

**Shift**

*Putting Principles into Practice*



# From Audit to Innovation: Advancing Human Rights in Global Supply Chains

August 2013

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## Shift

Shift is an independent, non-profit center for business and human rights practice. It is staffed by a team that was centrally involved in shaping and writing the UN Guiding Principles on Business and Human Rights, and is chaired by the author of the Guiding Principles, Professor John Ruggie.

Shift provides the expert knowledge and guidance for businesses and governments to put the UN Guiding Principles into practice. Based on lessons from this work, Shift develops public guidance materials to support improved practices for the respect and protection of human rights globally.

Further information on Shift and its work is available at [www.shiftproject.org](http://www.shiftproject.org) or at the following contact details:

Shift

1330 Avenue of the Americas, Suite 23A

New York, NY 10019

USA

email: [info@shiftproject.org](mailto:info@shiftproject.org)

## Acknowledgements

The research for this report was made possible through a generous grant from the Human Rights and Democracy Fund of the United Kingdom's Foreign and Commonwealth Office. Shift would also like to acknowledge the contributions of George Hodge, who served as a principal researcher on this project. In addition, Shift would like to thank the companies and individuals that participated in this research, as well as the Global Social Compliance Programme (GSCP) for its stimulus and support for this project including its assistance in facilitating interviews with member companies.



# Table of Contents

<b>I. Executive Summary.....</b>	<b>3</b>
<b>II. Introduction and Overview.....</b>	<b>5</b>
<b>III. A Spectrum of Approaches.....</b>	<b>8</b>
<b>Case Study A: From Policeman to Partner: Timberland's Shift from Compliance Auditing to Supplier Sustainability.....</b>	<b>22</b>
<b>Case Study B: Chiquita's Passion Fruit Supply in Costa Rica: Combining Commercial Incentives with Social Standards.....</b>	<b>34</b>
<b>Case Study C: Empowering Local Counterparts: Tesco's Support for Locally-Driven Social Compliance Initiatives.....</b>	<b>42</b>
<b>Case Study D: Partnering for Success: HP's Multilateral Approach to Systemic Challenges in its Supply Chain.....</b>	<b>49</b>

# I. Executive Summary

Over the last several decades, global companies have increasingly recognized their roles and responsibilities in addressing social impacts and labor conditions within their supply chains – a responsibility reaffirmed by the UN Guiding Principles on Business and Human Rights.

As awareness of this responsibility has increased, so too has a recognition of the limitations of the conventional approach to tackling these issues – social compliance auditing. Despite the hundreds of thousands of social compliance audits conducted each year to ensure minimum workplace conditions in companies' supply chains, there is little evidence that they alone have led to sustained improvements in many social performance issues, such as working hours, overtime, wage levels and freedom of association..

## ***Managing Social Performance in Supply Chains:***

*As awareness of the responsibility to address social impacts in supply chains has increased, so too has recognition of the limitations of traditional social compliance auditing.*

There are many reasons why the traditional audit paradigm has struggled to produce sustainable improvements in these and other key areas of social performance, with each of the following playing their respective roles:

- A **lack of disclosure** by suppliers of accurate information on their performance during some audit processes, calling into question the value and validity of information gathered;
- A **lack of capacity** among suppliers to address issues that have been identified for remediation in a sustainable way;
- A **lack of perceived incentives** among suppliers, both external and internal, to address social performance issues, and a corresponding lack of commitment to invest in sustainable improvements;
- **Systemic challenges** that are beyond the control of individual suppliers, including social context, regulatory environments, and industry-wide issues;
- The **purchasing practices** of global brands and retailers, and a need to recognize and improve upon the role they themselves may play in contributing to impacts on workers.

These issues are no secret to global brands and retailers, many of whom have grown increasingly frustrated with the limitations of the traditional audit paradigm. In the absence of clear alternatives, many companies

continue to base their due diligence and remediation solely on an audit approach that they privately acknowledge is not producing sustainable results.

However, a number of leading brands and retailers are attempting to change the conversation. They are openly acknowledging what everyone knows – that audits alone have not produced sustainable change. Instead they are asking – themselves, their industries, their suppliers, and other stakeholders – what to do

about it. They have a growing body of individual and collective experience with alternative and supplementary approaches to addressing social performance issues in their supply chains – approaches which seek to recast their relationships with suppliers, from 'policemen' to 'partners'.

*The traditional compliance audit paradigm no longer reflects the reality for leading global brands and retailers, who are innovating in their approaches to social compliance in their supply chains.*

This research, undertaken by Shift in collaboration with the Global Social Compliance Programme (GSCP), is based on conversations with leading companies, industry experts, and - for the four case studies presented - suppliers and other stakeholders. The first part of the report begins by identifying 10 leading trends and elements that form this new generation of social compliance programs for supply chains:

- 1) The shift from pass/fail compliance to **comprehensive continuous improvement programs**;
- 2) Replacing audits with **collaborative assessment** and root cause analysis;
- 3) The role of **grievance mechanisms** in improving social performance;
- 4) The integration of **capacity-building** approaches for suppliers;
- 5) Different forms of partnerships between global brand companies and **civil society organizations**;
- 6) Providing **commercial incentives** to suppliers for improvements in social performance, such as price, volume, duration, and supplier preference;
- 7) Developing **metrics** to help suppliers identify the business case for better social performance;
- 8) Efforts by brands to use their **leverage** to address systemic issues;
- 9) **Industry-wide collaboration** to tackle systemic issues; and
- 10) **Aligning internal purchasing practices** with social commitments made by global brands and retailers.

In the second part of the report, we highlight four company case experiences in more depth, whose approaches combine many of the elements identified above to address complex social performance challenges in supply chains:

- a) **Timberland's** approach to collaborative assessment, which has transformed its relationship with suppliers globally (p. 22);
- b) **Chiquita's** holistic approach to its passion fruit supply chain in Costa Rica, which combines commercial incentives and innovations, capacity-building, civil society partnerships, and adherence to social and environmental standards and practices (p. 34);
- c) **Tesco's** approach to promoting sustainable improvements in addressing issues within its agricultural supply chain in South Africa, premised on the support of local initiatives driven by local actors (p. 42);
- d) **HP's** multilateral approaches to a range of systemic challenges in different parts of its IT supply chain, through which it collaborates with industry, civil society, and government actors to address industry-wide issues (p. 49).

This report does not attempt to imply that any company has the best model for, nor a perfect record in, addressing supply chain human rights challenges. Nor did the research seek to rigorously test the models discussed. Rather, it explores innovative models used by leading companies, who themselves report their effectiveness, as a basis for further analysis and evaluation.

## II. Introduction and Overview

**Increased Attention to Social Impacts in Supply Chains:** Leading brands and retailers have, for several decades now, recognized the need to address adverse social and labor conditions within their supply chains. Many have been motivated by a sense of reputational risk, while others have approached the issue from the perspective of sustainability of their supply chains. Still others have addressed these issues simply out of a sense that it was the right thing to do.

The global convergence around the UN Guiding Principles on Business and Human Rights has reaffirmed that companies have a responsibility not only to avoid causing or contributing to adverse impacts, but also to seek to prevent or mitigate impacts that are linked to their operations, products or services by their business relationships, including their supply chains.<sup>1</sup>

**The Limitations of the Traditional Audit Paradigm:** This increased awareness and heightened attention has arrived at a time when the predominant approach to managing these issues – social compliance auditing – is coming under increased scrutiny. Despite many years of experience and hundreds of thousands of social compliance audits, global businesses and their stakeholders have failed to see sustainable or systemic improvements on some key issues such as worker health and safety, wages, working hours, or freedom of association in the workplace. In short, the traditional audit paradigm is only getting companies so far, without effectively solving deeper, tougher issues.

The underlying reasons for this have been the subject of well-known research, and – moreover – they are largely known to social compliance professionals.<sup>2</sup>

***In short, the traditional audit paradigm is only getting companies so far, without effectively solving deeper, tougher issues.***

*Despite many years of experience and hundreds of thousands of social compliance audits, global businesses and their stakeholders have failed to see sustainable or systemic improvements on some key issues, such as worker health and safety, wages, working hours, or freedom of association in the workplace.*

- **Limited visibility into the supply chain:** Some companies describe the traditional audit process as a ‘game of cat and mouse’, in which suppliers, fearing commercial penalties do not always act in the best interests of a transparent audit process. As a result, some companies do not always have an accurate picture of the realities of working conditions within their supply chains, and they cannot trust all the data they receive through the audit process. Without full visibility into their supply chain, they cannot fully understand where supply chain risks may lie or what issues to prioritize for remediation.

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<sup>1</sup> For a more detailed explanation, see “The Corporate Responsibility to Respect Human Rights: An Interpretive Guide”, pages 15-18, on Guiding Principle 13 of the UN Guiding Principles on Business and Human Rights, available at [http://www.ohchr.org/Documents/Publications/HR.PUB.12.2\\_En.pdf](http://www.ohchr.org/Documents/Publications/HR.PUB.12.2_En.pdf).

<sup>2</sup> See, Rick Locke, Matthew Amengual and Akshay Mangla. “Virtue out of Necessity?: Compliance, Commitment and the Improvement of Labor Conditions in Global Supply Chains”, MIT Sloan Working Paper No. 4719-08, MIT, Cambridge, MA (October 2008), updated March 2009.

- **Many suppliers lack capacity:** Where problems are identified, the most basic audit approaches ask and expect suppliers to ‘fix’ identified problems through corrective action plans. However, many suppliers lack the knowledge, systems, tools and resources to implement corrective action plans so as to address identified issues in a sustainable way. Others lack the basic management systems to track their operations, gauge productivity, or monitor some of the direct business consequences of poor working conditions, such as injuries, or worker turnover, which can have direct financial impacts.
- **Many suppliers lack incentives to commit to improved social performance:** Traditional notions of the leverage that companies hold over their suppliers, in many instances, do not reflect the present-day reality of relationships between companies and their suppliers. Where suppliers do have the capacity to address identified problems, many often do not perceive the internal (business case) or external (commercial) incentives to invest in sustainable social improvements.
- **Many issues are systemic in nature, beyond the direct control of suppliers:** While audits may reveal issues related to unsatisfactory working conditions, the root causes of many of these practices can be traced to structural or systemic issues, beyond the direct control of individual suppliers, requiring systemic responses – including social context, regulatory environments, and the broader labor relations context in the country. These issues are complex and daunting, and not amenable to quick fixes or immediate resolution.
- **Companies often fail to recognize their own role in contributing to adverse impacts on workers:** At the same time that brands and retailers preach social compliance, their own purchasing practices too often undercut their stated commitments to better social performance in their supply chains and contribute directly to the impacts they are intent on preventing. Companies may change designs, production volumes, and production schedules, without adjusting prices or timeframes, and without a clear understanding of the implications of these practices for their suppliers.

**New Approaches to Promoting Social Performance:** However, several leading brands and retailers have been attempting to change the conversation – internally within their companies, among their industry counterparts, and externally with their suppliers. They are increasingly acknowledging the ‘open secret’ across the industry that traditional compliance auditing is not producing sustainable improvements in many labor rights in supply chains.

They are adapting and evolving their approaches in an attempt to have more honest engagements with their suppliers and to enable meaningful remedial action. These approaches attempt to shift the dynamics between global company and supplier from ‘policeman’ to ‘partner.’ While many of these brands and retailers still recognize a role for good compliance audits as a scalable and replicable tool, they are integrating a variety of complementary approaches into more holistic models for social

*The approaches in this next generation of social compliance programs attempt to create more honesty in the relationship between global companies and suppliers, and to shift the dynamics – from ‘policeman’ to ‘partner’.*

compliance that respond to the dynamics identified above. Many of these approaches are still nascent in form. Most require more focused, less large-scale interventions than audit, and rely upon stronger relationships between buyers and suppliers in the context of longer-term partnerships. As such, they can represent a

significant shift in paradigm. Nevertheless, initial experience with these innovative approaches, as reported by global brands and retailers, is promising. At the very least, they merit further analysis and discussion

**Background on this Research:** The research has been undertaken by Shift, a non-profit center for business and human rights practice, in collaboration with the Global Social Compliance Programme (GSCP), a business-driven program for the continuous improvement of labor and environmental conditions in global supply chains. The research is intended to contribute to a new conversation around this next generation of social compliance programs, by sharing the experiences of leading brands and retailers in approaches that go beyond reliance on compliance audits alone.

**Shift:** *A non-profit center for business and human rights practice*

**Global Social Compliance Programme (GSCP):** *a business-driven program for the continuous improvement of labor and environmental conditions in global supply chains*

Based on a series of interviews with leading brands and retailers as well as industry experts, the report first presents a brief thematic overview of some of the common approaches that leading companies are using. The report then looks at how companies are using these approaches to respond to the underlying challenges faced in the traditional social audit approach. The report finally provides four in-depth case studies, highlighting the ways in which certain companies have combined

various elements in more holistic approaches to addressing social performance challenges in their supply chains.

As part of this research, Shift conducted approximately 20 interviews with several member companies of GSCP and other leading brands and retailers. Some of these companies have preferred not to be named, but a partial list includes Chiquita, Disney, H&M, HP, Marks & Spencer, PVH, Starbucks, Tesco and Timberland. Shift also interviewed industry experts, including organizations such as WRAP and ELEVATE (formerly INFACT). For each case study, Shift conducted 8-10 interviews with internal company representatives from various functions within the companies, as well as relevant external stakeholders that variously included suppliers, factory managers, workers, other brands, industry associations, and civil society organizations. Site visits were conducted for the Timberland (China), Chiquita (Costa Rica) and Tesco (South Africa) case studies.

This report does not attempt to imply that any company has the best model for, nor a perfect record in, addressing supply chain human rights challenges. None of the companies involved would make that claim either. The research did not seek to rigorously test the models discussed to prove positive and sustainable improvements in labor conditions in supply chains. Rather, it sought to gather and explore innovative models used by leading companies, who themselves report their effectiveness. This may then provide a basis for further analysis and evaluation.



### III. A Spectrum of Approaches

This section briefly sets out 10 of the leading approaches that emerge from this new body of experience around innovative approaches to social compliance in global supply chains. It looks at how companies are using these approaches to address the limitations of the compliance audit paradigm previously identified.

#### (1) The shift from ‘pass/fail’ compliance to comprehensive ‘continuous improvement’ programs

As a first step, many companies have shifted their social compliance philosophy from ‘pass/fail’ compliance to comprehensive ‘continuous improvement’ programs. One of the primary objectives in doing so is to create greater transparency in the audit process and greater visibility into the supply chain.

Under a continuous improvement model, companies shift the focus from the findings of an audit to what happens after the audit. Suppliers are held accountable for their commitment to, and the progress they make on, workplans that prioritize remedial actions based on the audit findings. By placing less emphasis on the findings of the audit, and more on the progress made to improve upon those findings, continuous improvement models are intended to enable greater honesty from suppliers in the audit process, without fear of commercial penalties. According to one company: “We have two conditions: first, you have to be honest, and second,

#### ***H&M’s Shift towards Continuous Improvement***

*Swedish apparel brand H&M’s journey towards a continuous improvement model is not dissimilar to the experience of many of the brands and retailers interviewed as part of this research. From 1998-2005, H&M conducted a robust program of compliance audits on its supply chain, encompassing thousands of suppliers. One H&M manager described most audit processes as a ‘game of hide and seek’, during which suppliers did everything possible to hide problems from the company. By 2005, the company had grown quite discouraged by the results of its audit program: while audits were catching the small infractions, they were missing the bigger picture issues; the program was failing to produce improvements over time; and its supplier base seemed uncommitted to making those improvements. These frustrations led H&M to transform its approach to supplier social performance.*

*Driven by a desire to create greater transparency, ownership and commitment from its suppliers, H&M’s new system is based on a philosophy of continuous improvement. The company conducts fewer audits, but the audit of each supplier is much more in-depth, lasting 6 days. The end result of each audit is a jointly developed 18-24 month workplan, based on shared prioritization of issues for improvement. Rather than conducting periodic follow-up audits, H&M follows up on progress made on the workplan. Suppliers have reported to H&M that ‘they now feel listened to, rather than just accused’, and that they now feel they ‘get credit for what they are getting right, not just what they are doing wrong.’*

*you have to commit to working with us over time to make improvements.”*

This may, in practice, mean that brands and retailers continue commercial relationships with suppliers that may technically be out of compliance. Proponents would argue that most companies already have all kinds of commercial relationships with suppliers who are, in practice, out of compliance. The difference here is that companies become aware of and openly acknowledge this reality, rather than relying on the false security provided by an audit they do not trust.

