

Gradient

Promoting best-practice management
of supply chain labour standards



Introducing Insight Investment

Insight Investment is the asset manager of UK financial services company HBOS. It currently¹ manages £69.7 billion. These funds represent the assets of millions of people in the form of their pensions, life insurance and other stock market-based investments. Insight has an explicit commitment to act as a responsible investor on behalf of its clients. For further information see Insight's Investor Responsibility Policy, available at www.insightinvestment.com/responsibility.

There are two principal reasons why Insight pursues a policy of actively engaging with companies in which it invests.

Firstly, Insight believes it is in its clients' long-term financial interests that the companies in which it invests behave responsibly. Failure to do so typically provokes government and civil society sanctions, such as fines, litigation, new regulation and taxes, consumer boycotts and damage to reputation, all of which create material risks to long-term shareholder value. Insight therefore undertakes analysis of companies, and engages with them, to assess and to encourage them to operate according to international best practice standards on a range of social, environmental and ethical issues.

Secondly, Insight accepts that investors, as shareholders, have some moral responsibility for what is done in their name by the companies in which they invest. Shareholders have a key role to play in the governance of companies. It is therefore reasonable to expect shareholders (particularly large investors) to provide company managers with active support and encouragement in their efforts to ensure that their companies conduct their business in a responsible manner.

Insight believes that it is particularly important that investors act to ensure strong governance with respect to social, environmental and ethical issues by companies that do business in developing countries, where the capacity for governments to regulate corporate behaviour effectively is frequently weaker than in developed countries. For a more detailed description of Insight's stance on investor responsibility and on its project to promote global business principles, visit http://www.insightinvestment.com/documents/responsibility/GBP_project_report.pdf.

Introducing AccountAbility

AccountAbility is an international not-for-profit professional institute dedicated to the promotion of organisational accountability for sustainable development. AccountAbility promotes this through assurance and accountability management tools, including AA1000, leading edge research and related advocacy, as well as through professional development. AccountAbility embraces an innovative, multi-stakeholder governance model, enabling the direct participation of its organisational and individual members, which span business, civil society organisations and the public sector from different countries across the world.

AccountAbility has facilitated and run FTSE's Europe-wide consultation meetings to determine how FTSE should incorporate supply chain labour standards into the FTSE4Good index. AccountAbility has also developed the Gradient Index – a tool to assess how well companies manage supply chain labour standards. The Gradient methodology has been adapted and used as the basis of analysis in this report. In addition, members of AccountAbility have been involved in the development of key institutions working on supply chain labour standards, including the ETI.

The Gradient Index is one of many indices developed by AccountAbility within its Gradient Programme, including its work on the "Best Workplaces in the UK" list 2003 with the *Financial Times*, the "Global Inclusion Benchmark 2003" with the Employers' Forum on Disability, and the "Responsible Competitiveness Index". AccountAbility, through its work on indices, seeks to promote mature and constructive global dialogues concerning complex accountability issues facing companies, governments and civil society. For more information on these indices, visit www.accountability.org.uk.

¹ As of December 30, 2003.

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Executive summary

Responsible supply chain management has become an essential aspect of modern-day risk management for companies that source from the developing world. As public concern mounts about supply chain labour standards, companies need to demonstrate they are taking the issues seriously. If they do not, they face the prospect of very public and damaging criticism that can impact brands, customers' trust, corporate reputations and shareholder value. Companies that rely extensively on overseas suppliers also face increasingly complex operational challenges if they fail to manage their supply chains effectively.

Not all sectors or companies in those sectors face the same level of risk. Risk exposure is dependent on a number of factors related to the nature and scale of a business and its supply chain. However, in order for investors and others to be able to evaluate a company's exposure to ethical supply chain risks, companies need to explain clearly in their reports the nature and extent of the risk faced, as well as the process used to assess that risk. In addition, there are compelling ethical reasons for companies to address issues of supply chain labour standards even when their brands do not face material risks related to these issues.

Gradient: promoting best-practice management of supply chain labour standards represents the first systematic comparison of how well 35 major FTSE listed companies manage labour standards in their supply chains, based on the companies' own reporting on this issue.

It has been produced jointly by Insight Investment, a large UK asset manager with a commitment to responsible investment, and AccountAbility, the international professional institute promoting accountability for sustainable development.

The report analyses the governance, policies, management, stakeholder engagement and auditing of supply chain labour standards of 35 FTSE 350 companies in six sectors that typically have extensive supply chains in the developing world. The methodology is based on AccountAbility's Gradient Index.

The findings of this report indicate that:

- Marks and Spencer stands out with the highest score of 84 percent – placing it significantly above the next-best performing company – demonstrating what can be achieved in the management and reporting of labour standards in supply chains.
- Thirty-one of the 35 companies score below 50 percent overall; sixteen scored below 25 percent. Clearly, many companies are a long way from achieving best practice.
- Within each sector the leaders are:
 - Beverages: Diageo
 - Food and drug retailers: J Sainsbury
 - Food producers and processors: Cadbury Schweppes
 - General retailers: Marks and Spencer
 - Telecommunications: BT
 - Tobacco: British American Tobacco

On a sector-by-sector basis (the most relevant for comparison), the findings are that:

- The food retail sector achieves the highest score, with an average of 37 percent;
- The beverage and tobacco sectors score most poorly overall;
- Food producers and processors, companies that also rely extensively on a large number of agricultural suppliers for whom labour standards and working conditions are known to be very poor, also score relatively weakly, with an average for the sector of 23 percent;
- The performance of general retailers, as the largest sector, was highly variable. The results indicate that while some companies in this sector, such as M&S, Kingfisher, Boots and GUS report relatively fully on this issue, others have yet to do so; and

- The results also suggest that the tobacco sector is addressing some key issues via an industry initiative (SRiTP), though not comprehensively.

More detailed findings with respect to specific elements of ethical supply chain management are:

- Thirty-one of the 35 companies recognise the importance of social, environmental and ethical issues to their businesses, as evidenced by their discussion of them in their annual report and accounts or in other literature;
- Fourteen companies either do not disclose a supply chain labour standards policy or code, or have a weak code that does not reference core ILO conventions;
- Only one company – M&S – aligns staff incentives to performance on these issues – likely indicating a significant disjoint among the other companies between high-level policy commitments and their integration into standard management processes;
- Twenty-six companies have declared a commitment to auditing programmes in their supply chains, though only eight commit to auditing across the full supply chain; and
- All members of the Ethical Trading Initiative (ETI) included in the study score relatively well; taken as a group, their average score is 45 percent, indicating the value that ETI membership can deliver to companies.

Companies' performance is assessed solely on the basis of their own publicly-available reported information on the management of labour standards in their supply chain. We recognise the limitations of this approach, but aim to respect the pleas of many companies not to send them additional, time-consuming questionnaires. We recognise that, in many cases, companies' reports and websites will not fully reflect the current extent of their activities, and that annual and corporate responsibility reports are retrospective and lag up to a year behind actual practice. Nevertheless, reporting can be a useful rear view mirror through which to view key aspects of performance and assess which aspects of performance companies are planning to address.

Readers are strongly encouraged to visit the Gradient website at www.gradient-index.net, where the study's results are available. This website includes an online tool that allows users to alter the weighting attributed to each group of criteria to reflect their own views regarding the relative importance of governance, codes, management, stakeholder engagement and auditing and reporting in the management of labour standards in the supply chain.

Insight hopes to have the opportunity in the coming months to discuss the results of this study with many of the companies included in it to encourage them to move toward best practice, as laid out in the report (see Box 2 on page 14). AccountAbility will continue to provide support to its members to do the same.

I. Introduction

This report compares how well 35 FTSE 350 companies manage labour and ethical trading issues in their supply chain according to their own reporting of this issue.

It is intended to help investors and other stakeholders identify those companies that are at the forefront on this issue, as well as those that are lagging behind their peers. We hope that it will serve as a starting point for further dialogue with companies, civil society and others about how this issue should be managed, measured and reported.

Responsible supply chain management is becoming an essential aspect of modern-day risk management, especially for companies that source extensively from the developing world. Amplified by the media, concern is mounting among consumers, NGOs and unions about abuses of workers in supply chains. Companies need to demonstrate that they take these issues seriously if they are to avoid the prospect of very public and damaging criticism that has the potential to damage their brands, undermine their customers' trust and tarnish their reputations – all of which can threaten shareholder value. However, there are also compelling ethical reasons for companies to address supply chain labour standards even when their brands do not face material risks related to this issue.

It is now four years since the publication of the Turnbull Report in the UK, with its recommendation that companies establish effective systems to identify, evaluate and manage all major risks, including those arising from social, environmental and ethical issues. It is also two years since the Association of British Insurers (ABI) published guidance for companies on providing information about social, ethical and environmental (SEE) risks for investors. We therefore believe it is reasonable to expect that companies would have begun, by now, to address the risks associated with ethical sourcing and to have adopted the necessary policies and management systems to address them.

The analysis uses a scoring system based on AccountAbility's online tool, the Gradient Index, available at www.gradient-index.net, which was developed over two years through extensive consultation with experts working on these issues both within and outside companies. This report sees the first full application of the Gradient Index.

Companies' performance was assessed solely on the basis of their own publicly-reported information. We recognise that there are limitations to this approach. It is possible that a company may be managing supply chain issues well, but not reporting this fact. In many instances we do not believe that this is the case, as there has been rapid growth in corporate responsibility reporting in the UK and most large companies now provide fairly detailed reports.

Furthermore, companies have, quite reasonably, expressed some frustration about the endless stream of questionnaires they receive from investors and others seeking information about their activities. Given the growing maturity of corporate responsibility reporting, we have opted to avoid burdening companies with an additional questionnaire on this occasion. In this respect, we see this report as something of an experiment to test whether investors and other stakeholders can use corporate responsibility reports to provide a reliable basis on which to analyse and compare company performance. We will be using the feedback from this exercise to evaluate the practicability of using only publicly-reported information in similar exercises in the future.

II. Why should companies address supply chain labour standards?

Changing sourcing patterns

Over recent years, many UK companies have begun to source an increasing proportion of their merchandise from developing countries in order to profit from their lower costs of production. Outsourcing production to the developing world can realise significant benefits in these countries in terms of foreign direct investment and resulting economic development. Customers benefit in terms of low product prices, and, for shareholders, it can bring about a greater return on their investment in the short term. However, the workers in the fields and factories that produce the goods often do not fare as well. The production of goods as diverse as medium density fibreboard, shrimp, circuit boards, spinach, leather, shoes and brassware all entail some negative social and environmental impacts. Indeed, as experience is being gained from research into more and more products, it is becoming increasingly clear how extensive and widespread these impacts can be.

