

# Insulating the Supply Network from Corporate Social Responsibility Risk

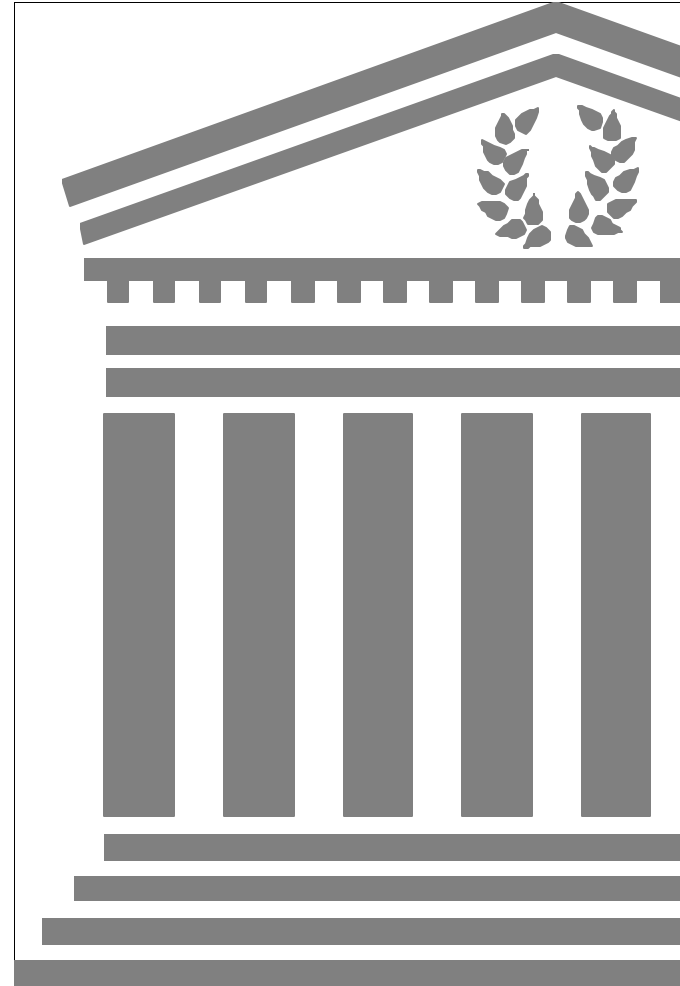
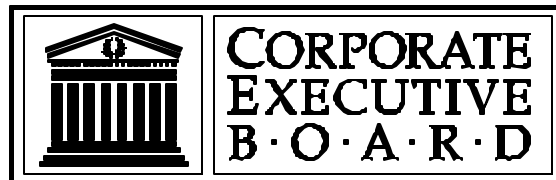
Session Code: BC

