

# Labour and Human Rights Risks in Supply-Chain Sourcing

Investment risks in  
S&P/ASX200 Consumer Discretionary  
and Consumer Staples companies



This study was commissioned by  
the Australian Council of Superannuation Investors and  
prepared by Regnan - Governance Research and Engagement.

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## Australian Council of Superannuation Investors

The Australian Council of Superannuation Investors (ACSI) provides independent research and advice to assist its member superannuation funds to manage environmental, social and corporate governance (ESG) investment risk. ACSI believes effective governance structures and processes decrease risk and potentially increase returns, because they create stability that supports the development of long-term investment strategies. ACSI's research platform serves to underpin policy positions and raise awareness of emerging governance issues. ACSI is owned by 35 superannuation funds who collectively manage over \$350 billion in assets.

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# Foreword

**The Australian Council of Superannuation Investors (ACSI) is pleased to introduce *Labour and Human Rights in Supply-Chain Sourcing: Investment risks in S&P/ASX200 Consumer Discretionary and Consumer Staples companies*. This research marks the third in a series of reports released by ACSI on the topic of labour and human rights (LHR) risks in S&P/ASX200 companies. It was commissioned by ACSI and undertaken by Regnan Governance Research & Engagement.**

Institutional investors recognise that an increasingly globalised marketplace entails increasingly complex inter-jurisdictional risks. Risk management issues now extend well beyond domestic borders, and the level of interconnectedness in global media means that companies and investors are now subject to the scrutiny of a much wider and better informed global audience. Companies are more frequently questioned about their stakeholder management practices, particularly where they operate in jurisdictions that are less transparent in their governance and LHR requirements. In this environment, opacity around disclosure and stakeholder relations poses a significant reputational risk to all Australian companies with expanding international supply-chains.

Such concerns have been particularly relevant to companies in the Consumer Staples and Consumer Discretionary sectors, which include many of Australia's best-known household brand names, built upon the trust of generations of consumers. Over the past decade, many companies in this highly competitive sector have shifted sourcing low-cost inputs from a range of developing overseas markets.

As highlighted by recent tragic incidents in some of these markets, the magnitude of LHR risks from these supply-chain sourcing patterns is a cause for deep concern from an investment as well as a broader humanitarian perspective.

In the context of investment, ACSI believes that poor management of stakeholders, both directly and via supply-chains, impacts upon the commercial success, stability and longevity of a company. Issues of LHR contraventions can impact upon companies' reputations, disrupt operations and potentially lead to adverse legal consequences. Ultimately these consequences threaten shareholder value and represent investment risks that need to be addressed.

As such, investors expect the companies in which they invest to guarantee, at a minimum, adequate processes and safeguards to ensure that all workers and other stakeholders in their expanded supply-chain are afforded basic human rights. In the context of employees, this extends to include labour rights such as protection against forced labour, child labour, provision for health and safety and freedom of association. Where companies utilise vast and complex supply-chain relationships in their operations, investors expect companies to enforce these same protections across those supply-chains, assuring the same standard of LHR is afforded to all stakeholders.

ACSI has therefore commissioned this research through Regnan to provide insight into the sourcing trends and risk management disclosure levels of Consumer Staples and Consumer Discretionary companies in the S&P/ASX200.

This report is the third research piece published by ACSI with regard to LHR issues. The first paper, *Supply-Chain Labour and Human Rights – S&P/ASX200 and Global Company Policies*, was released in December 2011 and benchmarked selected supply-chain LHR disclosures of ASX200 companies with respect to a global peer group. The results, in summary, showed Australian companies significantly lagging behind global peers from the United Kingdom, United States and Asia Pacific in terms of supply-chain LHR policy disclosure and implementation.

In May 2012 ACSI released *Labour and Human Rights in Corporate Australia – Policy and disclosure among the S&P/ASX200*, which looked at Australian companies' disclosure of LHR standards as applicable to direct employees. The research measured disclosure of various LHR indicators across each sector, with reference to corresponding levels of recorded LHR incidences in those sectors. The report found high levels of reporting regarding prohibition of discrimination and health and safety, but low levels of disclosure regarding other key LHR standards. Importantly, the report showed low levels of LHR policy disclosure among a number of sectors, including Consumer Staples and Consumer Discretionary.

ACSI commissioned this third research report to provide a deep dive into the supply-chain LHR risks in the Consumer Staples and Consumer Discretionary sectors due to concerns around the low levels of LHR transparency in these sectors identified in previous research. This was coupled with increased levels of consumer awareness and media attention on the supply-chain sourcing practices of these sectors.

The research is primarily based on public disclosures by the 34 companies concerned, as this remains the key mechanism for transparency and accountability for investors. The research also features compelling analysis of the fundamental changes in Australia's aggregate trading patterns, in particular the exponential growth in sourcing of products and services from Less Developed Countries (LDCs) as the relentless drive by companies to reduce input costs has persisted over the past decade.

ACSI hopes the findings of this research motivate companies in this sector to improve their risk management and disclosure practices as a matter of the highest priority. The research will also highlight to investors that there are significant and multi-faceted concerns around the LHR standards in the supply-chain of Australian Consumer Staples and Consumer Discretionary companies that need to be factored into the company analysis and engagement process.



Image by Ron Tandberg as featured in *The Age*, 30 April 2013

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# 1. Executive Summary

This report builds on previous research commissioned by ACSI into Labour and Human Rights (LHR) risks linked to company supply-chains, management of which is increasingly complex as efforts to pursue cost savings shift out-sourcing to lower wage economies and regions.

Given increasing exposure to these risks with extended supply-chains and use of intermediaries, investors need to be assured that the companies in which they invest are proactively identifying and addressing supply-chain LHR risks. The investment case for advocating improved management of LHR risks includes potential for operational impacts and disruptions to supply, reputation and brand damage, and long-term legal actions.

The research conducted by Regnan focused specifically on the Consumer Staples (CS) and Consumer Discretionary (CD) sectors of the S&P/ASX200. The research is based on findings of a report commissioned by LUCRF Super and ACSI through MSCI in 2012, which found these sectors to be lagging on implementation of controls to manage supply-chain LHR risks. A focus on the CS and CD sectors enabled detailed analysis at the company level, including development of more granular exposure assessments across the 34 companies included in the study, as well as analysis at the sub-sector level.

Research was also conducted into regional sourcing patterns underpinning supply-chain strategies, which fed into assessment of individual company exposures. Drawing on Australian trade data, a number of trends in sourcing were identified:

- In 2012 total goods imported from non-OECD countries were on par with goods imported from OECD countries.
- China remains the dominant source of products relevant to CS and CD companies, although sourcing is increasingly shifting to Less Developed Countries (LDCs).
- The largest increases in imports were recorded from Bangladesh, Cambodia and Vietnam: Imports from Bangladesh increased 15 fold between 2006 and 2012, imports from Cambodia increased six-fold and imports from Vietnam increased by a factor of approximately 2.7.

Detailed assessment of products and sourcing patterns showed highly variable exposure to LHR risks at the sub-sector level however. Most exposed are the Food and Staples retailing, Retail, Food and Beverage, and Consumer Durables sub-sectors, though considerable variability is apparent within these sub-sectors. Analysis also revealed a lack of depth in company responses to LHR risks. Some findings in the rates of policies and systems disclosed include:

- 38 per cent of all companies have a publicly disclosed supply-chain LHR policy.
- Child Labour and Forced Labour policies are disclosed by 30 per cent of companies.
- Only one third of companies in the sample disclosed supplier audits or risk assessments.
- Supplier blacklisting and membership of industry groups are the least cited systems at three per cent each, as well as board oversight of LHR issues at zero per cent.



Where controls are evident, these are generally limited to policies; disclosure of supporting systems in place to implement policies is largely absent (with the exception of Food and Staples retailers), suggesting that some LHR supply-chain strategies lack substance. Non-compliance with stated policies is therefore a significant risk. An alternative view is that LHR policies may be public relations-driven in some companies within this group. Further, benchmarking of controls against OECD multinational guidelines confirms previous research indicating that Australian CS and CD companies lag peers in Europe and North America.

From a risk management perspective, these companies may not be sufficiently prepared to enter new markets in which there are increased LHR risks or where consumers have higher expectations of performance and transparency on supply-chain LHR risks. Furthermore, changing expectations in existing markets may not be being adequately addressed. Enhancement of internal processes and supplier controls to improve labour standards is therefore prudent.

Whilst consumer awareness of LHR issues in supply-chains remains low in Australia relative to Europe and North America, there is some evidence that awareness is increasing, driven by media, Non-Government Organisations (NGOs) and exposure to international retailers through on-line shopping. This increased consumer awareness is likely to result in greater scrutiny of companies in these sectors.

## 2. Introduction

Improvements in transport, logistics, and information and communications technologies have in recent decades enabled companies to look further afield to secure lower-cost inputs and products. Along with economic reforms (such as relaxation of trade barriers), this has led to longer and more complex supply-chains – even for formerly difficult-to-source inputs (e.g. bulky or perishable goods).

Both the wide product range and the lower (real) prices enabled by these developments have become entrenched in consumer expectations. Domestic production can no longer meet demand for many items of foods, clothing or household goods (including electronics). This reinforces the pressure on companies to seek out supply in increasingly lower cost jurisdictions.

Lower wage structures are a key factor in low-cost supply of manufactured goods. These are often to be found in jurisdictions with less well-developed LHR safeguards and norms<sup>1</sup>. Even where regulations do exist, enforcement can be poor, and the lack of economic alternatives can mean workers are unwilling or unable to challenge non-compliance.

Meanwhile, increased complexity of supply-chains has made it more challenging for companies to monitor or influence supplier practices. This is especially difficult for companies in the CD and CS sectors with extended product supply-chains, given the volume and variety of inputs.

LHR risks are also particularly pertinent for CD and CS sectors, given the relevance of reputation for brands with which Australian consumers interact on a regular basis. Supply-chain concerns frequently attract global attention, with household names often implicated as involved or complicit. Aside from reputational impacts, costs to business can include diversion of management resources and supply disruptions, for instance, through time spent dealing with forensic or government enquiries, or protracted NGO campaigns. The case studies on page 11 provide insights into how Supply-chain risks have manifested.

This report examines investment risks from LHR issues associated with product sourcing by CD and CS companies, building on previous research commissioned by LUCRF Super and ACSI<sup>2</sup>. It compares CD and CS companies within the S&P/ASX200, referencing the extent to which oversight and risk management practices in each are commensurate with their LHR risk exposure<sup>3</sup>.

We focus specifically on sourcing of physical products rather than services, noting that outsourcing practices associated with service-related supply-chains are distinct from those associated with product sourcing, and that exposure to these services is generally low among companies in the target sectors<sup>4</sup>.

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<sup>1</sup> E.g. Rexha & Miyamoto (2000), *Journal of Supply Chain Management*, looked at international sourcing trends in Australia notes that “Problems arise from geographical distance and an absence of shared social and commercial cultures between trading parties”.

<sup>2</sup> ACSI & LUCRF Super, *Labour and Human Rights Standards in Corporate Australia*, 2012

<sup>3</sup> Wider human rights, for instance those of local communities, are outside the scope of this report.

<sup>4</sup> Potential exposure to service-related LHR risks is apparent in at least one gaming stock in the Hotels subsector.



## Consumer Staples and Consumer Discretionary defined

The sector definitions Consumer Staples and Consumer Discretionary are derived from the Global Industry Classification Standard (GICS), a global framework used by the market under providers and exchanges to classify companies within and across key markets indices.

The Consumer Staples (CS) sector refers to companies providing food, beverage, and staple goods purchased regularly and out of necessity. Demand for these products is relatively inelastic, but the Australian market exhibits competition on price. Consequently, CS companies face low margins, and must have access to price efficient and stable supply-chains.

The Consumer Discretionary (CD) sector is widely diversified, and includes manufacturers, retailers, and service providers. The range of products and services provided by S&P/ASX200 CD companies includes clothing, electronics, leisure goods, household goods, media, and gaming. The sourcing characteristics and needs of these companies are similarly varied.

## Business risks from LHR issues

LHR issues within the supply-chain are likely to manifest as reputational risks, operational risks, or legal risks, all of which have the potential to impose costs or constraints on companies.

### Reputational risks

The significant expenditures made by CS and CD companies on brand advertising and public relations indicate the relevance of brand and reputation to enterprise value. These assets may be vulnerable to increased consumer awareness of LHR issues.

A February 2013 study released by Oxfam<sup>5</sup> suggested that 75 per cent of Australians do not feel there is enough information about sourcing of food and drink products and how they are made, 52 per cent considered a company's ethical credentials when choosing among different food and beverage brands and 46 per cent would stop buying their favourite food and drink brand if they knew the company did not have ethical practices and policies.

*"We want our customers to have trust in the company and our products...our customers are taking our products into their homes, so we do not want to risk anything that might erode that trust."*

*Corporate Responsibility and Sustainability Manager, Australian retailer*

Social media has also become an outlet for discussion and information sharing on global supply-chains and labour standards. Websites such as Slaveryfootprint.org and Avoidplugin.com seek to promote awareness among consumers of the implications of their buying behaviour.

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<sup>5</sup> Oxfam, *Behind the Brands*, 2013

It is important to recognise that reputation risks can manifest regardless of a company's culpability in LHR incidents or transgressions. For instance, in seeking to underscore the relevance of an international story to a local audience, media reports frequently link distant events to local household names<sup>6</sup>. More generally, reputation can be subject to contagion effects, whereby negative sentiment is generalised to a wider product group, industry or region.

A company's ability to demonstrate prior evidence of a robust approach to LHR issues may be an important defence in such circumstances.

### Operational risks

Serious incidents can result in worker unrest or shutdowns and disrupt security of supply, and poor working conditions or worker disengagement can affect product quality.

Disruptions to supply can prove particularly costly to businesses in terms of lost management time dealing with such crises, but also particularly if consumers establish alternative purchasing habits (e.g. a substitute product or retailer) that persist beyond the duration of any disruption.

*"...The brands or retailers who had contracts with the Tazreen factory in Bangladesh would have seen their supply disrupted, as that fire killed over 100 workers and the factory burnt down."*

Corporate Responsibility and Sustainability Manager, Australian retailer

### Legal risks

Some labour rights and human rights are protected under law, with companies found to be complicit in breaching those rights subject to prosecution in certain jurisdictions. Regulatory shifts aimed at harmonising trade conditions could see the expansion of "extra territorial" regulation as has been evident in other areas of transnational regulation (e.g. foreign bribery). For instance, the *US Fair Labour Standards Act and the Transparency in Supply-chains Act* seek to affect practices beyond its borders<sup>7</sup>.

Further legal risks could arise through increased NGO activism that seeks to hold companies to their ethical claims. In March 2013 three French rights groups were reported to be suing Samsung for deceptive trading practices, citing the disparity between the high ethical standards Samsung claims to uphold (and for which it benefits financially) and the poor labour practices alleged by New York-based China Labour Watch. If successful, the lawsuit "could set a precedent with new implications for companies whose suppliers breach labour laws"<sup>8</sup>.

