

Where does the
shoe pinch?

Working conditions
in the sports goods
and apparel industry

From the Vescore sustainability series





Characteristics of the textiles industry and its supply chain	5
Different business models and product strategies	6
Sector's biggest social problems	9
Significant risks for companies and their investors	10
The industry's responses over the last 20 years	10
Integrating the risks into Vescore's sustainability analysis	14
Conclusion	18
Contact	20

For well over thirty years now, multinational companies in the sports goods and apparel industry have repeatedly been the target of criticism because of the poor working conditions in their suppliers' factories. These concerns are often raised in connection with tragic factory accidents, or global sports events such as the Olympic Games or international football championships. The devastating collapse of the Rana Plaza building in Bangladesh in 2013 and the violent protests by garment workers in Cambodia in 2014 are just two incidents that have drawn unwanted attention on to several high-profile brands in the garment industry, with both manufacturers and trading companies in the spotlight. This has not only altered the public perception of these companies, but in some cases has also caused financial losses.

The outsourcing of production is very typical for the entire garment sector. From a structural perspective, textiles companies are therefore also affected by the social problems of their employees, such as working conditions, trade union membership and the wages paid by suppliers. If these problems are not managed effectively, they can create financial risks for the outsourcing companies. Those fashion chains whose brands are their main selling point are particularly exposed to these risks. In the aftermath of the Rana Plaza disaster, new approaches are being explored in the areas of risk exposure and management, irrespective of the significant differences between the various apparel companies. One conclusion has been that social audits of suppliers, where the focus is on checking compliance with social standards, can only play a very limited role in solving the problems. A number of companies that lead the way in sustainable management now appear to be experimenting with new approaches to address the problems. Here the emphasis is on working together with stakeholders and other market players in an effort to promote the skills of workers, help them get organised and protect their employment rights. It is still too early to judge how effective these initiatives are, but they already seem to be tackling some of the shortcomings associated with social audits.

The first chapter of this report examines the special characteristics of the supply chain in the sports goods and

apparel industry. Chapter 2 discusses the extent to which the problems are predominantly influenced by production strategies. Chapter 3 looks at the most critical problems in the garment industry. The risks for the companies and investors are dealt with in Chapter 4. Chapter 5 takes a closer look at the initiatives instigated by companies in response to these problems. The final chapter explains how Vescore's sustainability analysis takes into account the relevant risks and solutions adopted by companies.

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1.Characteristics of the textiles industry and its supply chain

Two main factors characterise the supply chain of manufacturers of sportswear and garments: its complexity and globalisation.

Complexity of the supply chain

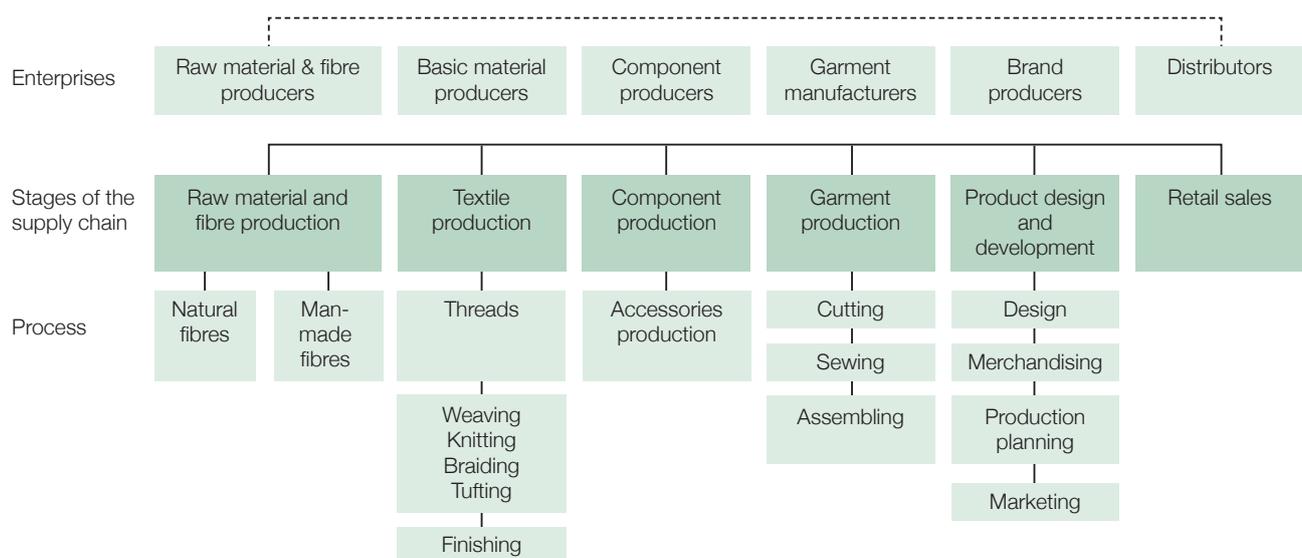
Unlike certain other branches of industry, such as luxury goods, production in the textiles sector (which also includes sports goods for the purposes of this report) is not vertically integrated – i.e. goods are not generally produced internally. As a result, the companies owning the brands have no direct control over production. In most cases manufacturing is instead outsourced to third parties in parts of the world where unit labour costs are extremely low. In other words, highly repetitive and labour-intensive production – involving minimal automation and no special skills – is outsourced to other countries purely to minimise costs. The supply chain of this sector is characterised not only by a high degree of complexity, but also by very poor traceability, as many different participants perform individual tasks in each production phase, often located in geographically distant regions. Figure 1 provides a simplified view of the production cycle of a T-shirt or pair of trainers, broken down into six stages.

The number of direct suppliers involved in the production of a garment is incredibly high. Figures published by Adidas, for example, show that it was working with 1,100 independent factories in 61 countries in 2015. Nike’s statistics for the same year report 554 supplier factories employing one million workers in total. Inditex, meanwhile, was working with more than 1,600 suppliers in the same year.

