

# The Benefits of Using Web-based Solutions to Improve Social and Ethical Compliance in the Supply Chain

## Abstract

In recent years, competitive pressures, globalization and increasingly discerning consumers have forced retail corporations to increase the number of suppliers they work with and the regions globally from which they source products. As a business diversifies and deepens its sources of supply it simultaneously increases its exposure to a greater number of material social and ethical risks in that supply chain. Given the number of suppliers typically involved and given the growing social conscience of consumers and an increasing use of the internet, the likelihood of actual brand and reputational harm as a result of poor social and ethical performance in the supply chain is greater than ever before.

As a result, most big brand retailers have not only accepted the need to take responsibility for the social and ethical performance of their suppliers but are increasingly recognizing the benefits of a proactive approach to improving supplier performance. Furthermore, they are recognizing the benefits of using web-based, purpose-built solutions to provide suppliers with the right tools and information to constantly monitor and improve supplier performance over time.

There are obviously a number of significant benefits inherent in an integrated, web-based and purpose-built software solution. These include being able to:

1. Improve access to information and data management;
2. Provide your corporation and all its stakeholders with a single, integrated solution;
3. Protect against erroneous allegations of poor performance;
4. Demonstrate transparency and increase public credibility;
5. Improve compliance, productivity, predictability and product quality;
6. Provide timely, meaningful and verifiable information to shareholders and stakeholders;
7. Improve the long-term effectiveness of social compliance programs by building supplier capability;
8. Increase the efficiency of your performance improvement efforts;
9. Improve the efficiency and effectiveness of assessors and verifiers;
10. Easily enable social and ethical performance reporting; and
11. Future-proof your performance management investments.

## Globalization, Consumer Consciousness and Growing Risks in the Retail Supply Chain

In recent years, competitive pressures, globalization, security of supply and increasingly discerning consumers have forced corporations - particularly big brand retailers - to increase the number of suppliers they work with and the regions globally from which they source products. With this demand for low-cost and diverse products steadily growing and the trend in global outsourcing only expected to increase; it is predicted that global sourcing will continue to be the basis for differentiation and competitive advantage in our increasingly cost-conscious consumer markets.

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However, as big-brand retailers have increased their sourcing activities in the developing world, particularly Asia and South and Central America, 'a wide range of stakeholders have taken an increasing interest in the social, ethical and environmental performance of the retail supply chain' <sup>1</sup> and companies operating in the global economy have been increasingly called upon to assume greater responsibility for social and ethical compliance in their supply chain operations <sup>2</sup>.

Companies operating in the global economy have been increasingly called upon to assume greater responsibility for social and ethical compliance in their supply chain.

As a result, and although most big brand retailers do not own or operate the factories that supply them, there is growing pressure in the marketplace for companies to take full ethical and social responsibility for all those involved in producing and providing the products they market. Whether it is poor working conditions, paying less than the minimum wage, denying maternity leave, forced labour, or the employment of under age workers, stakeholders worldwide are increasingly holding corporations accountable for labor and human rights violations in their supply chain.

Consequently, as a business diversifies and deepens its sources of supply, it simultaneously increases its exposure to a greater number of material social and ethical risks in that supply chain.

### **Increasing Risk Exposure in an Expanding Supply Chain**

Obviously, if a corporation increases the scope of its operations, all things being equal, it will expose itself to an increasing number of operational risks within that increased scope. However, in the case of social and ethical risks in the supply chain, the probability of risks materializing is increased significantly by two factors.

The first factor is the sheer magnitude of suppliers typically involved in the retail supply chain of most business-to-consumer retail corporations. For example, Nike has more than 660,000 contract manufacturing workers in some 900 factories in over 50 countries <sup>3</sup>; GAP clothing is made at over 400 facilities in China alone <sup>4</sup>; Walt Disney works with approximately 40,000 factories in over 50 countries.

Clearly, to be competitive and provide an increasingly diverse range of products, most big-brand retailers now deal with thousands of suppliers, each one of them presenting dozens if not hundreds of risks in relation to social and ethical issues alone. Consequently, the potential for social and ethical risk exposure increases with every new supplier. Effectively managing social and ethical risk is dependent on having a clear view of thousands of potential risks in that supply chain.

The second factor which increases the probability of risk materializing in the retail supply chain is growing stakeholder awareness and influence. Due to the increasing use of the internet and growing social conscience of consumers in general, stakeholders and stakeholder groups are far more informed, far more organized and far more influential than ever before. As a result, with the growth of shareholder activism, the growing influence of NGOs and advocacy groups together with the speed at which information is now shared around the globe, the likelihood of actual brand and reputational harm as a result of poor social and ethical performance in the supply chain is considerable.

