

# A Risky Business? Managing core labour standards in company supply chains

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## 1. Executive summary

This paper outlines the International Labour Organisation's (ILO's) core labour standards on child labour, forced labour, trade union rights and equal opportunities. It focuses on breaches of core labour standards in company supply chains and analyses the following sectors where the risk of breach is highest: clothing and footwear, consumer electronics and agricultural crops. It looks at countries where these labour standards are at risk of being breached, including an outline of trade union rights in Export Processing Zones, child labour in the Indian embroidery industry, forced labour in Jordan's Qualified Industrial Zones and discrimination through forced pregnancy testing in maquiladoras in Central and Southern America. The paper also considers other labour standards including working hours and wages. They are not included amongst the core labour standards but are central components of policies on supply chain labour standards.

It looks at stakeholder concerns about core labour standards and includes an in depth look into two companies who have been accused of child labour breaches in their supply chain, namely Gap and Primark. Pending legislation on core labour standards and how it may affect companies is also outlined. The implications for investors are also investigated, including the effect on the brand value of companies and the issue of moral liability.

The paper includes a section on EIRIS's findings on companies' policies on supply chain labour standards, management systems and reporting. This outlines current thinking on best practice on this issue, including the importance of fully covering freedom of association and collective bargaining in a supply chain policy and the necessity of going beyond auditing management systems. The benefits of training and capacity building are highlighted along with the need to integrate supply chain labour standard management systems into the company's procurement systems.

This is followed by an analysis using EIRIS' Convention Watch research into companies accused in their supply chains of breaching core standards set out by the ILO. The EIRIS Convention Watch supply chain criteria cover cases where companies have been accused of breaching the spirit of ILO Conventions on child labour, forced labour, freedom of association and collective bargaining, non-discrimination and working hours. The allegations are assessed against a series of indicators to determine whether the risk exposure is high or medium, with the more serious cases being given an assessment of high. Each company's response to a particular allegation is also assessed and given one of the following four grades: 'no evidence', 'limited', 'intermediate', or 'good'. An assessment of 'good' indicates that the company has fully addressed the issue.

## Findings

### **EIRIS research on supply chain labour standards**

- 13% of developed world large and mid-cap companies are assessed as high or medium risk for supply chain labour standards
- the majority (66%) of high and medium risk companies are from the consumer industry
- the consumer industry shows the most advanced response to this issue with 60% of high or medium risk companies demonstrating at least a limited response
- by region, European and North American companies demonstrate the most advanced response to supply chain labour standards risk, with 70% of high or medium risk European companies and 60% of high or medium risk US companies demonstrating a response to this issue
- NGO campaigns are the key driver behind these results, with the consumer industry and European and North American companies having had the most exposure to campaigns on this issue and demonstrating the most advanced response

### **EIRIS Convention Watch research on allegations of breaches of labour standards in company supply chains**

- companies in the consumer industry are the most likely to have been accused of breaching labour standards in their supply chains
- the consumer industry also has the most advanced response to such allegations with almost 40% of consumer goods allegations assessed as 'good' and none assessed as 'no evidence'
- by region, European and North American companies are the most likely to have been accused of breaching labour standards in their supply chains
- European and North American companies also have the most advanced response to such allegations with 90% of European companies and 70% of North American companies achieving an assessment of 'good' or 'intermediate'. All Japanese and other Asian companies achieve an assessment of 'limited'
- this again suggests that companies are responding to pressure from NGOs, with companies that have had the longest exposure to NGO campaigns demonstrating the best response to this issue

Management of supply chain risk and the response of companies to breaches of international labour standards in supply chains are rising up the investor agenda as company compliance with international standards grows in importance. Investors can identify companies at risk of breaching core labour standards in their supply chain by looking at the products sourced and the countries from which products are sourced. They can then engage with these companies to understand their current response to supply chain labour standard risk. This will enable investors to manage the risk of breaches in core labour standards in a company's supply chain by promoting improvements in a company's management systems.

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### **Engagement Recommendations**

1. Check the company's exposure to this issue and, where relevant, check that the company is aware of the particular issues concerning its products and the countries they are sourced from
2. Check that the company's supply chain labour standards policy covers all of the required labour standards
3. Check that the company's management systems for implementing this policy are comprehensive and encourage best practice elements
4. Encourage the company to join a multi-stakeholder initiative
5. Encourage the company to report comprehensively on this issue
6. Encourage the company to develop long-term relationships with its suppliers
7. If the company has been accused of breaching labour standards in its supply chain, check whether it has the following in place:
  - a. a supply chain policy which covers the labour standards it has been accused of breaching
  - b. adequate management systems in place to support this policy, ideally involving the use of local NGOs in countries of concern to help identify suppliers at particular risk of breaching labour standards or to help conduct audits
  - c. an open approach to dealing with allegations
  - d. a commitment to performance reporting

### **Engagement Questions**

- Has the company identified where products are being manufactured and what risks are associated with the manufacture of a particular product in a particular country?
- Does the company have a policy on supply chain labour standards and what does this policy cover?
- What management systems are in place to support the implementation of this policy?
- How does the company communicate this policy to suppliers?
- Does the company audit suppliers against this policy? If so how often?
- What procedures are in place to remedy any non-compliance found?
- Does the company provide training and capacity building on labour standards to its suppliers?
- How are the company's management systems for supply chain labour standards integrated with its procurement management systems?
- Does the company report publicly on this issue, in particular on the amount and type of non-compliance found with its policy?
- Does the company seek feedback from its stakeholders about the content of its report?

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Investors that want to work with other investors on this issue can join collaborative engagement initiatives as part of the UN Principles for Responsible Investment (PRI). The PRI Engagement Clearinghouse enables signatories to share information and proposals on shareholder and other engagement activities they are conducting with other signatories. Investors can work jointly to encourage an individual company to publish or adopt a supply chain labour standards policy or to improve its management systems.

Whether engaging with companies individually or working with other investors on this issue, it is important for investors to take the risk of breaches of core labour standards in company supply chains into account as they will impact on a company's value and performance. Conversely, companies that are managing this issue well will be gaining advantages through greater efficiencies in their supply chain and a reputation for addressing international standards. Companies can gain an insight into more efficient ways of working by understanding how their own behaviour can impact on working conditions within their own supply chain. Improved working conditions have also been linked to lower staff turnover in suppliers and improved quality of products. This issue is also of increasing importance to consumers and so companies which are actively addressing it may gain a reputational advantage over their peers who are doing less.

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## 2. Introduction

The aim of this study is to investigate how well companies are managing the risk of breaches of the ILO's core labour standards. The paper focuses on supply chain breaches as this is where companies face the greatest risk of a breach as they have less control over working conditions in their supply chains compared with their own operations. The management systems that companies need to put in place to support these standards in their supply chains are also very similar. Conversely, breaches of these standards in companies' own operations have very different causes and the management system response required varies greatly depending on the labour standard breached.

This study outlines the types of products and countries where there is a greater chance of supply chain labour standard breaches and includes an assessment of what stage companies are at now in terms of the systems they currently have in place to manage this risk. This study also outlines current thinking on best practice in managing this issue. It includes an analysis of allegations of breaches of core labour standards in company supply chains and investigates how well companies have addressed these allegations.

Finally, it highlights the importance of this issue to investors because of the financial and reputational risk it poses to companies. From an ethical perspective, investors may also want to ensure decent working conditions in company supply chains. The study concludes with information on how investors can engage with individual companies on this issue and the sorts of questions they can ask companies to find out how well they are managing this risk. It also provides information on how investors can work together on this issue.

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### 3. Background

#### a) International Standards – ILO

##### i) Core labour standards

The International Labour Organisation (ILO) Declaration on Fundamental Principles and Rights at Work was adopted in 1998. This declaration commits Member States to respect and promote principles and rights in four categories, whether or not they have ratified the relevant conventions. The Declaration makes it clear that these rights are universal and that they apply to all people in States regardless of the level of economic development.<sup>1</sup>

These rights are:

- freedom of association and the effective recognition of the right to collective bargaining
- the elimination of forced or compulsory labour
- the abolition of child labour
- the elimination of discrimination in respect of employment and occupation

On 10 June 2008, the ILO adopted the ILO Declaration on Social Justice for a Fair Globalisation. This reiterated the four strategic objectives of the ILO including the fundamental principles and rights at work.

##### The Core ILO Conventions

The core conventions are the eight conventions which cover the fundamental rights and principles at work.

##### Freedom of Association and Collective Bargaining

*C87 Freedom of Association and Protection of the Right to Organise Convention (1948)*. This convention includes the provision that workers shall have the right to establish and join organisations of their own choosing without previous authorisation.

*C98 Right to Organise and Collective Bargaining Convention (1949)*. This includes the provision that:

- workers shall enjoy adequate protection against acts of anti-union discrimination in respect of their employment. In particular, they will be protected against employment being made subject to the condition that they shall not join a union or relinquish union membership and they will be protected against dismissal or other prejudice by reason of union membership or participation in union activities.
- workers' organisations shall enjoy adequate protection against any acts of interference by the employer

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<sup>1</sup> <http://www.ilo.org/declaration/lang--en/index.htm>

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## Prohibition of Child labour – Conventions 138 and 182

*C138 Minimum Age Convention (1973)*. This includes the following provisions:

- the minimum age for employment shall not be less than the age of completion of compulsory schooling and shall not be less than 15 years
- a member state whose economy and education facilities are insufficiently developed may initially specify a minimum age of 14 years
- the minimum age for admission to any type of employment or work which by its nature or the circumstances in which it is carried out is likely to jeopardise the health, safety or morals of young persons shall not be less than 18 years

*C182 Worst Forms of Child Labour Convention (1999)*. This Convention outlines the prohibition and elimination of the worst forms of child labour which is defined as work performed by persons under the age of 18 which falls into the following categories:

- (a) all forms of slavery or practices similar to slavery, such as the sale and trafficking of children, debt bondage and serfdom and forced or compulsory labour, including forced or compulsory recruitment of children for use in armed conflict;
- (b) the use, procuring or offering of a child for prostitution, for the production of pornography or for pornographic performances;
- (c) the use, procuring or offering of a child for illicit activities, in particular for the production and trafficking of drugs as defined in the relevant international treaties;
- (d) work which, by its nature or the circumstances in which it is carried out, is likely to harm the health, safety or morals of children.

## Prohibition of Forced Labour – Conventions 29 and 105

*C29 Forced Labour Convention (1930)*. This includes the provision that each Member of the ILO will suppress the use of forced or compulsory labour. It defines 'forced or compulsory labour' as all work or service which is exacted from any person under the menace of any penalty and for which the said person has not offered himself voluntarily.

*C105 Abolition of Forced Labour Convention (1957)*. This includes the provision that each Member of the ILO which ratifies this Convention undertakes to suppress and not to make use of any form of forced or compulsory labour.

## Non-discrimination – Conventions 100 and 111

*C100 Equal Remuneration Convention (1951)*. This includes the provision that there is equal remuneration for men and women workers for work of equal value.

*C111 Discrimination (Employment and Occupation) Convention (1958)*. This includes the provision that there is no distinction, exclusion or preference made in the workplace on the basis of race, colour, sex, religion, political opinion, national extraction or social origin.

Conventions apply to states but companies are also expected to uphold the standards contained in these core conventions. For example, the Declaration on Fundamental

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Principles and Rights at Work makes it clear that these rights are universal and that they apply to all people in States. These Conventions are also included in the ILO's Tripartite Declaration of Principles concerning Multinational Enterprises and social policy. They are widely recognised and are included in the UN Global Compact's ten principles. The Global Compact is currently the largest corporate citizenship and sustainability initiative in the world, with over 5,200 corporate participants and stakeholders from over 130 countries. Its objectives include mainstreaming the ten principles in business activities around the world.<sup>2</sup>

## **ii) Other labour standards**

Other labour protections and benefits are known as cash standards because they mandate particular outcomes that raise labour costs.<sup>3</sup> These standards include working hours, wages and health and safety. They are not included amongst the core labour standards but are central components of policies on supply chain labour standards.

## **b) Sectors at risk and why**

Companies are at risk of breaching core labour standards in their supply chains because they have less control and knowledge of working conditions in their suppliers compared with their own operations. Supply chain risk is focused on certain sectors and is linked to the nature of products sourced from certain countries. Products which have a risk of poor labour standards associated with their manufacture include labour intensive products where there is a pressure on price, for example clothing, footwear, toys and consumer electronic items.

Some agricultural products also have a risk of poor labour standards in their production. Again this is partly due to the pressure to keep the cost of these products down. The following sections take a detailed look at these high risk sectors.

### **Clothing and footwear**

The amount of clothing and footwear (apparel) products made in developing countries has increased dramatically in recent years. This increase in demand has resulted in a considerable increase in the workload of the factory workers manufacturing the products and this has led to a deterioration in working conditions.<sup>4</sup>

Purchasing power is concentrated at the top of global supply chains with the international brands and large retailers. Factories in developing countries are at the bottom of the supply chain and must compete intensively for business. They face pressure from retailers to produce products at ever lower costs (retailers also operate in a highly competitive market and are competing with each other for customers). This means that suppliers face diminished profit margins and consequently require

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<sup>2</sup> <http://www.unglobalcompact.org>

<sup>3</sup> Elliott and Freeman, *The Role Global Labor Standards Could Play in Addressing Basic Needs* (Oxford University Press, 2003)

<sup>4</sup> Textile Sweatshops; Adidas, Bali Intimates, Hanesbrands Inc., Pilege Co (Felina Lingerie), Quiksilver, Regina Miracle Speedo, Walcoal America Inc., and Wal-Mart Made In China, China Labor Watch, November 2007

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their workers to work harder for less.<sup>5</sup>

In order to produce cheap products clothing and footwear manufacturers economise on labour costs.<sup>6</sup> As they operate in countries where labour regulations are often not enforced, this can involve not paying workers the minimum wage, forcing them to work unpaid overtime or not investing in health and safety equipment. It can also make them more reluctant to recognise and negotiate with trade unions out of a fear that this will result in increased wages. Furthermore, exploitative practices such as the use of child or forced labour are more likely to occur where these are perceived to be cheaper.

