SOCIAL RESPONSIBILITY

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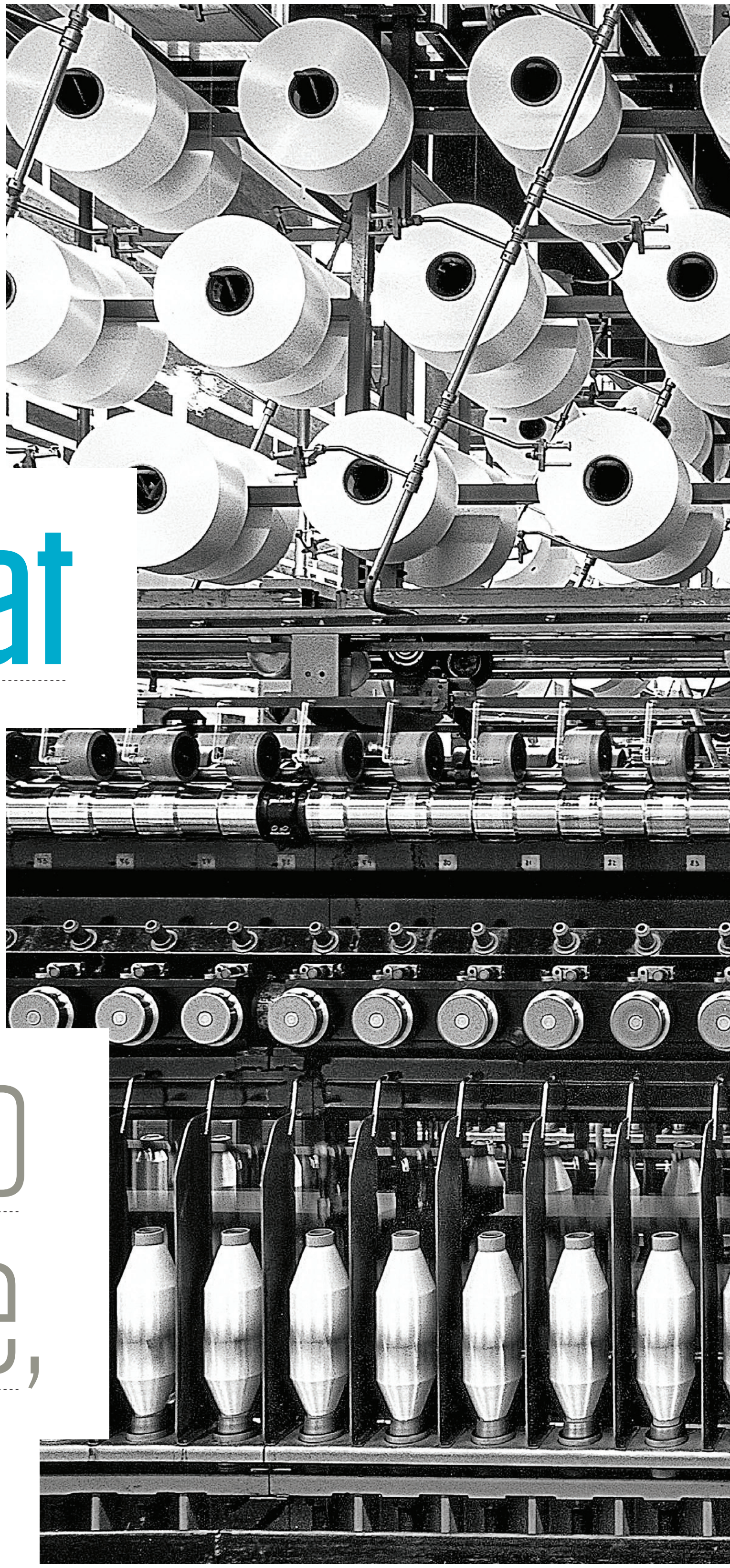
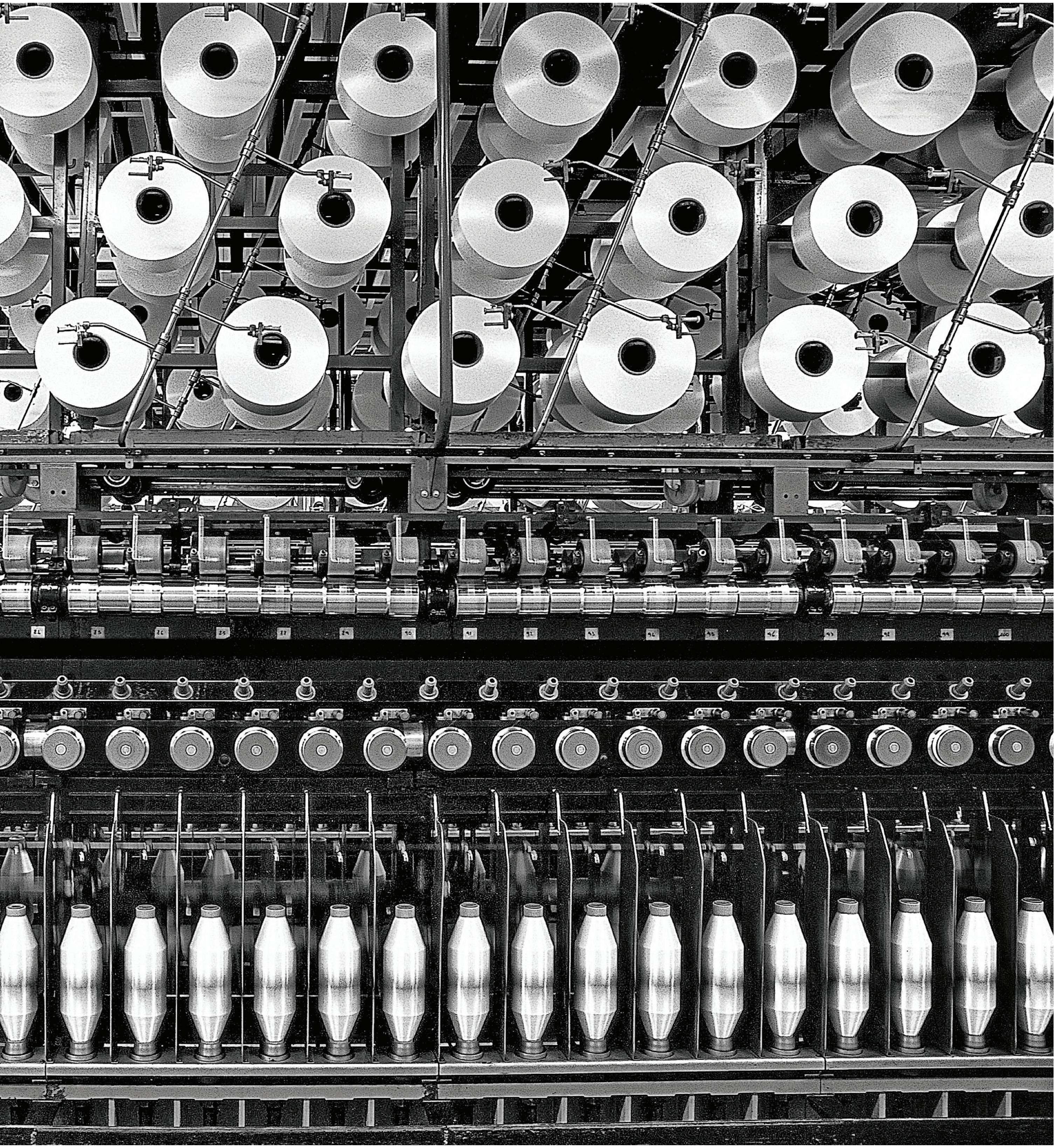


