

Labor Standards Performance in Your Supply Chain

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Introduction

Labor standards in the global supply chain is gaining recognition as an important issue. Consumers are becoming more aware of where their products come from and the conditions under which they were made. Socially responsible investors, both individuals and institutions, are looking more carefully at how a company operates – this extends to their supply chain. PS2 specifically extends some of its labor requirements to your suppliers.

You need to think of your company's place in the supply chain. If you export to the EU or the US, you are probably familiar with one or more codes of conduct. Regardless of what type of organization you are, you have a supply chain. You need to start to think about labor standards in your supply chain. You need to extend your management systems into your supply chain.

The push towards improvement in working conditions in the supply chain mostly began as a risk mitigation strategy by famous brands and retailers. It started as a means of protecting their corporate reputation in response to activist and media attention on poor labor conditions in emerging market factories. US and EU consumer-goods companies started to really take a look at what was happening in the factories making their products. In many cases, it was ugly. Clearly, they did not want their corporate image tarnished by being associated with pictures and stories of gross labor violations. So to reduce risk to their image, brands and retailers started to establish labor codes of conduct for their suppliers.

Over the same time period, consumers also came to expect a lot of today's retailer: a wide selection of products, always available at a competitive price; unique, constantly changing merchandise. And today's leading retailers, whether mass merchandisers, supermarkets or specialty stores, have developed systems to deliver all of this to consumers: global sourcing; integrated logistics systems; mass customization in manufacturing; growth in private label (store brands); sophisticated information technology that stretches from the cash register to the factory floor.

Think about what this does to purchasing practices in the global supply chain. What has this drive to deliver so much to the consumer done to the supply chain? What is the result on the factory floor or in the farm?

As companies and consumers routinely expect instant, 24-hour service, and a wider, constantly changing array of merchandise, factories face less predictable orders – this increases the likelihood that workers will be forced to work overtime to meet shorter delivery times, and cope with last minute product changes. Compounding the overtime issue is the demand for lower and lower prices. Suppliers compete intensely to get orders in today's competitive global economy. Especially in industries with low barriers-to-entry, downward price pressures can lower wages for workers.

As companies struggle to keep pace with delivery and price pressures, they outsource more production to sub-contractors. These sub-contractors might have low labor standards using contract labor, homeworkers and children. Workers hired under these terms face health and safety risks, discrimination, lower wages and a lack of proper contracts outlining their rights. They are often isolated and lack a system by which they can exercise their rights or address their grievances.

It is misguided to isolate any one company and look at its labor practices alone. Every link in the chain is interdependent.

Mapping Your Supply Chain

Three Levels to Consider:

1. In your company
2. In your direct suppliers
3. In the suppliers to your direct suppliers

Supply chains can be very complex. They can have many links in the chain. You always need to think of the entire supply chain. You need to think about your place in the chain. You need to think about who supplies your suppliers.