## **Toys**

China Labor Watch is an NGO which promotes labour rights in China. It has indicated that similar problems have been reported in factories manufacturing toys: wages are low; the working environment is dangerous; verbal, physical and sexual abuse/harassment are prevalent, and forced overtime is endemic in the industry. Many of the workers may be subjected to harmful chemical substances and they could be in danger of lead or plastic poisoning. Factories are accused of not providing enough information and adequate training to workers using chemicals. Many of these factories allegedly have poor ventilation systems and face masks are often not used. Moreover, these workers are not offered insurance as required by the law.<sup>7</sup>

## **Consumer Electronics**

Consumer electronics include items such as mobile phones, televisions, computers, DVD players, iPods and games consoles.<sup>8</sup> Electronics companies had managed to escape much of the scrutiny on workers' labour issues compared to their counterparts in the clothing and footwear sector until relatively recently. However, labour standards and conditions in electronics manufacturing are equally low.<sup>9</sup>

In search of cheaper labour, the global electronics industry began relocating to low-wage countries in the 1980s.<sup>10</sup> Many multinational companies now outsource production to contract manufacturers. For example, many stages of computer production are carried out by low-skilled, low-paid workers in developing countries.<sup>11</sup>

The competition to gain markets and to increase profits has contributed to the deterioration of workers' rights in many cases. Electronic equipment manufacturing is labour intensive and so in order to produce cheaper products and to increase profits, electronics manufacturers have cut labour costs. Multinational electronic companies demand high-quality products to extremely tight deadlines, and the contract manufacturers then pass on this pressure to the component manufacturers and

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<sup>5</sup> Subsidizing Sweatshops, SweatFree Communities July 2008

<sup>6</sup> Subsidizing Sweatshops, SweatFree Communities July 2008

<sup>7</sup> Investigations on Toy Suppliers In China; Workers are still suffering, China Labor Watch, August 2007

<sup>8</sup> Multinationals Electronics and Labour Rights in Mexico: Second report on working conditions in the Mexican electronics industry, Centre for Reflection and Action on Labour Issues (CEREAL), October 2007

<sup>9</sup> Clean up your Computer: Working Conditions in the Electronics Sector, A CAFOD report, January 2004

<sup>10</sup> Multinationals Electronics and Labour Rights in Mexico: Second report on working conditions in the Mexican electronics industry, Centre for Reflection and Action on Labour Issues (CEREAL), October 2007

<sup>11</sup> Clean up your Computer: Working Conditions in the Electronics Sector, A CAFOD report, January 2004

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eventually to the workforce at the bottom of the supply chain.<sup>12</sup> This has encouraged the appearance of a series of practices called 'new working methods' or 'flexible work'. These include the increased use of employment agencies and temporary hiring. The prohibition of joining a trade union and the abandonment of social benefits such as annual leave and maternity benefits are also increasingly seen. These practices are targeted at cutting labour costs further and are prevalent in the electronics industry in countries such as Mexico, China, Malaysia, Thailand, India and the Philippines.<sup>13</sup>

Workers are often subjected to humiliating practices, such as discrimination, sexual harassment, compulsory overtime and wages below the legal minimum. It has been alleged that these kinds of abuses are endemic in the electronics industry.<sup>14</sup>

A report by the ILO has indicated that 'export market dynamics have generated a layer of flexible and mobile workforce (casual, temporary workers, contract workers and homeworkers) who serve as a buffer to accommodate just-in-time ordering, fluctuations in orders and prices, and stiff competition among suppliers, while a smaller core of regular, permanent workers ensure quality and stability. The flexible workforce experiences high job turnover, moving from one factory or production workshop to another, or shifting between formal sector and informal activity. Case studies in agriculture and manufacturing across a range of countries have found that even first-level suppliers with direct linkages to internationally recognised brands and retailers often use casual, migrant and contract labour to meet seasonal fluctuations in demand or sudden changes in orders.'<sup>15</sup>

### **Agricultural crops**

The supply chains of certain agricultural crops are also associated with poor labour standards. This is particularly the case with products grown in developing countries where there is pressure from retailers to keep the cost of the products down. Suppliers keep costs down by employing workers on temporary contracts, paying them low wages and making them work long hours.

According to a report in the Guardian, a UK newspaper, producers in the fresh flower industry in Kenya are faced with low global prices for their products. It has been reported that while the demand for cut flowers is increasing in developed countries, the working conditions of flower farm workers around the world are worsening.<sup>16</sup> For example, poor worker rights and health concerns caused by pesticide exposure have been reported at flower farms near Lake Naivasha in Kenya.<sup>17</sup> Flower-farmers typically receive only a fraction of the final price paid by consumers in European supermarkets.

As a report by the ILO has noted, 'Under the current international division of labour, labour-intensive portions of production where wage costs are important are located in low-wage locations. These segments are at the low end of global supply chains, where

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<sup>12</sup> Clean up your Computer: Working Conditions in the Electronics Sector, A CAFOD report, January 2004

<sup>13</sup> Multinationals Electronics and Labour Rights in Mexico: Second report on working conditions in the Mexican electronics industry, Centre for Reflection and Action on Labour Issues (CEREAL), October 2007

<sup>14</sup> Multinationals Electronics and Labour Rights in Mexico: Second report on working conditions in the Mexican electronics industry, Centre for Reflection and Action on Labour Issues (CEREAL), October 2007

<sup>15</sup> Amelita King Dejardin, *Gender Dimensions of Globalization*, ILO, September 2008, p.7

<sup>16</sup> Leo Hickman, 'Is it OK ... to buy cut flowers? Leo Hickman's guide to a good life', *The Guardian*, Tuesday February 14 2006

<sup>17</sup> Ibid.

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workers and producers receive proportionately the least return for their labour, and wield the least negotiating power over the terms of the exchange.<sup>18</sup>

Poor labour standards can also be found at the very bottom of agricultural supply chains. Child labour in West African cocoa production is well documented and has received much publicity in recent years. Cocoa is grown on family farms in West Africa with all members of the family being involved, including children. The International Cocoa Initiative (ICI) is a multi-stakeholder initiative which promotes responsible labour standards in cocoa growing. It indicates that this is a natural way of life for cocoa farmers who want to train their children and also use them to reduce labour costs. The ICI indicates that this can have positive benefits for them and their families and cannot always be considered child labour. However, measures also need to be taken to ensure that this work is not hazardous and does not interfere with their schooling.<sup>19</sup>

ICI indicates that most of the children working on cocoa farms do so within their own family structure and may be exposed to some hazards as part of this. For example, Ghana and Cote d'Ivoire conducted surveys on child labour in their cocoa sectors in 2008. In Cote d'Ivoire, the survey indicated that 53.2% of children living in cocoa farms carry heavy loads, 8.4% spray fertilizers, 5.5% cut trees, 4.6% spray pesticides. Children between six and 14 are the most vulnerable to hazardous activities. In Ghana, 46.7% of children had participated in at least one hazardous activity during the last cocoa farming season, and less than a quarter (23.2%) used protective clothing while working on the farm.<sup>20</sup> In addition to those children working on family farms, a small proportion of children working away from their families are also at great risk of exploitation. ICI has indicated that it has identified and rescued trafficked children involved in cocoa production in both the Ivory Coast and Ghana.<sup>21</sup>

The lack of traceability makes it difficult for companies to identify the farms on which the cocoa they purchase is grown. Farmers deliver cocoa to an exporting company. In the receiving country, an importer will then deliver the cocoa to the manufacturer.<sup>22</sup> Due to the large number of farms delivering small amounts of cocoa to exporting companies, it is very difficult to trace the cocoa used by a company back to all the individual farms.

### **c) Countries at risk**

Working conditions in developing countries generally tend to be lower than those in developed countries. This is because of lower standards in labour laws and regulations particularly in areas such as health and safety and working hours. There is also a lack of enforcement of existing labour laws.

The case studies below look at each of the core labour standards and highlight key regions where these standards are at risk.

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<sup>18</sup> Amelita King Dejardin, *Gender Dimensions of Globalization*, ILO, September 2008, p.4

<sup>19</sup> <http://www.cocoainitiative.org/child-labour-in-cocoa-growing.htm>

<sup>20</sup> Ibid.

<sup>21</sup> Ibid.

<sup>22</sup> <http://www.worldcocoaafoundation.org/learn-about-cocoa/tree-to-table/global-market.asp>

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## Trade Union Rights in Export Processing Zones (EPZs)

EPZs are areas in a country where the government has removed barriers to trade, such as tariffs and quotas, in order to attract foreign investment. Trade union rights are an issue in most EPZs around the world. According to the ICFTU, now the International Trade Union Confederation (ITUC), some governments, in their efforts to attract investors, tend to exclude the EPZs from the scope of application of their labour laws. In other countries, labour legislation is simply not enforced, for example because the number of well-trained and equipped work inspectors is insufficient.<sup>23</sup>

## Child Labour in the Indian embroidery industry

Child labour is a problem in many developing countries because families often cannot afford the basic costs of food and housing without extra income from their children.<sup>24</sup> In many countries there is not universal access to free education or parents do not see the value of education and so sending their children out to work is the alternative.

According to UNICEF UK, child labour is a huge problem in India in a wide variety of sectors including those which intersect with the supply chains of global companies. For example child labour is found in the embroidery industry which supports the garment export business. This is partly because employers prefer to employ children, finding them more obedient and cheaper than adults. It is also because the intricacy of the work can only be achieved by smaller hands and fingers.<sup>25</sup>

Homeworking is one way in which child labour can find its way into the bottom of global supply chains. According to an article by Impactt, an organisation that works with companies to improve working conditions in their supply chains, homeworking is endemic in the Indian garment industry and it is customary practice for registered factories to outsource elements of production (embroidery, beading, embellishments and often whole garments) to sub-contractors who run small domestic units. Other work is distributed through a network of runners to individual homeworkers who are highly skilled at embroidery or beading. Retailers are generally unaware of the use of undeclared sub-contracting units.<sup>26</sup> This is because the work takes place in the home and so children are given garments to work on by their families. If the amount of work given to individual families is set at unrealistically high levels, then they often resort to using their children in order to ensure that it is completed on time.

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<sup>23</sup> International Confederation of Free Trade Unions (ICFTU), 'Export Processing Zones – Symbols of Exploitation and a Development Dead-End', September 2003  
<http://www.ictuglobalsolidarity.org/uploads/EPZ%20Report.pdf>

<sup>24</sup> UNICEF UK, 'End Child Exploitation', February 2005

<sup>25</sup> Ibid.

<sup>26</sup> Martin Buttle, '*Homeworking in the Indian garment industry: what are the issues and how can homeworkers' lives be improved*', Impactt, 18 July 2008

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## **Forced labour in Jordan's Qualifying Industrial Zones (QIZs)**

QIZs are free trade zones created in Jordan and Egypt in collaboration with Israel to take advantage of free trade agreements between the United States and Israel. There have been widespread reports of forced labour practices in factories within these zones in Jordan. According to the statistics issued by the Jordanian Ministry of Labor (MOL) for April 2006, the total workforce in the QIZs was over 54,000. Of these, 33% were Jordanian. The remaining workers were migrants from various Asian countries, including Bangladesh, China, Sri Lanka, Vietnam, and India.<sup>27</sup>

According to the US Department of State, foreign workers in the QIZs are recruited through a process involving registered recruitment agencies. However, source countries recruit unregistered sub-agents who feed workers into registered agencies but who also collect illegal fees.<sup>28</sup> These fees are often so large that they effectively leave workers in a situation of debt bondage as they feel obliged to continue working no matter how bad the conditions in order to pay off the money owed to the agent.

The textile industry in Jordan is a fast-growing industry, which has become heavily reliant on these migrant workers. Human trafficking of foreign guest workers and holding them under conditions of involuntary servitude has been frequently reported. In May 2006, the National Labor Committee published a report on the issue which alleged that over 10,000 foreign guest workers had had their passports confiscated by factories and were being held under conditions of involuntary servitude in several factories in Jordan.<sup>29</sup>

During 2007, allegations of forced labour decreased substantially due to more rigorous MOL inspections.<sup>30</sup> An improvement in conditions has been reported with the MOL demonstrating a commitment to improving working conditions for migrant workers, and also to improving working conditions in general in order to encourage more Jordanian workers into the sector, thus reducing its dependence on migrant labour.<sup>31</sup>

However, the US Department of State 2008 report notes that despite an increasing number of inspections, the number of prosecutions and penalties is still insufficient. With respect to the trafficking of people there are few convictions and persecutions are not sufficiently high.

## **Equal Opportunities: Forced pregnancy testing in maquiladoras in Central and Southern America**

Maquiladoras are factories which import materials on a duty-free basis and then export the finished product back to the originating country. They are located throughout Central and Southern America. It has been reported that women working in maquiladoras are subjected to gender discrimination, being required to undergo pregnancy testing when applying for work and forced to endure further pregnancy

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<sup>27</sup> FIAS, *Competitiveness and Corporate Social Responsibility in the Jordanian Apparel Industry - A component of IFC-Advisory Services Licensing and Inspection Program* (January 2008)

<sup>28</sup> <http://www.state.gov/g/drl/rls/hrrpt/2007/100598.htm>

<sup>29</sup> The National Labor Committee, *US - Jordan Free Trade Agreement: Descends into Human Trafficking & Involuntary Servitude* (May 2006)

<sup>30</sup> <http://www.state.gov/g/drl/rls/hrrpt/2007/100598.htm>

<sup>31</sup> USAID/Jordan, *Joint Labor Assessment and Training Project Jordan. Working Conditions in Jordan's Garment Sector*

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discrimination after they have been hired. Employers discriminate in order to avoid paying maternity benefits.<sup>32</sup>

There have been reports of pregnant women being dismissed or being mistreated in an effort to bring about their resignation.<sup>33</sup> In some instances, employers reassigned pregnant women to positions that required strenuous physical activity or exposed them to hazardous conditions to make them leave. This type of discrimination has been documented in Mexican electronic factories.<sup>34</sup> Other employers used short-term contracts of thirty to ninety days so as not to be obligated to offer permanent positions to pregnant workers.<sup>35</sup>

Verité is an independent non-profit organisation which monitors international labour rights abuses in overseas production sites. Its recent audits in Mexico found that pregnancy-related discrimination in factories is common. Its findings included women often being asked about their pregnancy status or being asked to take a pregnancy test when applying for a job. Women returning from maternity leave are also often given lower-paid jobs.<sup>36</sup>

Verité also identified sexual harassment, including sexual assault, as a problem in Mexico. Its auditors have found many cases of unwanted touching, threats and sexual assault. Verité states that the National Institute for Women (INMUJERES) has reported that 46% (15 million) of women employed in the formal economy suffer from some type of sexual harassment and that approximately 25% of these women are subsequently dismissed from their jobs and 40% are forced to leave.<sup>37</sup>

#### **d) Stakeholder concerns**

One result of globalisation has been an increase in the volume and range of products sourced from developing countries. Retailers have moved from sourcing products from their home country to sourcing products manufactured in developing countries where the cost of labour is cheaper.

Many developing countries have set up export processing zones where there are fewer restrictions on labour standards. NGOs and trade unions take an interest in the working conditions in these countries and zones, partly because globalisation is often promoted as being important in the fight against poverty as it creates jobs in countries where there are few employment opportunities. NGOs are therefore keen to expose exploitative working conditions which keep workers in poverty.

Trade unions are also concerned about the loss of jobs in developed countries when they are transferred to countries with lower standards. This is because such actions are perceived to undermine progress made on wages and working hours in developed countries and are seen as driving a 'race to the bottom'.