Manage the Suppliers That Could Harm Your Brand

Know when to avoid, engage, or drop them.

PHOTOGRAPHER NICCOLÒ BIDDAU



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Companies have long faced reputational risks from harmful and abusive working conditions in their supply chains.

In the 1990s exposés revealed rampant child labor and brutal conditions in factories making products for Nike, marring the brand's carefully cultivated image. In the early 2000s Apple faced a barrage of activist pressure and embarrassing media coverage following a rash of suicides at the factory of its supplier Foxconn. The pandemic is placing a new spotlight on such dangers: Consider the media allegations of low wages and inadequately protected frontline workers at UK suppliers' factories making apparel for Boohoo and the swift action by investors and retailers to dump the brand. One strategy that many companies adopt to avert such problems: Impose codes of conduct that stipulate minimally acceptable working conditions in suppliers' factories. Numerous firms also periodically audit their suppliers to assess compliance.

Do these measures actually help managers identify unethical suppliers and lead to improvements in conditions for workers? When an audit reveals that a supplier falls short, what are the chances the supplier will remedy matters? Is the relationship worth the risk to the purchasing company's brand? To answer these questions, we conducted a series of studies using tens of thousands of code-of-conduct audits of thousands of factories around the world. This uncovered several factors that predict which suppliers are likely to improve conditions over time and suggests several steps purchasing companies can take to ensure that they do. These insights can guide managers who are seeking to decide which potential suppliers to avoid, which existing supplier relationships to continue investing in, and which ones to walk away from. (See the digital version of this article for links to the research we cite. And for the latest managerial insights from research in this area, visit the Working Conditions in Supply Chains website we developed with colleagues at Harvard Business School: hbs.edu/workingconditions.)

Which Suppliers Are Likely to Improve?

