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LEIZ CASE STUDY #8

# Balancing Value Chain Due Diligence and Stakeholder Relationships

Josef Wieland  
Matthias Niedenführ

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Prof. Dr. Josef Wieland  
ORCID-ID: 0000-0003-2144-9694

Dr. Matthias Nidenführ  
ORCID-ID: 0000-0001-8998-0487

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LEIZ CASE STUDY SERIES

## **Relational Economics in Practice. An Introduction and User Guide**

Josef Wieland

Julika Baumann Montecinos

The research program of relational economics constitutes the core of the Leadership Excellence Institute Zeppelin | LEIZ. Building on the publications of the Springer series "Relational Economics and Organization Governance" and the annual conferences of the emerging relational economic community, a theory is developing and establishing itself that represents a paradigm shift in the field of economics: the unit of analysis is no longer the actor or the market, but the relational transaction in its complex, polyvalent, uncertain, context- and time-dependent constitution. The aim behind this is to come closer to an understanding of the real conditions and consequences of economic action. For this reason, and in view of the fact that the corresponding conceptual description tools are now available, it seems highly plausible and expedient to focus even more on examples of application. If relational economics has the declared aim of depicting economic realities as precisely as possible, then such an undertaking of practical application should not only be productive in terms of concrete recommendations for decisions, but should also, in turn, further confirm the relevance of the theoretical concept.

The series of case studies presented here aims to offer nothing more and nothing less: We invite students, practitioners and colleagues to join us in trying out what relational economics has to offer in its application to real case studies. The analytical tools available for this purpose are briefly presented below in order to provide our readers with a kind of instruction manual without implying that real-world complexity can be dealt with in a one-size-fits-all manner. Rather, the analytical steps proposed here are intended to help describe a relational transaction as a basis for then working out more context-

and time-specific options for action. This is carried out using the stakeholder model as the basic analytical structure, which is complemented in the respective cases by further case-specific methods derived from the toolbox of relational economics.

The attitude of a thorough and competent detective is required if one really wants to capture and describe a relational transaction appropriately: identifying and analysing the stakeholders involved, their resources and interests, and above all their mutual interaction, which, in turn, changes them, play a central role before further theoretical building blocks of relational economics can be applied. Accordingly, this analysis step also forms the common denominator with which the analysis of all the case studies collected here finds its starting point. For this reason, the stakeholder model is placed in the foreground in this user guide and is now briefly explained - other models are then introduced in the individual case studies and discussed in the application of these cases.

## Stakeholder Model of Relational Decision Making

The theory of relational economics defines a firm as a nexus of stakeholder interests and invested stakeholder resources and corporate action via relational transactions that combine, in a cooperative and productive manner, the interests and resources of the stakeholders involved. The fact that, in particular, this takes place across cultural and sectoral boundaries is emphasised here and is related to the claim to take the real complexity and uncertainty of economic activity into account – thinking, for example, of global value creation networks or of the requirements from the ESG discussion.

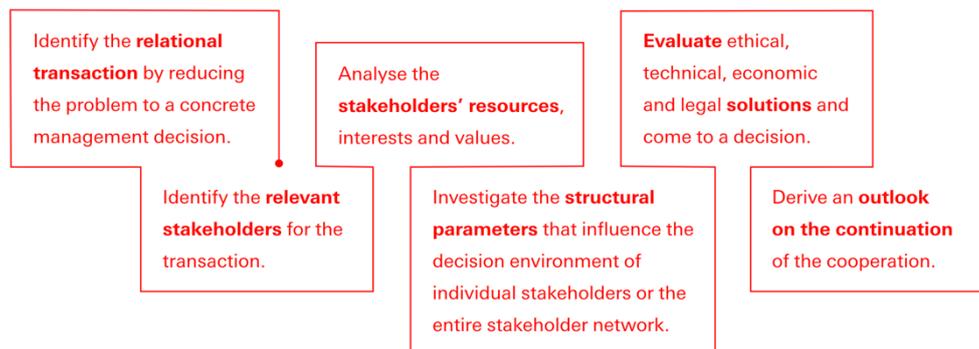
In order to derive a management decision in a specific constellation – for example, in the situations depicted in the LEIZ case studies – the stakeholder model provides the basic framework (Wieland 2020: 97ff.) and is presented here in a condensed form for the given purpose. The application of this model reveals the time- and context-specific microstructures of the relational processes and structures. It comprises six steps:

