Monograph:
LeBaron, G. and Lister, J. (2016) Ethical Audits and the Supply Chains of Global Corporations. Report. SPERI Global Political Economy Briefs (1). Sheffield Political Economy Research Institute (SPERI), University of Sheffield

The University Of Sheffield.

SPERI Global Political Economy Brief No. 1

Ethical Audits and the Supply Chains of Global Corporations.

speri. Sheffield Political Economy Research Institute.

About the authors

Genevieve LeBaron

Genevieve is Senior Lecturer attached to both the Department of Politics and SPERI at the University of Sheffield. For 2015-2016, she is also Yale University's Human Trafficking and Modern Day Slavery Fellow. Genevieve holds a British Academy Rising Star Engagement Award and a UK Economic and Social Research Council Future Research Leaders Grant.

Jane Lister

Jane is Senior Research Fellow and Associate Director of the Centre for Transportation Studies at the Sauder School of Business at the University of British Columbia. She is a former sustainability auditor with PriceWaterhouseCoopers.

Introduction

In recent years incidents such as the collapse of the Rana Plaza garment factory in Bangladesh in April 2013 and the exposé by *The Guardian* of slavery and human trafficking in the Thai shrimp industry in 2014 have focused attention on the supply chains of global corporations. What has been reported less is that both of these incidents, and many others, took place within 'certified' and audited supply chains. The Thai shrimp in British supermarkets had been 'ethically' certified by a Non-Governmental Organisation (NGO) that sets voluntary standards for the certification of agricultural products and encourages producers to adopt 'safe and sustainable practices'. Similarly, in Bangladesh the Rana Plaza factory, which made clothes for Matalan, Primark and Walmart amongst many others, passed a compliance audit just months before it collapsed.

Many key questions and serious concerns hang over the ethical audit regime. These include: are audits effective in identifying non-compliance and driving up standards, what does the audit regime mean for governments and NGOs, where does power lie within the audit regime and, ultimately, in whose interest is the ethical audit regime working?

To explore these issues we conducted 25 interviews (in 2012-14) with ethical auditors, business executives, NGOs and supplier firms in North America, the United Kingdom and China, as well as visiting factories in the Pearl River Delta region of China.

This new SPERI Global Political Economy Brief presents new evidence and key findings and argues that:

- Ultimately, the audit regime is 'working' for corporations, but failing workers and the planet. Labour abuses, poor working conditions and environmental degradation within global supply chains remain widespread.
- Audits are ineffective tools for detecting, reporting, or correcting environmental and labour problems in supply chains. They reinforce existing business models and preserve the global production status quo.
- Audits reinforce the labour and environmental problems that civil society NGOs are striving to improve.
- The audit regime, with the involvement and support of NGOs, is reducing the role of states in regulating corporate behaviour and re-orientating global corporate governance towards the interests of private business and away from social goods.

Part One of the Brief looks at the rise of ethical audits; Part Two considers the effectiveness of audits; and Part Three assesses the impact of the audit regime on global corporate governance.

Part I - The move to ethical audits

- Beginning in the 1980s, a high proportion of global manufacturing has shifted to emerging economies (particularly China). Large multinational companies typically outsource and subcontract the production of their goods to smaller low-cost, high-volume suppliers in developing countries. Walmart, for example, sources its goods from over 100,000 global suppliers, who themselves source from an extensive global production network.

- As offshore manufacturing has grown exponentially, exposés by NGOs and journalists of rampant child and 'sweatshop' labour and environmental malpractice in overseas production sites have led to calls for greater corporate transparency and accountability within global supply chains. Prominent examples include the use of sweatshop labour to make clothes for Gap and exploitative work practices leading to multiple employee suicides at Foxconn, one of Apple and HP's main suppliers.

- Following such exposés, corporations, supported by governments and international organisations, have launched Corporate Social Responsibility (CSR) initiatives to position themselves as part of the solution to globalised production challenges.

