the increased business internationalisation and integration in global value chains. Companies' activities can have **social and environmental impacts** in the regions where they themselves or other actors in their value chain operate, which are sometimes far from the country in which the company is registered. There is evidence of **violations of fundamental rights** related to business activity; as an example, in 2017, the International Labour Organization (ILO) reported 24.9 million people were victims of forced labour, of whom 16 million were in the private economy, in sectors such as manufacturing, construction, agriculture and domestic work. Research also shows **adverse environmental impacts**: 62 % of tropical forest loss is due to agricultural exploitation for commodity production, and 24 % is due to illegal agro-conversion for export markets.

In the light of these negative impacts, some major **initiatives at the international level**, such as the United Nations Guiding Principles on Business and Human Rights, have been taken to promote responsible business conduct and to prevent businesses' violations of human rights. These initiatives are important steps towards addressing negative impacts related to business activities, and they recommend the adoption of due diligence as a way to implement responsible business conduct. They are nevertheless voluntary measures and their uptake by companies appears limited. The UN working group on business and human rights itself points to the low prevalence of practices that reflect the UN Guiding Principles. There is a growing consensus **that the approaches applied, which are largely voluntary, suffer from limitations**.

The **EU is committed to protecting human rights and the environment**, and has assumed a number of international obligations in this respect. At the EU level, a number of initiatives –such as the Non-Financial Reporting Directive, the Timber Regulation and the Conflict Minerals Regulation – have been put in place to address the negative impacts of business activities. Still, these important steps remain focused on specific sectors, or are limited to reporting requirements.

There is evidence of a **limited uptake of due diligence practices among EU businesses**. A 2020 study commissioned by the European Commission's Directorate-General for Justice and Consumers (DG JUST) finds that just a little over a third of business respondents indicated that their companies undertake due diligence accounting for a broad range of impacts on human rights and the environment. Relatedly, there appear to be gaps in the effective access to remedy for victims, which is a right enshrined in the Charter of Fundamental Rights of the European Union.

Most research and business surveys underline the reduced **legal certainty** as regards the duties of companies due to the absence of a common legal approach at the EU level. Against this background, the **need for a level playing field** is mounting, since companies that are more proactive in social and environmental fields risk being exposed to a number of disadvantages.

This EAVA focuses on **a potential measure that requires companies to carry out due diligence to identify, prevent, mitigate and account for actual or potential human rights violations and negative environmental impacts in their operations and supply chain**. This is assessed against the current situation, where some but not all EU Member States have adopted laws in this regard, and where international voluntary guidelines already exist.

Overall, the **European added value of such a potential measure appears significant**, even if it is not possible to quantify each and every one of its components. The present study suggests that potential mandatory measures would increase **compliance** with standards such as the OECD Guidelines and the UN Guiding Principles. According to the European Union Agency for Fundamental Rights, effective due diligence practices can also help to strengthen victims' **access to remedy**. The impact can be substantial, depending on the quality of enforcement and on how the legal aspects are designed.

Action at the EU level would allow to **harmonise the rules** within the single market and thereby ensure its good functioning and the creation of a **level playing field** favouring fair competition. **Legal certainty** is expected to increase substantially, since EU-level due diligence requirements could address the concern raised by many businesses on the lack of clarity regarding their duties. A specially designed law-based standard would support current good practices and give companies **greater leverage** over their suppliers.

From a **company perspective**, mandatory due diligence involves implementation **costs** and has an impact on economic performance. According to the literature, these costs, while significant in some cases, are expected to be moderate as compared to company revenues. They will nevertheless be contingent on the type of company and especially its size.

The **impact** of environmental, social and governance accountability practices **on company outcomes** is usually considered **positive** in most literature thanks to: reduced risks, improved stakeholder relationships, lower costs resulting from conflicts, improved transparency and knowledge of the value chain, increased reputation and greater incentives to innovate.

The present study confirms these findings. Analysing a sample of EU companies, it indeed finds a **positive correlation between the extent to which companies implement environmental and social policies and their economic performance** (with a focus on profitability**)**. Interestingly, this correlation is stronger where companies have international operations. It is estimated that a one-step increase in environmental and social policies implementation could potentially increase the return on capital employed by 2.26 %.

Despite the caution needed in interpreting the results, it is possible to construct scenarios for 'upward harmonisation' that simulate EU companies' increased implementation of environmental and social policies. In terms of companies' profitability, the increase could range between 1 % in the least ambitious scenario and 3.05 % in the most ambitious one. The greatest benefits (about 4 %) are expected to accrue to companies that start from lower values.

It may therefore be expected that **a convergence of EU companies towards greater environmental and social accountability practices could contribute to their improved performance.**

Concerning the desired social outcome, i.e. the **reduction in human rights violations and negative environmental impacts, the impact of due diligence obligations is expected to be significantly positive**. Indeed, a recent EPRS study focusing on the potential impact of mandatory due diligence to halt and reverse global deforestation finds that it may reduce global **deforestation** by about 62 %.

Through a review of some case studies, the present EAVA finds that **being employed in a company that is part of a 'responsible value chain' can improve the social standards experienced by workers.** Relevant factors in this direction appear to include measures that hold companies responsible for violations in their supply chain and multi-stakeholder processes that involve the assessment of concerns, the holding of social dialogue, involvement of public authorities, the participation of workers in decisions and in representation bodies.

The implementation of companies' due diligence obligations in the supply chain could facilitate these enabling factors. It is safe to conclude, therefore, that implementing due diligence obligations can **significantly contribute to addressing environmental damage and human rights violations**, thus supporting the EU's commitment to respect for human rights and environmental protection.

Improvements in the respect for human rights and social standards are known to have a positive impact on economic growth. In addition, they could help in avoiding a 'race to the bottom' competition and, conversely, fuel an upward convergence in social and environmental standards in the global markets.

These considerations point to substantial **European added value**.

The present study also identifies a number of **risks and costs** that might result from the proposed regulatory instrument. Among these are the higher costs of implementation that are expected for SMEs and, at the same time, the potential negative impacts should they be excluded from due diligence obligations. This makes it all the more important to carefully spell out the details of the implementation, as they may be important in defining the precise costs and benefits.

Overall, it has to be recalled that this study is but a piece of a bigger picture and therefore has obvious limits, so it should be seen as a partial contribution to tackling the above-mentioned issues.

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1. Introduction and state of play

1.1. Scope of the study

European added value assessments (EAVA) are studies that provide support in the form of research-based evidence to European Parliament reports on legislative-initiative proposals drafted under Article 225 of the Treaty on the Functioning of the European Union (TFEU).

These studies examine the potential impacts and evaluate the potential EU added value of proposals made in legislative-initiative reports. European added value is understood as a positive net benefit if an action can be better achieved at EU level compared to Member-State level. The main objective of an EAVA is to provide an evidence-based quantitative and qualitative assessment that should identify potential gaps of the current EU legislation and estimate the possible benefits of taking common EU action in the framework of the legislative-initiative report that it accompanies.

The **EAVA on corporate due diligence and corporate accountability** is an assessment with a **focus on economic aspects**, which relies on both quantitative and qualitative approaches. It has been conducted partly in-house and partly through an externalised research paper focused on the quantification of the potential impact at the company level.[1]

The assessment involved the following **steps**:

- analysis of the status quo (providing an answer to the question what action is needed?')
- necessity and relevance of EU action required to depart from the status quo (providing an answer to the question 'why is EU action needed?')
- presentation of the policy option against the background of risks and gaps;
- European added value assessment (providing an answer to the question 'what would be the impact of action at the EU level?')

Part of the assessment is quantitative. It has to be considered an approximation of a possible intervention and not a detailed cost/benefit analysis, despite both costs and benefits are considered.

The starting point of this study is that there is evidence that **companies have an impact on the protection of human rights and the environment in the regions where they operate**, which are sometimes far from the country where the company is registered. The persisting evidence of negative impacts, including by EU companies and companies operating in the EU, despite the numerous national and international actions undertaken, is the basis for the present inquiry into the potential effects of EU action in tackling this aspect.

Against the background of the status quo, the present study defines the relevant policy option, focusing on **due diligence**; the assessment of the policy option is in the last section.

1 The outsourced paper is in Annex. When we refer to the “annex”, it means that we refer to the outsourced research paper. When we refer to the “appendix”, we mean the extra material at the end of the present EAVA written in-house.

1.2. State of play

1.2.1. Definitions

This section presents some key concepts of the debate (see also the paper in the Annex and the 2019 FRA publication).[2] These concepts are interlinked and not mutually exclusive. For a discussion on their interrelation and historical evolution, see the paper in the Annex.

Corporate social responsibility (CSR) refers to the integration in companies' strategies of a broader set of concerns than just those of the shareholders; a set of strategies 'whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis'.[3] Although voluntary, it has attained greater significance for regulating bodies over time. The development of CSR efforts should be led by companies, but 'public authorities should play a supporting role through a smart mix of voluntary policy measures and, where necessary, complementary regulation'[4] (on this evolution, see annexed paper).

Responsible business conduct (RBC) is a concept developed by the OECD through its Guidelines for multinational enterprises.[5] It is defined as 'making a positive contribution to economic, environmental and social progress with a view to achieving sustainable development and avoiding and addressing adverse impacts related to an enterprise's direct and indirect operations, products or services'. RBC 'means above all complying with laws, such as those on respecting human rights, environmental protection, labour relations and financial accountability, […]. It also involves responding to societal expectations communicated by channels other than the law […].'.[6] These social expectations beyond legal requirements are often considered as being synonymous to CSR.

Business and human rights (BHR) addresses the set of norms and practices aimed at avoiding human rights harm done by businesses. The 2011 United Nations Guiding Principles on Business and Human Rights (UNGP)[7] provide a widely accepted framework for understanding and implementing measures in this regard. The concept places emphasis on the rights-based aspect and on the need for ensuring that victims have access to remedy.

Due diligence (as applied to social, environmental and governance risks and impacts) is defined by the 2011 OECD Guidelines for multinational enterprises[8] as the 'process through which enterprises can identify, prevent, mitigate, and account for how they address their actual and potential adverse impacts as an integral part of business decision-making and risk management systems'.

Specifically, **human rights due diligence** is the process through which business enterprises should identify, prevent, mitigate and account for their potential and actual human rights impacts. Within

[2] Business-related human rights abuse reported in the EU and available remedies (2019), EU Fundamental Rights Agency's first report on the topic.

[3] ibid.

[4] European Commission, Green paper – Promoting a European framework for corporate social responsibility, COM/2001/0366 final, and Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, A renewed EU strategy 2011-14 for Corporate Social Responsibility (COM/2011/0681 final).

[5] OECD Guidelines for Multinational Enterprises.

[6] OECD policy framework for investment user's toolkit, Chapter 7: Promoting Responsible Business Conduct.

[7] United Nations Guiding Principles on Business and Human Rights

[8] OECD Guidelines for Multinational Enterprises.

the framework of the UNGPs, it is the core requirement towards business in meeting its responsibility to respect human rights.

1.2.2. Existing legislation and initiatives

Attempts to address the negative impact of business activities on the protection of human rights and the environment, and to promote respect for environmental, social and governance standards, have been ongoing for several years, with some very important instruments having been adopted at international, EU and national level. This section presents a review of these instruments; their limitations are examined in the following one.

The **European Union** is **committed to protecting both human rights and the environment**; it has a duty to promote respect for human rights and the environment in the legislation it adopts and implements and in its relations with the wider world. Human rights protection and the prevention of human rights abuses are embedded in the Treaties.[9] This is reaffirmed in the Charter of Fundamental Rights of the European Union, which requires the EU and the Member States to comply with human rights standards whenever implementing EU law. Moreover, Article 3.3 of the Treaty on European Union (TEU)[10] stipulates that the internal market 'shall work for the sustainable development of Europe' and should aim at 'full employment and social progress, and a high level of protection and improvement of the quality of the environment.' With regard to EU external action, Article 3.5 TEU provides that: 'in its relations with the wider world, the Union shall uphold and promote its values and interests and contribute to the protection of its citizens. It shall contribute to peace, security, the sustainable development of the Earth, solidarity and mutual respect among peoples, free and fair trade, eradication of poverty and the protection of human rights, in particular the rights of the child, as well as to the strict observance and the development of international law, including respect for the principles of the United Nations Charter'.

A **number of EU initiatives** have been put in place to address the negative impacts of businesses on the protection of human rights and the environment,. Three examples that are frequently cited in the present study are the Non-Financial Reporting Directive,[11] the Timber Regulation (EUTR)[12] and the Conflict Minerals Regulation.[13]

The **Non-Financial Reporting Directive**[14] requires large companies to disclose information on the policies they implement in relation to environmental protection, social responsibility and treatment of employees, respect for human rights, measures to counter corruption and bribery, and measures to ensure diversity on company boards. It only applies to large public-interest companies with more than 500 employees.[15]

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9 Articles 2, 3.5 and 21 TEU.

10 https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2008:115:0013:0045:EN:PDF#page=5

11 Non-Financial Reporting Directive (2014) – Directive 2014/95/EU of the European Parliament and the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups.

12 Timber Regulation (2010) – Regulation (EU) 995/2010 of the European Parliament and of the Council of 20 October 2010 laying down the obligations of operators who place timber and timber products on the market.

13 Conflict Minerals Regulation (2017) – Regulation (EU) 2017/821 of the European Parliament and of the Council of 17 May 2017 laying down supply chain due diligence obligations for Union importers of tin, tantalum and tungsten, their ores, and gold originating from conflict-affected and high-risk areas.

14 Non-Financial Reporting Directive

15 Requires from undertakings to include in their management report a non-financial statement containing information to the extent necessary for an understanding of their development, performance, position and impact of their activity,

The two main EU-level sectorial initiatives mandating due diligence relate to the value chains involving conflict minerals and illegally logged timber.

The **Timber Regulation (EUTR)**[16] came into force in March 2013 and aims to reduce illegal logging by ensuring that no illegal timber or timber products can be sold in the EU. The EUTR prohibits the placing on the EU market for the first time of illegally harvested timber and products derived from such timber; requires from those who place timber products on the EU market for the first time to exercise due diligence; and requires from those who buy or sell timber and timber products already on the market to keep records of their suppliers and customers so as to make timber easily traceable. The regulation defines due diligence based on three elements: information, risk assessment and risk mitigation.

The Conflict Minerals Regulation[17] states that EU importers of tin, tantalum, tungsten and gold must check what they are buying, to ensure it has not been produced in a way that funds conflict or other related illegal practices. The regulation requires importers to follow a five-step OECD framework.[18]

Some relevant EU institutional documents

European Parliament

European Parliament Resolution on sustainable finance (2018).

European Parliament Resolution on the impact of international trade and the EU's trade policies on global value chains (2017).

European Parliament Resolution on corporate liability for serious human rights abuses in third countries (2016).

Council

Conclusions on EU Priorities in UN Human Rights Fora (2019, 2020).

Conclusions on Business and Human Rights (2016).

Conclusions on the EU and Responsible Global Value Chains (2016).

Fundamental Rights Agency Opinion on improving access to remedy in the area of business and human rights at the EU level (2017).

Council of Europe Recommendation on Human Rights and Business (2016).

Office of the High Commissioner for Human Rights: Improving accountability and access to remedy for victims of business-related human rights abuse (2016).

At international level, there are three major attempts to reverse the negative impacts of business on human rights. While all three are non-binding measures, they are fundamental steps in safeguarding human rights in the corporate context.

First, the 2011 UNGPs affirm that business enterprises have a responsibility to respect human rights, and that States have a duty to ensure that they do so. The UNGPs are organised around three pillars: the State's duty to protect human rights; the responsibility of corporate entities to respect human rights; and the need to provide access to remedy for those who have been adversely affected by business-related activities. The UNGPs suggest due diligence as an operational means for business enterprises to respect human rights.

relating to, as a minimum, environmental, social and employee matters, respect for human rights, anticorruption and bribery matters (Article 19a).

16 Timber Regulation

17 Conflict Minerals Regulation

18 OECD, 'Due Diligence Guidance for Responsible Supply Chains from Conflict-Affected and High-Risk Areas'.

The OECD Guidelines on Responsible Business Conduct cover nine areas of responsible business conduct (RBC): information disclosure, human rights, employment, labour, environment, anti-corruption measures, consumer interest, science and technology, competition and taxation. They describe due diligence as implemented in five steps:

- Step 1. Establish strong management systems for due diligence: adopt a responsible business conduct policy, build internal capacity and functional alignment, supplier and business partner engagement, set up internal controls and data collection on supply chain, establish grievance mechanism.
- Step 2. Identify and assess risks of adverse impacts in the supply chain: map operations, business partners and supply chains, prioritise further assessment based on severity of harm, identify risks of circumstances inconsistent with standards in the guidelines.
- Step 3. Manage risks in the supply chain: inform senior management, fix internal systems, build leverage individually or collaboratively, use existing networks to manage risk, build internal and business partner capacity, provide remedies when the enterprise has 'caused' or 'contributed' to adverse impacts.
- Step 4. Verify the effectiveness of the enterprise's due diligence: where relevant, monitor medium-high-risk operations, products or services after change of circumstances; undertake audits and similar activities.
- Step 5. Report publicly and communicate, with due regard for commercial confidentiality and competitive concerns.

The ILO's Tripartite declaration of principles concerning multinational enterprises and social policy the MNE Declaration) provides direct guidance to enterprises on social policy and inclusive, responsible and sustainable workplace practices, building on international labour standards (ILO conventions and recommendations).

Several national initiatives have also been taken in recent years. The main EU **Member State initiatives** are:

- the French Duty of Vigilance Law,[19] adopted in 2017, obliging the largest French companies to identify and address adverse impacts on human rights and the environment linked to their global operations, whilst enhancing access to judicial remedy for victims in global supply chains;
- the Dutch Child Labour Due Diligence Law,[20] approved in 2019, obliging companies that deliver products or services to the Dutch market to declare that they have carried out supply chain due diligence relating to child labour. Failing to follow the law can lead to severe fines.

A debate on the introduction of laws imposing due diligence requirements on companies as regards human rights and/or social and environmental impacts is ongoing in several EU Member States (Austria, Germany, Denmark, Italy and Luxembourg).

[19] LOI n° 2017-399 du 27 mars 2017 relative au devoir de vigilance des sociétés mères et des entreprises donneuses d'ordre

[20] Information in English can be found on the Business and Human Rights Resource Centre website.

Overall, the main actions taken so far by the EU and its Member States can be grouped as follows:

- reporting obligations (Non-Financial Reporting Directive; this category also includes the UK Modern Slavery Act[21]);
- risk identification, obligation to take action and to report (Conflict Mineral Regulation, Timber Regulation, the Dutch Child Labour Due Diligence Law, 2019);
- civil corporate liability linked to due diligence (the French Duty of Vigilance Law, 2017).

There are several industry initiatives and companies' own voluntary measures on corporate social responsibility (CSR). This study does not give details on specific cases of such initiatives, but discusses some relevant elements in Section 2.1.3; in addition, these initiatives serve as a basis for the analysis presented in Section 4.1.3. CSR has received much attention in the literature as a tool within company-level strategies to incorporate the perspective of various stakeholders. For a conceptual and historical discussion on the topic, please refer to Chapter 1 of the annexed paper.

[21] United Kingdom, Modern Slavery Act, 2015.

2. Analysis of risks and gaps

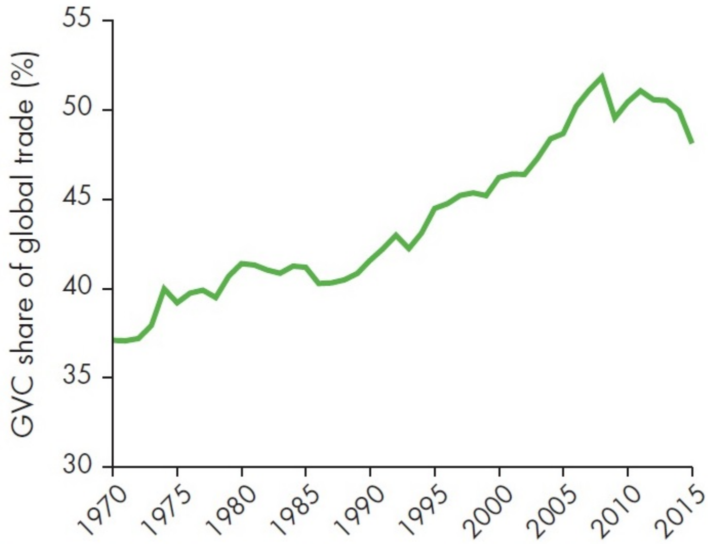
2.1. Risks and gaps in global economic trends

2.1.1. Increased business internationalisation, global value chains and possible downsides

Production has become strongly internationalised in the past decades, and its integration into the global value chains (GVC) has increased sharply.

According to the World Bank[22] (2020), there has been a steep increase in global value chains since the 1970s, with a slowdown after the 2008 crisis (see Figure 1). The World Development Report , underlines that integration into GVCs has often produced positive results in terms of economic growth and poverty reduction in the countries that moved 'up' in the value chain. At the same time, the report warns of possible downsides, especially in terms of growing **inequalities**. The net outcome crucially depends on 'how' the integration in value chains comes about, which opens an important space for regulation and international cooperation.

Figure 1: GVC trade as a share of global trade



Sources: WDR 2020 team, using data from Eora26 database; Borin and Mancini (2019); and Johnson and Noguera (2017). See appendix A for a description of the databases used in this Report.

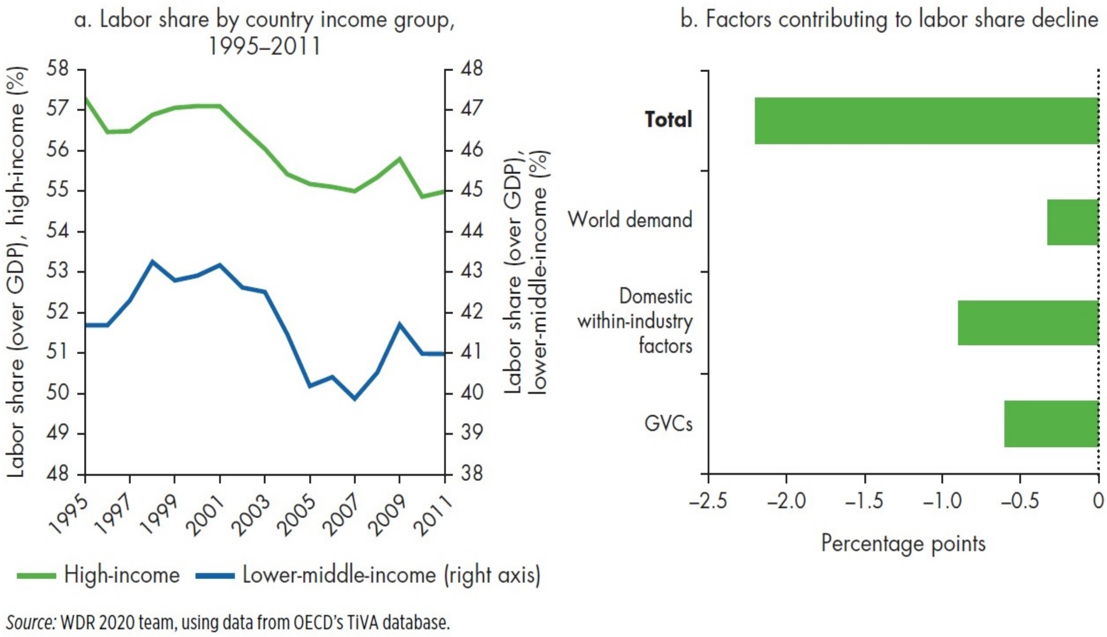
Source: World Development Report, 2020.

An indicator of these growing inequalities is that the labour share in national income has been declining in most countries in recent decades. The extent to which this is related to trade liberalisation is highly discussed. The analysis in the World Development Report ascribes to integration in global value chains a little more than one fourth of the decline of the labour share worldwide (overall by about 2 percentage points) (see Figure 2). According to the World Bank, one of the mechanisms connecting integration in global value chains to a decrease in the part of national

[22] World Bank, World Development Report. Trading for Development in the Age of Global Value Chains, 2020.

income that goes to labour is the increased mark-up for companies that does not translate into a corresponding increase in workers' and consumers' wellbeing.

Figure 2: Labour share and its components



Source: World Development Report, 2020.

Business internationalisation happens for many reasons, among them seeking more favourable fiscal conditions, lower labour costs or less stringent environmental standards. This phenomenon, unless properly regulated, risks creating room for a **race to the bottom** and endangers human rights, the environment and social standards all over the world.

Upsides and risks of GVC integration for countries in the Global South are also studied by the literature on global production networks and global value chains. Gereffi and Lee[23] point out that an 'economic upgrade' in GVC,[24] though desirable, is not enough to guarantee a 'social upgrade',[25] since there is plenty of evidence of violations of social and environmental standards and of poor working and production conditions. Barrientos, Gereffi and Rossi[26] provide evidence that integrating into global supply chains has heterogeneous effects on workers and can bring casualisation and informalisation; this happened, for example, in the fruit value chain in South Africa and in the garment sector in Morocco.

Research shows that value chain governance has an important impact on its social outcomes. As Gereffi and Lee[27] argue, it shows 'how corporate power exercised by global lead firm actively shapes

[23] Gereffi G. and Lee J. 'Economic and social upgrading in global value chains and industrial clusters: Why governance matters', *Journal of Business Ethics*, 133(1). 2016. pp. 25-38.

[24] Countries moving to higher positions in GVC thanks to improved technology.

[25] 'The process of improvement in the rights and entitlements of workers as social actors and the enhancement of the quality of their employment' (Barrientos, Gereffi and Rossi, 2011).

[26] Barrientos S., Gereffi G. and Rossi A. 'Economic and social upgrading in global production networks: A new paradigm for a changing world', *International Labour Review*, 150(3–4). 2011. pp. 319–340.

[27] Gereffi and Lee, 2016.

the distribution of profits and risks in an industry, and how this alters the upgrading prospects of firms in developed and developing economies that are included as well as excluded from the supply chains that constitute each industry' (p. 27). This affects the type of economic upgrading that is pursued. When upgrading relies mainly on the strategy of cutting labour costs, the jobs created are often low paid, informal and with undesirable working conditions, as in the case of the Indian leather cluster studied by Damodaran[28].

A 2016 ILO survey[29] investigates what GVC practices influence working conditions and wages. On one hand, a relevant share of respondents among suppliers indicate having unwritten contracts with buyers, and more of them indicate unclear clauses and attribution of responsibilities and duties. The same lack of clarity is found in the technical specifications of products from the buyer. The majority of suppliers indicated that between 30 % and 50 % of the orders they received had insufficient lead time. An important indicator is market power measuring the dependency of the supplier on the buyer, which is higher when a high share of a supplier's production is bough by a single buyer. The ILO finds that 54 % of the surveyed suppliers are at 'dependency risk' because they sell more than 35 % of their production to the same buyer, and this percentage rises to 75 % in the textile and garment sector.

On the other hand, the complex structure of companies makes it more difficult to trace responsibilities and creates separate boxes for different branches[30] . A harmonised system that requires the 'lead company' to ensure that all subcontractors and service providers respect environmental, social and governance standards is still missing.

As pointed out by Reddy[31] , the global economic arena can be seen as a context of strategic complementarities, where the rule-systems that encourage players to act in an undesirable way can create incentives for other players to act similarly undesirably. Liberalising trade without setting labour and environmental standards provides incentives to compete over these standards (to lower them in order to improve domestic companies' market access).[32] The benefits of avoiding a race to the bottom and, conversely, of entering into a path of upward convergence in social and environmental standards, are potentially large. As indicated by Reddy[33], across countries, labour and environmental standards are 'strategic complements': the higher these standards are in the trading partner country, the lower the cost is of maintaining these standards at home. There is indeed a gain

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[28] Damodaran S., Upgradation or flexible casualization? Exploring the dynamics of global value chain incorporation in the Indian leather industry. In A. Posthuma & D. Nathan (Eds.), Labour in global production networks in India (pp. 231–250). New Delhi; New York: Oxford University Press. 2010.

[29] ILO, Purchasing practices and working conditions in global supply chains: Global Survey results, INWORK Issue Brief No 10, 2017.

[30] Watt H. M. Private international law beyond the schism. Transnational legal theory, 2(3). 2011. pp. 347-428.

[31] Reddy S. G.,, International Trade as a Means to Diverse Ends: Development, Workers, the Environment, and Global Public Goods. in De Schutter, O. (2015). Trade in the service of sustainable development: Linking trade to labour rights and environmental standards. Bloomsbury Publishing. 2015.

[32] According to a paper by Bagwell and Staiger (1998) focusing on labour standards and WTO, the outcome of an international trading system designed without consideration for labour standards will be one in which both the degree of tariff liberalization and the extent of labour standards will be suboptimal. As reported by Barry and Reddy (2008), this undesirable outcome has to do with the fact that lowering labour standards is used strategically as a tool to strengthening market access of domestic firms; if labour standards are set independently by each country only on the basis of this concern and without regard to the 'external effect' that this decision has on other countries, then labour standards and tariffs will be jointly set at levels that are not optimal.

[33] Reddy (2015). Ibid.

from coordinated action aimed at reducing the incentives for lowering these standards, as also acknowledged by the European Commission.[34]

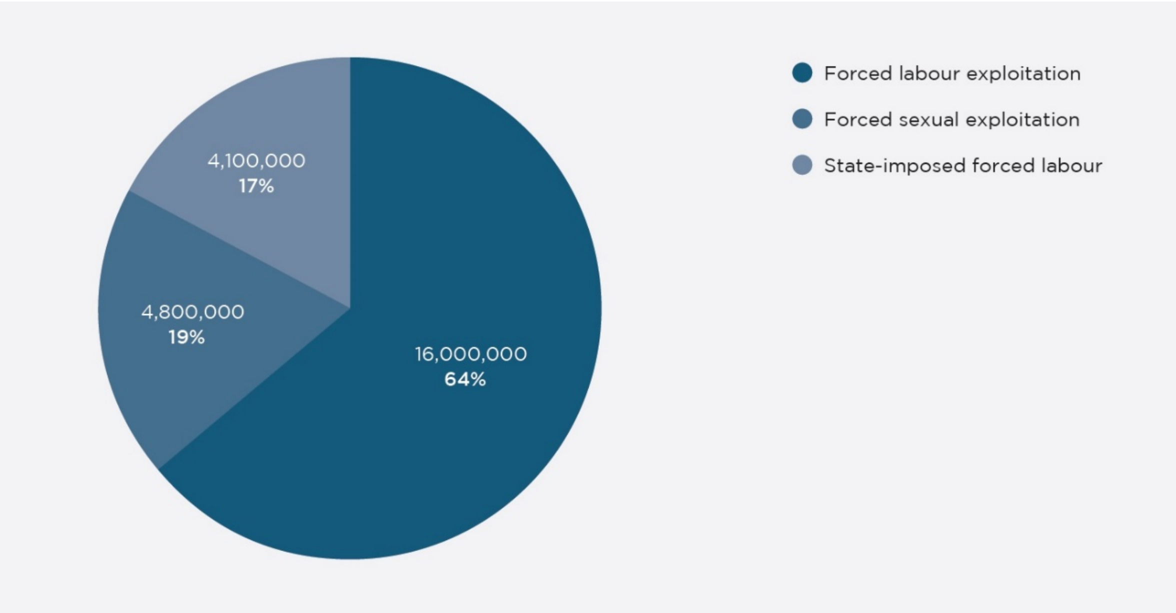
2.1.2. Evidence of fundamental rights violations, unfair worker treatment and negative externalities in global production

Despite the efforts mentioned in Section 1.2.2, there is still evidence of human rights violations, and of negative social and environmental impacts related to business practices. This section reviews some of the evidence in this regard, which calls for further action.

As a clear example, the ILO in 2017 published a report[35] on the number of people victims of **forced labour**.[36]

The ILO estimates that 24.9 million people are in forced labour globally, having been trafficked for labour and sexual exploitation or held in slavery-like conditions. According to the ILO classification, 16 million (64 %) of these forced labourers are exploited in the private economy, in sectors such as manufacturing, construction, agriculture and domestic work. Some 4.8 million are victims of forced sexual exploitation and 4.1 million are subject to State-imposed forms of forced labour.

Figure 3: Global estimates of forced labour



Source: ILO, 2017.

In a 2014 study, the ILO[37] estimated that the profits arising from labour exploitation outside domestic work, forced domestic work and forced sexual exploitation amount to about €128 billion[38]

34 European Commission, 2017 reflection paper on Harnessing Globalisation.

35 ILO, Global Estimates of Modern Slavery. Forced Labour and Forced Marriage, Geneva. 2017.

36 According to a definition linked to the ILO's Forced Labour Convention, 1930 (No 29), the measurement focused on persons meeting the following definition: men and women, boys and girls were considered as being in forced labour whenever their work was involuntary as a result of force, fraud or deception, and a penalty or threat of a penalty was used to coerce them or their parents in the case of children below the age of 18.

37 ILO. Profits and poverty. The economics of forced labour. Geneva. 2014.

38 Author's conversion of USD to EUR at September 2020 exchange rate.

per year. The regional distribution indicates that an important share of these profits accrues to players in high-income countries and the EU. Respect for the right to life and human dignity, as enshrined in the Charter of Fundamental Rights of the EU, including freedom from slavery and forced labour are some of the EU's fundamental values. Accordingly, steps have been taken to uphold these values, e.g. to combat human trafficking, which can be linked to forced labour exploitation.[39] It appears nevertheless that further action is needed.

Some value chains are particularly vulnerable to risks of human rights violations or lack of respect for social and environmental standards, even if, as acknowledged by a recent study published for the European Commission's DG JUST[40]), no sector should be seen as free from any risk. For example, the Corporate Human Rights Benchmark[41] monitors **agriculture, textile, garment, apparel and footwear, extractives, and ICT manufacturing**.

Here we limit ourselves to two brief overviews on textile, garment and footwear, and ICT manufacturing. It has to be noted that the extractive sector plays an important role and has received much attention in recent years, especially within the debates arising from regulatory and legislative initiatives.[42]

The textile, garment and footwear sector is especially vulnerable because of its strongly globalized value chain, the strong market power of both EU and US buyers (brands and retailers)[43], and workers' very low bargaining power in the supplier countries. The notorious 2013 Rana Plaza disaster in Bangladesh, which cost more than 1 000 lives, is sadly not an isolated case; several similar tragedies have occurred, caused to a large extent by the lack of effective, independent inspection mechanisms to ensure compliance with basic safety procedures[44].

There are several accounts of workers' and trade unions' rallies for higher wages in several countries.[45] Legal protection of workers and trade union activities are often seriously impeded, either by restrictive laws (e.g. in Vietnam, independent unions are banned from existence, although this is expected to change after reforms of the Labour Code and the country’s ratification the relevant ILO convention), or by de facto restrictive practices (e.g. in Bangladesh, where the requirements for setting up a union are very complex and unions cannot be set up in the special economic zones created to attract FDIs).[46]

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39 Directive 2011/36/EU of the European Parliament and of the Council of 5 April 2011 on preventing and combating trafficking in human beings and protecting its victims

40 BIICL, Civic Consulting, LSE, Study on due diligence requirements through the supply chain, Final report on behalf of DG JUST, the European Commission, 2020.

41 https://www.corporatebenchmark.org/

42 Some example of such initiatives are: the 2010 US law Dodd-Frank Act Section 1502 on conflict minerals originated in the Democratic Republic of the Congo or an adjoining country, on the 2017 EU Conflict Minerals regulation stating rules for EU importers of tin, tantalum, tungsten and gold. The 2010 OECD Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas are the major reference when focusing on voluntary international guidelines.

43 Russel M., Textile workers in developing countries and the European fashion industry. Towards sustainability?, briefing, EPRS, European Parliament, 2020.

44 Russell, 2020, Ibid.

45 For example, in Myanmar most textile workers are paid about €3 a day. This is half of the legal minimum wage, which, according to unions, is still below the threshold for a decent standard of living (Russell, 2020).

46 A wide programme aiming at improving working condition in the textile sector is the Better Work Program that the ILO and the IFC operate in a number of countries. A survey held before the start of the programme revealed a number of strong concerns in the fields of on-job safety (e.g. in Jordan, 40 % of surveyed workers indicate injuries as a concern), fundamental workers' rights (e.g. the right to move freely, especially in the cases where the majority of workers are

Regarding ICT and computer manufacturing in particular, an NGO report[47] documents extremely poor working conditions experienced by workers in Mexican, Thai and Chinese electronics factories that are outsourcing for big brands. In Mexico, there are discriminatory practices against women (e.g. workers fired if pregnant) and labour contracts are for as little as three months, in violation of the limits set by the Mexican law. In China, in the Pearl River Delta, workers are often rural migrants who are indebted to their employment agency and can only earn the legal minimum of US$54 a month by doing excessive overtime work. Interestingly, the report underlines that the big brands are starting to acknowledge their responsibility, but that 'the individual staff tasked with implementing supply-chain labour standards must battle against the much stronger commercial forces which drive costs, and with them working conditions, into a downward spiral'[48].

There is abundant evidence of environmental impacts, one such being the BP Deepwater Horizon oil spill in 2010, which inflicted massive damage. A number of large-scale incidents in the resource extraction sector in particular, have had extreme consequences for the environment. The connection between deforestation and commodity production for the international market is clearly acknowledged in the literature. According to a study[49], 62 % (or 4.5 million ha per year) of forest loss across tropics and subtropics is attributed to the expansion of agricultural and tree plantations for production of commodities. Brazil and Indonesia together accounted for 44 % of the deforestation attributed to expanding cropland, pastures and tree plantations between 2005 and 2013. The same study indicates that 24 % of all tropical deforestation between 2000 and 2012 was due to illegal agro-conversion for export markets. The study linked 65 % of Brazilian beef exports, 9 % of Argentinian beef exports, 41 % of Brazilian soy exports, 5 % of Argentinian soy exports and 30 % of Paraguayan soy exports with illegal deforestation[50].

Violations of human rights and environmental damage often go together, as in the cases where limitations are set on the freedoms of activists and civil society organisations[51] .

2.1.3. Gaps in existing international guidance and limitations of voluntary corporate measures

To address the existing evidence of human rights violations and negative environmental impacts, as mentioned in Section 1.2.2, tools have been put in place through a number of international initiatives. These represent important steps in tackling corporate harm to human rights and the environment by fostering compliance among companies. Nevertheless, some limitations continue to exist and many have insisted on the introduction of mandatory measures. According to the

migrants), and the right of association and unionisation (less than 10 % of workers in Haiti reported being part of a union when the programme began). In Nicaragua, 46 % of workers surveyed said they would avoid joining a union for fear of losing their job. Evidence of gender-based discrimination and lower pay for women was also relevant, together with the incidence of sexual harassment (at least three in 10 workers in Haiti, Jordan and Nicaragua reported that they were concerned about sexual harassment in their factory. In Indonesia four in five workers expressed this concern). Specifically relevant for migrant workers (especially in the Jordanian case) was the occurrence of restriction of movement and coercion (e.g. cases of employer holding the passport of the worker).

[47] CAFOD, Clean up your Computer. Working conditions in the electronics sector. 2014.

[48] CAFOD, 2014. Ibid.

[49] Pendrill F., Persson U. M., Godar J. and Kastner T., Deforestation displaced: trade in forest-risk commodities and the prospects for a global forest transition. Environmental Research Letters 14, 055003. 2019.

[50] Heflich A. An EU legal framework to halt and reverse EU-driven global deforestation. European added value assessment. EPRS. 2020.

[51] BIICL et al, 2020. Ibid.

European Coalition for Corporate Justice[52] , there are several accountability gaps due to the absence of legal standards defining companies' duties and ensuring access to justice for victims.

The UNGP recommend a mix of voluntary and mandatory tools and point out that States 'must protect against human rights abuse within their territory and/or jurisdiction by third parties, including business enterprises'. To do so, States 'should consider a mix of measures – national and international, mandatory and voluntary – to foster business respect for human rights'. According to a Shift Project analysis[53] , despite this encouragement, mandatory measures have not been a central part of the mix considered by States in the initial years of UNGPs implementation, besides some reporting requirements.

There is indeed evidence of low compliance with the existing voluntary frameworks. The UN Working Group on the issue of human rights and transnational corporations and other business enterprises[54] notes that 'according to human rights benchmarking and rating assessments, the majority of companies covered by the assessments do not demonstrate practices that meet the requirements set by the Guiding Principles. This may indicate that risks to workers and communities are not being managed adequately in spite of growing awareness and commitments'.[55]

The Corporate Human Rights Benchmark team prepares regular reports on a sample of companies, focusing on high-risk sectors (agriculture, apparel, extractives, ICT manufacturing). The topics considered are: commitments to respect for human rights; board-level accountability for human rights; embedding respect for human rights in company management systems; human rights due diligence; remedy and grievance mechanisms; performance: dealing with key risks and enabling factors for human rights; performance: responses to serious allegations; and transparency. A score is assigned to each indicator, with scores adding up to 100. The 2019 edition[56] reveals that the overall score of UNPG implementation is low (24 %). A lowest score is reported for companies newly entered into the dataset, indicating that companies that are not monitored score less than the ones that have already been. One quarter of companies score less than 10 % and a full half of companies fail to meet any of the five basic criteria for human rights due diligence.

Under the German government's National action plan on business and human rights (NAP),[57] a monitoring was conducted in 2019 of companies' compliance with human rights, according to the level of implementation of the NAP itself. Among the 456 corporate respondents, 17-19 % were considered compliant and 78-81 % 'non-compliant. Within the group of 'non-compliers', 9-12 % were 'on the right track' towards fulfilling the NAP.

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52 European Coalition for Corporate Justice, Key Features Of Mandatory Human Rights Due Diligence Legislation, ECCJ Position Paper, June 2018.

53 Shift Project, 'Let's talk Mandatory Measures'. 2019.

54 As reported in BIICL et al, 2020, Ibid.

55 UN Working Group on the issue of human rights and transnational corporations and other business enterprises, quoted in the study for DG JUST by BIICL et al (2020), page 219.

56 Corporate Human Rights Benchmark, Corporate Human Rights Benchmark, 2019 Key Findings Across Sectors: Agricultural Products, Apparel, Extractives & ICT Manufacturing, 2019.

57 National Action Plan on Business & Human Rights, Survey 2019 Interim Report, German Foreign Office, 2019.

The recently published study conducted on behalf of the European Commission DJ JUST [58], includes a survey on due diligence practices among businesses: 37.14 % of respondent businesses are undertaking due diligence that takes into account all human rights and environmental impacts, but only about 16 % cover the entire value chain. Only 7.43 % indicate that they are currently undertaking environmental or climate change due diligence that does not extend to other human rights.

Indeed, a number of national initiatives have moved towards mandatory measures, and discussions are currently underway to turn the UNGPs into a treaty and to adopt a legally binding instrument allowing for a uniform international-level approach that would regulate corporate behaviour, thereby overcoming the drawbacks linked to fragmented initiatives that are exposed to the risk of being circumvented by 'law shopping' practices.

Concerning business operations in third countries and respect for human rights, social and environmental standards in internationalised value chains, the limitations of existing voluntary and self-regulating measures developed in the corporate world have been analysed in several studies. For example, LeBaron and Lister[59] analyse the ethical auditing practices of brands, some of which include drafting codes of conduct for their suppliers and publishing transparency and ethical reports. The study suggests that audits are a weak tool for detecting non-compliance with corporate codes of conduct, that they foster a 'checklist' approach and are ultimately quite ineffective at improving standards. One of the reasons for this situation, according to the study, is that the process remains very much in the hands of the corporations, with the latter controlling the depth to which audits can scrutinise the supply chain and choosing whether to use independent third-party auditors or in-house ones. Moreover, by focusing on first-tier suppliers, most audits tend to exclude subcontractors further down the supply chain.

COVID 19 and responsible business conduct

According to the OECD, responsible business conduct can be of crucial importance in the context of the coronavirus crisis, since it could allow companies to have more sustainable and transparent value chains. RBC can also help companies in meeting the social costs that the crisis is imposing on them.

A recent article in the Financial Times suggests that companies that have social and environmental sustainability policies are performing better in the COVID crisis.

Indeed, Albuquerque and co-authors, in a recent paper (Albuquerque et al., 2020), observe the shock on the US stock market due to COVID 19 and find out that stocks with high environmental and social (ES) ratings have been more resilient during the first quarter of 2020 relative to other stocks.

This indicates that, in the important sell-out of stocks that occurred, investors considered the stocks of companies with higher ES scores to be more valuable and reliable.

They find that firms with high ES ratings earned an extra daily return of 0.45 % from February 24 to March 17 relative to firms with low ES ratings, with a cumulative difference of 7.2 %.

The paper interestingly rules out some possible competing explanations, e.g. the bias introduced by energy companies that usually have low ES scores and at the same time have been particularly hit by the decline in oil prices.

Barrientos and Smith[60] study how companies participating in the UK Ethical Trading Initiative apply

[58] BIICL et al, 2020, Ibid.

[59] LeBaron, G. and Lister, J. Ethical Audits and the Supply Chains of Global Corporations. Report. SPERI Global Political Economy Briefs (1). Sheffield Political Economy Research Institute (SPERI), University of Sheffield. 2016.

[60] Barrientos S. and Smith S. 'Do workers benefit from ethical trade? Assessing codes of labour practice in global production systems', *Third World Quarterly*, 28:4. 2007. pp. 713-729.

their codes of labour and how this affects working conditions. They find mixed results: positive effects are observed in regard to some outcome standards, such as health and safety measures (with the exception of some countries, such as South Africa, where improvements are mostly attributed to changes in the national legislations), while little change is observed in regard to process rights, such as the right to freedom of association and to collective bargaining. Little effect is observed in regard to discrimination on the basis of gender and ethnicity. Furthermore, it seems that the impact of labour codes has been uneven across the different categories of workers.

The OECD and the FAO[61] also underline the challenges posed by industry schemes in the agri-food sector: as they tend to provide a 'one-size-fits-all' methodological approach and do not provide much detail about what risks are present in the supply chain and how they are being managed on the ground. Moreover, companies can usually choose from a wide range of industry-wide schemes to support their due diligence process, which are not necessarily appropriate.

According to Bright[62], the fact that companies make limited use of the UNGPs and human rights due diligence shows the **limitations of over-reliance on voluntary approaches and 'soft law' regulation.** 'Against this backdrop, the need for a top-down approach with governments mandating (and not merely encouraging) companies to exercise due diligence has become more apparent' (p. 2). This has been the motivation for a number of States to implement 'hard law' on the matter.

