UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

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# CORPORATE SOCIAL RESPONSIBILITY IN GLOBAL VALUE CHAINS

*Evaluation and monitoring challenges for small and medium sized suppliers in developing countries*

UNITED NATIONS

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**Evaluation and monitoring challenges for small and medium sized suppliers in developing countries**

**UNITED NATIONS**
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# Preface

Over the past two decades, CSR has emerged from a small handful of industries to, today, a mainstream practice of international business. It is now common for large global firms to demand that their suppliers comply with codes of conduct covering social and environmental practices. This is the new business landscape facing small and medium sized enterprises in developing countries. Are they ready?

Many challenges exist for both large and small firms in the implementation of CSR practices. For small firms, overcoming these challenges has become a necessary condition of entering the global marketplace. Ensuring that SMEs are equipped to address CSR issues is therefore an important policy objective of enterprise development.

In 2008, at UNCTAD’s twelfth quadrennial meeting, member States asked UNCTAD to analyse voluntary enterprise policies on corporate social responsibility as a complement to national legislation, with a view to identifying best practices for maximizing the development impact of corporate activities. This report joins a growing body of work by UNCTAD on CSR issues. In UNCTAD’s 2011 World Investment Report, for example, a number of CSR factors and trends influencing TNC behaviour were identified.

This report looks at how SME suppliers in developing countries are affected by the CSR policies of TNCs. It discusses what topics are covered, for which members of the supply chain, and how private CSR policies are implemented and overseen. The image that emerges is both hopeful and concerning. It is a positive development that social and environmental issues are increasingly being integrated into global markets. But concerns arise around the general lack of coherence between private CSR policies and purchasing policies, and the insufficient assistance provided to SMEs in most developing countries to help them to meet the social and environmental conditions of their customers.

For our part, UNCTAD will take the lessons learned from this research and apply them to our capacity building efforts, to strengthen our existing programmes, such as UNCTAD’s Empretec programme which provides training for entrepreneurs around the world. Together with other development partners, we can help SMEs to meet the CSR expectations of customers, and in so doing, contribute to a more prosperous, sustainable and responsible world economy.

Supachai Panitchpakdi
Secretary-General, UNCTAD

Geneva, Sept 2012

# Acknowledgements

Corporate Social Responsibility in Global Value Chains was prepared by Anthony Miller, Economic Affairs Officer, Accounting and Corporate Governance Section, under the supervision of Tatiana Krylova, Head, Enterprise Development Branch, Division on Investment and Enterprise, and Jean Francois Baylocq, Chief, Accounting and Corporate Governance Section. James Zhan, Director of the Division on Investment and Enterprise provided overall direction.

This report was prepared by the UNCTAD secretariat on the basis of data compiled in 2011. Katharina Wortmann, UNCTAD Research Assistant on corporate social responsibility, provided crucial support in data gathering and drafting. Valuable comments were provided by Richard Bolwijn, Economic Affairs Officer, Office of the Division on Investment and Enterprise.

The report benefits from the discussions of experts at the joint UNCTAD, ILO and OECD *Round Table on CSR in Global Value Chains*, held in Geneva on 16 November 2011. Participants in that meeting included: Sean Ansett (Independent Advisor), Yuki Arai (ILO), Susan Bird (European Commission), Hans-Peter Egler (SECO), Amelia Espejo (IOE), Ashraf Gamal (Egyptian CR Centre), Michael Gestrin (OECD), Oliver von Hagen (ITC), Renate Hornung-Draus (BIAC / IOE), Anita Housham (UN Global Compact), Soren Jeppensen (Coppenhagen Business School), Dwight Justice (ITUC), Celina Kaseta (AMIA), Mathieu Lamolle (ITC), Xiaohui Liang (CNTAC), Larissa Luy (IFC), Ricarda McFalls (ILO), Steven Oates (SAI), Isabella Pagotto (GRI), Guo Peiyuan (Syntao), Dante Pesce (Centro Vincular), Anna Peters (Bertelsmann Foundation), Githa Roelans (ILO), Emily Sims (ILO), Joanna Webb (SEDEX), Natascha Weisert (UNIDO), Lene Wendland (UNOHCHR), Jochen Weikert (GIZ), Joseph Wozniak (ITC), Erick Zeballos (ILO). UNCTAD staff members at the meeting included: Fulvia Farinelli, Joachim Karl, Tatiana Krylova, Anthony Miller, Elizabeth Tuerk, and James Zhan. The views expressed in this report are those of UNCTAD unless otherwise stated; the report does not necessarily reflect the official views of participants or their respective organizations.

# Contents

# Acronyms and Abbreviations

| | |
|---|---|
| BSCI | Business Social Compliance Initiative |
| CAP | Corrective Action Plan |
| CNTAC | Chinese National Textile and Apparel Council |
| CSR | Corporate Social Responsibility |
| DANIDA | Danish International Development Agency |
| FLA | Fair Labor Association |
| GC | United Nations Global Compact |
| GIZ | Deutsche Gesellschaft für Internationale Zusammenarbeit |
| ILO | International Labour Organisation |
| MSI | Multi-Stakeholder Initiative |
| NGO | Non-Governmental Organization |
| OECD | Organization for Economic Co-operation and Development |
| PSCI | Pharmaceutical Supply Chain Initiative |
| SCORE | Sustaining Competitive and Responsible Enterprises Programme |
| SECO | State Secretariat for Economic Affairs |
| SEDEX | Supplier Ethical Data Exchange |
| SER | Social and Environmental Responsibility |
| SMETA | Sedex Members Ethical Trade Audit |
| SIDO | Small Industries Development Organization |
| SME | Small and Medium Sized Company |
| TNC | Transnational Corporation |
| UN | United Nations |
| UNCTAD | United Nations Conference on Trade and Development |
| UNDP | United Nations Development Programme |
| UNIDO | United Nations Industrial Development Organization |

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# Overview and policy implications

This analysis of the CSR practices of large companies and the implications of these practices for small and medium suppliers in developing countries, is intended to contribute to ongoing policy discussions about CSR and enterprise development. Today, supplier codes of conduct have become common among the world's largest companies in their efforts to influence the social and environmental behaviour of their value chain members. For many SMEs in developing countries, complying with these codes creates a new set of challenges as these firms attempt to enter into global value chains. Enterprise development programmes in many countries, however, have not adapted to this new business landscape and do not provide SMEs with the necessary skills to meet the CSR demands of the global market.

## *CSR is now mainstream in global value chains*

Chapter I of this report analyses the type, frequency, scope and content of buyer codes of conduct and their implications on SME-suppliers from developing countries. It is shown that the majority of companies, independent from the industry they are operating in, are relying on supplier codes of conduct developed internally by each company for its own operations. Due to the complexity of supply chains and the limitations of a company's sphere of influence, the codes normally only apply to suppliers at the first tier level. However, with CSR issues rising at different levels of the value chain, buyers are increasingly using codes and external certification schemes developed by Multi-Stakeholder Initiatives (MSI) and Business Associations. Through their commitment to only source certified sustainably produced products, they can influence suppliers higher up the supply chain, such as farmers, tanneries, processors, etc.

Chapter I shows that the penetration of codes does not leave the suppliers without challenges as they increasingly need to comply with national law and international standards on human rights, labour and the environment in order to obtain production contracts with foreign companies. The analysis of codes shows that especially in the area of human rights, suppliers need to be familiar with international frameworks such as the ILO Core Convention and the UN Universal Declaration of Human Rights, as more than half of the companies use them as a reference in their codes. Even though these international frameworks provide companies with a broad guidance on what to address, suppliers face the challenge that international frameworks often lack detailed (factory level) operational guidelines. To avoid confusion and implementation challenges at the enterprise level, more work needs to be done to provide such practical guidance on meeting international standards.

## *SMEs faced with implementation challenges and 'auditing fatigue'*

Chapter II provides an overview of the implementation processes companies have introduced in order to ensure that their suppliers comply with the underlying codes. Findings show that suppliers that operate in developing countries (which are often categorized as "high risk sourcing zones") are subject to particularly strong scrutiny from their customers. These suppliers are more frequently subject to CSR assessments, such as self-evaluation questionnaires, monitoring and auditing processes. Since most suppliers serve multiple customers, they often need to undergo multiple social audits throughout the year. This is especially challenging, as each auditor/purchasing company has its own factory evaluation checklist, which differs in specificity, length, requirements and topics addressed.

Chapter II also presents new approaches, initiated by different stakeholders, to create systems which attempt to reduce the 'monitoring fatigue' of suppliers and harmonize monitoring processes. The analysis finds that companies have introduced supplier sustainability scorecards in which they evaluate their suppliers on their social and environmental performance, in addition to traditional business performance indicators such as cost efficiency, quality and reliability. However, companies using this approach are few. It is found that the purchasing practices and the CSR practices within many buyers remain independent of one another, with the consequence that suppliers are receiving mixed messages. In the absence of greater coordination among companies, and within companies, SMEs face the burden of a large number of mostly redundant audits, and the challenge of meeting sometimes contradictory policies in the areas of CSR and purchasing.

### *CSR not included in most enterprise development programmes*

While almost all companies expect their suppliers to implement 'corrective action plans' to address deficiencies identified during the audits, these plans are often inadequate for creating long lasting change in a supplier's operation. To support developing country suppliers with the implementation of CSR programmes (in particular, mechanisms to ensure compliance with national and international standards) some stakeholders (companies, international organizations, civil society and national governments) have begun to develop enterprise development programmes with a CSR focus or component. Chapter III provides an overview of these programmes and discusses the different approaches used.

The analysis in Chapter III finds that most companies only offer development programmes to their key suppliers, which are often large companies in their own right, leaving SMEs without direct support. To fill the gap left by the private sector, various civil society and governmental stakeholders have engaged in SME-supplier development programmes. However, CSR enterprise development programmes for SMEs are still limited in number and scope. Where they exist, they are mostly initiated, funded and implemented by development agencies, intergovernmental organizations or civil society, with very limited involvement of local governments. The main challenges with externally funded programmes are scalability (how to apply them to a broader group of companies) and sustainability (how to ensure the programmes can sustain themselves over the long term).

