Factory Labour Standards in Emerging Markets: An Investor Perspective

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1. Why are investors interested in labour standards?

F&C invests over £90 billion[1] in companies listed publicly in Europe, North America, Asia-Pacific and Emerging Markets. As an investor in both manufacturers and distributors with global supply chains, F&C views the effective management of working conditions in factories as key to overall commercial success. Although standards in factories in emerging markets are rising in certain areas, such as health and safety, companies have not made inroads in resolving the greatest challenges, such as wages and child labour. These are symptomatic of deeper economic and political problems, and sometimes of failing and unaccountable governments. As these problems impact business performance, F&C believes that investors and companies must drive and develop effective responses. This research note focuses on steps companies can take to rise to key challenges in factory labour standards.

F&C's main concerns about labour standards are:

- **Security of supply:** Business models that rely on a low-cost supply base require a secure supply of high-volume goods. Under-investment in factory working conditions has been increasingly associated with lower productivity, particularly as factories require higher skills and labour pools begin to shrink. Poor conditions may fuel employee dissatisfaction, raising the risk of work stoppages or higher attrition, as has happened in certain regions in China where labour shortages have driven up wages, benefits and levels of staff turnover. Companies sourcing from such factories may therefore face greater disruption and be forced to find new suppliers at short notice.
- **The impact on consumers:** In Western markets, allegations of "sweatshops" can erode brand loyalty, especially if companies position themselves as "green" or "ethical", as is increasingly the case. Moreover, one key value driver in the capital shift to emerging markets is the rise of the domestic consumer, a trend that is fuelled by growing wages and rapidly-improving living standards. As emerging economies mature and wages rise, investors will seek out value by funding businesses that capitalise on this trend; conversely, this rise in living standards and aspirations can be expected to fuel the same expectations of improved productivity and working conditions as has been experienced in developed economies.
- **Transparent communication:** Investors expect to see evidence that supply chains are productive and secure; this means that as the capital markets' awareness of the importance of factory working conditions increases, disclosure of supply chain risks should include management of these risk factors. To the extent that this information is lacking, investors may be inclined to discount stocks of companies with poor disclosure or evidence of weak practices.
- **What are factory labour standards?** Factory labour standards[2] refer to the working conditions provided by the owners and managers of factories that manufacture goods for supply to domestic and international companies. This involves whether a factory provides a safe working environment for workers, acceptable hours of work and wages, respect for the right to join a trade union; and takes steps to avoid discrimination, child and forced labour in the workforce. Companies that buy goods from factories located in emerging markets are more likely to meet labour standards problems, as local employment regulation may be poorly enforced or not meet international standards.

[1] As at 30th September 2008

[2] In addition to factory labour standards, "supply chain labour standards" are often referred to by labour standards practitioners. These refer to the employment conditions for workers in the supply chains of companies sourcing good internationally, including in factories, farms, plantations and workers' homes. This research note focuses only on factories.

- **What defines "good" factory labour standards?** There is debate about whether international labour standards should form the basis of national regulation and company policies. As a global investor, F&C defers to the internationally-agreed standards already debated at the United Nations: the International Labour Organization's (ILO) core Conventions. These are defined by the United Nations as "fundamental to the rights of all human beings at work," and have been ratified and enshrined in legislation by a significant proportion of the world's nations, including the UK. However, some countries, including the USA and India, have not ratified all of the ILO Conventions,[3] which may explain why companies do not support these publicly.

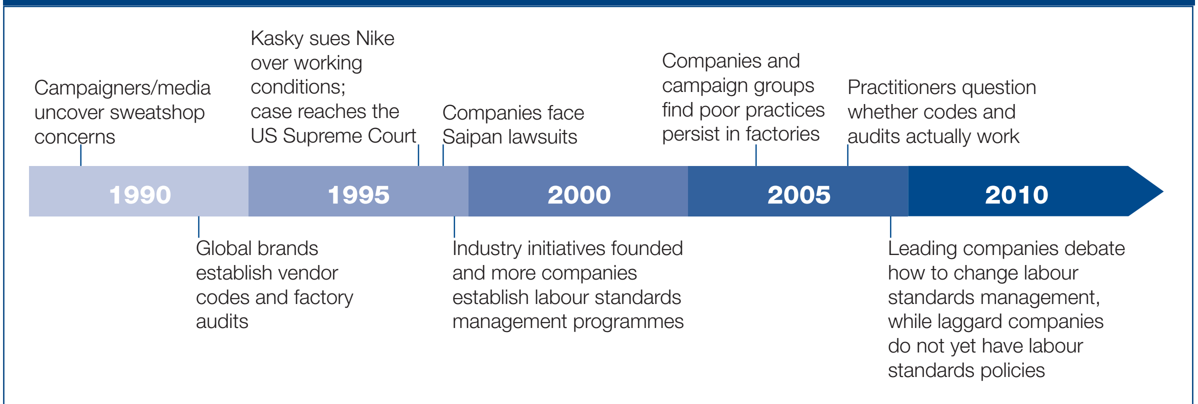
F&C's view is that to be effective, labour standards policies need to be informed by both national laws and recognised international standards. F&C expects companies to uphold local labour laws, and if operating across markets where regulation differs, to endorse the ILO core Conventions, as these international standards address the main concerns likely to arise in emerging markets factories.