The lack of duties for value chains is another major gap. The UN Working Group on the issue of human rights and transnational corporations and other business enterprises notes, in this respect: 'An apparent gap in current supply chain management is that human rights due diligence tends to be limited to tier-one companies. Efforts to go beyond tier one tend to happen only when the issue has been brought to light by the media or non-governmental organisations (NGOs). Few companies appear to be asking tier-one suppliers to demonstrate that they — and their suppliers in the tiers below — fulfil the responsibility to respect human rights by requiring assessments of the risks to and impacts on human rights'.[63]

The lack of requirements towards value chains moreover is a major obstacle faced by claimants seeking access to justice[64] ; the so called 'corporate veil' arises from the fact that, from a legal perspective, each entity forming the international group of companies is considered separately. A parent company cannot normally be held liable for human rights violations or environmental damage caused by its subsidiaries in another country, and this is even more so the case when such impacts are caused by suppliers or subcontractors. Moreover, as pointed out by Bright[65], the practice of **law shopping and forum shopping** is often used by multinational corporations to evade uncomfortable national legislative requirements.

In the textile and garment sector, a number of initiatives have taken place. A key one is the 2013 Accord on Fire and Building Safety in Bangladesh, signed by 190 (mostly European) companies (Russell, 2020), which is enforceable and makes international brands directly responsible for the

61 http://mneguidelines.oecd.org/Pilot-project-on-the-implementation-of-the-OECD-FAO-Guidance-for-Responsible-Agricultural-Supply-Chains-FINAL-REPORT.pdf

62 Bright C. Creating a legislative level playing field in business and human rights at the European level: is the French duty of vigilance law the way forward?, EIU Working Papers. 2020.

63 UN Working Group on the issue of human rights and transnational corporations and other business enterprises, A/73/163 (16 July 2018), para 29. Cited in BIICL et al (2020), page 218.

64 Bright, 2020. Ibid.

65 Bright, 2020, Ibid.

safety of supplier-company employees. This initiative has helped improve factory safety in Bangladesh after the Rana Plaza disaster.

Where legislation has been introduced, it has often focused specifically on transparency and disclosure. A research done for the ILO[66] analyses the impact of disclosure legislation that obliges companies to make information on specified dimensions of their operations publicly available. This tool relies on 'the scrutiny of the public light', that is, the idea that transparency drives consumers' and investors' purchasing decisions, thus enabling accountability. The study finds very mixed results and underlines that the quality of compliance is extremely 'patchy'. The reasons are both the shortcomings in the requirements contained in the legislation, and the wide margin of choice for companies in the extent to which they apply the legislation. Similar criticism has been addressed to the Non-Financial Reporting Directive (discussed in Section 2.2.2).

2.2. Gaps in current EU legislation

2.2.1. Evidence of adverse human rights and environmental impacts of EU companies

Evidence of adverse impacts of corporate behaviour on human rights and the environment is also found in relation to EU companies.

A recent EPRS study[67] focusing on global **deforestation** points at an important role of the EU in importing forest-risk commodities (FRC).[68] Compared to the US and China, the EU has the highest embodied deforestation imports share per capita; between 2000 and 2012, the EU was one of the biggest importers of commodities grown on illegally cleared land in the tropics[69]. This translates into a substantial contribution to GHG emissions from global deforestation and peat drainage in countries where FRCs are produced. For some EU countries (and other FRCs importers), GHG emissions associated with trade in FRCs amount to more than half of the national agricultural emissions.

There is also **evidence of allegations of human rights abuses involving EU companies,** both in third countries and within the EU.

A 2014 study[70] analysing companies listed on the UK's FTSE 100, France's CAC 40 and the German DAX 30, has found that over half of these companies have been linked to allegations or concerns about risks and adverse impacts in regard of human rights reported on between 2005 and 2013.

The most numerous and severe allegations against companies have been in the natural resource extraction sector; above all, companies have been accused of fuelling conflict or severe human rights abuse through security arrangements protecting or facilitating operations; of inflicting environmental damage resulting in adverse human rights impacts; and of actions that have had

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66 Phillips N., LeBaron G. and Wallin S., Mapping and measuring the effectiveness of labour-related disclosure requirements for global supply chains, ILO Working Paper No 32. 2018.

67 Heflich, 2020, Ibid.

68 The EU is among the major global importers of a number of FRCs, such as palm oil (27 %), maize (30 %), sugar (14 %), beef (12 %) and soy (10 %).For some other commodities, such as cocoa and coffee, the EU is the world's biggest importer, representing a share of over 60 % and 50 % respectively (Heflich, 2020).

69 Lawson S. Stolen Goods: The EU's complicity in illegal tropical deforestation, FERN, March 2015.

70 International Peace Information Service, Evidence of Adverse Human Rights Risks and Impacts of European Companies: getting a glimpse of the picture, 2014.

diverse impacts on indigenous peoples' rights, including dispossession of lands, involvement in corruption, and negotiation of legal frameworks that undermine human rights.

Similar allegations appear to exist in the financial sector, linked in particular with the fact that the provision of funding to certain companies has caused environmental damage or social harm. In this sector, the possible use of financial activities for corruption is particularly highlighted and there have been scandals over involvement in money laundering.

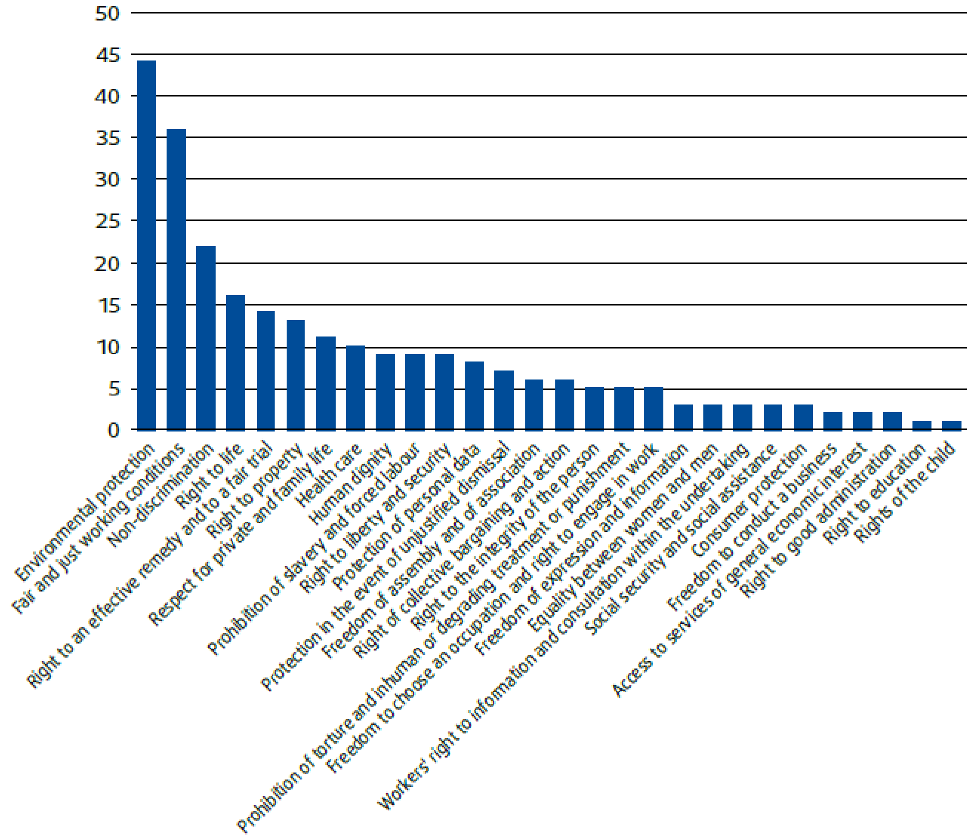
In the consumer goods sector (food and beverage, retail, consumer goods, supermarkets and clothing), the main issue of concern is labour rights, especially as regards the level of pay and health and safety at the workplace. On one hand, this sector is closer to consumers and is therefore prone to influence in the direction of ethical shopping, but on the other hand it is a highly competitive sector where purchasing practices in the value chain have a high risk of putting downward pressure on working conditions downstream. Indeed, the report argues that there have been cases of supermarkets accused of engaging in practices that transfer risks to workers in a bid to lower consumer costs.

A 2019 Fundamental Rights Agency study[71] collected and analysed information contained in reports on incidents of business-related human rights abuse in the EU-28 (plus North Macedonia and Serbia) between 2011 and 2018, grouping them by Charter article to which the violation referred (see Figure 5) and by sector (Figure 6). This study focuses on incidents involving EU companies both within and outside the EU, but with a special focus on the former.

The most frequent incidents had to do with environmental rights (Article 37 of the Charter) and working conditions (Article 31), followed by discrimination (Article 21), and incidents where human life (Article 2) and the right to an effective remedy (Article 47) were at stake. The sectors with the greatest number of incidents were natural resources, agriculture, food, beverages and tobacco, and textile and apparel, which is quite in line with the evidence on the world economy provided in Section 2.1.2).

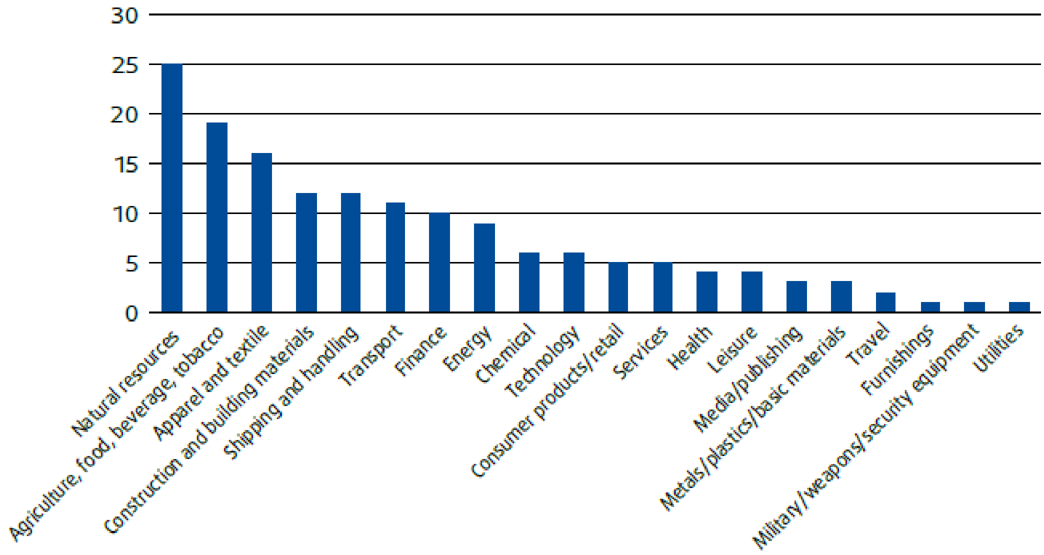
[71] Fundamental Rights Agency, Business-related human rights abuse reported in the EU and available remedies, 2019.

Figure 4: Total number of incidents in FRA study by Charter article



Source: Fundamental Rights Agency, 2019.

Figure 5: Distribution of incidents found in the FRA study by sector



Source: Fundamental Rights Agency (2019).

The FRA study brings evidence of incidents occurring as a result of possible violations of Charter rights not only outside the EU, but also **within the EU**. Below is an example of such a case that has been brought to court:

'[..] several Lithuanian nationals – who worked on chicken farms that supply eggs to leading United Kingdom supermarkets – were found to have been victims of trafficking and severe labour exploitation. The claimants alleged that they had been threatened and intimidated with fighting dogs, housed in appalling conditions, and denied sleep and toilet breaks. The company agreed to pay over £ 1 million in compensation after a high court found in 2016 that they had failed to pay the national minimum wage, had made unlawful deductions from wages, and had failed to provide their staff adequate facilities to wash, rest, eat and drink.' (FRA, 2019, p. 10).

The development of supply chains within Europe is part of the strategy of 'near-shoring', which allows to substantially reduce delivery time for companies. This strategy has been crucial in the textile, garment and footwear sectors, and has been applied especially – but not exclusively – towards subcontractors of western European brands in eastern European countries. According to a 2017 NGO report[72] , there are a number of concerns linked to low pay, weakness of unions in industrial relations, and widespread gender inequality. A recent report on the sector published by the same NGO in April 2020[73] argues that the average wage of surveyed employees was just a little above the legal minimum wage in the country, but always below the EU poverty line and far below the estimates of a living wage calculated by the NGO itself. The survey average net wages are about half of the average net wage in the country. Given that these sectors predominantly employ women, - especially for handling the lower-paid tasks, such as sewing, this low pay translates into gender inequality in the labour market. The 2019 survey also reports bad working conditions and widespread use of verbal abuse and threats by the hierarchy/employers.

Another sector where a high incidence of fundamental rights and labour standards violations is reported within the EU is agriculture. According to a report by the Italian trade union FLAI-CGIL[74], workers suffering from exploitation in the Italian agricultural sector have no contractual guarantee, are paid between €20 and €30 a day for an average working day between 8 and 12 hours, and receive wages about 50 % lower than what collective bargaining would prescribe. Women earn 20 % less than men. Workers who are recruited by labour intermediaries ('*caporali*') see part of the pay deducted for their living expenses. These illegal labour intermediaries that recruit workers outside the regular channels without offering any legal protection are a major source of labour exploitation that can become forced labour whenever it is accompanied by coercion[75] (Italian Ministry of Labour, 2019). According to the National Labour Inspectorate[76], almost 55 % of the 7 000 labour inspection done in 2018 found non-compliancy and risks of labour exploitation.

Migrant undocumented workers, who are an important part of the labour force at risk of exploitation in agriculture, are indeed in a more vulnerable position. In some of the worst cases highlighted by the above-mentioned 2018 report by the Italian trade union FLAI-CGIL, migrant workers were paid €1/hour. As indicated by a recent journalistic inquiry,[77] focusing on the migrant workforce in France and Spain, labour exploitation and inhumane working conditions in agriculture are also frequent in other Member States.

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72 Clean Clothes Campaign, L'Europa dello sfruttamento, 2017.

73 Clean Clothes Campaign, Exploitation Made in Europe. Human Rights Abuses in Facilities Producing for German Fashion Brands in Ukraine, Serbia, Croatia and Bulgaria, 2019.

74 FLAI-CGIL, Quarto Rapporto Agromafie E Caporalato - Osservatorio Placido Rizzotto, 2018.

75 Ministero del Lavoro e delle Politiche Sociali, Piano triennale di contrasto allo sfruttamento lavorativo in agricoltura e al caporalato 2020 - 2022, Roma, 2019.

76 Ministero del Lavoro e delle Politiche Sociali, 2019. Ibid.

77 https://www.euronews.com/2020/07/17/invisible-workers-underpaid-exploited-and-put-at-risk-on-europe-s-farms

Within the EU, a number of tools can be applied to mitigate such cases, from the legal instruments provided by texts like the Charter of Fundamental Rights, to acts such as the 2007 Rome II Regulation that includes a specific regime for environmental damage allowing, in particular situations, the person seeking compensation to choose, as applicable law, the law of the country where the damage originated rather than the law of the country where the damage occurred. The recently established European Labour Authority[78] should also aim at supporting labour inspectorates to better enforce fair labour standards. It appears nevertheless that a number of issues remain open and leave room for further action.

2.2.2. Limited use of due diligence measures and gaps in access to remedy

One of the main findings of the study commissioned by DG JUST earlier this year[79] is that EU companies make limited use of due diligence on possible adverse impacts on human rights and the environment, and therefore their uptake of the available guidance is limited. This evidence informs the ongoing discussion at the European Commission (DG JUST) on new tools to promote responsible business conduct.

Just a bit more than a third of business respondents indicated that their companies undertake due diligence accounting for all human rights- and environmental impacts, and a further third undertake due diligence limited to certain areas. Furthermore, the majority of business respondents that undertake due diligence include first-tier suppliers only. Due diligence practices beyond the first tier and for the downstream value chains are significantly more limited.

According to the same study, there are well-documented **gaps in the effective access to remedies** for those affected by human rights- and environmental harm inflicted by companies.

According to a 2017 Fundamental Rights Agency opinion[80], 'access to justice or in particular access to remedy, enables other rights to be realised'. The EU Charter of Fundamental Rights provides in Article 47 for a 'right to an effective remedy before a tribunal' and that '[l]egal aid shall be made available to those who lack sufficient resources in so far as such aid is necessary to ensure effective access to justice' (p. 18). Despite this, problems remain.

A study by the Alliance for Corporate Transparency[81] on companies' sustainability reports drafted under the NFRD finds that 22.2 % of companies report on human rights due diligence processes and only 6.9 % refer to their commitment to provide remedy for harmed people.

As illustrated by Marx et al (2019) in a study for the European Parliament[82] specifically addressing violations of EU companies in third countries, sources of this lack of access to remedies can be both of a legal nature and of a practical/procedural nature. Following UNGP Principle 26, the authors identify the main barriers by type and analyse them in legal and non-legal cases (OECD National Contact Points) of allegations for human rights violations of EU businesses.

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78 https://www.ela.europa.eu/

79 BIICL, Civic Consulting, LSE, Study on due diligence requirements through the supply chain, Final report on behalf of DG JUST, the European Commission, 2020..

80 Fundamental Rights Agency, Improving access to remedy in the area of business and human rights at the EU level. Opinion of the European Union Agency for Fundamental Rights. 2017.

81 Alliance for Corporate Transparency, Research Report 2019. An analysis of the sustainability reports of 1000 companies pursuant to the EU Non-Financial Reporting Directive, 2019.

82 Marx A., Bright C. and Wouters J., 'Access to Legal Remedies for Victims of Corporate Human Rights Abuses in Third Countries', study, European Parliament Policy Department, 2019.

The first type of barriers include: the barrier to attribution of legal responsibility among members of a corporate group, i.e. the difficulty in holding parent companies legally accountable for the human rights harms arising out of the activities of their subsidiaries is thought to be one of the main hurdles faced by claimants in cases involving business-related human rights abuses; denial of justice in the host State and difficulties in accessing home State courts, one such difficulty being presented by the doctrine of *forum non conveniens* that 'prevent[s] a case from moving forward in the jurisdiction in which it is filed on the basis that another jurisdiction is the more appropriate venue' (p. 15); and the de facto exclusion of specifically vulnerable groups. Barriers of the second type involve costs; difficulties in securing legal representation; and difficulties in aggregating claims in collective or 'class' action in the context of European States that often do not recognise this mechanism. Moreover, public prosecution often lacks resources, know-how or time to deal with complex transnational cases. Other factors are corruption and difficulties in accessing information, especially in contexts (existing in most EU Member States), where there is no discovery or disclosure rule obliging the defendant to divulge information in its possession.

As underlined by the legal opinion of the FRA[83], guaranteeing access to remedy is part of the commitments of the EU and its Member States within their obligations at international and EU level. They are all parties to the European Convention on Human Rights (ECHR), which includes provisions on fair trial (including access to courts) in civil and criminal procedures and effective remedy (Articles 6 and 13), both aspects being well developed in ECHR case law.

Moreover, EU and MS are bound by **a number of international and EU-level legal obligations on human rights and the environment** (see Appendix) and to universal and European standards on business and human rights, specifically referring to the adherence to the UN Guiding Principles. Within the context of the Council of Europe, the EU Member States have contributed to a recommendation that reaffirms and elaborates on the UN Guiding Principles. As underlined by the BBIC et al. study for the European Commission, there is a discrepancy between this legal framework and the actual obligations of Member States concerning international and EU human rights and environmental obligations. Indeed, Council conclusions[84] (2016) on business and human rights state that 'as part of their duty to protect against business-related human rights abuses, States should take appropriate steps to ensure, through judicial, administrative, legislative or other appropriate means, that when such abuses are committed within their territory and/or jurisdiction, those affected have access to effective remedy, as set forth in the [UN] Guiding Principles'.

2.2.3. Single Market fragmentation, lack of a level playing field and legal certainty

A central take-out of the study prepared for the European Commission[85] are the negative consequences, in terms of **legal certainty,** of the lack of general legal duty at supranational level establishing requirements for companies to undertake due diligence for impacts on human rights and the environment caused by their value chain. Survey respondents in that study indicated that the current legal landscape does not provide companies with legal certainty about their human rights and environmental due diligence obligations, and is not perceived as efficient, coherent and effective. Businesses' are indeed concerned because, even in the absence of a general legal duty for

[83] FRA, 2017. Ibid.

[84] Council Conclusions on Business and Human Rights,20 June 2016.

[85] BIICL et al. 2020. Ibid.

due diligence, companies are increasingly facing legal and other risks and costs as a result of a failure to undertake due diligence (see Section 4.1).

It appears that in some cases **companies have little leverage over subcontractors** because of the lack of clearly set legal obligations. A business organisation interviewed[86] states that:

Now we need to really obligate those subcontractor -companies to conduct their business according to the standards they are obligated to. As our answer "disagree" to this question…comes from the view that EU -companies at the end cannot feel absolutely safe and certain on their human rights and environmental due diligence obligations, because the different actors at the value chain / end level subcontractors cannot be efficiently obligated to comply with the standards. (p. 96)

A multinational corporation is reported as saying:

... you need not just the consumer-facing companies and those who get NGOs campaigns pushing them to do certain things, but you need all the actors along the supply chain to also have good reasons to pay attention and to put the resources towards solving those issues. (p. 106)

Harmonisation of corporate obligations and **creation of a level playing field for companies in the single market** is the other need highlighted more explicitly by companies in the European Commission study. The main idea is that competitiveness will be improved through the levelling of the playing field, so that competitors, peers, suppliers and third parties will be subjected to the same standard.

This point of view is also shared by a trade union respondent:

The current legal framework does not provide businesses with legal certainty because the status quo (i.e. no European regulation and only few national legal frameworks – often sectorial and not effective) is linked with fragmentation and with an uneven playing field in the single market. (p. 96)

Moreover, companies that are already taking extensive due diligence steps and dedicating significant resources to these matters report that they are sometimes being singled out and targeted for litigation. The same study[87] indicates that voluntary standards are increasingly being used in court to give content to the standard of care that was expected of the company. Companies that adopt these standards indeed bear the cost of their increased adherence to environmental, social and governance standards (ESG) and argue in favour of level-playing field measures.

If these negative consequences of lack of harmonisation are suffered by EU companies, also the functioning of the **single market** is limited by the existing **fragmentation**.

The **Non-Financial Reporting Directive**,[88] despite being an important step in the right direction, appears to have provided a limited answer to such issues. According to a large study done by the Alliance for Corporate Transparency[89], the share of companies that disclose fairly detailed policies is

[86] BIICL et al. 2020. Ibid.

[87] BIICL et al. 2020. Ibid.

[88] Directive 2014/95/EU of the European Parliament and of the Council of 22 October 2014 amending Directive 2013/34/EU as regards disclosure of non-financial and diversity information by certain large undertakings and groups. It requires EU companies with more than 500 employees to 'include in the management report a nonfinancial statement containing information to the extent necessary for an understanding of the undertaking's development, performance, position and impact of its activity, relating to, as a minimum, environmental, social and employee matters, respect for human rights, anticorruption and bribery matters' (Article 19a).

[89] Alliance for Corporate Transparency, 2019. Ibid.

small, while most businesses do not provide information that is necessary to understand their situation.

Moreover, there is an important gap between companies reporting on policies and companies reporting on policy outcomes. For example, the high percentage of companies reporting on human rights policies (over 80 %) is in contrast with a much lower share describing policy outcomes (less than 40 %). Compared to general results, companies from sectors facing higher risks in their supply chains tend to provide more specific information (38.2 % of apparel and textiles and 30.5 % of food & beverages companies disclosed specific risk descriptions, but other consumption goods companies were specific about risk descriptions in only 8.8 % cases).

Reporting on climate-related targets appears particularly low in crucial sectors: only 36.4 % of companies in energy and resource extraction and only 20.5 % of those in the financial sector report on climate-related targets, even though this sector is supposed to play an important role in contributing to the low-carbon transition.

A more general critique to an approach based on simple disclosure is brought by Buhmann,[90] who argues that this focus is inherently on accounting for actions of the past (ex-post), while 'preventing human rights abuse requires an ex-ante focus in order to stimulate organisational change for managers to avoid causing human rights abuse' (p. 4).

Fragmentation across Member States

The EU has the competence to harmonise national company laws so as to afford companies freedom of establishment, and to approximate legislation to ensure the proper functioning of the single market. In addition, Article 114 TFEU, in conjunction with Article 50, allows the EU to approximate legislation with the object of ensuring the proper functioning of the internal market. It indicates moreover that 'concerning health, safety, environmental protection and consumer protection, will take as a base a high level of protection'.

Some Member States have started developing national initiatives to establish due diligence obligations in the value chains, and in many others there are ongoing discussions in this regard.

Notably, in 2017, France adopted the Duty of Vigilance Law,[91] obliging the largest French companies to identify and address adverse human rights and environmental impacts linked to their global operations, while at the same time improving access to judicial remedy for victims in global supply chains.

In 2019, the Netherlands approved the Child Labour Due Diligence Act, [92] obliging companies that deliver products or services to the Dutch market (not only companies registered in the Netherlands) to investigate whether there is a 'reasonable suspicion' that the goods or services they provide have been produced using child labour, and to declare that they have carried out supply-chain due diligence relating to child labour.

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90 Buhmann K. 'Neglecting the Proactive Aspect of Human Rights Due Diligence? A Critical Appraisal of the EU's Non-Financial Reporting Directive as a Pillar One Avenue for Promoting Pillar Two Action', *Business and Human Rights Journal*, 3(1), 2018. pp. 23-45.

91 LOI n° 2017-399 du 27 mars 2017 relative au devoir de vigilance des sociétés mères et des entreprises donneuses d'ordre

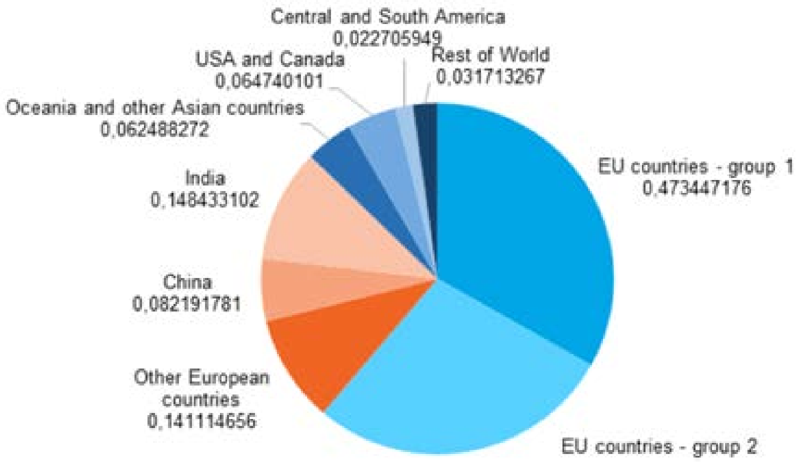
92 The Netherlands Child Labour Due Diligence Act 2019. See this document: http://www.bhrinlaw.org/key-developments/66-netherlands#child labour law

Countries where laws are under discussion include Austria, Germany, Denmark, Finland, Italy and Luxembourg.[93]

It has to be noted, moreover, that regulating corporate behaviour in the value chains is also of relevance within the single market, given that intra-EU value chains an important phenomenon. The single market thrives on increased intra-EU trade, and this makes an important contribution to economic growth. Evidence of the relevance of intra-EU trade within value chains is displayed in Figure 7, where the results of a Eurostat survey of companies' international sourcing strategies are presented. The majority of EU companies that outsource internationally, do so within the EU.

This again points at the relevance of a common legal framework for companies that would contribute to addressing the risks highlighted in the previous section.

Figure 6: Percentage of enterprises resorting to international sourcing, by destination (2014-2017)



Source: Eurostat, international sourcing statistics (percentages over total number of surveyed enterprises). Note: Multiple answers allowed. EU countries group 1: AT, BE, DK, EL, ES, FI, FR, IE, IT, LU, NL, PT, SE + UK. EU countries group 2: BG, CY, EE, HR, HU, LT, LV, MT, PO, RO, SI, SK. (classification done by Eurostat).

Fragmentation across sectors and areas of concern

Risks of violations of environmental, social and governance standards vary across sectors, as shown by the number of allegations displayed in Figure 6 above. For example, the Corporate Human Rights Benchmark[94] reports focus their analysis on agriculture, apparel, extractives and ICT manufacturing.

The sectoral laws and industry regulations that mandate respect for standards are numerous. Some of them have a scope that includes the value chain. The most notable examples of such rules at the EU level, whose adoption has been an important step, include the **EU Conflict Minerals**

93 http://www.bhrinlaw.org/key-developments

94 Corporate Human Rights Benchmark

Regulation[95] which applies to companies sourcing tin, tantalum, tungsten and gold from conflict-affected and high risks areas, and the EU Timber Regulation, which applies to operators who place timber or timber products on the EU market.[96]

The former mandates EU importers of tin, tantalum, tungsten and gold to ensure that their imports have not been produced in a way that funds conflict or other related illegal practices. The regulation requires importers to follow a five-step framework developed by the OECD in its 'Due diligence guidance for responsible supply chains from conflict-affected and high-risk areas', otherwise a voluntary tool. These steps are:

- establish strong company management systems;
- identify and assess risk in the supply chain;
- design and implement a strategy to respond to identified risks;
- carry out an independent third-party audit of supply chain due diligence;
- report annually on supply chain due diligence.

The **EU Timber Regulation** came into force in March 2013 and aims to reduce illegal logging by ensuring that no illegal timber or timber products can be sold in the EU. It defines 'legal' timber as the timber that is produced in compliance with the laws of the countries where it is harvested.

The regulation stipulates that:

- placing illegally harvested timber products derived from such timber on the EU market for the first time, is prohibited;
- EU operators – those who place timber products on the EU market for the first time – are required to exercise due diligence;
- traders – those who buy or sell timber and timber products already on the market – are required to keep information about their suppliers and customers to make timber easily traceable.

These requirements are significant steps in making companies accountable for their sourcing practices including those outside the EU.

At the same time, there are gaps associated with a sectoral approach in terms of legal certainty and harmonisation of regulation. From the Commission 2020 study[97], it appears that 'there is no sector of business which does not pose any potential risks to human rights or the environment. Yet current laws and industry regulatory measures which only apply to certain sectors, products or commodities fail to prevent or address adverse impacts which take place outside of this sector'. (p. 226).

[95] Regulation (EU) 2017/821 of the European Parliament and of the Council of 17 May 2017 laying down supply chain due diligence obligations for Union importers of tin, tantalum and tungsten, their ores, and gold originating from conflict-affected and high-risk areas.

[96] Regulation (EU) No 995/2010 of the European Parliament and of the Council of 20 October 2010 laying down the obligations of operators who place timber and timber products on the market.

[97] BIICL et al.. 2020. Ibid.

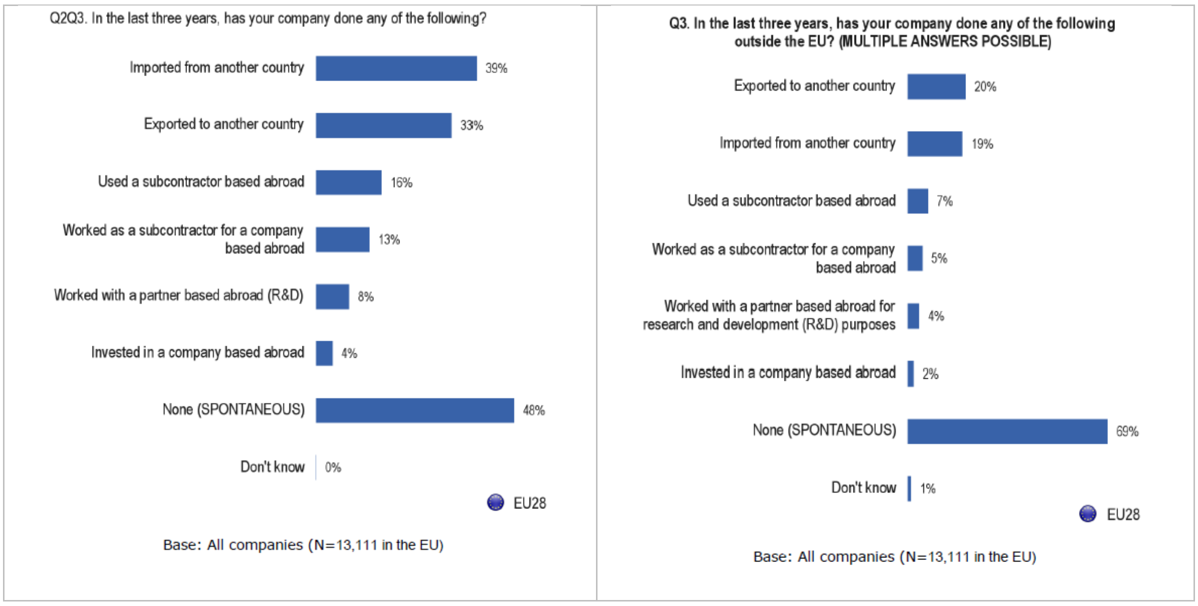
It appears moreover from the same study, using evidence from the OECD national contact points[98] on responsible business conduct, that regulations that are limited to specific issues have been found to be inadequate from the point of view of the OECD Guidelines.

Fragmentation across types of companies

A number of existing initiatives restrict their scope to big companies. This is especially the case of the French Law on Devoir de Vigilance[99] that focuses on companies of more than 5 000 employees; the NFRD[100] focuses on a wider range of companies, yet each employing more than 500 employees. While the rationale behind these choices is the assumed different 'risk' of small and big companies, and the different cost per employee that the two groups face, this restriction to bigger companies has been criticised[101] .

It is relevant to note that **SMEs** in the EU do engage in value chains and in international activities, albeit to a smaller extent than larger companies. According to a 2015 Eurobarometer,[102] a little more than half of SMEs (52 %) in the EU are involved in international business inside or outside the internal market. At least one in 10 has used a subcontractor based abroad (16 %) or worked as a subcontractor for a company based abroad (13 %).

Figure 7: Share of SMEs having had international activities (left) and international activities outside the EU (right)



Source: Eurostat, Flash Eurobarometer, 2015.

[98] https://mneguidelines.oecd.org/ncps/

[99] The legislation applies to companies incorporated or registered in France for two consecutive fiscal years, which employ at least 5 000 people in France (either directly or through their French subsidiaries), or at least 10 000 worldwide (through their subsidiaries located in France and abroad.

[100] Companies with more than 500 employees.

[101] Among others, by Bright C. Creating a legislative level playing field in business and human rights at the European level: is the French duty of vigilance law the way forward?, EIU Working Papers. 2020.

[102] https://ec.europa.eu/growth/smes/sme-strategy/access-to-markets/internationalisation_en

The share of SMEs that engage in cross-border initiatives is non-negligible, despite the fact that the Eurobarometer finds that the larger the company the more likely it is to have exported to or imported from countries outside the EU in the past three years.

From the recent literature in sociology of labour we know of the risks deriving from the fragmentation of regulation and company duties across firm size; this can become an incentive to strategically outsource to smaller companies for the mere fact that they have to abide to fewer regulations. 'Vertical disintegration'[103] of lead companies is a broadly and increasingly present phenomenon in several EU countries. Often outsourcing occurs towards companies that offer lower salaries and lower working conditions – e.g. through reassignment of work to an establishment with a different collective agreement (or no agreement); some authors argue that this has had a negative impact on working conditions.[104]

[103] Doellgast V. and Greer I. 'Vertical Disintegration and the Disorganization of German Industrial Relations, *British Journal of Industrial Relations*, 45(1). 2007 pp. 55-76.

[104] Doellgast and Greer, 2007. Ibid. and Dorigatti L. and Mori A. L'impatto delle scelte datoriali sulle condizioni di lavoro e sulle diseguaglianze: disintegrazione verticale, esternalizzazioni e appalti. Sociologia del lavoro. 2016.

3. Due diligence in the value chain

3.1. Necessity, relevance and EU added value

Human rights protection and the prevention of human rights abuses are embedded in the Treaties and the EU is committed to upholding these principles.[105] This is also required in order to comply with international duties and the United Nations Guiding Principles on Business and Human Rights. Indeed, the UNGPs affirm that business enterprises have a responsibility to respect human rights, and that States have a duty to ensure that they do so.

Moreover, Article 3.3 TEU[106] stipulates that the internal market 'shall work for the sustainable development of Europe' and should aim at 'full employment and social progress, and a high level of protection and improvement of the quality of the environment'.

The **persistence of cases of human rights violations and of adverse environmental impact** by EU companies (or within their value chains), and the evidence of **gaps in the access to remedy for victims** indicate that the **existing EU and international regulatory framework has a number of limitations**, despite the important steps forward discussed above.

The main limitations of the existing initiatives are that they (see Section 2.1.3):

- are voluntary and lack relevant enforcement mechanisms;
- only establish reporting requirements;
- either do not apply along the value chain, or apply only to specific sectors (illegal timber, conflict minerals);
- have not led to a satisfactory level of adoption of due diligence practices by EU companies.

In the light of recent evidence, most academic and institutional research has moved towards proposing the establishment of **due diligence obligations for companies.** The evidence on the limited adoption of existing measures moreover informs the ongoing discussion at the European Commission on supply chain due diligence.[107]

This EAVA focuses on mandatory due diligence, because voluntary measures are already in place but appear to fail to respond to the gaps referred to above. **Voluntary measures promoted by international organisations are already available** to companies in all Member States. From an assessment perspective, the existence of voluntary measures is incorporated in the baseline, and it would be methodologically difficult to distinguish it from the status quo.

For the same reason, and having identified in the interlinked global market a source of risks, this EAVA focuses on measures that involve the entire supply chain and apply across sectors.

Therefore, the potential policy option it assesses is the establishment of mandatory due diligence requirement at EU level that would **require companies to carry out due diligence to identify,**

105 Articles 2, 3.5, 21 of the Treaty on European Union.

106 https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2008:115:0013:0045:EN:PDF#page=5

107 https://www.euractiv.com/section/global-europe/news/new-human-rights-laws-in-2021-promises-eu-justice-chief/

prevent, mitigate and account for actual or potential human rights and environmental impacts in their own operations or supply chains.

This proposal is supported by previous work done by the European Parliament itself, starting from a 2016 resolution on corporate liability of companies for serious human rights abuses in third countries[108] that 'calls on companies, whether European or not, to carry out human rights due diligence and to integrate their findings into internal policies and procedures, with resources and authority assigned accordingly and duly implemented'.

Also relevant is a 2017 resolution on the impact of international trade and the EU's trade policies on global value chains,[109] in which the EP 'calls on the Commission to actively work within the WTO in order to increase transparency, and to define and promote multilateral rules for trade, including the sustainable management of GVCs, which should, in particular, include [...] mandatory supply chain due diligence and transparency requirements, building on the UN Guiding Principles on Business and Human Rights'.

In 2018, an EP resolution on sustainable finance[110] called, among others, for an 'overarching, mandatory due diligence framework including a duty of care to be fully phased-in within a transitional period and taking into account the proportionality principle, a responsible investment taxonomy, and a proposal to integrate ESG risks and factors into the prudential framework of financial institutions'.

Moreover, the March 2019 Shadow EU action plan on the implementation of the UNGPs,[111] drawn up by the Responsible Business Conduct Working Group (RBC Group), mentioned the adoption of mandatory due diligence for EU businesses and businesses operating within the EU, which would require them to carry out human rights due diligence regarding their operations, investments, business relationships and supply chains.

According to the Fundamental Right Agency[112], effective due diligence practices can also help to strengthen **access to remedy**. In this direction, the FRA points out that 'Implementing access to remedy in business-related human rights abuse cases would also benefit from stronger legislative incentives', and that due diligence can support access to remedy by bringing clarity to relationships and responsibilities between corporate entities, and detail efforts made to prevent abuse. FRA states that 'a recently adopted law in France could serve as a model for the EU, in addition to existing instruments such as the Non-Financial Reporting Directive'. (FRA, 2017, opinion 20).[113]

Relatedly, a study done for the European Parliament in 2019,[114] argues that access to remedy for victims of corporate human rights violations is currently jeopardised, and that EU-level legislation

108 European Parliament resolution of 25 October 2016 on corporate liability for serious human rights abuses in third countries (2015/2315(INI))

109 European Parliament resolution of 12 September 2017 on the impact of international trade and the EU's trade policies on global value chains (2016/2301(INI))

110 European Parliament resolution of 29 May 2018 on sustainable finance (2018/2007(INI))

111 Responsible Business Conduct Working Group, 'Shadow EU Action Plan on the Implementation of the UN Guiding Principles on Business and Human Rights within the EU' (March 2019).

112 FRA, 2017. Ibid.

113 The reference is to the afore-mentioned Duty of Vigilance law, LOI n° 2017-399 du 27 mars 2017 relative au devoir de vigilance des sociétés mères et des entreprises donneuses d'ordre

114 Marx A., Bright C. and Wouters J., 'Access to Legal Remedies for Victims of Corporate Human Rights Abuses in Third Countries', European Parliament Policy Department, 2019.

requiring mandatory human rights due diligence across sectors would go in the right direction.[115] According to the study, this would address many of the issues observed around the attribution of legal liability to parent companies in corporate groups, by imposing a legal duty on them to carry out due diligence throughout their supply chains. This study indicates that a possible legislative model could be the French Law on the Duty of Vigilance, but with a wider scope of application and a reversed burden of proof.

The current **fragmentation**, as discussed in Section 2.2.3, appears to be harmful both from the perspective of companies and from the perspective of the good functioning of the single market.

According to the results of the survey incorporated in the recent study conducted for DG JUST,[116] a large majority of economic and social players – 62.5 % of industry organisation respondents, 75.4 % of businesses and more than 96 % of civil society organisations – agree that a single set of EU standards would respond to the need of harmonisation:.

Rules harmonisation could also achieve a more **level playing field** to favour fair competition in the single market. Indeed, companies that currently commit to voluntary standards risk suffering from greater pressure than others. Again, the DG JUST study reports that a majority of businesses (71.6 %) and of civil society organisations (94.2 %) agree that a positive effect in this direction would appear if a uniform set of EU standards would be in place. Industry organisations are of the same opinion, but in a smaller proportion (54.2 %). The view of businesses in favour of a EU-level action is confirmed by the position adopted in the ongoing debate on the matter in Germany, where the secretary-general of the German Retail Federation declared that 'It would make much more sense to regulate at a European level, not nationally in Germany'.[117]

Legal certainty is another need that would be addressed by an intervention at the EU level. The BIICL et al., 2020 study reports that a majority of economic and social players, again, agree that EU wide standards would improve legal certainty. Baglayan (2018) indeed underlines that uncertainty on the legal standards of care that corporations must observe plays a role in the increasing litigation risk against companies, because business may not clearly understand where the line for abusive behaviour is without such guiding legal standards.

A unique standard set by law and therefore being non-negotiable, would support current good practices and would give companies **greater leverage** over suppliers, subcontractors, etc., especially in vulnerable contexts. This is also to be seen in the context of the EU common trade policy, and could reinforce the trade and sustainable development chapters of EU FTAs. The common trade policy develops in the framework of Article 3.5 of the Treaty on European Union,[118] which explicitly mentions the promotion of 'free and fair trade' as one of objectives of the European Union, together with the contribution to 'peace, security, the sustainable development of the Earth, solidarity and mutual respect among peoples ... eradication of poverty and the protection of human rights'.

As will be discussed later on, there are economic arguments in the literature that indicate a positive correlation between responsible business practices and positive business performance. Still, as

115 According to the study, this legislation should draw on the model provided by the French Law on the Duty of Vigilance, but with a wider scope of application and a reversed burden of proof.

116 BIICL, Civic Consulting, LSE, Study on due diligence requirements through the supply chain, Final report, On behalf of European Commission, DG JUST, 2020.

117 Financial Times, German proposals for supply chain law spark fierce debate

118 Article 3.5 of the Treaty on European Union.

argued by De Schutter,[119] this does not mean that businesses are automatically and necessarily pushed to 'behave responsibly' by simple market forces**,** as underlined by persistence of cases of violations and of negative externalities. Some businesses actually do adopt sustainable practices, depending on a complex mix of factors, including strategic choices, cost analysis and relationships with different stakeholders. Some of these drivers are discussed in the next section, and the annexed paper provides a detailed conceptual, historical and empirical framework. Policies and regulatory frameworks can act to create the conditions for businesses to adopt more sustainable behaviours. The very definition of **'negative externality'** indeed implies that there is a negative impact that does not become a 'cost' for companies and therefore is not necessarily and automatically taken into account in business decisions. What from a business perspective are 'external' effects are, on the contrary, costs for other stakeholders (workers, consumers, local communities, governments) or social costs for the society as a whole (e.g. climate change). The need to put these costs in the picture, from an economic perspective, calls for regulatory and policy action on the part of States and supranational entities.

As discussed in Section 4.1.1, depending on the companies' strategy, responsible business behaviours can represent a **positive factor for companies' performance**, as indicated by the literature on corporate social responsibility. Interestingly, the literature underlines that adopting sustainable/responsible standards can produce virtuous incentives, e.g. towards greater innovation or lower company's riskiness. The benefits for companies, indeed, materializes more clearly when adopting a long-term perspective, thus calling into question the short-termism that has been identified as a possible problem in corporate governance also in a recent study by the European Commission.[120]

Legal basis for policy intervention

The EU has the competence to **harmonise national company laws to ensure freedom of establishment to companies**, and to **approximate legislation to ensure the proper functioning of the single market**. Article 50(1) and (2)g TFEU gives competence to the EU to act, by means of directives, to harmonise national company laws so as to grant companies freedom of establishment.[121] In addition, Article 114 TFEU, in conjunction with Article 50, allows the EU to approximate legislation with the object of ensuring the proper functioning of the internal market. Article 114 states that 'concerning health, safety, environmental protection and consumer protection, [the EU] will take as a base a high level of protection'. These two provisions may serve as the legal basis for EU action on the matter.

In addition, the EU has the **duty to promote respect for human rights and the environment** when it adopts and implements legislation as well as in its relations with the wider world. The EU's regulatory competences in terms of promoting respect for human rights when adopting and implementing EU legislation, as well as with regard to its relationships with third countries, are grounded in the Treaty of the European Union . Article 2 TEU affirms that human rights are among the values upon which the EU has been founded, together with the respect for human dignity, freedom, democracy, equality and the rule of law.

The **Charter of Fundamental Rights of the European Union** is a legally binding instrument that applies to the EU in all of its actions and to Member States whenever they implement EU law. The

119 De Schutter O., 'Corporate social responsibility European style', *European Law Journal*, *14*(2), 2008, pp. 203-236.

120 EY, (2020), Study on directors' duties and sustainable corporate governance, on behalf of the European Commission DG JUST, June 2020

121 The Non-Financial Reporting Directive (NFRD) was adopted by the EU on this basis (BIICL et al, 2020).

Charter requires the EU and the Member States to comply with human rights standards whenever EU law is implemented.

With regard to the Union's external action, Article 3.5 TEU provides that: 'in its relations with the wider world, the Union shall uphold and promote its values and interests and contribute to the protection of its citizens. It shall contribute to peace, security, the sustainable development of the Earth, solidarity and mutual respect among peoples, free and fair trade, eradication of poverty and the protection of human rights, in particular the rights of the child, as well as to the strict observance and the development of international law, including respect for the principles of the United Nations Charter'.