Thursday, March 8 10:30-11:45 am

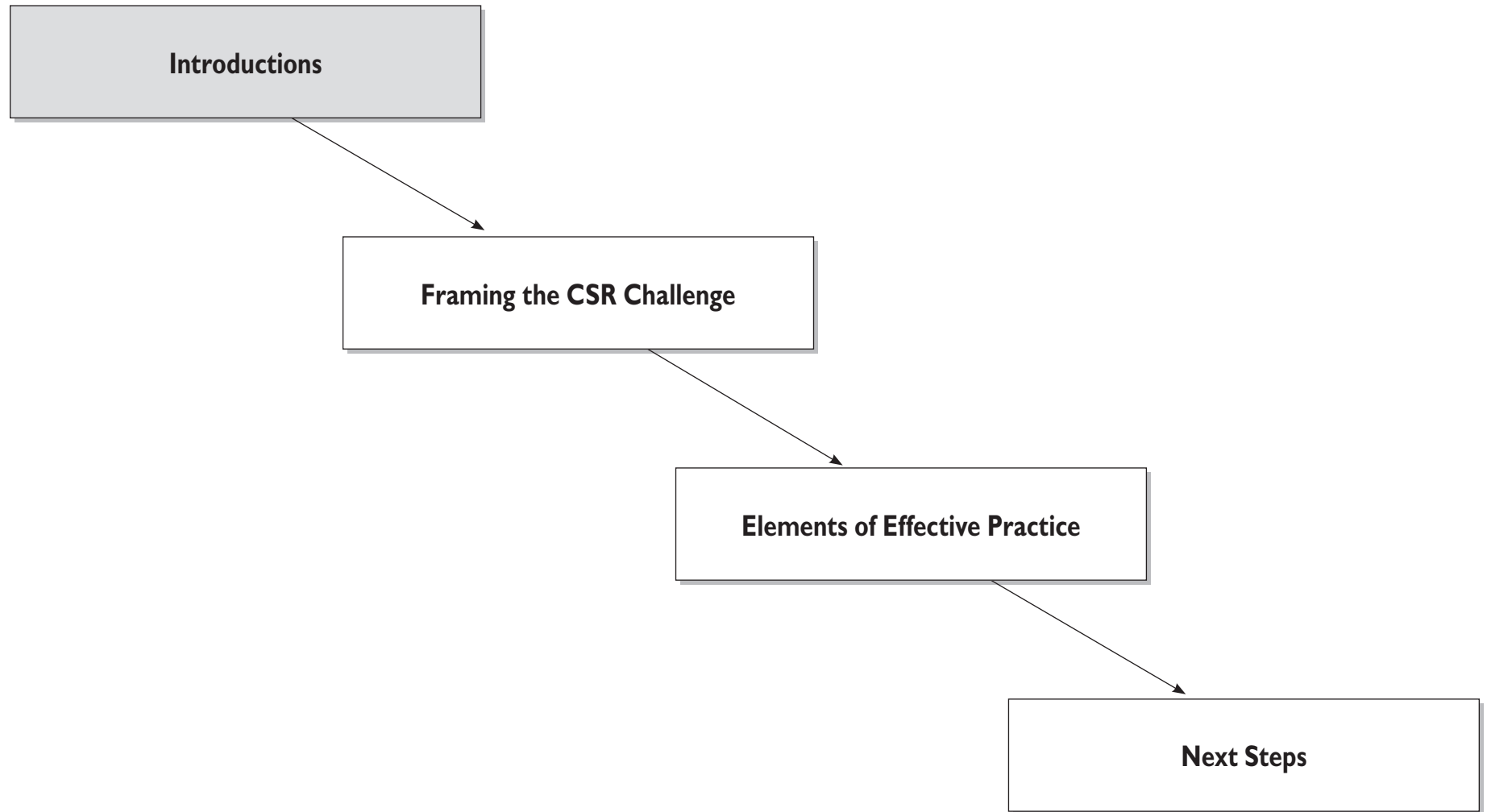
Robyn Bew

Senior Director, Operations Practice

Corporate Executive Board



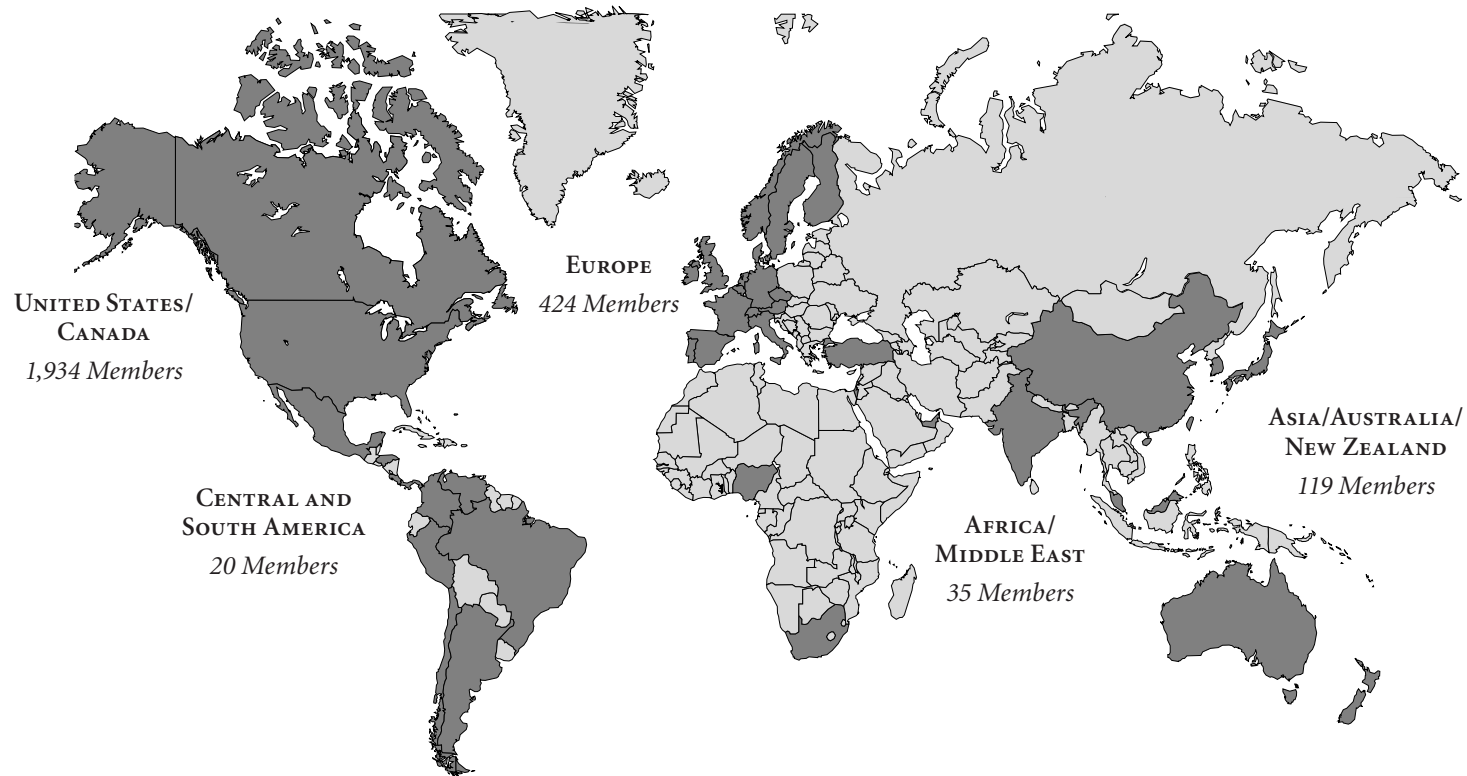
# ROAD MAP FOR TODAY'S DISCUSSION



# THE CORPORATE EXECUTIVE BOARD