Labour standards lacking

Although labour laws, unions and other institutions that serve to afford workers protection exist in these countries, the International Labour Organisation (ILO) labour standards are often not met, even where the countries are signatories to the relevant ILO conventions. In addition, laws are often not fully enforced by national and local government agencies charged with that responsibility. This is often due to a lack of capacity in these agencies, and corruption can undermine enforcement in some countries. Working conditions and labour standards in the workplace are therefore often very poor, and workers often suffer a wide range of human rights abuses, such as discrimination, physical and verbal abuse, excessive hours and overtime, inadequate wages, non-payment of overtime, high rates of injury and even death.

Consumer concern rising based on strengthening evidence

There is a widespread belief, especially among developed country consumers, that breaches of labour standards are morally unacceptable and that companies that condone or turn a blind eye to these breaches deserve to shoulder some of the blame².

Moreover, new research by Insight³ and others⁴ provides indications that companies' own buying strategies may also be contributing to pressures on suppliers and leading to the violation of labour standards – specifically through buying companies' purchasing and pricing practices.

Unions and NGOs that champion workers' causes collect evidence of these breaches and bring them to the attention of the global media. According to the International Confederation of Free Trade Unions, 213 trade union activists were assassinated or disappeared worldwide in 2002. In addition, 1,000 were attacked and beaten, 2,562 were detained, 89 received prison sentences, 30,000 were fired and some 20,000 were victims of harassment. Reports published by CAFOD and Oxfam (in January 2004 and February 2004 respectively) detail extensive labour standards abuses on the basis of hundreds of interviews with workers in tens of developing countries that manufacture and export goods to the west. These groups argue that ultimate responsibility for these abuses lies with well-known brands: IBM, Hewlett Packard and Dell in the case of CAFOD, and Tesco and El Corte Inglés in the case of Oxfam. Similar campaigns around Europe and in the US target other brand names in their markets.

² See for instance the article on ethical and fair trade estimating its value at £100 million in *The Independent*, March 30, 2004.

³ *Buying your way into trouble? The challenge of responsible supply chain management*, Insight Investment, February 2004.

⁴ *Trading Away Our Rights – women working in global supply chains*, Oxfam International, February 2004; *Clean up your computer: working conditions in the electronics sector*, CAFOD, January 2004.

Pressure groups becoming more effective

The tactics of pressure groups that work on this issue vary, but they are becoming more sophisticated and effective. Some ask consumers to boycott certain products or companies entirely, potentially reducing companies' revenues in the short or longer term. The latest Ethical Consumerism Report, published by the Co-operative Bank every year, estimates that the total costs imposed by ethical boycotts in the UK amounted to £2.58 billion in 2002 (or just over one percent of total retail sales for that year).

Others encourage consumers to write *en masse* to companies to ask questions about their policies and practices in an attempt to get the attention of senior management and thereby to encourage the company to take action on its social performance. What these groups have in common is that they tend to focus their campaigns on the biggest names and brands, which have the greatest recognition among consumers and thus have the most to lose.

A range of informal or 'soft' sanction processes is gradually emerging and being refined that provide NGOs, unions and other stakeholders with a means of challenging companies' performance on supply chain labour standards. For example, NGOs have recently challenged the UN Global Compact to develop an enforcement mechanism. In addition, they are also aiming to use National Contact Points, the establishment of one of which is a requirement for all signatory countries to the OECD Guidelines for Multinational Enterprises, to bring complaints against companies for breaching a clause (albeit cursory) on labour standards in the Guidelines.

In the US a series of expensive settlements has resulted from court cases brought by overseas workers themselves for poor health and safety and sweatshop conditions. Seventeen major US retailers were involved in a class action lawsuit in 1999 alleging sweatshop labour conditions on the island of Saipan (a US Commonwealth territory). The action targeted some of the biggest names in retailing, including Gap, Wal-Mart, JC Penney, Donna Karan and Ralph Lauren. Some of the companies have settled out of court, agreeing to pay US\$8 million to finance back wages to workers and to establish independent monitoring of factory conditions.

Impact on brand

Thus, while companies spend years building their brand and reputation, they can be damaged very quickly. Even if consumers do not boycott brands altogether, where they have a choice of product, they may choose the one from a competitor that they believe to be more responsible (or at least that hasn't been targeted by pressure groups). Consumers have long memories. Rebuilding damaged company and product brands can be time-consuming and costly. In recent years, UK companies such as Top Shop and Littlewoods have also been highlighted in media stories for sourcing from factories and farms that treat their workers poorly. *The Guardian* ran an extensive series of reports in May 2003 in which it investigated UK supermarkets' suppliers of flowers and produce in Kenya and elsewhere. The Environmental Justice Foundation is currently challenging UK supermarkets on their shrimp sourcing. It alleges that it has identified extensive and severe human rights and labour standards abuses in this sector.

The value of brand and corporate reputation

In today's global markets, intangible assets such as brands are more important than ever. Damage to a brand can be particularly destructive of shareholder value. Complex and highly sensitive ethical situations therefore pose potentially serious reputational risks to companies.

In the 'Voice of the Leaders Survey' of over 100 of the CEOs participating in the 2004 World Economic Forum, 60 percent of those surveyed estimated that corporate brand or reputation represents more than 40 percent of a company's market capitalisation. Seventy-seven percent said they believe that reputation has become more important over the last two years.

Ninety-two percent of corporate survey respondents perceive reputation as an important part of their corporate strategy, and 24 percent rated corporate reputation as the most important measure of success.

Operational risks and costs

Companies that do not manage labour standards issues not only face potential brand and reputational risks – the main concern underlying this report – but also face potential operational risks and related costs.

Poor working conditions in factories and on farms can erode quality, efficiency and productivity. These factors can increase wastage and push up costs, increasing the price paid by their customers. Businesses whose supply chains are vulnerable to weak labour standards, particularly the use of child and bonded labour, can face serious productivity issues relating to quality control and staff morale. Poor working practices in supplier factories may expose a purchasing company to the risk of poor quality and inconsistent standards. Excessive working hours, poor health and safety, low pay and dirty and unhygienic working conditions all contribute to low levels of worker motivation, high worker turnover and less attention to quality. The supply of goods from factories or farms with poor health and safety regimes can be severely disrupted by fire, accidents and injury. Factory fires are one of the most serious and common risks arising from low standards of housekeeping and poor factory management. Fires not only devastate lives, but also destroy property, materials, machinery and stock, often severely disrupting delivery. Major customers may also find themselves implicated in the deaths of workers.

Concern is spreading

Although much of the focus on labour standards abuses has, to date, been on the apparel and sportswear sectors, there is renewed and mounting concern about the production labour standards of other products, including bananas, furniture, computers and telecommunications equipment, horticultural products, electronics and toys. Indeed, any sector or individual company with an extensive global supply chain is liable to face intense and increasing scrutiny of its labour standards performance from NGOs, unions, investors and consumers alike, fanned by the media's appetite for scandal and the public's growing interest in these issues. Naturally, as pressure grows on companies to relocate from developed economies with, by and large, longer histories of respecting labour rights, to less-developed economies with shorter histories and therefore poorer records, the issue is certain to grow still further.

Box 1: Which labour standards?

Insight and AccountAbility share the belief that companies should operate to high international standards. The authoritative standard-setting body with respect to labour standards is the International Labour Organization (ILO). The ILO was created in 1919 primarily for the purpose of promoting international standards to cope with the problem of labour conditions involving "injustice, hardship and privation". Eight ILO core conventions have been identified by its governing body as fundamental to the rights of human beings at work, irrespective of the levels of development of individual member states. These rights are a precondition for all the others, in that they provide the necessary instruments with which to strive freely for the improvement of individual and collective conditions of work. These conventions are international treaties, subject to ratification by ILO member states.

They cover:

- Freedom from forced and bonded labour;
- Freedom from discrimination and the right to equal pay;
- Minimum working age (child labour);
- Worst forms of child labour;
- Freedom of association;
- The right to organise and bargain collectively.

The majority of the ILO's 177 member states have ratified most of these conventions. As an investor, Insight is therefore encouraging UK companies that source from these countries to ensure that they do not contravene the core conventions and that they uphold local labour laws. Failure to do so often subjects workers to unnecessary and unacceptable harm and exposes the sourcing company to reputational risks.

III. Exposure to labour standards risks

This report focuses on six sectors that typically have extensive overseas supply chains: beverages, food and drug retailers, food producers and processors, general retailers, telecommunications and tobacco.

However, not all sectors, and not all companies in those sectors, face the same level of risk. Risk exposure is dependent on a number of factors. For example, risks tend to be significantly lower in companies that:

- are small (i.e. a FTSE350 versus a FTSE100 company) since smaller companies are less likely to be criticised by NGOs;
- sell only branded goods, where direct responsibility for the ethical production of those goods lies with the company that owns the brands;
- source only a small or shrinking proportion of their goods from the developing world, and/or from particularly high risk developing countries;
- sell only second-tier brands, not well recognised by consumers, and are therefore less susceptible to brand damage.

In order to evaluate a company's exposure to ethical supply chain risks, investors need the company to explain clearly in its annual disclosure the nature and extent of the risk faced, as well as the process used to assess this risk. In addressing the risk, investors should expect companies to dedicate management and staff resources to managing it commensurate with its nature and scale. However, there are also important ethical reasons for companies to address supply chain labour standards even when their brands do not face material risks related to this issue.

IV. Methodology

Selection of sectors and companies

Six sectors were chosen as the focus of this study:

- Beverages
- Food and drug retailers
- Food producers and processors
- General retailers
- Telecommunications
- Tobacco

These sectors were chosen for two reasons. Firstly, their principal activity is to manufacture and/or retail products to consumers and they are therefore potentially more exposed to brand damage and criticism than sectors that are not as 'customer facing'. Secondly, these sectors typically rely extensively on developing country supply chains. While the structure and nature of the supply chains of companies in these sectors may differ, the ethical and managerial challenges they face are very similar.

Within the six sectors, those companies in the FTSE350 believed to have an extensive developing country supply chain, or that are in the process of developing one, and that have significant, direct control over those suppliers, are included in the analysis. A total of 35 out of 50 companies are therefore included⁶. (For example, companies that are excluded include e-retailers, such as ebookers and lastminute.com, companies that do not have an extensive developing country supply chain, such as Greggs and MFI Furniture, and companies that retail branded products only, such as Carphone Warehouse).