Accordingly, the risk of brand and reputational damage grows rapidly with the number of suppliers in a supply chain. Supply risk management is now a very real and real-time concern

in the corporate community.

### **The Costs of Poor Social and Ethical Compliance in the Supply Chain**

Poor social and ethical performance anywhere in your operations (internal or external) can lead to liabilities, fines, inefficiencies, lost revenue and ultimately higher costs. Thus, it is increasingly recognized that profits and ethics go hand-in-hand and that shareholder value is increasingly influenced by intangibles related to environmental impact, and social and ethical conduct. Ultimately, corporations that ignore ethical conduct are finding it matters to the bottom line and that not behaving ethically has economic consequences <sup>5</sup>.

Some of the more obvious costs associated with poor social and ethical conduct are:

- Poor product quality;
- Product recalls;
- Business discontinuity and supply chain disruption; and
- Damage to brand, reputation and shareholder value.

#### Poor product quality

Poor social and ethical performance in the supply chain leads directly to poor product quality and the costs and foregone revenue associated with poor quality products. This correlation is based on a very simple and defensible premise - low labour standards go hand-in-hand with poor productivity <sup>6</sup>. Substandard health and safety practices; paying less than the minimum wage; and forcing unpaid and excessive overtime to earn a living wage are all practices that reduce productivity and thus overall product quality.

#### Product recalls

In addition to the costs of product returns, lost sales and brand damage from poor quality products, poor social and ethical performance in the supply chain can also lead to product recalls; often costing the retail corporation millions in lost revenue, recall costs, damage control campaigns, litigation and fines - all of which can land a serious blow (sometimes fatal) to corporate reputation.

#### Business discontinuity and supply chain disruption

Poor social and ethical performance in the supply chain also presents serious threats to business continuity caused by supply chain disruption. Obviously, when workers are paid starvation wages, expected to work 13+ hour days without overtime pay, forced at gunpoint to produce or any of the many gross violations of human and labour rights that have occurred (and still occur) in the supply chains of many retailers, often the only recourse for these workers is physical rebellion.

Whether it is protracted (and often violent) labour disputes, sabotage or strikes, these actions all result in supply discontinuity and in some cases factory closures all of which have a significant impact on retailers.

#### Damage to brand, reputation and shareholder value

There are a wide range of direct and tangible costs associated with poor ethical and social performance in the supply chain. However, one of the most significant impacts (though less direct and tangible) is reputational damage.

While most consumers likely don't know that the Coke brand is valued at \$67 billion or that the Nike 'swoosh' is valued at \$10 billion, they do know what impact bad press can have on

the value of those brands <sup>7</sup>. Today, it is widely accepted that one of the most significant risks a business can face is damage to its corporate reputation and recently it has become painfully clear that having social and ethical problems in the supply chain is one of the fastest ways to damage reputation and erode brand value.

One doesn't have to look far to gauge the significance of this. Whether it is the experiences of: Nike in Pakistan and Cambodia <sup>8</sup>; Walt Disney in China, Bangladesh and Haiti <sup>9</sup>; Wal-Mart in Bangladesh and Nicaragua; GAP in China and El Salvador <sup>10</sup>; and many others including Ralph Lauren, Liz Claiborne, Ann Taylor, Esprit, J.C. Penny and Kmart throughout the developing world <sup>11</sup>, the impact of poor social and ethical performance in the supply chain can be devastating.

Whether actual or alleged, poor social and ethical performance in the supply chain has an impact on consumers, investors, employee morale and retention - if not all of a corporation's key stakeholders. The resulting impact on revenue, investor confidence, employee morale, and a corporation's license to operate ultimately all reduce productivity, profit and shareholder value.

### The Benefits of Improved Social and Ethical Compliance in the Supply Chain

Given the clear, direct and irrefutable costs associated with poor social and ethical performance in the supply chain, one of the most obvious benefits of improving supplier performance is that it improves a corporation's prospects of avoiding these (sometimes debilitating) costs.

However, in addition to simply avoiding the costs of poor performance in the supply chain, improved supplier performance brings with it other very real, calculable and tangible benefits.