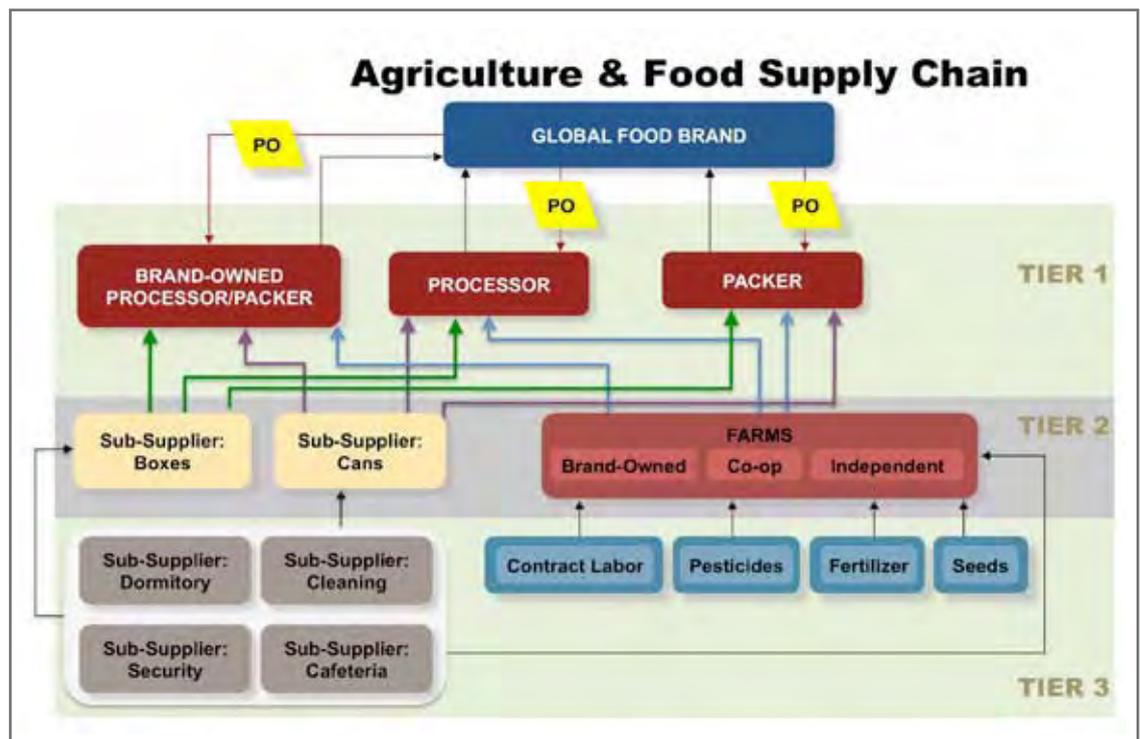
Your supply chain will include companies or people that supply you with products and services. They could be raw materials or components. They could be finished goods that you re-sell or use in your organization.

Here is an example that illustrates just a small part of a company's supply chain. We have added notes to highlight certain aspects of the supply chain for manufacturers and service providers. When

you look at this keep in mind that a large retailer may have 20,000 direct suppliers – each with a web of sub-contractors and sub-suppliers. A brand may have 1,000 or more direct suppliers – each with a web of sub-contractors and sub-suppliers.

The first step towards understanding and controlling your supply chain is to create a map. Don't worry, it doesn't need to be as detailed and multi-tiered as the example here. Start by identifying all of your direct suppliers.

In the Toolkit, we provide instructions and a form for you to use to list each supplier and to start to collect the information you will use to determine how much risk they pose to you.



Controlling your suppliers and contractors is one of the most difficult challenges in building a responsible company. It is common for suppliers to use sub-contractors to perform specific production functions or to provide additional capacity during peak periods. In many cases, the use of sub-contractors by your suppliers may be completely unknown to you. Labor standards in these unauthorized sub-contractors is a major issue.

In some labor-intensive operations, suppliers increasingly use sub-contractors to reduce costs and in some cases to evade legal obligations to the workers. There is evidence that as you move farther down the sub-contracting chain, there is an increased chance that workers receive lower pay, obtain little or no payment of legally required benefits, and have little or no safety and health protection.

The companies that you issue the purchase order to are your direct suppliers.

The same is true on the service side. The employment agency you use may be dealing with recruitment agencies that are withholding payments from workers or holding their identification or passports. The workers are subject to forced labor.

As you create a map of all of your direct suppliers, imagine lots of little boxes coming off each of your suppliers – like on the diagrams. That will start to give you an idea of the

complexity of your supply chain. Your direct supplier may be buying raw materials and components and packaging. These things are probably clear to you and expected. But they may also be sub-contracting for production or labor – in total or in part – to companies you do not know about. It may be for embroidery. It may be for powder-coating metal. It may be for making bricks. It may be for assembling components. It may be for processing and packaging fruit. It may be for recruiting permanent workers or temporary workers.