Development of methodology

For the last two years, AccountAbility has been working with a number of experts in the US, the UK and continental Europe to develop an innovative, web-based tool called Gradient (visit www.gradient-index.net for more information). This tool calculates percentage scores for discrete aspects of companies' performance regarding supply chain labour issues and allows users to weight each element of performance according to their own views and priorities. The online tool allows users to explore aspects of performance in greater detail by altering the weighting of the core index criteria so as to construct their own index, reflecting their own priorities and interests.

This approach has been tested in a number of workshops and was used as the basis for FTSE's consultations on how it should incorporate labour standards into the FTSE4Good Index. The criteria and index structure used here have been developed and refined further for this report. In particular, because this report uses only publicly-available information, the criteria have been amended to reflect data availability.

⁶ Companies were selected for inclusion in the study if they fell within the FTSE350 as of June 30, 2003, when research began. Some companies may now be within the FTSE350 that were not then, e.g. French Connection. Others have delisted during the research period, e.g. Debenhams and Selfridges, and are therefore not included.

Criteria

Taking the Gradient methodology as a starting point, a set of criteria was developed against which companies' own reported practice on managing labour standards risks and impacts was assessed. Box 2 describes the criteria in greater detail and indicates how they relate to emerging best practice. The criteria are organised within the following five categories:

1. Governance and risk management
2. Policy
3. Management
4. Stakeholder engagement
5. Auditing and reporting

Each company was evaluated against a total of 19 criteria spread between these five categories. Each category contained between two and seven criteria. Scores were awarded according to how close the company was to emerging best practice. The overall score for each company was used to compile the final ranked list of companies. The full set of criteria and results are set out in the Annex and are available at www.gradient-index.net.

Weighting

For the purposes of this analysis, an illustrative weighting has been chosen for each category, shown in the table below. However, the study's results are also available on the Gradient website where users are able and encouraged to assign their own weightings for each section, according to their own views on the importance of each issue. Stakeholders can therefore generate different results using weightings different to those we have used here.

Management issue	Weighting (% of total score)
Governance and risk management	20%
Code for labour standards in the supply chain	15%
Management	25%
Stakeholder engagement	15%
Auditing and reporting	25%
Total	100%

Box 2: ‘Best Practice’ explained: what have we measured?

In order to have scored 100 percent in this analysis, *i.e.* to meet what we have determined to be emerging best practice, companies would have to have been able to demonstrate all of the following commitments and activities in their published material. The model outlined here seeks to reflect the present views of leading companies, labour groups and NGOs; clearly, it is always evolving. These criteria seek in particular to translate the normative standards in Box 1 into more business-focused measures. Many more criteria could have been included that try to assess how well ethical trading commitments and buying practices are integrated; however, very few companies report on these aspects of supply chain management, and it would therefore have been very difficult to capture sufficient information to assess this aspect of performance.

1. Governance and risk management

- Company has a formal executive board sub-committee with explicit responsibility for labour standards in the supply chain and/or an executive board member with explicit responsibility for labour standards in the supply chain.
- Company provides discussion in the annual report and accounts of a systematic analysis of social, environmental and ethical issues as risk factors.
- Company provides a description of its approach to analysing risk with respect to labour standards in the supply chain.

2. Policy

- Company has a code for labour standards in the supply chain that covers all the issues of, and explicitly references, the *ILO Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy* or the ILO core conventions, including the living wage⁷.
- Company fully discloses its code in its reports or on its website.
- Company applies the code to the entire breadth of, or to almost the entire breadth of, its supply chain, including its own procurement.

3. Management

- Company has appointed a senior manager whose primary responsibility includes labour standards in the supply chain and who is no more than two reporting levels from the board.
- Company provides ongoing, scheduled training to buyers on labour standards in the supply chain.
- Company provides ongoing, scheduled training to personnel at the site of production, such as factory managers and suppliers, on labour standards in the supply chain.
- Company offers incentives to senior management and/or procurement staff that are explicitly linked to their performance on labour standards in the supply chain.

4. Stakeholder engagement

- Company is a member of the Ethical Trading Initiative (ETI) or a comparable initiative that includes input from both NGOs and unions.
- Company actively engages with stakeholders, specifically NGOs and/or trade unions (beyond membership of the above groups) at site level.

⁷ We selected the issue of the living wage, beyond the core conventions, because this issue is one of the most complex. We believe that the issue acts as a bellwether; if a company is addressing this issue, it has a relatively mature approach. We would also recommend that companies include the issues of working hours and health and safety in their policies and codes.

5. Auditing and reporting

- Company makes a clear commitment to auditing labour standards across the entire breadth of its supply chain.
- Company has a scheduled auditing plan that is currently being implemented.
- Company's audits involve third parties, with systematic input from NGOs and/or labour in the country of supply into the verification of labour standard audits.
- Company publishes its auditing methodology, which follows generally accepted practices and/or an explicit external standard(s).
- Audits of company's supply chain are carried out by auditors or assessors with specialist qualifications in all or some cases.

Companies were assessed **solely on the basis of their own non-confidential published literature**, such as annual reports, corporate social responsibility (CSR) reports or similar, and information on their websites available as of September 5, 2003. Other public domain literature not generated by the companies themselves was not taken into consideration.

We recognise that there are limitations to relying solely on publicly-available information to assess companies' performance in this area, as in many cases the reports do not fully reflect the extent of their activities. However, the methodological limitations of this report are reflected in its modest aims, which are that it should serve simply as a starting point for further dialogue with companies, civil society and others. Moreover, many UK companies, in response to demands from their stakeholders, have begun to report quite extensively on a range of corporate responsibility issues. They have asked investors and others to rely on this information for their analysis rather than submit extensive questionnaires to them, which are often extremely time-consuming to complete. We therefore hope that companies will appreciate our efforts to respect their wishes in this regard.

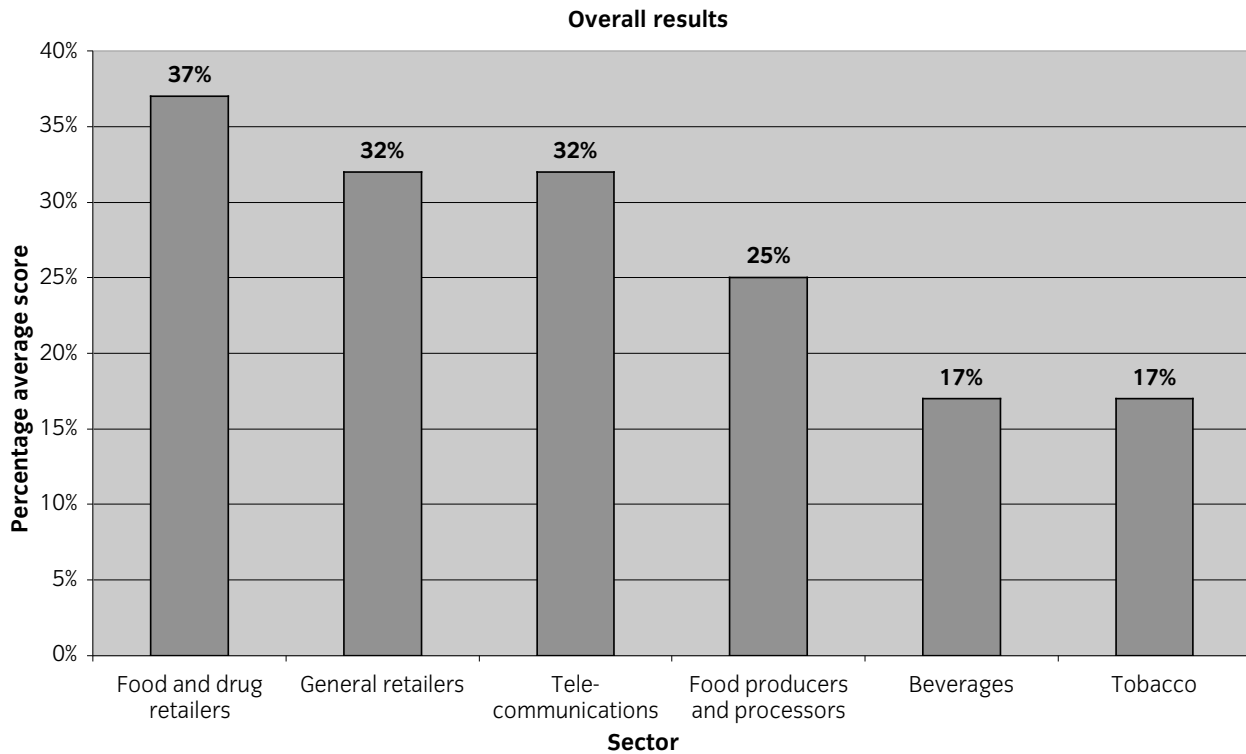
Company review and engagement process

In June 2003 we wrote to the chief executive of each of the 35 companies included in the project and invited each company to submit additional relevant information for consideration. Nine companies responded with a letter and/or provided additional non-confidential information.

In December 2003 we sent each company the initial results of our analysis. We also enclosed a list of the materials consulted to form a view of the company's performance and a letter inviting them to submit any further information that was available by September 5, 2003 (and that had not already been taken into consideration). Twenty-one companies responded with further information and/or comments on the results. Eight companies' scores changed on the basis of this information submitted. All companies were sent their final results at the end of March 2004; many also attended a seminar on March 31, at which the full results were presented and discussed.

V. Overall results

The chart below shows the final scores of all of the sectors assessed. Food and drug retailers achieved the highest average score as a sector, with 37 percent. The average score of the general retailers (the largest sector with 15 constituents included in this study) was 32 percent, as was that of the telecommunications sector. The five food producers averaged 25 percent, while the beverage and tobacco sectors performed most poorly, with an equal average score of 17 percent.



