

Main Report

Changing Course -

A study into Responsible Supply Chain Management

Authored by GLOBAL CSR and Copenhagen Business School
for the Danish Ministry of Foreign Affairs



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Readers guide

In this readers guide we would like to highlight four elements of our reporting from the study ‘Revisiting Responsible Supply Chain Management in the light of CSR’, namely i) the three components of the reporting, ii) the weight of the six hypotheses assessed and the perspective on the RSCM practices of the buyers, iii) how we have chosen to structure this report and finally, iv) a few remarks on key terms used.

Our reporting from the study contains three elements; 1) an executive summary, 2) a main report (this report titled ‘Changing Course – a study into Responsible Supply Chain Management’), and 3) an ‘annex volume’,

which includes the six Sub-reports and appendices. This reporting format is chosen in order to enhance the accessibility of the findings. The quick overview is found in the executive summary. More details on each of the six hypotheses, the challenges identified and the Responsible Supply Chain Management (RSCM) Generation 3.0



approach is contained in this main report. The in-depth information is found in the ‘Annex volume’ (elaboration on each hypothesis in the form of six Sub-reports, and the supporting appendices, including the Terms of Reference, the questionnaires used, the detailed methodology of the study, etc.).

Due to the (limited) amount of resources and time allocated as well as the complexity of the topic, it was decided from the outset of the study that the (developing economy) supplier perspective would be downplayed. Accordingly, the view point of the suppliers, and in particular SMEs and sub-suppliers from developing countries are not assessed in-depth. While the five hypotheses (A-E) are – with the given resources – thoroughly assessed, hypothesis F (SMEs are excluded from global supply chains) is not analysed as comprehensively. We have chosen to assess the RSCM practices of a number of front-runner companies, among large

international buyers, against our hypotheses and RSCM 3.0 model, so that we may generalise from our findings. This approach leads to an emphasis of the challenges and areas in where improvement is needed, described in the main report. However, please note that the detailed practices described in the Sub-reports, constitute the good or even best practices currently in the field. This also means that the practices and views of the SME-buyers are not included.¹

The main report is structured in four overall sections. The first section includes the presentation of the study, including the readers guide, abbreviations, motivation and focus areas and the methodology (pp. 4-11). The second section deals with the key findings of each hypothesis and the challenges that follow directly from the assessment of each hypothesis (pp. 11-36). In the third section, we present and discuss the RSCM Generation 3.0 approach and how it relates to the hypotheses (pp. 36-45), and finally, in the fourth section we outline the cross-cutting observations (challenges, recommendations & suggestions – pp. 45-51).

While we provide a list of definitions and key terms used in appendix 14 in the Annex volume, we would like to mention the usage of three terms here (buyers, suppliers, and RSCM Generations 1.0, 2.0 and 3.0). We use ‘buyers’ to denote the 16 international companies that we have interviewed. We use the terms ‘international buyers’, ‘international buyer companies’ and ‘buyers’ interchangeable. We use the term ‘suppliers’ to cover the first tier core suppliers that buyers engage with. We do not deal with ‘non-core’ suppliers (e.g. suppliers of stationary, food, materials, etc.); and we use the term ‘sub-suppliers’ covering second, third and additional tier suppliers. We use the terms RSCM Generations 1.0, 2.0 and 3.0 to denote current different categories of approaches to Responsible Supply Chain Management (for more details, see ‘Motivation and Focus Areas’ below) in contrast to ‘traditional’ procurement or sourcing practices (which we term Supply Chain Management or SCM). We use the terms ‘RSCM Generation 1.0’, ‘RSCM 1.0’ and ‘RSCM 1.0 approaches’ interchangeable.

Enjoy the reading.

¹ See further in the section on Cross-cutting challenges, point b 'Knowledge gaps on 'non' frontrunners, in particular smaller MNCs.

List of Abbreviations

BSR	Business for Social Responsibility
CBDS	Centre for Business and Development Studies
CBS	Copenhagen Business School
Codes	Codes of Conduct
CSR	Corporate Social Responsibility
EUR	Euro
DA	Donor Agency
MNC	Multi National Company
NGO	Non-Governmental Organisation
PSD	Private Sector Development
RSCM	Responsible Supply Chain Management
SCM	Supply Chain Management
SME	Small and Medium sized Enterprises
SRSG	Special Representative to the Secretary General
UN	United Nations
US	United States

Motivation and Focus areas

Danish and international companies have perceived Corporate Social Responsibility (CSR)² to include a requirement to ensure that minimum standards in relation to human rights (including core labour rights), basic environmental standards, and the eradication of corrupt practices are enforced in their global supply chains; this practice is referred to as Responsible Supply Chain Management (RSCM). RSCM primarily emerged in the 1990s as a corporate response to human rights violations appearing in suppliers' operations; sweat shops, child labour, forced labour, no living wage, discrimination, safety and health neglect and similar violations. Lack of effective human rights governance in the home state of the suppliers, as well as stakeholder pressures on the buyers to react, paved the way for RSCM as we observe it practiced by corporations today.

This report presents the overall results of the research and study on 'Revisiting Responsible Supply Chain Management in the light of CSR', undertaken by Global CSR and CBS and partly financed by the Danish Ministry of Foreign Affairs.³ The study has dealt with a set of pertinent issues in relation to RSCM; issues, which by the project team have been identified as of concern to both international buyers, local suppliers in developing countries, government agencies, Non-Governmental Organisations (NGOs) and other parties. The study has been structured around six main issues – termed hypotheses⁴ – of the present implications of RSCM. This publication describes key learning points from analysing practices in addressing corporate responsibility risks in the upstream value chain of corporations against the hypotheses shown in the Box below.

² In this study the term CSR covers how the business community can take responsibility with respect to its impact on people, planet and profit – also known as the Triple Bottom Line. In other words, CSR is how corporations take responsibility for contributing to, rather than becoming a barrier to, sustainable development.

³ The Terms of Reference for the study is found in appendix 1 in the Annex volume.

⁴ The hypotheses are explained in greater depth in the Terms of References in appendix 1 in the Annex volume.

- A. Businesses spend considerable resources on monitoring and auditing, yet research shows only relatively minor actual impact on (benefit to) workers and other stakeholders
- B. Mainstream RSCM Generation 1.0 approaches lead to 'code mania'
- C. Traditional corporate sourcing strategies and purchasing practices have been identified as some of the primary impediments to ensuring adequate standards with suppliers
- D. Most Responsible Supply Chain Management approaches limit themselves to a few basic human rights, and are not able to acknowledge the indivisibility, interdependency and interrelatedness of human rights to secure human dignity
- E. The extensive number of corporate suppliers and sub-suppliers, often amounting to tens of thousands for a single buyer, render non-discriminatory, transparent, accountable and independently verified SCM less than cost efficient, if de facto, not impossible under RSCM Generation 1.0 and 2.0
- F. SMEs are excluded from global supply chains as a result of RSCM practices

For the purpose of clarification and communication, this report has grouped present approaches to RSCM in two categories; RSCM Generations 1.0 and 2.0 respectively. Based on research, reviews, and anecdotal evidence from large companies and participants in initiatives, a range of challenges to RSCM Generations 1.0 and 2.0 can be identified.

RSCM 1.0 is the most widespread approach to RSCM. This approach involves a buyer company developing a code of conduct (Code) describing the demands that its suppliers are expected to meet. To ensure compliance to the Code, the buyer company will often include compliance to the Code in contractual obligations and include the possibility to monitor and audit its suppliers. Regular visits at suppliers' premises by company employees trained to assess suppliers' performance against Code requirements has become common practice. In addition, some companies require external auditing by independent third party CSR auditors (consultancy firms or NGOs). In addition to managing risk, companies implement RSCM 1.0 for reasons like building image and reputation, using CSR as a competitive advantage and maintaining internal control of the value chain.

RSCM 2.0 constitutes an attempt to address some of the pitfalls of the RSCM 1.0 approach. In RSCM 2.0, buyers use a shared Code (e.g. a Code for an entire industry or a Code established through a multi-stakeholder process) rather than individual Codes.⁵ In addition to creating and using common Codes, some RSCM Generation 2.0 initiatives are shifting focus from monitoring compliance to developing supplier capacity; most notable is the Business for Social Responsibility ‘Beyond Monitoring’ initiative. Often a shared ‘clearing house’ is established to take care of monitoring or certification of suppliers and accreditation of auditors.⁶

Though RSCM has received considerable attention over the years, an analysis that collects and synthesizes existing material and in addition, qualifies un-researched challenges by primary research is not available. The present study will focus on a clarification of such challenges and subsequently seeks to outline an approach to RSCM (Generation 3.0) that may answer these challenges. Taking into consideration the pace of which both non-Danish and especially Danish companies⁷ are expected to adopt RSCM Generation 1.0 and 2.0 solutions, in answering expectations of stakeholders and following peers, makes it timely to revisit our understanding of and practices in RSCM. It may lead to improved approaches that take into account the impact of RSCM on economic sustainability and align practices with the attempts made by donor agencies to create sustainable business environments in economically developing countries. The analysis seeks to enable Danida to maintain and enhance its position as a leading development agency, in relation to business or private sector development and CSR.

This main report thus provides a synthesis of six (sub-) reports, each covering one of the stated hypotheses.⁸ It outlines the key findings of each hypothesis, the challenges faced from each hypothesis, a presentation and discussion of RSCM Generation 3.0 and considers the cross-cutting observations leading to the lessons learned in the form of conclusions assessing each of

⁵ Examples of RSCM 2.0 approaches can be found in the Electronic Industry Code of Conduct (EICC), the Business Social Compliance Initiative (BSCI), the Ethical Trading Initiative (ETI), Social Accountability 8000 (SA 8000), ILO’s Better Work initiative and Fair Labour Association (FLA). Some RSCM 2.0 do not include a common Code, like the Danish Ethical Trading Initiative (www.dieh.dk).

⁶ The RSCM Generation 2.0 concept is wider than RSCM 1.0 and covers a range of different initiatives.

⁷ In December 2008 the Danish Act on Annual Accounts was amended mandating larger Danish companies to include a statement on CSR in their annual management declaration; the legal requirement has led to a drastic increase in the number of companies that engage with CSR and, consequently, with RSCM.

⁸ The six Sub-reports and the appendices are found in the Annex volume.

the hypotheses stated, as well as a set of recommendations to donor agencies (in particular Danida), to firms (international buyers) and suggestions for further analysis and research.

Methodology

Despite the attention to RSCM issues over the years, we actually have limited knowledge of a set of issues in the field. The lack of knowledge has spurred the ambition to take what we can term as the first step in dealing more systematically with RSCM. Nevertheless, this study has been undertaken with a limited resource allocation and within a short time-frame, when considering the breadth and complexity of the issues studied. The study has been carried out over six months, which includes preparation time. A team of six people worked part-time on the study.⁹ Given the circumstances, the approach of the study is explorative, seeking to establish a basic data foundation, to qualify a preliminary assessment of the six hypotheses.