Globalisation of outsourcing

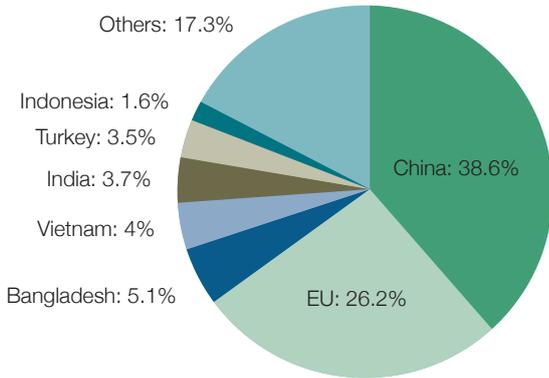
The globalisation of outsourcing and the proliferation of the actors in the supply chain have been two closely linked trends since the start of the 1990s. Up till then, manufacturing generally occurred within the country, or at least in a location not too distant from the company’s head office. But garment production has since shifted primarily to developing countries in Asia and Latin America in response to cut-throat competition between brands, coupled with intense price pressure and narrow margins. This progressive globalisation of outsourcing has gathered even more momentum since 2000 as world trade has become increasingly liberalised.

Figure 1: Different stages in the supply chain



Source: Due Diligence Guidance for Responsible Supply Chains in the Garment and Footwear Sector, OECD, 2016

Figure 2: Market share of major export countries for clothing in 2014



Source: WTO, 2016

According to figures from the World Trade Organization (WTO), China is still the world's biggest exporter of textile products, with a market share of 38.6% in 2014, even though production has shifted more towards southeast Asian countries such as Vietnam, Laos, Cambodia and Myanmar in recent years due to rising unit labour costs in China: an increase of 12% over the period 2003–2013. Around 60% of global exports of clothing, textiles and sports goods now come from Asia. In 2014 their production value amounted to almost 600 billion US dollars. Some 40 million people are employed in the textiles industry in Asia alone.

The textiles industry plays a crucial role for some of the world's poorest economies. According to the World Trade Organization (WTO), textile exports accounted for 81% of all exports in Bangladesh, 91% in Haiti, 54% in Cambodia and 44% in Sri Lanka in 2014. The textiles industry has been a key driver of these economies since the 1980s, even if the wages paid to workers are still very low. Depending on the country in question, the lowest monthly wages are somewhere between 70 US dollars in Bangladesh and 300 US dollars in China. Some estimates claim that labour costs (comprising the factory's margin and the wages actually paid to the workforce) only account for 14% of the total production costs of a basic T-shirt.

Today most companies in this sector concentrate on brand management: advertising, design, sales and distribution. These activities are what make the companies stand out from the competition more than any aspects of production, which is typically outsourced.

More recently, however, globalisation of outsourcing has been the subject of heated discussion, not least in the big multinational sports companies of Europe and the USA, some of whom are now considering bringing back part of their production to Europe or the USA. Burberry, Nike and Hanesbrands, for example, have already relocated some of their production back to the UK and the USA. In 2015 Nike announced plans to create up to 10,000 new jobs in the USA. This "re-shoring" trend is still comparatively small, and so far has had very little impact on either the globalisation of outsourcing or the importance of labour costs as a production factor.

2. Different business models and product strategies

As already mentioned, virtually all textiles companies are characterised by a complex and globalised supply chain, which often lacks transparency – even for the companies buying in the goods. This is an important aspect when it comes to the social problems that persist in the supply chain, and explains why this branch of industry is facing serious social challenges from a structural perspective.

However, companies can make a significant contribution to the resolution of these problems by altering their business models or adopting more sustainable sourcing and production strategies. For example, they can opt for direct rather than indirect external sourcing, favour long-term relationships with suppliers and follow socially responsible procurement practices with realistic production deadlines and fair prices.

Three different business models

An analysis of the leading brands in the sports goods and apparel sector (manufacturers and distributors) reveals three different business models:

- 1) The first is the model based on the **brand** and its popularity with the target audience. This group comprises the leading sports brands, listed in order of 2014 sales: Nike, Adidas, VF Corp, New Balance, Puma, Under Armour and Asics. With this model, production is outsourced to regions that are located a long way from the sales markets of these brand companies, making for long lead times. Since consumers tend to pay a relatively high price to wear these brands (which means



high profit margins), quality and reputation are key sales arguments. All these companies have very generous marketing budgets.

- 2) By contrast, the **low-cost** business model is based on continuous demand for very cheap products, as offered by fashion chains such as H&M, C&A or Primark, which generally goes hand in hand with low profit margins. These products are often simple garments that are bought from Asian suppliers in huge volumes. Orders are regular because demand is stable. Lead times are fairly long and quality is less important than for the brand model. Distributors normally have less control over the production chain.
- 3) The third and final group comprises fashion chains such as the Inditex Group (Zara, Massimo Dutti) or Japan's Fast Retailing (Uniqlo), whose dominant feature is the speed with which they cater for the latest wishes of their very fashion-conscious clientele. This model is known as fast fashion. There is an extremely rapid turnover of articles offered to consumers, and brand companies need to be able to rely on the agility and flexibility of their suppliers. In contrast to the first two business models, the suppliers for the **fast fashion** brands are not as far removed from their major distribution centres (Morocco, Portugal, Turkey, Eastern Europe, etc.), as the lead times imposed on the suppliers are very tight. Order volumes are not as important as they are for the first two business models.

The ability to respond to changing consumer tastes – including via online shopping – is increasingly becoming – a strategic competitive factor. For this reason, the companies who adopt the first two types of business model listed above cannot escape the fast-fashion trend.

The business model adopted by the brand companies has an impact on the choice of supply chain management approach and consequently on the concrete problems encountered in the garment factories of the manufacturing countries.