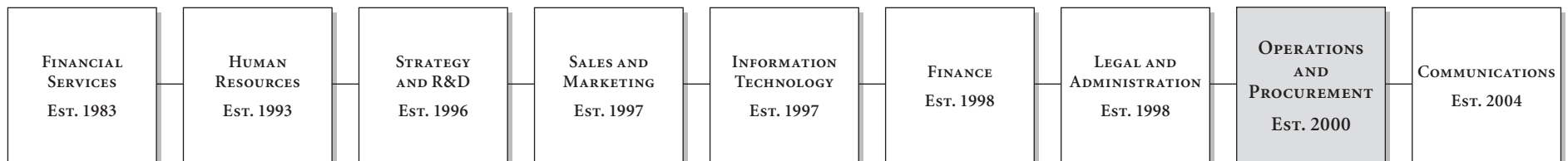
MORE THAN 2,500 CORPORATE EXECUTIVE BOARD MEMBERS AROUND THE WORLD

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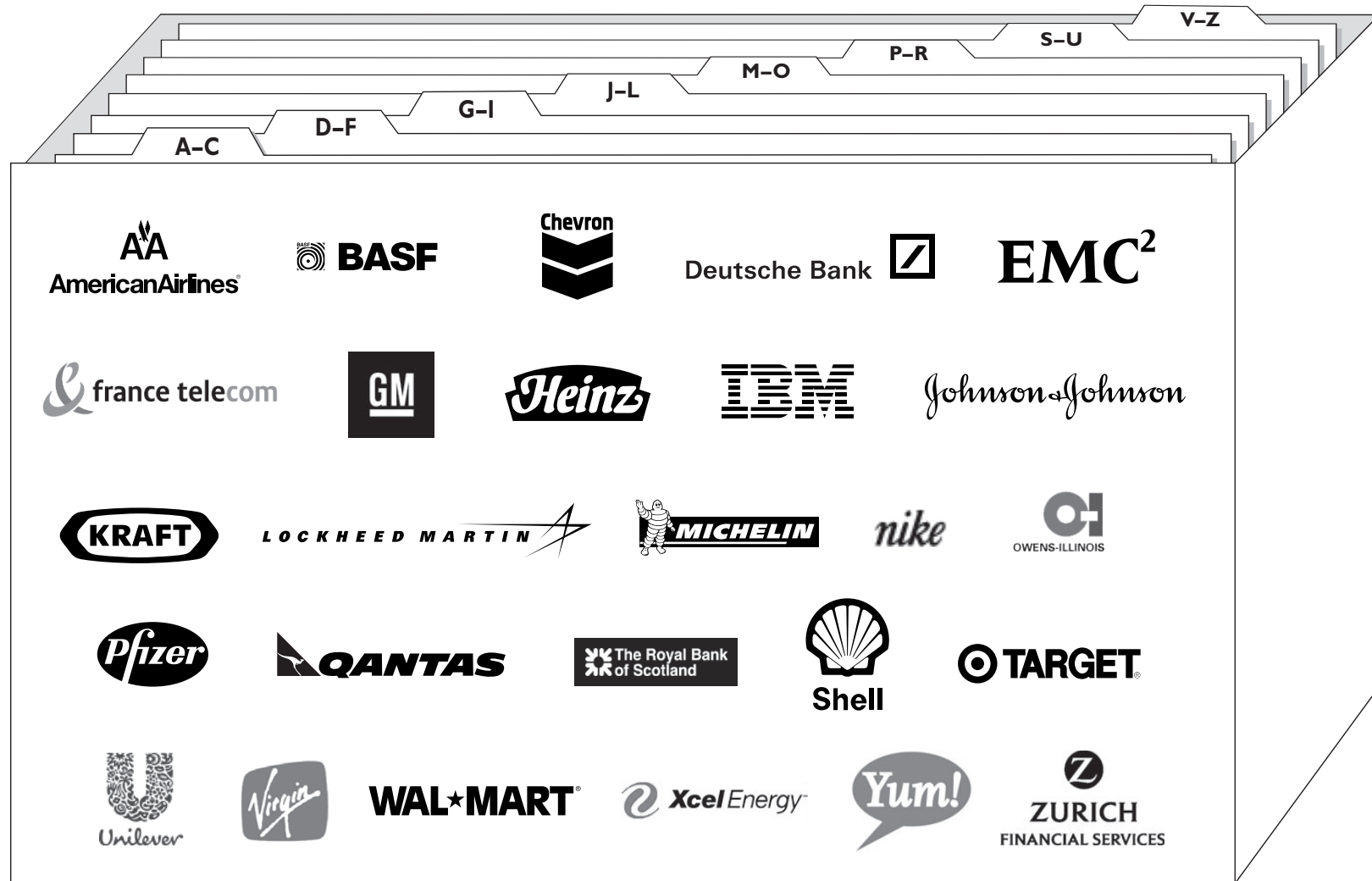
## NINE PRINCIPAL CORPORATE EXECUTIVE BOARD PRACTICE AREAS