To address these two challenges, some stakeholders are calling for government action in the area of CSR capacity building. Most national governments, however, have not yet introduced CSR in their SME/supplier development programmes on a regular/strategic basis. To address this issue, development agencies have also started to work at the macro level, with the aim to increase role of governments in the area of CSR, with a view to promoting voluntary and regulatory initiatives to improve compliance with national laws and international standards.

## *Policy Implications*

To ensure their continued growth and international competitiveness, developing country SME suppliers need support to cope with the challenges presented by CSR codes. Ways and means of providing such support include:

- *National governments and international organizations should mainstream CSR issues within existing national enterprise development programmes.* CSR has become a commonplace demand in most industries, and yet SMEs in developing countries are rarely provided the tools needed to address this challenge. Policy makers should therefore consider integrating training on environmental management, human resource management, and occupational safety and health.

- *National governments and international organizations should do more to assist enterprises with operational guidance for international standards.* As most private codes of conduct are making reference to international standards, it is necessary to provide more practical guidance on how these standards can be implemented on the factory floor.

- *TNCs should be encouraged to harmonize their CSR codes at the industry level and streamline application procedures.* Suppliers today can be subject to multiple audits or factory inspections per year. Most of these inspections are largely redundant with different buyers asking the same questions. Initiatives such as the Supplier Ethical Data Exchange (SEDEX)[1] help rationalize supplier inspections, promote shared information among buyers, harmonize reporting practices and generally reduce unnecessary burdens on suppliers. Policy makers should encourage and support such initiatives.

- *TNCs should be encouraged to integrate CSR policies into purchasing policies with the aim of ensuring that suppliers are effectively incentivized to meet all the demands being placed upon them.* There is a need for greater policy coherence within TNCs. For example, purchasing policies on price and delivery time, on the one hand, and CSR policies on pay and excessive overtime hours, on the other, need to have some level of alignment in order to avoid mutual exclusivity. Private CSR policies that are not fully aligned with private purchasing policies send mixed signals, and can create situations in which compliance becomes impossible.

Consumer and civil society concerns are driving CSR, raising the bar for market entry for developing country suppliers. Meeting these demands will require an upgrade of management skills. Governments can assist through capacity development programmes in this area, and by strengthening existing national institutions that promote compliance with labour and environmental laws. Countries that equip their SMEs with the capacity to meet CSR codes will create new opportunities for their enterprises in global value chains.

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[1] SEDEX is a not for profit membership organisation whose membership is comprised of private companies that use SEDEX's information sharing platform. http://www.sedexglobal.com/

# I. SUPPLIER CODES OF CONDUCT: A COMMON EXPECTATION FOR SME SUPPLIERS IN DEVELOPING COUNTRIES

## A. Company codes of conduct widespread across industries

Supplier codes of conduct are proliferating (figure I). More than three quarters of the companies from 10 different industries analyzed for this study (see Annex) have such a code. [2]While supplier codes are not a recent phenomenon, traditionally, they were associated with certain industries such as toys, apparel and footwear (UNRISD, 2001). In line with the UNRISD study, UNCTAD's research shows that many companies which work partly or entirely in the garment industry, such as companies from the apparel retail and department store industry, already introduced a supplier code of conduct in the early 1990s. However, their codes are not static and have evolved during the last twenty years and many companies have since then strengthened and formalized their codes (Riisgaard, 2009). UNCTAD´s research has shown for example, that most suppliers must now contractually bind themselves to the terms laid out in a customer code of conduct in order to engage in a business relationship with a customer. As a result, customers can terminate contracts with suppliers for failure to fulfill the requirements of the CSR code.

UNCTAD's research shows that codes are no longer limited to certain sectors, rather they are common across a broad range of industries. Suppliers from such diverse industries such as pharmaceuticals, paper products, personal products and restaurants are now also expected to comply with social and environmental performance standards. This is a relatively new phenomenon. In the pharmaceutical industry for example, suppliers were only recently presented with social and environmental requirements defined by their customers. The driver was the formation of the *Pharmaceutical Supply Chain Initiative* (PSCI), initiated by leading firms in the industry. After its launch in 2006, the PSCI developed the *Pharmaceutical Industry Principles for Responsible Supply Chain Management* in late 2007. These principles specify responsible business practices throughout the pharmaceutical industry's supply chain to which 12 companies in total are committed (including 8 companies in this study). Most companies that endorse these principles have made slight modifications and adapted the code to their objectives and priorities (See also section D).

Suppliers continue to face challenges meeting the expectations of CSR codes, which come on top of other business challenges already faced. As competition in buyer driven supply chains is high and the costs of changing suppliers low, customers are often in the position to dictate prices and demand tight delivery schedules, while at the same time expecting their suppliers to be compliant with their CSR codes (UNDESA, 2007). As many suppliers are new to CSR expectations, they have problems to react proactively to the request from their customers. Especially with limited access to information and support, suppliers, especially SMEs, face difficulties in bearing the direct and indirect costs of CSR compliance.

[2] Three of the companies were still developing a supplier code of conduct when the research was finished and are thus not included in the statistics.

**Table 1 Supplier codes of conduct are common across industries**

Number of top ten companies that have a supplier code of conduct
(n= 100)

| Industry | No of top 10 companies that have a supplier code of conduct |
|---|---|
| Pharmaceuticals | 10 |
| Computer Hardware | 10 |
| Apparel Retail | 9 |
| Paper Products | 8 |
| Department Stores | 8 |
| Restaurants | 8 |
| Packaged Food & Meats | 8 |
| Hypermarkets & Super Centers | 7 |
| Personal Products | 7 |
| Apparel, Accessories and Luxury Goods | 7 |
| Total | 82 |

Source: UNCTAD

## B. How far along the value chain do codes apply

Supplier codes of conduct can be applied to several levels of the value chain. Thus, one of the questions addressed in this study was how far along the value chain these standards apply. To find the answer to the question was not without challenges. Companies can be very vague when addressing the applicability of the code further up the supply chain. Many companies for example refer to *all business partners* in their code. However, the formulation and wording of the codes often leaves the reader without a concrete idea who is actually addressed.[3]

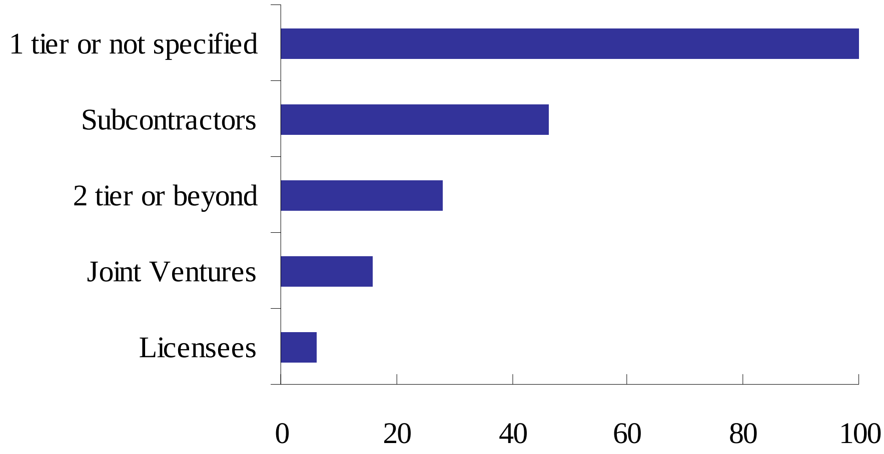
Most codes still address suppliers at the first tier level of the supply chain (figure 1). However, as noted by one of the leading packaged food and meat manufacturers, "*many of the (CSR) issues (…) arise in the further tiers of extended supply chains*". This is true for many industries and sectors (e.g. exposure of workers to chemicals in the mills in the apparel supply chain, the use of child labour in the cocoa supply chain and deforestation in the palm oil supply chain). Thus, focusing only on the first tier supplier might not be the most successful strategy to reduce risk of social and environmental problems within the supply chain. As mentioned by an apparel retailer in its 2010 CSR report "*today, sustainability is about so much more than just our direct suppliers.*" Consequently, companies have taken different steps to address these issues.

In 2009 for example, a leading apparel retailer started identifying fabric mills in China and Bangladesh that are considered key to their first tier suppliers and production. The 24 mills identified are now required to sign the company's code of conduct and will be included in the audit programme. This is an example of how second or third tier suppliers which are not directly linked to export markets are increasingly affected by the CSR practices of international buyers.

[3] In cases where no definition was provided or companies used general terms such as "business partners" and "business allies" and no further information could be drawn from company documents, this study classified such codes as applying to "first tier supplier or not specified".

**Figure 1. Codes of conduct go beyond the first tier supplier**

Type of value chain member addressed in the supplier code of conduct
(in per cent; n=82)




Source: UNCTAD

Some companies go even further up the value chain to address CSR issues. It is common for companies operating in the apparel industry, for example, to express concern about the use of forced child labour during the cotton harvest season in Uzbekistan. Nine companies studied that operate supply chains in the garment industry try to address the concern by tracing the cotton supply for their products. However, this is a challenging task as one company reports that it does "*not have direct business relations with cotton producers, and the routes of global cotton trade are often complex*". A group of companies now tries to investigate new "*methods, which can realistically be used routinely and on a large scale to trace the origin of cotton, to be able to promote or avoid certain markets*". (See section C).

A similar case can be found in the computer industry which experiences problems when it comes to the mining of minerals from conflict zones. One company from the computer hardware industry for example states on its website that "*although companies who source these minerals are (…), typically multiple tiers from our direct suppliers, we have a shared responsibility regarding conflict-free mineral sourcing*". The company goes on to say that they are "*working alongside companies in other industries to drive the creation of (…) a certification process to track conflict free minerals*".

