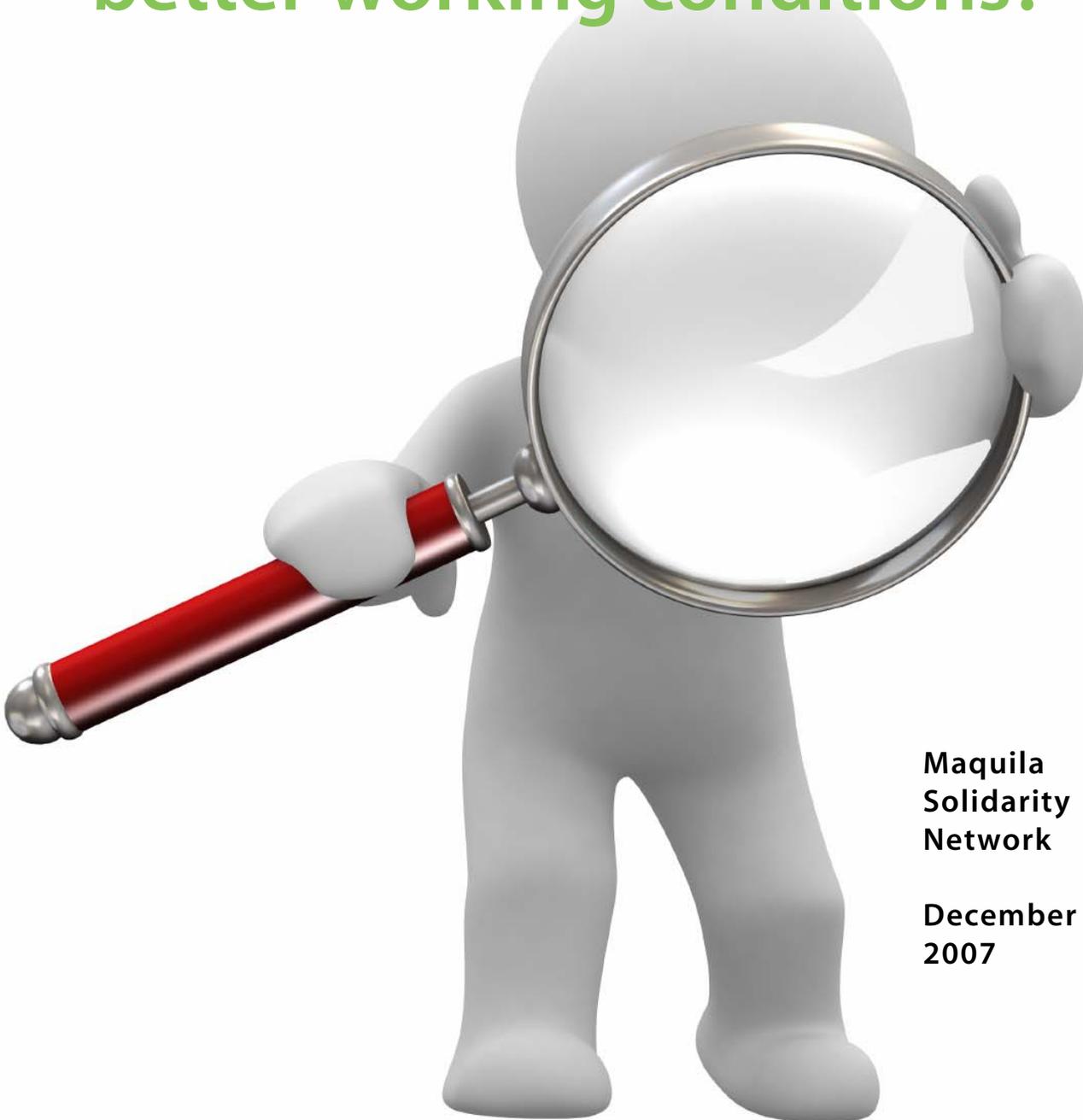




The next generation
of CSR reporting:

**Will better reporting result in
better working conditions?**



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The next generation of CSR reporting: Will better reporting result in better working conditions?

In the *Next Generation of CSR Reporting*, MSN reviews recent advances in Corporate Social Responsibility (CSR) reporting by four major companies involved in the apparel and sportswear sectors and look ahead at the kinds of reporting that will be needed to demonstrate whether companies are making progress on improving working conditions in their global supply chains.

Table of Contents

| | |
|---|-----------|
| Next generation reporting | 4 |
| Restructuring and consolidation | 5 |
| Factory disclosure | 5 |
| Production shifts | 6 |
| Closures and exit policies | 8 |
| The buying relationship | 9 |
| Uncovering the roots? | 11 |
| Pricing and wages | 13 |
| Training and engagement | 15 |
| Summing up | 16 |
| Moving forward | 18 |
| Reporting and transparency: key recommendations for 2008 | 18 |
| Endnotes | 20 |

Codes Memo

The Maquila Solidarity Network's *Codes Memos* profile trends in voluntary codes of conduct and government policy and explore critical issues and debates in the labour rights movement. *Codes Memos* are available in Spanish and English on the MSN website: www.maquilasolidarity.org. We welcome your comments and suggestions.



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Although public reporting on corporate social responsibility (CSR) initiatives is becoming increasingly common amongst major apparel and footwear brands, is it providing stakeholders with sufficient information to evaluate whether progress is actually being made in their supplier factories around the world?

Big brand CSR reports run the gamut from passing reference to broad social and environmental commitments; rosy talk of increased factory auditing; anecdotal reports on selected management training programs; disclosure and updating of hard data on factory audit findings; and frank and detailed discussions of the shortcomings in current labour standards compliance programs coupled with promises to revamp those programs in order to address roots causes of persistent violations.

As a general rule the increase in public CSR reporting is a positive response to consumer and investor demands for more information on companies' adherence to labour and environmental standards. However, good reporting is measured by quality not quantity. If the goal of public reporting is to clarify where a company stands on corporate social responsibility and what it is doing to meet internationally-recognized standards and reduce the risk of non-compliance with those standards, then the information provided must speak directly to the factors that matter most in ensuring compliance.

In 2005 and 2006, Canada's Ethical Trading Action Group (ETAG) issued "Transparency Report Cards" assessing and comparing public reporting on labour standards compliance by top apparel retailers and brands selling clothes in the Canadian market, including Levi Strauss, Nike, adidas, H&M, Mountain Equipment Co-op, Roots, La Senza, Reitmans and 22 others.

ETAG's report cards, which were prepared by MSN, attempted to measure what was being reported against a set of criteria that

would allow ethical consumers, investors and other stakeholders to evaluate how seriously a company was committed to ensuring compliance with labour standards in its supply chain. The criteria were designed to draw out the critical factors involved in ensuring labour standards compliance as opposed to narrative reporting on tangential matters.

Similarly, on an international scale, the Global Reporting Initiative (GRI) has produced a draft set of supplemental reporting standards for the apparel and footwear sector that also attempt to identify and standardize the kind of information expected from brands operating in the sector.

