STUDY

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Responsible Investing

ENGAGEMENT: Social Issues in the Supply Chain

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EXECUTIVE SUMMARY

Last April, more than a thousand people were killed by the collapse of a building in Dhaka, the capital of Bangladesh. Most of the victims were employed in the workshops of garment manufacturers housed in the building. This tragedy echoes a large number of controversies that have erupted in the last few years (Foxconn, 'horsegate', etc.) in being tied to poor practices among actors in the supply chain.

Responding to pressures from civil society, companies have begun to acknowledge the importance of environmental, social, or simply reputational risks within their supply chains. It is in their interest, and even more so in the public's, that companies forestall such events by increasing supervision of their various suppliers.

Here, we look at this issue from the standpoint of responsible investment. Working back from the analysis of supply chain risks, we attempt to define areas for improvement that take into account the specificities of each sector and company, and thereby encourage progress among the groups we invest in.

I. Supply chain and corporate social responsibility

Why integrate the supply chain into the perimeter of corporate social responsibility?

With the increasing trend toward globalisation, it is becoming more and more difficult to determine the boundaries of a business and its area of responsibility. This problem is well covered by the OECD in their 2011 Guidelines for Multi-National Enterprises (MNEs): 'Multinational enterprises, like their domestic counterparts, have evolved to encompass a broader range of business arrangements and organisational forms. Strategic alliances and closer relations with suppliers and contractors tend to blur the boundaries of the enterprise.' Consequently, the extent to which a company is responsible for what happens in its supply chain is not easy to determine. Firms found in supply chains are independent organisations that have complete autonomy over how they run their operations – making them outside the company's direct control.

> " Strategic alliances and closer relations with suppliers & contractors tend to blur the boundaries of the enterprise.
> – OECD Guidelines for MNEs, 2011

Historically, companies have only been held responsible for what happens within their walls. This is because, in the past, companies directly managed the majority of activities necessary for their business to function. However, with the growing trend of outsourcing and increasing globalisation, this is no longer the case. Companies are increasingly externalizing activities they no longer consider core to their business. For example, Adidas has transformed itself from a manufacturer of sports footwear that directly owned shoe factories, to become a sports brand company that outsources a big fraction of its production to third parties. The externalization of these activities also brings about a disassociation of the company from the accompanying risks. Be this as it may, environmental controversies and human rights violations have been revealed in the operations of several companies' suppliers, causing the general public to begin considering what goes on in the supply chain to be within companies' realm of responsibilities – regardless of whether they have direct control. Although the extent to which a company is legally responsible for these violations has yet to be determined, thereby creating a grey area of responsibility hovering at the perimeter of companies' direct operations, the possible impact of such controversies on their businesses and reputations leads civil society to seek a broader definition of the scope of companies' influence. The OECD's Guidelines for MNEs, for instance, are recommendations for responsible business conduct. This document is one of four elements that constitute the OECD Declaration and Decisions on International Investment and Multinational Enterprises, a policy commitment on the part of adhering governments to increase transparency for international investment and to encourage the positive economic and social contributions multinational enterprises have. Adhering governments work to promote the OECD Guidelines, and contribute to their implementation through the establishment of National Contact Points (NCP).[1] The OECD Guidelines are based on a variety of documents published by the United Nations and other supranational organisations. In terms of human rights and employee relations, the minimum required standards draw on the Universal Declaration of Human Rights and the ILO's Core Conventions on Labour Standards. While these guidelines cover several topics, the most relevant to this study are those covering the environment and human rights.

> “ Companies are expected to continually seek to improve corporate environmental performance at the level of the enterprise and, where appropriate, of its supply chain.
> – OECD Guidelines for MNEs, 2011

In their Environment section, the guidelines encourage several specific practices that can help companies to protect the environment, public health and safety, and conduct their activities so as to contribute to sustainable development. One such practice encourages companies to 'continually seek to improve corporate environmental performance at the level of the enterprise and, where appropriate, of its supply chain,' thereby including the company's supply chain within the company's realm of responsibilities when it comes to environmental matters.

The Human Rights section of the OECD guidelines have incorporated the principles prepared by Professor John Ruggie, the UN Special Representative for Business and Human Rights appointed in 2005 by then Secretary General Kofi Annan. Throughout his tenure as UN Special Representative, Professor Ruggie worked to identify and fully describe the human rights responsibilities of businesses. His work resulted in the UN Guiding Principles on Business and Human Rights, which was presented to the Human Rights Council (HRC) in 2011, which unanimously endorsed the Guiding Principles – making it the first global framework to define the responsibilities of businesses regarding respect for human rights.

The Guiding Principles are built on a framework supported by three pillars: Protect, Respect and Remedy. The first of these outlines the state's responsibilities in terms of protecting individuals against human rights abuses by third parties, including businesses. The second pillar, respect, focuses on companies' corporate responsibility to act with due diligence to protect human rights and mitigate any negative impact. Remedy, the third and final pillar, combines the roles of both state and companies, and explains their joint responsibility to provide access to remedy for any infringement of human rights by third parties. The framework reiterates that 'business enterprises should respect human rights' and that in order to do so, companies are required to:

(a) Avoid causing or contributing to adverse human rights impacts through their own activities, and address such impacts when they occur;

(b) Seek to prevent or mitigate adverse human rights impacts that are directly linked to their operations, products or services by their business relationships, even if they have not contributed to those impacts.

The latter statement speaks to the human rights responsibilities with respect to supply chains that devolve to businesses. It affirms that through their business relationships with firms in their supply chain, companies make themselves partially responsible for any human rights impacts that occur as a result of these operations, whether or not they have directly contributed to such impacts.