- Central to this has been the adoption of ethical auditing practices that purport to identify, correct and ultimately solve environmental and social problems in supply chains. Brands began to hire independent (but often for-profit) auditors to monitor factories, develop codes of conduct for their suppliers and publish transparency and ethical reports.

- Similarly, over the last decade, partly out of frustration with the failings of international organisations and governments to adopt binding global business regulations, NGOs have come to accept industry-led CSR programmes and private audits as legitimate opportunities to detect abuses within supply chains, improve factory conditions and hold corporations accountable. Governments have also moved to force NGOs to work with corporations as a requirement for receiving state funding.

- To monitor and verify standards, NGOs have developed transnational 'sustainable production' certification standards, such as the Rainforest Alliance certification, Marine Stewardship Councils and Fair Labour programmes. These certification standards are voluntary and rely on private audits, designed and paid for by corporations, to assess standards. NGOs have also increasingly partnered with firms to develop bespoke voluntary programmes: Greenpeace has worked with Coca Cola to reduce greenhouse gas emissions and Oxfam with Unilever to integrate smallholder farmers into its supply chains.

- As such, the contemporary governance of global supply chains is increasingly reliant on an ethical and voluntary 'benchmarking regime' supported by both corporations and civil society groups, which has audit inspections as its cornerstone. This auditing regime comprises company codes of supplier conduct, voluntary certifications, standardised metrics (e.g. the Higg Index for 'ethical' clothing) and aggregated indexes for comparing corporate environmental and social performance (e.g. the Global Reporting Initiative).

- As such, audits have evolved from a management tool that multinational corporations used to measure, track and enforce internal organisational standards into a central mechanism of global state and non-state efforts to monitor standards within corporate supply chains.

Part II - The effectiveness of audits

Audit deception and a lack of accountability beyond the factory gates

Our interviews highlight how deception in the audit regime is widespread and known to corporations. As Nike stated in a 2012 sustainability report, *"we have learned that monitoring does not bring about sustainable change. Often, it only reinforces a pattern of hiding problems."*

- Our interviewees explained how decisions on audit scheduling, such as the time of year, frequency, and whether it is an announced or surprise audit, significantly affect findings. Pre-announced audits enable producers to falsify records and rid facilities of unauthorised agency contractors or exploited workers during audits. As one informant noted, *"there could always be another group of people"* not on the books.

- This incomplete picture is not only a result of deception, but is structurally embedded within the audit regime. Corporations control how deep within the supply chain audits are conducted; one auditor told us: *"We will audit as far down as the brand wants to go"*.

- Many corporations design audit programmes that only inspect Tier 1 suppliers where the final assembly of products takes place. In 2012, for instance, US clothing company REI stated that it had audited *"a percentage of the Tier 1 factories in our supply chain"*, but this only amounted to 27% of its total global supply chain.

- By focusing on Tier 1 suppliers, most audits tend to exclude labour agencies and subcontractors further down the supply chain in low-value activities such as harvesting, processing, dyeing and mining. Evidence from food, clothing and other industries indicates that the most exploited workers (e.g. forced and child labour) tend to be found in sites with complex subcontracting arrangements. Some evidence suggests audits have worsened conditions by shifting problems further down the supply chain.

- One of our informants described how audits to certify 'Fair Trade' products face this problem: *"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!"*

- Audits often do not detect unauthorised subcontracting arrangements. As one informant told us, following the Rana Plaza factory collapse, *"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'."*

'A diagnostic tool; it doesn't fix things'

Our interviews suggest audits are: **a)** a weak tool at detecting non-compliance with corporate codes of conduct; **b)** a means of fostering a 'checklist' compliance approach to audits amongst suppliers; and **c)** are ineffective at improving standards.

- Auditors can usually only inspect areas that suppliers choose to show them and are often only able to speak to workers they happen to see. One auditor told us that, because most audits are announced, or at least semi-announced, the factory usually *"has the opportunity to drill their people on what they need to say"*.

