

Corporate Social Responsibility and Global Supply Chains

Corporate social responsibility is key to national economic growth, socioeconomic development, and enhanced business and labor competitiveness.

Corporate Social Responsibility, or CSR, is defined as operating a business in a manner that meets or exceeds legal and societal expectations, fostering both business benefits and positive development impacts. CSR covers a wide range of business activity, but everything centers on business' voluntary efforts to improve social and environmental standards. The distinction with corporate philanthropy is straightforward: CSR concerns the way a business is managed, philanthropy concerns the way business profits are allocated.

In the early 1990s, production outsourcing from developed countries increased at the same time that communication technologies were becoming increasingly global. A number of well publicized sweatshop scandals increased concerns about the conditions under which internationally outsourced goods and services were being produced. Many multinational corporations responded by designing voluntary codes of conduct that specified the social and environmental standards they wanted to see applied right through their supply chain, no matter where production was taking place. In almost all cases, the standards within these codes were higher than those that were being enforced at that time in developing country factories.

Code implementation

Sustained implementation of codes of conduct has helped ensure an effective compliance regime, which has contributed to improving factory working conditions and relationships with surrounding communities. This has in turn helped host governments ensure their national legislation is

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effectively enforced within factories. Good standards also appear to make good business sense. At the level of the supplier factory, there is growing evidence of a positive link between good labor management and increased productivity, improved quality through a reduced number of defects, lower employee turnover and absenteeism and a lower number of accidents. At the level of international buyers, the risk of negative publicity over child labor, for example, is mitigated, while an increasing number of premium brands seek to differentiate themselves in the consumer marketplace by including some concept of guaranteed production standards in their brand image.

The apparel and footwear industries were among the first to take the lead in using CSR as a minimalist mitigation strategy against negative publicity. They were among the first to adopt voluntary codes of conduct, and to develop mechanisms for monitoring, third party inspections, reporting, and the adoption of remediation systems and training programs for supplier factories. Each major international buyer typically implemented such sys-

tems down their individual supply chains, requiring sourcing factories to participate.

These activities have gained momentum over the last 15 years. Private inspection industries, labeling programs, and multi-stakeholder initiatives have multiplied. CSR practices and compliance with codes of conducts - of varying standards - are now seen as a prerequisite to doing business with most major international buyers. Yet, costs are higher for both buyers and suppliers; benefits are often assumed rather than measured; duplication and inefficiencies are widespread, since most apparel factories sell to multiple buyers, each requiring their individual code be implemented, monitored and inspected. And all of this monitoring activity happens alongside inspection regimes of host government labor and environment ministries.

A small but growing number of national governments are now beginning to recognize two things. First, that CSR systems can help them get their own labor and environment laws enforced within factories supplying international buyers with codes of

Box 1: Economic Theory and Evidence Related to Core Labor Standards

Forced labor: In addition to compelling moral and human rights concerns, forced labor reduces human capital development and erodes national competitiveness.

Child Labor: Child labor reduces human capital development (health & education), reduces future earnings, and is significantly related to the intergenerational transmission of poverty. The ILO estimates that if child labor is eliminated worldwide, the economic gain, at the present value, is in the order of US\$5 trillion between the 2000-2020 period (ILO, 2004).

Discrimination: Discrimination in employment and pay creates inefficiencies and impedes economic growth by underutilizing and misallocating human capital resources. It also can exacerbate poverty among already-vulnerable groups including women and ethnic and religious minorities.

Freedom of association and collective bargaining: No significant correlation with growth or productivity. Many studies show that unions reduce income inequality though little evidence in developing countries.

conduct; and hard-pressed public sector inspectorates, knowing these parallel systems are being implemented in major factories, can focus their limited inspection resources on factories supplying the domestic market where standards are typically much lower, or on other industries where CSR codes are not implemented. Secondly, national governments are realizing that guarantees of good labor standards can help their national economic competitiveness strategy, since evidence of good standards is increasingly required by buyers, investors and project financiers, and is increasingly included in free trade agreements or systems of trade preferences.

