

Supply Chain Briefing Part 1: Engagement - Help your suppliers become better businesses

Posted by [Stephen Gardner](#) [1] on Oct 4, 2012

Leading companies are seeking to extend sustainable thinking to their suppliers, as part of a strategy to make their supply chains as stable and efficient as possible

The figures are staggering. In 2010, the latest year for which the World Trade Organisation has crunched the data, world exports of manufactured goods were worth \$9.96tn, 18% more than in 2009. Asian exports of manufactured products grew by 30%. There was huge growth in some sectors and countries. Exports of car parts from Thailand grew by 61%. China sold 57% more integrated circuits. India exported 40% more textiles than in 2009.

Some of this growth can be explained by the post-crisis rebound. But it is also a sign of the increasing proliferation of global supply chains, or, more accurately, supply networks. Products are no longer manufactured in one place and sold in another. Rather, manufactured goods, especially complex products such as computers or cars, are collaborative efforts, involving numerous companies and countries.

An iPod, for example, is often described as being made by Chinese mega-supplier Foxconn. But Foxconn is better described as an assembler. The iPod hard drive is Japanese-designed, but manufactured in Thailand or another Asian country. The microcontroller is a British, Korean or US model, but made at a Taiwanese or other Asian plant. The display screen, processors and battery are contributed by various other east Asian suppliers.

For multi-product corporations, the situation is even more complicated. Wal-Mart counts about 60,000 suppliers. Tesco has some 6,000 in Britain alone. IBM's network is made up of 28,000 suppliers spread across 90 countries. Unilever has a solid claim to the biggest supply network, with 160,000 companies providing it with goods and services.

Such networks involve a trade-off. Globalisation means companies can cut costs: outsourcing production or assembly to locations that are far cheaper than their home markets. But responsibility for the product cannot be outsourced. The close interconnection between developed country brands and their developing nation suppliers creates leverage for consumers, governments and campaigners, who want to ensure that branded products are not tainted by human rights violations or environmental crimes in vulnerable countries.

Thomas Derry, chief executive officer of the Arizona-based Institute for Supply Management, says companies should pay attention to this risk. If problems arise, such as allegations of mistreatment of workers in supplier facilities, it will be the brands at the end of the chain that are "seen as the critical responsible party".

Responsible at home, responsible abroad

Derry cites the US Dodd-Frank Act as one example of the clear allocation of responsibility to companies such as Apple or Dell, which make use of complex supply networks. Under Dodd-Frank, about 6,000 companies that report to the US Securities and Exchange Commission are required to disclose their use of conflict minerals, defined as gold, tantalum, tin and tungsten from the Democratic Republic of Congo and neighbouring countries. "It's important for any corporation to have a 360 degree view of its suppliers," Derry says.

The increasingly close connection between purchasers and suppliers, and their mutual reliance, also means that responsibility and sustainability in the supply chain are justified by the same arguments as responsibility and sustainability at home. Pursuit of high ethical standards means that reputational risks are minimised, while pursuit of sustainability means that the supply network does not undermine its long-term viability for short-term gain.

"The leading practitioners realise that [sustainability] is more of an opportunity than a defensive play," says Derry. Companies want "above everything else a stable business environment", and supply chain sustainability creates "good fertile conditions to be able to conduct business".

Standards high

Leading companies have taken on board the message. Jörgen Karlsson, who oversees the supply chain for telecommunications equipment and services giant Ericsson, says it is "of utmost importance that our suppliers comply with the same strict requirements as we place on ourselves. High standards in areas such as working conditions, environmental management and anti-corruption must always be expected, regardless of country, category or size of supplier."

In most cases, suppliers buy in to the argument that "compliance with high ethical and sustainability standards is not only good from a humanitarian and environmental point of view, but also makes perfect business sense", Karlsson says. "Better working conditions lead to increased employee loyalty, reduced sick leave and lower accident rates. Reduced electricity consumption means lower energy costs. Compliance with the strictest anti-corruption standards earns respect from customers". Where Ericsson does ask a supplier to take corrective action, it is generally done on time and as agreed, Karlsson adds.

IBM, with its 28,000-strong supplier network, faces similar challenges to Ericsson. Cathy Rodgers, IBM vice-president for global engagement, says: "Through our sizeable purchasing power, we have a unique reach and responsibility." For social responsibility and sustainability, IBM takes the view that there are "clear benefits associated with best practices [and] costly risks related to omissions".

Rodgers adds: "The internet has created the ethical consumer activist. Consumers have both greater access and a greater desire to understand not just the product or service they are purchasing, but all aspects of the supply chain." This means that supply chain management "is playing a key and pivotal role in a company's ability to manage its brand image. Companies will be judged by the company they keep; this has major implications and obligations within the supply chain."

The name of the game: cooperation

The focus on sustainability means a growing emphasis on cooperation within the supply chain. There is movement away from the "traditional" model of the developed-country brand imposing codes of conduct on its suppliers, then attempting to police them, with punishments threatened for those that fail to make the grade.

IBM requires suppliers to do four things: address corporate responsibility through their management systems, establish environmental goals and measure their performance, disclose information about their environmental performance, and pass these requirements in turn to suppliers further down the chain.