Although ETAG is not producing a *Transparency Report Card* in 2007, this *Codes Memo* serves as an update on new advancements and recommendations on transparency for future CSR reporting in the apparel and footwear sectors, based primarily on recent reports from Gap Inc., Nike, Wal-Mart and Mountain Equipment Co-op (MEC).

**Codes
Memo
Number 22**

.....
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Network**

■ **3**

The CSR Reports and other documents discussed in this Codes Memo are all available on-line.

Nike: FY05-06 CR Report
www.maquilasolidarity.org/CodesMemo22/Nike

Gap: 2005-06 Social Responsibility Report
www.maquilasolidarity.org/CodesMemo22/Gap

Mountain Equipment Co-op: 2006 MEC Ethical Sourcing Report
www.maquilasolidarity.org/CodesMemo22/MEC

Wal-Mart: 2006 Ethical Sourcing Report
www.maquilasolidarity.org/CodesMemo22/WalMart

Global Reporting Initiative: Draft Apparel and Footwear Sector Supplement
www.maquilasolidarity.org/CodesMemo22/GRI

ETAG 2005 and 2006 Transparency Report Cards
www.maquilasolidarity.org/en/issues/ca/transparency

Next generation reporting

Even while there has been some emerging consensus on what should be reported by apparel and sports shoe companies on labour standards issues in their global supply chains, new challenges in the industry have given rise to a need for additional reporting measures.

For example, having recognized that a brand's own purchasing practices can foster labour rights abuses at the factory level, stakeholders have increasingly asked for more information on pricing, supply-chain management, delivery times and other purchasing practices.

Similarly, the dramatic impact of industry restructuring in the wake of the elimination of import quotas at the beginning of 2005 has demonstrated that a company's sourcing practices, consolidation plans and management of factory exits, closures and retrenchment are critical factors in how well a company is managing labour rights issues in its supply chain.

Initially, company CSR reporting in the apparel and sportswear sectors focused on general statements of values and principles and assurances that these values were being applied in the company's supply chain operations. When this approach was met with (well-deserved) skepticism, leading companies began reporting aggregated data about audit findings and company programs to minimize code of conduct violations in various geographic regions.

The collection, analysis and publication of hard data in company reports had the effect of concentrating management's attention on the problem and allowing for some measurement of progress. As that approach has become more widespread, the limitations of the methodology have also become clearer. The fact that updated data showed little or

no progress in eliminating persistent abuses raised serious questions about whether factory monitoring systems were effectively addressing the underlying causes of worker rights violations.

Over the past three years, leading companies have begun reporting more about the root causes of persistent non-compliance and poor audit results, as well as identifying changes in their approach to achieving and maintaining labour standards compliance based on these analyses.

In its *FY05-06 Corporate Responsibility Report* Nike acknowledges the "generational" approaches we've identified here:

In Generation I we set standards. In Generation II we developed tools and methods to monitor those standards. Each generation was a stepping stone to the next and delivered vital learning and experience for all stakeholders Generation III is what we call responsible competitiveness. While monitoring continues to be a cornerstone of our approach, we are taking a broader, more holistic look at our supply chain, focusing on root cause identification and solutions that will drive systemic change.¹

While the illustration of new approaches and recognition of root causes is welcome, there is a danger that reporting on these matters could devolve into the same kind of vague "statement of values" that preceded the introduction of hard data in company CSR reports.

The next generation of reporting, therefore, will have to include reliable measures of how a company is actually addressing the root causes and broader structural factors that are now recognized as impacting on individual factory compliance with labour standards. For example, such reporting will need to include better information on global production shifts, buying relationships, engagement and training, and prices and wages.

Codes

Memo

Number 22

Maquila

Solidarity

Network

■ 4

Restructuring and consolidation

One of the areas where there has been inadequate reporting has been on the impacts of restructuring of global supply chains. Over the past three years a dramatic restructuring of the apparel industry has been taking place at the global level. With the elimination of import quotas under the Multi-Fibre Arrangement (MFA) in January 2005, manufacturers, retailers and brand merchandisers were free to abandon entire countries whose competitive advantage was based primarily on their access to quotas.

The process of consolidating production is not yet complete and we will likely face more shocks in 2008 as the import safeguard measures imposed on China by the US and the EU expire, allowing more production to be relocated to China.

While this restructuring is still being played out, some impacts are already abundantly clear. Factories around the world are closing – many without the owners meeting their legal responsibilities – leaving workers without jobs and often without severance pay, back wages and other unpaid benefits.

Tragically, a number of factories that had been the site of hard-won union organizing victories and the successful negotiation of collective bargaining agreements have been closed, with manufacturers blaming buyers for shifting orders elsewhere and buyers blaming suppliers for failing to consult before making such decisions.

Within this new trade environment, some companies have expressed publicly their commitment to restructure in a manner that respects and/or enhances labour rights and what they call “responsible competitiveness.” The most prominent of these declarations is the MFA Forum’s *Collaborative Framework*, which outlines a set of agreed principles for action by companies, trade unions, govern-

ments and NGOs in light of industry restructuring.² Some of the Framework’s principles for buyers include:

- Maintain current country supply base and contain consolidation in-country;
- Seek to source from suppliers and countries that respect core labour standards; and
- Disclose supply chain information that facilitates accountability to external stakeholders.

Are these principles, like earlier codes of conduct, merely broad aspirational statements that are not being met or even attempted to be met in practice? This is one of the key issues the next generation of corporate reporting will need to address.

What is clear is that at this stage comprehensive information on where apparel brands source their products from and why is, for the most part, unavailable.

Factory disclosure

Some brands, like Nike, Levi Strauss, Timberland and, most recently, adidas, have taken the bold and critical step of disclosing their supply factory locations. Neither Gap, Wal-Mart nor Mountain Equipment Co-op (MEC) – a small Canadian retailer that, despite its size, ranked second in ETAG’s 2006 *Transparency Report Card* – has disclosed factory locations in their latest CSR reports. MEC has, however, promised to reveal factory locations beginning in 2008.

Factory disclosure lists are a useful check on a company’s claims and add credibility to a company’s efforts to achieve labour standards compliance, since they open up company supply chains to scrutiny by local and international NGOs and trade unions and encourage cooperation on compliance issues among buyers in shared factories. When such lists are updated on an annual basis, compar-

Codes

Memo

Number 22

Maquila

Solidarity

Network

■ 5

Codes

Memo

Number 22

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Maquila

Solidarity

Network

■ **6**

ing the lists also provides some limited information on global shifts in where orders are being placed.

In its most recent CSR report, Nike has included a full list of factories that manufacture its products, along with addresses. Nike argues that, since they first disclosed factory locations two years ago, the company is “seeing successes as a result of collaboration – shared information, shared best practices, leveraged resources and more effective coverage of supply chains within our industry.” Two years on, they add, “we have realized no competitive disadvantage from bringing greater transparency to our supply chain.”³

Although the number of brands that are disclosing factory locations has increased, it has yet to become a widespread phenomenon. Given Nike’s enthusiasm for the opportunities allowed by factory disclosure, and its repudiation of earlier claims that disclosure would bring competitive disadvantages, consumers, investors and workers should push recalcitrant companies to join with Nike in disclosing their own global supply chains.

