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Governing Global Supply Chain Sustainability through the Ethical Audit Regime

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ABSTRACT *Over the past two decades multinational corporations have been expanding 'ethical' audit programs with the stated aim of reducing the risk of sourcing from suppliers with poor practices. A wave of government regulation—such as the California Transparency in Supply Chains Act (2012) and the UK Modern Slavery Act (2015)—has enhanced the legitimacy of auditing as a tool to govern labor and environmental standards in global supply chains, backed by a broad range of civil society actors championing audits as a way of promoting corporate accountability. The growing adoption of auditing as a governance tool is a puzzling trend, given two decades of evidence that audit programs generally fail to detect or correct labor and environmental problems in global supply chains. Drawing on original field research, this article shows that in spite of its growing legitimacy and traction among government and civil society actors, the audit regime continues to respond to and protect industry commercial interests. Conceptually, the article challenges prevailing characterizations of the audit regime as a technical, neutral, and benign tool of supply chain governance, and highlights its embeddedness in struggles over the legitimacy and effectiveness of the industry-led privatization of global governance.*

Keywords: global supply chains, ethical audits, multinational corporations, environmental sustainability, labor standards and codes of conduct, corporate social responsibility

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1. Introduction

As global production has decentralized and diffused in recent decades, corporations have put in place strategies to try to control their supply chains while avoiding legal ownership. Compliance auditing, which involves independently verifying supplier performance to corporate codes of conduct, accelerated alongside outsourcing after the mid-1990s, as this gave multinational corporations (MNCs) like the Gap and Nike a way to measure, track, and enforce standards in their supply chains. Historically, audits have been used as a tool for internal business management, helping multinationals to minimize public relations risks and to reassure investors. But in recent years, a broad group of civil society actors have seized upon 'ethical auditing' as an opportunity to upgrade and improve factory conditions worldwide, and governments have conferred legitimacy onto audit programs by endorsing them in legislation. Amidst these trends, the accepted role of auditing has shifted from internal business management toward the governance of environmental and labor standards in global supply chains. Today, compliance audits are not only used as a business tool but also as an instrument of global governance to define and enforce transnational norms of corporate conduct.

As part of the shift over the past three decades toward the privatization of regulation and global governance (Büthe & Mattli, 2013; Cutler, 2012; Phillips & Mieres, 2015), non-state business actors have taken on roles as regulators, setting and enforcing standards in supply chains. Corporations have sought power and authority to make their own rules, and with this have implemented private supply chain governance mechanisms—including multistakeholder initiatives (MSI), standards, certifications, and codes of conduct—which purport to manage and solve environmental and social problems.

The ethical audit regime has ascended as part of this proliferation of market-based governance. Audits in this case are used to 'monitor' and 'verify' a company's conformance with the voluntary standards put in place by industry, often in collaboration with NGOs. As well, with declining state-based labor and environmental inspection systems in many countries (as governments outsource enforcement) auditing by private firms is being employed as a means to assess compliance with 'hard' environmental and labor law (see, for instance: International Labour Organization [ILO], 2008, 2009; MacDonald, 2014). Subnational and national governments in Europe, North America, and South America, for example, have adopted forest certification audit programs to supplement and in some cases replace state inspections and enforcement (Gulbrandsen, 2014; Lister, 2011). In the face of declining government inspections and widespread corporatization, NGOs have also come to accept corporate claims of 'continuous improvements' seen in the metrics and indicators of the private audit regime.

In short, the audit regime has become increasingly important in global corporate governance. Over the last few years, a wave of international guidelines and legislation to promote auditing as a way to enforce and verify standards in global supply chains has legitimized and expanded the use of audits as a governance instrument. US and EU legislation, for instance, has embraced private audit programs to determine the legality of imported wood fiber (Cashore & Stone, 2014). California's Transparency in Supply Chains Act 2012 requires large companies working in the state of California to disclose efforts to prevent modern slavery in their global supply chains, including by providing details on their audit programs. Disclosure legislation across several jurisdictions similarly emphasizes the importance of ethical auditing in global supply chain governance. For instance, the 2012 US Executive Order Strengthening Protections Against Trafficking in Persons in Federal Contracts requires federal contractors and sub-contractors to disclose measures to detect and eliminate forced labor and human trafficking in supply chains, including information about their social audit programs, while the US Dodd–Frank Act requires companies to use auditors when reporting on minerals from conflict zones. Ethical auditing is also an important feature of recent transnational regulation, including the EU Directive 2014/95 on Disclosure of Non-Financial and Diversity Information and Organisation for Economic Co-operation and Development Due Diligence Guidance for Responsible Supply Chains of Minerals from Conflict-Affected and High-Risk Areas. As governments and civil society actors encourage auditing, the audit regime has become widely regarded as a legitimate mechanism to enforce labor and environmental standards in global supply chains.