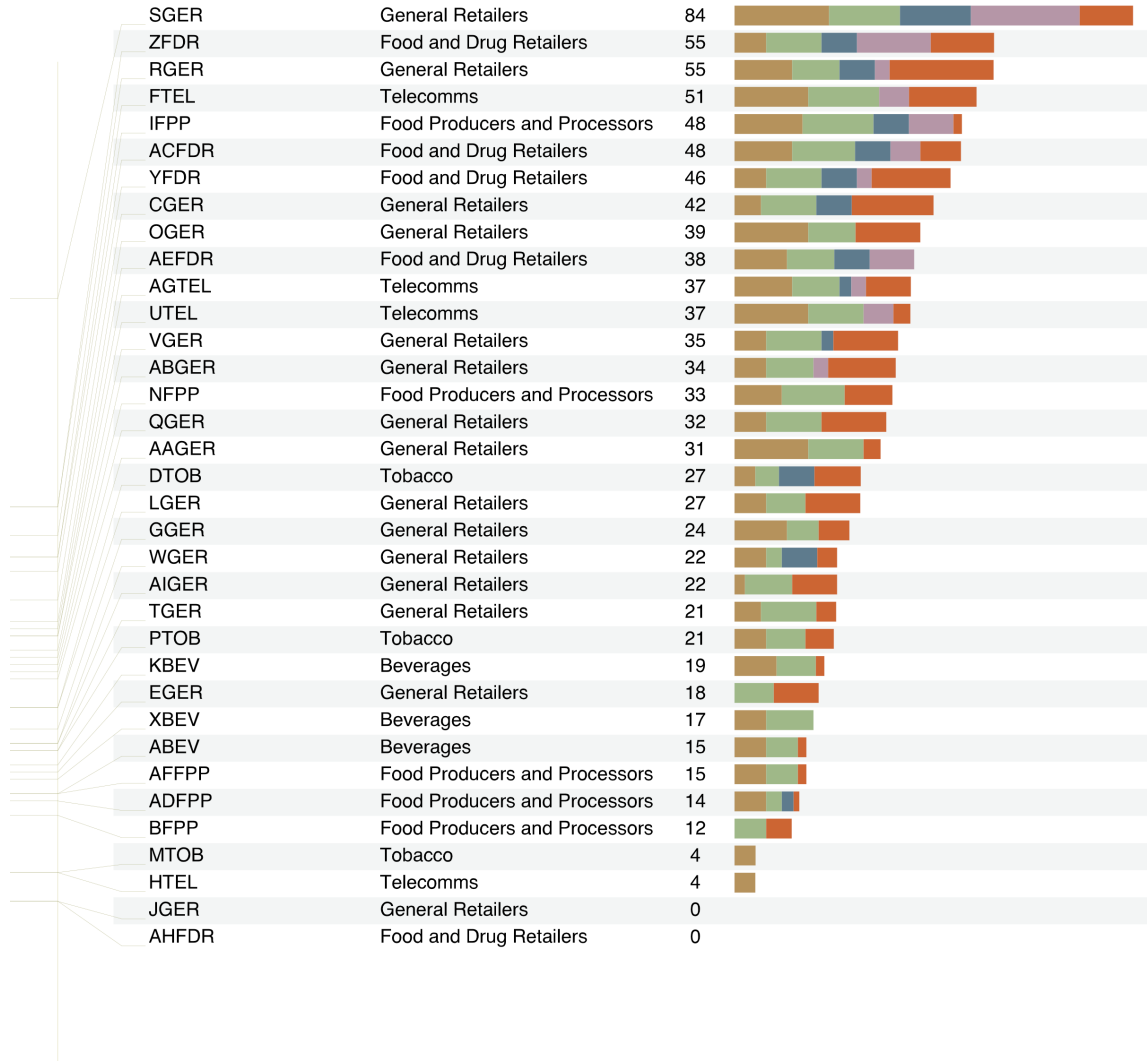
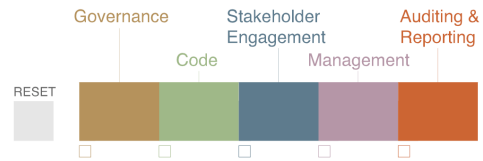
The diagram on page 17 shows how the results are presented on the Gradient website (www.gradient-index.net). The website allows users to adjust the weightings of the five categories of assessment criteria to suit their own needs and priorities. These are:

- Governance and risk management
- Code for labour standards in the supply chain
- Management
- Stakeholder engagement
- Auditing and reporting

The Gradient Index

The Gradient Index allows you to see comparative levels of corporate management of supply chain labour issues. However, it also allows you to focus on particular areas of interest by modifying how particular issues contribute to a company's overall score. You can do this by altering the size of the issue 'bands' with your cursor.

The Gradient Index then automatically recalculates the overall scores and rankings.



Tool design & development by **EthicaMedia**

Box 3: The leading company – Marks and Spencer

Marks and Spencer (M&S) is the clear leader in our study. M&S distinguishes itself by scoring the maximum available points in the 'Governance and risk management' and 'Stakeholder engagement' sections, but it is its performance in the 'Management' section that marks it out as so clearly ahead of other companies. M&S reports delivering scheduled training on labour standards in the supply chain to its own buyers, its suppliers and their sub-contractors. It also reports offering compliance incentives to procurement teams. There are two senior managers whose primary responsibility includes sourcing standards (one for food and one for non-food) and whose positions are reported as being one level from the CEO. The company is a member of the ETI but discloses that, in partnership with suppliers in developing countries, it goes beyond this membership to offer adult literacy classes and health care training to workers. In the area of governance, M&S reports that it has a board sub-committee with explicit responsibility for labour standards in the supply chain, while in its annual report it mentions ethical trading as one of several social, environmental and ethical risk areas in which it applies its risk assessment process.

While it could be argued that its high score is a function of the M&S business model (*i.e.* it sells only own-brand products and therefore can exert much greater influence over its suppliers), this does not appear to be the case. Several other general retailers that sell only own-brand goods score more poorly. Therefore, while M&S's business model may contribute to its ability to manage labour standards in the supply chain particularly effectively, the company's score does not seem to be wholly attributable to this factor.

VI. Analysis of results by sector

1. Food and drug retailers

The food and drug retail sector achieved the highest score of all sectors, with an average of 37 percent. Scores among the companies vary considerably; the highest score was that of J Sainsbury and the lowest was zero.

Companies in this sector tend to have large and complex supply bases, stocking both their own brands and branded goods and produce. Some, such as Tesco and J Sainsbury, also sell an increasing amount of clothing and housewares, which raises additional and different supply chain labour standards challenges. All companies in this sector, therefore, have extensive direct social impacts through their sourcing and face reputational and brand risks if they do not manage these issues well. However, the nature and significance of these impacts and risks vary according to the size and sourcing practices of each company.

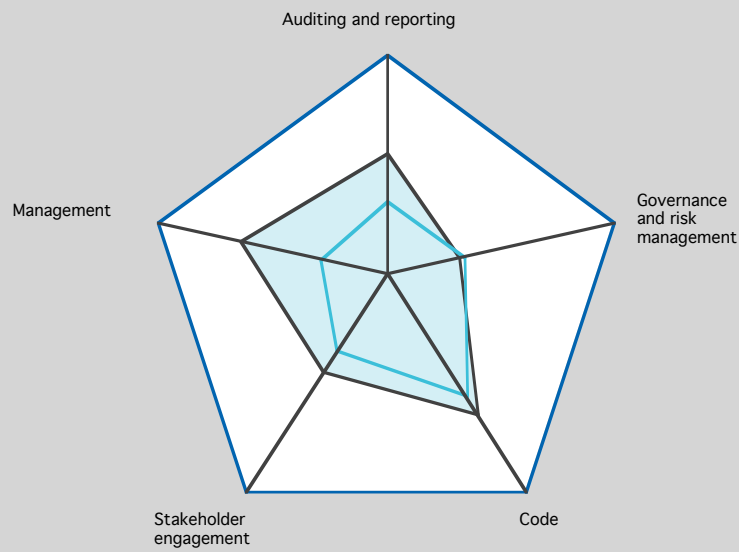
Main findings

- Two out of five companies report having carried out risk assessments of ethical issues in their supply chain and a third declares a commitment to undertaking one.
- Performance is comparatively strong on 'Stakeholder engagement' and is just above average on 'Codes for labour standards in their supply chain', due, in part, to extensive ETI membership (four out of five companies in this sector are members and therefore apply the ETI Base Code).
- This sector performs better than the others on 'Management'. For example, four of the five food and drug retailers state that they offer training to buyers on labour standards in the supply chain on either an *ad hoc* or scheduled basis. Three out of five companies (J Sainsbury, Sainsbury's and Somerfield) report that they have begun auditing labour standards in the supply chain. These companies also elaborate on the competencies of auditors carrying out the assessments and disclose that they have a staged approach to dealing with violations of the code when found.

Commentary

This sector's performance on 'Governance and risk management' indicates that supply chain labour standards are of relatively high importance to it and are, in general, being managed proactively. However codes and auditing presently appear to be applied to suppliers of own-brand products only. There is little or no evidence of work to address labour standards in the supply chains of branded goods. While this can be more difficult because companies often buy a very small proportion of any one supplier's output, some companies in other sectors are beginning to do so by exploring opportunities for addressing ethical trading challenges together with their major branded-goods suppliers. Because four of the five companies are ETI members, they also score relatively well on stakeholder engagement. However, these four companies score only between 38 percent and 55 percent, leaving significant room for improvement in their reporting of their activity in this area.

Food and Drug Retailers / J Sainsbury



Each 'spider web' diagram illustrates the performance of each sector by showing the score of the sector leader and the sector's average score compared with the maximum possible score for each of the five categories of assessment criteria. Each axis in the diagram represents one of these five categories. The outermost shape represents the maximum score available for that category. The average and the leader score are expressed as a proportion of this score on each axis.



Company performance



Sector average

Box 4: The Ethical Trading Initiative and its members' performance

The Ethical Trading Initiative (ETI) exists to identify and promote good practice in the implementation of codes of labour practice, including the monitoring and independent verification of code provisions. It is a UK-based alliance of companies, trade union organisations and non-governmental organisations (NGOs) committed to working together to achieve this aim. The ETI's ultimate goal is to ensure that the working conditions of employees in companies that supply goods to consumers in the UK meet or exceed international standards. The ETI Base Code is founded on ILO conventions and has become a model on which other codes are based.

The ETI was established in 1998 as an independent, not-for-profit organisation. It is funded by members' contributions and a grant from the Department for International Development (DFID). The ETI runs a series of experimental projects and working groups to help members unravel the detail and complexities of good practice. Each project focuses on areas in the implementation of codes that members find particularly challenging. Work in this field is constantly evolving, and the projects and groups provide members with a vehicle for learning-by-doing and for working collectively on problems. Through the projects, corporate members work not only with their suppliers but also with trade unions and NGOs – and sometimes with academic and business experts – to test different approaches to improving the labour practices in their supply chains. Working groups cover such issues as doing business in particular countries, such as China and Sri Lanka, child labour, and smallholders and homeworkers. They also focus on particular forms of production, such as banana production in Costa Rica, wine production in South Africa, horticulture in Zimbabwe and prawn harvesting. Others focus on issues such as risk assessment and training.

The ETI enables companies to participate in its various pilot projects to develop a deeper understanding of issues surrounding particular products or countries. Companies thereby work with ETI and union and NGO members in the UK, and have the opportunity to engage directly with similar stakeholders in supplier countries. The ETI requires each of its members to submit a report on its activities annually, which is confidential to the ETI. Only two companies, Somerfield and J Sainsbury, publish their ETI report.