[1] *The OECD guidelines for MNEs are non-binding principles and standards for responsible business conduct in a global context. Nevertheless, companies are held accountable for their actions, should the adhering government's NCP determine that the company has violated the guidelines.*

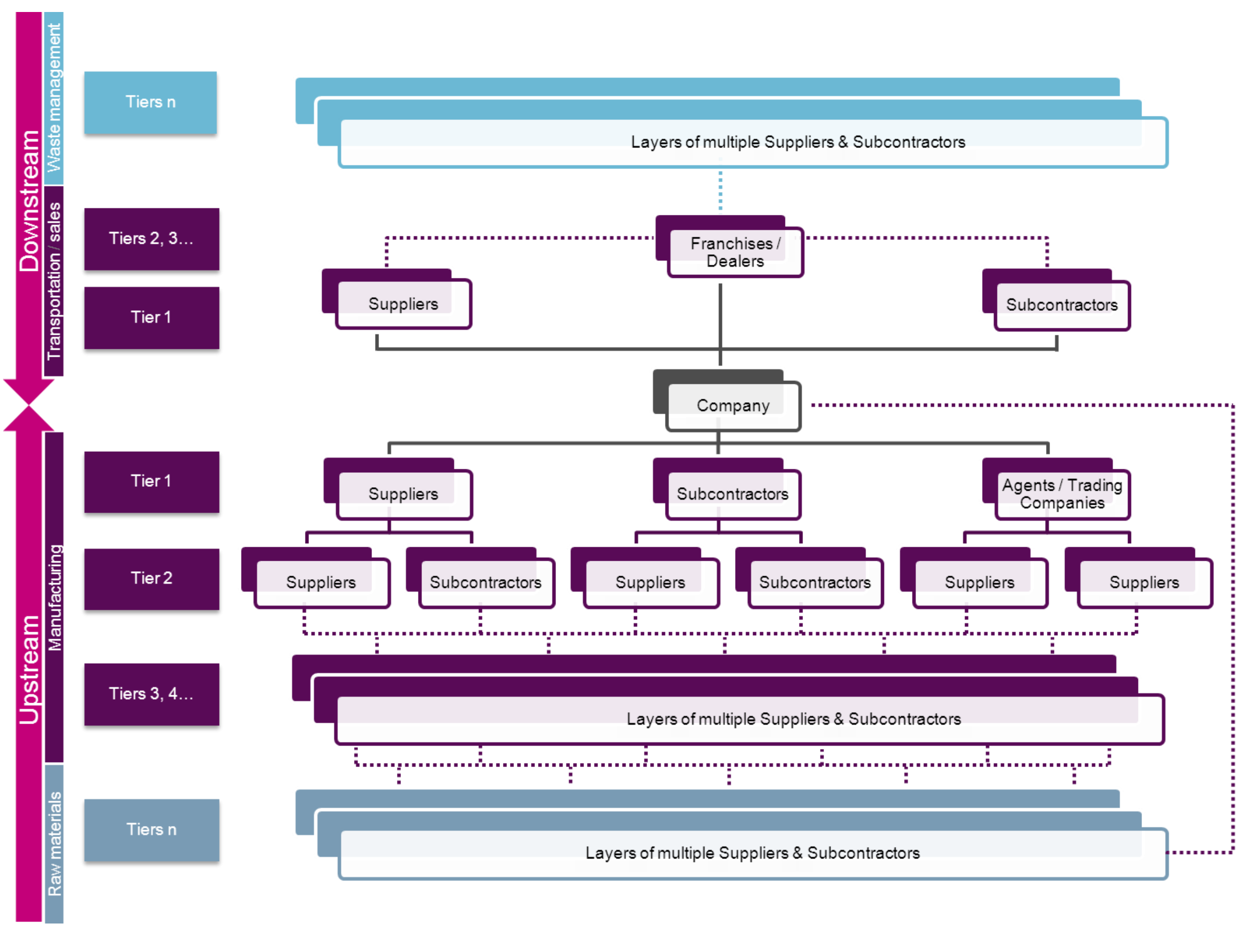
The OECD Guidelines for MNEs and the UN Guiding Principles on Business and Human Rights, both standards for responsible business conduct, have incorporated the supply chain into companies' realm of responsibilities – thereby integrating the operations in the supply chain as part of a company's corporate social responsibility.

What is a supply chain?

Understanding supply chain issues is, in most cases, quite complex. Indeed, in order to fulfil a customer's need, an entire network of interdependent entities is articulated to offer products and services that satisfy this need. This network, upstream and downstream from the company itself, is called a supply chain. It may be as simple as an individual who offers services directly to the final customer and as complex as various interlinked companies that include product designers, suppliers of raw materials, manufacturers, assemblers, warehouses, logistics providers, retailers and service providers.

Additional layers of complexity have been added to supply chains in our current era of globalization and 'specialization'. Organizations have begun using global suppliers in their businesses. Many have also re-thought their strategies to focus on their core business, outsourcing processes not falling within their area of specialty. The use of outside resources to handle activities that were previously performed internally is called outsourcing. Consequently, globalization and specialization, in their extreme cases, have engendered organizations that externalize their production, activities and risks to various companies in diverse countries.

Figure 1. Complexity of a Supply Chain Structure



Source: Mirova, 2014.

The large majority of companies have very complex supply chains which can be very different one from another, depending on the industry and business model. Following the UN's Guiding Principles, we adopt a broad definition of supply chain, covering all types of providers with which a company has business relationships. This includes direct suppliers (a business that provides a particular service or product) and subcontractors (companies hired to fulfil part of the company's activities or part of the suppliers' contractual commitments), and extends to the suppliers and subcontractors of these companies – as illustrated in Figure 1. Additionally, other parties may be involved, such as agents or trading companies – entities hired by the company to take over the relationship with some of its suppliers.

> " With the globalization and 'specialization' era, supply chains are becoming increasingly complex - implying the necessity to strengthen supply chain management.

One comprehensive approach to supply chain management involves the classification in 'tiers', a practice that has been adopted by a growing number of companies. Indeed, every single product and service can be seen as the cumulative effort of various 'layers' (or 'tiers') of organizations which collectively constitute the supply chain. By common understanding, Tier 1 refers to suppliers (and eventually other types of providers) with which the company maintains direct business relationships. Tier 2 consists of companies that supply these Tier 1 suppliers, and so on, down to providers of raw materials (for the upstream portion), and up to waste management suppliers (for the downstream links). Still, this classification should be handled with care, as companies often design their own approach to supply chain management, leading to different classification processes.