The eight ILO core Conventions cover:
1. The Worst Forms of Child Labour (Convention 182)
2. Minimum Age (Convention 138)
3. Abolition of Forced Labour (Convention 105)
4. Forced Labour (Convention 29)
5. Freedom of Association and Protection of the Right to Organise (Convention 87)
6. Discrimination in Employment and Opportunity (Convention 111)
7. Equal Remuneration (Convention 100)
8. Right to Organise and Collective Bargaining (Convention 98)

Is management of factory labour standards improving?

Over the last decade, companies have made substantial progress in improving labour standards in emerging markets, particularly in establishing codes of conduct and factory auditing. Yet despite this, customers have continued to be startled by exposés of "sweatshops" in the supply chains of global brands, suggesting that companies still struggle to spot problems early enough. The most intractable challenges in this area remain defining "fair" workers' wages, respecting union rights and curbing child labour.

Timeline of management of factory labour standards



[3] The USA and India have large populations of children and have not ratified Convention 138 concerning minimum age and relevant to eliminating child labour.

- **1998 – The year of the sweatshop:** Investors were first alerted to poor factory labour standards in the 1990s, when global brands were criticised by campaign groups and the media for sourcing from factories with "sweatshop" working conditions. A series of lawsuits[4] prompted investors, including F&C,[5] to assess the labour standards risks in their investments. In order to help protect brand and shareholder value, F&C actively pressed companies faced with significant labour standards risks to introduce a labour standards code of practice, and to audit factories in emerging markets to identify and manage labour standards risks.
- **2000 – A year of pledges:** Following unrelenting public pressure, including by F&C, many high-profile global brands had, by 2000, publicly committed to auditing factories against specified labour standards. A large number of companies had, by this time, introduced promising new labour standards programmes,[6] including formal labour standards policies and processes to drive compliance by suppliers.
- **2005 – 2007 – Broken promises:** Despite some examples of good practice, including GAP, Nike, Marks & Spencer and Nokia, companies have not been able to head off further exposés – to their frustration, and despite good-faith efforts to improve practices and uphold labour standards policies.

They said...

"The reality is that most major retail firms are in the same game, cutting costs and not considering the consequences. They should know by now what outsourcing to India means. It is an impossible task to track down all of these terrible sweatshops, particularly in the garment industry when you need little more than a basement or an attic crammed with small children to make a healthy profit."

– Global March Against Child Labour, 28th October 2007, The Observer

They said...

"Of the world's children, one in seven is in child labour of some kind....in the Asia-Pacific region 122 million children aged 5-14 work"

– ILO, Facts on Child Labour, 2006

- **2008 and 2009: The years of re-evaluation: Can labour standards management systems be effective in protecting shareholder value?** Action by manufacturers, wholesalers and retailers to tackle labour standards has resulted in change, but the pace of change has been slow. In 2008, with the Beijing 2008 Olympics, campaign groups have turned up the heat, pointing the finger at iconic brands and alleging persistent breaches, while Western consumers increasingly question whether where they shop really is "green" and "ethical." F&C has engaged with companies to understand the challenges they face in managing labour standards.

[4] In 1998, the issue reached the courts as high-profile litigation against Nike (Nike vs. Kasky) alleged the company had issued false statements about its labour standards. In 1999, campaign groups filed three lawsuits against 26 US retailers and 23 garment manufacturers in Saipan alleging violations of US labour laws and international human rights standards. This resulted in a $20 million settlement involving back payments to 30,000 workers and mandatory factory auditing.

[5] F&C's work in this area was undertaken by its predecessor companies, Friends Ivory & Sime and ISIS Asset Management.

[6] Labour standards programmes typically involved:
- Publishing a formal labour standards policy or vendor code;
- Dedicated personnel to oversee implementation of the code;
- Collecting data from suppliers to check the code was implemented, including auditing factories against it, either through in-house or third-party auditors;
- Requiring non-compliant factories to take "corrective actions" to meet the code;
- Participating in new industry initiatives to share good practice, such as the UK's Ethical Trading Initiative, in Europe the Business for Social Compliance and the Fair Wear Foundation and in the USA the Fair Factories Clearing House.