1. **Reducing the problem to a concrete management decision.** This concrete management decision ideally is a clearly narrowed down yes/no/alternative decision. This decision is the relational transaction that is to be analysed in the subsequent steps.
2. **Identifying the relevant stakeholders with reference to the transaction.** This includes the identification and prioritisation of the involved individual or collective stakeholders. Depending on the transaction, the stakeholders can be, for example, employees, management, customers, suppliers, investors, competitors, NGOs, political institutions or the public.
3. **Analysing the respective stakeholder resources, interests and values.** This entails a thorough look at the polyvalent constitution and motivation of each stakeholder. Such resources and interests could be, for example, economic, political, moral or professional, and the values can be, for example, performance values, communication values, cooperation values or moral values, which need to be combined and balanced.
4. **Investigating the problem along the structure of the decision environment.** This requires checking the relational transaction in depth via the following eight structural parameters (Wieland 2020: 99):
  - I. Decision-making stress (for example, due to political or media pressure)
  - II. Intrapersonal value conflicts (for example, conflicting values arising from role-based expectations)
  - III. Inter-organisational value conflicts (for example, ideals held by the collective actors that are non-negotiable for them)
  - IV. Intercultural values conflicts (for example, differences in the moral doctrines of different groups)
  - V. Information deficits (for example, regarding the scope and consequences of an assigned task)
  - VI. Communication deficits (for example, resulting from the type of communication between the network partners)
  - VII. Responsibility diffusion (for example, who is responsible for creating and solving a given problem and on what grounds)
  - VIII. Rules deficits (for example, resulting from the lack of private or state regulation, or from its unenforceability).

5. **Evaluating ethical, technical, economic and legal solutions and reaching a decision.** In most cases, this decision combines ethical, technical, economic and legal approaches by evaluating the transaction-specific advantages and disadvantages of the available decision logics and considering their interdependency.
6. **Deriving an outlook concerning the continuation of the cooperation.** The question here is what new commonalities have been formed and to what extent the stakeholders involved have changed as a result of the transaction (Baumann Montecinos 2022).

FIGURE 0

### An outline of what such an analysis could look like in general terms



Source: Own illustration.

Thus, the foundations have been laid for working on the LEIZ case studies. We will be delighted if this material is used to promote learning and exploration of relational economics, particularly in its strength of practical application. Feedback from and exchanges between lecturers would be more than welcome.

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## Balancing Value Chain Due Diligence and Stakeholder Relationships

Josef Wieland

Matthias Niedenführ

### Introduction

Globalisation has interconnected economies through offshoring and trade, creating interdependent networks. As a result, global supply chains—now referred to as global value networks—are increasingly becoming the focus of due diligence legislation. Both national and supranational due diligence laws serve as regulatory mechanisms, ensuring that these connections prioritise human rights and environmental sustainability. Although challenges such as enforcement and economic inequality remain, these laws aim to mitigate the negative externalities of globalisation, promoting a more ethical and resilient global economy. Companies involved in these global value networks face the challenge of balancing their business interests with their relationships with suppliers in countries that have vastly different cultural, legal, and political environments. They must navigate potential ethical, legal, and reputational dilemmas when doing business in emerging markets.

### Case Description

You are the Asia representative for Schneider & Sons, a prominent medium-sized company in the garment and apparel industry in southern Germany. This privately-owned family firm boasts a history of over 100 years and has successfully globalised its customer network, first extending to neighbouring European countries, later to the Americas, and, for the past decade, to emerging markets in South and East Asia.

Recently, Schneider & Sons has faced significant changes, resulting in a reduction of its workforce from 2,586 employees in late 2022 to 1,214 employees at the end of 2024. This dramatic decline in personnel was a direct outcome of a comprehensive restructuring initiative aimed at improving operational efficiency and adapting to market conditions. Despite these challenges, Schneider & Sons has maintained its reputation as a global leader in producing high-quality clothing, primarily targeting the mid to upper price range. The company is recognised for its commitment to craftsmanship and design, catering to discerning customers who value both style and durability in their choice of clothing.

Having joined Schneider & Sons in 2018, you are responsible for handling negotiations with suppliers in East and South Asia. While you have managed to navigate the recent job cut initiative, you are concerned about the possibility of losing your job, as many of your close colleagues have done.

In recent years, the company has experienced a steady increase in turnover, indicating positive growth and strong demand for its products. However, despite this rise in revenue, profitability continues to be a significant concern. The measures implemented to enhance efficiency and streamline operations on the production line have largely optimised existing processes, but they have not sufficiently addressed the underlying financial issues. As a result, profit margins remain unacceptably low, suggesting that further strategic initiatives are necessary to boost the company's overall financial health.