II. Review of the primary issues affecting supply chains

Today, supply chains are integral to companies' business operations for increasing overall efficiency. Nevertheless, supply chains are also a great source of risk due to the impossibility of fully controlling all operations throughout each link – as illustrated by the horsemeat scandal that spread throughout Europe at the beginning of 2013. Consequently, the last few years have seen increasing attention drawn to the importance for companies of a strong supply chain management system.

ESG risks in the supply chain

The first risks coming from the supply chain to be recognized by companies have been operational risks – the inability to deliver certain products in time, or to meet a company's quality controls, etc. This has led to the implementation of supply chain management systems to help mitigate and minimize these risks. Nevertheless, while such management systems have helped minimize operational risks, companies still face hazards arising from the supply chain, albeit of a different kind.

Environmental, social and governance (ESG) risks are related to a company's corporate behaviour. Examples of ESG risks include how a company treats its employees and manages its waste. For certain companies, however, a majority of their ESG risks are actually located within the supply chain. While these are and should be primarily the concern of these suppliers themselves, companies elsewhere along the supply chain can also be affected, especially when suppliers fail to meet certain standards. For instance, whenever a scandal surrounding Foxconn arises, Apple's name is almost always mentioned. Mirova acknowledges the negative effects that ESG risks can have on a company's ability to create long-term value, and we therefore include how companies manage ESG risks across their supply chains into our overall ESG rating. Moreover, we have categorized the ESG risks of supply chains as seen in Figure 2.

Figure 2. ESG Risks in the Supply Chain

Environment	Social	Governace
• Pollution & Waste Management • Energy Efficiency & Climate Change • Resources & Biodiversity	• Working Conditions • Human Rights Violations • Product Safety & Quality	• Business ethics

Source: Mirova, 2014.

Supply chain risks across sectors

The exact areas and the size of these risks vary widely depending on the company and the industry it is involved in. To better picture supply chain risks per industry and their relative importance, we have mapped them in Figure 3.

Figure 3. Supply Chain Risks across Different Industries

	Risks implied by the supply chain						
	Environment			Social			Governance
	Waste Management	Energy Efficiency / Climate change	Resources / Biodiversity	Working Conditions	Human Rights Violations	Product Quality and Safety	Corruption, Bribery and Fraud
Consumer Discretionary							
Automobiles & Components	Medium	High	High	High	Medium	High	Low
Consumer Durables (household electronics), Leisure Equipment	Medium	Low		High	High	High	
Consumer Services	Medium		Medium	Medium	Medium	Medium	
Media		Low					
Retailing & Apparel	Medium	Low	High	High	High	Medium	Low
Consumer Staples							
Food & Staples Retailing; Food, beverage & Tobacco	Medium	Medium	High	High	High	High	Low
Household & Personal Products	Medium	Low	High		Medium	High	
Information Technology							
Semiconductor, Technology Hardware & Equipment	Medium	Medium	Low	High	High	Low	Low
Software & Services	*Supply chain risks are irrelevent compared to direct ESG issues*						
Materials							
Materials	Medium	Low	Medium	Medium	Medium	Medium	Medium
Energy							
Energy (fossil fuel)	Low	Medium	High	High	High		High
Health care							
Heatlh care	Medium	Low	Low	Low		High	Medium
Utilities							
Electric & gas	High	High	High	High	High		Medium
Waste & water	Medium	Low	Medium	High	Medium		Low
Industrials							
Cap Goods	High	High	High	Medium	Low	Medium	Medium
Transportation		High	Low	Medium	Low	High	High
Commercial & Professional Services	*Supply chain risks are irrelevent compared to direct ESG issues*						
Financials							
Financials	*Supply chain risks are irrelevent compared to direct ESG issues*						

Legend: *High risks* *Medium risks* *Low risks*

Source: Mirova, 2014.

As the figure shows, there are certain industries which, due to the nature of their businesses (mainly services and other intangible products), incur almost no supply chain risks. Additionally, the raw materials sector, positioned as it is at the beginning of the supply chain, is limited in terms of exposure since most of their risks would be at the company's direct operations. At the same time, there is considerable variance in terms of potential ESG concerns even here. While the dark squares (signifying higher risks) vary across sectors and types of risks, the majority are clustered around social issues such as working conditions and human rights violations, highlighting the hazardousness of this area. Furthermore, news from the media and relevant NGOs further produce evidence that these social issues are increasingly pressing matter.

III. Addressing social issues in the supply chain

Considerable social risks with regards to fundamental rights

As seen in Figure 3, the risks pertaining to supply chains are predominately social, and more specifically concern working conditions and human rights violations. The sectors most exposed to these risks are consumer durables, retail & apparel, food & staples retailing, food, beverage & tobacco, semiconductors, technology hardware & equipment, and energy as well as electricity & gas.

> "The risks stemming from the supply chain are mainly social, and pertain most particularly to poor working conditions and human rights violations.

Based on similarities among the social risks posed by their supply chains, the six sectors mentioned above have been grouped into three categories:

- Group 1: consumer durables, retailing & apparel and semiconductor, technology hardware & equipment
- Group 2: food & staples retailing and food, beverage & tobacco
- Group 3: energy and electricity & gas

GROUP 1: The social risks of companies in these industries are to be found throughout their supply chains. They begin with the harvesting and procurement of raw materials and continue throughout the assembly and manufacturing of their final products. The retail and apparel industry is exposed to social risks in the harvesting of cotton in countries, like India, where the process remains labour intensive. The remaining industries in the group confront the possible risk of incorporating conflict materials procured from the Democratic Republic of Congo. In the manufacturing and assembly stages, all industries are exposed to the risks of poor working conditions and possible human rights violations on assembly lines and within manufacturing factories.

GROUP 2: The social risks of these companies are concentrated in the harvesting of agricultural produce. Farming practices in emerging and developing countries do not exhibit the level of automation shown by their counterparts in developed countries, and are thus still very much labour intensive. Additionally, agricultural employment is significantly less formalised than factory conditions, leading to heightened social risks (e.g. child labour, health and safety concerns arising from exposure to pesticides).