*“We have two conditions: first, you have to be honest, and second, you have to commit to working with us over time to make improvements.”*

Importantly, comprehensive ‘continuous improvement’ programs also mean that the goal of social compliance aims higher than a minimum baseline. Once ‘compliance’ is achieved, suppliers are still held accountable for continuing to improve. According to Louise Nichols of Marks & Spencer: *“We say that you [the supplier] must raise your game from bronze, to silver, to gold. If you’re silver now, in every product you sell, in a year’s time, you have to be gold to maintain that. It’s all about driving through the standards.”* Another company noted that this helps ensure that their social compliance program *“does not become a race to the bottom for our suppliers, rather than a race to the top. It is a more proactive and positive conversation.”* This approach also

### ***Tying it All Together: Marks & Spencer’s ‘Plan A’***

*In 2007, Marks & Spencer launched its holistic approach to social performance, which it calls ‘Plan A’ -- because, according to the company -- ‘there is no Plan B.’*

*The program began with 100 specific and measurable commitments related to Marks & Spencer’s own operations and its relationships with its suppliers, on which the company publicly reports its annual progress (the program has since expanded to 180 commitments). ‘Plan A’ includes pillars on involving customers, integrating sustainability into ‘the way we do business’, climate change, waste, natural resources, being a fair partner, and health and well-being.*

*Some of the components specific to labor rights and working conditions in the supply chain include:*

- a public commitment to a living wage;*
- substantial capacity-building programs and peer-learning forums for suppliers and their workers;*
- making and proving the business case for better working conditions for Marks & Spencer and for its suppliers;*
- a balanced scorecard approach, developed in collaboration with suppliers, which drives continuous improvement, linked to sourcing commitments;*
- an innovation fund to support supplier initiatives to address workplace conditions;*
- the integration of social performance issues into staff and directors’ performance reviews and pay, new product development, and product purchasing.*

helps companies determine which of their suppliers are willing to work with them towards a goal of better working conditions throughout the supply chain, and which are not.

Companies using a continuous improvement philosophy highlighted several critical factors: first, it can only work where there is a shared expectation of an ongoing relationship between company and supplier; second, companies need to ensure that audit staff have the skills to engage with suppliers in ways that engender trust and transparency; and lastly, companies should be prepared for some potentially difficult conversations with internal and external stakeholders, who may be uncomfortable with the idea of continuing commercial relationships with suppliers with known instances of non-compliance. Finally, they highlight that the shift to a philosophy of ‘continuous improvement’ requires – for it to be meaningful – many of the complementary approaches identified below. Otherwise, continuous improvement risks becoming a ‘free pass’ for non-compliance.

### ***From ‘Audit Metrics’ to ‘Performance Metrics’***

*As a key part of this shift from compliance audits towards continuous improvement models, many companies are shifting their reporting from ‘audit metrics’ to ‘performance metrics’ -- what industry experts ELEVATE refer to as ‘Metrics for Success’.*

*Common ‘audit metrics’ that companies have typically reported on include the number of audits conducted and completed, the number of instances of non-compliance found, and some of the specific data revealed by audits, on issues related to working hours, worker safety, and other workplace conditions. By way of comparison, ‘performance metrics’ focus more on key performance indicators (KPIs) such as production, worker turnover, wages, and worker satisfaction. According to Ian Spaulding at ELEVATE, these are not only more important indicators for worker conditions on the ground, but also better predictors for measuring the impact of initiatives to improve social performance. Marks & Spencer, for example, uses KPI data to monitor supplier performance on a weekly and monthly basis as a way to validate positive improvement in supplier social performance.*

## **(2) Collaborative Assessment**

While continuous improvement shifts the focus within the audit model from findings to corrective action, the collaborative assessment model employed by Timberland (featured in a case study later in this report) moves even further from the traditional audit paradigm. The company and its suppliers jointly engage in an assessment of factory performance on labor issues, undertake root cause analysis of identified issues and collaborate in joint problem-solving on identified priorities. As the case study highlights, the collaborative assessment model represents a true partnership approach between brand and supplier. In implementing the approach, Timberland’s social compliance team had to be trained in new methodologies for assessing suppliers, engaging with workers, and partnering with factory managers. As a result, Timberland reports that it has been able to achieve real visibility into the challenges faced by its suppliers and real transparency in its relationships with

factories, where their previous experience with audits had been less successful.

Other companies are combining some of the principles of a collaborative assessment model at later stages of their audit process. Marks & Spencer, for instance, invests both financial resources and the staff time of their regional teams to support suppliers in undertaking root cause analysis of identified challenges and working collaboratively to develop practical innovative solutions, such as workplace communication programs and leadership development programs. Several other companies engage external consultants to work with their suppliers similarly to undertake root cause analysis and identify solutions which can balance commercial necessities, practical realities and social imperatives.

*Read more about **Timberland's approach to collaborative assessment** in the case study on p. 22 of this report.*

### **(3) Supplier-Level Grievance Mechanisms**

A third tool for gaining greater visibility into the challenges faced in the supply chain is support for supplier-level grievance mechanisms. These grievance mechanisms can be particularly important in contexts in which organized labor is less prevalent or less mature. Equally, where trade unions are present, they are an important stakeholder in the design and functioning of effective complaints resolution processes. Indeed robust industrial relations processes can themselves be an important grievance mechanism.

Once there is buy-in among factory management, grievance mechanisms can serve as an early warning system for suppliers, identifying potential issues before they escalate. At the same time, well-designed grievance mechanisms can provide important additional data points (beyond audits) for brand companies and retailers, who want to better understand the practical realities of working conditions with a given supplier. Grievance mechanisms can also provide a process for identifying and addressing underlying root causes.

Tesco, Disney and PVH have all supported the development of supplier-level grievance mechanisms. Tesco supported the development of farm-level grievance mechanisms with its supply chain in South Africa, and learned several important lessons from that experience which have shaped its further efforts in South Africa (see the Tesco case study on p. 42 of this report). PVH has perhaps the most experience of the surveyed companies with supplier-level grievance mechanisms, having worked to establish them in their factories in Vietnam, Bangladesh, and elsewhere. PVH has found that they have been received positively by suppliers, have raised worker morale, and have provided PVH with real insight into the practical issues that arise for its supply chain workers.

Disney and PVH also have brand-level grievance mechanisms which are made available to workers within their supply chain. While the companies would prefer that issues get addressed at the supplier level, understanding why complainants have chosen to file their complaint with the brand rather than the supplier also provides useful information and increased visibility into workplace realities at the supplier level.

## (4) Capacity-Building with Suppliers

With the increased transparency and awareness of issues that accompanies the approaches mentioned above comes an added responsibility to ensure that suppliers are in a position to address identified challenges.

Otherwise, as one company noted, *'you just find yourself sitting on non-compliance'*.

All of the company approaches to social compliance surveyed in this research integrate substantial capacity-building components. Capacity-building for suppliers comes in many forms: from developing or paying for training courses on issues related to workplace rights, industrial relations or human resources management; to providing technical expertise to identify operational efficiencies that can reduce pressures on working hours and forced overtime; to training on advanced farming practices that can reduce social and environmental impacts. Part of that capacity may in fact be financial: Marks & Spencer has an 'innovation fund' as part of its holistic program to enable suppliers to trial new approaches to persistent challenges.

### **Examples of Capacity-Building Approaches**

- *Capacity-building in sustainable farming practices forms a key pillar of **Chiquita's** approach to its passion fruit supply chain in Costa Rica, featured in a case study in this report.*
- ***Disney** is developing a suite of good practice guides, resources and training programs for its licensees to help them manage issues related to labor rights, purchasing practices, grievance mechanisms, and due diligence on suppliers.*
- *Both **H&M** and **Marks & Spencer** are working with suppliers in China and Bangladesh in order to develop their management systems to track and analyze employee working hours – which can then provide the data for further analysis, operational efficiencies, and reductions in those working hours to acceptable standards.*
- ***Marks & Spencer's** Supplier Training and Education Programme (STEP) and its 'Supplier Exchange' forum provide capacity-building and peer-learning among suppliers on shared challenges and good practices, as well as collaborative development of tools, pilot projects, and guest speakers. In 2012, the Supplier Exchange included more than 15 global supplier conferences, engaging more than 3,000 supplier stakeholder attendees, on issues related to workplace conditions, environmental sustainability, and other social performance issues.*
- ***HP's capacity-building program** for its suppliers has five pillars, including: awareness-raising around specific industry standards on social performance; health and safety with a broad public health perspective; 'green' environmental management practices; worker/management communication; and general management systems.*
- *Another company's **peer-learning forum** for its strategic suppliers serves as a platform for introducing leading practices, challenging suppliers to take on improvement projects, and provide resources and support in the implementation of those projects. When one group of suppliers identified a shared objective to engage workers more systematically, the company identified external resources to help the suppliers develop a shared worker survey tool that they all implemented.*

In addition to providing suppliers with the necessary knowledge and skills to address social impacts, access to capacity-building resources is also often valued by suppliers as an additional incentive for committing to social performance improvements. According to Starbucks, its Café Practices program includes a price premium for suppliers that participate in the program, *‘but the real draw is the capacity-building. By participating in the program, farmers gain access to guidance documents, best practices, reference tools – as well as guidance on how to collect data that Starbucks may later ask for.’*

### **‘Segmentation’ for Targeted Capacity-Building**

*In collaboration with local suppliers in West Africa, Starbucks employs a farmer segmentation strategy to gain a better understanding of the particular needs of cocoa farmers, and to avoid treating all farmers as a single homogenous group with common needs. The segmentation strategy identifies various characteristics of farming communities, including agricultural practices and demographics, and other factors that may be obstacles to farmers’ ability to improve in various areas of performance. Working with local partners, Starbucks then implements targeted training based on needs identified by the farmers themselves, and identifies leaders in farming communities that can help promote the adoption of sustainable agronomic practices by other farmers.*

*“The farmer segmentation program represents a more strategic approach by Starbucks to really understand the needs of the farming community, instead of trying to force them to conform to guidelines that may or may not help them.”*

**- Pablo Ramirez, Starbucks**

## **(5) NGO Partnerships**

A key feature of the social compliance programs of many leading companies is the extensive partnerships they form with global and local civil society organizations. These civil society partnerships play several roles, from helping to set credible certification or compliance standards, to providing capacity-building support for suppliers in the form of training and guidance materials to help meet those standards, to joint problem-solving on particularly complex issues. For example, many companies engage with civil society partners around systemic challenges like child labor, where effective remediation requires sophisticated approaches. Collaboration with NGOs can also have the helpful side effect of reducing companies’ exposure to public critique since potential critics have the opportunity to engage with them in a more collaborative way. This can offer civil society organizations more direct and impactful channels to raise concerns. In addition to helping companies address labor risks in the supply chain, these NGO partnerships can also help companies to identify these issues in the first place. For example, NGO engagement helps HP to identify particularly vulnerable segments of its supply chain workforce, as part of its risk-mapping processes.

At the same time, one independent industry expert observes that civil society (including NGOs, socially responsible investors, and other civil society organizations) need to be willing to reward publicly those credible company efforts towards transparency and performance improvement, in the interest of promoting genuine impact: “Perfection should not be the enemy of the good. When it is, we force companies to keep with the

audit world view and we are not willing to admit real challenges and talk about genuine efforts to address what we know are complicated and grey issues.”

### **Examples of NGO Partnerships for Better Supply Chain Social Performance**

- **Chiquita** has had a 20-year partnership with the Rainforest Alliance, through which RFA has set external certification standards, has conducted audit processes, and has provided in-depth capacity-building to Chiquita’s passion fruit supply chain in Costa Rica, as detailed in the case study.
- **Starbucks** has a global partnership with Conservation International, which provides assistance with identifying best practices and developing resource guides for farmers, particularly on issues only tangential to Starbucks’ business, but potentially constructive for supply-chain farmers.
- **PVH** formed a partnership with a local NGO in Bangladesh focused on fire safety in factories, in order to build a broader advocacy base for promoting systemic change.
- **HP** has partnered with various NGOs in China to address workplace rights, student worker issues, and women’s health initiatives in the workplace.

## **(6) External Incentives: Commercial Benefits for Suppliers**

Having achieved increased visibility into the challenges of the supply chain and increased supplier capacity to address those challenges, a critical challenge many companies still face is the lack of commitment from suppliers to invest in improved working conditions. One way brands and retailers have attempted to address this is by providing various forms of commercial incentive in exchange for improvements in social performance – from price premiums, to volume increases, extended contract duration, and preferential contracting. In short, companies attempt to ‘pay’ for social compliance with commercial benefits, and/or compensate for the investment costs that can accompany supplier improvements in working conditions. According to one company leader, *“Money talks: You have to live in the land of market forces, or else you are living in the land of illusion.”*

*“Money talks: You have to live in the land of market forces, or else you are living in the land of illusion.”*

Several companies use ‘balanced scorecard’ approaches, which assess supplier performance against a number of commercial, technical, environmental, ethical and social performance indicators. The results of these scorecards entitle suppliers to various commercial benefits such as preferential contracting, additional business volumes, longer contract duration, or reduced audit frequency. Some of these companies develop their scorecards in collaboration with their suppliers, with indicators weighted to reflect both the importance of a particular social performance issue and the costs associated with investments to improve in those areas. Suppliers can then decide which areas to prioritize for improvement: ‘bigger picture’ indicators which are worth more points but may require substantial investment, or ‘smaller ticket’ items which may be more immediately

### **Premium Pricing for Social Performance: Chiquita Bananas in Latin America**

*In Latin America, Chiquita found that a small price premium that it paid for bananas could generate a very large impact. Farmers that earned certification against a Rainforest Alliance standard qualified for a price premium of approximately 1%. Given volumes of production, this amount could quickly add up for farmers. On Chiquita's side, being able to certify that their bananas were sustainably grown helped Chiquita protect its reputation as a premium brand.*

achievable but have less impact on the overall score. Others use up-front certification against external standards as the basis for price premiums.

Some companies have also found that symbolic recognition, not directly tied to commercial incentives, may be sufficient. For example, several companies have annual supplier awards tied to social performance and see significant interest from their suppliers to perform well and earn recognition for their efforts.

Interestingly, offering price premiums does not always enable suppliers to make the necessary investments in improved social performance. Starbucks initially incorporated

price premiums for its cocoa farmers, only to learn that many of the issues facing farmers were primarily due to access to infrastructure, not farmer incentives. In the end, Starbucks offered the premium to all farms. In other cases, Starbucks has learned from suppliers that access to capacity-building resources, and not the financial incentive, is what supplier farms value most.

## **(7) Internal Incentives: Making the Business Case for Suppliers**

While external incentives can provide an effective driver for suppliers to commit to social improvements, internal incentives – when recognized – may be an even more sustainable approach. There is substantial anecdotal evidence available of how improved working conditions can lead to reductions in costly workplace accidents, lower workforce turnover, higher workforce morale, and increased workplace productivity. However, there is still little quantitative data to make a compelling business case that there is both a cost to poor social performance and a direct business benefit to investing in improved workplace conditions.

Two companies – Starbucks and Timberland – are partnering with ELEVATE to develop systems with their suppliers to quantify the financial impacts associated with social performance. These systems will track and measure on a monthly basis the costs and business returns associated with workplace injuries, absenteeism, worker retention, recruitment, training,

### **Making the Business Case:**

*“All of the training we do on supplier codes, on the why's and wherefore's, that it's good to be good – people sit and nod politely, but they don't take it to heart. But if you can persuade them that there's a business benefit to all of this – that a properly looked-after workforce is more motivated and more efficient, that by taking care of people better and rewarding them better, you'll be more profitable – that's the holy grail.”*

*- Company Social Performance Leader*



and workplace productivity and efficiency. The system Starbucks is implementing will present a monthly 'profit and loss' statement based on social performance data, in a format more relevant to suppliers than an audit report. In one part of its supply chain, Starbucks is testing whether these 'profit and loss' statements can help to bypass the lack of transparency often encountered in the traditional compliance audit approach, and with the financial implications clear, work with its suppliers to prioritize areas for workplace improvements.

Separately, Timberland has found success at an anecdotal level with suppliers who have seen the direct benefits to the business from social investments. In its 'Beyond the Factory Walls' approach, Timberland initiates social investment projects in communities that are home to supply chain workers, particularly in challenges related to public health, such as water, sanitation and hygiene. The resulting community health benefits have had a direct correlation with reduced absenteeism in the workplace, higher morale and higher productivity. After an initial 'demonstration' period, factories have recognized these benefits and taken over

financial responsibility for these projects. Based on this success, Timberland is now developing more systematic tools to help suppliers understand the business case for these types of investment.

### **Marks & Spencer: Proving the Business Case**

*Marks & Spencer has worked actively to 'prove' the business case, demonstrating a net benefit from Plan A of £360M between 2007-2013, and focusing on the business case in each pilot and program. A good example is their 'ethical model factories', which seek to prove the proposition that better working conditions and better worker-management relationships will lead to increased workforce productivity, which can then finance a living wage in a sustainable way.*

Marks & Spencer is making the business case in several ways. The retailer has published the business case for raising social performance for itself and its suppliers, and supported that business case with independent reviews validating the commercial benefits. In a more experiential way, Marks & Spencer has demonstrated the business case through its program of 'ethical model factories', begun in 2009 in Bangladesh. The program grew out of asking the question, 'how can factories offer a living wage in a sustainable way?'. The pilot

factories are attempting to prove the proposition

that better working conditions and better worker-management relationships will lead to increased workforce productivity, which can then be used to finance wage increases. The focus of the program is on training for management teams on their roles and responsibilities; training for workers to be knowledgeable about their rights, roles and responsibilities; and training for all workers on health and well-being. The approach thus far has demonstrated dramatic reductions in worker absenteeism and attrition, reductions in worker grievances, and improved worker attitudes towards management.