Your suppliers may be reluctant to tell you about their use of sub-contractors. They are often concerned that you will try to by-pass them and deal directly with their sub-contractor. Suppliers are reluctant to turn down orders based on production capacity limitations, yet they are aware that buyers are concerned about the use of sub-contractors for quality and delivery reasons, as well as for labor standards performance. This also spurs suppliers to hide the use of sub-contractors from buyers.

TIP ↓

Tips on Terminology

- Tier 1
A Vendor and a Direct Supplier are the same thing – these can also be called Tier 1 suppliers
- Tier 2
Tier 2 refers to companies that directly supply Tier 1. Typical usage for Tier 2: Sub-supplier supplies raw materials or service to the Tier 1
- Tier 3
Tier 3 refers to companies that directly supply Tier 2

The labor standards people in your operations and procurement departments need to be aware of the business issues impacting the use of sub-contractors and the reason suppliers are reluctant to divulge their use. This is one area where your labor standards performance and operations departments often send conflicting messages to suppliers. Today, the vast majority of companies send conflicting messages to their suppliers. We hear this all the time. We hear it from suppliers. We hear it from candid brands and retailers. You may have experienced this yourself.

Your company needs to send a unified message to your suppliers. Open, transparent communication is the key. You also need to look at the situation from your supplier's point of view. This is critical to any meaningful dialog.

You need to make it clear to your suppliers that you expect them to adhere to the relevant requirements of PS2. You should help them to replicate the management systems you have in place for child labor and forced labor. Don't make them invent their own system. Help them. Give them your PS2 policies and procedures for child labor and forced labor.



In the Toolkit we provide instructions and forms for you to use in building your supply chain management system. We also have tools for you to use in building a Supplier Toolkit to give your suppliers.

Unauthorized Sub-Contractors are often the source of labor violations that get wide media coverage.

“If you want the order, you’ve got to come down on price. No way around it.”

“I don’t care how you do it, just make sure you ship on time. I need those products.”

“I know it was peak season, but there was clearly excessive overtime again. We have to drop your rating.”

“ Conflicting Messages to Suppliers ”

“We need to review your piece rate calculations. It seems many workers are not even making minimum wage.”

“We heard you may be using unauthorized sub-contractors. We need to look at your production records. You know this is a major problem for both of us.”

“Good news. The re-order quantity is 80% more than expected.... No, I can’t give you extra time.”

“Hey, remember which department issues the purchase orders!”

Supplier Risk Assessment

Look at the map of your supply chain. Think about the labor standards performance risk that each company may pose. Depending on the nature of your organization, your direct suppliers may include:

- Manufacturers or Processors
- Farms
- Distributors
- Trading Companies
- Importers
- International Brands
- Retailers
- Employment Agencies
- Security Companies
- Foodservice Companies
- Dormitory Operators
- Cleaning Services

Example Elements of a Supplier Risk Assessment

Region, country and area inside country

Industry or product category

Production process within the product category

Level of attention from activists, consumer groups or the media

Nationality or ethnic background of managers, supervisors and workers

Certification to labor standard or adherence to rigorous corporate or industry labor code

Presence of management systems for internal and supply chain labor standards performance

Estimated number of sub-suppliers and sub-contractors

Percent of their business that you represent

Difficulty of replacing them as a supplier

Labor relations and legal history

From a labor standards performance standpoint, each type of supplier poses different issues and different risks. You need to have a clearly defined plan based on the risk assessment of your supply chain.

To be effective, your supply chain management system must be in sync with the realities of your operations.

For example, if you are a construction company buying materials from 12 suppliers you have to approach your supply chain and supplier relationships differently than if you are a manufacturer issuing annual purchase contracts for 1,000,000 components to 20 companies. Both of these situations are obviously different than if you are an agricultural cooperative or a hospital.