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<sup>32</sup> Elizabeth Goergen, 'Women workers in Mexico: using the International human rights framework to achieve labor protection', *Georgetown Journal of International Law*, (1 January 2008)

<sup>33</sup> Stacey Pohl, 'The Struggle of Women in Maquiladoras', <http://www.ic.arizona.edu/ic/mcbride/ws200/pohl-hold.htm>

<sup>34</sup> Multinationals Electronics and Labour Rights in Mexico: Second report on working conditions in the Mexican electronics industry, Centre for Reflection and Action on Labour Issues (CEREAL), October 2007

<sup>35</sup> Natara Williams, 'Pre-hire pregnancy screening in Mexico's maquiladoras: is it discrimination?', *Duke Journal of Gender Law & Policy*, (Spring 2005)

<sup>36</sup> Verité, *Advancing Women's Rights and Social Responsibility: Capacity Building in Mexico* (August 2009)

<sup>37</sup> Ibid.

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For NGOs, the supply chains of retailers and supermarkets are a focus of their campaigns because these companies are easily recognisable brands, well-known to the general public. Campaigns exposing poor labour standards in the manufacture of these products therefore generate a large amount of publicity. They are also likely to achieve positive change within the company as much of a company's brand value depends on its public image which is tainted by allegations of poor working conditions.

There are a large number of NGOs which campaign on supply chain labour standard issues. These range from development-focused NGOs which periodically highlight supply chain labour standards issues, such as CAFOD and Oxfam, to organisations set up solely to expose poor working practices and to seek improvements such as the Maquila Solidarity Network and the National Labor Committee. Development-focused NGOs are interested in this issue because poor working practices, such as paying very low wages, are unlikely to raise people out of poverty.

Please see the appendix for a list of some of the major NGOs involved in this area. Campaigns can be focused on individual companies, on a particular country, or on a factory from which several companies are sourcing. These campaigns are a risk to a company's reputation when they identify a company as sourcing from a factory where labour standard breaches have occurred.

One of the most well-known campaigns against an individual company is the campaign against the working conditions in factories manufacturing products for Nike which was conducted in the 1990s. Several news reports made allegations of poor working conditions in its supply chain as did various NGOs. In response to the concerns about working conditions in its supply chain, Nike attempted to demonstrate that it was taking measures to improve conditions. Its campaign included newspaper advertisements, letters to editors and college and university presidents. In 1998, Marc Kasky sued Nike under California's false advertising laws. He alleged that Nike was making misleading claims. The case was eventually settled in 2003 with Nike paying USD 1.5m to the Fair Labor Association.<sup>38</sup>

In recent years, Nike has continued to face allegations about working conditions in its supply chain but is generally viewed as making real efforts to address the issues. It has put in place comprehensive systems to manage its supply chain labour standards and publicly reports in depth on conditions within its supply chain.

John Ruggie, the UN Special Representative of the Secretary General on business and human rights has indicated that supply chain labour standards come under the 'protect, respect and remedy' framework he has outlined for human rights. In his 2009 report to the Human Rights Council he states that 'Supply chains pose their own issues. It is often overlooked that suppliers are also companies, subject to the same responsibility to respect human rights as any other business. The challenge for buyers is to ensure they are not complicit in violations by their suppliers.'<sup>39</sup>

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<sup>38</sup> [http://www.sustainability.com/aboutsustainability/article\\_previous.asp?id=61](http://www.sustainability.com/aboutsustainability/article_previous.asp?id=61)

<sup>39</sup> Report of the Special Representative of the Secretary-General on the issue of human rights and transnational corporations and other business enterprises, *Business and human rights: Towards operationalizing the "protect, respect and remedy" framework* (22 April 2009), p. 18

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## e) Case studies

EIRIS's Convention Watch International Labour Standards criteria include the identification of allegations of breaches of core labour standards in companies' supply chains. Cases covered include high profile allegations of supply chain breaches which are reported in the press, such as the two examples below.

### **Gap – supply chain child labour**

One notable case which generated a lot of negative publicity for the company concerned was the case where allegations of child labour were made against an unauthorised subcontractor of Gap. The case was reported in the press in October 2007 and concerned an Indian subcontractor of Gap.

An undercover investigation for the UK's Observer newspaper published in October 2007 alleged that children aged as young as 10 worked for an unauthorised subcontractor of one of Gap's suppliers in Delhi, India. The Observer discovered the children working on garments marked with serial numbers which Gap later admitted corresponded with its own inventory.

Speaking to The Observer, the children described long hours of unwaged work, as well as threats and beatings. One of the children, Amitosh, was sold into bonded labour by his family. He indicated that he worked 16 hours a day hand-sewing garments. He explained that he was taken from his parent's village in the northern state of Bihar to Delhi along with 40 other children. He also indicated that he was working for free as the supervisor had told him that as he was learning he wouldn't get paid. This had been the situation for four months.

Another child working at the facility was quoted as stating that some of the boys had been badly beaten. He stated that 'last week, we spent four days working from dawn until about one o'clock in the morning the following day,' He also stated that 'If any of us cried we were hit with a rubber pipe. Some of the boys had oily cloths stuffed in their mouths as punishment.'<sup>40</sup>

The allegations were very serious as they involved some very young children and children who had been sold into bonded labour which is a type of forced labour. Despite the serious nature of these allegations, NGOs did not call for a boycott of Gap. In part this was because of the Company's quick response to the case and its openness in outlining what action it would take. As the Company already had a comprehensive management system in place for dealing with supply chain labour standards it was able to respond quickly and appropriately to assuage its critics.

### **Associated British Foods - Primark – supply chain child labour**

In 2008, Primark (a wholly-owned subsidiary of Associated British Foods) was the subject of an investigation by the BBC's Panorama programme. Journalists posed as industry buyers in India to produce the report. The Panorama documentary, broadcast on 23 June 2008, alleged that the Fab N' Fabrics factory, and two other factories in Tamil Nadu, India were outsourcing embroidery work to the nearby Bhavanisagar refugee camp. In the camp, Sri Lankan refugees including a girl of 11 and a boy of 12-14 years of age were found to be sewing sequins on Primark garments. The

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<sup>40</sup> *The Observer* 28 October 2007 and *The Economist* 03 November 2007

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factories also supplied other retailers, though these were not named by the programme.

The Observer article, published on 22 June 2008, stated that many of the children hand-sewing Primark garments had no fixed hours of work, or any trade union to represent them. In addition the article stated that the sum of the combined wages of five children was less than that of one adult.

Following notification of the issues by Panorama, Primark cancelled new orders from the factories and withdrew the garments from sale. These actions were criticised by several NGOs as a failure to address the issue in a way that would benefit workers.<sup>41</sup>

In addition there is some unease about the prices of Primark's products and concern that the very low prices they charge are at the expense of working conditions in their supply chain. For example, War On Want has produced two reports in recent years looking at the suppliers of UK high street brands which promote their products on the basis of low price. Its December 2006 report, *Fashion Victims - The true cost of cheap clothes at Primark, Asda and Tesco*, looked at the companies' suppliers in Bangladesh and links the very low prices of these brands' clothing products to the poor working conditions found in their suppliers. A follow-up report was published in December 2008, *Fashion Victims II - How UK clothing retailers are keeping workers in poverty*, which showed that little had changed.

The above examples also indicate how important it is that companies are able to monitor their whole supply chain, including any subcontractors used by their suppliers. Even though the two cases of child labour outlined above occurred in unauthorised subcontractors rather than in directly contracted suppliers, the brands for whom the products were being made were still the subject of extensive press reporting and were expected to respond to the issue.

Furthermore, they illustrate why this issue is so important to investors because they demonstrate the large amount of negative publicity such cases can generate for the company concerned. They also show how a company's reputation for managing these issues can be undermined by a high profile case showing otherwise.

## **f) Legislation**

In addition to the reputational risk of using suppliers which have poor working practices, breaches of core labour standards in a company's supply chain could potentially limit access to markets. In January 2006, President Bush signed into law the Trafficking Victims Protection Reauthorization Act of 2005 (TVPRA) which instructed the Department of Labor to monitor and combat child labour and forced labour in foreign countries in a number of different ways. This includes making available to the public a list of goods from countries that the Bureau of International Labor Affairs has reason to believe are produced by forced labour or child labour in violation of international standards.<sup>42</sup>

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<sup>41</sup> *The Observer*, 22 June 2008 and *The Telegraph*, 23 June 2008

<sup>42</sup> US Department of Labor Documents, *Notice of Procedural Guidelines for the Development and Maintenance of the List of Goods from Countries Produced by Child Labor or Forced Labor; Request for Information – Federal Register Extracts* (27 December 2007)

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One of the listed activities of the TVPRA is to 'Consult with other departments and agencies of the United States Government to reduce forced and child labor internationally and ensure that products made by forced labor and child labor in violation of international standards are not imported into the United States.'<sup>43</sup>

The list was published by the US Department of Labor (DOL) in September 2009 and Brian Campbell, International Labor Rights Fund Director of Policy and Legal Programs, has stated that "This list is a critical tool that consumers and businesses can use to identify the sectors where forced and child labor abuses continue."<sup>44</sup>

DOL has indicated that the list includes 122 goods from 58 countries. It states that "The most common agricultural goods listed are cotton, sugarcane, tobacco, coffee, rice, and cocoa. In the manufacturing sector, bricks, garments, carpets, and footwear appear most frequently; and in mined or quarried goods, gold and coal".<sup>45</sup> DOL has stated that "the primary purpose of the List is to raise public awareness about the incidence of child labor and forced labor in the production of goods in the countries listed, and, in turn, to promote efforts to eliminate such practices".<sup>46</sup>

Another potential piece of legislation is the Decent Working Conditions and Fair Competition Act (the Act). Several bills were introduced in the US Congress and had these been passed this legislation would have banned the import or sale of sweatshop goods in the US, including goods that had been made under conditions which violate the core conventions.<sup>47</sup> In June 2009, the National Labor Committee indicated that the Act would soon be re-introduced in the new Senate and House.<sup>48</sup> At the time of writing there were no further updates on the progress of this Act.

There are calls in other countries for governments to introduce legislation which will protect the rights of workers overseas. For example, War on Want, a UK-based NGO, has called on the UK government to introduce legislation that will enable overseas workers who supply UK companies and suffer exploitation to seek legal redress in the UK.<sup>49</sup>

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<sup>43</sup> <http://www.dol.gov/ILAB/programs/ocft/tvpra.htm>

<sup>44</sup> <http://www.laborrights.org/stop-child-forced-labor/news/12102>

<sup>45</sup> <http://www.dol.gov/ILAB/programs/ocft/tvpra.htm>

<sup>46</sup> <http://www.dol.gov/ILAB/programs/ocft/tvpra.htm>

<sup>47</sup> <http://www.aflcio.org/aboutus/thisistheafclcio/ecouncil/ec08082006b.cfm>

<sup>48</sup> <http://www.nlcnet.org/article.php?id=651>

<sup>49</sup> War on Want, *Fashion Victims II: How UK Clothing Retailers are keeping Workers in Poverty* (December 2008), p.12

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## g) Implications for investors

### **Breaches of Core Labour Standards - summary of key risks**

- Reputational risk to company – impact on brand value
- Management time and resources taken up
- Poorer quality products produced
- Company less likely to have an efficient approach to sourcing
- Potential for access to markets to be limited

Investors should be concerned about breaches of core labour standards in corporate supply chains because of the reputational risk it poses to the company concerned. Where breaches of international labour standards are identified and publicised by NGOs, this results in negative publicity for the company and potentially in consumer boycotts of the company's products. Potential employees may be put off working for a company which has a particularly poor reputation in this area.

In addition, if a company becomes the subject of a sustained campaign by NGOs, then this can take up a lot of management time and resources. Such campaigns can also become a distraction from other issues that the company may wish to publicise if the main reports in the press always concern supply chain labour standards.

Where there is an increased risk of poor working conditions there is also the risk of poorer quality products being manufactured. Workers who are forced to work excessive hours and who are not receiving adequate rest are more likely to make mistakes.

In addition, breaches of core labour standards in a company's supply chain could potentially limit access to markets. As discussed in the previous section, there are a couple of pieces of legislation pending in the US which, if passed, will restrict the import and sale of products manufactured in conditions which breach the core labour standards.

Companies that can demonstrate comprehensive policies and management systems on this issue are likely to have a better reputation with the general public. A reputation for managing supply chain labour standard issues well can create customer loyalty and distinguish the company from its competitors.

This is particularly important for companies which are or which own brand names as they have a high public profile making them vulnerable to scandals concerning labour standards. Brand reputation is very important to such companies and should be protected by comprehensive management systems for managing the risk of poor labour standards in the supply chain. Brand value is discussed in more detail below.

Companies that have looked at how their own purchasing practices impact on their suppliers' ability to uphold core labour standards also have the opportunity to develop

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a more efficient approach to sourcing. If a company has identified that its last minute changes to orders are resulting in excessive working hours and is looking at ways to improve its own systems then this is a learning opportunity which may result in greater efficiencies and innovation.

In its document *Combating forced labour: a handbook for employers and business* published in 2008, the ILO identifies several benefits for taking action on this issue. Some of these benefits also apply to taking action on supply chain labour standards in general. For example, reporting on how the policy is implemented raises brand image and company reputation. Taking action will minimize the risk of legal action and help avoid damages to company reputation that can result from association with abusive labour practices. Good practices help to prevent reputational risk for the company.<sup>50</sup>

The Pensions and Capital Stewardship Project Labor and Worklife Program at Harvard Law School, has produced a couple of papers looking at labour and human rights risk in relation to investment. The paper *Incorporating Labor and Human Rights Risk into Investment Decisions* outlines the sustainability risk perspective on this issue, indicating that a company's performance and its share price could be endangered if its business practices risk violating national or international standards on labour and human rights. 'Such violations may damage a company's reputation, undermining its standing with consumers, regulators, and lawmakers. They may also weaken its operational performance by increasing employee turnover and inhibiting worker motivation and productivity.'<sup>51</sup> The paper also notes that some Wall Street analysts have come to conclude that labour rights allegations have had a meaningful impact on some companies' performance.<sup>52</sup>

F&C Investments has outlined its investor concerns about labour standards in its report *Factory Labour Standards in Emerging Markets: An Investor Perspective*. In this it indicates that its main concerns about labour standards include the security of supply:

'Business models that rely on a low-cost supply base require a secure supply of high-volume goods. Under-investment in factory working conditions has been increasingly associated with low productivity, particularly as factories require higher skills and labour pools begin to shrink. Poor conditions may fuel employee dissatisfaction, raising the risk of work stoppages or higher attritions, as has happened in certain regions in China where labour shortages have driven up wages, benefits and levels of staff turnover. Companies sourcing from such factories may therefore face greater disruption and be forced to find new suppliers at short notice.'<sup>53</sup>

In addition, F&C has indicated that it is concerned about the impact on consumers as it states 'In Western markets, allegations of "sweatshops" can erode brand loyalty, especially if companies position themselves as "green" or "ethical", as is increasingly the case. Moreover, one key value driver in the capital shift to emerging markets is the rise of the domestic consumer, a trend that is fuelled by growing wages and

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<sup>50</sup> Adapted from ILO, *Combating forced labour: a handbook for employers and business*, (2008), p.3, p.5, p.9, p.11

<sup>51</sup> Aaron Bernstein, *Incorporating Labor and Human Rights Risk Into Investment Decisions*, Pensions and Capital Stewardship Project, Labor and Worklife Program, Harvard Law School (September 2008), p.2

<sup>52</sup> Ibid., p.6

<sup>53</sup> F&C Investments, *Factory Labour Standards in Emerging Markets: an Investor Perspective*, (January 2009), p.3

rapidly-improving living standards. As emerging economies mature and wages rise, investors will seek out value by funding businesses that capitalise on this trend; conversely this rise in living standards and aspirations can be expected to fuel the same expectations of improved productivity and working conditions as has been experienced in developed economies.<sup>54</sup>

## Brand value

Brand value is a key area which can be impacted by reputational risk, including that posed by unmanaged supply chain labour standard risk.<sup>55</sup> Investing in managing sustainability issues can have a positive impact on a company's brand value. Interbrand, a branding consultancy, has identified the following as some of the direct benefits of investing in sustainability issues: compliance with increasingly rigorous legislation, cost savings derived from the optimisation of production lines and meeting the desire for more ethical products.<sup>56</sup>

Brand value depends on factors such as the investments it receives (quantity and quality), brand image (brand's perceived personality and reputation) and customer franchise (relationship with customers).<sup>57</sup>

Brand image can be damaged by negative publicity such as exposés of child labour in factories used by the company. The brand name can then become associated with exploitation. For example, Nike experienced falls in sales and share price over allegations of the use of child labour in factories working as third party suppliers in the manufacture of its sportswear.<sup>58</sup>

A brand's customer franchise will also be damaged by negative publicity and NGO campaigns as customers will be less willing to buy a product associated with exploitative working practices and may choose a competitor's product instead.

