

2. DISINCENTIVES AND INCENTIVES FOR BUSINESS TO ACT

The list below sets out the main disincentives and incentives concerning businesses taking action on human rights, cited by State, business and civil society representatives interviewed for this Report. The following do not necessarily represent the perspective of IHRB, but provide an overview of some of the commonly held perceptions:

Disincentives for business to act on human rights issues:

- Red tape and anti-competitiveness arguments
- Absence of a level playing-field internationally
- Lack of clarity from States in terms of expectations
- No reward for undertaking human rights due diligence or transparency
- Complexity of human rights language and translation to business action and responsibility

Incentives for business to act on human rights issues:

- Inevitable trend, best to be ahead of compliance
- Risk management and “social license to operate”
- Competitive advantage in some cases
- Increasing investor interest
- Internal motivations, governance and corporate culture

2.1 Existing Disincentives for Business to Act

The complexities some businesses face when integrating human rights into their own systems and relationships are outlined and analysed in the two previous volumes of IHRB’s “state of play” series.²² The vast majority of the world’s companies are still unfamiliar with the UN Guiding Principles on Business and Human Rights, but the numbers are gradually rising, though slowly. The Business and Human Rights Resource Centre records 339 companies with human rights policies or policy statements.²³ These numbers rise if the incorporation of standards such as the Global Reporting Initiative or ISO 26000 is included (both of which contain human rights provisions). The UN Global Compact lists over 7,000 signatory companies in over 146 countries, all of which have in principle declared their intention to respect human rights.²⁴

These figures also suggest a gap between intention (i.e. signing up to the Global Compact) and practice (i.e. publishing a human rights policy statement as called for in the UN Guiding Principles). Since the corporate responsibility to respect human rights requires companies to have a publicly stated policy commitment²⁵ then based on the numbers above (i.e. 339 companies with policies listed on the Business & Human Rights Resource Centre vs. the 7,000 Global Compact signatories) as little as 5% of those seeking to implement the corporate responsibility to respect human rights are actually aligned with a basic component of it. Even if a time factor is allowed for – from proclamation to implementation – this would still not account for the gap. It implies there

²² See: IHRB, “The State of Play of Human Rights Due Diligence: Anticipating the next 5 years” (2011). Available at: http://www.ihrb.org/pdf/The_State_of_Play_of_Human_Rights_Due_Diligence.pdf; and, IHRB and the Global Business Initiative on Human Rights (GBI), “State of Play: The Corporate Responsibility to Respect Human Rights in Business Relationships” (2012). Available at: <http://www.ihrb.org/publications/reports/state-of-play.html>

²³ See: <http://www.business-humanrights.org/Documents/Policies>

²⁴ See: www.unglobalcompact.org

²⁵ UN Guiding Principle 15(a)

are major disincentives for many businesses to act, even amongst the 7,000+ companies who declare that they are aware of their human rights responsibilities by joining the Global Compact. It is likely that many of these companies do not yet understand where to begin in implementing the UN Guiding Principles or are not sure States themselves are serious about uptake of the UN Guiding Principles. Given the UN Global Compact is now 13 years old, it is surprising that so many companies can still make declaratory statements with no follow up action. The continued emphasis on the voluntary nature of an initiative such as the UN Global Compact, and the absence of accountability mechanisms, have for some been seen to weaken its potential to influence change. The relative ease of participation in Global Compact's activities can sometimes act as a disincentive for businesses to implement the UN Guiding Principles. Greater alignment within the UN (to speak to business directly with a clearer voice) is overdue.²⁶

Beyond transnational companies, there are many millions of small to medium sized enterprises (SMEs) around the world that also need to be incentivised to act. State-owned enterprises are yet another category requiring attention. To date less work has been done in these areas – but it is clear from efforts on health and safety, anti-corruption and non-discrimination over recent years that national Governments as well as national business associations, trade unions and local authorities all have an important role to play. Recent human rights guidance from the European Commission to SMEs is an example of a promising step in this direction.²⁷

2.2 How Governments Articulate the Business Case for Human Rights

The “business case” for respecting human rights by business is not new and has many facets, including, for example: because the law requires it; because the state is sometimes unable or unwilling to protect rights; because it helps manage reputation; because external or internal stakeholders call for it; or because it helps obtain local approval.

