

## ESG Keys

### Supply-chains in an age of hyper-transparency

#### Equities

Global  
Global Sustainability

#### Apparel supply chains expert call

We hosted a call with Sean Ansett of At Stake Advisors. Sean is a former executive director of the Bangladesh Safety Accord, and has over 15 years of experience in sustainability. He has held senior positions as Director of Corporate Responsibility at Burberry and Director of Global Partnership at Gap Inc. The following note contains the transcript and our take-aways from the call.

#### Owning the story in an age of hyper-transparency

Technological trends suggest that we are entering an age of hyper-transparency. Social media is increasing consumers' awareness of working conditions in global supply chains, and this is likely to pick-up pace. Most customers will not pay a premium for sustainability, but brands need to manage downside risks to their reputation. If apparel executives do not want to risk losing control over their message, Sean believes that they should be asking themselves: Do we own the story behind our products? Are we proud of that story?

#### Fixing supply chains issues will not be easy

Despite significant investment since the 1990s to address human rights issues in apparel supply chains, there is still significant progress to be made. Social audits have improved basic health and safety to some degree, and child labor in the first tier of suppliers is no longer an issue. But Sean sees little progress in fixing issues around non-discrimination, freedom of association, excessive working hours and low wages, especially beyond the first tier of suppliers. Over time, brands are realizing that they cannot do this alone and need to collaborate.

#### Cost of compliance vs. productivity gains

We believe that there are limited incentives for retailers to lead the front on sustainability. Sean argues that beyond the question of compliance and reputational risk, there are efficiency gains to be made in the apparel industry through the improvement of labour standards. To raise productivity one needs for example strong communication between management and workers in order to build trust.

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# Key take-aways

## Social media drives consumer awareness

We are likely to enter an age of hyper-transparency. The availability of smartphones, access to internet and the social media will likely empower workers and communities. This in turn is likely to increase consumers' awareness of supply chain issues. While those technological trends are positive for transparency and accountability, there is a risk for retailers to lose control of the message they want to send to consumers. In this context, key questions for retail and apparel executives become: what is the story behind our product? Are we proud of that story? Do we own the story or do others own it for us?

**Owning the story becomes more important**

## Customers are not yet driving change

Sean is yet to see a peer-reviewed academic study showing that consumers will pay more for good labour standards in the apparel sector. It is clear to us that customers are not yet driving change in the supply chain through changing demand patterns. Therefore change is being driven from the supply-side and this will likely be done if it is not detrimental to the relative price position of the retailer. In our view, customers will choose the more sustainable option all else being equal (e.g. organic cotton) but will not yet pay a premium for it. In the short-term, there is a risk to retailers of inadequate supply chain auditing that could entail brand risk but limited incentive to take further steps to lead the pack on sustainability.

**Limited incentives for retailers to lead the way on sustainability**

## Fixing supply chains will not be easy

Academic studies have highlighted the limited effectiveness of code implementation and social auditing<sup>1</sup>. Studies looking at the first tier supply chains in the garment industry generally agree that basic health and safety has improved to some degree and the extreme forms of child labor at the first tier is no longer an issue. But many other issues related to workers' conditions, wages and hours are still to be effectively tackled.

Despite limited progress, there are a number of encouraging trends including:

- Multi-stakeholder initiatives like the FLA or the ETI in the UK. This has produced some positive outcomes such as U.K. legislation protecting vulnerable workers and increased engagement with local NGOs and trade unions in developing countries.
- In June 2011, United Nations Human Rights Council unanimously endorsed the U.N. guiding principles. And the principles enjoy wide support from business, civil society and government. The guiding principles can play an important role in framing responsibility, boundaries and roles and setting expectations for business. It has started conversations internally and allows for human rights language to enter the business community.

**Multi-stakeholder initiatives had some positive outcomes**

**UN guiding principles help the business conversation on human rights**

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<sup>1</sup> See for example: Anner, Bair and Blasi, toward joint liability in global supply chains: Addressing the root causes of labor violations in international subcontracting networks' comparative labor law and Policy Journal, 2013

- The next most crucial step will likely have to deal with purchasing practices and business integration. Any solution to supply chain human rights issues will be multifaceted and require brands to assess how their own purchasing practices may be a part of the problem and impact the factory floor, the farm, or the mine.

**Purchasing practices are the next step**

## Some inefficiencies in the garment industry

Focussing on productivity, not on the cost of compliance, may be one path to fixing some of the supply chains issues in the apparel industry.