Governments have been following this innovative strategy in a number of different ways, ranging from self evaluation to certification. These forms of public-private collaboration present opportunities for achieving better and more comprehensive enforcement by capitalizing on private sector incentives. In each of these cases, the firm's motivation is the anticipation of market rewards, since these voluntary monitoring and certification schemes are typically required or appreciated by international buyers.

In early 2004, a number of brands and retailers, international institutions, trade unions and NGOs known together as the 'MFA Forum' came together internationally to better understand the implications of the end of the MFA, particularly for workers and communities, and to explore ways to best promote collaborative approaches in mitigating negative impacts while taking advantage of new opportunities. Several pieces of research have been the specific outputs of the Forum's work to date, intended to raise awareness and facilitate dialogue and action. Such works recognize "that a failure to responsibly handle the transition to a post-MFA world carries several dangers:

- Foremost is the negative impact on workers, communities and local and national economies of losing critical employment and earnings potential.

- Damage to the reputations of business as well as other institutions

Box 2: Message From Paul Pressler President and Chief Executive Officer, Gap Inc.

In the days after we released our first social responsibility report last year, it wasn't easy to see headlines like, "Gap admits factory abuses."

But this was more than offset by positive responses from the media, employees and other stakeholders who told us how much they appreciated our candor - and how they wanted to work with us to address the challenges described in the report.

Their response renewed our commitment to improving garment factory conditions, and reinforced our belief that talking about challenges is an important step toward resolving them.

Of course, we know that driving change of this magnitude isn't easy. We've taken important steps toward safer conditions and better treatment for workers in garment factories, but the social responsibility issues across the industry remain immensely complex.

I'm optimistic, however, that progress in our industry over the next decade will be more profound than anything we've seen, including improved labor standards, factory conditions and business practices - because ethical sourcing represents a better way of doing business in a global economy.

That doesn't mean we expect our efforts to create a competitive advantage. While ethical sourcing is an essential part of the long-term growth and sustainability of our business, our goal is to help improve conditions across the apparel industry as a whole. And we know that's not something we can do alone.

Over the past year, we've learned the power of collective engagement, and of open, honest discussion about the issues that we and many other companies face. As such, we have been expanding our participation in collaborative efforts.

In Cambodia, for example, we continue to support the International Labor Organization's (ILO) factory monitoring and training efforts, which, according to a World Bank survey, are helping the country compete more effectively in the international apparel market.

And we recently partnered with the International Finance Corporation's Mekong Private Sector Development Facility (IFC/MPDF) to launch a new managerial skills training program for factory supervisors.

The elimination of trade quotas represents an historic shift in our industry, changing how apparel retailers source their products. This creates new challenges, but it also creates new opportunities to build strategic relationships with garment manufacturers who share our commitment and values.

In 2004, I visited one such garment manufacturer in India. His factories provide workers with childcare facilities, free eye care and access to medical services. And he has incorporated sound environmental practices, like rainwater harvesting, into his operations. He sees that social responsibility is good business, and, as a result of his efforts, his turnover rates are low and his productivity is high.

We know that, unfortunately, this example isn't the norm. So we remain committed to working with garment manufacturers to help them improve.

For instance, we are partnering with the China Association of Enterprises with Foreign Investment (CAEFI) and several leading companies to form the Better Workplace Foundation in China. This group maintains an ongoing discussion about labor laws with the Chinese government, and will help factory owners understand how better labor standards can make their businesses stronger.

Examples like this are encouraging and reinforce that making progress requires going beyond what's expected. That's why we're continuing to push the boundaries of what's possible, piloting new programs and learning along the way.

These same principles of exploring, collaborating and continuous learning shape our efforts across the company and have become part of our culture.

Source: Gap, Inc., 2004 Social Responsibility Report (extract)

in not addressing negative impacts on workers, and resulting decline in trust and active collaboration with business in addressing the social and environmental dimensions of the sector.

- The erosion of trust in the broader agenda of development through trade."

The MFA Forum concludes that dangers can be most effectively addressed through action at several levels:

a) Promoting enabling public policy, for example, in the sphere of trade;

b) Building strategic supply chain partnerships that balance social and commercial interests; and

c) Mitigating negative social consequences of sector restructuring e.g. through compensation, promoting employment opportunities, and retraining.