The nine ETI members included within the analysis fall within the top 21 companies. Taken as a group, their average score is 45 percent – superior to all other sectors. There appears to be a strong correlation between ETI membership and those companies that effectively manage and report on their supply chain labour standards.

2. General retailers

The performance of the 15 companies in this, the largest sector, is extremely varied. The sector average is 32 percent. The highest-ranked company overall in the survey is this sector's leader, M&S, which scores 84 percent. The lowest score of a company in this sector is zero.

Main findings

- Thirteen of the 15 companies in this sector score on the 'Governance and risk management' section. Only four report reasonably comprehensively on their approach to identifying and managing SEE and supply chain risks.
- While several companies publish in full their policies and codes, only two, M&S and GUS, report that those policies also apply to their own procurement (rather than simply the products they buy to sell). Only one company – DFS Furniture – does not publish a code or policy at all.
- Only five companies score on the stakeholder engagement section, four of which are ETI members. Kingfisher is the other, which reports that it engages with some of its suppliers directly.
- Reporting on their approach to managing supply chain labour standards is the area in which companies in this sector score most poorly. However, Marks & Spencer provides a clear model for other companies to emulate.
- All but one company describe their commitments and/or approach to auditing.
- Beyond these trends, the performance of this sector is so varied that it is difficult to identify many patterns.

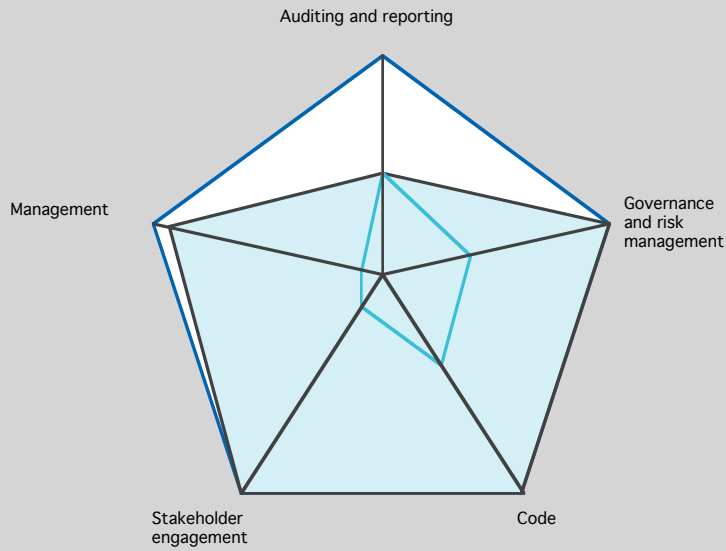
Commentary

Many companies in this, the largest sector included in the study, appear to have acknowledged that supply chain risks are a significant issue. The companies that score poorly have the benefit of being able to build on the experience of others in this sector to improve their own reporting and performance. The majority of companies has begun to address the issue by adopting policies and codes and by assigning board level responsibility for the issue.

However, as with food and drug retail companies, general retailers, with the notable exception of JJB Sports, appear only to be addressing labour standards in the supply chain for their own-brand goods. Some companies, such as M&S, stock only own-brand goods and thus have greater control of their supply chains, which makes their task somewhat easier. Other retailers stock branded goods to a greater or lesser extent. The companies from which they buy these goods can be of a size equal to or greater than their own. Where the retailer buys only a fraction of a supplier's output, it has little influence over that company. (For example, Dixons, although a relatively large company, buys only a fraction of the output of Sony and Panasonic, whose products it retails). It is therefore difficult for retailers in this position to insist that larger suppliers meet their own supply chain labour standards. (However, the telecommunications sector faces a similar dilemma but has begun to address the issue by convening meetings with its larger suppliers to discuss the issue with them).

Where a group has several operating companies and a decentralised approach to managing supply chain labour standards, a clear group position can be difficult to discern. This is another example of the how different business models can lead to differences in management of labour standards in the supply chain. Companies in this sector particularly need to improve on reporting more clearly who is assigned management responsibility for the issues within the business and how buyers and other staff and suppliers are trained and provided with incentives to implement company policies on ethical trading.

General Retailers / Marks & Spencer Group



Each 'spider web' diagram illustrates the performance of each sector by showing the score of the sector leader and the sector's average score compared with the maximum possible score for each of the five categories of assessment criteria. Each axis in the diagram represents one of these five categories. The outermost shape represents the maximum score available for that category. The average and the leader score are expressed as a proportion of this score on each axis.



Company performance



Sector average

3. Telecommunications

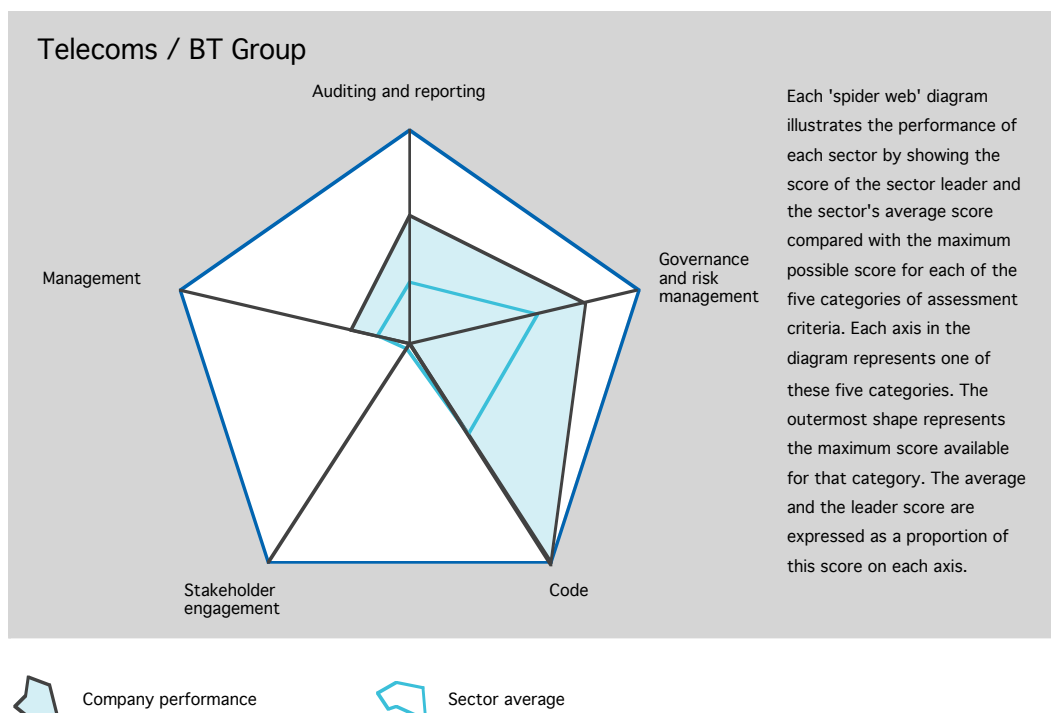
Overall, the telecommunications sector achieved the second-highest average sector score of 32 percent, equal to the General Retailers sector. BT is the leading company in this sector; the lowest score of any company is four percent.

Main findings

- Three of the four companies have stated a commitment to undertaking a risk or exposure analysis of ethical issues in the supply chain and so score relatively highly on governance.
- Management of labour standards seems to be more embedded into the business strategy and governance compared with other sectors. Two out of four companies report having a senior manager whose primary responsibility includes labour standards in the supply chain. Two state that they are conducting or have conducted training for buyers on supply chain labour standards.
- None of the companies in this sector is a member of the ETI. Only Vodafone reports that it has begun to initiate any stakeholder engagement. As a result, most companies, other than Vodafone, do not score at all in this section.
- Two out of the four companies state that they are auditing labour standards in the supply chain, but there is no evidence of these being externally verified.

Commentary

Three companies in this sector have clearly acknowledged and begun to address supply chain labour standards. Their relatively good scores are particularly notable as they typically deal with large, branded goods suppliers while companies in other sectors seem to have shied away from engaging with them on this issue. One company reports much less extensively on its stance on these issues. The four companies in this sector appear to be weakest in the area of stakeholder engagement; we would encourage all of these companies to report on this aspect of their work more fully. They could also do more to report more clearly on how responsibility is allocated for implementing their ethical trading policies within the business, how training is delivered and how performance incentives are structured.



4. Food producers and processors

The average score of this sector, comprising five companies, is 23 percent. Cadbury Schweppes stands out as the clear leader.

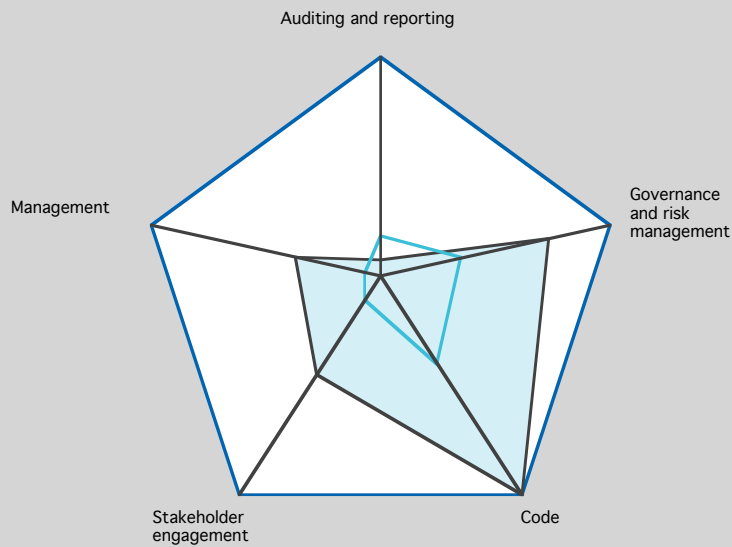
Main findings

- Four of the five companies score on “Governance and risk management”. Cadbury Schweppes reports having a board sub-committee with responsibility for supply chain labour standards and, along with Geest, states a commitment to undertake a risk assessment of labour standards within it. With the exception of this one company, all mention SEE risk in their annual reports, but only one, Geest, elaborates on the elements of this risk.
- All five companies disclose a code for supply chain labour standards, but these vary in completeness and strength.
- However, Cadbury Schweppes alone demonstrates that it dedicates resources to implementing its policy. The company reports that it runs scheduled training on labour standards in the supply chain for buyers and that it runs such training on an *ad hoc* basis for suppliers.
- All the companies in this sector score at least some points in ‘Auditing and reporting’; all but one state a commitment to partial or *ad hoc* auditing of the supply chain. However, none discloses that audits are verified externally, and only Geest reports on the types of audits used.