2. F&C's dialogue with companies: What have we learned?

F&C engaged with 231 companies on labour standards in 2007, through a combination of: exercising its voting rights at company Annual General Meetings, meetings and correspondence with Chief Executives, Finance Directors and specialists in Sustainability and Purchasing. F&C's findings are that:

- **There is a significant gap between leaders and laggards on factory labour standards.** Beyond the leading companies with established labour standards programmes, many companies have not adopted codes based on international labour standards, undertaken factory audits or reviewed their purchasing practices. Adoption of labour standards codes is less prevalent outside of Europe, among medium-sized companies and brands that have not been targeted by campaign groups. F&C's engagement indicates that such companies may be underestimating the extent to which labour standards could present both risks from business disruption and opportunities relating to enhancing productivity.

- **Transparency about labour standards varies widely. For investors,** poor disclosure about labour standards raises doubt as to whether a company understands, and is therefore actively managing, supply risks. Yet with the notable exception of such high-profile companies as GAP, Nike, Hennes & Mauritz and Inditex, public reporting on auditing methods and the results of remedial action plans is remarkably weak. Companies appear reluctant to improve public disclosure for several reasons:

  1. Data collection systems are still under development, so comprehensive factory audit data are unavailable;

  2. Companies fear that disclosure will backfire and generate negative publicity, as customers and other stakeholders fail to understand factory audit data and accuse companies of poor practices;

  3. Customers, competitors and investors have, until recently, not pressured them to publish factory audit data.

- **Robust audits are a starting point for spotting problems, but it is the follow-up and purchasing practices that matter most.** Action plans, follow-up visits and engagement of buyers and factory managers drive improvements on the ground. Moreover, research by Impactt,[7] an independent labour standards consultancy, has found systemic and persistent supply chain labour standards problems, highlighting that audits are vulnerable to fraud and may be of poor quality. F&C's company engagement reveals growing concern that the shortage of good quality external auditors and insufficient time for in-depth audits and follow-up actions will undermine their ability to spot and resolve problems. However, leading companies such as Hennes & Mauritz are developing robust audits and assisting factories in managing working conditions. They are undertaking more unannounced audits and worker interviews; examining the impact of buyers' purchasing practices and good critical path management on factories; and spending more time on follow-up and in training buyers, factory managers and workers.

- **Companies have gone for the low-hanging fruit,** as improvements reach certain areas, but not the most challenging ones. Research commissioned by the UK's Ethical Trading Initiative[8] has found that progress has been made in health and safety, working hours and child labour – but black holes remain in workers' wages, freedom of association, collective bargaining and the treatment of temporary, migrant and agency workers. Companies insist they can provide affordable, low-priced goods for consumers without cutting corners on labour standards, while campaign groups question how this is possible. Companies also point out that consumers are unwilling to pay higher prices, and if a single company takes on higher costs by raising wages in factories, they may find themselves at a competitive disadvantage – indicating the essential role of industry approaches towards such thorny issues.

- **Multi-stakeholder initiatives are effective and have prompted innovation,** including in auditing methods, excessive overtime and wages. However, solutions are still needed to confront child labour, the living wage issue and trade union rights. Also, smaller and less high-profile companies have not joined such initiatives, or may have joined but do not participate in them actively. In certain cases, their poor practices can place the reputation of the sector as a whole at risk. Companies at the forefront of best practice, including those that want to experiment with unconventional approaches to the living wage, complain that laggard companies are reluctant to move forward, which is holding up industry action.

[7] Impactt, 2007 Progress not Perfection: 10 Years of Making an Impactt
[8] Institute of Development Studies, The ETI code of labour practice: do workers really benefit?

Investors have increasingly voiced concerns about lagging supply chain standards through direct dialogue with companies and in voting on shareholder resolutions at Annual General Meetings. Following discussions with investors, including F&C, improvements are evident at several companies, thereby reducing the likelihood of damage to shareholder value. For example, **adidas** is protecting its high-profile sports brands through a comprehensive group-wide labour standards management system. **Wal-Mart** and **Tesco**, two global retailers requiring a throughput of goods, have beefed up factory audits aimed at picking up on potential problems early on – thereby minimising the risk of business disruption.

Of leaders, laggards and solutions: F&C's analysis

How are the leading companies doing?