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# A COMPREHENSIVE (AND GROWING) NETWORK OF PEERS

*Procurement Strategy Council Members Span a Broad Range of Industries and Geographies*



# THE POWER OF THE MEMBER NETWORK

## *Members Access Peers and Decision-Support Services Through Multiple Channels*

### Best-Practices Research



- Member-led research agenda refreshed annually
- Broad and deep archive spanning more than 150 practices from leading procurement organizations

### Tools and Templates



- Project Acceleration Toolkits
- Templates and process maps support initiative planning and implementation

### Executive Meeting Series



- Exclusive gatherings of seniormost procurement executives
- Interactive discussion of key research findings and member experiences

### Facilitated On-Sites



- Council staff join procurement executives, their teams, and senior management
- Interactive sessions to discuss specific best practice cases and implications for member's organization

### Project Support Desk



- Quick-turnaround service addressing issues of interest to individual members
- Deliverables take a variety of forms depending upon member needs

### Category Practitioner Panels



- Standing network of experienced peers tackling complex spend categories
- Regular teleconferences and ongoing research support to solve shared challenges

### Teleconferences



- Fast-cycle events to address time-sensitive member challenges
- Regularly scheduled sessions to review research findings and share member perspectives

### Council Online



- Round-the-clock access to all Council resources
- Peer database for convenient networking with target members

### — OUR SERVICE COMPACT —

1. Easy for you and your staff to access
2. Customized to support the projects and decisions on your desk today
3. Always “on” and always responsive
4. Proving the ROI of membership is on us