Oxfam Australia similarly committed to report misleading advertising to the Australian Competition and Consumer Commission (ACCC) after one company denied the use of sandblasting in its supply-chain whilst advertising sandblasted denim products to consumers. The company involved responded with a commitment to phase out sandblasting, averting Oxfam's report to the ACCC.

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<sup>6</sup> E.g. "The November fire at the Tazreen garment factory drew international attention... The factory made clothes for Wal-Mart, Disney" [http://www.afr.com/p/world/bangladesh\\_building\\_collapse\\_kills\\_NwpweREXm7lfgqNi6fFARO](http://www.afr.com/p/world/bangladesh_building_collapse_kills_NwpweREXm7lfgqNi6fFARO)

<sup>7</sup> The US Fair Labour Standards Act includes a "hot goods" provision, prohibiting the transport or sale of goods produced in violation of minimum wage, overtime paid, child labour or special minimum wage provisions. This places an onus even on those merely transporting goods to assure themselves of the labour standards associated with their cargo. The Californian Transparency in Supply Chains Act requires retailers and manufacturers with annual global revenue of US\$100m or more to disclose (among other things) whether audits of suppliers are conducted, and whether suppliers are required to certify that their components or materials are not associated with slave labour.

<sup>8</sup> Financial Times, 2013 <http://www.ft.com/cms/s/0/2b6d8012-83e0-11e2-b700-00144feabdc0.html#axzz2PXuelvZe>

### 3. Case Studies

Examples of business impacts from LHR issues illustrate evolving community expectations about the roles and responsibilities of companies in influencing practices within their supply-chains.

Year	Company	Description
1990s	Nike	<p>Nike was among the pioneers of retail outsourcing, with no production in its own factories. In the 1990s, Nike attracted criticism and NGO calls for consumer boycotts owing to the conditions in factories producing Nike-branded products resembling those of sweatshops, with workers, including children, enduring hazardous surroundings under very low wage conditions.</p> <p>Nike initially denied the allegations, and later in the face of evidence, then denied responsibility for the conditions of workers from which it sourced products. However under sustained pressure from campaign groups, the media, and consumer boycotts, which affected the company's bottom line, Nike's approach to the issue shifted. By 2001, Nike director Todd McKean was able to describe the previous Nike attitude of "hey, we don't own the factories" as "irresponsible" and compared Nike's ability to influence labour standards with that of the leverage and responsibility Nike exercised over other standards (e.g. product quality)<sup>9</sup>. Nike now publishes a list of its suppliers, enabling NGOs and other stakeholders to independently verify the working conditions in Nike's supply-chain. It has also published some of its supplier audit reports.</p>
2006	Apple	<p>Apple has also been linked with LHR issues in its supply-chain, including reports of underage labour, forced labour, excessive working hours, and other poor working conditions. Worker suicides at the facilities of one of the company's biggest suppliers, Foxconn, have been reported since 2010. This led to a collaborative investor engagement focussed on both Foxconn and Apple, which resulted in further media coverage and investor scrutiny of practices at these facilities<sup>10</sup>.</p> <p>Apple ultimately committed to improving conditions in its supply-chain and to transparency about its performance. In 2011, Apple released a list of all of its global suppliers, as well as audit findings. More recently reports show significant progress in supplier compliance in some areas (e.g. maximum working week) and detail actions taken in response to breaches that have been revealed by audits (for instance, the actions taken to bring to justice a labour agent responsible for employing 74 underage workers at one supplier)<sup>11</sup>.</p>
2012	Sherrin	<p>In September 2012, reports emerged that Sherrin branded footballs were being manufactured in India by children subcontracted to hand-stitch Sherrin Auskick balls in dangerous (and illegal) conditions. Major customer, the Australian Football League (AFL), issued Sherrin with a breach of agreement notice (the agreement explicitly prohibited the use of child labour)<sup>12</sup>.</p> <p>Sherrin sacked four subcontractors linked with the child labour allegations immediately, and made arrangements for its footballs to be stitched at a different Indian factory. Sherrin offered alternative employment to the families previously sub-contracted to stitch balls in their homes and committed to providing them with continued employment under improved conditions and better wages, at its Indian manufacturer's factory. Sherrin also committed to finding alternatives for those who indicated they did not wish to work in a factory environment. Sherrin reported that it would post an Australian employee to India to oversee the situation for as long as was necessary<sup>13</sup>.</p> <p>The prevalence of child labour in sports equipment production in countries such as India is well documented, therefore this incident calls into question the quality of the third party audit arrangements in place in to detect non-compliance.</p>

<sup>9</sup> The News-Gazette, Champaign-Urbana, Illinois, 2001. <http://www.highbeam.com/doc/1G1-80410049.html>

<sup>10</sup> Boston Common Asset Management, 2012. [http://www.unpri.org/viewer/?file=wp-content/uploads/2012-04-19\\_PRI\\_webinar\\_on\\_Occupational\\_Health\\_and\\_Safety-Steven\\_Heim\\_v1.pdf](http://www.unpri.org/viewer/?file=wp-content/uploads/2012-04-19_PRI_webinar_on_Occupational_Health_and_Safety-Steven_Heim_v1.pdf)

<sup>11</sup> Apple. [http://images.apple.com/au/supplierresponsibility/pdf/Apple\\_SR\\_2013\\_Progress\\_Report.pdf](http://images.apple.com/au/supplierresponsibility/pdf/Apple_SR_2013_Progress_Report.pdf)

<sup>12</sup> Manufacturing Monthly, 2012. <http://www.manmonthly.com.au/features/sherrin-recalls-auskick-balls-ends-child-labour>

<sup>13</sup> Sydney Morning Herald, 2012. <http://www.smh.com.au/afl/afl-news/sherrin-employs-parents-of-ball-workers-20120928-26q15.html?skin=text-only>

Year	Company	Description
2013	Various	<p>In April 2013 a building housing five garment factories and thousands of workers, the Rana Plaza, collapsed in a suburb of Dhaka, in Bangladesh. An estimated 2,500 people were injured, the death toll exceeding 1,100. Companies and brands implicated include Canada's Loblaw, Denmark's PWT Group, Ireland's Primark, Italy's Benetton, Spain's Mango, and the USA's VF Corporation which owns brands such as Wrangler and Timberland.</p> <p>Prior to this incident, 110 garment workers were killed in Bangladesh in a November 2012 factory fire. Another 28 factory fires were reported, with at least 591 workers injured and eight workers killed, in the ensuing two months to 28 January 2013<sup>14</sup>.</p> <p>These brands, and others known to be sourcing from Bangladesh, have attracted widespread scrutiny and censure. There is also some evidence that campaigns targeted at consumer habits are ramping up, as well as mainstream Australian media articles examining the role of consumers in effecting change, although impacts on purchasing behaviour are as yet unclear.</p> <p>A number of European brands and PVH in the USA have signed up to a legally binding agreement, the Accord on Fire and Building Safety in Bangladesh, which includes regulations on safety inspections and requires retailers to pay for factory repairs<sup>15</sup>.</p> <p>In April 2013 Oxfam called on Target, Big W, Kmart and Cotton On (companies selling garments made in Bangladesh) to release the locations of their Bangladeshi suppliers, so their factories could be independently assessed and the companies held to account<sup>16</sup>. None has so far indicated they will disclose their supplier lists. Big W has clearly stated that it would not discuss its supplier details publicly. Kmart has reported a decision not to source from any new suppliers who have factories above marketplaces or in shared premises due to safety concerns<sup>17</sup>.</p> <p>Stricter and systematic safety inspections have begun in Bangladesh. On 8 May 2013 officials announced the shutdown of 18 garment factories for safety reasons<sup>18</sup>. Worker strikes also closed hundreds of other garment factories for up to a week in the aftermath of the Rana Plaza collapse.</p>

<sup>14</sup> Clean Clothes Campaign, *Fatal Fashion*, March 2013.

<sup>15</sup> The Australian, 2013. <http://www.theaustralian.com.au/business/world/big-brands-zara-and-hm-back-bangladesh-health-and-safety-plan/story-e6frg90o-1226642063640>

<sup>16</sup> The Age, 2013. <http://www.theage.com.au/comment/what-we-wear-is-really-to-die-for-20130503-2iyj7.html>

<sup>17</sup> ABC, 2013. <http://www.abc.net.au/7.30/content/2013/s3748694.htm>

<sup>18</sup> Channel News Asia, 2013 <http://www.channelnewsasia.com/news/asiapacific/bangladesh-shuts-18-garment-factories-af/667892.html>

## Past studies of company performance on LHR issues and supply-chains

Previous research suggests that assurances available to investors in S&P/ASX200 companies are partial at best and fall short of those provided by global peers.

Research undertaken by MSCI on behalf of LUCRF Super and ACSI in 2012 found that just 31 per cent of S&P/ASX200 CD and 63 per cent of CS companies disclosed a LHR policy for suppliers. By contrast, a FTSE (2012) study in the same year<sup>19</sup> identified global companies associated with these sectors<sup>20</sup> to be more advanced in implementing supply-chain labour management approaches than other subsectors, attributing this to the experience of CD companies as targets of early campaigns and criticism regarding supply-chain standards. The FTSE study also found that Australian companies lagged European and North American peers, with none of the eight Australian companies assessed demonstrating 'good' disclosure of action on supply-chain labour standards, and the majority demonstrating 'limited' or no disclosure of action.

The ACSI and LUCRF Super (2012) research suggests an increase over previous years in the number of companies providing assurances, but the overall picture of Australian companies lagging global peers has remained consistent. A separate study conducted for ACSI in 2011 examined 2508 companies<sup>21</sup> and found that Australian companies addressed LHR issues at half the rate of their global peers. While 34 per cent of companies globally disclosed a supply-chain LHR policy, and 30 per cent disclosed a system for implementing the policies; the comparable rates for Australian companies were just 17 per cent and 13 per cent respectively.

Higher levels of policy disclosure by CD companies globally (42 per cent) are commensurate with the increased risk generally associated with this sector over others. Not so for Australian companies, with just nine per cent of S&P/ASX200 CD companies having issued policies. This mismatch was also highlighted in an ACCA/Net Balance study of S&P/ASX200 disclosures (2011) which also identified CD companies as among the laggards within the Australian index<sup>22</sup>.

Against this background of poor relative disclosure practices, this study examines in more detail the risk profile of companies within the S&P/ASX200 CD and CS sectors. Analysis of supply-chains is conducted for individual companies based on products sourced, and the LHR risks to which each company would be exposed. It also identifies specific policies and practices in place to manage these risks, where these have been disclosed by the company. In doing so, it aims to build a more detailed picture for investors, and provides a basis for identifying risks to future returns within their portfolios.

The study is organised on the following basis:

- First, an analysis of the sourcing trends of CS and CD companies, in particular highlighting the exponential growth in sourcing from less-developed countries in Asia.
- Second, a discussion of the heightening risk factors implicit in this trend, in particular surrounding key LHR risks such as child labour, workplace health and safety, wages and working conditions for example.
- Thirdly, an assessment of the relevant risk exposures against the controls in place among companies on a sector and sub-sector basis across the sample.

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<sup>19</sup> FTSE, 'Brand value at risk: Defusing the supply chain labour reputation bomb', 2012

<sup>20</sup> Footwear, apparel, retail, home improvement and clothing & accessories subsectors

<sup>21</sup> ACSI, 2011 'Supply Chain Labour and Human Rights'

<sup>22</sup> ACCA/Net Balance, 2011 'Disclosures on supply chain sustainability'

# 4. Supply-Chain Sourcing Trends

## Complexity of the supply-chain

The supply “chain” may better be understood as a “web”. Production is often spread across a network of individual suppliers around the globe. Also notable is the rise of the ‘factory-less’ company, particularly in the retail sector, for which product design, branding and marketing is undertaken in-house and all production is outsourced.

A major complicating factor in tracing sources is the rise in the trade of complex intermediate goods such as processed sugar or steel, imported by developing countries for further processing and eventual export. These constitute more than 60 per cent of Asia’s total imports.

Supplier countries differ in the types of labour provided into the supply-chain; for instance, countries such as Japan tend to specialise in the export of products involving medium-to high-skilled labour, while for others, low-skilled, labour intensive activities dominate. Importantly however, membership of each group is far from static. Most recently, there have been reports of Chinese contracts moving to Bangladesh, Cambodia and other LDCs – chasing ever lower costs for products requiring low-skilled labour.

Subcontracting arrangements are common, whereby the supplier subcontracts to firms or individuals who may themselves subcontract work to others, often without the consent or knowledge of the original contracting company.

\*Excerpt from IDE-JETRO and World Trade Organization, *Trade Patterns and Global Value Chains in East Asia: From trade in goods to trade in tasks*, 2011

A fundamental aspect of supply-chain risk arises from the geographic footprint of a company’s supply-chain. Overall trade volumes evidence clear and continuing shifts to countries with ever-lower labour costs. As comparatively low labour costs tend to be found in jurisdictions in which LHR protections are weaker, country exposure represents the main indicator of elevated exposure to LHR risks for any given product set.

## Australian reliance on ‘Factory Asia’

Australia has become increasingly reliant on imports, with a decrease in domestic manufacturing between 2003 and 2012<sup>23</sup> accompanied by an increase in imports of 91 per cent over the same period. Moreover a breakdown of trade composition shows that by 2012, goods imports from (poorer) non-OECD countries exceeded that of imports from OECD countries (Figure 1)<sup>24</sup>.

<sup>23</sup> Australian Bureau of Statistics, *5206.0 National Accounts and External Account*

<sup>24</sup> Data from DFAT publication ‘*Composition of trade Australia 2011-12*’



**Total goods import volumes split by OECD and non-OECD countries (AU\$m)  
2006-2012**

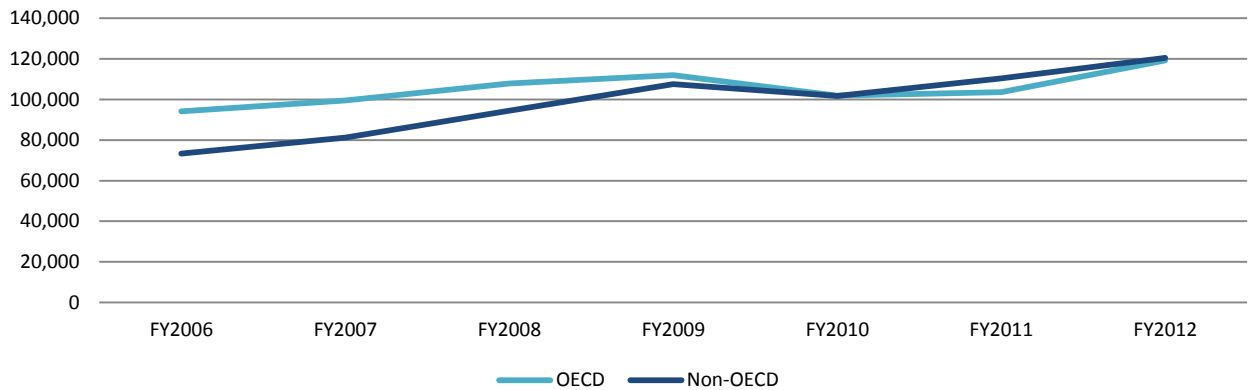


Figure 1

Total goods imported from non-OECD countries have steadily increased since 2006 and are currently on par with imports from OECD countries.