Commentary

The companies in this sector seem to have begun to recognise that they have extensive social impacts on the agricultural producers on which they rely, evidenced by the fact that they have adopted ethical trading policies. However, none of the companies in the sector elaborates on its SEE risk, which appears to indicate that they are not yet acknowledging this information as important to their stakeholders. On the basis of their reporting, these companies seem to have made little progress in implementing their codes. This is of particular concern as these companies rely extensively on the agricultural sector, where extensive labour standards failures are known to occur. While all companies report that they are auditing labour standards in the supply chain, they do not supply details of the auditing process. Taking policy forward into practice, and clarifying publicly the steps that companies in this sector have taken to operationalise those policies, appear to be the main challenges facing this sector.

Food Producers & Processors / Cadbury Schweppes



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Company performance



Sector average

5. Beverages

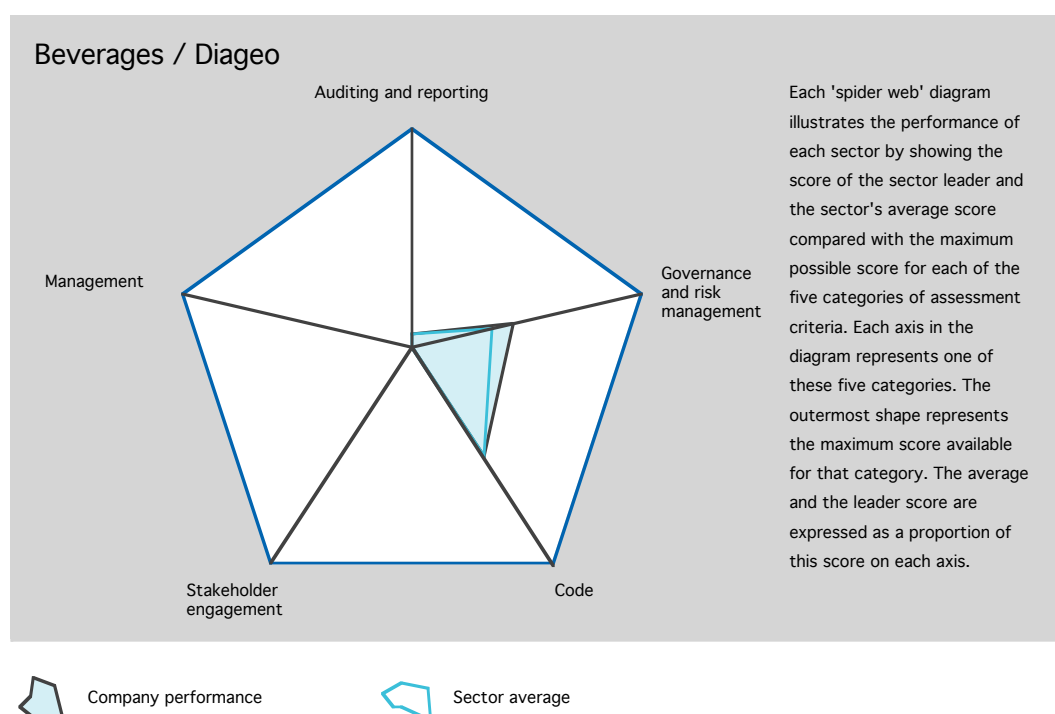
This sector, comprising three companies, has the lowest average score overall, along with the tobacco sector, of 17 percent.

Main findings

- All companies score in the 'Governance and risk management' section for a board-level commitment to CSR (or, in one case, for labour standards in the supply chain specifically) and because they mention SEE risk in their annual reports, but these risks are not elaborated upon. It is not clear, therefore, whether they consider supply chain labour standards to be a significant business risk.
- All three companies score zero for both the 'Management' section and for the 'Stakeholder engagement' section.
- All three companies clearly accept that they bear some responsibility for addressing their supply chain impacts because they have adopted a policy or code. These codes are weak, however, and only one, SABMiller, discloses having a code that references and covers all aspects of the ILO core conventions, including the living wage. The other two companies have codes that are incomplete and that do not reference the ILO.
- Two of the three companies state a commitment to some auditing of labour standards, but there is little elaboration on the types of audit or competencies of auditors. Furthermore, the codes audited against are weak or incomplete in some cases.

Commentary

The poor performance of this sector is of some concern, given its dependence on agricultural products and its extensive presence and sourcing in developing countries. The three companies have clearly identified supply chain labour standards as an important issue to their businesses, and have adopted codes of practice. However, these are of variable quality and scope. As yet, they do provide an explanation about how the issue is managed internally – the level of resources dedicated to implementation, whether training is provided etc. Further, none of the companies yet explains how fully how it audits its supply chains, or whether or how it engages with stakeholders.



6. Tobacco

There are only three companies in this sector. Relative to other sectors, performance is not strong - the sector average is 17 percent. BAT is the sector leader.

Typically, tobacco companies have a large number of suppliers of tobacco leaf. For example, BAT has a relationship with 250,000 tobacco farmers. Some, such as Imperial, control their own tobacco production directly, whereas others buy from a wide range of independent suppliers. These companies therefore have a substantial impact on tobacco workers' welfare. Child labour on tobacco farms has been identified by the industry itself as a key issue for this sector.

Main findings

- Two of the three companies belong to the Social Responsibility in Tobacco Production (SRiTP) programme, an industry-led initiative set up to address a variety of issues. These include child labour and health and safety, but the initiative does not focus solely on labour standards. Most of the points the companies in this sector score in all sections relate to work they do through this programme.
- None of the companies explains in its reports whether it considers supply chain labour standards to be a significant risk or not, or describes its view of its responsibility for these issues.
- Only BAT reports engagement with stakeholders.

Commentary

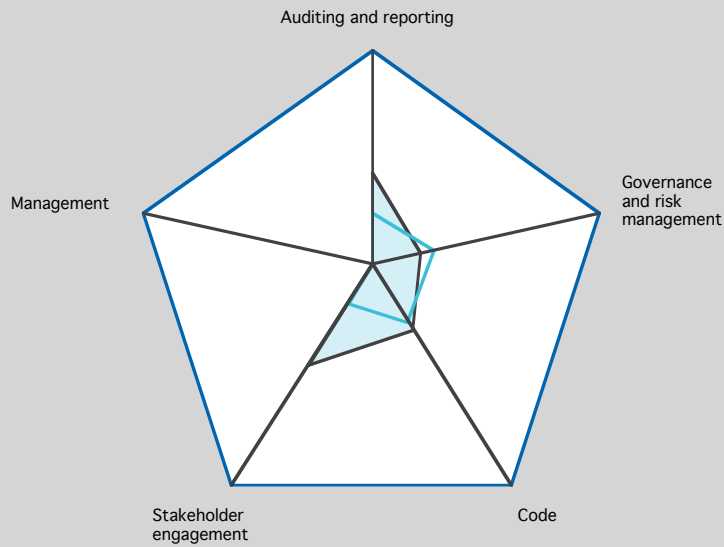
The two companies that are members of the SRiTP programme appear to be addressing supply chain labour standards principally through this programme, rather than developing their own policies and plans of action. However, while SRiTP addresses child labour, there appears to be little or no action by the tobacco companies to address other aspects of labour standards, such as freedom of association and the living wage. For example, the codes applied by BAT and Imperial to labour standards in the supply chain go no further than SRiTP, and there is no sign of codes addressing labour standards in the supply chains of products other than tobacco leaf.

Although two of these companies score in the 'Auditing and reporting' section, this is for auditing against the SRiTP programme, which covers limited aspects of labour standards, *i.e.* child labour and standard of living, through local community investment and capacity building.

None of the companies score at all in the 'Management' section; they have not disclosed the level of resources dedicated to implementing their supply chain labour standards policies or that they have begun training buying or other staff on these issues. This indicates that codes, auditing and other such 'end-of-pipe' activities are preceding the integration of management of supply chain labour standards into the business at a governance and management level, or through changing buying and inventory management practice.

All three companies need, therefore, either to develop more comprehensive approaches to managing their supply chain labour standards risks and impacts or to work with SRiTP to ensure that the programme is extended to address all labour standards effectively. They should be aware, however, that industry-led programmes often do not engender trust and credibility if they do not involve key stakeholders.

Tobacco / British American Tobacco



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Company performance



Sector average

VII. Analysis by management issue

1. Governance and risk management (weighting 20%)

The purpose of this section is to determine the extent to which the companies' boards have recognised and begun to address the potential risks posed by ethical trading issues. Questions focused on whether companies:

- disclose explicit board responsibility for the issue;
- report thoroughly on SEE risks overall (as required by Turnbull); and
- have undertaken a risk analysis of their supply chain.

Main findings

- Most companies (other than four) score in this section, which indicates that they have all begun to recognise the importance of SEE issues to their business, if not of supply chain labour standards *per se*.
- While many companies mention SEE risk in their annual report and accounts, very few describe this risk in more detail or offer an explanation of how significant it is considered to be or how it is being addressed.
- Only four out of 35 companies disclose that they have an executive board member responsible for ethical issues in the supply chain, and only two companies, Marks & Spencer and Cadbury Schweppes, report having an executive board committee with explicit responsibility for this area.
- Board-level committees or board members responsible for corporate social responsibility (CSR), with no further specification of whether or not this responsibility includes labour standards in the supply chain, are far more common within the group – 18 of the companies (51 percent) refer to such a committee. This is a principal reason why a relatively large number of companies (31 out of 35, or 89 percent) scored points in the 'Governance and risk management' section.
- Overall, the telecommunications sector scores most highly in this section. The tobacco sector scores most poorly.

Commentary

These results point to a trend toward companies beginning to recognise SEE issues as risk factors in their business, which is encouraging. However, the majority of companies do not provide any further information about the constituent elements of this risk in their annual report. Readers are therefore unable to gain a clear understanding of the so-called "non-financial risks" that are relevant to the company or to understand whether or not labour standards are deemed to be of material risk to the business.

2. Codes for labour standards in the supply chain (weighting 15%)

The purpose of this section is to assess the completeness, disclosure and application of companies' policies and codes of conduct on labour standards in their supply chains. Questions focused on whether companies:

- explicitly reference all of the core ILO conventions on labour standards and working conditions in their policies and address the 'living wage' issue;
- are selective in their choice of conventions to adopt;
- publish policies in full or in part; and
- apply policies to their own-brand goods alone, to part of the supply chain or to all goods and the entire breadth of the supply chain.