Interbrand argues that 'a sustainable brand will also enhance a company's reputation and secure future earnings through stakeholder loyalty and advocacy, thus increasing brand value.'<sup>59</sup>

Brand value can account for a large proportion of a company's market value. The table below shows the brand value of a number of companies with global supply chains, as reported in Interbrand's report, *Best Global Brands 2008*.<sup>60</sup>

Company	Brand value
Nokia	USD 35,942m
Walt Disney	USD 29,251m
Hewlett-Packard	USD 23, 509m

<sup>54</sup> Ibid.

<sup>55</sup> AON, quoted in *The Changing Landscape of Liability*, SustainAbility, (2004), p.17

<sup>56</sup> Interbrand, *Best Global Brands 2008*, p.12

<sup>57</sup> Ibid., p.14

<sup>58</sup> SustainAbility, *The Changing Landscape of Liability*, 2004, p.16

<sup>59</sup> Interbrand, Op.Cit., p.14

<sup>60</sup> Ibid., p.82

Hennes & Mauritz	USD 13,840m
Sony	USD 13,583m
Nike	USD 12,672m
Dell	USD 11,695m
Philips	USD 8,325m
Zara (part of Inditex)	USD 5,955m
Nestle	USD 5,592m
Adidas	USD 5,072m
Gap	USD 4,357m
Starbucks	USD 3,879m
Motorola	USD 3,721m

### **Moral liability**

In the 2004 report, *The Changing Landscape of Liability: A Director's Guide to Trends in Corporate Environmental, Social and Economic Liability*, SustainAbility highlighted the issue of moral liability which it identified as occurring when a company violates stakeholder expectations of ethical behaviour in such a way as to put business value at risk. It argued that moral liability could affect a company's licence to operate (the permission to carry out its business) as this also depends on compliance with stakeholder expectations rather than on simple compliance with the law. Moral liability reflects a shift in societal expectations of responsible business which are forcing companies to adopt new business models in relation to a number of different areas including their supply chain. Issues which were once dismissed as unquantifiable, such as reputation, are becoming increasingly tangible, in part because investors and insurers are linking Corporate Social Responsibility (CSR) with business value.<sup>61</sup>

This report recommends, amongst other suggestions, that companies should make stakeholder engagement an integral part of risk management. For example, by engaging with stakeholders on their expectations of responsible management of social issues. It argues that as familiarity generally breeds favourability it is beneficial to be transparent and open. Companies should therefore report fully and frankly to stakeholders on all material risks and issues.<sup>62</sup>

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<sup>61</sup> SustainAbility, *The Changing Landscape of Liability: A Director's Guide to Trends in Corporate Environmental, Social and Economic Liability* (2004), p.8

<sup>62</sup> Ibid., p.7

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## 4) Company research

### a) Supply chain labour standards management – best practice

In response to numerous NGO and trade union campaigns on supplier working conditions, clothing and footwear companies began adopting codes of conduct for their overseas suppliers. Most major clothing brands and retailers now have some form of code of conduct in place and some management systems in place to support this policy. However, the policies vary in terms of the number of core labour standards they cover and there are also great differences in the quality of the management systems in place to support compliance with the policy.

#### i) Supply chain policies

A large number of different initiatives have been set up to tackle the issue of supply chain labour standards. These range from multi-stakeholder initiatives such as the Ethical Trading Initiative (ETI), the Fair Labor Association (FLA), and Social Accountability International (SAI) to industry initiatives such as the Business Social Compliance Initiative (BSCI). These codes typically cover the same labour standards:

- Prohibition of child labour
- Prohibition of forced labour
- Non-discrimination
- Freedom of association and collective bargaining
- Health and safety
- Working hours
- Wages
- Disciplinary practices

#### ii) Supply chain management systems

Most management systems for ensuring compliance with a supply chain labour standards policy involve communicating the policy to suppliers, some form of monitoring to compare actual conditions against the policy and a procedure to deal with any non-compliance found. Monitoring can range from simply sending a survey to suppliers asking them about working conditions, to an unannounced audit of a factory taking several days and involving interviews with workers.

In recent years, dissatisfaction has been expressed with the auditing model for managing supply chain labour standards. In particular, audits are not very good at picking up non-compliance relating to discrimination, freedom of association and collective bargaining. In China, a whole industry has been developed involved in providing fake time and payroll records to supplier companies in order to enable them to pass audits.<sup>63</sup> The incentive for suppliers to hide violations from auditors is great as suppliers face increased costs in order to remedy violations and can lose contracts altogether if they repeatedly fail audits.<sup>64</sup>

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<sup>63</sup> <http://www.laborrights.org/creating-a-sweatfree-world/news/11017>

<sup>64</sup> Aaron Bernstein, *Quantifying Labor and Human Rights Portfolio Risk*, Pensions and Capital Stewardship Project, Labor and Worklife Program, Harvard Law School (June 2009), p.8

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However, auditing is important because it enables companies to monitor working conditions in supplier factories and to track improvements over time. It helps companies identify particular problems in a factory and target its remediation efforts accordingly. A number of organisations specialise in the auditing of supply chains for labour standards. For example, Social Accountability International, a multi-stakeholder organisation, has developed the SA8000 standard which is based on the principles of international conventions and is used to audit suppliers. If they meet the standard, suppliers are then certified as being in compliance with SA8000. Verité, an independent non-profit organisation, conducts auditing of companies' overseas suppliers.

In order for long-term, sustainable improvements to occur, current thinking on best practice indicates that this needs training and capacity building of suppliers, in addition to auditing. It is also important for companies to look at how their own actions impact on supply chain working conditions.

Training and capacity building enables companies to demonstrate the benefits of implementing a code of conduct to suppliers. It is also an opportunity to communicate the business case and to develop skills and knowledge that the supplier may not necessarily have. By explaining the benefits to suppliers and by being seen to want to work with them to improve conditions, companies can develop stronger and more open relationships with their suppliers. Companies that simply audit their suppliers are more likely to create a situation where suppliers strive to pass audits, often by concealing the real working conditions. Training and capacity building enable companies to have a dialogue with their suppliers and to learn what the real issues are for suppliers and the areas where they have trouble complying.

It has also been recognised that companies need to look at how their own behaviour impacts upon labour standards. For example, if companies make last minute changes to orders or force suppliers to meet unrealistic deadlines then this will result in suppliers forcing their workers to work excessive hours. By undertaking an assessment of a factory's capacity, companies can ensure that the supplier will be able to meet the deadline set without having to resort to forced overtime.

Having clear links with procurement management systems is also increasingly important for companies to drive meaningful change in their supply chain. If companies' ethical trading departments are separate to the procurement department, then suppliers can receive mixed messages from companies; on the one hand being told that the wages they are paying their workers are too low, whilst on the other hand being asked to reduce the final cost of the product. Therefore it is important for those responsible for supply chain labour standards to work closely with those responsible for the buying function.

Examples of good practice include incorporating labour standards as a large part of the assessment process when deciding which suppliers to source from (alongside issues such as price and quality). If companies ensure that they do not make last minute changes to orders, this prevents suppliers from having to force workers to work very long hours in order to complete the order in time.

Companies can also assess the capacity of a factory when placing orders to see if a supplier will be able to process an order within reasonable working hours given the number of workers available.

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### iii) Supply chain reporting

Companies are increasingly expected to publish more details about their supply chain management systems. NGOs and other stakeholder groups expect companies to publish data on the findings of their audits, for example by publishing information on any non-compliance found with different labour standards. In addition they are also expected to publish information on supplier assessments such as how many suppliers pass audits and how many have their contracts terminated because they fail to make any changes after audits have uncovered problems.

Detailed disclosure about the working conditions in a company's supply chain enables stakeholders to measure performance and to see whether conditions are improving over time. It also allows them to compare performance between companies.

It is also good practice for companies to respond publicly to any non-compliance uncovered by third party organisations. Public reporting on a company's response enables stakeholders to easily access information on how well a company has dealt with a particular issue. This level of transparency and openness should prevent companies becoming the target of NGOs who want to know how companies are dealing with any problems found.

Stakeholder verification of the report or evidence that the company has consulted stakeholders when considering what to include in its report are also important elements to look for. They demonstrate that the company is willing to discuss supply chain issues with its stakeholders and take their views into account when deciding what to report on.

NGOs have, for many years, been pushing companies to report publicly on certain supply chain issues. In 2003, Gap was the first company to publicly report comprehensively on the findings of its audits and the degree of non-compliance it found with its policy globally. Stakeholders wanted companies to publish this data as it would enable them to monitor a company's progress over time.

Nike was the first company in its industry to publish a list of its suppliers' names and addresses online as part of its reporting for the 2004 financial year. NGOs had been asking companies to publish the locations of their suppliers so that independent monitors could check the labour standards in these factories.

Transparency also reduces the likelihood that a company will become the target of NGOs campaigning for companies to put comprehensive management systems in place. If a company has published detailed information on what it is doing, NGOs are more likely to focus their efforts on those companies which appear to be doing very little.

F&C Investments has outlined the importance of transparency on labour standards for investors and states that 'poor disclosure about labour standards raises doubt as to whether a company understands, and is therefore actively managing, supply risks.'<sup>65</sup>

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<sup>65</sup> F&C Investments, *Factory Labour Standards in Emerging Markets: an Investor Perspective* (January 2009), p.6

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## **b) EIRIS supply chain labour standards criteria**

EIRIS' supply chain labour standards criteria reflect current thinking on best practice in the following ways:

- The policy criteria assess whether the policy has been integrated into the company's procurement process and whether the company is a member of a multistakeholder initiative
- The management systems criteria assess whether the company undertakes any training for its employees and suppliers on this issue, whether the systems are targeted to the areas of highest risk within its supply chain, and whether the systems are clearly integrated within its procurement process
- The reporting criteria assess whether the company publicly reports details and data in relation to the non-compliance it finds with its policy, whether it has responded publicly to non-compliance identified by NGOs or the press, and whether it shows evidence of engaging with its stakeholders in relation to what its report covers

The criteria also include an assessment of the company's overall management approach which is based on the company's assessment in each of the three areas outlined above.

## **c) Our findings**

### **i) Supply chain labour standards criteria**

This section looks at what stage companies are at now in terms of the policies, management systems and reporting they have put in place in response to supply chain labour standards risk.

EIRIS identifies companies which have a high or medium potential risk in relation to supply chain labour standards.

Risk exposure is assessed by analysing the absolute and relative turnover of high risk products sourced from high risk countries. Companies involved in these activities below the turnover thresholds are assessed as medium risk. Companies are also assessed as medium risk if they are sourcing other products not covered by the high risk definition from high risk countries.

Both medium and high risk companies are assessed on their policy, management systems and reporting on this issue, based on information they have made publicly available in their annual reports, on their websites, and in responses to the EIRIS supply chain labour standards survey.

Companies can achieve one of five grades in each area: 'no evidence', 'limited', 'intermediate', 'good', or 'advanced'. An explanation of each of the five grades is given below.

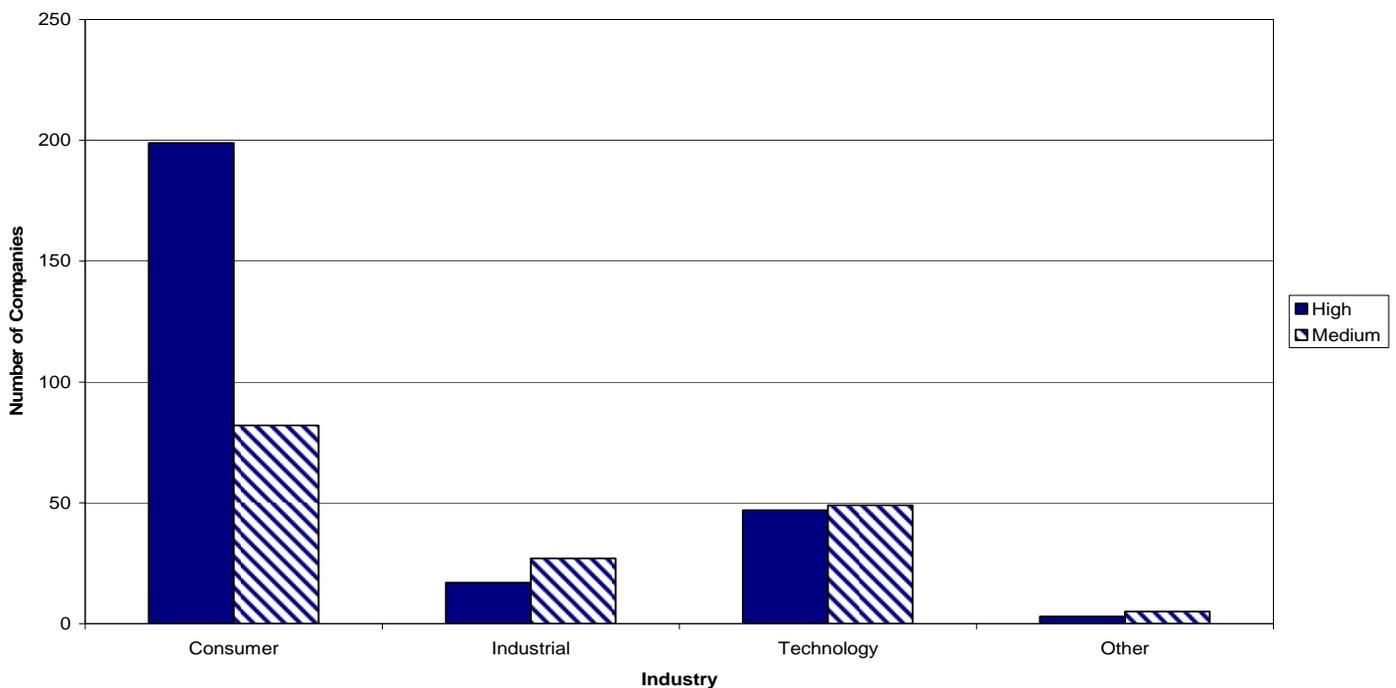
Grade	Explanation
No evidence	No evidence of the selected indicators
Limited	There is some evidence that the company is aware of this issue and has taken steps to address it
Intermediate	The company is some way towards managing the issue
Good	The company is managing the issue well
Advanced	This category is intended to identify leading companies that may be gaining a competitive advantage (with stakeholders or society in general) by addressing the issues

Below are a series of comparisons which analyse policy, systems and reporting results by industry sector and region.