GROUP 3: The social risks to which these industries are exposed concern mainly the production and procurement of coal and, to a lesser extent, oil. Similar to the agricultural sector, employment in coal mining is poorly formalised. This fact, combined with inherently dangerous working conditions brings about elevated social risks. Unfortunately, because these products are highly commoditized, it is difficult to reliably trace the origins of these products. As such, the lack of traceability in the area makes it difficult for companies to have a good overview of all its risks.

In all three groups, those most at risk are also the most vulnerable populations (i.e. people from low-income communities) since the type of work required is low-skilled labour. However while the risks are clear and persistent, the leverage available to companies for inducing change may not be as evident. Even if companies are expected to mitigate the risks present across the entire supply chain, their ability to do so may not follow suit. The further down the supply chain negative social impacts are, the more difficult it is for companies to influence and improve conditions in these suppliers.

Looking at the three groups of industries, group 3 is the one where social risks are situated farthest from the corporations whose responsibility is being invoked: energy and electricity & gas. Coal, a highly commoditized product, goes through several intermediaries before reaching energy companies, which are thus not able to fully trace the exact origins of the coal they buy, thereby diminishing their capacity to encourage change. Companies in group 2, on the other hand, are better able to pinpoint where in their supply chain social risks occur. While certain of their raw materials are also commoditized, food companies have an interest in increasing the traceability of their products due to the need to ensure product quality. Nevertheless, companies' ability to influence better social practices on actual farms is still limited – again, due to the number of intermediaries between these farmers and the companies themselves. Finally, the companies in group 1 encounter social risks at different phases of their supply chain. Like the previous groups, they face risks in the procurement of their raw materials; however, they are also confronted with risks further along in their supply chain, in the manufacturing and assembly of their nearly finished to finished products. Because these manufacturing and assembly factories are usually located in tier 1 of companies' supply chain, they have direct contact with these suppliers and thus have greater leverage they can exercise to induce change within their operations. This is why we have narrowed our focus to companies in the Retail & Apparel and IT industries.

Focus on Retail & Apparel and IT supply chain risks

Companies in these industries have been repeatedly enmired in controversies over their supply chains during the past years. The most well-known controversies are the Foxconn suicides in 2010 (technology sector) and, more recently, the collapse of Rana Plaza in 2013 (clothing industry).[2] More than anything, these events highlight the urgency of immediate and long-lasting action on the part of governments, civil society, and even companies.

> “ The Foxconn and Rana Plaza tragedies highlight the urgency of immediate and long-term action from governments, civil society, and even companies.

Following the tragedy in Rana Plaza, the French National Contact Point (NCP) for implementing the OECD Guidelines for MNEs published a report[3] regarding how the textile industry can better apply these guidelines in light of what happened. In this report, the French NCP describes two types of supply chains found within the industry as described below.

- **Customized Production**

  Companies that rely on this type of supply chain have a certain level of know-how regarding how the product they need is manufactured and require products with more specific production processes. Supply chains like these are usually fairly well-integrated and factories are geographically close to the company to allow for better quality management. Additionally, due to the need for products with higher added value, costs and purchase price are rarely an issue. Companies whose supply chains fall into this category, have a better understanding of their supply chain structure and are, consequently, better able to manage the risks.

  The supply chains of luxury goods companies fall under this category, as the quality of the final products takes precedence over other factors, thereby requiring them to have a better handle on what goes on during the production of their goods.

- **Mass Production**

  This kind of supply chain manufactures products for mass distribution. In this type of structure, the costs of production are the most important driver. As a result, all other factors, like product quality, are pushed a significant step back. This kind of supply chain has a constantly changing structure dependent on the prevailing price for the product in question – leading to very complicated structures with multiple layers in an attempt to ensure the lowest costs possible. Additionally, companies with this kind of supply chain are expected to provide their consumers with these products within a very short time frame relative to that needed for their manufacturing, further adding to the burdens of an already complex structure.

  Retail and apparel companies addressing mid to lower income markets typically have this type of supply chain. Hypermarkets and department stores that provide a low-cost private label also fall under this category. Finally, although meant to describe the supply chain of companies in the textile industry, we also believe that technology companies should also be categorized here due to their

[2] *For more information regarding the Rana Plaza tragedy in Bangladesh and Mirova's position, please refer to the Focus entitled 'Cheap Clothing – At What Cost' which can be found online at www.mirova.com.*

[3] http://www.tresor.economie.gouv.fr/File/393376

similar business environments. Companies in these industries (clothing and technology) are expected to regularly provide customers with a new line of products at accessible prices in a very short time frame.

The second type of supply chain poses the greatest risks in terms of social issues – mainly due to the cost-driven aspects of the structure. Furthermore, to ensure that costs stay down, players all along the supply chain cut corners, usually at the expense of human rights. Accordingly, if changes are to be induced, they need to start at the level of the factories.

Moving toward responsible supply chain management

Responsible supply chain management

According to the Council of Supply Chain Management Professionals, 'supply chain management encompasses the planning and management of all activities involved in sourcing and procurement, conversion, and all logistics management activities'. While traditional supply chain management has mainly looked at costs, and, to a certain extent the quality of products, past events have shown that the public expects companies to monitor the operations of their suppliers and ensure they meet certain environmental, social and governance (ESG) standards. For this reason, a growing number of companies have developed and implemented responsible supply chain management within its operations.

> " Audit practices must be shored up and complemented with other initiatives.

The International Chamber of Commerce defines responsible supply chain management as a voluntary commitment by companies to take into account social and environmental considerations when managing their relationships with suppliers. Responsible supply chain management relies on the presumption that while companies do not directly control the actions of their entire supplier base, the client status of a company may provide sufficient leverage to influence and monitor suppliers' ESG performance.

While there are several tools available for companies to ensure their suppliers' performance reaches certain standards, the most commonly used is auditing. The effectiveness of supplier audits depends on several factors. One of these is how they are conducted – how deep into detail does the audit go, are they announced or unexpected? Are workers able to freely discuss their concerns with the auditor? For the moment, companies do not provide enough communication regarding the implementation of the audits they perform – making it difficult to determine whether or not they are effective in detecting actual risks at the factories examined. Beyond transparency, developing industry standards would help in structuring audits, thereby strengthening companies' capacity to implement a responsible approach to supplier-related risks.