As supply chains are complex and traceability can be limited, some companies have started to shift more responsibility to their first tier suppliers to promote and implement socially and environmentally sound practices further up the value chain. As one company puts it:

> *It is essential that our direct suppliers recognize the role they have to play in promoting responsible sourcing practices with their own suppliers, in ensuring the principles are cascaded and compliance monitoring takes place. Therefore, our direct suppliers will take responsibility to require adherence to the principles of this Supplier Code from their direct suppliers and exercise diligence in verifying that these principles are being adhered to in their supply chains.*

This makes explicit the expectation that suppliers are to set social and environmental goals for their own supply chain and build the management systems to implement and monitor the performance of their suppliers. Instead of just responding to their customers' CSR expectations, suppliers are now expected to take ownership over the CSR issues in order to cascade them throughout their own value chains.

### C. Multistakeholder codes of conduct and sustainable sourcing commitments

The geographic dispersion and the level of complexity and fragmentation of a supply chain can have a strong influence on a customer's ability to influence the social and environmental conditions under which its products are being produced. Thus, when measuring the impacts of supplier codes of conduct it is important to note that supply chains differ greatly depending on the industry. The supply chain structure and mode of operation in agribusiness, for example, differs greatly from the apparel industry. Products such as cocoa, coffee, cotton or palm oil are traditionally traded by intermediaries, which inhibits direct interaction between the customer and its supplier. These arm's length relationships, combined with the nondescript commodity nature of the product itself, make it difficult or impossible for a customer to track the origins of its merchandise. This is especially so in the case of products such as cocoa, coffee or cotton, where the supply base consists of a very large number of small-scale farmers.

Responding to this situation, companies that operate in industries where a direct relationship with their suppliers is less common or that have a broad product portfolio (e.g. hypermarkets, department stores, packaged food and meat) try to enhance the social and environmental performance of their supply chain through the use of external standards. External standards are often developed by so called Multi-Stakeholder Initiatives (MSIs). MSIs are typically comprised of companies, unions and NGOs. Together they agree on a code of conduct which can be industry specific or cross industry. Based on the code, the MSIs then commonly build up a monitoring and certification program, which companies use to demonstrate that their supplier factories are operating within the performance standards outlined by the MSI. To obtain a certification, inspectors authorized by the MSI audit a supplier facility and make a determination as to whether the supplier is in compliance with the MSI's standard. One of the benefits to suppliers of external certification is that it is often recognized by other customers and thus alleviates the burden on suppliers to comply with multiple company specific codes.[4]

The use of external standards with certification and labeling schemes has become common practice among companies. Almost all companies from the packaged foods and meats industry have committed themselves to increase the purchase of goods from sustainable sources. Two of the companies, for example, have announced that they plan to shift to 100 per cent certified palm oil, and increase their purchase of other certified products such as cocoa, tee, soy, sugar and coffee. Several companies from the hypermarket and department stores industry have made similar commitments, including increased purchases of certified fish, wood and paper products, among others.[5]

[4] For a comprehensive overview of MSI initiative, please see UNCTAD's World Investment Report 2011, Chapter III, page 111-120.

[5] Information taken from the latest CSR reports of the respective companies as of March 2011.

MSI standards are not confined to commodities, however. Companies in the apparel and footwear industries, for example, are making use of MSI standards as a means to influence firms further up their supply chains. As highlighted by one of the leading companies from the apparel, accessories, and luxury goods industry:

> *the major environmental impact of our operations occurs in the manufacturing of our products and the [upstream]supply chain. We only have a limited influence in this area as we have outsourced most production. Therefore, collaboration with other organisations (...) is critical to build a consensus and the critical mass to develop effective solutions.*

According to the same company's CSR report, it has focused on different areas in which it tries to improve the environmental performance in its supply chain. By 2018 for example, the company aims to have 100 per cent of the cotton used in its products to meet the Better Cotton Initiative[6] standard, a sector specific MSI.

The motivation for using an MSI standard can differ. A company from the apparel retail industry for example uses "*the results from the FLA's audits as a benchmark in order to ensure the quality of [the company's] internal monitoring programme*". The apparel retailer has only accredited its souring factories from China and Turkey to the Fair Labor Association, while the company's internal auditing team is responsible to monitor their suppliers from other countries. Another company from the same industry prefers working with third parties, such as the Ethical Trading Initiative, as "*it adds credibility to the programme*". Additionally, the same company has signed an International Framework Agreement with the International Textile, Garment and Leather Workers' Federation to ensure that the "*code of conduct improves workers' conditions within [the company's] supply chain*".

## D. Towards convergence: Business Association codes of conduct

Apart from the use of MSI standards and individual company codes, there have also been efforts by industry groups and business associations to collectively address CSR issues in the supply chain. This collective approach is based on the fact that it is common for many companies in an industry to share the same suppliers. Thus, suppliers have started to request more collaboration among their customers when it comes to the dissemination and implementation of codes. Consequently, the members of a number of industry specific associations have negotiated industry specific codes (examples include the *Electronic Industry Code of Conduct* and the *Pharmaceutical Industry Principles for Responsible Supply Chain Management*). Cross industry associations have also developed non-industry specific codes that can be used as a model for companies operating in different industries (e.g. the *Business Social Compliance Initiative*, developed by the Foreign Trade Association).

One challenge with business association codes of conduct is that while many companies use them as a benchmark, most companies will modify them according to their specific needs to create a unique company code. This can undermine the value to suppliers seeking the standardization of codes and the associated reduction in compliance costs. Very few of the 100 companies examined in this study have completely given up their own code to adopt an industry code. Often, companies make reference to a business association code or even adopt and endorse more than

[6] http://www.bettercotton.org/

one. Adopting multiple codes is particularly common among companies with a broad product portfolio cutting across different industries. In addition to their own overall company code of conduct, such multi-sector companies typically make use of MSI and business association codes which are more focused on industry specific CSR risk factors.

### E. Subjects addressed in the codes

One of the main discussions around supplier codes of conduct addresses the question which subjects are covered in the code. So far, different studies have been conducted to investigate this issue in detail (OECD 2001, UNRISD, 2001, ILO 2003). In line with these studies, it was found that the majority of the codes address the four core CSR subjects as indicated in the UN Global Compact: Human Rights (100 per cent), Labor Practices (98 per cent), Environment (90 per cent) and Bribery (68 per cent) (figure 2).

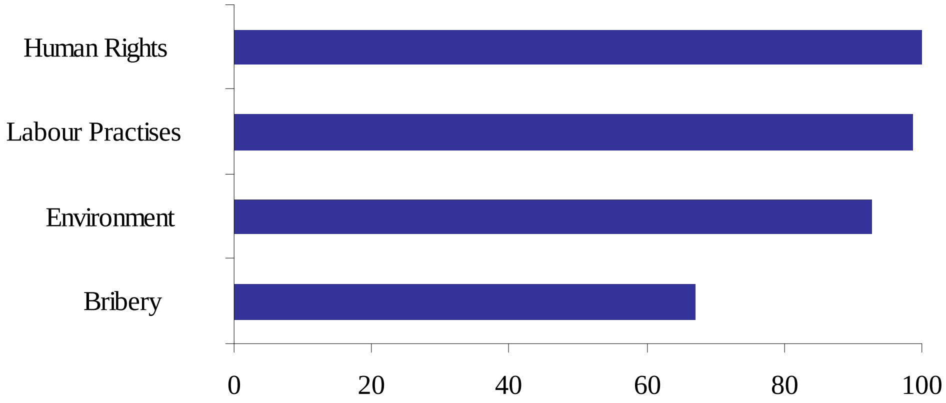
The extent to which the codes cover these four core subjects can differ significantly between industries. Variations in the focus of different industries on different CSR subjects is reflective of the industry specific nature of a number of CSR issues. Companies dealing with textiles, garments and electronic devices, for example, typically deal with a broader range of labour standards, extending beyond those included within the ILO core conventions, to more detailed ILO standards on wages, overtime, health and safety and accommodation. In these codes, environmental issues often receive only a brief mention.

In contrast, in the paper and pharmaceutical industries, codes are much more focused on environmental standards. All companies in the paper industry that have a code also introduced statements on labour standards which are covered by the ILO Core Conventions.[7] Codes may also address other issues which are specific to the industry. Suppliers from the pharmaceutical and restaurant industry are also more likely to focus on animal welfare standards, in addition to the topics mentioned above. Corruption, the least referred to topic of the four core subjects, tends to be the focus issue of certain industries with historically more frequent incidents of bribery. Recent regulatory initiatives in some countries may see the inclusion of this subject in the codes of a broader range of industries: the recently introduced UK anti-bribery act for example requires companies to include anti-bribery clauses in all business contracts with supply chain members.

[7] Companies in the paper industry were considered to have a code of conduct for their suppliers if they required their suppliers to be certified to the Forest Stewardship Council (FSC) standard.

**Figure 2. Most companies address core issues of CSR in their supplier codes of conduct**

Companies that address human rights, corruption, labour and environmental standards and in the code
(in per cent; n=82)




Source: UNCTAD

## F. The use of international (normative) frameworks for codes

International frameworks can guide companies on the question of what to expect from their suppliers and suppliers on how to comply with the expectations of their customers. International frameworks (especially the core ILO conventions, the UN Universal Declaration of Human Rights, the UN Global Compact and the OECD Guidelines) influence the development of supplier codes of conduct (figure 3). While all codes examined in this study referred to national law, 51 per cent of the companies reference at least one international framework. These international frameworks are often consistent or even exceed the requirements of national law. In some cases, we found that companies use a mix of both:

> *Factories shall only employ workers who meet the applicable minimum legal age required or at least 15 years of age, whichever is greater (Based on the ILO Conventions 138 and 182)*

This code of conduct from one of the leading apparel companies illustrates the practice of using international standards even if such standards are higher than those allowed by local law. International standards are thus used by some companies as a basic minimum standard internationally. However, many companies make use of a loophole and grant primacy to national law, in which case an age indication in the code does not provide any international minimum for the supplier. An example from one company's code reads:

> *All workers shall be at least fifteen (15) years old unless the applicable local law allows otherwise*

Such cases draw into question the contribution of codes to better working conditions since local law already defines the minimum standard to which the supplier needs to adhere. Since most countries already have laws on child labour, if codes do not give priority to international standards that may be higher than national law in some cases, then such codes should simply state that companies should follow local law. If the company is dedicated to implement and monitor the application of the code at its supplier facilities, it can support the enforcement of national law, especially where weak enforcement mechanisms exist (ILO, 2001).