States too are beginning to reflect these arguments when promoting their own approaches. For example, the UK Nation Action Plan states:

Companies increasingly understand that there is a business case for respect for human rights and that this brings business benefit in various ways, by:

- *helping to protect and enhance a company's reputation and brand value;*
- *protecting and increasing the customer base as consumers increasingly seek out companies with higher ethical standards;*
- *helping companies attract and retain good staff, contributing to lower rates of staff turnover and higher productivity, and increasing employer motivation;*
- *reducing risks to operational continuity resulting from conflict inside the company itself (strikes and other labour disputes), or with the local community or other parties (social licence to operate);*
- *appealing to institutional investors, including pension funds, who are increasingly taking ethical, including human rights, factors into account in their investment decisions;*
- *helping companies to become a partner/investor of choice for other businesses or governments that are concerned to avoid human rights risks.*²⁸

There have been and continue to be significant discussions about whether there really is a business case for human rights, whether the business case is enough to prompt business to act, or whether there should be any discussion of a business case at all given that the discussion is ultimately about

²⁶ See further: IHRB, “UN Global Compact: Developing a vision for 2020” (October 2010). Available at: http://www.ihrb.org/pdf/UNGC_and_Human_Rights-18Oct2010-optimised.pdf

²⁷ European Commission, “My business and human rights: A guide to human rights for SMEs” (2013). Available at: http://ec.europa.eu/enterprise/policies/sustainable-business/files/csr-sme/human-rights-sme-guide-final_en.pdf

²⁸ Government of the United Kingdom, “Good Business: Implementing the UN Guiding Principles on Business and Human Rights”, (September 2013). Available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/236901/BHR_Action_Plan_-_final_online_version_1_.pdf

basic human dignity. There is little to argue with any of the statements made in the UK's National Action Plan, as they are all true some of the time. However, it is equally true that none of the statements are true all of the time. There are instances where the business case for human rights alone is not enough to ensure that businesses respect human rights. Taking solely a business case approach inevitably means that in cases where there may be no clear immediate bottom line, reputational or motivational return, businesses would then be absolved from the responsibility to respect human rights. That goes against the now consolidated expectations expressed in the UN Guiding Principles, and often national law. It is often in precisely those murky situations where corporate responsibility to respect human rights may be most important.

2.3 Reward Versus Risk

Businesses often undertake risks in order to obtain rewards. The higher the risk, the higher the reward sought. Arguably the greatest motivation for business in relation to human rights is the risk-reward ratio. Bad (and often illegal) practices like paying bribes, degrading the local environment, or discriminating between employees may show short-term "benefits" to a company because in many poorly-administered jurisdictions the risk of criminal or civil action are slim to none. It is important therefore that the penalties for not respecting human rights are firmly advanced by States to ensure the risk-reward ratio incentivises active knowledge acquisition on the part of companies and a race to the top in terms of human rights awareness and prevention. The creation of appropriate laws, the monitoring and regulating of businesses, and the enforcement of laws are clearly paramount to disincentivise bad behaviour by business. Deaths in the workplace may not necessarily be an issue of criminal culpability, but a growing number of companies have set targets for zero tolerance around workplace fatalities. Here the companies have decided that the benefit of being seen as an industry leader in health and safety outweighs the savings of not investing in the highest levels of safety, security, scrutiny and due diligence.

There are as yet few examples of companies being rewarded for undertaking adequate human right due diligence. NGOs, the press and politicians are instead focused on companies that experience crisis, especially well-known brands, and some run campaigns against them. Recognising that companies may not be able to control all risks all the time, some regulatory regimes (for example, securities and corruption) provide some dispensation (e.g. a reduction of penalties or a defence to liability) for companies that can show they have management systems in place to manage the issues.