Nevertheless, companies that expect their suppliers to reach certain ESG standards are often the very same companies that actually cause, or at least encourage suppliers to violate these standards. As previously mentioned, cost and lead times are the two biggest factors that drive companies' purchasing decisions. Knowing this, suppliers promise to provide products at a cost and within a timeline they know they can't reach without violating the ESG standards imposed on them. For most suppliers, auditing is just a formality – they have yet to understand how reaching required standards can lead them to do more business. Consequently, auditing alone is not enough and must be complemented with other practices, the most important being for companies to integrate responsible sourcing policies into their own buying practices. A responsible supply chain policy would be one where buyers take into consideration factors other than cost and lead time when placing orders. Buyers should also be aware of the maximum capacities of the factories where they place their orders, and the feasibility of the time frame given. Suppliers are more susceptible to violations when their clients put in rush orders, require last-minute changes and/or place orders that exceed suppliers' capabilities. All things considered, the most effective way to ensure a sustainable positive impact is through the development of a long-term collaborative relationship between the company and its suppliers.

A responsible supply chain management is one where companies integrate a responsible sourcing policy into company buying practices and develop a long-term collaborative relationship with key suppliers.

Responsible supply chain management: Best practices

Due to increasing public scrutiny of supply chain practices, standard practice is for companies to require suppliers to adhere to a code of conduct and perform external audits to ensure suppliers' compliance. However events have shown that this is not sufficient. Companies have therefore taken further steps toward minimizing social risks in their supply chains. Below is a compilation of the best practices currently found in the industries under consideration. Though not exhaustive, these practices have been shown to serve as a company's best defence against controversies in the supply chain.

- **Risk mapping**

Before anything else, companies need to understand the structure of their respective supply chains and map out the risks inherent in each aspect. This includes knowing the several actors operating at each level, discerning the connections between them, determining their importance to the company's entire supply chain and identifying the risks linked to each one and the sources of these risks (whether due to the geographic location or a specificity of the industry).

Simple as it may sound, this is actually extremely complicated due to the increased complexity of globalized supply chains (the supply chain structure illustrated in Figure 1 is more common than we think). Nevertheless, this is highly necessary, as it shows companies where the greatest areas of risk are, allowing a better allocation of time and resources.

> " Considering the increasing complexity of supply chains, risk mapping is a vital – yet equally complex – prerequisite to responsible management.

- **Increased transparency**

Increased transparency benefits a company in several ways. The most relevant of which is that it eases communication between companies and its stakeholders allowing external parties to better understand the company's supply chain risks and the efforts they have in place to manage these risks.

Since the 1990's it has been somewhat standard practice to have suppliers adhere to a code of conduct or workplace standards, and to perform audits to ensure compliance. The codes of conduct to which multi-national companies adhere are usually based on the ILO's Core Conventions and generally contain the following social provisions:

- Employment practices
  - Prohibition of forced and/or child labour and discrimination
  - Salaries of at least the minimum wage or the prevailing industry wage plus benefits
  - Maximum of 60 working hours per week
  - Recognition of and respect for employees' freedom of association and collective bargaining
  - Publication and enforcement of a non-retaliation policy
- Health and safety requirements for the workplace and residential facilities (where provided by the company)
  - Accident prevention
  - Access to clean and proper sanitation facilities
  - Health and safety training

While the publication of a supplier code of conduct is almost industry-wide, there is still a lack of transparency regarding how the audits that ensure compliance with the code are conducted, and specifically: the methodology used, the results of these audits, and the progress of suppliers following these audits.

In summary, disclosure of the information below would provide the general public with a better view of the company's supply chain and its inherent risks:

1. List of suppliers and their geographic locations
2. Conditions required of the suppliers
3. Results and frequency of the audits performed
4. Corrective action plans taken (if any)
5. Measures to safeguard against illegal subcontracting

- **Enhanced supplier relationships**

Company-supplier relationships are an integral part of sustainable supply chain management. For the most part, supplier-company relationships entail numerous audits, compliance checks and regular interactions regarding the orders to be filled. Additionally, suppliers in Group 1 industries are regularly faced with a dilemma: on one hand companies ask them to pay their workers a living wage, enhance working conditions and limit overtime, while on the other hand expecting them to produce quickly and be flexible at low cost. As a result, suppliers often violate the code of conduct (e.g. paying low wages, increasing overtime and hiring illegal subcontractors) in order to meet the demands that ensure their subsistence. Building a strong relationship between the company and suppliers allows companies to better understand the limits of their suppliers and thus better protect themselves against illegal subcontracting.

Building a relationship with suppliers starts within the company itself. In terms of policy, companies should integrate the use of ESG criteria into the supplier selection process, thereby encouraging suppliers to perform well from an ESG perspective. Moreover, they should train and educate 1) their purchasers, about the need to provide suppliers with fair lead times, fair pricing, on-time payments and open and clear communication, 2) factory owners and management, on what are considered adequate working conditions and how to best comply with standards and 3) factory workers, regarding their rights, how to ensure that these are upheld by their employers and what to do when their rights have been violated. A relationship is also better encouraged by having the company's production offices geographically close to suppliers. Having a clear ESG integrated purchasing policy, open communication lines and proximity encourages trust between a company and its suppliers.

> " Creating a sustainable relationship enhances suppliers' loyalty, and is thus key to enhancing compliance.

- **Geared towards a systematic approach**

Problems in the supply chain are currently too ingrained to be solved by the individual efforts of companies. Furthermore, companies may possess sufficient leverage to instigate change among their suppliers. Indeed, despite the audits performed in factories, controversies over working conditions and human rights continue to arise. Additionally, issues such as establishing globally accepted standards for supply chain audits, paying a fair wage and ensuring freedom of association amongst employees cannot be addressed by an individual company and can only be systematically addressed using the combined leverage and resources of participating companies. The companies in an industry would thus need to collaborate both amongst themselves and with various stakeholders to tackle certain issues.