# DEFINING OUR TERMS

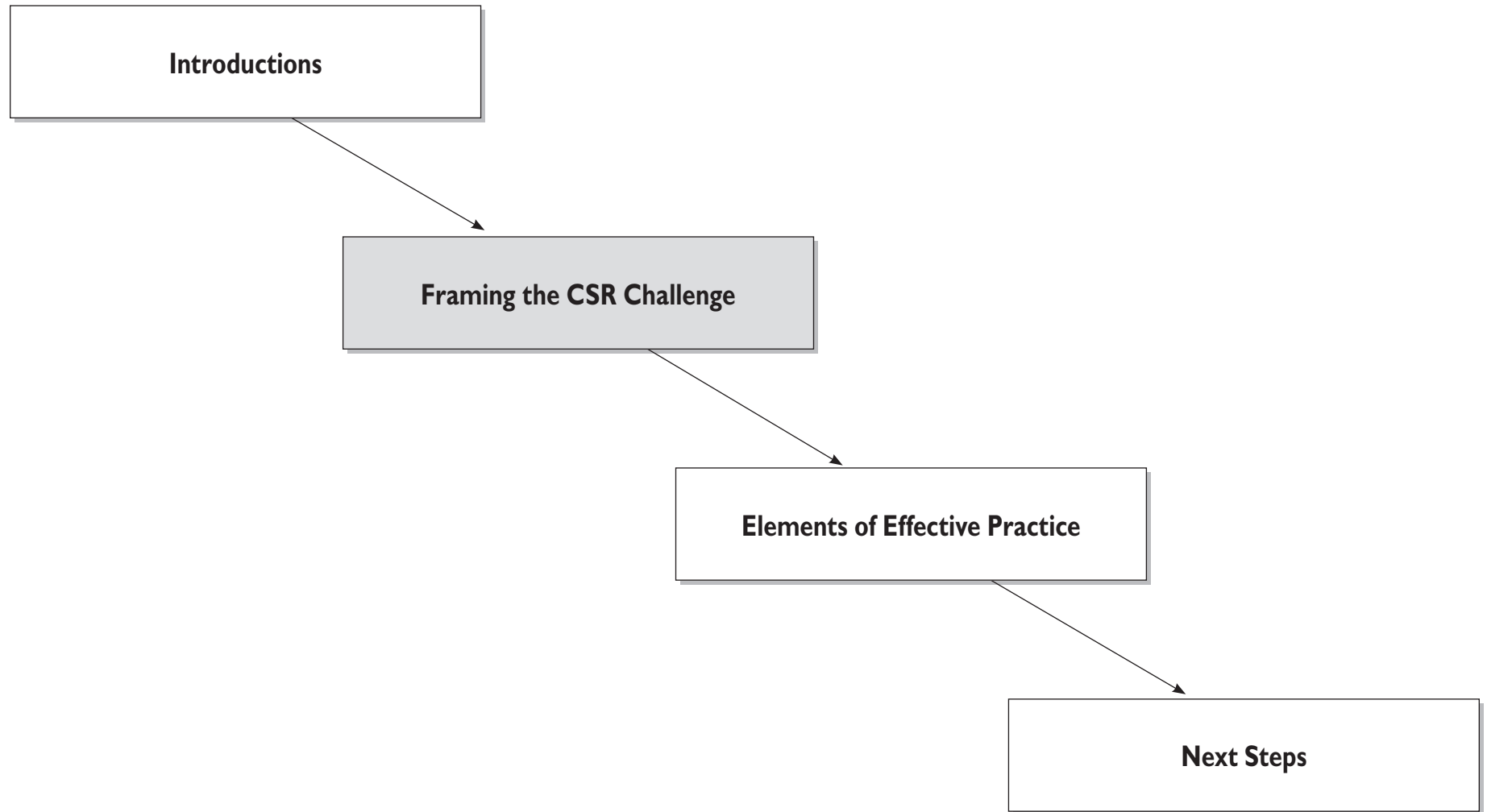
## CORPORATE SOCIAL RESPONSIBILITY (CSR)

The commitment of businesses to contribute to sustainable economic development by working with employees, their families, the local community and society at large to improve their lives in ways that are good for business and development.

*The World Bank*

Source: International Finance Corporation, "Corporate Social Responsibility,"  
<http://www.ifc.org/ifcext/economics.nsf/Content/CSR-IntroPage>

# ROAD MAP FOR TODAY'S DISCUSSION

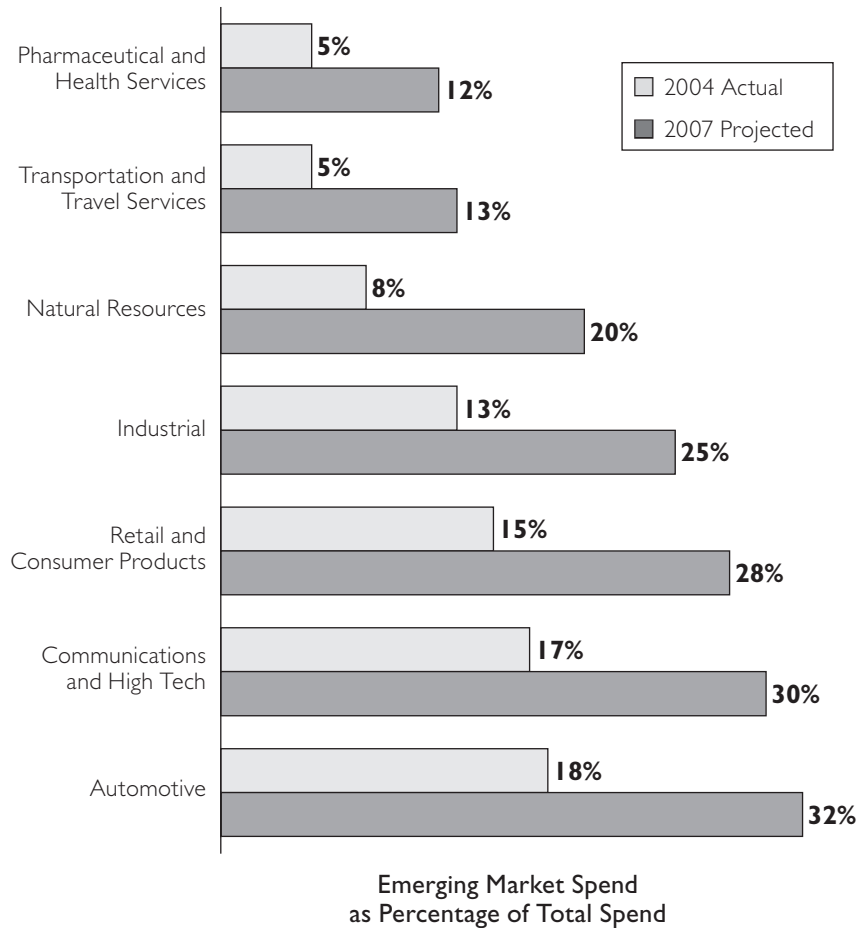


# ALL IN THIS TOGETHER

**Many sectors source extensively from emerging markets...**

Share of Spend in Emerging Markets, 2004 and 2007 (Projected)