This trend is puzzling, given our empirical findings (based on interviews with industry practitioners—see Section 3), and the many studies conducted over the last two decades that suggest audit programs often fail to detect, report, and resolve labor and environmental problems in global supply chains. The early audit literature—especially the work of Dara O'Rourke (2000, 2003) and Jill Esbenshade (2001, 2004)—documented structural flaws inherent in the use of private audit firms to monitor and improve standards in supply chains. O'Rourke's study of PricewaterhouseCoopers noted that factory audits 'miss many major issues, and paint a false impression of the factory's compliance with local laws' (O'Rourke, 2000, p. 6; see also Power, 1997, 2003). This early audit literature identified critical shortcomings with efforts to monitor and change supplier practices through private auditing, including: financial relationships between auditors and their clients that create conflict of interest and skew audit processes, reporting, and corrective action; the tendency of corporations to commission lenient audits; the limited power of auditors compared to state-based inspectors; and the confidentiality of audit results, which creates a lack of transparency and accountability. Subsequent studies across a range of industries have confirmed what our interviews also revealed: the ineffectiveness of audits in detecting non-compliance and spurring long-term improvements in environmental and labor standards (Appelbaum & Lichtenstein, 2016; Clean Clothes Campaign, 2005; Locke, 2013; Locke, Qin, & Brause, 2007). A competing body of evidence, produced by NGOs, industry, and some scholars, suggests that under certain circumstances, in some sectors, audit schemes can lead to limited improvements; however, even these studies reveal the impact of audits to be uneven and mixed across issues (Barrientos & Smith, 2007; Locke, 2013).

Why then, even as evidence mounts of its ineffectiveness, is the retail audit regime gaining legitimacy as a global regulatory mechanism? This paradox highlights the urgent need to investigate the regime's deepening traction within global supply chain governance. Most of the recent literature on audits, however, has surprisingly little to say about these questions, or the evolving power and politics of the audit regime more broadly. Rather, in line with the wider literature on global supply chains, which has turned away from macro-political questions in favor of a focus on functional challenges (see Bair, 2008), most of the recent literature is focusing on ways to improve the quality of audits (cf. Barrientos, 2008; Plambeck, Lee, & Yatsko, 2012; Short, Toffel, & Hugill, 2015). Recent studies, for instance, have investigated how auditor team characteristics (such as gender and training) influence auditors' ability to detect and report problems (Short et al., 2015) and how auditing systems could be redesigned to better protect workers' rights (Marx & Wouters, 2013). These questions are important. But the evolution of debates along highly technical problem-based lines of inquiry has yielded a lack of critical study to identify and challenge the underlying contradictions of audits as highly political rather than neutral processes of governance. As the literature has become preoccupied with ways to improve the effectiveness of audits, it has neglected the fundamental governance question of *who* the audit regime is effective *for*, as well as the consequences of its acceleration for struggles to promote labor standards and environmental sustainability in global supply chains.

To address this research gap, we analyze the divergent interests at play in the audit regime and, especially, the highly strategic role that retail and brand corporations commissioning audits leverage over their design and implementation as they use the audit regime to shape risk, rights, and rules in global supply chains. We argue that in spite of growing engagement in the audit regime by governments and some NGOs, retail and brand corporations continue to use audits as a mechanism to legitimize and protect their business interests, rather than as a tool to detect and address social and environmental problems. Empirically, we focus on the industry-led audit regime within China-based consumer goods manufacturing. Conceptually, our aim is to contribute to critical political economy theory on the role of corporations in global governance by arguing that the audit regime is not merely a technical and benign tool to *enforce* private governance as it is often portrayed in the literature; rather, the audit regime is itself a mechanism to enhance the legitimacy of industry-led privatized forms of global governance, whose deficiencies are well-known.

The paper unfolds in four parts. Section 2 outlines our theoretical approach, arguing that audits are not neutral or passive tools, but rather are a productive form of power led by industry in the context of the privatization of global governance. Section 3 describes our research methodology for analyzing the audit regime within consumer goods manufacturing in China. Section 4 probes the politics of audit discretion and deception in the consumer goods industry, documenting how retail and brand companies shape audit design and implementation in ways that make it challenging for auditors to detect problems on the ground. Here, we argue that far from an effective policy instrument to advance environmental and social norms, auditing creates an illusion of governance effectiveness—and is serving to stabilize rather than resolve the tensions and contradictions of outsourcing within the global retail economy. We conclude the paper by discussing the consequences of ethical auditing for marginalizing public interests within global governance.

2. The Private Audit Regime

The prominent explanation for the rise of supply chain auditing is that globalization has created a situation in which developing countries lack the capacity (or willingness) to enforce labor and environmental standards in their factories, and so, 'lead companies' have stepped in to rectify this 'regulatory void' by hiring third-party firms and civil society organizations to 'monitor' and 'verify' factories through auditing (Braithwaite & Drahos, 2000; Gereffi, Humphrey, & Sturgeon, 2005; Vogel, 2008). Subsequent research on the spread of the 'ethical audit' regime reflects the broad acceptance of market-based solutions—depoliticizing the role of audits in entrenching contemporary forms of global corporate governance. As mentioned in the Introduction, there has been a tendency to focus on problem-solving the shortcomings of the audit regime, rather than critically analyzing its consequences.

This literature has tended to overlook the disproportionate power of industry actors in the audit regime's inception, design, and implementation. It has also tended to discount the role of states and corporations in engineering the weak international corporate accountability regimes that have been used to justify the 'need' for 'private governance'. Relatedly, there has been limited recognition that the audit regime is designed to reinforce—rather than resolve—these governance deficits. The first step in addressing these weaknesses in the literature is to develop a stronger theoretical explanation for the rise of the audit regime, and the divergent interests of its core players, namely corporations and powerful segments of civil society.