F&C has researched ten companies[9] to assess the extent to which they have progressed from simply auditing factories against a labour standards policy, to engaging suppliers and tackling the most difficult problems. The results indicate that:

- **Good policies and co-operation are evident:** Most companies base management systems on the ILO core Conventions, and have recognised that progress in this area is essential to their commercial success, without necessarily being a competitive issue. They have ramped up cooperation with fellow retailers, suppliers and factories to improve working conditions. Many, though not all, companies are using more unannounced audits and worker interviews to identify less obvious problems, such as double-bookkeeping.
- **Implementation is mixed, particularly in purchasing practices.** While all companies provide training to factories, only some disclose how they manage their buyers' purchasing practices. Purchasing practices concern buyers' instructions to suppliers, including critical path management and lead times. Poor supply planning, over-ambitious lead times and last-minute changes to orders can impact working conditions seriously, resulting in workers undertaking long, involuntary and sometimes unpaid overtime hours.
- Until companies' purchasing practices are aligned with labour standards goals, and buyers are better trained in labour standards, companies are not using the full range of tools available to avert rather than solve problems.
- **Difficult issues persist:** While certain companies are addressing child labour, trade unions and migrant labour, these remain the greatest challenges, insofar as they are symptomatic of deeper societal and political problems that are beyond the control of any one company. As such, companies may need to work together to address these more pro-actively.

Company name and country of primary listing	Publicly committed to the ILO?	Participant in industry/multi-stakeholder approach?[10]	Factory training provided?[11]	Factory audit results disclosed?[12]	Unannounced audits and use of worker interviews?	Addressing purchasing practices?[13]	Tackling difficult labour standards challenges e.g. living wages, trade union rights?[14]
adidas, Germany	✔	✔	✔	✔	✔	✔	✔
Carrefour, France	✔	✔	✔	✔	✔	✔	✔
H&M, Sweden	✔	✔	✔	✔	✔	✔	✔
Nike, USA	✔	✔	✔	✔	✔	✔	✔
Tesco, UK	✔	✔	✔	✔	✔	✔	✔
Wal-Mart, USA	✔	✔	✔	✔	✔	✔	✔
Inditex, Spain	✔	✔	✔	✔	✔	✔	✔
PPR, France	✔	✔	✔	✔			
Li & Fung, Hong Kong	✔	✔	✔				
Target, USA	✔		✔		✔		

[9] These companies were selected because they have established labour standards programmes over 4 years ago, enabling a meaningful assessment of progress. All of these companies have undertaken "bulk" factory audits, meaning they audit a high volume of factories. Research was based on publicly available information on the grounds that this also indicates how transparent such companies are about their practices. F&C recognises these findings are limited as they are based on public reporting, rather than in-depth qualitative research of factory workers.

[10] For example, through an initiative launched by the company, participation in an industry or multi-stakeholder initiative, or through a pilot project. These include the Fair Labor Association, the Global Social Compliance Programme, Business for Social Responsibility, the Ethical Trading Initiative or the Social Clause Initiative.

[11] Either through training provided directly to factory owners and managers or through training to first-tier suppliers.

[12] Either through disclosing the percentage of factories audited that meet the labour standards policy, disclosure of the percentage of high-risk factories engaged with to improve labour standards, or through commentary on factory performance, such as discussion of strengths, areas of weakness and challenges.

[13] For example through an internal review of how purchasing practices may conflict with labour standards goals, through more active critical path management, or through establishing supplier and buyer incentives based on labour standards management and performance.

[14] There are many "difficult" labour standards, but they refer here to child labour, freedom of association and the living wage. Companies are assessed as addressing these if they have started pilot projects or innovative practices to start implementing these labour standards more effectively.

How far behind are the laggards?

F&C has researched ten companies that source from emerging markets, to assess how effectively they are mitigating supply chain labour standards risks. Overall, F&C has found them significantly behind the leaders described above; their weak management may impact their own long-term business performance, and puts at risk the reputations of entire retail and manufacturing sectors.

- **Basic policies are not evident:** Companies such as Land of Leather source over 80% of products from China, yet have no labour standards policy. High-profile brands, such as Yamaha and Bed, Bath & Beyond, do not communicate a policy to investors or customers. This indicates little awareness of risks relating to factory working conditions in emerging markets.
- **Companies are unlikely to pick up on problems until it is too late:** None of the companies below visit factories to check specifically for labour standards problems, or working with suppliers to improve working conditions. Problems such as poor safety are more likely to go unnoticed, heightening the risk of business disruption, such as a fire, which can paralyse production and interrupt supplies in a key trading period. These companies may be missing opportunities to drive productivity improvements and mitigate supply risks.
- **Companies are not working together to improve labour standards:** None of the companies below are participating in industry initiatives specifically to improve labour standards, meaning they are missing opportunities to share innovative good practice. The poor practices of laggards means co-operative initiatives have less impact, holding up the change that leaders want to see.