- Most audit firms have no investigative powers and so have limited capacity to verify that information presented to them, whether about safety conditions, contracts or environmental standards, is accurate. One interviewee remarked: *"you have no powers of search so you cannot open a locked drawer … you can look at a record that says something but you wouldn't be able to go and find out whether it's actually true."*

- Our interviews also highlighted the existence of a 'checklist' audit-compliance mentality. A Director of a UK audit firm told us that the majority of audits are *"not trying to find things out, they're trying to prove that something is not there".*

- Production for multiple retailers often takes place in the same factory, which means throughout a year factories can face many different audit teams, all with different standards and procedures. We were told that, as a result, suppliers hire former auditors as consultants to help them meet and beat a system of multiple audits.

- A growing number of sites have passed audits only to have major violations discovered or catastrophes take place soon after. In 2008 60 forced labourers were discovered at Emmetts UK – a large vegetable grower and supplier to Tesco and Waitrose – only months after the farm had passed two successful audits. In Bangladesh in 2012 the Tazreen Fashion factory was audited on behalf of Walmart. Safety concerns were noted, but it was not recommended that the plant be closed. Two months later, the factory burned down, killing over 100 people.

- The former Director of CSR for a major US retail company clearly emphasised the limits of audits: *"Within the social compliance world, it is now standard operating understanding that audits don't work to achieve change within organizations"*. Similarly, a London-based manager at a global audit firm told us: *"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."*

The power lies with the corporation

Our interviews highlighted how audit contracts and the reporting of information gathered from audits demonstrate that the power within the audit regime lies with the corporation.

- Corporations can choose whether to use independent third-party auditors or in-house auditors. Third-party auditors are generally deemed more neutral and hence legitimate, but even third-party auditors are not impartial. Walmart, for example, applies its own criteria for selecting a list of whom it deems 'acceptable' auditors.

- Auditors are bound by rigid confidentiality clauses and clients exercise full discretion over what audit information is reported. Auditors produce standardised metrics and rankings that give the appearance of transparent and neutral monitoring; yet the information audits provide is selective and fundamentally shaped by the client. Information about abuses and non-compliance is rarely made available to governments or consumers and, as such, they are rarely resolved.

- Auditors typically offer advice to help factories prepare action plans to address non-compliance findings. However, auditors have no influence over a company's eventual business decisions; their advice can be ignored; and there is no external accountability for the action plans. One auditor told us: *"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."*

A sharp divide between labour and environmental standards

Audits typically treat social concerns separately from environmental concerns. This divide allows companies to work towards, and highlight, improvements in one sphere – typically the environmental – whilst allowing social standards to persist or even worsen.

- A major 2012 study that evaluated 300 clothing brands on their efforts to address child and forced labour in their supply chains highlighted this divide. Despite of making improvements around renewable energy and waste, Walmart's traceability, transparency, and labour rights records ranked among the lowest in protecting against child and forced labour.

- Similarly, the Lipton brand of tea has recently achieved the 'green' Rainforest Alliance Certification, despite illegal labour practices in its supply chain being widely reported.

- Our interviews with companies in the Pearl River region in China further exposed this divide. We found that companies were investing in clean water and eco-friendly technology to secure 'eco' certifications and attract business, but that this often came at the expense of social goals. Labour costs were being reduced through greater use of overtime and agency workers (who tend to be lower-paid and face severe restrictions on their ability to assert their rights) and by replacing human labour with machinery.

Part Three – the impact of audits on global corporate governance

The growth of the audit regime is carving out an ever greater role for corporations in global corporate governance and enforcing an ever smaller role for states. While the drivers motivating industry, NGOs and states vary, increasing participation by all three sets of actors reflects an alignment of support for market-based global governance. This Part of the Brief considers the drivers behind this trend.