2.1. *The Privatization of Global Corporate Governance*

The adoption of audits as a corporate governance tool is linked to broader shifts toward neoliberal economic governance (Brenner, Peck, & Theodore, 2010; Gills, 2002; Peck, 2010). States have removed restrictions (Soederberg, 2007; Taylor, 2011) and devolved authority to transnational corporations to set and enforce their own rules (Cutler, 1999; Cutler, Haufler, & Porter, 1999). This neoliberal regime of global corporate governance has facilitated a reorganization of international production. Beginning in the 1980s, as constraints on production, investment, and trade were eased, a high proportion of manufacturing shifted to the developing world. At the same time, the organization and character of production was transformed as retail and brand companies increasingly sourced goods from supplier firms rather than producing goods themselves (Appelbaum & Lichtenstein, 2016; Gereffi & Mayer, 2010; Lichtenstein, 2009). The key innovation behind this new business model—which is described in the literature as a global supply, commodity, or value chain—has been to restructure production in such a way that lead firms can maximize profits while minimizing liability. The ascent of global supply chains allowed companies to transcend nationally based labor and environmental legislation by outsourcing and subcontracting, and to transfer risk, legal liability, and the duties of employment onto suppliers.

Focused on low-cost, high-volume production, evidence across many sectors and regions suggests that labor exploitation and environmental degradation are endemic in the global supply chain business model (cf. Appelbaum & Lichtenstein, 2016; Dauvergne, 2008). Yet, as part of a broader commitment to the ‘open-ended and contradictory process of politically assisted market rule’ (Peck, 2010, p. xii), most states have scaled back state-based monitoring of production practices. This is true even in advanced economies such as the US, where, according to a study by the US National Employment Law Project, ‘an employer would have to operate for 1,000 years to have even a 1 percent chance of being audited by Department of Labor inspectors’ (Lafer, 2013, p. 29; see also Weil, 2014).

Corporations began auditing the environmental and social conditions of supplier factories in the 1980s, with a rise in the 1990s (Gray, Owen, & Adams, 1996; Power, 2003). Since then, supply chain auditing has increased rapidly with the growth of offshore manufacturing in the emerging economies (particularly China), and the associated increasing concerns about effectively managing supplier performance to reassure investors and protect brand reputations (Locke, 2013; Plambeck et al., 2012). With origins in transaction-cost economics, companies have embraced auditing as a ‘key governance mechanism for reducing transaction costs resulting from business partners’ opportunistic exploitation of information asymmetries’ (Short et al., 2015, p. 4). Consequently, for the most part companies have viewed the idea of ethical auditing in technical and managerial terms, or what O’Rourke (2014) refers to as the ‘science’ of sustainable supply chains.

This is not a straightforward story, however, of corporations simply taking over the same tasks previously performed by states. There are important differences between the power and function of private auditors compared to state-based labor and environmental inspectors. Although these differences are governed by national law and thus vary by country, private auditors generally lack powers of investigation and prosecution. Whereas state labor and environmental inspectors can impose injunctions and monetary penalties against businesses that fail to comply with the law, and can launch criminal prosecution and litigation to recover back wages or correct environmental damage (Allain, Crane, LeBaron, & Behbahani, 2013), private auditors cannot even require factory owners to open locked doors or drawers, nor can they protect employees who speak out from retribution (see, Esbenshade, 2004; European Center for Constitutional and Human Rights, Activist Anthropologist Bangladesh, Clean Clothes Campaign, & Medico International, 2015; Hammer, Plugor, Nolan, & Clark, 2015). This is not to suggest that state-based inspection systems are without fault; they too can be weakened by corruption. Nevertheless, formally speaking, state-based inspectors have greater powers during inspection and in regards to spurring corrective action. The results of their investigations are also often available to the public, whereas those of auditors remain confidential to the audit client.

2.2. *Adopting Audits*

Of course, the rise of weak national and international corporate accountability regimes has not gone unchallenged. As Gills (2002, p. 3) has correctly pointed out, globalization both 'weakens and simultaneously activates social forces of resistance'. As part of a Polanyian 'double movement' (Soederberg, 2007, p. 501), a range of resistance movements, advocacy organizations, and NGOs have contested the deepening power of corporations, and called for more controls on their activities. In response, many corporations—often supported by governments and international organizations—have launched initiatives to position themselves as part of the solution to the challenges of globalized production.

Many civil society organizations remain skeptical of audits, and of Corporate Social Responsibility (CSR) more broadly. Indeed, workers' rights organizations, such as the Clean Clothes Campaign, and trade unions, such as the American Federation of Labor and Congress of Industrial Organizations, have been the audit industry's earliest and most outspoken critics (cf. AFL-CIO, 2013; Clean Clothes Campaign, 2005). But over the last decade, a powerful group of civil society actors—especially large NGOs like Walk Free Foundation and WWF (World Wildlife Fund/World Wide Fund for Nature), as well as standard-setting organizations like Fairtrade—have come to accept industry-led CSR programs as legitimate and necessary components of global governance (cf. Dauvergne & LeBaron, 2014; Dauvergne & Lister, 2013; Sadler & Lloyd, 2009). Frustrated with the failure of international organizations and governments to adopt binding global business regulations, these actors have sought strategies to hold corporations directly accountable. This has included the development of transnational 'sustainable production' certification standards such as the Forest Stewardship and Marine Stewardship Councils, and Ethical Trade and Fair Labor programs—all of which rely on audits to monitor and verify corporate practices (Cashore, 2002; Haufler, 2003). The number of NGOs embracing private audits to monitor business performance has grown as firms have hired NGO experts to develop social and environmental supply chain programs and certification schemes (which are verified through audits), as well as through NGO and corporate collaboration toward initiatives such as the post-Rana Plaza Bangladesh Accord, which also relies on audits and related forms of monitoring. While some organizations, such as Oxfam, are both critical of the audit regime (see Wilshaw, 2011) and entangled in it (such as through the Ethical Trading Initiative and Fairtrade Foundation), other NGOs have enthusiastically supported increased auditing, paying little attention to the broader governance consequences of shifting regulatory power (rule-making and enforcement) toward private interests.

