

Supply Chain Due Diligence Act (LkSG): Meeting due diligence obligations along the supply chain

The German Supply Chain Due Diligence Act (LkSG) obliges companies in Germany to observe human rights and environmental standards in their global supply chains. It applies to companies domiciled, resident or having their principal place of business in Germany and takes effect above certain employee thresholds. For procurement and supply chain professionals, the Act thus becomes an integral part of supplier selection, contract design and risk management.

Key facts

- The LkSG requires risk-based due diligence in a company's own operations, for direct suppliers and for indirect suppliers.
- In practice, it typically applies to companies with 1,000 or more employees in Germany; an EU-wide harmonisation through the Supply Chain Directive Implementation Act must be observed.
- Core obligations are risk analysis, preventive and remedial measures, a complaints procedure, documentation and annual reporting.
- Responsibility lies with the company's own management; delegation to procurement does not release from overall responsibility.
- Fines can be considerable depending on company size; exclusion from public contracts for up to three years is possible.
- Supplier management with a supplier audit score, risk-based reviews and contractual obligations is the key implementation lever in procurement.

Definition: Supply Chain Due Diligence Act

The Supply Chain Due Diligence Act (LkSG) is a German federal law that obliges companies to identify, prevent, minimise and respond to human rights and environmental risks in their supply chains. It entered into force in stages and initially targets larger companies; through the award of orders along the value chain, the obligations effectively also impact small and medium-sized suppliers.

Scope of application and thresholds

In Germany, the Act typically applies from an employee count of 1,000 employees domestically; lower thresholds applied during the initial phases. The decisive factor is a registered office or principal place of business in Germany, regardless of where the risks arise. In corporate groups, the combined number of employees is counted. Suppliers without their own LkSG obligations are brought in via cascading contracts and purchasing terms.

- Own operations: direct obligations of the company
- Direct suppliers: contractually agreed obligations and controls

- Indirect suppliers: action-oriented review only upon substantiated suspicion

Distinction from the EU Supply Chain Directive

In parallel with the LkSG, an EU Directive on sustainability and due diligence obligations was adopted, which member states must transpose into national law. In Germany, the Supply Chain Due Diligence Act Implementation Act, or its further development, is planned for this purpose. Companies should examine the thresholds, scopes of obligations and sanction mechanisms of the national and European regulations separately and design their compliance framework to be as Directive-compliant as possible. The version in force is legally binding in each individual case; legal advice is recommended.

Methods and approach: embedding due diligence in procurement

The Act prescribes an annual, risk-based process that must be maintained on an ongoing basis throughout the financial year. Procurement is the central implementation function, as the source of risk often lies in purchasing. A structured approach combines sourcing pipeline, supplier evaluation and contractual mechanisms.

Risk analysis and prioritisation

The basis is an abstract risk analysis by country, industry sector and risk type (e.g. forced labour, child labour, occupational safety, protected land, mercury or chemical risks). This is followed by a concrete analysis of known factual indications, for example from media monitoring, complaints or audit findings. In practice, it has proven effective to combine procurement volume, the criticality of the goods and the country or industry risk in order to classify suppliers accordingly.

- Document country and industry risk and update annually
- Prioritise suppliers by volume, criticality and risk profile
- Incorporate results into the sourcing pipeline and supplier onboarding approval

Prevention, contracts and supplier audit score

Preventive measures are required to address identified risks, in particular training, contractual assurances and control agreements. For direct suppliers, commitments through contracts or supplier code of conduct declarations with written consent are expected; violations must be addressed. A supplier audit score that links compliance, social and environmental criteria to purchase considerations makes the status measurable. Onsite audits and self-disclosures typically alternate on a risk basis in practice.

Complaints procedure and remediation

Companies must establish an internal complaints procedure accessible to employees, supplier networks and affected parties in the supply chain. Incoming reports are documented, reviewed and transferred into a remediation plan. For direct suppliers, the principle of proportionality applies: remediation is to be sought first, then the business relationship suspended or terminated. Renegotiations on prices must not come at the expense of social standards; a documented renegotiation with procurement targets and compliance ceilings can support this.

Integration into procurement processes and performance indicators

Due diligence obligations are only effective when embedded in ongoing processes – from demand notification through onboarding to supplier integration. A stand-alone compliance department without an anchor in procurement creates, in practice, documentation burden without impact.

Supplier selection and contracting

As early as the enquiry stage via Request for Information (RFI) or electronic tendering, sustainability and human rights criteria should be included as evaluation fields. In the contract text, companies anchor the code of conduct, evidence rights, audit rights, escalation levels and termination rights in the event of breaches of obligations. Standardised clauses facilitate efficient implementation across large supplier portfolios.

Ongoing monitoring and KPIs

Key performance indicators are the proportion of risk-assessed suppliers, the proportion of audited suppliers in high-risk countries, the disclosure rate for self-disclosures, time-to-onboarding for new suppliers, and the number of open remedial actions. In addition, compliance indicators can be combined with operational metrics such as on-time delivery rate or total cost of ownership to make trade-offs visible early on.

Documentation and reporting obligations

All process steps must be documented and retained for at least seven years; reporting takes place annually, in practice often via the sustainability statement or the risk management system. Clear role allocation – management, compliance, procurement, quality management – prevents frictional losses. Credible reporting also reduces the effort involved in customer enquiries, certifications and bank guarantee checks in international payment transactions.

Risks and controls: liability, sanctions, trade-offs

Violations of the LkSG can be penalised as regulatory offences with fines which, in practice, can amount to a percentage of annual turnover; in addition, bans on payments to board members and exclusions from public contracts are possible. Civil law claims by affected parties typically come into play only after preceding procedures.