3.2. A description of the policy option

Due diligence, as defined by the 2011 OECD Guidelines for Multinational Enterprises in Responsible Business Conduct,[122] is the 'process through which enterprises can **identify, prevent, mitigate, and account for how they address their actual and potential adverse impacts as an integral part of business decision-making and risk management systems'**.

Within the framework of the UNGPs, it is the core requirement of business in meeting its responsibility to respect human rights. The two main sources establishing the steps that compose a due diligence process are the UNGPs[123] and the OECD Guidelines for Responsible Business Conduct.

According to the former, due diligence is defined as a process that includes four broad components:[124]

- identifying and assessing actual and potential impacts;
- integrating and acting upon the findings;
- tracking the effectiveness of these actions; and
- communicating how impacts are addressed, including through reporting.

The latter identifies the following steps:

- Step 1. Establish strong management systems for due diligence: Adopt a responsible business conduct policy, build internal capacity & functional alignment, supplier & business partner engagement (outreach, incorporating into contracts, etc.), set-up internal controls & data collection on supply chain, establish grievance mechanism.
- Step 2. Identify and assess risks of adverse impacts in the supply chain: Map operations, business partners & supply chains, prioritize further assessment based on severity of harm (sector, counterparty, and site for high-risk issues), identify risks of circumstances inconsistent with standards in the Guidelines.
- Step 3. Manage risks in the supply chain: inform senior management, fix internal systems, build leverage individually or collaboratively, use existing networks to manage risk (e.g. industry, workers reps, non-traditional partnerships), build internal

[122] https://mneguidelines.oecd.org/mneguidelines/

[123] https://www.ohchr.org/documents/publications/guidingprinciplesbusinesshr_en.pdf

[124] UNGP point 17.

and business partner capacity, provide remedies when 'caused' or 'contributed' to adverse impacts

- Step 4. Verify the effectiveness of the enterprise's due diligence: where relevant, monitor medium-high-risk operations, products or services, after change of circumstance; undertake audits, assurance, etc.
- Step 5. Report publicly and communicate, with due regard for commercial confidentiality and competitive concerns

As discussed in the DG JUST presentation of Option 4[125] (New regulation requiring mandatory due diligence), in line with the UNGPs, the OECD Guidelines and the ILO MNE declaration, the due diligence process should include meaningful consultation and collaboration with stakeholders (including civil society organisations, workers' organisations, and investors) along the value chain.

This duty would require companies to meet a certain **standard of care** of due diligence for the human rights and environmental impacts in their own operations and supply or value chains. The enquiry into whether the standard of care was met would take into account what processes or steps were put in place, whether these steps were adequate, reasonable and/or appropriate in the particular circumstances (taking into account the relevant context and the risks), whether the process was implemented and how it was implemented in practice.

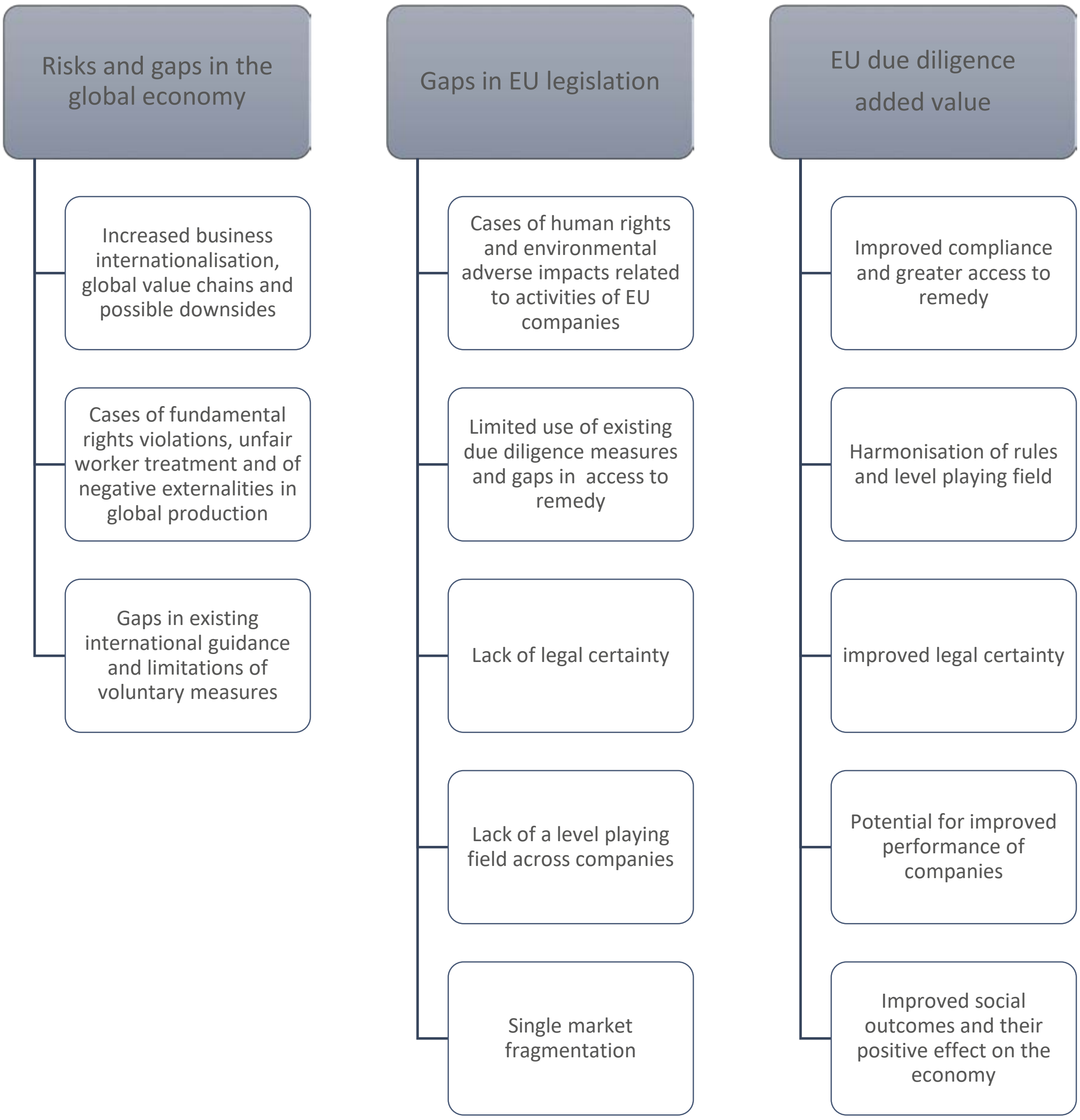
This regulatory measure is assumed to cover the entire spectrum of EU companies, but it can be especially relevant for companies that are in industries with a greater risk of violation of human rights and environmental standards, and for companies that resort to international sourcing (largely manufacturing companies, followed by companies in the retail sector).

It has to be noted that most companies in the EU are SMEs or micro-businesses. At the same time, as pointed out in Section 2.2.2, SMEs do have international activities, although to a lesser extent than big businesses. As shown in Table 12in the appendix, they are also present in sectors usually considered to be 'riskier'. Still, this issue may require particular attention (see Section 4 for more details).

Figure 8 provides a summary of the analysis of risks, of gaps at the EU level, and of the added value generated by the introduction of due diligence obligations at the EU level.

125 BIICL, Civic Consulting, LSE, Study on due diligence requirements through the supply chain, Final report on behalf of DG JUST, the European Commission, 2020.

Figure 8: Summary of risks, gaps and added value of due diligence



Source: author's elaboration.

4. European added value assessment

This section assesses the potential effect of EU action to address the negative impacts of businesses on human rights and the environment.

The focus is on the assessment of a **policy intervention** that establishes **due diligence obligations for all EU companies regarding their social and environmental impacts along their value chain, including impacts in third countries**.

The status quo includes voluntary due diligence measures. Consequently, this section focuses on **mandatory measures** to assess the difference with respect to this status quo. There is a broad consensus that the existing broad spectrum of voluntary measures, though having been an important step in the right direction, has proven insufficient to improve the situation.

Throughout the section, the main idea behind the approach applied is to **approximate** the potential impact of EU action (the 'European added value') and answer the question 'what would happen if all EU companies were adopting social and environmental responsibility policies as those who do it the most?'. The author of this study considers this as an **'upward harmonisation'**, or an 'upward convergence' scenario.

With regard to the scheme in Figure *9*, a focus is placed on **the potential impacts on company performance and on social outcomes**, using both quantitative and qualitative methods.

4.1. Company level

4.1.1. Benefits and economic drivers for companies

As pointed out in the study done for DG JUST in 2020[126], estimates on how regulatory schemes that set due diligence obligations affect company performance are still missing. This section relies therefore on the literature on corporate practices of corporate social responsibility (CSR) and of environmental, social and governance (ESG) accountability. The estimates that follow model the establishment of due diligence obligations at EU level as a generalised increase ('upward harmonisation') in such practices towards the top performers.

For a detailed literature review, see Section 2 of the paper in Annex.

Where do benefits arise from?

The literature has identified a number of factors that would drive companies to implement CSR policies in order to increase their corporate performance; these factors broadly relate to cost reduction, strengthening legitimacy and reputation, building a competitive advantage, and synergistic value creation (Camoletto et al, 2020, in Annex).

The main areas where there is evidence of a positive impact on companies of adopting such practices, can be summarised as follows:

- reduced risks, which are reflected in the financial markets in lower costs of capital;[127]

[126] BIICL et al., 2020, Ibid.

[127] OECD and Columbia-SIPA, Quantifying the Costs, Benefits and Risks of Due Diligence for Responsible Business Conduct, 2016; Hoepner A. G., Oikonomou I., Sautner Z., Starks L. T. and Zhou X., ESG shareholder engagement and

- improved stakeholder relationships (especially with employees, leading to higher productivity);[128]
- reduced costs of conflicts (including legal costs);[129]
- improved transparency and knowledge of the value chain;[130]
- increased reputation;[131]
- greater incentives to innovate.[132]

A forthcoming study, being done at the Danish Institute for Human Rights,[133] argues that these pathways are likely to be activated by companies that thoroughly implement the UNGPs to improve their respect for human rights.

According to a comprehensive systematisation done by the OECD,[134] due diligence for responsible business conduct brings a number of 'intermediate' benefits that can be connected in different ways to 'bottom-line' benefits. These are summarised in Figure 9 below. According to the OECD literature review, the main advantages of engaging in due diligence are of improved transparency, improved governance and relationships with all stakeholders, and lower risk, in particular with regard to disruption in the value chains thanks to increased operational knowledge. These elements have both advantages per se and advantages in terms of reputation and brand name.

downside risk, ECGI Working Paper. 2018; Albuquerque R., Yrjö K., Chendi Zh. Corporate Social Responsibility and Firm Risk: Theory and Empirical Evidence. *Management Science* 65(10). 2019. Pp. 4451-4469; Nordea Equity Research, Cracking the ESG code, Nordic Ideas, Strategy and Quant, September 2017.

128 OECD and Columbia-SIPA, 2016, Ibid.; Bağlayan B., Landau I., McVey M. and Wodajo K. Good Business: The Economic Case for Protecting Human Rights; Sun L. and Stuebs, M, 'Corporate social responsibility and firm productivity: Evidence from the chemical industry in the United States', *Journal of Business Ethics*, 2013, Vol. 118, No 2, pp. 251- 263.

129 OECD and Columbia-SIPA, 2016, Ibid.; Baglayan et al. 2018. Ibid.

130 OECD and Columbia-SIPA, 2016, Ibid. ; Baglayan et al. 2018. Ibid

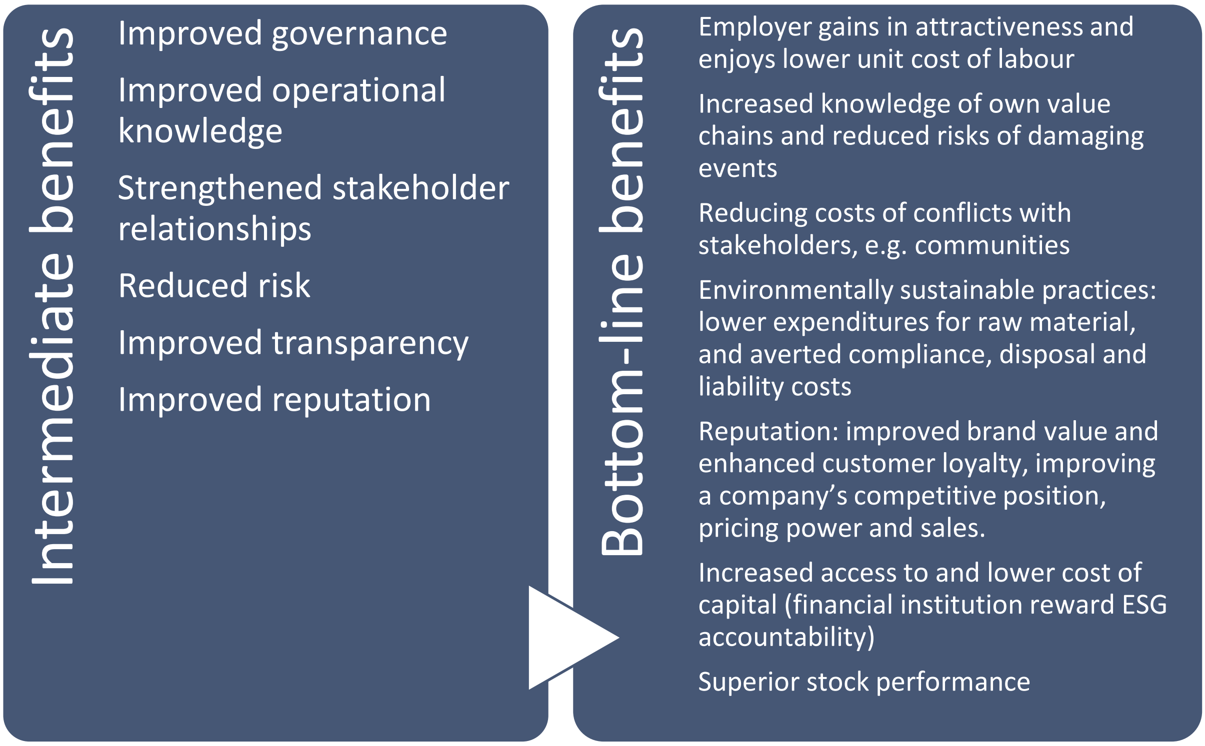
131 OECD and Columbia-SIPA, 2016, Ibid; Salama, A.. A note on the impact of environmental performance on financial performance. Structural change and economic dynamics, 16(3), 2005. Pp. 413-421.

132 Sun et al. 2013. Ibid.; Hasan I., Kobeissi N., Liu L. and Wang H. 'Corporate social responsibility and firm financial performance: The mediating role of productivity', *Journal of Business Ethics*, 149(3). 2018. pp. 671-688.

133 Marslev K., 'Doing well by doing right? Exploring the potentials and limitations of a business case for human rights', Research Report, The Danish Institute for Human Rights, Copenhagen. 2020, forthcoming.

134 OECD and Columbia-SIPA 2016, Ibid.

Figure 9: Benefits of due diligence (OECD, 2016)

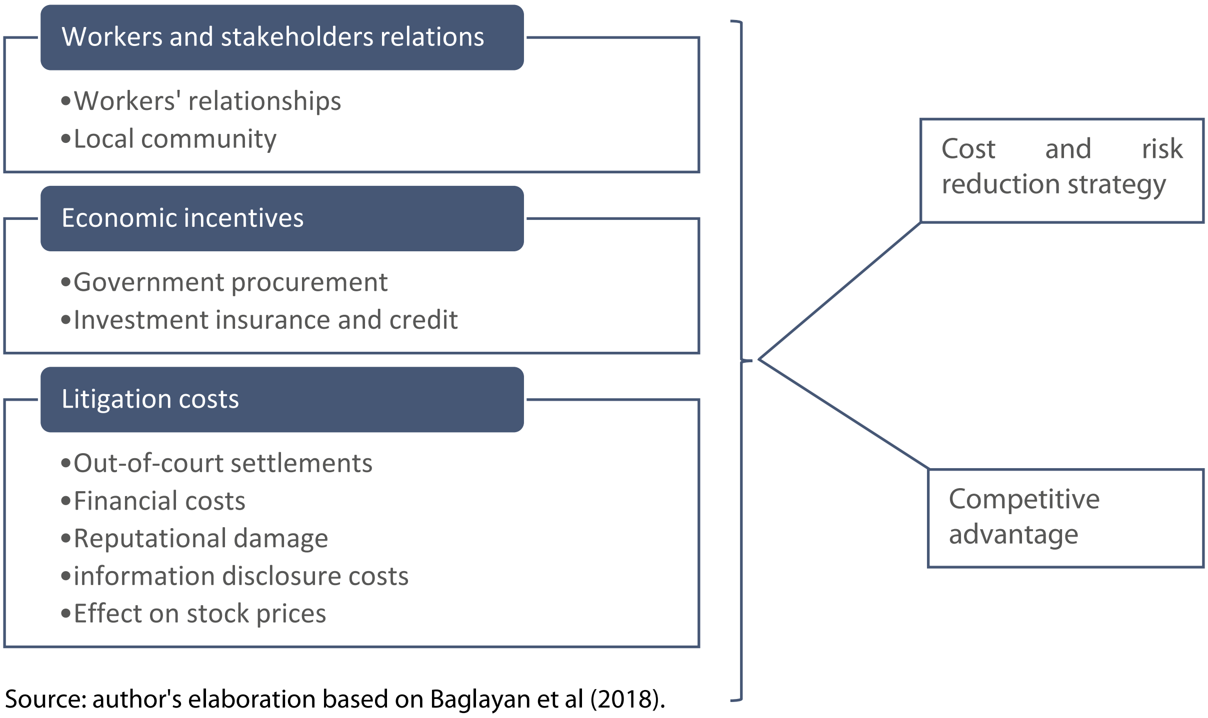


Source: author's elaboration based on OECD and Columbia-SIPA(2016).

Another relevant systematisation of the available evidence is done by Baglayan and co-authors[135]. They identify the main economic drivers for respecting human rights when doing business; a selection of these drivers is presented below. Each driver has two components: a cost and risk reduction where respect for human rights directly serves company performance and objectives (e.g. by reducing litigation costs), and a competitive advantage strategy (where the company expects a benefit by differentiating with respect to others).

[135] Baglayan et al. 2018. Ibid.

Figure 10: Benefits of human-rights responsible business conduct (Baglayan et al, 2018)



Source: author's elaboration based on Baglayan et al (2018).

Empirical literature

The most recent survey done among businesses on the potential impact of EU legislation on due diligence[136] finds out that, according to the majority of respondents, the main incentives to conduct due diligence are reputational risks (66 %), followed by investors and consumers requiring high standards (51 % and 47 %, respectively). Operational risks, regulation requiring reporting (42 % each) and financial risks (41 %) are also important drivers for due diligence activities.

In 2016, a survey conducted on the OECD Guidance on Conflict Minerals[137] found that 82.8 % of respondents believe that fulfilling the standards set out by the OECD Guidance results in significant benefits, even though most of them cannot be quantified. These are due to reputation, supply chain rationalisation including securing future supply, financial performance and risk indicators, and productivity and innovation.

The annexed paper conducts a thorough review of the empirical evidence of the relationship between CSR and ESG accountability and company performance. Below, Tables 1-4 with summaries of selected results focus on the effects of:

- CSR or ESG accountability practices on financial performance of companies;
- CSR or ESG accountability practices on productivity and innovation;
- workers' rights protection on company performance.

[136] BIICL et al. 2020. Ibid.

[137] Blome C., Hofmann H., and Schleper M. Stopping conflict minerals with the OECD guidance for responsible mineral supply chains: Status quo in Europe, University of Sussex. 2016.

Table 1: Effects of CSR or ESG accountability practices on the financial performance of companies

Study	Result
Nordea (2017)	Strong ESG performance contributes to risk mitigation, but it is also an indicator of strong operational and share price performance: ➢ significant 'alpha' generated 40 % difference between bottom and top performers; ➢ companies with the top ESG ratings have higher ROE, ROCE (return on capital employed) and lower net debt/EBITDA (return before tax, depreciation, interests, amortisation) than the market average; ➢ higher stability of returns and lower share price volatility; ➢ valuation premium. Evidence of significant downside protection in times of crisis, such as the financial crisis of 2008, when value took a severe beating.
Albuquerque et al (2019)	Analyse the effect of CSR on company value, proxied by Tobin's Q: the association between Tobin's Q and CSR is positive and (20 %) stronger for companies with greater product differentiation: a one standard deviation increase in CSR increases Tobin's Q by 0.073-0.087, which is a 4-5 % increase relative to the average Tobin's Q. The level of systematic risk faced by US companies is statistically significantly lower for companies with a higher CSR score: one standard deviation increase in company CSR score is associated with a company beta (measure of riskiness) that is 1 % lower relative to beta's sample mean. Profits for companies with a high CSR score are less correlated with the business cycle than the profits for companies with a low CSR score.
Hoepner et al. (2020)	A commitment to environmental, social and governance (ESG) issues can benefit shareholders by reducing companies' downside risk. Risk is reduced by: ➢ distribution of returns that fall below the 0 %-return-threshold ➢ the fact that companies with better ESG performance are less vulnerable to company-specific negative events.

Table 2: Effects of CSR or ESG accountability practices on productivity and innovation

Study	Result
Hasan et al. (2018)	In a sample of US manufacturing companies between 1992 and 2009, total factor productivity significantly mediates the social-financial relationship. A one unit increase of the CSR indicator increases TFP by 3 %, then in turn increases financial performance. The effect of CSP on TFP is stronger for companies with a higher organisational risk.
Sun et al. (2013)	Results from the regression analysis support a significantly positive relationship between CSR and future company productivity, suggesting that CSR can lead to higher productivity (both in shorter and longer time spans) in the chemical industry.

In terms of employee relationships, responsible business conduct policies make companies more attractive employers, which increases productivity and motivation, and reduces turnover.

This positive relationship is also present when looking at companies in the Global South. There have been a number of studies especially focused on production occurring within GVCs. The most relevant evidence is provided by the evaluation of the Better Work Program (BWP, a joint ILO and IFC-WB programme aimed at improving working conditions along several dimensions in the garment sectors in a selected number of countries).[138] The result of the evaluation indicated that better working conditions were linked to higher levels of worker productivity. After four years of participation under the Better Work Program, companies' average profitability increased by 25 % and proper training for supervisors, particularly female supervisors, resulted in a 22 % increase in productivity.

Table 3: Effects of workers' rights protection on company performance

Study	Result
Edmans (2012)[139]	Companies listed in the '100 Best Companies to Work for in America' generated 2.3 % to 3.8 % higher stock returns per year than their peers from 1984 through 2011
Damiani et al (2016)[140]	Positive effects of employment protection on productivity (TFP) in the EU
Better work Program ILO (2016)[141]	After four years of participation with Better Work, average profitability increased by 25 % and proper training for supervisors, particularly female supervisors resulted in a 22 % increase in productivity. In the Vietnam garment sector: ➢ factories experience a 5.9 % boost in profitability when workers perceive improvements in working conditions traditionally associated with 'sweatshops', including improvements in their sense of physical security and assurance in wage payments; ➢ profitability is 7.6 % higher, and workers experience a comfortable environment and a trusting workplace. Profitability improves in factories with better working conditions because workers are more productive (Brown et al (2015): greater compliance made Cambodian companies more resilient to the 2008 crisis (reduced exports to the US).
Baglayan et al. (2018)	The Harvard Business Review reported on the growing body of work in organisational psychology demonstrating that not only was a 'cut-throat environment harmful to productivity over time, but that a positive environment will lead to dramatic benefits for employers, employees, and the bottom line'. In the UK, the combined costs of sickness absence, non-employment, effects on unpaid work and output losses is £26 billion a year. It is estimated that more than US$500 billion in the US economy and 550 million workdays are lost each year due to workplace stress.

[138] The assessment on company performance has been carried out in Haiti, Indonesia, Jordan, Nicaragua and Vietnam.

[139] Edmans, A.. The link between job satisfaction and firm value, with implications for corporate social responsibility. *Academy of Management Perspectives*, *26*(4), 2012, pp. 1-19.

[140] Damiani M., Pompei F. and Ricci A. 'Temporary employment protection and productivity growth in EU economies', *International Labour Review*, 155(4). 2016. pp. 587-622.

[141] Better Work Program, Progress and Potential: How Better Work is improving garment workers' lives and boosting factory competitiveness, A summary of an independent assessment of the Better Work programme, ILO and IFC, 2016.

World Bank Group, (2015)[142]	On the Better Work Program (ILO-IFC): Profits, productivity, and company survival are positively associated with improvements in working conditions and increased compliance with labour standards
Jetha and Linsen (2015)[143]	On the Better Work Program (ILO-IFC): An analysis of Cambodian garment factories found that increased compliance with social protection standards was associated with reduced odds of factory closure
Brown et al. (2016)[144]	Garment factories with higher compliance with international labour standards have higher labour productivity and higher profitability
Oka (2005)[145]	Better compliance with labour standards increases suppliers' likelihood of retaining buyers that are reputation-conscious, though it does not drive buyers' sourcing decisions

At the intersection of the abovementioned categories, Surroca et al.[146] find – in a sample of companies in 28 countries – that the relationship between CSR and corporate financial performance (measured by Tobin's Q) is mediated by 'intangibles': innovation, human resources, reputation, company culture.

In the literature on business and human rights, there are moreover numerous accounts of evidence on high litigation costs[147]. Indeed, companies are increasingly subject to high-profile lawsuits for alleged failure to prevent human rights abuse or environmental harm. Voluntary or non-binding standards are increasingly being used in such lawsuits[148]. According to scholars[149], without visibility from source to retail, companies may be unaware of human rights violations in their supply chains. Human rights due diligence can help mitigate supply chain disruption and minimise legal risk by increasing transparency and ensuring suitable grievance mechanisms.

Table 4: Evidence on litigation costs for companies

Type of cost	Descriptions	Examples
Financial costs	Risk of being excluded from public procurement	Article 57 of EU Directive 2014/24/EU on Public Procurement: one of the grounds of exclusion from public bidding is conviction by final judgment of using child labour or other forms of human trafficking

[142] World Bank. 'Interwoven: How the Better Work Program improves job and life quality in the apparel sector'. 2015.

[143] Jetha Q. and J. Linsen. 'Survival of the Fittest – and Most Compliant: Evidence on the relationship between firm survival and social protection compliance', Better Work Discussion Paper Series No 19, ILO, Geneva. 2015.

[144] Brown D. et al. The Impact of Better Work – A Joint Program of the International Labour Organization and the International Finance Corporation, Tufts University Labor Lab. 2016.

[145] Oka C. Does Better Labour Standard Compliance Pay?: Linking Labour Standard Compliance and Supplier Competitiveness, ILO. 2005.

[146] Surroca J., Tribó J. A. and Waddock S. 'Corporate responsibility and financial performance: The role of intangible resources', *Strategic Management Journal*, 31(5). 2010. pp. 463-490.

[147] Baglayan et al, 2018, Ibid.

[148] BIICL et al, 2020, Ibid.

[149] Baglayan et al, 2018, Ibid.

	Increased costs of capital and lower access to credit	Facing a lawsuit and the potential risk of being a judgment debtor are recognised and viewed negatively by credit rating agencies (Moody's comments cited in Baglayan, 2018, p. 43)
Information disclosure costs	Production of evidence requires information disclosure	Victims' (plaintiffs) right to obtain information is the backbone of the right to a remedy, to enable victims of business-related abuses to show the link between the company and the harm suffered. The UN Guiding Principles 21 and 31 require businesses to communicate human rights impacts of their operations in response to stakeholder concerns and victims' right of access to information, respectively.
	Legal proceedings create an environment for increased levels of activism, which it turn can have reputational impacts on companies (see below)	
Costs of out-of-court-settlements	Increased use of settlements out of court (24.5 % in Baglayan et al, 2018)	Companies' strategy to avoid litigation costs Out-of-court settlements are costly themselves (they have increased in number and size since 2009)
Reputational cost	Direct decline in the value of the company (intangible component) Increased likelihood of consumers boycott Increased difficulty in attracting talents and motivated workers	
Litigation effect on stock performance	Summarises the above effects	E.g. BP oil spill 2010 (Deepwater Horizon): the company's stock performance decline amounted to a 50 % fall in its share price

Source: author's elaboration based on Baglayan et al (2018).

4.1.2. Costs for companies

Where do costs arise from?

As indicated in several studies[150], costs of implementing due diligence have various sources.

These costs include one-time and recurring costs. One-time costs are made for the purpose of:

- developing and instituting a due diligence policy,
- procuring and installing necessary IT systems,
- informing and training staff and supply chain partners.

Recurring costs are incurred for:

- designating the employees who would be dedicated for the task,
- systems maintenance,
- data aggregation and analysis.

[150] OECD and Columbia-SIPA, 2016, Ibid.. Blome, 2016, Ibid. and BIICL et al., 2020, Ibid.

Each step of the due diligence process involves some specific costs:

- the risk identification phase: costs of acquiring knowledge of the company's operations and supply chain;
- the prevention and mitigation phase: costs of developing capacity of suppliers, mitigation measures;
- the accounting phase: costs of monitoring, reporting and communicating on due diligence findings and measures taken.

Empirical literature

A number of attempts to quantify the costs of introducing a due diligence process have been made. The most extensive evidence can be derived from the conflict minerals sector, governed by US legislation (Dodd-Frank Act, 2010), the EU Conflict Minerals Regulation (to enter into force in 2021), and the OECD guidelines.

Surveys usually identify **limited costs with respect to the value of sales**. **Costs are usually considered to vary substantially depending on company size**. Usually costs are considered to decrease over time.

Table 5: Main studies assessing costs of due diligence requirements for companies

Study[151]	Case and method	Result
Securities and Exchange Commission (SEC) (2010)	Pre-implementation estimate Dodd-Frank Act US	Estimated annual cost of US$14 000 for companies that have to carry out due diligence but don't have to file a report to the SEC to US$53 000 for companies that have to also undergo an audit (+US$25 000) and file a report (+US$3 600 to US$10 800 consultant costs).
National Association of Manufacturers (NAM) (2011)	Pre-implementation estimate Dodd-Frank Act US	Estimated annual burden of US$1.2 to US$25 million per company, with an industry-wide total cost of US$8 to US$16 billion; Over 90 % of total cost per company related to the updating of IT systems (for large companies estimate of required upgrades of US$25 million) This study has been heavily criticized because of overestimation of IT costs (OECD, 2016).
Claigan, Environmental comment to the SEC (2011)	Pre-implementation estimate Dodd-Frank Act US	Estimated first-year costs of US$228 000 for companies with over US$1 billion in revenue; Estimated first-year costs of US$813 000 for companies with over US$10 billion in revenue; Estimates costs would drop by 50 % in each of the following two years as experience and efficiency of supply chain due diligence increased
Bayer, C. et al (2011) Tulane University	Post-implementation analysis Dodd-Frank Act US	Found the average costs in the first year of implementation varied from US$235 000 ('small companies') to US$1.1 million ('large companies') and US$28 500 (small companies) to US$106 000 (large companies) in the following years.

[151] Unless otherwise specified, studies are reported in in OECD and Columbia-SIPA, 2016, Ibid.

Green Research. 2012. The Costs and Benefits of Dodd-Frank Section 1502. A Company-Level Perspective		Compliance cost varied widely with the size and complexity of companies' supply chains but seemed to be manageable for all types of companies. Largest companies (annual revenue over US$50 billion) to face one-time costs ranging from US$500 000 to US$2 million. Smaller companies expected to be able to meet their obligations for less than the cost of a full-time employee in the first year, with costs declining over time
Impact assessment Conflict Minerals Regulation (2014)	Ex ante assessment EU Conflict Mineral Regulation	Majority of the participants reported relatively low-cost efforts for conflict minerals due diligence and reporting, with expenditures predominantly estimated €13 500 for initial efforts (74 %) and at €2 700 for on-going efforts (63.8 %), despite the fact that only 17 % of the respondents were small companies with less than 50 employees.
Blome et al. (2016)[152]	Cost/benefit analysis for companies of OECD non-binding guidelines on conflict minerals	Relatively low with respect to sales: The average implementation cost for the sample in this study is 0.0002 % of total annual sales. The cost of implementation to sales ratio is higher for small companies and for one firm was 1 % of their sales volume. The implementation costs for the vast majority is less than 0.1 % of annual sales. Overall, companies estimate an average of approximately €270 000 as investment cost in the first year, followed by recurring annual cost expenditures of €535 000 for full implementation. Also, these costs can be further reduced significantly through industry and supply chain collaboration.
European Commission, SWD (2016) 34 final, Evaluation of the EUTR[153]	Evaluation of the EUTR	Costs reported by operators for developing and operating a DDS vary significantly. Data extracted from consultations with operators and a survey carried out by the Global Timber Forum (GTF) on the DDS, which were based on a limited sample, show that development costs could range between €5 000 and €90 000 and annual operating costs between €1 000 and €70 000. Costs of developing a DDS and exercising due diligence seem to have only marginally (if at all) been passed on to clients.
CSES for European Commission (2011)[154]	Evaluation of NFRD	For large companies in the range of €155 000 to €604 000 and for smaller companies in the range of €8 000 to €25 000. On a per employee basis, costs were much higher for small companies (between €68 and €212 per employee) than for large companies where the cost was between €3 and €13.

152 Blome C., Hofmann H., and Schleper M. Stopping conflict minerals with the OECD guidance for responsible mineral supply chains: Status quo in Europe, University of Sussex. 2016.

153 European Commission Staff Working Document Evaluation of Regulation (EU) No 995/2010 of the European Parliament and of the Council of 20 October 2010 laying down the obligations of operators who place timber and timber products on the market (the EU Timber Regulation) Accompanying the document. SWD/2016/034 final

154 CSES. Framework Contract for Evaluation and Impact Assessment activities of Disclosure of non-financial information by Companies, final report, Centre for Strategy and Evaluation Services, UK. 2011.

BIICL et al (2020) for DG JUST[155]	Ex ante assessment of EU level due diligence (option 4)	Estimate of recurrent costs: large companies €9 400-€4 700 000 depending on revenues; SMEs €1 400-€69 300 depending on revenues.

Source: author's elaboration on OECD, 2016.

The study for DG JUST[156] points out that 1) a representative large company with revenues of €10 billion would face additional labour costs of approximately €500 920; 2) a representative SME with revenues of €1 million would face additional annual labour cost of approximately €740; and 3) a large SME with annual revenues of €50 million (upper bound for the Eurostat definition of SME) would face an additional annual labour cost of €36 990. A particularly high cost increase is estimated for SMEs with very high revenues, which are expected to face additional total costs worth €94 700. As stated in the study, these estimates, being based on survey responses on person-day estimates, have to be treated with caution.

The overall estimate[157] of costs for EU companies is of about €33 billion/year, of which €22 billion in additional labour costs. This cost analysis does not incorporate the cost of divergence in regulatory frameworks across the EU, which creates additional costs for businesses and impedes intra-EU trade and investment. 'Compared to fully harmonised EU regulation we expect the additional cost to be significantly higher if companies would have to comply with 28 national laws for which different DD obligations and reporting requirements apply.' (p. 417)[158]

Costs can moreover be affected by the quality of guidance and support that public authorities will put in place.

4.1.3. Estimating the potential impact that the introduction of human rights and environmental due diligence would have on EU companies' performance

This section aims to contribute to the assessment of the European added value by modelling the potential **impact on EU companies' performance of the introduction of due diligence obligations in the environmental, social and governance fields**.

Since no existing study assesses this impact, the present study approximates it with an analysis of a generalised increase ('upward harmonisation') in environmental, social and governance accountability practices (ESG, or corporate social responsibility practices) of EU companies towards the 'top performers'. This section therefore uses data on voluntary measures to extrapolate what would happen if these measures were generalised to all companies.

This section is based on external expertise; for details, see the annexed paper (Camoletto et al, 2020).

The empirical strategy relies on the dataset Asset4-Thomson Reuters, which provides environmental and social information deriving from different sources such as companies' annual reports, CSR

155 BIICL, Civic Consulting, LSE, Study on due diligence requirements through the supply chain, Final report on behalf of DG JUST, the European Commission, 2020..

156 BIICL et al. 2020, Ibid.

157 BIICL et al. 2020, Ibid.

158 BIICL et al. 2020, Ibid.

reports, NGO websites, etc. The dataset provides information on the implementation of these policies at the company level.

For the purpose of this study it is important to point out that environmental and social policies[159] put in place by companies are measured by **'degrees of implementation'**, i.e. not only the number of policies that companies have 'on paper', but the extent to which their implementation plan is actually pursued.

Specifically, the dataset provides information on whether a company has just implemented the policy, without established additional steps, or it has implemented the policy and put in place related processes to establish this policy in its business strategy, or it has also determined specific objectives to achieve the related goals and monitoring the improvements.

This information is available on policies that aim to reduce negative environmental and social impacts. Thanks to this in-depth information, it is possible to calculate a 'degree of ES[160] implementation' for each company. This approximates, though still not exactly, a due diligence process.

The dataset comprises 511 companies registered in the EU. The analysis uses mostly 2018 data, but sensitivity checks are run using all the available years (2015, 2017, 2018).

The analysis is done in two steps:

1) the measurement of the correlation between company performance (measured as return on capital employed, a measure of company profitability[161]) and the 'degree of ES implementation' as described above; it offers a measurement of the percentage change of company performance associated to a change in the ES score.

2) This measure is then used to construct 'upward harmonisation' scenarios. This is based on:

- the correlation found above, which can measure to what extent company performance changes as a result of changes in ES policies;
- the expected increase in 'degree of ES implementation' under different scenarios.

Table 6 shows different degrees of ES implementation and some corresponding average information on companies: higher ES implementation is associated with higher profitability, larger company size (both in terms of asset and employees), and higher revenues (sales).

Table 6: Description of ES groups

degree of ES implementation	Average ROCE (year 2018)	Average of total assets (year 2018)	Average of total employees (year 2018)	Average SALE (year 2018)
ES low (LP = 'low performer')	0.0797	7.9316	16.1608	3.5888
ES medium-low (MLP='medium-low performer')	0.0951	23.1608	21.1602	4.6120

159 In the annexed paper these are defined as corporate social responsibility policies, CSR).

160 Environmental and social.

161 ROCE= surplus/(assets-liabilities).

ES medium-high (MHP='medium-high performer')	0.1005	81.5789	41.6085	10.2729
ES high (HP='high performer')	0.1021	84.3662	83.7832	26.8524

Source: annexed paper Camoletto et al (2020) Note: Average of return on capital employed (ROCE), total assets (in millions of euros), total employees (in thousands) and sales (in millions of euros) for 511 EU companies that have available information in 2017 regarding the environmental and social policies they have implemented, the processes they have put in place, and the objectives they have set themselves to achieve.

Through a multivariate analysis, the present study then explores what correlation exists between ES and return on capital (ROCE), 'other things being equal' (i.e. comparing companies in each sector, in order to account for sectorial differences for companies of the same size[162]).

The positive correlation is shown in Table 7[163] and can be interpreted as an 'elasticity' of company performance to environmental and social policy implementation: for a one-step[164] increase in the ES implementation degree, companies show a 2.26 % increase in ROCE. This result is consistent with the literature presented in Section 4.1.1.

Table 7: Regression results: ES implementation and company performance (ROCE)[165]

	Return on capital employed (ROCE)
degree of ES implementation	0.0226*** (0.008)
Number of companies	511

Source: annexed paper Camoletto et al (2020). Year 2018.

Interestingly, these **results are stronger if we restrict the sample to companies that have operations abroad** with respect to their registration country (see Table 13 in Appendix).

Based on the groups listed in Table 6, the second step is to construct scenarios taking into account the potential impacts of policy options that introduce mandatory due diligence and are assumed to increase the level of ES practices, pushing them to converge towards the highest values.

162 The authors included in the analysis the most common control variables suggested by the literature: Size, which, consistently with the number of works in the field, is measured by the natural logarithm of total assets (Hasan et al., 2018, Albuquerque et al. 2019); Debt_ratio, which is the debt level calculated by using the share of debt in the total assets; INT variable (Velte, 2017), which is a dummy variable assuming value 1 if the company has a non-zero amount in the international operating income, being 0 otherwise; Board_size, which is the sum of all corporate directors at the end of the fiscal year; Board_ind, which describes the independence of the board and is calculated as the percentage of independent members of the board over the total number. Moreover, the authors added a control for the different sectors (SEC).

163 It is confirmed by using a random effect model and is also found on other indicators (Tobin's Q, which measures efficiency and approximates the intangible assets of the company). The correlation does not hold for productivity measures, but these measures suffer of data limitations.

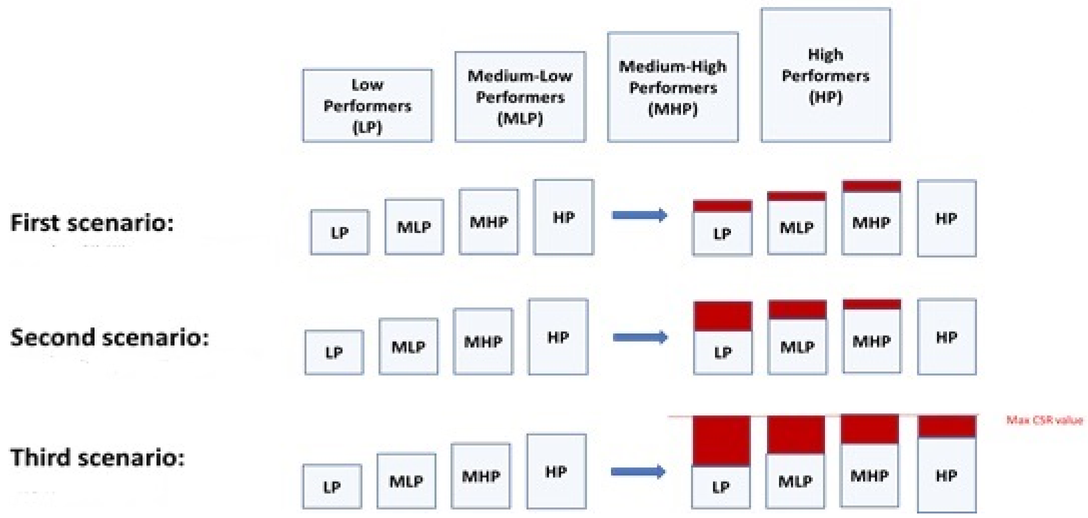
164 It can be interpreted as moving one step, for instance, from degree 0 to 1 (i.e. a company not having a policy compared with those that have a policy).

165 The full regression table is in the appendix.

These higher values are represented by three scenarios of different degrees of ambition, which are described in Figure 11.

- *'one step increase'*: the companies from a group at one level climb one level up;
- *'convergence to top performers'*: all companies increase their ES implementation degree to the level of the 'ES high' group;
- *'convergence to the top'*: all companies increase their ES implementation to the maximum value possible, which is 3, meaning that the company has the value of 3 in every policy area (has a policy and a process, and has set specific objectives to achieve the related goals and monitor improvement).[166]

Figure 11: A visual representation of 'upward convergence' scenarios



Source: author's elaboration on Camoletto et al (2020), paper in Annex.

In the first scenario, the companies in the first group increase their average ES degree index in order to reach the second group's value; the companies in the second group adjust their values to reach the values of the ES degree index of the third group, and the companies in the third group increase their average ES degree index in order to reach the fourth group value(s).

In the second scenario, the harmonisation of the ES degree is done by taking the average ES degree index of the top performers as a reference index. In this case, low performers, medium-low performers, and medium-top performers increase their ES degree index in order to reach the average value of the CSR index of the top performers.

In the third scenario, companies in all groups 'move upwards', and all converge to the maximum value of ES degree implementation.

The three scenarios can be seen as steps over time, where the first scenario can be associated with short-run potential changes and the more ambitious scenarios with longer run impacts.

[166] The label used in the annexed paper is 'idealistic' scenario.

Table 8: Scenarios of return on capital employed (ROCE)

Degree of ESG implementation	Average aggregated degree index	Average ROCE (year 2018)	Increase in ROCE 'one-step increase'	Increase in ROCE 'convergence to top performer'	Increase in ROCE 'convergence to top'
ES low	0.6817	0.0797	1.74 %	4.01 %	5.24 %
ES medium-low	1.4525	0.0951	1.29 %	2.26 %	3.5 %
ES medium-high	2.0214	0.1005	0.97 %	0.97 %	2.21 %
ES high	2.4521	0.1021	0 %	0 %	1.24 %
Average expected increase in ROCE under the three scenarios			1 %	1.89 %	3.05 %

Source: annexed paper Camoletto et al (2020).

The average increase in profitability (ROCE) is expected to be between 1 % and 3 %, depending on the scenario.

Companies that start from a lower-level ES policy would gain the most (under the 'convergence to top performers' scenario, the increase is expected to be 4 % for the companies that start from lower values, and between 1 % and 2 % for companies that start from medium values).

In order to have a representation closer to the whole spectrum of EU companies, the sample is then rescaled around the average EU-27 ROCE (Eurostat in 2017 = 0.2265[167]). Under the restrictive assumption that the sample used is representative of EU companies, it is possible to derive the expected increase in ROCE under the two scenarios for the average of the EU-27.

Under the scenario of 'convergence to top performer', it would be expected that there would be a potential increase of the average EU-27 ROCE from the current value of 0.2265, to a value of 0.2444.

Despite the caution that we have to use in interpreting this extrapolation, it indicates a potential significant **increase in EU companies' profitability.**

Table 9: Projected return on capital employed (ROCE) for the EU-27

degree of ESG implementation	Sample distribution ROCE (2018)	Replication for the EU-27 ROCE (2018)	Projected ROCE for the EU-27 'one-step increase'	Projected ROCE for the EU-27 'convergence to top performer'	Projected ROCE for the EU-27 'convergence to top'
ES low	0.0797	0.1912	0.2080	0.2312	0.2436
ES medium-low	0.0951	0.2282	0.2410	0.2507	0.2631
ES medium-high	0.1005	0.2411	0.2508	0.2508	0.2632

167 The average ROCE is taken from the Eurostat annual sector accounts.

ES high	0.1021	0.2449	0.2449	0.2449	0.2573
Average expected increase in ROCE under the three scenarios			**0.2363**	**0.2444**	**0.2569**

Source: annexed paper Camoletto et al (2020). Note: To project ROCE for the EU-27, we use as a reference sample the 511 EU companies from 17 EU countries that that have available information in 2017 regarding the environmental and social policies, they have implemented, the processes that they have put in place and the objectives they have set themselves to achieve. We assume that the sample distribution is similar in the EU-27. The average ROCE in this sample is 0.0944 and the average ROCE in the EU-27 is 0.2265.