NGO acceptance of the audit regime is anchored in its appeal as a strategy to implement new business rules and increase corporate transparency and accountability, beyond government intervention. Every NGO multistakeholder transnational certification program—whether for bananas, apparel, timber, fish, or diamonds—relies on private audits to check on and verify performance standards. Ideally, with the provision of reliable audit information NGOs then aim to create further incentives for change by praising corporate leaders and shaming laggards. NGOs are also extending the audit approach more broadly to the use of metrics and indices as the basis for their advocacy campaigns. Greenpeace, for example, now produces annual 'scorecards' based on company-reported information, to benchmark, rate, and rank the environmental performance of companies in sectors such as apparel and electronics. Similar to brand companies, many NGOs see the strategic advantages from how audit programs can be shaped to reveal or conceal (i.e. poor corporate practices reported to legitimize the launch of a campaign and good audit results showing improvements to sustain the campaign).

The reasons NGOs support the audit regime vary across organizations. Some transnational NGOs have embraced industry as an ally (Dauvergne & LeBaron, 2014; Dauvergne & Lister, 2013). The US Environmental Defense Fund relocated their office to Bentonville, Arkansas, to be next to Walmart headquarters. The Walk Free Foundation—which strives to abolish modern slavery globally—works alongside the Chartered Institute of Procurement and Supply to 'slavery-proof' global supply chains (see, CIPS, 2013; Walk Free Foundation, 2014), describing audits as 'one of the key mechanisms for monitoring supplier performance against agreed upon standards' (Walk Free Foundation, 2014, p. 23). Other NGOs have partnered with companies around audit-based supply chain programs in the face of pressure from government and funders to collaborate with industry. Through a memorandum of understanding with the Yunnan provincial government in China, Conservation International partners with Starbucks to certify Chinese coffee producers to the Starbucks CAFE 'sustainable coffee' audit-based certification program. With US Environmental Protection Agency (EPA) encouragement, the Environmental Defense Fund partners with Walmart to audit suppliers for chemical usage.

Civil society support of auditing helps explain state endorsement of auditing as a supply chain governance tool in recent legislation. In several of the bargaining processes behind this wave of legislation, factions of the NGO and investor-driven coalitions publicly endorsed private governance mechanisms as a key part of the solution. Governments created statutory references to existing voluntary measures like auditing rather than imposing stricter regulations. This was the case, for instance, with the 2015 UK Modern Slavery Act, where a 'Transparency in Supply Chains' coalition comprising industry and NGOs (including Amnesty International, Unseen, Anti-Slavery International, and Traidcraft) endorsed a transparency clause designed to spur voluntary CSR activity to eradicate forced labor, human trafficking, and slavery in global supply chains such as through auditing, rather than continuing to push for more stringent forms of legislation (for details, see LeBaron & Rümkorf, forthcoming).

2.3. *The Profit-Driven Audit Regime*

The audit regime is not a neutral monitoring and enforcement mechanism, but rather disproportionally benefits the MNCs at the helm of global supply chains, as well as the auditing organizations and NGOs that profit from the regime. For nearly two decades, workers' rights and trade union organizations, scholars, and auditors themselves have documented the flaws of the audit regime; yet, corporations have done little to transform it. The problem is not one of finessing the institutional design or audit methodology, but rather relates to corporate power, politics, and profits. As we document below, retail and brand corporations shape the audit regime in ways that legitimate and protect their business model, defined by low-cost, high-volume, just-in-time inventory turnover. Restructuring the audit regime would reveal labor exploitation and environmental non-compliance as endemic features of contemporary global production.

Unlike state-based labor and environmental inspection programs, private auditing is a for-profit industry. The Ethical Trading Initiative reports that 'the third-party audit business is now estimated to be worth around US$50 billion (£25.5 billion), with companies typically devoting up to 80% of their ethical sourcing budget on auditing alone' (ETI, 2015). According to the Social Accountability Accreditation Services, auditors charge between $500 and $1500 per day, with some audits lasting more than two weeks (Bernstein & Scott, 2015, p. 71). Audit firm TÜV Rheinland's revenues alone were €1.6 billion in 2013.

The industry has expanded rapidly in recent years as brand companies have increased reliance on auditing, with Apple, for instance, increasing its number of audits from 39 in 2007 to 640 in 2015 (Apple, 2016, p. 7). As we document in Section 4, financial relations between audit firms and their clients introduce incentives toward leniency as auditors compete to retain and expand their customer base. Before documenting this, however, we need to explain our methodology for garnering our evidence on the politics of the ethical audit regime.