In 2012, Asia was the largest exporter of goods to Australia by geographic region after experiencing a 44 per cent growth between 2006 and 2012. This was predominantly accounted for by imports from North East Asia, Southern Asia, and South East Asia. For this reason, data presented below highlights imports from selected Asian countries (Appendix 3 provides a breakdown of regional imports to Australia). Within Asia (ex-Japan), the overwhelming dominance of Chinese imports (by value) is apparent (Figure 2)<sup>25</sup>.

**Total goods import volumes from selected Asian countries (AU\$m) 2006-2012**

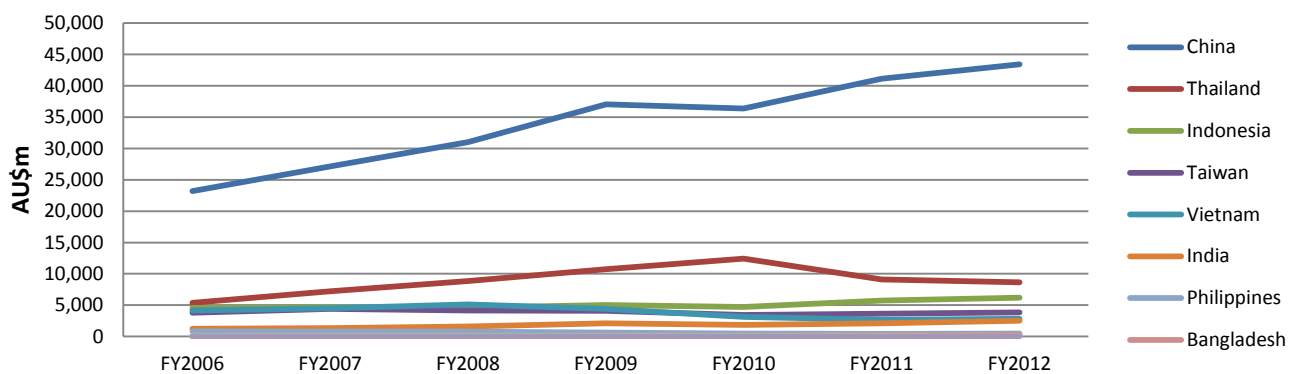


Figure 2

**Key points:**

- China continues to lead in total goods import volumes
- Thailand, Indonesia and Taiwan also continue to be leading import sources.

<sup>25</sup> Also excluded in Figure 2 are Bhutan, Brunei Darussalam, East Timor, Laos, Maldives, Mongolia, Nepal, North Korea and all countries in Central Asia.

## Rapid growth in sourcing from LDCs

While China continues to dominate total trade in goods relevant for the CS and CD sectors (i.e. garment, electronic, and food products) trade data indicates that slowing growth in these products from China (and Thailand) since 2009<sup>26</sup> was accompanied by an increasing proportion of consumer product imports from Lesser Developed Countries (LDCs)<sup>27</sup> (Figure 3). Real wages in China more than tripled between 2000 and 2010 according to the ILO Global Wage Report 2012/2013<sup>28</sup>, a key factor driving out-sourcing to low-wage LDC economies.

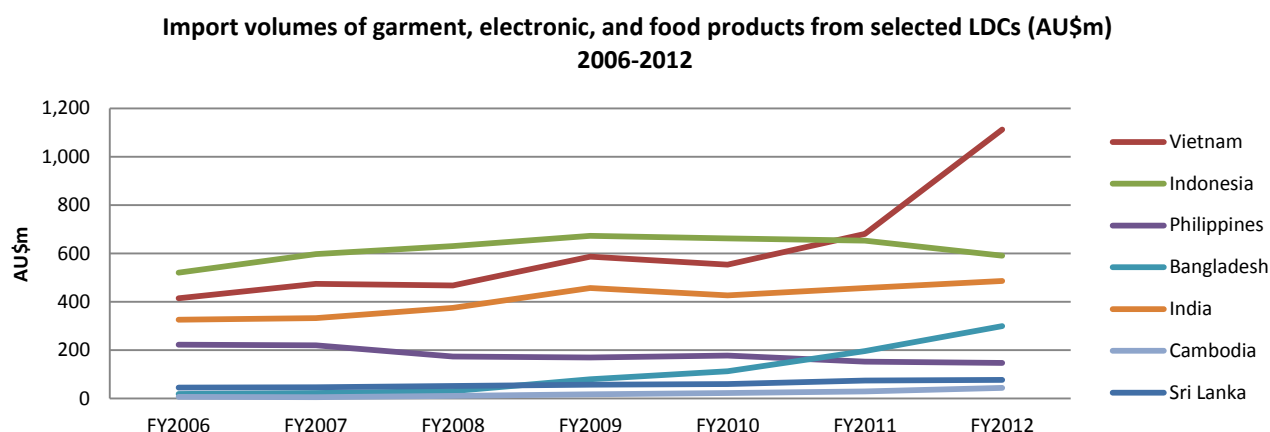


Figure 3

Between 2006 and 2012, annual imports increased as follows:

- from Bangladesh increase 15 fold (driven largely by clothing)
- from Cambodia increase six-fold
- from Vietnam increase by a factor of 2.68

Annual imports from Bangladesh increased nearly 15 fold between 2006 and 2012 from \$20 million to \$300 million, dominated by clothing (which increased over 20 fold). Cambodia's garment, electronic and food export volumes increased nearly six-fold in this period, albeit from a low starting point. Imports from Vietnam more than doubled over this period, from approximately \$415 million to \$1.11 billion representing a factor of 2.68, driven primarily by increased imports of telecom equipment, footwear, and seafood. The Philippines saw a decrease in its exports to Australia in the garment, food and electronic goods categories. The shift from China to still lower-skilled and lower-wage markets is a reminder that LHR risks in supply-chains are a constant that will continue to accompany such shifts as these countries too ultimately experience upward pressure on wages (and consequently prices) as has been the case in China over the last decade<sup>29</sup>.

...risks in supply-chains are a constant that will continue to accompany such shifts as these countries too ultimately experience upward pressure on wages...

<sup>26</sup> Year-on-year growth of imports of relevant products averaged 14.1 per cent between 2006-2010, but dropped to 3.7 per cent between 2010 and 2012 (source: DFAT trade data).

<sup>27</sup> The DFAT data breaks down exports from each country by commodity, which provides of a basis to adjust for changes in sourcing patterns of specific products and commodities relevant to the consumer discretionary and consumer staples sectors, by removing the effect of fluctuations of trade in crude petroleum, vehicles, minerals, and other commodities.

<sup>28</sup> International Labour Organisation, *Global Wage Report 2012/2013: Wages and equitable growth*, 2013

<sup>29</sup> International Labour Organisation, *ibid*.

# 5. Sourcing from LDCs

The changing sourcing patterns outlined in the previous section also have implications for LHR risks in the supply-chains of Australian companies. LDCs (and developed countries during their earlier stages of industrialisation) have tended to have less well-developed LHR protections, including both legal and other institutional mechanisms (such as labour organisations) and social/cultural norms.

Particularly in response to sudden demand growth, development can outpace the progress of institutional protections or corporate oversight mechanisms. This is particularly relevant for sourcing of the inputs supplied to CD and CS companies such as textiles, electronics, foodstuffs, home wares, and other product components as these have higher labour components relative to other inputs<sup>30</sup>.

In Bangladesh for example, it has been noted by advocacy groups that as enterprises compete to deliver new, large orders quickly and at low prices, management imposes extremely long hours on workers, sometimes by forcible means and without allowing breaks, whilst continuing to pay particularly low wages. Furthermore, the rapid expansion of the garment industry has meant infrastructure development has been outpaced. One garment retailer has noted that many manufacturing premises weren't originally built as factories, most are converted residential buildings, and are therefore cramped, lacking in fire exits, and suitable electrical infrastructure. This has led to repeated health and safety incidents, injuries and lives lost.

Safety issues are prevalent in many LDCs, as are issues such as bonded labour, trafficking, child labour in dangerous environments, and extensive working hours.

*"Sourcing patterns now mean that as a producer or retailer, you're moving into markets that are new and emerging and then you have to do the training and accreditation all over again."*

Responsible Supply-chain expert

In the context of distant and diffuse supply-chains, potential LHR issues are likely to become visible (and most costly) in the context of a high profile crisis. While inherently unpredictable, it is likely that the risks will be greatest when labour practices in the supply-chain most violate the norms and expectations of customers and stakeholders of exposed companies.

## Key LHR risks in LDCs

### Child labour

Child labour is prevalent in many developing countries<sup>31</sup>. Notwithstanding global conventions, it remains an important source of economic sustenance for many impoverished children and families.

The different contexts of developed-country expectations about child labour and the situation in LDCs where children are often required or encouraged to contribute to their household economically mean that child labour is among the likelier LHR issues to become problematic for Australian companies whose supply-chains span LDCs.

### Forced labour

Forced labour involves constraints on the autonomy of workers, for instance restricting freedom of movement, withholding wages or identity documents, use of coercion such as physical or sexual violence or threats, and/or requiring their labour to service debts or indentures that have been imposed without workers' free, prior, informed consent. It is generally accompanied by dangerous working conditions and poor compensation (if any).

<sup>30</sup> Case studies of companies impacted are discussed on pages 7-10 and the risks of sourcing from countries with lower LHR protection are discussed on pages 16-17 and in Appendix 4.

<sup>31</sup> E.g. UN Special Envoy for Global Education, *Child Labour & Educational Disadvantage – Breaking the Link, Building Opportunity*, 2012

The International Labour Organisation estimates that nearly three in every thousand people globally are victims of forced labour, with more than half of all victims (56 per cent) in the Asia Pacific region<sup>32</sup>. The ILO estimates that 25 per cent of victims of forced labour are children.

As with child labour, revelations that a company's low prices are facilitated by forced labour within its supply-chain have the potential to be very damaging to a company's reputation.

### **Health and safety**

Health and safety conditions are another area where legal and cultural differences can result in large gaps between the norms and practices of supplier countries and the expectations of customers and other stakeholders in developed countries.

Workplace deaths, in particular, can attract widespread scrutiny, particularly where cost pressures passed down the supply-chain have contributed to lack of safe equipment or safety training, dangerous or poorly maintained facilities or machinery, or dangerous manufacturing practices, for example.

### **Wages and working conditions**

Fair wage provisions can be a concern that can interact unpredictably with expectations of developed-country customers, as was seen in the Nike example. Some stakeholders expressed the view that Nike's previous practice of relocating to successively lower cost jurisdictions was a means to avoid providing workers with the improved wages and conditions they sought<sup>33</sup>.

While norms for wages, conditions and benefits differ across jurisdictions, experts in the field of labour rights emphasise that these should support a minimum standard of living. This often differs from legislated minimums<sup>34</sup>.

### **Freedom of association and collective bargaining**

Companies domiciled in places with strong cultural norms favouring freedom of association and collective bargaining may be at risk if they are sourcing from jurisdictions where workers are not guaranteed these rights. In practice, this is most likely to be problematic where the denial of these labour rights accompanies poor practices – such as unfair wages or conditions – which, without the ability to negotiate, workers have no means to redress. In the case of Lonmin workers in South Africa, workers denied a mechanism for negotiation took to protest as a means of effecting change. This was met with severe force, resulting in widespread unrest in neighbouring communities for an extended period of time<sup>35</sup>.

Some jurisdictions do not permit the right of association for any workers. In others, a range of factors can impede employees' ability to avail of their rights. Numerous reports indicate that employee representatives can experience persecution ranging from harassment through imprisonment and fatal physical attacks. Covert discrimination (preferring to hire non-union workers) is less visible but likely occurs with still greater frequency.

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<sup>32</sup> International Labour Organisation, 'ILO 2012 Global estimate of forced labour'

<sup>33</sup> Kellner, D., *The Sports Spectacle, Michael Jordan, and Nike: Unholy Alliance?*  
<http://pages.gseis.ucla.edu/faculty/kellner/essays/sportsspectaclemichaeljordan.pdf>

<sup>34</sup> E.g. ILO, *Estimating a living wage: A methodological review*, 2011

<sup>35</sup> Australian Financial Review, 2012. [http://www.afr.com/p/world/unrest\\_spreads\\_across\\_south\\_africa\\_KYCYg9rhbC6y4DAcRQpzK](http://www.afr.com/p/world/unrest_spreads_across_south_africa_KYCYg9rhbC6y4DAcRQpzK)

## **Discrimination, harassment, physical and sexual violence**

Harassment can take the form of physical abuse, sexual harassment, or psychological harassment, among others. Discrimination against migrant workers is common as is sexual harassment of female workers; both issues have led to worker unrest, strikes, and disruption in supply.

These trends are documented in OECD countries as well as LDCs, indicating that even where legislative protections exist for migrant workers, implementation of these protections are not necessarily ensured.

## **Key countries of concern**

Labour standards in non-OECD countries are generally lower than those in OECD countries<sup>36</sup>, however the LHR risk profile of each country differs according to its specific social, legal and economic contexts these differences in turn give rise to a unique set of issues and protections.

LHR issues have been identified throughout the Asian countries that dominate supply to Australian CS and CD companies. The table overleaf summarises key exports and known LHR risks for Asian exporting countries, given data which shows these countries are likely sources of product for companies considered in this report<sup>37</sup>.

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<sup>36</sup> FTSE, *'Brand value at risk: Defusing the supply chain labour reputation bomb'* 2012

<sup>37</sup> DFAT, *'Composition of trade Australia 2011-12'*

Table 1: Summary table

Country	Key exports	Key LHR risks									
		Child labour	Discrimination	Forced or bonded labour and trafficking	Freedom of association	Health and safety	Working hours	Wages	Harassment	Export Processing Zones	Sourcing agents
Bangladesh	Textiles	•	•	•	•	•	•	•		•	
Cambodia	Foodstuffs Leisure goods Textiles	•	•	•	•	•	•	•		•	
China	Electronics Foodstuffs Furniture Leisure goods Textiles	•	•	•	•	•	•	•		•	
Hong Kong	Electronics Leisure goods Textiles				•						•
India	Foodstuffs Leisure goods Textiles	•	•	•	•	•	•	•		•	
Indonesia	Electronics Furniture Leisure goods Textiles	•	•	•	•	•	•	•		•	
Malaysia	Electronics Furniture	•	•	•	•	•		•		•	
Pakistan	Foodstuffs Textiles	•	•	•	•	•		•	•	•	
Philippines	Electronics Foodstuffs Textiles	•	•	•	•	•					
Republic of Korea	Electronics Textiles				•					•	
Singapore	Electronics Foodstuffs		•	•							
Sri Lanka	Foodstuffs Textiles	•	•	•	•	•		•	•	•	
Taiwan	Electronics Furniture Leisure goods Textiles		•	•	•		•				
Thailand	Foodstuffs Furniture Leisure goods Textiles	•	•	•	•	•				•	
Vietnam	Electronics Foodstuffs Leisure goods Textiles	•	•		•	•	•			•	



# 6. Company Analysis

A summary of the risks for all countries listed in Table 1 from the previous section is provided in Appendix 4.

