

# Material Concerns

How responsible sourcing can  
deliver the goods for business  
and workers in the garment industry





# Executive Summary

This report is intended for sourcing and commercial directors with responsibility for the sourcing or buying functions within garment retailers or brands. The garment sector has experienced sustained pressure over the past ten years to improve working conditions in supplying factories. Yet, despite sterling efforts by many purchasing companies to police labour standards in supply chains, time and time again, campaigners are easily able to identify specific instances of poor working conditions. Policing supply chains has clearly not been effective either in eliminating problems or in protecting retailers and brands against the reputational risk of damaging exposés.

For some years concerns have been raised about how retailers and brands buy and whether this, in itself, contributes to compromised labour standards in supply chains. Some argue that it is these purchasing practices themselves which exacerbate problems, despite the best efforts of compliance programmes. However, these purchasing practices have evolved in response to market pressures and industry norms; abandoning them could result in companies becoming uncompetitive. This report suggests a new approach to sourcing which both protects and enhances commercial goals and improves labour standards.

Commercial and sourcing directors are tasked with delivering the right product, at the right price, at the right time, whilst ensuring continued supply for their business. Sourcing and buying teams are very familiar with the day-to-day challenges of meeting these targets, but longer term risks and impacts within the supply base remain less obvious.

Whilst a supply chain code of conduct on labour standards is generally embedded in contractual relationships between buyers and suppliers, in reality the day-to-day relationship between buying team and supplier (be that agent, manufacturer, or in some cases regional sourcing office) does not provide an environment which promotes better

labour practices and can directly result in breaches of the buyer's code of conduct. This exposes retailers and brands to reputational risk.

This report suggests a two pronged approach to implementing a comprehensive and effective responsible sourcing strategy:

1. Establish a clear set of **operational principles** which define the ground rules for purchasing relationships.
2. Develop an **enabling environment** where buyers and suppliers are incentivised on performance against both commercial and ethical trading targets.

Establishing operational principles is necessary to bring about improvements in working conditions, but is not sufficient to deliver better labour practices. A solution must be found to convert the vicious circle – 'better, cheaper, faster, less ethical' – to a virtuous circle – 'better, cheaper, faster, more ethical' as the dominant business model. To achieve this, both buyers and suppliers must be incentivised for ethical as well as commercial performance. These incentives must go beyond delivering good labour standards audit results (which have limited effectiveness in improving performance and can easily be manipulated) to reward behaviours which deliver demonstrable benefits for workers. The report offers sample buyer and supplier ethical scorecards [see pages 12 and 13] as examples of how this incentive structure could be implemented.

Implementing the operational principles and establishing an enabling environment will achieve the quadruple wins of:

- meeting commercial targets
- delivering efficiencies
- meeting labour standards targets
- reducing reputational risk.

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# The Critical Path

The challenge is to think in a new way about implementing responsible sourcing strategies so that 'ethical trading' no longer consists of a list of compliance requirements on labour standards to be implemented in the teeth of purchasing practices which threaten to undermine them.

This report identifies a set of specific operational principles to establish better purchasing practices:

- Awareness of cause and effect of decisions on a product's critical path.
- Set targets for the number of sampling phases and volume of samples.
- Transparency of location of production and each production site's capacity.
- Confirmation in writing of forecast volume and timings in advance of placing an order.
- Fairer and more transparent allocation of the costs of late changes.
- Repeat orders require separate critical path, and may increase cost price if specification changes.
- Understand minimum sustainable cost price at different volumes which enables the payment of a living wage.

These operational principles should reduce the effects of the 'pinch points' which create undue pressures within the critical path. Pinch points are points in the design and manufacturing process where delays or difficulties can occur due to issues of volume, timing, design, approvals, etc. Pinch points can cause a knock-on effect on the supplier's ability to meet deadlines, which may therefore have a significant impact on labour standards.

The diagram on the right sets out each stage of the critical path and should be read in conjunction with the diagrams on subsequent pages identifying the related pinch points, commercial impacts, supplier and worker outcomes and solutions for the buying teams.

## Critical Path

### Product Development

- A product need is established and product specifications are developed including:
  - Technical specifications – materials, size of production runs
  - Timing required and in-store date
  - Style and design
- Product critical path, including target in-store date, developed

### Sampling

- Specific design, style and technical aspects of a product are sampled
- Production sites demonstrate their technical capacity to produce specified garments

### Supplier Selection

- Review of cost quotations made by suppliers
- Selection of new or existing supplier (by retailer, regional office, agent or manufacturing office) to produce order. Consideration may be made based on:
  - Country-specific beneficial trade or tariff agreements
  - Perceived country and site capacity and skill level
  - Site social and technical audits
  - Customer's leverage over site
  - Site's quoted cost price, and access to raw materials

### Placement of Orders and Production

- Placing of production order with factories
- Buying of raw material
- Production process, including reworking
- Subcontracting (including homeworking) where necessary, to meet required quantity within specified timescales, or specific technical processes e.g. embroidery and printing

### Delivery

- Shipping of order from production site to UK
- Dependent on contract this may be 'landed UK' where the supplier bears responsibility for the shipment, or Freight on Board (FOB) where the retailer/brand bears responsibility for the shipment

### Ongoing Product Management

- Ongoing product management, leading to repeat orders, style change, new supplier sourcing for similar products

# Introduction

## Pinch Points

### Product Development

- Lack of technical knowledge of production process by buyers
- Lack of commercial focus by designer
- Designers and buyers talking different languages
  - Style is not commercially viable for suppliers at desired costs
  - Sampling process begins with lack of technical knowledge
- Lack of feedback on technical viability by suppliers

### Sampling

- Multiple changes made to design by buying team
- Large volume and number of samples required
- Late sample approval by retailer/brand
- Significant cost of producing samples

### Supplier Selection

- Lack of communication on the actual capacity, and capacity constraints, of each site for each time period
- Manufacturing site or supplying agent is chosen based on profit margins, responsiveness of site, volume capacity, etc.
- Last-minute supplier selection does not allow for detailed and accurate site production planning
- Requirement of site to have social audit, and delay in waiting for results

