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Richard Welford – Chairman of CSR Asia

CSR Asia and Acona have worked on a number of projects over the last 4 years, so it's great to be here today at our partnership lunch. The other reason I'm in the country this week is because we have opened a CSR Asia office in the UK, to serve the European regions. Having opened 8 offices across the Asia Pacific region, with the philosophy of giving CSR an Asian flavour, we are now trying to export that Asian flavour back to Europe, along with all the other exports that are coming this way. We're not here to compete with the local consultancies – we're here to provide services on what we know about and that is what is happening inside Asia.



Today I am going to give you an overview of some of the developments and risks and opportunities that are existing in Asia. I don't think it's too much to say that Asia is going to be the engine of recovery in the global economy. I think it's also not too far to say the recession has not really impacted on Asia terribly much. If you look at I where live, for example, in Hong Kong you'd think it was boom time not recession time. And that's certainly the case in much of China as well. One of the things we've seen, particularly in China, is a massive rebound in economic activity and a massive rebound in the manufacturing sector. I think that's the case across much of the Asia Pacific as well. That has had some major repercussions; one of the things we've seen across most of the region unbelievably is a major labour shortage. China, one of the most populous countries in the world, cannot find enough workers. At the beginning of February we had Chinese New Year where migrant workers traditionally go back to their villages for 10 days or so. The return rate to factories in China has been between 30% and 70%. So even the better factories are finding that only two thirds of their factory workers are coming back and factory owners and managers have had to find quite innovative ways to get their workers back, including for example offering them bonuses and if they bring another worker with them, doubling those bonuses.

The massive labour shortage that we are experiencing across the whole of the Asia region has also led to another set of challenges. If I go to factories in the southern part of China I will find a lot of Vietnamese workers. If I go to factories in Vietnam I will find workers from Cambodia and Laos. If I go to plantations in Malaysia I will find workers from Indonesia. If I go to food processing plants in Thailand I will find workers from Myanmar – many of whom are refugees from Myanmar. One of the things that link all of those workers together is that a large proportion of those migrant workers have actually crossed borders illegally. So we have a whole new wave of illegal migrant workers which could well be in your supply chain. In many cases the situation is worse, in many cases we know that some of those illegal migrant workers have been trafficked across borders. And so we now have people who are working in factories, in plantations and in fish processing plants who are victims of human trafficking – which is of course a major human rights abuse.

Talking about human rights abuses, there's no doubt at all that child labour is on the increase, and we have significant evidence for that. This child labour has taken on a whole new form, so what you'll find in places like China is children working as "work experience" or on short term "apprenticeships" or "sabbaticals" from school, or children working in the evenings after school. In fact we have evidence to demonstrate that some teachers are actually being paid fees to encourage their children to work after school and to work during school holidays. I

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think that poses a huge risk to your supply chain. Most of you who have supply chains, I don't doubt, have your Codes of Conduct, specifying exactly what is expected of the factories that source your products. Most of us will recognise that Codes of Conduct are necessary but not sufficient to ensure that standards and human rights are protected. We know that many factories cheat, we know that when you audit factories, out comes the protective equipment, the whole place is cleaned up, the hot water is switched on in the dormitories and as soon as the auditors leave, the protective equipment goes back into the box and the hot water's switched off. And so for a long time, as you are aware, there have been concerns about whether auditing and factory inspections have actually been working. Well I want to tell you that things have just got a whole lot worse, because we have significant evidence now to demonstrate that not only are factories cheating, but so are auditors. We know that many auditors are actually asking for bribes from factories in order to pass audits. We had evidence of that last year from third party auditors; we have evidence this year from auditors within the big brands themselves. Auditors who are going to factories and saying, "you'll pass this audit if you give me a bribe". That bribe is commonly about 20,000 RMB, which is about \$3,000. So for \$3,000 they'll pass their factory audit, which allows them to keep their brand as a customer.