In the retail industry, there is an increasing trend of companies working together to address systemic issues in developing countries. The best examples to date are the Accord for Fire and Building Safety in Bangladesh and the Alliance for Bangladesh Worker Safety, for which separate retail industry working groups formed to tackle building safety issues in the country. While they employ different methods, both agreements promote the common goal of improving health and building standards in the factories of suppliers in Bangladesh. More details on these agreements will be outlined in the later section devoted to Bangladesh.

> " Collaboration throughout the industry may ultimately be the solution to ingrained supply chain issues.

In the ICT sector, the Electronic Industry Citizenship Coalition (EICC) brings together over 80 major companies (among them Apple, Microsoft, Samsung, etc.) to develop a Code of Conduct covering all aspects of ESG, from protection of the environment (mainly carbon footprint and conflict-free minerals) to high ethical standards, health & safety and appropriate labour conditions. Members are required to adopt the code and to invest in its implementation internally and within their supply chains. In order to ensure accountability, companies are committed to various levels of transparency depending on their membership category (two implementation phases exist – applicant and full). The EICC develops a comprehensive set of tools and methods that support credible implementation of the EICC Code of Conduct throughout the supply chain: assessment tools (initial risk assessment for the members and self-assessment questionnaire for suppliers), capability building (training tools for members, their suppliers' and their suppliers' employees), environmental sustainability, Validated Audit Process (a common model to assess compliance with the EICC code, laws and regulations), and reporting tools. The EICC follows-up on its members' improvements through an extensive set of KPIs disclosed in its annual report.

To get a clearer view of what is currently happening in the industry, we mapped the different initiatives of each of the industries' biggest companies according to four best practice categories (see Figures 4 and 5). Using this tool, we can see that companies actually still show room for improvement. Certain practices, like publication of their entire supplier list and the locations of said suppliers, are not systematic among all companies – highlighting the fact that the journey towards a truly sustainable supply chain is by no means finished.

Figure 4. Technology Companies Initiatives

	Best practice			Systematic Approach	
	Risk mapping	*Increased transparency*	*Enhanced supplier relationship*	*Initiative*	*Involvement*
APPLE		- Discloses full list of its top 200 suppliers (name and addresses), representing 97% of spending. - Joined FLA and has the FLA conduct audits (Foxconn). - Discloses number of audits and evolution of compliance rate per issue. - Discloses audit findings and corrective actions. - Audits on tiers 1 and 2 (393 in 2012). - Audits are targeted on recurring issues: surprise audits, FLA audit of Foxconn, weekly tracking of working hours.	- Training for suppliers (workers and managers) on anti-discrimination, health and safety, conflict resolution. - Training for suppliers employees on their rights and their employers' obligations (1.3 million workers. - Actions taken based on audit, especially one case where business was terminated, with proper monitoring from the company. - Measures to protect the rights of workers who move from their home country (suppliers are to reimburse excess foreign contract worker fees).	EICC	-Adopted EICC.
ERICSSON		- Prioritization of audits over suppliers' assessment, as a more robust approach. - Transparent disclosure on number of assessments, audits, auditors, as well as on audit findings (per degree of non-compliance and through time).	- Training of suppliers: requirements and training material available online in various languages.	Self-founded initiative	- Ericsson launched a Joint Audit Cooperation with 9 European telecom operators which are also clients of the group)
HEWLETT PACKARD		- List of production suppliers including addresses of all facilities used for HP (represent over 95% of spending). - Internal scorecard to assess suppliers' practices. - Audit findings are transmitted to corporate governance bodies (general counsel, board committee and ad hoc council which reports to the executive committee). - Transparency on audits, audit findings and targets: extensive data per type of audit, issue and through time. - Labour rights NGO SAI runs independent assessment of HP's supply chain management system. Findings are disclosed (scope could be extended and recurring working hours non-compliance). Appropriate actions were taken. - HP commissioned an independent study on Chinese wages and a focus on health and safety.	- Suppliers are required to schedule and pay for the independent external audits and resulting corrective actions (enhance suppliers responsibility). - Five-tier rating system of suppliers' facilities focusing on labour practices. Highly rated will be rewarded, while poorly rated face decrease in terms of business awarded. - Suppliers training and capacity building: training Tier 1 suppliers to manage and audit HP's Tier 2 suppliers, participation to Tier 2 suppliers' training to manage Tier 3.	EICC & various	- HP joined EICC in 2012 and co-chairs the working group on working hours. - HP participates in various NGO initiatives on human rights (Institute for Human Rights and Business, Global Business Initiative on Human Rights, UN BSR).
INGENICO			- Clauses relative to environment, health & safety, child labour, bonded labour, discrimination and corruption are included in "quality" contracts with the suppliers.		
MICROSOFT & NOKIA		- Required suppliers self-assessment as part of the on boarding process, based on Nokia's code and the web-based E-TASC (GeSi). Information on areas of improvements found in 2012. - Disclosure on number and type of audits, as well as selection of targeted suppliers. every new supplier is reviewed, suppliers with significant organizational changes / high non-compliance risk / key suppliers are reviewed every 2 years. Onsite assessments are also run specifically on E&S matters.	- Enforcement of the requirements through contractual agreements and verified by assessments. - Nokia trains its suppliers and helps them build internal capacity to ensure compliance.	GeSi IDH EICC	- Nokia uses the Global e-Sustainability initiative to assess its suppliers' risks - Nokia works within the IDH Sustainable Trade Initiative for improvements of working conditions and environmental performance - Nokia refers to EICC for sustainable sourcing issues (conflict materials) and uses EICC-validated audit process
SAMSUNG		- Requires supplier self-assessment of ESG performance (1791 suppliers reported in 2012). - External audit in China (249 major suppliers in 2012) following EICC's process (to be expanded).	- Offers CSR training to suppliers (4380 people in 2012). - Actions taken based on audit to tackle labour violations (recruiting process, penalty system, safety equipment, etc.). - Launch of a specific program aimed at favouring long term relationship: opportunities for SME's to become a supplier, for 2nd/3rd tier suppliers to qualify for 1st tier, guidelines to implement actions against illegal subcontracting, bribery, etc. (5392 contracts signed). - Training for suppliers employees on their rights and whistleblowing measures.	EICC	- Adopted EICC in 2009. - Adopted EICC's Validated Audit Process in 2012.