It is difficult to compare this result with the cost analysis done for the European Commission (BIICL et al, 2020) and expect to obtain a final comprehensive picture. Still, these results point to a **potential benefit for the EU economy deriving from all EU companies converging towards an enhancement of their environmental and social policies.**

The annexed paper has conducted a similar analysis relying on a similar yet distinct dataset, which collects data differently and more simply than the one used for the analysis presented before. In this second dataset, it is simply registered whether a company has a policy in the environmental (e.g. emission reduction) and social (e.g. child labour) area, without information on the "degree of implementation" In this second case, we are observing the effect of 'adding one more policy', without knowing to what extent it is being implemented. In this case, the increase in ES policies is still correlated with profitability, but the correlation is weaker, and it disappears for highly profitable companies.[168] Less engaging policies seem to have lower beneficial effects for companies. Finally, when disaggregating the indexes between the social and the environmental dimension, results seem to be driven by either the environmental or the social dimension, depending on the data and the specification. Observing the 'ES degrees of implementation', environmental variables seem to be the 'driver' of the positive effect on profitability. If we observe the number of policies, it is on the contrary the social dimension that shows a consistent positive effect. These last results indicate the complexity and multidimensional nature of the issue analysed.

It is important to **interpret the results** all across this section **with caution**, since this work relies on a number of restrictive assumptions that have to be borne in mind and are detailed in the paper in annex. The main assumptions are the following: first, the impact of a regulatory change is assumed to be similar to the impact in the increase in voluntary strategies. Since the regulatory change would be inspired by existing voluntary guidelines, this does not appear as a major limitation. Second, the sample used has limitations in its representativeness of EU companies, and all conclusions drawn in regard to the EU economy should be taken with caution, especially the extrapolation on the possible changes of the average ROCE. Third, the scenario construction relies on the assumption that the correlation between the ES index and the ROCE is actually a causal effect. Despite the accuracy of the estimates and the robustness checks carried out, caution is needed in interpreting the causality link between ESG accountability and profitability.

168 In a quartile regression, a positive effect is found for the two first quartiles, but it is not significant in the third and the fourth.

4.2. Social level

4.2.1. Reduced negative impacts and improved social and environmental outcomes

The main aim of a legislative initiative in the domain examined by this EAVA is to address social and environmental harm caused by corporate behaviour; the main measure of social gain therefore is the extent to which such an initiative would be able to reduce such harm and provide access to remedy for the victims.

Despite the fact that several national legislations and some sectorial EU initiatives impose mandatory due diligence obligations (French Law on Devoir de Vigilance, Dutch Law on Child Labour, UK Modern Slavery Act, EUTR, Conflict Minerals Regulation), ex-post evaluation is rarely performed. This is mainly due to the recent implementation of these measures and the difficulty of measuring impacts on the ground, arising from the very nature of these obligations (the fact that they have a broad scope and include actions to be taken in third countries, where the operations of companies and their subcontractors and suppliers are located).

In the study conducted for DG JUST[169], a large **majority of business (66 %) and stakeholder (86 %) respondents expect social impacts** from a new regulation introducing mandatory due diligence. Business and stakeholder respondents mainly expect positive impacts on labour rights, i.e. the elimination of all forms of forced or compulsory labour (78 % and 85 %, respectively), and the effective abolition of child labour (77 % and 85 %, respectively). Over 60 % of respondents expect positive impacts on all human rights areas, especially concerning the right to freedom from slavery, the rights of the child, women's rights, the right to non-discrimination/equality, the rights of indigenous persons, and the right to life, liberty and security of persons. This effect is expected to hold when considering third countries, but the study underlines that the design of the policy could create important differences, especially in fostering effective compliance and in avoiding crowding-out of EU companies to the advantage of less compliant companies from other jurisdictions (see Section 4.2.3 below). A substantial percentage of stakeholders (82 %) and about the half of businesses (53 %) consider the introduction of mandatory due diligence requirements as likely to have positive impacts on the environment.

Overall, this study[170] maintains that the mandatory process that companies would have to follow to limit their potential adverse impact is expected to have positive effects in the social-, human rights- and environmental domains.

An example of a possible positive environmental effect is provided in a recent EPRS study on EU-driven **deforestation**[171]. When analysing the potential impact of mandatory due diligence (which envisages that all economic operators who place forest-risk commodities on the EU market would have to undertake a risk assessment of their merchandise throughout the supply chain), the EPRS study finds that it would decrease deforestation and associated carbon emissions by 62 % compared to the baseline (saving up to 160.197 ha of forest and avoiding up to 45 775 855 tonnes of CO_2

[169] BIICL, Civic Consulting, LSE, Study on due diligence requirements through the supply chain, Final report on behalf of DG JUST, the European Commission, 2020.

[170] BIICL et al, 2020, Ibid.

[171] Heflich A., An EU legal framework to halt and reverse EU-driven global deforestation, European added value assessment, EPRS, 2020.

emissions). The same study underlines that this impact is substantially higher than the one potentially driven by mandatory labelling of products.

Evaluations on the **EU Timber Regulation** indicate that operators progressively require suppliers to provide evidence on the legality of the products prior to their delivery to the EU market and favour third-party verified or certified suppliers as a risk mitigation tool, and that this is encouraging sustainable forest management. Overall, the European Commission states that the EUTR has proved highly relevant in tackling illegal logging.[172]

In terms of take-up rates of non-binding initiatives, the **OECD guidelines'** impact has been evaluated in a monitoring assessment of a group of companies in the agri-food value chain performed by the OECD and the FAO:[173] interestingly, the assessment finds that companies have indeed taken steps towards due diligence, but this occurred often under pressure from existing legislation or civil society. Still, in the analysis of improvements in due diligence implementation, almost all (88 %) of participating companies had either adopted or taken steps towards adopting new formalised commitments. This share declines when it comes to taking further steps (for instance, assessing and managing the specific risks that have emerged as relevant).

As indicated by the literature on global value chains and global production networks (see Section 2.1), **governance of value chains can have substantial impacts on social outcomes on the ground**, i.e. respect for human rights and fair and decent working conditions. While voluntary CSR measures in global value chains have shown limitations[174] , the role of buyers can be relevant and can lead to increased compliance up to 35 %[175]. From this literature, we expect that a company that adheres to responsible business conduct principles and therefore adopts due diligence in the value chains, will have a positive social impact in the context where it operates and where its suppliers operate.

At this point, the present study considers two examples of interventions aiming to improve working conditions in downstream factories by involving buyer companies that use – at least partially – enforceable measures involving brands:[176] the joint ILO and IFC/WB Better Work Program[177] and the 2013 Accord on Fire and Building Safety in Bangladesh.[178] Both interventions are in the textile and garment sector.

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172 Commission Staff Working Document – Evaluation of Regulation (EU) No 995/2010 of the European Parliament and of the Council of 20 October 2010 laying down the obligations of operators who place timber and timber products on the market (the EU Timber Regulation)

173 OECD/FAO (2019), OECD-FAO Pilot project on the implementation of the OECD-FAO Guidance for Responsible Agricultural Supply Chains : Final Report, OECD Publishing, Paris.

174 Barrientos S. and Smith S. 'Do workers benefit from ethical trade? Assessing codes of labour practice in global production systems', *Third World Quarterly*, 28:4. 2007. pp. 713-729.

175 Rossi A. 'Better work: Harnessing incentives and influencing policy to strengthen labour standards compliance in global production networks', *Cambridge Journal of Regions, Economy and Society*, 8(3). 2015. pp. 505-520.

176 These are not properly cases of due diligence requirements, but they share useful similarities that will allow for some qualitative conclusions regarding due diligence obligations.

177 The Better Work Program is a partnership of the ILO with the International Finance Corporation (IFC) set up in 2007 with the objective of improving working conditions and promoting competitiveness in global apparel supply chains (Rossi, 2015). The programme aims to take stock of the lessons learned from the shortcomings of buyer-led initiatives (including ILO-sponsored ones).

178 https://bangladeshaccord.org/

The Better Work Program aims to improve workplace conditions by influencing upstream companies' behaviour in the textile and garment value chain.[179] This programme acts on the recognition that in buyer-driven value chains,[180] the role of the buying company is crucial not only in the organisation of production, but also in the respect of social standards.

Interestingly, the programme takes into account the need for a process to be put in place that involves assessing concerns, investing in managers' and workers' capacity-building, implementing workplace cooperation and social dialogue, together with the public authorities of the countries where the factories are established. The programme further recognises that there is a shared responsibility among all players involved – including buyers brands in global value chains – for the extent to which labour standards are applied. Since 2012 the program has established a binding partnership model with global brands. This move reinforced the companies' commitment to intervene to mitigate the harm resulting from non-compliance in their supply chains, still avoiding divestment. The aim was also to eliminate those sourcing practices that are themselves exacerbating labour standards violations, e.g. pressure on costs, speed and flexibility.[181]

Factories enrolled in Better Work indeed typically improve their compliance with ILO core labour standards and national labour laws.[182] Changes include improvements in compensation, contracts, occupational safety and health and working time. The programme has had an impact in reducing forced labour and coercive practices (e.g. withdrawing the passports of migrant workers), especially notably in the case of the Jordanian sample. There has been a substantial reduction in verbal abuse towards workers that appears to be often related to pressure from buyers on delivery schedules, and a reduction in sexual harassment at the workplace[183]). In terms of health and safety at work, statistically significant effects have been established in regard to water quality and exposure to chemical smells. The proportion of workers reporting injuries has declined in Indonesia and Jordan. In Jordan, the proportion of people reporting to be suffering from hunger at the workplace has declined.[184] In Vietnam and Indonesia, working hours have been decreased and the weekly pay has been raised.

Overall, participation in the programme (measured by its duration, i.e. by being in the programme longer than the median) **improves compliance** by 4.3 percentage points and the obligatory disclosure clause (the rule that cases of violations must be reported to the public) improves compliance by 3.7 percentage points.[185]

Nevertheless, it appears that the behaviour of upstream companies in the value chain still poses serious challenges (uncertain orders, late penalties, change in technical requirements and defect penalties). Buyers' practices, especially uncertain orders, lead to harmful overtime practices despite

179 Baglayan (2018) consider it as a relevant example of a 'business case' for human rights.

180 Gereffi, G. The organization of buyer-driven global commodity chains: How US retailers shape overseas production networks. In G. Gereffi & M. Korzeniewicz (Eds.), *Commodity chains and global capitalism* (pp. 95–122). Westport, CT: Greenwood Press. 1994; Rossi, 2015. Ibid.

181 Rossi, 2015, Ibid.

182 Better Work Program, Progress and Potential: How Better Work is improving garment workers' lives and boosting factory competitiveness, A summary of an independent assessment of the Better Work programme, ILO and IFC, 2016.

183 Better Work Program, 2016, Ibid.

184 Brown D. et al. The Impact of Better Work – A Joint Program of the International Labour Organization and the International Finance Corporation, Tufts University Labor Lab. 2016.

185 Holloweg C. H. Firm Compliance and Public Disclosure in Vietnam, The World Bank Working Papers. 2019.

the social commitments. This also points in the direction of more compelling requirements towards buying companies.

The **Accord on Fire and Building Safety in Bangladesh and the Alliance for Bangladesh Worker Safety** brought global retailers and brands into collaboration with other concerned stakeholders to tackle problems in factories from which they sourced their garments. This collaboration was established in the aftermath of the 2013 Rana Plaza disaster. It was signed by 190 (mostly European) companies[186] and is particularly important, since it is **enforceable** and makes international brands directly responsible for the safety of supplier-company employees.

According to researchers[187] the accord and the alliance have been perceived as a move away from an approach totally relying on voluntary action at the buyer level, to a more collaborative multi-stakeholder approach.

As of April 2020, the 1 600 Bangladeshi factories covered by the accord had addressed over 90 % of the safety issues identified in 37 000 inspections, for example, by installing fire alarm systems and sprinklers, ensuring access to emergency exits and remedying structural defects. The number of serious accidents has indeed fallen. This indicates a good degree of success in improving workplace safety, which is generally ascribed to the accord's enforceable nature. Still, limitations exist because manufacturers subcontract to companies that may not be covered by the accord.[188]

Research[189] among 1 500 Bangladeshi garment factory workers finds that the impact of participation in the accord (and/or Alliance) has been substantial in terms of many indicators of working conditions. Workers in factories affiliated with the accord or the alliance are less afraid of losing their job and more likely to receive a written letter of appointment upon recruitment. Health and workplace safety indicators improve in these factories. There is also a positive effect on workers' awareness and knowledge of codes of conduct and labour laws, and on the likelihood of their involvement in worker participation committees. The perception of a positive change in safety conditions after the Rana Plaza collapse was greater in affiliated factories by about 20 %.

Interestingly, there is a positive correlation between the perception of positive changes and the effectiveness of worker participation committees, meaning that the latter became effective due to their ability to bring about positive changes, indicating a positive role of a multi-stakeholder approach and of workers' participation and representation.

Still, the majority of workers attributed these positive changes to pressures by the buyer, possibly representing the effective incentive that the accord provided, through enforceability, for buyer companies to properly assess risks in the workplaces.

This study, on the contrary, does not find a major significant impact on wages (it is positive only when including overtime). Indeed, research confirms that aspects other than safety have seen less improvement. In Bangladesh, initial progress on workers' representation and wage levels in 2013 has not been followed by sustained improvement, and the downward pressure on costs has

[186] Russell M., Textile workers in developing countries and the European fashion industry. Towards sustainability?, briefing, EPRS, European Parliament, 2020.

[187] Kabeer N., Huq L. and Sulaiman M. Paradigm Shift or Business as Usual? Workers' Views on Multi-stakeholder Initiatives in Bangladesh. Development and Change. 2020.

[188] Russell M., 2020, Ibid.

[189] Kabeer N. et al, 2020, ibid.

continued: a 2018 research on ready-made garment suppliers in Bangladesh[190] finds out that the average FOB price was US$4.64 in 2016, which is a 7.79 % decline from a FOB price point of US$5.03 in 2011. The price point declined by 10.67 % for US buyers and by 9.04 % for EU buyers.

This indicates, as stated in an EPRS briefing,[191] that 'manufacturers are unlikely to offer their workers better conditions unless they can pass on at least some of the additional costs to purchasers, but so far this is not happening.' (p. 7). This indicates that another relevant factor for improving working conditions – especially in some sectors – would be to address those sourcing practices that are themselves exacerbating labour standards violations.

These two brief 'case studies' provide examples of **positive consequences on fundamental labour rights and working conditions in factories being embedded in 'responsible value chains'**. It appears that buyers' responsible business conduct can have a substantial impact on compliance of downstream companies, and this is reflected in better working conditions, including when measured by perceptions of workers. Interestingly, studies find that a single responsible (or 'reputation-conscious') company can do much less than the entire group of companies sourcing from the same factory or area. Being employed in a company that is part of a 'responsible value chain' appears to have benefits for workers and, in the case discussed, this appears to be related to the fact that:

- **enforceable** measures are in place that hold companies responsible for violations in the supply chains;
- a **multi-stakeholder process** is established that involves the assessment of concerns, social dialogue, involvement of public authorities;
- there is ex-ante **integration** of the requirements to protect human rights and the environment in companies' **business practices**, e.g. to limit sourcing practices that further exacerbate labour standards violations (e.g., pressure on delivery schedules and cost-reduction pressure), which still appear as a major concern also in contexts where major advancements have taken place.
- greater **participation of workers** is favoured in decisions and initiatives at the factory level concerning workplace conditions;
- a greater effect is expected when **several companies** sourcing from the same factory or area adopt a higher standard of responsibility.

The introduction of due diligence obligations is expected to favour the abovementioned factors, pointing in the direction of a **potential significant impact** in addressing environmental damage and human rights violations.

The positive impacts in terms of reduced social and environmental harm and enhanced human rights protection could be limited by a number of factors, including low compliance by companies and their resorting to 'quick responses', such as divestment from areas where risks of violations are higher. This second aspect is discussed in greater detail in Section 4.2.3 below.

[190] Anner M., Binding power: The sourcing squeeze, workers' rights, and building safety in Bangladesh since Rana Plaza, Center for Global Workers' Rights, 2018.

[191] Russell M., 2020, Ibid.

4.2.2. Economic consequences of human rights and labour standards protection

As discussed at the beginning of this study, the global economic arena can be seen as a context of strategic complementarities, where the rule-systems that encourage players to act in an undesirable way can create incentives for other players to act similarly undesirably.[192] There is indeed a gain from coordinated action aimed at reducing the incentives to lower social and environmental standards, and to avoid a 'race to the bottom' as also acknowledged by the European Commission.[193]

Moreover, from a macroeconomic perspective, several strands of literature underline a positive correlation between rights protection and economic performance of countries.

The main reference in this respect is the work of the Nobel Prize winner, economist Amartya Sen, who developed a right-based definition of development that incorporates 'substantial freedoms' ('capabilities')[194]. Sen argues that political liberties and civil freedoms are directly important in their own right, but are also a necessary tool for sound economic development, while economic growth *per se* does not necessarily lead to increased human rights. In line with this approach, McKay and Vizard[195] argue in their review that there is no trade-off between human rights and economic growth and, on the contrary, there are several complementarities.

Another field of literature focuses on the 'quality' of institutions[196], underlying the role of rule of law for long-term growth. Haggard and Tiede[197] identify a specific relevant role for institutions that guarantee the security of the person and freedom from violence. While Acemoglu and co-authors point to property rights protection as being a major driving factor, Haggard and Tiede find a more relevant role for control of corruption, suggesting private capture may be as damaging as predatory governments.[198]

Specifically focusing on human rights, Marslev and Sano[199] identify and explore four possible pathways through which human rights may affect economic growth: 1) reduced economic inequality, 2) human development, 3) effective institutions and governance, and 4) absence of conflict and political instability. The authors argue that the four aspects are causally linked to economic growth.

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192 Reddy S. G.,, International Trade as a Means to Diverse Ends: Development, Workers, the Environment, and Global Public Goods. in De Schutter, O. (2015). Trade in the service of sustainable development: Linking trade to labour rights and environmental standards. Bloomsbury Publishing. 2015.

193 European Commission, 2017 reflection paper on Harnessing Globalisation.

194 Sen A. *Development as Freedom*, Oxford Paperbacks. 2001.

195 McKay A. and Vizard P. 'Rights and Economic Growth: Inevitable Conflict or 'Common Ground'?', Overseas Development Institute. 2005.

196 Among others, Barro R. J. 'Determinants of economic growth in a panel of countries', *Annals of economics and finance*, 4. 2003. pp. 231-274; Acemoglu D, Johnson S, Robinson J., Institutions as the fundamental cause of long-run growth. In Handbook of Economic Growth, Vol. 1A, ed. P Aghion, S Durlauf, Amsterdam: North Holland. 2005. pp. 385–472.

197 Haggard S. and Tiede L., 'The rule of law and economic growth: where are we?', *World Development*, 39(5), 2011. pp. 673-685.

198 The EPRS has produced a report on the Cost of Non-Europe in the Area of Organised Crime and Corruption, which specifically measures the GDP lost in the EU because of corruption.

199 Marslev K. and Sano H-O. 'The Economy of Human Rights. Exploring Potential Linkages between Human Rights and Economic Development'. *Matters of Concern,* the Danish Institute for Human Rights, Copenhagen. 2016.

On the empirical side, a cross-country analysis by Blume and Voigt[200] does not find a significant negative impact of human rights on welfare and growth. Specifically, basic human rights have a positive effect on investment, while social rights contribute to productivity improvements.

A more recent empirical analysis has been conducted by the Danish Institute for Human Rights[201]. Observing how empowerment has developed over a 10-15-year period, the authors find that there is a significant causal effect[202] of freedom and participation rights on economic growth.in the long term. The same causal effect is not found in the other direction, meaning that economic growth *per se* does not yield greater freedom and participation rights. They construct an 'empowerment index' encompassing freedom of domestic and foreign movement, freedom of speech, freedom of assembly and association, workers' rights, electoral self-determination and freedom of religion. They find that a permanent one-unit increase in the empowerment index in a given country will increase growth (in that country) by approximately 0.62 percentage points in the long run.

Similarly, Bazillier[203] finds a positive long-term impact of labour standards on per capita income. He takes into account factors such as the ratification of ILO conventions and compliance with standards against child labour, in favour of freedom of association and collective bargaining, against gender discrimination and against forced labour. In his analysis, all things being equal (meaning for same levels of investments, human capital, labour force composition), labour standards have a positive impact on long-term per capita income. The coefficient has a mean of 0.50, which is higher than the estimated coefficient of education or investment. A one standard deviation change in the log variable of labour standards (0.88) will increase the GDP per capita by 44 %. It has to be noted that one standard deviation change is an important change: the author argues that, for a country like Burundi, it would mean to switch to the labour standard value of Bulgaria.

The expected positive effects especially work through productivity and human capital accumulation. Freedom of association and unionisation are expected to strengthen workers' voices, making it more likely that conflicts will be resolved through discussion rather than pressure,[204] and to decrease turnover, making it more likely that employees will develop valuable job-specific skills and that employers will invest in long-term training, thereby contributing to productivity growth. Cheap and vulnerable labour, besides being a problem for workers and their families' wellbeing, may weaken incentives for companies to lower their costs by developing or adopting new technologies, thus harming productivity growth. Positive impacts on human capital are moreover expected by the eradication of child labour and of forced labour, by an increase in unionisation (because of the lower turnover), and by the decrease of discrimination on the labour market connected to inequalities in access to education.[205]

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200 Blume L. and Voigt S. 'The Economic Effects of Human Rights'. *Kyklos,* Vol. 60 No 4. 2007. pp. 509– 538.

201 Koob S. A., Jørgensen S. S. and Sano H. O., 'An Econometric Analysis of Freedom And Participation Rights', *Matters of Concern working papers,* the Danish Institute for Human Rights, 2017/1. Copenhagen. 2017

202 Using a Granger causality test.

203 Bazillier R. 'Core labor standards and development: Impact on long-term income', *World Development,* 36(1). 2008. pp. 17-38.

204 Baglayan et al (2018) propose as an example that in the apparel sector in Cambodia in 2014, forced overtime, poor working conditions, low wages, and anti-union discrimination by factories that supply companies like H&M and Zara resulted in reoccurring strikes of tens of thousands of workers across 300 factories.

205 Baziller, 2008, Ibid.

4.2.3. Costs and risks

Costs for the economy due to increased costs of imports:

In the absence of a proper macroeconomic simulation, it is not possible to assess how increased costs of imports are going to influence the costs for the economy. We can nevertheless make some assumptions based on a recent EPRS study focusing on supply chain due diligence to halt deforestation.[206]

According to the EPRS study, these costs appear to be relatively low. The GDP is expected to drop by about 0.001 % because of the introduction of due diligence requirements in the value chains of forest risk commodities. The main reasons for this is that the costs of implementing due diligence appear to be small when considered as a share of values traded, and are not expected to substantially decrease demand.

Risk of the 'tick-box exercise':

The fact that due diligence is understood as a set of policies to have on paper represents a risk, since it lowers the effectiveness regarding social outcomes (the NFRD case has shown that companies often have a policy in place, but no detailed objectives).

It would also represent a missed economic opportunity for companies, since the positive effect on companies identified in Section 4.1.3 is expected to be smaller: the analysis shows that the positive correlation between environmental and social policies and profitability is weaker if we look at the simple number of policies that companies have. Although imprecisely, this measure can approximate the effect of policies that exist 'on paper' instead of measuring how practically effective they are. For medium-high profitable companies, 'ticking another box' does not increase performance.

Costs for SMEs:

SMEs are also present in the sectors where there is a higher risk of social and environmental harm and, although to a lesser extent than big businesses, they also engage in international sourcing. There is evidence of the involvement of SMEs in global value chains.[207]

As mentioned in Section 4.1.2, the European Commission's study[208] finds that costs/employee are substantially higher for SMEs. The study argues that small companies with low profit margins are more likely to be driven out of business than large companies with low profit margins.

At the same time, the study acknowledges that due diligence includes a prioritisation exercise based on severity of risks, which in its turn is based on sector, location and type of production activities, complexity of the value chain, etc. 'An application whereby a micro business is expected to undertake disproportionately burdensome activities that these activities drive it out of business, would not be a correct interpretation of the standard'. Moreover, if due diligence is expected from

206 Heflich A., An EU legal framework to halt and reverse EU-driven global deforestation, European added value assessment, EPRS, 2020.

207 For example, Lernborg C. M. and Sendlhofer T. The case of [partial] organising for CSR: Bridging the responsibility gap for SMEs. In Kallifatides, M., & Lerpold, L. Sustainable development and business: an introduction. Sustainable development and business. Stockholm School of Economics. 2017.

208 BIICL et al, 2020, Ibid.

all players in the supply chain, small businesses are likely to have lower costs, as they would mainly need to focus on their own risks.

However, the creation of differentiated regulatory regimes for big and small companies poses potential problems. It creates the incentives for big companies to outsource to small companies exactly because they have lower regulation, as it has been pointed out in the case of labour regulation. It moreover risks creating incentives for companies to 'stay small' to avoid regulation, or creating bottlenecks to growth for SMEs that would otherwise have the chance to increase in size.

Interestingly, Lernborg and Sendhofer[209] highlight some cases of Swedish SMEs that have been frontrunners in developing corporate social responsibility initiatives, for example, in the 'textile industry in which Nudie, a small Swedish brand, implemented a living wage at its supplier, something which allegedly "could not be done" according to fashion giant H&M' (p. 286). The authors suggest that SMEs establish some form of organisation with each other as a way to circumvent the high costs of CSR they may face.

Costs of excluding non-EU companies operating in the EU:

This risk of creating a disparity of treatment between EU companies and non-EU companies placing products in the EU, thus creating the risk of a disadvantage for EU companies, is an important concern.

The Fundamental Rights Agency in its 2017 opinion[210] stated that 'In addition to EU companies, any business acting within the EU would certainly have to comply with EU standards'.

In the same direction, the Shadow EU Action Plan on the Implementation of the UNGPs[211] presented in 2019 by the European Parliament's Responsible Business Conduct Working Group (RBC Group) recommended, as a tool for the implementation of Pillar I of the UNGPs, the adoption of mandatory due diligence for *both* EU businesses and businesses operating within the EU.

This is indeed the solution adopted by the Dutch Child Labour Due Diligence Act, whose provisions cover companies operating on the Dutch market regardless of whether they are registered in the Netherlands.

Cost for the public administration:

The NFRD impact assessment assumes that there would be no substantial budgetary increase for its implementation.[212]

On the contrary, the Conflict Mineral Regulation, under the option of mandatory due diligence as per the OECD guidelines[213], expects an increase in human resources equal to 2 full-time-equivalents

209 Lernborg and Sendhofer, 2016, Ibid.

210 Fundamental Rights Agency, Improving access to remedy in the area of business and human rights at the EU level. Opinion of the European Union Agency for Fundamental Rights. 2017.

211 Responsible Business Conduct Working Group, 'Shadow EU Action Plan on the Implementation of the UN Guiding Principles on Business and Human Rights within the EU', March 2019.

212 Commission Staff Working Document Impact Assessment Accompanying The Document Proposal For A Directive Of The European Parliament And Of The Council amending Council Directives 78/660/EEC and 83/349/EEC as regards disclosure of non-financial and diversity information by certain large companies and groups.

213 European Commission (2014), Impact Assessment Accompanying the document Proposal for a Regulation of the European Parliament and of the Council setting up a Union system for supply chain due diligence self-certification of responsible importers of tin, tantalum and tungsten, their ores, and gold originating in conflict-affected and high-risk areas..

(FTEs) for implementing guidance and 1.5 FTE per Member States (control body), plus some costs for setting up a study and management committee (€200 000 + €120 000/year), to which inspection costs should be added.

The study commissioned by DG JUST[214] reviews some other cases. Overall, it seems that costs for public administrations can be expected to be quite moderate.

Risks of EU companies leaving from high-risk areas.

In terms of impacts on the ground, a mixed picture emerges from the analysis of the impact of Section 1502 of the Dodd-Frank Act, the US law on conflict minerals (2010) requiring publicly traded companies to ensure that the raw materials they use to make their products are not tied to the conflict in Congo.

A first assessment by The Enough Project,[215] which conducted field research in 2015 and 2016 in eastern Congo, found positive impacts and increased security for civilians in some mining areas and a significant reduction in armed group control in tin, tungsten and tantalum ("3T") mining areas. Conversely, subsequent studies found negative unintended effects due to the fact that the law acted as a *de facto* ban on the import of minerals from the area, thus impacting negatively the livelihood of the households depending on mining incomes[216] a study finds a steep increase in child mortality because of a decrease in income of women). Subsequently, a new study[217] criticised these previous ones indicating that they were based on outdated data and that the negative impacts were fading out.

Despite these criticisms, the studies point to a potentially real risk: that of companies divesting from areas where the risks of human rights violations are considered too high. There is moreover the risk that the 'empty space' left by EU companies would be filled by non-complying companies.

It should be noted that the Dodd-Frank Act has some specificities that are not present in the EU Resolution on Conflict Minerals, notably the fact that it has singled out a specific conflict country, the Democratic Republic of Congo, thereby establishing a *de facto* 'ban' on imports from this country. This is an important difference between this case and a potential cross-sector EU legislation mandating due diligence.

The study done for DG JUST underlines that literature has also shown that companies very rarely terminate their business relations on the basis of social and human rights concerns. In addition, due diligence is a process that should not, in principle, act as an outright ban, but as a establishing a process of progressive improvement that may lead to divestment/breaking of the commercial relationship only as solution of last resort.[218]

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214 BIICL et al, 2020, Ibid.

215 Enough Project, Point of Origin: Status Report on the Impact of Dodd-Frank 1502 in Congo, 2016.

216 Parker D. P., Foltz J. D. and Elsea D. 'Unintended consequences of sanctions for human rights: Conflict minerals and infant mortality', *The Journal of Law and Economics*, *59*(4). 2016. pp. 731-774.

217 Koch D. J. and Kinsbergen S. ' Exaggerating unintended effects? Competing narratives on the impact of conflict minerals regulation', *Resources Policy*, *57*. 2018. pp. 255-263.

218 BIICl et al, 2020, Ibid.

5. Conclusions

The starting point of this study is the evidence of the **impact of businesses on human rights and environmental protection in the places where they operate**, which are sometimes far from the country where the company is registered. The persisting evidence of negative impacts – including by EU companies and companies operating in the EU – despite numerous national and international actions, is the basis for the inquiry into the potential effects of **EU action**.

The EU has competence to harmonise national company laws so as to afford companies freedom of establishment, and to approximate legislation so as to ensure the **proper functioning of the single market**. Furthermore, both in its internal and its external action, the EU is committed to **respect for human rights and the environment**.

The present study has focused on a potential measure that **requires companies to carry out due diligence to identify, prevent, mitigate and account for actual or potential human rights and environmental impacts in their own operations or supply chains.**

Overall, the **European added value of such a measure appears significant,** even though it has not been possible to quantify all of its components.

Using Figure 8 as a framework, we expect that mandatory measures would increase **compliance** to standards such as the OECD guidelines and the UNGPs, which represent crucial steps in the right direction, but appear to be integrated in a minority of companies' business practices. According to the Fundamental Right Agency and to several scholars, effective due diligence practices can also help to strengthen **access to remedy for victims.** This impact can be substantial, even though it may depend on the quality of enforcement and on the design of the legal aspects, as revealed in the debate on the French Law on Devoir de Vigilance regarding the possible reversal of the burden of proof.

Action at the EU level would allow to **harmonise the rules** within the single market, which would support its good functioning and favour the creation of a **level playing field** favouring fair competition. The increase in **legal certainty** is expected to be substantial, since EU-level due diligence requirements could address the concern raised by many businesses regarding the lack of clarity in their duties. A unique standard set by law and therefore non-negotiable would support current good practices and would give companies **greater leverage** over their suppliers.

From a **companyperspective**, mandatory due diligence would have costs of implementation and impacts on economic performance. Most literature indicates that **costs** should be overall moderate and represent a relatively small share of revenues. This can vary depending on company type (and especially size) and be important in some cases. Due diligence costs are expected nevertheless to depend on the risk that the company generates, which depends in turn on several factors, including sector, type of activity, international nature of activities, and complexity of the value chain.

The **impact on company outcomes** is usually considered to be **positive** in the literature on corporate social responsibility, responsible business conduct and environmental, social and governance accountability. The present study finds evidence in the same direction by studying a sample of EU companies that provides information about the social and environmental policies they are currently implementing. Companies with a higher implementation rate have also better performance indicators on average.

Indeed, the study finds a **positive correlation between the extent to which environmental and social policies are implemented by companies and their measure of profitability** (return on capital employed, ROCE). Interestingly, this correlation is stronger for companies that have international operations. For an increase in one step of implementation of environmental and social policies, the estimated potential increase in return on capital is 2.26 %.

Bearing in mind the limitations and the assumptions of the analysis and therefore the caution that should be used, it is possible to construct scenarios for 'upward harmonisation', where EU companies are simulated to have increased their incorporation of environmental and social policies. The increases that could possibly be expected in companies' profitability are summarised in the table below. Greatest benefits are expected to accrue to companies that start from lower values, e.g. in the 'convergence to top performer' scenario, the group with a lower current application of ES policies could see an increase in ROCE of about 4 %.

Table 10: Summary of the 'upward harmonisation' scenarios: potential impacts on EU companies' profitability

Degree of ESG implementation	Increase in ROCE 'one-step increase'	Increase in ROCE 'convergence to top performer'	Increase in ROCE 'convergence to top'
ES low	1.74 %	4.01 %	5.24 %
ES medium-low	1.29 %	2.26 %	3.5 %
ES medium-high	0.97 %	0.97 %	2.21 %
ES high	0 %	0 %	1.24 %
Average expected increase in ROCE under the scenario	**1 %**	**1.89 %**	**3.05 %**

Source: authors' elaboration on annexed paper by Camoletto et al (2020).

By projecting these expected changes on the population of EU companies (which is another step to be taken with caution), we could expect a change in ROCE from the current value of 0.226 (Eurostat data), to a value of 0.244.

Concerning the desired social outcome, i.e. the **reduction in human rights violations and environmental negative impacts, the impact of due diligence obligations is expected to be significantly positive.**

There is evidence that integration in international trade and especially in global value chains, together with a potential for growth and poverty reduction in the Global South, has possible downsides and risks, and that the benefits of integration in GVC **crucially depends on 'how' this integration comes about**.

There is indeed important **scope for regulation and international cooperation.** The EU can play a crucial role in shaping international production and trade, in a way that supports human rights (including social standards) and environmental protection, and follows a path of socially and ecologically sustainable growth.

In support of the above, a recent EPRS study focusing on the potential impact of mandatory due diligence to halt and reverse global deforestation finds that it may reduce global **deforestation** by about 62 %.

Through a review of some case studies, the present EAVA finds that **being employed in a company that is part of a 'responsible value chain' has benefits in terms of social standards faced by workers** and, in the case discussed, this mainly depends on some factors including:

- the enforceability of measures that hold companies responsible for violations in the supply chains;
- a multi-stakeholder process that involves the assessment of concerns, social dialogue, involvement of public authorities, and the participation of workers in decisions and representative bodies;
- the integration of compliance with human rights and environmental protection in business practices, e.g. to limit those sourcing practices that exacerbate labour standards violations;
- the extent to which several companies sourcing from the same factory or area adopt a higher standard of responsibility.

These characteristics appear potentially relevant to due diligence processes and point in the direction of a **potential significant impact** in addressing environmental damage and human rights violations.

Improvements in the respect of human rights and social standards have in turn positive impacts on economic growth, as shown by research findings. The table below summarises these findings.

Table 11: Summary table of the European added value accruing from the introduction of due diligence obligations in the supply chain

	Status quo (including voluntary measures)	Mandatory supply chain DD for all companies	
Improve compliance and access to remedy	Limitations in compliance to international guidelines (e.g. the UNGPs) and gaps in access to remedy for victims	Expected increase in compliance if obligations are introduced, and expected increase in access to remedy for victims	++
Harmonisation and level playing field	Lack of level playing field among EU companies	A unique EU set of legal obligations is expected to level out current disparities	+++
Legal certainty	Gaps in legal certainty on duties that companies have to respect	A unique EU set of legal obligations is expected to increase legal certainty on company duties and increase their leverage over suppliers	+++
Potential for EU companies	Greater costs, but evidence of increased performance for more responsible companies	DD is expected to increase costs for the companies that are currently not conducting it, but it could also enhance their performance, possibly outweighing the costs. Potential increase in average profitability of EU companies	+
Social outcomes and their effect on the economy	There is evidence of violations of human rights and environmental standards related to business activities.	Positive Impact on respect for human rights, social and environmental standards is expected to increase in countries where business operations	++

		are located, both within and outside the EU	

Source: author's elaboration.

The present study identifies a number of **possible risks and gaps** deriving from the proposed regulatory instrument. This indicates that the details of the implementation may be important in precisely defining costs and benefits.

Overall, it has to be remembered that this study constitutes a piece in a bigger picture and has obvious limitations, and should therefore be seen as a partial exploration. The analysed regulatory instrument should be seen within a broader context of measures (including economic, industrial and trade policies, international cooperation and external action) and in the framework of possible enhancements at global and multilateral level as regards possible regulation.

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APPENDIX

International and EU-level obligations of EU and Member States concerning Human Rights and the environment

The EU and Member States have a number of obligations, including the following:

The Universal Declaration of Human Rights

The International Covenant on Civil and Political Rights

The International Covenant on Economic, Social and Cultural Rights

The principles concerning fundamental rights in the eight ILO core conventions

The Declaration on Fundamental Principles and Rights at Work

The International Convention on the Elimination of All Forms of Racial Discrimination

The Convention on the Elimination of All Forms of Discrimination against Women

The Convention against Torture and Other Cruel, Inhuman or Degrading Treatment or Punishment

The United Nations Convention on the Right of the Child

The International Convention on the Protection of the Rights of All Migrant Workers and Members of Their Families

The Convention on the Rights of Persons with Disabilities

The International Convention for the Protection of All Persons from Enforced Disappearance

The United Nations Declaration on the Rights of Indigenous People

The Convention for the Protection of Human Rights and Fundamental Freedoms ('European Convention on Human Rights')

The Charter of Fundamental Human Rights of the European Union

The UN Guiding Principles on Business and Human Rights

The Paris Agreement on climate change

The UN 2030 Agenda for Sustainable Development of 2015

The ILO Tripartite declaration of principles concerning multinational enterprises and social policy ('MNE Declaration') of March 2017

The ILO Centenary Declaration for the Future of Work of 2019

The Beijing Declaration and Platform for Action of 1995

The Women's Empowerment Principles of 2010

Characteristics of the market

A summary overview of the panorama of EU-27 companies is the following. The manufacturing subsectors selected in the table below are those where it appears on average a greater exposure to risk of human rights and environmental standards violations, but it has to be borne in mind that the risk can be widespread across the economy (FRA, 2019).

Table 12: Number of EU companies in selected sectors by size

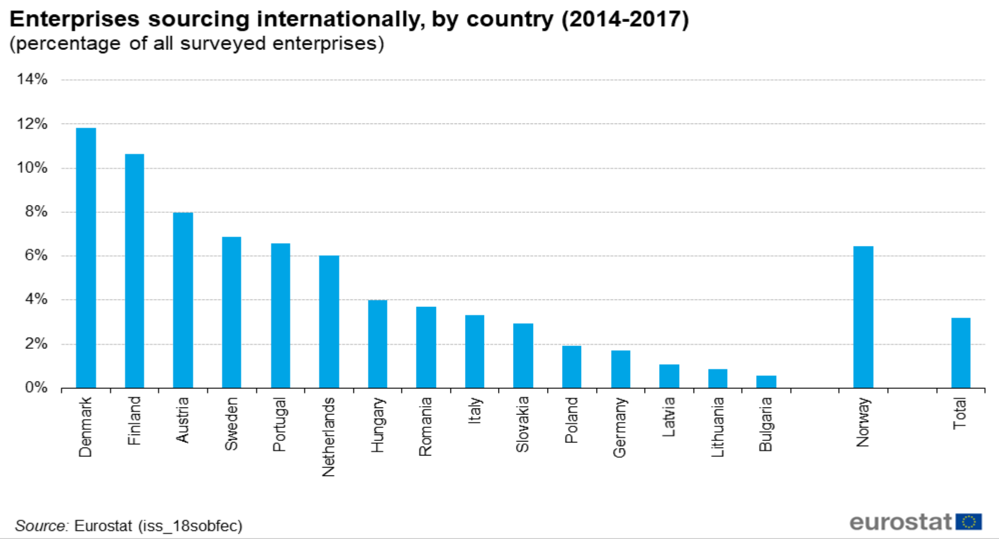
NACE_R2/SIZE_EMP	Total	0-9	10-249	250 +
B-N_S95_X_K - Total business economy; repair of computers, personal and household goods; except financial and insurance activities	22.234.234	20.000.000	651.994	41.491
B - Mining and quarrying	17.507	13.500	3.808	166
C - Manufacturing	1.964.946	1.635.774	313.588	15.400
C10 - Manufacture of food products	251.655	200.753	48.700	2.140
C11 - Manufacture of beverages	29.000	24.000	925	
C12 - Manufacture of tobacco products	315	175	35	
C13 - Manufacture of textiles	56.300	48.000	4.500	257
C14 - Manufacture of wearing apparel	118.782	103.979	14.459	
C15 - Manufacture of leather and related products	37.200	29.451	7.624	169
C20 - Manufacture of chemicals and chemical products	27.000	18.104	8.022	775
C26 - Manufacture of computer, electronic and optical products	34.000	26.000	7.830	600
D - Electricity, gas, steam and air conditioning supply	98.557	93.700	4.270	600
E - Water supply; sewerage, waste management and remediation activities	71.347	56.000	14.151	
F - Construction	3.193.012	3.004.881	186.507	1.580
G - Wholesale and retail trade; repair of motor vehicles and motorcycles	5.765.980	5.401.096	358.000	6.960
G45 - Wholesale and retail trade and repair of motor vehicles and motorcycles	796.455	745.657	44.000	700
G47 - Retail trade, except of motor vehicles and motorcycles	3.295.208	3.132.796	159.050	3.433
H - Transportation and storage	1.157.424	1.049.642	104.355	3.426
I - Accommodation and food service activities	1.850.461	1.656.044	193.240	1.500
J - Information and communication	1.020.448	960.259	57.606	
L - Real estate activities	1.319.778	1.296.964	21.781	342
M - Professional, scientific and technical activities	4.179.909	4.053.854	123.288	2.300
N - Administrative and support service activities	1.401.997	1.295.077	100.900	6.018

Source: author's elaboration based on Eurostat Structural Business Statistics.

A possible, though not the only, source of exposure to risks of the international dimension of production.

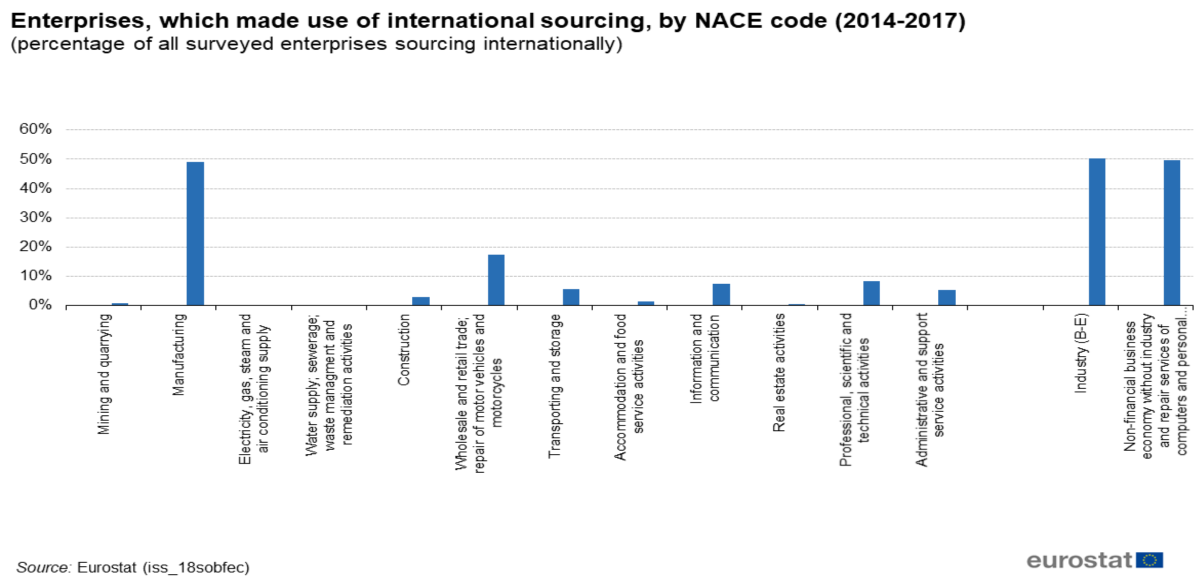
The prevalence of businesses that resort to international sourcing by country and sector is displayed below, using data from the International Sourcing (IS) survey done by Eurostat in 16 European countries, covering the periods 2014-2016 and 2015-2017. The survey results cover nearly 60 000 businesses each with more than 50 persons employed.[219]

Figure 12: Enterprises sourcing internationally, by country (2014-2017)



Source: Eurostat, International Sourcing Survey

Figure 13: Enterprises, which made use of international sourcing, by NACE code (2014-2017)



Source: Eurostat, International Sourcing Survey

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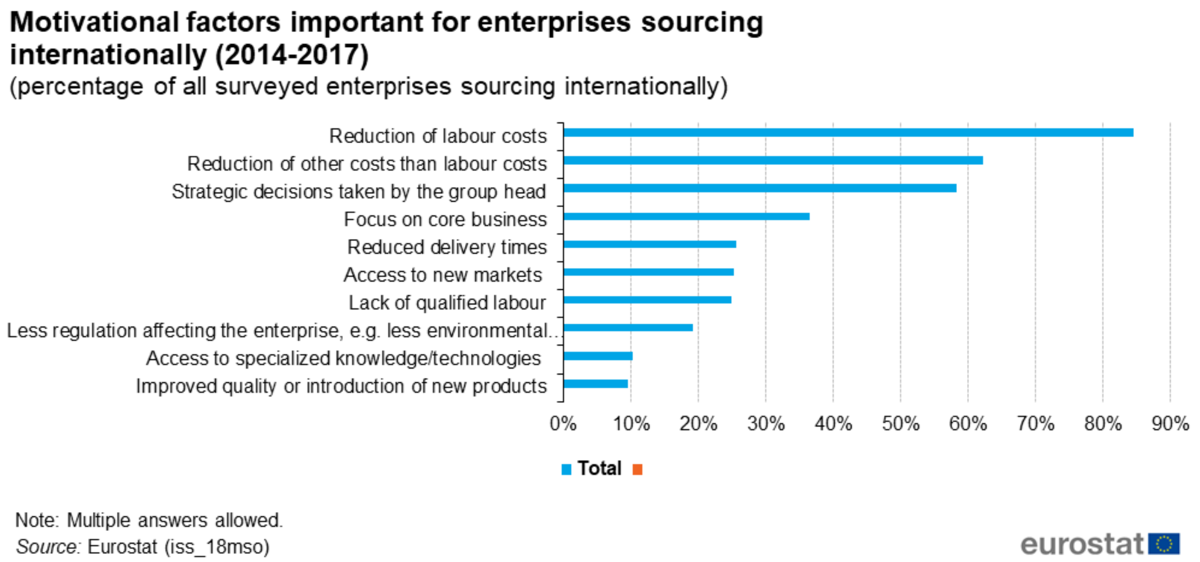
[219] https://ec.europa.eu/eurostat/web/structural-business-statistics/global-value-chains/international-sourcing and https://ec.europa.eu/eurostat/statistics-explained/index.php?title=International_sourcing_and_relocation_of_business_functions

Figure 14: Motivational factors important for enterprises sourcing internationally (2014-2017)



Source: Eurostat, International Sourcing Survey

Table 13: Regression results of aggregated index of 'ES degree of implementation' on ROCE in 2018 (1) all sample and (2) only companies that have international operations.