3. Research Methodology

Our research methodology triangulates primary and secondary empirical data. The overall approach is qualitative—designed to yield an in-depth understanding of the audit regime's politics and power relations, through the lens of China-based consumer goods manufacturing. We chose to study consumer goods manufacturing (also referred to as consumer-packaged-goods or CPG) for three reasons:

- Its economic size and reliance on supply chains for profitability;
- Its reliance on auditing to govern supply chains;
- Its relative under-investigation compared to other industries such as agriculture.

We focused on China-based manufacturing because China is the world's leading exporter, exporting US$2.3 trillion in 2015 (WTO, 2015, p. 25).

Our field research, conducted by the two lead authors, consisted of three components:

- A survey of consumer goods suppliers at the 2012 China Import and Export Fair ('The Canton Fair') in Guangzhou, China, and follow-up, in-depth, semi-structured interviews with buyers and other key informants at and around the Fair;
- Semi-structured interviews of auditors and their consumer goods company clients in North America and the UK;
- Participatory observation at the US Retail Industry Leaders Association (RILA) annual sustainability conference (2015, 2013).

3.1. *Canton Fair Research*

The Canton Fair is China's oldest trade fair, hosting around 25,000 vendors and 200,000 buyers, including multinational brand retailers. At the 2012 Fair, 83 of the world's largest retail companies attended, including Walmart, Tesco, and Carrefour. At the Fair, we used a purposive sampling strategy, seeking to interview suppliers of four different types of consumer goods categories. As summarized in Figure 1, the product types were: kitchenware (e.g. plates, pans, cups); personal care (e.g. diapers, toilet paper, tooth brushes); furniture (wooden frames, boxes, indoor and outdoor chairs, tables, decking); and household goods (toys, pet products,

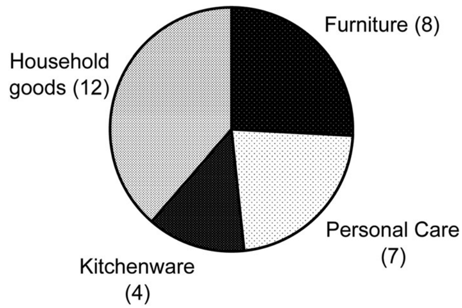

Figure 1. Canton Fair vendor interview sample (by industry category).

cleaning products). We selected these product categories to cut across auditing patterns in different types of manufacturing (e.g. labor intensive vs. high tech), expecting that auditors would confront varied labor and environmental challenges across these different settings. Within the categories, we selected suppliers who advertised (through posters and certificates displaying logos at the entrance of their exhibits) that: (i) they had brand customers; and (ii) they participated in private governance schemes verified through audits (e.g. Forest Stewardship Council (FSC)). Random sampling would not have been appropriate given the high number of small vendors who primarily supply to non-branded buyers from smaller companies. We recruited participants ($N = 31$) at the Fair.

Our survey of manufacturers focused on four themes:

- Vendors' experience of auditing processes, and especially, how these differed across the companies commissioning (e.g. Walmart vs. Target) and conducting audits (e.g. SGS vs. UL);
- The role of client companies in shaping audit design, procedures, and implementation;
- Whether and how auditing has changed over the last five years;
- Whether and how audit performance impacts their business.

Following our survey, we sought to consolidate our findings by interviewing informants in and around Guangzhou, including buyers, shippers, auditors, government officials, consultants, and a sub-tier factory, as summarized in Figure 2. These interviews were semi-structured, conducted at

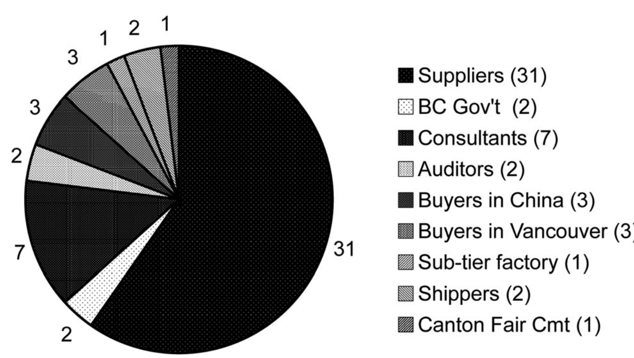

Figure 2. China research interviews, April 2012.

the Fair, and at surrounding government and consultant offices and factories, and were 30 minutes to 3 hours in duration.

3.2. *Elite Interviews and Observation*

Our research in China shed light on supplier firms' experiences of auditing, including how suppliers manage the multiple and different audit schemes imposed by their clients and the role of audit results in shaping their business model and performance. The interviews also provided broader insights into the evolving role of auditing within the business and politics of global consumer goods supply chains.

The second strand of our empirical research moved 'up' the supply chain to hone in on the relationship and interactions between auditors and the companies that commission them. We conducted 38 semi-structured elite interviews of auditors and their consumer goods company clients in large North American cities and in London, UK. Interviews took place in neutral locations or company offices and lasted between one and two and a half hours. We focused on the consumer goods companies and auditors named by vendors we interviewed at the Fair.

Our elite interviews generated insights into how audit programs are designed and implemented; the role of auditors and companies within these processes; the discretion afforded to auditors; auditors' experiences of implementing audit processes, including of their shortcomings; and how auditing practices have evolved over time. In our preliminary data analysis, we observed that our interviewees were highly critical of auditing, so we sought to triangulate our findings through participatory observation at the US RILA annual sustainability conference (2015, 2013). Hundreds of consumer goods manufacturers and retailers attend RILA each year, such as Amazon, Costco, Walmart, Unilever, Target, and Toys R Us (RILA, 2015). At RILA, we observed industry meetings on the topics of audit methodology, innovation, cooperation, and moving 'beyond audits'. We also elicited feedback on our preliminary findings through dozens of informal interviews of brand company representatives.