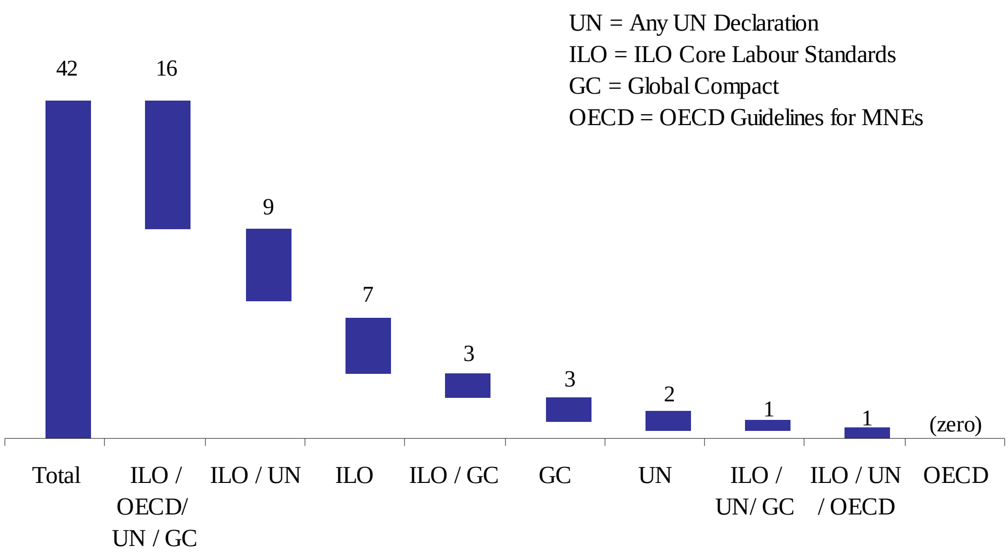
Even when using international standards, not all companies provide a clear indication of what is expected from the supplier, such as a specific age in the case of child labour. In these cases suppliers need to be familiar with international principles. This would help them to better react to the requirements of their customers. For example, suppliers are expected to be familiar with the ILO Declaration on Fundamental Principles and Rights at Work in the case of a company's code from the Packaged Food and Meat Industry:

> *Supplier will not employ child labor, consistent with the principles contained in the International Labour Organization's 1998 Declaration on Fundamental Principles and Rights at Work.*

Some critics question the application of international frameworks for SMEs in developing countries, especially when it comes to standards that could influence the competitiveness and market performance of the supplier, such as a 'living wage' and the limitation of working hours and overtime. If suppliers need to limit working hours and overtime without at the same time improving productivity through other means, it can have a negative effect on production cost and thus on the profit margin.

**Figure 3. International frameworks play an influential role in codes of conduct**

Companies referencing international frameworks in their supplier codes of conduct and the combination of international frameworks addressed
(number of companies; n=82)




Source: UNCTAD

# II. IMPLEMENTATION OF CSR CODES OF CONDUCT: THE CHALLENGES FOR SUPPLIERS OF MEETING THE NEW EXPECTATIONS

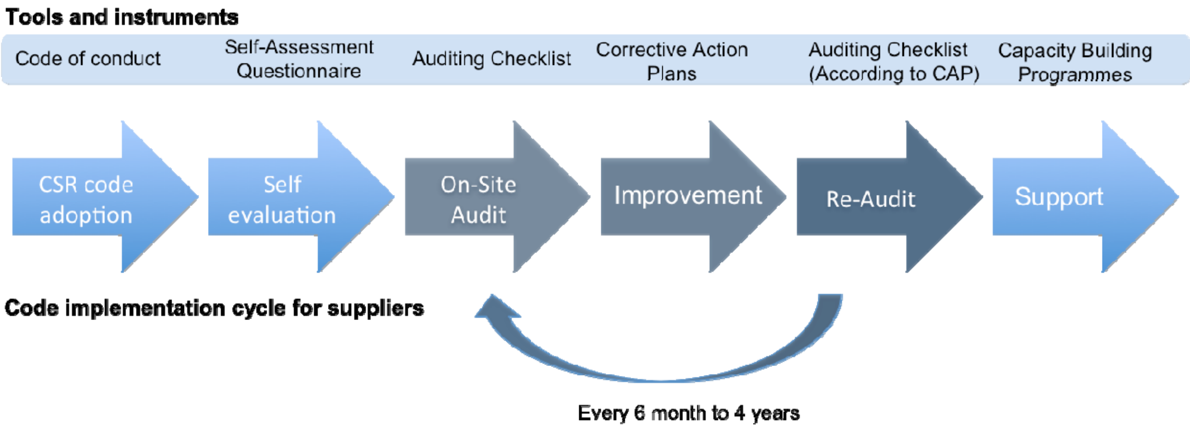
Today, most lead companies not only adopt a supplier code of conduct and communicate that code to their suppliers, but they also have an implementation programme to try to ensure supplier compliance with the code. Such implementation programmes consist of assessment and monitoring procedures which can generally be divided into six steps:

1. CSR code adoption, i.e. agreement by the supplier, often included in contract)
2. an initial self-evaluation;
3. an on site audit;
4. improvement, i.e. the development and implementation of a corrective action plan (CAP);
5. a re-audit; and
6. capacity building activities (in some cases).

While the use of self-evaluation and capacity building initiatives can vary among companies and industries (from often used to rarely or never used), the majority of companies studied focus their code implementation practices on on-site audit, improvement and re-audit (figure 4).

**Figure 4. Code implementation puts requirements on suppliers**

Overview of typical code implementation process




Source: UNCTAD

## A. Self-evaluation

Once a company has distributed its code of conduct to a supplier, it sometimes requests the supplier to provide a self-evaluation of its CSR performance. The self-evaluation takes the form of a questionnaire, which is sent to each supplier individually or is made accessible through an online platform such as SEDEX (see Chapter II, section C).

CSR self-evaluations can provide the supplier with a starting point for establishing a more systemic approach to managing social and environmental issues. The self-evaluation questionnaires break down the codes into specific items that can be directly linked to the administration of the supplier's operational and management systems. Consequently, by going through the self-evaluation the supplier can begin to identify practical measures that can be implemented in order to improve organizational procedures and workplace safety (box 2). Further, with the self-evaluation, suppliers get a first impression of what customers expect to see during an on-site audit.

While on-site audits are mostly done only at *selected* supplier facilities, those companies that make use of self-evaluation questionnaires normally require *all* their suppliers to complete one. The results will be included in the company's internal supplier risk management process. Apart from the results of the self-evaluation, the risk assessment is also based on criteria such as the volume purchased from the supplier, its geographical location and the type of products produced.

Some companies from the computer hardware, pharmaceutical, as well as from the accessories, apparel and luxury industry mention that their suppliers are categorized according to their location in OECD and non-OECD countries, with the risk of non-compliance with labour, safety and environmental standards expected to be higher in the non-OECD countries. The overall result of the risk assessment, including the supplier self-evaluation, will then determine if the supplier will be subject to an on-site audit or not. Already due to their geographic location, suppliers from developing countries will be subject to more intense scrutiny from their customers (box 1).

**Box 1. Developing country suppliers are subject to more scrutiny from customers**

Sample extract from a supplier-risk evaluation form

| Supplier Criteria | High | Medium | Low |
|---|---|---|---|
| **Manufacturing Location (#1)** | **China, SE Asia, India, Central and South America, Eastern Europe** ☐ | **Other** ☐ | **US, Canada, Northern Europe** ☐ |
| | **#1 -** If the majority of a supplier's manufacturing facilities are in developing countries and they are conducting business for your company at these facilities, then the supplier's priority rating is heightened. Determine priority by the location of the supplier's largest manufacturing facilities conducting business for your company. Suppliers are to complete SER self-assessment questionnaires for each manufacturing facility that conducts business for your company. (SE Asia = Malaysia, Singapore, Thailand, Indonesia; Eastern Europe = Hungary, Czech, Romania) | | |
| **Manufacturing Process / Operations (#2)** | **Chemical and/or labor intensive operations** ☐ | **Other** ☐ | **Minimal chemical or labor operations** ☐ |
| | **#2 -** If the facility's operations are heavily chemical (with environmental hazards and implications) or labor intensive (large number of laborers with health, safety, and human rights implications), the supplier's priority rating is heightened. | | |

Source: EICC Supplier Risk Assessment and Audit Selection Criteria Template

A challenge of the self-evaluation process is that many questions are formulated using non-specific terms. Questions such as: "*are all workers free to leave your employment upon giving* ***reasonable*** *notice*?" are very common. If the customer does not define in specific terms what is meant by ***reasonable*** the question will be, at best, difficult to answer, and at worst, meaningless. As many suppliers in developing countries are new to the concept of CSR, they may not be able to understand the meaning of certain concepts, expressions and standards. As processes in each company differ, it might not be possible to answer a question with a simple yes or no, yet questionnaires rarely provide suppliers the option for further explanation.

As many companies are using self-evaluations, suppliers have been overwhelmed with filling in questionnaires on their CSR performance. Among the 100 companies examined in this study, questionnaires have been found with more than 20 pages, covering up to 400 items. If a supplier has different factories, the questionnaire needs to be filled in for each of the facilities. A challenge for suppliers is that the questionnaires from different customers can be very different (form, questions asked, topics addressed, etc) (see box 2). Suppliers will need to go over each questionnaire in detail in order to satisfy the request of their customers.