Countries and cities vary, of course, in terms of production costs, labor availability, general working conditions, and propensity for strikes and other disruptions. Our research indicates that such locational differences can reinforce or undermine efforts to encourage suppliers to improve their

IDEA IN BRIEF

THE PROBLEM

To ensure that their suppliers don't abuse or harm workers, companies impose codes of conduct and perform periodic audits. But the effectiveness of these measures has been unclear. How can companies know which potential suppliers to avoid, which existing relationships to maintain, and which ones to end?

THE PREDICTORS

Research by the authors and others suggests that five factors indicate whether suppliers are likely to improve conditions over time: certified compliance with common quality and environmental standards, the adoption of lean management, unionization, rejection of piece-rate pay, and serving once-tarnished buyers.

EFFECTIVE PRACTICES

Companies can take seven steps to assess suppliers' performance and increase the odds of improvement. They can use highly trained auditors, announce audits in advance, rotate auditors or change the auditing firm, include at least one female auditor, choose and pay auditors themselves, avoid fully outsourcing audits, and align activities of their purchasing and social responsibility teams.

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working conditions. For example, we found greater improvement among suppliers in countries with more nongovernmental organizations per capita and more media freedom than in other countries; both factors heighten the probability that harmful working conditions will be exposed. This suggests that buyers ought to monitor suppliers in countries with low NGO density and restricted media freedom—countries such as Bangladesh and China—more closely than they monitor suppliers in countries with high NGO density and media freedom, such as Honduras and Jordan.

But that's just a start. Factories within a given country may vary widely with regard to working conditions and the willingness and ability of their owners and operators to improve them. Which suppliers are more likely than others to take the necessary steps? On the basis of our research and that of others, we have identified five factors.

Certified compliance with management system standards. Our research with Yanhua Bird found that factories adhering to management system standards such as ISO 9001 (process quality) and ISO 14001 (environmental management) tended to be better than uncertified suppliers at improving working conditions. Suppliers opt in to such standards and hire third parties to attest that they comply. The standards require suppliers to conduct internal audits and institute procedures to promote continuous improvement, such as action plans that encourage workers and managers across silos to identify, communicate about, and remedy problems. Such a system creates an engine that drives improvement not only in quality and environmental protections but also in working conditions.

Adoption of lean management. The lean system is a set of practices that include standardizing procedures, team-based problem-solving and quality control, continuous improvement to eliminate waste, and production planning to minimize peaks and troughs in the use of labor and equipment. Two studies of Nike suppliers (one by Greg Distelhorst, Jens Hainmueller, and Richard Locke and the other by Richard Locke, Fei Qin, and Alberto Brause) found that it improved compliance with labor standards relating to wages and hours. (Compliance with health and safety standards was unaffected.) In addition, lean management requires training workers to identify quality problems and managers

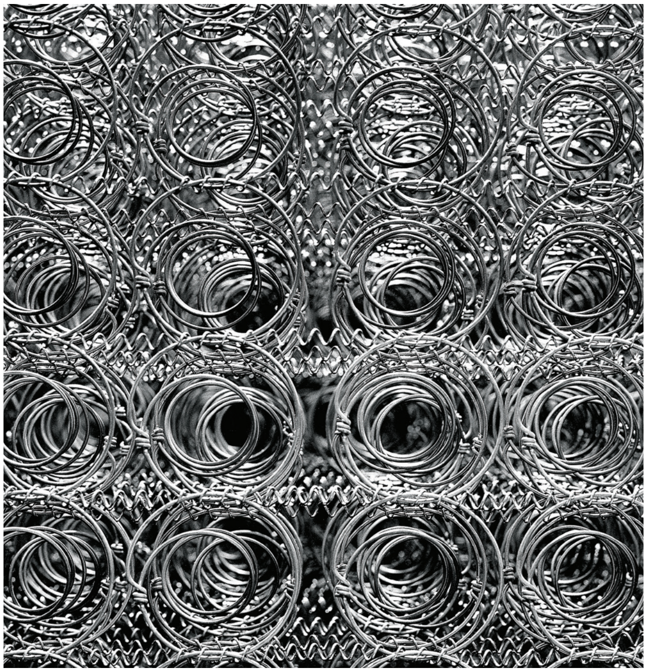
Audits tend to spark greater improvement when they are conducted by highly trained auditors, who are better not just at detecting problems but also at suggesting solutions.

to schedule workloads more efficiently to avoid excessive overtime. The studies found that after a factory adopted the lean system, managers became more reluctant to mistreat workers and exhibited greater concern that people might defect to a competitor. Results suggest that applying lean management can increase workers' skills and boost management's efforts to motivate and retain workers through better employment terms.