Company reporting on labour standards[15]

Company name and country of primary listing	F&C's investor concerns about labour standards-related risks	Published a labour standards policy[16]	Audits factories and reviews performance data[17]	Working with suppliers to improve factory labour standards[18]	Working with industry peers[19]
Land of Leather, UK	Leather sofa retailer with relatively low-profile brand. However, security of supply is potentially at risk if factory labour standards are managed inadequately; company sources 82% of products from China, with Fast East suppliers representing 92% of company's total purchases in 2007.				
Ports Design, Hong Kong	Designs, manufactures and retails high-end fashion garments and accessories. Operations in North America, Europe and Asia. Sources from emerging markets. Growth requires strong, high-end brands, and these may be impacted negatively if company is associated with sweatshops.				
Bed, Bath & Beyond, USA	Chain of superstores selling domestics merchandise and home furnishings. Sources from emerging markets, with potential risks to own-brand from poor labour standards.				
Aldi Group, not publicly listed	Chain of discount stores throughout Europe and USA, of German origin. Privately held, but poor practices could harm the reputation of the entire retail sector and so affect publicly listed companies and investors like F&C.				
Lidl UK Gmbh, not publicly listed	European discount store chain. Privately held by the Schwarz Group, of German origin. Poor practices could harm the reputation of the entire retail sector and so affect publicly listed companies and investors like F&C.				
Yamaha, Japan	Global brand that manufactures and sells diverse branded products, including musical instruments, audio and video products, computer/network-related products, electronic devices, sporting equipment and high-end interior furnishings. Sources from emerging markets, raising potential risk to global brand.	✔			
Family Dollar Store, USA	Chain of discount stores in the United States, targeting family-oriented customers. Sources from emerging markets, with potential risks to reputation from poor labour standards.	✔			
Ted Baker, UK	High-profile, fast-growing lifestyle brand, present in department stores and has its own stores. Strategy is to expand internationally and company sources from emerging markets. Potential risks to reputation and relationships with department store customers if company is associated with poor management of factory labour standards.	✔			
Sports Direct, UK	UK's leading sports retailer by revenue and operating profit, with ambitions to become the world's leading sports retailer. Sources from emerging markets, with poor labour standards raising potential risks to company reputation, relationship with governments and future "license to operate" in emerging markets.	✔			
Coach Inc, USA	Coach designs, produces and markets high quality and luxury leather goods, such as handbags, luggage, and gloves. Sources from emerging markets including China, India, Mexico and Turkey. Risk to luxury brand if associated with sweatshops.	✔	Partial[20]	Partial	

[15] Based on standard publicly available materials viewed by investors; Annual Report, company website, CSR report.
[16] Publication of a labour standards code indicates a company's basic awareness of and intention to manage factory labour standards.
[17] Effective factory audits may be conducted by internal or independent external staff. Reviews of factory performance are essential to identifying serious labour standards problems and informing action to resolve these.
[18] Working with suppliers is essential to improving factory working conditions. F&C would expect, for example, to see evidence of training suppliers and agreeing improvements needed
[19] Industry action is needed to drive standards higher, with individual companies limited in the change they can achieve single-handedly. F&C looks for company participation in specific labour standards initiatives and credible programmes, such as the Ethical Trading Initiative.
[20] Coach conducts due diligence audits of new suppliers, but does not commit publicly to ongoing supplier monitoring or reviewing performance data regularly.

What challenges do factories face in improving labour standards?

F&C has witnessed unannounced factory audits in both China and Honduras that were conducted on behalf of leading western retailers. Although these two visits give little more than a partial impression, we have observed that:

- **Factory managers are more likely to invest in improving working conditions if they develop a long-term relationship with their clients.** Conversely, companies are more likely to make headway with suppliers that they have identified as important to their sourcing strategy; the factories of such suppliers will see the benefits of long-term, stable business relationships, involving high levels of trust, predictability and healthy, growing order books.
- **Unannounced audits and worker interviews can play an important role in uncovering problems, reducing opportunities to hide bad practices.** Audits may be more effective as a result. However, some companies have reported that unannounced audits can undermine long-term trust with factories, and so they prefer to undertake "semi-announced audits," whereby factories are given some notice (for example, three weeks), that an audit will take place.
- **For improvements to take place action plans agreed with factory managers must include clear deadlines and auditors must undertake follow-up audits.** Companies need to go beyond initial audits and work with factories on an ongoing basis to see and reward better performance.

Focus On: Eliminating child labour

The problem: Although the global rate of child labour is declining according to the ILO, thanks in part to efforts by governments and companies, it continues to surface in factories in emerging markets. This is in spite of regulation and good faith efforts by companies to eliminate child labour. Challenges for companies include public acceptability of child labour in host countries, forged or poor documentation (i.e. no birth certificates) meaning auditors may not detect children easily, and unapproved sub-contracting by factories to others with poor working conditions. When children are found, if handled badly, they and their families can face immediate loss of income and end up in worse, more unsafe working conditions.