Dependent variable:	Return on capital employed (ROCE)	
Estimator:	OLS (year 2018)	
Variables	(1)	(2)
CSRDegree_Index	0.0226*** (0.008)	0.0320** (0.014)
SIZE	-0.0118*** (0.004)	-0.0176*** (0.006)
Debt ratio	-0.0003 (0.000)	-0.0004 (0.000)
INT	0.0089 (0.009)	
Board_size	-0.0008 (0.001)	-0.0013 (0.002)
Board_ind	0.0002	-0.0000

	(0.000)	(0.000)
Technology	0.0351 (0.026)	-0.0383 (0.039)
Telecommunications	0.0177 (0.026)	0.0173 (0.044)
Health care	0.0097 (0.024)	0.0127 (0.037)
Financials	-0.0144 (0.023)	-0.0045 (0.032)
Real States	0.0149 (0.027)	-0.0102 (0.041)
Consumer discretionary	0.0636*** (0.022)	0.0826*** (0.031)
Consumer staples	0.0549** (0.025)	0.0456 (0.036)
Industrials	0.0359* (0.021)	0.0230 (0.031)
Basic materials	0.0252 (0.024)	0.0106 (0.038)
Energy	0.0398 (0.027)	0.0297 (0.039)
Observations	511	219
R-squared	0.144	0.263
R^2 adjusted	0.116	0.2083

Source: Camoletto et al (2020), paper in Annex. Note: Regression (1) and (2) results respectively for 511 and 219 EU firms that have a non-missing information in 2017 regarding the undertaken environmental and social policies, the processes that are put in place and the established objectives to be achieved. Independent and controls variables are introduced in the analysis with one-year lagged. The reported significance levels are: * 10 %, ** 5 %, *** 1 %.

Annex

An estimation of the economic impact of Environmental, Social and Governance due diligence and corporate accountability for EU companies

A firm-level analysis

This study aims at exploring possible impacts deriving from the adherence to Corporate Social Responsibility measures and Environmental Social and Governance practices by all European firms. This exploratory analysis contributes to the scientific debate on the topic by providing empirical evidence on the economic impact of Environmental, Social and Governance due diligence and corporate accountability practices at the firm-level.

In the first part, the paper provides a literature review on key issues related to Corporate Social Responsibility, Environmental Social Governance due diligence, Responsible Business Conduct and "shared value" in order to shed light on the main academic, policy and institutional contributions that helped the development of these interconnected concepts and their empirical implementation. Moreover, this first part allows to identify the results of the main empirical studies that analyse firms' performance in relation to their implementation of ESG/CSR policies.

In the second section, a two-fold empirical research, relying mainly on Asset4-Thomson Reuters datasets, is performed. The first step, through econometric analysis, allows to measure the potential percentage change of firm performance associated to a change in the Environmental Social Governance score. The second step, by relying on the 'elasticity' estimated in the first step, constructs different 'upward harmonisation' scenarios, describing what would happen to EU companies if they all moved to higher Environmental Social Governance scores.

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Executive summary

The main purpose of this empirical investigation is to shed light on Corporate Social Responsibility and Environmental Social Governance due diligence practices and implementation in EU: this work paves the way for a comprehensive understanding of the possible impacts of CSR/ESG practices on firm performance in the European economic landscape.

As suggested by our literature review, the interconnected concepts of CSR, due diligence on Environmental Social and Governance risks, and Responsible Business Conduct, despite their different academic and institutional origins, are often used interchangeably. We discuss their interconnectedness and specificities, discussing the main elements of their theoretical foundations.

Although the increasing amount of literature on CSR, ESG and RBC reveals an ever-growing interest on the subject by both the academic and the institutional world, only a few works empirically investigate this pressing topic in Europe and, in this regard, the literature has pointed out the difficulties on the creation of a unique and comparative "European" CSR index. These difficulties relate to both the complexity of this topic as well as the limited availability of data.

Nevertheless, our empirical literature review unveils a general positive correlation between CSR/ESG practices implemented by firms and their improved corporate performance. As a matter of fact, the empirical literature points out that the implementation of CSR/ESG policies can translate into 1. lower cost of debt, 2. increased market share, 3. better product quality, 4. competitive advantages, 5. improved reputation and 6. brand value; better stakeholder governance can moreover trigger 7. improved employee productivity and talent acquisition/retention, which in turn 8. may improve government and civil society relationships and, whenever the case, can 9. lower risk and adverse event costs for companies.

In the empirical investigation, the paper aims at assessing the complex and empirically underexplored topic of CSR and ESG accountability policies in EU. This work exploits an innovative database called Asset4-Thomson Reuters. This database allows to go beyond the generation of single case studies at the EU level. It offers the opportunity to implement a data driven investigation of ESG accountability practices, that we will consider as an approximation for companies' adoption of due diligence procedures in EU. However, it is important to remember that this exploratory study, differently from the works analysed in the literature review, is not based on long time-series, but the findings are coherent with the cited literature.

Our empirical strategy implements a two-step analysis. The first step inquires the correlation between firm performance and CSR/ESG policies, and the second one describes possible "upward harmonization" scenarios.

By investigating the correlation between a CSR index and firm performance, the first step of the analysis offers a measurement of the potential percentage change of firm performance associated to a change of ESG score (i.e. an "elasticity"). We implement several empirical models by using the most common performance measures such as Tobin's Q and Return on Capital Employed (ROCE). We focus on ROCE for the construction of the scenarios in the second step.

In this second step, indeed, we identify four categories of "CSR performance" (based on environmental and social indicators): low performers, medium-low performers, medium-high performers, and high performers. Starting from these four groups of firms, the scenario analysis presents three alternative future developments: a less ambitious scenario, where companies do a "single jump" in the CSR scale (i.e. the low performers reach the medium-low performers, the low-medium performers reach the medium-high performers and so on); an ambitious scenario, where all firms reach the CSR index of the high performers; an "idealistic" scenario, that describes a situation where all companies move to the maximum possible value of the CSR index. After the exploration of the different scenarios, the second part of the empirical analysis proposes a robustness check and a further analysis that exploits a different dataset within the Asset4-Thomson Reuters database.

Our findings confirm the positive correlation between environmental and social accountability practices and firm performance and the estimated elasticity presents a magnitude coherent with some of the most outstanding contributions in the field, such as Hasan et al.'s (2018). Both the robustness check and the further analysis based on the second dataset confirm the positive correlation between CSR indexes and firm performance. Concerning the construction of the three scenarios, it appears that the first scenario could represent short-term impacts, while we argue that it is only in the long term that firms can adjust their CSR practices by strongly reconfiguring their processes, as in the more ambitious scenarios. Of course, by looking at the results of our analysis, the impact on ROCE of the less ambitious scenario is lower than the impact of the more ambitious ones, but it still presents large gains.

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1. Conceptual literature review on the interconnected concepts of CSR, ESG, DUE Diligence and derived categories drawing on main academic and institutional contributions on the subject

1.1. CSR concept origins and main contributions on the subject: an historical perspective

Our literature review on CSR has highlighted the fact that **Corporate Social Responsibility** is a true cross-disciplinary issue that has been handled by a variety of disciplines and academic perspectives that have struggled to give it a proper and shared academic definition.

As some scholars explicitly argue, in both the corporate and the academic world, there is uncertainty as to how CSR should be defined (McWilliams et al., 2006; Dalshrud, 2008). This is mainly due to: 1) an abundance of definitions in the literature that prevent the development and the implementation of the concept (Van Marrewijk, 2003, McWilliams et al., 2006; Gjølberg, 2009) and 2) a general lack of empirical methodology that demonstrates how CSR measures are implemented (Dalshrud, 2008). The CSR issue, given its both theoretical and many practical implications, thus appears as a conceptual category intrinsically fuzzy and multifaceted.

From an historical perspective, the modern academic debate, deriving mainly from the Great Depression of 1930s in the USA, involves two main competing versions about corporations' desirable role within a society. The first one, that can be easily summarized as the shareholders view, stated that the first corporation’s purpose is to advance the financial interests of the owners (Berle, 1931). A second contemporary contribution (Dodd, 1932)[1] pointed out for the first time how the corporation should be viewed also as a “social institution” that take into consideration the whole of its stakeholders, namely the social community in which it is embedded, workers and consumers. In 1953, the economist Bowen explicitly introduced the issue of corporate social responsibility defined as "the obligation of businessmen to pursue those policies, to make those decisions, or to follow those lines of action which are desirable in terms of the objectives and values of our society" (Carroll, 1999, p.4). Bowen’s proposal marked out the beginning of a long-lasting discussion about the desirable role of corporations within the society. During the 1950s and 1960s, philanthropy, or "community service and employee welfare" were the terms used to categorize CSR activities, which were seemingly aimed at serving the well-being of citizens and the community. In reality, it also benefited their own entrepreneurial "enlightened self-interest" as Banerjee (2007, p.7) argued. Often viewed as duties, these obligations were deemed "desirable in terms of the objectives and values of society" (Bowen, 1953, p.6): attempts to define CSR began thus and Bowen’s (1953) book and definition marked the modern, serious discussion of the topic. The “Father of Corporate Social Responsibility” retained that social responsibility is “no panacea, as it contains an important truth that must guide business in the future” (Carroll, 1999, p.270).

[1] *Cfr.* Macintosh, J. C. (1999). *The issues, effects and consequences of the Berle–Dodd debate, 1931–1932*. Accounting, Organizations and Society, *24(2)*, 139-153.

CSR concept evolved despite academic scepticism as that clearly expressed by Friedman (1962) in his well-known statement: "In a free economy there is one and only one social responsibility of business: to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game" (Friedman, 2002, p.133). Throughout the 1970s, most studies aimed at defining distinctive features and rules of CSR. Johnson through his “lexicographic utility theory" (1971) suggested that strongly profit-motivated firms should engage in socially responsible strategies, arguing that "once they attain their profit targets, they act as if social responsibility were an important goal, even though it isn’t” (Carroll, 1999, p.274). In a way, he explicitly ascertained the potential of CSR activities for increasing profits and gaining new markets. A major debate took place in 1972 when Manne proposed his definition by arguing that any CSR definition should include at least three factors. "To qualify as socially responsible a corporate action, a business expenditure or activity must be one for which the marginal returns to the corporation are less than the returns available from some alternative expenditure, must be purely voluntary, and must be an actual corporate expenditure rather than a conduit for individual largesse” (Carroll, 1999, p.276). This element of voluntariness, though implicit from the very first conceptualizations, has been carried forward into many contemporary definitions of CSR. The voluntariness feature was restated by his colleague Wallich that defined responsibility as "a condition in which the corporation is at least in some measure a free agent", even though it is hard to distinguish between that which is “purely voluntary” and that which responses to social norms (Carroll, 1999, p.276). During the mid-70's, there was clearly an emphasis on **CSP** (corporate social performance) which was aimed at assessing the outcomes of socially responsible initiatives (Carroll, 1979; Wartick and Cochran, 1985; Wood, 1991).

The term "corporate social performance" (CSP) has been used for several years in the business and society literature. In most cases, as for CSR, CSP[2] has been vaguely defined and it has been used indistinctively as a synonym for corporate social responsibility, corporate social responsiveness, or any other interaction between business and the social environment. As Wartick and Cochran (1985) argued, from Carroll’s work (1979) onward, one main strand of literature has focused on the distinctive features of the CSP model: “corporate social responsibility” that refers to the ethical basis, and the two tools to operationalize it, i.e. “social responsiveness” and “social issues management”.

The most outstanding theoretical contribution of the 1970s was undoubtedly Carroll's one. In 1979, Carroll proposed a path-breaking four-part definition of CSR, stating that “the social responsibility of business encompasses the economic, legal, ethical, and discretionary expectations that society has of organizations at a given point in time” (Carroll, 1979, p.500). Carroll's well-known pyramid[3] stated peremptorily that responsibilities of an enterprise extended beyond making a profit and obeying the law, embracing a full range of responsibilities of business towards society. More in general, scientific contributions of the 1970s created the theoretical base for a new, complete definition of the stakeholders theory, due to Edward Freeman (1984). In the 1980s, the importance of stakeholder management increased as stakeholders were ‘‘those groups who can affect or are affected by the achievement of an organization’s purpose’’ (Freeman, 1984, p.49) in a general awareness that those who claim to have ties to the company become "responsible players". Many authors, especially Drucker (1984), started to highlight possible positive relationships between social

[2] For a detailed description of the CSP concept, *Cfr.* Cooper, S. (2017). Corporate social performance: a stakeholder approach. Taylor & Francis.

[3] Carroll (1979) organized different corporate social responsibilities as a four-layered pyramid model and called it the pyramid of responsibilities. The four different responsibilities - economical, legal, ethical and philanthropic - are the layers of the pyramid.

responsibility and business opportunities in terms of market opportunities, productivity, human capabilities, and the bettering of the competitive context. Following this growing interest and demand of operationalizing CSR and catching its practical implications, many scholars became interested in the question of whether socially responsible firms were also profitable enterprises (*Cfr*. Cochran and Wood, 1984; Aupperle et al., 1985). A precise example of the growing interest in operationalizing CSR and seeing if it influenced the financial performance was Cochran and Wood's pioneering research (1984). The authors analyzed the various ways in which social and financial performance had been operationalized in the past and decided to use a reputation index to evaluate CSR (Carroll, 1999, p. 286).

During the 1990s, the concept of CSR evolved significantly towards alternative themes including, along with the theory of stakeholders, also business ethics topics, Corporate Social Performance, and corporate citizenship. Carroll revisited his four-part CSR definition (Carroll, 1991); he labelled the discretionary component as being “philanthropic”, by suggesting that the philanthropic responsibility was tied to corporate citizenship. Carroll's contributions could represent a theoretical springboard for most recent definitions and derived categories descending from traditional works on CSR.

Following the academic hints and institutional requirements, in management, marketing studies, business ethics and Organizational Behaviour theories, several streams of research have focused on understanding why companies increasingly engage in CSR initiatives (Aguilera et al., 2007; Balmer et al., 2007).

As a matter of fact, as some scholars clearly point out, CSR initiatives have become increasingly common as organizations compete for customers and try to meet the growing and dynamic expectations of their stakeholders (Matten and Moon, 2004). Simultaneously other scholars have analyzed the prominence of CSR initiatives for gaining employees and stakeholders' trust, fostering a sort of corporate citizenship (Dawkins, 2002) or, as previously mentioned, for increasing corporate performance (Cochran et al., 1984; Albuquerque et al., 2013). The importance in stakeholders trust is equally highlighted in corporate marketing and identity literature, which suggest that stakeholder perceptions and attitudes about an organization’s ethics play an important role in shaping their attitude with regard to management (Balmer et al., 2002) or a general trust in the organization (Fukukawa et al., 2007; Rupp et al., 2006). Other scholars have then examined the proposition that CSR initiatives help firms develop positive ethical identities with key stakeholders such as customers and investors (Balmer et al., 2007).

We will discuss in detail this relationship in the empirical literature review presented in section 1.3.

Figure 1: CSR research topics in European Business Schools

Research topic	Percentage
Business Ethics	36
Environmental/Ecology Management	21
Corporate Social Responsibility	20
Sustainable development	18
Corporate Governance	17
Accounting and Finance, incl. social/environmental reporting accountability	13
Stakeholder Management	12
Globalisation	11
Strategy	5
Business and Society	4
Leadership	3
Corporate Citizenship	3
Marketing	3
Corporate communication	2.4
Culture	2.4
Corruption/Crime/Racism	1.8
E-commerce	1.8
Ethical Investment	1.8
Management	1.8
Corporate reputation	1
Gender	1
Sociology	1
Spirituality	1
Supply chain	1
Tourism, incl. Ecotourism Sustainable tourism	1
Trust	1

Source: Matten and Moon, 2004

Relying on our literature review on CSR, we conclude that, despite the cross-disciplinary contributions and the development of derivate concepts, the most-quoted articles on Google Scholar pertain primarily to three main disciplines: management, marketing, and business ethics. Matten and Moon's study (2004), concerning corporate social responsibility's education in Europe, sustains the outcome of the results of our literature review, confirming that there is a growing trend of CSR research that is mainly under the umbrella of the business literature (*Cfr.* fig. 1). Although the term CSR, its current agenda items and other business-society items have gained currency, many programs are still grounded in the longer-term orientations of business ethics and environmental management. Moreover, authors point out that there is a highly diverse understanding, contextualization of CSR teaching programs in European business schools and it can be certainly attributed to the intrinsic complexity of the concept (*Cfr.* fig.1).

Linked to this research stream, Gjølberg's article (2009) dwells on the challenges related to measuring and quantifying CSR practices and performance. She argues that prevailing definitions of CSR are not suitable as a basis for a comparative measure of CSR practices. An additional limitation is the lack of comparable data at the firm-level. The ever-growing amount of literature on "the varieties of capitalisms", focuses on how state, market and civil society relations are organised differently across capitalist systems (Amable, 2006; Crouch, 2005; Hall & Soskice, 2001; Whitley, 1998, 1999; Matten and Moon, 2004) influencing different understanding and implementation of CSR practices (*Cfr.* Matten and Moon, 2008; Habisch et al., 2005). This would make the creating of a unique and comparative "European" CSR index difficult both for the different cross-disciplinary and cross-country understanding of CSR and related concepts and the lack of comparable data at a company level.

Still in reference to our literature review, we would like to focus on some relevant contributions that we consider important as they retrace the main evolutionary stages of the discourse on CSR, both from an academic and a policy point of view. More significantly, we think that the selected works have historically enriched and widened the semantic borders of CSR from both a theoretical and a practical perspective.

Among the most outstanding contributions, that we have analyzed and to which we will refer to, we would like to mention:

1. Carroll's work offers a full detailed historical description of the evolution of the concept, from its origins to the 1990s (Carroll, 1991). Moreover, his work is particularly interesting for two main aspects: 1) it points out the growing relevance of CSR within the new institutional concerns for the relationships between society and businesses; 2) it sheds light on two main dimensions characterizing CSR: an **internal dimension** dealing with Corporate Social Performance (**CSP**), stakeholders theory and an increasingly important **external dimension** that deals with new social, political, environmental issues. Moreover, he highlights how in the 1990s, the CSR concept “transitioned significantly to alternative themes such as stakeholder theory and business ethics topics” (Carroll, 1999, p.292); 3) it sheds light on the intrinsic fuzziness and the historical evolution of the understanding and the use of the concept: <u>from 1980’s the term “corporate social responsibility” has been used interchangeably with competing, complementary and overlapping concepts such as “corporate citizenship”, “business ethics”, “stakeholder management” and “sustainability”.</u> At the same time, the concept of corporate social performance (CSP) which, as previously explained, can be considered a subset of CSR, has become “an established umbrella term and a more popular expression to embrace both the descriptive and normative aspects of the field, as well as the description of CSR policies, practices and results implemented by firms” (Carroll and Shabana, 2010, p.86);
2. McWilliams and Siegel's work (2000) can be considered one of the first relevant contribution that link CSR to CFP (corporate financial performance) and one of the first attempts to put forth an explanatory model including R&D variable;
3. Van Marrewijk's article (2003) provides a useful distinction between corporate sustainability that refers mainly to “value creation, environmental management, environmentally friendly production system, human capital management” and CSR that concerns firstly phenomena such as “transparency, stakeholders dialogue and sustainability reporting” (Van Marrewijk, 2003, p. 8);
4. Matten and Moon's study (2008), along with their 2004 article, argue that <u>explicit CSR practices (voluntary programs and communications) have spread over Europe in recent years, where "implicit practices" (which are related to values, norms and rules) prevailed before</u> explicit CRS took over and required corporations to address mainly stakeholder issues.

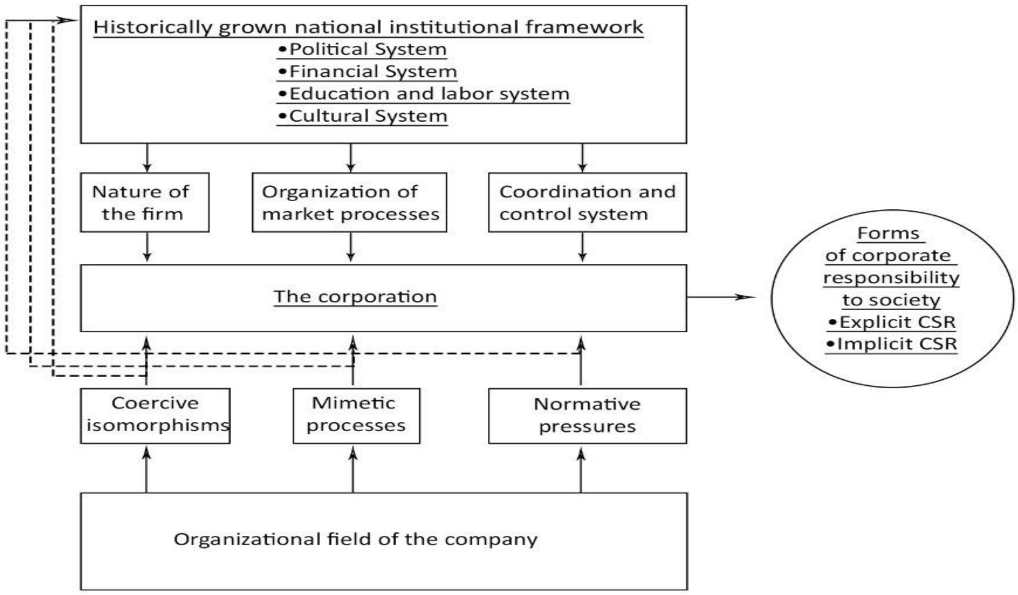
They assert that the key to interpret those changes are ascribable to the changes in the institutional assets that concern:

coercive isomorphisms: neo-institutionalism assumes that "externally codified rules, norms, or laws assign legitimacy to new management practices". For instance, "the growth of socially responsible investments indexes, and the adoption of CSR-type criteria by more mainstream investment funds, can constitute new drivers for corporations to develop explicit CSR policies in order to access these sources of capital" (Matten and Moon, 2008, p. 411-412);

mimetic processes: "in a business climate of growing uncertainty, competition and increasingly complex technologies, managers tend to consider practices legitimate if they are regarded as using the <best practices> standards of their organizational field (e.g. total quality management)" (Matten and Moon, 2008, p. 412);

normative pressures: new laws encouraging CSR attitude, that are due to the reorganizing of national and supranational European institutions, combined with the ever-growing financialization of markets and changes in the education and labour system (Matten and Moon, 2008, p. 412).

Figure 2: An interpretative schema to connect CSR to the institutional context of the firm



Source: Matten and Moon, 2008

At the same time, concerns about a corporation's own legitimacy have urged corporations to implement and communicate explicit CSR practices to the whole of their stakeholders (*Cfr.* fig.2).

The study by Matten and Moon (2008) is inspired by the ideas offered by the comparative capitalism (CC) literature and it has put forth a comparative model for understanding CSR implementation in Europe and US. The CC literature looks at economic activity as being socially embedded within institutional contexts and compares the various institutional frameworks in a multi-level logic across different scales (e.g. nations, regions, sectors). Institutional interdependence, along with social embeddedness, is seen as a major resource of institutional stability in national systems (Dore, 2001; Biggart, 1991). The comparative approach is based on the premise that the variety of institutional configurations that are historically embedded with specific strengths and weaknesses for different kinds of economic activity originate different comparative institutional advantages. Moreover, the CC literature has been interpreted to imply a theory of institutional path dependence (Dore, 2001; Hall and

Soskice, 2001; Jackson and Deeg, 2006) that is referred to as "historical grown national institutional frameworks" by Matten and Moon.

This would explain the existence of a variety of capitalisms and the subsequent different nature of corporations. Corporations' attitudes and strategies are influenced by ongoing and recursive dynamics when it comes to both institutional frameworks and changes in the organizational field: both of these dynamics, that act at a macro, meso and micro organizational level, generate different business attitudes and different ways of interpreting and implementing CSR policies.

5 Dahlsrud 's study (2008) proposes a useful analysis of 37 main definitions based on an extensive review of the literature, which consists of both journal articles and frequency counts on Google. Through an in-depth content analysis, Dahlsrud identifies five main dimensions, namely, in order of importance: the stakeholder, social, economic, voluntariness and environmental dimensions, proposing a useful taxonomy to classify CSR;

6 European Commission's Green Paper (2001) can be considered a CSR ground-breaking policy document at a European level. It can be seen as the founding contribution of the institutional discourse on CSR at a European level which reaffirms what a large part of the literature has highlighted as fundamental characteristics of the concept: above all, the voluntariness and multidimensionality of the concept. In particular, the Green Paper (2001, p.3) encourages companies in that direction and states that: "their social responsibility and **voluntarily** taking on commitments which go beyond common regulatory and conventional requirements, which they would have to respect in any case […] companies endeavour to raise the standards of social development, environmental protection and respect of fundamental rights and embrace an open governance, reconciling interests of various stakeholders in an overall approach of quality and sustainability". In this institutional document, there are five main dimensions (stakeholder, social, economic, voluntariness and environmental) that are detected, as well as an internal dimension of CSR that involves company employees and issues relating to 1) human capital, 2) health and safety, 3) managing change. On the other hand, the external dimension concerns 4) local communities, 5) business partners, 6) suppliers and consumers, 7) environmental and social concerns.

1.2. The evolution of CSR concept towards new derived categories

The most recent contributions have most definitely unveiled the cross-disciplinary nature of the CSR concept that has naturally evolved towards complex and derived categories such as "corporate citizenship" (Scherer and Palazzo, 2008; Matten and Crane, 2003), "CSR policies" (Scherer and Palazzo, 2011) and corporate "shared value" (Porter and Kramer, 2011).

Porter and Kramer (2011) theorized the corporate **shared value** as an attempt to connect profit and social progress in the enterprise, drawing an unprecedented turning point in the reflection about sustainable capitalism and analyzing possible and desirable connection between economic and social concerns. "This new socio-economic frontier is proposed explicitly in face of the pressing requirement of restoring a capitalism <under siege> (Porter and Kramer, 2011, p.4) in which economic activities need to review their basic aims and actions in face of a series of unprecedented socio-economic criticisms" (Bellandi and Camoletto, 2019, p.2).

"It is an attempt to connect profit and social progress in the enterprise", where "social value encompasses all the company's stakeholders" so that "the competitiveness of a company and the health of related communities are closely intertwined" (*ibid.,* p.2). As a matter of fact, shared value "turns out to be a recommended, broader conception of capitalism and value chain creation, which harnesses its full potential to meet societal new needs, environmental challenges and innovation policies and processes. The new formula <creating shared value> moves away from the traditional <creating profit> prescription, namely companies' commitment to maximize profit from their participation to value chains. There would be three distinct and spiralling ways to generate shared value: 1) by re-conceiving products and markets aligned with new societal needs; 2) through a redefinition of the value chain by a more efficient use of scarce natural resources; and 3) by building sustainable business clusters at the company's locations. In this way, environmental and social issues would be automatically introduced into the core of management strategies and corporate missions" (*ibid.,* p.2).

Even though directly connected to the concept of Corporate Social Responsibility[4], "shared value is not <social responsibility> ex-post, nor a separate business unit of external diplomacy and philanthropy, as it turns out to be an ex-ante strategy of conceiving business and gaining economic advantage" (Bellandi and Camoletto, 2019, p.2). It implies "a radical reorientation in the mind-set of businessmen, economists, politicians, and legislators, blurring existing frontiers between public and private spheres" (Bellandi and Camoletto, 2019, pp.2-3). Porter and Kramer's "shared value" represents "symbolically and operatively a last-ditch effort to face a crisis of legitimacy and productivity that the 21st century's capitalistic firm has to deal with" (Bellandi and Camoletto, 2019, p.17).

Scherer and Palazzo (2011) used the expression "CSR policy" to indicate the growing involvement of the firm in the public sphere, next to national governments and supranational organizations, by arguing that, "under the conditions of globalization, the strict division of labour between private business and nation-state governance does not hold any more" (Scherer and Palazzo, 2011, p. 899). The globalization process leads to questioning about the efficacy and legitimacy of the determined roles and responsibilities of a nationally contained democracy that could build upon a clear-cut division of labour between corporations, politics, and civil society (Kobrin, 2009; Pies et al., 2009). Being that societal challenges are no longer restricted to "self-contained" political systems, socio-political decisions and solutions have become embedded in decentralized processes that include non-state actors such as NGOs and businesses.

Kang and Moon (2012), in their comparative study about different capitalistic models and drawing on institutional theory and comparative capitalism literature[5] argued that CSR assumes different forms and satisfies different functions in different political contexts. Therefore, assuming that varieties of capitalisms deploy in a *continuum* that range from the 2 ideal types of liberal market economies (LMEs) and coordinated-market economies, they argue that in coordinated-market economies (CMEs), firms' motivation for CSR is predominantly socially-cohesive, orientated to stakeholders' value systems; changes are more clearly observable in state-led market economies where firms' motivation for CSR is largely geared towards public value. As changes occur in broader institutional arrangements and in corporate governance, CSR adapts to and adheres to the changes accordingly. For instance, in

4 In their previous works, the authors deal extensively with CSR and the social and economic effects of CSR carried out by enterprises. *Cfr.* Porter and Kramer 2002, 2006.

5 *Cfr.* Deeg, R. and Jackson, G. (2007) *Toward a More Dynamic Theory of Capitalist Variety*,

Socio -Economic Review, 5, 149–179; Dore, R., Lazonick, W., & O'Sullivan, M. (1999). *Varieties of capitalism in the twentieth century*. Oxford Review of Economic Policy, *15(*4), 102-120.

CMEs, firms' motivation for CSR is predominantly socially cohesive, and this type of CSR complements the stakeholder value system of corporate governance. The complementarity logic is reinforced by a rationale of similarity and is established by the fact that players in the two spheres adopt similar non-market-based, neo-corporatist socio-economic solutions. In CMEs, CSR complements corporate governance by highlighting the social contract on which the corporate governance system relies upon, strengthening stakeholder value.

It is worth mentioning the increasingly pressing debate on CSR and its impacts in developing countries: this is mostly due to the tension between demands for compliance with codes of conduct present in many global value chains (GVCs) and the expectation for locally appropriate responses to these pressures. Recently, there has been much emphasis in the GVC literature on investigating how global lead firms implement Responsible Business Conduct codes throughout their supply chains and exploring how CSR practices affect workers' conditions (Barrientos and Smith, 2007; Locke and Romis, 2007). On the one hand, internationally branded companies may be affected by negative media reports regarding child labour, poor working conditions[6], worker rights abuses, and other types of 'unethical' conduct in their supply chains that may tarnish their public image. On the other hand, local suppliers in the developing world could worry about the added costs that are associated with CSR compliance and the simultaneous pressures from buyers to reduce prices (Barrientos, 2008; Lund-Thomsen and Nadvi, 2010).

Other scholars have then highlighted the limitations of traditional compliance-based models of working with CSR in GVCs. Within this model, international NGOs, civil organizations, and other stakeholders normally place pressure on multinational companies to induce them to adopt voluntary social and environmental guidelines for their supplier factories' working conditions and performance in developing countries. According to Lund-Thomsen and Lindgreen (2014), the compliance model has shown little improvement in labour conditions for workers in export-oriented industries of developing countries. A new cooperation-based model would be more suitable for compensating the shortcomings of the compliance-based paradigm, still inadequate for altering the power relations of international buyers, suppliers, and workers in global value chains (Lund-Thomsen and Lindgreen, 2014).

Works on CSR over the past twenty years provide witness to a semantic and operational expansion of company boundaries intended to be an evolving socio-economic entity that operates in constantly-changing global contexts. At the same time, the evolved economic context and new social and environmental requirements have triggered a more pro-active institutional attitude aimed at defining new rules and canons in the field of CSR: thus, works and institutional guidelines by regulatory bodies from the last decade have promoted more stringent and integrated strategies with regard to corporate responsibilities.

In a certain sense, the most recent institutional documents reflect the need to implement new integrated operational strategies into a multi-level logic (firm, national, supranational levels) that transcend the traditional approaches of CSR contributions and which call for more stringent productive and regulatory changes that could be ascribable to the recent "shared value" paradigm.

6 Codes of labour practice implemented by corporate buyers in their global production networks are normally considered as one dimension of CSR (Barrientos, 2008).

1.3. A brief literature review on the ESG, due diligence, ESG due diligence concepts and their applications

Over the years, academic literature has labelled the plethora of investment practices that integrate the consideration of 'environmental, social and governance' (ESG) in many ways. Hence, ESG practices have been indistinctly defined as and linked to Responsible Investment (e.g. Rosen et al., 1991; Abramson and Chung, 2000; Statman, 2008); Ethical Investment (e.g. Irvine, 1987; Mackenzie, 1998; Schwartz, Tamari and Schwab, 2007); Social Investment (e.g. Dunfee, 2003; Cox, Brammer and Millington, 2007); Responsible Investment (e.g. Dembinski et al., 2003; Thamotheram and Wildsmith, 2007; Viviers et al., 2009), and Sustainability/Sustainable Investment (e.g. Koellner et al., 2007).

From a historical perspective, the first theoretical model for testing CSR investments in organizations based on legal, economic, ethical principles is encompassed in Carroll's initial studies on CSR (1979). Since then, expressions such as sustainability, corporate social responsibility, socio-environmental governance and environmental, social and governance (ESG), corporate governance, have been used as synonyms by many authors (Sanchez Garcia et al., 2017, p.136).

Relying on our literature review, we have come across a tendency to link and correlate the ESG issue especially to financial themes such as financial performance and responsible investing (SRI) in both the academic (Eccles et al., 2011; Sparkes, 2001; Friede et al., 2015) and the institutional world (UN, 2004).[7]

It should be noted that even though some authors argue that ESG investing literature is part of a broader literature on Corporate Social Responsibility (Hvidkjær, 2017, p.6), other recent documents use the two terms CSR and ESG interchangeably (Fatemi et al., 2017). Some (practitioner) works bring CSR and ESG literature together under the label of "sustainability" (Clark et al., 2015) by arguing that the sum of E, S, G information is generally treated as a firm's quality of social responsibility, while acknowledging that ESG is a subtopic of CSR (Clark and Viehs, 2014, p.4).

We are leaning towards the first interpretation because, both from a chronological and a content point of view, we believe that ESG constitutes a more recent segment of the larger and more "historical" corpus of studies dealing with CSR. In particular, as Eccles and Viviers (2011) point out in their study concerning the analysis of 190 academic papers, spanning a period between 1975 and mid-2009, the topic of ESG practices linked mainly to responsible investment was given more importance starting in the mid-1970s. It had been classified under a variety of different denominations that conveyed the idea of how the financial investment market needed to be inspired by matters such as "responsibility" and "sustainability".

CSR cross-disciplinary literature, born embryonically after 1929's Great Crisis, set up a broader line of studies and conceptualizations that have naturally flowed into modern derived categories such as those addressed in the previous paragraph. CSR represents therefore every company's efforts to trigger a positive impact on its stakeholders (employees, consumers, the environment, and communities). ESG, on the other hand, measures and evaluates these activities to come to a more accurate assessment of a company's actions. In particular, ESG looks at how businesses: 1) answers to climate change, 2) manage their supply chains, 2) create trust and foster innovation, 4) interact with their stakeholders. Unlike the concept of CSR, which benefits from "historical" vastness and theoretical complexity, ESG's explicit wording -

[7] *Cfr.* United Nations Global Compact (2004). *Who cares wins. Connecting financial markets to a changing world.*

that ideally derives from previous works on Social Investing - only dates back to the early 2000s. It can be ideally linked to the *Who cares wins report* (2004) which reaffirms the principles of the Global Compact and concentrates on the mechanisms of the financial market. In the analysis of the empirical literature, we will discuss the application of ESG issue to corporate performance in more detail.

As for CSR, there is no shared and univocal definition of "due diligence" (DD). Regardless, we can distinguish among the main areas of legal, financial, risk and insurance, commercial, reputational, cultural, tax, environmental, operational due diligence by referring to a common taxonomy (Spedding, 2009).

The concept has US origins and expresses the first practical attempt to legally regulate commercial transactions appearing in the Security Act of 1933. Traditionally, due diligence literature has mainly dealt with a process of legal regulation of key business transactions and operational activities. Therefore, DD has become a pillar in decision-making in regard to mergers and acquisitions, joint ventures, selecting appropriate partners, buying and selling assets.

Although there are different definitions of "due diligence", it is safe to say that due diligence can be understood both as 1. a tool available to companies that guides a legal and financial course of action to prevent litigation and reduce transaction costs, but also to establish the price and the risk of such transactions by analysing and evaluating available data, and as 2. a self-regulating company tool through which companies record their actions and transactions confirming that they are supported by a legal and institutional framework [8].

In any regard, the semantic borders of due diligence have broadened over the years and nowadays extends to areas of business activity that go beyond economic and legal transactions and regulation.

The term "due diligence" historically originated in the legal field and primarily referred to the reduction of commercial and financial risks. Today, due diligence literature has expanded to the social risks field: at this purpose, we will briefly refer to the definition proposed by the OECD and the literature on Human Rights Due Diligence.

A very important contribution in this regard is certainly that of the OECD Guidelines for Multinational Enterprises (2011a) which provides a very clear definition of "due diligence" linked to the ESG dimensions. Due diligence can be described as "the process enterprises should carry out to identify, prevent, mitigate and account for how they address their actual and potential adverse impacts as an integral part of business decision-making and risk management systems"(OECD, 2011a, p.23)[9] . Effective DD should be backed by efforts to embed RBC (responsible business conduct) into policies and management systems, and aims to enable corporations to fix adverse impacts that they create or to which they contribute. The 2011 OECD Guidelines encompass some central elements from UN Guiding Principles (UNGPs) "Guiding Principles on Business and Human Rights: Implementing the United Nations 'Protect, Respect and Remedy' Framework" (2011), which were delivered by the Special Representative

8 Since the analysis of the concept of "due diligence" is not one of the main goals of this research, but rather it is the derived concept of ESG due diligence, please refer to Spedding (2009) for an in-depth analysis of the various applications and evolution of the concept.

9 *Cfr.*OECD (2011a). OECD Guidelines for Multinational Enterprises, OECD Publishing. http://dx.doi.org/10.1787/9789264115415-en.

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

http://mneguidelines.oecd.org/OECD-Due-Diligence-GuidanceforResponsible-Business-Conduct.pdf.

of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises. The 31 UNGPs should be understood as a coherent *unicuum* in terms of their far-sighted objectives for "enhancing standards and practices with regard to business and human rights so as to achieve tangible results for individuals and communities, and thereby also contributing to a socially sustainable development" (UN, 2011, p.1). That's the reason why, relying on the "Protect, Respect, Remedy" framework[10], they address: (a) States' existing (and future) duties to respect, protect and fulfil human rights and basic liberties, with an emphasis on the state's obligation to protect against human rights abuse by third parties, through appropriate policies, regulation and adjudication; (b) the role of businesses that are expected to face "social" and "responsible" requirements, and that are pushed to comply with laws and to respect human rights; (c) "the need for rights and obligations to be matched to adequate and effective remedies when breached"(UN, 2011, p.2) , placing importance on the need for an effectively access to judicial and non-judicial remedies by victims of corporate injustices.

Concerning our study's main objectives, the UNGPs guidance (and specifically Pillar II) along with the adoption of National Action Plans (NAPs) on Business and Human Rights by governments, aims at incentivizing and supporting businesses to fulfil their responsibility to 1. comply with human rights, 2. encourage local capacity building relying on a joint co-operation with the local community, 3. enhance human capital formation, 4. implement good corporate governance principles, 5. carry out risk-based due diligence in order to avoid and attenuate actual and potential adverse impacts, 6. engage in or support multi-stakeholder initiatives and social dialogue on responsible supply chain management while guaranteeing that these efforts take into account their social and economic effects (OECD, 2011a, pp.19-26). At the European level, the study which was promoted by the European Parliament in 2017[11]describes the international progress in the due diligence field, the international adherence to the UNGPs, and the state of the art on the "EU Roadmap" in the DD field, highlighting how up to 31st December 2016 only twelve countries, ten of which are from Europe, had produced National Action Plans: "the United Kingdom (UK) (2013, 2016), the Netherlands (2013), Denmark (2014), Finland (2014), Lithuania (2015), Sweden (2015), Norway (2015), Colombia (2015), Switzerland (2016), Germany (2016), Italy (2016) and the United States (2016)" (UN, 2017, p.8). The document then aspires for a continuous call for higher levels of human rights protection and an exerting institutional pressure for monitoring developments in that direction and that should lead to the development of a European Action Plan on Business and Human Rights. The report of the European Union Agency for Fundamental Rights (2019) speaks specifically of "Human Rights Due Diligence" reporting a definition very similar to that of the OECD (2011b): HRDD is defined as that process through which business enterprises should "identify, prevent, mitigate and account for their potential and actual human rights impacts… within the framework of the UNGPs" (p.3). Meanwhile, the document suggests that Business and Human Rights (BHR) is the common label used to address the joint action of states and businesses in relation to the human rights field, to be related to as a non-negligible aspect of CSR and, more generally, of RBC practices (*ibid.,* p.2).

Some authors focus mainly on the regulatory/legal aspect of DD and dwell on the role countries should have in protecting HR: especially in the context of global economic activity

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10 The 'Protect, Respect and Remedy' Framework developed by the SRSG on Human Rights and Business was endorsed by UN member states in the UN Human Rights Council Resolution on the Mandate of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises (UN Human Rights Council, 2008).

11 European Parliament. Directorate-General for External Policies (2017). *Implementation of the UN Guiding Principles on Business and Human Rights.*

expansion, governments have often failed to find a balance between the power of business and the duty of the State to defend human rights (De Schutter et al., 2012, p.1). De Schutter et al. (2012) assert that a diversity in legal traditions and a variety in HR contexts at the national level, implies that there will not be a single form of DD regulation that will be suitable for every jurisdiction. Governments should take on a pivotal role in order to consolidate and strengthen current protections, and to move forward in safeguarding the full range of human rights through 4 main regulatory approaches:

1 the first approach imposes "a due diligence requirement as a matter of regulatory compliance";

2 "the second regulatory approach provides incentives and benefits to companies, in return for their being able to demonstrate due diligence practice";

3 "a third approach is for States to encourage due diligence through transparency and disclosure mechanisms. States implement rules that require business enterprises to disclose the presence or absence of due diligence activities and any identified harms that their activities may create, such as the presence of child labor in a company's supply chain";

4 the fourth approach involves "a combination of one or more of these methods, as normally happens for States that regularly combine aspects of these approaches in order to construct an incentive structure that promotes respect by business for the standards set down in the rules and ensures that compliance". It aims at building an incentive structure that increases respect on behalf of businesses for the standards established by the law and ensures that compliance can be assessed in an efficient and effective manner. Enforcement of such rules can "combine administrative penalties, such as fines, and criminal law sanctions; and the possibility of civil action"(De Schutter, 2012, pp. 4-5).

The expression "ESG Due Diligence" is quite recent in the literature and is mainly attributable to the institutional contributions of the last decade that we have analysed so far. These works witness a broadening of the DD issue that go beyond its traditional legal and economic core, by encompassing HR and, more generally, ESG discourse and requirements. Even if sometimes the expression is not used explicitly or is addressed in similar forms such as that of "HR DD", the intention to link DD to CSR / ESG practices is increasingly evident. Due diligence applied to social, environmental and governance risks, appears to represent an attempt, although embryonic, to theoretically combine the "economic" heart of CSR literature with the normative, legal and prescriptive core of the due diligence corpus of studies.

Although further and future research is needed to disentangle each and every aspect of this new research stream, for now we can go forward with some hypotheses on the future semantic and operational developments of the expression that is likely to be used as a synonym for:

1 "good company performance" as an outcome of a DD process, implying that there is an integration of ESG factors in companies' investment and performance strategies (Zaccone and Pedrini, 2020), stressing the importance of 2) a regulatory attempt on behalf of institutional bodies that should be more stringent on ESG and CSR practices. An attempt that nowadays is likely to overcome the traditional canon of voluntariness that regulates CSR / ESG practices in order to account for new social global requirements that would demand a more structured and mandatory actions by corporations.

1.4. Institutional works and requirements on Corporate Social Responsibility, Responsible Business Conduct, and due diligence.

As aforementioned, the **Green Paper** presented by the European Commission in July 2001 represents a crucial turning point of institutional commitment aimed at boosting CSR culture among European businesses.

The Communication from the European Commission published in July 2002 underlines the need for public action to promote CSR (Commission of the European Communities, 2002b, p. 8)[12]. This greater attention to CSR issues was consistent with the final goal of the Sustainable Development Strategy for Europe, approved in June 2001, that "in the long term, economic growth, social cohesion and environmental protection must go hand in hand" (Commission of the European Communities, 2001a, p.2).

Since the early 2000's, other international organizations have also promoted similar joint actions.

2000's **Global Compact**[13] is a corporate responsibility initiative promoted by the United Nations with the main objective of implementing universal responsible principles in business and society, in order to allow corporations to take on an active role in creating solutions to challenges that globalisation poses. The Compact can be considered one of the first world's biggest network-based voluntary corporate citizenship initiative (Hemphill, 2005). This international action brings companies together with UN agencies, labour and civil society to support and adhere to ten principles in the areas of human rights, working conditions, the environment, and anti-corruption.

2004's report *Who cares wins*[14] reaffirms the principles of the Global Compact and concentrates upon the financial market. In particular, the report aims at developing guidelines and recommendations on how to better integrate environmental, social and governance (ESG) issues in asset management, securities brokerage services and associated research functions (UN, 2004, p. VII).

The 2007-2008's economic crisis has triggered some unprecedented socio-economic consequences and to some extent has damaged consumer confidence and levels of trust in business. Since then, the Commission kept on renewing efforts to promote a CSR culture, by creating the circumstances favourable to sustainable, long-term growth, responsible business behaviour and durable employment generation in the medium and long term (EU, 2011, p.4)[15]. Within this post-crisis scenario, the new definition of CSR put forth in 2011 as "the responsibility of enterprises for their impacts on society", conveys a new sensitiveness about the desirable role of businesses in society. First of all, the updated understanding of CSR (2011)

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12 https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52002DC0694&from=DE

13 https://www.unglobalcompact.org/what-is-gc;

Ki-moon, B. (2010). *The United Nations global compact: Achievements, trends and challenges*. Cambridge University Press.