### 1) Supply chain exposure

Approximately 13% of companies in the EIRIS research universe are assessed as high or medium risk for supply chain labour standards. Of these, almost two-thirds are assessed as high risk and just under one-third are medium risk.

**Assessment of Supply Chain Exposure by Industry**



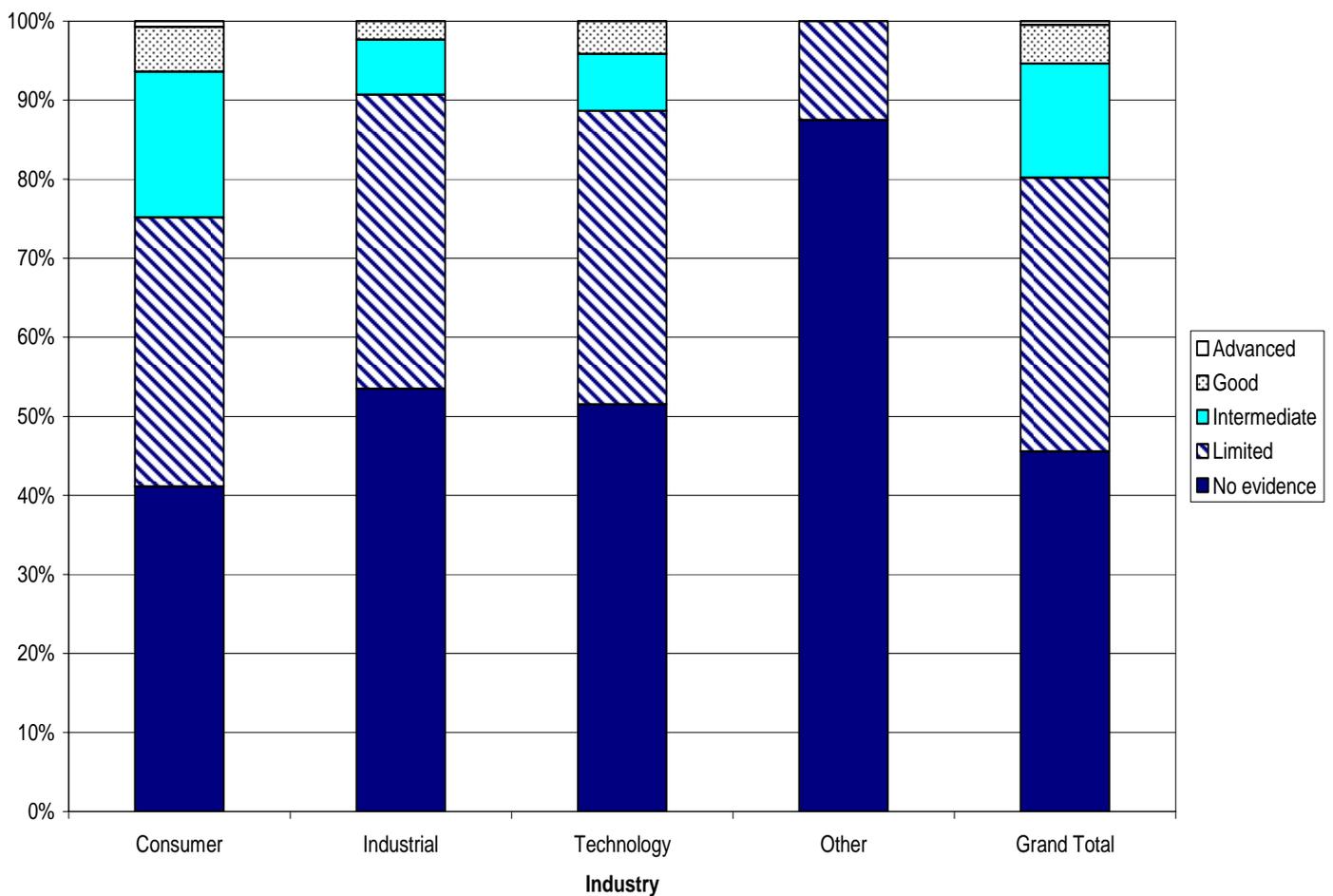
The majority of companies assessed as having high or medium risk for supply chain labour standards are found in the consumer industry. A number of technology companies are also captured by the criteria as these sectors include electronics

companies sourcing consumer electrical products or their components from a global supply chain. In total 66% of high and medium risk companies are from the consumer industry, 22% are from the technology industry, 10% are from the industrial industry and 2% are from other industries.

## 2) Supply chain assessment by industry

The graph below shows the overall supply chain assessment for companies assessed as medium or high exposure in each industry. This overall assessment is based on an assessment of each company in each of the following areas: supply chain policy, supply chain systems and supply chain reporting.

**Supply Chain Overall Assessment by Industry**



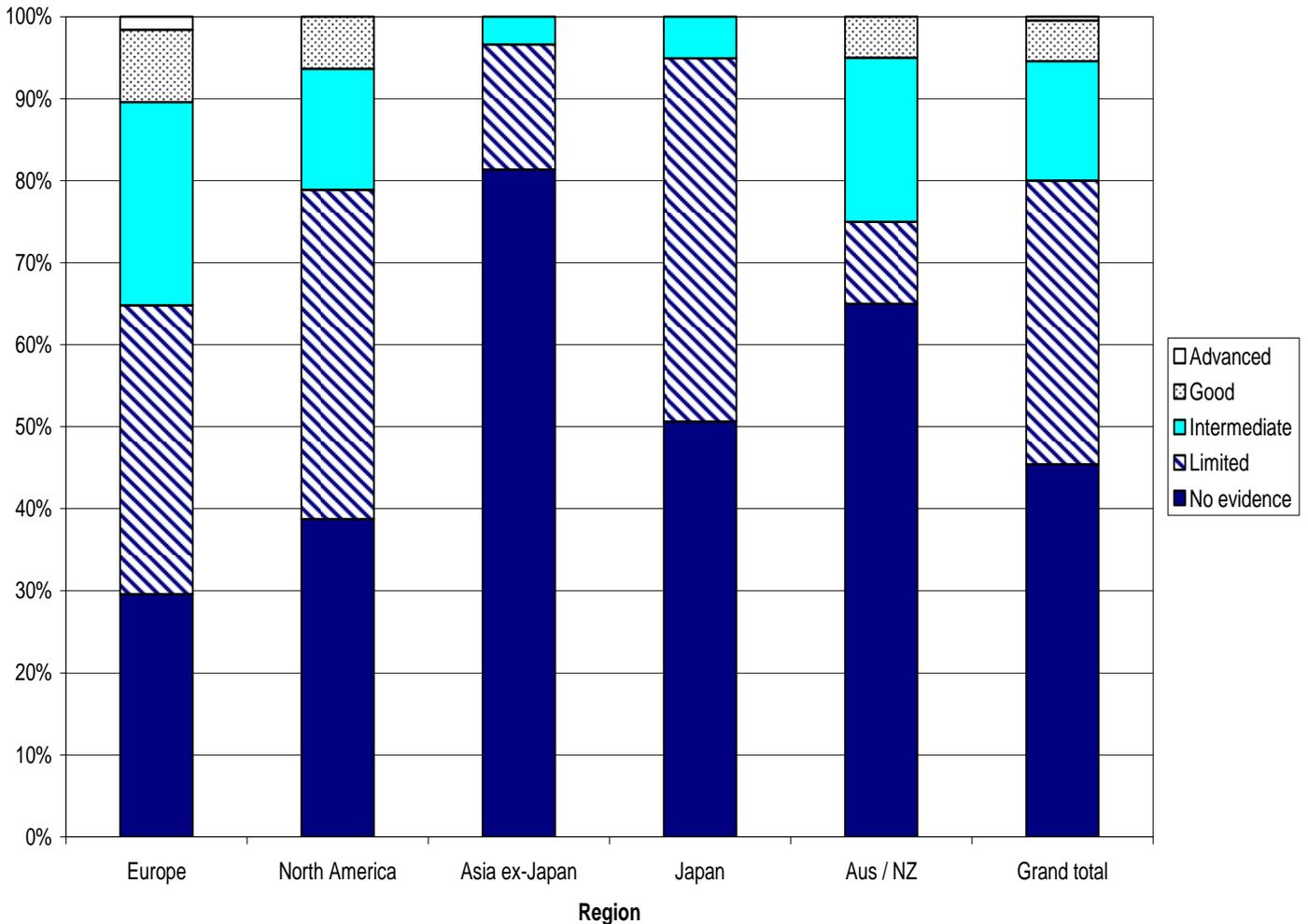
The consumer industry achieves the highest assessment with the lowest proportion of companies (40%) achieving an assessment of 'no evidence'. It also has the highest proportion of companies (7%) achieving an overall assessment of 'good'. The consumer industry includes sectors such as the food and drug retailers and general retailers which have been the focus of NGO campaigns on supply chain labour

standards for several years and which have been under pressure to develop policies and systems on this issue.

In comparison, the industrial and technology industries include sectors such as electronic and electrical equipment, mobile telecommunications and technology hardware and equipment which have only been the focus of NGO attention in the last few years. Within these industries, a small number of companies have begun to develop comprehensive policies and systems. These two industries have a larger proportion of companies (over 50%) which have no evidence of any policies or systems. A similar proportion of companies achieve an assessment of 'limited' in comparison with the consumer industry but a lower proportion (7%) achieve an assessment of 'intermediate' compared with 20% in the consumer industry.

### 3) Supply chain assessment by region

Supply Chain Overall Assessment by Region



European companies achieve the best overall assessment with 30% of companies scoring 'no evidence' compared to 80% of Asian companies (excluding Japan), 64% of Australian and New Zealand companies, 50% of Japanese companies and 39% of North American companies. 35% of European companies achieve an assessment of 'intermediate' or above, compared with only 3% of Asian companies (excluding Japan), 25% of Australian and New Zealand companies, 5% of Japanese companies and 21% of North American companies.

The better assessments of European and North American companies are likely to be due to NGO campaigns in these regions which have put pressure on companies to develop policies and systems for this issue. In Asia, where there is less pressure from NGOs, the response from companies is lower. The better response of European and North American companies may also be due to the fact that they are under more pressure from investors and consumers to demonstrate corporate responsibility. There is likely to be more domestic investor demand for responsible investment products which identify companies with a good response to this issue in Europe and North America compared to other regions.

Japanese companies show a better overall assessment compared to other Asian companies. This could be due to the fact that Japanese companies have started to come under pressure from some investors on this issue. In addition, Japanese consumer companies selling into global markets, including European and North American markets, are likely to be aware of the importance of this issue here and may have begun to put policies and management systems in place in order to protect their reputation.

## ii) Convention Watch supply chain labour standard allegations

This section analyses EIRIS research on companies accused of breaching core labour and working hours standards in their supply chains. Working hours are not one of the core labour standards but are included here as a large number of allegations concerning company supply chains relate to this issue.

The EIRIS Convention Watch supply chain criteria cover cases where companies have been accused of breaching the spirit of International Labour Organisation (ILO) conventions on child labour, forced labour, freedom of association and collective bargaining, non-discrimination and working hours. The allegations are assessed against a series of indicators to determine whether the risk exposure is high or medium, with the more serious cases being given an assessment of high.

Each company's response to a particular allegation is also assessed and given one of the following four grades:

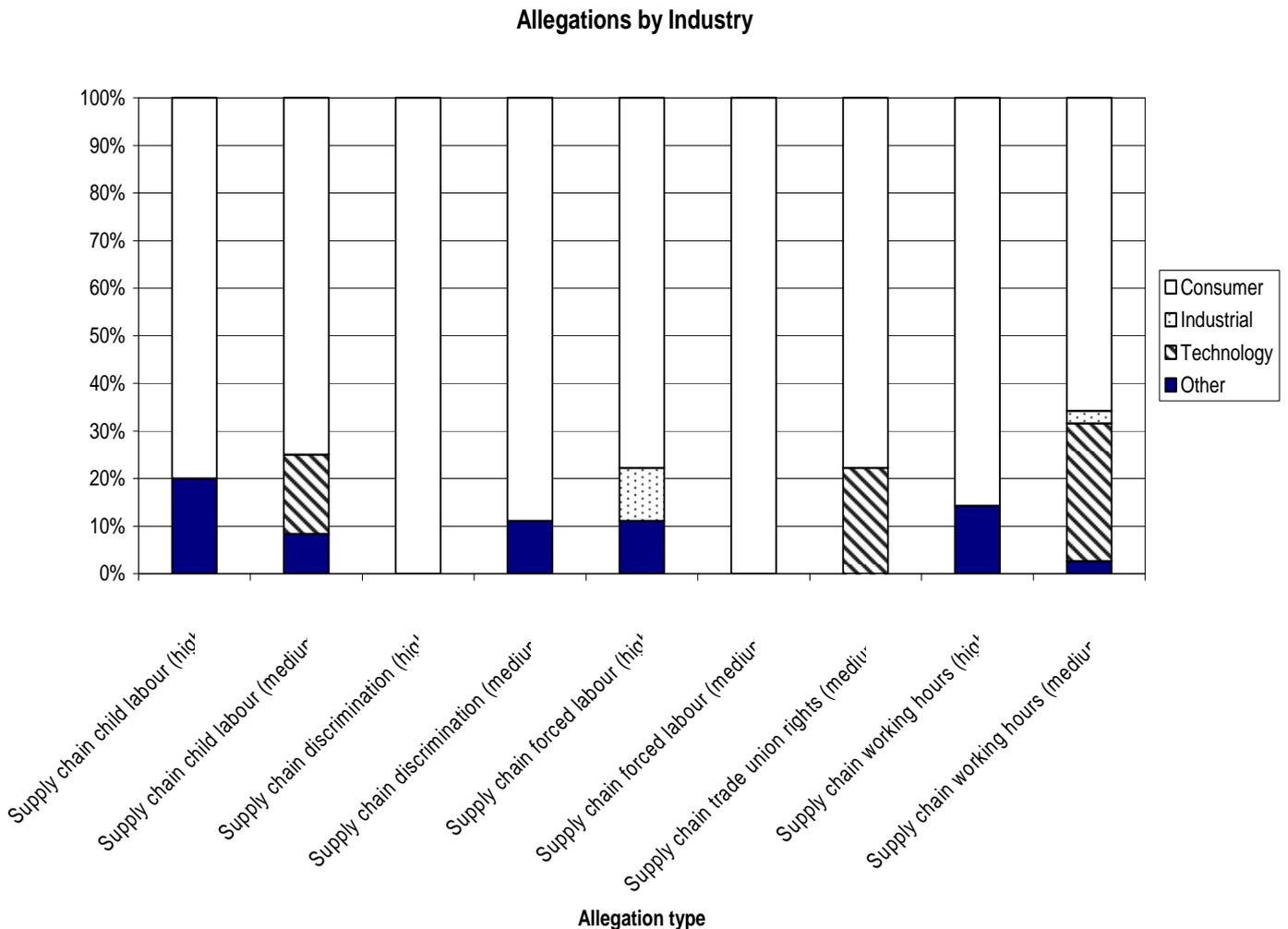
<b>Grade</b>	<b>Explanation</b>
No evidence	The company's response does not meet any of the selected indicators
Limited	The company's response partially meets the policy or the systems indicator
Intermediate	The company's response fully meets the policy indicator and partially meets the systems indicator OR The company's response partially meets the policy