2.4 Longer-term versus Shorter-term Considerations

The ruling paradigm of market-based economics has long been the pursuit of profit. Most markets and most investors still reward companies, their boards and senior management, on the basis of short-term success rather than for long-term sustainability. Traditionally, the business case has been the only incentive for CEOs to consider human rights issues, motivated on a brand niche or differentiation basis – leaving out the vast majority of companies whose boards were not sufficiently moved by the business case for human rights. However, if States want companies to respect human rights, then they need to create incentive structures that mobilise the vast majority and not just the minority of companies. States can and do influence the balance between short and long term thinking in key international markets. It is generally true, that the shorter term the business thinking, the less likely that human rights due diligence will be done unless it is a firm legal requirement. States can regulate markets to place a greater emphasis on longer-term considerations, in particular reporting requirements and director duties can be framed in this way as will be discussed later in this report. Indeed, there is a positive trend developing around mandating social responsibility within directors' duties in some States (see section 3).

In some countries, the industry itself has started to move on this issue, for example with calls for an end to the practice of quarterly earnings statements in the **UK** (which is not in fact a legal requirement but a market practice). Another example would be *The Nairobi Process: A Pact for*

*Responsible Business in East Africa.*²⁹ In addition to galvanising action by both home and host States, the aim is for oil and gas exploration companies to make human rights a material issue during the acquisition process. Whether exploration companies should be required by law to undertake human rights due diligence is one issue, and a good case can be made. In any case, business respect for human rights will likely be even stronger if exploration companies, as some of the earliest operators in oil and gas projects, are also incentivised to address these issues at every stage of operations. States cannot require major oil companies to price in good human rights due diligence and the associated “social licence to operate” when acquiring junior exploration companies or their finds, but States should at a minimum ensure that market structures lead and do not lag such trends. Similar arguments can be made in how brands could incentivise responsible suppliers in retail markets. Bilateral trade agreements, export processing zones and efforts such as the ILO’s Better Work Initiative (discussed further in section 5) can all assist to counter the short-term incentives that pervade the apparel sector.

2.5 National or Regional Exceptionalism

There are different types of national exceptionalism, which is perhaps more likely to be voiced by business than by other actors even if the thinking is more widely held. For example, in many parts of **Europe**, and the OECD more generally, there is the perception that human rights do not matter so much at home (as “developed nations”) and that the issue of business and human rights is only material for transnational companies operating in high-risk areas. Such reactions are pervasive and reflect wider societal pre-conceptions that infiltrate how the company itself perceives human rights. Outside the OECD, the human rights agenda may be portrayed as being imposed from outside the country, in particular by powerful State and business interests. Unfortunately there remain too many States in all regions willing to criticise each other for their respective human rights shortcomings, but who are much less accepting of criticism domestically. States need to be open about their own shortcomings, as well as those of business hosted and headquartered within their jurisdictions.

It is often much harder to have domestic business and human rights dialogues for this reason. And yet, businesses are regularly addressing specific human rights issues such as gender, migrant workers, collective bargaining, healthcare, or freedom of expression and privacy without understanding or acknowledging that these themes are parts of a broader international framework. It should also be acknowledged here that the words “human rights” continue to be understood and interpreted differently in different parts of the world, sometimes with negative implications in the eyes of Governments, the public and other actors, including business.

2.6 The Business Model: Size and Structure

Clearly some business models, such as cooperatives and partnerships, more explicitly value positive social impact including positive support to human rights. Publicly listed companies are often relatively slow moving in their adoption of human rights due diligence, driven partly by the expectations of investors, but also constrained by short-term market forces. However, they do ensure at least some in-built accountability to shareholders and also the stock exchange or listing agency. As such, social considerations are becoming increasingly explicit within listing requirements around the world (see section 3 for further discussion). Private companies tend to either lead the pack as “early adopters” due to the vision of these founders or CEOs, or as laggards where investors or other external actors have little or no leverage other than through legislation.