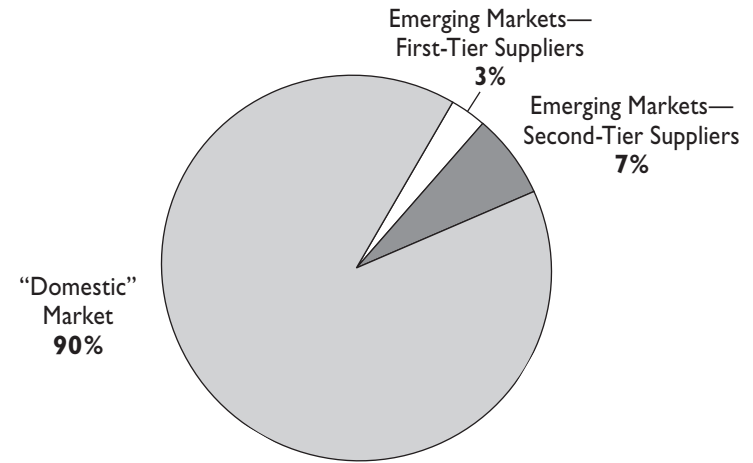
Selected Industries



**...and even traditionally “domestic” sectors are exposed to global supply chains...**

Distribution of Spend, Representative Electric Utility

2005



**...sometimes with alarming consequences**

## Case in Point: Global Supply Risk Hits Close to Home



- A major electric utility contracts out design and drawing work on its power plants to a domestic-based engineering firm, which in turn sends a portion of the work to engineers in Thailand.
- Media portray the arrangement as a serious security risk, prompting the utility to conduct damage control to allay concerns and protect the company's reputation.

n = 238.

Source: “Where East Meets West: Driving High Performance in Low-Cost Country Sourcing,” Accenture (2004); U.S. Bureau of Economic Analysis; Procurement Strategy Council survey and research.



# EMERGING MARKET SOURCES OF REPUTATION RISK

**Company Reputations Encounter a Broad Range of Corporate Social Responsibility Challenges in Emerging Markets**

## Human Rights, Health and Safety



### Representative Problems

- Child/slave labor
- Lack of freedom of association
- Excessive working hours/unpaid overtime
- Denial of minimum wage
- Poor working conditions/inhumane treatment
- Discrimination

### Sample Regulations/Standards

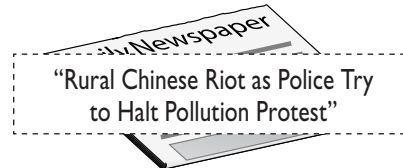
- SA 8000
- United Nations Global Compact

### DAMAGING NEWS

"The last thing I want is a headline saying we buy protective clothing made by underpaid children from the developing world."

Vice President,  
Purchasing  
Utility Company

## Environmental



### Representative Problems

- Deforestation
- Air/water/land pollution
- Unsafe use and disposal of hazardous materials
- Inadequate waste disposal
- Nonbiodegradable packaging
- Nonsustainable development

### Sample Regulations/Standards

- ISO 14000
- Clean Air Act

### ENVIRONMENTALLY UNFRIENDLY

"It turns out that production of this commodity directly endangers several species, an issue of great concern to our customers."

Head of Supply  
Management  
Consumer Products  
Company

## Data Privacy



### Representative Problems

- Private customer data loss
- Unauthorized access to employee records
- Stolen intellectual property
- Unprotected personal financial data
- Stolen patient records
- Identity theft

### Sample Regulations/Standards

- HIPAA
- EU Data Protection Directive

### VIOLATION OF PRIVACY

"We could lose personal information about payroll, which would destroy staff morale. And how do you calculate the cost of that?"

Director, Vendor  
Management  
Financial Services  
Company

Source: "London Police Probe Call Center Fraud Claim," *Times of India*, 23 June 2005; "Sweatshop Accusations on IT Equipment Manufacturers," *Business Respect* no.70 (31 January 2004); Yardley, Jim, "Rural Chinese Riot as Police Try to Halt Pollution Protest," *New York Times*, 14 April 2005; Procurement Strategy Council research.