Increased knowledge about suppliers

One such benefit of improved social and ethical performance in the supply chain is that it increases buyers' knowledge of suppliers. Engaging with suppliers to ensure ongoing improvements in social and ethical performance by definition means a corporation will have better and increasing knowledge about that supplier. Proactive engagement improves the relationship a buyer has with its suppliers, which provides:

- A better and earlier view of potential or impending issues and risks;
- A proactive rather than reactive approach to managing issues and risks;
- The ability to solve the root causes of problems and not just the symptoms, thus improving long-term product quality and continuity;
- The basis for educating a workforce about compliance requirements, procedures and standards, thereby empowering a supplier's workforce to improve over the long term; and
- The framework for working collaboratively to improve working conditions and labour practices in the supply chain rather than simply cutting the supply relationship (which often has far worse implications on the workers and communities involved).

Ultimately, 'companies are beginning to see there is a win-win relationship between business and ethics. If a company has a more long-term relationship with suppliers, it can build a

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relationship of trust – and this will bring risk management opportunities and efficiency gains for retailers who can really rely on their producers in the supply chain’<sup>12</sup>.

#### Support brand values

Given that ‘today’s consumers are prepared to hold an enterprise accountable for its - and its suppliers’ - ethical lapses’<sup>13</sup> corporations that continue to only pay lip service to their social and ethical responsibilities will sooner or later be punished in the marketplace. As a result, corporations that make a sincere effort to engage with their suppliers and improve supply chain performance will avoid an inevitable punitive market reaction but also support, strengthen and legitimize any stated corporate social responsibility objectives, ethical mission statements and brand values they purport to adhere to.

#### Cost saving and product differentiation

Another clear benefit of improving social and ethical performance in the supply chain is long term cost-competitiveness and product differentiation. Clearly, the stronger (and more mutual and symbiotic) a supplier-buyer relationship is, the more likely a buyer will be able to help a supplier improve long-term productivity, resource efficiency, and cost-competitiveness. Similarly, the stronger and more stable the relationship between buyer and supplier, the more likely a buyer will be able to dictate (and safely invest in) product development strategies to meet longer term needs in the marketplace.

#### Improved Corporate Governance

One of the most significant benefits of reducing social and ethical risks in the supply chain is that that activity itself is increasingly recognized as a fundamental component of good governance. As such, improvement in supply chain risk management directly improves the corporate governance of a corporation.

As any director, CXO or senior executive now appreciates, ‘corporate governance is at the forefront of investors’ thinking’<sup>14</sup> and ‘integral to the operations of every company, large and small, public and private’<sup>15</sup>. Consequently, in recent years the practical application of good governance has matured from the prosaic preserve of things like executive compensation and board independence to include the much broader and fundamental activity of managing all the material risks that an enterprise faces and that ultimately pose a threat to the interests of the stakeholders (primarily shareholders) of a corporation.

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As a result, for a system of governance to now be considered effective it must have enterprise-wide risk management at its core. Whether governance activities are modeled on the Turnbull Framework<sup>16</sup>, the COSO Framework<sup>17</sup> or a combination of the two (Figures 1 & 2), enterprise-wide risk management is now widely accepted as the heart of good governance.



Figure 1. The Turnbull Framework of Corporate Governance

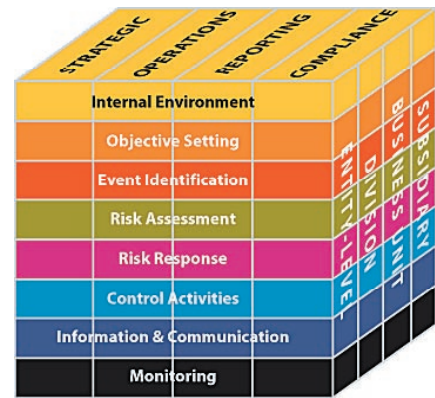


Figure 2. The COSO Framework of Corporate Governance

Therefore, as a corporation improves the management of risks throughout the supply chain it therefore, by default, improves and matures its systems of corporate governance.

### Improving Supplier Performance in Practice

Clearly, corporations that do not attempt to improve social and ethical performance in their supply chain do so at their peril. Consequently, in the last decade, most multinational companies with global supply chains, particularly those that extend deep into the developing world, have implemented codes of conduct to ensure a minimum standard of social, environmental and ethical practice. These codes typically address child labour, forced labour, wages and benefits, working hours, disciplinary practices, freedom of association, health & safety, and environmental impact<sup>2</sup>.