### Placement of Orders and Production

- Lack of contractual commitment to production volumes and price given to suppliers
- Payment terms (e.g. Letter of Credit) used which place the risk of financing production on suppliers
- Style changes made post production sample approval
- Changing production schedules after critical path has been agreed
- Changing (or use of complicated) labelling and packaging requirements

### Delivery

- Any late deliveries require air freight to meet the agreed in-store date
- Increased cost of air freight not reflected in cost prices
- Financial penalties are levied for late deliveries, mistakes, incomplete deliveries and rework
- Low-selling lines may be subject to discount or return at the suppliers' cost

### Ongoing Product Management

- Adjustment of agreed supply terms (such as cost price, volumes, etc.) based on sales results
- Fines levied to suppliers
- Repeat orders with short lead times
- Style updates (changes to style specifications, colour, etc.) with no adjustment made to critical path or cost price

This report is intended for sourcing and commercial directors with responsibility for the sourcing or buying functions within garment retailers or brands. The garment sector has experienced sustained pressure over the past ten years to improve working conditions in supplying factories. Efforts by purchasing companies to police labour standards through social auditing have clearly not been effective either in eliminating problems or in protecting retailers and brands against the reputational risk of damaging exposés.

Over the past four years, since the publication in 2004 of Insight Investment and Acona's 'Buying Your Way Into Trouble?'<sup>1</sup> and Oxfam's 'Trading Away Our Rights'<sup>2</sup>, followed in 2006 by Traidcraft's report specific to purchasing practices, 'Buying Matters'<sup>3</sup>, the debate has shifted to focus on how the way retailers and brands buy, in itself, contributes to compromised labour standards in their own supply chains. Some argue that it is these very purchasing practices which exacerbate problems, despite the best efforts of compliance programmes. This results in suppliers reacting to commercial imperatives without regard to their social impacts. Whilst sourcing or commercial directors are only one player in the highly complex garment industry, they hold significant influence over the lives of workers in their supply chain given that they dictate who is a supplier and on what terms they will trade with those suppliers.

This report balances the commercial and ethical agendas and sets out a potential win:win position, which is both good for business and better for workers.



# Challenges in the Garment Industry

Business conditions in the garment industry and elsewhere are becoming increasingly challenging. China is the largest source country for EU garments, exporting more than 20% of €50,177 million garments imports into the EU in 2007<sup>4</sup>. The strong Chinese currency, the new Chinese labour law (unveiled in January 2008) along with global increases in cost of oil and raw materials have meant that production costs have increased significantly over the past five years. In 2007 inflation in China grew by 4.8% and the US bureau of Labor Statistics estimated that the price index of goods from China rose 2.4% in 2007<sup>5</sup>. This has had knock-on effects on other garment producing countries such as Bangladesh [see Case Study on page 9], and the fact remains that global price pressures can lead to suppliers cutting corners on labour standards, irrespective of where their manufacturing is based. Meanwhile, trading conditions in the UK are increasingly tough, as customers are faced with higher fuel and food bills, rising rates of inflation, and are tightening their belts in anticipation of the effects of the global credit crunch.

To remain competitive many retailers and brands are driving down retail prices, and fighting to maintain their own margins. In the quest to deliver fast, affordable fashion, two different supplier models have emerged:

- **Full service** - the 'upskilling' of the supply base. Full service suppliers propose, design and produce garments, taking on greater responsibility for keeping designs on-trend, delivering technical aspects of quality and compliance, contributing to marketing and in some cases providing warehousing.
- **Direct sourcing** - the 'stripping down' of the supplier function. In this model, the retailer, brand or agent takes responsibility for design and all supplementary production functions and identifies factories which will solely perform a 'CMT' (cut, make, trim) operation. In general, even functions such as the sourcing of raw materials have been removed from these factories and transferred higher up the supply chain, meaning that labour is the only variable cost component on site.

Retailers and brands use a combination of these models to develop a supply base with the capacity to deliver the right product, at the right price, at the right time.

Our research in sourcing countries indicates that both full service and direct sourcing supply chains involve agents acting as intermediaries, and that the intense competition both within and between these models exerts a strong downward pressure in supply chains. This manifests itself in reduced margins for manufacturers in supply chains, a marked reduction in production lead times and a buying environment where the relative negotiating power of a buyer is ever increasing.

*"A bag they maybe bought for £3.50 they now want for £3.20. Or if they wanted it for £6.20, they now want it for £5.20. That is happening a lot. In general they want more on the bag for less money."*  
**Hong Kong-based agent**

*"They do not give reasons for cutting price, they just want us to make their price target"*  
**Factory manager - China**

*"[Lead times have] decreased by 10 to 15 days [in the past three years]... such changes lead us to work overtime and thus increase our costs."*  
**Factory manager - Cambodia**



# Challenges Faced by Commercial and Sourcing Directors

## Commercial Impacts

### Product Development

- Excessive time taken to develop product – waste of time/resources
- Products designed with little or no consideration for commercial targets
- Delays at product development stage increase time pressure for specific in-store date
- Conflicting messages sent from buying team to suppliers

### Sampling

- Excessive time taken to develop product
- Possible need to source new/alternative raw material suppliers
- Significant cost of sample production frequently passed to suppliers, increasing the pressure on supplier profit margin
- Low 'hit rate' of sample approval for suppliers adds significant on-costs to production

### Supplier Selection

- Volumes at manufacturing sites may be excessively high or low dependent on orders placed by other customers or other buying teams within the same retailer or brand
- Sites book space for particular orders, but are then forced to cancel if the order is not placed

### Placement of Orders and Production

- High financial risk for manufacturing site due to lack of contractual commitment to order
- Confusion over whether an order has actually been placed, and whether a site should commence production
- Increased pressure on production speed and capacity
- Use of unmonitored subcontractors in the production process increases the likelihood of technical and quality product issues

### Delivery

- Product is delivered late at financial cost to supplier
- Quality is compromised due to pressure of deadlines
- Zero or negative profit for any airfreighted product, due to high cost of air freight

### Ongoing Product Management

- Higher unit costs for late changes
- Wastage at production site due to late changes
- Costs of reworking to accommodate style changes absorbed
- Risk of late delivery

Buying and sourcing directors are tasked with delivering:

- Right product
- Right price
- Right time
- Now and in the future

Sourcing and buying teams are familiar with the day-to-day challenges presented by meeting these targets, such as the difficulties of accurately predicting trends and ensuring that product is delivered on time. The longer term risks are less obvious. For example, the very pressure on meeting immediate requirements, resulting in reactive management, can often mean that the supply base is not able proactively to invest in developing the skills and infrastructure to enable it to meet commercial targets sustainably. Some of the day-to-day challenges and longer term risks are set out in the table below right.