## Current sourcing practices of Australian companies

Table 2 below lists companies covered in this report which Regnan analysis has found are exposed to LHR risks through sourcing relevant products from high risk countries. The table is grouped by product, highlighting the likely countries from which product is sourced, and the companies linked with each product category. These sourcing locations were identified through analysis of DFAT data on trade by country and product category.

The largest exporters of each relevant product or commodity group have been identified, indicating likely sources for the CS and CD companies in the sample. It should be noted that products would also be sourced from countries additional to those recorded below as they have lower LHR risks (such as Europe or the USA); however these sourcing locations are not included. Further, companies with minor inputs sourced from high risk countries are not included in this list.

**Table 2: Product sourcing locations of CS and CD companies in sample**

Key product categories	Likely sourcing locations w/ LHR exposure (DFAT)	Key company exposures in CD/CS sectors
Electrical goods/appliances	China, Malaysia, Republic of Korea, Thailand, Taiwan, Vietnam	Aristocrat Leisure, Breville, David Jones, GUD Holdings, Harvey Norman, JB HiFi, Myer, Wesfarmers, Woolworths
Apparel/footwear/textiles	China, Bangladesh, India, Indonesia, Malaysia, Taiwan, Thailand, Vietnam	Billabong, David Jones, Myer, Pacific Brands, Premier Investments, Wesfarmers, Woolworths
Home wares and leisure products	China, Hong Kong, India, Indonesia, Malaysia, Pakistan, Republic of Korea, Taiwan, Thailand, Vietnam	Billabong, David Jones, Harvey Norman, Myer, Pacific Brands, Super Retail Group, The Reject Shop
Food products	China, Malaysia, Singapore, Thailand, Vietnam	Goodman Fielder, Metcash, Woolworths, Wesfarmers
Food commodities	China, Thailand, Brazil, Papua New Guinea	Coca Cola Amatil
Furniture/timber products	China, Indonesia, Malaysia, Thailand, Vietnam	Harvey Norman, Invocare, Myer, Woolworths

The media companies in the sample have been assessed as not materially exposed to international LHR sourcing risks, as have those in the hotels and gaming sector (with the exception of Aristocrat, which manufactures electronic gaming machines) and the consumer services companies (e.g. Navitas, Wotif.com), except Invocare who likely source wood internationally. This leaves 19 companies materially exposed to international LHR risks.

The majority of companies in the Food and Beverage, Food and Staples retailing, Consumer Durables and Retail sub-sectors are likely to be sourcing from locations with exposure to LHR issues<sup>38</sup>. Investors should therefore expect these companies to evidence sound controls to manage these risks.

<sup>38</sup> Some consumer staples and consumer discretionary companies are not included in this table because they have clearly disclosed sourcing from low risk countries only. These are: Treasury Wine Estates, which sources grapes from vineyards in Australia, New Zealand, North America, South America, and Europe only; Graincorp, which sources grain from Australia, the USA, Canada, Germany and the UK only; and Fleetwood Corporation, which manufactures caravans in Australia, and although is likely to source parts and components internationally, this was not deemed to pose material risk.

The analysis consists of company-level exposure assessments, incorporating assessment of product segments, sourcing locations, brand risk, and evidence of previous incidents in the company supply-chain. Benchmarks applied to assess company controls were developed with reference to recognised standards.

The companies covered include the CS and CD sectors of the S&P/ASX200 as at 31 March 2013 and number thirty-four companies in total.

An exposure score is assigned to each company based on the level of exposure to LHR issues in their supply-chains (5 highly exposed, 0 no exposure). Scores were also assigned for controls evidenced, determined with reference to policies and systems disclosed by the companies (5 best practice controls, 0 no controls were evidenced). Whilst the scores are used for benchmarking purposes only and are not directly correlated, companies' controls scores should generally be commensurate with exposure. A gap between the exposure and controls score (exposure > controls) suggests that risks may not be fully addressed. (A more detailed description of the methodology and scoring is provided in Appendix 5).

**Table 3: Sample CS and CD companies – sector and GICS classification**

Sector	Sub-sector	Company	GICS Industry	
Consumer Staples	Food, Beverage & Tobacco	Coca-Cola Amatil Ltd	Beverages	
		Goodman Fielder Ltd	Food Products	
		Graincorp Ltd	Food Products	
		Treasury Wine Estates Ltd	Beverages	
	Food and Staples Retailing	Metcash Ltd	Food and staples retailing	
		Wesfarmers Ltd	Food and staples retailing	
		Woolworths Ltd	Food and staples retailing	
	Consumer Durables	Consumer Durables	Fleetwood Corporation Ltd	Leisure Equipment & Products
			GUD Holdings Ltd	Household Durables
			Breville Group Ltd	Distributors
Aristocrat Leisure Ltd			Hotels Restaurants & Leisure	
Billabong International Ltd			Textiles, Apparel & Luxury Goods	
David Jones Ltd			Multiline Retail	
Harvey Norman Holdings Ltd			Multiline Retail	
JB Hi-Fi Ltd			Specialty Retail	
Consumer Discretionary	Retail	Myer Holdings Ltd	Multiline Retail	
		Pacific Brands Ltd	Specialty Retail	
		Premier Investments Ltd	Specialty Retail	
		Super Retail Group Ltd	Specialty Retail	
		The Reject Shop Ltd	Specialty Retail	
		Wotif.com Holdings Ltd	Internet & Catalog Retail	
	Diversified Consumer Services	Diversified Consumer Services	Flight Centre Ltd	Hotels Restaurants & Leisure
			Navitas Ltd	Diversified Consumer Services
			InvoCare Ltd	Diversified Consumer Services
	Media	Media	News Corporation	Media
			Seven West Media Ltd	Media
			Southern Cross Media Group Ltd	Media
			Fairfax Media Ltd	Media
			Ten Network Holdings Ltd	Media
Hotels Restaurants & Leisure	Hotels Restaurants & Leisure	Tatts Group Ltd	Hotels Restaurants & Leisure	
		Ardent Leisure Group	Hotels Restaurants & Leisure	
		Crown Ltd	Hotels Restaurants & Leisure	
		Echo Entertainment Group Ltd	Hotels Restaurants & Leisure	
		Tabcorp Holdings Ltd	Hotels Restaurants & Leisure	

## Current disclosure practices of Australian companies

This section presents results from company analysis, drawn from both company disclosure and externally sourced data and information.

### Overall controls vs. exposure

The scatter diagram below (Figure 4) plots exposure and controls for the thirty-four companies included in the CS and CD sectors. The diagonal line indicates where publicly disclosed controls are commensurate with LHR exposure in the supply-chain. Companies below the line to the right (towards the red corner) may not be sufficiently managing exposure based on their public disclosure and risk exposure assessment.

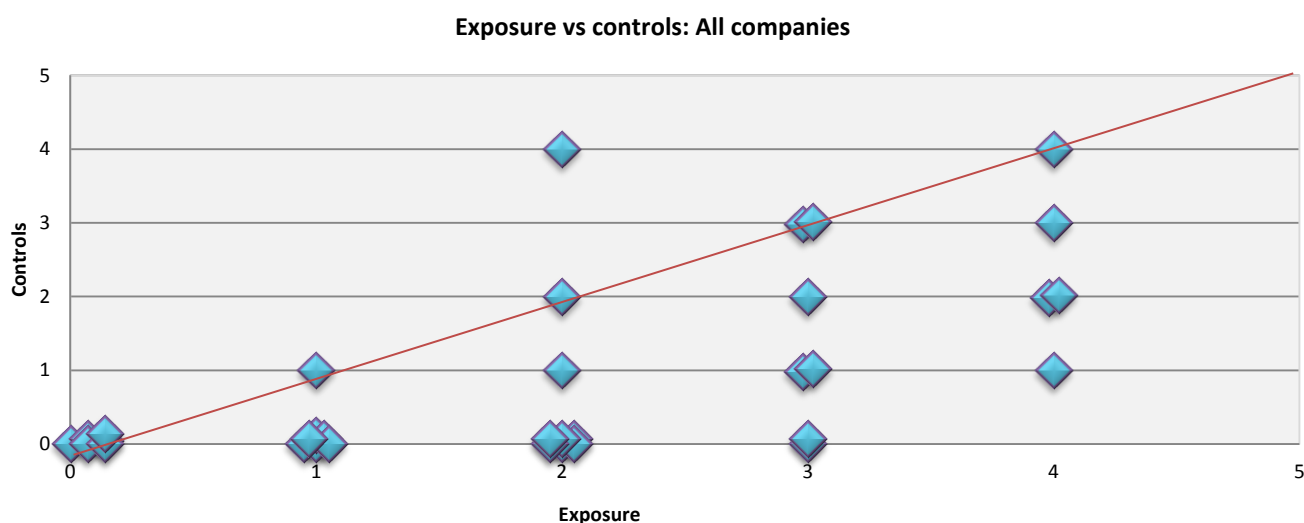


Figure 4

#### Key sample percentages:

- 62 per cent of companies with exposure score of more than 1
- 65 per cent of companies with greater exposure than controls
- 35 per cent of companies' scores indicate they have adequate controls to meet exposure or greater controls than exposure.

The majority of companies (22 out of 34) fall below the line, but it is worth noting that six of these are not sufficiently exposed to warrant concern (i.e. those with exposure scores equal to one or less).

The highly variable exposure to supply-chain LHR risks across the companies in this study is also apparent from this chart. Scores range from those most highly exposed at four, to those with exposure scores of zero. Likewise the level of management of LHR issues is variable, suggesting poor management of LHR risks in some cases (e.g. two companies with an exposure score of three but a control score of zero), or due to lack of exposure in particular companies (e.g. media, diversified consumer services, and hotels).

## Gap analysis: Sub-sector level

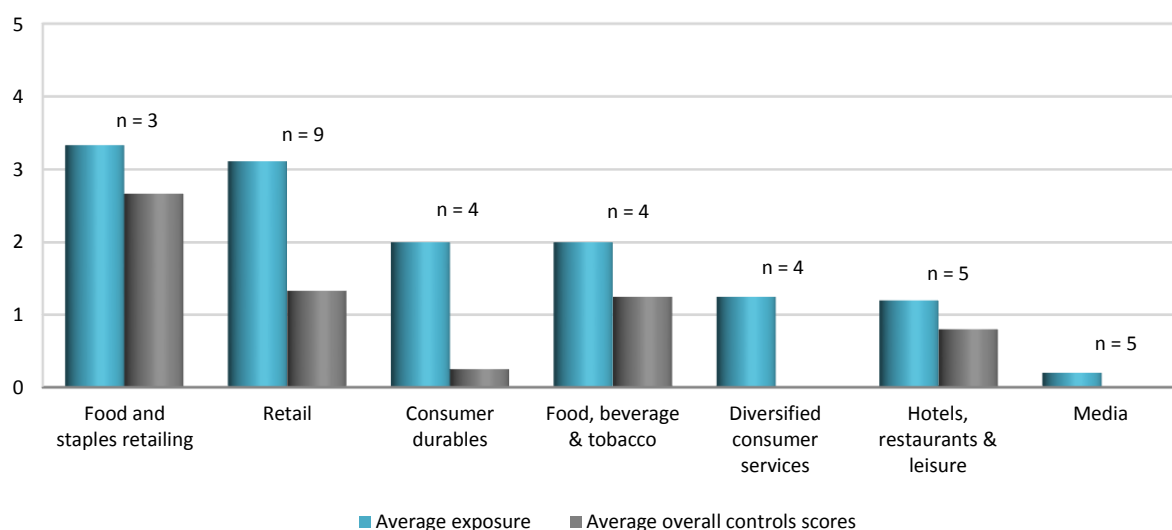


Figure 5

### Key sub-sectors of concern:

- Retail – 9 companies
- Consumer Durables – 4 companies
- Food & Staples Retailing – 3 companies
- Food, Beverage & Tobacco – 4 companies

To accommodate the diversity of companies across the CS and CD sectors, the companies were split by sub-sector. This facilitates comparisons across companies with similar business models (Figure 5). Whilst these sub-sector comparisons provide a more informed picture of relative risk as indicated by the gap between exposure and controls, variations in business models and the small data set limit the ability to draw definitive conclusions.

Nevertheless some general observations can be made. The gap analysis suggests sub-sectors most at risk to LHR issues in the supply-chain include Food and Staples retailers, Retailers, Consumer Durables and Food, Beverage & Tobacco companies.

The companies in the most exposed sub-sector, Food and Staples retailing, also evidence more extensive management controls. Exposure in this sub-sector is driven by wide-ranging product categories (both food and retail consumer products), high-risk sourcing locations, LHR incidents in the supply-chain, and increasing consumer awareness. The stronger controls in this sub-sector reflect significant brand risk, particularly for the major food retailers. Despite more extensive controls, risks remain in this sub-sector given increasing consumer attention to food sourcing.

*The Retail sub-sector shows a significant gap between exposure and controls, and therefore appears to be most at risk.*

The Retail sub-sector shows a significant gap between exposure and controls, and therefore appears to be most at risk. Exposure in this sub-sector is driven by high-risk products, namely clothing/garments, high-risk sourcing locations, brand value, and growing consumer awareness. Companies in this sub-sector evidence limited (sometimes non-existent) controls. Whilst the clothing retail sector in Australia has not been subject to the levels of scrutiny experienced in Europe and North America, risks associated with supply-chains are well-known in this sub-sector, hence risks could escalate in the event of a high profile incident (e.g. on the scale of the Bangladesh factory building collapse).

The Consumer Durables sub-sector also stands out due to very limited evidence of controls. Although exposure to LHR risks in their supply-chains varies in this sub-sector, controls should be further advanced.

The Food, Beverage and Tobacco sub-sector, in general, shows smaller gaps between exposure and controls, though considerable variation in controls is apparent across this group. Exposure here is driven by some high-risk products (namely primary agricultural commodities) and high-risk sourcing locations. Two of the four companies in this sector have very limited exposure.

The Food and Staples, Retail, and Consumer Durables sub-sectors are likely to be subject to higher levels of scrutiny and more likely to be targeted by NGOs or the press given product categories which are more readily tied to LHR issues in their supply-chains. These sectors also appear most prone to possible sub-contracting to LDCs and use of intermediaries in supply-chains, presenting challenges to implementation of effective control regimes.

However, the remaining sub-sectors have low exposure to LHR risks (i.e. exposure less than or equal to 1) given very little or no exposure to out-sourced products, and are therefore not considered in further sub-sector analysis.

### Policies disclosed

Figure 6 shows the percentage of all companies in the sample that evidence policies on LHR issues in management of supply-chains. Most apparent is the low level of controls evidenced in current disclosure; 38 per cent of all companies have a publicly-disclosed policy or acknowledgement of some type, a relatively low number given identified exposures.