The study has combined four sets of data: a) primary data collection from 16 major international buyer companies (Danish and non-Danish)¹⁰, b) primary data from 27 selected suppliers and suppliers' associations from field studies in two countries (Kenya and Bangladesh¹¹), c) primary data from seven organisations, associations and individuals working in the field, and d) secondary data gathered through three desk studies, including i) a review of the international literature on Codes of conduct, ii) a review of the international literature on SMEs & Codes/CSR and finally iii) a web study of the content of the Codes of conduct of 38 international buyer companies, industry associations and multi-stakeholder initiatives.¹² The three reviews have each provided a synthesis of existing material and knowledge.

Given that the large international buyers have been selected as so-called 'critical cases' (being front-runner companies) and the thoroughness of the three desk studies; it was acknowledged from the outset of the study that the view(s) of suppliers would be underrepresented compared

⁹ The project team is shown in appendix 4 in the Annex volume with short bios of each team member.

¹⁰ Small and medium sized companies are thus not included on the buyer side, they are however included as suppliers via the interviews in Kenya and Bangladesh.

¹¹ For a summary of the observations and findings in Kenya and Bangladesh see appendix 17, Annex volume.

¹² For a list of the 38 companies, see appendix 10, Annex volume.

to the buyers.¹³ The suppliers represented were randomly selected, focusing on including SMEs.

The detailed methodology regarding the content of the interview guides and the identification of the literature for the two reviews of the international literature on Codes and SMEs & Codes, etc. is described in appendix 3. Furthermore, the concrete methodological approaches for each of the sub-studies are presented in the methodology section of each of the six Sub-reports in the Annex Volume.

Hypothesis A – Cost-efficiency

The hypothesis reads: *Businesses spend considerable resources on monitoring and auditing, yet research shows only relatively minor actual impact on (benefit to) workers and other stakeholders.*

The study confirms the hypothesis. Although buyers do not appear to track the exact additional costs that RSCM practices imply for their operations, basic estimations point towards the fact that ‘best practice’ RSCM incur considerable annual costs. Though positive impact is mentioned by the interviewed companies, compared to the effects on the ground, which in the international literature are measured and assessed to be limited and hence yielding only minor positive impacts - RSCM 1.0 in particular does not appear cost-efficient.

The hypothesis is twofold in nature, as it on the one hand concerns the identification of the costs of monitoring and auditing, while it on the other hand evaluates the actual impacts that follow as a result of RSCM practices.

The cost of monitoring & auditing

Impediments to calculation of costs

It has been impossible to establish definite calculations on the costs of monitoring and auditing¹⁴ in RSCM Generation 1.0 and 2.0. Several impediments for this were identified, i.e. i)

¹³ As well as the practices and views of SME-buyers, also termed 'smaller MNCs', as mentioned above.

¹⁴ The term monitoring refers to the compliance monitoring of suppliers ‘internally’, by a buyer company’s own employees. The term ‘auditing’ refers to the ‘external’ monitoring of suppliers, where a buyer makes use of a 3rd party (usually an auditing firm or NGO) to assess compliance with their Supplier Code.

limited tracking of expenses by buyers, ii) costs are handed down to suppliers, as one supplier states: *“It is the suppliers that have to pay for the compliance and monitoring, and getting the proper certificate is expensive. Global GAP [an industry standard required by many buyers in the food industry] used to be at least 1000 Euro, now we are lucky that it has come a bit down and we can get it for around 500 Euro... If we have 1.5 million farmers in Kenya and you had everybody getting a certificate for 1000 Euro, the total is 1.5 billion. The total export of Kenya is 1 billion US Dollars. Thus, you are in a situation, where the total cost of certification would be higher than the total export of the country and that is only for one standard”*, iii) internal monitoring systems are increasingly complex and diffused, iv) buyer company profiles vary immensely, including the participation in RSCM 2.0 initiatives, making it difficult to constitute common denominators, and v) there seems to be no standard monitoring system.

Minimum costs

Despite the above challenges it is possible, by way of example, to establish the minimum cost of running a RSCM Generation 1.0 model for a large Danish buyer company.¹⁵ Thus, based on simple headcount costs for stated numbers of employees who manage RSCM, the investigated Danish companies on average use a minimum of 0, 22 % of their annual turnover on running RSCM Generation 1.0 monitoring procedures. The total revenue for Danish businesses in 2009¹⁶ was approximately 393 294 million EUR. If all Danish companies would follow best practice and adopt RSCM 1.0 approaches, we can estimate that the total cost for this group of companies will amount to approximately 865 million EUR. Compared with the Danish Development Aid budget, Danish companies could thus spend about 40 % of the total amount used for development aid in a year, on Generation 1.0 RSCM models. These costs represent the mere minimum, not including possible auditing, training, travel and other costs. In addition, auditing suppliers by way of a 3rd party, amounts to approximately 1500 EUR per auditing session, are also not included.

¹⁵ The participation in RSCM 2.0 includes additional costs. However, as some buyers are participating in one RSCM 2.0 initiative, others two RSCM 2.0 initiatives and yet others several RSCM 2.0 initiatives, it is difficult to indicate the costs.

¹⁶ Danmarks Statistik <http://www.dst.dk/pukora/epub/Nyt/2010/NR201.pdf>

Monitoring and auditing practices

The discovery of the complexities involved in calculating and tracking RSCM costs led the research team to identify some of the challenges. The impediments foremost appear to be linked to great differences in the monitoring procedures of buyers, such as whether buyers use internal monitoring, external auditing (or a combination of both), the frequency and form of monitoring and auditing, as well as their use of local or international resources. The findings show that current monitoring systems are rather complex. In addition, it must be questioned whether existing monitoring practices imply a reliable way of measuring actual impact.

Impact

Positive impacts

The study was able to confirm positive impacts in relation to limited areas, such as workplace environment, i.e. health and safety, and environmental standards. Buyers, as well as suppliers, mention that RSCM has had a positive impact on such areas. Whether the positive impacts are actually realized, seems to depend on whether several factors are in place as catalysts for impact. Various factors have been identified. It seems as if they have great consequences for the processes leading to positive impacts. These factors are i) communication and engagement, ii) openness and trust, and iii) length and intensity of relationship.



Negative impacts

Several negative impacts following the introduction of supplier Codes were also recorded; i) an increase in costs, ii) pressure on management time, *“I heard of one factory owner who had so many buyers, that it resulted in 28 audits in one month and another, who had experienced having as much as 3 audits in one day”* (Supplier-representative), iii) low job security, and iv) an unbalanced impact on human rights. Findings from the international literature suggest that positive impacts are often

limited in scope, reaching certain workers only (e.g. permanently employed male workers), while excluding others (e.g. female, migrant workers); and mainly concerns improvements of some outcome rights, while limited or no improvements were visible on process rights. Further limitations stem from the fact that current RSCM practices only reach first tier suppliers. In addition, RSCM practices are challenged for creating impacts that are limited to the duration of the buyer-supplier relationship or, even worse, the duration of the audit.

Measurement of impacts

The appropriate method of identifying and measuring actual impact appears to be a challenge in itself. It could not be assessed, whether existing monitoring and auditing practices manage to meet this challenge. The measurement of impacts related to human rights poses a particular challenge. Furthermore, possible biases with monitoring personnel or auditors can impair impact assessments. Another assessment of the overall value of monitoring and auditing, has demonstrated that issues such as double bookkeeping, insufficient monitoring and auditing methods and methods of identifying impacts pose serious challenges to the value of monitoring and auditing, calling for a re-evaluation.

Capacity development

Recent changes in RSCM imply an increased focus on capacity development with suppliers. Buyers who work with capacity development of suppliers mention that their aim is to build the capabilities of suppliers, instead of enforcing ‘pass or fail’ audits, thereby ensuring a positive impact. However, capacity development seems to focus on enabling suppliers to comply with Codes, i.e. to act as a part of existing risk management strategies, instead of enabling suppliers to become genuine CSR practitioners contributing to sustainable development. Buyers are likely to not achieve the desired improvement of risk-management as other challenges surface. Suppliers often experience capacity development as activities which ultimately always infer extra costs: *“Even though I get help with training from both ABD and PIP, I find, by the end of the day that I will have spent a million shillings just on doing the necessary improvements they [the Codes] require”*. Suppliers do not oppose the training and education they receive, but merely point out that they do not have the financial capacity to implement the knowledge they receive. Capacity development provided

by buyers therefore seems to have some clear limitations, though adding some value, making it an unsustainable solution for securing impact in its current form.

Challenges

On the basis of this Sub-report, the cost effectiveness of RSCM 1.0 and 2.0 monitoring and auditing procedures should be questioned. Though difficult to assess precisely, the international buyers clearly spend significant amount of resources on RSCM 1.0 and 2.0. While some positive impacts have been identified, the international literature also reveals several negative impacts. Even though the estimation of these costs could prove a daunting project, researchers may approach this challenge by trying to establish more exact costs for a few buyers and their suppliers. As importantly, the current approaches to impact assessment need to be developed and utilised to ensure the more accurate evaluation of actual impact of RSCM in relation to human rights, including labour rights, the environment and corruption practices.

Another challenge concerns the limited role played by local governments in assisting suppliers in capacity development and improving compliance. Suppliers in Kenya and in Bangladesh expressed the need for governments to play a more active role in enhancing opportunities for capacity development and ensuring suppliers' compliance. Kenyan suppliers suggest that the grants should be paid by foreign ministries, such as Denmark's, which should be used to, e.g. build capacity within the local ministries of a particular area, who could appoint a single body to be in charge of executing the audits and promoting standards. The latter proposal resembles the Ghana Business Code initiative by Danida in Ghana. RSCM 3.0 proposes to take one step further, by also suggesting the more active involvement of buyers.

A final challenge for buyers concerns a closer assessment of the consequences of capacity building programmes for suppliers. The study has shown that suppliers are faced with considerable challenges relating to training programmes that, if followed, would infer extensive additional costs.

Hypothesis B – Code Mania

The hypothesis states that *“Mainstream RSCM Generation 1.0 approaches lead to 'code mania'”*.

The term ‘code mania’ covers how suppliers are met with a multitude of codes of conduct simultaneously. The data examined in this study generally confirms this hypothesis. Suppliers do not experience Code provisions problematic as such. The Codes are usually phrased on a few pages and are very similar in content. The challenges appear during implementation, where the subset of requirements in relation to various items in the Codes differs considerably. Thus, suppliers generally appreciate the general aim of the Codes, but nonetheless, experience and suffer from code mania via Code monitoring and implementation. Interviews with suppliers reveal how RSCM processes in fact take place and highlighted the urgency of addressing code mania.