Unions. Our study with Yanhua Bird also revealed that following an audit, unionized suppliers improved working conditions more than nonunionized suppliers did. Although unions in developing countries can't always increase workers' political power, they promote dialogue between managers and workers in ways that can be helpful. They can enable workers to make management aware of hazards and to share proposals for mitigating them. They can also help management communicate with workers about health and safety standards and reinforce adherence to desired procedures.

Avoidance of piece-rate compensation. Factories that pay workers by the units they produce tend to exhibit less improvement in working conditions than factories with other compensation systems, according to our research with Yanhua Bird. Piece-rate pay incentivizes workers to focus on short-term production goals, potentially discouraging practices that would boost compliance with labor standards but might reduce productivity—for instance, wearing protective equipment, participating in safety and emergency preparedness training, and using machine guards.

Serving once-tarnished buyers. Our most recent research with Andrea Hugill found greater improvements in working conditions among suppliers serving brands that had experienced negative publicity related to other suppliers' labor practices. We suspect that this happens because such buyers are particularly worried about facing similar criticism in the future, which would demonstrate that they hadn't learned their lesson. Consequently, they are more likely to be cautious when selecting new suppliers and to step up efforts to scrutinize them, encourage and support improvements, and walk away when bad conditions persist. Such suppliers should be attractive to companies with unblemished records, which can piggyback on the due diligence of their once-compromised counterparts.



How Can Monitoring Improve Working Conditions?

Companies can boost the odds of improvement by using monitoring methods we identified in separate research projects conducted with Ashley Palmarozzo and Andrea Hugill. They should:

Use highly trained auditors. We found that audits tend to spark greater improvement when they are conducted by highly trained auditors, who are better not just at detecting problems but also at suggesting solutions. The notion that auditors can play a valuable role by making suggestions is supported by other work. For example, a study one of us conducted with David Levine and Matthew Johnson showed that health and safety regulatory inspections in California prompted substantial reductions in injuries. The head of the Occupational Safety and Health Administration at the time attributed this to inspectors' having essentially provided "a professional safety or industrial hygiene consultation" while they were assessing compliance.

Announce audits in advance. Many companies conduct surprise audits to avoid giving suppliers time to cover up transgressions. Indeed, our research has shown that unannounced audits reveal more problems than preannounced visits do. But that's only part of the story. Although companies want a full picture of what's going on at their suppliers, they also want their suppliers to improve. And according to a study by Richard Locke, Matthew Amengual, and Akshay Mangla, announcing audits in advance can foster teamwork and trust between the auditor and the supplier, which promotes learning. Our research with Andrea Hugill likewise shows that announcing audits can speed improvement. Companies should align the design of their audit programs with the programs' goals. If the primary goal is to catch suppliers in the act, notifying them of upcoming audits is a bad idea. But if the goal is to foster relationships that will lead to improvement over time, such notifications can be a useful tool.

Align the activities of the purchasing department and the social responsibility team. A study of Gap's suppliers by Matthew Amengual and Greg Distelhorst found that suppliers that failed an audit improved only after Gap formally linked the future of the business relationship to the supplier's labor standards by coordinating the activities of its own purchasing and social responsibility departments. When those departments were siloed, as they are in many companies, failing suppliers made no improvement.

How Can Firms Better Track Performance?

Our research also reveals several factors that result in more-accurate audit reports, critical to managing brand risk.

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Rotate auditors or audit firms. We discovered that audit teams produce more-accurate audits when any member is conducting his or her first inspection of the factory at hand or when the factory's prior audits were conducted by a different firm. This finding demonstrates the importance of fresh eyes.

Include a female auditor. We found that audit teams with at least one female member reported more violations, perhaps because they were less likely to let violations slide or because women are more likely than men to elicit sensitive information in interviews, particularly if the factory's workforce is largely female.

Choose and pay auditors rather than have the supplier do so. Many companies reduce costs by requiring their suppliers to pay for audits—and some even allow suppliers to choose the auditor—but that can be "penny wise and pound foolish." It sets up a conflict of interest that might tempt auditors to paint an unduly rosy picture. Indeed, our research has shown that when the purchasing company pays the auditor, more violations are reported.

Don't fully outsource auditing. Our ongoing work with Ashley Palmarozzo is yielding preliminary evidence that audits are more accurate when the purchasing company uses its own staff or hires third-party auditors but has its own staff conduct some inspections in the same market. This approach increases the control that buying companies have over auditors and allows them to better monitor the quality of any third-party audits they use. Companies need to carefully weigh the trade-off between the greater flexibility and cost-efficiency of outsourcing audits and the higher quality that tends to result from using at least some in-house staffers.

MANAGING WORKING CONDITIONS in global supply chains is an ongoing challenge. The findings described here can empower managers to better predict which factories are more likely to improve working conditions and to design monitoring programs to foster such improvement and accurately track performance.

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