Harnessing power within global value chains for sustainable development*

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Abstract

Global value chains (GVCs) are a powerful vehicle through which multinational enterprises (MNEs) can help address the grand challenges that humanity faces. But optimally utilizing GVCs for sustainability requires fundamental changes in corporate behaviour. In this paper we expound the concept of MNE economic power within GVCs and discuss needed changes for MNE business models to fill governance gaps. We debate the renewed role of public governance to promote social and environmental standards along GVCs and outline policies that governments should adopt to help MNEs and lead firms alter their business model.

Keywords: global value chains, private governance, sustainable development, due diligence

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1. Introduction

How can global investment be mobilized to build a more resilient, sustainable and inclusive post-pandemic world? Leading members of the global investment-development community gathered at the 7th UNCTAD World Investment Forum to discuss this grand societal challenge.

Two underlying themes relating to the multinational enterprise (MNE) permeated conference discussions. First, speakers repeatedly called on MNEs to act with renewed urgency to intensify their contribution to a sustainable future by providing innovative solutions that avoid further harm and actively do good. Beyond simply asking for deeper corporate engagement, speakers emphasized the need for real corporate change. UNCTAD Secretary-General Rebeca Grynspan, for example, suggested in her opening remarks to the Global Investment Game Changers Summit that making investment work for sustainable development requires "game-changing" enterprises that integrate social, environmental and health objectives into their business models. Abdulla Shahid, president of the 76th Session of the UN General Assembly, complemented these thoughts by saying that "[s]ustainability and resilience must be fully ingrained into countries' policies and companies' corporate culture." Speakers urged policymakers to develop new policy instruments that can foster responsible corporate change for sustainable development.

Second, participants recurrently called on MNEs to reconfigure their global value chains (GVCs) to help transform the global economy towards a resilient, sustainable and inclusive future. MNEs were asked to embrace "diversification, replication, reshoring and regionalization" to make their supply chains more resilient against increased volatility, uncertainty, complexity and ambiguity in the global business environment (see also Zhan et al. (2020) and Zhan (2021)). They were solicited to work only with suppliers that adhere to social and environmental standards. And they were pushed to pay attention to the environmental footprint when building complex international value chains. Here again, speakers urged policymakers to develop more potent policies that increase MNEs' accountability for social and environmental standards throughout their GVCs.

In this commentary, we argue that academics and policymakers can get significant mileage in their development of actionable policies by combining insights from these two themes. We will point out that GVCs are a potent vehicle through which MNEs can promote real change towards sustainable development across firm and country boundaries, and it is therefore imperative to identify how GVCs can be best configured to foster sustainable development. Yet we will also suggest that MNEs need to make real corporate changes to their business models to develop the dynamic orchestration capabilities that are required to utilize their power in GVCs for sustainability.

We conclude by discussing the renewed role of public governance in promoting social and environmental standards along GVCs (including due diligence policies) and by examining the policies governments should adopt to help MNEs and lead firms alter their business models.

2. MNEs’ economic power in GVCs

Large corporations have enormous power in GVCs (Gereffi, Humphrey and Sturgeon, 2005; Dallas, Ponte and Sturgeon, 2019). Sitting at the top of a hierarchical chain, they have the muscle to select which firms are included or excluded in GVCs, to determine the terms of supply-chain membership and to allocate where, when and by whom value is added. It is this power that has allowed MNEs to create GVCs and to use them to enhance productivity and efficiency.

MNEs can leverage this economic power not only to strengthen economic performance but also to promote social standards and environmental stewardship along the chain (Pietrobelli, Rabellotti and Van Assche, 2021). They can remediate poor labour and environmental conditions in global supply chain factories, for example, by pledging to work only with first-tier suppliers that adhere to strict social and environmental codes of conduct (Locke, Amengual and Mangla, 2009). This promotion of social and environmental standards can cascade down the chain if MNEs make a first-tier supplier’s GVC participation not only conditional on their own compliance with sustainability standards, but also on the compliance of their suppliers, and so on (Narula, 2019).

In both academic and policy circles, the recognition that MNEs can use their economic power to dictate the social and environmental terms along the value chain which stretches beyond firm and country boundaries has generated considerable enthusiasm for the idea that MNEs can create private governance to fill important gaps in global regulation (Scherer and Palazzo, 2011). A common frustration for many policymakers is that regulatory efforts to enable and promote responsible business behaviour are habitually restricted by national boundaries and that there is little appetite for international collaboration. The sprouting of private regulation that aims to independently regulate social and environmental issues along GVCs in recent decades was, in this sense, a welcome trend. On the environmental side, there has been a proliferation of sustainable production initiatives, ranging from the Forest Stewardship Council to the Marine Stewardship Council to the Roundtable on Sustainable Palm Oil (Ponte, 2014). On the social side, labour-focused initiatives have mushroomed, ranging from the Fair Labor Association to numerous brand-specific ethical sourcing projects (Barrientos 2019). In all instances, MNEs have de facto become new regulatory actors beyond the State that can support sustainable development.