An outsourcing programme, launched in 2023, is finally poised to generate positive revenue results for the first time after a prolonged period of investment and restructuring. A critical component of this initiative has been the strategic identification and collaboration with low-cost suppliers situated in vibrant regions such as Mumbai, Guangdong, and Hanoi. These suppliers have been meticulously selected for their ability to procure high-quality cloth and fabrics. The Chinese, Indian, and Vietnamese suppliers oversee extensive networks of smaller, specialised factories renowned for their dedication to producing premium textiles at competitive prices. This network not only enhances the supply chain efficiency of Schneider & Sons but also ensures consistency in quality and timely delivery.

## Challenges

While on a flight returning from Singapore, where your regional sourcing office is located, you come across a photo essay in a magazine titled “Child Labour in China.” The images depict the dire and hopeless situations children endure, prompting you to think about your own children and the stark disparities in life. As you continue reading, you are startled to realise that the photos were taken in small, remote textile factories in Guangdong. The article states that a significant portion of their production is destined for Europe. Additionally, a representative from the International League for the Protection of Children announces that her organisation plans to launch a worldwide campaign against child labour next spring.

Although your company, Schneider & Sons, maintains contractual relationships only with your direct suppliers, you are increasingly concerned about the potential repercussions that could arise if the company were to become embroiled in a controversial campaign. The complexity of the situation is heightened by the fact that you have limited access to the network of factories used by your suppliers, which raises questions regarding their manufacturing practices and labour conditions.

Schneider & Sons indirectly provides jobs across various regions, so it is prudent to consider how any negative publicity could impact not only the company’s reputation but also the livelihoods of employees and their communities. In the light of these considerations, you are weighing up the pros and cons of bringing this issue to the attention of your headquarters in Germany.

Another potential complication for Schneider & Sons is their fabric sourcing from China for the garment and apparel industry. The Uyghur Forced Labour Prevention Act (UFLPA), signed into federal law in 2021, establishes a rebuttable presumption that the importation of goods that are wholly or partially mined, produced, or manufactured in China’s Xinjiang Uyghur Autonomous Region, or by specific entities, is prohibited. This presumption applies unless the Commissioner of U.S. Customs and Border Protection (CBP) determines that the importer of record has complied with specified conditions and that the goods were not produced using forced labour. Trade in cotton from Xinjiang province, a major commodity from that region, has been one major issue for Western garment and apparel makers, including from Japan, as a result of this law. Although Schneider & Sons’ supplier is in southern China’s Guangdong province, it

remains unclear whether this supplier sources the cotton for their fabrics from a supplier from Xinjiang. Even as a German manufacturer, the potential sourcing of Xinjiang cotton may become an issue for the CPB when Schneider & Sons delivers goods for the US market.

## Questions

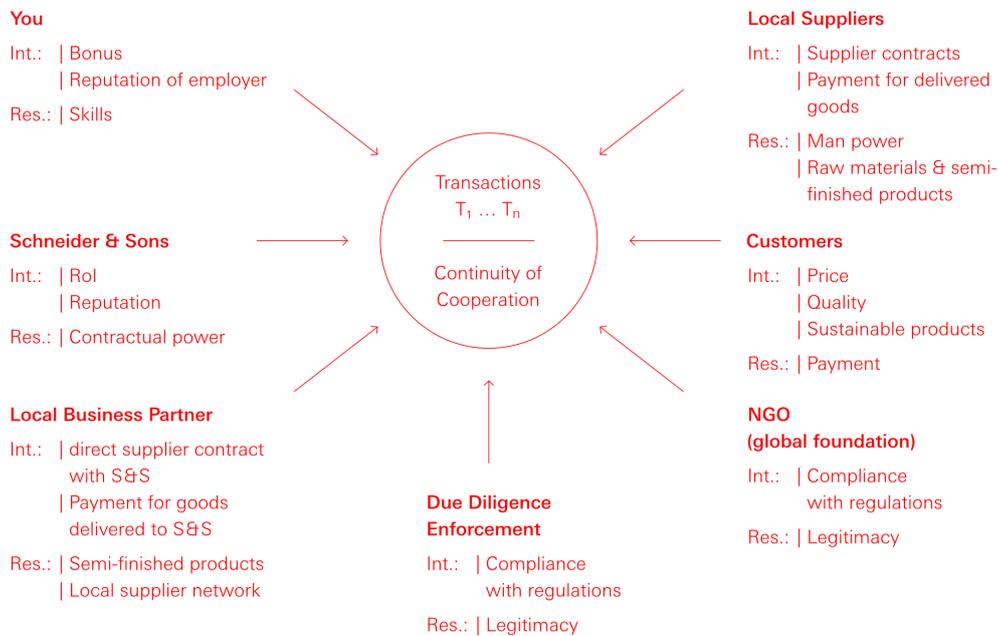
1. What ethical dilemmas are present in this situation?
2. Who are the relevant stakeholders in this particular situation? What are their respective interests? What type of relationship do they share with one another in this situation?
3. What risks might your company face if the NGO establishes a link between your supplier in China, India, or Vietnam and a second or third-tier supplier identified as using child labour?
4. What potential legal consequences could you encounter as a result? What potential reputational damage might your company face?
5. What strategy can you devise to mitigate these risks?
6. How might the fact that you have personal “skin in the game” influence your decision-making?