The solution: Eradicating child labour is a mammoth task, requiring joint action by governments, families, international and domestic companies, and factories. After finding child labour in India, GAP took full responsibility and initiated an industry forum as a first step towards identifying the causes of child labour and industry solutions. Hennes & Mauritz works with doctors to help judge whether young workers are children, where documentation is unavailable. The company applies a clear policy if child labour is found, involving putting the child's best interests first: working with the supplier, local partners and the child's family to encourage school attendance; and paying wages to protect the family's income.

They said...

"The estimated cost of the elimination of child labour is US$760 billion over a 20-year period. The estimated benefits in terms of better education and health are over US$4 trillion. The benefits would therefore outweigh the costs by nearly 6 to 1."

– ILO, Facts on Child Labour, 2006

They said...

"[GAP]'s investigation has found that one of its approved vendors contracted with a small embroidery company to have hand embroidery work done on a GapKids product in an approved rural community center. At some point, a small proportion of these goods was sent through an unauthorized facility in New Delhi where at least one child was seen working on the product. This is in direct violation of Gap Inc's Vendor Compliance Agreement and Code of Vendor Conduct. What happened here was without the knowledge or approval of Gap Inc. or, we believe, of the vendor. Nonetheless, we hold ourselves and our vendor fully accountable."

– GAP Inc statement following investigation into child labour allegations, November 14th, 2007

Do co-operative initiatives promise more "breakthroughs?"

F&C's assessment is that multi-stakeholder initiatives – involving companies, trade unions and campaign groups – can play a key role in assisting companies and factories to address intractable problems through creativity and innovation.

Focus On: Factory managers change their ways

The problem: Despite auditors alerting factories to serious problems, many continue to breach policies, with workers reluctant to tell management about poor practices and factory managers slow to change. Project Kaleidoscope aimed to address this, involving McDonalds Corporation, The Walt Disney Company, supplier factories, civil society organisations and investors, including the Interfaith Center on Corporate Responsibility, of which F&C is a member.[21]

The solution: The project piloted a new management system in factories, involving two-way communication between factory workers and managers on working conditions.[22] It also involved managers taking action when external factors affected workers severely – such as higher-than-expected demand for a new product, which might result in unwanted, exceptionally high levels of overtime hours. Factory managers were asked to talk to workers, and find and fix problems immediately, rather than waiting for the audit process to pick these up. Subsequently, 78%-100% of workers surveyed in participating factories said conditions had improved, managers concluded it made business sense to talk to workers and take early action, and fewer factories experienced excessive working hours or incorrectly-paid wages.

[21] F&C was not specifically involved in the Project Kaleidoscope Working Group itself. For a copy of the report see http://www.iccr.org
[22] The project was unusual in using "Participatory Rapid Appraisal," which involves group exercises to facilitate information sharing, analysis and action among stakeholders. It is normally used by development practitioners to involve local communities in identifying and resolving problems that affect their lives, and is not yet commonly used in factories.

Focus On: Wages and living standards

The problem: A country's legal minimum wage may be too low to cover workers' basic costs of living, particularly as inflation, food and fuel bills soar. Labour market dynamics, in particular a persistent oversupply of labour despite wages that drop below the cost of survival, mean there is no natural pressure for factory managers to raise wages above the market rate. Moreover, if a single factory raises its wages above the market-clearing rate, it risks higher overheads and putting itself at a cost disadvantage, which may prove unsustainable. This is particularly the case as the economic downturn bites and Western consumers seek retailers offering affordable goods.

At a practical level, many companies struggle to estimate a wage that accurately reflects a worker's costs of living, including dependents, at each site. Many emerging markets lack mature industrial relations and mechanisms for management to discuss wages with workers, with government curbs on trade unions in certain regions, and regular, constructive, worker-management dialogue uncommon. There are a handful of companies that want to pay a wage to factory workers that meets their living costs because they believe this is "the right thing to do." However, to solve the problem at hand, these isolated cases needs to be complemented by more "mass market" approaches to wages, that are sustainable economically and on scale.

The solution: A strong domestic consumer base is an important driver for economic growth in emerging markets. Companies that offer competitive and sustainable wages help to generate the "consumers of tomorrow," opening up new "mass-markets" in consumer goods. To build these new markets, companies need to think beyond wages and consider how they can contribute to better living standards, which are essential for sustainable, long-term economic growth. Government and civil society must establish development and economic growth targets, but companies must identify the best options for contributing towards these, for example through industry initiatives to improve education and healthcare, or by improving the value of workers' take-home packet through providing better non-wage benefits.