Achieving these commercial targets means developing a supply base with sufficient flexibility to deliver reliability, creativity, responsiveness and value, time after time. This demands a mix of long term and short term relationships, a combination of direct sourcing and full service vendors and a range of source countries to deliver the right assortment of on-trend and core products, within the required timescales. The challenge facing sourcing directors is how to deliver this combination of supply solutions, whilst also creating an environment for their buying teams and suppliers which allows better labour practices to flourish in both long and short term relationships.

Brands need to respond to the increase in customer interest towards the processes involved in the production of high street fashion. 2008 has seen television programmes such as 'Blood, Sweat and T-shirts'<sup>6</sup> and Panorama's 'On the Rack'<sup>7</sup> which have prompted renewed interest amongst customers. There is clear evidence<sup>8</sup> that customers are aware of ethical issues and that a growing number of purchasing decisions are influenced by perceptions of retailers' labour standards performance. Following the Panorama programme an online poll<sup>9</sup> indicated that 15% of respondents would never shop at Primark again.



Our research found a widely held perception across supply chains that implementing and monitoring an ethical code of conduct increases pressure on suppliers. Not only are factories required to deliver higher volumes, within shorter timescales, at tighter margins and meet a range of demanding technical specifications, they must also adopt and implement their customers' ethical codes of conduct.

whilst continuing to deliver on other customer requirements. Deceptive practices can include misleading auditors (maintaining double books, coaching workers), bribery of auditors, show factories (compliant factories which are audited, whilst much of the production takes place elsewhere) and unauthorised sub-contracting.

*"You know they want all these ethical standards, they want these labour hours and they want the factory to be like it would be in the UK... But they don't want any effect on the price, they don't want any effect on the quality, they don't want any effect on the lead times. Something has to give."*  
UK-based agent

*"Factories cannot meet the requirements and now everybody falsifies the wage and hour records."*  
Chinese factory manager

*"[It's an] unfair expectation... They want these perfect ethical factories, you can't use PVC, you can't use nickel. But you can't change the price. Really the pricing architecture has to change. We are not in the same world we were in 10 years ago."*  
UK-based agent

*"Chinese labour law is too strict and is unrealistic, but the enforcement is loose. How many factories can really abide with the OT [overtime] limits? In order to pass audits, they can only fake documents."*  
Chinese factory manager

*"It is ironic that suppliers have to pay for the audit even when the audit is mandated by the retailers."*  
Chinese supplier

*"Almost all male auditors take bribes. For female auditors, they want money but they are less forthright, so it's best to give them ornaments, jewellery or cosmetics."*  
Chinese factory manager writing on a Chinese internet forum<sup>10</sup>

By negotiating hard on price and supply conditions, buyers may unwittingly force suppliers to commit to production schedules they are unable to keep, if they are to meet the minimum required labour standards. This leads to a situation where suppliers must give the impression of ethical compliance

Whilst an ethical code of conduct is generally embedded in contractual relationships between buyers and suppliers, in reality the day-to-day relationship between buying team and supplier (be that agent, manufacturer, or in some cases regional sourcing office) does not provide an environment which promotes better labour practices and can directly result in breaches of the ethical code of conduct. This leaves retailers and brands open to significant reputational risk and the threat of campaigner and journalist exposés.

Commercial target	Day-to-day commercial challenges	Longer term risk
Right product	Predicting trends and meeting technical specifications (including raw materials, finish and quality) to hit sales targets, without incurring unnecessary costs or disruptions as a result of late changes, cancellations or over-trialling.	Quality and technical specifications are not met, garments are off-trend or reductions and stock loss are high, suppliers don't have time or resources to up-skill workforces to produce fast fashion, leading to overtime and high rework rates.
Right price	Increasing costs of raw materials and inputs leads to tighter margins and reduced gross profit.	As margins are squeezed, manufacturing processes are compromised in the supply chain, and corners are cut to achieve lower cost prices.
Right time	Managing a complex supply chain to ensure that product is delivered on time. This must happen in spite of any disruptions which occur.	Suppliers are forced to work overtime to meet orders and availability targets, and may require the use of temporary labour or (legal or illegal) outsourcing. If target in-store date is missed, orders may be cancelled outright since trend has moved on.
Now and in the future	Ensuring continuity of supply and having alternative sources of supply in case of disruption.	Over-reliance on one source country or one supply route can lead to inability to deliver when suppliers go out of business or are unable to deliver competitive prices. But if suppliers have no stability they are reluctant to decline an order and can commit to unachievable deadlines and requirements.