## Discussion

While we suggest referring to the stakeholder model of relational decision-making, this model does not give you an easy, correct answer to this puzzle. The decision of how to confront this situation is very complex.

FIGURE 1

## Identification of relevant stakeholders, resources and interests



Source: Own illustration based on Wieland 2024: 111.

There is a looming risk of a potential scandal uncovered by the International League for the Protection of Children. You might discover a supplier of your supplier that relies on child labour, which could have potential legal ramifications for Schneider & Sons. Any attempt to investigate the supplier network will require the assistance of your local partner. You could face additional costs instead of reducing expenses, which might negatively impact the financial situation your employer already faces. This will increase your individual employment risk, on top of the other risks mentioned. As a parent, you cannot ignore the uneasiness surrounding the potential entanglement of your company in relying on goods sourced from suppliers tainted by child labour.

Neglecting child welfare is unethical, particularly in relation to child labour. Article 25, section 2 of the International Declaration of Human Rights underscores the necessity for childhood assistance. The abolition of child labour is further addressed in Principle 5 of the United Nations Global Principles, as well as in the ILO Declaration on

Multinational Enterprises and other relevant documents. Legally, it is declared that China, India and Vietnam all have laws in place prohibiting child labour in the sector where your suppliers are operating.

Furthermore, accountability for human rights violations—including child labour—in the supply chain has recently been established in various national and supranational laws. Over the last few years, the issue of due diligence in global value chains, or more accurately, global value networks, has gained prominence on the political agenda, not only in Europe but also in the United States. As a result, a series of new regulations has emerged: the German Supply Chain Due Diligence Act and the EU's Directive for Corporate Sustainability Due Diligence both came into effect in 2024. Due diligence legislation is also in place in the UK and the US, although it is not as substantial.

These regulations may impact European, American, and other Western companies operating in the emerging economies of the Global South, potentially holding them liable for the actions of their suppliers and even their suppliers' suppliers. The international scope of these regulations means that your company could face legal action in the US, the UK, or Europe, including Germany, for the misconduct of companies with which you do not have a direct contractual relationship. Although your company is of medium size, you may technically be exempt from the more complex regulations of the Supply Chain Due Diligence Act. However, your larger B2B partners, such as retail chains in Europe or the US, may still exert pressure on your company to remain compliant.

The fact that an NGO fighting child labour is planning to launch a campaign to expose foreign companies indirectly involved in supporting this practice poses a direct threat to your company's reputation, not only in its German home market but also in all markets that Schneider & Sons serves globally. This reputational risk must be considered, even though your company may be able to circumvent legal issues.

To shed some light on your supplier network, you will have to engage your local partner on a sensitive issue. Exact information about its local suppliers is an important business secret that your partner might not want to divulge because of the risk of being cut out as a middleman. If you can convince your partner – for instance, by explaining the ramifications of the new EU due diligence regulations – to share information, your partner will have to charge local suppliers with the task of collecting due diligence data

for you on the ground in rural India, China or Vietnam. You will need to devise a compelling strategy to persuade your partners on the ground to assist you. The differences in political systems and the perceived roles that NGOs and the “third sector” play in India, China, and Vietnam will be further elements for your strategy to consider.

Although you already have a two-year business relationship with the suppliers, you may encounter increased costs. The expenses associated with collating the data will be partially added to the price of your sourced goods. Furthermore, you will face relational costs resulting in strain on your business relationship, particularly regarding the established goodwill and trust of your business partner.

The timeframe for the announced NGO campaign is somewhat short. Nonetheless, you might suggest to your HQ that the due diligence effort of investigating your supplier network could be transformed into an incentive to join sustainable garment and apparel labels, such as the Global Organic Textile Standard (GOTS). The application process may take some time, potentially longer than the timeframe before the campaign; however, you could justify this due diligence effort as part of a strategic sustainability decision. This would enable your company not only to be better equipped to mitigate legal and reputational risks but also to turn this particular situation into a pivotal moment for enhancing the sustainability profile of your company. A sustainability label might help justify higher prices to alleviate the financial pressure on Schneider & Sons.

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## Keywords

child labour, corporate ethical dilemmas, cultural complexity, due diligence regulations, international and national labour standards, ramifications, local solutions, risk of reputational loss, stakeholder model, standard setting and taking

## Picture Credits

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