3.3. *Data Analysis and Limits*

We analyzed our data in Excel using thematic analysis. A number of themes emerged and were consistent across our three tranches of data, as we describe in Section 4. This research approach shed light on three key actors within the audit industry: retail and brand corporations, auditors, and consumer goods suppliers. We did not interview standard-setters or accreditation organizations. Focusing on a single industry sector allowed us to assess the dynamics of auditing across a comparable set of companies and their suppliers. To some extent this limits the ability to generalize our findings given that the audit regime operates differently across different sectors, schemes, and regions. Our research does, however, flag critical issues and offer a guide for further research on the evolving role of audits in other sectors and for global governance more generally.

4. The Illusion of Governance Effectiveness

Our evidence highlights that the audit regime is mediating but failing to resolve the tensions of unsustainable production practices within the global consumer goods supply chain. Our survey of suppliers brought to light shortcomings in the quality and integrity of the audit regime. Our informants confirmed these deficiencies, and openly described audits as a weak management mechanism for detecting and addressing non-compliance. Only two of our interviewees spoke positively about the audit regime's effectiveness at improving standards within global supply chains. As one of our interviewees, a former director of sustainability for a large US retail company, explains: 'Within the social compliance world, it is now standard operating understanding that audits don't work to achieve change within organizations'.[1] A London-based sustainability manager at a global audit firm, similarly remarked, 'an audit is a diagnostic tool; it doesn't fix things. It doesn't matter how many times we audit a factory, it doesn't mean they're going to improve'.[2]

The remainder of this section presents our findings, focusing on four descriptive themes that surfaced across our research: (i) Auditor and company discretion; (ii) Cheating and corruption; (iii) Widespread awareness of shortcomings; (iv) Expanding governance power of the audit industry.

4.1. *Auditor/company Discretion*

Our research suggests that the most significant barriers to audit effectiveness are not technical but political—in other words in the disproportionate power and control that companies yield over the pathway, timing, and implementation of audits. Although auditors are often portrayed as independent, in reality brands give them strict instructions about when, where, and how to audit. Companies that commission audits have full discretion over how deep within the supply chain the audit will go. As one of the auditors we interviewed explained, 'We will audit as far down as the brand wants to go'.[3] Many retailers only audit their Tier 1 suppliers, or a percentage of them. When describing the intentional gaps in the auditing of fair trade, one of our informants explained: 'I'm going to go audit the crap out of your coop coffee bean company to make sure you're actually paying the farmers. Who checks to see if the farmer is paying the pickers? Nobody!'.[4]

Several of the auditors interviewed expressed concern that their clients are guiding audits down pathways that circumvent the most vulnerable workers, and that the factories in which they do audit have become adept at creating temporarily (and superficially) compliant workspaces. Facing more audits, some Tier 1 suppliers have turned to unauthorized subcontracting and contract workers to limit their legal responsibility and reduce the risk of auditors uncovering violations. For instance, one company manager remarked that in the aftermath of the collapse of the Rana Plaza complex in Bangladesh in 2013:

> many of the brands that found themselves in the factory were as surprised as the next person to find their brand in there. And the immediate defense was, 'We never gave work to that factory and the people who gave them the work were in violation of the contract'.[5]

At RILA, retailers voiced awareness of the trend among Tier 1 suppliers to shift and limit responsibility. Still, the pathway of most audits remains structured around Tier 1 suppliers and excludes labor agencies and contractors.

Most companies that audit Tier 1 suppliers expect these suppliers to audit suppliers lower down the chain. Companies told us that they informed their Tier 1 suppliers that it was their responsibility to audit their sub-contracted suppliers. However, the vendors that we interviewed at the Canton Fair lacked information about the labor and environmental practices of their subcontracted suppliers, and many of the suppliers we spoke to noted that they did not conduct any audits of their suppliers.

Furthermore, lacking investigative powers auditors are usually only able to inspect areas that suppliers choose to show them and are only able to speak to or contact the workers that they happen to see that day. Audits take a partial snapshot of a supplier on a given day; by their very nature audits cannot reveal the full picture of the operations of suppliers and sub-contractors. Because most audits are announced, or at least semi-announced, as one informant said, the factory usually 'has the opportunity to drill their people on what they need to say'.[6]

There is also no guarantee that firms will address problems when audits do detect them. Several of the auditors interviewed noted that pressures can often work the other way—toward covering up and understating problems out of concern for losing business. This tendency has been exposed through a recent wave of preventable disasters— including fires and building collapses—at factories that have recently passed audit inspections. Our research participants hesitated to speak about these incidents on the record, but one auditor pointed us toward the work of journalist Andy Kroll, who has recently reported on China Labor Watch, an NGO headquartered in New York. According to Kroll (2012), the NGO 'obtained documents from a Walmart packaging supplier on how to hide or adjust safety and environmental records; how workers should lie to auditors about wages, benefits, and working hours; and how to conceal a shadow factory'. In a second case of a Walmart supplier in China, China Labor Watch 'uncovered forced overtime, phony pay stubs, poor living conditions, and the use of hazardous chemicals at a Walmart shoe factory' (Kroll, 2012). Walmart had audited both of these factories in the past. Yet, as Kroll (2012) writes, 'Walmart-hired auditors had previously raised no concerns with either plant'. Our interviewees gave several examples of similar dynamics occurring outside of China. For instance, we heard that in Bangladesh in 2012, Underwriters Laboratory audited a Tazreen Fashion factory on behalf of Walmart, noting safety concerns, but not recommending the closing of the plant or withdrawing business; 2 months later the factory burned down, killing more than 100 people (Henn, 2013; see also Stiles, 2013).