## **(8) Using Corporate Leverage to Address Systemic Challenges**

The approaches discussed thus far have primarily focused on the role of suppliers in social performance – the way suppliers share information with global brands and retailers, the capacity of suppliers to understand and

address social impacts, and the motivation of suppliers to commit to improving social performance. However, many of the workplace issues that manifest on factory floors and on farms are driven by social, economic and political dynamics beyond the control of individual suppliers. These are some of the hardest challenges: complex and daunting, and not amenable to 'quick fixes' or clear paths towards resolution.

*Many of these social performance issues are systemic in nature – beyond the control of individual suppliers. These can be the hardest, most complex, most daunting challenges for global brands and retailers to address.*

Nevertheless, leading brands and retailers recognize that some of these structural and systemic issues must be addressed as the underlying root causes of poor workplace conditions in some contexts. A select few are using their leverage to engage a broader range of stakeholders towards identifying systemic solutions to systemic problems – including better regulatory enforcement and regulatory change. In some cases, brands and retailers may have untapped leverage due to the substantial role they play in industries that are key to the national or regional economy or because of their relationships with other stakeholders.

### ***Using Leverage to Address Systemic Issues: H&M in Bangladesh***

*In the apparel industry in Bangladesh, many global brands and retailers are deeply concerned about systemic challenges with workplace health and safety, sub-standard wages, and excessive working hours. Restrictions on freedom of association and trade union activities, coupled with the political power of the domestic industry association, have resulted in weak regulation, even weaker enforcement, repeated factory tragedies, and labor unrest. New factories open daily and illegal sub-contracting is rampant, making it difficult even to know where production is actually taking place. And in an industry hyper-sensitive to cost, in which purchasing decisions are often based on fractions of a cent, individual suppliers fear that unilateral wage increases will risk commercial non-viability.*

*H&M decided to try to tackle these issues through its commercial leverage. Already one of the largest global brands in Bangladesh, H&M has identified substantial opportunities for growth in Bangladesh if systemic social performance risks can be addressed. In a high-profile visit to Bangladesh, H&M's CEO and Global Head of Production offered a commitment to double H&M's production in Bangladesh, on the condition that a platform acceptable to all stakeholders could be created to systematically address wage issues. Behind the scenes, H&M engaged at the highest levels of government to attempt to build the political will to tackle these issues. When the tragedy of Rana Plaza focused wider industry attention on issues related to fire and building safety, H&M engaged actively with industry counterparts and broader stakeholders to address those issues through industry-wide collaboration (see the text box on Rana Plaza below).*

For example, H&M is using its commercial leverage to engage political and industry leaders on systemic issues related to wage levels. Industry analysts pointed to IKEA's work with the Indian government to address child labor issues, and to Coca-Cola's efforts to address similar issues in Brazil, Latin America and the Caribbean by engaging with political and commercial actors. The HP case study that appears on p. 49 of this report highlights HP's use of its leverage to start a multi-stakeholder conversation around labor impacts on student workers in China, bringing government, suppliers and NGOs to the table, with the goal of developing a shared understanding of the challenge and possible solutions.

To be clear, these efforts are not always successful. To achieve their full potential, they typically require the active and constructive engagement of national and/or local government actors to strengthen and enforce their own labor laws. However, what distinguishes the companies that pursue these approaches is that they are acknowledging with honesty the scope of the challenge and are taking what steps they can, based on the leverage they have and can build, to address the issues.

## **(9) Industry-Wide Collaboration to Address Systemic Issues**

In many instances, global companies lack the leverage to address systemic issues unilaterally. Many of these issues can only be addressed through collaborative industry-wide action. Several companies related experiences with these multilateral approaches – partnering with industry counterparts and competitors to address common challenges.

- The Bangladesh Accord on Fire and Building Safety involves over 80 apparel brands and retailers, and aims to address systemic fire and building safety issues in the ready-made garment sector in Bangladesh, where standards, oversight, compliance and infrastructure are all insufficiently protecting workers' rights (see text box below). The Accord includes a multi-stakeholder steering committee, with equal representation of trade unions and corporations, and regular engagement of NGOs, the Bangladeshi government, and the International Labor Organization. Signatories of the Accord, and their stakeholders, have committed to working together to ensure workers and their representatives are involved in comprehensive inspections, remediation, factory upgrades, capacity building, and the creation of credible grievance mechanisms and dispute resolution processes.
- The HP case study highlights examples of HP's industry-wide approaches to addressing issues related to conflict minerals through the Electronics Industry Citizenship Coalition (EICC) and worker relations in the electronics industry in Mexico through CANIETI, the Mexican electronics industry association.
- Business associations that bring together like-minded companies such as the Global Social Compliance Programme (GSCP), EICC, and the Global E-Sustainability Initiative (GeSI), or the shared audit platform of SEDEX, as well as multi-stakeholder initiatives (like the Fair Labor Association (FLA) and the Ethical Trade Initiative (ETI)), create platforms for industries to address shared challenges. These can include common approaches to audit that can free up buyer and supplier resources, shared standards and expectations to enable industry to tackle systemic issues collectively, and effective capacity-building approaches that can benefit from the resources realized.

## ***Tragedies in Bangladesh: Systemic Issues in the Garment Industry***

*Disasters in Bangladesh in November 2012 and April 2013 focused global attention on systemic weaknesses in building and fire safety in factories and on the government's regulation of the country's ready-made garment (RMG) industry.*

*In November 2012, a fatal fire killed more than 112 people at the Tazreen Fashions garment factory near Dhaka. The fire started on the ground floor, where large amounts of fabric and yarn were illegally stored, and quickly spread. The factory lacked a sprinkler system and an outdoor fire escape, and many employees were trapped. Bangladeshi law requires that such flammable materials be stored in a room with fireproof walls.*

*Five months later, the Rana Plaza factory building collapsed, claiming more than 1,100 lives, due to code violations, structural faults and illegal operating permits within the building. Rana Plaza is also located near Dhaka and produced clothing for several European and American brands.*

*Both incidents have brought attention at the international level to unsafe working conditions in Bangladesh, as well as low wages and limits on freedom of association. They have also prompted questions about global brands' supply chain monitoring systems and transparency.*

*As such, they have created an obvious and urgent case for brands and retailers to work through collaborative processes with other key stakeholders - business, government and civil society - to address challenges that run far beyond the control of any one actor or grouping. The Bangladesh Accord on Fire and Building Safety, discussed briefly on p. 17, provides an important model in this regard.*

## **(10) Alignment between Purchasing Practices and Social Performance Objectives**

In the supply chain context, many companies have come to understand how they can be linked to business impacts through their supply chain relationships. Fewer have understood the important role that they can play in contributing to adverse labor impacts, through their purchasing practices. Many companies operate in functional silos, where one department is responsible for social performance within the supply chain, and another department makes commercial purchasing decisions. As one industry expert observed, *"Buyers can say yes, but compliance can only say no."* At the simple level of purchasing decisions, companies can undercut their stated commitments to social performance if their purchasing practices are not aligned with their social performance approach – for instance, by failing to take due account of social performance in making those decisions, by shifting supply bases for short-term financial benefit, and/or by terminating commercial relationships with suppliers that have invested in better workplace conditions on the assumption of a continuing relationship.

In the apparel industry, the need for alignment is even greater. Brands may make changes to product design, product volume, production timeframes and place last-minute orders – without recognizing increased costs to the factory or adjusting end delivery dates. All of these changes can stress factory operations, slow down production, and as a result, require excessive working hours to turn around product delivery on time. According to one industry expert, few companies have fully understood or acknowledged their own roles in contributing to the social performance challenges within their supply chain.

*“Companies that do not take a hard look internally at how they themselves contribute to the issues that arise in their supply chain are only playing around the edges of social compliance issues.”*

**– Industry Analyst**

Several leading brands and retailers have really focused in on this challenge of internal alignment, including companies such as Coca-Cola, Gap, Marks & Spencer, New Balance, Next, Nike, PVH and Starbucks.<sup>3</sup>

- Several companies have attempted to create greater functional alignment by locating social compliance programs within purchasing departments, ensuring a ‘seat at the table’ when purchasing policies and practices are discussed.
- PVH’s purchasing practices include review by the social compliance team of all purchase orders before they are placed, enabling a more holistic approach to the company’s purchasing practices.
- Marks & Spencer has integrated ethical trading metrics into the performance objectives and reviews of all of their staff, including tying directors’ pay to company-wide performance on ‘Plan A’, the retailer’s holistic approach to sustainability and social performance issues.
- PVH and Starbucks provide monthly reports to buyers on the social performance of their supply chains, and whether they are achieving shared targets. Buyers – who have stronger relationships with suppliers – then manage conversations with suppliers around the sources of problems (the role of the buyer’s own purchasing practices, the role of orders from other buyers, and the role of internal factory operations) and potential solutions.
- Several companies train their purchasing departments on social compliance issues and the link between purchasing practices and impacts on the factory floor. This has led some companies to change the way they place and revise orders – based on an understanding of the impact of different variables in production processes, including potential impacts on the workforce.
- Another company engages in joint forward-planning with its suppliers, which enables the supplier to understand anticipated production schedules and demand, and to staff its factories accordingly.

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<sup>3</sup> The GSCP’s Reference Tool on Supply Chain Social Performance Management Systems

(<http://www.gscpnet.com/working-plan/step-4-management-systems.html>), which provides guidance more broadly on the management systems that buying organizations (brands and retailers) use to monitor and improve social performance in their supply chains, recognizes and incorporates many of these ‘internal alignment’ challenges within its guidance.

## CONCLUSION

While the traditional paradigm of social compliance auditing has an important role to play in helping global brands and retailers to identify potential labor and human rights risks in their supply chains, experience has shown that compliance auditing alone has in most instances not led to sustainable improvements in social performance. Rather, leading brands and retailers are increasingly developing innovative approaches to managing social risks within their supply chains and promote sustainable improvements in social performance.

The innovative approaches described in this report demonstrate a range of ways that brands and retailers have the systems to identify potential labor and human rights risks more accurately and effectively, that their supply chain partners have the capacity and incentives to address these risks, and that brands and retailers recognize and take appropriate action to address those types of risks that cannot be addressed by supplier action alone. These more holistic approaches are key to helping these companies address potential adverse impacts from their business activities and implement the UN Guiding Principles on Business and Human Rights.

# Case Study A:

## From Policeman to Partner: Timberland's Shift from Compliance Auditing to Supplier Sustainability

### Introduction

“Doing well and doing good” has long been Timberland’s philosophy in approaching its footwear and apparel manufacturing business. However, like many manufacturers in the shoe and apparel industries, Timberland struggled for many years to address poor working conditions in its extensive supply chain relationships, which spread across 35 countries, in Asia, Europe and Central America.

Until 2004, Timberland sought to manage these issues as many companies in the industry still do: by establishing codes of conduct for its suppliers, auditing factories against those codes, and requiring remediation through corrective action plans. However, Timberland grew increasingly frustrated with this approach and its failure to produce sustainable improvements in working conditions in its supply chain.

In 2005, Timberland made a radical shift in its approach to managing social impacts within its supply chain, adopting its Supplier Sustainability Program. At the heart of that approach was a shift in how Timberland positions itself with its suppliers – ‘from policeman to partner’ – and to the process of ‘collaborative assessment’ that has largely replaced the traditional approach to social compliance auditing.

*In 2005, Timberland made a radical shift in its approach to managing social impacts within its supply chain: shifting from ‘policeman’ to ‘partner’, and from traditional social compliance auditing to a process of ‘collaborative assessment’ with its suppliers.*

According to Timberland, the new approach has demonstrated a remarkable transformation in relationships with suppliers, resulting in greater transparency within its supply chain and improved working conditions for supply chain workers. In the words of one of Timberland’s supplier factories in China: “Finally, they are leading the way to change.”

### Company Profile

Based in Stratham, New Hampshire, Timberland markets its footwear and apparel lines through its own retail stores as well as through department stores and independent retailers. Approximately 70% of Timberland’s product sales are from footwear products and 30% from apparel and accessories.<sup>4</sup> In 2011, Timberland reported sales of \$1.5 billion dollars and, that same year, became a wholly owned subsidiary of VF Corporation, an \$11 billion apparel and footwear company based in Greensboro, North Carolina.<sup>5</sup>

Throughout its 35-year history, Timberland has maintained its reputation for manufacturing premium quality footwear, and has also become known for its commitment to environmental and social sustainability, as well as community service in all the areas of its operations. The company’s stated philosophy is “doing well and doing good,” in part by “delivering world class products [and] making a difference in the world community-at-large...”<sup>6</sup>

<sup>4</sup> Timberland Corporate Information Fact Sheet

<sup>5</sup> [VF Corporation](#) owns more than 30 brands including Lee, Wrangler, Reef, and the North Face.

<sup>6</sup> See Timberland’s ‘Beyond the Factory Walls’ Report, 2009, on its website, <http://responsibility.timberland.com>.

*Timberland has developed a reputation as a company committed to high-quality products, to social and environmental sustainability, and to having a positive social impact on the world at large.*

Timberland's supply chain stretches across Asia, Europe, and Central America, encompassing approximately 400 third-party contract manufacturers and suppliers (hereafter referred to collectively as suppliers) in 38 countries. A large percentage of Timberland's suppliers are located in Asia. And the majority of its manufacturing, approximately 40%, is done in China, with large amounts made in factories in Thailand, Vietnam,

India, and Bangladesh. In addition to sourcing footwear from third party suppliers, Timberland continues to manufacture footwear at a facility that it owns and operates in the Dominican Republic, providing approximately 12 - 15% of Timberland's annual production requirements.

Timberland refers to suppliers that manufacture finished footwear and apparel goods as Tier 1 suppliers. Tier 2 suppliers are companies that provide factories with essential manufactured components that go into making finished products (for example, mesh fabric)<sup>7</sup>. Tier 3 is comprised of 'raw material sources' (such as cotton farms and slaughter houses).

## **The Old Approach: Timberland's Experience with Social Compliance Audits**

Timberland faces the same labor and human rights challenges within its supply chain that are prevalent across the footwear and apparel industries. Across the industry, compliance challenges include a range of issues related to workers' rights and working conditions, including: excessive working hours and overtime, failure to provide adequate rest periods or breaks during long shifts, sub-standard wages, issues pertaining to the health and safety of workers, both inside of the factory and in their surrounding communities, and over-reliance on temporary workers and student 'interns', who are often more vulnerable to adverse labor conditions.

Some experts point to underlying causes that drive these issues, including: (1) escalating labor costs for the factory as the demand for workers has begun to outpace supply, resulting in efforts to cut-back elsewhere or commit to fulfilling orders beyond production capacity, leading to excessive overtime; (2) exceedingly high worker turnover and absenteeism levels (especially in China, where monthly turnover can typically range from 15-20% ), which can be both a cause and effect of continuing poor working conditions; and (3) the lack of sophisticated management systems and managerial capabilities in many countries where supply chain factories are present.

Until 2004, like the majority of brands at that time and many still today, Timberland sought to manage these issues through a Code of Conduct that placed certain expectations upon its suppliers, a Code of Conduct Team that monitored compliance, and a framework of social compliance auditing to ensure that suppliers complied with the Code of Conduct. Like many in the industry, Timberland considered the social compliance auditing regime to be 'best practice' for managing social impacts within the supply chain, including labor conditions.

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<sup>7</sup> Although tanneries are considered Tier 2 suppliers, Timberland treats them as Tier 1 within the compliance and supplier sustainability context, due to the large amounts of leather that Timberland buys and the fact that leather is an important component in most products.



At a fundamental level, the industry's emphasis on auditing reinforced an underlying view held by factories – that brands were there to police them and find fault with their actions. Suppliers believed that brands were unwilling to grant them sufficient time or to provide support and assistance that would allow them to remediate deficiencies. And, more importantly, many factory managers were not persuaded that the costs associated with implementing a remediation plan would be offset by increased business from the brand - given the brands' tendency to “hop-scotch” from factory to factory in search of a better price - or that the changes themselves would lead to increased profit as a result of increased efficiency.

*Until 2004, Timberland – like the majority of brands at the time and many who still do today – considered compliance auditing to be 'best practice' for managing social impacts within the supply chain.*

Like others in the industry, Timberland saw these dynamics play out in their compliance auditing processes. Suppliers employed a “cat and mouse”<sup>8</sup> strategy, using deceptive tactics and multiple book-keeping (practices that still continue in the industry) to thwart the efforts of auditors and hide the true state of working conditions inside the factories.

When external auditors did identify violations at a factory, Timberland's Code of Conduct team would present a remediation plan to factory management. The expectation was that suppliers could manage the remediation effort by themselves. However, if factory managers believed they were unable to correct the deficiency on their own, the compliance process included provisions for requesting and receiving assistance from Timberland.