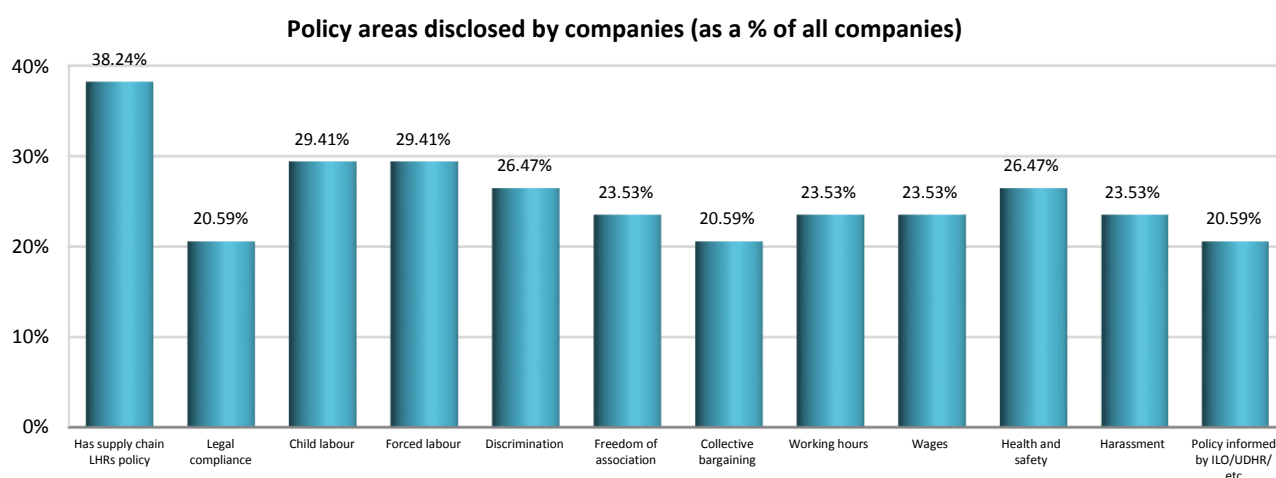


Figure 6

#### Policies most frequently disclosed:

- 38 per cent of all companies have publicly disclosed a supply-chain LHR policy
- Child Labour and Forced Labour are second most frequently disclosed supply-chain policies at 30 per cent
- Discrimination and Health and Safety supply-chain policies are disclosed by almost 27 per cent of the sample, followed closely by Freedom of Association, Working Hours, Wages and Harassment.

30 per cent of all companies specifically include child labour and forced labour in their supply-chain policies, and 27 per cent include discrimination. These are three of the four ILO core labour standards. The fourth standard, trade union rights (split into freedom of association and collective bargaining) is included by 24 per cent and 21 per cent of companies respectively. Evidence of specific policies relevant to other LHR issues is limited across the CS and CD sectors.

## Systems disclosed

The percentage of companies evidencing systems to implement LHR policies (Figure 7) suggests that follow-through is lacking among the majority of CS and CD companies. This is a key finding from the analysis, which suggests that some companies have not disclosed sufficiently advanced implementation programs to ensure compliance with stated policies.

...some companies have not disclosed sufficiently advanced implementation programs to ensure compliance with stated policies.

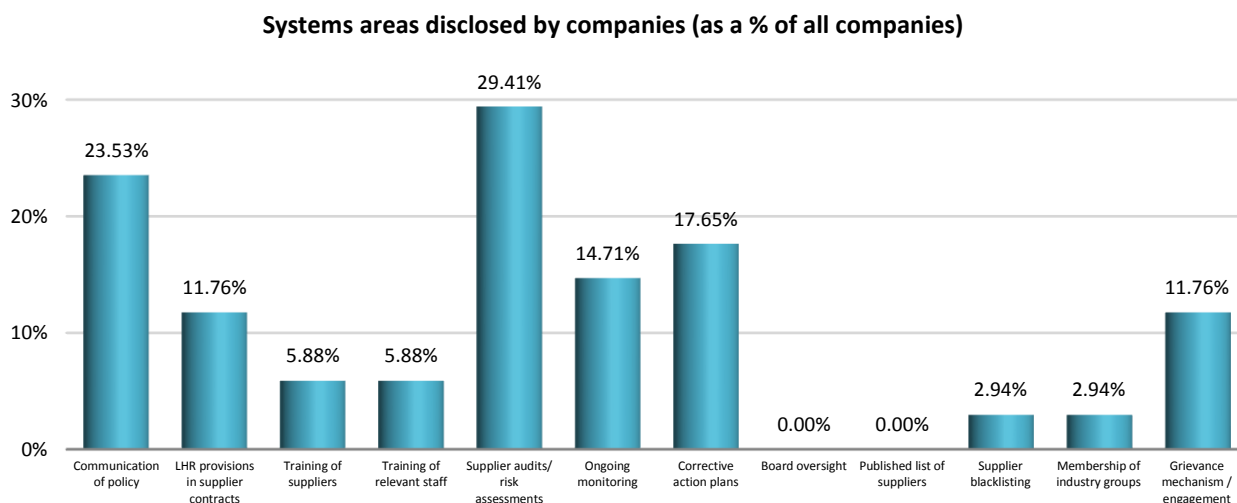


Figure 7

Systems areas most frequently disclosed:

- Almost 30 per cent of sample disclosed supplier audits/risk assessments
- 24 per cent cite communication of policy and 18 per cent disclose corrective action plans.
- Less than 15 per cent of companies disclose that on-going monitoring, grievance mechanisms or LHR provisions in supplier contracts are being pursued.
- Supplier blacklisting and membership of industry groups are least cited systems areas at 3 per cent.

The general lack of disclosure on systems implementation is apparent across most companies in the CS and CD sectors. Specific system controls most frequently disclosed include policy communication and supplier audits/risk assessments. Notably, board oversight of supply-chain LHR issues has not been disclosed by any of the companies in the study group.

...board oversight of supply-chain LHR issues has not been disclosed by any of the companies in the study group.

The absence of systems to implement LHR policies suggests the development of corporate responses to LHR issues in supply-chains remains at an embryonic level, reflecting minimal pressure from stakeholder groups and market actors to date. It is likely that supporting mechanisms to implement policies will emerge as market drivers to manage LHR risks strengthen, and consumer awareness increases.

It can also be interpreted that LHR policy development relating to supply-chains may be public relations-driven in some companies, particularly those companies which disclose policies but do not evidence systems of any kind.



## Exposure adjustments - Increasing consumer awareness

The exposure scores are informed by a number of factors including types of products sourced, brand value, and sourcing locations. Exposure scores are augmented by assessment of current consumer awareness about international LHR issues in the supply-chain, and the number or severity of any incidents reported in the company's supply-chain. Currently consumer awareness or activism is considered to be lower in Australia than Europe or the USA. Further, reporting of incidents related to the supply-chains of Australian companies has also been found to be low relative to European and US companies, though it may be that incidents associated with Australian companies are not investigated or reported as frequently.

However, consumer awareness and media interest appear to be on the rise. Additionally, Australian consumers are coming into contact with more European and US brands and companies through on-line shopping, some of which include clear statements on their websites about measures in place to manage LHR issues in their supply-chains. This trend is likely to intensify as on-line shopping continues to surge, which may act to both educate Australian consumers and raise expectations on supply-chain management for domestic brands and companies.

We illustrate the likely effect of increasing consumer awareness on company exposure (Figure 8), deduced from excluding the consumer brand awareness indicator from the overall scores, therefore mitigating the effect of the currently low levels of consumer brand awareness in Australia. This shows elevated exposure particularly for the Food and Staples retailing and Retailing sub-sectors. The Food and Staples retailing sub-sector warrants specific consideration given the heightened interest in the food importing practices of the major retail companies. Whilst the attention to food product imports has to date largely focused on food safety and the sourcing pressures on Australian farmers, wider supply-chain impacts are likely to draw attention in the future. Similarly, consumer awareness is likely to increase in the Retail sub-sector given increasing exposure to LDCs.

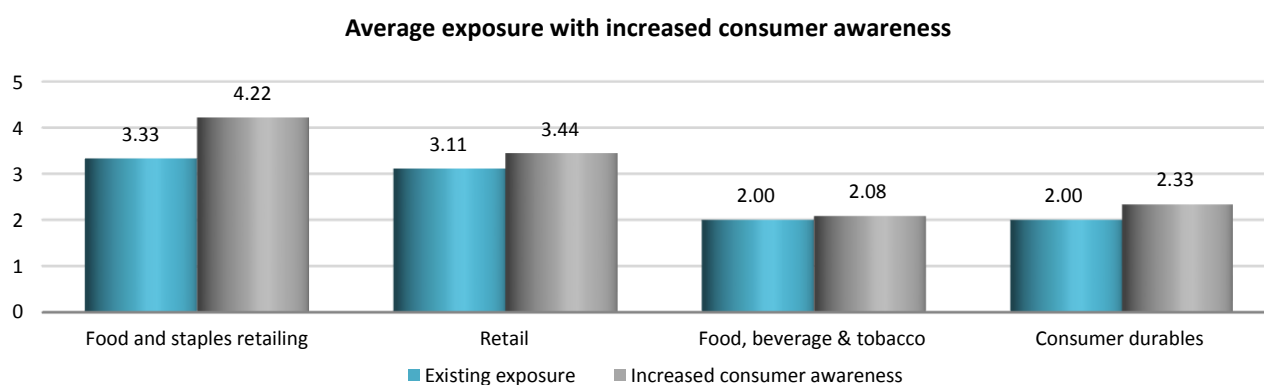


Figure 8

Increased consumer awareness most greatly impacts average exposure score of

- Food and staples retailing (exposure increased to over 4)
- Retail (exposure increased to approximately 3.5).

This illustrates the impact on Australian companies if Australian consumers grow to become as brand conscious as their counterparts in the US and Europe. Adoption of risk-based approaches to manage LHR risks in anticipation of consumer activism are particularly warranted in these sub-sectors.

## Comparison with international best practice

The OECD Guidelines for Multinational Enterprises, as discussed later in this report, provide overarching recommendations on management of human rights impacts in company supply-chains<sup>39</sup>. Whilst the Guidelines are regarded by stakeholders as a work-in-progress, they provide a basis for comparison against international standards. Benchmarking of company controls against the OECD Guidelines provides an indication of the extent to which Australian CS and CD companies are keeping pace with internationally recognised standards and processes.

Recommendations of the OECD Guidelines relevant to supply-chain LHR issues are outlined in Appendix 6, along with the corresponding control elements against which the companies were assessed during this study (bullet points). Disclosure rates for these controls against the OECD guidelines are shown in Figure 9.

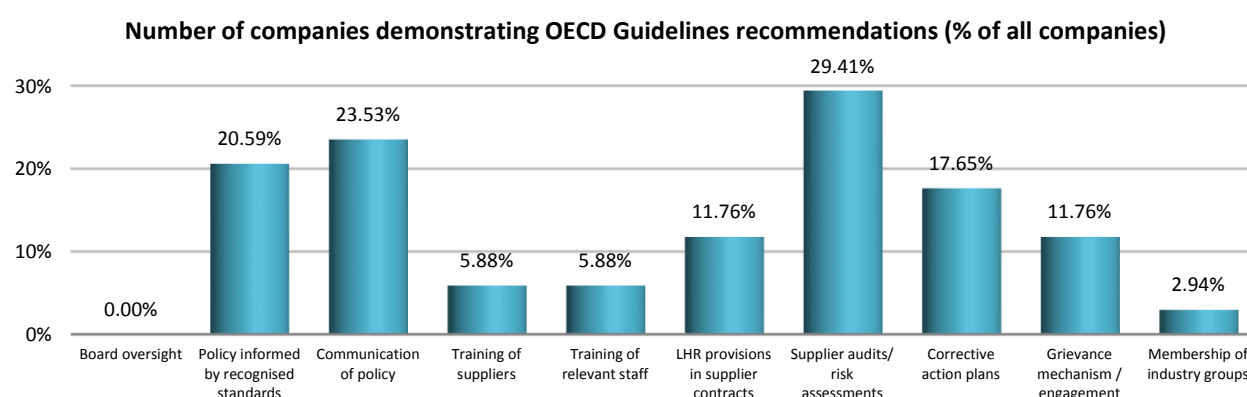


Figure 9

Alignment with OECD Guidelines recommendations:

- Highest alignment (30 per cent) to supplier audits/risk assessments recommendation
- Recommendations for communication of policy (24 per cent), policy informed by recognised standards (21 per cent) and corrective actions plans (18 per cent) show moderate levels of alignment.
- Training of suppliers, training of relevant staff and membership of industry groups are least referenced recommendations.

Benchmarking of CS and CD company controls against the OECD Guidelines shows low levels of alignment.

Benchmarking of CS and CD company controls against the OECD Guidelines shows low levels of alignment. Within the sample of Australian companies covered, there are outliers who demonstrate elements of good practice. For example, one large multiline retailer has joined the Global Social Compliance Programme, which is a business-driven programme seeking to drive continuous improvement of working and environmental conditions in global supply-chains. However, this was the only company to disclose membership of a relevant body or working group.

Another company has demonstrated alignment with an internationally agreed standard: Social Accountability 8000. The company reports how many of its suppliers have achieved full compliance with the standard, and how many suppliers were audited against it in the last reporting period.

<sup>39</sup> As well as their impacts in terms of the environment, bribery, consumer rights, science and technology, competition and taxation.

*“I think in Australia we haven’t had the big movement that there has been in the UK and Europe, so the processes aren’t as sophisticated in Australia.”*

Responsible sourcing expert

Four companies in the study disclose having grievance mechanisms in place. One of these companies stands out for its specific requirement that workers be trained on their rights and on how to use the mechanism. Another company stipulates that all workers should not fear reprisal should they make use of the grievance mechanism available.

...Observers have noted that Australian companies are yet to demonstrate transparency or proactive approaches to management of supply-chain LHR risks.

Despite a few stand-out examples, a common thread emerging in interviews conducted as part of this study has been that Australian companies are lagging on managing LHR risks in supply-chains relative to peers in Europe and North America. Observers have noted that Australian companies are yet to demonstrate transparency or proactive approaches to management of supply-chain LHR risks, including disclosure of practices on websites.

Some companies in the CS and CD sectors may be managing their risks internally, without disclosing to stakeholders publicly. An interviewee from an international advocacy group working on international labour standards highlighted a case of an Australian company (which is included in this study) which disclosed privately the steps taken and processes implemented to manage their supply-chain risks. When asked why these responses had not been publicly disclosed, the company indicated that it considered such risks within its general risk framework, and therefore unnecessary to disclose.

*“When we have discussed specific supply-chain labour issues with Australian companies, the reaction we get is sometimes very similar to the reaction we got from Nike back in the early 1990s.”*

Labour rights advocacy officer

However without such disclosures, investors are unable to assure themselves as to the inclusion of LHR issues within risk management practices.

# 7. Responsible Sourcing

## Responsible sourcing as a tool to manage the LHR risks in LDCs

Given the risks companies face, investors should expect evidence that companies are managing these risks. Recognised global frameworks provide platforms to define company responsibilities, as well as mechanisms and procedures to execute these responsibilities.