Production shifts

While factory disclosure provides opportunities for collaboration among buyers in shared factories, as well as between buyers and civil society organizations, and allows increased scrutiny of a company’s claims, it does not provide complete data on how a company is reacting to the new liberalized trade environment by participating in rapid shifts in global production that are having such dramatic effects on workers, communities and countries.

Production shifts – or at least the threat thereof – impact on the ability of workers and national governments to press for improved working conditions, greater respect for workers’ rights, and better enforcement of labour laws.

“Transnational corporations must recognize that their current business model, which promotes haphazard buying practices and shifting production – especially to countries or Free Trade Zones that refuse to give legal force to workers’ right to freedom of association – negatively impacts on working conditions,” says Kelly Dent of Oxfam Australia.⁴

Martin Hearson, Campaign Coordinator for the Labour Behind the Label coalition in the UK, says the threat of relocating orders is also having an impact on government regulation and/or the enforcement of labour laws. “At national level, labour rights groups and unions are pessimistic about demanding better labour legislation from governments, knowing that there is a balancing act between raising conditions and maintaining competitiveness.”⁵

Nike’s factory disclosure lists reveal that over the past two years the company has discontinued using 60% of the factories it formerly sourced from in Portugal, 7 of the 8 factories it used in Bulgaria, 3 of 4 factories in the Philippines, and 5 of the 6 factories in El Salvador (although one new Salvadoran factory was added to the list). The lists also show that the company has completely vacated Albania, the Dominican Republic,⁶ Macedonia, New Zealand, Peru and Switzerland, while adding eleven new factories in Brazil and two in Cambodia (for a total of three). After adding and subtracting a large number of factories in China, Nike has ended up with a small increase in the number of factories it uses there.

Nike’s CSR report also charts, by region, how many factories it is using for each type of product (e.g. apparel, equipment, and footwear) and how many employees in each region are engaged in manufacturing its products.⁷ Although the source countries are aggregated into four broad geographic regions – the Americas (including the USA), EMEA (Europe, the Middle East and Africa), North Asia and South Asia – the information

is a useful companion to more detailed data, provided it is updated over time.

What is not readily apparent from the factory lists disclosed by Nike and other brands, however, is whether there are significant shifts of production volume from some regions to others.

For example, although Nike has maintained a similar number of active supply factories in China, it's not clear whether the volume of orders at those factories has increased, decreased, or remained constant. In the Philippines, did Nike consolidate orders at one factory, or shift those orders out of the country altogether?

For footwear production, Nike has provided more information than have other brands, identifying the percentage of production in four main countries, not only in their FY05-6 report, but also in their annual 10K filings with the US Security Exchange Commission (SEC), which has allowed for tracking changes over time. For instance, information provided reveals that the four main countries producing footwear for Nike in the 2007 fiscal year represent 98% of Nike's footwear production:

In fiscal 2007, contract suppliers in China, Vietnam, Indonesia and Thailand manufactured 35 percent, 31 percent, 21 percent and 12 percent of total NIKE brand footwear, respectively.⁸

For apparel, which is currently undergoing a much more volatile restructuring, Nike is not quite as forthcoming:

Almost all of NIKE brand apparel production for sale to the United States market, and all of our apparel production for sale to the international market, was manufactured outside of the United States by independent contract manufacturers located in 36 countries. Most of this apparel production occurred in China, Thailand, Indonesia, Malaysia, Turkey, Honduras, Vietnam, Sri

Lanka, Mexico, Taiwan, Cambodia, India and Bangladesh.⁹

Nike also reports that 6% of its apparel is made in a single factory, and 6% of footwear is also made in a single factory. There is no information on other factory production vol-

umes, nor are the names of these two factories mentioned. It would be useful for Nike to report on apparel production volumes in the same way it reports on footwear production.

MEC has taken steps in this direction. In its *2006 Ethical Sourcing Report*, the company identifies the dollar value of inventory purchased over the past year in all categories –

MEC branded goods as well as other brands. Then, MEC identifies the dollar value of MEC-branded goods and how many factories produced those goods. It provides a table showing the volume of purchases from factories both by value and as a percentage of MEC's total purchases. For example, the chart tells us that MEC bought over \$5 million in goods from two of its factories (a total of \$14,030,584 between the two), which represented 27% of its total worldwide purchases.

Such reporting could be improved by identifying where the factories were located. MEC does provide a chart showing the increase or decrease in its orders from particular regions (Canada, China, Vietnam and the "Rest of Asia") over the last three years, both in dollar amounts and as a percentage of total purchases, but this could be broken down further.

In its *2005-06 Social Responsibility Report*, Gap Inc. identifies how many active factories it had in eleven regions.¹⁰ Because Gap included a similar chart in its *2004 Social Responsibility Report*,¹¹ it is possible to identify shifts in the use of factories regionally. The results show a significant consolidation of

"Their current business model, which promotes haphazard buying practices and shifting production ... negatively impacts on working conditions."

Kelly Dent, Oxfam

Codes

Memo

Number 22

.....
Maquila

Solidarity

Network

■ **7**

Codes

Memo

Number 22

.....
Maquila

Solidarity

Network

■ **8**

production, with the number of active factories shrinking 23%, from 2,672 factories in 2004 to 2,053 factories in 2006. In the same period, Sub-Saharan Africa lost almost 60% of its active Gap factories.

And yet the Gap report fails to provide sufficient information to give us an accurate picture of the impact of its sourcing decisions on workers in specific countries, because the information is aggregated by broad geographic region and does not include specific information on production levels in each country. It is possible, for example, that Gap's production levels in Sub-Saharan Africa have remained constant but are simply consolidated in fewer factories and/or countries, but Gap's reporting is not clear on this.¹²

Gap does report that China "represented 20 percent of our total merchandise units purchased and 19% of total merchandise cost" in 2006.¹³ It does not, however, provide this breakdown for other countries.

All three of these companies have taken significant steps to disclose more information in this area than have most of their competitors. However, these and other apparel companies should be disclosing additional information to not only make it possible to measure the impact of restructuring and consolidation on workers in the countries that are losing jobs, but also whether and to what degree labour standards compliance factors into their regional and global sourcing decisions.

For instance, they should be providing sufficient information to determine whether and to what degree they are adhering to the principles of the *MFA Forum Collaborative Framework* by consolidating production in-country, whenever possible, and giving preference to factories and countries that provide decent work.

One simple measure of whether companies are giving preference to factories that provide decent work, as well as whether they

are promoting respect for freedom of association in their supplier factories, would be if they included in their CSR reports updates on union density in their supply chains. The *GRI Draft Apparel and Footwear Sector Supplement* suggests measuring the percentage of factories in the supply chain in which there is one or more trade unions, broken down by country. In addition, the draft supplement asks companies to report on the presence of collective bargaining agreements.¹⁴

Closures and exit policies

Since the end of quotas the issue of factory closures and factory exits has been at the forefront of worker rights efforts, as workers and communities around the world struggle with the negative impacts of job losses. However, companies currently report very little on the efforts they are making to ensure that workers' rights are respected during factory closures and worker layoffs.