# AN UNWELCOME CALL FROM THE CEO

**Supply Management Professionals Bear the Burden of Managing Reputation Risk from Suppliers' Unethical Behavior**

## Executive Committee Meeting

*Illustrative*



## Supply Chain Risk Exposure

Selected Supply Chain Risks	Supplier Financial Viability	Supplier Performance	Commodity Price Risk	Reputation Risk from Unethical Supplier Behavior
Breadth of Mitigation Toolkit	Financial Statements, Solvency Analysis, Third-Party Data Services	SLAs, EDI Scorecards, Audits	Hedging, Global Market Analysis, Third-Party Sources	Codes of Conduct, Periodic Site Visits



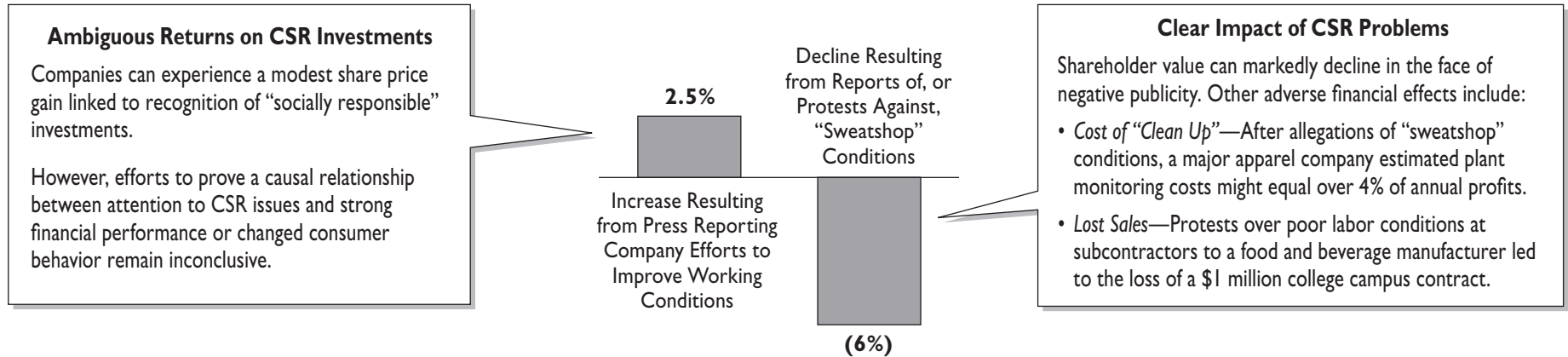
Source: Procurement Strategy Council research.

# THE BUSINESS IMPACT OF REPUTATION RISK

*While direct financial benefits of CSR initiatives remain unclear, the costs of failure are more tangible...*

Median Change in Share Price as a Result of Publicity Around Labor Conditions

2003; 71 Cases



*...enabling supply management executives to make the business case by focusing on the risk of noncompliance*



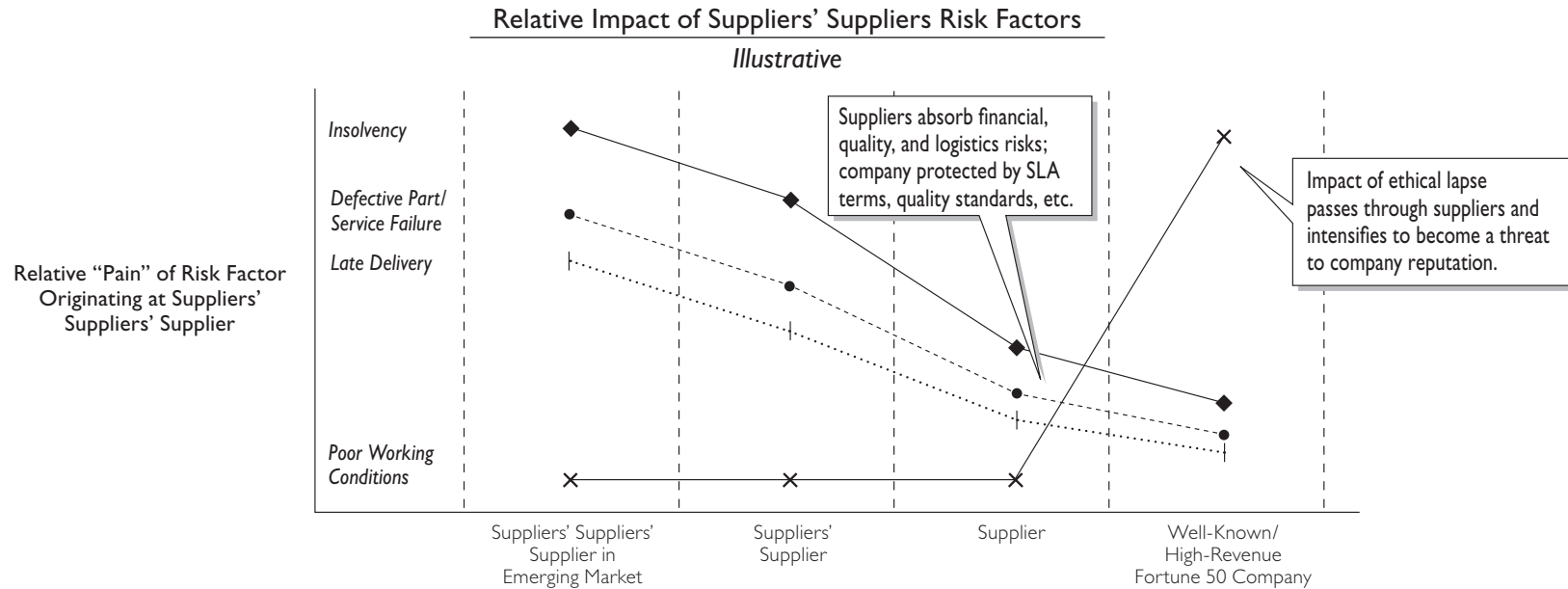
## Insights from Procurement Strategy Council Member Discussions