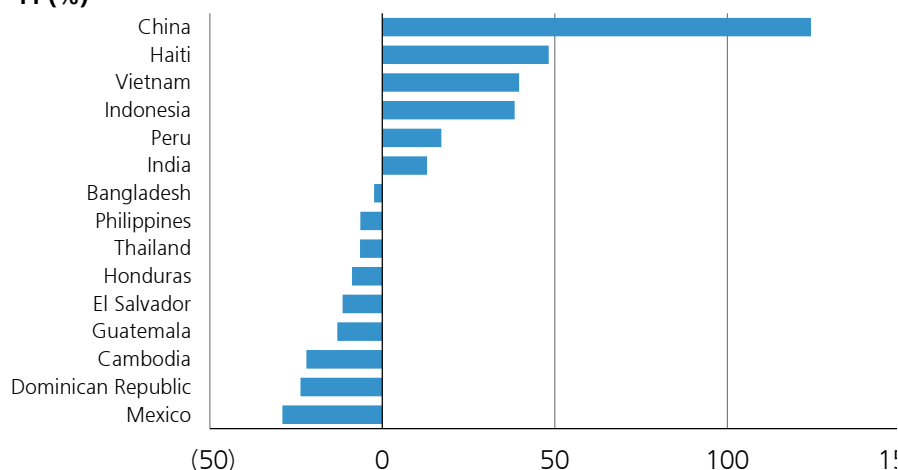
- Direct labour costs are a relatively small proportion of cost of goods sold in the apparel industry (a 2010 note from UBS retail team estimated those costs at around c20% of total COGS for European retailers, although there are the indirect labour costs incurred in picking crops, creating fabrics, as well as transport<sup>2</sup>). There is some evidence that in several textile exporting countries, garment workers' wages have been falling in real terms. A study from the labor right consortium, a university-led labor-rights monitoring organization, found a mixed picture in terms of garment workers wage inflation, with real wages declining in 9 of the top 15 exporters to the US (please see chart below).
- Reducing reputation risks vs. the cost of compliance are not the entire equation. In Sean's experience, a majority of factories have inefficiencies and there is room for productivity improvements. One way to achieve those efficiency gains is through better communication between management and workers, and oftentimes where a lot of the issues happen are at that worker/supervisor level. In one case in China, for example, Sean saw productivity jumps of 10 to 15 percent in a factory, but also reduction in working hours of about the same amount and wages going up 7/8%.

**Real wages seem to have been falling in some countries for garment workers**

**Wages are not necessarily a zero-sum game**

**Figure 1: Real wage trends in the garment industry show a mixed picture**

**% change in garment workers monthly real wage between 2001-11 (%)**



Source: Global wage trends for apparel workers, 2001-11, Workers rights consortium, 2013

<sup>2</sup> UBS Investment Research European Retail, 11 November 2010, Adam Cochrane

# Supply chains conf call transcript

**Hubert Jeaneau:** Hi everybody and welcome to this call on supply chain risks. I am Hubert Jeaneau from the ESG team at UBS and I'm really pleased to introduce our speaker today, Sean Ansett from At Stake Advisors. Sean has over 15 years' experience in sustainability and he's currently providing strategic advice to corporations, social enterprises, UN agencies and nonprofits through his consultancy. He was recently executive director of the Bangladesh Safety Accord and he's currently Chief Sustainability Officer at Fairphone. He previously held senior positions as director of corporate responsibility at Burberry and director of global partnership at GAP. Thank you Sean for participating to this call - We are really looking forward to your insight on the current challenges faced by retailers on sourcing but also to understand the potential opportunities of making sustainability fashionable.

**Sean Ansett:** Well thanks again for the invitation. And really what I wanted to share today are some of my reflections over the course of the last 16 years working primarily on labor and human rights issues in supply chains. I'm also happy to talk about environmental issues, although my focus will primarily be on the labor and human rights aspects.

As you're all aware, supply chain human rights issues continue to make the headlines. Even in industries like apparel it seems we are far from solutions, despite significant investments to address systematic supply chain human rights issues since the 1990s.

Technological trends suggest that the next several years will enter an age of hyper transparency both in the upstream and downstream supply chain with lower cost technologies including smart phones creating new communication platforms for workers and communities in the global south. This brave new world is empowering to some stakeholders and creates much needed transparency and thus accountability. However, it may be of concern to others. New engagement processes will be required as information loops exponentially picks up pace and brands, retailers lose control of their message and engagement strategies.

In response to this evolution, every corporate retail or apparel executives should be asking themselves the following questions – what is the story behind our product or service? Are we proud of that story? Would my customers be proud of that story? And do we own the story or do others own it for us?