Source: Company Websites / Mirova, 2014.

Figure 5. Retail & Apparel Companies Initiatives

	Best practice			Systematic Approach	
	Risk mapping	*Increased transparency*	*Enhanced supplier relationship*	*Initiative*	*Involvement*
ADIDAS	- Five categories of suppliers: main suppliers, subcontractors, material and other service providers, and licensees & agents - Three sourcing relationships: direct sourcing model (direct contractual relationships with core suppliers suprevised by Global Operations), indirect sourcing model (minor portion of production handled by agents or are made under licence), and local market production (sourcing done by the subsidiaries and not overseen by Global Operations, suppliers do not have authorisation from the Social and Environmentam Affairs team)	- Communicates the following lists of factories: Group Global Factory List, Group Licensee Factory List, and event specific factory lists (e.g. London Olympics and FIFA World Cup South Africa) - Basic concepts of how direct suppliers are audited: code of conduct, the six fundamental elements of social compliance, the C-rating score raging from 1, lowest, to 5, highest, and the clusters of the suppliers based on their results (risk management, partnership, and self-governance clusters) - Explication of procedure in case of non-compliance by suppliers and the top 10 labour non-complaince findings from assessments	- Compliance rating results are integrated into the supplier decision making process - Staff and personnel training on fundamentals (workplace standards, new factory approval process, the operating guidelines), performance (assessment monitoring methods and specific issues like labour and health & safety practices), and sustainability (KPI and rating tools, sustainable compliance planning and supplier self-assessment methods) - Supplier training on how to improve social, health, safety and environmental performance through several initiatives such as the Better Work Programme	Bangladesh Building Safety	- Signed the Accord on Fire and Building Safety in Bangladesh in 2013
FAST RETAILING		- Basic concepts of auditing program: code of conduct, grading system of audit (A, no violations, to E, highly unethical with serious offenses) and workplace monitoring framework	- Enforces the Guidelinse to Prevent the Abuse of Superior Bargaining Power within purchasing departments - Conducts surveys amongs suppliers to identify unresolved monetary issues	Bangladesh Building Safety	- Signed the Accord on Fire and Building Safety in Bangladesh in 2013
H&M	- Identified suppliers who are considered long-term strategic partners (20%of total suppliers)	- Communicates on thenames and location of suppliers representing 95% of production volume - Basic concepts of their Full Audit Program (FAP) and internal rating, Index Code of Conduct (ICoC): minimum requirements, performance of head audits and follow-up audits, a focus on management systems	- Have 15 production offices around the world to maintain close relations with suppliers - Conducted an anonymous survey amongst suppliers to see how they feel working with H&M - In-house buying and merchandising teams receive regular traininf on sustainability issues - Performs capacity buildings for suppliers to understand their sustainability issues better and to raise the workers' awareness of their rights - Rewards suppliers that show strong improvement in business performance and in the company's ICoC	Bangladesh Building Safety	- Signed the Accord on Fire and Building Safety in Bangladesh in 2013 - Collaborated with 18 other brands and employer associatiosn, BGMEA & BKMEA, to spread two training films to increase fire safety awareness amongst employees
				Sumangali Schemes in India Textile Industry	- Joined a three year multi stakeholder project headed by the Ethical Trading Initiative to tackle the issues
INDITEX		- Basic concepts of auditing program: code of conduct, grading system (A-D), six different stages (raising awareness, supplier self-assessment, social auditing, assigning a rating, application of corrective action plans, monitoring programs) - 50% of manufacturing are done by local suppliers	- In-house training done to buyer teams and all suppliers on the Code of Conduct and its updates - Preference shown for suppliers with superior labour management performance	Bangladesh Building Safety	- Signed the Accord on Fire and Building Safety in Bangladesh in 2013 (part of the Steering Committee)
PUMA	-Defined the 4 tiers of their supply chain: Tier 1 (manufacturing), Tier 2 (outsourcing), Tier 3 (processing) and Tier 4 (raw material) - Identified 47 of all Tier 1 factories as strategic partners	- Produced the list of supplier - Supplier's sustainability reports are found in company's website - Basic concepts of auditing program: code of conduct, rating system, areas of failures on different aspects of the audit	- Rewards suppliers who comply with basic standards and maintain proper management systems with more stable business	Bangladesh Building Safety	- Signed the Accord on Fire and Building Safety in Bangladesh in 2013
WAL-MART		- Produced a list of not approved facotries in Bangladesh - Basic concepts of audit system: code of conduct, grading system (colour coded, green, yellow, orange, and red), minimal rating to work with the company (yellow), stages of the audit process (opening meeting, factory tour, employee interviews, documentation & review, and closing meeting)	- Has several types of training programs: supply chain capacity building, factory audit orientation, violation correction training, orange school program, supplier development program, supplier round table, and women in factories training program - Preference shown for suppliers with superior labour management performance	Bangladesh Building Safety	- Founded and signed Alliance for Bangladesh Worker Safety in 2013 (part of the leadership committee)

Source: Company Websites / Mirova, 2014.

IV. Focus: Rana Plaza, the aftermath

A recap of what happened

On the morning of April 24, 2013 Rana Plaza, an eight-story building, collapsed in Savar, a suburb of Bangladesh's capital city Dhaka. The building was home to five garment factories that supply Western brands and, taken altogether, employed at least 3,500 people. The death toll reached more than 1,100. While not the first tragedy in the country's garment factories (a fire at another garment factory had occurred just months before), it is by far the most fatal accident to have taken place in the country.

The importance of the garment industry to Bangladesh's economy is not to be overlooked. In 2012, the industry contributed to 17% of the country's GDP and 77% of the country's total exports (BGMEA). Over the past 30 years, total exports have increased radically from around US$131 million in 1985 to worth US$19 billion in 2012 – creating jobs for many people from low-income populations. However, this rapid growth, in addition attempts at keeping costs down, may have led many factory owners to cut corners when it comes to building safety requirements.

> " Two industry-wide initiatives have been launched in response to the Rana Plaza tragedy.