# Challenges in Supplier Countries

## Supplier and Worker Outcomes

### Product Development

- Manufacturing sites are required to mock up samples for designs which will never be commercially viable
- Costs are incurred at manufacturing site due to internal conflict of communication in buying team

### Sampling

- Tight timescales for delivery of samples may require overtime working
- Delays in sampling approval increase time pressure for specific in-store date
- Significant cost of multiple samples and low 'hit rate' are absorbed by manufacturing sites, increasing pressure on profit margins

### Supplier Selection

- Site may initially over-promise on its ability to deliver products due to unpredictability of 'confirmed' orders
- Critical path, in particular production time, may be squeezed due to overpromising of volumes from specific site
- Over-promising on volumes may lead to the use of unmonitored sub-contractors to complete work
- Workers experience unpredictable working hours, increased time pressure and unmonitored working conditions due to unpredictable production volumes

### Placement of Orders and Production

- Site's margins are squeezed due to constraints on cash flow and pressure on cost price. Unethical working practices may be adopted as a means to reduce the labour cost component of production
- Late payment of wages to workers
- Critical path may be squeezed as a result of changes made in production, or reworking due to mistakes made
- High reputational risk of using unmonitored sub-contractors

### Delivery

- Excessive use of overtime to meet delivery dates
- High pressure environment on the production floor, with supervisors pushed into shouting at workers and pressuring them to deliver orders on time
- Use of 'toilet cards' and cancellation/shortening of rest breaks to keep workers working on the lines
- Spikes in overtime for particular workers, particularly in packing or finishing areas

### Ongoing Product Management

- Long hours to produce on short lead times
- Erosion of piece rate due to reduced prices

The garment industry is a vital source of foreign exchange earnings and employment, especially of women, for many developing countries. In 2004, 19 million workers in China and 2 million workers in Bangladesh were directly dependent on the export clothing and textile industries<sup>11</sup>. In 2006 more than 40% of the total export earnings of Bangladesh, Cambodia, Lesotho, and Sri Lanka was gained from exporting garments, predominantly from the labour-intensive 'cut, make, trim' (CMT) stage of garment supply chains.

UK retailers' and brands' purchasing alone was responsible for employing approximately 350,000, 18% of Bangladeshi garment workers in 2004<sup>12</sup>. In 2006 EU purchasing of Cambodia's garment exports employed 80,000 workers, and indirectly supported approximately 11% of Cambodia's 13 million population<sup>13</sup>.

Despite the industry's economic importance to exporting countries, garment workers frequently do not earn a living wage sufficient to meet their basic needs (housing and food) and additional costs of health care, transport, utilities and education. In 2008 the purchasing price index rose by as much as 20% in the coastal cities of China where most of the manufacturing is located<sup>14</sup>. Recent food price inflation has placed workers under significant additional strain, rendering retailers' and brands' assessments of adequate living wages out of date. Between March and April 2008, the global price of rice rose sharply by almost 75%. South East Asia has been particularly hard hit by these price rises; in Bangladesh the real price of rice reached a 19 year high as it rose by 70% between 2007 and 2008 and 10,000 garment workers rioted in response to low wages and high food prices<sup>15</sup>. Riots due to rising food prices have also occurred in Cameroon, Egypt, Ethiopia, Haiti, Indonesia, Mexico and Philippines. According to the World Bank, the poor spend as much as 75% of their income on food. Juan Jose Daboub, a senior director at the World Bank, has said, "In virtually every East Asian country, high food prices are... contributing to a significant decline in the real incomes of the poor."<sup>16</sup> Low wage rates for adults have knock-on effects, making it more likely that children will need to work to supplement the family's income.

The table on the right identifies the disparity between minimum wage rates set by a country and the estimated living wage. Where a country has no living wage provision, it is fair to estimate that a living wage would be greater than the minimum wage by at least the rate of inflation since it was set.



## Living Wages in Garment Producing Countries

Country	Minimum Wage Rate	Is the Minimum Wage a Living Wage?	Minimum Wage as % of Living Wage Estimate	Living Wage Details
Bangladesh	1,662.50 TK per month (£12.50) Varies according to skill levels	NO	35%	Living Wage estimated to be 4,800 TK (£35) per month <sup>17</sup>
Cambodia	197,985 KHR per month (approx £25)	NO	84%	Living Wage estimated to be 235,000 KHR (£30) per month <sup>18</sup>
China	Varies by region, municipality and company ownership (foreign or state-owned). Per month figures: Shanghai: RMB840 (£58.52) Shenzhen: RMB850 (£59.22) Hangzhou City: RMB850 (£59.22)	NO	98% 99% 99%	Living Wage estimated to be 855.64 RMB (£66) per month <sup>19</sup>
India	The minimum wage ranges from Rs 1250 (£15.41) to Rs 3750 (£46.26) per month for unskilled labourers.  22 States also require a 'Dearness Allowance' (DA) – a percentage of salary added to basic wages which combine to give the total salary.	NO	30% - 89%	Living Wage estimated to be 4213.06 Rs (£52) per month <sup>20</sup>
Turkey	608.40 New Lira per month (£257.62)	NO	28% - 48%	Living Wage estimated to be 1865 - 2200 New Lira (£833.93 - £984.28) per month <sup>21</sup>
Vietnam	540K VND (£15) per month for state-owned enterprises 800K-1,000K VND (£25-£30) per month for foreign-owned or funded enterprises	NO	39% 57% - 71%	Living wage is estimated to be 1,401K VND (£45) per month <sup>22</sup>

### Bangladesh Case Study: Supply chain structure and living wage

The garment industry in Bangladesh has experienced robust growth with garment exports accounting for 16.9% of GDP in 2006 up from 5.5% in 1991. Despite this growth, Bangladesh has experienced unprecedented labour unrest. It is widely agreed that the causes of the unrest stem from poor labour conditions within the garment industry, in particular relating to the payment of very low wages to workers.

According to research carried out in 2007 with manufacturers in Bangladesh, retailers, brands and their agents are rarely concerned about the different components of cost structure, including payment of a living wage. In addition, manufacturers identified differences in purchasing practices according to the different purchasing channels used (direct buyer, buying house/agent or brand's regional sourcing office). Varying practices related to price, levels of compliance demanded and methods for settlement of disputes. It is

clear that the role and number of agents or intermediaries in a supply chain can decrease the income available to the production stages of the garment supply chain. On average, agents earned 5% of the FOB value of a ready made garment<sup>23</sup>. Agents' own purchasing practices can play a large part in whether workers are paid a living wage. Research suggests that as a target price given to the agent is squeezed, agents seek to safeguard their own margins by achieving lower costs within their supply chains and sometimes by accepting less stringent conditions at manufacturing sites. In addition some manufacturers with weak labour standards preferred dealing with agents rather than with retailers' or brands' regional sourcing offices since some agents have a reputation of being less strict on labour standards. The implication is that there is more transparency and control within vertically integrated supply chains where retailers with local sourcing offices will have more influence over the upholding of labour standards in their supply chain.