Addressing supply chain human rights issues is not easy, and in fairness, there is still a number of companies who are free riders in the industry and invest little or nothing in ethical trade. However, there's much to be learned from mistakes of the past and the opportunities to leverage that learning. The industry's approach to addressing these issues has come in a number of acts and what may be seen as an evolving play.

With each act comes learning about what has not worked and understanding for how the script should be developed. Companies need to keep evolving along with this unfolding narrative. So back in the 1990s, we started with codes and auditing which you're all familiar with. And brands have been auditing really as a cat and mouse game for the past 15 or more years.

Let's recall that way back in 1991, Levis was the first company to establish their comprehensive global sourcing and operating guidelines. While these efforts were

**We are entering an age of hyper-transparency**

**Addressing supply chain issues is not easy**

welcome, their impact on the factory floor, farms, mines, of global supply chains has largely been ineffective and this is validated now by numerous academic peer reviewed studies and has created great duplication.

These studies have highlighted the limited effectiveness of code implementation and social auditing. Those studies looking at the first tier supply chains in this example in the garment industry generally agree that basic health and safety has improved to some degree and the extreme forms of child labor at the first tier is no longer an issue.

Sadly however, very little progress has been achieved on issues like this nondiscrimination, freedom of association and collective bargaining, excessive working hours and wages. And again, this is only at the first tier. First tier for example for an apparel company or a garment manufacturer would be the cut and sew process where the fabric is cut into clothing or an electronics industry for example where components are assembled to make a smart phone.

And in some cases, working conditions may have actually worsened over time. Bangladesh is a case in point, there are over 4500 garment producing factories that employ 3.5 million quite predominantly young female workers and where most major brands source product attracted by the low labor costs.

You're all familiar with the Rana Plaza tragedy – over a thousand lives were lost there – and before that there was over 600 worker deaths related to fire and structural collapse just seven years before. So this is not a new issue in Bangladesh. And auditors were tripping over each other on the factory floors and were unable to identify in my opinion basic fire and structural safety issues.

There have been attempts to improve ethical trade practice including additional skills training for social auditors, codes of conduct alignment amongst the brands and retailers, and some at times formal and informal sharing of audits to reduce audit fatigue and free up resources for other interventions. However, the harsh reality is, they are all dependent upon largely a broken monitoring system.

So to investors, I would say you should really question the data you're receiving from some of these auditing practices. Over time, brands realized they could not do this alone and that they needed to collaborate in order to drive scalable, effective change to complex and seemingly intractable challenges. There's a need for new approaches including collaboration engagement.

As you're aware, there was a rise in multi-stakeholder initiatives. You could say the ethical trading initiative in U.K. or (FAI) or the Fair Labor Association in the US with an intent to leverage the expertise and experience and resources of multiple actors. This has produced some positive outcomes such as U.K. legislation protecting vulnerable workers and increased engagement with local NGOs and trade unions in developing countries.

However, the jury is still out on the cumulative impact that these initiatives have had and will have in the coming years. Brands also learned that training at the supplier level was important. And brands either independently or in partnership with other stakeholders has launched a series of training programs in various areas including worker rights, responsibilities, labor law, health and safety, management systems development, supervisory skills training, worker and management dialog and productivity enhancements.

**Improvements in health and safety, but limited effectiveness of social auditing**

**Over time, brands realized they could not do it alone**

**Positive impact from the Ethical trading initiative and the fair labor association**

While these trainings do target key needs in suppliers, we have largely failed to reach scale and sustain themselves over time. Like the code fatigue mentioned earlier, the industry is beginning to face training fatigue with multiple and duplicate training programs targeting the same supplier. And rarely do you see any impact measurements on what was actually learned or achieved, as you know as investors oftentimes corporate responsibility reports mention the number of trainings delivered perhaps to the number of supervisors or workers, but rarely do you see any sort of impact metrics on what was actually learned and even more rare is to see what's changed over the course of a year, two years, five years or beyond.

Then there is a phase and I think this is still an emerging area, and what I like to call responsible lobbying. And there are tremendous opportunities for brands and retailers to engage collectively with governments and other international organizations on their expectations related to labor and human rights. As they have a shared interest in a level playing field, rule of law, remedy processes, and developing competent and resources labor inspectorates, then the brands really shouldn't be in the business of monitoring factories. That's the role of government and other institutions.

But unfortunately, due to lack of resource capacity and in some cases corruption, they're been very ineffective in many countries around the world. Many governments feel if they enforce their labor and environmental laws that retailers and brands will leave due to the increase cost of compliance. Yet price is not the only consideration in sourcing decisions.