The nuances discovered by the study could lead to the rephrasing of the original hypothesis: *Mainstream RSCM Generation 1.0 and 2.0 approaches lead to 'code mania', creating a situation where suppliers are met with multiple, contradictory and differing sub-demands during monitoring and implementation.*

When addressing compliance with these demands, suppliers experience that such efforts require considerable human and financial resources. This finding contributes to support hypothesis F (exclusion of SMEs), as SMEs in general have fewer available resources to devote to issues that are not focused on short-term financial objectives in order to survive.¹⁷

Code ‘Implementation’ Mania

The study establishes that the problem of code mania does not exist on Code or principle level, as the content of the Codes are very similar, even across RSCM 1.0 and 2.0 Codes. More than 98% of the Codes include the four core labour rights. Furthermore, the majority of Codes make use of the same 8-10 rights only.¹⁸ Differences thus arise on the implementation level, where there are large variations in how buyers interpret the principles stated in their Codes into implementation guidelines. The accompanying monitoring and auditing requirements for Codes, which are seldom displayed in public, are very diverse.

¹⁷ For more on exclusion of SMEs, see hypothesis F below.

¹⁸ Confer hypothesis D below.

How Code Mania takes place

Suppliers helped shed light on how code mania in fact takes place. Accordingly, the problem of code mania faced by suppliers is expressed in three different ways. Firstly, complying with multiple Codes simultaneously entails being monitored and audited repetitively on more or less the same issues. In general, this exercise appears non-constructive and tiresome for suppliers. Secondly, suppliers are often faced with contradictory sub-requirements, on a practical level during monitoring and implementation, of the overall similar principles contained by the Codes. In practice, conflicting sub-requirements make it impossible for suppliers to comply with the Codes simultaneously. One supplier explained: *“I had an issue with the factory doors. Some buyers wanted the door to open one way and another one wanted it to open the other way. So I suggested a sliding system”*. Thirdly, buyers’ sub-demands often differ considering which level of standard is required. In practice, suppliers need to conform to the highest implementation standard, in order to be compliant with all buyer demands. This in turn has two challenging consequences; a) suppliers are excluded from supply chains because they do not have disposal over the necessary resources and flexibility to fulfil the highest Code implementation requirements of all buyers, and b) buyer company free-riding takes place, resulting in some buyer companies, only investing minimal efforts and resources, while benefiting from the high standards and training provided to their supplier by another buyer. The buyer benefiting from this may often be a competitor.

Capacity requirements

In general, code mania results in rising time and financial requirements among suppliers. Many large suppliers have created ‘compliance departments’ within their administration. The suppliers have up to as much as 10 % of their administrative staff working full-time, ensuring compliance and handling visits from auditors or monitoring employees from buyers. In addition, also other management staffs use



resources in this field. The financial requirements also add pressure on the suppliers: *“Compliance makes the cost of production high. And you will only recover these costs long-term. Compliance forces us to invest so much and the returns will take quite a while before the investment is recouped”* (Supplier-representative). This is especially hard on SMEs, who do not have the flexibility or surplus of time, or finances, at their disposal. The added pressure might furthermore contribute to their exclusion of global supply chains.

Addressing Code Mania

Some buyers recognise the negative consequences of RSCM 1.0 and 2.0 practices for suppliers. However, only few initiatives try to improve on the coordination between buyers, in order to decrease the pressure on suppliers. A buyer stated: *“... in Bangladesh and India, we discuss it [the issue of coordination] with other buyers, but this effort has not been very successful, I should say. There seems to be reluctance on giving up one’s own approach, and this reluctance is blocking efforts to harmonize the implementation”*. Meanwhile, initiatives on the coordination of RSCM efforts are highly appreciated by the suppliers, many of whom express a desire for a harmonization of Codes and, monitoring and auditing procedures.

RSCM Generation 2.0 also contributes to Code Mania

The study also reveals that code mania is not only a RSCM 1.0 phenomenon. RSCM 2.0 Codes contribute significantly. Apparently, buyers are using the RSCM 2.0 Codes, simultaneously with their individual RSCM 1.0 Code, or they build in company specific annexes to the industry RSCM 2.0 Codes. This is because the RSCM Codes are, e.g. not considered comprehensive enough to cover all necessary risk-factors. Finally, suppliers believe they are met with different industry Codes, depending on which market the particular buyer comes from. *“Every market has its own standard and if you read the standards they all sing the same song. It is only the name on the front cover that differs, but the document inside is the same”*. As long as the RSCM 2.0 Codes do not replace, but only supplement the company Codes, code mania is worsened by well-intentioned RSCM 2.0 initiatives.¹⁹ Code mania can, in addition, be escalated by continuously making sub-requirements to the RSCM 2.0 Codes more elaborate and demanding for suppliers.

¹⁹ We found one example of a buyer, which had shifted to RSCM 2.0 only.

Challenges

Code mania constitutes a serious strain on human and financial resources among the suppliers. The lack of coordination among buyers using codes, which in general are very alike, and having implementation practices that vary leads to a waste of valuable resources. This is furthered by the lack of transparency among buyers as the implementation manuals and procedures are not public. While RSCM 2.0 has been viewed as a solution to this problem, the present situation shows that RSCM 2.0 adds to the problem as buyers choose to add RSCM 2.0 to their existing use of RSCM 1.0. Only one of the buyers in this study had shifted to RSCM 2.0 only. The lack of knowledge on the use and contents of monitoring and implementation manuals limits the possibilities of assessing possible solutions to code mania.

Hypothesis C – Impediments from traditional Supply Chain Management

The hypothesis reads; *“Traditional corporate sourcing strategies and purchasing practices have been identified as some of the primary impediments to ensuring adequate standards with suppliers”*. Overall, the findings confirm the hypothesis.

The data reveal that buyers manage their supply chain through a set of traditional procurement criteria involving; price, delivery time, flexibility in meeting orders, economic solidity, quality etc. Additionally, they are increasingly adopting CSR practices, leading to the implementation of Codes in global supply chains. Hence, a new set of criteria on human rights, including labour rights, the environment and anti-corruption standards, is handed down to the suppliers. It is also important to note that numerous buyers highlighted that they had spent or are spending considerable resources in seeking to adjust the traditional procurement and the CSR practices.

Arising conflict between SCM and RSCM practices

The imposition of buyers’ additional CSR requirements to their traditional SCM entails that suppliers have to live up to criteria from both practices simultaneously – CSR on one side and procurement on the other. These two practices may, however, present opposing and conflicting demands, which have severe implications for suppliers’ ability to comply. Hence, buyers’

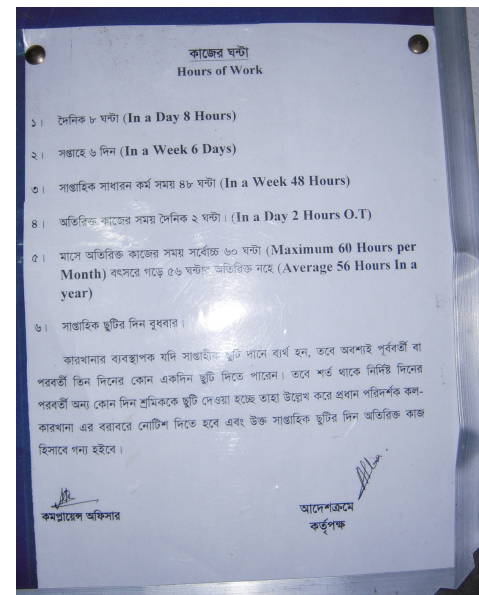
conflicting demands, arising from the ‘additionality’ of CSR requirements are the main challenge in achieving adequate standards with suppliers. The data has also shed some new light on the topic at hand and presents a more nuanced picture of where conflicting demands surface, also exemplifying the concrete challenges that suppliers experience. Buyers’ conflicting CSR and SCM demands occur within three particular areas described below.

High CSR standards vs. low prices

First, conflict occurs when buyers require suppliers to adopt high CSR standards, which in itself is costly, while insisting on a low price for the products. Suppliers experience that buyers are not willing to compromise on either price or CSR requirements, but instead expect suppliers to *“improve without paying for it...the price does not change...when they order it is not in the back of their minds that they should pay for our compliance...they order and push the price down while at the same time demanding [high CSR standards]...”*(Supplier-representative). Pressuring suppliers from both sides, as in this case, reduces the profit margin of suppliers, making CSR bad business. From the supplier’s viewpoint, demanding compliance without negotiating prices, is asking for the impossible.

Overtime vs. Delivery time

The second conflict arises when buyers expect suppliers to ensure on-time delivery on the one hand, while making sure they do not make use of overtime on the other hand. This condition poses a great challenge to suppliers’ compliance abilities; often they cannot comply with both demands simultaneously. Contextual conditions in developing economies can also intensify such compliance challenges. Power cuts, as often experienced in Bangladesh, exemplifies the large impact that such contextual condition may have on the supplier’s ability to ensure ‘on time’ delivery. One supplier expressed it accordingly; *“when I have to meet a deadline and we lose four hours of electricity in a day that will naturally affect the workers that have to work more”*.



Minimum wages vs. low prices

A final dilemma surfaces, when buyers want low prices, while demanding that suppliers live up to a certain minimum wage level, at the same time. This can be illustrated in two examples. 1) The supplier will offer a low price to accommodate the price demand. The only way to do that is by cutting down the variable costs, which means cutting down labour costs. This is however, in conflict with the buyers' CSR demands on ensuring a minimum wage level. 2) The supplier will increase the wage level and pay a minimum wage to accommodate the buyer's demands on wages. However, wage increases may negatively impact the suppliers' competitiveness. The suppliers were rather critical regarding the wage expectations of buyers since they were well-aware that the reason that they got orders in the first place, was due to their low prices, made possible by low labour costs. A continuous wage increase will, from the supplier's perspective, ruin their comparative advantage and drive international buyers away.

Paradoxes resulting from a lack of integration

Hence, buyers imposing CSR and procurement demands have severe consequences for suppliers. Suppliers experience difficulties in complying while still making profitable business. Conflicts are increased when RSCM processes run in parallel to or fragmented from, rather than integrated in, ordinary SCM practices by buyers. What has been presented on conflicting demands clearly indicate the prevailing fragmentation of buyers' SCM and RSCM practices. One supplier provided a clear example illustrating how buyers' fragmented approaches became apparent during the monitoring process at the supplier's premises. *"... In one day we can be [monitored] twice from the same buyer. In the morning, the procurement people will come to check whether we are able to make the order in time and they are happy to see that we are, but then in the afternoon comes the compliance team and they are unhappy by the fact that we used three hours of overtime yesterday"*.

Moving towards a more integrated approach

Nonetheless, some buyers are increasingly recognizing the need to change their fragmented RSCM approaches to diminish the level of conflict and to address the compliance challenges experienced at supplier premises. This has been evident from some of the buyer initiatives that focus on 1) ensuring open and on-going dialogue with suppliers and 2) uniting the RSCM and SCM practices in the monitoring process. Hence, integrating RSCM and SCM practices is a

trend among a group of buyers – with a development over time from fragmented, parallel systems towards more integrated systems. However, it appears that there is long way to go before completing and reaching a fully integrated RSCM and SCM approach.