Echo Sourcing, a Bangladeshi supplier to UK fashion retailer New Look, offers a positive example, as a "community development company." F&C considers that this example could be replicated by other retailers, where they have long-term relationships with a limited number of suppliers – meaning there are win-win benefits from investing in working conditions. With New Look seeking a secure and efficient supply chain, Echo Sourcing has invested in win-win human resources practices to "get the product made quicker and better" and raise workers' living standards. Echo Sourcing established worker committees for regular dialogue with management, and following feedback from these, it now offers workers a "provident fund," an on-site doctor, training and free lunches – the main meal of the day for many workers. Echo Sourcing has also established productivity incentives for workers and better supply forecasting by New Look to reduce sudden production changes. This has enabled Echo Sourcing to find an optimum point at which overtime hours fall, productivity increases and workers' take-home pay rises.

Are standards in transparency sufficiently high?

Lack of transparency means it is difficult for investors to assess how well positioned individual companies are to deal with labour standards risks and opportunities. Multi-stakeholder initiatives and industry bodies play an important role in ensuring that voluntary standards are continuously raised, including in transparency and public accountability. However, although these bodies provide annual reporting that aggregates member companies' labour standards performance and indicates performance trends, they do not require companies to report individually on management systems and performance. Such bodies could actively encourage companies to report publicly on their management systems and supplier performance against policies. This could be through a company's website, Annual Report or Corporate Responsibility Report. The table overleaf indicates that in the absence of this requirement and concerted public pressure, companies have been slow to develop voluntary good practice in public reporting. Better transparency would help build public confidence in industry efforts to improve working conditions.

Company reporting on labour standards

Industry/multi-stakeholder initiative[23]	Example member company and country of primary listing	Does the member company report separately on its labour standards management system	Does the member company report separately on its results of engagement with suppliers or factory audits?[24]
BSCI	Ahold, Netherlands	✔	
BSCI	Esprit Holdings, Hong Kong	✔	
ETI	Tesco plc, UK	✔	✔
ETI	WH Smith plc, UK	✔	
FLA	Liz Claiborne Inc, USA	✔	
FLA	Nordstrom Inc, USA	✔	
EICC	Samsung Electronics, S.Korea	✔	
EICC	Sony Corporation, Japan	✔	Partial[25]

Focus On: A data management solution covering 2 million workers

The problem: Reliable, comprehensive data on factory working conditions are essential in order both to tackle problems and report publicly on factory performance to investors. However, companies with vast supply chains struggle to track and understand working conditions in factories on the ground, let alone report on these meaningfully to investors.

The solution: The Supplier Ethical Data Exchange (SEDEX) is a secure database for companies to store labour standards data from factories. This includes factories' self-assessments against customers' labour standards policies, results of third-party audits and actions taken by factories to improve labour standards. Good management of labour standards data means companies can spot high-risk factories, while suppliers find cost efficiencies as they can make one data set available to multiple customers. SEDEX currently covers 20,000 sites and 2 million workers, with 255 member companies, including Diageo, Levi Strauss & Co, Li & Fung, Marks & Spencer, Nestlé, PepsiCo, Tesco and Unilever.

F&C is a SEDEX Advisory Board Member and encourages companies to join SEDEX to help analyse factory performance data and better understand their supply chains, drive improvements and communicate publicly on progress to investors.

[23] These are the Business for Social Compliance Initiative (BSCI), Ethical Trading Initiative (ETI), Fair Labor Association (FLA) and the Electronic Industry Code of Conduct (EICC)
[24] Either within the company's Report & Accounts, through a Corporate Responsibility Report or the company website, as these are standard documents used by investors such as F&C. Information as available on 25th March 2007.
[25] Sony reports on factory audit results, but this only covers 18 suppliers and the scope of information provided is limited.

3. Key elements of good labour standards management

What are the key success factors that enable companies to maintain good labour standards? When evaluating companies, F&C considers the following basic indicators:

- **Policy:** Adoption of a labour standards policy based on the ILO's core Conventions
- **Performance monitoring/Audit:** Robust auditing against the policy, aimed at driving improvements, including through risk assessment, unannounced audits, worker interviews and whistleblower protection mechanisms.
- **Integrated processes:** Integration of labour standards goals in commercial management processes and the company's "buying culture."
- **Engagement:** Working with suppliers and factories to raise standards, and active participation in industry approaches to tackle challenging issues
- **Transparency:** Public reporting on labour standards management systems and performance.