Brands and retailers also factor into the equation supply chain stability, good infrastructure, quality skills, customer service and innovation. Some brands have taken the step of making clear that they welcome the effective enforcement of labor environmental standards, as this provides greater predictability and less risk for their business. We'll also see different lobbying platforms. If you recall Nike some years ago in China, left their traditional lobby, the US Chamber of Commerce and supported improved labor standards in China, and there are other examples like that.

However, while there has been some admirable one-off efforts to develop responsible lobby platforms, they've generally not gained traction. I think two examples are quite positive. In Mexico with Maquiladora, the Solidarity Network, a Canadian NGO worked collectively with global brands to pressure Mexican state governors to intervene and protect human rights leading to positive outcomes for those affected and this was particularly the case where labor advocacy groups were imprisoned and their freedom of speech was hindered and through joint efforts by NGOs and brands, these leaders were released from prison.

And also the Uzbek Cotton Coalition which is made up of NGOs, responsible investors, and trade unions have been collectively lobbying the Uzbek government and the International Labor Organization to intervene and put an end to the practice of forced child labor in the Uzbek cotton fields. Brands can play an important role in sending a clear, unified message to national governments about their concerns regarding human rights protection, leveraging the role they play in providing employment opportunities and economic development.

Now moving forward, a positive development that defines responsibility of brands and suppliers in relation to human rights including the United Nations guiding principles on business on human rights. In June 2011, United Nations Human

Rights Council unanimously endorsed the U.N. guiding principles. And the principles enjoy wide support from business, civil society and government.

The principles outline the corporate responsibility to respect human rights. In order to meet their responsibility to respect human rights, business enterprises should have in place policies and processes appropriate to their size and circumstances, including a policy to meet the responsibility to respect human rights, human rights due diligence process to identify, prevent, mitigate, and account for how they address their impacts on human rights and the process to enable the remediation of any adverse human rights impacts they cause or to which they contribute.

The guiding principles can play an important role in reducing this duplication, framing responsibility boundaries and roles and setting expectations for business. And I must say that even in the last couple of years, it has started a conversation internally and allows for human rights language to enter the business community, which I think is a positive step forward.

I think the next step and probably the most crucial step is purchasing practices and business integration. Any solution of supply chain human rights issues will be multifaceted and require brands to look into the mirror to assess how their own purchasing practices may be a part of the problem and impact the factory floor, the farm, or the mine.

**Purchasing practices and business integration are a most crucial next step**

The guiding principles require that a company looks at how their own activities may contribute to human rights impacts through their business relationships as a part of their responsibility to respect human rights. Brands and retailers should therefore determine if their own purchasing practices are undermining the monitoring efforts of their internal compliance teams or their external auditors.

If you consider making a deep dive assessment of their product pricing, supplier capacity, this is really important, a supplier is rarely going to say no to orders. If you – but if you don't know the supplier capacity, oftentimes your product will end up outside of the factory into another supplier that you have never visited and oftentimes these are the big stories we hear about in the media, forced labor, child labor and the like.

Also looking at product lead times, how much time are you allowing the supplier to complete a product? How many changes are you making to a product? So oftentimes a merchant will ask, let's just say for example a two-button pink polo shirt and then three days later change the order to a one-button purple polo shirt but not change the ship date on the product. Obviously that can lead to excessive overtime and also your product ending out the backdoor.

Some critical path management is important to determine the ways to improve and take unnecessary pressure off suppliers and the workers they employ. There are no silver bullets, but there are some practical steps that be taken to address the pressures that underline purchasing practices.

Developing longer term trust base relationships between retailers and supplier that send a signal to suppliers that the brand or retailers investing in them and will be around next season. Developing financial incentives for suppliers and rewarding them for transparency and compliance. Appropriate product pricing, retailers should set product pricing that a factory can realistically need without subcontracting and have the technical capacity to question when pricing is too good to be true.

Launching new communications technologies that use mobile phone, text and voice messaging to enable workers, NGOs, trade unions and communities to alert retailers and others to unauthorized subcontracting and other abuses, also a great way to test sentiment of workers.

Improve systems to measure supplier production capacity, recalibrating buyer performance evaluations. So the buyers and their own internal performance evaluations, to include labor standards performance and not just the traditional metrics for quality, price, and speed of delivery. And so apparel brands and retailers take responsibility for their own purchasing practices, monitoring and auditing will continue to be a cat and mouse game with little or no positive impact and a great deal of wasted resources.

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