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	indicator and fully meets the systems indicator
Good	The company has met both the policy and systems indicators in full and is considered to have addressed the issue

## 1) Supply chain labour standard allegations by industry

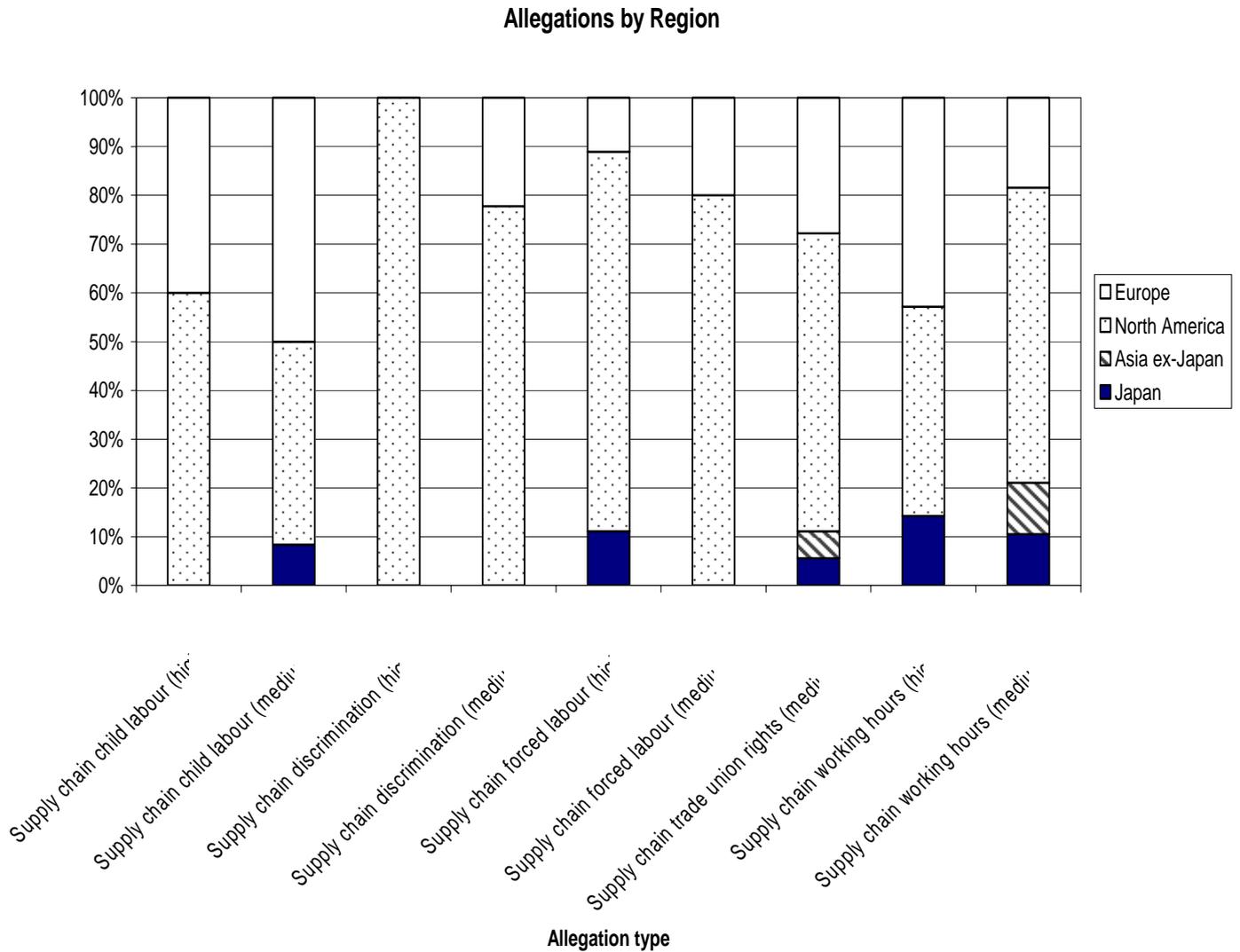
The graph below shows the different types of supply chain labour standard allegations recorded and the percentage from different industries.



The majority of supply chain allegations, over 70% for all but one of the allegation types recorded, concern companies in the consumer industry. This industry has the greatest exposure to global supply chains and because many of these companies are high profile brand names, they tend to be the focus of NGO campaigns on this issue. Companies in the technology industry are the next most likely to have supply chain allegations made against them and this is because they include electronics companies with global supply chains which have become the focus of NGO campaigns in recent years.

## 2) Supply chain labour standard allegations by region

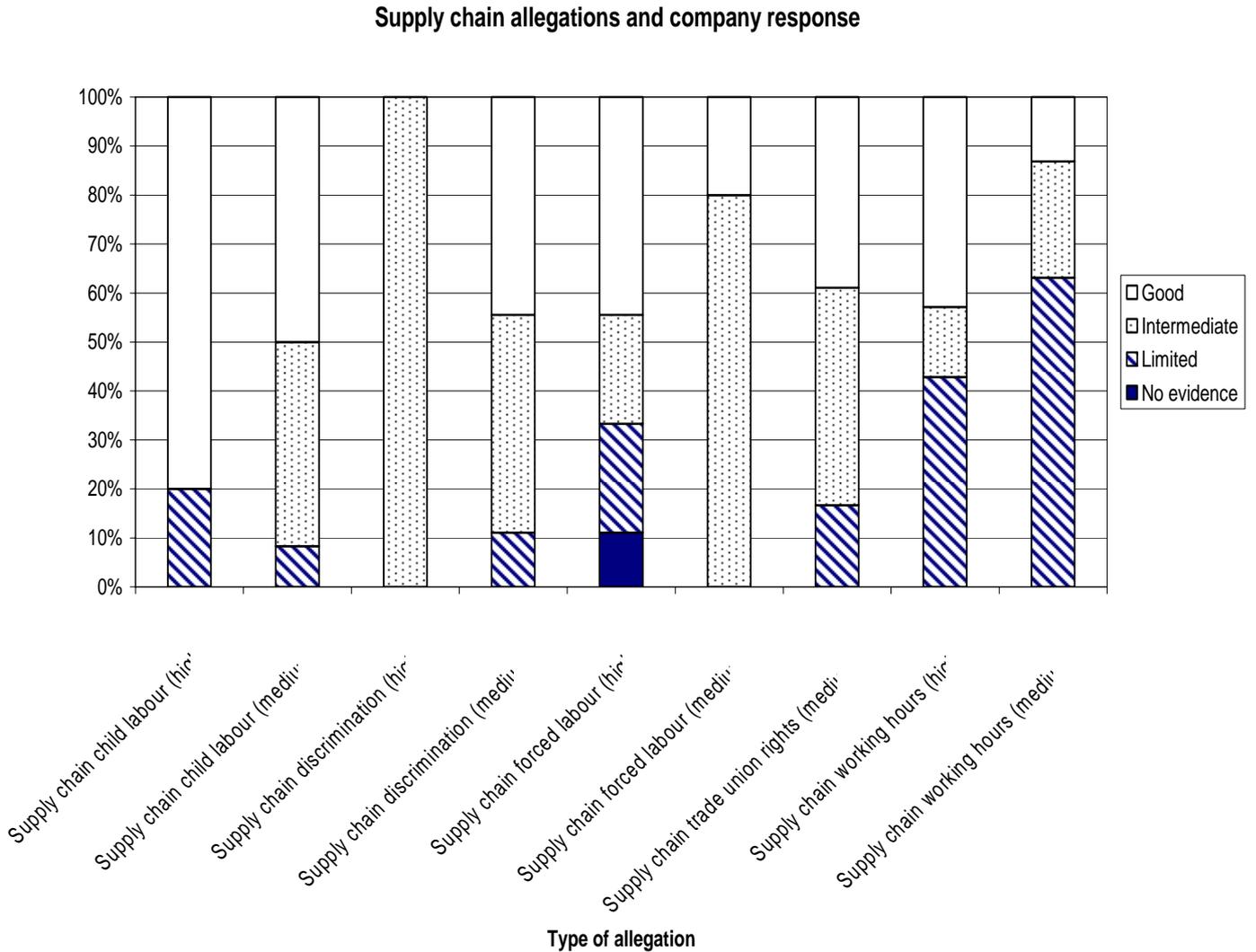
The graph below shows the different types of supply chain labour standard allegations recorded and the percentage from different regions.



North American companies followed by European companies are the most likely to have supply chain labour standard allegations. A key reason for this is the large number of NGOs present in these regions which campaign on these issues. There are NGOs in Japan and Asia focusing on this issue but not to the same extent and when they do make allegations they tend to concern factories in the supply chains of European and North American companies.

### 3) Supply chain labour standard allegations and company response by allegation type

The graph below shows the different types of allegations recorded in company supply chains and shows the percentage of the responses to these allegations which have been assessed as 'good', 'intermediate', 'limited', or 'no evidence'.

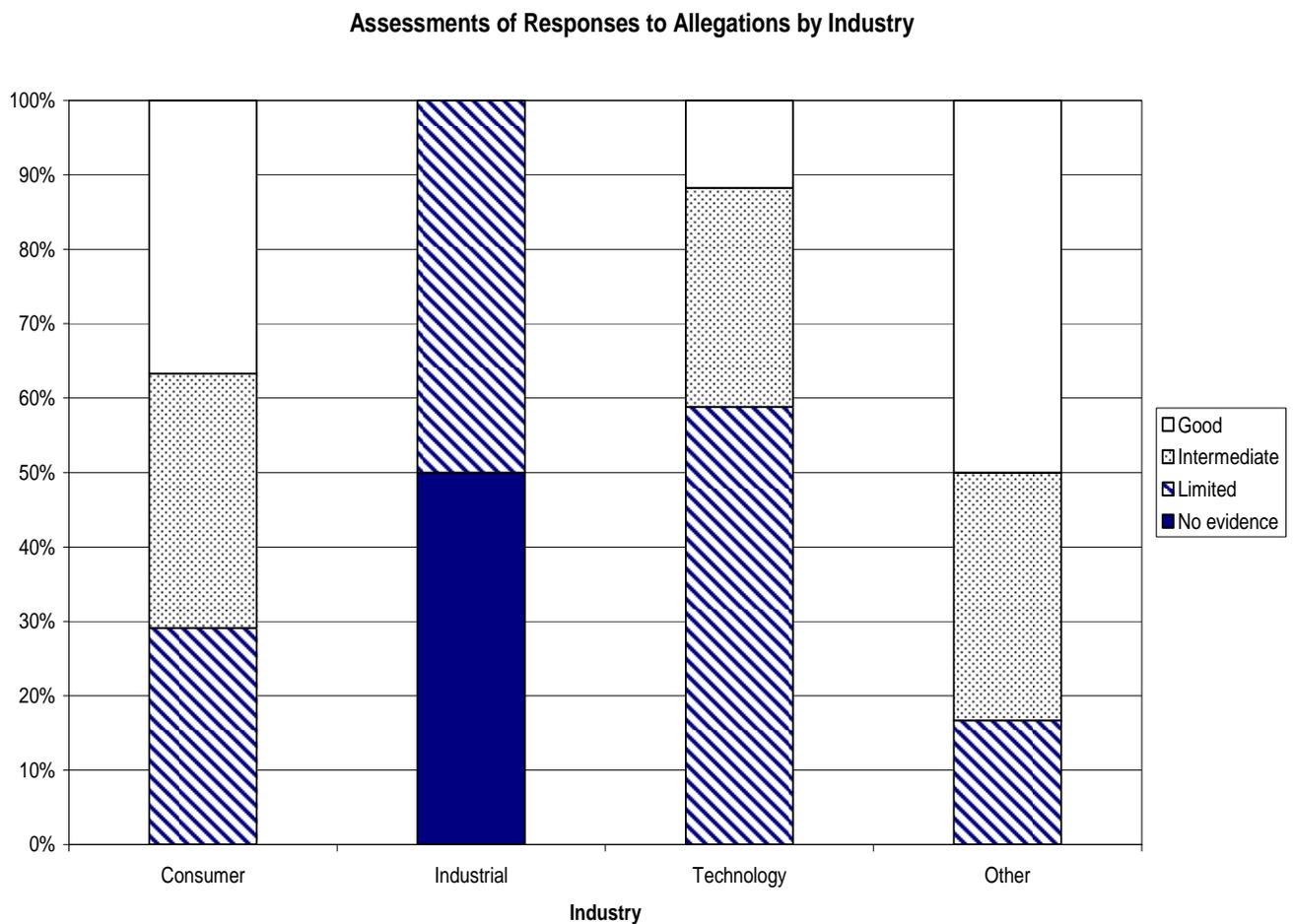


80% of supply chain child labour allegations assessed as high have a 'good' response from the company. 95% of supply chain child labour allegations assessed as medium have a 'good' or 'intermediate' response from the company. This indicates that companies recognise the reputational risk that such allegations pose and so respond to them in a robust way in order to mitigate this risk. Similarly 70% of supply chain forced labour cases assessed as high and all cases assessed as medium have either an 'intermediate' or 'good' assessment.

Working hours allegations show the highest percentage of responses assessed as 'limited' or below. This may be due to the fact that the addressed criteria require companies' working hours policies to cover a number of elements and most companies policies are not comprehensive enough to meet the criteria.