This same enthusiasm has also provided the impetus for the United Nations to call for stronger business involvement in the Global Compact and Sustainable Development Goals (Van Zanten and Van Tulder, 2018). Since MNEs are among the only actors that can effectively influence social and environmental conditions across the globe through their economic power, it is important to engage them further in sustainable development efforts.

3. Private governance gaps

Nonetheless, the modest and uneven improvements in social and environmental conditions in many GVCs have tempered the enthusiasm about private governance in recent years (Voss, 2020; Zagelmeyer and Sinkovics, 2019). Even the best-intentioned MNEs often appear to lack the capability to improve their suppliers' social and environmental standards. For example, media headlines have feasted on the allegations that Uniqlo, Skechers and Zara have profited from exploiting forced labour in the Chinese Uyghur community. For many, this suggests that there is something missing in the business models of MNEs – showing governance gaps – that prevent them from using their economic power to address societal challenges (Scherer and Voegtlin, 2020; Schrage and Gilbert, 2021).

A common explanation for weak improvements to social justice and environmental stewardship in GVCs is that many MNEs are not motivated to use their power within GVCs for sustainable development. They either cajole with too small a carrot to incentivize compliance among their suppliers or use too small a stick when there is non-compliance, or a combination of both. Indeed, several scholars have blamed MNEs for heaping the costs of compliance upon suppliers without installing effective cost-sharing, monitoring or penalty systems (Bird and Soundararajan, 2020; Locke, Amengual and Mangla, 2009). MNEs are alleged to go ahead with such ineffective governance schemes since they care more about "looking good" rather than "doing good" (Lund-Thomsen, 2020).

Other studies recognize the real engagement of many MNEs in supporting sustainable development, but they question the efficacy of current business models to promote social standards and environmental stewardship along GVCs. Several scholars argue that the cascading compliance model, which heavily relies on MNE-engineered codes of conduct and third-party auditing, cannot work without trust-inducing mechanisms that engage suppliers in joint problem solving and information sharing that are in the mutual self-interest of suppliers and lead firms (Bird and Soundararajan, 2020; Locke, Amengual and Mangla, 2009; Lund-Thomsen and Lindgreen, 2014). Other scholars point out that MNEs' engagements need to be particularly enhanced with the lower-tier suppliers to which the firms are not directly connected (Alexander, 2020).

A central insight from these studies is the importance for MNEs to develop a better understanding of who their GVC partners are (first-tier and beyond) and how they should interact with them.

Fiske, Goerzen and Van Assche (2021) go a step farther by suggesting that most MNEs need a change of their business model to overcome these private governance gaps. They identify three distinct clusters of dynamic capabilities that MNEs need to develop to successfully promote sustainability along a value chain. As an *internal prioritizer*, they need to continuously sense new opportunities and challenges related to the sustainability of their operations, on the basis of shifting internal and external stakeholder concerns; as *an external developer*, they need to constantly appraise what mix of supplier capability-building, compliance systems and alliances enables them to best address newly emerging compliance bottlenecks in their GVCs; and as a *network transformer*, they need to set up a system that enables them to promulgate new lessons learned about sustainability promotion practices across the GVC. These dynamic orchestration capabilities are not innate to MNEs and need to be purposefully fostered. They require firms to develop governance mechanisms that enable them to detect potential problems related to GVCs more rapidly and enact instruments that can address them.

Taken together, recent studies suggest that systemic governance gaps prevent MNEs from effectively using their economic power for sustainable development. To fortify this power within GVCs, there is a need for MNEs to develop new business models that enable them to improve transparency and traceability at every level of production and in all aspects of value chains. Without a keen awareness of who is involved in GVCs, where compliance bottlenecks are most likely to sprout and how these hold-ups can be remediated, it is hard for MNEs to utilize their power within GVCs to achieve sustainable development.

4. A renewed role for public governance

With the recognition that MNEs face private governance gaps in the implementation of self-selected pressures along GVCs, new public policies are called for that can pressure lead firms to promote sustainability extraterritorially more effectively while recognizing that such policies can be implemented and enforced only within national borders. In other words, there is a need for national regulations and/or other policy instruments that can harness the MNEs' power within GVCs in a way that fosters social standards and environmental stewardship of partner firms within the value chain (Voss, 2020).

Corporate due diligence obligations have in this respect emerged as an interesting policy option (see figure 1). Such policies require firms that operate in a national territory to identify, prevent, mitigate and account for violations that occur to legislatively defined sustainability standards all along their GVC (Buhmann, 2018). In line with the need for more traceability and transparency in GVCs, firms would be required to develop orchestration capabilities and business practices that enable them to identify and address the potential and actual adverse social and environmental impacts linked to their products or services and within their value chains and business relationships (EC, 2021).

Figure 1. Due diligence for sustainability framework

Source: Authors' elaboration.