Challenges

The clash between traditional procurement and CSR practices highlights difficult issues to address and seek to solve in order to support economic development in developing countries. Whether the dilemma concerns a) high CSR standards versus low prices, b) overtime versus delivery time, or c) minimum wages versus low prices, it has an impact on buyers and suppliers. The limited knowledge on best-practice examples hampers the possibilities of increasing the awareness on how to solve these dilemmas. Furthermore, buyers are challenged as long as they operate with a fragmented approach to SCM and RSCM. The compliance challenges are very complex and more knowledge is thus needed to enable sustainable solutions – either by ensuring fully integrated R/SCM approaches or – as suggested in RSCM 3.0 by addressing the structural challenges at suppliers' location. Governments and, where relevant, donor agencies will be needed to partake in future collaborations.

Finally, suppliers were particularly concerned about the cost challenge; complying with costly CSR demands. To avoid this challenge, suppliers proposed that buyers carry some of the costs. In other words, the product price would increase. Requesting buyers to financially support the burden of suppliers' compliance seem questionable when buyers source from developing economies to ensure low prices. Also, if the supplier transfer the full compliance cost to the product price the supplier may well experience that the business will lack local competitiveness.

Hypothesis D – Code Limitations

Hypothesis D states that: *Most Responsible Supply Chain Management approaches limit themselves to a few basic human rights, and are not able to acknowledge the indivisibility, interdependency and interrelatedness of human rights to secure human dignity.* The hypothesis is based on a United Nations Declaration, following the Conference on Human Rights in Vienna 1993, stating that every human right

should be treated on the same footing, and with the same emphasis²⁰ and the UN Framework for Human Rights and Business adopted by the UN Human Rights Council in June 2008²¹, stating that all business sectors in all regions of the world can potentially affect all human rights contained in the International Bill of Human Rights.

The review of 38 supplier Codes confirmed hypothesis D showing that current Codes from front-runner buyer companies include only few basic human rights. Furthermore, a range of nuances to the hypothesis has also come to our attention; these are also highlighted below.

Most human rights are not included in the Codes

This study confirms the hypothesis, in determining that many human rights are indeed, not included in current RSCM approaches. To be more precise, no Code incorporates all human rights. The Code, which includes the most human rights, includes 15 out of the 36 human rights derived from the International Bill on Human Rights (42%) only. The Codes include the same basic rights to a large extent. Thus, 11 human rights are not mentioned in any of the 38 Codes reviewed. In addition, more than 50% of the human rights are referred to in less than 10% of the Codes. In general, the Codes only make reference to 32% of the human rights included in the International Bill of Human Rights.²²

In 2008, on the basis of the Vienna declaration and an extensive empirical survey, the SRSG, found that corporations have been criticized for violations of *all* human rights from the International Bill of Human Rights - not only the core labour rights.²³ He therefore stressed the relevance of all human rights for corporations, although some might only be relevant through corporate complicity. This present study however reveals that front-runner companies, currently far from include all rights in their RSCM approach. The buyer companies presently seem to copy from each other, including few and the same rights. Thus, current RSCM approaches do not adequately cover corporate risks on human rights.

²⁰ <http://www.unhchr.ch/huridocda/huridoca.nsf/%28symbol%29/a.conf.157.23.en> (20.05.10).

²¹ Confer the third report of the UN Special Representative to the Secretary General on Human Rights and Business, Professor John Ruggie, see <http://www.reports-and-materials.org/Ruggie-report-7-Apr-2008.pdf> (10.06.10).

²² See Sub-report D for further information.

²³ <http://www.reports-and-materials.org/Ruggie-report-7-Apr-2008.pdf> (20.05.10).

Few and similar human rights are included in the Codes

As mentioned, the Codes are quite similar concerning which rights they do, or do not include. Thus five rights are included in all of the reviewed Codes and ten rights in more than 80% of the Codes. These ten rights include the four core labour rights namely; abolition of forced and compulsory labour, freedom of association/right to form a trade union, elimination of discrimination and abolition of child labour.²⁴ See *Table 1* below for an overview of the mentioned rights.

Table 1 - Human rights mentioned in the Codes of Conduct

Human right	Generation 1.0 Codes (%)	Generation 2.0 Codes (%)	% of total Codes mentioning the right
Prohibition against Slavery, Forced- or compulsory labour	100	100	100
The right to a family life (marriage, maternity & children) + prohibition of exploitative child labour	100	100	100
The rights of the child	100	100	100
Non-discrimination	100	100	100
The equal right of men and women	100	100	100
The right to form & join trade unions and the right to strike	96	100	97
Freedom of association , incl. right to form & join trade unions	93	100	95
Right to a living wage , The right to safe and healthy working conditions , The right to rest, leisure and holidays	86	100	89
The right to health	82	100	87
Prohibition against torture, inhumane & degrading treatment	75	100	82
The right to education	46	70	53
The right to adequate food , fair distribution of food, the right to clothing and the right to housing	18	50	26
The right to privacy	11	40	18
Minority rights to culture, religious practice and language	14	20	16
The right of peaceful assembly	18	10	16
The right to work	4	30	11
The right to hold opinions, freedom of expression, freedom of information	14	0	11

Note: The table show the rights mentioned in more than 10% of the Codes. The "equal rights of men and women" is an outlier in comparison with the other rights, as it almost exclusively is mentioned implicit, e.g. as references to gender issues, etc.

Table 1 also shows that there are some differences between RSCM 1.0 and RSCM 2.0 Codes, concerning how comprehensive they are. In general, RSCM 2.0 initiatives have wider human

²⁴ http://www.ilo.org/global/About_the_ILO/Mainpillars/TheRightsatwork/lang-en/index.htm (20.05.10).

rights coverage than individual company Codes and have wider coverage of risks, though not fulfilling the recommendations by the SRSG.

Differentiation between rights

In addition to not including all human rights, some of the interviewed buyers explained that they added more emphasis to some of the included rights than others. *“We have a different approach depending on the rights. Child Labour is never accepted, whereas we have a more pragmatic approach to overtime issues... Overtime hours – is the most prevalent issue when it comes to non-compliance. We constantly struggle with this problem”*. This approach does not correspond to the UN recommendation that every right should be treated with the same emphasis.

Rights based approach?

Even though no Code includes all of the human rights, quite a number of the Codes make a general reference to human rights or take a rights-based approach to certain issues, e.g., child labour. Thus, 71 % of all Codes reviewed explicitly mention human rights. In addition, 42 % make reference to the UN Global Compact, which also includes the respect and support of human rights in its first principle. However, the sheer mention of human rights does not guarantee adequate risk management, or safeguard the company against violations. Unless the framework is unfolded and the rights implemented on a more concrete level, it remains nothing but a proclamation carrying no real weight, no guarantee of actual impact and providing little direction on operational level.²⁵

The three bottom lines

In addition to having the responsibility to respect all human rights, businesses also have an environmental as well as an economic responsibility. However, the Code review reveals that current Generation 1.0 and 2.0 RSCM practices are very biased towards the People bottom line. In none of the Codes, are environmental and economic responsibilities unfolded as comprehensively as the social responsibilities. This finding entails a hidden paradox; as the area which is seemingly given most priority in the Codes, still does not provide adequate coverage.

²⁵ Emmelhainz, Magaret (1999): *The apparel industry response to sweatshop concerns: A review and analysis of codes of conducts*, ‘The journal of supply chain management: A global review of purchasing and supply’, p. 56.

This finding implies that the environmental and economic issues are far from covered in current approaches. Nevertheless, the suppliers emphasize that buyers are slowly beginning to increase the amount of environmental demands in the Codes they are met with.²⁶

Challenges

Buyers, as well as many different stakeholders, tend to find the notion that ‘all human rights should be included’ very challenging. Many argue that knowing how companies are not even able to incorporate (and enforce) all relevant labour rights in current Codes, it is far from realistic that other (non-labour) rights such as ‘the right to a fair trial’ will be included within the near future. As one stakeholder argues: “... *A large part of these rights are linked to the political and legal system in the country the supplier is based*”, which implies that violations of these rights are beyond the control of companies and belong to the duties of government.

This argument is only valid in so far as one sees current RSCM approaches (Codes and Monitoring) and their established scope, as the only way of practising RSCM. However, if one accepts and appreciates that buyer



companies do have risks in relation to all human rights (even though some of them might only be relevant through corporate complicity)²⁷, buyer companies need to address the challenge of widening the scope of rights assessed in order to manage risks effectively.

Hypothesis E - The extensive number of suppliers and sub-suppliers

The hypothesis reads: “*The extensive number of corporate suppliers and sub-suppliers, often amounting to tens of thousands for a single buyer, render non-discriminatory, transparent, accountable and independently verified SCM less than cost efficient, if de facto, not impossible under RSCM Generation 1.0 and 2.0.*”

²⁶ Some buyers have had their main focus on environmental demands due to the nature of their operation.

²⁷ <http://www.reports-and-materials.org/Ruggie-report-7-Apr-2008.pdf>, p. 20 (05.06.10).

RSCM 1.0 and 2.0 basically add a number of additional (CSR) requirements to SCM. Common expectations to RSCM approaches would include that they are non-discriminatory, transparent, accountable and independently verified.

The study confirms that it is highly unlikely that non-discriminatory, transparent, accountable and independently verified RSCM 1.0 and 2.0 engagements with all suppliers from all tiers will ever happen. Indeed, the mere challenge of engaging in such diligent RSCM approaches in relation to first tier suppliers appears daunting and impossible in relation to sub-suppliers.

Relations between buyers, suppliers and sub-suppliers (the suppliers of first tier suppliers) differ considerably, which highlights a need to distinguish between the two types of relations for further analysis. It also confirms that RSCM 1.0 and 2.0 approaches cannot be carried out in relation to all tier suppliers. In the following the diligence criteria are first discussed in relation to the buyer's first tier supplier relations and secondly in relation to the buyer-sub-supplier relations. First we make an estimation of the number of suppliers, buyers usually deal with.

The number of suppliers

All buyers address first tier suppliers in their RSCM approach. However, in order to be able to manage the engagement, they first tend to differentiate between core and non-core suppliers. The core suppliers are very important for the buyer. The number of first tier core suppliers ranges from about 200 as the lowest to several thousand. The average is around 1700 first tier core suppliers.²⁸ In addition to these suppliers, the international buyers have a vast number of 'non-core' suppliers, often 5-10 times as many as the core first tier suppliers²⁹; i.e. in average between 8500 and 17000 non-core suppliers. In addition to the first tier (and the non-core) suppliers, the buyer companies then have a substantially larger number of sub-suppliers. The number of sub-suppliers is not known to the buyers. The large number of suppliers and sub-suppliers makes ensuring non-discriminatory, transparent, accountable and independently verified RSCM vis á vis all suppliers and sub-suppliers a huge challenge, if not impossible.

²⁸ See Sub-report A and appendix 12 in the Annex volume. The figure is higher for the non-Danish buyers (app. 3200) than for the Danish buyers (app. 1100).