**Box 2. Questionnaires from customers can differ significantly even though they cover the same topics**

Sample extracts from four different supplier-questionnaires in the same industry addressing forced labour

| Section 1 | Employment is freely chosen | |
|---|---|---|
| 1.1 | Do you have a signed (or equivalent) copy of a contract of employment with each worker? | Yes/NO |
| 1.2 | Do all workers have a copy of their contract of employment | Yes/NO |
| 1.2.1 | If NO: How do you communicate terms of their contract to workers? | Displayed o<br>Individual ve<br>Meeting with<br>Other |
| 1.3 | Are all workers free to leave the site during No-working hours or at the end of their shift? (this includes workers who live on site) | Yes/NO |
| 1.4 | Do you have a written procedure for resignation which is communicated to the workforce? | Yes/NO |
| 1.5 | Are all workers free to leave your employment upon giving reasonable Notice? | Yes/NO/Oth |
| 1.6 | Do you hold workers Id Cards/Passports? | Yes/NO |
| 1.6.1 | Are they originals or copies? | Copy / Origi |
| 1.6.1.1 | If originals: Is holding original ID papers a legal requirement in your country? | Yes/NO |
| 1.6.1.2 | Are workers able to have their ID papers returned to them on request at any time? | Yes/NO |
| 1.7 | Are workers required to lodge deposits? | Yes/NO |

**Principle 2: Prohibition of Forced Labor** Facilities will not use involuntary or forced labor.

**Question 2.1 Are all employees working at the facility voluntarily? ____Yes ____No**

Please give a summary of your objective evidence to support this question.

If No, please explain:

**2.2 Does your facility issue payment of wages directly to employees? ____Yes ____No**

Please give a summary of your objective evidence to support this question.

If No, please explain:

**2.3 Do you have agreements for contracted security guards and/or job descriptions for security employees that limit their tasks to normal security matters such as protection of facility property or security for facility personnel? _____Yes _____No**

| FORCED LABOUR | |
|---|---|
| Do the workers work spontaneously? | |
| Do you have a recruitment policy? If so, which? | |
| Do you have security guards or watchmen in the organisation? | |
| Are the workers free to leave the workplace at the end of the work shift? | |
| Are the workers free to terminate their employment provided that they give reasonable notice to their employer? | |

**4 Forced or Compulsory Labour**

| Questions | Yes | No |
|---|---|---|
| 4.1 Are employees allowed to leave the premises at any time after the work? | ☐ | ☐ |
| 4.2 Are emergency exits easily accessible and unlocked? | ☐ | ☐ |
| 4.3 Are original documents, such as ID cards, educational certificates, birth certificates etc., returned to employees after hiring? | ☐ | ☐ |
| 4.4 Are the employees free of monetary deposits to the enterprise? | ☐ | ☐ |

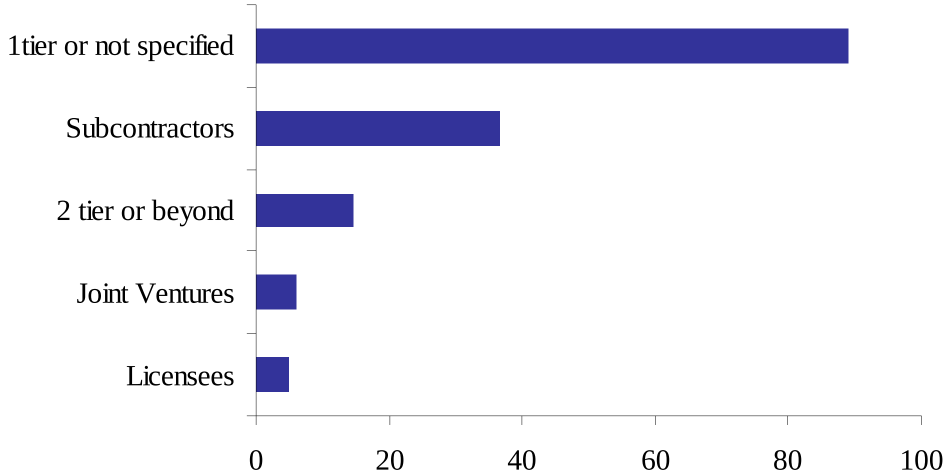
Source: Self-Assessment Questionnaires from different Multi-Stakeholder Initiatives and Business Associations

## B. On-site monitoring

The use of self-assessment questionnaires might reduce the number of on-site audits for those suppliers that seem to be compliant with the code. However, regular visits at factories to monitor a suppliers' social and environmental performance are still common practice (figure 5). Eighty-nine per cent of the companies examined verify code compliance through social audits. Most companies (76 per cent) use independent third party auditors trained to assess a supplier's performance against a company's code of conduct. These third parties can either be professional consulting firms such as Verité and Global Standards, or NGO and MSIs such as Social Accountability International or the Fair Labor Association. One of the challenges with social audits is that the business is not yet professionalized. As there are no standards or officially recognized qualifications a social auditor needs to fulfill, questions have risen concerning the quality of service, including issues of corruption, which can undermine the credibility and usefulness of such audits.

**Figure 5. Monitoring of code compliance through on site audits is common practice**

Type of value chain member subject to on site audits to verify code compliance (in per cent; n=82)




Source: UNCTAD

The remaining 24 per cent of the companies use their internal staff for monitoring purposes. The approach to using internal staff for monitoring can vary widely. Some companies (especially from the apparel industry) have hired staff members specifically trained to monitor the implementation of its supplier code. In this case, the companies use local personnel to make sure they are familiar with the language, culture and local context of the country. Some companies (especially from the packaged food and meat industry) rely on the purchasing staff for code verification. Both approaches have their benefits and challenges.

The frequency, depth and format of the monitoring processes can change considerably from company to company. While some companies (especially from the packaged foods, restaurants and paper industry) require their suppliers to undergo an audit before the first contract is established and then expect their suppliers to be monitored every three to four years, other companies verify their suppliers on a more regular basis, up to every six-months. Generally, the audit process involves an inspection of the factory site and interviews with management and workers (individually and in groups) and an analysis of company files and records, such as time-sheets, wage records and employment contracts. The time in which a company fulfils the audit can take between a half a day and six days, depending on the size of the supplier.

Companies are normally afraid that factory operators will hide violations before inspectors arrive. Therefore, the majority of companies in the study prefer unannounced audits in order to be able „*to uncover serious issues*" (company from the electronic hardware industry). One of the leading apparel retail companies for example writes in its 2010 CSR report that *"68 percent of all our head audits were unannounced and we work to further increase this percentage"*.

Unannounced audits can be challenging for suppliers. During an audit, management as well as workers will need to dedicate time and resources to answer questions and guide the monitors through the factories. While large suppliers often have established compliance offices who are responsible to deal with the audits, SMEs often do not have the resources to do so. Especially if an SME is audited several times per month, audits can interrupt work and undermine an SME's ability to further develop its company, meet production targets and delivery schedules.

In those industries, where companies have been engaged in monitoring of codes over a relatively long time (since the late 1990s and early 2000s), there has been a tendency to systematize the approach towards supplier monitoring. Suppliers often face difficulties as a result of a lack of coordination between departments within a lead company. A lead firm's purchasing department (which is in regular contact with the suppliers and responsible for quality and delivery schedules) often does not coordinate with the CSR department regarding audit schedules or results.

In an attempt to better coordinate CSR and purchasing functions, some companies have started to introduce supplier sustainability scorecards, which are used to base purchasing decisions not only on criteria such as price, quality, and delivery schedules, but also on social and environmental practices. According to these companies, suppliers with high scores will then receive priority in purchasing orders. One limitation of this approach however is that the companies normally do not disclose to what extent social and environmental performance objectives count within the overall supplier rating. Therefore, even though companies have an integrated approach to CSR, the priority given to price, quality, and time to market can greatly outweigh social and environmental performance. Such considerations can also be linked to performance ratings of the purchasing staff in the lead firm where annual performance ratings are often directly linked to non-CSR criteria (Yu, 2008). Two companies in this study seek to address these issues by basing purchasing staff performance reviews and the subsequent determination of their annual bonus on the staff's economic and individual performance goals as well as on its social and environmental objectives, stating:

> *To help make programs stick,* [*the company*] *ties procurement goals directly to variable compensation in such areas as CSR and traceability.*

Further, purchasing staff of the companies is required to assist trainings and workshops on how purchasing decisions can affect the social and environmental conditions in supplier factories.

## C. Monitoring tools

Although the different codes may address similar subjects, the underlying monitoring and auditing tools companies use to verify code compliance differ significantly. To perform a social audit, companies or auditing firms transform a code of conduct into a checklist. Similar to the self assessment questionnaires, these checklists are much more detailed than the code and can include between 80 and 400 questions on social, environmental and management issues, depending on the company or third party who conducts the audit. As one of the apparel retail companies explains in its CSR report:

> *The questionnaire consists of more than 90 main questions and a number of verification points and is the main tool used during our audits.*

Suppliers that submit to the audits from the business driven “Business Social Compliance Initiative” will have to deal with a much longer checklist.

> *The 10 social requirements included in the BSCI code of conduct are translated into an auditing questionnaire consisting of more than 400 questions which are filled in by the auditor.*

Similar to the self assessment questionnaires, for many points addressed in the checklist no national or international standards exist, thus questions often lack specificity and leave space for arbitrary interpretation by the company/ auditor. Questions such as: *“Is the workplace temperature adequate”*, *“Are there enough fire exits for all workers to leave all buildings safely in an emergency?”* can thus lead to confusion and misunderstanding on the suppliers’ side as there is room for interpretation. Here it might be useful if the company specifies minimum requirements to which the supplier needs to adhere to:

> *There should be a minimum of 2 exits per floor where up to 500 employees are stationed. Alternatively, there should be a minimum of 3 exits per floor where 500 or more employees are stationed. These exits should be located on opposite sides of the floor. (example from company code of conduct / company audit questionnaire)*

However, the danger of creating a multitude of differing company specific standards exists, along with the consequent possibility that different customers can require mutually exclusive requirements, such as one customer expecting the supplier to implement doors that open one way while another customer expects doors to open the other way (Copenhagen Business School, 2010).