Corporations have claimed supply chain monitoring for themselves

Corporations have embraced CSR goals and ethical audits as an opportunity to preserve their business model and take responsibility for supply-chain monitoring out of the hands of governments.

- Corporate adoption of CSR has brought the *"supply chain ball"* back into their court, and away from governments. One informant described Walmart's CSR adoption: *"By adopting the process that said 'we got it, this is our ball, we're going to do something about 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'."*

- Through the presentation of active monitoring and 'continuous improvement', corporations have been able to deflect pressure for stricter state and international regulation that might otherwise curb business growth. This enables the preservation of existing business models and profits.

- Adopting ethical audits has also enabled corporations to position themselves as responsible companies. This helps drive sales as retailers increasingly recognise the importance of 'eco' and 'ethical' products for consumers. A 2013 study of 1000 brands found that 28% of brand value relates to corporate social responsibility.

State support for corporate self-governance

In the face of fiscal restraints and jurisdictional constraints, states are increasingly entrusting corporations to govern themselves, either by supplementing official methods or by substituting their own inspection and monitoring responsibilities. The International Labour Organisation (ILO) reports a steep downturn in labour inspections in both the global South and North. This trend towards corporate self-governance is illustrated by the increasing adoption of voluntary corporate codes of conduct by states and international bodies:

- Central and local governments in China have signed memorandum of understanding agreements with retailers such as Starbucks and IKEA to roll out their sustainable supply chain commitments and ethical audit programs to suppliers across China. The agreements, based on private audits, are used as a supplementary policy instrument to help encourage domestic Chinese firms to improve social and environmental practices.

- Regional and national governments in Europe and North and South America have adopted forest certification audit programmes as a supplement and in some cases as a replacement for state forestry inspections and enforcement. The EU and the US are adopting private audit-enforcement mechanisms into new laws to determine the legality of imported timber.

- There is also a growing adoption of audit-based initiatives at the global level. The United Nations' voluntary Global Compact – 'the world's largest corporate sustainability initiative' – is wholly based upon the use of audit-based initiatives.

The legitimising role of NGOs

Our interviews suggest that by working with corporations and governments NGOs have served to deepen the credibility and legitimacy of audit-based industry-led governance of corporations.

- Every NGO multi-stakeholder transnational certification programme, whether for bananas, timber, fish or diamonds, relies on private audits to check and verify standards.

- NGOs have worked with corporations and governments to develop such initiatives and have co-operated bilaterally with corporations to design their codes of conduct.

- As such, NGOs have arguably helped to codify and neutralise corporations' poor social and environmental records and, in so doing, have undermined the role of states in global corporate governance.

Conclusion

The increasing use of private audits to monitor supply chains is serving to restructure the global regulatory system to privilege the private interests of business growth, profit and market advantage over the public interest and social goods of improving labour standards, general wellbeing and ecological protection. In a nutshell, the audit regime is 'working' for corporations, but failing workers and the planet.

- The increasing use of audits as a tool of governance is bolstering corporate interests and influence over consumers and policymakers and, ultimately, deepens corporations' power to make their own rules and norms and evaluate and report on their own performance.

- Whilst audits give the impression of active supply-chain monitoring and 'continuous improvement', the regime actually reinforces endemic problems in supply chains. It deflects pressure for stricter, state-based regulation and legitimises unsustainable global production models – in particular, a retail economy that promotes consumption and environmental degradation.

- Through voluntary certification programmes, and with state support, the structural problems within the audit regime – deception, failing to detect or ignoring problems within supply chains, and a compliance mentality – are being swiftly institutionalised within global governance mechanisms.

The University Of Sheffield.

January 2016

www.sheffield.ac.uk/speri

Sheffield Political Economy Research Institute
Interdisciplinary Centre of the Social Sciences
219 Portobello
Sheffield S1 4DP

T: +44 (0)114 222 8346
E: speri@sheffield.ac.uk

twitter.com/SPERIshefuni
facebook.com/speri