A number of such schemes exist in different countries with the encouragement of national governments. Emerging good practices are typically defined to be:

1. Sector-wide aiming for 100% of firms in the sector, since one bad apple can ruin the reputation for all firms in a country.

2. Transparent.

3. Have a shared governance structure.

4. Involve international buyers.

5. Reduce inefficiencies (duplication in monitoring) among both public and private inspections.

6. Measure productivity gains systematically, including firm-level baselines.

7. Achieve market-based incentives.

Labor standards and economic development

Adherence to labor standards can contribute to a country's overall economic and social development, as well as expanding market access. The link between development and labor standards has been examined most closely for a subset of 'core' labor standards: progressive elimination of child labor; ban on forced labor; non-discrimination in employment; and free-

dom of association and the right to collective bargaining. These standards enjoy very strong international support. Economic evidence also suggests the importance of these as national economic policy priorities.

Collectively, compliance with core labor standards is correlated with higher national income. At least one study has also found that the rates of economic growth are higher for countries with good or medium level core labor standards, with stronger effects in developing countries. There is also evidence that low labor standards can erode national competitiveness by reducing incentives for human capital investment. Higher labor standards provide firms incentives to invest in

productivity-enhancing training to justify the expense of complying with standards. Likewise, workers have an incentive to improve their skills, as there are opportunities for higher wages when minimum standards are respected. Low wages as the result of repression of core labor standards also reduce incentives for firms to adopt labor-saving technology, thereby limiting the productivity and growth potential of firms in countries with low standards.

Studies reveal that foreign direct investment does not favor low standard economies or that such countries have higher aggregate exports. The World Bank has also concluded that many East Asian countries can

Box 3: Survey of Buyers Intentions by FIAS

In mid2004, FIAS surveyed key international buyers from Cambodia about their perceptions of Cambodia's performance on these issues relative to regional competitors (Thailand, Bangladesh, China, and Vietnam).

Fifteen of the largest US and EU buyers, together accounting for 45% of Cambodia's garment exports, were interviewed using one-on-one structured interviews. Senior sourcing staffs, rather than CSR staff, were targeted in order to avoid any bias towards CSR. Interviewees understood the survey to be about apparel competitiveness and were not initially aware of the CSR focus.

Performance ratings on each of the sourcing criteria listed show that buyers consider Cambodia to have an advantage over Bangladesh, Thailand, Vietnam and China on labor standards. They also consider Cambodia to outperform competitors over tariff preference and union rights while ranking less well on access to international materials and supplies; political and economic stability; and customs efficiency.

When asked about key challenges facing Cambodia's industry at the end of the quota system, buyers mentioned the need to balance increased labor standards with competitive prices and labor costs, against intensified competition from China. Improving productivity, infrastructure, the level of education and skills of workers, the sourcing of raw materials and the speed to market while reducing corruption were cited as important issues to address to improve Cambodia's competitiveness.

Cambodia ranked fairly well on quality, but has progress to make on price and delivery lead times if it is to be competitive in the post-MFA world. Buyers were insistent that compliance with labor standards is not sufficient for the Cambodian garment industry to survive and grow. Seventy-five percent of buyers surveyed said that red tape, corruption and high energy costs must also be addressed, if production costs are to be competitive.

The survey results confirm the existence of a market niche based on high labor standards. Not only do buyers rank compliance as a top priority but an overwhelming 79% stated that auditing of labor standards remains crucial after January 2005. This labor standards advantage is the only issue on which buyers surveyed believe Cambodia outperforms its regional competitors.

Source: FIAS, Cambodia: Corporate Social Responsibility in the Apparel Sector and Potential Implications for Other Industry Sectors (pages 10-16)

improve protection of fundamental worker rights advising that doing so would not negatively impact competitiveness in labor-intensive exports.

Standards beyond this core set of basic worker rights - sometimes referred to as "cash standards" such as minimum wages, mandatory benefits (e.g. canteens, health centers), hours of work, and occupational safety and health standards - may more directly affect labor costs. Here, the evidence is mixed and the outcomes depend very much on the level at which the standards are set. Though under-studied in poorer countries, occupational safety and health provisions tend to be beneficial. For example, costs of work-related accidents and illnesses in OECD countries are estimated at 2 to 4% of GDP.