#### 4) Supply chain labour standard allegations and company response by industry

The graph below shows the response to supply chain allegations by industry.



In terms of how well companies in different sectors respond to labour standard allegations in their supply chains, it is interesting that in the consumer industry, which has the majority of allegations, almost 40% of companies achieve a good assessment. This is compared to no companies in the industrial industry and approximately 10% of companies in the technology industry.

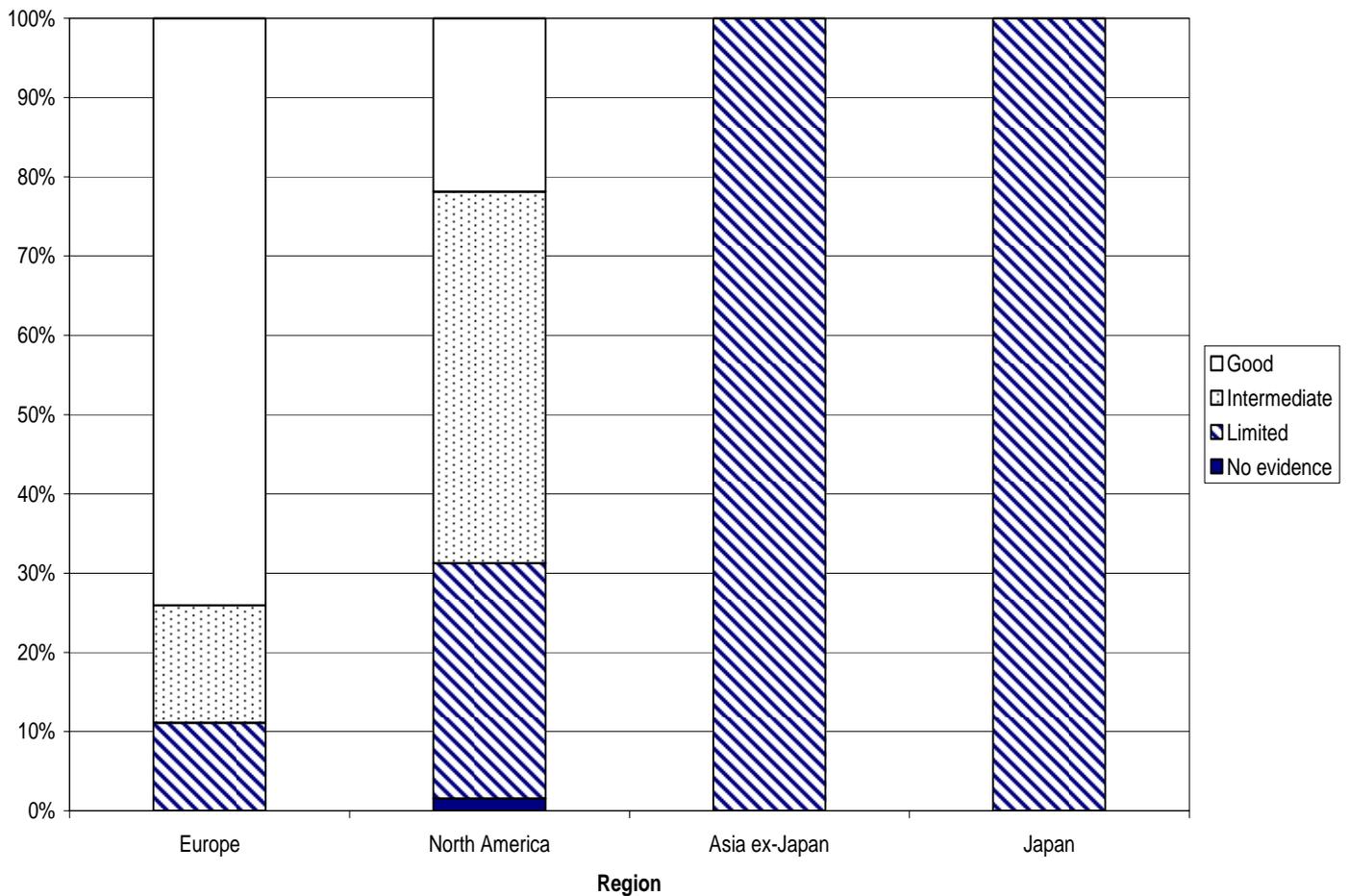
The consumer industry is where supply chain risk is greatest and is where the greatest number of allegations is focused. Companies in consumer industry sectors demonstrate a better response because they have come under greater scrutiny for

supply chain labour standards than other sectors and have more comprehensive policies and systems in place for dealing with this issue.

### 5) Supply chain labour standard allegations and company response by region

The graph below shows the response to supply chain allegations by region.

**Assessment of Responses to Allegations by Region**



Looking at companies' response to allegations by region, only companies in those regions where NGOs are most active in this area (Europe and North America) achieve assessments above 'limited'. Over 70% of European companies with a supply chain labour standard allegation achieve an assessment of 'good' and 90% achieve an assessment of 'good' or 'intermediate'. This is compared with approximately 20% of North American companies achieving an assessment of good and 70% achieving an assessment of 'good' or 'intermediate'. All Japanese and other Asian companies achieve an assessment of 'limited'.

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### **iii) Examples of best practice**

A small number of companies in the EIRIS universe demonstrate best practice elements for managing supply chain labour standard risk.

#### **Policy**

Puma is a German sportswear company which sources clothing and footwear from developing countries. More than 80% of its products are sourced from the Asia/Pacific region. Puma demonstrates best practice elements in each of the following areas: policy, management systems and reporting. Under policy, it displays best practice by clearly integrating its policy into the procurement process. The Company's policy is included in all business contracts and it audits active and potential suppliers against its policy and awards them one of four grades. Potential supplier factories which achieve a 'D' grade will not be used as they do not conform to the Company's policy. 'C'-graded factories with serious non-compliance issues may be included on the Company's active list depending on the suppliers' willingness to improve. This will be assessed by the Company in a second audit.

#### **Management systems**

Nike is a US sportswear and footwear company which sources its products from independent contract factories located in developing countries. It has come under extensive criticism in the past for the working conditions in some of the factories it uses in its supply chain to manufacture its products and in response has developed a comprehensive management system for this issue. For example, it targets its management systems to the areas of its supply chain at highest risk of non-compliance. It assesses factories for non-compliance risk and then focuses its audits on these factories. In addition, it demonstrates clear links between its management systems for supply chain labour standards and its procurement management systems through the use of a balanced scorecard that helps the Company's sourcing managers to make sourcing decisions based on corporate responsibility issues, as well as price, delivery and quality requirements.

#### **Reporting**

Gap operates retail stores selling casual apparel, accessories, and personal care products for men, women and children. Its products are manufactured by independent companies in various countries, including China, Egypt, Bulgaria, Romania, Turkey, India and Cambodia. Like Nike, it has come under criticism in the past for the working conditions in some of the factories manufacturing its products and has responded by developing comprehensive management systems for this issue. It reports extensively on its management systems and also on the actual conditions within its supply chain. For example, it describes specific violations of its policy in different countries in its CSR reports and has previously disclosed the percentage of compliance violations found in factories. It also publishes data on supplier performance by disclosing the results of its factory rating system, classifying factories according to the level of urgency of the violations found. Gap was the first company to publish details of the number and type of non-compliance found in its supply chain in its 2003 CSR report and it continues to do so.

Fast Retailing, a Japanese company operating stores specialising in casualwear, has

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previously published examples of non-compliance found in its supply chain and has also published a graph illustrating supplier performance.

Few companies outside of the US and Europe demonstrate best practice elements in any of the areas of policy, management systems or reporting. An exception is Billabong, an Australian provider of surf wear, sports apparel and shoes, which has published data on supplier performance by indicating on its website that it has terminated the contracts of 10% of its suppliers for non-compliance. However, it does not report in detail on such non-compliance.

In general it tends to be US and European companies which demonstrate best practice elements, most likely because they have had the longest exposure to campaigns from NGOs on this issue. It is significant that both Gap and Nike, which have faced extensive criticism in the past, now publish detailed information on their response to supply chain labour standard risk.

Due to the endemic nature of the problem in some markets, even when a company demonstrates best practice elements in its policy, management systems and reporting on this issue it does not necessarily mean that its supply chain will be free of labour standard breaches. However, such companies do demonstrate how the issue can be managed and are constantly improving in order to try and reduce the number of breaches in their supply chain.

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## 5. Conclusion - Investor action

Supply chain labour standards are an important issue for investors because of the financial and reputational risk breaches of these standards pose to companies. From an ethical perspective, investors may also want to ensure decent working conditions in company supply chains.

### a) Engaging with individual companies

Investors can identify companies at risk of breaches of core labour standards in their supply chain by looking at the products sourced and the countries from which they are sourced. They can then engage with these companies to find out their current supply chain labour standard policy and management systems and encourage them to adopt more comprehensive policies and systems where relevant. This will enable investors to manage the risk of breaches of core labour standards in a company's supply chain by promoting improvements in the company's management systems. Below is a list of areas that investors could focus on.

#### i) Check the company's exposure to this issue and, where relevant, check that the company is aware of the particular issues concerning their products and the countries they are sourced from

Companies will be better placed to manage associated risks if they are aware of the specific issues affecting both the countries they source from and the sourced products themselves. For example, in China it has been suggested that foreign companies could monitor closely whether forced labour institutions are part of their supply chain and could ask for access for independent monitors to all suppliers under suspicion.<sup>66</sup>

Companies that are aware of the particular challenges involved in monitoring product manufacturing for breaches of core labour standards, will be able to respond to these challenges in the management system that they put in place. It is easier to monitor the first tier of a supply chain, for example the factory manufacturing a product, than it is to monitor the bottom tier, such as the farm growing the raw material. Agricultural products can therefore present more of a challenge for companies but they can familiarise themselves with any issues associated with a particular product, and if they exist, involve themselves in an initiative set up to combat the problem.

#### ii) Check that the company's supply chain labour standards policy covers all of the required labour standards

Investors could check that companies' supply chain codes cover all of the following labour standards:

- Prohibition of child labour
- Prohibition of forced labour
- Non-discrimination
- Freedom of association and collective bargaining
- Health and safety
- Working hours
- Wages

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<sup>66</sup> Amnesty International, *When In China: Encounters with Human Rights* (September 2006)

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- Disciplinary practices

Most importantly, they could ensure that freedom of association and collective bargaining are covered in full. Many company codes do not cover collective bargaining. However, freedom of association and collective bargaining are the two fundamental labour standards of any code because they give workers the ability to raise concerns with their employers and resolve labour standard problems without having to rely on a third party. An active trade union in a factory enables workers to raise concerns about working conditions with management and creates a mechanism for resolving any issues identified. This is a more effective way to maintain adequate labour standards than an annual audit.

### **iii) Check that the company's management systems for implementing this policy are comprehensive and include some best practice elements**

In order to mitigate the risk of breaches of core labour standards in their supply chains, companies can ensure that they clearly communicate to suppliers that these are not acceptable practices. In addition they can put robust monitoring and auditing systems in place to identify any potential problems and a system to remedy any non-compliance found. Preferably, this system will be targeted at the areas of highest risk within their supply chain.

Most importantly, companies can make sure that their own procurement practices do not result in suppliers resorting to breaches of core labour standards. For example, if suppliers are pressured to reduce costs to unrealistically low levels they may attempt to block the formation of trade unions if they are afraid that collective bargaining will result in wage increases.

Companies can also support core labour standards in their supply chains by guaranteeing long term orders to suppliers which support freedom of association and collective bargaining rights.

### **iv) Encourage the company to join a multi-stakeholder initiative**

There are many initiatives concerned with supply chain labour standards which companies can join. These are an excellent way for companies to improve conditions within their supply chain as they provide the opportunity to work together with other companies and so enable them to pool resources and knowledge. Some of the causes of poor working conditions in supplier factories cannot be tackled by one company alone but require an industry-wide response.

There are many different types of initiatives and some have a better reputation than others. NGOs tend to have a higher opinion of multi-stakeholder initiatives such as the Ethical Trading Initiative (ETI) which involve companies, trade unions and NGOs to an equal extent. Industry initiatives such as the Business Social Compliance Initiative have received some criticism in the past. This can be for different reasons; either because the initiative's code does not fully support all of the core labour standards (collective bargaining is not always included in industry codes), or because NGOs and trade unions do not have the same representation within the initiative as industry. New industry initiatives which are set up are criticised because it is argued that companies would be better off joining an existing multi-stakeholder initiative rather than creating a new one.

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In the regions where companies source products, companies can also work with local organisations, such as local NGOs and trade unions. They can provide companies with useful information on particular problems in that region and the types of violations they need to look out for in local factories.

**v) Encourage the company to report comprehensively on this issue**

Companies that have implemented comprehensive systems for managing this issue should be encouraged to report publicly on what they have done. Such reporting can improve a company's reputation with consumers and also reduce the likelihood that it will become the target of an NGO campaign to put policies and systems in place. It is also important for other investors to be able to see what a company is doing in response to this issue.

**vi) Encourage the company to develop long-term relationships with its suppliers**

Companies that have long-term relationships with their suppliers are likely to have more influence over them. Long-term relationships give the company time to develop trust with the supplier and to implement sustainable solutions to the causes of poor working conditions rather than just deal with the symptoms.

As noted by F&C Investments, 'companies are more likely to make headway with suppliers that they have identified as important to their sourcing strategy; the factories of such suppliers will see the benefits of long-term, stable business relationships, involving high levels of trust, predictability and healthy, growing order books.'<sup>67</sup>

**vii) If the company has been accused of breaching labour standards in its supply chain, investors can check that it has the following in place:**

- a supply chain policy which covers the labour standards it has been accused of breaching
- adequate management systems in place to support this policy, ideally involving the use of local NGOs in countries of concern to help it identify suppliers at particular risk of breaching labour standards or to help conduct audits (for example by talking to workers)
- an open approach to dealing with allegations – the company readily responds to questions about the case and publishes information on its website about how it plans to address this
- a commitment to performance reporting – the company reports publicly on performance within its supply chain including numbers and details of any non-compliance found

In cases where a company has been accused of breaching core labour standards, engagement may be the best way to improve company performance. In the paper *Incorporating Labor and Human Rights Risk into Investment Decisions*, it is noted that

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<sup>67</sup> F&C Investments, *Factory Labour Standards in Emerging Markets: an Investor Perspective* (January 2009), p.9

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one traditional SRI response to such breaches has been to ban investments in these companies. However, it notes that this may not be the best way to ensure that companies manage these risks so as to maximize corporate performance and portfolio returns and 'It may be even more inappropriate for so-called universal owners, a phrase increasingly used to describe long-term investment strategies that typically buy indexes of an asset class and hold them for the long term without selling.'<sup>68</sup>

Some investors are concerned about breaches of international norms and how well a company has addressed the issue. EIRIS's Convention Watch service can provide investors with information on which companies have been accused of breaching international standards and how well they have responded to the issue.