Following the collapse of Rana Plaza retail and apparel companies present in the area rushed to provide financial resources for victims and their families. Many also pledged to improve the fire and building safety of garment factories in the country by signing either the Accord on Fire and Building Safety in Bangladesh or the Alliance for Bangladesh Worker Safety.

Accord vs. Alliance

The Accord on Fire and Building Safety in Bangladesh and the Alliance for Bangladesh Worker Safety have several similar aspects – the most important being their common goal: to ensure that the factories where their products are being produced in Bangladesh meet building and fire safety standards. Additionally, companies that have signed the Accord and companies that have signed the Alliance have several suppliers in common. The two initiatives have then decided to collaborate and require the same set of standards from their suppliers – better allocating the resources of both the suppliers and the companies.

- **Accord on Fire and Building Safety in Bangladesh**

The Accord for Fire and Building Safety in Bangladesh, initially sponsored by IndustriALL Global Union and the UNI Global Union, is an agreement whereby its signatories agree to establish a fire and building safety program for a period of five years, thereby committing companies to remain in and source from Bangladesh for that length of time. Additionally, companies are required to maintain order volumes with certain factories for a minimum of two years. A legally-binding agreement, the accord commits signatories to financing and implementing a programme aimed at inspecting and remediating their suppliers in the country. Of the companies that have signed the accord, the most notable are Swedish clothing company, H&M, and their Spanish counterpart, Inditex. The governance of the programme will be headed by a Steering Committee with equal representation from the trade union signatories, company signatories and a representative from the International Labour Organization. Additionally, the participation of workers via workers representatives will add value to the discussions. The inspections will be performed by an independent and qualified Safety Inspector, chosen by the Steering Committee, and corrective actions will be undertaken by suppliers according to a mandatory and time-bound schedule. A Training Coordinator, chosen by the Steering Committee, will also design and deliver an extensive fire and building safety training programme. Finally, one of the key aspects of the programme is its dedication to transparency' inspection reports will be publicly available as long as a remediation plan has been finalized and insofar as it poses no imminent danger.

- **Alliance for Bangladesh Worker Safety**

The Alliance for Bangladesh Worker Safety was founded by a group of North American apparel companies. Signatory companies commit to a five-year undertaking that aims to be transparent, results-oriented, measureable and verifiable. The governance of the agreement will be entrusted to a Board of Directors consisting of four company representatives (Gap, Wal-Mart, VF Brands and Target) and four stakeholder representatives (former US ambassador to Bangladesh, a representative from BGMEA, BRAC and an expert in fire protection and safety). Initiatives launched through this agreement are focused on 1) worker empowerment – establishing an anonymous hotline to report any safety concerns, 2) fire and building safety training of factory workers and management – a training committee will develop a uniform set of fire and building safety educational standards and curricula, and 3) development and implementation of a common standard for inspections – a committee of experts in fire and building safety will develop and implement the standards and the inspection process. Funds raised through the agreement will be used to fund the efforts enumerated above and to provide low cost capital for factory upgrades. In terms of transparency, the Alliance will develop a common information-sharing platform using the Fair Factories Clearinghouse, an already established platform for sharing factory information provided by companies.

> " The initiatives that will be launched by the Alliance for Bangladesh Worker Safety are focused on worker empowerment, fire building & safety training and standards for inspection.

While both agreements contribute to the same goal, the methods by which they intend to achieve them differ. For Mirova, we feel that because of its stronger commitment to the inclusion of workers in the implementation of the agreement (trade unions are present in the steering committee and workers & workers representatives participate in the discussions) as well as its legally binding aspect, the Accord on Building and Fire Safety in Bangladesh has the potential to be more robust. Nevertheless, regardless of the agreement a company has signed, what is eventually evaluated and taken into consideration are the results that stem out.

It is important to note that these two agreements only address the issue of building and fire safety in the Bangladeshi garment factories. While relevant to workers' health and safety, it does not address the other underlying issue at hand…

Illegal subcontracting: the underlying issue

In its report, the French NCP identified illegal subcontracting as the source of some of the biggest risks in supply chains. Illegal subcontracting happens when suppliers subcontract part of their workload to other factories without securing the approval of their clients.

As already mentioned, cost is the most important factor driving most buying decisions in the mass market supply chain under consideration. The second most important factor is lead time. Consequently, increased pressure is placed on the suppliers to drive costs down and meet orders in time. In order to do this, suppliers engage in illegal subcontracting activities. As a result, products are being made in unauthorized factories without the company's knowledge. Had such factories been inspected and audited by the company, they would likely not have met the minimum requirements.

V. Conclusion: towards a more integrated approach

Recurring events involving human rights violations in the supply chain reveal how, despite current efforts, global companies in the clothing, textile and technology industries are not yet able to ensure proper working conditions and eliminate negative human rights impacts in the entirety of their supply chains, particularly in the assembly and manufacturing stages. While these efforts have brought about positive changes in certain factories, evidence shows that there is still a long way to go.

> " While individual efforts have brought about positive changes, evidence shows that there is still a long way to go.

As a responsible investor and signatory to the PRI, we now believe it is necessary to reach out to clothing, textile and technology companies and encourage them to enhance their current supply chain management practices and work towards a more responsible supply chain.

To this end, we will discuss the following responsible supply chain management practices with companies for which they are pertinent:

- → Mapping social risks throughout the entire supply chain
- → Increasing transparency and communication concerning the supplier scorecard methodology, the nature and results of audits conducted and the action plans established for achieving improvement
- → Developing longer-term and more sustainable relationships with key suppliers through a purchasing policy that integrates ESG criteria in the decision making process and opening communication lines between the company and its suppliers
- → Participating in multi-stakeholder initiatives to aggregate companies' leverage for systematic change, particularly with regard to establishing globally accepted supply chain audit standards

Additionally, for companies exposed to Bangladesh, we will also discuss the following topics:

- → Participating in the Accord on Building and Fire Safety in Bangladesh
- → Putting in place measures to combat the risks of illegal subcontracting (e.g. enhancing company-supplier relationships)

While companies already certain best practices have in place, they still circle around the issue of communication. If there is truly to be a global sustainable supply chain, companies have to step up to the plate and take a more active stance towards improving the conditions in factories.

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