# Operational Principles for Better Purchasing Practices

## Solutions for the Buying Team

### Product Development: Awareness of cause and effect

- Buying team to meet to ensure all members are fully briefed on commercial targets, design and technical specifications before product development requests are communicated to suppliers. The more complex the product design (e.g. embellishments), the more complex the supply chain is likely to be (i.e. the use of many agents and sub-contractors) and therefore the more likely it is that labour standards may be compromised
- All buying team members should understand the implications of product and commercial specifications on product critical path

### Sampling: Reduce wastage of time and resources

- Buying team to set specific targets, per order, with suppliers on a fixed number of sampling phases, and volume of samples required, particularly where the supplier is required to pay for the samples
- Buying teams to monitor the 'hit/conversion rate' of key suppliers to understand the cost implications of the sampling process
- Clear communication of the sampling requirements to suppliers to enable suppliers to predict the cost of sampling production, and to factor this into any cost quotations made
- Buying teams should coordinate and prioritise any sampling requests made from different divisions to one supplier

### Supplier Selection: Supply chain transparency

- Supplier and buying team must have clear communication on each site's capacity and planned orders in advance of any order, to allow for adequate production planning
- Buyers should show knowledge of the issue of overtime in their negotiations, and ask suppliers whether the selected manufacturing site will have capacity without using excessive and regular overtime
- Buyers should understand that letting down suppliers over order placement 'promises' has an impact on the perceived reliability of that supplier with its supply base, and therefore has implications on the supplier's ability to book production space with good sub-contractors

### Placement of Orders and Production: Clearly defined volume and time commitments

- Buyers to solicit from sites accurate information about when space has been booked for a particular order, and to give clear indication to the buyer of the dates needed for production sign-off to reach the target in-store date without the use of overtime
- Buyers should be aware that by sourcing from sites which offer CMT alone, negotiations to reduce costs are highly likely to have an impact on the amount paid to workers
- Clear written commitment must be given by the buyer to the supplier, immediately following placement of a particular order

### Delivery: Fairer and more transparent allocation of the costs of late changes

- Any changes in production design made post production sample sign-off should result in either a delay to the in-store date, or a commitment from the buyer to pay for any air freight required
- Agree between buying team and supplier that the party which caused the change to the critical path will pay for the unplanned air freight
- If mistakes are made by suppliers, buyers should consider allowing a part-air, part-sea freighted delivery to reduce overall cost of air-freight to supplier
- Where last-minute changes by the buying team have resulted in wastage or excessive stock holding by supplier, retailer or brand should commit to either using the stock in future, or compensating the supplier for the wastage

### Ongoing Product Management: Repeat orders and changing sustainable cost price

- Define specifications and separate critical path for repeat orders
- Identify where style and specification changes result in increased unit cost prices, and renegotiate cost price where applicable
- Evaluate/determine the minimum sustainable cost prices at different volumes which enable the payment of a living wage



The table on the left lays out a set of operational principles which tackle each of the pinch points identified on page 4. Recognising the pinch points and developing a clear set of operational principles is the first step to more responsible purchasing practices. These operational principles must be hard-wired into the normal buying policies and processes followed across the commercial department.

This will support more efficient purchasing and reduce some of the pressures on suppliers which contribute to poor working conditions.

However, these operational principles can do no more than mitigate the effects of the pinch points in purchasing. They are necessary to enable sustainable improvements in working conditions, but are not sufficient to deliver better labour practices. To make sustainable change, the incentive structure for both buyers and suppliers must also be transformed. The next section sets out how incentives can create a purchasing culture which is good for business and better for workers.



### Creating Incentives That Reward the Right Behaviour: Balanced Supplier Scorecard

Nike uses a balanced supplier scorecard which incorporates corporate responsibility along with quality, delivery/planning, product readiness and FOB cost. Nike realises that "without a clear business case contract factories have a difficult time embracing investments in human resource management systems because the external market

pressures are too overwhelming and the rule of law too weak... Investing in workplaces in which workers' rights are central to the business proposition often leads to greater ROI to the business." The company's current plans indicate they will update the "balanced scorecard to include direct correlations between business processes and resulting excessive overtime on the factory floor."<sup>24</sup>

# The Win:Win - Incentives: Creating an enabling environment

## Creating an Enabling Environment

Suppliers are incentivised to provide the right product, at the right price, at the right time. Their performance in these areas determines whether they receive more orders in the future. Conspicuous failure to meet minimum ethical standards is a risk to suppliers, in that being found out may result in reduction of orders or termination of contract. In many instances, factories must be signed off by the code of conduct team before they are able to start supplying a retailer or brand. However, as we have seen, the current system encourages suppliers to demonstrate the appearance of compliance, rather than incentivising genuinely good labour standards. During our research, factory managers, manufacturers and agents said that there was no incentive for them to make real ethical efforts, since they saw competitors making less effort yet being rewarded by orders.

Meanwhile, several buyers interviewed said that, whilst they wanted to source from suppliers with better working conditions, as long as their performance is measured solely on margin and other commercial measures, there is no incentive to 'do the right thing'.

A solution must be found to convert the vicious circle – 'better, cheaper, faster, less ethical' – to a virtuous circle – 'better, cheaper, faster, more ethical' as the dominant business model. To achieve this, both buyers and suppliers must be incentivised for ethical, as well as commercial performance. These incentives must go beyond delivering good labour standards audit results (which, as we have seen, have not delivered the required results and which can easily be manipulated) to reward behaviours which deliver demonstrable benefits for workers.