However, the labor standards principles are the same – and the underlying management system components are the same. But to be effective, the scope and implementation of your plan must be adapted to your business realities or your plan will sit on the shelf isolated from the day-to-day activities of the company.

After mapping your supply chain, the next step is to do a Risk Assessment. The Risk Assessment forms the basis of defining the scope of your program and developing an implementation plan. The Toolkit has instructions and a form for doing a Supplier Risk Assessment.



After conducting the Risk Assessment, the next step is to define the scope of your program and draft a plan. The key to an effective plan is to allocate your resources in a way that balances minimizing your risk and pushing for improvement in labor standards among your suppliers.

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Once you complete the Risk Assessment for each supplier you need to develop a plan for where to put your resources.

Depending on the number of suppliers that you have, it is unlikely that you can tackle all of them at one time. So you will need to prioritize. The scope needs to be realistic given the nature of your business or organization. You want to focus your resources in a way that mitigates your very highest risks and impacts your largest sourcing areas. You need to be aware of where you have leverage to push for labor standards and change among your suppliers. You need to establish clear criteria for how you prioritize companies.

You need to be pragmatic.

We suggest that your plan have four time frames:

- Current status (where are we now)
- Short-term priority (1-12 months)
- Mid-term expansion (2-5 years)
- Future vision (what do we want this to be in 10 years)

TIP ↓

Developing a Plan and Allocating Resources

- Balance the highest risk areas with those that represent the largest purchasing volume
- Focus on processes that are likely to use sub-contractors and that have extremely high-risk potential even if they represent a small amount of your total volume (embroidery, beading, harvesting, metal finishing, etc.)
- Focus on service providers that deal with recruiting, placing or contracting labor
- Suppliers with a rigorous, well-established labor standards policies and implementation systems get a low-priority (famous brands, international retailers, etc.)
- If you are sourcing from companies commonly targeted by activists, keep them in your short terms plans regardless of the quality of the labor standards performance system they have in place
- Give a low priority to suppliers that are members in good standing of multi-stakeholder systems or well-established industry initiatives
- Give a low priority to suppliers that are certified to a rigorous industry or labor standard
- If you source directly from manufacturers and through trading companies or importers, you must include all of these channels in your initial scope. If you do not, the importers and trading companies can become a channel for sourcing goods from suppliers with extremely poor social and environmental standards performance

Using the SAI Process-based Rating System for Suppliers & Contractors

Realistically, you cannot wake up tomorrow and announce that all suppliers need to meet PS2 immediately. So what do you do? How do you start the journey from where you are today to a supply chain that has better labor standards performance?



Use the same measure and improve approach that you use in your company. Use the SAI Process-based Rating System. Refer to the Toolkit and Section 4 - Labor Standards Performance in Your Company: Measure and Improve. This approach has several positive elements. Most importantly, it is pragmatic. It recognizes that you have to keep buying products, resources and services. It recognizes that not all of your suppliers are going to be fully compliant with PS2. It allows for you to engage with your suppliers and use your leverage to drive improvement. This is really beneficial.

Using the SAI Process-based Rating System also allows for more cooperation between your labor standards and sourcing departments. You can measure the overall labor standards performance rating of your purchasing or contracting departments. Improved, but realistic, labor standards performance targets can be set for each year.

There are some basic questions with the tiered rating approach that need to be addressed. The first issue has to do with what level is acceptable and for how long it is acceptable. For example, if you find a key supplier is a Level 1 (lowest) in labor standards performance, how long do you allow them to stay at that low level before terminating them as a supplier?

We suggest that you look at your supply chain management in terms of existing suppliers and new suppliers. With new suppliers, break it down into pre-contract and post-contract. The leverage in your relationship changes with new suppliers once a contract is signed, so we think it is useful to differentiate between the two stages.