I think that is a huge challenge and that is leading to many big brands, along with ourselves, looking at going "beyond the audit", which is not working in some cases. What we've been working on over the last four years is "capacity building". Trying to get factories themselves to recognise that Corporate Social Responsibility is good for them and not simply cheating their way to try and pass the audit tests. There is a trend now from some of the big brands to say we don't want to be the policeman anymore. What we want to do is move away from this policeman mentality towards being social workers. We want to help factories recognise that CSR is important and help those first tier factories and other suppliers push this down their own supply chains as well.

I think this is the challenge. If we look back over the last 4 years at the various product scandals we've had; toys, fake foods and fake drugs, one of the things that we realise is that most of the risks to brands are actually much further down the supply chain. There is a challenge about how far do you need to go, is auditing the first tier of suppliers what we should be doing? I would argue that is no longer sufficient. If you're worried about social responsibility and product security, then your strategy needs to start focusing much more down your supply chain. The further you go down those supply chains the more those risks become apparent. It is often in the primary sector, associated with things like forestry, plantations, agriculture and fishing where you will find human rights abuses.

Looking towards the future, we have started seeing 3 emerging trends.

The first trend and something we already have evidence for is illegal subcontracting. Where factories take orders and subcontract them out to home workers who do not have the same level of protection, both legally and from a health and safety perspective. This is a big risk area, something that is going to threaten your brand reputation, if you don't get it under control.

The second trend that people are talking a lot about now in the Asia Pacific region is climate change. Much of that area is going to be severely impacted by climate change. Every year, for our Strategic Partners, we undertake a piece of research that we call "CSR in 10", which maps out the 10 hot topics that will emerge in the CSR arena in the next 10 years. For the last three years now, our research shows that the main concern is climate change. Places like the Philippines, Hong Kong and most of southern China are on typhoon tracks, where typhoons

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have been getting more frequent and stronger. Places like Vietnam and Bangladesh are already being impacted by sea level rises. And if you've been in Vanuatu this week you'll have felt the effects of both freak weather and sea level rise.

The third big challenge we are going to experience is water. China last year became a water deficit country; it does not have enough water for its own needs. It is highly dependent now on importing water from places like Mongolia. One of our big clients in southern China last year had to actually close down one of their power stations because they could not get enough water for their cooling towers, which in turn of course created an energy shortage, in the locality of the power station, creating black outs for people and for businesses. We've been doing a lot of research around the areas of climate change mitigation and adaptation and what we're hearing from the private sector is a great deal of concern about business continuity, business planning and business resilience. People are saying things like when, and it is "when" a super typhoon smacks into southern China, where are we going to get our t-shirts from? How are we going to do business with places that become inundated with flood water? So there's a great deal of risk associated with changing weather patterns and climate change that we are beginning to see.

Another thing to bear in mind is that although parts of the Asia Pacific are booming, other parts of the Asia Pacific are very poor. Although we've taken a lot of people out of poverty over the last few decades because of massive inward investment, there are still a lot of people who are still in poverty. One of the things we're seeing in this area is a lot of business now reorienting their philanthropy and their community investment strategies towards things like poverty alleviation. Something that's really buzzing in the Asia Pacific region at the moment is a new emphasis on social business, social enterprise and social entrepreneurship. Looking at models where we can look at big business to start helping small business, to develop and thrive and be sustainable.

My conclusion is that all these issues pose a great deal of risk but they also pose a great deal of opportunity, to help you develop social businesses and to help people and communities to adapt to climate change. One of the biggest risks goes back to this supply chain issue. If you, like some of the brands, can start thinking carefully about what's next for your supply chain, how are we going to ensure that your supply chain is not subject to human rights risks, how are we going to push our projects down supply chains and start looking at things like traceability issues, then there are great opportunities for you to do that.

Simon Hodgson – Managing Director of Acona

Thank you Richard for your view 'from Asia'. I'm now going to give you the view from the UK.

I'm going to cover three practical trends – three things that we're observing in companies based here in the UK, that relate to the supply chain. Then I'll move onto two or three more philosophical points to start our debate. The points are about the limits to our responsibility and the root causes to some of the issues.