## Buyer Ethical Scorecard

Desired behaviour	Indicators
Choice of and loyalty to suppliers who demonstrate commitment and actions to improve working conditions	<ul style="list-style-type: none"> <li>• % of business through suppliers scoring well on this indicator (through number of sites with active trade union, steps towards paying a living wage, provision of social benefits (healthcare, schooling, nutrition, etc.), lower staff turnover)</li> </ul>
Sticking with suppliers who are willing to work through labour standards problems Exiting from suppliers who have demonstrated, after a period of time, no commitment to improving working conditions	<ul style="list-style-type: none"> <li>• % of suppliers who have acknowledged issues and made improvements</li> <li>• % of suppliers making no progress who have been delisted</li> </ul>
Loyalty to suppliers with long relationships with production sites	<ul style="list-style-type: none"> <li>• Average length of relationship with individual production sites</li> </ul>
Commitment to a critical path which allows sufficient planning and production time	<ul style="list-style-type: none"> <li>• Number of deviations from critical path</li> <li>• Sampling hit/conversion rate</li> <li>• Number of late changes in orders</li> </ul>
Contributing to an enabling environment for improved labour standards within the retailer's supply chain	<ul style="list-style-type: none"> <li>• Level of willingness to work collaboratively to bring about sustainable labour standards improvements within the retailer's supply chain. This may include working with NGOs, trade unions, government, trade associations and suppliers</li> </ul>



# that is good for business and better for workers

## Buyer and Supplier Ethical Scorecards

The tables below suggest how social responsibility could be integrated into buyer and supplier assessments alongside existing commercial KPIs. The assessment of buyers should include these social responsibility considerations, partially based on feedback from suppliers on their trading relationship. Any assessment of suppliers (for the awarding of new or repeat business) should include these social responsibility considerations, alongside usual aspects of service delivery such as quality, design, development, and margin. (Subjective indicators will require companies to identify what good, average and poor performance looks like to enable consistent assessment.)

Implementing operational principles and establishing an enabling environment which incentivises buyers and suppliers through the proposed scorecards will achieve the quadruple wins of:

- meeting commercial targets
- delivering efficiencies
- meeting ethical targets
- reducing reputational risk.

Working in this way creates a virtuous circle where commercial and ethical strategies are complementary, bringing business benefits including:

- Streamlined internal communication processes
- Improved communication and information flow with supply base
- Shared knowledge of and responsibility for commercial targets
- Collaborative approach to meeting critical path deadlines

## Supplier Ethical Scorecard

Desired behaviour	Indicators
Championing better jobs for workers, good labour standards and having a positive impact in the community	<ul style="list-style-type: none"> <li>• Staff turnover at production sites</li> <li>• Good human resources management systems</li> <li>• Good labour standards audit results</li> <li>• Sharing good practice with other suppliers</li> </ul>
Taking pride in steps taken to demonstrate improved working conditions at all times including when issues are discovered	<ul style="list-style-type: none"> <li>• Sites with particular initiatives such as active trade union representation (worker representation where Trade Union not allowed), steps towards paying a living wage, provision of social benefits (healthcare, schooling, nutrition, etc.)</li> <li>• Existing recognition agreement and Collective Bargaining Agreement</li> <li>• Analysis of working hours</li> </ul>
Stable relationships with own suppliers/sub-contractors	<ul style="list-style-type: none"> <li>• Average length of relationship with individual production sites</li> <li>• Open dialogue on labour standards in subcontracting sites</li> </ul>
Transparent about supply chain and production	<ul style="list-style-type: none"> <li>• Shared list of all sources of supply, including sub-contractors and home-workers</li> </ul>
Open dialogue on labour conditions	<ul style="list-style-type: none"> <li>• Level of willingness to discuss issues such as pressures on working hours and pay</li> <li>• Retrospective comparison of planned vs. actual timings and volume outputs, measured against overtime worked at site</li> </ul>
Constructive feedback on how purchasing and manufacturing process can be adapted to meet business as well as minimum social objectives	<ul style="list-style-type: none"> <li>• Quality of business relationship between brand/retailer and supplier, gauged by 360 degree feedback</li> </ul>
Contributing to an enabling environment for improved labour standards on site	<ul style="list-style-type: none"> <li>• Level of willingness to work collaboratively to bring about sustainable labour standards improvements on site. This may include working with NGOs, trade unions, government, trade associations and suppliers</li> </ul>

# The Win:Win - Process: What needs to change?

To establish an enabling environment, companies need to ensure that they are equipped with:

## The right information:

- Open communication channels in both directions between supply base and buying team. This should include a feedback loop which enables prediction and resolution of disruptions to the critical path.
- Full transparency within the supply chain, leading to detailed understanding of the processes occurring in the supply chain, helps mitigate any disruptions which may arise.
- Sufficient training of internal buying team to ensure buyers' technical knowledge of production process, production limitations, logistics of supply, macro-economic impacts on pricing and trading conditions between sourcing countries.  
A technical knowledge of the production process should be included in the buyer's job description.
- Sufficient cross-collaboration within buying team to ensure designers are fully briefed on commercial targets, and include this in their design specifications.

## The right internal processes:

- Formalised and streamlined internal buying processes (from line development to production and delivery targets). These should provide internal and external partners along the supply chain with the correct timelines, and should allow for the swift sharing of relevant information.
- A realistic critical path for each order placed, which is communicated to and agreed upon by suppliers at the earliest possible time, and updated throughout the production schedule.  
To include:
  - Defined sampling, approval processes
  - Production time not based on excessive overtime
  - Two-way information exchange.
- Identification of key steps to be taken to resolve disruption to an agreed critical path.
- Pre-definition of points of contact for efficient exchange of information between suppliers and commercial teams.
- Sharing of relevant supplier, financial and market data as soon as it comes to light.

## The right suppliers:

- Suppliers committed to achieving retailer/brands' long term goals and are rewarded for their achievement against the supplier ethical scorecard (see page 13).
- Relationships are based on trust and openness, working towards mutual transparency.
- Commitment to technically competent suppliers who will help to achieve commercial targets.