14 *Cfr.* United Nations (2004). *Who cares wins: Connecting financial markets to a changing world.* The Global Compact. New York.

https://www.unepfi.org/fileadmin/events/2004/stocks/who_cares_wins_global_compact_2004.pdf

15 *Cfr.* European Commission (2011). *A renewed EU strategy 2011-14 for Corporate Social Responsibility*. Brussels.

constitutes a **paradigm shift in EU policy** as the European Commission has moved towards a set of guidelines that go beyond the voluntary engagement of companies (Eurocommerce, 2012, p.2). Additionally, the new wording reflects and incorporates the dictates of a wide range of new internationally recognised principles and guidelines, in particular the OECD Guidelines for Multinational Enterprises, the ten principles of the United Nations Global Compact, the ISO 26000 Guidance Standard on Social Responsibility, the ILO Tri-partite Declaration of Principles Concerning Multinational Enterprises and Social Policy, and the United Nations Guiding Principles on Business and Human Rights Respect for applicable legislation (EU, 2011, p.6).

This change of course expressed in a new definition that no longer dwells on the requisite of voluntariness - one of the cornerstones of traditional definitions on CSR - encompasses a new agenda for action that in every way encourages the dissemination and assimilation of the CSR culture in a multi-stakeholders perspective that take account of the views of enterprises, non-business stakeholders and Member States. Since 2011, the Commission has launched a plethora of programmes to work with enterprises and other stakeholders on critical social and environmental issues within these new requirements. The Commission has therefore concentrated upon promoting dialogue with firms and other stakeholders on issues such as employability, demographic change and active ageing, and workplace challenges (including diversity management, gender equality, education and training, and employee health and well-being).

In particular, nine priority areas and thirty action proposals are identified in EU CSR Strategy 2011-2014: 1. Intensifying the visibility of CSR and disseminating good practices, 2. Improving and tracking levels of trust in business, 3. Improving self- and co-regulation processes, 4. Promoting market reward and public procurement[16] for responsible business conduct, 5. Fostering responsible consumption and consumer attention to CSR-related issues, 6. Boosting responsible investment, 7. Promoting and rewarding transparency in business practices, 8. Promoting CSR in Education, Training and Research 9. Aligning EU & global approaches in subject of CSR.

2011's agenda on CSR underpins the objectives of the Europe 2020 strategy for "smart, sustainable and inclusive" (EU, 2011, p.3) development growth in order to improve Europe's competitiveness and productivity and support the creation of a sustainable social market economy.

Hereinafter, European Union action has focused on and made progress along some crucial interlinked fronts that emphasize the connections among CSR, Business and Human Rights[17] and Sustainability in implementing a cohesive, sustainable, and long-term development strategy. This underpinning connection is again emphasized in 2019's EU working document[18] that "provides an overview of progress in implementation that has been made on Corporate

[16] In 2011 the Commission published a guide on Socially Responsible Public Procurement (SRPP), explaining how to integrate social considerations into public procurement while respecting the existing EU legal framework, *Cfr.* EU (2011). Communication from the Commission to the European Parliament, the council, the European Economic and Social Committee and the Committee of the Regions. A renewed EU strategy 2011-14 for Corporate Social Responsibility, p.10.

[17] In 2011, the UN Human Rights Council endorsed unanimously a set of 31 "Guiding Principles on Business and Human Rights" (UNGPs), structured in three distinct but interrelated pillars: 1) the state duty to protect against human rights abuses by third parties, including businesses, through appropriate policies, regulation and adjudication; 2) the corporate responsibility to respect human rights, in essence meaning to act with due diligence to avoid infringing on the rights of others; and 3) the need for an effective access to judicial and non-judicial remedy by victims of corporate abuse.

[18] *Cfr.* European Union (2019). Corporate Social Responsibility, Responsible Business Conduct, and Business & Human Rights: Overview of Progress.

Social Responsibility or Responsible Business Conduct and Business and Human Rights by the Commission and European External Action Service (EEAS) since the renewed EU strategy for Corporate Social Responsibility of 2011" (EU, 2019, p. 2).

In this institutional report, the two terms CSR and RBC (Responsible Business Conduct) are used interchangeably (EU, 2019, pp. 2-3) even though the first, as explained before, has a long intellectual history in academic literature, whereas the latter has an institutional foundation and was formally introduced in 2013 by OECD in close cooperation with businesses, trade unions and non-governmental organizations.

Responsible business conduct (**RBC**) entails various goals, especially compliance with laws and practices related to human rights, environmental protection, labour relations, and financial accountability. It also concerns societal expectations communicated through channels other than specifically the law, e.g. inter-governmental organizations, within the workplace, by local communities and trade unions, or via the press. "Private voluntary initiatives addressing this latter aspect of RBC are often referred to as corporate social responsibility (CSR)" (OECD, 2011b, p.2).[19]

The OECD has defined RBC as a fundamental tool and a broad philosophy to guarantee a positive contribution to economic, environmental and social progress with a view to (a) achieving sustainable development and (b) avoiding and facing adverse impacts related to an enterprise's operations, products or services. As OECD (2016) once again underlines, the term RBC is often "used interchangeably with the terms ESG (Environmental Social & Governance) compliance, sustainability, CSR (corporate social responsibility), socially responsible activities, but RBC as envisaged strives to encompass virtues of all of them and more" (OECD, 2016, p.4). OECD's due diligence recommendations are contained in the Guidelines for Multinational Enterprises. The **Guidelines**[20] can be appreciated as one of the first worldwide documents and tool that focus on respect for human rights as a corporate responsibility. This is the first step leading to an alignment between the OECD's due diligence recommendations and the UN's Guiding Principles on Business and Human Rights. The Guidelines, along with UNGPs, are also among the first international corporate responsibility instrument to recommend assimilating risk-based DD into all areas where business operations converge with society. Governments adhering to these guidelines have made a legally-binding commitment to promote RBC, through dedicated authorities (so-called National Contact Points), answering to enquiries, and providing mediation and reconciliation platforms to assist in resolving legal matters tied to the non-observance of the OECD MNE Guidelines.

The OECD Due Diligence Guidance for Responsible Business Conduct provides "practical support to enterprises on the implementation of the OECD Guidelines for Multinational Enterprises". Enforcing "these recommendations helps enterprises avoid and address adverse impacts related to workers, human rights, the environment, bribery, consumers and corporate governance that may be associated with their operations, supply chains and other business relationships" (OECD, 2018, p.3).

All of the topics dealt with so far are embedded in the comprehensive proposal developed by the EU in the 2019 document which acts upon three interlinked fronts: 1) CSR/RBC; 2) Business and Human Rights and the protection of human rights in general; and 3) Sustainability and the implementation of the UN 2030 Agenda for Sustainable Development. "Given the overlaps

[19] *Cfr.* https://www.oecd.org/investment/toolkit/policyareas/responsiblebusinessconduct/

[20] *Cfr.* OECD (2017), Responsible business conduct for institutional investors: Key considerations for due diligence under the OECD Guidelines for Multinational Enterprises

between CSR/RBC, the SDGs and UNGPs, the Commission has taken a holistic and integrated approach focused on practical action, irrespective of whether it is labelled 'CSR', 'RBC', 'Business and Human Rights', 'SDG' or all four together, while at the same time recognising the differences in focus between those agendas." (EU, 2019, p.5). The European Commission in 2020 launched a study on due diligence in the value chain.

This includes a survey on 334 European businesses and other 297 key respondents[21] (business associations, industry organizations, worker representatives and trade unions, legal practitioners and government bodies) just over one-third of business respondents indicated that their companies engaged in DD practices by taking into account human rights and environmental impacts; another third affirmed to engage in due diligence only in certain areas. Moreover, most respondents emphasized how they seemed unconvinced that EU voluntary guidance would have considerable social, environmental, and human rights effects. This adds to the fact that the existing laws that require corporate human rights due diligence – such as the French Duty of Vigilance Law, the U.S. Conflict Minerals Rule, the EU Conflict Minerals Regulation and the U.S. Federal Acquisition Regulation anti-trafficking provisions – apply to a relatively small number of companies and/or a narrow set of issues.

For example, the French Due Diligence Law only applies to enterprises employing at least 5,000 employees; the EU Conflict Mineral Regulation "applies to EU importers, smelters and refiners, as long as their annual import volume of the minerals or metals concerned is above certain volume thresholds" (EU, 2020b, p.7). It is therefore clear that "the majority of existing legislation applies only to companies of a certain size" (EU, 2020b, p.8) mainly excluding SMEs.

Following the outcomes of the abovementioned study (EU, 2020a), at the end of April, EU Commissioner for Justice Didier Reynders announced that the European Commission is evaluating the introduction of mandatory human rights due diligence legislation in the first quarter of 2021.[22]

We wish to conclude this brief review of the CSR/ due diligence/ RBC concepts at the heart of our research by highlighting that, beyond their different academic and institutional origins, these are strongly interconnected and sometimes overlapping concepts as they all convey the importance of a socio-economic renewal inspired by urgent and unavoidable precepts of "360° sustainability", connected to Porter and Kramer's shared value.

It is undeniable that the great debate on corporations' responsibilities that began in the 1930s has highlighted the intrinsic dual nature, both economic and social, of businesses.

At the same time, this debate has made it possible to broaden the discussion on the role of businesses by triggering a reflection on companies' desirable commitments in the new global economic, political, and social order. The canon of voluntariness is no longer considered essential and foundational of the very definition of CSR and, as previously addressed, the European legislation has recently reaffirmed this position by laying down the foundation for a more peremptory and essential regulatory approach which focuses on mandatory due diligence, and promotes a more holistic and all-encompassing CSR culture where, as recommended by UNGPs, both mandatory and voluntary measures are considered interlinked and highly recommended.

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21 *Cfr.* European Commission (2020a). *Study on due diligence requirements through the supply chain.* Brussels.

22 *Cfr.*https://www.europarl.europa.eu/meetdocs/2014_2019/plmrep/COMMITTEES/DROI/DV/2020/06-22/DGEXPObriefingHumanRightsDueDiligence_EN.pdf

In the past decade, adherence to CSR principles, which has been strongly encouraged unanimously by various supra-national bodies (EU, OECD, UN) through definitions, tools and operational guidelines, have promoted a CSR culture oriented towards a radical and ongoing change in business and social practices that could be associated to the new more long-termed sustainable and cohesive paradigm of "**shared value**".

2. Empirical review connecting the concepts of CSR, ESG, DUE DILIGENCE to corporate performance.

2.1. CSR/ESG's impacts on firm performance: some evidence pointed out by the literature

In this paragraph, we will use the concepts of ESG/RBC and CSR interchangeably and we will review all the main contributions that highlight a correlation between CSR/ESG/RBC practices and corporate performance.

2.1.1. CSR/ESG effects highlighted by traditional literature on CSR

As mentioned in the previous section, from the 1970's scholars' attention to the business case for CSR has become increasingly more acknowledged (Carroll and Shabana, 2010). Some authors (Lee, 2008; Vogel, 2005) have reasonably observed a trend in the evolution of CSR theories from an ethics standpoint to a prevailing performance orientation. This has evolved in tandem with the level of the analysis that moved away from a macro-social level to an organizational level. Vogel (2005) rightly observes some features of the 'new world of CSR' that emphasizes the link between CSR and corporate financial success that seems to have grown from an 'old style' CSR of the 1960s and 1970s that was primarily focused on social considerations.

Generally speaking, the literature has pointed out four arguments that would drive companies to implement CSR policies in order to increase their corporate performance: (1) reducing cost and risk; (2) strengthening legitimacy and reputation; (3) building a competitive advantage; and (4) creating win-win situations through synergistic value creation (Kurucz et al., 2008; Carroll and Shabana, 2010).

The cost and risk **reduction** arguments hypothesize that engaging in certain CSR activities will reduce costs and risks for the firm. By relying on CSR activities, the firm may reduce its risk of facing opposition/litigation from its stakeholders, by diminishing the possible threats through a threshold level of social or environmental engagement (Kurucz et al., 2008; Berman et al., 1999; Robinson and Dechant, 1997; Thomas and Ely, 1996); some authors have demonstrated that firms' commitment to CSR engagement in the form of equal employment opportunity (EEO) policies and practices and environmentally responsible actions may enhance long-term shareholder value (Smith, 2005).

Baglayan et al. (2018) identify 5 main areas that could be affected by litigation-costs:

1 financial costs: in addition to potential exclusion from public procurement, companies' exposure to litigation in social, environmental and HR field, may negatively affect their credit rating and access to capital; 2) costs of Out-of-Court Settlement Proceeding: settling cases is expensive for enterprises; 3) information disclosure costs: litigation proceedings include the disclosure of numerous types of internal company information. First, the production of evidence requires information disclosure. Secondly and indirectly, litigation will sometimes create an environment where the increased activism may lead to information disclosure (e.g. plaintiffs that seek to raise public awareness and put pressure on stakeholders). Both types of information disclosure may be risky for the firm; 4) reputational costs: bad publicity that comes with the lawsuit can hurt a company's reputation independently of whether or not the defendant wins, loses, or settles; 5) litigation effects on stock performance: stock prices declining could represent, among

other issues for the firm in question, a mix of cost factors such as legal penalties, lawsuit settlements, fines, and a damaged reputation by the firm under question.

Legitimacy and reputation assertions maintain that CSR activities help strengthen a firm's legitimacy and reputation towards customers and investors when it is capable of satisfying stakeholders' needs and contextually operate profitably (Kurucz et al., 2008; Smith, 2005). Marketing[23] and corporate philanthropy (Chen et al., 2008) are useful tools to strengthen firms' legitimacy and reputation.

Competitive advantage logic argues that, by implementing certain CSR activities, a firm may be able to build stronger and long-term relationships with its stakeholders and gain their support in the form of lower levels of employee turnover (Kurucz et al., 2008), acquire access to more skilled and talented prospects (Smith, 2005), and enhance customer/brand loyalty (Pivato et al., 2008). In turn, the enterprise will be able to differentiate itself from its competitors.

Synergistic value maintains that CSR activities may provide opportunities for firms that would allow them to meet the needs of their stakeholders, and at the same time pursue their profit goals. The idea of creating win-win relationships and outcomes that reconcile different stakeholder requirements is historically due to Drucker (1984). However, by going through various contributions (Porter and Kramer, 2006; Wheeler et al., 2003), it becomes one of the main pillars of Porter and Kramer's shared value (2011). Moreover, the synergistic view could be in the same way linked to corporations' competitive advantage: Vilanova et al. (2009) analyse CSR in relation to competitive advantage and put forth a multidimensional definition of c.a. that relies on 5 five main aspects: performance, quality, productivity, image and innovation.

Table 1: CSR/ESG effects highlighted by traditional literature on CSR

Topic	Main contributions
Cost and risk reduction	Kurucz et al., 2008; Berman et al., 1999; Robinson and Dechant, 1997; Thomas and Ely, 1996 Smith, 2005. Baglayan et al., 2018
Legitimacy and reputation	Kurucz et al., 2008; Smith, 2005 ; Chen et al., 2008
Competitive advantage	Kurucz et al., 2008; Smith, 2005 and Pivato et al., 2008
Synergistic value	Drucker, 1984; Porter and Kramer, 2006; Wheeler et al., 2003; Porter and Kramer, 2011; Vilanova et al., 2008

2.1.2. CSR/ESG effects highlighted by institutional reports and other works

From the practitioner's point of view, *From Stockholder to the Stakeholder* report (Clark et al., 2015), which is based on a meta-analysis of 200 different studies, is geared towards producing an updated and all-inclusive overview of the current "sustainability" research, a broader term used to encompass all the topics and literary hints tied to sustainable responsible investing (SRI), CSR and ESG issues. The study aims at supporting decision makers by providing both "solid and transparent evidence that demonstrates the impact it has on sustainable corporate

[23] Carroll and Shabana (2010, p.99) reporting the results of Smith and Alcron (1991) argue that *cause marketing* can be a useful strategy because, in addition to emphasizing product advantages, product benefits are linked to appeals for charitable giving.

management and investment practices" (Clark et al., 2015, p.10). The report confirms what the traditional CSR literature has highlighted.

There are three major ways, among others, that sustainability can lead to having a competitive advantage through the integration of environmental, social and governance (ESG) issues: 1) by reducing specific company risks, 2) by increasing company performance, 3) by improving the company's reputation (Clark et al., 2015, p.13).

1 **Risk reduction** is an incredibly positive outcome in terms of successfully integrating sustainability into a company's culture and strategic management. Neglecting sustainability issues can have a considerable impact on a company's business operations from the mid to long term. When properly implemented, superior sustainability policies can relieve aspects of financial, reputational, and environmental risks. A practical example of the harmful effects, on the reputational side and on the financial performance, was BP's Deepwater Horizon 2010 oil spill in the Gulf of Mexico. It is one of the most recent high-profile examples of how environmental risks can have considerable financial and reputational consequences. Calculating BP's costs is difficult: the Economist estimated $42bn in clean-up and compensation costs whereas the Financial Times estimated that the clean-up costs alone could amount to $90bn. BP's share price lost 50% between 20th April 2010 and 29th June 2010 as the disaster unfolded.[24]

   Bauer and Hann (2010) analyse how poor environmental practices influence the credit standing of borrowing firms through legal, reputational, and regulatory risks: firms that engage in proactive environmental practices benefit from a lower cost of debt financing (*Cfr.* Annex A, tab.1).

   Lee and Faff's study (2009) demonstrates that a large proportion of the return difference of firms or portfolios that lead or lag in CSP (corporate social performance) is plausibly explained by differences in idiosyncratic risk. Relying on previous literature about the relation between CSP-CFP where a majority of SRI (social responsible investment) studies at the firm level find a positive CSP-CFP link (inter alia*Cfr.* Orlitzky, Schmidt and Ryes, 2003; Hasan et al., 2018) while others show a negative link between CSP and CFP (Brammer et al., 2006), the authors highlighted the importance of including a CSP proxy (DSJI- Dow Jones Sustainability Index) to describe economic, social, and environmental risk management strategies (*Cfr.* Annex A, tab.1).

   Cai et al. (2014) examine the empirical influence of Corporate Environmental Responsibility (CER) involvement on firm risk for a comprehensive sample of US firms from 1991 to 2012. They find that CER engagement is negatively associated with firm risk after analysing various firm features. (*Cfr.* ANNEX A, tab.1).

   Hoepner et al. (2018) analyse whether shareholder commitment with regard to ESG activities can indeed diminish downside risk at portfolio firms. They introduce supporting evidence for by analysing 1,712 investments across 573 firms around the world between 2005 to 2018. They discover that investor firms usually designate their resources for corporate governance issues, which accounts for 43% of the investments. Investors also participate in environmental (22%), social (20%), and strategy (16%) themes. By support the validity of these findings through time-series tests that examine the effects of participation on the exposure of the targeted firms' returns to a downside-risk factor, they find that the

24 For more in-depth information, *Cfr.* Clark et al. (2015, p.14); Cichon, A. M., & Neghaiwi, N. (2014). ESG & Credit Risk; New Study Demonstrates a Clear Link. RepRisk AG. Retrieved from http://www.reprisk.com/**marketing**/wp-content/uploads/2014/04/Cornerstone-article.pdf

downside-risk factor exposure significantly decreases after successful shareholder engagement (*Cfr.* Annex A, tab.1).

Albuquerque et al. (2019) study a mechanism through which CSR policies affect firms' systematic risk based on the premise that CSR produces a differentiation strategy. Authors measure changes in firm profitability, through panel regressions of changes in firm profitability on GDP growth and GDP growth interacted with CSR, with year-on-year changes in ROA (return on assets) and use the two CSR measures. Main outcomes of the study highlight that: 1) the level of systematic risk is statistically and economically significantly lower for firms with a higher CSR score; 2) there is a positive correlation between CSR score and Tobin's Q (financial performance) (*Cfr.* Annex A, tab.1).

2 Dealing with the **CSR-firm performance** relationship, we can distinguish between operational corporate performance (OCP) and corporate financial performance (CFP). Back in the 1990s, a new stream of research dealing with the hypothesized relationship between CSR and CSP emerged; in order to assess this plausible connection, scholars started relying on a new data source, namely the Kinder, Lydenberg, and Domini (KLD) data. Waddock and Graves's (1997) seminal work is considered the starting point of that emerging literature strand. The authors constructed an aggregate CSR based on the KLD data and tested the effect of that index on corporate operational performance measures such as return-on-equity, return-on-assets, and return-on-sales. The authors came to a two-folded conclusion: in the first place, the quality of a corporation's social responsibility depends on past financial performance; and secondly, they ascribed future financial performance on good CSR and management practices.

The conclusion that a significant and positive effect of CSR on CFP is driven by R&D investment came from McWilliams and Siegel's contribution (2000). Regardless of the original and outstanding contribution, the limit of this study is probably due to the fact that the authors' measure for CSR is a binary variable, that is probably not equipped to describe the complexity of this versatile concept, indicating whether a firm is a member of a particular social stock market index.

Evidence in favour of a relationship between CSR and CFP is provided also by Servaes and Tamayo's work (2013). To measure performance, they employ Tobin's Q, which is the market value of the firm, divided by the replacement value of its assets. Their assertion that CSR increases a firm's value with higher customer awareness relies on the "advertising" variable as being a good proxy for awareness. They estimate panel regressions of Tobin's Q as a function of CSR involvement and an interaction term between the CSR measure and advertising intensity. Research's main outcomes highlight that 1) a firm's value can increase for firms with high public awareness, as proxied by advertising intensity (proxy of consumer awareness); 2) firms with high public awareness tend to be penalized more often if there are CSR concerns; 3) for firms with low public awareness and disclosure, the impact of CSR activities on firm value is either insignificant or negative; 4) CSR-value relation can be negatively affected by advertising if there is an inconsistency between the firm's CSR efforts and the company's overall reputation; 5) after including firm fixed effects there is no direct relation between CSR and firm value (*Cfr.* Annex A, tab.1).

Hasan et al.'s study (2018), based on a comprehensive longitudinal dataset of the US manufacturing firms from 1992 to 2009, unearths the relationship between corporate social performance and financial performance (*Cfr.* Annex A, tab.1).

The analysis, based on a comprehensive longitudinal dataset of the US manufacturing firms from 1992 to 2009, uncovers a productivity-based, context-dependent mechanism underlying the relationship between corporate social performance and financial performance. The research relies on these 2 hypotheses:

H1 Corporate social performance is positively related to firm total factor productivity

H2 The relationship between corporate social performance and financial performance is mediated by firm total factor productivity

To test their hypotheses, they supplement the Compustat database with the NBER-CES Manufacturing Industry database and estimate firm-level TFP for all publicly traded U.S. firms in the manufacturing sector (SIC 2000–3999).

Being their main explanatory variable an index of CSP, they rely on KLD dataset for information on firm social performance. As the KLD database has better coverage on firm social performance after 1991 and the NBER-CES database ends in 2009, authors merged the Compustat and KLD data for 1992–2009. They also retrieved stock price information from the Center for Research in Security Prices (CRSP) to calculate firm market-based financial performance. After dropping observations with incomplete information, their matching procedure produces a final sample of 5,516 firm-year observations including 986 US firms.

By employing multiple approaches, including fixed effects regression, instrumental variable estimation, and propensity score matching method, to control for endogeneity issues and ensure making proper causal inferences, authors demonstrate that:

- CSR is positively related to firm TFP with a magnitude of 0.030
- the relationship between CSP and CFP is mediated by firm total factor productivity
- the relationship between CSP and firm TFP is stronger for firms with higher levels of discretionary cash and discretionary risk (two considered contingencies).

Environmental practices and firm performance

Derwall et al. (2005), by analysing the performance of a set of enterprises between 1995-2003, find that the most eco-efficient firms perform significantly higher returns than non-eco efficient firms.

King and Lennox's (2001) results demonstrate that the better a company practiced waste prevention, the better was the company's financial performance. Guenster et al. (2011) come to similar conclusions by examining the relationship between eco-efficiency and CFP of corporations between 1997 and 2004: their outcomes highlight that 1. better eco-efficiency significantly increases corporations' operating performance, measured by their return-on-assets and that 2. CFP, measured by Tobin's Q, is generally positively and significantly influenced by the firm's eco-efficiency.

Similarly, Salama (2005) demonstrates there is a positive relationship between CEP and CFP. By relying on median regression on a panel data of British companies, he points out the importance for companies of developing a reputation in environmental affairs: a good environmental reputation can lead to higher performance results.

Other studies provide evidence for a negative relationship between corporate environmental and financial performance. For instance, Brammer et al. (2006) show that UK firms with good CSR ratings tend to underperform in relationship to their poor CSR counterparts. They attribute these results to the environmental indicators, while they don't find a correlation with community-related CSR, leaving room for further research and hypothesising that for achieving a proper picture of the effects of CSR, various aspects of corporate social behaviour must be examined separately (*Cfr.* Annex A, tab.1).

The same argument is covered by Jayachandran et al. (2013) who claim that CSR should not be measured on an aggregate basis. By analysing 518 firms and 3,701 corresponding firm-years, they find that a firm's environmental performance does not significantly relate to Tobin's Q.

Social engagement and firm performance

The literature also investigates the effect of particular social issues on CFP. CSR's social domain mainly refers to employee/stakeholder relations (Edmans, 2011), or charitable giving (Brammer and Millington, 2008) as corporate social issues.

Margolis et al. (2003) perform an in-depth review of 127 studies that, over the span of 3 decades, empirically focused on the relationship between CSP and CFP: 109 of the studies based its financial performance predictions on corporate social performance, nearly half of the results (54) show a positive relationship between CSP and CFP. Only seven of the studies find that there is a negative relationship; 28 studies report insignificant relationships, while another 20 report mixed outcomes.

Another outstanding contribution on the social dimension of ESG and its beneficial effect on CFP is Edman's study (2011). He performs an in-depth investigation on the "100 Best Companies to Work For" in order to determine whether there is a correlation between employees' overall well-being and an increase in stock returns of those specific companies.

His results indicate that companies with higher levels of employees' well-being showed an annual risk-adjusted abnormal return of 3.5 per cents above the risk-free rate from 1984 to 2009 and 2.1 per cent above industry benchmarks. In his follow-up article, Edmans (2012) extends the sample period until 2011 and tests for any abnormal returns over the new sample period from 1984 to 2011. These new results mirror his earlier outcomes, which indicate an abnormal profit of 3.8 per cent annually in excess of the risk-free rate. Likewise, the abnormal returns adjusting for industries are higher than in the shorter sample period with 2.3 per cent annually (Edmans, 2012).

Still in regard to human resources and workers' rights, Baglayan et al. (2018) analyse "the social impact of embracing or ignoring human rights by companies along two dimensions: workplace and community relations. By establishing strong human rights-based policies in the workplace, businesses can benefit from greater loyalty and significantly increased productivity - as demonstrated for example by Better Work Programme implemented in garment factories in Vietnam -, avoid supply chain disruption, and minimise legal risk. Failing to implement human rights standards can significantly harm a company's stakeholder and community relations" (Baglayan et al., 2018, p.10). By determining strong human rights-based policies in the workplace, businesses can benefit from greater loyalty and increased productivity, avoid supply chain disruption, minimise legal risk and get economic incentives. Not adhering to human right standards can have a negative impact on a corporation's stakeholders and community relations. "These costs generally come in the form of diverting staff to deal with community conflict, as well as lost opportunity costs. Positively engaging with communities can prevent these costs, as well as provide financial rewards in the long term." (*ibid.,* p.10).

An increasing amount of studies have tried various ways of identifying the relationship between firm performance and working conditions. These studies demonstrate that profits, productivity, and firm survival can be attributed to the improvement in working conditions and increased compliance with labour standards (World Bank Group, 2015). For instance, a management and labour survey in the Lao PDR garment industry found that by failing to improve workers' well-being led to dissatisfaction, higher employee turnover, lower productivity levels, and the firms' opportunity to strengthen participation in garment GVCs was undermined (World Bank, 2012).

Oka (2012) analyses the plausible connection between labour standards and supplier competitiveness. The study reveals that improved labour practices compliance increases a suppliers' chances of gaining and keeping buyers that are reputation-conscious even if it does not influence buyers' sourcing decisions.

Brammer and Millington (2008) also focus on one specific dimension of CSR (corporate philanthropic donations) to test whether it is advantageous and worthwhile for companies "to be different". They find that companies that make either surprisingly very high or very low CSR charitable donations tend to benefit from higher financial performance than companies that do not and deduce that good social performers thrive in financial terms over longer periods of time. However, it is worthwhile noting that their study is based on UK firms only and the same authors acknowledge that the results may be biased because the majority of donations come from corporations.

Analysis of the banking industry also reveals a positive connection between CSR and financial performance. Simpson and Kohers (2002) demonstrate that banks with better ratings in regard to the "Community Reinvestment Act Ratings" exhibit better financial performance, even though also corporate reputation plays an important role (McGuire et al., 1988).

In sum, even acknowledging that further research is needed, we can state that the majority of studies were able to find a positive connection between the quality of the social dimension of CSR and CFP.

3 **Reputation** concerns the two primary issues of managing stakeholders and customers.

   Research shows that corporate reputation is an important input factor for continuous value maximization (Roberts and Dowling, 2002). Companies' productivity is influenced by the quality of human capital because it is one of the primary resources that make operating and delivering goods and services to customers possible.

   Maintaining a good reputation (in regard to corporate working environments) can lead to job security and to the hiring of high quality, highly skilled and talented employees (Edmans, 2011, 2012). This also translates to gaining an edge in the market and to excellent financial performance. Moreover, good reputation with respect to corporate working environments can foster job embeddedness and ensure the retaining of talented employees. External surveys, such as Fortune's *Best Companies To Work For*[25], prove to be a value asset in terms of providing an independent way to ascertain the reputation of a company in terms of workforce attraction.

[25] The annual lists of the best companies to work for are published on Fortune's website at: http://fortune.com/best-companies.

Table 2: CSR/ESG effects highlighted by institutional reports and other works

Topic	Main contributions
Cost and risk-reduction	Bauer and Hann (2010) Lee and Faff (2009) Cai et al. (2014) Hoepner et al. (2018) Albuquerque et al. (2019)
Firm performance	Waddock and Graves (1997) McWilliams and Siegel (2000) Servaes and Tamayo (2013) Hasan et al. (2018) Derwall et al. (2005) King and Lennox (200 Salama (2005) Brammer et al. (2006) Jayachandran et al. (2013) Margolis et al. (2003) Edmans (2011, 2012) Baglayan et al. (2018) Oka (2012) Brammer and Millington (2008) Simpson and Kohers (2002)
Reputation	Roberts and Dowling (2002) Fortune's 100 Companies to Work for

2.2. CSR/ESG effects analysed by institutional works: a focus on OECD's study

In addition to academic contributions, some institutional works focus on the advantages of CSR/ESG implementation by corporations.

OECD's report (2016) on "Costs, Benefits and Risks of Due Diligence for Responsible Business Conduct" confirms the results of the previous CSR literature review about what businesses would derive from it when incorporating risk-based due diligence for responsible business conduct.

The study provides a useful prospectus to identify benefits and costs of RBC due diligence. The beginning of their extensive literature review is based on the ideas offered by Margolis, Elfenbein and Walsh's study (2007) in their meta-analysis of 192 effects revealed in 167 studies. In general, they found that the overall effect is positive but small with only 2% of the individual studies reporting a significant negative effect on shareholder value.

The study proposes a slightly different, even though partly overlapping taxonomy, that distinguishes among **7 areas**. What is worth mentioning is that OECD' s study proposes an original interpretative framework that distinguishes between intermediate benefits (improved governance, improved operational knowledge, strengthen stakeholder management, reduced risk, improved transparency and improved reputation) and bottom-line benefits (lower cost of labour, superior operational efficiency, risks reduction, lower cost of capital, superior comparative positioning and growth opportunities, enhanced brand equity).

1 Stock Price: the reference studies rely on a comparison of stock price performance related to company sustainability policies. Research by Eccles et al. (2011) shows that high sustainability firms in the long term outperform the low sustainability ones in terms of both stock market and accounting measures. As treated before, Clark et al. (2015), relying on an extensive review of more than 200 contributions, demonstrate a positive correlation between good ESG practices and financial market performance/cost of capital. Servaes and Tamayo (2013), covering all companies in the S&P 500 index and the Domini 400 Social Index from 1991 to 2005, show the positive relation between CSR initiatives and firm value when public awareness, proxied by advertising activities, is high.

2 Cost of capital: superior CFP is strictly tied to CSR/ESG corporations' engagement. Cheng et al. (2011)[26]suggest that good CSR performance and disclosure paired with stakeholder engagement leads to lower capital constraints and, in turn, lower capital constraints tend to lead to an improvement in CSR engagement by corporations. Ghoul et al. (2011) conducted an extensive research that relied upon 12,915 observations collected annually from US firms, from 1992 to 2007. They merged 4 datasets (Thompson Institutional Brokers Earnings Services, Compustat North Ameria, KLD STATS, CRSP monthly return files) to assess the relationship between CSR score and cost of capital. Findings demonstrate that companies with better CSR performance have less expensive equity financing and lower equity costs.

3 Reputation: ESG/CSR engagement affects corporation's bottom line, namely cost of capital, brand reputation and operational performance. Clark et al. (2015) demonstrate how company's good reputation can lead to high CFP and increase attractiveness of the company to potential employees. Edmans' research (2011) on "100 Best Companies to Work For in America" assesses the positive relationship between workers satisfaction and companies' long-run stock market returns. Godfrey et al. (2005) focus on the relationship between CSR and shared value: CSR, by acting as a risk management tool, helps to enhance moral capital that protects the firm from possible negative consequences. Additionally, active participation on behalf of secondary stakeholders in institutional CSR activities is likely to provide "insurance-like" benefits if in the event the company were to be sued for any reason. Nielsen[27](2012) analyses the pervasiveness of the concept of sustainability also from the consumers' point of view: by relying upon the results of a poll of 30,000 consumers in 60 countries, he finds that approximately half of the respondents are willing to pay extra for products and services provided by companies that engage in "responsible" ESG activities.

4 Operational efficiency: many contributions provide evidence that ESG/CSR performance positively impacts firms' operational performance (*Cfr.* Clark et al., 2015). It's worth pointing out that by the term "operational performance", some authors refer to the measurable aspects of the outcomes of an organization's processes, such as reliability, production cycle

[26] *Cfr.* Cheng, B., Ioannou, I., & Serafeim, G. (2014). *Corporate social responsibility and access to finance.* Strategic management journal, *35*(1), 1-23.

[27] Nielsen (2012). Doing Well by Doing Good. http://www.nielsen.com/content/dam/nielsenglobal/apac/docs/reports/2014/Nielsen-Global-Corporate-Social-Responsibility-Report-June-2014.pdf

time, and inventory turns; operational performance in turn affects business performance measures (Samson and Terziovski, 1999). However, the term is most used in a more general way as a synonym of "business performance", measured by performance indicators such as ROA (return on assets), ROE (return on equity), Tobins'Q.

5 Human resources: mainly concerns how CSR measures affect a company's attractiveness regarding potential employees and employee satisfaction. Greening's study (2000) reveals that companies with a good CSR reputation tend to attract and to retain employees, which equates to reduced turnover, lower recruitment and training costs. This affects also existing employees who tend to be more motivated, involved and productive: employees of socially responsible, purpose-driven companies tend to have less sick days and lower turnover rates, which directly affects the cost of doing business. Similarly, ADP's survey[28] confirms that CSR policies are attractive to millennials who claim that CSR directly influences whether or not they would work at a specific organization. Good working conditions and employee satisfaction can lead to reduction in employee turnover (Blake, 2006) and are directly tied to employers' return on capital growth (Prakash-Mani et al., 2002) and higher stock returns (Edmans, 2012). To conclude, RBC policies make companies more attractive employers.

6 Risk management deals with the effect of negative CSR on shareholder value.

Lahrech's study (2011) focuses on short term capital market reaction to CSR negative events. The analysis, dealing with companies listed on the FTSE 100 Review of the Financial Times identify 151 events associated with 78 companies between 2007 and 2011, and reveals a significant negative stock price response to CSR related negative events. Moreover, CSR, by acting as a risk management tool, helps to enhance moral capital that protects the firm from possible negative consequences. Additionally, active participation on behalf of secondary stakeholders in institutional CSR activities are likely to provide "insurance-like" benefits, in the event that the company were sued for any reason. Moreover, reputational, and legal risks can pose a significant threat to a company's market value: investors are likely to take into consideration the firm's reputational and legal risks, which influence their opinion of its future profitability. In the same manner, Hong et al. (2019), analysing a sample of 101 Foreign Corrupt Practices Act cases against corporations starting in 1991 through 2015, highlight the fact that if companies perform more responsibly, they are more likely to receive a more lenient settlement from prosecutors on lawsuits (e.g. reduced fines companies have to pay in corporate infractions) and have higher market valuations.

7 Environment: focuses on the relation between corporate environmental responsibility and firm performance.

Most studies indicate a positive relationship between proper corporate environmental policies and firm operational performance: most eco-efficient firms exhibit better operational performance as measured by return on assets (ROA) and higher financial performance (Tobin's Q) (*Cfr.* Clark et al., 2015). The literature also shows the benefits of dealing with pollution before it occurs and, generally speaking, environmental investments: after the initial inconvenience of up-front investments in technology and training, efforts to reduce emissions were significantly related to an increase in operational performance (ROA, ROS) after 1 year and an increase in financial performance (ROE) after 2

28 ADP (2015). *Attracting Talent Through Corporate Social Responsibility: 3 Myths Debunked.* ADP Human Capital Insights. Vol.4

years (Hart & Ahuja, 1996).

The literature has highlighted the many benefits that companies receive as a result of implementing due diligence for RBC. It can be summarized as follows: from the company's perspective, the implementation of CSR/ESG policies can translate to lower Cost of Debt, increased Market Share, better Product Quality, more Pricing Power for companies, a company's improved reputation, along with its brand value and stakeholder governance, can trigger improved employee productivity and talent acquisition/retention, which in turn improves government and civil society relationships and, whenever the case, can lower adverse event costs.

3. An empirical analysis on ESG due diligence and corporate accountability in EU

3.1. Introduction

The aim of this empirical investigation is to shed light on the complex and empirically underexplored topic of CSR and ESG due diligence in EU. This work paves the way for a comprehensive understanding of the possible impacts of CSR/ESG accountability practices on firm performance in the European economic landscape.

By exploiting an innovative database called Asset4-Thomson Reuters, we carry on a two-fold empirical research. Firstly, our methodological strategy aims at providing a measurement of "elasticity", and secondly an "upward harmonization" scenario. The former offers a measurement of the percentage change of firm performance in response to a change of ESG score. The latter, by relying on the elasticity measurement estimated in the first step, offers a construction of scenarios describing the impact of an enlargement of CSR practices on firm performance.

In the first part of this work, we propose an aggregated index of CSR, by combining both environmental and social policies, and an elasticity index for EU firms. The scenario analysis presents three alternative future developments: one ambitious scenario, where all firms reach the CSR index of the top performers, another scenario based on a single jump of the firms through the CSR scale (i.e. the low performers reach the medium-low performers, the low-medium performers reach the medium-high performers and so on), and an idealistic scenario, that describes a scenario where all companies move to the maximum possible value of the CSR index (i.e. 3). After the exploration of the different scenarios, the second part of the work proposes a robustness check and a further analysis by exploiting different datasets within the Asset4-Thomson Reuters database.

3.2. CSR elasticity measurement for EU firms and upward harmonization scenarios

3.2.1. Data and Methodology

Data description

The analysis is based on the Asset4-Thomson Reuters database, which we will refer to as "Asset4" from heron. Asset4 provides environmental, social and governance (ESG) information deriving from different sources such as firms' annual reports, CSR reports, NGO website, among others. This CSR information is reported through more than 250 key performance indicators (KPI), grounded on more than 750 individual value points.

The dataset provides an overall score, which is discounted for ESG controversies that practically impact the value of the corporations. The scores are available on over 6,000 companies globally. Thomson Reuters Asset4 ESG scores is the most recent attempt to quantify and evaluate corporations' CSR/ESG practices. It is indeed the first benchmark against which we can measure the impact of environmental and social categories and the impact of a change in environmental and social categories on firm performance across industries and countries.

This information is merged with financial data at a firm-level. Financial data of companies from different countries and industries are provided by the Worldscope[29] database. Data is available until 2018.

Since Asset4 is a heterogeneous and complex database, in the scenario analysis we take advantage of a dataset including only environmental and social information. This dataset includes information for 511 firms that have non-missing values in 2017 regarding to the undertaken environmental and social policies, the processes that are put in place and the established objectives to be achieved. Independent and control variables are introduced in the analysis with one-year lagged. Our sample cannot be identified as a representative sample of the total EU firms because of the unbalanced sectoral and country distributions. In this regard, we explore the main limitations of our sample in the discussion. Despite this limitation, Asset4 allows a first and pioneering assessment of the impact of CSR practices on EU firm performance.

Going deeper in the exploration of the selected dataset, it is important to underline that in the scenario construction, information on the implementation of these policies at a firm-level is included in our dataset just for the environmental and social dimension, neglecting all the governance policies.[30] The use of this dataset can be advantageous because it offers information about the exploitation of such policies that refer to the extent to which these policies are applied in the business model of a firm. Specifically, the dataset provides information on whether or not a firm has just implemented the policy, without having established additional steps, or if a firm has implemented the policy and put in place related processes to implement the policy in the firm' business strategy. Additionally, the dataset provides insights on whether a firm has determined specific objectives in order to achieve related goals and monitoring the improvements.

Thanks to this in-depth information, it is possible to calculate a degree of CSR for each firm, that we will call "CSR degree index". However, it is important to remember that this dataset does not follow a policy-based specific perspective (as in the case of the second dataset, that we will exploit in subsection 3.3.2). On the contrary, it applies a general-macro policy level perspective without going into detail (see tab. B1).

By relying on the literature review presented in the first part of this work, we selected as dependent variable the most common performance measure, that is Tobin's Q, and an alternative measure, i.e. ROCE. ROCE allows us to assess the relation between CSR and firm performance and build up our upward harmonization scenarios both for our sample and the EU economic landscape. Because of the just explored reason, in what follows, we focus only on ROCE. The results of Tobin's Q[31] are presented in the Annex C and D.

Our main dependent variable is therefore Return on Capital Employed (ROCE). ROCE is a measure of company's profitability in terms of all its capital (i.e. the denominator is computed as total assets minus current liabilities). It reflects how well a company is generating profits from its capital. Indeed, it can be used to compare profitability levels across companies in

29 The Worldscope Global Database is a financial industry's source of financial statement data on public companies that are domiciled outside of US.

30 In this part of the empirical analysis, consistently with the main purpose of our work, we decided to focus just on these two dimensions of ESG practices.

31 Tobin's Q is measured as market value of firm as captured by enterprise value divided by book value of total assets.

terms of capital, as it can be interpreted as the amount of profit a company is generating per 1Euro of capital employed.

Our main independent variable is the CSR degree index. The CSR degree index is computed according to the following rationales:

- if a firm has not established the policy, then it is assigned the value 0;
- if a firm has only established the policy, and no additional steps have been taken, then it is assigned the value 1
- if a firm has established the policy and has put the implementation process in place, then it is assigned the value 2;
- if a firm has established the policy, put the process into place, and has determined specific objectives to achieve related goals and monitoring the improvements, then it is assigned the value 3.

Moreover, Asset4 database allows us to select a broad range of controls. By starting from the most common control variables presented by the literature review, we include several control variables in the exploration of the impact on financial performance of CSR implementation (Velte, 2017). More information on the control variables used in the analysis are presented in the section related to the elasticity measurement.

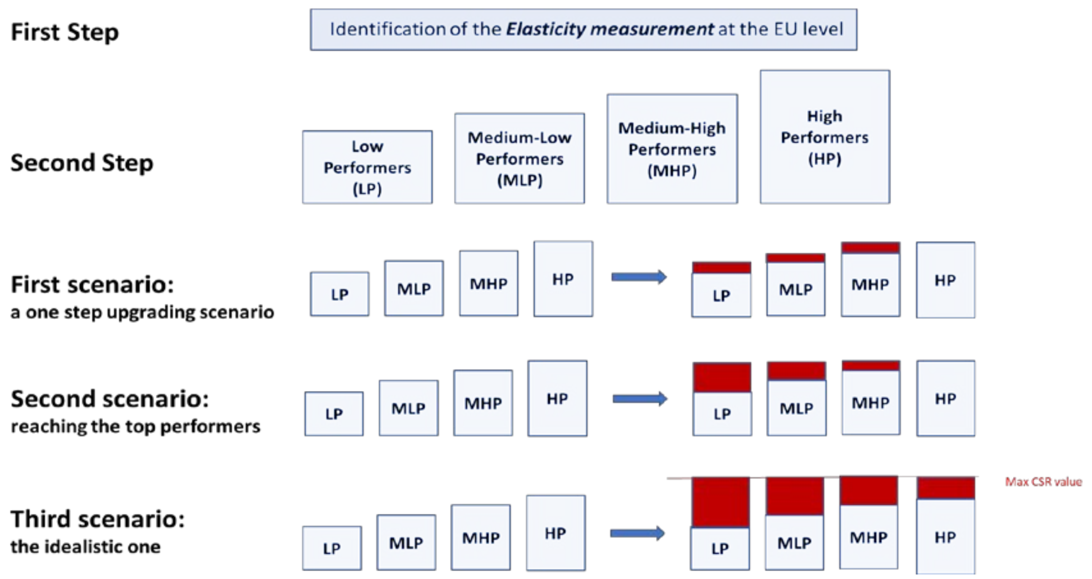
Methodology for the scenario analysis

Considering the complexity of the just mentioned datasets, the identification of a robust elasticity measure and the construction of the scenario is not a trivial task. As reported in Figure 3, we implement a two-step analysis. Thanks to this methodology, we can propose "upward harmonization" scenarios that foster a more comprehensive understanding of the impact of CSR implementation and exploitation actions of CSR practices put in place by EU firms.

In the first step of the analysis, we aim at offering an elasticity measure capable of capturing the impact not only of a simple enlargement of a CSR policies checklist[32], but also the impact of an exploitation of such policies referring to the extent to which these policies are applied in the business model. We measure elasticity by implementing an OLS regression approach to the just recalled dataset and taking into account the last year available in Asset4, i.e. 2018.

[32] We will better explore this aspect of the Asset4 database in the section related to further analysis and robustness check.

Figure 3: A graphical representation of the different steps making up the scenario analysis.



In the second step, we proceed to the construction of scenarios by identifying **low performers** in terms of CSR performance, **medium-low performers**, **medium-high performers**, and **high performers**. In order to identify the set of firms describing all these groups, we divide our sample in quartiles, by using the CSR degree index. Thanks to this approach, we can generate a starting point picture that describe four groups of performers as presented in Figure 3.