Today however, as stakeholder consciousness, awareness and influence steadily increase, so too do the expectations placed on corporations to consistently improve social and ethical performance in the supply chain. As a result, and given the immense complexity of managing thousands of supply chain risks, corporations today are desperately looking for tools and systems to help improve the management of supplier social and ethical performance.

Naturally, given the sheer number of suppliers, risks, issues, information and interactions involved it is virtually impossible to manage supply chain compliance issues (let alone performance improvement) without the use of some form of information technology solution. Consequently, as the number of suppliers increases, the business case for using a web-based, purpose-built software solution also steadily grows.

### The Business Case for Using Web-based, Purpose-built Software to Improve Performance in the Supply Chain

In recent years, most big brand retailers have accepted the need to take responsibility for the social and ethical performance of suppliers and most have implemented some form of software solution to assist in this process. Understandably, the approaches have been wide and varied, and ranged from the use of Excel spreadsheets and Access databases to piggybacking parts of existing ERP systems originally designed and purchased for a very different purpose. Clearly, however, long-term performance improvement and risk management now necessitate



- Provide traffic-light trend analysis and early warning reporting across the supply chain; (see Figure 3 above); and
- Provide all stakeholders with instant, meaningful, accurate and verifiable information about performance throughout a company's supply chain.

### 3) Protect against erroneous allegations of poor performance

As any branded retail business knows, the bigger the brand the more likely it is to be targeted by advocacy groups looking to expose poor ethical practices in the supply chain. When allegations of poor performance are made corporations are generally regarded as 'guilty until proven innocent' as consumer trust and confidence will invariably lie with the advocacy group unless and until the targeted corporation can prove otherwise.

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Having a robust web-based, purpose-built management system means that corporations can now provide transparency and instant visibility of the compliance activities across their entire supply chain and therefore provide a real-time and verifiable picture of compliance status throughout it. Consequently, when allegations of poor social and ethical conduct occur – as they inevitably will – the corporation can instantly and credibly dismiss false, malicious and damaging allegations.

### 4) Demonstrate transparency and increase public credibility

Business-to-consumer retailers are increasingly being required to not only improve the social, environmental and ethical practices throughout their supply chain, but also provide transparency in their monitoring and assurance practices and activities. A supply chain management programme supported by a robust, web-based information management system provides stakeholders with both the transparency and assurance required.

Similarly, by implementing systems to manage a corporation's social and ethical footprint, a corporation is taking a proactive, long-term approach to performance. This not only strengthens and substantiates stated ethical principles and values but also 'demonstrates to external audiences what actions are being undertaken to ensure high standards'<sup>1</sup> in its business and in its supply chain.

### 5) Improve compliance, productivity, predictability and product quality

On-going compliance monitoring and real-time, on-line visibility of a supplier's performance will foster a workplace environment that reduces injuries, lost time, poor product quality, and supply chain disruptions which will inevitably improve compliance, overall supplier performance, delivery predictability and product quality.

### 6) Provide timely, meaningful and verifiable information to shareholders and stakeholders

Whether it is timely annual reporting or on-going performance reporting, a web-based platform for managing social and ethical compliance information provides instant reporting and transparency of supplier performance. Furthermore, as web-based solutions automatically provide data audit trails and verification features, companies and their shareholders can be confidently assured that the reported data is timely, accurate and meaningful.

## 7) Improve the long-term effectiveness of social compliance programs by building supplier capability

With the growing need to move from basic compliance management to continuous performance improvement in the supply chain, corporations that employ purpose-built, web-based supply chain performance management software solutions are provided with a distinct advantage.

By using a web-based management system for performance improvement in the supply chain, corporations are able to significantly enhance a supplier's capability to improve performance over time. With such a management system platform, corporations can easily provide suppliers with their own access to key areas of the management system that are ultimately necessary to empower those suppliers to improve performance. As an example, giving your suppliers access to your own management system solution provides:

- Suppliers and workers with instant and on-going access to your corporation's policies on social and ethical performance;
- Suppliers and workers with access to standard operating procedures (SOPs) and best practice information to ensure ongoing compliance;
- Workers with an instant and up-to-date analysis of their training needs to ensure they understand policies, procedures and compliance requirements;
- Suppliers with on-going visibility of the compliance assessment requirements;
- Suppliers with the ability to conduct pre-assessment evaluations and self-assessments against stated compliance standards; and
- Suppliers with the tools to manage, rectify and close any non-conformances found in the 2nd party assessment activities.