Unfortunately, an auditor's workload was such that they could ill-afford to spend more than a few hours at a time on a given factory visit. Under these conditions, attempts to get to the root causes of issues proved challenging and, as a result, remediation plans – even when implemented – failed to produce sustainable improvements, because the process treated only the symptoms of problems.

*Under these conditions, attempts to get to the root causes of issues proved challenging and, as a result, remediation plans – even when implemented – failed to produce sustainable improvements.*

In some instances, where serious non-compliance was identified by Timberland's auditors and the supplier proved unwilling or unable to comply with the Code of Conduct, Timberland would sometimes end the business relationship. However, this action was not taken lightly, because severing business relationships often

comes at a cost to all parties involved – including the workers whose rights were at issue in the first place, but whose jobs might be lost as a consequence of ending the relationship. In one notable case, after working for almost three years with little success to resolve ongoing labor violations, Timberland decided in 2005 that they had no other choice but to end their relationship with a particular supplier. The decision cost Timberland,

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<sup>8</sup> The widespread practice of coaching factory workers to respond in a misleading manner to auditors' questions, and the keeping of “double books,” one set that reflect accurate financial record keeping and a second set, presented to auditors for inspection, which purport to show that workers are being paid fairly and are not being made to work excessive hours.

reportedly, over \$1 million. According to media reports at the time<sup>9</sup>, the factory owners announced that the loss of Timberland's business (Timberland had been their largest customer) would result in the termination of 12,000 workers.

Although this kind of action was not typical, the general lack of satisfactory social performance by suppliers, together with pressure from civil society stakeholders who complained about how factory workers were being treated, added to Timberland's increasing frustration with their compliance approach. Along the way, Timberland made several modifications to their audit processes, and realigned compliance issues under a broader CSR function. Although some incremental improvements were seen on issues like health and safety, from an overall perspective, the company was not seeing sustainable improvements in working conditions within its supply chain.

## A 'Radical Shift' in Approach: Timberland's Supplier Sustainability Program

In 2005, Timberland leaders engaged in substantial internal discussion at all levels within the company, including among the Board of Directors, about creating an alternative to the 'policeman' approach and defining a more over-arching CSR strategy. Internally, this resulted in the establishment of a Board-level CSR committee and an operational-level CSR team to coordinate and implement activities across the organization. For suppliers, it resulted in Timberland shifting away from solely relying on compliance auditing to a more collaborative, more comprehensive Supplier Sustainability Program.

Underlying Timberland's new Supplier Sustainability Program are several key premises: the need for long-term strategic partnerships with suppliers, the need for trust and transparency in those relationships, and the willingness to work together to identify and address social and environmental performance challenges.

## Developing a Long-Term Strategic Relationship with Suppliers

As one industry expert observed, *"Brands can't take a transactional relationship with a factory and expect them to improve. You actually have to have a strategic partnership between the brand-retailer and that factory, where the factory is meaningful to the brand and the brand is meaningful to the factory."*

Timberland considers its supplier relationships to be crucial to its success in the marketplace. Historically, the company has maintained long-standing relationships with its Tier 1 suppliers. Some of the company's footwear

relationships in China go back more than 25 years.

This period is shorter in other countries. In Bangladesh, for example, Timberland has been sourcing from suppliers for slightly longer than 7 years. Relationships with factories in the apparel segment, even those in China, tend to be not quite as long given more inherent volatility in the consumer apparel market.

Like other brands, Timberland has shifted some of its production from China to other Asian countries to take advantage of lower costs of labor. However, unlike some other brands, in countries where they

*"The infrastructure we would need to manage the risk involved in engaging in a race to the bottom, chasing price and churning factories, would at the end of the day be far greater than the potential benefit you'd see on paper in terms of gross margin improvement."*

**- Gareth Brooks, Timberland  
Vice President, Value Chain**

<sup>9</sup> South China Morning Post 14 Mar. 2006.

<http://www.scmp.com/article/540378/kingmaker-close-plants-after-losing-timberland-deal>

maintain a supplier base, Timberland has eschewed the practice of constantly shifting production from one supplier to another in search of price reductions. As a practical matter, said Gareth Brooks (Vice President, Value Chain), *“The infrastructure we would need to manage the risk involved in engaging in a race to the bottom, chasing price and churning factories, would at the end of the day be far greater than the potential benefit you'd see on paper in terms of gross margin improvement.”*

Timberland's Colleen Von Haden (Senior Manager, Supplier Sustainability) made the same point when she said, *“We want to demonstrate to factories that [the Supplier Sustainability Program] actually has a business value...it is an expense to the brand but we believe it will prove to be financially beneficial in the long run for suppliers. As a result, we believe we'll have a more resilient supply chain: one that could be more productive and less at risk with respect to labor issues”* for both the brand and the supplier. The company maintains a relatively small but stable supplier base so that they might be, according to Apparel Product Development and Production Director, Elaine Garson, *“more meaningful to less people.”*

## Building Trust in a New Approach

When Timberland decided to change its approach, by shifting from an audit paradigm to a collaborative support paradigm, the company's senior management and the CSR team understood the challenges ahead. They recognized that establishing a high level of trust and obtaining buy-in from factory managers were necessary pre-conditions for successful implementation of the Supplier Sustainability Program. In 2006, after they had developed the program, Timberland began the process of educating and persuading factories to adopt this new way of doing business. Colleen Von Haden recalled the tenor of the meetings in those early days: *“As we started to roll out the program, almost every factory in the opening meeting would say, ‘Okay, I like what I'm hearing. This sounds great. But I don't buy it. This is still an audit. Nothing is really different. You're just calling it something different.’”*

Jackson He and Songpon Pengchamsri, Timberland's Regional Sustainability Managers based in China and Thailand respectively, and who share responsibility for all of Asia, were both at Timberland prior to the change in strategy, and were also involved in the initial meetings. Overcoming suppliers' initial reluctance to embrace the new approach required patience and persistence, they both said. They each met frequently with factory managers to explain the program and answer their questions. As Jackson He noted, *“One of the big challenges for effective collaboration is establishing a trust*

*“The key to building trust and getting management buy-in was: first, identify the strengths of the factory — not focus on what they're doing wrong, as we would do before — then you ask for input about challenges, you ask for suggestions about how to overcome those challenges — and then you need to explain how Timberland proposes to help them overcome those challenges on a step-by-step basis.”*

**– Songpon Pengchamsri, Timberland Regional Sustainability Manager in Thailand**

*relationship. In order to build a trust relationship you cannot meet with factory management and personnel every 6 months. You must meet with them every month or every other month.”* From Songpon Pengchamsri's perspective, in addition to more frequent meetings, the change in the discourse between the Timberland

assessor<sup>10</sup> and the factory was also important. *“The key to building trust and getting management buy-in was,”* he said, *“first, identify the strengths of the factory — not focus on what they’re doing wrong, as we would do before — then you ask for input about challenges, you ask for suggestions about how to overcome those challenges — and then you need to explain how Timberland proposes to help them overcome those challenges on a step-by-step basis.”*

As one might expect, the factories did not all embrace the new approach at the same time. Some factories adopted the collaborative approach relatively quickly. Others, according to Timberland’s regional managers, sometimes took 6 months or as long as one year before factory management saw the benefit of working with Timberland in a more collaborative and transparent manner. And there still are a relatively small number of suppliers who resist fully embracing the Supplier Sustainability Program. Both Jackson He and Songpon Pengchamsri said that these tend to be comparatively small factories that are either constrained by their current level of management expertise and resources, or ones where the company culture prevents a fully trusting relationship from developing.

For the majority of its suppliers though, there did eventually come a time when, at the end of a particular meeting, the factory manager would say, *“Okay, this was really different. You weren’t here to try and uncover hidden things, you were really here to try and understand my business and the challenges I face,”* Von Haden said. Typically, this would happen after Timberland demonstrated that they would not only work with factories to resolve social and labor issues but also help them understand how better management of the issues could help address their daily business challenges such as turnover, absenteeism and employee training.

## **Collaborative Assessment at the Factory Level**

Understanding the shift from audit to collaborative assessment may best be described by one of Timberland’s long-time suppliers, the Pou Yuen factory in China:

*“Ten years ago, they didn’t listen to much reason. They just wanted to have their checklist: Yes, No, Yes, No.*

*Now, it’s not just an audit checklist, it’s an assessment. The assessment is not just focused on one point. It reviews the entire situation - why the situation exists. We trust each other, and are really transparent; we disclose issues, nothing’s hidden. Maybe it’s a structure problem or a person’s capacity issue or some kind of problem with communication. Afterwards, we sit down together and discuss what we have to do to solve the problem, and then discuss a timeframe for when the problem will be solved.”*

**- Eugenia Hsu, Health and Safety Manager, Pou Yuen**

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<sup>10</sup> A member of what was once known as the Code of Conduct team, who had previously been primarily responsible for audits and factory assessments, and is now part of the Supplier Sustainability Team. Formerly called auditors, they are now known as Supplier Sustainability Specialists.

Under the collaborative assessment approach, because the focus is less on auditing<sup>11</sup> and more on assessment and capacity-building, the Timberland Supplier Sustainability Specialists (SSTs) function more like consultants to factory management. With this change came the need for the former auditors to learn new skills and to be trained in various tools and assessment methodologies that Timberland now uses in conjunction with the Supplier Sustainability Program.

Assessments at Pou Yuen and other suppliers are conducted using two primary tools: the SAI Social Fingerprint assessment tool<sup>12</sup> and the GSCP Environmental Module<sup>13</sup>. The Supplier Sustainability Team measures a factory's performance and provides ongoing feedback and reporting to its managers. *"The entire purpose of the supplier sustainability program, and the collaborative approach that we take,"* Von Haden said, *"is to help suppliers run their business in a better way. And we focus our attention and look for ways to tie it all back to things that would make the business case for our suppliers... so productivity, worker retention or absenteeism are key indicators that we look at, to assure suppliers that if we work on these things together, they will see improvement in their overall business."*

To strengthen existing capabilities and close a gap that currently exists, Timberland is currently working with ELEVATE,<sup>14</sup> a company that develops supply chain productivity solutions, to develop a robust metrics system for introduction to Timberland's supplier base. Von Haden believes that this is a crucial next step in terms of obtaining objective, accurate data that will enable Timberland to make a stronger business case to suppliers regarding the benefits of increasing their overall performance against the standards for social and environmental performance.

## Putting Workers at the Center

One of the fundamental differences between the original compliance audit approach and the collaborative assessment approach Timberland currently uses is the perspective from which the company views workers. As Timberland views it, workers should be placed "in the center of the process."

One of the ways the company tries to achieve this is by working with factory management to implement Internal Social Performance Teams (ISPTs)<sup>15</sup>, which are often called worker committees, or in the case of Pou Yuen,

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<sup>11</sup> The collaborative assessment approach does not obviate the need for periodic audits. Audits are still carried out annually but the resulting 'rating score' is utilized as a single data point, one that is combined with other performance indicators (from the SAI 'Social Fingerprint' tool) to form a judgment about a factory's overall level of performance. Moreover, Since VF's acquisition of Timberland in 2011, audits have been performed by VF personnel, and Timberland personnel work in concert with VF audit staff to remediate issues -- giving them more time to focus on capacity-building.

<sup>12</sup> Timberland uses the SAI Social Fingerprint tool (<http://www.socialfingerprint.org>) to measure supplier performance across nine dimensions - to determine, among other things: the effectiveness of a suppliers complaint management and resolution system; whether a supplier has created an Internal Social Performance team, and the level of authority and responsibility the team has been granted; how well the supplier manages its own suppliers and contractors; and the degree to which there is effective, ongoing dialogue between workers and managers.

<sup>13</sup> For more information on the GSCP Environmental Module, see <http://www.gscpnet.com/working-plan/environmental-module.html>

<sup>14</sup> ELEVATE was formerly known as INFACCT Global Partners, <http://www.infactory-solutions.com/index.php/en>

<sup>15</sup> An ISPT functions as an internal monitoring mechanism, fulfilling many of the functions, and using some of the same tools and information that is available to auditors. The underlying premise of an ISPT is that workers are in the best position to identify reasons why adverse labor conditions exist and, working collaboratively with factory management, to propose solutions on how best to resolve them.

Worker Participation Groups. These committees, which are comprised of both management and worker representatives elected directly by workers themselves, continually assess the needs of workers and function as a vital communication link between both groups. Pou Yuen set up its Worker Participation Groups only in the past five years, as it took some time for the factory management to be comfortable with the idea. Worker representatives receive training in communication skills to be better able to convey to management the key issues affecting workers.

In addition, Timberland's assessors engage directly with workers during their factory visits, and have been specially trained in a variety of methodologies for doing so more effectively.

### ***Collaborative Assessment in Practice: Root Cause Analysis and Response***

*Employee turnover is an important issue in the supply chain, but is especially critical in China. Pou Yuen managers, therefore, pay a great deal of attention to the issue and they believe that the culture of the company and the programs they have put into place are one of the key reasons why their employee turnover rate, according to Eugenia Hsu, Health and Safety Manager at Pou Yuen, is less than 7% (the national average is 15-20%).*

*Pou Yuen's decreased turnover is the result of many targeted programs that begin at the factory level, and Timberland assessors often collaborate with Pou Yuen on the best way to carry out these initiatives. Two years ago, for example, a summer camp program was developed at the factory based on worker input. Many workers are from rural areas and do not see their children often because they live and work far from their homes. To address this situation, Pou Yuen developed a summer camp program that provides an opportunity for children to spend four to five weeks during the summer with their parents. During the day, activities are provided for the children while the parents are at work; in the evenings, and on weekends, they are able to spend time with their parents. Pou Yuen pays for the cost of the summer camp and provides extra financial assistance to parents who are especially needy. The company reports that it has been a successful program, and employees have volunteered to help with it. "One program alone probably can't make the turnover rate go down a lot," Hsu says, but among the people who have been involved in this program, their retention is higher than our overall average. It is more than 95%".*

## **Aligning Sourcing Practices with Supplier Capacity**

While many of the challenges in global supply chains can be traced to supplier business practices or broader regulatory or social context factors, some can be caused by the purchasing practices of brands themselves. Footwear and apparel brands may require quick turn-around times and flexible production capacity from their supply chains. Suppliers may be called upon to shift production schedules and staffing capacity with little advance notice. For their own part, factories often over-commit beyond their existing capacity, motivated by the uncertainty of their continuing relationships with brands, who may shift production if a better price is found.

Aware of these risks, Timberland's sourcing group takes a collaborative approach with many of its Tier 1 and Tier 2 suppliers with respect to product design and manufacture. Particularly in footwear, Timberland designers and engineers work in factories alongside their supplier counterparts. Timberland Global Sourcing Director, Gareth Brooks said, *"[It is] much better to invest the time and effort working with a supplier than it is to continually chase lower prices from new suppliers - then spend years teaching them how to make the products, which is an added cost for the brand that some companies don't consider."*

Both footwear and apparel are actively engaged in collaborative production planning with suppliers as well. Elaine Garson and Colin Browne, Sourcing Directors for the apparel and footwear teams respectively, consider it vitally important to undertake joint mid-term business planning. They report that their respective teams meet with suppliers and jointly develop "capacity commitments" that extend out for 18 months. Following a detailed planning process that takes into account the rhythm and flow of activities characteristic of engineering and designing processes, both sides are able to come to agreement on a production schedule that does not overload the production pipeline. This in turn helps mitigate issues related to overtime. Every 6 months Timberland and suppliers conduct a review – "official partner meetings" as Brown referred to them - at which time they discuss any actual or potential developments that may affect the plan, which is then updated as required.

***'Collaboration' between Timberland and its suppliers extends beyond the 'assessment' process:***

- *In footwear, designers and engineers work in factories alongside supplier counterparts.*
- *Footwear and apparel teams engage in joint forward planning with suppliers to develop 'capacity commitments' that extend out for 18 months.*
- *Progress is reviewed every 6 months in official partner meetings to update the plans.*

Timberland's strategy of maintaining a stable supplier base and viewing its relationship with suppliers as a collaborative partnership is at least partly informed by the company's direct manufacturing experience – both past and present. Timberland's factory in the Dominican Republic makes a variety of different products that the company also sources from factories in Asia, and therefore, said Brooks, Timberland has an *"opportunity to really understand how we plan the factory, how we operate a factory, how we flow their orders. How we communicate with the factory, about issues pertaining to product development or commercialization or future capacity booking. I think that gives us real insight how then to behave with our source partners in Asia."*

## **Internal Alignment: Collaboration Between Timberland's Supplier Sustainability and Sourcing Teams**

Timberland's Supplier Sustainability and Sourcing teams work very closely together on issues related to supplier performance. To underscore the point, Brooks puts it as follows: *"The sourcing organization is not called 'Timberland Sourcing LLC.' Unlike some other organizations, we're not a remote purchasing arm far removed from other aspects of the business. We both live in this organization, under its principles, and so we need to cooperate with one another."*

On an ongoing basis, the Supplier Sustainability Team and the Sourcing Team review the performance levels of factories. At many companies, sourcing managers have more influence than their counterparts who are

responsible for compliance or sustainability issues.<sup>16</sup> At Timberland, whenever performance issues arise, managers of the sourcing and supplier sustainability teams are obligated to negotiate a mutually satisfactory decision about a joint plan on how to move forward: they have conversations directly with both the factory and the internal Timberland teams to make sure there is alignment in terms of plans and timelines that have been agreed to.