Recent years have seen several promising steps towards the development of corporate due diligence principles for sustainability. Following Special Representative of the UN Secretary General John Ruggie's "conceptual and policy framework" to address the relationship between business and human rights, the United Nations in 2011 developed the United Nations' Guiding Principles on Business and Human Rights (UNGPs) (UNHR, 2011). This framework comprises a set of guidelines for States and companies to prevent, address and remedy human rights abuses committed in business operations along the GVC. Several other intergovernmental organizations followed suit by developing their own guiding due diligence frameworks, including the Organisation for Economic Co-operation and Development's (OECD) Guidelines for Multinational Enterprises (OECD, 2011), the OECD's Due Diligence Guidance for Responsible Business Conduct (OECD, 2016) and the International Labour Organization's (ILO) Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy (ILO, 2017).

So far, these supranational guidelines have been voluntary and have thus arguably lacked teeth to pressure lead firms to make significant changes within their GVCs, as a study by the European Commission on its own due diligence guidelines shows (EC 2020 and 2021; see also Lupu, 2016). Thus, the implementation of stricter due diligence policies by intergovernmental organizations is successful only if governments support the application of such policies and ensure their implementation with national policies. Using these supranational policies as a guide, many governments have started to implement such stricter due diligence policies and imposed administrative fines in case of compliance failure and violations (Bueno and Bright, 2020). For example, the French government implemented the Duty of Vigilance Law to impose a legal duty to exercise human rights due diligence in 2017 (Crossart, Chaplier and Beau de Lomenie, 2017), and the Dutch government adopted the Child Labour Due Diligence Act in 2019 (Littenberg and Binder, 2019).

Some governments have also started to implement due diligence policies for their own public procurement activities (OECD, 2020; Martin-Ortega, 2018; Corvaglia and Li, 2018). With average global governmental spending on public procurement of between 13 to 20 percent of GDP (World Bank, 2020), governments are significant actors within the national business environment and in GVCs. The sustainable adaptation of public procurement policies and practices has been shown to be highly effective in implementing sustainability standards in countries. That is, previous policy changes reduced the global production of greenhouse gas emissions, the use of clean water and the disposal of a variety of waste/hazardous materials, and improved the participation of a variety of underprivileged groups in economic activities (Stritch et al., 2020). Due diligence policies thus are an opportunity for governments to influence social and environmental standards within GVCs (Martin-Ortega, 2018; Martin-Ortega and O'Brien, 2017); besides being GVC actors with significant power, by implementing due diligence in their own procurement activities they also indirectly affect MNEs as role models (Appolloni et al., 2014; Cravero, 2017).

5. Questions for future research

More research is needed to validate the applicability of due diligence policies for sustainable development within GVCs. Questions remain on the stringency of the due diligence policies necessary to overcome MNEs' private governance gaps. Bueno and Bright (2020) highlight that due diligence requirements can take different forms: (1) firms need to disclose information on their own activities related to human rights and environmental impacts; (2) firms need to disclose substantive due diligence exercises without clarifying liability conditions in case harm does occur; and (3) firms are liable in case of evidenced harm by the firm or its GVC partners. To our knowledge, very few studies to date have linked the scope of due diligence obligations to sustainability outcomes, as many mandatory due diligence initiatives are too recent to permit full evaluation of their influence on sustainability standards throughout GVCs.

Further questions remain on the need for alterations of MNE business models to comply with due diligence obligations. What operating routines are needed to identify, prevent, mitigate and account for sustainability violations within GVCs?

The development of coherent routines might be challenged by the heterogeneity of MNEs and their partner firms within GVCs, as well as often altered business models in continuously changing global environments.

Last, questions remain about the compatibility of due diligence policies with frameworks of multilateral trade governance, specifically by the World Trade Organization (WTO). Some scholars have raised the concern that the regulatory use of due diligence obligations to achieve sustainability objectives extraterritorially may violate the principle of non-discrimination in trade based on the origin of the products and services (Corvaglia and Li, 2018). This lack of consideration is reflected also in the absence of any sustainability related due diligence discussion at the WTO. Thus, how far can due diligence principles really go without compatibility with trade governance?

6. Conclusion

We argue that GVCs are a potent vehicle through which MNEs can promote real change towards sustainable development across firm and country boundaries. MNEs are important actors that can effectively influence social and environmental conditions across the globe through their economic power within GVCs. Yet, MNEs need to make real corporate changes to their business models to develop the dynamic orchestration capabilities that are required to utilize this power in GVCs for sustainable development. This recognition of private governance gaps by MNEs in implementing self-selected pressures and the acknowledgement that entire GVCs need to be reconfigured to be more sustainable results in the call for policies that move along them, go beyond national boundaries and harness the power of lead firms to foster sustainable development within value chains. Corporate due diligence policies are a step in the right direction since they require firms and the public sector to assess and monitor their own and their relations' and networks' operations and report violations to the authorities. These policies help MNEs and lead firms alter their business model and allow governments to directly and indirectly influence social and environmental standards within GVCs.

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