Some international evidence indicates that regulations which significantly limit employers' decisions in hiring and retention of workers tend to be associated with a less dynamic labor market, lower aggregate employment levels and higher informal employment. Low income countries that have not established good mechanisms for income support or social safety nets outside the firm tend to regulate this employment relationship more strictly. When enforced, these provisions can benefit workers who are employed and covered by the legislation, but at the cost of total employment gains. On the other hand, many have argued that employment protection rules strengthen workers' attachment to firms and skill development, which reduce costs.

CSR advocates and many leading companies have argued that improving working conditions can have firm-level benefits beyond accessing or expanding orders from reputation-sensitive buyers. Many anecdotes support this argument, but there is an absence of rigorous analyses on the impacts of labor standards compliance on firm level indicators such as productivity and profitability.

A number of factories that have voluntarily improved working conditions in order to attract buyers often report other benefits. For example, a state owned textile factory in

Vietnam reported a 5% increase in productivity after achieving certification under the Social Accountability 8000 standard. A private apparel firm also operating in Vietnam noted a 20% increase in profits following investments in labor standards improvements. Participants in the ILO Factory Improvement Program in Sri Lanka were found to reduce end

line defects from 13% to 8%. Worker absenteeism went down from 8% to 5% and turnover from 9% to 7%. Factories involved in an adapted version of the Sri Lankan program piloted in Cambodia reported impressive results in quality and productivity gains: one factory reported a 67% drop in turnover, 48% improvement in productivity and 16% increase in wages.

Box 4: CSR in the Cambodia's Tourism Industry

The tourism industry is the second biggest contributor to GDP and with its recent high profile labor dispute and international press coverage on child prostitution, the hotel and tourism sector seemed to be one where CSR-based initiatives for social and environmental standards might be a promising initial development and risk mitigation strategy.

The FIAS advisory project team consulted with most industry stakeholders within Cambodia. The industry was unanimous in assessing that the sector is not boosting the local economy as much as it could through backward linkages. Few Cambodian products and services are available that meet the needs and standards of the industry. 95% of all food produce is imported into Cambodia from Vietnam and Thailand. All businesses consulted agreed that buying more local products and services would be an important contribution to the economic development of communities in Cambodia and at the same time reduce costs.

Finally, businesses also mentioned the lack of initiatives targeting visitors' introduction to Cambodian culture. Traditional performing arts, historic restoration, handicrafts and other local aspects are an important part of the Cambodian culture, but few consider it their role to undertake or support initiatives in this area.

There is no Tourism Law in the Kingdom of Cambodia, and no legally enforceable regulations to govern the development of tourism. The Private Sector Working Group on Tourism is playing a key role in working with the government to help develop and review a Tourism Law, a system for Hotel Classification, and the development of a Cambodia Tourism Marketing and Promotions Board (MPB). But these three legal instruments have not yet been approved.

Efforts to develop tourism certification programs with international recognition are in their infancy. These initiatives, though anecdotal, confirm the existence of trend in responsible tourism that could be built on by Cambodia, if the country chooses to brand itself as a comparative haven of responsibility. Costa Rica, for example, has a nationwide certification scheme for its tourism industry since 1997.

As Cambodia looks ahead to develop a marketing strategy it could differentiate its offer by developing a niche appeal to the CSR-conscious and higher-end tourists. This would require to shift from the current strategy of seeking to maximize the number of visitors - posing a threat to the environment while providing little returns in terms of amount spent or length of stay - towards one of developing higher-end quality tourism.

This would as well reinforce the Royal Government of Cambodia's strategy to promote the country as environmentally and socially responsible, building on the achievements of the garment sector in improving labor standards. Tour operators are beginning to produce codes of conduct and supply chain guidelines that could help market Cambodia to this growing segment of the tourist market, as well as help the Cambodian industry understand the demands of the socially responsible tourist. The Private Sector Working Group's current process of drafting "Chart of Tourism" is a step in the right direction.

Source: FIAS, *Cambodia: Corporate Social Responsibility in the Apparel Sector and Potential Implications for Other Industry Sectors* (pages 24-27)