After the identification of the groups, based on their different CSR degree values, we then carry on the scenario analysis. First of all, it is important to remember that the scenario analysis does not aim to present one exact picture of the future, but it is a process proposing several alternative future developments by starting from some general information at some point in time. Since, several scenarios risk making the analysis overly complicated, we focus on and propose just three scenarios, the *less ambitious* scenario, the *ambitious* scenario, and the *idealistic scenario*, that describes a scenario where all companies move to the maximum possible value of the index (i.e. 3). [33]

As described by Figure 3, the first scenario answers the following research question:

What would happen to firm performance if all firms moved up by one-step in the scale described by the CSR degree index?

The second scenario presents a different possibility and refers to the question:

What would happen to firm performance if all firms moved to the CSR degree index of the top performers?

The third scenario tries instead to give an answer to the question:

What would happen to firm performance if all firms moved to the top CSR degree index?

[33] These scenarios are just one of the many possible scenarios.

In what follows, we present the analysis passing through the two main steps. In the next section, we present the results of the elasticity measurement and in the section 3.2.3 we build up the scenarios.

3.2.2. First step: the elasticity measurement

In order to estimate the elasticity measurement for EU firms, we now estimate the following OLS linear regression model:

$$ROCE_{i,t}=\alpha+\beta_1 CSRDegree\_Index_{i,t-1}+\beta_2 SIZE_{i,t-1}+\beta_3 Debt\_ratio_{i,t-1}+\beta_4 INT_{i,t}+\beta_5 Board\_size_{i,t}+\beta_6 Board\_ind_{i,t}+\beta_7 SEC_{i,t}+\varrho_{i,t} \quad (1)$$

As explored in the data description, our dependent variable is ROCE at a firm-level in 2018. As for the independent variables, we selected our variables by referring to the literature review. Our main independent variable is the CSR degree index, that is a categorical and composite index considering both the environmental and social dimensions. We included in our analysis the most common control variables suggested by the literature: Size, that, coherently with the several works in the field, is measured by the natural logarithm of total assets (Hasan et al., 2018, Albuquerque et al. 2019); Debt _ratio, that is the debt level calculated by using the share of debt on the total assets; INT variable (Velte, 2017), which is a dummy variable assuming value 1 if the firm has non-zero amount in the international operating income, being 0 otherwise; Board_size that is the sum of all corporate directors at the end of the fiscal year; Board_ind that describes the degree of independency of the board and it is calculated as the percentage of independent members of the board over the total number. Moreover, we added a control for the different sectors (SEC) (see Annex A).[34] Control variables are introduced in the analysis with one-year lagged.

In the calculation of the elasticity measurement, we decided to investigate both the whole set of firms and a subset of firms operating at least in more than one country (TNCs). In the first sample we have 511 firms in 2018. Instead, the sample of firms that have international operations (i.e. INT=1) are 219 firms in 2018.[35]

Table 3: Regression results of aggregated index of environmental and social degree on ROCE in 2018

Dependent variable:	Return on capital employed (ROCE)	
Estimator:	OLS (year 2018)	
Variables	(1)	(2)
CSRDegree_Index	0.0226*** (0.008)	0.0320** (0.014)
SIZE	-0.0118*** (0.004)	-0.0176*** (0.006)
Debt ratio	-0.0003 (0.000)	-0.0004 (0.000)
INT	0.0089 (0.009)	

34 Even if R&D is generally an interesting control variable as suggested by the literature, because of the several missing values, we decided to drop this control.

35 It is important to remember that INT as control variable is not included in the model as this subsample has all "1" in INT variable.

Board_size	-0.0008 (0.001)	-0.0013 (0.002)
Board_ind	0.0002 (0.000)	-0.0000 (0.000)
Technology	0.0351 (0.026)	-0.0383 (0.039)
Telecommunications	0.0177 (0.026)	0.0173 (0.044)
Health care	0.0097 (0.024)	0.0127 (0.037)
Financials	-0.0144 (0.023)	-0.0045 (0.032)
Real States	0.0149 (0.027)	-0.0102 (0.041)
Consumer discretionary	0.0636*** (0.022)	0.0826*** (0.031)
Consumer staples	0.0549** (0.025)	0.0456 (0.036)
Industrials	0.0359* (0.021)	0.0230 (0.031)
Basic materials	0.0252 (0.024)	0.0106 (0.038)
Energy	0.0398 (0.027)	0.0297 (0.039)
Observations	511	219
R-squared	0.144	0.263
R^2 adjusted	0.116	0.2083

Note: Regression (1) and (2) results respectively for 511 and 219 EU firms that have a non-missing information in 2017 regarding the undertaken environmental and social policies, the processes that are put in place and the established objectives to be achieved. Independent and control variables are introduced in the analysis with one-year lagged. The reported significance levels are: * 10%, ** 5%, *** 1%.

The results of our estimation present a positive and significant coefficient of 0.0226 for the CSR Degree_Index in the first model (i.e. 511 EU firms) and of 0.0320 for the second model (i.e. 219 EU firms). The interpretation of this result is not obvious. It means that when CSR Degree_Index increases of a "unit" we have an increase of 2.26% of ROCE. It is important to remember that the CSR index is a categorical variable. It can be interpreted as moving one step, for instance, from degree 0 to 1 (i.e. firm not having a policy compared with those that have a policy). Therefore, following our results, by moving one step forward on the CSR degree index scale, there is an increase of 0.0226 in the ROCE index (i.e. ROCE+0.0226).

The results, looking at the coefficient, are coherent with some of the most relevant works in the field, such as Hasan et al.'s (2018). If we focus on the subsample, results suggest that for what concerns the firms that operate in more than one country (TNCs), the impact of an increase of a unit of CSR degree index is stronger. Indeed, the coefficient measuring elasticity is higher than the index calculated over the whole sample of firms (see tab. 3). In this regard, it seems that firms more open to external markets can gain more if they increase their CSR degree index.

Taking both of our estimations of elasticity, in the next subsections we will propose the scenarios construction.

3.2.3. Second step: the scenarios construction

In this second step, we start by identifying **low performers** in terms of CSR performance, **medium-low performers**, **medium-high performers**, and **high performers**. As anticipated in the methodological part, we decided to identify these groups by dividing our sample in quartiles: in order to do so, we use our main independent variable (the CSRdegree_index) which takes into account both environmental and social policies.

As presented by Table4, the first quartile which refers to the **low performers** presents an average CSR degree index of 0.6817 in 2017. It is important to recall that the CSR degree index is computed using the following procedure. If a firm has only established the policy, and no additional steps have been taken, then it is assigned the value 1. If a firm has established the policy and also has put in place the implementation process, then it is assigned the value 2. If a firm has established the policy, put the process in place, and also determined specific goals to be achieved, then it is assigned the value 3. The class of firms referring to the **low performers** is clearly the worst performing in term of ROCE, showing an average ROCE equal to 0.0797 and an average sale (in millions of euros) equal to 3.5888. The **medium-low performers** (i.e. second quartile) present an average CSR degree index that is significantly higher than the first quartile (i.e. 1.4525) and also ROCE presents a higher value (i.e. 0.0951); however, both sales and size are closer to the first quartile than to the third one. As for the **medium-high performers**, they present an average ROCE equal to 0.1005, 0.0016 points less than the **high performers**, and an average total asset equal to 81.5789 compared to the 84.3662 of the fourth quartile. These last two quartiles, **medium-high performers** and **high performers** are clearly dominated by bigger firms compared to **low performers** and **medium-low performers**.

Table 4: Averages of ROCE, total assets, total employees, and net sales in each quartile of the CSR degree index

CSRDegree_Index	Average ROCE (year 2018)	Average of total assets (year 2018)	Average of total employees (year 2018)	Average SALE (year 2018)
low performers (0.6817)	0.0797	7.9316	16.1608	3.5888
medium-low performers (1.4525)	0.0951	23.1608	21.1602	4.6120
medium-high performers (2.0214)	0.1005	81.5789	41.6085	10.2729
high performers (2.4521)	0.1021	84.3662	83.7832	26.8524

Note: Average of Return on capital employed (ROCE), total assets (in millions of euros), total employees (in thousands) and sales (in millions of euros) for 511 EU firms that have a non-missing information in 2017 regarding the undertaken environmental and social policies, the processes that are put in place and the established objectives to be achieved.

Starting from these four groups, we build our scenario by applying both estimations, i.e. the one calculated over the whole dataset and the other focused on firms that operate in more than one country (TNCs).

One step upgrading scenario

The first scenario, i.e. the less ambitious scenario, refers to a single jump scenario. It means that the firms of the first quartile increase their average CSR degree index in order to reach the second quartile's value; the firms of the second quartile adjust their values to reach the values of the CSR degree index of the third quartile, and the firms of the third quartile increase their average CSR degree index in order to reach the fourth quartile's value(s). This scenario could be considered a more suitable approximation if we look at the impact deriving from an increase of CSR practices at a firm-level in a short-term harmonization scenario. In the long term, it is possible for firms to adjust their CSR practices by strongly reconfiguring their processes, but in the short term this is not a trivial task. Of course, as we can see from Table 5, the impact on ROCE of this scenario is lower than the more ambitious ones, but it still presents an important increase of ROCE, especially for the lower performers (i.e. 1.74%).

Figure 4: A less ambitious scenario. The red parts underline the jumps that each group need to perform in order to reach the average value of the CSR index of the higher neighbour.

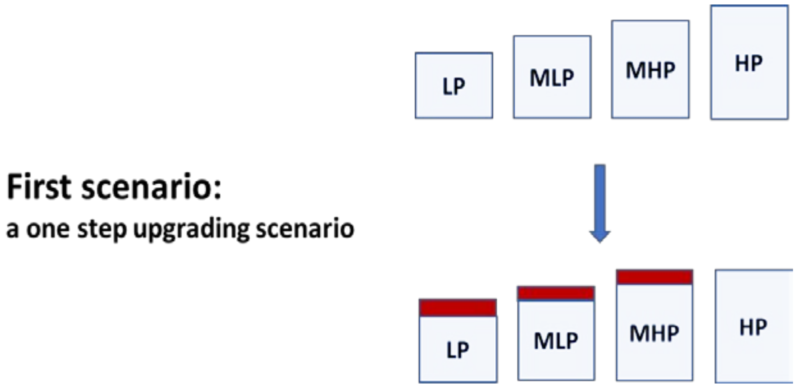


Table 5: First Scenario of Return on capital employed (ROCE)

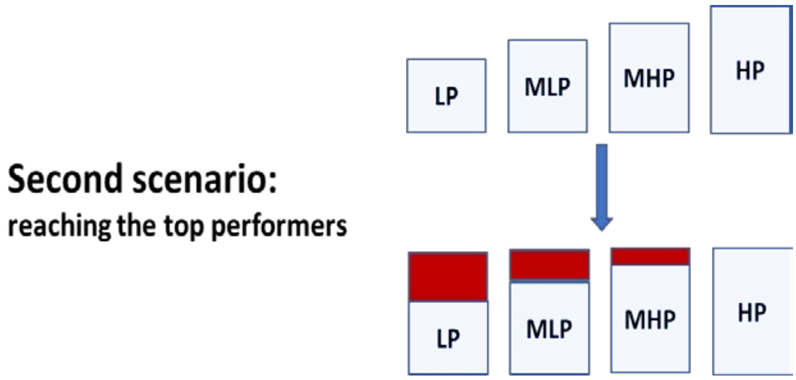
CSRDegree_Index	Average aggregated degree index	Average ROCE (year 2018)	Elasticity of ROCE to the aggregated degree index	Gap between its average value of degree index and the average value of the next quartile**	ROCE "lost" by companies if they do not fill that gap: relative change (%)
low performers	0.6817	0.0797	0.0226	0.7708	1.74%
medium-low performers	1.4525	0.0951		0.5689	1.29%
medium-high performers	2.0214	0.1005		0.4307	0.97%
high performers	2.4521	0.1021		0	0 %

Note: Tables' results are based on a sample of 511 EU firms of 17 EU countries that have a non-missing information in 2017 regarding 1. the undertaken environmental and social policies, 2. the processes that are put in place and 3. the established objectives to be achieved.

Reaching the top performers

The second scenario that we are going to construct, after the calculation of the elasticity index and the definition of the different classes of performers (see tab. 4), is one of the two ambitious scenarios. It refers indeed to a harmonization of the CSR degree index taking the average CSR degree index of the high performers as reference index. In this case, low performers, medium-low performers, and medium-high performers increase their CSR degree index to reach the average value of the CSR index of the high performers.

Figure 5: An ambitious scenario. The red parts underline the jumps that each group need to perform in order to reach the average value of the CSR index of the high performers.



This scenario allows the identification of a new ROCE. If all the low performing (LP) firms, in term of CSR index, moved from the 1st quartile (i.e. the CSR index of these firms refers just to the implementation of some environmental and/or social policies) to the HP group (i.e. here firms are putting in place some processes and setting certain objectives to be achieved) there will be an increase of 4% on the low performers' Return on capital employed (ROCE). Again, the interpretation of this result is not obvious. Therefore, based on our results, we take that LP moving from the first quartile to the fourth one, that is defined by the HP firms, perform an increase of 0.04 in their ROCE (i.e. ROCE+0,04).

Going further in the exploration of our results, presented in Table 6, we can identify the impact of the medium-low performers, which are the firms that put in place some environmental and social policies as well as some processes helping the implementation and exploitation of such CSR policies, of a further exploitation[36] of their CSR practices. These firms would experience an increase of 2.26% in their ROCE. As for medium-high performers increasing their CSR degree index, the impact on ROCE is related to an increase of ROCE equal to 0.97%.

Table 6: Second Scenarios of Return on capital employed (ROCE)

CSR Degree_Index	Average aggregated degree index	Average ROCE (year 2018)	Elasticity of ROCE to the aggregated degree index	Gap between its average value of degree index and the average value of degree index 4th quartile**	ROCE "lost" by companies if they do not fill that gap: Relative change (%)
low performers	0.6817	0.0797	0.0226	1.7704	4.01 %
medium-low performers	1.4525	0.0951		0.9996	2.26%
medium-high performers	2.0214	0.1005		0.4307	0.97%
high performers	2.4521	0.1021		0	0 %

[36] Here exploitation refers to the extent to which these policies are applied in the business model of a firm.

Note: Tables' results are based on a sample of 511 EU firms of 17 EU countries that have a non-missing information in 2017 regarding 1. the undertaken environmental and social policies, 2. the processes that are put in place and 3. the established objectives to be achieved.

The Idealistic scenario

The last scenario that we want to propose refers to the most ambitious one, and in some extent to an "idealistic" scenario. Taking the higher value of the CSR degree index, that is 3, we assume that all our firms increase their CSR degree index as presented in Figure 6. This scenario is not likely to happen in a short term, because all firms have to establish the policy, put the process into place, and determine specific objectives to achieve related goals and monitoring the improvements. The groups of firms referring to HP are proned to reach this value in the short term as well, but LP need to implement several steps to achieve this ambitious goal. By looking at Table 7, it is possible to understand the magnitude of the ROCE "lost" by companies if they do not fill that gap.

Figure 6: The idealistic scenario. When firms reach the maximum level of CSR degree index.

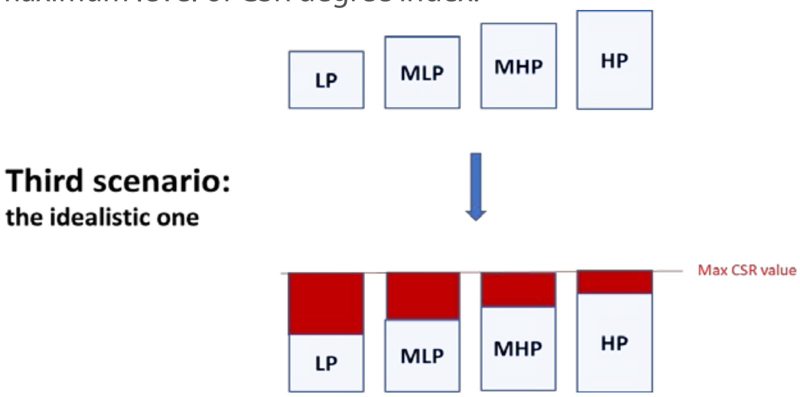


Table 7: Third Scenario of Return on capital employed (ROCE)

CSR Degree_Index	Average aggregated degree index	Average ROCE (year 2018)	Elasticity of ROCE to the aggregated degree index	Gap between its average value of degree index and the average value of degree index 4th quartile**	ROCE "lost" by companies if they do not fill that gap: relative change (%)
low performers	0.6817	0.0797	0.0226	2.3183	5.24%
medium-low performers	1.4525	0.0951		1.5475	3.5%
medium-high performers	2.0214	0.1005		0.9786	2.21%
high performers	2.4521	0.1021		0.5479	1.24%

Note: Tables' results are based on a sample of 511 EU firms of 17 EU countries that have a non-missing information in 2017 regarding 1. the undertaken environmental and social policies, 2. the processes that are put in place and 3. the established objectives to be achieved.

A simulation for the EU economic landscape

Referring to the results of the two upward harmonization scenarios, proposed by our scenario analysis, where we consider the elasticity measure calculated on the whole sample of firms (see the scenarios constructed on the sample of firms that are more open to external markets,

Appendix B), we decided to calculate the projected ROCE for the EU27 considering an average ROCE for EU27 at 2018 equal to 0.2265[37].

Since we have only the average ROCE for the EU27 and we do not have an average ROCE for each firm category (i.e. low performers, medium-low performers, medium-high performers, and high performers), we must replicate the distribution of our sample assuming that the distance between the different groups of firms, in terms of average ROCE at the EU level, is the same as our sample (see column related to the Replication for the EU27 ROCE in 2018).

After these assumptions and the generation of the EU27 quartile configuration in 2018, we calculate the projected ROCE for the EU27 for all the three proposed scenarios (see tab. 8).

Table 8: Projected Return on capital employed (ROCE) for EU27 (Most and less ambitious scenarios) using 511 EU firms as the reference in the projection.

CSR Degree_Index	Sample distribution ROCE (2018)	Replication for the EU27 ROCE (2018)	Projected ROCE for the EU27 (Ambitious)	Projected ROCE for the EU27 (Ambitious) (Average)	Projected ROCE for the EU27 (Less ambitious)	Projected ROCE for the EU27 (Less ambitious) (Average)	Projected ROCE for the EU27 (Idealistic scenario)	Projected ROCE for the EU27 (Idealistic scenario) (Average)
low performers	0.0797	0.1912	0.2312	0.2444	0.2080	0.2363	0.2436	0.2569
medium-low performers	0.0951	0.2282	0.2507		0.2410		0.2631	
medium-high performers	0.1005	0.2411	0.2508		0.2508		0.2632	
high performers	0.1021	0.2449	0.2449		0.2449		0.2573	

Note: To project ROCE for EU27, we use as a reference sample the 511 EU firms from 17 EU countries that that have a non-missing information in 2017 regarding 1. the undertaken environmental and social policies, 2. the processes that are put in place and 3. the established objectives to be achieved. We assume that the sample distribution is equal to the EU27. The average ROCE in this sample is 0.0944 and the average ROCE in EU27 is 0.2265

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37 The average ROCE is taken from Eurostat Annual Sector Accounts https://ec.europa.eu/eurostat/web/sector-accounts/data/database, last accessed on 20th September 2020

3.3. Robustness checks and further analysis

In this second part of this work, we exploit the introduced dataset in order to check the robustness of the scenarios analysis and we integrate the analysis with a further investigation of the economic impact of Environmental, Social and Governance due diligence and corporate accountability practices at a firm-level in EU by using a second dataset still based on Asset4.

3.3.1. Robustness check

Data and Methodology

The robustness check analysis is still based on Asset4, this dataset encompasses an unbalanced panel of **568 European firms during the period 2016-2018**. In this robustness check we exploit the previous dataset; this panel includes information about the undertaken environmental and social policies, the processes that are put in place, and the established objectives to be achieved during the exploitation of such policies. It is important to remember that this dataset does not include a specification of each policy. On the contrary, it applies a general-macro policy level perspective without going into detail.

This second dataset offers indeed, for the environmental and social dimension, information on the implementation of these policies at a firm level. Specifically, the dataset provides information on whether or not a firm has just implemented the policy, without established additional steps, or if a firm has implemented the policy and put in place related processes to establish the policy in the firm' business strategy and also if it has determined specific objectives in order to achieve related goals and monitoring the improvements. Thanks to this in-depth information, it is possible to calculate a degree of CSR for each firm, that we called CSR degree indexes. Another advantage of this dataset is related to its wider time-span, referring to three years, i.e. 2016, 2017, and 2018.

We implement our robustness check by using as dependent variable Return on Capital Employed (ROCE) that is a measure of company's profitability in terms of all its capital; in the Annex C, a second model presents the same analysis by using a market-based measures (i.e. Tobin's Q).

Our main independent variable is still the CSR degree index. In this analysis, we decided to check for both an aggregate CSR degree index, as in the scenario construction, and two disaggregated degree indexes (i.e. Environmental and Social degree index). Each area of environmental and social dimension is computed using the following procedure. If a firm has only established the policy, and no additional steps have been taken, then it is assigned the value 1. If a firm has established the policy and has put in place the process for implementing such policies, then it is assigned the value 2. If a firm has established the policy, put in place the process, and has also determined specific goals to be achieved, then it is assigned the value 3. The values of each area (Environmental and Social) then are used to compute as an average to obtain the "environmental degree" and "social degree". The aggregated index of environmental and social is then computed as average of both dimensions.

As for the control variables, we maintain: size, that is measured as in the previous part of the work as the logarithm of total assets; leverage or the debt level was calculated by using the total debt to equity ratio; and international variable, which is a dummy variable that takes the value 1 if the firm has non-zero amount as international operating income, being 0 otherwise. In this model, we moreover added new controls: RD intensity that is computed used as R&D expenses over the total sales; Board size that is the sum of all corporate directors at the end of the fiscal year; and the board independent that is the percentage of independent members of the board over total.

In order to investigate the possible impacts on the firm performance of CSR practices, we apply therefore a random effects regression to the recalled dataset with N= 569 and T=3, that results the proper model to be used according to Hausman test (Hausman, 1978).

Results

Starting from the exploration of the descriptive statistics, we can identify a strong heterogeneity between the values of CSR degree index at country level. In our sample, the most performing country is Finland (see Annex C) and the second one is France. Still, it is important to remember that the distribution across countries in our sample does not mirror the European economic landscape and the same apply for sectors and firm size (see Annex C).

Table 9: Descriptive statistics for the selected variable implemented in the analysis

Variables	Mean	Standard deviation	Minimum	Maximum
Return on capital employed (ROCE)	0.10	0.12	-1.17	2.12
Aggregated index of environmental and social degrees	1.63	0.72	0.00	2.88
Environmental degree index	1.76	0.90	0.00	3.00
Social degree index	1.51	0.65	0.00	2.75
Size (log of assets)	15.96	1.68	10.05	21.45
Debt ratio	26.66	16.83	0.00	112.68
International	0.44	0.50	0.00	1.00
Board size	11.66	4.13	3.00	30.00
Board independent	56.78	25.68	0.00	100.00

Table 10: Random effects regression results

Dependent variable:	Return on capital employed (ROCE)		
Estimator:	Random effects regression		
Variables	(1)	(2)	(3)
CSR Degree_Index		0.0212*** (0.008)	
Environmental degree index			0.0191** (0.008)
Social degree index			-0.0025 (0.009)
Size (log of assets)	-0.0141*** (0.005)	-0.0191*** (0.005)	-0.0187*** (0.005)
Debt ratio	-0.0005 (0.000)	-0.0004 (0.000)	-0.0004 (0.000)
International	-0.0009 (0.008)	-0.0005 (0.008)	-0.0003 (0.008)
Board size	0.0018 (0.001)	0.0013 (0.001)	0.0014 (0.001)
Board independent	0.0004** (0.000)	0.0004** (0.000)	0.0004** (0.000)
Technology	0.0281 (0.020)	0.0241 (0.020)	0.0255 (0.020)

Telecommunications	0.0199 (0.015)	0.0183 (0.016)	0.0178 (0.016)
Health care	-0.0072 (0.021)	-0.0030 (0.021)	-0.0025 (0.021)
Financials	-0.0090 (0.015)	0.0075 (0.018)	0.0079 (0.018)
Real States	0.0220* (0.012)	0.0273** (0.012)	0.0200 (0.014)
Consumer discretionary	0.0589*** (0.020)	0.0553*** (0.020)	0.0555*** (0.020)
Consumer staples	0.0533*** (0.017)	0.0482*** (0.017)	0.0488*** (0.017)
Industrials	0.0325*** (0.011)	0.0275** (0.011)	0.0280** (0.011)
Basic materials	0.0206 (0.013)	0.0120 (0.014)	0.0139 (0.014)
Energy	0.0015 (0.025)	-0.0047 (0.025)	-0.0033 (0.025)
Observations	1,532	1,532	1,532
R^2 (overall)	0,104	0,110	0,112

Note: Unbalanced panel of 568 EU firms during the period (2016-2018). Dependent and control variables are introduced in the analysis with one-year lagged. Year dummies are included, but not reported. The reported significance levels are: * 10%, ** 5%, *** 1%.

The results of the three proposed models show that our findings, both the ones in Table 3 and the results of Table 10, are robust. The aggregated index of CSR is positive and significant at 5% in explaining ROCE, and the magnitude is close to the one identified by the OLS model, respectively 0.0212 and 0.0226. Also, in the longitudinal analysis, the exploitation of single policies supports higher performance at a firm-level. By focusing on the different dimensions of the CSR degree indexes, we can see that in model 3 the environmental index is positive and significant at 5% to explain ROCE. Social index is instead negative and not significant.[38]

As presented by Table 3 and Table 10, R^2 is low in both cases.[39] Even though it can refer to a low capability of our models to explain the variance for the dependent variable, we are confident of the results being this R^2 values coherent with Velte (2017) who explores possible links between ESG scores, as determined by the Asset4 database, and accounting and market-based measures for German firms.

38 It important to remember that the sign of the displayed industries in the tables is in relative to this reference industry, meaning a positive sign that a specific industry performs better than utility industry and a negative sign as it performs worse than utility industry. The reference industry is the Utilities.

39 We added more variables to better explain the variance for the model we choose. Despite the different tests, the R^2 values do not change.

3.3.2. An analysis of CSR policies Indexes

Data and Methodology

The most important difference between this analysis and the previous ones relies on the used dataset. In the previous dataset, the CSR degree indexes are calculated by looking at whether a firm has implemented the policy, and how far it has gone towards the establishment of additional steps. In this further analysis, we just consider a set of different dummy variables related to a set of CSR policies, i.e. environmental, social and governance policies (see Annex D).

This dataset includes information on several detailed policies related to the three recalled dimensions, i.e. environmental, social and governance dimension. Environmental, social and governance information refers to many different policies (for more details on the included policies see tab. D1, Annex D). In this dataset, CSR policies are described by applying a policy specific perspective. Examples of environmental policies are fossil fuel divestment policies, and environmental supply chain policies. As for social and governance policies, some examples are, for the former, child labour policies employee health & safety policy, but also diversity and opportunity guidelines; for the latter some examples relate to board diversity and equal voting right policies. For each firm, the dataset provides a dummy variable informing whether or not the policy has been implemented. It is worth specifying that in this dataset we have no information about the exploitation of such policies by each firm, namely the extent to which these policies are implemented. Therefore, this dataset lets us build CRS indexes at a firm level, referring to the number of policies implemented by each company in the three different CSR dimensions. The main limitation of this dataset is since it refers just to 2 years, 2017-2018. Currently, the full set of European firms covered in Asset4 is 1,157 firms. However, considering the missing values in some of the policy variables, our sample is defined by **684 European firms.**

Differently to the previous dataset, this second one considers several environmental, governance and social policies. In order to operationalise the dummy variables related to each policy, we decided to construct different CSR policy indexes. The different policies taken into account by this dataset have not the same importance for the main purposes of this research. Therefore, we decided to select some of the available policies with the EPRS staff, with the scope of addressing the most relevant topics that are likely to be more useful for the European Parliament's legislative initiatives. Consistently with the robustness check part, and the just recalled needs, we generated three different indexes. The first index considers the two CSR dimensions that are in dataset, i.e. environmental and social policies, and it is therefore an aggregated. The second index refers just to environmental policies and the third one to social policies.

We created a comprehensive CSR index based on the number of implemented CSR policies (Core2), without distinguishing among the different dimensions, and two-dimension specific CSR indexes (i.e. Env2 and Soc2). These indexes mostly focus on policies aiming at reducing companies' negative externalities, therefore we dropped the policies more directed at board composition issues.

In order to investigate the relationship between CSR indexes and firm performance, we implement a quantile regression to the first dataset, that is used as a cross-section: we decide to implement this kind of analysis taking into account the fundamental heterogeneity in the returns between firms and countries for an increase of CSR. The quantile regression techniques appear well-suited to the just recalled specification. Before implementing the quantile regression techniques, we have moreover considered and explored different firm performance indicators over the different indexes that we have created (see Annex D, tab. 3).

Results

Our sample is mainly characterised by medium and big firms. The share of firms with less than 250 employees, i.e. small and medium sized firms, in 2018 is around 4% (see Annex D, tab. D1).

We proceed by drawing on descriptive statistics to show and assess the possible impacts on the firm performance of ESG practices in the European economic landscape over the 2017-2018 span-time.

Table 11: Descriptive statistics for different firm performance indexes in 2018

	Obs	Mean	Std. Dev.	Min	Max
TOBINSQ	674	1.261433	1.343626	.057	12.446
ROCE	541	.0719947	.4680433	-6.535563	1.632584

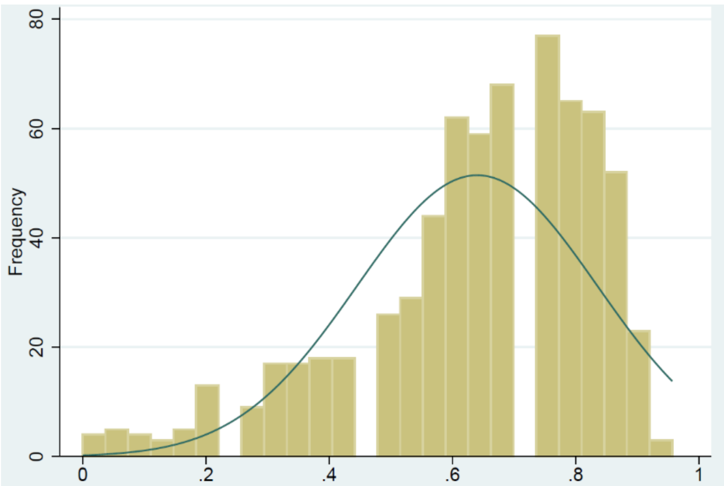
Just to remind the meaning of main dependent variables: **Tobins'Q** (TOBINSQ) is measured as the market value of a firm as captured by the enterprise value divided by the book value of total assets; Return on Capital Employed (**ROCE**) is a measure of company's profitability in terms of all its capital (i.e. the denominator is computed as total assets minus current liabilities).

Table 12: Descriptive statistics for different firm size indexes in 2018

	Obs	Mean	Std. Dev.	Min	Max
Total employees	663	35797.71	68825.08	0	664496
Total assets*	676	1.14e+08	6.81e+08	114864	1.46e+10

*in millions of euro

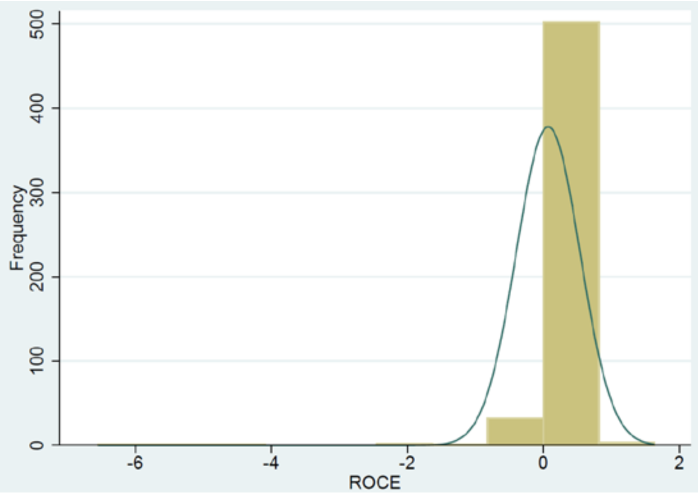
Figure 7: Distribution of Core2



If we exploit performance and size measurements across the different quartiles (calculated according to CSR policy Indexes), it seems that all of these performance indicators grow with the increase of the index. However, for Core1, the last quartile of firms does not show the highest levels of performance. Moreover, focusing on the distribution of our sample by the different CSR policy indexes, we can see that for Core1, firms are mainly defined by high values (see figure Annex D). Indeed, this index does not follow a normal distribution. Instead, if we look more closely at the distribution of Core2 (Figure 7), we identify a distribution that is more concentrated around the median. For that reason, in what follows, we decided to focus on Core2, that is the most balanced index and it limits the overestimation of our sample.

By looking at the countries' specificity for the different values of Core2, we can identify Finland as the best performing country, for its environmental and social policies at a country and at a more local level. France and Spain show high values of Core2 as well. The lowest values refer to Romania and Czech Republic (Czechia), but it is important to underline that, for these countries, our observations are based on just a couple of firms (respectively, 2 and 4 firms).

Figure 8: Distribution of ROCE



Considering our previous analysis, we selected ROCE as the dependent variable of our main econometric analysis. Moreover, to check for the robustness of our results, we added in the Annex D the results for Tobins'q as well. Since the ROCE variable does not present a normal distribution (see figure 8), we decided to implement an estimation of linear models by applying a quantile regression method. It is preferable to the usual regression methods because the values for ROCE follow a skewed distribution.

As argued by Mosteller and Tukey (1977): "What the regression curve does is a grand summary for the averages of the distributions corresponding to the set of x's. We could go further and compute several different regression curves corresponding to the various percentage points of the distribution and thus get a more complete picture."

Quantile regression results are indeed characteristically robust to heavy-tailed distributions and outliers. Moreover, it is important to underline that conventional regressions focus on the mean, whereas the quantile regressions can describe the entire conditional distribution of the dependent variable.

Another advantage is that the quantile regression approach avoids the assumption that the error terms are identically distributed at all points of the conditional distribution.

We estimate the two following linear regression models, one for Core2 and the other for Soc1 and Env1:

$$ROCE_{i,t} = \alpha + \beta_1 Core2_{i,t-1} + \beta_2 IND_{i,t} + \beta_3 Debt\_ratio_{i,t-1} + \beta_4 SIZE_{i,t-1} + \beta_5 INT_{i,t} + \varrho_{i,t} \quad (1)$$

The two-dimension related indexes, resulting from Core 2, gives us too correlated measures (see tab. D8). Therefore, for the second model, we decided to focus on human rights policies (Soc1) and core environmental polices (Env1), that refer to Core1 (for the list of policies see tab. D6a). Core1 based on the policies that are explicitly related to companies' negative externalities.

$$ROCE_{i,t} = \alpha + \beta_1 Soc1_{i,t-1} + \beta_2 Env1_{i,t-1} + \beta_3 IND_{i,t} + \beta_4 Debt\_ratio_{i,t-1} + \beta_5 SIZE_{i,t-1} + \beta_6 INT_{i,t} + \varrho_{i,t} \quad (2)$$

We select as independent variable ROCE that refers to 2018. As controls, we chose for the first model Core2 for firm i at time t – 1, and for the second one Soc1 and Env1 for firm i at time t – 1. In this regard, it is possible to understand from the correlation matrix in the Annex that Soc2 and Env2 are correlated, with a coefficient of 0.6122. Therefore, we focus on Soc1 and Env1 for dimension specific indexes and Core2 as aggregated index offering a larger range of policies considered.

Moreover, other control variables are: size, that we calculate as the log of total asset; 2-digit industry dummies related to manufacturing; and lagged debt ratio, which refers to the share of debt on the total assets. For the sectoral definition, we decided to use in this last part of the analysis the SIC classification that allows us to split the sample in more detailed sectoral classifications. Specifically, the SIC codes from 20 to 39 define manufacturing sectors (IND) and these sectors are likely to help to define the possible impacts on the firm performance of CSR practices in the European firms. Finally, we added a control for Internationalization (INT), which is a dummy variable that takes the value of 1 if the firm has non-zero amount as international operating income, being 0 otherwise. See correlation matrix, Table D7 in the Annex D.

Table 13: Quartile regression Results

Dependent variable:	Return on capital employed (ROCE)							
Estimator:	quantile regression							
	(1)				(2)			
Variables	(.25)	(.50)	(.75)	(.90)	(.25)	(.50)	(.75)	(.90)
Core2	0.0600** (0.025)	0.0414** (0.021)	0.0257 (0.028)	0.0746 (0.058)				
Env1					0.0193 (0.016)	0.0104 (0.016)	-0.0154 (0.023)	-0.0154 (0.040)
Soc1					0.0326** (0.016)	0.0267* (0.014)	0.0409** (0.017)	0.0615** (0.027)
Debt ratio	- 0.0009*** (0.000)	- 0.0012*** (0.000)	- 0.0015*** (0.000)	- 0.0014*** (0.000)	-0.0008*** (0.000)	-0.0011*** (0.000)	- 0.0014*** (0.000)	- 0.0013*** (0.000)
Size (Log_asset)	-0.0050 (0.003)	- 0.0081*** (0.003)	- 0.0162*** (0.004)	- 0.0276*** (0.004)	-0.0050 (0.003)	-0.0079*** (0.002)	- 0.0174*** (0.003)	- 0.0284*** (0.004)
INT	0.0044 (0.007)	0.0112 (0.009)	0.0148 (0.011)	0.0425** (0.020)	0.0059 (0.007)	0.0072 (0.008)	0.0092 (0.011)	0.0411** (0.019)
Constant	0.1240** (0.048)	0.2221*** (0.043)	0.4224*** (0.055)	0.6203*** (0.078)	0.1363*** (0.049)	0.2279*** (0.040)	0.4351*** (0.051)	0.6397*** (0.074)
Observations	543	543	543	543	543	543	543	543
R^2	0.044	0.029	0.013	0.003	0.041	0.030	0.012	0.002

Note: Standard errors in parentheses. The reported significance levels are: *** p<0.01, ** p<0.05, * p<0.1

We observe that is of crucial importance for the 'low-performing' (i.e. firms with low ROCE) firms. As we can see from our first regression model, the first and the second quantile show a positive correlation between CSR and ROCE. This does not apply for the third and the fourth quartile. For each of the proposed models, and for the models in Annex D calculated by using Tobins'q as dependent variable, the coefficient on CSR as aggregated index (i.e. Core2) is much larger for the lower quantiles. The evidence here suggests that, when we consider the lowest performing firms, investments in the implementation of CSR policies represent an important contribution to their superior growth performance. If we split the CSR index into two dimensions, i.e. environmental and social, we can see that the positive impact of the implementation of a set of social policies applies for all the categories of firms. The implementation of social policies is positively correlated with ROCE in the entire distribution, i.e. in all quartiles the coefficient is positive and significant. On the other hand, the coefficient on environmental policies is not significant, meaning that we detect neither positive nor negative effect, even if the coefficient is positive.

3.4. Discussion

The analysis done in the previous sections offers a pioneering exploration of the CRS-firm performance relation in EU. The issue is inherently multilevel, requiring a deeper analysis at a firm, sector, and country level as well.

Asset4-Thomson Reuters database offers data at the micro-level, and allowed us to provide insight on the impact of CSR/ESG actions on firm performance at the firm level. We implemented a two-fold empirical research. First, we found that ROCE (profitability) is positively correlated to CSR and we provided a measurement of its potential changes associated to changes in CSR, and second, we propose the construction of "upward harmonization" scenarios.

Concerning the scenario analysis, we presented three alternative future developments: a scenario based on a single jump of the firms through the CSR scale (i.e. the low performers reach the medium-low performers, the low-medium performers reach the medium-high performers and so on); an ambitious scenario, where all firms reach the CSR index of the top performers; and an "idealistic" scenario, that describes a situation where all companies move to the maximum possible value of the CSR index (i.e. 3). We expect that the ambitious scenario and the idealistic scenario are not likely to happen in the short term, because all firms would have to establish the policy, put the process into place, and determine specific objectives in order to achieve related goals and monitoring the improvements. Especially "low performers" (LP) would need to implement several steps to achieve this ambitious goal. The less ambitious scenario (i.e. the "single jump" scenario) could be considered a more suitable approximation of a short-term harmonization scenario.

Our literature review on the relationship between CSR and corporate performance indicates that it is plausible to ascertain a general positive relation between CSR/ESG practices and businesses' performance (Waddock and Graves, 1997; Servaes and Tamayo, 2012; Hasan et al., 2018). It has to be said that most of the empirical works analysed so far focus on US firms and many of them exploit panel data that allowed scholars to describe and assess more deeply the effects of CSR/ESG implementation on firms over a longer period of time. These studies inspired our research approach and drove us in the definition of relevant dependent (e.g. ROCE, Tobin's Q) and independent variables (e.g. size, sector). Moreover, our estimation of elasticity presents a magnitude coherent with some of the most outstanding contributions in the field, such as Hasan et al.'s (2018).

We implemented a robustness check based on an unbalanced panel of 568 EU firms covering the period 2016-2018. Results based on the robustness check confirmed the main outcomes of our analysis. These results pointed out that the positive effects of an increase of CSR can differ along the different dimensions of CSR (environmental and social).

The analysis so far exploited an index constructed on the different "degrees" of implementation of CSR policies. By exploiting the Asset4-Thomson Reuters database, we carried on further analysis to understand if similar results are obtained using simple dummy variables that indicate whether companies have (or not) each single policy. This additional research step, that includes more detailed policies, but is silent about the extent of their implementation, shows that CSR might be of crucial importance for firms characterised by lower performances. Indeed, our results suggest that the relationship may not be always monotonic and does not apply in the same manner to the different CSR/ESG dimensions and to the two datasets.

Our exploratory study, differently from the works analysed in the literature review, is not based on long time-series; nevertheless, the findings are coherent with the main outcomes of the cited literature: we were able to find an overall positive correlation between CSR (aggregate index) and firm performance.

Moreover, by exploiting Asset4, we implemented a complex analysis considering separately the different dimensions of CSR as well. As some studies already pointed out (Brammer et al., 2006), it would be more appropriate to tackle an exploration of the impact of ESG/CSR practices considering, in a distinct and separate manner, the three dimensions (social, environmental, governance).

Our empirical analysis is consistent with the main results reported by the literature analyzed in the first part of the work: CSR/ESG practices are positively correlated to corporate performance; nevertheless, for a more-detailed analysis of such an impact, it would be better to consider each CSR/ESG dimension (environmental, social and governance) separately.

The research pointed out that firms operating in more than one country (TNCs) benefit more, from an operational viewpoint, of an increase of their CSR degree index.

As introduced in the data description, our sample generated by Asset4 presents some main limitations. 1. the distribution is mainly characterised by high values of CSR policy indexes, that leads us to assume that our sample overestimates the levels of CSR in the EU companies; 2. an unbalanced distribution for both countries and sectors (see Annexes C and D) and 3. covering mainly big firms, it underrepresents the huge population of SMEs that characterises the EU landscape.

It is important to underline that the identified positive statistical relationship between an increase of CSR degree index and ROCE does not imply causation. However, in the robustness check (i.e. the longitudinal analyses), to overcome endogeneity and reverse causality problems, we used temporal lags between our main dependent variable and the different control variables. Despite these limitations, we decided to base our scenario analysis on the elasticity measurement relying on Asset4.

1. Considering the data analysis and the operational difficulties encountered on our dataset (too small and not completely representative) which, in any case, has allowed a pioneering exploration of the phenomenon in Europe and 2. referring to the studies analyzed so far that demonstrate the medium-long term effects of CSR on firm performance, especially in the US, this study can be considered a preliminary step in the analysis of the impacts of CSR/ESG practices in EU, paving the way for further and in-depth analysis. This research needs to be carried on thanks to new, comprehensive datasets on CSR practices and firm performance indexes that, to this day, are not available. Further research is therefore needed with the desirable aid of more extensive and complete datasets that would let us perform scientific investigations capable of bringing out stronger evidence about the effects on company performance deriving from increases in the CSR indexes.

4. ANNEXES

ANNEX A- Empirical review connecting the concepts of CSR, ESG, DUE DILIGENCE to corporate performance.

Table A1: Empirical review, a focus on some relevant studies

Study	Methodology	Focus of the study	Findings
Waddock and Graves (1997)	Authors construct an index of CSP, based on eight corporate social performance attributes from KLD dataset. Firm financial performance (profitability) is measured using three accounting variables: ROA, ROE, ROS. Size, risk, and industry are used as control variables both for CSP and firm performance.	Relation between CSP and corporate financial performance **CSP-CFP**	Evidence shows that CSP is linked to positive past financial performance. Moreover, CSP is likely to influence future financial performance, which supports the theory that good management and CSP are positively related.
Brammer, Brooks and Pavelin (2006)	Relationship between CSP and CFP, measured using stock returns, for a sample of 451 UK quoted companies. Authors rely on **EIRIS dataset** (2003) dealing with CSP scores that concern 6 dimensions: 1. health and safety systems, 2. employee training and development, 3. equal opportunities policies, 4. equal opportunities systems, 5. systems for good employee relations, and 6. systems for job creation and security. Cross-sectional regressions of the stock returns on the composite CSP measure and separately on the three indicators on environment, employment, and community.	Relation between corporate social performance and corporate financial performance in the UK **CSP-CFP**	Companies with the lowest possible CSP scores did the best on the market, and companies that tended towards lower returns had the highest social performance scores. Nevertheless, disaggregation shows that environmental and employment indexes show a negative correlation with returns while the community indicators are weakly positively related.
Lee and Faff (2009)	Authors investigate the relative performance of firms classified into “leading” or “lagging” CSP portfolios within a BOS ratings approach.		