### Frameworks

#### OECD Guidelines for Multinational Enterprises

The OECD Guidelines for Multinational Enterprises provides guidance on business approaches to issues such as employment, human rights, the environment, bribery, consumer rights, science and technology, competition, and taxation. These were first developed in 1976, and most recently revised in 2011 to include “workers” rather than only “employees”<sup>40</sup>.

The Guidelines include human rights provisions that cover labour rights in the workplace. They aim to cover the ILO’s Fundamental Principles and Rights at Work as declared in 1998 (including freedom of association, collective bargaining, effective abolition of child labour, elimination of forced labour, and non-discrimination in employment and occupation), as well as the ILO MNE Declaration, revised in 2006, which includes principles in the fields of employment, training, working conditions and industrial relations.

The Guidelines encourage companies to improve supplier practices through contractual arrangements, pre-qualification requirements for suppliers, voting trusts, and license or franchise agreements, and by being consistent with the principle of using leverage to effect improvements. The Guidelines also suggest supplier capacity building and training, collaborative efforts with other enterprises with which common suppliers are shared and multi-stakeholder initiatives and social dialogue on responsible supply-chain management.

#### United Nations Framework for Business and Human Rights: Respect, Protect and Remedy

The United Nations (UN) has worked for several decades to develop global human rights standards for businesses. In 2005, the UN appointed a Special Representative on Business and Human Rights, which culminated in the “Protect, Respect and Remedy” framework (widely known as the ‘Ruggie framework’) which summarises the roles of different actors in ensuring rights are realised. The framework stipulates that the state has the duty to protect against human rights abuses by third parties; corporations have a responsibility to respect human rights; and effective remedies to rights abuses must be sought<sup>41</sup>.

The responsibilities for corporations as set out in the Guiding Principles for Implementation require that business enterprises:

- a) Avoid causing or contributing to adverse human rights activities impacts through their own activities, and address such impacts when they do occur.
- b) Seek to prevent or mitigate adverse human rights impacts that are directly linked to their operations, products or services by their business relationships, even if they have not contributed to those impacts<sup>42</sup>.

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<sup>40</sup> OECD, *OECD Guidelines for Multinational Enterprises*, 2011

<sup>41</sup> United Nations Human Rights Office of the High Commissioner, *Guiding Principles on Business and Human rights*, 2011  
[http://www.unglobalcompact.org/Issues/human\\_rights/The\\_UN\\_SRSG\\_and\\_the\\_UN\\_Global\\_Compact.html](http://www.unglobalcompact.org/Issues/human_rights/The_UN_SRSG_and_the_UN_Global_Compact.html)

<sup>42</sup> United Nations Office of the High Commissioner on Human Rights,  
[http://www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR\\_EN.pdf](http://www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR_EN.pdf)

Importantly, this framework also contemplates businesses' obligations to workers other than those with whom they have a direct relationship.

These two frameworks are clear in defining broadly the span of a company's obligations. For instance, "causing or contributing to" adverse impacts could include insisting on short production deadlines that contribute to human rights violations by suppliers.

### Tools available to companies

Responsible sourcing, ethical procurement and sustainable purchasing are some of the terms used to describe an emerging management discipline involving the consideration and management of environmental, social and governance impacts in the supply-chain. The common elements of this discipline are described below.

*"Companies are realising that we don't come up with these policies and advice to create more work, but instead it will save them more work and organisational time when issues come up."*

Labour rights advocacy officer

### Codes of conduct

A common and widely-accepted first step that companies take in managing the LHR risks in their supply-chain is to develop a code of conduct, or to sign a national, international, or industry code. Examples of these include the ETI Base Code, the SA 8000 standards, or the Fair Labor Association Code and Benchmarks. The OECD Guidelines recommend that this policy:

- (i) is approved at the most senior level of the business enterprise.
- (ii) is informed by relevant internal and/or external expertise.
- (iii) stipulates the enterprise's human rights expectations of personnel, business partners and other parties directly linked to its operations, products or services.
- (iv) is publicly available and communicated internally and externally to all personnel, business partners and other relevant parties.
- (v) is reflected in operational policies and procedures necessary to embed it throughout the business enterprise<sup>43</sup>.

One limitation of such codes used in isolation is the limited means by which companies can monitor supplier practices due to lengthened and diffuse supply-chains.

### Supplier audits

Audits of supply-chain partners can go some way to redressing the information asymmetry, as companies can determine for themselves the extent of supplier compliance with standards they have set through attendance at supplier's premises. This can be carried out through observations, document checks, and interviews with management and workers. However, despite its widespread use, the social audit model has its critics and limitations.

*"Auditing and accreditation has been effective with environmental issues, but from a labour rights perspective it's difficult, unless you mobilise the workforce and have some vehicle to raise issues and have some vehicle for reporting them and making changes... I've done audits myself and you know you're not getting a true picture."*

Responsible Supply-chain expert

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<sup>43</sup> OECD, *OECD Guidelines for Multinational Enterprises*, 2011

One ethical garment expert noted that audits can be weak at detecting problems, particularly where workers are fearful of the consequences of raising issues, either for themselves (being sacked or otherwise discriminated against) or for their employer (losing a contract could mean losing their job).

*“There’s a problem in that companies think they’re only sourcing from the factories with clean audits, but the producers don’t work like that and suppliers can move production around continually.”*

*Dr. Annie Delaney, Victoria University*

Supplier audits also rely on transparency about subcontract arrangements in place. As noted earlier in this report, much outsourced production is then outsourced again, often to numerous other factories or even individual home workers.

This is exacerbated by widespread poverty in LDCs, which mean manufacturing workers in Asia are often desperately poor, and prefer exploitative working conditions to unemployment.

### **Grievance mechanisms for workers**

Best practice for managing supply-chain labour standards has evolved to include ways in which to encourage workers to report labour rights violations and seek redress. This can take two forms.

The freedom to organise and collectively bargain is a means by which workers can voice their interests and concerns, and negotiate with their employer. A labour rights advocacy officer at a leading international NGO notes the value in allowing workers to develop mature relationships with their employers can lead to fulfilment of workplace rights more generally. Under this formulation, the onus is placed on companies to require their suppliers to respect their employees’ right to freedom of association and collective bargaining – which may be not be possible in jurisdictions that prohibit this, such as Vietnam and China.

*“Auditing and accreditation goes so far, and it has been very effective with environmental issues, but from a labour conditions perspective it’s really difficult unless you mobilise that workforce to have some vehicle to raise issues and make changes.”*

*Responsible Supply-chain expert*

A second means by which to provide supply-chain workers with a channel to report violations or problems to the company directly can include a telephone helpline in the local language. Anonymity, confidentiality and even access to a telephone can be obstacles for workers to making use of this option, so best practice can include working with a local NGO to provide education to workers about their rights and operate the hotline. According to one expert, if a level of trust has been established in a culturally appropriate manner during such a training process, workers are more likely to feel able to make use of such facilities.

*“A supplier is not going to be seriously influenced to consider improving health and safety policies or engagement with unions unless it thinks a company is going to source from them on an ongoing basis.”*

*Labour rights advocacy officer*

A labour rights advocacy officer also notes that the absence of grievance mechanisms leads to aggrieved employees reporting problems elsewhere, such as local or international NGOs or the international press. Problems can then become very public, rather than being dealt with by the company in an internal manner. From this perspective, an effective grievance mechanism constitutes strong management of a business risk.

## Engaging with suppliers

Firstly, suppliers must be made aware of the expectations placed on them regarding working conditions in their operations, through clear communication and/or training.

*“Some Australian retailers have reported problems with the bargaining power they have with supplier factories. Often, factories are reported to say well you’re only a small percentage of my overall production, and you’re making it really difficult for me, your demands are too rigorous, we just won’t trade with you.”*

*Responsible Supply-chain expert*

While it can be tempting for companies to ‘cut and run’ when a problem arises in the supply-chain, best practice involves working through the issues with their supplier as far as possible. Working with suppliers to mitigate or remedy rights abuses are features of both the OECD Guidelines and the Ruggie framework.

Some Australian companies have reported that they have faced difficulties in engaging with suppliers to improve standards, due to their relatively small order volumes and lack of leverage. In a PriceWaterhouseCoopers survey of supply-chain executives; 87 per cent said it is best to reach an agreement with suppliers on adhering to the highest ethical standards, 81 per cent favoured collaborating with their suppliers to create a responsible supply-chain footprint and procurement framework, and 71 per cent said effective track-and-trace capabilities are also important<sup>44</sup>.

The importance of a long term sourcing relationship is also recognised, to enable mutual understanding and foster a collaborative approach to issues such as product quality and working standards.

## Collaborative initiatives

One of the general policies of the OECD Guidelines is the encouragement of private or multi-stakeholder initiatives and dialogue on responsible supply-chain management. Enterprises that share common suppliers are encouraged to collaborate on supply-chain policies, manage risks by sharing information<sup>45</sup>.

*“It would be a good idea for Australian companies to join multi-stakeholder initiatives, and investors should encourage companies to do this”*

*Dr. Tim Connor, University of Newcastle*

Multi-stakeholder or industry initiatives include broad initiatives such as those of the Ethical Trading Initiative, Fair Wear Foundation, Fair Labor Association, and Global Social Compliance Programme. More specific programs include the Indonesian Freedom of Association Protocol, which is an agreement between textile, clothing and footwear unions, major supplier factories, and major sportswear brands including Adidas, Puma and Nike to uphold the right to freedom of association. Other initiatives are ongoing globally, covering issues such as forced labour, safety, harassment, and Sumangali schemes<sup>46</sup>.

*“In Australia companies are very rarely signed up to voluntary mechanisms. More often, companies go it alone and write some kind of company standard or code. There’s a real governance gap in terms of how Australian companies approach conditions in their supply-chains.”*

*Dr. Annie Delaney, Victoria University*

The OECD Guidelines do however note that self-regulation or other initiatives should not be considered a substitute for effective law and regulation by governments<sup>47</sup>.

<sup>44</sup> PricewaterhouseCoopers, *Global Supply Chain Survey 2013: Next-generation supply chains*, 2013

<sup>45</sup> OECD, *OECD Guidelines for Multinational Enterprises*, 2011

<sup>46</sup> Sumangali schemes (India) involve illegally contracting female minors for work (often in textile production) under often poor conditions. See glossary for further details.

<sup>47</sup> OECD, *ibid.*

# 8. Conclusion and Recommendations

With increasing exposure to LHR issues within their supply-chains, it might be expected that companies within the CS and CD sectors would evidence proactive attention to the management of these risks. As noted by the findings of this research however, disclosure of such efforts is significantly lacking among ASX200 companies in these sectors.

While the 34 companies surveyed have varying levels of exposure to these risks, the assessment of their policies and controls shows that even basic checks and balances regarding management of LHR risks are not well communicated. This is despite exponential increases in imports from countries with higher LHR risks over the last six years and a growing level of consumer awareness.

Notably, not a single company assessed disclosed the nature of board-level oversight of these risks, contrary to contemporary best practice. This is of particular concern in the Retail sub-sector where there exists a significant gap between risk exposure and disclosed controls. This is also the sub-sector considered to have a high likelihood of increased consumer awareness and media attention, as evidenced by recent reports from both Australian and international news bodies.

The findings also show that while supplier audits were the most commonly disclosed system, a mere 30 per cent of companies surveyed cited such measures as a risk management tool. Commitments to ongoing monitoring and corrective action plans were even less frequently referenced. Another notably low score was for membership of industry organisations, a vehicle frequently used by this industry globally in combatting LHR risks.

The lack of depth in company disclosure regarding LHR risks potentially indicates poorly developed strategies and programs for addressing these risks within their supply-chains. This presents difficulties for companies facing higher consumer expectations about their supply-chain oversight and practices.

From an investor perspective, the lack of transparency around risk management for supplier relationships creates uncertainty about whether LHR risks are being appropriately managed. Trends indicate that LHR are a constant risk for companies in this sector, and policies and controls need to be regularly reconciled with the level of company exposure to these risks to ensure longevity and stability of operations.

Companies with material exposure are recommended to demonstrate to investors that they are properly managing this risk by:

- Being transparent about sourcing practices. For instance, companies may disclose sourcing locations or suppliers, or general geographic distribution of suppliers.
- Having and disclosing a board-endorsed policy on LHR standards within the supply-chain, including disclosure of any policies with which suppliers are expected to comply.
- Evidencing appropriate internal and/or external resourcing for the monitoring/management of LHR issues within the supply-chain – for instance ensuring relevant sourcing personnel are aware of LHR issues associated with particular sourcing regions, and that sourcing decisions are made on the basis of the appropriate risk/return trade-off.



- Implementing and disclosing effective mechanisms for detecting and acting on instances of non-compliance with stipulated standards by suppliers or others. This can include supplier audits, whistle-blower provisions, and workplace training at supplier facilities to promote worker awareness of avenues through which they can report concerns.
- Participating in and supporting industry and international collaborations aimed at establishing improved standards for LHR practices in jurisdictions of concern.

The ability to demonstrate a proactive approach to LHR standards is an important form of protection against perceptions of exploitation when sourcing from lower-cost jurisdictions. Both investors and companies have an important part to play in ensuring transparency and accountability for LHR risks in CS and CD companies.

# Appendices

## Appendix 1: Acronyms

BFC	Better Factories Cambodia
CD	Consumer Discretionary
CS	Consumer Staples
EPZ	Export Processing Zone
FAO	Food and Agriculture Organisation
ICT	Information and Communication Technology
IFC	International Finance Corporation
ILO	International Labour Organisation
ITUC	International Trade Union Confederation
LDC	Less Developed Country
LHR	Labour and human rights
MNC	Multinational Corporation
NGO	Non-governmental Organisation
OECD	Organisation for Economic Co-operation and Development
WTO	World Trade Organisation

## Appendix 2: Glossary

### Export Processing Zones

Export Processing Zones (EPZs) are areas designated as free trade zones, allowing goods to be handled, manufactured, and re-exported with lower taxes and tariffs, subsidized infrastructure, and exemption from some regulations. EPZs (also known as Free Trade Areas) are designed to attract investment and stimulate growth.

### Intermediate goods

Goods used as inputs in the production of other goods, including partly-finished or final products. Examples include cotton, metals, or foods.

### Sandblasting

A process by which denim garments are given a 'worn' or 'distressed' look. The dust created in the process, which often involves blasting sand at the denim, can cause silicosis and other serious respiratory illnesses if suitable protective equipment and training is not provided. As this process is often outsourced to subcontractors, monitoring the conditions under which it is performed is very difficult for clothing retailers.

## Sourcing agents

Agents engaged in outsourcing activities, connecting international buyers with suppliers in a region.

## Sumangali workers

A practice becoming more common in India, generally involving young women who are hired on a contract, often in the textile industry, for three to five years as an apprentice of sorts. These workers earn a small wage during this contract period, but are also promised a lump sum upon completion of the contract, which is usually used as a dowry. The women are generally also housed by their employer, under strict conditions. The women are vulnerable to exploitation and can be trapped working in poor conditions due to their lump sum only being awarded at the end of their contract. There are allegations of forced overtime, beatings, starvation and abuse.