"Achieving the objectives goes well beyond just monitoring and compliance," Rodgers says. "Programmes have shifted from relations that are managed with a control-and-contain attitude to those that are constructive, collaborative and more productive." Groups such as the Electronic Industry Citizenship Coalition, of which IBM is a member, alongside other electronics brands and their suppliers, help to promote cooperation on issues such as training and capacity building, conflict minerals and working hours.

Ericsson also emphasises collaboration. Audits of suppliers are carried out, but "importantly, we view audits as a tool for improvement, not a policing activity", Jörgen Karlsson says. Alongside the audits, the Ericsson code of conduct for suppliers is promoted through "key supplier" sustainability events and online training, in languages such as Bengali, Chinese and Turkish.

Sustainability in the Ericsson supply chain is a work in progress. "This collaborative approach has proved successful and we observe statistically significant improvement in the supply chain year-on-year," Karlsson says.

Paving the way

In the globalised world, smaller companies can also have supply chains that stretch across continents. The risks can be as big as they are for the multinationals.

Marshalls is a British company with about 2,300 employees that produces stone paving. It used to source granite, limestone and sandstone from western Europe, but because of diminishing supplies it has, over the past decade, switched to quarries in Asia: China for granite, China and Vietnam for limestone, and India for sandstone.

The transition to new sources has thrown up a number of ethical challenges, from child labour in India to use of prison labour in Vietnam, says Marshalls marketing director Chris Harrop. Marshalls has learned, he says, that auditing has limited value. Companies must “concentrate on capacity and implementation in partnership with suppliers and workers”.

This means finding solutions, rather than simply proscribing certain behaviours. Marshalls found that children commonly worked in quarries in India alongside their families because limited schooling was available to them, and they were needed to contribute to the family’s income.

In response, Marshalls worked with a local non-profit group, Hadoti Hast Shilp Sansthan, in Rajasthan where the Indian quarries are located, to set up schools, and provide a safety net through health checks and insurance for labourers. The basic aim was to improve standards in the quarries. “There is a financial argument,” says Harrop. The cost of accidents harms the business, and “workers who are tired are not producing quality work”.

Marshalls monitors conditions in its source quarries, but believes that “audit with a stick encourages audit fraud”. Marshalls local staff in Rajasthan visit sites regularly, but if shortcomings are found, they negotiate with, rather than censure, quarry owners. “It’s about showing them the benefits [of sustainability] rather than the loss that could accrue,” Harrop says.

Marshalls’ experience suggests a number of recommendations for companies facing similar supply chain issues. The first step for avoiding problems is to select suppliers that can be trusted. This might entail organisational change at head office, if the emphasis has traditionally been only on the financial relationship with suppliers. Harrop also recommends “collapsing supply into fewer suppliers and rewarding good suppliers [so that] their businesses grow as we grow”.

Ultimately, suppliers have the same constraints as the companies they sell to. Sustainable thinking will become necessary because of resource limits, and because costs will be passed up the chain if efficiency is lacking, reducing the competitiveness of the brand whose label is on the final product. For any company, resisting new ideas is “not a good winning strategy”, says Thomas Derry of the Institute for Supply Management. Companies must work ever more closely with their suppliers, to “enhance the performance of both”.

Fire traps

The appalling **Karachi** garment-factory fire of 11 September 2012, which killed 264 people – Pakistan’s worst factory blaze to date – was a grim reminder that in many developing countries, **health and safety controls** are weak, and that laws that are in place might not be enforced.

The Karachi fire – and another fire on the same day at a Lahore shoe factory, where 25 people died – recalled a conflagration in **Bangladesh** in December 2010 at a factory making clothes for **Tommy Hilfiger** and other brands. An investigation into that fire by US news network ABC apparently caught Hilfiger himself unawares. He told **ABC** that his company “will never manufacture clothes in any of those factories again” and claimed to be the “gold standard” for health and safety.

A humiliating climb-down followed, with Hilfiger admitting that his branded clothing was

still being made in Bangladesh. Parent company **Phillips-Van Heusen**, which owns Hilfiger's clothing line, conceded that inspections had failed to pick up problems at the factory, such as locked fire exits and barred windows, which made it impossible for workers to escape the blaze. Hilfiger subsequently pledged up to **\$2m** to improve fire safety at factories making his clothes.

Sean Ansett, of sustainability consultants At Stake Advisors, says the episode highlights a number of issues with modern supply networks. At supplier facilities, as a minimum there should be "compliance with national laws; that is absolutely a fair expectation", he says.

He adds, however, that although many countries have the right laws in place, "there is a **lack of capacity** to enforce those laws. Companies have become the default labour inspectorates due to these challenges on the ground."

Companies with long supply chains should beware of **complacency**. In developing-country supplier companies, "there are progressive and switched-on owners and managers, but it tends to be a very small percentage", Ansett says.

"Generally speaking, health and safety has improved, but some of the core issues such as discrimination, freedom of association and living wages remain largely unaddressed." Companies should work with their suppliers to promote "strong **worker/management committees** for these concerns to be raised, and freedom of association and collective bargaining so workers have a say in their own safety".

As Hilfiger learned, lack of awareness about weak points in the supply chain is a **reputational risk**. Brands "definitely have responsibility for how their products are manufactured, but that is a shared responsibility [with suppliers]", Ansett says. "Smart companies are already looking at strategies to address these issues."

Links:

[1] <http://www.ethicalcorp.com/users/stephen-gardner>