	A composite CSP score is calculated for each of the DJGI (Dow Jones Global Index) firms with leading CSP representing those firms with the best (highest) composite corporate sustainability score. The best of sector (BOS) leading sustainability approach is then used to rank all firms within each of the DJGI industry groups, over 34 countries. Authors construct two mutually exclusive portfolios with differing CSP profiles: a portfolio of leading CSP firms that are brought together to form the DJSI portfolio dataset while the second portfolio (lagging CSP firms) represents the DJGI 2,500 sample universe once the DJSI firms have been removed. Results derive from a short panel on the 1998–2002 sample period. Return and risk values are presented as monthly percentages.	Relationship between corporate sustainability portfolios (DJSI as proxy of CSP) and idiosyncratic risk **CSP-idiosyncratic risk**	While scores on a composite social performance indicator are negatively related to stock returns, authors specify that the poor financial reward obtained by those companies is attributable to their good social performance on the environmental side and, to a lesser extent, the community aspects. A large amount of returns come from holding a portfolio of the socially least desirable stocks. This result can be justified by multi-factor models for explaining the cross-sectional variation in returns, but not by industry effects.
Bauer And Hann (2010)	Authors analyse the cross-sectional variation of 582 US public companies between 1995 and 2006. Authors run a series of regressions (cost of debt on measures of environmental management performance and two sets of control variables). They construct aggregate measures for firms' CER (environmental strengths and concerns of firms) and run test on their relationship with the yield spread of newly issued bonds, bond ratings, and long-term issuer ratings. They use three distinct measures of credit risk: the cost of debt financing, bond ratings, and long-term issuer ratings.	Relation between corporate environmental engagement/ responsibility (CER) and credit risk **CER-risk**	Public corporations' environmental engagement has credit risk implications for bond investors: CER engagement explains the cross-sectional variation in credit risk for the 582 US companies between 1995 and 2006. Environmental practices affect the financial wealth of borrowing firms, by determining their exposure to potentially costly legal, reputational, and regulatory risks. Companies with environmental concerns have higher cost of debt financing and have lower credit scores; on the other hand, firms that are environmentally-conscious benefit from a lower cost of

			debt, and there is evidence that they also have higher credit ratings. Lower bond spreads are associated to companies' use of innovative products and services with environmental benefits, and the companies' attempt to cut down their impact on climate change and air pollution.
Ghoul et al. (2011)	Authors analyse a sample of 12,915 U.S. firm-year observations from 1992 to 2007 (2,809 firms). The variables and the sample are obtained through merging of 4 databases: 1. Thompson Institutional Brokers Earnings Services (I/B/E/S), (analyst forecast data), 2. Compustat North America, (industry affiliation and financial data), 3. KLD STATS (CSR data), and 4. CRSP monthly return files, (information on stock returns) Regression variables: cost of equity capital, corporate social responsibility	Relation between CSR score and cost of capital **CSR-cost of capital**	Companies with better CSR scores exhibit cheaper equity financing. In particular, findings suggest positive impacts of 1. investing in responsible employee relations improvement, 2. environmental policies, and 3. product strategies On the contrary, engagement in CSR actions in the areas of community relations, diversity, and human rights do not show the same results. Participation in two "sin" industries, namely, tobacco and nuclear power, increases companies' cost of equity. The key channels of these effects are the effects of CSR on information asymmetry and perceived risk.
Houssam (2011)	Event-study analysis of companies listed on the FTSE 100 Review of the Financial Times identified 151 events (reduced to 71 events), associated with 78 companies spanning from 2007 to 2011. Use of Vigeo data	Short term capital market reaction to CSR negative events **CSR-cost of capital**	The event study analysis shows a negative stock price response to CSR related negative events, especially for reputation and legal risks. This means that investors include reputational and legal risks into their evaluation on the future profitability of a firm.

Servaes and Tamayo (2012)	To build their CSR index, authors employ KLD data over the period 1991-2005 by combining 5 categories (community, diversity, employees, environment, and human rights) into one CSR measure. They also construct a broader measure, by including industry. They then subtract the industry score from the conservative measure. To measure corporate performance, authors employ Tobin's Q. They estimate panel regressions of Tobin's Q as a function of CSR measures, and the CSR-related advertising.	Relation between CSR and firm value (through the customer awareness) **CSR-firm value**	CSR activities can enhance firm value for firms with high public awareness, as proxied by advertising intensity. However, 1) firms with high public awareness are also penalized more when there are CSR concerns; 2) in firms with low public awareness, the impact of CSR on firm value is null or negative; these outcomes also indicate that, without awareness, customers are unable to reward corporations' engagement in CSR activities; 3) advertising has a negative impact on the CSR– value in cases of inconsistency between the firm's CSR efforts and the company's overall reputation; 4) after including firm fixed effects there is no direct relation between CSR and firm value. Overall, CSR activities can add value to the company but only in certain circumstances.
Cai et al. (2014)	Authors take a sample from KLD dataset from 1991 to 2012 to measure the CER (considering "strength" and "concern" indicators). (23.000 firms). Authors use two independent measures of CER and three variables of firm risk as the main variables.	Relation between Corporate Environmental Responsibility (CER) and risk in U.S. public firms **CER-risk**	CER engagement inversely affects firm risk after controlling for various firm characteristics. This is especially true for manufacturing, while does not hold for services.
Hasan et al. (2018)	Authors analyse a comprehensive longitudinal dataset of the U.S. manufacturing firms from 1992 to 2009. Companies in the KLD dataset are evaluated in seven major qualitative issue areas: environment, community, corporate governance, diversity, employee relations,	**Hypothesis 1** Corporate social performance is positively related to firm total factor productivity. **Hypothesis 2** The relationship between corporate social	CSP positively affects TFP and TFP mediates the CSP–CFP relationship.

	human rights, and product quality and safety.	performance and financial performance is mediated by firm TFP. **CSR-CFP**	
Hoepner et al. (2019)	Authors analyze 1,712 engagements across 573 firms, covering the period between January 2005 and April 2018. Authors use two variables to measure downside risk: LPM (lower partial moment, this measure captures negative return fluctuations, reflecting many long-term investors' perceptions of risk) and VaR (investment's value at risk). They use 3 methods: 1) Difference-in-Difference (DiD) regressions to test whether ESG engagement is related to future downside-risk reduction; 2) panel-regressions; 3) through a time-series tests that examine the effects of engagement on the exposure of targeted firms' returns to a downside-risk factor.	Relation between ESG engagement and firms' downside risks **ESG-risk**	Engagement targets experience a decline in downside risk from before to after engagement, compared to control firms. Investors most commonly engage firms over corporate governance issues, accounting for 43% of the engagements. The investors also actively engage on environmental (22%), social (20%), and strategy (16%) themes. The risk-reduction effects of ESG engagement vary across engagement themes, being driven primarily by the effects of environmental issues, especially climate change.
Albuquerque et al. (2019)	Firm-level CSR data are taken from KLD Research and Analytics, and range from 2003 to 2015. The ratings consider social, environmental, and corporate governance factors (community, diversity, employee relations, environment, product, human rights, and governance) that are relevant to a firm's financial performance and its risk management. Authors have 28,578 firm-year observations from 4,670 US companies. They conduct a series of panel-regressions to assess changes in CFP (Tobin's Q) and profitability (returns on	Relation between CSR and firms' systematic risk **CSR-risk**	Main outcomes of the study highlight that: 1) the level of systematic risk is statistically and economically significantly lower for firms with a higher CSR score 2) there is a positive correlation between CSR score and Tobin's Q (CFP) 3) profitability of firms that have higher CSR is less cyclical (depends less on GDP growth) 4) including stocks with higher CSR would have the effect of lowering the overall

	assets). All regressions include industry and year fixed effects.		riskiness of the company portfolio 5) projects that increase firms' reputation for CSR should be discounted with lower cost of equity compared with otherwise similar projects

ANNEX B- CSR elasticity measurement for EU firms and upward harmonization scenarios

Table B1: List of general polices

Dimension	Policy
Environmental	Resource reduction
Social	Human rights
	Health & Safety
	Training and Development

Table B2: Scenarios of Return on capital employed (ROCE) for the subset of firms operating at least in more than one country (TNCs) (Most ambitious scenario)

CSR Degree_Index	Average aggregated degree index	Average ROCE (year 2018)	Elasticity of ROCE to the aggregated degree index	Gap between its average value of degree index and the average value of degree index 4th quartile**	ROCE "lost" by companies if they do not fill that gap: Relative change (%)
low performers	0.7098	0.0864	0.0320	1.7215	5.51%
medium-low performers	1.4522	0.0799		0.9791	3.13%
medium-high performers	1.9863	0.0968		0.445	1.42%
high performers	2.4313	0.1013		0	0

Note: Both tables' results are based on a sample of 219 EU firms of 17 EU countries that have a non-missing information in 2017 regarding the undertaken environmental and social policies, the processes that are put in place and the established objectives to be achieved.

Table B3: Scenarios of Return on capital employed (ROCE) for the subset of the EU firms operating in more than one country (TNCs) (Less ambitious scenario)

CSR Degree_Index	Average aggregated degree index	Average ROCE (year 2018)	Elasticity of ROCE to the aggregated degree index	Gap between its average value of degree index and the average value of the next quartile**	ROCE "lost" by companies if they do not fill that gap: Relative change (%)
low performers	0.7098	0.0864	0.0320	0.7424	2,38%
medium-low performers	1.4522	0.0799		0.5341	1.71%
medium-high performers	1.9863	0.0968		0.445	1.42%
high performers	2.4313	0.1013		0	0

Note: Both tables' results are based on a sample of 219 EU firms of 17 EU countries that have a non-missing information in 2017 regarding the undertaken environmental and social policies, the processes that are put in place and the established objectives to be achieved.

Table B4. Projected Return on capital employed (ROCE) for EU27 (Most and less ambitious scenarios) using 219 EU firms as the reference in the projection.

CSR Degree_Index	Sample distribution ROCE (2018)	Replication for the EU27 ROCE (2018)	Projected ROCE for the EU27 (Most ambitious)	Projected ROCE for the EU27 (Most ambitious) (Average)	Projected ROCE for the EU27 (Less ambitious)	Projected ROCE for the EU27 (Less ambitious) (Average)
low performers	0.0864	0.2186	0.2736		0.2463	
medium-low performers	0.0907	0.2294	0.2608		0.2465	
medium-high performers	0.0999	0.2527	0.2669	0.2644	0.2667	0.2530
high performers	0.1013	0.2562	0.2562		0.2562	

Note: To project ROCE for EU27, we use as a reference sample the 219 EU firms that operated in more than one country from 16 EU countries. We assume that the sample distribution is similar to the EU27. The average ROCE in this sample is 0.0895 and the average ROCE in EU27 is 0.2265.

ANNEX C- An exploitation of the CSR degree dataset

Table C1: Descriptive statistics of aggregated index of degree per country (year 2017)

Country	Aggregated index (Degree)		Freq.
	Mean	Std. Dev.	
Austria	1.48	0.49	12
Belgium	1.46	0.79	26
Czechia	1.54	0.18	3
Denmark	1.88	0.59	18
Finland	2.06	0.47	24
France	2.01	0.55	86
Germany	1.62	0.72	82
Hungary	1.56	0.68	3
Ireland	1.39	0.73	35
Italy	1.65	0.67	33
Luxembourg	1.08	0.69	13
Netherlands	1.73	0.75	42
Poland	0.97	0.54	26
Portugal	1.71	0.50	8
Romania	1.81	0.49	40
Spain	1.51	0.72	60
Sweden	1.48	0.49	12
Total	1.65	0.69	511

Note: Distribution of 511 EU firms that have a non-missing information in 2017 regarding the undertaken environmental and social policies, the processes that are put in place and the established objectives to be achieved.

Table C2: Sample distribution per country & small and medium size

Variables	No. of firms	SMALL (10-49 persons employed)	MEDIUM (50-249 persons employed)	Small & medium sized firms (Less than 250 persons employed)
Austria	15	0	0	1
Belgium	26	1	4	5
Cyprus	1	0	0	0
Czechia	3	0	0	0
Denmark	22	0	0	0

Finland	25	0	0	0
France	96	0	0	0
Germany	92	2	0	2
Hungary	3	0	0	0
Ireland	35	0	0	0
Italy	37	0	0	0
Luxembourg	15	0	0	0
Netherlands	46	0	2	2
Poland	31	0	1	1
Portugal	10	0	0	0
Spain	44	0	3	3
Sweden	67	1	6	6
Total	568	4	16	20 (3.5%)

Note: Total number of firms across 17 EU countries included in the study. A 3.5% of the total firms are small and medium size firms with less than 250 persons employed.

Table C3: Sample distribution per industry

ICB codes	Sectors	Total firms	%
10	Technology	33	5.81%
15	Telecommunications	31	5.46%
20	Health care	48	8.45%
30	Financials	73	12.85%
35	Real States	27	4.75%
40	Consumer discretionary	87	15.32%
45	Consumer staples	36	6.34%
50	Industrials	122	21.48%
55	Basic materials	51	8.98%
60	Energy	28	4.93%
65	Utilities	32	5.63%
	Total	568	

Note: Total number of firms across 11 industries classified according to the Industry Classification Benchmarking (ICB).

Table C4: Random effects regression results on Tobins'Q

Dependent variable:	Tobins' Q		
Estimator:	Random effects regression		
Variables	(1)	(2)	(3)
Aggregated index of environmental and social degree		0.0042 (0.053)	
Environmental degree index			0.0743* (0.042)
Social degree index			-0.1024 (0.063)
Size (log of assets)	-0.1868*** (0.031)	-0.1877*** (0.031)	-0.1852*** (0.031)
Debt ratio	0.0001 (0.002)	0.0002 (0.002)	0.0003 (0.002)
International	0.0553 (0.041)	0.0553 (0.041)	0.0585 (0.041)
Board size	-0.0033 (0.004)	-0.0033 (0.005)	-0.0032 (0.005)
Board independent	0.0021** (0.001)	0.0020** (0.001)	0.0021** (0.001)
Technology	0.6695*** (0.178)	0.6689*** (0.178)	0.6807*** (0.180)
Telecommunications	0.5276*** (0.125)	0.5275*** (0.125)	0.5235*** (0.126)
Health care	1.1404*** (0.179)	1.1413*** (0.182)	1.1477*** (0.182)
Financials	-0.0291 (0.086)	-0.0259 (0.092)	-0.0195 (0.094)
Real States	-0.0318 (0.075)	-0.0304 (0.078)	-0.0864 (0.089)
Consumer discretionary	0.6404*** (0.134)	0.6397*** (0.136)	0.6425*** (0.137)
Consumer staples	0.6245*** (0.159)	0.6237*** (0.158)	0.6283*** (0.157)
Industrials	0.3016*** (0.089)	0.3006*** (0.089)	0.3046*** (0.090)
Basic materials	0.1907** (0.094)	0.1890** (0.096)	0.2050** (0.097)
Energy	0.0037 (0.106)	0.0027 (0.105)	0.0148 (0.107)
Observations	1,532	1,532	1,532
R^2 (overall)	0.316	0.316	0.319

Note: Unbalanced panel of 568 EU firms during the period (2016-2018). Independent and control variables are introduced in the analysis with one-year lagged. Year dummies are included, but not reported. The reported significance levels are: * 10%, ** 5%, *** 1%.

Table C5: Averages of the environmental and social degree indexes (2015-2017)

Variables	2015	2016	2017
Aggregated index of environmental and social degrees	1.66	1.67	1.72
Environmental degree index	1.81	1.81	1.85
Social degree index	1.50	1.53	1.59

Note: The table displays the averages degree of a total 444 EU firms instead of the initial 568 EU firms. Here, the sample size is reduced, and it only retains firms that has not missing values in the degree variables during the entire period of the study.

ANNEX D- An analysis of CSR policies Indexes

Table D1: Composition of our sample by firm size

SIZE	Freq.	Percent	Cum.
Small & medium size firms (Less than 249 persons employed)	24	3.51	3.51
Less than 499 persons employed	9	1.32	4.82
More than 500	651	95.18	100.00
Total	684	100.00	

Table D2: Distribution of firms by countries in 2017

Country	Freq.	Percent	Cum.
Austria	18	2.63	2.63
Belgium	31	4.53	7.16
Czechia	4	0.58	7.75
Denmark	112	16.37	24.12
Germany	31	4.53	28.65
Spain	51	7.46	36.11
Finland	29	4.24	40.35
France	109	15.94	56.29
Hungary	4	0.58	56.87
Ireland	39	5.70	62.57
Italy	59	8.63	71.20
Luxembourg	23	3.36	74.56
Netherlands	56	8.19	82.75
Poland	32	4.68	87.43
Portugal	11	1.61	89.04
Romania	2	0.29	89.33
Sweden	72	10.53	99.85
Slovenia	1	0.15	100.00
Total	684	100.00	

Table D3: Descriptive statistics for different firm performance indexes in 2018

	Obs	Mean	Std. Dev.	Min	Max
TOBINSQ	674	1.261433	1.343626	.057	12.446
ROCE	541	.0719947	.4680433	-6.535563	1.632584
Net sales	676	2.80e+07	2.08e+08	-8940000	5.17e+09
Productivity*	662	2206.408	11775.14	11.88058	199024.6

*We calculated Productivity dividing the net sales by total employees.

Table D4: Distribution of firms by sectors in 2017

SIC	Denomination	Freq	Percent	Cum
10	Metal Mining	4	0.58	0.58
12	Coal Mining	1	0.15	0.73
13	Oil And Gas Extraction	12	1.75	2.49
14	Mining And Quarrying Of Nonmetallic Minerals, Except Fuels	2	0.29	2.78
15	Building Construction General Contractors And Operative Builders	11	1.61	4.39
16	Heavy Construction Other Than Building Construction Contractors	12	1.75	6.14
20	Food And Kindred Products	17	2.49	8.63
21	Tobacco Products	1	0.15	8.77
22	Textile Mill Products	1	0.15	8.92
23	Apparel And Other Finished Products Made From Fabrics And Similar Materials	6	0.88	9.80
24	Lumber And Wood Products, Except Furniture	4	0.58	10.38
26	Paper And Allied Products	12	1.75	12.13
27	Printing, Publishing, And Allied Industries	9	1.32	13.45
28	Chemicals And Allied Products	57	8.33	21.78
29	Petroleum Refining And Related Industries	9	1.32	23.10
30	Rubber And Miscellaneous Plastics Products	9	1.32	24.42
31	Leather And Leather Products	5	0.73	25.15
32	Stone, Clay, Glass, And Concrete Products	7	1.02	26.17
33	Primary Metal Industries	15	2.19	28.36
34	Fabricated Metal Products, Except Machinery And Transportation Equipment	5	0.73	29.09
35	Industrial And Commercial Machinery And Computer Equipment	41	5.99	35.09
36	Electronic And Other Electrical Equipment And Components, Except Computer Equipment	23	3.36	38.45

37	Transportation Equipment	30	4.39	42.84
38	Measuring, Analyzing, And Controlling Instruments; Photographic, Medical And Optical Goods; Watches And Clocks	21	3.07	45.91
39	Miscellaneous Manufacturing Industries	3	0.44	46.35
40	Railroad Transportation	1	0.15	46.49
41	Local And Suburban Transit And Interurban Highway Passenger Transportation	1	0.15	46.64
42	Motor Freight Transportation And Warehousing	5	0.73	47.37
43	United States Postal Service	3	0.44	47.81
44	Water Transportation	5	0.73	48.54
45	Transportation By Air	10	1.46	50.00
47	Transportation Services	2	0.29	50.29
48	Communications	42	6.14	56.43
49	Electric, Gas, And Sanitary Services	37	5.41	61.84
50	Wholesale Trade-durable Goods	10	1.46	63.30
51	Wholesale Trade-non-durable Goods	9	1.32	64.62
52	Building Materials, Hardware, Garden Supply, And Mobile Home Dealers	1	0.15	64.77
53	General Merchandise Stores	1	0.15	64.91
54	Food Stores	12	1.75	66.67
56	Apparel And Accessory Stores	4	0.58	67.25
57	Home Furniture, Furnishings, And Equipment Stores	3	0.44	67.69
58	Eating And Drinking Places	3	0.44	68.13
59	Miscellaneous Retail	4	0.58	68.71
60	Depository Institutions	64	9.36	78.07
61	Non-depository Credit Institutions	2	0.29	78.36
62	Security And Commodity Brokers, Dealers, Exchanges, And Services	7	1.02	79.39
63	Insurance Carriers	20	2.92	82.31
64	Insurance Agents, Brokers, And Service	3	0.44	82.75
65	Real Estate	29	4.24	86.99
67	Holding And Other Investment Offices	11	1.61	88.60
70	Hotels, Rooming Houses, Camps, And Other Lodging Places	2	0.29	88.89
72	Personal Services	1	0.15	89.04
73	Business Services	43	6.29	95.32
75	Automotive Repair, Services, And Parking	4	0.58	95.91
76	Miscellaneous Repair Services	2	0.29	96.20

78	Motion Pictures	1	0.15	96.35
79	Amusement And Recreation Services	3	0.44	96.78
80	Health Services	4	0.58	97.37
87	Engineering, Accounting, Research, Management, And Related Services	17	2.49	99.85
NA		1	0.15	100.00
Tot		684	100.00	

Table D5: Policies considered by Asset4-Thomson Reuters database

Dimension	Policy Description
Environmental policies	Fossil Fuel Divestment Policy
	Emission Reduction Processes/Policy Emissions Reduction
	Resource Efficiency Processes/Policy Energy Efficiency
	Resource Efficiency Processes/Policy Environmental Supply Chain
	Resource Efficiency Processes/Policy Sustainable Packaging
	Resource Efficiency Processes/Policy Water Efficiency
	Value - Resource Reduction/Policy
Social policies	Value - Health & Safety /Policy
	Value - Human Rights/Policy
	Community Reputation Code of Conduct/Policy Bribery and Corruption
	Community Reputation Code of Conduct/Policy Business Ethics
	Training and Career Development Processes/Policy Career Development
	Human Rights Processes/Policy Child Labor
	Community Reputation Processes/Policy Community Involvement
	Product Responsibility Processes/Policy Customer Health & Safety
	Product Responsibility Processes/Policy Data Privacy
	Diversity and Opportunity Processes/Policy Diversity and Opportunity
	Employee Health & Safety Processes/Policy Employee Health & Safety
	Community Reputation Code of Conduct/Policy Fair Competition
	Product Responsibility Processes/Policy Fair Trade
	Human Rights Processes/Policy Forced Labor
	Human Rights Processes/Policy Freedom of Association
	Human Rights Processes/Policy Human Rights
	Product Responsibility Processes/Policy Responsible Marketing
	Training and Career Development Processes/Policy Skills Training
	Employee Health & Safety Processes/Policy Supply Chain Health & Safety
	Value - Training and Development/Policy
	Value - Board Functions/Policy

Governance policies	Value - Board Structure/Policy
	Confidential Voting Policy
	Value - Compensation Policy/Policy
	Balanced Board Structure Policy Elements/Policy Board Diversity
	Balanced Board Structure Policy Elements/Policy Board Experience
	Balanced Board Structure Policy Elements/Policy Board Independence
	Balanced Board Structure Policy Elements/Policy Board Size
	Shareholder Rights Policy Elements/Policy Equal Voting Right
	Compensation Policy Elements/Policy ESG Related Compensation
	Compensation Policy Elements/Policy Performance Oriented
	Compensation Policy Elements/Policy Executive Retention
	Shareholder Rights Policy Elements/Policy Shareholder Engagement
	Value - Shareholder Rights/Policy

Table D6a: Description of the policies that are considered in Core1 index

Dimension	Policies Description
Environmental	Emission Reduction Processes/Policy Emissions Reduction
	Fossil Fuel Divestment Policy
	Resource Efficiency Processes/Policy Water Efficiency
Social	Community Reputation Code of Conduct/Policy Bribery and Corruption
	Human Rights Processes/Policy Freedom of Association
	Human Rights Processes/Policy Child Labour
	Human Rights Processes/Policy Forced Labour
	Human Rights Processes/Policy Human Rights
	Employee Health & Safety Processes/Policy Employee Health & Safety
	Employee Health & Safety Processes/Policy Supply Chain Health & Safety

Table D6b: Description of the policies that are considered in Core2 index

Dimension	Policies Description
Governance	Balanced Board Structure Policy Elements/Policy Board Independence
	Balanced Board Structure Policy Elements/Policy Board Diversity
Environmental	Emission Reduction Processes/Policy Emissions Reduction
	Fossil Fuel Divestment Policy
	Resource Efficiency Processes/Policy Water Efficiency
	Resource Efficiency Processes/Policy Energy Efficiency
	Resource Efficiency Processes/Policy Sustainable Packaging

	Resource Efficiency Processes/Policy Environmental Supply Chain
Social	Community Reputation Code of Conduct/Policy Fair Competition
	Community Reputation Code of Conduct/Policy Bribery and Corruption
	Community Reputation Code of Conduct/Policy Business Ethics
	Community Reputation Processes/Policy Community Involvement
	Diversity and Opportunity Processes/Policy Diversity and Opportunity
	Human Rights Processes/Policy Freedom of Association
	Human Rights Processes/Policy Child Labour
	Human Rights Processes/Policy Forced Labour
	Human Rights Processes/Policy Human Rights
	Employee Health & Safety Processes/Policy Employee Health & Safety
	Employee Health & Safety Processes/Policy Supply Chain Health & Safety
	Product Responsibility Processes/Policy Customer Health & Safety
	Product Responsibility Processes/Policy Fair Trade
	Training and Career Development Processes/Policy Skills Training

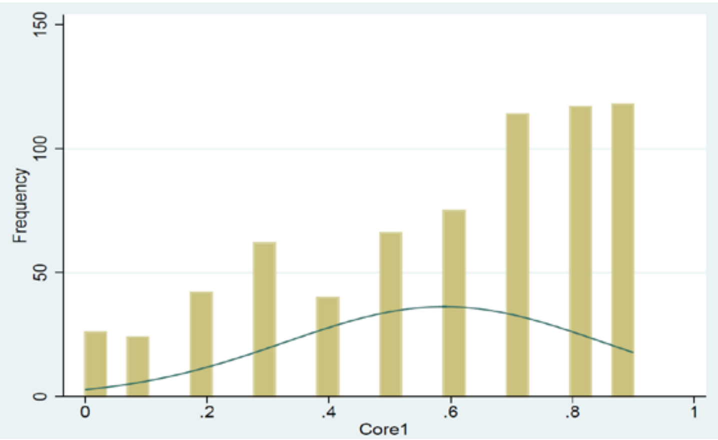
Table D7: Descriptive of the different types of CSR policy Indexes implemented in the analysis

	Core1	Core2	Soc1	Soc2	Env1	Env2
Mean	0.589	0.640	0.639	0.721	0.287	0.539
Median	0.7	0.696	0.714	0.786	0.5	0.667
Mode	0.9	0.739	0.857	0.857	0.5	0.667
Max	0.9	0.957	1	1.071	1	0.833
Min	0	0	0	0	0	0
1st quartile	0.4	0.565	0.429	0.571	0	0.5
2nd quartile	0.7	0.696	0.714	0.786	0.5	0.667
3rd quartile	0.8	0.783	0.857	0.929	0.5	0.667
4th quartile	0.9	0.957	1	1.071	1	0.833

Table D8: Correlation matrix for the different control variables

	Core1	Core2	Soc1	Soc2	Env1	Env2	INT	ROCE	SIZE	Debt _ratio
Core1	1.0000									
Core2	0.8958	1.0000								
Soc1	0.9761	0.8589	1.0000							
Soc2	0.9225	0.9435	0.9271	1.0000						
Env1	0.5589	0.5676	0.3928	0.4317	1.0000					
Env2	0.6372	0.8014	0.5312	0.6122	0.7126	1.0000				
INT	0.0221	-0.0063	0.0306	0.0052	-0.0190	-0.0210	1.0000			
ROCE	0.0753	0.0888	0.0652	0.0687	0.0745	0.0805	-0.0079	1.0000		
SIZE	0.3433	0.3671	0.3323	0.3519	0.2430	0.3132	-0.0270	0.0891	1.0000	
Debt _ratio	-0.0511	-0.0339	-0.0564	-0.0323	-0.0126	-0.0593	-0.0400	-0.1791	0.1083	1.0000

Figure 9: Distribution of Core1



Focusing on the distribution of Core1 and Core2, we assume that our sample overestimates how much EU companies do CSR.

Table D9: Descriptive statistics for the four quartiles of Core1 by the different firm performance

Core1	Average net sales	Average Productivity	Average TOBINSQ	Average ROCE	Average size*
Index 1st quartile (0,4)	13,210,837	5,918.458	.970825	.0867742	15,268.308
Index 2nd quartile (0,7)	28,472,922	1,972.5458	1.1560789	.0361225	40,019.188
Index 3rd quartile (0,8)	66,248,124	2,742.9923	1.4560708	.08493719	68,687.85
Index 4th quartile (0,9)	34,681,327	1,639.2229	1.3997373	.13850289	57,813.746

*Here size refers to the total employees

Table D10: Descriptive statistics of Core2 by countries

Country	Core2		Freq.
	Mean	Std. Dev.	
Austria	.58695652	.13929817	18
Belgium	.56100982	.25236246	31
Czechia	.4673913	.09640677	4
Denmark	.64984472	.20224049	112
Germany	.65918654	.15477967	31
Spain	.70502984	.14402104	51
Finland	.71814093	.1068923	29
France	.71519745	.15637028	109
Hungary	.68478261	.1143459	4
Ireland	.61538462	.18189313	39
Italy	.61901253	.18256924	59
Luxembourg	.51606805	.22980537	23
Netherlands	.67701863	.17990797	56
Poland	.45788043	.22712685	32
Portugal	.63241107	.17538899	11
Romania	.39130435	.24595018	2
Sweden	.60990338	.21186764	72
Slovenia	.69565217	0	1
Total	.64009662	.19506048	684

Table D11: Descriptive statistics of Core2 by sectors

SIC	Denomination	Core2		Freq
		Mean	Std. Dev.	
10	Metal Mining	.63043478	.05613019	4
12	Coal Mining	.47826087	0	1
13	Oil And Gas Extraction	.68115942	.09868239	12
14	Mining And Quarrying Of Nonmetallic Minerals, Except Fuels	.73913043	.06148755	2
15	Building Construction General Contractors And Operative Builders	.6916996	.13109189	11
16	Heavy Construction Other Than Building Construction Contractors	.65942029	.2128646	12
20	Food And Kindred Products	.72634271	.16178113	17
21	Tobacco Products	.86956522	0	1

22	Textile Mill Products	.65217391	0	1
23	Apparel And Other Finished Products Made From Fabrics And Similar Materials	.77536232	.13587681	6
24	Lumber And Wood Products, Except Furniture	.52173913	.37062933	4
26	Paper And Allied Products	.75362319	.08151625	12
27	Printing, Publishing, And Allied Industries	.56038647	.18115942	9
28	Chemicals And Allied Products	.71700992	.16981245	57
29	Petroleum Refining And Related Industries	.72463768	.10425721	9
30	Rubber And Miscellaneous Plastics Products	.73429952	.18882339	9
31	Leather And Leather Products	.79130435	.0836321	5
32	Stone, Clay, Glass, And Concrete Products	.70807453	.10262554	7
33	Primary Metal Industries	.69855072	.06462812	15
34	Fabricated Metal Products, Except Machinery And Transportation Equipment	.77391304	.03637652	5
35	Industrial And Commercial Machinery And Computer Equipment	.69247084	.18198398	41
36	Electronic And Other Electrical Equipment And Components, Except Computer Equipment	.73913043	.1528781	23
37	Transportation Equipment	.66231884	.23251258	30
38	Measuring, Analyzing, And Controlling Instruments; Photographic, Medical And Optical Goods; Watches And Clocks	.71221532	.17253596	21
39	Miscellaneous Manufacturing Industries	.85507246	.05020437	3
40	Railroad Transportation	.69565217	0	1
41	Local And Suburban Transit And Interurban Highway Passenger Transportation	.56521739	0	1
42	Motor Freight Transportation And Warehousing	.66956522	.14615423	5
43	United States Postal Service	.69565217	.11503267	3
44	Water Transportation	.63478261	.15856159	5
45	Transportation By Air	.63913043	.09624323	10
47	Transportation Services	.73913043	0	2
48	Communications	.63561077	.19584705	42
49	Electric, Gas, And Sanitary Services	.653349	.15925106	37
50	Wholesale Trade-durable Goods	.56956522	.18610637	10
51	Wholesale Trade-non-durable Goods	.61835749	.13710788	9
52	Building Materials, Hardware, Garden Supply, And Mobile Home Dealers	.69565217	0	1

53	General Merchandise Stores	.39130435	0	1
54	Food Stores	.72463768	.24478288	12
56	Apparel And Accessory Stores	.81521739	.04162727	4
57	Home Furniture, Furnishings, And Equipment Stores	.73913043	.04347826	3
58	Eating And Drinking Places	.8115942	.09050722	3
59	Miscellaneous Retail	.57608696	.23913043	4
60	Depository Institutions	.55366848	.18868306	64
61	Non-depository Credit Institutions	.47826087	.18446264	2
62	Security And Commodity Brokers, Dealers, Exchanges, And Services	.39130435	.2173913	7
63	Insurance Carriers	.63043478	.12812602	20
64	Insurance Agents, Brokers, And Service	.43478261	.11503267	3
65	Real Estate	.52473763	.17114688	29
67	Holding And Other Investment Offices	.22134387	.18287201	11
70	Hotels, Rooming Houses, Camps, And Other Lodging Places	.80434783	.03074377	2
72	Personal Services	.60869565	0	1
73	Business Services	.56319515	.20370002	43
75	Automotive Repair, Services, And Parking	.47826087	.22452077	4
76	Miscellaneous Repair Services	.60869565	.30743773	2
78	Motion Pictures	.73913043	0	1
79	Amusement And Recreation Services	.4057971	.13282828	3
80	Health Services	.66304348	.23913043	4
87	Engineering, Accounting, Research, Management, And Related Services	.54987212	.21352053	17
NA		.82608696	0	1
Total		.64009662	.19506048	684

Table D12: Descriptive statistics for the four quartiles of Core2 by the different firm performance

Core2	Average net sales	Productivity**	Average Tobin Q	Average ROCE	Average size*
Index 1st quartile (0,5652)	11,040,698	884.71989	.93361364	.09899425	19,682.791
Index 2nd quartile (0,6956)	23,422,869	1,426.4855	1.089806	-.0332049	30,607.603
Index 3rd quartile (0,7826)	41,544,224	1,948.2437	1.261375	.06270569	67,306.813
Index 4th quartile (0,9565)	38,351,800	271.73153	2.0373333	.14796932	151,829.33

** Average sales/L *Size refers to the total employees.

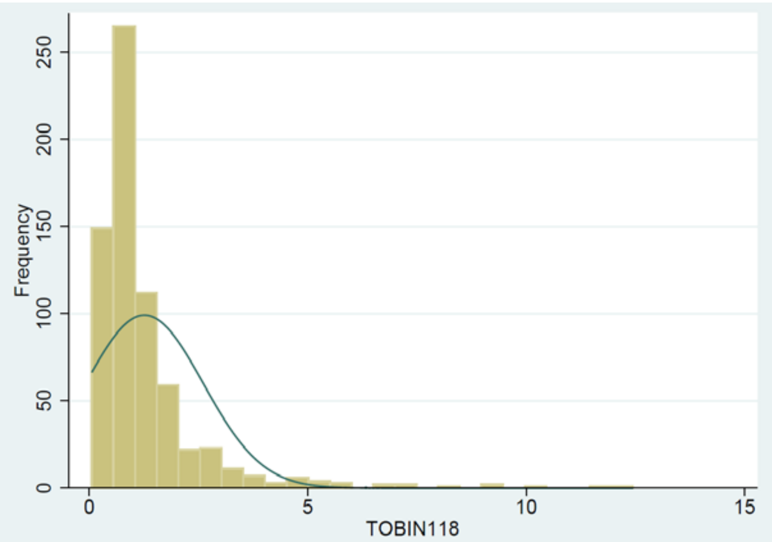
Table D13: Quartile regression Results

Dependent variable:	Return on capital employed (ROCE)							
Estimator:	quantile regression							
	(1)				(2)			
Variables	(.25)	(.50)	(.75)	(.90)	(.25)	(.50)	(.75)	(.90)
Core2	0.0600** (0.025)	0.0414** (0.021)	0.0257 (0.028)	0.0746 (0.058)				
Env1					0.0193 (0.016)	0.0104 (0.016)	-0.0154 (0.023)	-0.0154 (0.040)
Soc1					0.0326** (0.016)	0.0267* (0.014)	0.0409** (0.017)	0.0615** (0.027)
Sic20	0.0131 (0.024)	-0.0062 (0.023)	-0.0306 (0.026)	-0.1089*** (0.016)	0.0070 (0.024)	-0.0112 (0.023)	-0.0165 (0.027)	-0.0942*** (0.023)
Sic23	0.0090 (0.016)	-0.0073 (0.017)	-0.0035 (0.023)	-0.0353 (0.030)	0.0031 (0.016)	-0.0055 (0.017)	-0.0029 (0.022)	-0.0201 (0.035)
Sic26	0.0567*** (0.014)	0.0316* (0.016)	-0.0027 (0.016)	-0.0314 (0.039)	0.0539*** (0.014)	0.0290* (0.017)	0.0049 (0.025)	-0.0245 (0.031)
Sic27	-0.3819*** (0.043)	-0.0782** (0.034)	-0.0591 (0.050)	-0.1033*** (0.028)	-0.3761*** (0.050)	-0.0750** (0.034)	-0.0687** (0.029)	-0.0970*** (0.018)
Sic28	-0.0083 (0.010)	-0.0008 (0.013)	-0.0085 (0.020)	0.0239 (0.049)	-0.0131 (0.012)	-0.0052 (0.014)	-0.0003 (0.018)	0.0222 (0.041)
Sic29	0.0028 (0.021)	0.0637* (0.038)	0.0516*** (0.017)	0.0776*** (0.029)	0.0040 (0.030)	0.0555** (0.025)	0.0617*** (0.018)	0.0846*** (0.019)
Sic30	0.0357** (0.016)	0.0062 (0.019)	0.0057 (0.034)	0.1195*** (0.036)	0.0253 (0.021)	0.0062 (0.019)	-0.0046 (0.032)	0.1244*** (0.037)
Sic31	0.0176 (0.048)	0.0747 (0.055)	0.0796* (0.044)	0.0489* (0.027)	0.0163 (0.047)	0.0762 (0.054)	0.0763* (0.043)	0.0568** (0.027)

Sic32	-0.0119 (0.018)	-0.0207 (0.017)	-0.0496* (0.026)	-0.0611** (0.028)	-0.0183 (0.025)	-0.0238 (0.022)	-0.0485* (0.027)	-0.0649** (0.032)
Sic33	-0.0126 (0.036)	0.0063 (0.013)	-0.0411*** (0.014)	-0.0603 (0.058)	-0.0234 (0.024)	0.0027 (0.013)	-0.0332** (0.014)	-0.0477 (0.057)
Sic34	0.0437** (0.018)	0.0143 (0.019)	-0.0330** (0.015)	-0.0019 (0.025)	0.0367** (0.018)	0.0090 (0.014)	-0.0429*** (0.015)	0.0078 (0.026)
Sic35	0.0255*** (0.010)	0.0251 (0.016)	0.0124 (0.019)	0.0884*** (0.027)	0.0206* (0.011)	0.0189 (0.015)	0.0084 (0.017)	0.0647** (0.031)
Sic36	-0.0359 (0.032)	0.0016 (0.016)	-0.0269* (0.015)	0.0354 (0.037)	-0.0371 (0.044)	0.0049 (0.014)	-0.0224 (0.016)	0.0430 (0.044)
Sic37	0.0224** (0.010)	0.0368** (0.014)	0.0267* (0.015)	0.0277 (0.022)	0.0213** (0.010)	0.0290* (0.016)	0.0254* (0.014)	0.0299 (0.018)
Sic38	0.0007 (0.019)	0.0027 (0.017)	-0.0160 (0.020)	0.0108 (0.042)	0.0003 (0.018)	0.0016 (0.017)	-0.0217 (0.019)	-0.0108 (0.078)
Debt ratio	-0.0009*** (0.000)	-0.0012*** (0.000)	-0.0015*** (0.000)	-0.0014*** (0.000)	-0.0008*** (0.000)	-0.0011*** (0.000)	-0.0014*** (0.000)	-0.0013*** (0.000)
Size (Log_asset)	-0.0050 (0.003)	-0.0081*** (0.003)	-0.0162*** (0.004)	-0.0276*** (0.004)	-0.0050 (0.003)	-0.0079*** (0.002)	-0.0174*** (0.003)	-0.0284*** (0.004)
INT	0.0044 (0.007)	0.0112 (0.009)	0.0148 (0.011)	0.0425** (0.020)	0.0059 (0.007)	0.0072 (0.008)	0.0092 (0.011)	0.0411** (0.019)
Constant	0.1240** (0.048)	0.2221*** (0.043)	0.4224*** (0.055)	0.6203*** (0.078)	0.1363*** (0.049)	0.2279*** (0.040)	0.4351*** (0.051)	0.6397*** (0.074)
Observations	543	543	543	543	543	543	543	543
R^2	0.044	0.029	0.013	0.003	0.041	0.030	0.012	0.002

Note: Standard errors in parentheses. The reported significance levels are: *** p<0.01, ** p<0.05, * p<0.1

Figure 10: Distribution of Tobins'q 2018



Tobin's Q is measured as market value of firm as captured by enterprise value divided by book value of total assets.

Table D14: Results of quantile regression based on Tobin's q

Dependent variable:	Tobin's q 2018			
Estimator:	quantile regression			
Variables	(.25)	(.50)	(.75)	(.90)
Core2	0. 1745**	0.3495***	0.3287	-0.7106
	(0.088)	(0.132)	(0.267)	(1.377)
Sic20	-0.2107*	-0.3646**	-0.8167***	-1.4836***
	(0.109)	(0.164)	(0.184)	(0.454)
Sic23	0.2959**	0.5228***	0.4228***	0.0723
	(0.131)	(0.168)	(0.128)	(0.355)
Sic26	-0.1502	0.3303	0.9817***	0.0743
	(0.324)	(0.392)	(0.337)	(0.373)
Sic27	-0.1824	-0.3064*	-0.4105*	-0.0570
	(0.139)	(0.159)	(0.224)	(0.741)
Sic28	0.2648***	0.6094***	0.9751	0.8657
	(0.086)	(0.120)	(1.223)	(0.583)
Sic29	0.1617	0.2345*	0.0836	0.6802
	(0.203)	(0.125)	(0.237)	(0.527)
Sic30	0.1804	0.0307	-0.0618	-0.9500***
	(0.202)	(0.170)	(0.441)	(0.359)
Sic31	0.9058***	1.5900***	1.3210***	4.4057***
	(0.318)	(0.199)	(0.333)	(0.602)
Sic32	0.0107	-0.1657*	-0.2982	-0.5727*
	(0.114)	(0.094)	(0.382)	(0.323)
Sic33	-0.1554**	-0.3024***	-0.4643***	-0.9293***
	(0.075)	(0.084)	(0.149)	(0.308)
Sic34	0.5299*	0.8845***	0.5256***	-0.3094
	(0.319)	(0.129)	(0.134)	(0.331)
Sic35	0.1479*	0.0876	0.3836	1.1031**
	(0.082)	(0.128)	(0.243)	(0.495)
Sic36	0.3710*	0.3475***	0.1686	-0.3397
	(0.199)	(0.111)	(0.157)	(0.351)
Sic37	0.0134	0.0315	0.0290	0.1296

	(0.060)	(0.101)	(0.187)	(0.467)
Sic38	0.5412*	0.9276	1.7847***	2.0205*
	(0.297)	(0.742)	(0.239)	(1.039)
T Debt ratio	0.0083***	0.0064***	0.0013	-0.0101**
	(0.001)	(0.001)	(0.002)	(0.004)
Size(Log_asset)	-0.1914***	-0.3217***	-0.4521***	-0.7964***
	(0.025)	(0.037)	(0.085)	(0.161)
INT	-0.0334	0.0081	0.0969	0.3096
	(0.037)	(0.052)	(0.111)	(0.216)
Constant	1.6686***	2.8024***	4.2173***	7.7167***
	(0.188)	(0.271)	(0.670)	(1.455)
Observations	671	671	671	671
R^2	0.100	0.159	0.193	0.188

Note: Standard errors in parentheses. The reported significance levels are: *** p<0.01, ** p<0.05, * p<0.1

Table D15 Results of quantile regression based on Tobin's q

Dependent variable:	Tobin's q 2018			
Estimator:	quantile regression			
Variables	(.25)	(.50)	(.75)	(.90)
Env1	-0.0240	-0.1248	-0.3025**	-0.6242
	(0.065)	(0.093)	(0.136)	(0.423)
Soc1	0.1186**	0.3074***	0.3371**	0.6309**
	(0.059)	(0.075)	(0.155)	(0.294)
Sic20	-0.1964	-0.3198**	-0.6729***	-1.2593***
	(0.156)	(0.159)	(0.175)	(0.230)
Sic23	0.3336***	0.5089***	0.5353***	-0.1569
	(0.106)	(0.162)	(0.143)	(0.210)
Sic26	-0.1878	0.3171	1.0174***	0.1044
	(0.320)	(0.378)	(0.319)	(0.293)
Sic27	-0.1742	-0.2011	-0.3904***	0.4061
	(0.138)	(0.227)	(0.148)	(0.378)
Sic28	0.2595***	0.6747***	0.9869	0.7968**
	(0.078)	(0.097)	(1.154)	(0.396)
Sic29	0.1925	0.2554	0.1706	0.5933*
	(0.200)	(0.156)	(0.224)	(0.348)
Sic30	0.1714	0.0468	-0.0812	-0.9902***
	(0.199)	(0.160)	(0.212)	(0.287)
Sic31	0.9274***	1.6023***	1.3877***	4.4718***
	(0.312)	(0.361)	(0.317)	(0.469)
Sic32	0.0012	-0.1797**	-0.2292	-0.5325**
	(0.114)	(0.088)	(0.370)	(0.250)
Sic33	-0.1400*	-0.2903***	-0.3992***	-1.0586***
	(0.075)	(0.074)	(0.149)	(0.205)
Sic34	0.5333*	0.8497***	0.5425***	-0.2434
	(0.313)	(0.176)	(0.174)	(0.255)
Sic35	0.1515*	0.0919	0.2603	0.8896
	(0.080)	(0.148)	(0.241)	(0.616)
Sic36	0.3787*	0.2938***	0.2251*	-0.5077*
	(0.196)	(0.097)	(0.134)	(0.305)
Sic37	0.0072	0.0790	0.0505	-0.0495

	(0.064)	(0.081)	(0.205)	(0.306)
Sic38	0.5441*	0.9493	1.8618***	1.9310**
	(0.294)	(0.714)	(0.238)	(0.926)
Debt ratio	0.0083***	0.0064***	0.0013	-0.0101**
	(0.001)	(0.001)	(0.002)	(0.004)
Size (Log_asset)	-0.1914***	-0.3217***	-0.4521***	-0.7964***
	(0.025)	(0.037)	(0.085)	(0.161)
INT	-0.0334	0.0081	0.0969	0.3096
	(0.037)	(0.052)	(0.111)	(0.216)
Constant	1.6686***	2.8024***	4.2173***	7.7167***
	(0.188)	(0.271)	(0.670)	(1.455)
Observations	671	671	671	671
R^2	0.100	0.159	0.193	0.188

Note: Standard errors in parentheses. The reported significance levels are: *** p<0.01, ** p<0.05, * p<0.1

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There is evidence of human rights violations and negative environmental impacts related to business activities, including of EU companies. Several actions have been taken at both international and EU level to promote responsible business conduct and to prevent such violations. While being important steps forward, these initiatives suffer from several limitations, as they are either voluntary, sector-specific, or limited to reporting obligations. The EU is committed to upholding human rights and environmental protection, and has the competence to harmonise national company law to ensure the proper functioning of the single market. This study analyses the European added value of a potential measure requiring companies to carry out due diligence on possible social and environmental risks in their operations and supply chains. It analyses why action should be taken at the EU level and points to its potential impacts from the perspective of both EU companies and society at large.

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