²⁹ As the 'non-core' suppliers are perceived of less importance to the buyer companies; they are thus not included in the RSCM approaches, do not have to live up to the same requirements as core suppliers and do not have to be monitored and/or audited. Accordingly, the study does not deal with these companies.

RSCM and the first tier suppliers

Below follows a summary of the findings on current RSCM practices in relation to the four parameters.

Non-discrimination

Though the buyers are moving towards an emphasis on 'capacity development of suppliers' and spend increasing amounts of money and human resources on establishing a close and intensive relationship with their first tier core suppliers, they do not have one uniform approach in dealing with their suppliers. In addition, the choice of determining which suppliers to engage with is biased. Present RSCM 1.0 and 2.0 approaches tend to discriminate based on country of origin and on size. The economic developing country suppliers are discriminated against as they continue to be viewed a higher risk than the economic developed country suppliers; by the mere fact of their national origin. Smaller suppliers are also considered more a higher risk than larger suppliers or; the larger suppliers are considered 'risk free' and hence not in need of being monitored.

RSCM 1.0 and 2.0 demands, or engagement requirements, pose a burden to suppliers.³⁰ The initiatives are directed at legal persons and may, from a contractual point of view, be acceptable. However, the practices would appear to constitute a challenge in relation to core CSR and thus basic Human Rights principles. Discrimination against physical persons based on national origin is prohibited. Interestingly, the practice of choosing which suppliers to monitor and engage with appears un-questioned when dealing with legal persons. The practice becomes even more questionable considering the findings of one buyer; '*we continue to find areas on non-compliance among our European and American suppliers*'. The UN SRSG, similarly highlights that all business sectors in all parts of the world were found to violate basic human rights.

Lack of transparency

While the Codes are public and very similar in content, the implementation practices are neither publicly accessible nor similar. As described above, this leads to code mania and means that it is the monitors who have the final decision when concluding an assessment of the level of

³⁰ Confer Sub-report C.

compliance of a given supplier, while the supplier has little choice other than to follow the demands.

Some buyers have a 'higher level' of tolerance, other buyers have a 'limited level' of tolerance, so while a supplier can experience that time is given to remedy non-compliance from one buyer, it happens that contracts are terminated by other buyers with a 'zero-tolerance' approach. Accordingly, we find limited or even a lack of transparency on behalf of the buyers. The lack of transparency has further consequences for the accountability and independency.

Lack of accountability and independent verification

When monitoring and implementation is not publicly accessible, it is impossible to ensure accountability and independent verification in RSCM approaches, particularly with regard to RSCM 1.0.³¹ This means that the demand for responsible supply chain practices by various stakeholders is fraught with dilemmas. Transparency in relation to publicising the Codes or demands for 3rd party auditing, does not imply that RSCM 1.0 leads to accountability and independent verification. Firstly, most buyers monitor the Codes themselves and the use of auditors is actually limited.³² This means that accountable and independently verified RSCM is rare. Secondly, when it is found, it is hampered by the lack of transparency, as described above.

Some RSCM Generation 2.0 initiatives are relatively more open and transparent and the application of these approaches could also improve accountability and verification measures.

The number of suppliers as a hindrance

Even when restricting RSCM to encompass only core suppliers, international buyers as mentioned deal with several hundred up to several thousand first tier suppliers and an even higher number of sub-suppliers as part of their supply chains. The large number of suppliers is in itself a hindrance for achieving commonly desired standards like non-discriminatory, transparent, accountable and independently verified SCM in the relationships between buyers and first tier suppliers.

³¹ We are aware that many companies provide general statistics from auditing reports, e.g. according to region. Nevertheless, most of the data on which these statistics are based, have not been independently verified.

³² See Sub-report A, Annex volume.

Considering the vast number of suppliers and sub-suppliers of a single company, the study has thus confirmed that it is unlikely that non-discriminatory, transparent, accountable and independently verified RSCM 1.0 and 2.0 engagements with all suppliers from all tiers will ever happen. Indeed, the mere challenge of engaging in such diligent RSCM approaches in relation to first tiers suppliers appears daunting for buyers.

RSCM and the sub-suppliers

Inclusion and exclusion of sub-suppliers in RSCM Generation 1.0

All interviewed buyers have supply chains which extend to second, third and additional tiers of (sub-) suppliers, but none of them includes the sub-suppliers in their RSCM approaches. All buyers, however, recognise that sub-suppliers constitute a major risk to buyers' reputation as stakeholders expect a company to deal with its entire supply chain. Considering that buyers' RSCM approaches do not include the sub-suppliers, the issues of discrimination, transparency, accountability and independent verification cannot be discussed for this relation. The study briefly addresses why sub-suppliers are not included in RSCM approaches.

Six reasons for not including, engaging with and monitoring the sub-suppliers are mentioned, ranging from lack of contractual control, resistance from first tier suppliers, difficulties in extracting information from the sub-suppliers as well as difficulties in simply following the supply chains, to lack of capacity and human resources.

The findings also reveal that there is an emerging trend of experimenting with inclusion of a limited number of sub-suppliers. This trend seems closely connected to the trend of developing capacity with first tier suppliers with the ambition of having first tier suppliers monitor the sub-suppliers.

Many RSCM 1.0 and RSCM 2.0 Codes contain a paragraph requiring suppliers to enforce the Code towards their first tier suppliers, i.e. the buyers' sub-suppliers. 43% of RSCM 1.0 and 30%



of RSCM 2.0 Codes reviewed include such a paragraph, highlighting a wish from the buyers to control the potential risks further down the supply chains by transferring the obligation (and the costs) to their first tier suppliers. Buyers are thus attempting to start a ripple effect, where first tiers control of their own first tiers is an attempt to manage the risk from sub-suppliers. The buyers openly state that supply chains are so long and complex that the task is impossible for them, thus hoping that the suppliers can handle the task.

Given that none of the present front-runner international buyers manage to include sub-suppliers in the RSCM approaches, it is plausible to assume that no buyers do. Since corporations undertake RSCM in order to manage risk and risks emerges from all tiers of suppliers, present challenges indicate a need for establishing an approach that cuts across tiers and hence presents an alternative to present approaches.³³ While a few buyer companies have dealt with, or have just started working on possible solutions, all buyers and suppliers acknowledge the major problems involved. Some buyers even view the challenge of including sub-suppliers as the *key* future issue to deal with.

The hypothesis can thus be verified. The extensive number of sub-suppliers, often amounting to tens of thousands for a single buyer, render non-discriminatory, transparent, accountable and independently verified RSCM less than cost efficient, if, de facto, not impossible under RSCM Generation 1.0 and 2.0.

Challenges

Two key challenges need to be addressed. Firstly, buyers are recommended to revise current practices to answer some of the challenges identified in this study, e.g. avoiding discrimination either by removing the 'national risk' criteria or directing RSCM at governments and public authorities. Buyers may also consider improving transparency by disclosing the implementation and monitoring guidelines. Secondly, the sheer number of suppliers and in particular sub-suppliers poses a major challenge to the RSCM 1.0 and 2.0 approaches. While the trend among buyers is to emphasise capacity development of (first tier) suppliers in order for these suppliers to engage with sub-suppliers, the magnitude of sub-suppliers makes this trend insufficient. In

³³ This is discussed below in the section 'RSCM Generation 3.0'.

addition, to the challenges identified when investigating this hypothesis, the study also revealed a major lack of knowledge in this area, which poses an obstacle to focusing on RSCM and the suppliers (first tier and sub-suppliers - larger and SMEs).³⁴

Hypothesis F – Exclusion of SMEs

This hypothesis deals with the possible exclusion of small and medium-sized enterprises (SMEs) from global supply chains as a result of RSCM practices and therefore reads: *SMEs are excluded from global supply chains as a result of RSCM practices.*

On the basis of this study it is difficult to verify the hypothesis 100%. This is mainly due to the set up of the study, the inability to separate RSCM and SCM practices and the limited information from buyers. It has, in other words, been difficult to isolate the possible cause of exclusion, which stems directly from RSCM, and not just a general tendency of SME exclusion within global supply chains. Nevertheless, the findings from the study indicate that SMEs are hit harder by the consequences of RSCM practices due to their inherent characteristics compared to larger suppliers. Thus, the study concludes that the existing trend under traditional SCM practices of excluding SMEs from global supply chains appears to be accelerated by RSCM practices.

Consolidation of the supply chain

Our findings clearly indicate that there is a trend of pressuring and excluding SMEs from global supply chains. Nearly half of the buyers report a reduction in the number of suppliers over the last five years, and a number of the 25% of buyers stating 'no change' and of the 25% reporting an increase, state that the reduction of the supplier base happened more than five years ago and/or that consolidation among the suppliers is currently taking place. With the majority of the suppliers being SMEs from developing economies³⁵, we assume that exclusion has taken and is taking place.

³⁴ See also Sub report F, Annex volume.

³⁵ See appendix 12 in the Annex volume for figures on numbers of suppliers from developing economies.

Isolating the cause of exclusion

A couple of factors prevent us from fully verifying the hypothesis. Firstly, the study set up has not allowed an in-depth assessment of, whether SMEs are excluded or not, in particular, as it is difficult to isolate what the determining factor of exclusion is - RSCM Generation 1.0 and 2.0 or existing general SCM practices. Secondly, the data from the international buyers were in some cases limited or lacking as a number of buyers do not record the size of their suppliers. Nevertheless, whereas the study did not establish the evidence to determine whether RSCM excludes or does not exclude per se, it has established strong indications that RSCM demands accelerate already existing consequences of exclusion in SCM practices. Furthermore, the concentration of the supplier base is mentioned in many studies. Finally, the study was not able to identify any elements in RSCM approaches, which counteract this trend and pointed towards an increase of the number of SMEs.

Unequal distribution of negative side-effects

Buyers state that all suppliers are treated equal when it comes to RSCM (large as small suppliers, existing as new suppliers). However, our findings above show that the cost pressure, code mania, risk assessments and other factors have worse consequences for the SMEs, leading to an unequal playing field. As Baden et al. states: *“The (compliance) tick-box approach not only fails to capture the idiosyncratic, informal and diverse engagement in CSR by the SMEs involved, but also evokes cynicism and resentment among many SMEs”*.³⁶

SME characteristics as a play stopper

While their mere size excludes SMEs from supplying buyers, due to inability to meet delivery schedules or volumes required; key factors from a RSCM perspective are the financial and human resources limitations. The financial elements concern the combined effect of SMEs having difficulties in acquiring loans, due to lack of collateral, and/or mobilizing own funds due to limited earnings and of the cost burdens that monitoring and auditing lead to (whether being in terms of investments in meeting compliance and/or payment for certifications). The human resource element (skills and knowledge) concerns the combined effect of limited management

³⁶ Baden D.A., Harwood I.A. and Woodward D.G. (2009). *The effect of buyer pressure on suppliers in SMEs to demonstrate CSR practices: An added incentive or counterproductive?*, 'European Management Journal', Vol. 27, p. 429-441 (p. 439).

time (of which substantial parts need to be employed in relation to auditing and monitoring visits), lacking skills in particular areas of expertise, and in some cases lacking awareness of the importance of RSCM practices.