One of the most often cited “challenges” in business and human rights terms is the small or medium-sized enterprise (SME). SMEs are generally viewed to have relatively less resources to devote to social issues. However, this grossly underestimates SMEs as the future of every nation’s economy and limits opportunities for the business and human rights agenda to be recognised as essential for the entrepreneur. In fact, smaller companies are generally closer to issues such as

²⁹ See: <http://www.ihrb.org/about/programmes/nairobi-process.html>

social impact and less burdened by hierarchy and bureaucracy. A number of key observations were made during the interviews for this Report:

- SMEs in some sectors, such as those with large global reach or particularly severe potential human rights risks, need to give considerable attention to human rights due diligence, such as ICT companies or junior companies in the extractive sectors.
- SMEs might rightly claim their operations are often less complex, for example, in terms of global supply chains. However, there are a range of issues relevant to all employers, such as non-discrimination or workplace health and safety, where size clearly does not matter.
- The due diligence expected under international standards is proportionate to the size of the operation, but also the significance of the risk it may create. If an SME is focused on high-risk products, materials or markets, then due diligence needs to be a larger percentage of overall investment.

Although expectations on SMEs should be proportionate to the risks they pose, there is no “get out clause” – they too have human rights risks, impacts and responsibilities. What remains the case however is that many national business associations represent not just international companies, but predominately also SMEs, for whom the words “human rights due diligence” do not sound like an opportunity. This will shift as human rights more generally become better understood in the context of specific issues such as discrimination or health and safety – and some guidance has begun to be produced to assist such considerations³⁰ – but there is an onus on States to lead this transition.

2.7 Language and Communication

Businesses often report that the language of human rights is not the most accessible for business managers.³¹ Therefore, many companies will cite that they have undertaken human rights relevant due diligence even if human rights are not explicitly stated in associated policies and procedures. It is not always necessary or even appropriate that a policy dealing with human rights be called a human rights policy. In some countries, using explicit human rights terms may ring alarm bells and draw unwarranted attention that leads to unproductive outcomes where others in the area are unfamiliar or suspicious of human rights language. For example, a company does not need to rename its existing health and safety procedures as those relating to the right to life and the right to health in the workplace. Existing approaches to sustainability and social impact assessments often cover key human rights concerns. But if the choice is made not to use human rights language, there should be an understanding and articulation among management about why the choice was made, an understanding of the links between relevant topics and human rights, and an awareness of the terms stakeholders may use to talk about these rights.

The State plays a key role in clarifying the expectations of its companies, ideally with the involvement of other actors such as workers, trade unions, investors and civil society. Clearly national legislation plays an interpretative role between international law and domestic law. As mentioned earlier, it is also the role of UN and other treaty bodies, the UN Human Rights Council and other inter-State mechanisms to contribute to human rights interpretation and implementation. Moreover, even if not legislated domestically, States can support businesses by publishing guidance and toolkits to help standardise human rights understandings and approaches by companies. The European Commission sought to do this for example, with the production of

³⁰ See for example the SME Guide to the UN Guiding Principles produced by the European Commission at: <http://ec.europa.eu/enterprise/policies/sustainable-business/corporate-social-responsibility/human-rights/>; see also the UK Equality and Human Rights Commission’s SME Guide on human rights at: http://www.equalityhumanrights.com/uploaded_files/sme_hr.pdf

³¹ See, for example: IHRB, “The State of Play of Human Rights Due Diligence: Anticipating the next 5 years” (2011). Available at: http://www.ihrb.org/pdf/The_State_of_Play_of_Human_Rights_Due_Diligence.pdf; and, IHRB and the Global Business Initiative on Human Rights (GBI), “State of Play: The Corporate Responsibility to Respect Human Rights in Business Relationships” (Dec. 2012). Available at: <http://www.ihrb.org/publications/reports/state-of-play.html>

sector guides on the corporate responsibility to respect in three industries – Oil & Gas, ICT, and Employment & Recruitment Agencies.³²