Direct versus indirect external sourcing

Indirect external sourcing of production is now standard practice in countries such as Bangladesh. Many direct or “tier one” suppliers to brand companies are large factories which in turn subcontract certain activities towards the end of the supply chain in order to meet extremely short lead times and save significant costs. These “sub-tier” suppliers are generally small factories that are not known to the brand companies outsourcing their production. The bigger suppliers receiving the orders directly from the international brand companies take care of all the various production stages: sourcing the raw materials, cutting, sewing, finishing and dispatch. They are under a lot of pressure and do everything in their power to retain their customers, incentivised by massive order volumes.

When it comes to outsourcing production to sub-tier suppliers, the tier-one suppliers are not particularly concerned about working conditions and social standards. The focus of their purchasing departments is on costs, meeting

Table 1: Characteristics of the leading market players, based on their business model

Business model	Typical company	Degree of outsourcing	Profit margin per product	Production volume	Production countries	Social risks
Brand	Nike, Adidas, Puma, Asics	medium - high	high	high - medium	China, SE-Asia	medium
Low Cost	Primark, C&A, H&M	high	low	very high	Low-wage countries: Bangladesh	high
Fast Fashion	Inditex (Zara), Fast Retailing (Uniqlo)	medium	medium	low	Geographically close countries	medium
Luxury	LVMH, Richemont	low	high	low	Internal production	low

Source: Vescore Ltd

deadlines and (for the big brand companies) quality. Another very common practice – and one that is often even worse when it comes to working conditions – is collaboration with agents. As intermediaries between the factories and the brand companies, they manage the different production stages and also the delivery of the end product. With this scenario, the brand company exercises virtually no control.

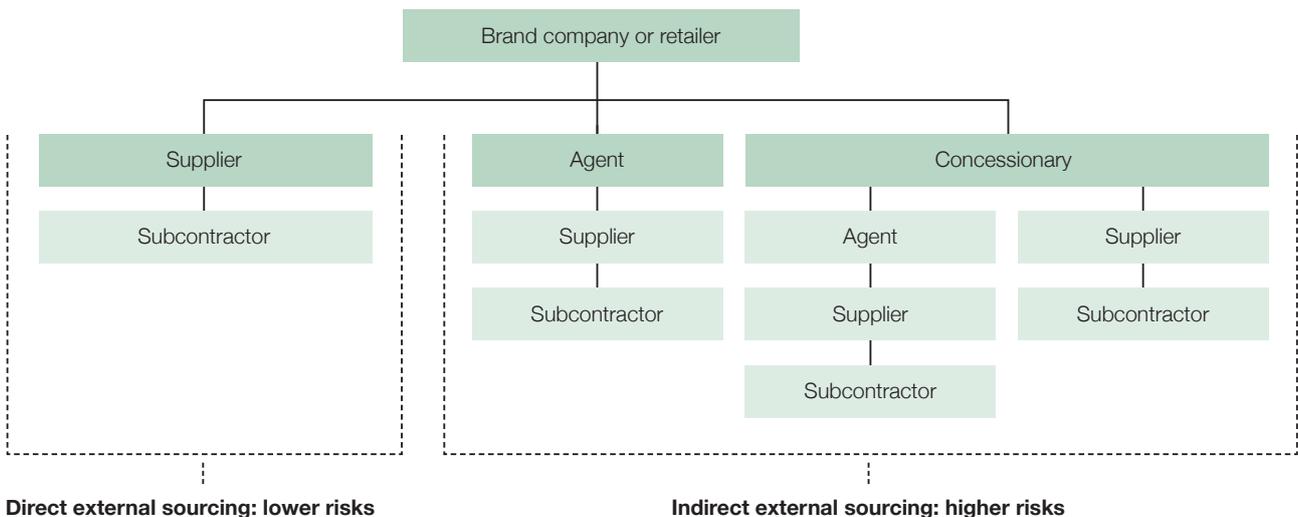
Even so, certain agents – such as Li & Fung, a specialist in supply-chain management for the garment industry – perform audits to check compliance with social standards at their customers’ request. However, this service incurs costs which many brand companies and retailers in the low-end of the segment are not prepared to accept. According to a study by the CYU Stern Center for Business and Human Rights, around 3,800 of the 7,000 factories inspected in 2015 outsourced some production to subcontractors. These subcontractors usually operate in the shadow economy, are not registered with trade organisations and are characterised by particularly poor health & safety records and bad working conditions.

This practice of subcontracting production to sub-tier suppliers makes direct external sourcing even more complex, due to the lack of transparency and traceability in the supply chain. Distributors and brand companies adopting such practices find it particularly difficult to ensure that the end product was made under reasonable working conditions.

In the case of direct external sourcing, stable and long-term partnerships can be built with supplier factories. Thanks to the higher degree of visibility and security provided by such a relationship, direct suppliers are more prepared to invest in infrastructure and pay higher wages. A continuous dialogue can also be established with these factories so as to motivate them to comply with the social standards of the end customers – for example through incentives such as paying a premium if certain quality or social standards are met. By agreeing reasonable lead times, the outsourcing company can also give tier-one manufacturers time to organise themselves so that they can meet these deadlines without being forced to subcontract work to smaller suppliers. Some brand companies agree supply agreements extending over several years with fixed order volumes and precise quality and delivery requirements, and this has proven to be a very good practice.

Although companies such as H&M, Inditex and Fast Retailing (Uniqlo) stand out from the competition by virtue of their better practices, their business models (Low Cost and Fast Fashion) rely primarily on the sourcing and production strategies of indirect external sourcing. By contrast, the more up-market brand companies, whose clientele often tends to be sustainably minded, give quality a higher priority in their production costs and are more prepared to monitor their supply chain and build long-term partnerships with the direct tier-one suppliers they already work with.