Addressing root causes

Though governments and donor agencies are active in assisting SMEs through various policies and initiatives, they are fighting an up-hill battle trying to assist SMEs in being capable of participating in international supply chains accessing export markets, while the general business conditions by no means are conducive or supportive of this. One option is therefore, that incorporating CSR criteria into procurement decisions should be done comprehensively, or not done at all. Raynard et al argues for the need of a “third Generation of CSR”, in order to tackle poverty, exclusion and environmental degradation that goes beyond individual voluntary corporate approaches (RSCM 1.0) and successfully engages with civil society and public policy (some RSCM 2.0 initiatives and RSCM 3.0).³⁷

The SME Business Case

The interviews with suppliers in Kenya and Bangladesh, as well as international literature, demonstrate that present RSCM Generation 1.0 and 2.0 models do not enable the suppliers, and hence SMEs, to see or experience a business case. The SMEs predominantly experience a win-lose (some would say lose-lose) situation, where fulfilling requirements enable them to maintain orders to international buyers, but at a cost, probably leading to a decrease in earnings. Another example reported is that the sales prices to the buyers remain stable or stagnant, while the costs constantly increase. An added element is, as noted by Luetkenhorst, is that the SMEs face CSR requirements that “do not yet apply to their domestic markets”.³⁸ This means that the SMEs (or other local suppliers) have limited chances or opportunities of reclaiming the investments to meet the RSCM requirements.

³⁷ Raynard P. and Forstater M. (2002). *Corporate Social Responsibility: Implications for Small and Medium Enterprises in Developing Countries*, ‘UNIDO’s Small and Medium Enterprises Branch and the World Summit on Sustainable Development’.

³⁸ Luetkenhorst W. (2004). *Corporate Social Responsibility and the Development Agenda: The Case for Actively Involving Small and Medium Enterprises*, ‘Intereconomics’, Vol. 39, No. 3 (p. 161).

The Global Aspect

The exclusion of SMEs is serious to government and donor agencies that strive to support the SMEs in order to enhance local business development and hence, increase economic development and growth. It can be debated whether participation in global supply chains is necessarily the only means to secure these objectives, as local supply chains can also be considered important. The exclusion of developing economy SMEs from such global supply chains naturally entails their exclusion from international markets.³⁹ This is clearly problematic as it restricts the possibilities of acquiring new knowledge and skills among the SMEs, with the risk of further marginalizing them under the rising demands in the global economy and hence, limits the chances of securing economic growth and a rise in employment in developing economies.

Challenges

The exclusionary mechanisms of RSCM thus pose a major challenge to and counteract much of the present Private Sector Development (PSD) activities, which are undertaken by developing country governments and donor agencies, and call for new approaches. Accordingly, it is critical that governments, donor agencies and buyers address the present RSCM biases towards SMEs. The biases include insufficient financial support and loans, certification costs to SMEs, lack of appropriate 'business development/business support initiatives', e.g. aimed at increasing the skills base and creating awareness of responsible practices.

An additional challenge, in particular for governments and donor agencies, concerns the lack of appropriate infrastructure. If suppliers operate in a business environment characterised by lack of basic governance and infrastructure, it only aggravates existing problems. While we came across problems with frequent power-cuts, forcing suppliers involved to adapting to



³⁹ Raynard et al. (2002).

unfavourable circumstances, the problems also include poor roads and transportation systems, lack of assistance on how to deal with trade requirements, and corruption. Not only do these circumstances pose additional challenge to SMEs and sub-suppliers, they also create mistrust to governments.

Finally, lack of knowledge, including a considerable gap in the literature that specifically addresses the needs and perspectives of SMEs in relation to RSCM, constitute a challenge. There is a particular lack of empirical evidence⁴⁰ (and more so, on the social responsibility behaviour of micro enterprises and SMEs, as well as the impact of Codes on SMEs⁴¹). There is a body of the literature highlighting the differences in terms of resources and structural realities between SMEs and MNCs.⁴² Others point to the need for a different approach, often speaking of a “Small business behaviour” or “Small Business Social Responsibility”.⁴³ Empirical studies suggest that SMEs often have CSR activities but that they do not report or communicate these to the external stakeholders, or do so informally.⁴⁴

Responsible Supply Chain Management Generation 3.0

RSCM 3.0 is introduced below as a possible response to the challenges identified in relation to RSCM 1.0 and 2.0. RSCM 3.0, however, represents a long term solution to establishing a sustainable approach to RSCM. Therefore, in the outset of integrating the RSCM 3.0 approach, RSCM 3.0 should be understood as a supplement to current RSCM approaches. With time RSCM 3.0 can, however, be an alternative to RSCM 1.0 and 2.0. In the following the concept of RSCM 3.0 is unfolded, secondly RSCM 3.0 is presented in light of the findings of this study, and finally the concept is analysed vis-à-vis each of the six hypotheses.

⁴⁰ Luken R. and Stares R. (2005): *Small Business Responsibility in Developing Countries: A Threat or an Opportunity?*, ‘Business Strategy and the Environment’, 14, p. 38-53.

⁴¹ Kumari P. (2008): *Comparison of Major Issues Pertaining to Social Responsibility in Corporate and Micro, Small and Medium Enterprises (MSMEs) in India*, UNIDO.

⁴² Fassin, Y. (2008). *SMEs and the fallacy of formalizing CSR*, ‘Business Ethics: A European Review’, Vol. 17, October; and Raynard P. and Forstater M. (2002). *Corporate Social Responsibility: Implications for Small and Medium Enterprises in Developing Countries*, ‘UNIDO’s Small and Medium Enterprises Branch and the World Summit on Sustainable Development’.

⁴³ Vives A. (2005). *Social and Environmental Responsibility in Small and Medium Enterprises in Latin America*, Journal of Corporate Citizenship, Vol. 21, p. 39-50; Fassin, Y. (2008); Luetkenhorst, W. (2004); Raynard and Forstater (2002); Kumari, P. (2008); Dutta S. and Banerjee S. (2009). *Ownership Patterns and Ethical Practices of Small Enterprises in Kolkata*, ‘The Journal of Entrepreneurship’, Vol. 18, No. 2, p. 191-207.

⁴⁴ Fassin, Y. (2008); Raynard and Forstater (2002); Kumari, P. (2008).

The Concept

A Vision of 'CSR Risk Free Sourcing and Investment Zones'

The vision of RSCM 3.0 is to build 'CSR risk free sourcing and investment zones'. These are envisioned as geographical areas from which buyer companies can source without the risk that their suppliers are involved in violations of internationally agreed standards derived from the UN Global Compact principles.⁴⁵ Buyer (or investor) companies are in this regard expected to motivate and support local governments to develop structures assuring that businesses in the area do not violate basic standards within the UN Global Compact framework.

Partnership approach

RSCM 3.0 introduces a partnership approach, where the creation of partnerships between international buyers and local government bodies is central. When applying the model in developing countries a third partner becomes important, namely Donor Agencies (DAs). DAs become facilitators for the process, but only by invitation from the local authorities. Depending on existing governance structures, local exporting companies (suppliers), labour- and employers' associations, civil society and other stakeholders could also be involved in a RSCM 3.0 model.

'Bringing the State back in'

A key difference between RSCM 1.0 and 2.0 and RSCM 3.0 is the inclusion of the state or local authorities as crucial partners in the latter approach. The inclusion of the state acknowledges the first pillar of the UN SRSG's framework on business and human rights; the state duty to protect from human rights violations. Similarly international requirements rest on states, in relation to environmental protection and to the eradication of corruption. Thus, RSCM 3.0 combines the SRSGs framework concerning the state's duty to *protect* against human rights abuses by third parties, and the corporate responsibility to *respect* human rights.⁴⁶ The RSCM 3.0 approach thus abstains from developing competing parallel structures to the traditional state-society relation and, instead, seeks to motivate and enable the state to carry out its international

⁴⁵ <http://www.unglobalcompact.org/> (16.06.10).

⁴⁶ <http://www.reports-and-materials.org/Ruggie-report-7-Apr-2008.pdf> (16.06.10).

obligations and to enforce its legislation. Adequate legislation ensuring that international obligations are adhered to is already in place in most countries – also in developing countries.

Capacity Development

As mentioned above, legislation might be in place and international principles are acknowledged by the vast majority of states, nevertheless, challenges often arise in relation to enforcement. Provided that the will exist, many governments in developing economies do not currently have the resources to build capacity in order to adequately enforce laws in accordance with international principles. Establishment of ‘CSR risk free sourcing and investment zones’ thus requires the development of local state capacity in order for the state to become capable of carrying out the necessary control, monitoring and business development. In addition, to ensuring compliance with local regulations in accordance with international principles, such capacity development activity can be combined with developing and enhancing local authorities’ skills to develop local business’ (and thus suppliers’) capacity to improve performances, similar to the capacity development that buyers appear to engage in today.

The Role of Buyers and Donor Agencies

Buyers, as well as DAs, have important roles to play in the realization of RSCM 3.0. Buyer companies have a good opportunity to create leverage with local state authorities since their willingness to source from, or invest in a specific geographical area, has great economic impact locally. If local governments succeed in establishing a ‘CSR risk free sourcing and investment zone’, the ability of local business environment to sell goods and to attract investments will increase. Buyer companies’ role in RSCM 3.0 is to motivate for and possibly facilitate with local authorities to commit to, plan and execute the establishment of a ‘CSR risk free sourcing and investment zone’. DAs have been engaged in capacity development activities for decades and thus, have large experience in doing so. The capacity development component of RSCM 3.0 thus feeds directly into the approach of many DAs. The pressure and support from buyer companies combined with the expertise and support from DAs are expected to in cohesion

enable the local governments, to establish a ‘CSR risk free sourcing and investment zone’ within their country or a specific locality.⁴⁷

Implementation and Transition

The terms RSCM Generation 1.0, 2.0 and 3.0 might lead readers to expect that the three approaches function stepwise. However, companies need not start by practicing Generation 1.0 then upgrading to Generation 2.0 and so forth. Furthermore, the terms 1.0, 2.0 and 3.0 do not indicate that Generation 3.0 is the most difficult approach of the three. However, shifting from Generations 1.0 and 2.0 to Generation 3.0 may pose some challenges; corporate management systems established and professionals taking care of the systems may be expected to resist changes; although the risks that previous systems tried to address continue to exist and the challenges identified in this report call for a change of direction.

So, change will not be made overnight. In order to keep up risk management in relation to suppliers’ conduct, it should be expected that buyers will engage in a long term transition, where traditional RSCM approaches are continued and gradually phased out, while capacities in relation to RSCM 3.0 are built. Hence, in the outset of integrating the RSCM 3.0 approach, RSCM 3.0 will only act as a supplement to RSCM 1.0 and RSCM 2.0, which will eventually be phased out. Thus, there will be a period where RSCM 1.0, 2.0 and 3.0 will unfold simultaneously.