Brand exits from factories may occur for any number of reasons – poor quality, changing product focus, location, pricing (including tax, tariff and currency changes), and compliance issues or public controversy, amongst others. Sometimes factory exits by major buyers lead to closure or retrenchment of large numbers of workers. Since workers' legal rights and entitlements are often at great risk during a factory closure, it is critical that brand buyers develop and report on policies and practices that ensure that their factory exit and/or factory closure do not lead to worker rights violations.

The *GRI Draft Apparel and Footwear Sector Supplement* asks companies to report on their "strategy for managing impact of exiting [factories]."¹⁶

Nike has taken a step towards this, outlining its factory exit strategy in a flow chart format. The company follows this up with a set of case studies demonstrating Nike's

actions in two factory exits, and discussing the development of new “responsible transitions” guidelines within the MFA Forum framework.¹⁷

Gap Inc., which, like Nike, has been involved in the MFA Forum’s working group on “responsible transitions,” does not report on its closures or exit policies in its latest CSR report. Gap did make note of the issue in its 2004 report, but did not provide the level of detail evident in Nike’s 2005-06 report. Walmart does not discuss closures or factory exits in its 2006 report.

Demonstrating a clear understanding of the potential impacts of factory exits as well as defining responsible policies and practices to address those impacts has become imperative in an industry rocked by closures and restructuring. Nike’s initial moves in this direction should be reciprocated by other companies.

From the Clean Clothes Campaign Bulletin on Closures:

“Given the great impact of the purchasing practices from the buyer on the economic situation of the supplier, and therefore on labour welfare, we should also expect a high degree of transparency and (collective) action from buyers in the process surrounding the closure, especially when it comes to determining whether alternatives to closure are possible, and to ensuring that negotiations take place in good faith. However, as various high-profile cases in the past years have demonstrated, in practice buyers are extremely reluctant to become involved in this area.”¹⁵

The Bulletin describe a range of international directives that should be applied when closures are contemplated, including ILO Recommendations 119 and 180, and Convention 173.

Further, even as factory exits have raised critical worker rights concerns, the question of whether buyers are willing to make longer-term commitments to suppliers and factories as they consolidate production is also coming to the forefront. As MEC, which did not report on factory exits in its latest CSR report, notes, “The more we’re involved in factories and the longer we’ve known them, the more we can positively influence workers’ rights.”¹⁸

The buying relationship

While continuing to campaign against brand exits from factories where workers have organized unions and negotiated improvements in wages and working conditions, as well as against violations of workers’ rights during closures, labour rights advocates are also pushing for longer-term and more stable relationships between buyers and the factories producing their goods. Longer-term and more stable business relationships make it more likely that an employer can address workplace issues that require either more training, more capital investment, or quite simply more time to address the root causes of the problems.

Increasingly leading brands are also talking about the need for longer-term relationships with trusted suppliers or vendors, and point to this as a potential positive outcome of restructuring and consolidation. However, since suppliers often own a number of production facilities, long-term relationships with fewer large suppliers do not necessarily translate into long-term commitments to specific factories, or to giving priority to factories where wages and working conditions are improving.

“Interestingly, many brands reject campaigners’ description of a footloose sourcing model, telling us that they have long-term relationships with the bulk of their supply

Codes

Memo

Number 22

Maquila

Solidarity

Network

■ 9

Codes

Memo

Number 22

Maquila

Solidarity

Network

■ 10

bases," says Martin Hearson, Campaign Coordinator at Labour Behind the Label in the UK.¹⁹

"There are several reasons why companies can make this claim despite continued insecurity at the factory level," he says. "First, many 'suppliers' are themselves increasingly multinational, so the decision about where to source from is devolved from brand to supplier: what the brand sees as a stable relationship with its supplier may not lead to stable relationships with particular factories.

"Second, stability and security are two very different things. A brand may well have what it sees as an ongoing, long-term relationship with a supplier, but this can be based on contracts lasting as little as six-months, with no guarantee that the brand won't pick up and go elsewhere after that time.

Hearson acknowledges that there is some evidence of more stable relationships with some supply factories. "In the quest for more streamlined supply chains, many brands are moving into more direct sourcing from factories, and much more collaborative working with suppliers, which has to be based on longer-term relationships," he notes.

"Knowing your supplier well makes business sense when you want to turn round an order in just a few weeks, or you want to shave every last penny from the production costs.

"While this trend might apply to a brand's 'core suppliers' (typically around a half to a third of its suppliers, but representing a higher proportion of its production)," he continues, "there is still a sizeable amount of production outside of these stable relationships, with a shifting supply base dependent on trends and national/factory specialties, fabric types, and of course price."

There is currently very little information available in company reports about the length of buyer relationships with supply factories or the stability of its contracting system, although there are some indications

that this kind of information may become more available in future CSR reporting. In its *2006 Ethical Sourcing Report*, Wal-Mart admits that there is a "need for a transformation in the Company-supplier relationship, shifting from a primarily transactional association (purchase orders) to longer-term commitments." The *Report* goes on to say:

If suppliers can depend on future business as a result of positive performance, they will have more incentive to conform to the Standards for Suppliers. Wal-Mart envisions that these measures will improve factory audit results. The goal is for suppliers to deliver consistently higher-quality merchandise produced in factories that demonstrate a strong commitment to Wal-Mart's labor and environmental standards. The specific details of the strategy, including milestones and metrics, are still being developed, but work is underway. We will report on progress in our next Ethical Sourcing Report.²⁰

However, Wal-Mart provides no information on current length of relationships with supply factories in its 2006 report.

Nike says in its latest report:

Our core focus within apparel and footwear is to move toward fewer strong, long-term, strategic partnerships and a manufacturing model that drives efficiency and productivity and creates opportunities for workers.²¹

Yet there is little reporting to date on Nike's actual practice on this issue.

Although Gap also expressed awareness of the issue of developing longer term relationships with suppliers in its *2004 Social Responsibility Report*,²² there was no mention of it in Gap's most recent report, let alone indicators of how the company was handling the issue.

MEC once again has provided more information in this area. The company tries to address the question of the length of its relationship with factories by identifying the approximate number of factories (30 out of 56) it has worked with for over five years. MEC reports that "relationships with the

remaining factories have been more fluid, typically last less than a few years, and are subject to a more transient product shelf life."²³

MEC's innovation in reporting in this area is useful, but could be improved by identifying the number of factories with which it has worked for a wider set of increments – one, three, five, ten or more year increments, for example. The question here is whether there is a pattern of shifting orders regularly (increasing uncertainty for factories and

therefore workers) or whether factories can expect ongoing business from the company.

Brands could also disclose whether they enter into longer term supply contracts with factories committing to a certain volume of production over a specific time frame (as opposed to just order-by-order buying).

While the GRI's *Draft Apparel and Footwear Supplement* does not provide strong guidance on the measurements it is seeking in this area, it does explicitly ask companies to report on

"methods for integrating

Code of Conduct implementation into business practices, including but not limited to, sourcing policy and supplier relationships."²⁴ Reporting on the length of business relationships with supplier factories, pricing policies and incentives that encourage and reward labour standards compliance, and overall integration of company CSR policy with sourcing decisions should therefore be considered a response to this new draft GRI indicator.