Figure 3: Direct versus indirect external sourcing



Source: Vescore Ltd



3. Sector's biggest social problems

The garment and footwear industry's characteristics outlined above — complex outsourcing, globalisation and sourcing strategies — make it particularly vulnerable to certain social risks. The direct victims are obviously the workers at the end of the supply chain. However, the companies themselves, and their investors, are indirectly affected as well. The problems are not new, but have changed over the course of time.

At the start of the 1990s the first campaigns were launched in the USA against poor working conditions in the “sweatshops” of the garment industry. Criticism was targeted at brands such as Nike and Gap who made use of such factories. Their names were associated with serious abuse of human rights: forced labour, child labour, violence, suppression of trade union rights, starvation wages, etc. The worst cases of human rights abuse, such as child or forced labour, are no longer as common – at least in the case of the business model of the brand companies, which resolutely condemn such injustices. However, the problem still exists in factories that work with unethical procurers – often distributors offering low-priced but poor-quality goods – as they have no control whatsoever over their supply chain or are simply not interested in working conditions.

In 2012 and 2013 the factory fires that occurred in Bangladesh and Pakistan and which left several hundred workers dead or injured, drew attention to the crumbling infrastructure and the very poor safety standards in the garment industry. According to the social audits mentioned in the sustainability reports of the three leading sportswear companies Nike, Adidas and Puma, the main problems apart from the dilapidated infrastructure are the paltry wages and very long working hours. Another study published in 2015 by Human Rights Watch on working conditions in Cambodian textiles factories reported that 94% of the factories inspected by the International Labor Organization (ILO) in 2014 were in breach of overtime rules (Better Factories Cambodia programme).

Wages in the textiles industry are 35% lower than in the rest of the manufacturing industry. In another study published in 2014, the Clean Clothes Campaign calculated the living wage for the most important manufacturing countries and compared them with the legal minimum wage. The study's conclusion was unmistakable: the wages paid are not nearly enough to live on.

Table 2: Comparison of minimum wage and living wage in the textiles industry

	Minimum wage per month (in euro)	Living wage per month (in euro)	Minimum wage as a % of living wage
Bangladesh	49.56	259.80	19%
Cambodia	72.64	285.83	25%
China	174.60	376.07	46%
India	51.70	195.30	26%
Indonesia	82.14	266.85	31%
Malaysia	196.06	361.21	54%
Sri Lanka	50.31	259.46	19%

Source: Clean Clothes Campaign 2014

Specialist organisations (NGOs, research bodies, etc.) highlight another problem that is difficult to detect during the companies' social audits but which is key to most other problems: the inability of workers to organise themselves in order to defend their rights in countries that have no tradition of trade unions or fair democratic conditions. The right of assembly and the right of collective wage bargaining are fundamentally important for ensuring that workers have access to better working conditions and an adequate living wage. As already mentioned, the latter is higher than the minimum wages generally paid by suppliers.

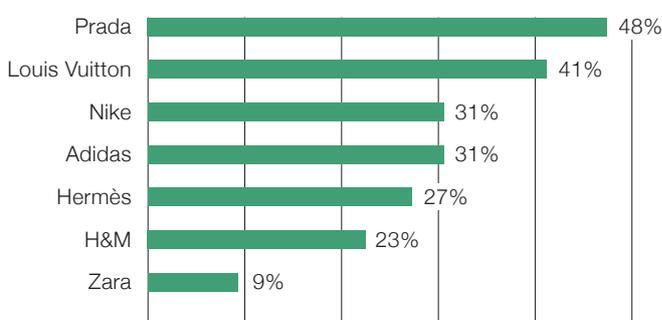
4. Significant risks for companies and their investors

Globalisation, complexity and non-transparency of outsourcing, indirect external sourcing, constant price pressure and tight lead times, impoverished manufacturing countries with low standards of public governance: this reality presents serious challenges to both brand companies and retailers when it comes to corporate social responsibility (CSR). Failure to address the sustainability challenges poses a risk that companies – especially those in the consumer goods sector – increasingly cannot afford to take.

Today, in the age of global information exchange in real time, any wrong moves by listed companies are not only flagged up by NGOs but also by specialist media, international organisations, consumer associations and even investor coalitions. This carries reputation risks that can have serious financial consequences for corporations. Many companies publicly acknowledge this risk in their annual report. In its 2015 annual report, for example, Nike explains that not only its reputation but also its sales and “financial health” tend to suffer as a result of every violation of social standards by either its direct or indirect suppliers. Leading and popular brands such as GAP are particularly exposed to this image risk. In 2014 Greenpeace and Berne Declaration (EvB) gave GAP the Public Eye “award of shame” due its failure to follow through measures to improve safety in Bangladeshi factories following the Rana Plaza factory disaster. For the same reason, America’s Cornell University cancelled a contract with VF Corp (owner of The North Face, Jan Sport, Timberland and other brands) to supply orders worth around four million US dollars. All global companies are aware of risks to their reputation, especially if they own a popular brand and well-known logo. Although it is difficult to prove a systematic correlation between social controversies and a decline in sales, the importance is significant when considering the brand value. Figure 4 shows the brand value as a percentage of the stock market capitalisation of various apparel companies that feature in the Forbes’ rankings of the world 100 most valuable brands (status: May 2015). This shows how important it is for companies working in the consumer goods segment to protect their brands from any erosion in value, especially as a result of damage to the company’s reputation.

The operational risks for the sector should not be underestimated either. In Cambodia, Vietnam and China, protests by workers demonstrating against low wages and precarious employment contracts in 2013 and 2014 were

Figure 4: Brand value as a percentage of total market capitalisation in 2015



Source: Forbes, The World’s Most Valuable Brands, May 2015

overshadowed by violence and led to production stoppages for Asics, New Balance, Nike and Puma. A number of brand companies remonstrated against the brutal police intervention and persuaded their suppliers to negotiate directly with the local workforce. Many brand companies are now attaching increasing importance to production quality and reasonable lead times rather than labour costs.