Findings from the study and RSCM 3.0

From interviews with buyers, suppliers and other stakeholders, carried out in relation to this study, it became clear that imagining RSCM 3.0 as a possible solution to some of the challenges associated with traditional RSCM practices, is not just a theoretical exercise. When asking practitioners in broad terms, without giving them any prior information about the RSCM 3.0 concept, how they could picture a possible solution to current challenges, many (especially suppliers) envisioned a RSCM approach that feeds well into the concept described above. One supplier explains: *“Maybe the solution is within one of the government arms.... If, for instance, the Danish Ministry could support our Ministry, and together they could come up with a common thing, then as a company,*

⁴⁷ State, region, city or even an export processing zone.

no matter the industry or market, you would know [that] these are the requirements. Then you also only need one audit.” Several suppliers mentioned how the support from other countries is crucial, if their own government is to lift the task of securing a certain standard within the business environment.⁴⁸ A buyer also emphasized how using a partnership approach and including the local government has helped them reach beyond first tier suppliers: “In India, a supplier was subcontracting to a child labour factory. Instead of terminating the relationship, we engaged in dialogue with the supplier. We also involved civil society and also government who could intervene regarding the amount of child labour in the region.”

According to suppliers the support needs to come not only from other governments, but also from international companies: “The western companies and even governments don’t seem to have a lot of confidence with our local [government]. All of the grants that are being channelled, if they can be setup to capacity build a Ministry and the departments which could do the audits, then these funds could be a useful cost. And it could help build the confidence needed, so that if our government has allowed something, then it is a standard that can pass internationally.”

Some suppliers stressed how national ownership and implementation of a common code should include an international outlook or a foundation in international principles. “The ideal scenario would be to have one common and global standard/code. But the country itself should have a minimum standard that is benchmarked to the global standard. The government in a given country should make these minimum standards and it is a country’s duty to develop the accountability mechanisms and the quality check - that would be doable through the help of associations. It is not possible to do this if the national governments are not included; it can create a disconnect and discontent because nothing can survive if the national government is not involved; for the sustainability of a system you need the national buy-in!”

The quotations above demonstrate that stakeholders are far from unwilling to include the state in an improvement of RSCM approaches. Rather, several stakeholders see the inclusion of the state as a condition for the success of sustainable RSCM approaches.

⁴⁸ It shall be noted that the study only involved suppliers from Kenya and Bangladesh.

Possible limitations to RSCM 3.0

Some interviewees did, however, also raise important considerations, in regard to developing a possible new approach to RSCM. A stakeholder emphasized: *“The Government is not fulfilling its basic obligations at the moment. There are problems with infrastructure, electricity, communication etc... As long as these basic services are not in place, how can we expect the government to take on another responsibility?”* This quotation highlights the major importance of the capacity development of local governments, as a crucial part of the RSCM 3.0 approach, especially when establishing the concept in developing countries. Without support from DAs and buyers, it will not be realistic for governments to take on the responsibility and ensure enforcement. Clearly, the needed capacity will not be developed overnight, or even within the time-frames that buyers provide for individual suppliers to improve performance; normally half a year. However, if a local government commits itself to establish and run a ‘CSR risk free sourcing and investment zone’ and receives sufficient support - on different areas and levels – from DAs, buyers, local industry and civil society, it is possible that the necessary capacity will be built and developed over a number of years. In some cases, it may take 5-10 years, in other cases; capacity development will take at least 20 or more years. This all depends on the local context and the existing state of governance ability, which varies significantly among countries and even states, regions and municipalities.

A second concern is that RSCM 3.0 will be more attractive to and have a larger impact on industries, where production is standardized and predominantly outsourced to developing countries; compared to more knowledge and technology intensive industries, which require high(er) skills and to a large extent continue to be localized in developed economies. Thus, the concern is that RSCM 3.0 is a geographically skewed approach.

However, this concern reflects the bias by existing RSCM approaches well. The extent, to which buyer companies practice RSCM today, varies greatly from industry to industry and thereby also from country to country. Examples of industries where RSCM have become quite common are textiles, clothing, footwear, electronics, electrical appliances, automotive components, agribusiness/horticulture and furniture. In these industries RSCM 1.0 is applied by many international buyers, though far from all.

The corporate responsibility to respect human rights is, however, not restricted to some industries or countries - it is universal. Moreover, the SRSR, as confirmed by one of the buyers in this study, reminds us that all sectors in all regions of the world face human rights challenges. That being said, the fact, that RSCM is more widespread in some industries and thereby some countries, in comparison to others can be seen as an opportunity. Enabling such 'burdened' countries to the first reaping of the outlined benefits of a RSCM 3.0 model can motivate them to move forward.

A final concern is the issue of corruption within governmental bodies. There is a general fear that inclusion of governmental agencies, in the enforcement of a standard, will create more room for corruption, ultimately hurting the suppliers. A stakeholder emphasised: *“All developing countries are facing corruption and bad government structures so it [a change] will not happen overnight – it will be a big challenge”*. Anti-



corruption thus needs to be a key focus point in a RSCM 3.0 model. An obvious course of action would be to build on the experiences of DAs, working with anti-corruption together with governments in developing economies. Other stakeholders also emphasize that corruption should not be an excuse to abstain from involving local governments in a new approach: *“... it is the citizens of a country and the private sector that can mobilise a change in corruption. Because the private sector actually rules the government; they are the ones that are funding money to the government and they can make those decisions if they want to. So there has to be a buy-in of the private sector, they have to lobby and advocate with the government.”* This comment stresses the importance of the leverage that buyer companies have with local governments. If buyers as well as suppliers see an advantage in changing to a RSCM 3.0 model, then it is likely that governments too will be motivated to partake in the initiative. *“Therefore, the solution should be a partnership between several actors, e.g. a tripartite [partnership] between a governmental Bureau of Standards, the industries and the countries buying from us.”*

Since RSCM 3.0 should be built on the universal principles of the UN Global Compact; anti-corruption will be one of the basic requirements for establishing a ‘CSR risk free sourcing and investment zone’, confer UN Global Compact principle 10.⁴⁹ Thus, anti-corruption will be part and parcel of the basic requirement in relation to economic sustainability for the zones to be established.

Hypotheses in context of RSCM 3.0

Below it will be described if and how RSCM 3.0 can meet the challenges that current RSCM approaches face. The challenges are addressed hypotheses by hypotheses.

A. Businesses spend considerable resources on monitoring and auditing, yet research shows only relatively minor actual impact on (benefit to) workers and other stakeholders

Concerning the issue of costs, we expect that buyer as well as supplier companies will be able to gradually cut costs with a transition to RSCM 3.0. Buyer company expenditures will be limited to a share of the initial phase of a RSCM 3.0 project and can with time cease completely, if so desired, once capacity development financed by DAs starts with the authorities. However, in the initiation phase, buyer companies will have to use additional funds, since they need to maintain current RSCM practices until a CSR risk free sourcing and investment zone is fully established in the countries they source from. During this time, buyers may choose to scale down their existing RSCM activities and start redirecting funds towards RSCM 3.0 thus keeping their expenses status quo, or actually realizing savings depending on their current engagements.

It is expected that government ownership of RSCM will have a larger and lasting impact compared to current practices. Evidence pointing in this direction can be found in some developed economies, where governments, in collaboration with associations and the business sector, have taken it upon themselves to ensure respect for, e.g. workers rights. However, it will be a continuous task to evaluate and ensure the impact of a RSCM 3.0 model on workers and

⁴⁹ Global Compact [Principle 10](http://www.unglobalcompact.org/AboutTheGC/TheTenPrinciples/principle10.html): Businesses should work against corruption in all its forms, including extortion and bribery. <http://www.unglobalcompact.org/AboutTheGC/TheTenPrinciples/principle10.html> (Retrieved: 22.06.10).

other stakeholders. Here the vast experience of DAs on measuring impact and development will be of great value.

B. Mainstream RSCM Generation 1.0 approaches lead to 'code mania'

RSCM 3.0 has the potential to end code mania with time. Supplier companies will have to comply with the law and possibly additional regulation reflecting the international standards, instead of a multitude of individual Codes. Compliance will be established by the authorities with adequate checks and balances by the involvement of, e.g. labour associations, civil society and/or independent governmental institutions. The abolition of code mania will release a lot of time and financial resources among suppliers. These resources can be put in to improving their core business activities, ensuring compliance, as well as demonstrating best practice, contributing to sustainable development locally.

C. Traditional corporate sourcing strategies and purchasing practices have been identified as some of the primary impediments to ensuring adequate standards with suppliers

Traditional SCM practices will continue to be a challenge, also in 'CSR risk free sourcing and investment zones'. The buyers' desire for low prices, on time delivery, etc. will not change as a result of RSCM 3.0. However, RSCM 3.0 will release resources among suppliers to better handle traditional SCM demands; issues that will constantly remain key competitive parameters for any business.

D. Most Responsible Supply Chain Management approaches limit themselves to a few basic human rights, and are not able to acknowledge the indivisibility, interdependency and interrelatedness of human rights to secure human dignity

RSCM 3.0 meets this challenge as the approach is designed with its outset in internationally agreed principles; i.e. the full range of human rights. This includes that the governments involved recognise that the state's duty to protect relates to all rights. In other words, the RSCM 3.0 approach acknowledges the framework from the UN SRSG stating that *all* human rights are in danger of corporate violations. In addition, the approach acknowledges that

businesses have responsibilities on all three bottom lines (social, environmental and economic). The relevant point of departure is the internationally agreed standards described in the UN Global Compact.

E. The extensive number of corporate suppliers and sub-suppliers, often amounting to tens of thousands for a single buyer, render non-discriminatory, transparent, accountable and independently verified SCM less than cost efficient, if de facto, not impossible under RSCM Generation 1.0 and 2.0.

The geographical focus of Generation 3.0 has the potential to circumvent one of the main challenges with current RSCM practices. RSCM 3.0 marks a shift away from the vertical buyer-first tier supplier approach and instead focuses on the entire business community within a given geographical area or zone. In so doing, no company is excluded and even sub-suppliers are targeted. The approach thus entails a deeper risk management approach for buyer companies.

F. SMEs are excluded from global supply chains as a result of RSCM practices

As stated in the section above; removal of RSCM, as a part of every buyer-supplier relation, is expected to simultaneously remove the cause of exclusion for SMEs in supply chains, associated with current RSCM approaches. However, as stressed in relation to this hypothesis, RSCM is far from the only mechanism that is currently contributing to excluding SMEs from supply chains. Therefore, there will be a continuous need to have a special focus on SMEs, also in relation to their capacity development in order to improve their CSR performances.

Cross-cutting Challenges

While some challenges specifically regard one hypothesis and not the rest, others appear to have relevance across several or all of the six hypotheses. Though these challenges are related, we present them under five key headings below.