Auditors themselves express frustration with the lack of corrective action following an audit. As one auditor explained, 'Now we may well go in there and think, we can see what you need to do. But people aren't going to do it just because we've said so'.[7] While auditors generate corrective action plans, the lack of external reporting around non-compliance means that suppliers are ultimately accountable only to retailers, rather than to governments or the public.

Our research unearthed evidence that audits are being designed and implemented in ways that conceal problems rather than bring them to light. Given these dynamics, it is not surprising that auditing seems to have done little to address endemic labor and environmental problems within the consumer goods industry. For instance, several of the supplier firms we interviewed described how worker overtime and low piece rates remained necessary strategies to maintain brand contracts. One plastics supplier gloated that even with only 100 workers, he could handle very large orders of 50 containers a month. When we asked how, he replied directly, 'overtime'.[8] We were told that many workers in the industry now commonly work three shifts in a row. Low piece rate wages make workers dependent on overtime for most of their pay. One furniture supplier even talked about the importance of paying workers by piece rate so that 'lazy workers get less'.[9] Auditors we interviewed acknowledged worker exploitation issues related to overtime, but explained that because many exploited workers are technically employed by labor providers and contractors or at off-site production facilities, they are thus not officially on the books, and so auditors had little scope to detect or address this issue.

4.2. *Cheating and Corruption*

Cheating and corruption also undermine the effectiveness of audits. Interviews with companies and auditors suggest that corruption and cheating are escalating as vendors become aware of brand buyers' sustainability expectations, sparking an 'arms race' between auditors and supplier factories. As auditing has become more elaborate, evasion has become more efficient and sophisticated. Suppliers are adopting double sets of books, documenting false emissions (based on purchased monitoring data), and secretly re-locating production to unknown 'shadow factories'.

Because brand companies do not coordinate their audit programs, throughout the year a factory may face many different audit teams—all with different standards and procedures. 'In one audit the fire extinguisher needs to be 36 inches from the ground. In the next audit, it needs to be 32 inches', an interviewee explained.[10] The multitude of varied and changing audit requirements creates confusion and audit fatigue. Many suppliers now hire former auditors as consultants to help them meet—and beat—the system. 'Install two hooks and rotate the extinguisher back-and-forth', the factory was advised.[11]

Aware of the business value of auditing, vendors have also devised strategies to falsify and misrepresent audit results and certifications to prospective customers. At the Fair, suppliers made false claims about audit results and certification. The two most common forms were: (i) claiming certification but not displaying any official certification form; and (ii) claiming certification to an ambiguous standard. In the first case, many suppliers had framed pieces of paper advertising ISO 14000 certification, but without the name of the auditor or certificate number. In the second case, suppliers displayed logos (e.g. Good Management Practice Company, GMPG, certified), which further research revealed not to be attached to a coherent or specific set of standards. One furniture supplier to Shangri La hotels was advertising their pieces as 'green furniture', but had never heard of FSC certification. Another furniture supplier explained they had had FSC certification in the past and could simply 'get it back' if it was needed for an order (a dubious claim, considering that FSC certification requires audits and substantial time to achieve).[12]

4.3. *Widespread Awareness of Audit Shortcomings*

Almost all of the auditors and company representatives we spoke to were aware of the aforementioned shortcomings and ineffectiveness of auditing as a tool to govern supply chains. Our interviewees offered a range of explanations for why auditing is accelerating in the face of ineffectiveness, including the profitability of the industry, the lack of pressure to reform it, political obstacles to reforming it, and the lack of viable alternative means of monitoring and enforcing standards.

The most skeptical of our interviewees, an NGO director, argued that the audit regime is *designed* to be ineffective, and that this is a 'win–win' for every key actor in the audit industry: consistent labor and environmental problems means that companies keep auditing, NGOs have issues to campaign about, and auditors continue to profit. As he explained, 'there is a whole industry of ethical auditors out there now who will find nothing if you pay them to go and find nothing'.[13]

One reason that companies have done so little to address these shortcomings is that they are generally not required to do so in order to obtain sought-after certifications. One consumer goods buyer noted that sustainability knowledge and practices among his Chinese suppliers remained low; however, most audit programs, especially those that involve self-reporting, fail to detect this. He described how the German government now requires 'green dot' eco-certification with forms for suppliers to sign off to indicate they have read and understood the requirements. When he tried to go through the forms and explain waste reduction and the other targets to his Chinese suppliers they had 'no clue and just simply signed'.[14]

Auditors and company representatives also highlighted the importance of political context in shaping audit effectiveness, and emphasized the difficulty of strengthening audit systems in countries where there is a lack of political will to require transparency in business. For instance, one German buyer explained that the business environment in China makes it difficult to correct the shortcomings of audits. As he noted, ‘I am prohibited from going to see parts of companies even though they are supplying to me and I am a major buyer’.[15]