5. The industry’s responses over the last 20 years

An analysis of the measures taken by clothing companies over the last two decades reveal three different phases

Phase 1: Private social standards and audits

Under pressure from possible disclosures about exploitative firms in their supply chain, apparel companies started to establish Corporate Social Responsibility departments from the 1990s onwards in a bid to cushion the negative impacts of their production activities. The failure of emerging-market countries to take over international labour standards into their national legislation encouraged textiles companies to pursue their own self-regulatory initiatives. When describing the CSR model adopted at the time, some authors cite the concept of compliance, where suppliers agree to be bound by various standards set by the brand companies and trading firms in their own code of conduct. In theory this model persuades suppliers to meet certain standards either through a rewards system (contracts, premiums) or



through fear of sanctions (cancellation of contracts). With this approach, the main instrument is the in-house or third-party audit. With external audits, specialist firms are commissioned to carry out an on-site inspection to check the implementation of these standards (child labour, working conditions, safety, etc.). In practice, however, a social audit faces many obstacles, such as:

- Lack of independence and legitimacy: The external audits are performed by specialist private firms who rely on mandates from the brand companies and trading companies. They therefore represent the interests of their customers, rather than those of the suppliers' employees.
- Lack of transparency: The audits are voluntary and private. It is up to the company commissioning the audit whether or not to publish the findings.
- Inefficiency: Sometimes the audits are announced in advance, giving suppliers time to prepare for them and allowing them to pass an audit they might otherwise have failed. In these cases, the lack of compliance is covered up. Bribery is also possible. In addition, audits are not always thorough enough due to lack of time and resources.
- Diverse requirements: Suppliers who work for a selection of customers are often subject to different codes of conduct with diverse requirements and may therefore have to submit to a number of different audits.
- "Invisible" problems: The audits are not suitable for identifying certain problems in connection with trade union rights, discrimination, wages, working hours and other abuses. Furthermore, the audit concentrates on the direct suppliers and generally ignores the other links in the supply chain, especially the sub-tier suppliers at the end of the chain.

These shortcomings have been raised by numerous critical observers (trade unions, academics, NGOs) of CSR programmes, and over time apparel companies and their distribution partners have taken this criticism on board to some extent. Their response has taken the form of multi-stakeholder industry initiatives. This type of initiative involving many different stakeholders (companies in the same sector, NGOs, trade union officials, representatives from civil society or communities) also exists in other particularly sensitive business sectors such as electronics, agriculture

and food, telecommunications, etc. The common denominator in these initiatives is that poor public governance can be countered by regulation to tackle the sustainability problems identified by non-governmental bodies.

Phase 2: Audits improved as a result of multi-stakeholder initiatives

Thanks to the different multi-stakeholder initiatives, brand and trading companies now adhere to common social standards which they publicly support. These collaborative initiatives are replacing the individual codes of conduct imposed on suppliers. They try to include as many stakeholders as possible. This is not simply a matter of adopting negotiated and harmonised standards, but also of using tools (exchange and education platforms) as well as social audit mechanisms for the efficient and credible implementation of standards. The basic idea is to improve the level of compliance on the one hand ("level playing field", or same rules for all) and on the other hand to give workers the chance to make these social standards their own ("capacity building", or self-help). The audits performed on the basis of these initiatives are more systematic and professional than the private audits commissioned by individual companies. This helps to strengthen the transparency and credibility of the participating companies, which receive a form of accreditation or label for sustainable supply chain management. The Nike Group, for example, was able to repair the damage to its image caused by the sweatshop scandal by helping to found the Fair Labor Association in 1999, which specialises in social audits, and by continuing to work with this organisation ever since.

However, the sector’s multi-stakeholder initiatives are currently attracting increasing criticism, particularly with regard to the following points:

- NGOs and trade unions are not adequately represented in their steering committees
- Standards are too vague and too lax – especially those concerning the living wage
- Dependence on companies that are the primary funders
- Audits lack credibility and efficiency
- Not enough consideration given to companies’ sourcing practices

Three initiatives address these criticisms quite effectively: the Fair Wear Foundation (FWF), the Fair Labor Association (FLA) and the Sustainable Apparel Coalition (SAC). The FWF in particular attracts praise from NGOs and trade unions for the robustness and quality of its criteria in matters of trans-

parency and a living wage. However, the Fair Wear Foundation only has a few members: none of the big corporations are involved, but just “small” brands such as Switcher and Mammut, which have a strong commitment to sustainability. The procurement practices of the companies involved are checked down to the last detail. On top of that, listening to the grievances of the workforce is a high priority for the FWF. The independent audits are performed both at the level of the management of the member companies and on site at the factories. SAC is an interesting initiative that has moved away from the audit model. It offers members handy collective tools for measuring and reducing their social impacts in the supply chain especially.

Thanks to the collaborative efforts of market players and stakeholders, these initiatives have brought more positive changes than private audits, which only check compliance with a firm’s code of conduct. One of the most remarkable results is that the audit and monitoring instruments signifi-