Recognizing these challenges faced by suppliers, lead firms have started to better coordinate activities in order to simplify their monitoring procedures. One example is the online database Supplier Ethical Data Exchange (SEDEX), which was established in 2004 to ease the burden on suppliers facing multiple audits, questionnaires and certifications.[8] SEDEX has created a common audit methodology and report format, the Sedex Members Ethical Trade Audit (SMETA), which aims to harmonize monitoring and auditing processes between companies. The online platform allows companies to store and share information about the social and environmental performance of their suppliers. Thus a buyer can use the auditing and monitoring results of another buyer, without having to conduct its own separate audit. This reduces the costs of monitoring for both the buyers and the suppliers.

Initiatives within SEDEX where companies agree on mutual recognition or collaboration between themselves in supplier audits and training need to be created by the companies themselves. One such initiative is the AIM-Progress group. It consists of a number of companies from different industries which have committed to recognize the audit programmes completed on behalf of another company within the group. While all supplier policies, codes and supplier programmes remain unique to each member company, most participants within the AIM-Progress group recognize

[8] Sedex is a not for profit membership organisation whose membership is comprised of private companies that use SEDEX’s information sharing platform. http://www.sedexglobal.com/

the SMETA audit form and encourage their suppliers to propose the SMETA format when dealing with an auditing firm. For example a company from the packaged food and meats industry that forms part of the AIM-Progress group wrote in its CSR report 2010, that it has shifted from the use of internally developed checklists to the SMETA format; as suppliers have recognized the benefits of sharing information among customers, the company's switch to the standardized audit form has "*led to the registration of 1,282 suppliers on the Sedex platform in 2010*".

Lately, there has also been a tendency to move away from tick the box checklists. As one buyer reports:

> *We have started to place a strong focus on analyzing the existence and effectiveness of our suppliers' management systems instead of remedying instances of non-compliance when they arise. In this way we feel that we can help suppliers even more to understand and prevent workplace and environmental issues more effectively day-to-day, rather than just responding to the findings of our (or other buyers') audits.*

Especially MSIs, such as Social Accountability International, Fair Wear Foundation and the Fair Labor Association, have developed special guides with questions, which aimed at discovering the root problems of non-compliance. Instead of monitoring the supplier according to a predefined standard of outcomes, the monitors are trained to assess the process challenges that suppliers are facing.

## D. Corrective action plans

Research for this study has shown that most lead companies are reluctant to drop a supplier directly in case of non-compliance with a code. In the context of CSR, buyers only drop suppliers in cases of extraordinary infractions or failure to take steps towards improvement. If an audit detects that a supplier does not meet the standards of the customer, supplier is typically expected to develop and implement a corrective action plan (CAP) (Table 2). As noted in one company's CSR report:

> [The company] *prefers remediation rather than termination, which delivers improved conditions that offer a longer term benefit to the supplier and the community, but we will discontinue our relationship with any supplier who fails to make the corrections requested of them within a specified, reasonable time period.*

A company from the personal product industry, for example, states that "*corrective actions must be implemented immediately for areas in which (the company) has zero tolerance (e.g., confirmed child labor)*". For issues the company views as important but less urgent, corrective actions plans must be submitted within 15 days and implemented within 30 to 60 days. A company from the computer hardware industry also "*requires suppliers to provide a written, detailed corrective action plan addressing all identified non-conformances within 30 days*". The suppliers then have up to 180 days to correct an identified major non-conformance.

The potential developmental effect and transfer of learning offered by CAPs, however, depend on the approach taken by the lead company. Properly administered, corrective action programs can have the effect of being supplier development programs for social and environmental issues (Yu, 2007). According to a report from the Danish CSR Center (2008), SMEs can benefit from CAPs where such programmes provide feedback on a supplier's management and operational processes, pointing out inadequate practices and suggesting improvements. Such dialogue with large customers, which can include technical advice and assistance, can help SMEs to improve basic business processes that often lie at the root of non-compliance issues.

**Table 2. Companies expect their suppliers to carry out corrective actions in case non compliance was found during the audit**

Number of top ten companies that expect suppliers to implement corrective actions plans in case of non compliance with their code
(n= 82)

| Industry | No of top 10 companies that expect suppliers to implement corrective action plans in case of non-compliance |
|---|---|
| Pharmaceuticals | 10 |
| Apparel Retail | 8 |
| Packaged Food & Meats | 7 |
| Department Stores | 6 |
| Hypermarkets & Super Centers | 6 |
| Computer Hardware | 5 |
| Paper Products | 5 |
| Personal Products | 5 |
| Apparel, Accessories and Luxury Goods | 5 |
| Restaurants | 4 |
| Total | 61 |

Source: UNCTAD

The potential benefits of CAPs, however, are reduced considerably where buyers expect CAPs to be developed by suppliers themselves, with the buyer only auditing the implementation progress. In order to foster supplier development on CSR issues, it is important to provide at least some technical guidance and support (including the possible provision of financial incentives or assistance) during the CAP implementation phase. To implement corrective actions, suppliers often need to undertake significant investments (e.g. restructure the factory layout, acquire new machinery and equipment, etc). Also on a managerial level, supplier compliance with the requirements of their customers can imply major time costs.

Subjects addressed by CAPS vary, but among the companies in this study that report on the non-compliance of their suppliers, one of the main non-compliance issues mentioned was excessive working hours and improper compensation of overtime. These issues are linked to production scheduling processes and as such involve both the management of such processes at the supplier level, but also the purchasing demands and time-lines imposed by buyers. While CAPs today focus almost exclusively on supplier corrective actions, it would be worthwhile for buyers to also review their processes (especially in the area of order lead times) to ensure that the root cause of supplier malpractices does not lie with buyer practices.

More generally, CAPs address weak management skills and inadequate systems, including poor record keeping and internal control. SMEs are less likely to have formal systems for recording their human resource practices and many of the record keeping requirements of their customers present a significant challenge for SMEs, especially in developing countries. The focus on proper internal documentation, such as wage records, formal contracts, etc is, therefore, a common issue addressed by buyers. (see example below).

*We believe transparency is the first step to driving change and to encouraging transparency among suppliers. Our CSR team in China has required about 50 percent of our Chinese supplier factories (…) to submit wage and overtime records monthly for all workers.* (Apparel retail company)

Another challenge for suppliers in the context of CAPs are the sometimes contradictory requirements of different buyers. Suppliers are often forced to find innovative solutions in order to implement the corrective actions proposed by different customers. This, however, requires time, knowledge and money. In the case mentioned above of which direction factory doors should open, for example, the supplier proposed to install sliding doors which would satisfy both customers.

While buyers are reluctant to drop suppliers for simple non-compliance with a code, persistent failure to show progressive improvements in the implementation of the proposed corrective actions will lead to the termination of business contracts. This is a clearly stated policy among many lead companies, especially companies from the apparel retail, department store, pharmaceutical and accessories, apparel and luxury industries. Thus the CAP process for suppliers has become an integral part of participating in a global value chain.

# III. ENTERPRISE DEVELOPMENT AND CSR

The proliferation of supplier codes of conduct and the implementation practices of companies within their supplier base, can create challenges for the export business of SMEs in developing countries. As mentioned in Chapter II, SMEs often lack the capacity, resources and knowledge to comply with the CSR requirements of large buyers and can be excluded from global value chains if they are unable to implement corrective action plans. Therefore, building SME capacities to meet the social and environmental expectations of their customers has become an important aspect of enterprise development.

A number of different actors have developed capacity building programmes that provide direct support to SMEs in developing countries on CSR related issues. In this chapter, some of the programmes are highlighted. The aim of the chapter is not to describe the programmes in detail but to present overall observations. The capacity building programmes will be categorized according to the different parties who have initiated or have taken the lead on the programme. However, it needs to be kept in mind that most of the initiatives are hybrid, involving more than one stakeholder/actor in the development, financing and implementation of the programme.

## A. Private sector enterprise development programmes in CSR

While monitoring and corrective action programmes are important for measuring the performance of suppliers and providing basic guidance on how to improve, some lead companies have realized that this approach is not sufficient for helping many SMEs to development the necessary capacity to address social and environmental issues. A number of buyers have therefore begun to support the implementation of codes with specific supplier capacity building programmes. Companies taking this approach will typically mention that they will "*support suppliers to build the necessary capacities to comply with the company's code*" (excerpt from company CSR report). However, details on how the programmes are structured, and the results achieved are largely missing.

No standardized approach towards CSR supplier development was found among the sample of 100 companies reviewed in this study. On the contrary, one of the findings was that CSR capacity building programmes for suppliers differ significantly from each other. One of the most common approaches found was that companies organize seminars for suppliers to inform them on their code of conduct. These seminars are often one day long and provide the suppliers with an overview of the companies' CSR expectations. These sessions may help suppliers to obtain additional information on the code and raise awareness on CSR issues. However, while such seminars are important, they do not appear designed to help a supplier to acquire the necessary knowledge of how to become compliant with the code, e.g. how to set up and run the necessary information systems, how to manage production schedules to avoid excessive overtime hours, etc.

Some companies engage in more long term CSR projects with their suppliers to help them to reach compliance with their code or to increase their overall social and environmental performance. An apparel retailer for example tries to achieve this through active „*co-operation (...) where we help our suppliers to improve performance through a full package of activities – not just auditing*". This "package of activities" focuses on human resources management practices, health and safety (such as proper handling of chemicals) waste-water treatment, improved worker-management communication and workers participation.

Such training programmes seem promising, but in practice are very limited in scale, typically applying only to a small portion of a company's supplier base. The company mentioned above for example only works with ten suppliers in the area of chemical handling and with three suppliers in the area of workers rights, yet has more than 800 suppliers in total. Additionally, most training programmes focus only on selected topics addressed in a code: for example, suppliers, which rely on manufacturing processes with high human capital involvement, will be offered more training on human resource management, health and safety or freedom of association, than on environmental issues.

In selecting their suppliers for CSR capacity building programmes, companies follow different approaches. The majority of the companies studied demonstrate a more reactive approach to capacity building within their supply chain. Companies normally react to issues that have been raised by civil society or NGOs or other watchdog agencies. The 2011 Greenpeace report Dirty Laundry[9] for example alleges that there is a "problem of toxic water pollution resulting from the release of hazardous chemicals by the textile industry in China".[10] Different western apparel companies have been accused of sourcing products from suppliers identified in the report and thus indirectly contributing to the pollution of rivers. The suppliers studied by Greenpeace were all subject to their various customers' codes on chemical management. However, only after the release of the report, have the customers started working with their suppliers in the area of waste-water treatment to ensure they are able to comply with the codes' requirements.