The first trend and something that is very obvious to us is that 'capacity' and 'capability' are moving East. In a lot of the companies we are dealing with there is a big flow East into Asia of expertise and capacity. The simple model is expats – people moving from here to there, to begin building ethical teams in buying and sourcing offices. Very quickly that's being supplemented by the growth of Asian experts and I was quite amused



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to hear Richard describe Acona as the 'local' consultancy, that just shows the way the world is changing. In fact, we've had the experience over the last 5 months of doing a lot of training and a lot of work with major western brands working in Asia and the people we are training now – the room – is half Asian and half Western. That's an immediate and visible distinction to me that the balance of power and knowledge is shifting east.

Now that has a couple of implications, firstly, it makes it very important that we've got our thinking straight here, because we are no longer a 'developed' world, educating a 'developing' world on how they should be running their business. If that's your philosophy when you stand up in front of a room like that you're going to feel embarrassed pretty quickly. It's now about a true partnership between companies in one country and companies in another country – trying to work together to resolve the subtle and intractable issues of sustainability. And this moves us immediately past this Audit/Code framework – the "just do what we say, cause we say it".

The second implication we're seeing is increasingly the Asian offices – the sourcing offices, the ethical teams in Asia – they are running the day to day part of the compliance programme. So they are running the audits, they are running the corrective action plans and they are following through on that in Asia. The question is, what does that leave the teams in the UK to do? I think the teams in the UK are changing their role – so instead of running the mechanics of an ethical trading programme, they are beginning to look at the bigger policy questions and trying to develop longer term partnerships and trying to develop strategic responses to things in a way they weren't doing previously.

The second trend is about the integration between the ethical trade part of a business and the mainstream commercial part of a business. We wrote some years ago a report with Insight Investment, a report we called "Buying your way into trouble". This was at Insight's request. They said, we have a suspicion that what western brands are doing is sending an ethical trading team into a factory and saying we want you to give people long term contracts, and we want you to give decent wages and we want you to make sure people aren't working overtime. And then the next day, the buyers are going into that same supplier and saying we need to reduce the buying margin, we need to shorten the lead time and we need more flexibility in the contract. Insight questioned whether these two sides weren't fighting each other to some degree.

So Acona did a big piece of research with many companies, some of which are in the room today. What we found wasn't so much a conflict between the two – but we found that many of the issues that led to, what you might call, 'ethical' implications had common cause with commercial failings. So, there were problems in the way that companies specified, managed critical paths and set contracts up and took a short term view with suppliers and those were all making it hard for the suppliers to meet the ethical standards required. They also meant that the commercial relationship wasn't optimised.

That was 4 years ago. Since then the ETI has set up its "Purchasing Practices" group to begin to look at this and a few brave companies have begun to explore it. But it's been just in the last 6 months that we've seen a real getting to grips with this problem. It's by no means common but in many of the companies we are dealing with, we are beginning to see interest and engagement from the commercial buying teams, in these root cause questions. How can we solve these problems at source? It is early days, but we are seeing a lot of buyer training and we are seeing some interesting case studies and examples coming out of companies now. I think there is a new generation of buyers – some of the "hard bitten old hands" still believe in thumbscrews – but there is a new generation of buyers who are beginning to look for more

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creative “win/win” solutions. And I think as costs and wages rise in Asia, as they are inevitably going to do – this is a part of the world where billions of people are wanting to improve their living standards, as we’ve improved our living standards – as those costs and wages rise, we’re going to have to find cleverer ways of taking cost out of the supply chain. The current retail negotiation model – and I’m simplifying – but it can often lead to “pass the parcel” with costs i.e. we will reduce the cost here and the supplier will carry it. Actually if you look at very sophisticated supply chains, like electronics and automotive manufacturing where margins have been tight for many years, suppliers and buyers have worked together to find quite clever ways of taking the cost out altogether, which means that both parties can share the benefit. So I see the beginnings of integration between mainstream buying and ethical trade.