Table 3: Overview of major multi-stakeholder initiatives

Initiative	Main role	Main activities	Governance	No. of members	Some well-known members
Business Social Compliance Initiative (BSCI)	Develop common standards	Support and raising awareness of member companies	Only companies	900 companies	Aldi, Calida, Coop, Migros, Charles Vögele
Fair Labor Association (FLA)	Develop social standards and ensure their implementation	Introduction of independent and external audits, publication of results, support for companies	Universities, companies, civil societies	30 companies, 200 universities	Adidas, Apple, Hugo Boss, H&M, Puma, Nestlé, Nike, Patagonia, New Balance
Ethical Trading Initiative (ETI)	Provide a platform for sharing good practices (standards, tools etc.)	Support for companies	Companies, trade unions, NGOs	70 companies	GAP, H&M, C&A, The Body Shop
Social Accountability International (SAI)	Develop a social standard: SA8000	Offering certification tool and training the certifiers	Companies, trade unions, NGOs, civil society	3663 factories	–
Fair Wear Foundation (FWF)	Develop social standards and ensure their implementation	Introduction of independent and external audits, publication of results, support for companies	Companies, trade unions, NGOs, civil society	80 companies	Jack Wolfskin, Mammut, Switcher
Sustainable Apparel Coalition (SAC)	Offer companies a common approach for measuring their ecological and social footprint	Development of tools for company self-assessment (Higg Index)	Companies, suppliers, universities, NGOs, governments	174 members, including 117 companies	Adidas, Asics, Burberry, Fast Retailing, H&M, New Balance, Nike, Puma

Source: Vescore Ltd

Figure 5: Company responses to CSR in three phases



cantly raise the awareness of the companies participating in these initiatives of their risk exposure to social problems. Another positive consequence of this awareness-raising exercise is that companies are no longer as tolerant of the more serious human rights abuses (forced and child labour).

Although the individual initiatives are rated very differently, one general criticism directed at all of them is their limited effect in addressing certain problems, especially the inability of textile workers to organise themselves in areas such as working hours, quality of infrastructures and wages. Critics claim that these initiatives fail to tackle the root of the problem and do not adequately represent the workers’ interests, specifically regarding membership of the steering committees responsible for defining the standards and audit procedures.

Phase 3: : New solutions in the form of legally binding global agreements that include stakeholders

A series of tragic incidents in recent years have shown that the traditional solutions adopted by companies have reached their limits and the problems persist. In 2014 violent workers’ protests broke out in Cambodia against low pay and high accident rates in garment factories, mainly as a result of bad working conditions (physical exhaustion, malnutrition, fainting fits). This campaign singled out the brand companies outsourcing their production to this country as the main target of criticism: Adidas, Gap, H&M, Levi’s, Puma, Walmart, etc.

The factory fires that broke out in 2012 and 2013 in Bangladesh (Tazreen and Rana Plaza) and in Pakistan (Ali Enterprises) caused hundreds of deaths and injuries. At the Rana Plaza disaster alone, locked fire-exits left a tally of 1,130 dead and 1,800 injured. These vast, dilapidated multi-storey buildings housed several suppliers to well-known fashion brands. Prominent names such as C&A, Walmart and Disney were mentioned in connection with the Tazreen fire, while the disaster in Rana Plaza was linked to 32 brand names, including Primark, Gap, Benetton and Mango.

Just a few months before the catastrophe, the inspection company TÜV Rheinland issued an audit certificate for the workshop operated by Phantom Apparel Ltd. which was housed in the Rana Plaza complex and supplied goods to

several European and US trading companies. The audit report did not identify any building or safety problems. In September 2012, 300 workers died in a fire at the garment factory owned by Ali Enterprises in Pakistan. Just three weeks beforehand, this garment firm had received an SA8000 certificate from the inspection company Rina.

These events shocked the public and acted as a catalyst for producing a new solution for rectifying the shortcomings of private audits: global framework agreements with international trade unions. The “Accord on Fire and Building Safety in Bangladesh” (the “Accord”) is symbolic of the recent paradigm shift. In contrast to the unilateral and not legally binding multi-stakeholder initiatives, where trade unions and NGOs were not adequately represented, these new agreements are legally binding on all participating companies. They are agreed and implemented in a multilateral fashion with the support and cooperation of the major international trade unions (including IndustriALL and Global Union). The aim of the Accord signed in May 2013 by over 200 fashion brands, distributors and international and local trade unions is to guarantee the safety of garment workers in Bangladesh. A number of specialist NGOs, including the Clean Clothes Campaign, also signed the Accord in an observer capacity. The International Labor Organization (ILO) has declared its willingness to monitor the steering committee. The Accord is a five-year agreement that obliges the signatories to have their factories inspected by independent experts and to take remedial action if standards are not complied with. The Accord extends to more than 1,000 suppliers. The results of the inspections are published in a transparent form. The employees are trained in aspects such as safety measures and have the chance to make their grievances known anonymously. All the leading European brands have signed the Accord. The US and Japanese brands such as Nike, Gap and Asics, on the other hand, have opted for a much less demanding alternative: the “Alliance for Bangladesh Worker Safety”.

It is still too early to assess the efficacy of these new solutions. However, they certainly represent a step in the right direction, as they offer an alternative to the unilateral and non-legally-binding agreements and initiatives. They demonstrate

the increasing awareness of the need for more effective measures among the more sustainably minded textiles companies. Some major brands such as Nike, Adidas and Puma have understood that the audit approach only has a limited effect and have already voiced their interest in this new solution. These brand companies have not only signed the Accord in Bangladesh, but also the Freedom of Association Protocol in Indonesia, an initiative that enables trade unions, suppliers and brand producers to meet at the same table to negotiate freedom of assembly.

6. Integrating the risks into Vescore’s sustainability analysis

The quality of sustainability analysis depends on which sustainability criteria are identified for each sector, which specific indicators are used to measure companies’ sustainability performance and the weighting given to these indicators when producing the overall company rating. The sustainability credentials of a textiles company, for example, are not assessed in the same way as for automobile manufacturers.

When assessing textiles companies, Vescore’s sustainability research gives social themes (employees, suppliers, customers, society) a weighting of 45% in the overall rating, while the environment carries a weighting of 30% and corporate governance 25%. As far as social criteria are concerned, particular importance is attached to checking relations with suppliers (50% weighting within the social dimension). When checking environmental criteria, the main focus is on issues connected with the production and supply chain, such as manufacturing methods and the treatment of chemical substances, water consumption, cotton procurement, etc. Problems associated with workers’ health and safety, as well as responsible marketing practices and the quality of products, are also important, but less so than the problems associated with supply chain management.