A brand may well have what it sees as an ongoing, long-term relationship with a supplier, but this can be based on contracts lasting as little as six-months, with no guarantee that the brand won't pick up and go elsewhere after that time.

Martin Hearson
Labour Behind the Label

Uncovering the roots?

Central to the next generation reporting is the question of root causes of persistent labour rights abuses.

The Nike and Gap reports, and to a lesser extent those of Wal-Mart and MEC, do a good job of outlining some of the factors that may contribute to recurring labour rights violations within their supply chains.

Nike, for example, outlines what it believes are some of the root causes of excessive overtime hours:

Late design changes and poor forecasting by buyers pressure factory management who may already have done a poor job of production planning or have accepted orders beyond their capacity as a means of managing risk in a fluctuating market. The pressure on contract factories is compounded by unexpected events such as power shortages or late material arrivals.

The pressure on the factory to deliver product on time often seems to outweigh concerns about legal compliance, code compliance and general good work practices. A negative reinforcing loop may occur: Excessive overtime can result in decreased quality or productivity, promoting further excess hours to meet production targets. Many in local industry also are able to circumvent or ignore legal compliance standards, which may reflect a more generalized lack of clarity about or enforcement of the law.²⁵

Based on this understanding, Nike sets out plans to eliminate excessive overtime in its contract factories by 2011 using a combination of approaches, including:

- increasing productivity per product style by decreasing the complexity within the supply chain;
- consolidating materials;
- ensuring the hand off from the designer to factory takes place within an agreed upon time frame so that added pressure to deliver to market on time is not placed on the factory;

Codes

Memo

Number 22

Maquila

Solidarity

Network

■ 11

- increasing forecast accuracy; and
- reducing the number of sales samples.

Outlining the company's understanding of the problem and the steps it is taking to address it, as well as setting precise targets for completion, represents a step forward for CSR reporting.

Gap Inc. has engaged in a study of its purchasing practices – notably in partnership with the UK-based NGO Women Working Worldwide – and has reported on some of the results in its latest CSR report. Some of the initial findings point to the same kind of decision-making and planning process issues that Nike identifies as root causes of excessive overtime. Based on the initial findings of the study, Gap outlines steps it has taken and intends to take to begin to address the issue. A final report from the study is still not completed. It is not yet clear whether the full report will be made available to the public.

"This [Gap] study definitely set the pace," says Dan Rees, Director of the UK Ethical Trading Initiative (ETI). "The question is, so now you know purchasing practices have these impacts, what are you going to do about it? What lessons can we share with other companies?"²⁶

"Gap has taken an important step in looking at something that's a real industry-wide problem," he adds.

The importance of reporting on purchasing practices is illustrated by a chart reproduced below from Gap's 2004 CSR report. The chart identifies a number of factors driving non-compliance and divides them into categories based on the extent of Gap's influence.²⁷

Some categories, like "unreasonable expectations regarding cost and speed" are things which the brand can control. Others, like "poor economic, financial and civic infrastructure" are less within the control of the brand.

While the brand's interpretation of the level of control it has over some factors, such as prices, could be disputed by labour rights activists, the fact that Gap reveals its understanding of the root causes driving non-compliance makes it possible for stakeholders to hold the company accountable on issues over which it admits to having some control while challenging it on other issues. For this reason, more reporting on a company's understanding of the root causes of non-compliance is welcome.

Nonetheless, labour rights activists should take note of what kinds of issues, "root caus-

Codes

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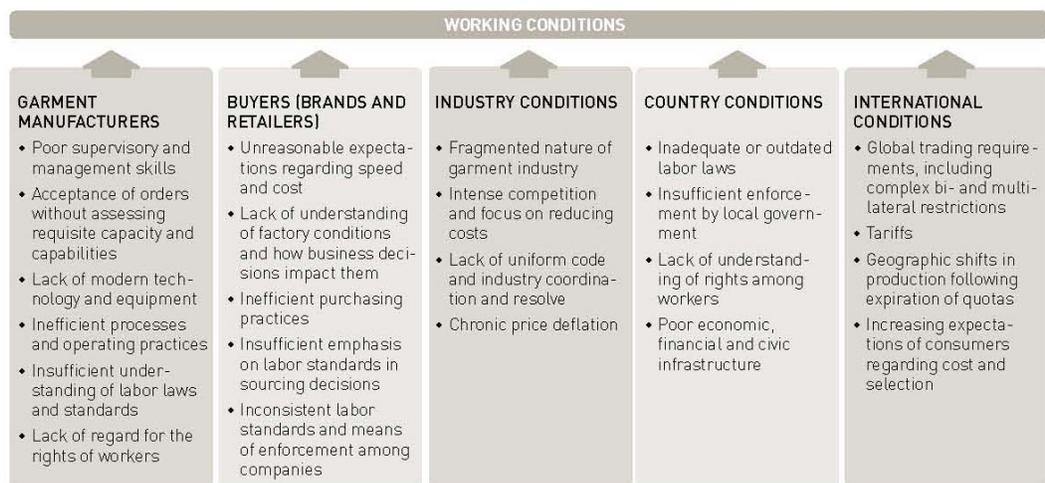
Number 22

Maquila

Solidarity

Network

FACTORS CONTRIBUTING TO POOR WORKING CONDITIONS IN GARMENT FACTORIES



Source: Gap Inc. 2004 Social Responsibility Report

es” and proposed actions are given prominence in company CSR reports and which are not. For example, while some process-based purchasing practices like lead times and design changes are now cited in many CSR reports, a frank discussion of lower prices paid by buyers to suppliers and their impact on wages is harder to find.

It’s also notable that the majority of the “root causes” elaborated in company reports tend to focus on supplier and factory level causes (and sometimes market or government causes) while less attention is given to “root causes” that are more squarely within the brand’s control.

For instance, Wal-Mart notes that “in certain circumstances, factories commit to produce more than they have capacity to produce, and in some situations, production expectations change and the factories subcontract to meet their deadlines.” They add that “high risk violations are often found in undeclared subcontractor factories.” However Wal-Mart’s response is to ask auditors to look for undeclared subcontracting and ensure that any subcontracted factories are subjected to Wal-Mart’s compliance program.²⁸ Wal-Mart could also contribute to resolving the issue by addressing instability in the volume and timing of Wal-Mart’s orders that might lead factories to take on as many orders as are available at a given time – even if it requires subcontracting or excessive overtime.

Brands have increasingly focused on “supplier ownership” of compliance programs in an effort to encourage suppliers to take responsibility for conditions in their factories.²⁹ While there is no doubt that suppliers need to take responsibility for working conditions, brands need to acknowledge that their own practices can constrain the options available to suppliers and make compliance more difficult.

Pricing and wages

Another fundamental purchasing practice issue that is seldom discussed in CSR reports is the matter of prices paid to suppliers and how they impact on the wages paid by suppliers to workers.