Main findings

- Over half of the companies (21) have a supplier code of conduct that references the ILO core conventions or that covers all of these elements but without specific reference to the ILO. Ten address the living wage issue and reference the ILO or ETI. Of these, five do not make any mention of being members of the ETI.
- The codes of many of the remaining companies vary greatly in their strength and/or scope. The weakest of these are generalised statements about engaging with suppliers that hold similar corporate values as well as those codes that are limited to certain aspects of labour standards, such as child labour.
- Fourteen of the 35 companies either do not disclose having a code for labour standards in the supply chain or have a weak code, *i.e.* a code that covers only some issues of the ILO core conventions and that does not reference the ILO or the ETI.
- Of the 21 companies that have a code that refers to the ILO or the ETI, or that covers all the elements of the ILO core conventions, eight companies' codes cover only some of these core conventions. In some cases, their code covers all issues except that of the living wage.
- The tobacco sector scores most poorly in this area.

Commentary

These results are encouraging in that several companies in all sectors have begun to address labour standards in the supply chain by putting in place a code that states their commitment to upholding key ILO conventions. However, others have yet to do so, despite the fact that their peers, through putting in place their own code, have acknowledged that the issue is important and that they bear some responsibility for addressing it. It is interesting to note that eight companies have a code in place that does not clearly cover all the ILO core conventions and the living wage issue, yet that does reference the ILO or ETI. This appears to indicate that companies are aware of international standards in this area but that they, either deliberately or unintentionally, fail to assign equal importance to each of the core conventions – as is intended by the UN and ILO.

3. Management (weighting 25%)

While companies can create board committees and adopt labour standards policies relatively easily, to ensure that they deliver on their commitments, responsibility needs to be assigned to one or more managers (and to other staff in the company). The purpose of the questions in this category is to develop an understanding of the level of resources that companies are dedicating to implement their ethical sourcing policies, *i.e.* of how seriously they are taking their commitments. Questions focused on:

- the seniority of managers and the extent of management resources directed to addressing ethical trading;
- whether companies offer training for buyers and/or suppliers; and
- whether the company aligns its incentives for senior management and buyers with its commitments on supply chain labour standards.

Main findings

- Only seven companies (20 percent) state that they have a dedicated manager whose primary responsibility includes labour standards in the supply chain. In only one company (M&S) is the manager's position clearly two or fewer reporting levels from the board.
- The number of companies offering training on ethical trading to buyers is low overall, with eight companies (23 percent) reporting that they offer any training on either a scheduled or an *ad hoc* basis. This includes four of the five food and drug retailers, one of the three telecommunications companies (BT), a general retailer (M&S) and a food producer and processor (Cadbury Schweppes).
- Only one company states that it offers incentives based on performance around labour standards in the supply chain to buying or ethical trading teams (M&S), and none of the companies in the study states that incentives are offered to senior management or procurement staff on this basis.
- The food and drug retailers score most highly in this section. The beverage and tobacco sectors fail to score at all.

Commentary

While six companies have assigned board-level responsibility for ethical trading and put policies in place, few seem to have begun to implement their commitments in earnest. A small proportion of companies report having put in place a dedicated manager with responsibility for implementing their responsible trading policies. Few report having started to offer training to buyers consistently; fewer still extend that training to their suppliers. The fact that only one company reports that it has aligned buyers' compensation with its commitment to ethical trading implies that the vast majority of companies have yet to fully embrace and integrate such commitments with their buying practices. Other companies would do well to follow the lead of M&S by implementing and disclosing similar good management practices, such as the appointment of a senior manager with responsibility for this issue and good access to the board, and offering labour standards-based incentives to procurement staff.

4. Stakeholder engagement (weighting 15%)

The purpose of this section is to assess the extent to which companies proactively engage with key stakeholders, such as NGOs and unions, both in the UK and in source countries, in order to identify and address situations leading to poor working conditions.

Main findings

- Only 12 companies (34 percent) scored here. In the case of seven of these companies, this was because they are members of the Ethical Trading Initiative through which they have ongoing dialogue with the ETI's union and NGO members.
- Only one company (M&S) scored both for membership of the ETI and for delivery or engagement with stakeholders in source countries.
- This section has the lowest score of all the sections, along with 'Management'. The beverage and tobacco sectors fail to score at all, and only one telecommunications company, Vodafone, reports being involved in stakeholder dialogue on this issue. The best average score is posted by the food and drug retailers, likely because many of them are members of the ETI and so are able to engage with stakeholders in that forum.

Commentary

Very few companies outside the retail sector report that they have begun to work with organisations such as NGOs and trade unions to help them develop a more responsible approach to sourcing. Those companies that have developed such relationships in the UK have yet to extend them to their countries of supply or, if they are involved in them, to report on them more fully. ETI membership appears to offer companies a mechanism to engage effectively with UK and overseas unions, NGOs and workers.

Box 5: The SEDEX project

What is SEDEX?

SEDEX is being developed by Impactt Limited, a UK consulting company, in conjunction with a range of retailers. It will be a web-based system supported by M&S, Safeway, Tesco, Waitrose, Northern Foods, RHM and Uniq to enable their suppliers to maintain data on labour standards at production sites and to make information available to companies with which they are in a trading relationship. Core objectives are to reduce the number of multiple supplier audits and assessments and to focus attention on making improvements to working conditions and labour standards in their operations.

Why SEDEX is needed

Currently each retailer carries out its own individual supply chain evaluations via separate site assessments and audits using its own staff or independent auditors. Since many sites are common to more than one retailer supply chain, this often results in the following problems:

- Multiple assessments or audits of the same sites;
- Extra costs and time lost in multiple audits;
- Conflicting corrective actions. These can result in confusion, inaction and, in extreme cases, harm to workers;
- Different data on the same site held by a number of retailers. None can be sure whether it has access to the most up-to-date or accurate information; and
- Disempowerment of sites and suppliers because, while suppliers often pay for the process, they often have no ownership of the data.

SEDEX aims to address some or all of these issues.

Key principles

SEDEX is based on the following key principles:

- **Subsidiarity:** Data is entered and maintained at the lowest practicable point in the supply chain. This may be at manufacturing sites or on farms. So, for example, an individual site or group of sites would be responsible for holding and updating assessment information about its own operations.
- **Ownership:** Data is owned by the supplier who enters and maintains it.
- **Access:** Access to data is controlled by the supplier. Each form will contain a field enabling the supplier to allow access to one or more purchasers.

SEDEX will be launched in 2004. For updates visit www.sedex.org.uk.

5. Auditing and reporting (weighting 25%)

The purpose of this section is to assess the extent to which companies have begun to audit their supply chains and the approach they take in doing so.

Questions focused on:

- companies' commitment to auditing;
- the expertise of those undertaking their audits;
- the transparency of their audit methodology;
- companies' disclosure of audit results; and
- companies' approach to dealing with non-compliance, if found.

Main findings

- Twenty-six companies declare some level of commitment to auditing labour standards in the supply chain.
- Of these, eight state a commitment to auditing labour standards across the entire breadth of the supply chain, while 18 state a commitment only to partial or *ad hoc* auditing.
- Some companies are auditing against relatively weak codes that address only certain aspects of labour standards in the supply chain, or may simply be auditing against compliance with labour law, which goes some way toward explaining why a large number of companies report that they are auditing their supply chains.
- The large number of companies that disclose a commitment to auditing labour standards in the supply chain may be a reflection of the perceived importance to stakeholders of monitoring. That is to say, companies may be reporting on their auditing activities because they believe this is what their stakeholders consider to be important.
- Relatively few companies offer information about the competencies of their auditors or assessors. Many companies stress the independence of auditors rather than their qualifications or knowledge around the topic. In many cases, audits are conducted by the company's quality assurance (QA) teams or by product technologists as part of product safety or quality checks.
- Only nine companies report that they verify labour standards audits externally, and only two companies state that they offer suppliers the option of being audited against a publicly-available and accepted standard, namely SA8000. However, other companies, such as BT, do provide an overview of what their auditing methodology comprises.
- Disclosure of audit findings is poor overall. Only three companies report any quantitative data in connection with audit findings, and in only two cases did this extend to more than a simple description of the number of non-compliance cases found. Five other companies discuss their aggregated audit findings in a broader manner without mentioning any numbers in connection with their findings.
- General retailers score most highly in this section and beverages most poorly.

Commentary

While many companies have a code in place and are conducting audits, there is a wide variation in the strength and scope of codes and in the competencies of audits (e.g. audits being conducted by an external specialist vs. the quality assessment team visits incorporating labour standards). The level of reporting on competencies and verification of audits varies greatly. Some of this variation may be attributable to different business models, which can affect the size of the supply chain, the amount of influence a buying company has over it and where the responsibility for labour standards lies (*i.e.* a centralised vs. decentralised approach).

VIII. Conclusions

The objective of this research is to gain an understanding of current practice in the management of labour standards in the supply chain of 35 selected UK companies that source extensively from the developing world. We have begun to do this by assessing companies' performance in this regard exclusively on the basis of their own reporting in this area – respecting the increasingly vociferous pleas of many companies not to send them long, time-consuming questionnaires to fill in – despite the limitations of this approach. We recognise that, in many cases, companies' reports and websites will not fully reflect the current extent of their activities, and that annual and corporate responsibility reports are retrospective and lag up to a year behind actual practice. Moreover, it is often not practical for companies to publish full details of their activities.

We recognise that not all sectors, nor all companies in those sectors, face the same level of risk. Risk exposure is dependent on a number of factors. In order for investors and others to be able to evaluate a company's exposure to ethical supply chain risks, companies need to explain clearly in their reports the nature and extent of the risk faced, as well as the process used to assess that risk. However, there are also important ethical reasons for companies to address supply chain labour standards issues even when their brands do not face material risks related to this issue.

Overall, we are concerned by the poor results of the majority of companies in this study. Several years after concerns were first raised about labour abuses in supply chains, we are surprised to find that the vast majority of UK companies that source from the developing world still seem not to accept that they share a degree of responsibility for those impacts. Furthermore, they do not seem to consider that these issues can pose a real reputational risk to their business. This is of particular concern given that public disquiet about the conditions in which the goods they buy are made seems set to heighten rather than abate in the near future. We had expected that companies susceptible to this kind of exposure, especially those with the most extensive developing country supply chains, would by now be offering comprehensive explanations of how they are addressing their risks and impacts. Also, given most companies' own recognition of and commitment to corporate responsibility over recent years, we would have expected to see more substantial reporting on these issues from more companies.

While food retailers do better, on average, than the other sectors, the performance of companies within all six sectors is relatively poor, and varies enormously. The results indicate that supply chain labour standards have been recognised as an important issue by at least one company in each sector, but that their sector peers have ground to make up.

One company – M&S – stands alone at the top with a score of 84 percent, providing clear evidence of strong management practices in this area. Only four out of 35 companies are approaching this level of performance, *i.e.* through scoring more than 50 percent.