Key dimensions assessed: risk exposure and supply chain management

As already mentioned in Chapter 4, a company’s business model and production strategy largely dictates the extent to which the business is exposed to social risks. Table 4 shows how this risk exposure is actually integrated into Vescore’s sustainability analysis.

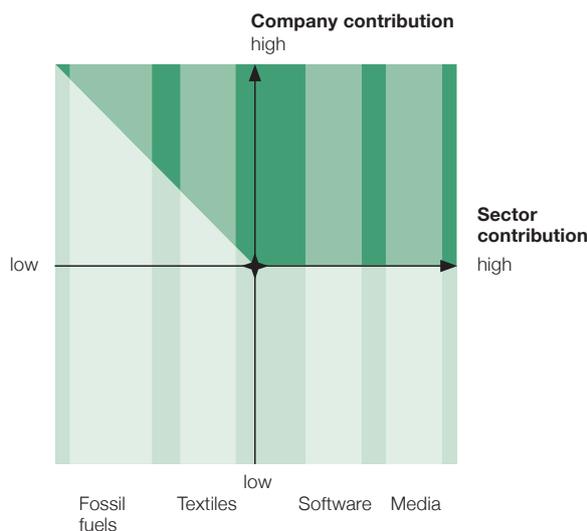
In this phase, the analysis already differentiates between subsectors such as luxury goods companies, fashion brands, distributors, sports apparel companies, footwear producers, etc. In practice, companies like LVMH or Richemont which sell luxury goods such as watches, jewellery, accessories, clothing, etc. often apply an integrated production strategy, which gives them tighter control over different stages of the value chain and reduces their social risks. In a second phase, the individual companies are analysed based on a series of criteria that assess their sustainability strategy and the measures taken to reduce the social risks along the supply chain. The next table provides an overview of the most important dimensions and the indicators used to measure the performance of the companies.

These elements represent the “classic” compliance methods adopted by the textiles industry over the past two decades, where social audits are carried out to check adherence to social standards.

Good business practices as a response to the limited efficacy of audits: criteria and examples

The added value created by the sector sustainability analysis also lies in the assessment of “new” solutions proposed by the brand companies which are meant to address some of the shortcomings of “classic” approaches based primarily

Figure 6: Vescore’s sustainability monitor



■ **Sustainability pool:** companies rated as sustainable and eligible for investment

Source: Vescore Ltd



Table 4: Companies' exposure to social risks in the supply chain

Dimensions	Categorisation	Risks	Companies involved
Production	Significant internal production	low	Luxury goods sector
	Significant outsourcing	medium - high	Sports goods and fashion brands
	No information available	high	Charles Vögele, Metro Boutique
Control of outsourcing and traceability	Significant direct external sourcing	low	Adidas, Puma, Nike, Marks & Spencer, Switcher
	Significant indirect external sourcing	medium	Asics, Under Armour, Inditex, H&M
	100% outsourcing	high	Aldi
Production in risk countries	Major controversies: Pakistan, Bangladesh, Cambodia, etc.	high	Charles Vögele
	Controversies: China, Indonesia, Vietnam, India, Sri Lanka, etc.	medium - high	H&M, Adidas, Asics, C&A, Puma, Nike, Under Armour
	Minor controversies: Turkey, Morocco, Brazil, Italy, Portugal etc.	medium	Inditex, Calida, Switcher

Table 5: Sustainability criteria in the area of supply chain management

Dimensions	Examples of performance indicators
Social standards	Reference to recognised international standards (ILO)
	Relevance of standards: living wage, trade union freedoms, working hours, health, safety of infrastructure, discrimination, etc.
	Choice of supplier
	Implementation of social rating criteria
Social audits	Percentage of suppliers audited every year
	Internal and external audits (number, results)
	Percentage of non-compliance cases
	Corrective measures, sanctions applied (warning, cancellation of contract)
Help for suppliers	Training measures, number of training sessions per year
Participation in industry initiatives	Participation in major initiatives, control of standard implementation, certification
Transparency	List of direct suppliers with name and address
Controversies	Accident analysis (severity, repeat frequency)
	Companies' response

Source table 4 and 5: Vescore Ltd

on the verification of compliance. The aim here is to identify the best practices within the sector (e.g. “Accord on Fire and Building Safety in Bangladesh”), which are based on the following main principles:

- Empowering workers to organise themselves and negotiate
- Concrete commitment to a living wage (rather than just a minimum wage) and acceptance of benchmarks
- Introduction of an anonymous complaints procedure for textile workers
- Signing of, and participation in, global and legally binding industry accords, in collaboration with suppliers, NGOs and local/international trade unions regarding issues such as the safety of infrastructures, trade union membership, living wage, etc.
- Extension of supply chain management to include indirect (subcontracted) suppliers
- Concrete commitment to responsible sourcing practices and a dialogue with all suppliers

Certainly not every company is prepared to agree to these practices. Even so, some companies that are sustainability leaders in their sector are starting to find out why a more comprehensive, in-depth analysis is necessary. Here are a few examples:

Adidas: This sportswear company has a programme to promote a “Self-Governance Model” for its suppliers. The purpose of this programme is to reduce the number of social audits and help suppliers to control their own compliance with company standards (2015: 26% of direct suppliers). Since 2012 around 260,000 workers (or roughly a quarter of all the suppliers’ employees) in Vietnam, Cambodia and Indonesia are able to report grievances to Adidas management by sending an anonymous SMS message to a hotline. The company, which favours direct external sourcing (85% of suppliers), stands out from other brand producers with its special programme for responsible sourcing

practices. This extends not only to direct, but also indirect (agents) suppliers. As an FLA member, the company voluntarily submits to external and independent social audits.