“Unit labour costs of most garments assembled for the export market remain at a criminally low level – anywhere between 1 and 10 US cents per minute,” says Doug Miller of the International Textile, Garment and Leather Workers Federation (ITGLWF). “Compare that with what a designer, marketing manager or CEO earns per minute further up the value chain!”³⁰

“Companies are under intense campaign pressure on the issue of low wages, particularly in countries like Bangladesh,” says the ETI’s Dan Rees.³¹ According to Rees, the ETI is currently looking at developing a collective approach among its members on the issue of how to achieve a living wage in Bangladesh, and plans to roll out a pilot project in the near future.

“The core principle,” Rees says, “is looking at using price incentives along side other mechanisms such as productivity to encourage suppliers to increase wages. Productivity increases and other methods have been tried but on their own, there is little evidence that they have led to significant or sustained increases in wages. We are at the early stages of examining approaches and of course there are problems to manage. For example, how do you get the right leverage on the factories, and how do you get their buy-in?”

Chronic price deflation in the apparel industry contributes to an environment in which wage increases are difficult to achieve. And even where there have been increases in the minimum wage, new problems are emerging.

When prices paid to suppliers fall and/or workers press for higher wages, factory management looks to increased production tar-

Codes

Memo

Number 22

Maquila

Solidarity

Network

■ 13

Codes

Memo

Number 22

Maquila

Solidarity

Network

14

gets as a way of dealing with the squeeze on revenues, says Miller. “No wonder forced overtime and abusive line management seem to be becoming the norm for apparel supply chains everywhere,” he adds.

In its latest CSR report, Nike has taken the positive step of describing its understanding of the low-wage problem and its approach to addressing worker compensation. However, Nike continues to reject setting living wage targets, saying that wage levels “should be determined by negotiations with workers and management and through public policy.”

To help achieve better wage levels, Nike commits to “educating managers and workers in our contract factories about freedom of association and collective bargaining, as well as helping factories implement strong human resources management systems and practices.”

To its credit, Nike does admit that downward pressure on prices is a problem:

In the traditional business model of the apparel and footwear industry, where the key driver has been lowering the landed cost of goods, stakeholders have rightly expressed concern that a market-driven downward pressure on price can undermine efforts to improve working conditions. They’re specifically concerned that downward pressures on pricing can be a factor in maintaining wages at artificially low levels.

Although a small fraction of the total cost of a product, wages have traditionally been one of the only parts of the manufacturing process with elasticity. Across the industry, we see contract factories closing, often blaming lower wages in other countries. For those that stay open, negotiations between management and worker representatives are often tough, with little room for bargaining in such a price-sensitive market.³²

Gap’s discussion of purchasing practices in its latest CSR report is also a welcome explanation of some of the issues facing the industry, but nowhere in Gap’s report is there information nor a serious discussion on prices and/or wages, other than the perfunc-

tory collection of data on non-payment of minimum wages.³³

Wal-Mart acknowledges wages as a top global issue, although its concern is for payment of legally-mandated wages rather than whether the legal minimum wage is sufficient to meet a worker’s basic needs.³⁴

Wal-Mart does indicate, however, that it is reviewing purchasing practices and incentives for suppliers:

We are also examining our internal processes to accomplish the following:

- **Identify internal processes that might contribute to non-compliance with Wal-Mart’s Standards for Suppliers, such as short lead time for production and last minute design changes;**
- **Increase internal alignment between social and commercial objectives, factoring labor compliance and social responsibility into purchasing decisions; and**
- **Provide suppliers who drive compliance throughout their supply chain but still deliver on quality, on-time shipping, and price with incentives in the form of future business**

We envision that the above measures will improve factory audit results, as suppliers are given increased incentives for positive performance.³⁵

Unfortunately, none of this suggests that Wal-Mart’s prices and/or purchasing practices related to prices are subject to this promised review.

“Information on sourcing policies and practices is conspicuously absent from [Wal-Mart’s] Ethical Standards reports,” says the International Labor Rights Forum in a recently published analysis of the company’s public reporting and labour practices. “Pressure of these purchasing policy decisions encourages excessive overtime and illegally low wages due to Wal-Mart’s unreasonable deadlines for orders and demands for ultra-low prices,” charges the ILRF.³⁶

In its latest CSR report, MEC recognizes that this is “an extremely price-driven indus-

try,³⁷ but fails to discuss its own pricing strategies or their impact on wages. The company has indicated in the past that it will rely on the guidance of the Fair Labor Association (FLA) on the development of a living wage standard. The FLA does not currently have a living wage provision in its code of conduct.

While actual price data is considered competitive information and therefore confidential, companies should report on what safeguards are in place to ensure that prices are sufficient to allow compliance with code of conduct provisions, including wages that meet workers' basic needs. Further, brands should report on the kinds of price incentives being offered for compliance or for improvements in compliance on key standards, such as wages, overtime pay and other monetary benefits, that may have price implications.

A brand's approach to pricing and incentives should be considered an indicator of the brand's commitment to establishing business practices that facilitate compliance with international labour standards.

Further, given that insufficient wages have been a long-standing, persistent issue in apparel supply chains, it is disturbing to see how little attention is being paid in brand CSR reports to the need to increase wages and other monetary benefits. Brands should be reporting on how they intend to achieve living wages that meet basic needs by local standards within their supply chains, with measurable targets.

Training and engagement

Since the discussion of root causes in company CSR reports has tended to focus on persistent factory-level problems, it is not surprising that the solutions proposed by brand buyers have emphasized training for and engagement with factory management

to improve HR practices, materials management, and productivity. Consequently, discussion of training programs, as well as engagement with local labour and non-governmental organizations, has been given more prominence in recent CSR reports.

Gap's latest CSR report includes a map of the world identifying the initiatives and projects in which it is engaged in each country, which helps stakeholders visualize the extent to which the company has committed to engagement and training across its supply chain.³⁸ Most companies report only a select few pilot projects or successful training projects, which may give readers a sense of a company's most advanced initiatives, but do not necessarily provide an accurate picture of the breadth and quality of all its training and engagement activities.

Further, while many reports on training are at best a listing of activities, Gap goes further by reporting some measurable results from its training programs. For example, Gap describes a 2005 Supervisory Skills Capacity Building training program in Cambodia that was delivered to 650 factory supervisors. The results, measured in employee turnover and absenteeism, rejection rates, productivity, and production levels, are set out in a chart.³⁹

While Gap does not provide a similar chart for each training program, the move towards more open reporting on results rather than events, as well as clear information on how training results are being measured, should be encouraged. It's also in keeping with the GRI *Draft Supplement*, which asks that for each training program companies "summarize the goals, content, implementation, and participants" and "assess each program's effects."⁴⁰

One strong focus for training programs in coming years appears to be freedom of association and collective bargaining, known as "enabling rights" because they provide workers with the ability to enforce compliance with labour standards.