Other companies follow a more pro-active approach. They use an internal risk assessment process to determine which suppliers have a strategic impact on the company and are thus most critical to focus on regarding code compliance. These "focus factories" or key suppliers are mostly suppliers that supply the company with high purchasing volumes, operate in developing countries and can be directly associated with the customer's brand (e.g. the products supplied carry the brand name or logo).

The number of key suppliers can vary depending on the buyer. A company from the apparel retail industry with more than 900 direct suppliers states that the 125 *"selected suppliers* [*for CSR capacity building programmes*] *are long-term partners with more than 25 percent of their business from our company, and who have more than 400 workers each.*" A leading company from the department store industry takes a different approach: with more than 1,500 direct suppliers which produce the company's own products, the buyer has defined only 20 as key suppliers.

Capacity building projects for key suppliers typically focus on the root causes of non-compliance. The aim is to identify and implement management systems that will lead to sound social and environmental practices and thus remedy code non-compliance in the long run. As noted by one of the leading apparel retailers:

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9 http://www.greenpeace.org/international/Global/international/publications/toxics/Water%202011/dirty-laundry-report.pdf

10 From executive summary.

> *We started with an approach you could call policing. We pushed suppliers to comply with our requirements and sometimes even terminated business relations if not. We had to learn our lessons; for example, that real lasting progress is only made when our suppliers understand their non-compliance issues.*

As noted by Mamic (2005), this is an important requirement for the successful implementation of a supplier code of conduct. Therefore, it is important to focus on how the code of conduct is implemented in order to improve working conditions. Working towards compliance without changing the management systems might lead to a supplier's disadvantage. Capacity building programmes that focus on management practices rather than on code compliance can help suppliers to upgrade within the supply chain as new management and operational practices increase productivity, efficiency and innovation (Locke, 2007).

The focus on key suppliers for capacity development programmes however puts SMEs in a difficult position. Most SMEs are not strategically important enough for their customers to define them as a 'key supplier', but still they will need to comply with all the CSR requirements of their customers, undertake audits and implement CAPs. Even if SMEs are involved in a supplier capacity building programme, these are mostly one or two day awareness raising workshops which may be of little help when it comes to implementation. As a result, private sector efforts at supplier development are insufficient to meet the need: many SME suppliers in developing countries receive no assistance in this area, leaving a large gap in SME training that public sector bodies could address.

## B. International initiatives on enterprise development programmes on CSR

As most companies focus on their key suppliers or provide training on CSR when problems have already risen, intergovernmental organizations, development agencies and civil society organizations have initiated capacity building programmes to fill in the void left by the market. The aim of these programmes is to support SMEs in their effort to reach compliance with their customers' codes of conduct and thus enhance their competitiveness and their ability to form linkages with global value chains.

Like company initiatives, the format and topic of the capacity building programmes varies according to the organizations' priorities. It also needs to be kept in mind that most of the programmes are run in partnership, with a number of different stakeholders involved. As many programmes are very resource intensive (both financial and non-financial), organizations often join forces with other actors that work in this field to share costs, information and knowledge. Depending on the complexity and outreach of the programme more than 30 partners can be involved, representing intergovernmental organizations, national government agencies, industry associations, research institutions, consultancies, civil society organizations and individual companies.

Development agencies such as the Deutsche Gesellschaft für International Zusammenarbeit (GIZ), the Danish International Development Agency (DANIDA) and the Swiss State Secretariat for Economic Affairs (SECO) normally promote CSR in SMEs as a cross cutting topic. CSR components are integrated into different development interventions, such as trade promotion, value chain linkages or private sector development.

In Vietnam for example, one objective of SECOs *Economic Development Cooperation Programme* is to "increase the international competitiveness of SMEs by promoting Corporate Governance, Corporate Social Responsibility and Climate Protection Practices". The trainings consist of off-site seminars to introduce SME managers to social and environmental concepts and are complemented by on-site technical assistance and consultancy services. The focus of the programmes is to improve human resource practices, introduce new management systems and improve health and safety standards.

GIZ's *Private Sector Development Programme* follows a similar idea. The overall aim is to "strengthen the business relationship between international buyers and SMEs". CSR is used as a means to help SMEs to upgrade their processes through improved labour and resource productivity. Social and environmental practices will be taken into account as part of the core business. Additionally, GIZ has developed the "Profitable Social Management" training programme to promote awareness among SMEs in developing countries about the benefits of adhering to internationally recognized social standards. The training takes up to five days but, different to SECOs approach, only involves management representatives of SMEs. The approach of the training is participatory and includes plenary discussions, presentations, role plays and round table discussions. Both GIZ and SECO promote the business case that compliance with international standards is a integral part of long term profitability and competitiveness, especially as international pressure and enforcement of regulation and policies from national governments is increasing.

While development agencies and intergovernmental organizations have their own programmes, they also provide major funding to international and civil society organizations specialized in this area, in order to carry out the training. One example is the "Sustaining Competitive and Responsible Enterprises Programme" (SCORE) initiated by the International Labour Organization. The project is funded and supported by different development agencies such as SECO and the Norwegian Agency for Development Cooperation (NORAD). The aim is to help SMEs to acquire "access to national and global markets by meeting buyer requirements and national labour law requirements, as well as to "increase productivity and quality, with healthier, more committed employees". The programmes consist of a nine-month training which is divided into five different modules covering topics such as workplace cooperation, health and safety, quality control, cleaner production methods and human resource management. It is a mixture of class room training for managers and workers as well as on site counselling to support and monitor the implementation of the programme. The project has been rolled out in nine countries targeting four different sectors, with the idea of further expansion. In each country the development actors collaborate with a local organizations (e.g. Faridabad Small Industries Association in India, the China Enterprise Confederation in China) , which have a broad knowledge of the country's institutional and economical situation and are especially familiar with the capacity building needs of SMEs.

Among benefits reported by the ILO and SECO were a rise in productivity and a decrease in absenteeism, by 20 per cent for both areas. SECO also reports that the quality of the work itself has improved, and some of the measures taken could reduce the number of working hours. This makes the businesses more competitive, enabling them to more effectively participate in global value chains.

For many projects, development agencies also involve international companies. The idea is to work through selected lead companies that have a large SME supplier base and whose suppliers show a strong dependency on the customer. One of the challenges in the customer – supplier relationship is exactly this dependency in which the customers are able to impose a number of conditions on their suppliers. This leads to a "one-way contract" in which SMEs are forced to comply with the customers' requirement without having the possibility to push back and enforce their own contractual rights (e.g. payment on time, agreed delivery schedules, etc). The buyer-supplier relationship is missing a process of adequate two way engagement and communication. Through the creation of partnerships and the establishment of dialogue, development agencies aim to develop a mutual understanding between large customers and SMEs. Given the different conditions, efficient and effective CSR for SMEs will differ significantly from the approaches used by TNCs. Therefore these projects enable customers to develop an understanding of the CSR activities suitable for the conditions of SME- suppliers. These projects have the effect that they also create long-term relationships between the supplier and customer and thus strengthen the position of the SMEs within the customers' value chains.

However, in some sectors, where such a partnership is not a practical approach, such as in the agricultural sector, where the supply base can be very broad and SMEs are normally not in direct contact with the customers, development agencies work with MSIs to train SMEs to become certified to an external standard. For the coffee supply chain, GIZ offers an extensive capacity building programme to coffee farmers to acquire the MSI "4C" coffee certification. The certification is expected to improve not only the social and environmental conditions under which the coffee is being produced but also to lead to a better quality and efficiency as well as enhanced marketing opportunities for the farm owner.

Within the "Vietnam Business Linkages Initiative" which tries to establish a Vietnamese brand for its main export products, such as textile, leather and footwear, UNIDO has developed the project "Helping Vietnamese SMEs Adapt & Adopt CSR for Improved Linkages with Global Supply Chains in Sustainable Production". While many programmes within the Business Linkages Initiative focus on large scale suppliers, UNIDO committed to support SMEs in order to promote "awareness, understanding and adoption of environmentally sound production, improvement of labor/social practices and enhancement of international competitiveness". The project goes hand in hand with process and management upgrading, and is linked to quality, productivity and consumer satisfaction. The general objective is that SMEs stop seeing CSR as an externally imposed requirement but take ownership over their CSR activities. UNIDO does this through class room and on-site training but also through the distribution of information material in which the organization explains in very plain language the concept of CSR and its benefits for the business case.

Similarly, the UN's *Joint Programme on Green Production and Trade*[11] which focuses on the handicraft sector in Vietnam, provides assistance to SMEs in the areas of: cleaner production (e.g. reduction of hazardous chemicals, waste and pollution); improved technologies and sustainable design for export-oriented SMEs; and labor standards and ways to improve working conditions towards productivity

[11] The full name is the "Joint programme on green production and trade to increase income and employment opportunities for the rural poor". http://www.greentrade.org.vn/

and competitiveness. The programme involves a number of UN agencies working together (FAO, ILO, ITC, UNIDO and UNCTAD) each bringing unique skills and technical knowledge to assist SMEs to better address a broad range of CSR issues as well as fundamental business skills focused on competitiveness. At policy level, the programme involves public-private dialogue with provincial and district officials aimed at contributing to a more enabling business environment. Emerging good practices at commune and province level are identified and recommended for relevant national policies.

Capacity building projects may also focus on only one specific CSR topic rather than a comprehensive approach to the broad range of CSR issues. These types of programmes are mostly done in partnership with organizations that have a specialized knowledge in the area in which SMEs are going to be trained. The Global Reporting Initiative (GRI), which develops and disseminates "Sustainability Reporting Guidelines" for example, has formed a partnership with GIZ. Together, they aim to build the reporting capacity of SMEs in developing countries which are regularly doing business with big international buyers. Through the initiative, SMEs can build up the capacity to formulate their CSR mission and report on their CSR practices, thus enhancing transparency and increasing their appeal to lead firms. At the same time, the preparation of the reports can assist SMEs to develop internal management skills to identify CSR risks and opportunities.