Members of both teams work together to encourage factories to adopt the collaborative assessment model. For example, Jackson He described times when, after he has encountered prolonged resistance from a factory about implementing some aspect of the Supplier Sustainability Program, he has turned to the sourcing team for

help. Both teams have a mutual interest in supporting one another.

*Members of both the assessment teams and the sourcing teams are held accountable for social and environmental performance within their factories, with KPIs tied to their performance evaluations.*

Timberland Supplier Sustainability Specialists are held directly accountable for the performance of their assigned factories. One of the key performance indicators included in their annual performance evaluation is a requirement that assigned factories demonstrate a minimum of 30% improvement over the previous year.<sup>17</sup> Members of the sourcing team are also held accountable for factory

performance levels and therefore they, too, have established KPIs (metrics related to environmental sustainability, social sustainability, and basic compliance), which are tied to that individual's overall evaluation.

## The Role of the Sustainable Living Environments Program

Many issues that affect workers' lives trace back to the prevailing wages in a particular industry and national context – which may mean that workers with full-time jobs nevertheless live at or below poverty levels.

Addressing those wage levels unilaterally is not always feasible for a brand, particularly when a factory produces for more than one brand or retailer – and yet the resulting poverty is a systemic cause of so many other adverse working conditions. In response, Timberland developed the Sustainable Living Environments (SLE) approach to help alleviate poverty for workers in their supplier factories and to help ensure that basic needs are met.

*The needs of workers cannot be separated between 'inside' and 'outside' the factory. What happens in one sphere is bound to affect what happens in the other.*

Through joint collaboration between Timberland, individual factories, and local NGOs, SLE projects provide workers, their families and members of the community with adequate and affordable access to such essential needs as food and water, medical services and health care, housing, child care, savings and credit services, life-skills development, education, transportation, and recreation in a number of emerging countries where

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<sup>16</sup> See, Locke, R., M. Amengual, and A. Mangla. "Virtue out of Necessity? Compliance, Commitment, and the Improvement of Labor Conditions in Global Supply Chains." *Politics & Society* 37 (2009): p. 326.

<sup>17</sup> Responsibility Beyond Factory Walls: Engaging Factory Workers & Strengthening Communities. Rep. 2009. Timberland. <[http://responsibility.timberland.com/wp-content/uploads/2011/05/Beyond\\_Factory\\_Walls\\_2009\\_Timberland\\_report.pdf](http://responsibility.timberland.com/wp-content/uploads/2011/05/Beyond_Factory_Walls_2009_Timberland_report.pdf)>.



Timberland has suppliers. In any given year, there are approximately 30 different factories involved in these kinds of projects.

Ideas for projects usually begin with conversations that assessors have with workers, through which they inquire about whether basic needs are being met, stress factors that impact workers negatively (at home or at work), and whether there are services they need which they cannot afford. Based on that information, Timberland assessors cooperate with factory management to investigate whether these issues are broader concerns in the local community and whether there are potential solutions.

There have been times when the requests from workers are much different than one might expect. Von Haden recounted how in 2012, in China, they saw a pattern emerge out of conversations with workers from 25 factories. In this instance, the workers were not most worried about health, safety, or wages but rather, their “parenting skills”, especially as most of them worked and lived far from their families. Parents with adolescent children were especially concerned that they were not available to provide them with the proper guidance. Von Haden said she was struck by the notion that, in some respects, *“many of the factories in China, in Timberland’s supply chain at least, have evolved to the point where these are the kinds of issues workers care most about.”* In this particular case, Timberland arranged to have external experts train representatives from the 25 factories to deliver parenting skills classes.

In other instances, the projects have ranged from establishing a day care facility in Chennai, India, providing improved access to health services and micro-finance for women in Bangladesh, and building clean drinking water towers in Vietnam.

In all cases, Timberland insists on working with both the factory and a local NGO to ensure that it’s a truly sustainable partnership. Timberland provides seed funding (up to a maximum of approximately \$15,000) for projects. For projects like this to ultimately work, Von Haden says, *“We need the factories to commit to work with the NGO organization on a budget that maintains sustainability over the long-term. For the project to be sustainable we need the factories’ commitment; and in order for the factory to come to the table, there needs to be a business case.”*

*“We need the factories to commit to work with the NGO organization on a budget that maintains sustainability over the long-term. For the project to be sustainable we need the factories’ commitment; and in order for the factory to come to the table, there needs to be a business case.”*

**- Colleen Von Haden, Timberland Supplier Sustainability**

That business case is based on factories seeing a healthier workforce, both physically and emotionally, which translates into increased productivity at work; and a more loyal workforce, which translates into higher retention and lower absenteeism rates. This is supported in practice by Timberland’s supplier factories assuming responsibility for sustaining investments in SLE projects after a period of initial seed funding from Timberland.

For Von Haden, the SLE program is both complementary to and integral to the Supplier Sustainability Program, because the needs of workers cannot be separated between “inside” and “outside” the factory. What happens in one sphere is bound to affect what happens in the other. *“If you look at what most brands in the footwear and apparel industry are doing today, 80% of them still monitor their supply chains using a compliance police approach. I would estimate that roughly 15-20% are going beyond basic compliance and looking at*

*management systems and root causes. But it's the final piece (SLE), in really trying to address workers' needs, that makes the difference. That's where the business case can be made for a return on investment. Being compliant is required, it's your license to operate, there is little if any return on that investment. Being simply compliant won't give a factory a competitive advantage or better business performance. You won't see a business return unless you're really addressing workers' true needs."*

## **Conclusion**

Timberland's shift away from traditional social compliance auditing and towards a holistic approach to supplier sustainability has transformed both its relationships with its suppliers and the impact Timberland has on workers in its supply chain. That shift has included a focus on collaborative assessment of issues in supply chain factories, with both factory management and workers; providing meaningful capacity-building to address underlying challenges; partnering with factories and NGOs to develop community-based programs that address issues that manifest in the workplace; and looking internally at Timberland's own purchasing practices and the role they can play in incentivizing and contributing to better or worse working conditions. By moving from a posture of 'policeman' to 'partner', Timberland is seeing sustainable improvements in labor and human rights issues in its supply chain.

# Case Study B:

## Chiquita's Passion Fruit Supply in Costa Rica: Combining Commercial Incentives with Social Standards

### Introduction

As a brand, Chiquita prides itself on its commitment to sustainable sourcing practices and its reputation for high-quality products, and a belief that the company's commercial and social performance goals are not mutually exclusive. In Ecuador, however, where the majority of the passion fruit business was based until 2010, poor visibility into a diffuse small-holder supply chain dominated by 'middle-men' trading agents – and the speculative pricing practices of those trading agents – meant that Chiquita could not attest to or effectively influence the quality of its produce or the social and environmental conditions under which that produce was farmed.

After many years of frustration, these twin drivers of commercial instability and social/environmental uncertainty led Chiquita to develop a new passion fruit supply chain in Costa Rica.

Chiquita developed its Small Grower Initiative, a package of financial incentives and capacity-building measures, and leveraged its long-standing partnership with the Rainforest Alliance. The initiative allowed Chiquita to obtain a cost-competitive product that meets the company's high social and environmental standards, while simultaneously providing substantial socio-economic benefits for growers. It has also laid the foundation for sustainable agricultural practices among members of the wider growing community.

*Chiquita's approach to its passion fruit supply chain in Costa Rica is based on the company's philosophy that its commercial and social performance objectives are not mutually exclusive, but can be combined in innovative ways for the benefit of both Chiquita and its suppliers.*

### Company Profile

Chiquita Brands is a leading producer and distributor of fruits and fruit-based products around the world. Best known for its bananas, the company employs more than 20,000 people and has operations in approximately 70 countries. In 2011, Chiquita Brands reported annual revenues of approximately \$3 billion.

The company takes pride in its commitment to sustainable sourcing practices and its reputation for producing high-quality products, and leverages these as market differentiators. Both are crucial elements of a commercial strategy that established Chiquita Brands as a market leader and allows the company to enjoy a price premium for many of its products.

*Chiquita's commitment to sustainable sourcing practices and its reputation for producing high-quality products are both crucial elements of a commercial strategy aimed at establishing Chiquita Brands as a market leader and allowing the company to enjoy a price premium for many of its products.*

Because sustainable sourcing practices are strategically important to the company, Chiquita Brands has been a partner in the Rainforest Alliance since 1992, and all Chiquita-owned farms are Rainforest Alliance certified. Moreover, in 2002, the company adopted the SA8000 labor standards developed by Social Accountability International<sup>18</sup> and, by the end of 2005, 100% of Chiquita-owned farms in Latin America were SA8000 certified. More recently, the company demonstrated its continued commitment to operating in an environmentally responsible manner with the inauguration of its innovative Biodigester System. Located at Chiquita Fruit Solutions' Mundimar facility in Costa Rica, the Biodigester uses industrial waste left over from processing to create electricity for the administrative offices during peak hours, a total of 6 hours per day. As an additional benefit, the fertilizer produced as a byproduct of the conversion process is provided at no cost to local farmers.

Chiquita Fruit Solutions (Chiquita), a business-to-business division of Chiquita Brands, markets processed fruit and fruit ingredients to other companies. Until recently, Chiquita maintained processing facilities in Costa Rica and Ecuador. However, as of January 2013, with the deactivation of its Ecuaplantation processing plant in Ecuador, in part due to a decrease in demand from the European market<sup>19</sup>, the Mundimar facility in Costa Rica is the company's sole processing plant. The Mundimar facility, as explained below, is integral to Chiquita's efforts to develop the passion fruit industry in that country.

## Passion Fruit Market in Ecuador

Prior to 2010, Chiquita faced ongoing challenges in the passion fruit market in Ecuador. The company became increasingly concerned about growing speculation in the market and the impact it was having on the company's commercial business. Adding to their concern were the social risks in the supply chain, which Chiquita found virtually impossible to address in an effective manner.

Internationally, approximately 80% of all passion fruit juice<sup>20</sup> produced for the export market originates in Ecuador. Unlike bananas, which are grown on large plantations that average between 100-200 acres in size, passion fruit is grown by more than 10,000 small-holder Ecuadorian growers across the country, each of whom typically has 5-10 acres under cultivation.

The passion fruit market in Ecuador is effectively controlled by "middlemen" - trading agents who purchase fruit from farmers to be resold to exporters for a profit. The rise in international demand for passion fruit juice in recent years brought with it increasingly speculative pricing practices by these middlemen. Their actions, along with the strategic alliances they have formed with processing companies, contribute to volatile pricing and a lack of transparency in the market.

*"We knew nothing about the farms where the fruit came from or the conditions that existed there. We could not be certain, for example, that child labor standards or environmental standards related to the use of fertilizers and pesticides were being upheld on these farms. And that kind of situation is not at all consistent with our standards and practices."*

**- George Jaksch, Chiquita,  
Corporate Social Responsibility**

<sup>18</sup> See <http://www.sa-intl.org/sa8000>

<sup>19</sup> See [http://www.foodbusinessnews.net/articles/news\\_home/Supplier-Innovations/2013/04/Chiquita\\_Fruit\\_Solutions\\_sweet.aspx?ID={D6706CE1-0A8A-4858-88DE-C815C1E2E668}&cck=1](http://www.foodbusinessnews.net/articles/news_home/Supplier-Innovations/2013/04/Chiquita_Fruit_Solutions_sweet.aspx?ID={D6706CE1-0A8A-4858-88DE-C815C1E2E668}&cck=1)

<sup>20</sup> According to information provided by Chiquita

Both of these factors created business conditions that Chiquita believed were preventing them from adequately meeting the needs of their customers.

In addition to these commercial challenges, Chiquita was also concerned by the social impacts created by trading agents – who have been accused of taking unfair advantage of growers who are often poor, not well-educated, and reliant on middlemen for financing. Traders routinely paid growers late and at very low rates that left growers with very little income from the sale of their fruit. As a result, most of the profit from the passion fruit business ends up in the hands of traders, as opposed to the farmers that grow the fruit.

Moreover, because Chiquita could not engage directly with the many thousands of small-growers behind the middlemen, the company found that it had neither visibility to the growers nor influence over growing and harvesting conditions. As Chiquita's Senior Director, Corporate Responsibility, and Public Affairs, George Jaksch, explained, *"We knew nothing about the farms where the fruit came from or the conditions that existed there. We could not be certain, for example, that child labor standards or environmental standards related to the use of fertilizers and pesticides were being upheld on these farms. And that kind of situation is not at all consistent with our standards and practices."*

## **Combining Commercial Incentives with Social and Environmental Performance**

Given these challenges, Chiquita made the strategic decision to begin looking for an alternate source of passion fruit. This decision was not taken lightly, as severing relationships with an existing supply chain can have its own adverse impacts. However, Chiquita determined that – given the structure of the Ecuadorian market and despite many years of effort – it was not going to be able to create conditions under which it could exercise sufficient leverage over the supply chain to have a positive influence on the market.

As a result, in 2010, after a year of planning, the company introduced the Small-Grower Initiative as a pilot program in two regions of Costa Rica. What Chiquita envisioned creating was a model supply chain, one that would be completely transparent, free of the market-distorting activities of middlemen, and comprised of growers that would provide a consistently high quality, stable supply of passion fruit – all done using agricultural methods that comport with Chiquita's social and environmental standards.

At the outset, the pilot was comprised of 129 growers. Conceptually, the Small Grower Initiative was a package of commercial incentives, social and environmental performance standards, and capacity-building measures, undertaken in collaboration with government and NGO partners, which collectively provided benefits to both Chiquita and passion fruit growers.

### ***Key Components of Chiquita's Passion Fruit Supply Chain in Costa Rica***

- *Long-Term Contracts*
- *Fixed Pricing*
- *Expedited Payment Terms*
- *Direct Relationships with Growers*
- *Capacity-Building Support in Sustainable Agricultural Practices*
- *Social and Environmental Certification Standards*
- *Partnerships between Chiquita, small-holder growers, government agencies,*

Key components of the initiative that provided benefits directly to growers include:

- Long-Term Contracts
- Guaranteed Price and Volume Commitments
- Direct Relationship between Growers and Chiquita (elimination of ‘middle-men’)
- Expedited Payment Terms
- Capacity-Building in Sustainable Agricultural Practices, undertaken in partnership with government agencies and the Rainforest Alliance

*“All of our growers have fixed price deals. We don’t do anything with market dependent pricing – we don’t do any of that, because we’ve always felt the grower needs to have security as to what he’s going to get.”*

**- George Jaksch, Chiquita**

While these components were designed to produce economic and social benefits for growers, they also made business sense for Chiquita, which was able to derive the following commercial benefits:

- A Stable Source of Supply
- Rainforest Alliance-Certified Passion Fruit Products
- Guaranteed Pricing to Chiquita Customers
- Direct Visibility into its Supply Chain (to enable adaptation as necessary)

The Small Grower Initiative pilot provided very small growers with a business opportunity they would not otherwise have had. Many of the growers lived in poverty, and the region suffers from high unemployment, underutilization of available farmland and an excess supply of labor. Typically, these growers, because of their size and capacity, would not be in a position to conduct business with companies like Chiquita on a contractual basis.

## Long-Term Contracts

Chiquita elected to enter into two-year agreements with the growers, even though in the agricultural industry contracts tend to be awarded on an annual basis. The company believed it would take at least as long as that to evaluate the effectiveness of the pilot and a long-term agreement would be an incentive for growers to remain in the program. For growers, who were accustomed to selling crops in an informal ad-hoc manner at a local market, a long-term agreement offered enhanced stability with respect to planning their lives and financial affairs. Moreover, because passion fruit is harvested twice annually, farmers would be paid four times over the course of the two years.

## Guaranteed Price and Volume Commitments

In the Ecuadorian market, after each harvest, growers negotiated with middlemen over the volume of fruit the middlemen would purchase. Growers often found themselves in a vulnerable position, given that they would already have cultivated a crop without knowing beforehand what the market price was likely to be or how much of it, if any, would be purchased by the traders.

In the Costa Rica model, Chiquita addressed this problem by reaching agreement with each grower over the amount of land that would be set aside for passion fruit cultivation, estimating yield projections, and committing to purchase the full amount of passion fruit produced. Chiquita also fixed prices for the duration of the agreements to guarantee a return to growers. As Jaksch noted, *“All of our growers have fixed price deals. We don’t do anything with market dependent pricing—we don’t do any of that, because we’ve always felt the grower needs to have security as to what he’s going to get.”*

## Direct Relationships Between Chiquita and Growers (Eliminating the ‘Middle-men’)

The lack of a middleman structure not only benefited growers by ensuring that they would receive a fair price for their fruit and could rely on a relatively stable source of income, but it also benefited Chiquita as well. Chiquita’s involvement in all phases of production ensured that it would have visibility throughout the supply chain. The increased transparency helped bring stability to its pricing structure and allowed the company to have more confidence when negotiating fixed price contracts with its business-to-business customers. *“[We try] as much as we possibly can,”* Jaksch said, *“to have fixed price, long-term deals with our customers. And that brings some stability to our business.”*

Chiquita also created visibility from “end-to-end” in the supply chain - beginning from the time the passion fruit seedling is planted, through harvesting, transportation, processing, and final shipment to customers. As a

*‘End-to-end’ visibility into its supply chain has provided Chiquita with the assurance that all of its products have met the highest sustainable sourcing standards.*

result, Chiquita achieved full confidence in the methods used to produce the fruit, the quality of the produce, and the conditions on every farm where the fruit was grown and harvested. This level of visibility into its passion-fruit supply chain in Costa Rica has provided Chiquita with the confidence to claim in the market that all of its products meet the highest sustainable sourcing standards.