## The right context:

The responsibility of purchasing companies to influence the production conditions of garment workers is shared with suppliers, governments, and workers themselves. To ensure a contribution is made to raising labour standards across the industry, retailers and brands should:

- Collaborate with other retailers, suppliers and relevant industry associations to:
  - Develop an industry wide code on responsible purchasing.
  - Develop a capacity model for the garment sector based on number of workers, the basic working week and the payment of a living wage in the supplier country.
- Work with other organisations who have complementary knowledge and expertise to bring about sustainable improvements to workers' lives at production sites, including trade unions, community organisations, charities/NGOs, relevant government departments.
- Adopt a mechanism for determining a living wage in the supplier country. This needs to be communicated to suppliers to ensure that increases in the cost price are translated to better conditions for the workers.
- Provide relevant information to organisations which can support positive changes at sites of production, for example through public reporting of information about the supply chain. Companies such as Gap<sup>25</sup> have demonstrated commitment to support positive change by publishing the names of their sites or locations of production.



## Case Study: Inditex and ITGLWF's International Framework Agreement

Inditex, the owners of the clothing brand Zara, and the International Textile, Garments and Leather Workers Federation (ITGLWF), a global trade union body with 217 affiliated unions worldwide, signed an International Framework Agreement, designed to reinforce worker rights, in October 2007<sup>26</sup>.

This agreement, with a particular focus on the rights of free trade unions to bargain collectively, means that the two organisations will collaborate to ensure that Inditex's code of conduct improves workers' conditions within Inditex's supply chain.

Inditex has committed to informing all of their suppliers of this agreement, and the ITGLWF will notify all of its member unions worldwide. The two organisations plan to work together on worker education programmes focusing on the rights to freedom of association and collective bargaining. In the event of a breach of the code Inditex and the ITGLWF will launch a joint investigation of the issue.



## Case Study: Buyers collaborate to meet workers' needs following Spectrum factory collapse

Following the collapse of the Spectrum Sweaters factory in Bangladesh, European retailers are collaborating to set up a relief fund for former workers. The nine-storey factory, which produced nearly 80,000 pieces of clothing for export annually, collapsed in April 2005 after a boiler exploded, killing 64 people. As a result of the closure, hundreds of people were left jobless and many of the Spectrum families have been plunged into poverty and debt. The objective of the fund is to provide the victims and families of the survivors with a monthly income and medical care. Solo Invest (France), KarstadtQuelle (Germany), Scapino (Netherlands), Inditex (Spain), and New Wave Group (Sweden), who were sourcing from Spectrum and the adjoining Shahriyar Fabric, have agreed to participate in the fund<sup>27</sup>.

*"Every month I have to take out a loan to maintain my family. I cannot repay the loans, the amount is increasing day by day ... I feel sick while thinking about all this."* 40-year-old Zarina, whose husband Solaiman was killed in the factory collapse. She and her three children only have her daughter's meagre income from another garment factory job, which does not cover their basic needs.



# The Win:Win - People: What needs to change?

Just as a company's processes need to be streamlined to support an enabling environment, specific job roles need to be defined to ensure ethical targets are achieved.

## For Sourcing or Buying Directors

- Implement a clear set of operational principles as part of a dynamic sourcing strategy (see page 10).
- Raise the profile of the brand or retailer through the promotion of procurement procedures.
- Instigate a periodic, frequent 360 degree feedback process where suppliers are able to comment anonymously on their relationships with buyers and buying teams. This will allow full visibility of pinch points and tracking of progress to targets.
- Streamline internal team structures and bonuses to improve communication routes with suppliers.
  - Create named buyer as key contact for each supplier with responsibility for taking decisions relating to that supplier. Use proposed ethical scorecard (see page 12) to review the performance of and reward buyers.
  - Other staff (design, technical, merchandising, code of conduct) should communicate through, or copy, the buyer when communicating with the supplier. The code of conduct team should provide advice, information and best practice to support buyers to bring about positive change at the production sites they have selected.
- Lead discussions within the business on the need to promote an innovative business model which supports better social conditions for workers in the supply chain.

## For Buyers

- Know the types of organisations being bought from and whether the supplier is acting as an agent or manufacturer. Understand the implications this has for the supplier's ability to reduce cost prices, improve lead times and promote best practice.
- Seek full understanding of hidden costs involved in maintaining full flexibility of the supply base. All costs charged to suppliers will ultimately result in raised cost prices or increased risk.
- Build honest relationships – establish clarity about length of relationships, provide honest feedback and build trust so that problems can be shared and tackled collaboratively.
- Demonstrate and communicate commitment to have a positive impact on the workers in the

supply chains. Ask targeted questions of suppliers about the conditions of the workers.

- Recognise that buying from a short term supplier involves different decisions compared to longer term relationships.
- Recognise that as a buyer you may need to commit to allocating additional volumes to tide the supplier over the troughs of low season work.
- Only negotiate on price when a supplier is able to flex prices based on variables other than labour (e.g. quality, timing, payment terms, volumes).

## For Designers

- Understand the context of who makes and pays for samples.
- Track sample 'hit /conversion rate' per manufacturer (not per agent).
- Work together with buyer to ensure that samples desired can match price points and type of products envisaged for in-store.

## For Technologists

- Ensure testing or checking processes do not act as pinch points or cause delay to manufacturing.
- Share knowledge and analysis of supplier, production sites and capability with buyers to build better relationships.