It is possible, and quite likely, that many companies' actual performance is better than this study indicates, since the analysis is based solely on publicly-available information. If this is the case, we would encourage those companies to significantly improve their reporting on how they manage supply chain labour standards. In so doing, they will go some way toward deflecting criticism levelled by pressure groups and other stakeholders concerned about these issues. We would, however, caution against companies producing reports that do not accurately portray or reflect actual commitment or performance, especially on recognised key company or sector-specific issues.

If, on the other hand, the level of companies' reporting broadly captures the nature and extent of their management of supply chain labour standards, many need to improve significantly their activity in this area to improve their currently poor performance. The effective management of this aspect of corporate responsibility is dependent on its integration into companies' day-to-day business practices.

It is clearly counterproductive for responsible supply chain management processes to be disconnected from – or even in conflict with – parallel buying processes, forecasting or inventory management systems that do not incorporate a consideration of their effects on workers' labour standards. We believe that those companies that seek to align responsible

supply chain management with operational management will be better able to address a clear and growing business risk as well as to demonstrate their responsibility to their stakeholders to minimise the adverse impacts of their business.

The relatively strong performance of most ETI member companies appears to indicate that membership of this cross-sectoral initiative can help companies to improve their performance and reporting on managing supply chain labour standards and to develop working relationships with key stakeholders, both in the UK and in their source countries. We would therefore encourage other companies to consider joining the ETI.

Readers are strongly encouraged to visit the Gradient website at www.gradient-index.net where the full results are available. Using this online tool, the weighting of each section can be changed to reflect the user's own views regarding the relative importance of governance, codes, management, stakeholder engagement and auditing and reporting in the management of labour standards in the supply chain.

Insight hopes to have the opportunity to discuss companies' results with them in the coming months to encourage them to demonstrate that they are working on ensuring their suppliers uphold international labour standards. AccountAbility will continue to provide support to its members to do the same.

Annex: Assessment criteria

1. Governance and risk management (20%)

1.1 Board-level responsibility for ethical issues in the supply chain

There is a formal executive board sub-committee with explicit responsibility for ethical issues in the supply chain.

There is an executive board member with explicit responsibility for ethical issues in the supply chain.

There is an executive board member or committee with responsibility for CSR issues, but it is not clear if this includes responsibility for ethical issues in the supply chain.

There is no evidence of responsibility at executive board level for ethical issues in the supply chain either specifically or as part of responsibility for CSR issues.

1.2 Reporting of social, environmental and ethical (SEE) issues as a risk factor

There is evidence in the annual report and accounts of a systematic analysis of SEE issues as a risk factor.

There is mention in the annual report and accounts of SEE issues as a risk factor.

There is mention on the corporate website or in other corporate material of SEE issues as a risk factor.

There is no mention of SEE issues as a risk factor.

1.3 Risk analysis of ethical issues in the supply chain

A risk or exposure analysis of ethical issues in the supply chain has been conducted.

A risk or exposure analysis of ethical issues in the supply chain is yet to be conducted, but there is a stated commitment to undertake one.

There is no mention of conducting a risk or exposure analysis of ethical issues in the supply chain.

2. Code for labour standards in the supply chain (15%)

2.1 Quality and scope of the code for labour standards in the supply chain

There is a code for labour standards in the supply chain that covers all the issues of and explicitly references the ILO Tripartite Agreement and/or the ILO core conventions plus living wage.	<i>Reference to the ILO can be a reference to the ETI Base Code, as this code directly references the ILO core conventions. Where there is a code that covers only some of the issues of the ILO core conventions in a comparable manner and that does not reference the ILO core conventions, Tripartite Agreement or ETI, score is 0.</i>
A code for labour standards in the supply chain exists that covers some of the issues of the ILO Tripartite Agreement and/or all the core conventions without addressing the issue of living wage, and that references the ILO.	
A code for labour standards in the supply chain exists that addresses all the issues of the ILO core conventions and/or the ILO Tripartite Agreement in a comparable manner but without explicitly referencing the ILO.	
There is no code that addresses labour standards in the supply chain, or a code exists that addresses some of the issues of the ILO core conventions without reference to the ILO, or that does not address any of these issues in a comparable manner.	

2.2 Publication and availability of the code for labour standards in the supply chain

The complete code for supply chain labour standards is published.	<i>To score 100%, all the elements of the code must be published, rather than all the details surrounding its implementation.</i>
The code for supply chain labour standards is referred to in published information.	
The company will supply the code for supply chain labour standards on request, but there is no reference to it in published information.	
There is no evidence of a code for supply chain labour standards in published information.	

2.3 Application of the code for supply chain labour standards

The code for supply chain labour standards applies to the entire breadth of or almost the entire breadth of the supply chain, including the company's own procurement.	<i>Where a company sources branded products as well as own-brand products, the "entire breadth of the supply chain" is taken to refer to the supply chain for own-brand products.</i>
The code for supply chain labour standards applies to the entire breadth of or almost the entire breadth of the supply chain but does not apply to the company's own procurement.	
Application of the code is (clearly or deliberately) limited to the UK supply chain or to certain products or to selected suppliers or countries of supply.	
It is unclear how much of the supply chain the code for supply chain labour standards applies to, or there is no code addressing labour standards in the supply chain.	

3. Stakeholder engagement (15%)

3.1 Membership of multi-stakeholder processes

The company is a member of the Ethical Trading Initiative and/or is involved in a comparable initiative that includes input from both NGOs and labour.

The company is not a member of the Ethical Trading Initiative or of a comparable initiative including input from both NGOs and labour.

3.2 Engagement with NGOs and/or trade unions relating to labour standards in supply chains

There is evidence of stakeholder engagement over time with NGOs and/or trade unions (excluding membership of groups in 3.1) that includes delivery and/or engagement at site.

There is evidence of stakeholder engagement over time with NGOs and/or trade unions (beyond membership of groups in 3.1) in the host country (UK) only, or it is unclear where this engagement is based.

There is evidence of ad hoc stakeholder engagement with NGOs and/or trade unions (beyond membership of groups in 3.1), or it is unclear whether this engagement is taking place over time.

There is no proactive engagement with NGOs and/or trade unions beyond membership of groups in 3.1.

4. Management (25%)

4.1 Resource commitment

There is a senior manager whose primary responsibility includes labour standards in the supply chain. The manager is two or fewer reporting levels from the board.	<i>Evidence sought specifically of a senior manager rather than a senior management-level committee.</i>
There is a senior manager whose primary responsibility includes labour standards in the supply chain. The manager is more than two reporting levels from the board, or it is not clear how many levels from the board he or she is.	
There is no senior manager whose primary responsibility includes labour standards in the supply chain.	

4.2 Training for buyers

There is ongoing, scheduled training for buyers on labour standards in the supply chain.	
There is training for buyers on labour standards in the supply chain, but it is on an ad hoc rather than scheduled basis.	
There is no training for buyers on labour standards in the supply chain.	

4.3 Training in the country of supply

There is ongoing, scheduled training for personnel at the site of production on labour standards in the supply chain.	<i>"Personnel at the site of production" includes (but is not limited to) factory managers, factory workers and suppliers.</i>
There is training for personnel at the site of production on labour standards in the supply chain, but it is on an ad hoc rather than scheduled basis.	
There is no training for personnel at the site of production on labour standards in the supply chain.	

4.4 Reward and incentivisation

Incentives for senior management and/or procurement staff are explicitly linked to their performance on labour standards in the supply chain.	
Incentives for buying and/or ethical trading staff are explicitly linked to their performance on labour standards in the supply chain.	
Incentives for labour teams are explicitly linked to their performance on labour standards in the supply chain.	
There is no mention of incentives that are linked to labour standards in the supply chain.	

5 Supply chain auditing and reporting (25%)

5.1 Commitment to auditing labour standards in the supply chain

There is a policy committing to auditing labour standards across the entire breadth of the supply chain.	
There is a policy committing to auditing, to ad hoc auditing or to pilot audits of labour standards across at least part of the supply chain, or the level of commitment to auditing labour standards in the supply chain is unclear.	
There is no evidence of a policy committing to any form of auditing labour standards across any part of the supply chain.	

5.2 Status of the audit schedule

An auditing work plan has been scheduled and is currently being implemented.	<i>“Work plan” refers to a schedule for auditing labour standards in the supply chain.</i>
An auditing work plan has been scheduled but has not yet been implemented.	
There is no scheduled work plan for auditing labour standards in the supply chain, or there is no auditing of labour standards in the supply chain.	

5.3 External verification of labour standard audits

There is third party involvement that includes systematic input from NGOs and/or labour in the country of supply into the verification of labour standard audits.	
There is third party involvement that includes ad hoc input from NGOs and/or labour in the country of supply into verification of labour standard audits, or it is unclear how systematic this involvement is.	
There is third party involvement in the verification of labour standard audits, but there is no input from NGOs or labour in the country of supply.	
There is no external verification of supply chain labour standard audits.	

5.4 Transparency of the labour standards auditing methodology

The supply chain labour standards auditing methodology is publicly-available and follows generally accepted practices and/or at least one explicit external standard.	<i>An example of an explicit external standard is the SA8000 standard.</i>
The auditing methodology is not publicly-available and/or is not grounded in a generally accepted practice and/or external standard, or there are no audits of labour standards in the supply chain.	

5.5 Competencies of audits of labour standards in the supply chain

Audits of labour standards in the supply chain are carried out by auditors or assessors with specialist qualifications and/or knowledge in all or some cases.	
Audits of labour standards in the supply chain are carried out by auditors or assessors without specialist qualifications and/or knowledge, or the specialist qualifications and/or knowledge of auditors are/is not specified.	
Audits of labour standards in the supply chain are carried out on a self-assessment basis only.	
There is no specification of the competency of auditors or assessors and/or of the type of audit employed of labour standards in the supply chain.	

5.6 Reporting the results of audits of labour standards in the supply chain	
There is full and complete disclosure including quantitative analysis of audit findings at the factory or supplier level.	
There is some disclosure and analysis of audit findings at a factory or supplier level.	
There is full and complete disclosure and quantitative analysis of aggregate audit findings.	
There is a broad commentary on aggregate audit findings, but no figures are disclosed.	
There is no discussion of audit findings.	

5.7 Dealing with non-compliance	
There is a policy for handling instances of non-compliance with the code, and this policy includes a staged approach to dealing with violations.	
There is reference to handling non-compliance with the code. Details of how this is handled are given, but there is no indication of a staged approach to dealing with violations of the code.	
There is reference to handling non-compliance with the code, but there are no details of the approach used.	
There is no mention of dealing with non-compliance with the code.	

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