Knowledge gaps

Given that the study has been motivated by a lack of knowledge on the addressed issues and that this study provides new knowledge, by digging a level deeper into the challenges connected

to RSCM 1.0 and 2.0; we have naturally identified a set of specific and pertinent knowledge gaps. We find crucial knowledge gaps in at least three different areas.

a. Knowledge gap on front-runner companies

Regarding the front-runner buyers, we have presented the findings as if the (16) buyers are a homogeneous group of firms, although we have mentioned some differences. While similarities are certainly found, e.g. in the content of the Codes, we are aware that one should always have their inherent differences in mind. In other words, we lack in-depth knowledge on specific traits in relation to the different industries and, whether specific issues have to be addressed with, e.g. textiles and clothing, electronics, machinery components, chemicals, bioscience, etc.

b. Knowledge gaps on ‘non’ front-runners, in particular smaller MNCs

This study - similar to previous studies – has a focus on the (large) front-runners, partly due to the willingness and the open approach these buyers have to sharing their experiences; and partly because these buyers are important as trend-setters within the field. However, we lack information about all the ‘non’ front-runner companies – probably 90% of all large corporations.⁵⁰ As highlighted by various sources, including a number of the mentioned references, these 90% of the buyers differ a lot in RSCM practices, if applied at all. However, there is currently very little knowledge on how smaller MNCs and SME-buyers handle RSCM practices.

c. Knowledge gaps on the developing economy companies (suppliers and sub-suppliers, including SMEs)

There is a major lack of knowledge on how RSCM is received among suppliers and sub-suppliers and the long-term impact of RSCM on suppliers in developing economies. This study does make a relevant contribution in describing the suppliers’ perspective, highlighting the difficult business environment that these firms experience and the lack of win-win situations for suppliers, in particular SMEs.⁵¹ Nevertheless, the limitation of resources has not allowed this study to address the situation further. Both buyers and (first tier) suppliers find that dealing adequately with sub-suppliers constitute a major challenge. The lack of knowledge both

⁵⁰ See introduction for a definition of ‘front-runner buyer company’.

⁵¹ In particular in Sub-reports E and F, but also as part of the Sub-reports A, B and C.

in terms of impact and methodology, hampers the considerations of how to address the need for enhanced Private Sector Development (PSD) in developing economies, including establishing the business case for suppliers and sub-suppliers.

Knowledge gaps limits progress in the field and concern all involved stakeholders. Buyers spend a lot of resources with limited impact; or in the case of the ‘non front-runners’ buyers are on their way of doing so.⁵² Buyers new to RSCM will be uncertain of how to address this challenge. Peer approaches will have an enormous impact on decisions in this field, notwithstanding the new developments in the field, such as the consequences of implementing the SRSF’s framework and, how to address the challenges concerning sub-suppliers. It shall be noted that many of the buyers interviewed, agree that the current approaches have severe limitations. In addition, suppliers are frustrated; working in very challenging business environments and not experiencing that RSCM contributes significantly to job creation and poverty alleviation. Governments seek to support the local private sector through various initiatives, but experience limited progress – and are by some criticized for in-sufficient infrastructure, lack of capacity and in some cases corrupt practices. Donor agencies are emphasizing PSD and in particular support to SMEs in order to, e.g. upgrade and make these firms internationally competitive. However, the donor agencies appear to be caught in a Sisyphus-dilemma, given the indication of SMEs being excluded from global supply chains also due to current RSCM approaches.

RSCM/SCM is undermining (sustainable) Private Sector Development

The exclusion of SMEs poses a serious challenge to the work of governments and DAs, striving to support SMEs, in order to enhance local economic development and growth. Exclusion of SMEs from the international market is evidently problematic, as it restricts the possibilities of SMEs to acquire new knowledge and skills, with the risk of further marginalization under the rising demands of the global economy. The exclusion hence limits the chances of securing economic growth and a rise in employment in developing economies.

⁵² In this respect, it shall be considered that best practice guidelines, private and public advice, all point in the direction of RSCM 1.0 and RSCM 2.0; see as examples the newly published best practice guideline on supply chain management from the UN Global Compact, the recently published “The Global Compact Self Assessment Tool”, the Danish Government’s CSR Compass and many more guidelines.

Presently, a series of the identified issues, in relation to traditional SCM (stagnant or decreasing prices, short delivery time, product quality requirements, etc.), indicate a situation of ‘a race to the bottom’. The pressures make ‘decent’ business more difficult. Although RSCM 1.0 and 2.0 might have counteracted some of the problems caused by the race to the bottom, by improving some minimum standards with some suppliers (e.g. wages, working conditions, safety and health and environmental conditions), the situation is far from good. These challenges clearly point to the need for action from governments, assisted by DAs, buyers, labour organizations, NGOs and others.

Negligence of the Importance of Context

While we find an increasing awareness of the importance of knowing the local context and applying approaches that are sensitive to the particular contextual circumstances, the SCM/RSCM 1.0 and 2.0 still contain major elements of standardization.⁵³ Some of the problems associated with current RSCM practices are related to what we can term ‘negligence’ of the importance of context. Whether it is the issue of child labour in Kenya, power cuts in Bangladesh or discrimination in Denmark, all of these national or regional differences make current ‘one size fits all’ Codes implementation methodologies insufficient and in some cases unsuitable. A Kenyan supplier highlighted: *“Most of the Codes were developed in the West for a very Eastern context and this has created some issues for us in Africa”*.

However, adapting RSCM approaches to the local context, does not imply accepting human rights violations in countries where they are prevalent. As mentioned above all human rights should according to the UN be treated with the same emphasis. However, implementation of respect for all human rights can and should be adapted to the local context. There is no inherent problem in adapting the human rights to local situations. Codes and in particular their



⁵³ As highlighted concerning Code mania and the Content of Codes, see Sub-reports B and D in the Annex volume for further information.

implementation manuals, which are often developed at a desk in Europe or North America, do not necessarily translate easily into every supplier context around the globe.

Cross-cutting Recommendations & Suggestions

We recommend a number of practical and research oriented activities to be undertaken as a response to the cross-cutting challenges presented above. Hence, each of the challenges presented above will be addressed below. By improving present practices via the recommendations below, we expect benefits to all included.⁵⁴ In terms of action, we propose that governments, including local authorities, buyers, donor agencies, and international organisations be the key actors.

In regard to the time horizon, immediate, specific and to a large extent short-term challenges have already been mentioned in relation to each of the six hypotheses. Addressing these earlier mentioned challenges will be an important ingredient in seeking to respond to the flaws of RSCM 1.0 and 2.0, while RSCM 3.0 is initiated. As the three approaches are envisaged to take place concurrently, it is crucial to look at best practices and relevant initiatives to meet the described problems. Secondly, RSCM 3.0 provides for a long-term solution to the challenges. This section therefore presents recommendations to be undertaken in the short to medium term.

Addressing the knowledge gaps

To shed further light on how buyers can improve current practices, it is recommended that:

- A study of practices among the 90% non-frontrunner buyers, including the SME-buyers and their procurement & RSCM practices is undertaken in order to assess, how they differ from the large front-runner buyers, which challenges this highlight and how to address these challenges. In addition, it could be of value to establish which directions they consider in relation to RSCM.

⁵⁴ E.g. to buyers in terms of saving resources, both time and money wise; to suppliers in becoming less vulnerably positioned in the global supply chains; to workers in getting better working conditions and higher wages, and to customers in having a higher likelihood of buying products made in 'CSR Risk Free Sourcing and Investment Zones'.

- Further studies (short-term investigations as well as long-term research projects) are undertaken to provide more knowledge on the situation of the vast number of smaller firms in the supply chains. This would include studies that address the needs and perspectives of SMEs in relation to RSCM and provide additional and needed empirical evidence, including the impact of Codes on SMEs, as well as CSR behaviour of micro enterprises and SMEs.⁵⁵ A comprehensive study on a number of (SME)-suppliers from economic developing countries, and the change they experience over time could shed more light on a range of issues identified. This would entail a study covering a number of years, e.g. three to five years, a number of important sectors and a number of countries.⁵⁶

Moving towards enhanced Private Sector Development

In an attempt to address the issue of aligning RSCM with PSD initiatives it is suggested that:

- Considerations regarding adjustment of Private Sector Development activities, in particular regarding SMEs, are carried out.
- International support to RSCM 3.0 pilot projects is prioritised, both in terms of funding for pilot projects and advocacy in favour of RSCM 3.0 (from the Danish side, e.g. by aligning the interest of like-minded stakeholders).

Addressing the local needs, improving understanding of the local context and aligning perspectives

In acknowledging of ‘context matters’ it is suggested that:

- Further emphasis is put on including the perspective of suppliers in eventual improvements of RSCM practices.

⁵⁵ Luken R. and Stares R. (2005): *Small Business Responsibility in Developing Countries: A Threat or an Opportunity?*, ‘Business Strategy and the Environment’, 14, p. 38-53, and Kumari P. (2008): *Comparison of Major Issues Pertaining to Social Responsibility in Corporate and Micro, Small and Medium Enterprises (MSMEs) in India*, UNIDO.

⁵⁶ Points of departure can be found, e.g. in the body of the literature highlighting the differences in terms of resources and structural realities between SMEs and MNCs; or among the contributions, which argue the case of “Small business behavior” or “Small Business Social Responsibility”. These studies include: Fassin, Y. (2008); Raynard and Forstater, 2002, Luetkenhorst, W. (2004); Vives, A. (2005); Kumari, P. (2008); Dutta and Banerjee (2009).

- The business case of CSR for suppliers, in particular SMEs, is addressed. While this points to further studies, it is a prerequisite in order to develop better policies and initiatives among governments, DAs and buyers. We find a clear need for a study on the business case for (SME)-suppliers – how do we make win-win situations for these companies? Addressing the issues of improving financial support and a decrease in the costs of participating in global supply chains, as well as enhancing skills development and access to appropriate knowledge, will be crucial starting points. As suggested by one supplier, we need to tackle the issue by investigating how SMEs can get loans that are related and focused on implementing CSR activities, e.g. by cooperating with an SME Foundation, and how SMEs can get guidance from business service centres on how to implement CSR activities.

Ensuring increased collaboration

By stressing the importance of increased collaboration across stakeholders within the field of RSCM it is suggested that:

- Support and participation in the pilot testing of RSCM 3.0 is prioritised by a broad range of stakeholders in order to gain experiences of how RSCM 3.0 can benefit buyers, e.g. by reducing costs on monitoring and auditing, as well as suppliers by removing most of the identified challenges to RSCM 1.0 and 2.0.
- Further analysis is conducted on the capacity and resources that DAs have available for developing local capacity in the field of monitoring and evaluation. DAs are in possession of elaborate systems of evaluating impact. These systems could be developed and utilised to ensure the more accurate evaluation of actual impact of RSCM on human rights, the environment and corruption. The challenge of impartiality and validity of evaluation can be met through a RSCM 3.0 model, where the state with support from DAs takes an active role in ensuring that monitoring practices are fair and positive impacts reach buyers, suppliers and the local community.
- Further insights and experience is gathered with regard to the need expressed by suppliers in Kenya and in Bangladesh for local governments to play a more active role in enhancing opportunities for capacity development.