## Expedited Payment Terms

Typically, industrial growers receive payment one or two months after delivery of their fruit, which can pose an undue financial burden on small growers while they wait for payment after crops have been delivered. Recognizing this potential burden, Chiquita set up a process whereby Chiquita trucks picked up fruit directly from farms on a weekly basis during the harvest season, weighed the fruit in the presence of the grower and generated a receipt note certifying that Chiquita had taken custody of the volume from the grower. The corresponding invoice generated shortly thereafter by the grower would be paid by Chiquita one week later.

This process has had the added benefit of allowing growers who had not previously participated in the formal banking structures to open bank accounts based on their agreements with Chiquita, as well as eliminating transportation costs for passion fruit growers to move their harvest to their market.

## The Need for Capacity-Building

Chiquita sought to implement the Small Grower Initiative in a region in which none of the small-holder growers had prior experience cultivating passion fruit. Although many had experience growing a mix of other crops, some participants in the pilot had no previous farming experience of any kind. Moreover, there were no standards governing the agricultural practices of domestic producers. According to Luis Valverde, Sourcing Manager, Chiquita Mundimar: *“The growers in this area, they don’t know anything about certification. They are*

only involved in the local market ... in our country, local markets usually means no rules. There aren't strict quality norms [that apply to the local market]."<sup>21</sup>

The company therefore needed to adopt a comprehensive approach to capacity-building, drawing on its own internal resources as well as resources from its government agency partners, and its long-time civil society partner for sustainability issues. Part of that capacity-building approach includes ongoing technical assistance from the Chiquita team for best agricultural practices, laboratory testing, and seed inspection, as well as the development and distribution of manuals and training documents for all of its growers. That technical assistance is also paying off in substantially higher annual yields -- from 5-10 tons per hectare per production cycle, to an expected yield of 30 tons per hectare per production cycle in 2014.

### **Economic Benefits to Growers**

*Overall, growers involved in the pilot reported that they have obtained very satisfactory economic benefits. According to one grower, the program has allowed him to improve his financial condition significantly.*

*"At the end of the first of year," he said, "I earned more than \$4 million colónes (approximately \$8000). With this additional money I was able to buy a house and pay off some of my loans."*

**- Don Gerardo (70), a campesino farmer involved in the program**

### **Partnering with Government Agencies to Build Grower Capacity**

The Small-Grower Initiative was developed in collaboration with the Costa Rican Ministry of Agriculture (MAG), the Agrarian Development Institute (Instituto de Desarrollo Agrario, or IDA<sup>22</sup>), and the Agricultural Centers of the two regions where the project was implemented.

Both MAG and IDA were instrumental in helping Chiquita to develop relationships with growers, especially in the early stages when Chiquita was challenged by the reluctance of some growers to participate in the pilot.

Referring to the initial skepticism of some growers, Humberto Wedderburn, General Manager, Chiquita Mundimar plant explained, "Sometimes, it is hard to get the poor people in rural areas to trust big companies. Chiquita had to work very hard to establish trust and gain the confidence of this group. And we were fortunate to have the help of MAG and IDA, two government agencies that already had relationships with the growers."

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<sup>21</sup> "Rainforest Alliance." A Passion for Passion Fruit. <<http://www.rainforest-alliance.org/multimedia/passion-fruit>>

<sup>22</sup> IDA was created in 1961 for the purpose of re-distributing Costa Rican land to "maximize agricultural production and create small farmers and thus establish social equality." The aim was to prevent the kind of social unrest that has been characteristic of other countries in the region where the majority of land is controlled by a small group of individuals. Under IDA's auspices, the government acquired large tracts of land that were then subdivided into agricultural plots (Parcelas Agrícolas) and provided to small farmers, with the condition that they would farm the land for a specified period of time. See, <http://www.costaricalaw.com/the-government-targets-ida-properties.html>



*Initially, it was difficult for Chiquita to build trust with local growers. It overcame this challenge through partnerships with respected government and civil society partners. Today, there is a waiting list of over 300 growers who wish to participate in the program.*

Both government agencies also helped Chiquita to identify and pre-select growers who might be interested in participating in the pilot, and the company and government agencies collaborated on in-field training and capacity-building programs.

From Chiquita's perspective, the time and effort they expended—first by training the growers and then providing follow-up support on a frequent basis—was not merely for the growers'

benefit. It allowed the company to develop an effective working relationship with the growers and also to remain aware of activities and conditions on the farms.

Nevertheless, persuading growers to adopt sustainable farming practices with which they were unaccustomed proved challenging at times. Overcoming it required constant dialogue and reinforcement. Wedderburn noted Chiquita's understanding that *"it will take time, but we believe that we can create [a different] culture - new farming procedures, techniques, and business model- with the growers here in Costa Rica."*

## **Partnering with Rainforest Alliance to Certify Growers**

Chiquita considered it important that the company be able to go to the passion fruit market and demonstrate that all of the passion fruit they process is produced according to specified social and environmental standards. As a result, Chiquita's goal was for the grower community to be 100% Rainforest Alliance certified, from the first harvest onward.

The growers also benefited from the Rainforest Alliance certification because the good practices they learned enabled them to operate their farms more efficiently and safely. The techniques and processes that they applied to passion fruit cultivation are not unique to that crop and can therefore be applied to their other crops as well. Moreover, by maintaining their farm's certification status and remaining in the program, the income that growers received (on a guaranteed, long-term basis) from passion fruit production is seen as leading to improved economic prospects for them and for their families.

Therefore, Rainforest Alliance, in partnership with Chiquita, conducted training workshops in the field, educating growers on issues and best practices including the health and safety of employees, water conservation, the safe and effective use of fertilizer and pesticides, and the proper ways to handle and dispose of waste material.

Chiquita, with Rainforest Alliance's agreement, functioned as a kind of "administrative manager" of the growers as a group<sup>23</sup> to prepare the growers for their first audit, which occurred in March 2011. Shortly afterward, the very first passion fruit crop was certified by Rainforest Alliance. For all of its passion fruit growers, Chiquita bears the cost of the Rainforest Alliance certification process.

*"It wasn't easy, but our goal was 100%, not 91% or 95% - and if one [grower] failed, then we would have failed,"* Wedderburn added. And failure would have meant that Chiquita would not have been able to lay claim

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<sup>23</sup> According to Humberto Wedderburn, it was more feasible for Chiquita to take on this role because the growers were very small farmers and not part of a large plantation or a cooperative.

to what they believed would be a competitive advantage: the ability to claim that the product was produced in a sustainable manner.

Since the pilot program has been in operation, Chiquita has conducted formal internal (Chiquita) audits of certified farms once each year, monitoring them to ensure that applicable social and ethical standards

are being followed; for example, that underage children are not being made to work on the farm. This policy will remain in effect on an ongoing basis, so that the farms can keep their certification status. In addition, Rainforest Alliance conducts periodic inspection visits as well.

*Chiquita's goal was that 100% of its small-holder growers would be Rain Forest Alliance certified. Chiquita and Rain Forest Alliance conducted training workshops to educate growers on issues and best practices to enable the farms to operate efficiently, safely and sustainably – practices equally relevant for growing other crops as well.*

## Women's Empowerment

One of the important ways in which the small grower initiative has created benefits for the wider grower community is with respect to women. Traditionally, jobs at nurseries in Costa Rica tend to be filled by women, and the three nurseries that produce the passion fruit seedlings for growers in the pilot are all managed by women. Some of the women working in the nurseries were single mothers and several reported that the additional income allowed them to take better care of their children's basic needs.<sup>24</sup>

In addition to the women who worked in the nurseries, an increasing number of the growers themselves are women, who often head single-parent households. According to Valverde, *"For some of the campesino women in particular, the Small Grower Initiative represents a good opportunity because of the lack of other available full-time or part-time employment."*

## Conclusion

When Chiquita ultimately decided that it needed to create an alternative source of passion fruit supply – driven by both commercial and social/environmental factors – it sought to create a model supply chain in Costa Rica. It did so by innovatively marrying a range of commercial incentives for both small-holder growers and the company, social and environmental standards in production, and multi-stakeholder partnerships to ensure effective capacity-building support. While many companies may not be in a position to exit certain supply chain relationships, or where doing so might create additional adverse impacts, Chiquita's experience nevertheless points to opportunities to take a more holistic approach to supply chain relationships, in which commercial incentives and social and environmental performance can be mutually reinforcing.

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<sup>24</sup> Chiquita provided video: no title

# Case Study C:

## Empowering Local Counterparts:

### Tesco's Support for Locally-Driven Social Compliance Initiatives

#### Introduction

Tesco, a UK-based retailer, has long been concerned about social impacts in its extensive supply chain, including on farms in South Africa – a key country in Tesco's agricultural supply chain. As early as 2007, Tesco recognized that its focus on compliance auditing was not yielding the sustainable improvements in the supply chain that it sought, and the company shifted to a focus on capacity-building with suppliers.

Tesco was invited in 2009 to test the design of operational-level grievance mechanisms, as part of the work that supported John Ruggie's mandate as the former Special Representative of the United Nations Secretary-General for Business and Human Rights. The company saw in this an important opportunity to build upon its commitment to better social performance on the farms from which it sourced. However, despite the company's

*One of the key lessons Tesco took away from the experience was that for these types of initiatives to be sustainable, they need to be driven and owned by local stakeholders.*

efforts to create local ownership of the pilot project, Tesco ended up playing a more active role in the pilot project than it had initially intended, contributing to a perception that the grievance mechanism was a 'Tesco pilot'.

One of the key lessons Tesco took away from the experience was that for these types of initiatives to be sustainable, they need to be driven and owned by local stakeholders. Applying this learning, Tesco's

current programs in South Africa demonstrate a shift to supporting promising local initiatives. In particular, since 2010, Tesco has been supporting Fruit South Africa's SIZA program – a locally-owned, locally-driven social compliance standard and capacity-building program – which seeks to create a unifying set of standards for South Africa's agricultural producers. In addition, Tesco is working with other local organizations to promote managerial capacity-building for a more diverse pool of future farm managers.

By empowering local counterparts, Tesco is looking to ensure that its investments in the social performance of its agricultural supply chain in South Africa will be sustainable in the long-term.

#### Company Profile

Tesco Stores Ltd (Tesco) is a UK-based retailer with 6,784 stores worldwide and group sales of £72.4 billion in 2012. The company has "tens of thousands of suppliers and distributors"<sup>25</sup> in more than 70 countries. In its approach to sustainable sourcing and ethical trading, Tesco seeks to balance compliance monitoring with the provision of capacity-building assistance to suppliers, to help them increase their ability to address adverse impacts and improve labor conditions for workers.<sup>26</sup>

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<sup>25</sup> Tesco and Society, Rep., Tesco PLC, 2013

<[http://www.tescopl.com/files/pdf/reports/tesco\\_and\\_society\\_2013\\_ipad.pdf](http://www.tescopl.com/files/pdf/reports/tesco_and_society_2013_ipad.pdf)>. pg. 4

<sup>26</sup> Our Trading Fairly Approach. Tesco PLC.

<[http://www.tescopl.com/assets/files/cms/Resources/Trading\\_Fairly\\_statement\\_20052013.pdf](http://www.tescopl.com/assets/files/cms/Resources/Trading_Fairly_statement_20052013.pdf)>. pg. 2

In South Africa, Tesco purchases fruit for sale in the UK and Northern European markets. Tesco is South Africa's single largest purchaser of fruit, by volume, and Tesco considers South Africa to be a "key supply [country] where suppliers and workers face significant and persistent challenges" in meeting international labor norms.<sup>27</sup> Tesco's in-country ethical trade team works collaboratively with key actors across the local fruit supply chain to address potential social performance challenges. The company provides assistance and resources to local groups, and supports the development of solutions that seek to bring about sustainable improvement in labor conditions on farms.

*Tesco's in-country ethical trade team works collaboratively with key actors across the local fruit supply chain to address potential social performance challenges.*

## Shifting from Compliance Auditing to a Comprehensive Approach

Until 2007, Tesco used audits as the primary mechanism for ensuring that fruit suppliers complied with standards set out in the company's ethical trading policy.<sup>28</sup> At the time, the expectation was that suppliers, upon notification, would develop and implement their own corrective action plans to remediate identified deficiencies. Suppliers that consistently failed to take corrective action risked having Tesco end the relationship. Through the implementation of this audit program, the company identified patterns of adverse social impacts attributable to discriminatory hiring and employment practices, by farm managers and owners; a lack of trust and communication between farm managers and workers; and conditions on farms that caused workers there to be concerned about their health and safety. Local and international NGOs identified many of the same issues, and characterized them as being both ongoing and pervasive in the local supply chain.

Tesco, sharing these concerns, responded by modifying its approach to its suppliers. In 2008, the company reported that, from that point forward, "joint efforts at capacity-building with suppliers and [the] implementation of remediation plans across the supply chain"<sup>29</sup> would be part of a "comprehensive plan to improve labor standards"<sup>30</sup> on farms, and, furthermore, that the company would develop mechanisms for supporting suppliers by investing in "labour conditions expertise,"<sup>31</sup> with the aim of facilitating a closer working relationship between Tesco and its supplier base.

## Tesco's Experience with the Grievance Mechanism Pilot

In 2009, Tesco was invited to participate in a pilot project on operational-level grievance mechanisms being undertaken by Harvard University's Corporate Social Responsibility Initiative (CSRI), on behalf of the former Special Representative of the United Nations Secretary-General (SRSG) for Business and Human Rights, Professor John Ruggie.

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<sup>27</sup> Ibid pg. 13

<sup>28</sup> Tesco uses the ETI Base Code, a code of labor practice based on International Labour Organisation (ILO) conventions and developed by the Ethical Trade Initiative (ETI), a multi-stakeholder body. Tesco is a founding member of ETI. For more information see [www.ethicaltrade.org](http://www.ethicaltrade.org).

<sup>29</sup> Corporate Responsibility Review 2008. Rep. Tesco PLC.

[http://www.tescopl.com/files/pdf/reports/tesco\\_cr\\_review\\_2008.pdf](http://www.tescopl.com/files/pdf/reports/tesco_cr_review_2008.pdf)>. pg. 29

<sup>30</sup> Ibid

<sup>31</sup> Ibid

The purpose of the project was to ‘road-test’ the practical application of a set of ‘effectiveness criteria’ for operational-level grievance mechanisms. This was done by working with companies in different industries and regions to test the development or adaptation of such complaints-handling mechanisms, based on these criteria.<sup>32</sup>

Tesco agreed to participate in the pilot, viewing it as an opportunity to strengthen its efforts to engage with the local stakeholder community and, within the scope of the pilot, to collaborate with them to address long-identified social impacts.

In implementing the pilot, Tesco sought to have the local stakeholder community maintain as much ownership over the grievance mechanism design and development process as possible. It did so by creating an Oversight Stakeholder Body (OSB), comprised of representatives from business, government, trade unions, and other civil society organizations.<sup>33</sup> Tesco - represented primarily by its local Ethical Trading Manager, Tania Moodley<sup>34</sup> - viewed its role, initially, as being a facilitator of the OSB’s functions, and elected to become a non-voting member of the body.

However, as implementation unfolded, Tesco ended up playing a more active role than it had initially envisioned – eventually acting as a de facto project manager and administrator. This was in part due to challenges in the internal dynamics at the OSB level, and a lack of initial trust between various OSB members. At the time, the fruit supply chain was marked by poor communication and mistrust between key stakeholders: farmers, exporters, retailers, and civil society

### ***Grievance Mechanism Pilot Project***

*Tesco initially sought to create local ownership over the project by creating an Oversight Stakeholder Body. Although Tesco viewed its role initially as being a facilitator of the OSB’s functions, a number of factors led the company to play a more active role in project implementation.*

organizations; and their representatives on the OSB<sup>35</sup> found it difficult to put aside historical differences and institutional agendas. For example, union representatives only agreed to participate if a third-party mediator helped to facilitate the process. To overcome this and other challenges, Tesco engaged a neutral third-party facilitator, who helped OSB members find common ground and, ultimately, develop the grievance mechanism.