By giving your suppliers access to certain areas and tools of a web-based performance management system, you immediately communicate expectations. You empower, educate and enable your suppliers themselves to improve long-term risk, compliance and performance management. This improves the effectiveness of your efforts and improves the prospect for performance improvement in your supply chain.

## 8) Increase the efficiency of your performance improvement efforts

By using a web-based solution to manage social and ethical performance in the supply chain, a corporation can easily and instantly compare and contrast the performance of suppliers throughout the entire supply chain.

With 'traffic-light' performance reporting across a sector, region or entire supply chain, a corporation can easily pin point suppliers with poorer performance and target the improvement efforts where they are needed most. This will significantly improve the effectiveness and efficiency of their performance improvement efforts and investment in their supply chain.

## 9) Improve the efficiency and effectiveness of assessors and verifiers

Whether a business uses internal or external assessors and verifiers to audit supplier compliance, most retailers deal with thousands of suppliers. Consequently, effective compliance management means that a corporation must manage, compile, report and follow up on hundreds of thousands of assessments annually.

By using a web-based system for supply chain performance management much of the tedium and time involved in data collection, collation and reporting is done automatically, which significantly reduces the time needed to manage information, thereby increasing the time afforded to monitoring and actually improving performance.

A web-based solution provides assessors and verifiers with the tools to improve the speed, effectiveness and efficiency of corrective and preventive actions and ensures consistency and global visibility of findings and recommendations and means that assessment results and follow up activities can be tracked on-line, off-site and in real time.

#### 10) Easily enable social and ethical performance reporting

Whether it is a company's annual report, UK OFR reporting, Sarbanes-Oxley compliance or reporting in accordance with GRI guidelines, for multinational corporations with extended supply chains collecting, collating, deciphering, verifying and reporting social and ethical performance data has traditionally been a gargantuan task fraught with delay, tedium, inefficiency, inaccuracy and cost. With a web-based compliance management system, data can be verified, collated, and reported instantly and can easily be customized to meet any of the various reporting requirements placed on a business.

#### 11) Future-proof your performance management investments

Ultimately, as the performance expectations of investors, consumers, the media, NGOs, regulators and employees steadily grows and matures, a corporation's performance (and certainly compliance) management systems will also have to grow and mature. While a simple 'social compliance model' of monitoring basic compliance within a supply chain may suffice today, in time businesses that source globally will have to: collaborate at industry and sector levels; actively engage with and build capability within their supply chain; understand and strengthen the relationships they have with suppliers; and integrate their supply chain management processes with wider business objectives and risk management systems and practices.

If your supply chain management program is based on a robust, web-enabled platform, your management system will, by design, automatically enable collaboration, build supplier capacity, improve communication and allow for system integration with other IT tools and platforms within your business – all of which future-proof your management system investment.

### Conclusions

In recent years, competitive pressures, globalization and increasingly discerning consumers have forced retail corporations to increase the number of suppliers they work with and the regions globally from which they source products. As a business diversifies and deepens its sources of supply it simultaneously increases its exposure to a greater number of material social and ethical risks in that supply chain. Given the large number of suppliers typically involved in the retail supply chain and given the growing social conscience of consumers and an increasing use of the internet, the likelihood of actual brand and reputational harm as a result of poor social and ethical performance in the supply chain is greater than ever before.

As a result, in recent years most big brand retailers have accepted the need to take responsibility for the social and ethical performance of their supply chain. They are also recognizing the benefits of a proactive approach to supplier performance improvement and

the benefits of using web-based, purpose-built solutions to provide suppliers, workers, risk managers, compliance departments, boards of directors, investors, consumers, etc. with the right tools and information to constantly monitor, improve and enable supplier performance improvement over time.

There are obviously a number of significant benefits naturally inherent in an integrated, web-based and purpose-built software solution including: improved access to information, a single corporate-wide data source, improved data management, and real-time analysis and performance reporting. Such a solution can also:

1. Improve access to information and data management;
2. Provide your corporation and all its stakeholders with a single, integrated solution;
3. Protect against erroneous allegations of poor performance;
4. Demonstrate transparency and increase public credibility;
5. Improve compliance, productivity, predictability and product quality;
6. Provide timely, meaningful and verifiable information to shareholders and stakeholders;
7. Improve the long-term effectiveness of social compliance programs by building supplier capability;
8. Increase the efficiency of your performance improvement efforts;
9. Improve the efficiency and effectiveness of assessors and verifiers;
10. Easily enable social and ethical performance reporting; and
11. Future-proof your performance management investments.

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