Puma: One factor that sets this brand company apart from the competition is its support for the living wage. The company applies a wage scale system (Fair Wage Network) in order to check the progress made towards the payment of a living wage. As a point of reference, this scale integrates the Asia Floor Wage, a tool that is recognised both by trade unions and workers. The company announced that in future it intends to offer a premium to those suppliers prepared to pay a wage that is higher than the minimum wage. Together with Nike, Asics, New Balance, Pentland and Adidas, Puma has signed a protocol in favour of the freedom of assembly for workers in Indonesia; this practice has also been welcomed by critical NGOs.

Puma, Nike and Adidas have adopted innovative and practical measures which correspond in each case to a specific strategy: fewer internal audits in the longer term, but more measures to support suppliers (“capacity building”), closer cooperation between stakeholders and competitors when drafting solutions, less indirect external sourcing, better control and traceability of the supply chain, choice of suppliers located closer to the distribution centres, etc.

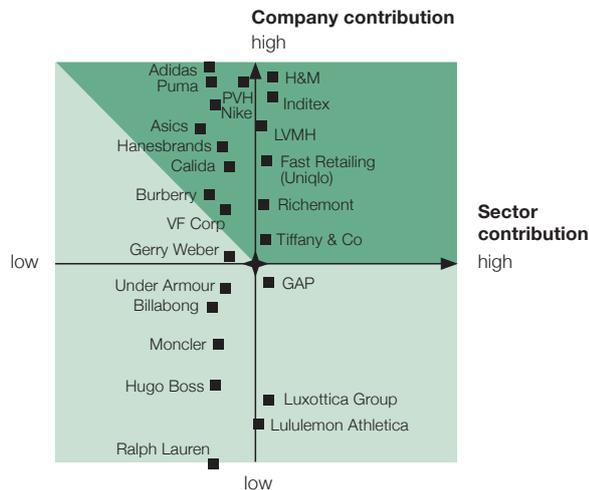
Inditex: The Spanish trading group (Zara, Massimo Dutti) stands out from the competition with its practical programme for promoting the rights of suppliers’ workers and their ability to organise themselves. This programme was implemented with the help of specialist organisations, including local trade unions. Inditex is also one of the few distributors to have signed global and legally binding agreements with the international trade union IndustrialALL and the ILO to allow the resolution of employment law problems. This accord covers the entire supply chain, including almost one million workers in some 6,000 factories.

Company sustainability ratings

The next figure shows the positioning of various leading sports goods and apparel brands (manufacturers or distributors) in Vescore’s Sustainability Monitor. The companies positioned in the dark blue area pass the “sustainability filters” and can therefore be invested in by portfolio management.



Figure 7: Positioning of leading clothing and luxury goods brands in Vescore's Sustainability Monitor



■ **Sustainability pool:** companies rated as sustainable and eligible for investment

Source: Vescore Ltd

- Smaller companies with a well-developed sustainability culture, such as Switcher or Patagonia, are not included in this assessment because they are not listed on the stock exchange. However, their sustainability strategy and measures are more ambitious than the major brands with the best sustainability ratings, especially regarding their commitment to paying a living wage.
- Those companies who are currently rated as sustainable do not necessarily have a negative sustainability impact. In most cases, however, they are criticised for their poor transparency, which makes it more difficult to produce an accurate rating.

The following points should be noted for these ratings:

- The companies are assessed on the basis of numerous environmental, social and governance (ESG) criteria. The sustainability leaders, positioned around the upper part of the vertical axis, are all companies with good supply chain management, as this dimension is very important.
- The rating is based on the best-in-class approach: The leadership position reflects a relative performance. In absolute terms, these leaders can still improve – especially when it comes to the good practices described above.
- The well-known sports goods companies are generally well positioned. Apart from a truly modern sustainability strategy, one thing they have in common is that they deploy substantial resources in order to preserve the value of their brand (Adidas, Puma, Nike).

Conclusion:

The tragic disaster in Rana Plaza was a landmark event. It not only had a lasting impact on public opinion, but also fundamentally changed the way that many players in the textiles industry now perceive the social risks in the supply chain and their role in addressing the problems. This has resulted in what can best be described as a “pre-” and “post-” Rana Plaza mentality. Nowadays, for example, a number of significant trends are emerging that reflect a new awareness of corporate social responsibility that takes in the entire supply chain.

- A growing number of companies are turning away from an approach based purely on compliance, and are reducing the number of internal social audits performed every year at their direct suppliers. These social audits are increasingly being carried out according to an external procedure based on cooperation between different market participants (multi-stakeholder initiatives).
- The companies understand that the main reason for the social problems is because workers are unable to organise themselves and negotiate in order to defend their rights and working conditions. In addition, programmes are being implemented to strengthen the position of employees and give them empowerment, i.e. assuming responsibility themselves with the help of training, raising awareness and mediation.
- The control of the supply chain and the assessment of social risks is increasingly no longer restricted to direct suppliers, but also extends to agents and indirect suppliers/subcontractors.
- Cooperation between brand companies and stakeholders is becoming more and more important. This takes the form of legally binding agreements which several stakeholders sign up to in order to address concrete social problems. Most importantly, trade unions are also participating in these industry accords. The cooperation also extends to initiatives that bring together different market players and are designed to encourage the sharing of rating tools, good practices and even information about suppliers.

These trends are very encouraging. Even so, it is still too early to say whether these initiatives will produce results in

the long term – and moreover whether they will be taken over by the entire sector or only by companies that are already sustainability leaders.

An analysis of the difficulties encountered in the textiles industry shows that sustainability analysis can offer an important source of added value for investors. With the help of specific ESG criteria, sustainability analysis allows sector-specific identification of companies that are particularly exposed to these risks and those businesses which, based on various measures, show a particularly positive approach and performance in the area of sustainability.



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