The most common explanation was that the audit compliance approach tends to facilitate some initial, incremental, partial improvements to supplier practices, but then it tends to stall—and at the end of the day block—more transformative environmental and social change. ‘With a focus on compliance you lose innovation’, a retail manager elaborated.[16] Another noted that even though it falls short, auditing persists because it is the easier path for the retail buyers. ‘Retailers feel they can’t build trust with suppliers and so they turn to audits. It gives a quick fix to step 1 but it then becomes a barrier to steps 2–5’, the retail manager explained.[17]

4.4. *Growing Governance Power of the Audit Industry*

Another recurring theme was the growing governance power of the audit industry. Suppliers noted the power and importance of audit results in shaping which customers they could attract and retain; auditors described the (often unwanted) growing regulatory and governance function of auditing; and company representatives described the deepening need for auditing in the face of governance gaps in many parts of the world.

Significantly, the growth of the audit regime has increased the role and power of non-state actors in determining and enforcing an accepted framework for supply chain compliance. As such, it is now companies and NGOs—through audit-based voluntary initiatives such as global fair trade and eco-certification standards and transnational reporting programs such as the *Global Reporting Initiative* (GRI)—that guide states on what the sustainability rules should be, and lend expertise in deciding how best to enforce these rules.

This trend is carving out an ever-greater role for corporations, and an ever-smaller role for states. As one informant noted, Walmart’s adoption of CSR goals and audit protocols had the effect of bringing the ‘supply chain ball’ back into their court, and taking it out of the hands of governments. As he described,

> By adopting the process that said we got it, this is our ball, we’re going to do something about our supply chain ... Walmart, on behalf of the entire retail industry, said, this is our problem. This isn’t a government regulatory problem. This isn’t China’s problem, this isn’t Vietnam’s problem. This is our problem. We have the power, resources, and ability to deal with it and we will.[18]

Even auditors agree, however, that audits have clear limits as a regulatory instrument. As a Director of a UK audit firm said, the majority of audits are ‘not trying to find things out, they’re trying to prove that something is not there’.[19]

5. Conclusion

It is at first glance puzzling that the retail audit regime is gaining acceptance despite its long-standing failures to detect or correct labor and environmental problems in global supply chains. Deeper probing reveals the fundamental dynamics. Essentially, NGOs and governments are endorsing and delegating regulatory authority to audit mechanisms as part of the broadly held neoliberal consensus of private and market-based approaches as an effective way of governing global change. The regime achieves incremental advances while preserving the business status quo. Auditing helps retailers legitimize and grow their businesses, and maintain and increase their supply chain power. Brand companies use ethical audit programs to position themselves as responsible companies, enhancing their social license to operate—a vital advantage in today's volatile markets. Auditing also helps retailers to monitor suppliers (and thus risk) in a highly decentralized system of global production, in which concern is rising about inequality, environmental degradation, and corporate power, and pressure is growing for more corporate accountability and transparency. While the audit regime is enhancing corporate legitimacy, brand value, and risk assessment within supply chains, as a mechanism of transnational governance it is also exclusionary and failing.

Fully assessing the consequences of the audit regime will require more detailed empirical research—including analyses of variations across sectors and jurisdictions. Within the context of our case study, it is clear that the audit regime is designed to 'work' for corporations by creating an illusion rather than a reality of effective global supply chain governance. It is not designed to address the underlying problems that would lead to the far-reaching changes to labor and environmental standards that some civil society actors are calling for. Rather it serves to preserve the retail business model that hinges on rewards from cheap labor, cheap goods, low prices, and short-term purchase contracts. As a retail manager explained, even with audit program requirements, in almost all cases the standard purchase order contract based on price and quality continues to be 'the only thing that matters to suppliers'.[20]

By deflecting pressure for stricter, state-based regulation, the regime ultimately legitimizes intrinsically unsustainable models of global production—in particular, a discount retail economy that promotes wasteful consumption and widening power asymmetries that underlie global social and ecological crises. In this light, from a critical political economy lens, rather than providing a technical solution to complex global problems, the private ethical audit regime is best understood as performing a stabilizing and legitimizing role.

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Notes

1 Interview with brand retailer, 12 July 2013, Seattle.

2 Interview with auditor, 13 March 2013, London.
3 Interview with auditor, 13 March 2013, London.
4 Interview with brand retailer, 12 July 2013, Seattle.
5 Interview with brand retailer, 12 July 2013, Seattle.
6 Interview with auditor, 13 March 2013, London.
7 Interview with auditor, 13 March 2013, London.
8 Interview with supplier, 25 April 2012, Guangzhou.
9 Interview with supplier, 25 April 2012, Guangzhou.
10 Interview with brand retailer, 12 July 2013, Seattle.
11 Interview with brand retailer, 12 July 2013, Seattle.
12 Interview with supplier, 26 April 2012, Guangzhou.
13 Interview with labor NGO representative, London, 8 March 2013.
14 Interview with consumer goods buyer, 24 April 2012, Guangzhou.
15 Interview with buyer, 24 April 2012, Guangzhou.
16 Interview with buyer, 12 July 2013, Seattle.
17 Interview with brand retailer, 12 July 2013, Seattle.
18 Interview with brand retailer 12 July 2013, Seattle.
19 Interview with auditor, 6 March 2013, United Kingdom.
20 Interview with brand retailer 12 July 2013, Seattle.

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