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<sup>32</sup> See Caroline Rees, “Piloting Principles for Effective Company-Stakeholder Grievance Mechanisms: A Report of Lessons Learned”, (2011); Harvard University, Kennedy School of Government, Corporate Social Responsibility Initiative; available at: [http://www.hks.harvard.edu/m-rcbg/CSRI/publications/report\\_46\\_GM\\_pilots.pdf](http://www.hks.harvard.edu/m-rcbg/CSRI/publications/report_46_GM_pilots.pdf).

<sup>33</sup> Stakeholder groups represented on the OSB were business: Fruit SA, co-chair, and Colors; civil society: Women on Farms Project (WFP) and Centre for Rural Legal Studies (CRLS); trade unions: Food and Allied Workers Union (FAWU), co-chair, and Building Wood and Allied Workers Union of South Africa (BAWUSA); and government: Department of Agriculture. Tesco was a non-voting member of the OSB.

<sup>34</sup> Three other staff members from Tesco’s UK headquarters, who provided general oversight and technical support, also contributed to the project.

<sup>35</sup> Farm workers, although they were not directly represented on the OSB, had two civil society organizations (in addition to union representatives) to advance their interests. One of the two, Women on Farms Project (WFP), a local NGO, had been instrumental in bringing many of the supply chain issues directly to Tesco’s attention in 2006 and 2007. See also Women on Farms Project, “Seasonal Fruit Picker Campaigns in London On Behalf Of South African Farmworkers,” press release, 29 June 2007, <<http://www.wfp.org.za/>.

A second major challenge arose in misaligned expectations between what some OSB members wanted the mechanism to address (broad systemic issues in the supply chain) and the more narrow objectives and tight timeframes of the pilot project (focused on site-specific dispute resolution processes at the farm level). As a result, Tesco stepped in with leadership and decision-making to help accelerate the pace of project implementation.

During the course of developing the grievance mechanism, it also became apparent to Tesco that, on most farms, necessary communication channels and skills did not yet exist between and among farm workers and managers to enable an effective grievance mechanism. Commenting on the need to develop these systems and provide the necessary foundational training, Moodley said that, *“We realized we couldn't have an effective grievance mechanism if workers couldn't understand how to use it, and couldn't access it the way that they felt most comfortable.”* As a consequence, additional foundational work was needed to address the challenge of ‘accessibility’ of the pilot grievance mechanisms, within an already compressed timeframe.

### ***Lessons Learned from Grievance Mechanism Pilot Project:***

*Although the pilot project produced important learning about grievance mechanisms – for local stakeholders and in informing the Guiding Principles – the key learning for Tesco was the need to ensure that local stakeholders own and drive initiatives to improve social performance.*

The grievance mechanism pilots produced important learning – for both local stakeholders and in informing the ‘effectiveness criteria’ of the Guiding Principles. Outside of the pilot process, a number of South African farms have now developed and adopted local site-based grievance mechanisms, and the tools and resources developed as part of that process (such as the ‘worker communication toolkit’) continue to be used by stakeholders in South Africa.

However, Tesco’s more active role in the OSB’s decision-making process and Tesco’s funding of the pilot project contributed to the perception that the project was being directed by Tesco, for the company’s benefit. These factors created perceptions among many stakeholders – rightly or wrongly – that led them to refer to the grievance mechanism project as “the Tesco pilot.”

### **Lesson Learned: Shaping Tesco’s Future Efforts**

For Tesco, the key lesson from the grievance mechanism pilot project was that – for these types of initiatives to be successful and sustainable in the long term – local stakeholders need to feel that they own and drive the process, and not that they are being driven by multinational brands and retailers. This is especially crucial in South Africa where there is a strong belief among stakeholders that adverse social impacts are best resolved through local initiatives, and that recommended solutions are more likely to be adopted when they are not perceived as being imposed by parties from outside the country. As the grievance mechanism project concluded, Tesco applied this lesson by shifting its focus to support locally-driven initiatives – taking more of a ‘back seat’ role and using its resources to empower local counterparts.

## Supporting SIZA: A Locally-Driven Standard and Capacity-Building Program

This shift in focus is perhaps best exemplified by Tesco's support for the SIZA program<sup>36</sup>, the South African fruit industry's locally-driven ethical trading program, developed by Fruit South Africa (Fruit SA), the local growers' association.<sup>37</sup> Even before it became involved with the pilot as a stakeholder member of the OSB,<sup>38</sup> Fruit SA had taken note of rising consumer complaints in the UK regarding sub-standard labor conditions in the supply chain. Concerned about the implications for the local fruit industry, it announced in 2008 that it would develop its own ethical trade program, with standards based on South African laws and the Global Social Compliance Programme (GSCP) Reference Code and Reference Audit Process and Methodology<sup>39</sup>, and International Labor Organization (ILO) conventions (which are included in the GSCP reference tools).<sup>40</sup>

### ***The main components of the SIZA program include:***

- *A self-assessment protocol for suppliers.*
- *The SIZA Standard (the Standard), a code of practice based on the Global Social Compliance Programme's (GSCP) Reference Code and Reference Tool on Audit Process and Methodology.*
- *A data platform for collecting and analyzing audit results.*
- *Tools, resources, and support mechanisms designed to help drive continuous improvement of social and labor conditions on farms.*

Tesco has supported the SIZA initiative with technical assistance, financial resources, and – importantly -- 'political' support.

On the technical side, Tesco has made available for SIZA's use all of the tools and materials developed through the CSRI grievance mechanism pilot. Principal among these tools is the Workplace Communication Toolkit, designed to help improve a supplier's capacity to address social impacts.<sup>41</sup> Using the toolkit, a supplier, for example, can utilize the *Setting up a Task Team as a Workplace Communication Channel* to help improve communication between farm managers and workers, thereby mitigating the potential for conflict. Or, when conflicts arise, they can turn to the *Grievance Mechanism Guide* to learn about best practices with regard to

<sup>36</sup> For more information about SIZA and its ethical standard, see:

<http://www.fruitsa-ethical.org.za/intro-fsa-ethical-trade-programme.php>.

<sup>37</sup> Fruit SA represents the interests of four growers' associations as well as those of the Fresh Produce Exporters' Forum (FPEF). The growers' associations and FPEF are comprised of approximately 5000 suppliers and 90 export companies respectively. According to FPEF CEO Anton Kruger, the forum represents approximately 85% of all the fresh fruit exporters in South Africa.

<sup>38</sup> Fruit South Africa (Fruit SA) was one of two co-chairs and the primary business representative on the OSB.

<sup>39</sup> To drive convergence, the GSCP is building a set of reference tools that describe existing practice, uphold relevant international standards, where they exist, and provide a common interpretation of fair labor and environmental requirements and their interpretation. For more information, see: <http://www.gscpnet.com>.

<sup>40</sup> Post-Harvest Innovation Programme 2012, Rep., Fresh Produce Exporters Forum (FPEF), [http://www.fpef.co.za/images/stories/PHI\\_Programme2012.pdf](http://www.fpef.co.za/images/stories/PHI_Programme2012.pdf) pg. 90

<sup>41</sup> The Workplace Communication Toolkit is comprised of four guides: 1) Setting up a Task Team as a Workplace Communication Channel; 2) Grievance Mechanism; 3) Disciplinary & Appeals Policy and Procedure; and 4) Producers' Implementation Guide.

the reporting, management, and resolution of worker grievances. These guides are particularly useful given the generally limited capacity of communication systems on farms, and in light of the provision in the SIZA Standard stating that suppliers “shall ensure that there is an effective mechanism in place by which workers can make grievances known to management.”<sup>42</sup>

Moodley says Tesco plans on continuing its support for the SIZA program by helping to fund training workshops or similar events that aid in educating suppliers about the SIZA standard and informing them about the various capacity-building components of the SIZA program.

Tesco’s ‘political’ support is perhaps just as important as its technical support. Tesco is one of the first international retailers to express its commitment to recognizing and utilizing the SIZA standard, and is actively working with and encouraging industry counterparts to do the same. According to Moodley, “Our approach is to converge with industry best practices wherever possible and we know that [the SIZA Standard] is robust enough: it is benchmarked internationally, it is adapted to meet local needs, it avoids duplication – so we will align ourselves to that.”

### **Tesco’s Support to SIZA:**

- *Technical: Tools and Resources*
- *Financial: Core and project-specific funding*
- *Political: Putting the ‘weight’ of the Tesco brand behind support for the SIZA standard*

*“Our approach is to converge with industry best practices wherever possible, and we know that [the SIZA Standard] is robust enough: it is benchmarked internationally, it is adapted to meet local needs, it avoids duplication – so we will align ourselves to that.”*

**– Tania Moodley, Tesco,  
Ethical Trading Manager (Africa)**

Fruit SA’s Ethical Trade Program Coordinator Colleen Chennells<sup>43</sup> noted that, in October 2012, after a review process that took more than eight months, the SIZA Standard was judged to be more than 92% equivalent<sup>44</sup> with the GSCP reference code, an outcome crucial not only to attaining Tesco’s support but also for SIZA’s goal of becoming the industry standard in South Africa.

## **Promoting Management Diversity**

Tesco’s approach of supporting locally-driven initiatives is also demonstrated in how it has approached a systemic challenge in the agricultural industry in South Africa: the lack of racial diversity in farm management, which can reinforce economic disparities and contribute to tensions at the farm level. Rather than attempting to tackle the problem on its own, Tesco identified a locally-driven initiative which seeks to identify and train

<sup>42</sup> [http://www.fruitsa-ethical.org.za/documents/FSA\\_Ethical\\_SIZA\\_Standard\\_V4.pdf](http://www.fruitsa-ethical.org.za/documents/FSA_Ethical_SIZA_Standard_V4.pdf) pg. 35

<sup>43</sup> Chennells also represented Fruit SA on the 2009 pilot project’s OSB, as one of two co-chairs.

<sup>44</sup> The GSCP Equivalence Process allows organizations to benchmark their standards, methodologies, and audit processes against agreed best existing practice as described in the GSCP Reference Tools, in an effort to harmonize audit process, increase mutual recognition of audit results, and reduce duplication.



promising candidates from among the pool of previously disadvantaged individuals for farm management positions.

The Leadership and Mentoring Program, which is owned and implemented by the Fruit Producers Export Forum (FPEF) and initially funded by International Produce Limited (IPL), a Walmart subsidiary company, is a 12 month-long modular training program designed to provide individuals with training in a variety of business skills and techniques. In addition to receiving management training, each individual in the program is matched with a mentor-manager from his or her organization. Over the course of the program, the mentor and trainee jointly participate in portions of the training program, and Tesco adapted the course to include a coaching component. Both mentor and trainee are attached to an external coach who works with them on commonly agreed upon objectives for that year.

Participating in the program for the first time, Tesco committed to sponsoring a total of 16 students in 2013. They also invited other local retailers to participate in funding the program. However, other retailers appear to be taking a “wait and see” attitude towards the program.

*Tesco is also tackling the systemic challenge of a lack of racial diversity in farm management by supporting local initiatives. The Leadership and Mentoring Program of the Fruit Producers Export Forum (FPEF) of South Africa provides capacity-building to help farm workers develop the skills they will need to become farm managers.*

## Conclusion

Tesco’s efforts to promote sustainable improvements in its agricultural supply chain in South Africa represent an evolution of learning about ‘what works’ in South Africa. The company’s experience with the grievance mechanism pilot project underscored the importance of local ownership if these initiatives are to prove sustainable. Applying that lesson, Tesco has shifted its efforts to promote sustainable change in its agricultural supply chain in South Africa towards support for locally-driven initiatives, such as the SIZA program and the Management Diversity capacity-building program. By taking more of a ‘back seat’, Tesco hopes that its efforts will be more sustainable in the long run.

# Case Study D:

## Partnering for Success: HP's Multilateral Approach to Systemic Challenges in its Supply Chain

### Introduction

As a global electronics giant, HP is substantially invested in its supply chain for the technology products it brings to market. From the minerals essential to critical components to the assembly of its final products, HP's business model engages a vast supply chain. As a result, HP, like most multi-national brands, is sometimes several steps removed from the supplier or sub-supplier activities that could pose some of the most significant social risks. Many of these risks are relevant to the electronics industry as a whole, as well as to other industries at deeper levels of the supply chain.

HP often has limited direct leverage to incentivize better social performance by suppliers deep in this complex and multi-tiered supply chain. Equally, HP's suppliers are often not in a position individually to address these systemic challenges, which may have as their root cause issues related to political conflict, broad social

context, and national regulatory deficiencies.

### ***Tackling the Hardest Challenges***

*Some of the most significant human rights and labor risks in the electronics industry are systemic challenges, buried deep within supply chain, over which brands – and in many instances their suppliers as well – have limited leverage to promote improved conditions.*

These are often the hardest social performance challenges for companies to address. Companies cannot on their own prevent or mitigate the risk of these impacts, nor can their suppliers always do so through corrective action plans.

While many companies either feel powerless or forced to 'turn a blind eye' to problems that are systemic in nature and/or buried deep within their supply chains, HP

has taken a different approach. It begins with a systematic process of identifying the most severe forms of risk – regardless of where they might be found in their supply chain. It acknowledges a level of responsibility for addressing them, and works creatively through multilateral approaches with partners to seek constructive ways to do so.

### Systemic Challenges and the Electronics Industry

HP is one of the largest electronics manufacturers in the world, with a supply chain that stretches to virtually every corner of the globe. The company prides itself on its global citizenship, dating back to the vision of its founders to have a positive impact on the world through the company's business activities and the technology it produces.

However, HP's extensive supply chain touches upon some of the most difficult and systemic social performance challenges: from the extraction of 'conflict minerals' in conflict-prone parts of the world, to the manufacturing of its finished products in places like China and Mexico, where labor rights and working conditions pose systemic challenges. This is far from unusual in the sector today.

In managing these social issues, HP has taken a comprehensive approach to identifying and addressing human rights (including labor) risks. One important component of that approach is traditional social compliance auditing of its suppliers, which informs the identification of potential risks and requires suppliers to take corrective actions to address those risks. Suppliers are incentivized to undertake corrective actions through HP's supplier preference system, which places significant weight on social performance issues.

However, HP has also recognized that this approach alone would be ineffective in addressing many of the most severe risks in the company's supply chain, for several key reasons:

- First, many of the most severe impacts linked to HP's products are buried deep within HP's supply chain, several steps removed from the company, reducing its visibility into these issues and its leverage to address them;
- Second, much of HP's supply chain is shared with industry competitors and counterparts, and at the level of raw minerals, with other industries. This can pose further challenges to the direct leverage HP alone has over many of its suppliers;
- Third, many of these impacts are systemic in nature, having at their root cause factors that are beyond the control of individual suppliers to address effectively: factors such as armed political conflict (in the case of conflict minerals), social contexts, and deficiencies in national regulatory contexts for working conditions and labor rights. This means that, even with the best intentions, suppliers are often not in a position to address them on their own.

### **Systemic Human Rights Issues in HP's Global Supply Chain**

- *Conflict Minerals*
- *Labor Unrest in Mexico*
- *Student Workers in China*
- *Public Health for Migrant Women Workers*

## **A Multilateral Approach to Tackling Systemic Challenges**

The key features of HP's approach in tackling these types of systemic impacts is that the company openly identifies these challenges, accepts that it may not have complete solutions immediately at hand, and engages multilaterally with key partners and actors to attempt to address them. HP's Supply Chain Social and

Environmental Responsibility Team (SER) engages in a comprehensive 'heat map' exercise to identify the most severe human rights risks within its supply chain, based on internal inputs as well as feedback from external stakeholders. HP acknowledges a level of forward-looking responsibility to address these impacts, in line with the UN Guiding Principles for Business and Human Rights, and develops tailored programs around priority impacts, identifying key stakeholders with which to work.

*"So much good comes simply from talking about your problems, if you're open with [stakeholders]. You don't always have to have the solution. This kind of transparency breeds good will, common problem-solving, and other benefits."*

**– Bob Mitchell, Global Manager,  
HP Supply Chain Social and  
Environmental Responsibility**

Examples of HP programs (discussed below), include those that address responsible sourcing of ‘conflict minerals’ in its supply chain, labor grievances in the electronics industry in Mexico, the vulnerabilities of student and dispatch workers in China, and women’s health for migrant women workers in Asia. These programs – ranging from the development of industry standards, to the establishment of an industry-wide grievance mechanism, to the creation of multilateral dialogue processes, to a variety of training, education and capacity-building programs – illustrate multilateral partnerships with industry counterparts and associations; with NGOs, Socially Responsible Investors (SRIs) and other civil society organizations; with government authorities; and with suppliers. According to Jay Celorie, who manages HP’s conflict minerals program, *“What’s our end goal? We want to make a difference. We want to use our enterprise to make the right kind of difference in the communities in which we work. That objective shapes our response.”*

In looking across the range of HP’s programs to manage systemic social impacts, a consistent theme of multilateral engagement emerges. Zoe McMahon, HP’s Director of Global Social & Environmental Responsibility, credits three factors for this multilateral posture:

- A corporate culture premised on good global citizenship and having a positive impact on society through its business activities: *“There’s a sense at the company, that when faced with an issue where we might be linked to an impact, there’s a right thing to do as a company in general. As a result, there’s a high degree of tolerance for any recommendations that can enable us to make a positive contribution.”*
- Cross-industry learning, having seen early on the lessons from the garment industry in trying to tackle these problems individually as companies. As a result, there was an early evolution in the electronics industry towards cross-industry collaboration, through platforms like the Electronics Industry Citizenship Coalition (EICC).
- The personal approach of the initial internal champions within HP, who brought a background in mediation and an appreciation for the power of bringing people with different perspectives together to solve a problem. When the NGO SACOM (Students and Scholars Against Corporate Misbehavior) targeted HP and the electronics industry in general for being linked to ‘high-tech sweatshops’ through supply chains in Asia, according to McMahon, HP was willing to say, *‘We haven’t quite figured this out yet. We don’t know how to do this. You think you can help, so let’s work together on it.’*

This posture of multilateral engagement, and specifically engaging with vocal public critics, seemed like a radical move at the time, but it now defines HP’s approach to managing all types of challenging systemic issues.