For existing suppliers, you need to start the process of having each one rated. This can be done by having the supplier conduct a self-assessment; then have a trained member of your Internal Labor Standards Performance Team rate them too. A critical part of the process will be effectively positioning and introducing the rating system as part of a capacity building and improvement process. Make it clear to them that this is not an audit, it is a benchmark. It is to measure where they are and identify areas where they need to improve.

Improving Overall Labor Standards Performance in Your Supply Chain

Set a minimum labor standards performance rating for new suppliers and work with your existing suppliers to improve by giving them specific goals and deadlines.

Your rating can be based on reviewing audit reports, through phone calls or through factory visits. Remember, it is a process; it is not going to happen overnight. If you have 20 suppliers the job may seem manageable, but if you have 1,000 it may seem frightening. The key is to get started. It will save you time and money in the coming years.

In the beginning it is recommended that you have some independent verification of your supplier ratings. The independent rating will help you to calibrate your rating and give it more credibility.

Tell each existing suppliers how they rate. Talk to them about the areas where they did poorly. If feasible, provide them with training or toolkits to help them improve. Give them a specific target for improvement and a deadline. If they are a Level 1 now, tell them they need to reach Level 2 within 12 months. It is up to you to set the improvement targets, but for your system to have credibility you need to make the rules and enforce them.



For new suppliers, you can set a threshold to become your supplier. You can set a policy saying that a new supplier must be Level 2 prior to signing a contract or issuing a purchase order. Once the contract is signed, they would go into the pool of existing suppliers and follow those rules. Setting a minimum level for new suppliers is one way to upgrade the overall labor standards performance of your supply base. The Toolkit has instructions and forms for you to use to get started.

TIP ↓

Getting the Most Value from Using a Rating System

- **Require suppliers to implement management systems and form Internal Labor Standards Performance Teams to meet PS2**
- **Assist your suppliers to get training and technical assistance to implement management systems and form Internal Labor Standards Performance Teams**
- **Rate all suppliers to establish a baseline aggregate labor standards performance level – this should be provided to each purchasing and/or merchandising department so you can see the comparative performance level for each department**
- **Make suppliers' labor standards performance part of the performance measurement and compensation plan for relevant workers in your company**
- **Set specific targets for improving the aggregate labor standards performance level in each purchasing and/or merchandising department**
- **Provide specific timeframes with incentives to suppliers for measurably improving their labor standards performance level**
- **Conversely, provide penalties for suppliers that stay at a labor standards performance level past the established timeline**

Training Your Suppliers & Contractors

You will need to introduce your suppliers to PS2 and the supply chain requirements related to child labor and forced labor. Think of the supplier training as a primary communications channel. You need to send a clear message about the importance of labor standards performance. You need to tell suppliers about your adoption of PS2 and what it means for them. You need to establish specific goals and incentives and/or penalties.

Basic Recommended Training for Suppliers

Introduction to PS2

Management systems design and implementation for labor standards performance

Building an Internal Labor Standards Performance Team

Effective worker communication and grievance mechanisms

Managing sub-contractors

Supplier training needs vary depending on the nature of the business relationship with the supplier and the degree of risk to your company. If they are providing cement for your construction site or packaging fruit into boxes bearing your company name, they need training like they are part of your company. If you are buying stainless steel or fertilizer from large multi-nationals with a credible labor standards performance code, it is probably not an effective place to focus your supplier training.

Again, you need to focus attention on the suppliers that are the highest risk and where you have some influence.

The labor standards performance training for your suppliers can be part of the production training you provide them or part of the ongoing communication with the company. Training is one of the most important elements of supplier development. Position the training as a benefit that is only offered to key suppliers. The labor standards performance team member in your company should be

trained to provide the needed supplier training.

As we have stressed throughout, management systems are the key to ongoing performance. If you help teach your suppliers how to implement a management systems approach to labor standards performance, you will have less risk. You should also be able to spend less time and money dealing with audits and problems later. Remember, you need to position labor standards performance as an investment, not a cost. Auditing is a cost. Training is an investment.