Fines and exclusion from public contracts

Fine frameworks are based on company size and can, for large companies, reach double-digit million amounts or a turnover-related maximum value. Exclusion from tender procedures for up to three years particularly affects groups with public sector business. Since fine liability attaches to the company, internal controls, four-eyes principles and management reviews are required.

Typical weaknesses in practice

Common deficiencies are outdated risk analyses, lack of evidence for indirect suppliers, incomplete complaints procedures and insufficient integration with day-to-day operational procurement. Even in disaster recovery (DR) or force majeure situations, emergency sourcing must not increase compliance risk; emergency sources should therefore be vetted in advance.

Control instruments in procurement

Effective controls include risk-based audits, regular self-disclosures, escalation management, exit plans and an effective procurement policy. The supplier audit score should be weighted in supplier evaluation;

politically sensitive or geopolitically sensitive sourcing markets require deeper review. Documentation chains up to the certificate of origin are particularly relevant for minerals and raw materials, as special due diligence obligations may apply here.

Current developments and outlook

Supply chain regulation is increasingly moving from national rules towards European harmonisation. Companies that rely solely on the LkSG as a minimum level must expect stricter requirements. At the same time, indirect influence is growing through customer tenders, whose cascade effects also affect SME suppliers.

European harmonisation

The EU Directive on corporate due diligence will be transposed into the existing LkSG in Germany via an implementation act, or will replace it. Extended scopes of obligations, stronger climate-related obligations and civil liability elements are to be expected. Companies should therefore design their risk management to be Directive-compliant from the outset, rather than rebuilding twice.

Digitalisation of due diligence

In practice, companies are increasingly relying on software-based risk monitoring, supplier portals and standardised data exchange formats. Traceability along the value chain, blockchain-based proof of origin and AI-supported media monitoring complement classic audits. Decisive is the integration with master data and procurement systems, so that compliance status automatically takes effect in approval processes.

Typical metrics

Proportion of risk-assessed suppliers: > 95 %

Proportion of suppliers with a completed risk analysis relative to the relevant procurement volume

Audit coverage of high-risk suppliers: > 80 %

Proportion of audited suppliers in high-risk countries, defined on a risk basis

Self-disclosure rate: > 90 %

Proportion of direct suppliers with a valid compliance self-disclosure

Open remedial actions: < 5 %

Proportion of identified remediation cases with no progress beyond the agreed deadline

Practical example

A mid-sized mechanical engineering company with around 1,200 employees in Germany sources components from several European and two Asian countries. Procurement had compliance clauses in its standard terms and conditions, but no risk-based steering. Following an internal self-assessment, deficiencies were identified in monitoring and in the handling of complaints.

- Risk analysis by country, industry sector and risk type for all direct suppliers, prioritised by volume and criticality
- Supplier code of conduct with written consent, contractual audit and evidence rights in new contracts
- Establishment of a supplier audit score with weighting in the supplier ranking and annual updates
- Complaints procedure with documented escalation and remediation plan, interfacing with the risk

Conclusion

The Supply Chain Due Diligence Act makes human rights and environmental risks a regular subject of procurement management. Companies that implement due diligence obligations on a risk basis, embedded in processes and with strong documentation, not only reduce sanction risks but also improve supply capability and supplier quality. The decisive factor is integration with the sourcing pipeline, contract design and ongoing monitoring, rather than a one-off compliance project. Given the European harmonisation, a Directive-compliant design is worthwhile from the outset. The applicable statutory versions and legal advice must be considered in each individual case.

Frequently asked questions

Who does the Supply Chain Due Diligence Act apply to?

The Supply Chain Due Diligence Act (LkSG) applies to companies domiciled, resident or having their principal place of business in Germany. It typically applies from 1,000 employees in Germany; earlier thresholds were 3,000 and then 1,000 employees. Subsidiaries and corporate groups may also be covered. The applicable version in force must be checked in each individual case.

What are the central obligations under the LkSG?

Core obligations are annual and ongoing risk analysis, preventive measures within the company's own operations, remedial measures for direct suppliers, a complaints procedure, documentation and annual reporting. For indirect suppliers, obligations only apply upon substantiated suspicion. A risk-based approach determines the depth of review.

What penalties are imposed for violations of the LkSG?

Violations can be penalised as regulatory offences with fines which, in practice, can amount to a percentage of annual turnover. In addition, exclusion from public contracts for up to three years and bans on payments to board members are possible. Civil law claims by affected parties also come into play. The specific amount depends on the individual case.

Are small suppliers also affected by the LkSG?

SMEs are typically not directly covered by the scope of application. Indirectly, however, they are affected via cascading contract requirements, supplier codes of conduct and customer requirements. Large customers demand self-disclosure forms, participation in audits and supporting evidence. Those who build up their own processes early avoid later margin-eroding adjustment pressures.

How does the LkSG differ from the EU Supply Chain Directive?

The EU Directive establishes a uniform framework for due diligence obligations across the EU and takes effect through national implementation laws. In Germany, a further development of the LkSG is planned for this purpose. Differences concern thresholds, scopes of obligations, climate obligations and civil liability. Companies should align with the Directive to avoid duplicate restructuring.

How do you practically start implementing the LkSG in procurement?

In practice, you start with a complete clean-up of supplier master data, followed by a risk analysis by country, industry sector and risk type. Suppliers are then prioritised, contract clauses added, and an audit and escalation concept established. Integration into existing processes such as the sourcing

pipeline and supplier onboarding approval is decisive for effectiveness.