### ***A Multilateral Approach***

*This posture of multilateral engagement, and engaging with vocal public critics, seemed like a radical move at the time, but now defines HP’s approach to managing all types of challenging systemic issues.*

## A Multi-Stakeholder Approach to Addressing Conflict Minerals

By the late 2000's, the electronics industry had been singled out by global civil society organizations for their use of 'conflict minerals' and their derivatives, including gold, tungsten, tin and tantalum, some of which are found and mined in parts of the world that are home to violent and entrenched armed conflicts. The mining of these minerals – used in a variety of ways in electronics products, as well as by other industries – in the Democratic Republic of Congo (DRC) and adjoining countries has been associated with severe human rights impacts on local communities, including the use of forced labor and extra-judicial killings by armed factions that control the minerals. However, for global electronics companies, these impacts occur in the deepest parts of their supply chains, many steps removed from the brands that manufacture electronics products, which generally have limited leverage to influence the conditions under which the minerals are sourced.

### **'Conflict Minerals'**

*Tin, tantalum, tungsten and gold are used in a variety of ways in electronics and other industries. But some of these are mined in the Democratic Republic of Congo (DRC) and adjoining countries, which are home to violent and entrenched armed conflicts, with severe human rights impacts on local communities.*

In response to these heightening concerns, HP was among a handful of leading technology companies that sought to engage early and begin addressing the issue of conflict minerals, as well as exploring how to source these minerals responsibly. Eventually, public attention to the issue would lead to US regulation placing reporting requirements on companies that source or use these minerals (through Section 1502 of the Dodd-Frank Act and the SEC's final rule implementing it, which apply to US-listed companies). However, even before this came about, HP worked with key industry and stakeholder counterparts to develop practical and feasible responses, which credibly positioned HP and the industry to help shape and inform the ultimate regulation, in addition to developing a range of supportive programs and activities.

Working through the Electronics Industry Citizenship Coalition (EICC) (an industry-wide platform of leading electronics companies focused on responsible sourcing in global supply chains) and the Global E-Sustainability Initiative (an initiative that promotes collaborative and innovative approaches to sustainability within the ICT industry), HP and industry counterparts formed an Extractives Working Group to tackle the issue of conflict minerals.<sup>45</sup>

The initial focus of the group was on tantalum, a mineral frequently used in the semi-conductors and micro-processors that power computers and other electronics, where the electronics industry's leverage was greatest. The Extractives Working Group then partnered with the tantalum industry association to develop an audit protocol for tantalum smelters, recognizing that smelters are the 'choke point' in the supply chain. This focus led to the Conflict-Free Smelter (CFS) program, which involves an independent audit of smelters to validate that their minerals are DRC conflict-free. According to Celorie: *"At the end of the day, smelters choosing to participate in the CFS program are making a business decision. So, for the program to be successful, it was necessary to get enough of their customers requesting their participation in the program."*

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<sup>45</sup> For more information, see: <http://www.eicc.info/>, and <http://gesi.org/>.

*“We all had common objectives. We didn’t like what was going on, and our stakeholders didn’t either. We all wanted to mitigate those impacts. But we needed them to understand the limitations of what we can do as companies at one end of the supply chain, where our leverage lies, and what was practical and feasible, and yet still would have the desired impact.”*

**– Jay Celorie, Manager of HP’s Conflict Minerals Program**

Accompanying the Conflict Free Smelter (CFS) program for tantalum were substantial joint training, education and awareness-raising activities, to ensure that all of industry understood the issues and saw the feasibility of the response. The CFS program is now being transitioned from an industry-led working group to a true multi-stakeholder initiative, involving civil society organizations and socially responsible investors. HP and the Extractives Working Group are turning their attention to tin and tungsten, which requires reaching out to other industries that are primary users of those minerals. Celorie summarized, *“It’s amazing how much you can achieve working collaboratively like that... You don’t feel like you’re trying to boil the ocean alone.”*

HP also participated in and supported a multi-stakeholder dialogue platform with socially responsible investors and civil society organizations concerned about the issue, ultimately leading to a joint consensus letter to the US Securities and Exchange Commission – one of the relevant regulatory agencies. According to Jay Celorie, who manages HP’s conflict minerals program: *“We all had common objectives. We didn’t like what was going on, and our stakeholders didn’t either. We all wanted to mitigate those impacts. But we needed the SEC to understand the limitations of what we can do as companies at our end of the supply chain, where our leverage lies, and what was practical and feasible, and yet still would have the desired impact.”*

## **Collaborating to Promote Industry/Labor Dialogue in Mexico**

In Mexico, there is a thriving electronics manufacturing industry. HP has a significant presence, and the company plays a leading role in CANIETI, the electronics industry association in Mexico,<sup>46</sup> as well as other cross-industry business associations.

In the past several years, much work has been done in Mexico to strengthen the legal and regulatory framework for labor issues across many different industries. However, in practice, many significant challenges remain for workers in all types of factories, such as employers’ failure to pay social insurance and other benefits, health and safety issues, working hours, and the rights of terminated workers. More broadly, the weakness or exclusion of trade unions, and the absence of constructive channels for dialogue when these issues do arise means that they often lead to worker strikes and management lockouts. These challenges, and the broader labor unrest that result, are not a problem for one specific company or industry in particular, but an issue across industries that frames the broader business context and labor relations climate in Mexico. Battles are often waged through public media campaigns by industry representatives and the civil society organizations that represent workers’ rights, despite ongoing efforts to create forums to address these issues before they escalate, and for constructive dialogue when they do.

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<sup>46</sup> See, <http://www.canieti.org/Inicio/English/englishcan.aspx>.

As an industry leader, HP grew concerned about this broader confrontational climate. In one instance, HP leaders were able to play a brokering role between the NGO CEREAL<sup>47</sup>, which campaigns for workers' rights, and a company in another industry, to promote more constructive dialogue around allegations of poor working conditions. In getting to know and understand CEREAL, HP saw an opportunity to have a positive impact on labor relations more generally.

The mediating experience “created the opportunity to sit with CEREAL, learn about their approach and the issues they cared about, and realize that they were not the ‘monster’ they had been made out to be, but that they were working for the common good on issues also important to HP,” according to Iliana Ponce, from HP’s SER team in Mexico. The feeling was, “If this worked, why not try something at a more institutional level? Why not tackle these issues more systematically and proactively? So we created a grievance process to be used in the electronics industry and to help CEREAL mediate between them [i.e., workers] and the company.”

*The feeling was, “If this worked, why not try something at a more institutional level? Why not tackle these issues more systematically and proactively? So we created a grievance process to be used in the electronics industry and to help CEREAL mediate between them [i.e., workers] and the company.”*

**– Iliana Ponce, HP SER Team in Mexico**

This process of dialogue between HP and CEREAL led to the establishment of an industry-wide grievance mechanism for labor complaints by workers against companies. The mechanism is managed by CEREAL and CANIETI and is intended to address issues at an early stage, before they need to become the subject of mass public campaigns. In the first stage, CEREAL brings labor complaints to the mechanism, and CANIETI facilitates a direct point of contact within the company that is the subject of the complaint. If direct dialogue fails to produce a satisfactory resolution, the mechanism offers third-party mediation.

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**– Felipe Burgueno Gonzalez,  
CEREAL, International Liaison**

According to CEREAL,<sup>48</sup> some of the positive results of the mechanism have included substantial reductions in cases of discrimination in the workplace and the incidence of workplace accidents; much more rapid resolution of cases (from an average time of 1 year to an average time of 2 months); and a platform for dialogue on more difficult issues such as freedom of association and the use of temporary workers. Felipe

<sup>47</sup> See, <http://www.cerealgdl.org/index.php/en/>.

<sup>48</sup> CEREAL, “Labor Rights in a Time of Crisis, CEREAL’s third report on working conditions in the electronics industry in Mexico,” 2009, available at [http://goodelectronics.org/publications-en/Publication\\_3281/at\\_download/fullfile](http://goodelectronics.org/publications-en/Publication_3281/at_download/fullfile)

Burgueno Gonzalez, the International Liaison at CEREAL, added, *“Since we started the dialogue with the electronics industry, HP has played a very important role in the consolidation of the dialogue with other companies in the electronics industry, and its role has been crucial to remedy some of the cases before going public to the media. We have had many advances in human rights since we started the dialogue several years ago, and the relationship has grown in trust and closeness. However, it is necessary to make further progress on [more systemic] issues that we have not yet worked on very deeply, such as freedom of association and decent wages. We believe in dialogue and hope HP will continue being a part of it.”*

In addition, HP now hosts a joint meeting each year, before CEREAL releases its annual report profiling company labor practices, to which they invite all the companies named in the report and CEREAL. The companies are provided with both a chance to hear directly from the aggrieved workers and an opportunity to respond to and address the allegations before the report is published.

The process has transformed the dynamics between the parties and created constructive dialogue where there was none before. HP is now leading some of the industry association’s efforts to collaborate on training for others in the industry – particularly small and medium-sized enterprises and out-sourcing companies (which hire a substantial portion of their workers from third-party employment and recruitment agencies), which face problems of both capacity and commitment. With the out-sourcing companies, HP is working with industry counterparts to exercise collective leverage on those suppliers to prevent and manage labor grievances more effectively.

## **Vulnerable Supply Chain Workers: Student Workers in China**

In China, student workers are a particularly vulnerable category of workers. According to Sanna Johnson of the Center for Child Rights and Corporate Social Responsibility in China, there are more than 13,000 vocational training schools in China, with more than 22 million students, each required to do an internship. While these internships are supposed to be supervised experiential learning opportunities, they have become a ready supply of inexpensive labor for factories facing a broad national labor shortage, while production demands continue to escalate.

Many of these students, who seek internships across a variety of industries, are between 16 and 18 years old, isolated from their families, and dependent on their teachers and institutions for their degrees. This combination of factors makes them particularly vulnerable to any labor practices that might violate international norms and standards, as domestic regulations and

enforcement evolve to catch up with the issue. Students may be required to work well in excess of the legal eight-hour daily maximums, their pay may be withheld by teachers, and they may not be free to leave without penalty if they were to decide to return home. Confrontational communications with managers, who may lack managerial skills, can add to psychological stress. Students may also be subject to recruitment fees, fines, and other financial penalties that further cut into the pay students are intended to earn.

Impacts on student workers in HP’s supply chain in China recently emerged as a high-priority risk in the company’s ‘heat map’ exercise, based on the company’s own analysis and feedback from stakeholders. According to Bob Mitchell, who manages HP’s Social and Environmental Responsibility in Supply Chain

*“Brands who have their eyes open don’t like the way these practices look, and NGO’s don’t either.”*

**– Bob Mitchell, HP**



program, *“Brands who have their eyes open don’t like the way these practices look, and NGO’s don’t either.”* However, the status of student labor in China is a daunting, systemic reality, in which no company working on their own can expect to have significant leverage over the many factors that influence the situation.

One of HP’s first moves in addressing the challenge of student labor was to identify credible partners, interested in addressing the problem and with which it could work. According to Ernest Wong, who manages SER issues for HP in Asia: *“We really want to see some improvement. We want to understand the root cause. If we can’t do it on our own, we want to figure out who we can partner with.”* HP approached two China-based civil society organizations with expertise on the issue, the Center for Child Rights and Corporate Social

*“We really want to see some improvement. We want to understand the root cause. If we can’t do it on our own, we want to figure out who we can partner with.”*

**- Ernest Wong, HP**

Responsibility (CCRCR) and the Labor Education Service Network. Together, they developed and distributed draft guidelines for their suppliers, which set clear expectations for how to manage student labor responsibly. The standard requires labor agreements signed by student, school and factory, supervision from the technical schools, fair payment of at least the legal minimum wage to

students, insurance coverage, and the presence of effective grievance mechanisms. It also sets a target that no more than 20% of a factory’s workforce should be comprised of student labor, and requires suppliers to engage in the necessary due diligence with the vocational schools with which they partner. According to Sanna Johnson of CCRCR, *“The HP framework takes all the right actions: maximum working hours, the difficulty of the work, tripartite agreements signed by all parties, with a focus on the learning experience for the students.”*

HP then tested those guidelines through several audit events and through multi-stakeholder forums convened with its civil society counterparts in Chongqing and Shanghai. The forums, which also sought to better understand the problem from multiple perspectives and explore possible solutions, included relevant government agencies, NGO partners, a total of 70 suppliers, technical schools, and an industry counterpart.

Informed by that dialogue, HP is continuing to refine its guidance standard, and released a new version of the guidelines publicly in July 2013, with stakeholder feedback integrated to improve the standard. In addition, HP created a specific audit protocol with a well-known third-party audit firm to measure supplier performance against the student worker guidelines. HP is now working with its NGO partners to provide training and capacity-building for factories around the standard. At the same time, HP is educating industry counterparts about the standard and hopes to take it forward at an industry level through platforms like EICC.

*“Who should bear the costs of these efforts? That is where HP is good. They recognize their responsibility towards their supply chain, and they recognize the need to take action themselves. We see other companies that just complain that suppliers should be taking the responsibility.”*

**- Sanna Johnson, Center for Children’s Rights and Corporate Social Responsibility**

According to Johnson of CCRCSSR, one of the biggest challenges is that multinational companies have been slow to acknowledge responsibility for these impacts: *“Who should bear the cost of these efforts? That is where HP is good. They recognize their responsibility towards their supply chain, and they recognize the need to take action themselves. We see other companies that just complain that suppliers should be taking the responsibility... We hope that the steps that HP is taking will guide others. You need to invest in your suppliers, set expectations, and help them see the business benefit of improving working conditions.”* Johnson says that some factories are now approaching CCRCSSR for similar training, having recognized a business case in retention of workers and a competitive advantage with international brands if they can manage these issues responsibly.

## Vulnerable Supply Chain Workers: Women’s Health among Migrant Workers

Another issue that has emerged through HP’s ‘heat map’ exercise is the vulnerability of women migrant workers across its supply chain. These workers often come from rural areas to work in factories, where they lack family support and lack basic knowledge of public health issues. HP engaged with Business for Social

Responsibility’s (BSR) HER project (‘Health Enables Returns’)<sup>49</sup>, through which brands partner with BSR, their factories and local NGO training partners to provide peer education on public health issues to women workers.

Traditionally, the project has been very popular in the apparel industry, but less so in the electronics industry. A case study by Levi’s and BSR on the project

measured the return on investment for suppliers

participating in the program, which moved beyond good public health outcomes to a net positive return for the business. Although HP has not measured the effectiveness of the program in pure financial terms, the program is tremendously popular with its suppliers, and HP has seen a correlation with overall social performance: suppliers that participate in the HER project systematically out-perform suppliers who do not in their overall social and environmental performance.

HP acts as a facilitator in the project, connecting factories to BSR and local NGO training partners. Initially, HP secured seed funding from the Packard Foundation for several of its suppliers, but suppliers now pay the cost of the program themselves.

## ‘Leaning Into’ Relationships with NGOs

One of the defining characteristics of HP’s approach to systemic supply chain challenges is a corporate culture that views its relationships with key stakeholders, many of whom are often critical of HP’s management of social

*“We value our relationships with NGOs, SRIs [Socially Responsible Investors], and other stakeholders. We lean into these relationships, as opposed to leaning out.”*

**– Jay Celorie, HP**

<sup>49</sup> See, <http://herproject.org/>.

and environmental issues, as constructive opportunities. According to Jay Celorie, *“We value our relationships with NGOs, SRIs [Socially Responsible Investors], and other stakeholders. We lean into these relationships, as opposed to leaning out.”* HP relies on these relationships both at the front end – in identifying potential social risks to address in its supply chain – and at the back end – collaborating on potential solutions. *“We get as much out of talking with them as they do out of talking with us. They help us in our risk identification and assessment processes. We can find out what they’re working on, and tell them what we’ve been working on.”*

## **Conclusion**

Through its multilateral approaches, HP has not fully ‘solved’ systemic labor and human rights risks such as conflict minerals, labor grievances in Mexico, the vulnerabilities of student workers in its supply chain in China, or women’s health in its workforce. However, HP has recognized its responsibility to address these issues and used its leverage to engage relevant actors – counterparts from industry, suppliers, government authorities, and civil society – around better understanding the problem and exploring solutions.