



FROM COMMODITY TO VALUE-ADDED

MAKING FACTORY AUDITS EFFECTIVE AGAIN

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The recent deaths of more than 1,200 people in the collapse of Rana Plaza in Bangladesh, the site of several clothing factories, have once again highlighted the poor and sometimes lethal conditions that still exist in corporate supply chains.

These concerns are not new. Back in the 1990s, the discovery of labor abuses in Asian factories led the anti-sweatshop movement to target major apparel and footwear brands supplied by those factories. These negative campaigns were an important trigger for companies to start corporate social responsibility (CSR) initiatives, which were meant to ensure that certain labor standards were met in their fragmented supply chains and to protect their brands' reputation.

Codes of conduct were at the core of CSR programs. They included provisions on labor conditions covering human rights and occupational health and safety requirements. To verify suppliers' adherence to buyers' codes of conduct, brands created compliance teams to audit factories or got third parties to do audits for them.

To analyze the effectiveness of two decades of social audits, we interviewed more than 30 experts in sustainability compliance management from consumer goods companies, auditing bodies, multi-stakeholder initiatives and academia.¹

The main insight from this research is that the quantity of audits has often been overemphasized at the expense of quality. As a result, the effectiveness of mainstream audits in inducing real change in working conditions is very limited. In the words of a number of compliance experts, "audits have become a commodity."

One observation we heard is that experienced executives no longer need audits to highlight non-compliance with labor regulations. "We know that freedom of association and legislation on working hours are seldom respected in China, just as we know that leather stitching in South East Asia most likely involves child labor," says one expert. Yet the approach often is to conduct as many audits as possible, perhaps simply because they help in "keeping stakeholders quiet," says another.

Another problem is the snapshot nature of audits, which allows factories to cheat easily. Audits are often announced in advance, giving factories time to look good and train workers to say the right things during interviews with auditors. To hide excessive overtime, many cunning factory managers keep double books and create computer-faked pay slips. Cheating is made easier because mainstream audits are often too superficial. Some experts say auditors lack the experience to identify non-compliance because their turnover is high and they are required to work with different sectors, which limits their industry-specific knowledge. Others say auditors keep one eye open and the other closed, either because of bribes or simply because reporting non-compliance makes their lives more complicated than ignoring it. It is easier to report large numbers of audits conducted and a high percentage of audits passed.

Making things better

More encouragingly, our interviewees agree on how compliance programs can be improved.

Tackling the current duplication of audits would be a good start. In today's interrelated supply chains, where different brands and retailers share suppliers, it is not unusual for a factory to be audited up to 40 or 50 times a year. The same third-party auditor may visit the same factory in two consecutive weeks on behalf of two different buyers, a clear sign that resources are being wasted. The extra costs are generally passed through the supply chain to the consumer.

More data-sharing, especially between brands and retailers buying from the same factories, has great potential to reduce audit duplication. This sounds simple in theory, but in practice there are several barriers. Different companies have different levels of compliance. Some firms are concerned about free riders and don't want to disclose their factory list to competitors. And there is no single global standard for the content and format of compliance data.

¹ A 20-page article was written on this research project: Comas Martí, J.M. and Székely, F., 2013. *Social and environmental compliance collaboration: A remedy for audit duplication and supplier audit fatigue*, IMD Working Paper, April 2013.

To overcome these barriers, several multi-stakeholder initiatives were created in the 1990s and the early 2000s—such as Social Accountability International (SAI), Business Social Compliance Initiative (BSCI) and Supplier Ethical Data Exchange (SEDEX). Although these have improved data-sharing among their members, they don't fully satisfy the monitoring needs of all companies. And data exchange between different initiatives is still a work in progress.

Exchanging compliance data should soon become much easier, thanks to work by the Global Social Compliance Programme (GSCP) and by the Fair Factories Clearinghouse (FFC) in collaboration with the US National Retail Federation's Association for Retail Technology Standards (ARTS). The key question is whether companies are willing to share data with competitors. Some forward-thinking firms, such as the adidas Group, VF Corporation and Nike, seem keen and say this will benefit them and the entire industry.

Companies could also improve things by developing partnerships with suppliers rather than policing them. In other words, less box-ticking and more capacity building. This means conducting more thorough factory assessments to identify the root causes of non-compliance and giving suppliers the training and management tools to address these issues.

In addition, companies need to have a more consistent view of their supply chains. Too often different functions impose conflicting requirements on suppliers, with the procurement department asking for "cheap and quick" products and the compliance people imposing limits on overtime. Companies need to raise awareness internally as to how the actions of different business functions are interrelated, and revise their incentive schemes to include sustainability metrics in addition to more traditional ones.

Since the Rana Plaza tragedy several big European apparel companies and retailers, including H&M, Inditex, Carrefour and Benetton, have agreed to help pay for fire safety and building improvements in the factories they use in Bangladesh. Leading US retailers have promised to stop production immediately if major safety problems arise but seem less willing to help pay for the improvements.

The recent events in Bangladesh are a terrible reminder that social audits may provide an illusion of assurance with the aim of keeping everyone happy, while leaving major issues unresolved. The hope is that companies will swap more compliance data with each other and form deeper relations with their suppliers. Whether this will happen remains to be seen.

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