How does one get past the rhetoric and gauge performance on the ground? When assessing whether a company's management system is adequate, F&C takes into account sector and country risks, and company-specific factors. For high-risk companies, F&C assesses practices against the following questions:

1. Does the company grasp why labour standards in factories matter?
2. Are clear and high standards demanded of factories, based on the ILO core Conventions?
3. Are strong labour standards a part of everyday commercial practices?
4. Can the company spot problems in factories early on?
5. Is the company driving genuine improvements in factories?
6. Is the company transparent about factory labour standards?
7. Is the company well positioned to tackle labour standards challenges?

F&C's recommendations

Companies depend on reliable and efficient supply chains, which, in turn, depending partly on good, stable factory working conditions. Despite real efforts to drive up standards, obstacles remain, in the form of persistent regulatory breaches, lax enforcement, poor awareness by factory managers and a consumer appetite for "fast fashion" that undermines efforts to build in better time planning. F&C recommends companies take the following four actions to overcome these obstacles:

1. **Develop effective management systems for security of supply:** Business models that rely on a low-cost supply base typically require a predictable supply of high-volume goods. F&C recommends companies guard against business disruption and under-investment in factories by:
   - Taking active steps to assist key factories in improving productivity, such as training factory managers in industrial relations.
   - Modifying purchasing practices so that they can meet the twin challenges of growing the order book and providing good working conditions.
   - Working closely with factories when growing volumes, to minimise the risk of unauthorised outsourcing to poorly-managed factories.
   - Developing emergency response systems for resolving serious problems that arise, including significant allegations of poor practice.
2. **Reach for the high-hanging fruit:** Changes have been achieved in health and safety and even in child labour, which means the time has come for companies to confront the more intractable problems that remain, such as wages. Business has yet to find the answers, and work needs to be done to build business confidence in co-operative industry approaches to cost-sensitive issues. F&C recommends that companies consider working more closely with local industry trade associations to promote industry-wide approaches to such challenges. F&C also recommends that business leaders reach out more actively to host governments and laggard companies, as without action on their part, changes cannot be achieved – and the reputation of entire retail and manufacturing sectors remains at risk.

3. **Get consumers bought in:** In Western markets, companies need to plug the gap between consumer understanding of labour standards and the realities on the ground. Although consumers profess increasing concern about labour standards abuses, they fail to appreciate how their shopping preferences can exacerbate the pressures on supply chains and the challenges that companies face in improving factory working conditions. F&C recommends companies communicate with customers on their labour practices, and not only reinforce positive messages about the company, but also indicate the challenges of operating in emerging markets. This will mean that if problems do surface – as is inevitable in vast supply chains – companies are less likely to find themselves under pressure to "cut and run," and that "doing the right thing," such as sticking with factories to resolve problems may help build customer loyalty.

4. **Communicate transparently, warts and all:** Investors expect evidence that factory labour standards are managed and delivering improvements, such as higher productivity in the supply chain and stronger supplier relations. Transparency about working conditions and plans for improvements is essential to meaningful dialogue with investors on supply risks and opportunities. For leading companies, public reporting offers the opportunity to showcase effective management systems and commitment to raising standards higher. For laggards, reporting may be a potent driver of self-improvement; companies that report annually are more likely to set targets and measure progress against these. Open communication about factory management systems and performance is also a useful policy against accusations of bad faith from critics.

4. Conclusion

F&C has been in dialogue with major companies involved in global sourcing – including Wal-Mart, Apple, Tesco and Carrefour – as well as influential stakeholders from civil society, the trade union movement, and fellow investors.[26] F&C's assessment is that criticism of companies over sweatshops will continue until their responses are better adapted to the challenges of sourcing from factories in emerging markets.

Working conditions in these factories reflect a range of social and economic factors, only some of which fall within the control of purchasing companies. Yet rightly or wrongly, it is the factory operators and their customers who will get much of the blame, and risk compromising their brands and supply chains, unless labour standards improve.

In addition, over the next ten years, companies will increasingly draw their revenues from the expanding ranks of middle-income consumers in emerging markets. Much as Henry Ford built his automotive empire on the swelling purchasing power of the automotive factory worker, **so working conditions in emerging markets factories can help drive the next wave of consumer product sales. As factory worker incomes improve, healthier and wealthier consumers will form the new domestic market for consumer goods and brands.**

[26] Campaign groups and not-for-profit organisations included: ActionAid, Anti-Slavery International, Oxfam, SEDEX, The China Labor Bulletin, The Ethical Trading Initiative, Traidcraft and War on Want. Trade unions included the TUC and SEIU. Consultants/auditors included Impactt and SGS. Business groups included: The British Retail Consortium, The Business Social Compliance Initiative, The European Retail Roundtable, The Global Social Compliance Programme. Investor groups included: the Association of British Insurers, the Interfaith Center on Corporate Responsibility (ICCR) and the UK Social Investment Forum.

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