## Appendix 3: Australian import volumes by region in 2012

Total 2012 imports of goods relevant to the companies in the CS and CD sectors (foodstuffs, apparel, electronics, leisure goods and furniture) are presented split by macro region in Table 4 and more detailed regions in Table 5.

Table 4: Macro-level regional import percentages

Regions	Total selected imports (AU\$m)	Percentage of total
Asia	30,195	71.67 per cent
Europe	5,039	11.96 per cent
Americas	4,164	9.88 per cent
Oceania & Antarctica	2,343	5.56 per cent
Africa	208	0.49 per cent
Other	181	0.43 per cent
<b>Total</b>	<b>42,131</b>	<b>100.00 per cent</b>

Table 5: Regional import percentages

Regions	Total selected imports (AU\$m)	Percentage of total
East Asia	29,236	69.39 per cent
Northern & Western Europe	3,420	8.12 per cent
North America	3,163	7.51 per cent
Pacific Island Forum Countries	2,342	5.56 per cent
Eastern & Southern Europe	1,619	3.84 per cent
Central & Southern Asia	967	2.30 per cent
Latin America	825	1.96 per cent
Other	181	0.43 per cent
Sub-Saharan Africa	180	0.43 per cent
Middle East	135	0.32 per cent
Caribbean	34	0.08 per cent
North Africa	28	0.07 per cent
Other Oceania & Antarctica	2	0.00 per cent
<b>Total</b>	<b>42,131</b>	<b>100.00 per cent</b>

## Appendix 4: Key countries of concern

Table 6: Country export profiles and LHR concerns

Bangladesh	
Export profile	Total imports increased 800 per cent between 2006 and 2012, with a 2,000 per cent increase in garment, textile and footwear product imports.
LHR concerns	<p>Export processing zones (EPZs) are exempt from laws on trade union rights, wages, hours, and safety and health standards.</p> <p>Limited freedom of association is allowed, without formal collective bargaining rights.</p> <p>Pressure to deliver new, large orders quickly and at low prices, results in the imposition of long hours sometimes by forcible means.</p> <p>Sexual harassment of women in the workplace; forced labour and trafficking. Recruitment fees charged by agents can be exorbitant, resulting in high levels of bonded labour through worker indebtedness.</p> <p>Rapid expansion of the garment industry has meant infrastructure development has been outpaced. Key incidents have been attributed to manufacturing occurring in premises unsafe for heavier plant and equipment. Many buildings are residential, lacking in fire exits, and suitable electrical infrastructure. This has led to repeated health and safety incidents, injuries and lives lost. At least 591 workers were injured and eight workers lost their lives in the two months until 28 January 2013<sup>48</sup>.</p> <p>Child labour also occurs, mostly in agriculture, manufacturing, services and street-based activities.</p>
Cambodia	
Export profile	<p>The garment industry is Cambodia's largest contributor of exports and employment. Exports to Australia increased nearly threefold since 2006, albeit from a low base.</p> <p>The majority of exports from Cambodia to Australia are garments, textiles and footwear, with rice also featuring.</p>
LHR concerns	<p>The rights to organise and bargain collectively are legally recognised, but in practice intimidation of union workers is reported to have been carried out by both authorities and employers. The clothing industry is reported to use mainly subcontracted labour, causing difficulties in unionisation and reducing annual and maternity leave entitlements.</p> <p>The Better Factories Cambodia programme was launched in 2001 after the USA promised Cambodia better access to US markets in exchange for improved working conditions in the garment sector. The ILO thus established a project to help the sector make these improvements<sup>49</sup>. The latest BFC report in 2012 highlighted problems with excessive working hours, discrimination, underage workers, and pay discrepancies.</p> <p>Child labour is also common in rural areas in agriculture, shrimp and other seafood industries, construction and domestic servitude. Forced labour and trafficking are reportedly widespread, with men and women often sent to Malaysia or Thailand<sup>50</sup>.</p>

<sup>48</sup> Clean Clothes Campaign, *Fatal Fashion*, 2013.

<sup>49</sup> Better Work, [http://betterwork.org/global/?page\\_id=328](http://betterwork.org/global/?page_id=328)

<sup>50</sup> ITUC, International Trade Union Confederation, *Internationally recognised core labour standards in Cambodia*, 2011

China	
Export profile	<p>Although some sourcing volume is shifting away from China, imports from China have continued to grow steadily in the last decade. Real wages in China more than tripled between 2000 and 2010 according to the ILO Global Wage Report 2012/2013<sup>51</sup>, a key factor driving outsourcing to low-wage LDC economies.</p> <p>Electronics, foods, furnishings, toys, sporting goods, clothing, and footwear are major imports from China.</p>
LHR concerns	<p>Denial of workers' rights to freedom of association, which is argued to have led to proliferation of worker exploitation and poor working standards.</p> <p>Forced labour, bonded labour, child labour, excessive working hours, and poor workplace conditions are also reported.</p>
Hong Kong	
Export profile	<p>Total imports from Hong Kong decreased by 30 per cent between 2006 and 2012.</p> <p>The largest category exported to Australia in 2012 was telecommunications equipment, however also includes plastic articles, toys, games, sporting goods, and clothing.</p>
LHR concerns	<p>The main risk of sourcing goods from Hong Kong is the possibility that they have come through other countries in the region with dubious manufacturing workers standards. There are also a number of sourcing agents working out of Hong Kong, including Li &amp; Fung and MAC Group. These agents have been implicated in supply agreements with suppliers with poor labour conditions in countries like China and Bangladesh.</p>
India	
Export profile	<p>Total imports from India have more than doubled since 2006. Main consumer-related exports to Australia are textiles, footwear and clothing, tea, and rice. Imports of textiles and clothing have increased by nearly 50 per cent since 2006.</p>
LHR concerns	<p>The rights to organise, bargain collectively and strike are legally restricted in India. There is also a considerable gender pay gap in India, and child labour including in its worst forms is common in agriculture (including cotton and tea plantations) and textile manufacture. Forced labour is also found to be a problem in many sectors, including in agriculture, particularly through trafficking of Dalits<sup>52</sup>.</p> <p>Specific issues have also gained attention in the media, NGO campaigns and company responses. Sumangali workers (see Glossary) are a key concern in India.</p>
Indonesia	
Export profile	<p>Total exports to Australia increased by 36 per cent between 2006 and 2012, but this was mainly driven by increases in crude petroleum, metals and fertilisers.</p> <p>ILO characterises Indonesia as "one of the world's leading exporters of textiles and apparel products" and cites garment industry growth of over 8 per cent per annum."<sup>53</sup></p> <p>Main consumer-related exports to Australia include furnishings, footwear, and electronics.</p>

<sup>51</sup> International Labour Organisation, *Global Wage Report 2012/2013: Wages and equitable growth*, 2013

<sup>52</sup> International Trade Union Confederation, *Internationally recognised core labour standards in India*, 2011

<sup>53</sup> International Labour Organisation, [http://www.ilo.org/jakarta/whatwedo/projects/WCMS\\_180290/lang--en/index.htm](http://www.ilo.org/jakarta/whatwedo/projects/WCMS_180290/lang--en/index.htm)

LHR concerns	<p>Systematic violation of trade union rights, prevalence of gender discrimination in employment and remuneration, child labour (including hazardous work and trafficking), and forced labour, particularly involving migrant labour.</p> <p>Short-term contracts used as a tool to exploit workers and prevent reporting dissatisfaction with their working conditions or seeking redress<sup>54</sup>. Some factories have been found to pay less than the legal minimum wage, and very few pay a living wage. Employees are found to be forced to work overtime, sometimes without pay.</p>
<b>Korea</b>	
Export profile	<p>Total exports to Australia from Republic of Korea increased by 39 per cent between 2006 and 2012. The largest increases were seen in metals and petroleum products</p> <p>Cars and electronics are the largest categories of exports from Republic of Korea to Australia, (not including petroleum products).</p>
LHR concerns	<p>The ITUC describes discrimination against women and foreign workers as “frequent and serious.”<sup>55</sup> Child labour is not considered to be a widespread problem in Korea, and Koreans are not found to be subject to forced labour, although bonded labour of migrant workers is a risk. Also, foreign-owned enterprises located in free economic zones or EPZs are exempt from otherwise mandatory monthly leave, paid holidays, or menstruation leave for women.</p>
<b>Malaysia</b>	
Export profile	<p>Total imports from Malaysia increased by 36 per cent between 2006 and 2012, with large increases seen in imports of hydrocarbons, and some electronic equipment.</p> <p>Other than petroleum products, the majority of exports from Malaysia to Australia are electronics and furnishings. Only a small increase in these products has been seen since 2006.</p>
LHR concerns	<p>Forced labour via withholding of migrant workers’ payment and travel documents, including in garment manufacturing; human trafficking<sup>56</sup>. The US Bureau of International Labour Affairs in October 2012 added Malaysia to a list of countries suspected of using forced labour, with respect to palm oil production as well as garment manufacture.</p> <p>There is a significant gender pay gap, no minimum wage, and some prevalence of child labour, particularly in rural agriculture.</p>
<b>Myanmar</b>	
Export profile	<p>Australia’s trade with Myanmar (mainly in fish and seafood) peaked in 2009. However, with recent diplomatic and trade discussions, it is widely held that trade with Myanmar may open up significantly.</p>
LHR concerns	<p>One trade union representative said “given that trade relations are in the process of normalising, and there’s a significant amount of interest from MNCs to invest in Burma. We want to make sure that Australian companies that are seeking to do that are adhering to the Ruggie and OECD guidelines... we feel there is more that can be done to educate companies about their responsibilities, but also it is the responsibility of companies to educate themselves about this.”</p>

<sup>54</sup> International Trade Union Confederation, *An overview of working conditions in the sportswear factories in Indonesia, Sri Lanka & the Philippines*, 2011

<sup>55</sup> International Trade Union Confederation, *Internationally recognised core labour standards in the Republic of Korea*, 2008

<sup>56</sup> International Trade Union Confederation, *Internationally recognised core labour standards in Malaysia*, 2010

Pakistan	
Export profile	Total exports to Australia from Pakistan increased by 20 per cent between 2006 and 2012. Main imports were textiles and clothing, toys, sporting goods, and rice; imports of these increased by 32 per cent between 2006 and 2012.
LHR concerns	<p>Union organisation and collective bargaining are prohibited in Pakistan’s EPZ.</p> <p>There is a gender pay gap, and sexual harassment in the workplace is not legally prohibited.</p> <p>Child labour is present, potentially due to the lack of state provision of schooling.</p> <p>Bonded labour is also reported to be widespread, with Pakistan described as a source, transit and destination country for trafficked persons.</p> <p>An Australian garment retailer has also indicated that “there are issues in Pakistan with safety and fires, as well as child labour. A large percentage of women in the workforce increases the potential for worker exploitation.”</p>
Philippines	
Export profile	Total exports to Australia from Philippines decreased by 44 per cent between 2006 and 2012. Main exports to Australia include electronics, toys, games and sporting goods, fruit and nuts.
LHR concerns	<p>There is reported to be an environment of violence and intimidation against union members and employers engaging in anti-union measures.</p> <p>Child labour, involving dangerous conditions and involuntary servitude, is found, but the government appears to be making some efforts to remedy this situation.</p> <p>Forced labour is found in agriculture and fisheries, through debt bondage, as well as trafficking, with allegations of police complicity<sup>57</sup>.</p>
Singapore	
Export profile	Total imports from Singapore increased by 41 per cent between 2006 and 2012. Large increases were seen in the metals, petroleum, food and ships commodity groups. The most significant exports from Singapore to Australia include foods, and electronics. Exports of these groups of commodities increased by 24 per cent between 2006 and 2012.
LHR concerns	<p>There is little to no indication of child labour in Singapore, but trafficking has been reported as a problem and sexual exploitation in particular<sup>58</sup>.</p> <p>Although Singapore is a non-OECD country, it does not appear to present the same high LHR risks that some of the other countries listed here do. That said, due diligence should still be carried out by companies sourcing from Singapore.</p>
Sri Lanka	
Export profile	<p>Total imports from Sri Lanka increased by 36 per cent between 2006 and 2012. The export of clothing and textiles to Australia has more than doubled since 2006 (albeit from a relatively low level), which has been described as a continuing trend by many in the industry, most likely in the face of rising prices in China.</p> <p>The principal exports from Sri Lanka to Australia are tea, tyres and clothing and textiles.</p>

<sup>57</sup> International Trade Union Confederation, *Internationally recognised core labour standards in Philippines*, 2011

<sup>58</sup> International Trade Union Confederation, *Internationally recognised core labour standards in the Republic of Korea*, 2008

LHR concerns	<p>EPZs, within which wages and working conditions are set by the Board of Investment and union activists are only permitted with employer approval.</p> <p>Government labour inspectors are not permitted to enter unannounced.</p> <p>Child labour is described as prevalent in agriculture, but this is generally found to be around attending school, and there have been no reports of prevalent child labour in the EPZs or the garment industry, although the UNHCR<sup>59</sup> suggests children work in some other industries, including fireworks manufacture and fishing.</p>
<b>Taiwan</b>	
Export profile	Total imports from Taiwan increased marginally between 2006 and 2012. Significant increases in paper and telecom equipment seen in this period were offset by decreases in a range of other commodities including other electronics and medicaments. Leading consumer-related exports to Australia include electronics, toys, games, and sporting goods. These increased only slightly between 2006 and 2012.
LHR concerns	<p>The LHR risks in Taiwan mainly fall under the areas of freedom of association, forced labour, and gender discrimination. Child labour appears to be effectively legislated against, and this legislation is generally well enforced<sup>60</sup>.</p> <p>Taiwan does present LHR risks in sourcing, but allegations of poor standards are not considered as numerous or egregious as in other countries.</p>
<b>Thailand</b>	
Export profile	Total imports from Thailand increased by 60 per cent between 2006 and 2012. Large increases were seen in paper, petroleum and sugar imports in this period. Thailand's exports to Australia are led by vehicles, gold, and plumbing equipment. Imports of seafood increased by 53 per cent between 2006 and 2012.
LHR concerns	<p>Forced labour exists in Thailand's shrimp, fishing and seafood processing industries<sup>61</sup>. The ITUC reports that an assessment found that 57 per cent of Burmese migrant workers in the seafood industry in one province in central Thailand experience conditions of forced labour.<sup>62</sup> Lack of legal protections is an issue for migrant workers, various ethnic groups, indigenous people or stateless people with the ILO finding that the state apparatus has often been complicit in forced labour and trafficking.<sup>63</sup></p> <p>The ITUC reports that children are employed in fisheries, shrimp farms and seafood processing under conditions which are often hazardous, and that "many children are also employed in textile and garment factories close to the border with Burma and they are reported to operate dangerous machinery".<sup>64</sup> Notwithstanding government programs to address child labour, prosecutions have been rare.</p>
<b>Vietnam</b>	
Export profile	Total imports from Vietnam decreased by 31 per cent between 2006 and 2012. Garment, electronic and food products exported to Australia have increased by 168 per cent since 2006. Other consumer-related imports to Australia include furnishings, footwear, seafood, coffee, fruit and nuts.
LHR concerns	Child labour, health and safety concerns, working hours, collective bargaining rights, and discrimination are all widely documented LHR risks in Vietnam. Protections against these risks are generally not codified in law, however amendments to labour laws made in 2012, are expected to improve the situation. The new laws will be implemented in 2013 <sup>65</sup> .