## For Merchandisers

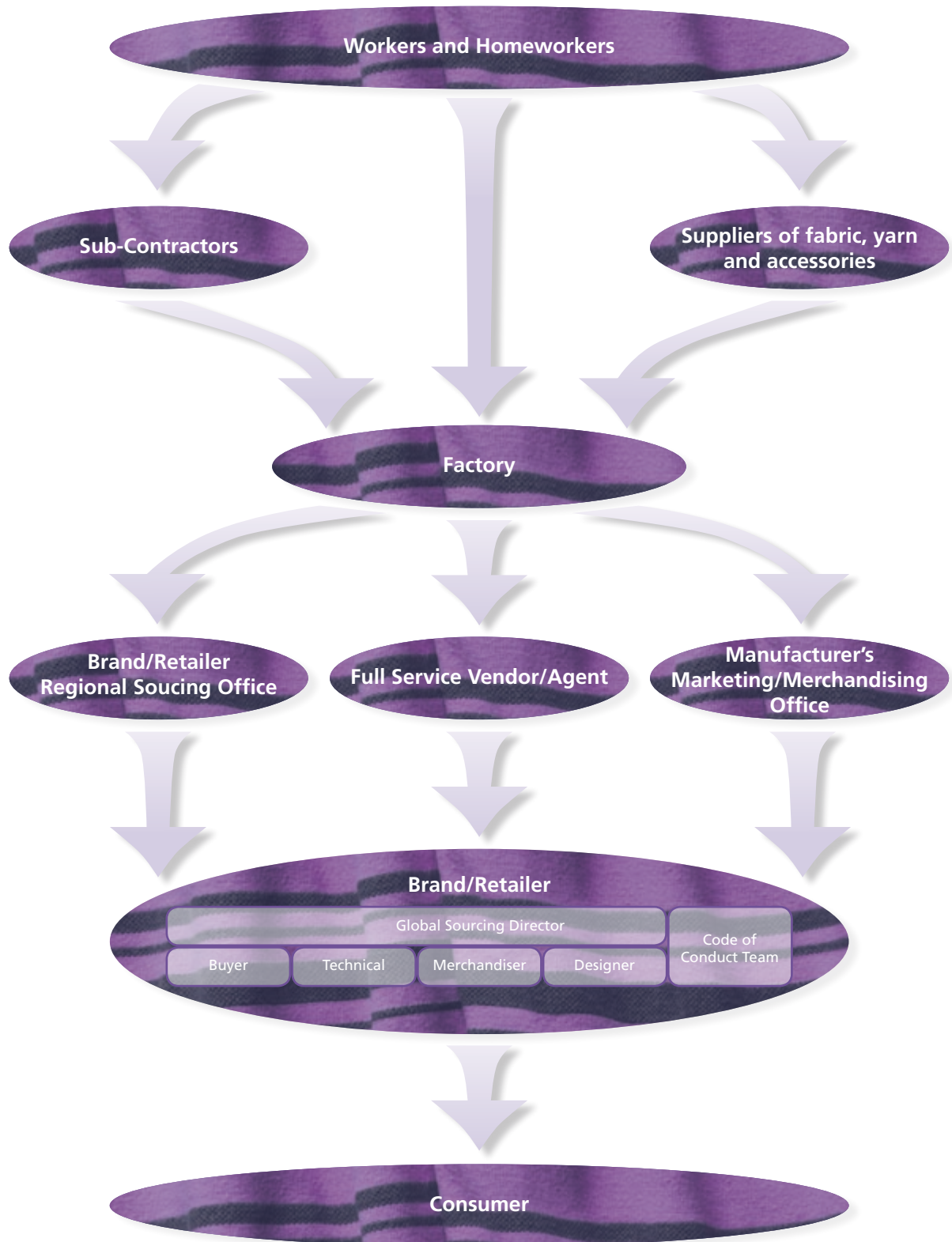
- Take ownership for the product critical path, and ensure that all members of the buying team are aware of specific dates. If any changes are made to the critical path, ensure that buying teams and suppliers are made aware, and any adjustments are communicated accordingly.
- Provide order breakdowns (size, style) and delivery deadlines in good time. Explore flexible solutions to resolve potential pinch points and pressure in manufacturing process.

## Code of conduct team members

- Be available to support the buying team to explore how to solve problematic issues.
- Undertake analysis to assess what are systematic problems in the retailer or brand's supply chain.
- Build capacity of local organisations in country to help pre-empt and solve issues at production sites.
- Recognise that audit data provides a snapshot of information which may need to be corroborated by further investigation.
- Challenge buyers when orders are placed with suppliers with known poor labour standards.



# The Garment Supply Chain



## This report is co-authored by Impactt and Traidcraft Exchange.

Traidcraft Exchange is the UK's only development charity specialising in making trade work for the poor. In collaboration with local partners we work to create opportunities for poor people to harness the benefits of trade, helping them to develop sustainable livelihoods and offering them hope for a better future. Traidcraft also uses the experience of its counterpart, Traidcraft plc, a fair trade company, to improve wider trade practices. Impactt is a specialist consultancy working with a broad range of businesses on improving labour practices in supply chains. Impactt strives to improve working conditions in supply chains whilst bringing clear business benefits to purchasers, suppliers, factories, workers, and communities.

The findings of this report are based on a series of face-to-face and telephone interviews conducted between March and July 2008, as well as research in Cambodia and Bangladesh conducted in 2007.

Interviews were held with:

- 6 retailers (5 UK and 1 continental European company)
- 4 regional sourcing offices based in Hong Kong
- 6 agents (2 UK, 3 Hong Kong and China, 1 Bangladesh)
- 8 manufacturers (5 China, 2 Bangladesh and 1 Cambodia)
- 43 key informant interviews (17 in Hong Kong and China, 10 in Cambodia, and 16 in Bangladesh), including a focus group with workers in Cambodia.

The report also draws on Impactt's extensive experience of working with all players in the garment supply chain and Traidcraft's participation in the Ethical Trading Initiative and establishment of the Responsible Purchasing Initiative. This report is part of the Responsible Purchasing Initiative's work to improve the purchasing practices of EU companies so that minimum human rights standards are realised by the workers in the developing countries involved in producing products.

We would welcome your feedback on this report. Please email your comments direct to [responsible-purchasing@traidcraft.org.uk](mailto:responsible-purchasing@traidcraft.org.uk) or visit our website at [www.responsible-purchasing.org](http://www.responsible-purchasing.org)

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