### **Convention Watch**

Convention Watch is a service that evaluates the many serious allegations made against companies in press articles and through NGO campaigns. It reviews and assesses allegations of company breaches of the spirit of major international conventions on human rights, labour standards, the environment (including climate change), corruption, anti-personnel landmines and cluster munitions. Allegations are classified as having medium or high risk exposure depending on how they compare against five indicators. Companies are encouraged to respond in detail to the allegations and full reports on companies' performance are provided. Companies' responses to the allegations are classified as 'no evidence', 'limited', 'intermediate', or 'good' with 'good' indicating that a company has adequately addressed the issue.

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<sup>68</sup> Bernstein, *Incorporating Labor and Human Rights Risk Into Investment Decisions*, Pensions and Capital Stewardship Project, Labor and Worklife Program, Harvard Law School, September 2008, p.4

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Below is a list of questions that investors could ask companies:

### **Engagement Questions**

- Has the company identified where products are being manufactured and what risks are associated with the manufacture of a particular product in a particular country?
- Does the company have a policy on supply chain labour standards and what does this policy cover?
- What management systems are in place to support the implementation of this policy?
- How does the company communicate this policy to suppliers?
- Does the company audit suppliers against this policy? If so, how often?
- What procedures are in place to remedy any non-compliance found?
- Does the company provide training and capacity building to its suppliers on labour standards?
- How are the company's management systems for supply chain labour standards integrated with its procurement management systems?
- Does the company report publicly on this issue, in particular on the amount and type of non-compliance found with its policy?
- Does the company seek feedback from its stakeholders about the content of its report?

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## b) Working with other investors

Investors that want to work with other investors on this issue can join the UN Principles for Responsible Investment (PRI). These principles were developed by a group of institutional investors supported by a multi-stakeholder group of experts. The PRI require signatories to incorporate environmental, social and governance (ESG) issues into investment analysis and decision-making and to seek appropriate disclosure on ESG issues by the entities in which they invest. The PRI Engagement Clearinghouse enables signatories to share information and proposals on shareholder and other engagement activities they are conducting with other signatories.<sup>69</sup>

Investors concerned about potential breaches of core labour standards in a company's supply chain can sign-up to the PRI and work jointly with other investors to encourage an individual company to publish or adopt a supply chain labour standards policy or to improve its management systems. Investors can also work together on a particular issue, for example some labour standard issues are associated with certain countries and it is possible for investors to collaborate to bring about improvements in countries where their investees source products. The PRI also includes resources that investors can use to keep abreast of emerging labour standard issues and individual companies.

In the US, investors have used the proxy resolution process to improve companies' management systems for supply chain labour standards and reporting. US shareowner groups, mostly public and religious pension funds, have filed numerous resolutions at companies perceived to have serious labour rights problems. Typically they have involved ad hoc coalitions of five or ten shareowner groups, many organised by the Interfaith Center on Corporate Responsibility (ICCR) or the New York City pension funds, both of which have taken the lead on the issue.<sup>70</sup>

Investors can also support initiatives aimed at improving company reporting on labour standards. For example, in 2008 the European Sustainable Investment Forum (EUROSIF), a trade association for the SRI industry, discussed the issue of mandatory ESG reporting with Richard Howitt, the European Parliament spokesperson on CSR.<sup>71</sup> In 2009, the Global Reporting Initiative (GRI), the UN Global Compact and Realizing Rights: The Ethical Globalization Initiative set up a joint initiative, the 'Human Rights: a Call to Action' which challenged companies to identify an area of their reporting on human rights that they could improve. It invites other organisations to call on businesses to improve the quantity and quality of their CSR reporting and so is something investors could support.<sup>72</sup> Investors could be on the look out for similar initiatives to support in the future.

Whether engaging with individual companies or working with other investors on this issue, investors should be encouraged to take into account the risk of breaches of core labour standards in company supply chains, as they may impact on a company's value and performance. Conversely, companies that are managing this issue well could gain advantages through greater efficiency in their supply chain as well as a reputation for addressing international standards.

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<sup>69</sup> <http://www.unpri.org>

<sup>70</sup> Bernstein, *Quantifying Labor and Human Rights Portfolio Risk*, Pensions and Capital Stewardship Project, Labor and Worklife Program, Harvard Law School, June 2009, p.23

<sup>71</sup> *Ibid.*, p.27

<sup>72</sup> <http://www.globalreporting.org/NR/rdonlyres/4C5DB4C6-5084-4A84-BE51-0D134B3B5A2E/1951/HumanRightsCallToAction1.pdf>

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## **PRI Toolkit**

Recognising the challenges investors face in committing to the UN Principles for Responsible Investment, EIRIS has developed a **PRI toolkit** consisting of 3 evaluation tools: an ***ElRisk Rating***, ***Global Compact Engager*** and a ***Report Monitor*** to assist signatories to implement the UN PRI - in particular Principles 1, 2 and 3.

**ElRisk** helps investors determine a company's overall ability to manage ESG risks that are material to its business, assessing both its risk exposure and management response to the relevant ESG issues. Companies are assigned to one of seven categories from 'Alert' (companies which have not resolved allegations relating to breaches of international norms) to 'Risks mitigated' (for good practice companies that have demonstrated an adequate level of risk management in the relevant ESG areas).

**Global Compact Engager** highlights good practice companies and those that fall short on performance, focusing on the 10 principles of the UN Global Compact, to help investors prioritise their engagement.

**Report Monitor** is an assessment that focuses exclusively on companies' reporting practices, grading them from A to E to encourage improved disclosure.

Please see [www.eiris.org/managers/rfm\\_ps\\_PRI\\_toolkit.html](http://www.eiris.org/managers/rfm_ps_PRI_toolkit.html) for more details

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## 6. Appendix

### a. Examples of NGOs that have campaigned on supply chain labour standards

Behind the Label: [www.behindthelabel.org](http://www.behindthelabel.org)

CAFOD: [www.cafod.org.uk](http://www.cafod.org.uk)

Campaign for Labor Rights: [www.clrlabor.org](http://www.clrlabor.org)

China Labor Watch: [www.chinalaborwatch.org](http://www.chinalaborwatch.org)

Clean Clothes Campaign (CCC): [www.cleanclothes.org](http://www.cleanclothes.org)

Global March Against Child Labour: [www.globalmarch.org](http://www.globalmarch.org)

India Committee of the Netherlands (ICN): [www.indianet.nl](http://www.indianet.nl)

International Labor Rights Fund: [www.laborrights.org](http://www.laborrights.org)

Labour Behind the Label: [www.labourbehindthelabel.org](http://www.labourbehindthelabel.org)

Maquila Solidarity Network (MSN): [www.maquilasolidarity.org](http://www.maquilasolidarity.org)

National Labor Committee: [www.nlcnet.org](http://www.nlcnet.org)

Oxfam: [www.oxfam.org.uk](http://www.oxfam.org.uk)

Social Observatory Institute: [www.observatoriosocial.org.br](http://www.observatoriosocial.org.br)

Thai Labour Campaign: [www.thailabour.org](http://www.thailabour.org)

United Students Against Sweatshops (USAS): [www.studentsagainstsweatshops.org](http://www.studentsagainstsweatshops.org)

US/Labor Education in the Americas Project: [www.usleap.org](http://www.usleap.org)

War on Want: [www.waronwant.org](http://www.waronwant.org)

Worker Rights Consortium: [www.workersrights.org](http://www.workersrights.org)

### b. List of verifiers

#### Key multi-stakeholder initiatives

Eliminating Child Labour in Tobacco Growing Foundation: [www.eclt.org](http://www.eclt.org)

Ethical Trading Initiative (UK): [www.ethicaltrade.org](http://www.ethicaltrade.org)

Fair Wear Foundation (Netherlands): [en.fairwear.nl](http://en.fairwear.nl)

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Fair Labor Association (USA): [www.fairlabor.org](http://www.fairlabor.org)

International Cocoa Initiative: [www.cocoainitiative.org](http://www.cocoainitiative.org)

Social Accountability International (Global): [www.sa-intl.org](http://www.sa-intl.org)

Verité (USA): [www.verite.org](http://www.verite.org)

Examples of industry-based initiatives

Electronic Industry Citizenship Coalition (EICC): [www.eicc.info](http://www.eicc.info)

Ethical Tea Partnership: [www.ethicalteapartnership.org](http://www.ethicalteapartnership.org)

International Council of Toy Industries: [www.toy-icti.org](http://www.toy-icti.org)

World Federation of the Sporting Goods Industry: [www.wfsgi.org](http://www.wfsgi.org)

Worldwide Responsible Apparel Production (USA): [www.wrapapparel.org](http://www.wrapapparel.org)

**c. Example Code of Conduct**

**Ethical Trading Initiative Base Code<sup>73</sup>**

1. EMPLOYMENT IS FREELY CHOSEN

1.1 There is no forced, bonded or involuntary prison labour.

1.2 Workers are not required to lodge "deposits" or their identity papers with their employer and are free to leave their employer after reasonable notice.

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2. FREEDOM OF ASSOCIATION AND THE RIGHT TO COLLECTIVE BARGAINING ARE RESPECTED

2.1 Workers, without distinction, have the right to join or form trade unions of their own choosing and to bargain collectively.

2.2 The employer adopts an open attitude towards the activities of trade unions and their organisational activities.

2.3 Workers representatives are not discriminated against and have access to carry out their representative functions in the workplace.

2.4 Where the right to freedom of association and collective bargaining is restricted under law, the employer facilitates, and does not hinder, the development of parallel means for independent and free association and bargaining.

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3. WORKING CONDITIONS ARE SAFE AND HYGIENIC

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<sup>73</sup> [http://www.ethicaltrade.org/sites/default/files/resources/ETI%20Base%20Code%20-%20English\\_0.pdf](http://www.ethicaltrade.org/sites/default/files/resources/ETI%20Base%20Code%20-%20English_0.pdf)

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3.1 A safe and hygienic working environment shall be provided, bearing in mind the prevailing knowledge of the industry and of any specific hazards. Adequate steps shall be taken to prevent accidents and injury to health arising out of, associated with, or occurring in the course of work, by minimising, so far as is reasonably practicable, the causes of hazards inherent in the working environment.

3.2 Workers shall receive regular and recorded health and safety training, and such training shall be repeated for new or reassigned workers.

3.3 Access to clean toilet facilities and to potable water, and, if appropriate, sanitary facilities for food storage shall be provided.

3.4 Accommodation, where provided, shall be clean, safe, and meet the basic needs of the workers.

3.5 The company observing the code shall assign responsibility for health and safety to a senior management representative.

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#### 4. CHILD LABOUR SHALL NOT BE USED

4.1 There shall be no new recruitment of child labour.

4.2 Companies shall develop or participate in and contribute to policies and programmes which provide for the transition of any child found to be performing child labour to enable her or him to attend and remain in quality education until no longer a child ("child" and "child labour" as defined in the appendices).

4.3 Children and young persons under 18 shall not be employed at night or in hazardous conditions.

4.4 These policies and procedures shall conform to the provisions of the relevant ILO standards.

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#### 5. LIVING WAGES ARE PAID

5.1 Wages and benefits paid for a standard working week meet, at a minimum, national legal standards or industry benchmark standards, whichever is higher. In any event wages should always be enough to meet basic needs and to provide some discretionary income.

5.2 All workers shall be provided with written and understandable information about their employment conditions in respect to wages before they enter employment and about the particulars of their wages for the pay period concerned each time that they are paid.

5.3 Deductions from wages as a disciplinary measure shall not be permitted nor shall any deductions from wages not provided for by national law be permitted without the express permission of the worker concerned. All disciplinary measures should be recorded.

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#### 6. WORKING HOURS ARE NOT EXCESSIVE

6.1 Working hours comply with national laws and benchmark industry standards, whichever affords greater protection.

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6.2 In any event, workers shall not on a regular basis be required to work in excess of 48 hours per week and shall be provided with at least one day off for every 7 day period on average. Overtime shall be voluntary, shall not exceed 12 hours per week, shall not be demanded on a regular basis and shall always be compensated at a premium rate.

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## 7. NO DISCRIMINATION IS PRACTISED

7.1 There is no discrimination in hiring, compensation, access to training, promotion, termination or retirement based on race, caste, national origin, religion, age, disability, gender, marital status, sexual orientation, union membership or political affiliation.

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## 8. REGULAR EMPLOYMENT IS PROVIDED

8.1 To every extent possible work performed must be on the basis of recognised employment relationship established through national law and practice.

8.2 Obligations to employees under labour or social security laws and regulations arising from the regular employment relationship shall not be avoided through the use of labour-only contracting, sub-contracting, or home-working arrangements, or through apprenticeship schemes where there is no real intent to impart skills or provide regular employment, nor shall any such obligations be avoided through the excessive use of fixed-term contracts of employment.

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## 9. NO HARSH OR INHUMANE TREATMENT IS ALLOWED

9.1 Physical abuse or discipline, the threat of physical abuse, sexual or other harassment and verbal abuse or other forms of intimidation shall be prohibited.

The provisions of this code constitute minimum and not maximum standards and this code should not be used to prevent companies from exceeding these standards. Companies applying this code are expected to comply with national and other applicable law and, where the provisions of law and this Base Code address the same subject, to apply that provision which affords the greater protection.

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## **EIRIS Foundation**

This paper was written with the financial support of the EIRIS Foundation. The EIRIS Foundation is a leading UK charity working in the area of responsible investment. The Foundation has over 25 years experience of providing free, objective and trusted information on ethical finance to members of the public. A not-for-profit organisation, its mission is to empower investors with independent assessments of companies and advice on integrating them with investment decisions.

The Foundation regularly reviews the areas of work it is particularly interested in supporting. Its current areas of interest are:

- increasing the numbers of charities investing ethically
- creating a new one-stop shop website on ethical money to promote responsible investment and encourage more consumers to choose ethical options as part of their financial planning
- working with charities and NGOs to explore how best they can influence the direction of responsible investment
- undertaking new research that is not yet commercially viable – we are currently looking at research into emerging markets, corporate HIV/AIDS policies and health and safety research
- making responsible investment more widely practiced and/or more effective
- disseminating existing and new responsible investment research to a wider audience

## **Further information**

You can find out more about EIRIS and its products and services for investors by calling +44 (0)20 7840 5742 or emailing [clients@eiris.org](mailto:clients@eiris.org) or visiting website [www.eiris.org](http://www.eiris.org)

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## **About EIRIS**

EIRIS is a leading global provider of independent research into the social, environmental governance and ethical performance of companies. A UK-based organisation with offices in France and the US and research partners around the world, EIRIS has a wealth of experience in the field of responsible investment research. EIRIS provides comprehensive research on around 3,000 companies in Europe, North America and the Asia Pacific region. EIRIS is already retained by 100 institutional clients including pension and retail fund managers, banks, private client brokers, charities and religious institutions across Europe, North America, Australia and Asia. For more information on EIRIS' products and services visit [www.eiris.org](http://www.eiris.org) or email [clients@eiris.org](mailto:clients@eiris.org)