Codes

Memo

Number 22

.....
Maquila

Solidarity

Network

■ **15**

Codes

Memo

Number 22

.....
Maquila

Solidarity

Network

■ 16

Both Nike and Gap have explicitly set a goal of increasing training related to freedom of association and collective bargaining in the coming years. While the scope and content of the upcoming training is not set out in the companies' CSR reports, the commitment to efforts in this area has been welcomed by trade union leaders and other labour rights advocates. Neil Kearney, General Secretary of the International Textile, Garment and Leather Workers Federation (ITGLWF), says, "Fifteen years of learning will now be followed, according to the targets set by Nike, by four years of embedding a commitment to unionization and collective bargaining and making it work."⁴¹

Significantly, Nike's plans include training and educational programs for workers – who are often left out of the code compliance process – and are set to roll out a specific timeline, to be completed by Nike's fiscal year 2011. The company intends to implement training in 100% of its "focus factories."⁴² The term "focus factories" is not well defined in the report itself, but refers to the approximately 130 contract factories (out of 687) Nike defines as "key."⁴³ It's not clear what percentage of Nike's production takes place in these "key" factories.

Gap reports that it has partnered with the ITGLWF to train internal monitoring staff on freedom of association and collective bargaining, followed by joint workshops in two sub-regions and national level workshops with suppliers.⁴⁴ The ITGLWF reports that the workshops focused on "how to identify whether freedom of association and collective bargaining are respected, how to proceed where there are, at present, no unions, how employer resistance to deal with unions can be overcome, how to develop in-plant capacity on the part of both management and unions, and how to promote the benefits of mature systems of industrial relations."⁴⁵

The Wal-Mart CSR report lists training it is rolling out for its sourcing staff on how their

decisions might impact working conditions, as well as training for suppliers on Wal-Mart's Standards for Suppliers. However, there is little information provided on the content or effectiveness of the training, though Wal-Mart does report that it is developing ways of measuring the effectiveness of its training programs.⁴⁶ Hopefully these will form part of Wal-Mart's reporting efforts in coming years.

Wal-Mart does not report any specific training for workers, factory management personnel, or the company's own compliance or sourcing staff on freedom of association and collective bargaining.

Summing up

The most recent Nike, Gap and MEC CSR reports signal a shift amongst leading brands from generalized CSR reporting that focuses on monitoring to a more process-based reporting that identifies issues, explains the company's approach, and sets out strategies and target dates for addressing the problems the company identifies.

This approach is also reflected in part in the GRI *Draft Apparel and Footwear Sector Supplement*, which attempt to develop more rigorous reporting on how a company is actually addressing key process issues.

Of particular note, the GRI's measurement of trade union density within the company's supply chain is one way of measuring both progress on Freedom of Association as well as whether a company has taken steps to engage trade unions in its efforts to improve labour practices at its supply factories.

As well, the GRI *Supplement's* measure of "Process from Design to Delivery" asks companies to provide more information on some of the purchasing practices that can impact on conditions in the supply chain. The Supplement also asks companies to report on how CSR performance is linked to sourcing decisions.

One of the strengths of Nike's *FY05-06 Report* is its articulation of how Nike intends to address ethical sourcing in its supply chain. This includes analysis of some of the root causes of persistent non-compliance and acknowledgment of the role of Nike's own sourcing decisions. The *Report* also reveals some of Nike's own business processes and compliance measures, and literally opens the books on some of its own auditing tools. In the *Report*, Nike sets some specific targets for future work on excessive overtime and freedom of association, although it does not commit to measuring freedom of association using the indicators suggested in the GRI draft guidelines.

Where Nike's discussion of root causes is weakest is in its analysis of how to improve wages. That analysis emphasizes increased productivity as the company's primary solution to inadequate wages, without substantial evidence that productivity gains will actually reach the workers in the form of higher wages. However Nike does commit to studying the impact of productivity gains on workers' wages. Hopefully, Nike will make the results of its study public.

Gap's *2005-06 Social Responsibility Report* is strongest in its discussion of purchasing practices. The *Report* outlines some of the steps the company has taken to engage with NGOs on research to help it identify and address poor purchasing practices. It also includes the perspectives of NGOs and trade unions on the issue in that discussion.

In the *Report*, Gap also commits to engage with the ITGLWF on regional and national-level freedom of association training.

Gap's description of its training and engagement efforts in producing countries is relatively thorough, and the company goes a step further than others by assessing some of the outcomes of training

Where the *Gap Report* is weakest is in its omission of any discussion of how the company intends to improve wages for produc-

tion workers, or of how Gap's own purchasing practices and/or prices may contribute to the problem of low wages.

In the *Report*, Gap discloses some data on sourcing patterns, but not enough to identify and evaluate the global shifts in sourcing or the possible impacts these changes might have for countries, communities and workers. Nor does Gap report on its closure or exit policies, or discuss the length or stability of its relationships with supply factories.

Unlike Nike, Gap has not yet disclosed factory locations, nor has it made any commitment to do so.

Mountain Equipment Co-op, on the other hand, has committed to making its factory list public in 2008. While MEC is a small player compared to the other companies discussed here, it has taken some important steps forward, such as disclosing the volume of its production that is being done in various regions of the world, the increase or decrease in orders placed in a number of regions over the last three years, and the length of relationships with particular supply factories, albeit at a fairly coarse level of detail.

In its *2006 Ethical Sourcing Report*, MEC discusses the root causes of persistent non-compliance problems, but, like the other CSR reports discussed here, the MEC report is weakest on the question of wages.

In contrast to the above reports, Wal-Mart's *2006 Ethical Sourcing Report* fails to provide specific information on the company's commitments, strategies or targets to address roots causes of persistent worker rights violations over time, although it does include some narrative reporting on its understanding of root causes.

As noted above, Wal-Mart does not disclose factory locations, nor has it made a commitment to do so. Nor does its 2006 report discuss the company's closures or factory exit policies or how it intends to address the negative impacts of exits and closures on countries, communities and workers.

Codes

Memo

Number 22

.....
Maquila

Solidarity

Network

■ **17**

Reporting and transparency: key recommendations for 2008

Apparel and Footwear brands should:

- Develop and report on reliable measures of how the company is actually addressing the root causes and broader structural factors that are now recognized as impacting on individual factory compliance with labour standards.
- Disclose a full list of the names and addresses of supply contract factories used by the brand to produce its goods, updated on at least an annual basis.
- Provide sufficient information to determine whether and to what degree the company is adhering to the principles of the MFA Forum *Collaborative Framework*, including whether the company is consolidating production in-country, whenever possible, and giving preference to factories and countries that provide decent work.
- Report on whether there have been significant shifts of production from some regions or countries to others, perhaps by indicating the volume of orders being placed annually in each country.
- Develop and report on the company's strategy for managing impacts of exiting or significantly decreasing orders to factories, including policies and practices that ensure that the company's factory exit and/or factory closure does not lead to worker rights violations.
- Provide information in company reports about the length of buyer relationships with supply factories and the stability of its contracting system. Identify the number of factories with which it has had

As a result, Wal-Mart investors, consumers and workers are left without assurances that the company is seriously grappling with these issues.

However Wal-Mart does hold out the promise of improved reporting on purchasing practices in future CSR reports. Hopefully Wal-Mart's practice in this area can be informed by both the positive and negative experiences of other companies in addressing these issues, as well as through input and engagement with NGOs and trade unions. It would also be hoped that Wal-Mart would address the question of prices and wages in its future CSR reports.