### C. National enterprise development programmes on CSR

In developing countries, CSR capacity building programmes are mainly donor driven, with relatively little involvement of national governments. Although donor driven capacity building programmes can benefit a number of SMEs, they will not be able to reach the whole supply base, leaving most SMEs without technical assistance. Externally funded programmes often lack the strategic vision of how to make projects sustainable once the project cycle has ended. Consequently, these programmes have a limited possibility of being scaled up, duplicated or transferred to other sectors without the commitment of external funders. Different parties therefore have called for more involvement of governments to strengthen the sustainability and scalability of CSR projects. Very few examples have been found were national government institutions have taken the lead in the area of CSR. While some governments have assigned different public institutions with specific tasks on CSR, there is often no public entity as a whole responsible for the development, implementation and coordination of CSR activities that take place in the country. Thus, most of the initiatives are missing coordination and the possibility of mutual learning. This can lead to inefficiencies and duplication of programmes.

To address this issue, development agencies have also started to work at the macro level, in order to promote national ownership of CSR programmes. Recent years have seen an increasing role of governments in the area of CSR, especially in their role of providing a level playing field. By developing an effective policy framework that encourages responsible business practices, governments can help national companies, particularly SMEs, meet the CSR demands of global buyers. Therefore, many CSR initiatives led by intergovernmental organizations, civil society and development agencies not only focus on the micro level, but also support national governments in their effort to implement an overall CSR policy framework which allows them to take ownership over the CSR activities taking place in their country.

The involvement of governments is necessary to reach a critical mass, scale up existing projects and ensure their sustainability. It is important, however, that CSR projects be appropriately applied in that they complement the government's traditional obligation to develop, implement and enforce a legal framework for protecting human rights and the environment. CSR programmes should assist governments in developing and strengthening the institutions which are necessary to ensure socially and environmentally responsible corporate behaviour.

One example where the government has taken a greater role in CSR is the case of India. After years of collaboration in CSR development projects, the Indian government and GIZ have developed a CSR concept which has led to a greater understanding of its importance on the macro but also on the micro level. Under the leadership of the Indian Ministry of Corporate Affairs, the government has introduced relevant guidelines and introduced a framework for voluntary non-financial reporting. To implement the policies on the company level, pilots in the area of capacity building have been carried out, which aim at promoting responsible business behaviour in groups of SMEs (clusters). The programme tries to demonstrate the business case of CSR, helping SMEs to integrate CSR into their core business practices through a range of simple measures, such as energy efficiency and safe and hygienic working conditions. [12]

The Polish government has shown similar leadership. Although CSR has only recently entered the political debate, public authorities have established an inter-ministerial working group to promote CSR on a public policy level. The Ministry of Economy which deals informally with issues on CSR has recently supported the development of the project "*Enhancement of regional competitiveness through Corporate Social Responsibility (CSR) measures*".[13] The project, implemented by the Polish Agency for Enterprise Development and co-financed by SECO, aims at enhancing the know-how of SMEs on CSR at local level. Within the project specialised CSR trainings will be offered for local SMEs to enhance their competitiveness through the introduction of sustainable business processes.

The government driven Chinese National Textile and Apparel Council (CNTAC) has even gone further. As many Chinese SMEs have been in the spotlight of companies' CSR audits, the government has decided to develop China's own CSR standard (CSC9000T).[14] The management system is based on national laws and international conventions and is complemented by capacity building programmes to facilitate the implementation of sound social and environmental practices among Chinese firms. Taking ownership over CSR activities, this initiative has helped to localize the understanding of CSR and shift the perception of some Chinese managers who viewed CSR being a foreign concept developed and owned by foreign companies.

Similarly, in Egypt the government (with technical assistance from UNDP) created the Egyptian Corporate Responsibility Center (ECRC). An initiative based within the Ministry of Investment, the ECRC provides training and assistance to Egyptian companies to help them better understand both national and international standards related to CSR. The ECRC provides a range of training programmes on

[12] http://www.responsible-business.in/IICA-GIZ-CSR-Initiative

[13] http://www.programszwajcarski.gov.pl/english/thematic_priorities/priority_areas/private_sector/development_of_the_private_sector/strony/start.aspx

[14] http://www.csc9000.org.cn/en/CSC9000T.asp

CSR related management skills, such as sustainability reporting, social auditing, and 'sustainable competitiveness' (how firms can integrate sustainability and economic competitiveness). Beyond its own training activities, the ECRC acts a coordinator for CSR training programmes in the country more generally, and a national focal point for UN Global Compact activities and signatories in Egypt.

Some examples have been found where governments have integrated CSR as an additional component to their existing training curriculum for SMEs. However, the number of programmes related to CSR is still very limited, especially when considering that SME enterprise development programmes are common in developing countries. The government led Malaysian agency SMECorp for example offers ample training courses for SMEs on financial management, productivity improvement, maintenance, labelling and packaging, computerization, logistics and inventory management. Other services offered by the agency also focus very much on traditional business topics. Within its "SME Competitiveness Rating for Enhancement" programme, a diagnostic tool used to rate and enhance competitiveness of SMEs measures are based on seven parameters that vary across sectors. None of the measures relate to CSR. However the Malaysian government has entered into partnerships with other private training institutes, and subsidizes SMEs participation in the CSR courses of these institutes. For example, the Malaysian government finances fifty per cent of a course on CSR held by the Malaysian Institute for Accountants as well as additional courses on health and safety issues, environmental management and fundamentals of labour law offered by other organizations.

The Mexican Government also provides subsidies for CSR training including a fifty per cent reduction for selected SMEs to attend courses on CSR, and eighty per cent of reduction to attend courses which cover traditional business topics, such as finance, marketing, import and export, etc.

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To be effective, these national government initiatives will need to establish themselves as credible in the eyes of international companies (buyers) and more importantly, consumers. The most credible programmes are those that are most closely linked to existing internationally agreed standards, such as ILO labour standards. The International Organization for Standardization (ISO) standard on social responsibility (ISO 26000) also provides countries around the world a credible internationally agreed standard upon which to base national initiatives. Much of the work of local initiatives should be focused on building the capacity to meet existing internationally accepted standards. SMEs capable of meeting international standards will be better positioned to access and succeed in today's international value chains.

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# ANNEX: METHODOLOGICAL NOTES

## A. Methodology

The sample used for this study represents a customized group of 100 companies from 10 different industries* selected from the Morgan Stanley Capital Internation (MSCI) All World Index. When selecting the industry sample, industries characterized by high outsourcing intensity and complex value chain structures were preferred. Within each industry, the 10 companies with the highest market capitalization were then chosen. The GICS was used as it presents an objective classification of companies, with market capitalization providing a rough indication of the size and economic significance of the company.

The collection of data was carried out through a binary questionnaire which consisted of 9 main research questions, broken down into sub-questions, resulting in 46 different data points per company (with a total of 4,600 data points for the entire study). The data was collected by examining publicly available sources, such as:

- Supplier codes of conducts;
- CSR and sustainability reports;
- Annual reports;
- Other public company documents (e.g. policies and official statements);
- Information on company websites.

Each of the 100 companies was sent a preliminary copy of the data collected for their company in order to offer them the opportunity to provide feedback. A response rate of 21 per cent was observed. Note that the data was *not* collected to assess impact or to rank companies, but to provide a snapshot of companies' current CSR practices and policies in their value chains.

## B. Companies included in the study (by sub-industry)*

**Apparel, Accessories and Luxury Goods**
Adidas
Burberry Group
Coach
Hermes International
Luxottica Group
LVMH
Polo Ralph Lauren
Richemont
Swatch Group
VF Corp

**Packaged Foods and Meats**
Brasil Foods On
Conagra Foods
Danone
General Mills
Heinz (H.J) Co
Kellogg Co
Kraft Foods
Mead Johnson Nutrition
Nestlé
Unilever NV Cert

* Industry groups as defined by the Global Industry Classification Standard (GICS). Strictly speaking the 'industry' categories selected for this study are 'sub-industries' as defined by GICS. To avoid confusion, this report only uses the more general term 'industry'. For more information on GICS please vist: www.mscibarra.com/products/indices/gics/

**Apparel Retail**
Belle International Holdings
Esprit Holdings
Fast Retailing
GAP
Hennes & Mauritz
Inditex
Limited Brands
Ross Stores
TJX Cos
Truworths International

**Computer Hardware**
Apple
Acer
Asustek Computer
Compal Electronics
Dell
Fujitsu
Hewlett - Packard Co
Nec Corp
Quanta Computer
Toshiba Corp

**Department Stores**
Isetan Mitsukoshi Holdings
Kohls Corp
Lojas Renner
Lotte Shopping
Macy's
Marks & Spencer Group
Next
Nordstrom
Penney (J.C) CO
PPR

**Hypermarkets & Super Centers**
Aeon Co
Carrefour
Cencosud
Costco Wholesale
Massmart Holdings
Metro Stamm
Pao de Acucar
Shinsegae Co
Wal-Mart Stores
Wesfarmers

**Paper Products**
CMPC (Empresas)
Fibria Celulose ON
Int'l Paper Co
Meadwestvaco Corp
Nine Dragons Paper
Oji Paper
Sappi
SCA SV Cellulosa B
Stora Enso
UPM-Kymmene Corporation

**Personal Products**
Amore Pacific
Avon
BDF
Estee Lauder
Hengan
Hypermarcas
Kao Corp
L'Oreal Group
Natura
Shiseido

**Pharmaceuticals**
Abbott Laboratories
Astrazeneca
Bayer
GlaxoSmithKline
Johnson & Johnson
Merck & Co.
Novartis
Pfizer
Roche Holding
Sanofi-Aventis

**Restaurants**
Autorgrill
Compass Group
Darden Restaurants
Jollibee Foods Corp
McDonald's Corp
Sodexo
Starbucks
Tim Hortons
Whitbread
Yum Brands