The third trend is a growing interest from what we might call B2B businesses. So, this whole topic started with consumer goods, things that consumers wanted, like a pair of trainers and they didn’t want to think that they had been made in a sweat shop. And that means that the consumer goods and retail sectors have a 10 to 15 year start here. But we are seeing increasing interest from companies who just have big supply chains where the goods are not going straight onto the customers. There are quite a few publishers in the room and I know there’s a lot of work being done to look at paper sourcing. We’re also seeing requests from pharmaceutical companies and finance companies, beginning to want to tackle their supply chains, saying what should we do? They’re saying “we appreciate we have some responsibility, how do we discharge it?” Now there are still many of those companies who are in the early days of their journey – they are still labouring away with questionnaires, they are still trying to “boil the ocean” and look at thousands of suppliers all at once, they’re still not quite clear what they do once they have all the information – but they are catching up very fast and I think we want them to learn from the FMCG/retailer models; what’s worked and what hasn’t? I’m already seeing an appetite for a B2B SEDEX, somewhere people can begin to share this kind of information and move quickly to having an understanding.

So those are the three trends, let me move on now to some more open ended questions to start the debate.

The first thing I want to talk about is root causes, because what we’ve learnt from doing 10 years or more of the cycle of ‘standard setting - auditing - corrective action plans’, is that solving problems in factories is very hard. Corrective actions can remain open for months or even years – we just don’t get them cleared away. Or, if you put too much pressure on, you just drive them underground in the way Richard was talking about. So solving these things is difficult and in many parts of the world and in many of the sectors that we are dealing with, it’s probably true to say that there isn’t a single factory we could choose that would meet all of the agreed UN/ILO/ETI sorts of standards. We’re picking from what we’ve got. There is some progress from the corrective action plan model and it can solve some things. And we’re already beginning to see some leading companies go beyond audit, with Capacity Building, recognising another angle on the problem. But we still think that much more attention needs to be paid to the question of root cause. Why are these problems there in the factory in the first place? And until we really deconstruct it and get under the skin of it, we think it’s always going to be difficult to solve them. Why is this problem in the factory? Is it just inertia? No-one’s got round to solving it? Is it a lack of knowledge, they don’t know how to solve it? Is it a conflict (back to the purchasing practices question)? Is it a lack of capital? Is it a cost issue in the end? Or is there some wider systemic social issue? Until we tease these apart, we think we’ll be banging our heads on a brick wall trying to solve them.

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We've seen some good examples of people trying to do that recently, assign root causes, and it's a hot topic in the world of international development. We think there's an opportunity here for companies to begin to do the same – because once you've got the idea of root cause you realise that issues don't all take the same solution. So if the problem is one of inertia, then we can do corrective action plans. But if the problem is more subtle we can't solve it like that. We need to find a way of solving it locally, with people on the ground, changing maybe the culture of a whole industry, working within some kind of local context.

Only by understanding the root causes can we begin to develop the solutions. And we know that in the hard to treat issues, like wages and living standards, in large parts of the world we are not meeting the standards set out in most of our Codes. If we're serious about trying to change that we're going to need a different solution. Understanding the root causes gives us the best chance.

My final point is, "Should we?" What is the limit to our responsibility? Should we try and take ownership for all of these issues? Is it our job to try and fix them? Or is there a concept of bounded responsibility in our supply chains: "we should discharge our responsibility so far, but no further"? At the moment, we're held accountable for everything, so when a problem is found in one of our supplier factories we have to act. Do we need to have a more nuanced set of conversations about what we can and can't do?

Now this might be seen as a bit of wriggling to get us off the hook. But I think there is a wider sustainability angle to this – the best long term solution for the countries, sectors and industries we're talking about is well developed, local/national regulation, enforced properly through capable, local regulators. There's an argument that every time we try and solve the problem unilaterally we're taking the legs out from that local solution. So, do we have a role to build the capacity of the regulator and regulations in the countries we are dealing with?

I should say that I don't think it's yet a big issue in retail supply chains, because I don't think yet we have the clout, but I think there are examples in the extractive industries where this has happened. Where major multinationals working in different parts of the world have come under pressure to solve social problems and have kind of unilaterally solved them by becoming the police force, the court system and the development company all at once. It may solve the problem locally, but I think it further undermines, you could argue, the fragile governments in the countries that really ought to be solving those problems. So the question I want to leave us with is, is there a limit to our responsibility? Should we try and solve everything? Or, should we be having a much more grown up discussion about what we can do, what we are reasonably going to try to do and what we can't do?