Moving forward

A critical question concerning the next generation of company CSR reporting is whether it will provide the kind of information needed to assess whether companies are making progress on labour practices and working conditions in their global supply chains.

As leading companies move forward to a new generation of reporting, it is important that narrative reports that are heavy on root cause analysis and processes intended to tackle those root causes do not wholly replace hard data on current labour practices and working conditions and progress being made toward labour standards compliance.

Instead, a series of new measurements – some of which are beginning to appear in the reports studied here, some of which are in the GRI guidelines, and some of which still need to be developed and/or fine-tuned – will be necessary to track changes in labour practices and working conditions and provide assurance to consumers, investors and workers that real progress is being made on labour standards compliance in global supply chains.

Codes

Memo

Number 22

Maquila

Solidarity

Network

■ 18

worked for a set of increments – one, three, five, ten or more year increments, for example.

- Disclose whether the company enters into longer-term supply contracts with factories, committing to a certain volume of production over a specific time frame (as opposed to just order-by-order buying).
- Outline the company's understanding of the root causes of persistent labour standards compliance issues and the steps it is taking to address them. Set precise targets for completion of these steps.
- Describe the company's understanding of the low-wage problem and the company's approach to addressing it, including how the company intends to achieve living wages that meet basic needs by local standards within its supply chain, with measurable targets.
- Report on what safeguards are in place to ensure that prices paid to suppliers are sufficient to allow compliance with code of conduct provisions, including wages that meet basic needs. Further, brands should report on the kinds of price incentives being offered for compliance or improvements in compliance on key standards, such as wages, overtime pay and other monetary benefits, that may have price implications.

- Report on union density in its supply chain and the steps being taken to engage with trade union organizations on the effective implementation of provisions in its code of conduct on freedom of association and collective bargaining.
- For training programs aimed at improving working conditions in supply factories, the company should describe the complete breadth of programs undertaken over the reporting period. For each training program, the company should summarize the goals, content, implementation, and participants, and assess each program's impacts.
- Report on training and educational programs for workers – who are often left out of the code compliance process – and set specific timelines, objectives and targets for such training.

For further specific reporting measures, please see the Global Reporting Initiative's *Draft Apparel and Footwear Sector Supplement*, and ETAG's *2006 Transparency Report Card*. Both are available at: www.maquilasolidarity.org/issues/ca/transparency

Codes

Memo

Number 22

Maquila

Solidarity

Network

Endnotes

- 1 Nike. *FY05-06 Corporate Responsibility Report*, p.17
- 2 <http://www.mfa-forum.net/docs/Collaborative.pdf>
- 3 Nike. *FY05-06 Corporate Responsibility Report*, p.18
- 4 Email from Kelly Dent, October 26, 2007.
- 5 E-mail from Martin Hearson, October 26, 2007
- 6 Nike was only sourcing from one factory in the Dominican Republic before it exited the country, but that factory was unionized, and its closure therefore took on a great deal of significance for local and international trade union organizations and labour rights NGOs.
- 7 Nike. *FY05-06 Corporate Responsibility Report*, p.25
- 8 Nike, Inc. *Form 10-K*, 27 July, 2007. p.5
- 9 Ibid
- 10 Gap Inc. *2005-2006 Social Responsibility Report*, pp.30-31.
- 11 Gap Inc. *2004 Social Responsibility Report*, p.22.
- 12 Gap has committed to keeping orders in Lesotho during the post-quota restructuring period, and has reported on a number of initiatives it has taken in the small southern-African country including work with the MFA Forum and the government of Lesotho to enhance its apparel industry.
- 13 Gap Inc. *2005-2006 Social Responsibility Report*, p.37
- 14 Global Reporting Initiative. *Draft Apparel and Footwear Sector Supplement*, available at <http://tinyurl.com/yrnjtm>
- 15 Zeldenrust, Ineke and Tessel Pauli. *Expectations in Relation to Factory Closures and Mass Dismissals*. September 2007. p.11. Available at: www.cleanclothes.org/publications/07-09-e_buletin_ccc.htm
- 16 Global Reporting Initiative. *Draft Apparel and Footwear Sector Supplement*, p.16
- 17 Nike. *FY05-06 Corporate Responsibility Report*, pp.39-42. The MFA Forum guidelines are currently being circulated for feedback and are not available publicly.
- 18 Mountain Equipment Co-op. *2006 Ethical Sourcing Report*, p.5
- 19 E-mail from Martin Hearson, October 26, 2007
- 20 Wal-Mart. *2006 Ethical Sourcing Report*, p.26
- 21 Nike. *FY05-06 Corporate Responsibility Report*, p.22
- 22 Gap Inc. *2004 Social Responsibility Report*, pp.28-29
- 23 Mountain Equipment Co-op. *2006 Ethical Sourcing Report*, p.5
- 24 Global Reporting Initiative. *Draft Apparel and Footwear Sector Supplement*, measure AF48
- 25 Nike. *FY05-06 Corporate Responsibility Report*, p.45
- 26 Phone interview with Dan Rees, November 8, 2007
- 27 Gap Inc. *2005-2006 Social Responsibility Report*, p.24
- 28 Wal-Mart. *2006 Ethical Sourcing Report*. p.27
- 29 See, for example, Gap Inc.'s "Vendor Ownership Program", discussed in Gap Inc. *2005-2006 Social Responsibility Report*, p.26.
- 30 Email from Doug Miller, October 25, 2007
- 31 Phone interview with Dan Rees, November 8, 2007
- 32 Nike. *FY05-06 Corporate Responsibility Report*, p.47
- 33 One positive note in Gap's report is the commitment to bring their code into alignment with the Ethical Trading Initiative and Social Accountability International codes in 2007, both of which include living wage provisions. It will be interesting to see, in future reports, how Gap is working to achieve these standards.
- 34 Wal-Mart. *2006 Ethical Sourcing Report*, p.25
- 35 Ibid, p.4
- 36 International Labor Rights Forum. *Ethical Standards and Working Conditions in Wal-Mart's Supply Chain*. p.9, available at: <http://www.laborrights.org/publications/WMEthicalSourcing102407.pdf>
- 37 Mountain Equipment Co-op. *2006 Ethical Sourcing Report*, p.7
- 38 Gap Inc. *2005-2006 Social Responsibility Report*, pp.84-85.
- 39 Ibid, p.35
- 40 Global Reporting Initiative. *Draft Apparel and Footwear Sector Supplement*, p.17
- 41 <http://www.itglwf.org/DisplayDocument.aspx?idarticle=15311&langue=2>
- 42 Nike. *FY05-06 Corporate Responsibility Report*, p.29
- 43 Email from Caitlin Morris, October 11, 2007.
- 44 Gap Inc. *2005-2006 Social Responsibility Report*, p.26
- 45 <http://www.itglwf.org/DisplayDocument.aspx?idarticle=15216&langue=2>
- 46 Wal-Mart. *2006 Ethical Sourcing Report*, p.30