2.8 The Scope of the Human Rights Due Diligence

Businesses constantly wish to know how much due diligence and associated mitigation is enough to meet legal requirements, how much is adequate by external benchmarks, and how much is expected of a responsible company by society. Human rights due diligence is not an absolute, it is finite and limited by resources, time and context. Nonetheless, it must be predicated on a thorough understanding of human rights risks caused by or associated with business activities. Clarity from the State, and other actors, is needed regarding what level of due diligence is adequate in relation to particular risks and impacts in order for companies to move forward with implementation of their corporate responsibility to respect human rights. Such thresholds are unlikely to be fixed universally, but will likely be developed over time and need to respond to the specifics of particular operations and community needs.

Whilst each company needs to prioritise what it examines as part of its human rights due diligence, Governments can create incentives and disincentives so that certain priorities are reflected. This can be done through legislation, such as has been done on issues such as trafficking or forced labour, or in relation to business investments in countries where it was previously disallowed. Specific commodities can be identified in legislation where more rigorous approaches to supply chain due diligence are seen as necessary. States can also require such due diligence before granting licences. States can also prioritise issues through involvement in specific multi-stakeholder initiatives, or by making specific multi-stakeholder standards part of public procurement requirements. It is clear also that embassies, trade missions, bilateral investment treaties, export credit, as well as public procurement, all have an increasingly important role in informing business about expectations regarding the scope of the human rights due diligence to be undertaken.

Clear consequences for companies unwilling to conduct adequate human rights due diligence or provide effective remedies could include economic disincentives for companies refusing to engage meaningfully with legitimate human rights entities, such as National Human Rights Institutions, OECD National Contact Points or other national mechanisms for mediation or investigation, such as exclusion from public procurement or forming joint ventures with State-Owned Enterprises, for example. Human rights due diligence could also be accepted as a defence against charges of criminal, civil or administrative violations, as is practiced in the environmental and anti-corruption realms.

Consistent reporting and disclosure standards on these issues can also help to reduce competition on these issues and incentivise collaboration between competitors. Competition in terms of the quality of disclosure and reporting can be a good thing, but States need to ensure that the baseline of “respecting all human rights” is met. Current approaches to non-financial reporting that are premised on a “comply or explain” basis can use investor and civil society pressure to prompt robust disclosures and explanations that will contribute to the development of due diligence thresholds (see section 3).

2.9 Summary Note

For business, the concept of “human rights due diligence” is central to preventing human rights impacts and implementing the corporate responsibility to respect human rights as set out in the UN Guiding Principles. However, the scope and extent of the due diligence expected depends on numerous factors, not least of which is operating context. While expectations to conduct due diligence are clear, the scope and extent of such processes often are not. In the past, companies have not been incentivised by States or investors to acquire such knowledge and in fact many have

³² See further: <http://www.ihrb.org/publications/reports/human-rights-guides.html>

often preferred to remain uninformed about risks and abuses. An obvious consequence is that companies often refrained from undertaking rigorous human rights due diligence precisely in locations where it was and is most necessary. The development of the UN Guiding Principles have flipped that approach on its head, affirming the international expectation today is that all companies should be aware of their own actions, and those of their business relationships, that may lead to negative human rights impacts.

The vast majority of the world's companies are still unfamiliar with the UN Guiding Principles however. States can put in place a number of economic incentives and disincentives to raise companies' awareness of their human rights responsibilities and guide company behaviour. Some States are beginning to experiment with economic levers they already possess, such as export credit and public procurement, to influence corporate behaviour with regard to human rights. There is room for much greater alignment between market-based mechanisms, as well as State licencing and oversight, which would serve to make human rights a commercially-relevant issue for all companies concerned. States are only beginning to think about far deeper structural reorientations, to redesign incentives and disincentives to move from rewarding short-term performance to longer-term outcomes, which are far more aligned with sustainability goals, including around human rights.