<sup>59</sup> United Nations High Commissioner for Refugees, <http://www.unhcr.org/refworld/country,,USDOL,,LKA,,4e8c398fc,0.html>

<sup>60</sup> International Trade Union Confederation, *Internationally recognised core labour standards in Chinese Taipei*, 2010

<sup>61</sup> International Labour Organisation, *Forced Labour: Facts and Figures. The Cost of Coercion: Regional Perspectives*, 2009

<sup>62</sup> ITUC, *ibid.*

<sup>63</sup> International Trade Union Confederation, *Internationally recognised core labour standards in Thailand*, 2011

<sup>64</sup> ITUC, *ibid.*

<sup>65</sup> ILO, 2013 [http://www.ilo.org/hanoi/Informationresources/Publicinformation/Pressreleases/WCMS\\_190124/lang--en/index.htm](http://www.ilo.org/hanoi/Informationresources/Publicinformation/Pressreleases/WCMS_190124/lang--en/index.htm)



## Appendix 5: Data and methodology

### Sample

As summarised in the introduction to this report, the companies covered include the CS and CD sectors of the S&P/ASX200, and number 34 companies in total (seven CS companies, and the remaining 27 from the CD sector). The sample cut-off date was 31 March 2013 (i.e. the sample comprises CD and CS companies within the S&P/ASX200 as at 31 March 2013).

### Sub-sectors

Within these sectors, subsectors by level of exposure to LHR issues were identified, and each company was assigned a sub-sector, as indicated below (see later for a description of exposure assessments). This enabled analysis of sub-sectors and company comparison with their peers. It should be noted however that considerable variation in business activities relevant to LHR risks is still present at the sub-sector level; therefore peer comparisons should be interpreted accordingly.

### Research method

Each company was assessed using publicly available sources, including corporate websites, annual reports, sustainability reports, and published corporate policies. External sources were used to assess the company's exposure to LHR issues, explained below.

Each company assessment is split by exposure to LHR issues in the supply-chain and, separately, LHR supply-chain controls disclosed by companies.

### Scoring system

An exposure score is assigned to each company based on the level of exposure to LHR issues in their supply-chains (5 highly exposed through to 0 no exposure). Scores were also assigned for controls evidenced, determined with reference to policies and systems disclosed by the companies (5 best practice controls through to 0 no controls were evidenced).

Whilst the scales are used for benchmarking purposes only and are not directly correlated, control scores should generally be commensurate with exposure scores. A gap between the exposure and controls score (exposure > controls) suggests that risks may not be fully addressed.

### Exposure assessments

Recognising highly variable business models, products, and sourcing strategies each company was assessed to see how far it is individually exposed to risks or issues related to LHR in the supply-chain. These assessments are made using the company's own public reporting, external sources (trade data, media reports on supply-chain incidents), and evaluation of exposures by Regnan analysts. Some assumptions were applied based on knowledge of general industry sourcing patterns and likelihoods based on the company's product offering due to the absence of disclosed information on company sourcing locations. Incident assessments were made based on media or NGO reports. The exposure analysis fed into one data point; that of overall exposure.

**Table 7: Summary table of exposure components**

Final products	Consumer products	Does the company retail / supply products that are ‘high risk’ for LHR issues? E.g. textiles, footwear, food commodities, electronics?
	Manufactured goods	
	Agricultural products/flowers	
Brand impact/ consumer concern	Brand value	Is the company’s brand important to its business / highly valued and highly present in its products?
	Level of consumer awareness	How far are consumers aware of actual or potential supply-chain LHR issues for the company?
	Incidents	Have there been any LHR incidents linked to the company’s supply-chain? How severe are these incidents?
Sourcing locations	Reliance on internationally sourced products	How reliant is the company on overseas sourcing as compared with domestic sourcing?
	Sourcing from high risk countries/locations	Does the company source from any countries known to be associated with LHR issues in the workforce?
Overall exposure	Combining findings from all of the above, how far is the company exposed to LHR issues in its supply-chain?	

### Assessment of controls

Each company was also assessed on its controls relevant to LHR issues. These were split by policies and management systems, which included 12 data points each (listed in Table 8). The companies were first assessed to see if they either have a supply-chain LHR policy, or make reference to supply-chain LHR issues as well as efforts being made in this arena. If the company has a publicly-available policy, this was then assessed against the final 11 data points. The systems elements were assessed to see how far the company systematically works towards monitoring or improving supply-chain labour standards.

The policies and systems assessed were taken from internationally agreed standards such as the OECD Guidelines, the Ethical Trading Initiative (ETI) Base Code, ILO conventions, and the practice of companies internationally recognised as being leaders on management of supply-chain LHR issues.

In assigning an overall controls score, the different controls were weighted: all policy elements were weighted as one point each; the first eight system elements were weighted with two points each; and the final four system elements (italicised in Table 8) were weighted with three points. The systems elements were weighted more heavily, as there is wide consensus that corporate supply-chain policies need to be underpinned or supported by systems to achieve high levels of compliance. The final four systems elements are deemed to be ‘stretch’ controls, or more aspirational, and so were weighted more heavily.

**Table 8: Summary table of data points**

Policy elements	Company has a supply-chain policy, or makes reference to supply-chain LHR	Does the company have a policy or policies that require protections for LHR in the supply-chain?
	Legal compliance	
	Child labour	
	Forced labour	
	Discrimination	
	Freedom of association	
	Collective bargaining	What specific elements are included in this policy?
	Working hours	
	Wages	
	Health and safety	
Harassment		
Policy informed by ILO/UDHR/industry code		
Management systems/ approaches:	Communication of policy to suppliers	
	Training of suppliers	Are suppliers aware of the LHR standards expected of them?
	Inclusion of LHR provisions in supplier contracts	
	Training of relevant staff (e.g. procurement staff)	Are company staff trained on the requirements on them?
	Supplier audits/risk assessments	Are suppliers assessed for their level of risk in terms of LHR breaches, and are they audited? Once audited, are they monitored on an ongoing basis?
	Ongoing monitoring of suppliers	
	Corrective action plans	If non-compliance with the LHR policy is found, does the company set corrective action plans with the suppliers concerned?
	Board oversight/reporting to board on LHR in the supply-chain	Does the board have oversight of LHR in the supply-chain, or are reports made to the board of compliance/non-compliance with the company's supply-chain LHR policy?
	<i>Grievance mechanisms / stakeholder engagement (e.g. local NGOs)</i>	Does the offer a channel of reporting for workers? Or engage with local NGOs, supplier staff, or LHR experts?
	<i>Published list of suppliers and locations</i>	Does the company publish a list of suppliers and their operating locations?
<i>Supplier/agent blacklisting</i>	If suppliers are found to repeatedly fail to comply with LHR expectations, are they blacklisted for future contracts?	
<i>Membership of relevant industry groups</i>	Is the company a member of any industry or working groups focused on LHR in the supply-chain?	
Overall controls	Combining the scores from all of the above elements gives an overall controls score	

## Assumptions and limitations

The analysis of controls was based on information disclosed by companies and is thus affected by levels of disclosure. Whilst some companies may have controls in place which are not publicly disclosed, this approach was deemed most reliable for the purposes of comparative analysis, though it should be noted that controls may exist beyond those reported.

Where a company has multiple divisions or subsidiaries, differing approaches were taken. Where a supply-chain policy was found in at least one but not all divisions, policies were assessed and scored for the parent company. E.g. The Just Group's Ethical Supply approach was assessed and incorporated into the Premier Investment Limited control score. Where multiple codes were found for all or many divisions of the same company, the strongest codes or management systems for all codes found were factored into the control score.

## Appendix 6: Matching of OECD Guidelines to research benchmarks

### OECD Guidelines:

*"...enterprises express their commitment to respect human rights through a statement of policy that:*

- (i) is approved at the most senior level of the enterprise;*
- (ii) is informed by relevant internal and/or external expertise;*
- (iii) stipulates the enterprise's human rights expectations of personnel, business partners and other parties directly linked to its operations, products or services;*
- (iv) is publicly available and communicated internally and externally to all personnel, business partners and other relevant parties;*
- (v) is reflected in operational policies and procedures necessary to embed it throughout the enterprise."*

Controls relevant to these recommendations:

- Board oversight of LHR in the supply-chain;
- Having a policy informed or referring to bodies such as the ILO or relevant industry codes;
- Communication of policy to suppliers; and
- Training of relevant staff (e.g. procurement staff).

### OECD Guidelines:

*"Enterprises may also engage with suppliers and other entities in the supply-chain to improve their performance, in co-operation with other stakeholders, including through personnel training and other forms of capacity building"*

Control relevant to this recommendation:

- Training of suppliers.

### OECD Guidelines:

*"... enterprises can also influence suppliers through contractual arrangements such as management contracts, pre-qualification requirements for potential suppliers."*

Control relevant to this recommendation:

- LHR provisions in supplier contracts.

#### OECD Guidelines:

*“Where enterprises have large numbers of suppliers, they are encouraged to identify general areas where the risk of adverse impacts is most significant and, based on this risk assessment, prioritise suppliers for due diligence.”*

Control relevant to this recommendation:

- Supplier audits / risk assessments.

#### OECD Guidelines:

*“If the enterprise identifies a risk of contributing to an adverse impact, then it should take the necessary steps to cease or prevent its contribution and use its leverage to mitigate any remaining impacts to the greatest extent possible.”*

Control relevant to this recommendation:

- Corrective action plans.

#### OECD Guidelines:

*“...operational-level grievance mechanisms for those potentially impacted by enterprises’ activities can be an effective means of providing for such processes when they meet the core criteria of: legitimacy, accessibility, predictability, equitability, compatibility with the Guidelines and transparency, and are based on dialogue and engagement with a view to seeking agreed solutions.”*

Control relevant to this recommendation:

- Grievance mechanisms / stakeholder engagement.

#### OECD Guidelines:

*“Engage in or support, where appropriate, private or multi-stakeholder initiatives and social dialogue on responsible supply-chain management.”*

Control relevant to this recommendation:

- Membership of industry groups.

## **Appendix 7: Additional issues associated with LHR**

While beyond the scope of this paper, a number of related areas may offer fruitful avenues for further research in building a fuller picture of the impacts of corporate sourcing practices and the extent to which risks for investors may arise from these.

### **Other companies in the S&P/ASX200 which may be highly exposed to LHR issues in the supply-chain**

Regnan company analysis suggests additional companies across the S&P/ASX200 are exposed to LHR issues in supply-chain beyond the CS and CD sectors. We note for example, that resource companies operating in emerging markets source supplies extensively from these markets. Similarly, companies across multiple industry sectors are increasing their exposure to emerging markets to seek new avenues of growth. We would thus recommend extending analysis of LHR risks to other sectors, drawing on company-level analysis to identify specific exposures to countries and regions.

## **Sourcing of services**

Out-sourcing of services to emerging markets has grown in parallel with product sourcing, and this trend appears to be moving into new service areas beyond well-known services such as call centres and back-office processing. Noteworthy additions include global logistics and professional services, among others. Further analysis is required to both identify emerging risks in these areas and specific S&P/ASX200 exposures.

## **Suppliers of inputs and intermediate goods**

The analysis of the supply-chain in this paper has focused mainly on relationships with and risks from direct suppliers. Second-tier and third-tier suppliers, or those providing direct suppliers with inputs such as cotton or electronic components, have not been discussed in great detail. The risks here are likely to be less obvious to business, as clear links are less commonly made between poor labour standards in cotton production and brands or companies selling garments, for example. However, as NGO campaigns become more focused and sophisticated, a possible reputation risk is evident; the case of NGOs targeting brands to commit to avoid cotton sourced in Uzbekistan is an example of how this risk could eventuate for companies. Supply disruption risks could also manifest through LHR issues further upstream in the supply-chain.

Conflict sourcing is a further area of contention in international sourcing. Funding conflict through the purchase of resources, which have often been produced or mined through bonded or forced labour, is internationally censured. Being linked with conflict sourcing is a significant reputation and international relations risk for entities.

## **Non-labour impacts on human rights**

The impacts of sourcing practices on people *other than* those providing labour into the company's supply-chain can be significant, and distinct from those associated with labour. This is likely to be particularly relevant for companies that source commodities such as minerals, forestry products, palm oil or fish from overseas jurisdictions, but would also have relevance for companies selling products for which these are significant inputs (electronic items, paper products, toiletries or food items).

Issues for investigation include:

### Free Prior Informed Consent from local and indigenous populations

The issue of indigenous rights and protections have mainly been seen in the extraction of natural resources requiring access to land. While the rights of indigenous populations are not protected under law in all jurisdictions, international standards for upholding and respecting indigenous rights have been set, and the principle of free, prior and informed consent has been set as a framework for achieving land use agreements. Cases of disagreement and dispute over access to land are frequent, and reports of corporate abuses of indigenous rights have been widespread. Companies selling products with resource inputs garnered by disputed means can have relevance for their reputation.

### Legality of supply

Inputs to finished products can be difficult to trace, such as wood and paper; the product of forestry. The practice of illegal forestry is endemic in some regions, and timber logged without permits or regard for environmental or social standards can enter global supply-chains untraced. This can have impacts on the rights of those living or relying on forests for their livelihoods. Sophisticated means of tracking and tracking of inputs such as timber have been developed, and the subjects of NGO focus. Australian companies have been accused of handling illegally logged timber, for example. The legitimacy of governments selling resources or granting permits has also been an issue of contention in some jurisdictions.

### Health and safety issues for local communities

A further impact outside of the workplace that has relevance for the supply-chain is that of the impact on communities of production or manufacturing processes. For example, pollutants entering local environments and degradation of ecosystem services on which health and welfare depends (e.g. rivers, game populations) can have impacts on neighbouring communities. Access to resources such as water can also be impacted by large-scale manufacturing.

### Social impact of population influx and / or inequity

Production or manufacturing sites with growing international demand can see increases in production and employment. This in turn can see population influx through migrating workers and families. This can lead to social conflict, stress on local infrastructure resources (e.g. roads, water), and increases of communicable diseases. Sustainable and equitable management of this is clearly complex.

Many Australian-based public companies with their own operations overseas do address these issues in some detail however it is less clear that arrangements with suppliers require the same standards be upheld.

### **General issues associated with supply-chains**

- Reliance on labour associated with shipping and handling (ports, customs / inspection), and on key nodes in the physical infrastructure network (ports, airports). These can have both social and LHR implications through labour unrest etc., and also increasingly frequent extreme weather may present disproportionate risks.
- Fair treatment of suppliers including terms and pricing power has been a recent topic of discussion in Australia. There have been and are key groups that attract community sympathy (e.g. Australian farmers), and the treatment of these groups whilst balancing business goals presents a risk.
- Sustainability of supply-chains, in terms of environmental impacts. This can include environmentally-damaging processes used in production, waste, and inefficient use of resources.