- ✓ **Noncompliance can create competitive disadvantage:** CSR problems can place companies at a disadvantage in the marketplace by damaging company brand.
- ✓ **Violations alienate more than the customer base:** Reports of environmental and labor abuses tend to have a negative effect on company recruitment efforts and employee morale.
- ✓ **Offense is better than defense:** Companies are less likely to suffer lasting reputation damage from unethical supplier practices if CSR measures are proactively established; reactive measures following negative press are often unsuccessful.

Source: Institute for International Economics, “Can Labor Standards Improve Under Globalization” (June 2003); Procurement Strategy Council research.

# IN SEARCH OF THE DEEPEST POCKETS

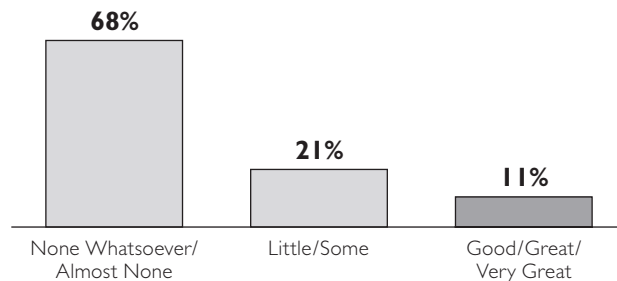
**Supplier social responsibility risk disproportionately affects companies far from the source of trouble...**



**...yet rigorous assessment of suppliers' suppliers is infrequent and difficult**

**Assessment of Key Secondary Suppliers to Ensure Compliance with Human Rights Policies**

*Percentage of Respondents, 2005*



n = 950; approximately 20% of respondents have annual spend of over \$500 million.

## **Solution: "Scalable" Mitigation Practices**

Progressive supply management organizations pool risk-mitigation and supplier-verification resources to extend the reach and effectiveness of solutions across a wider network.

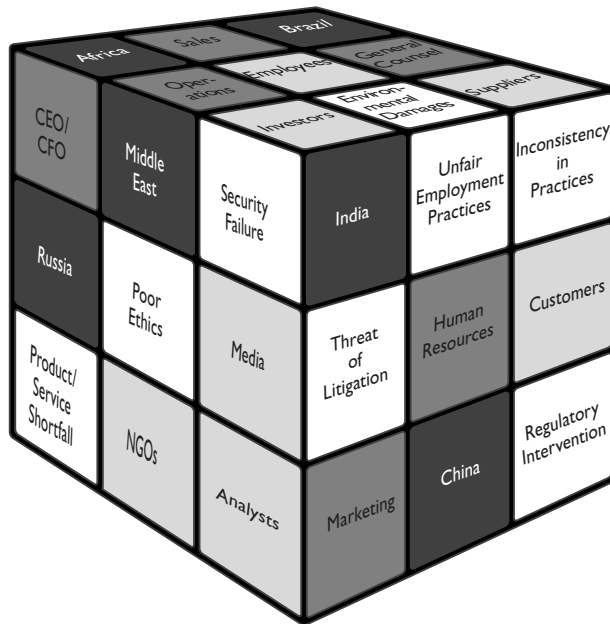
Source: Institute for Supply Management, *Social Responsibility and the Supply Management Profession: A Baseline Study* (April 2004); Procurement Strategy Council research.

# WHERE TO BEGIN?

***A daunting range of considerations accompanies supplier social responsibility management...***

Complexity in Managing Reputation Risk from the Supply Base

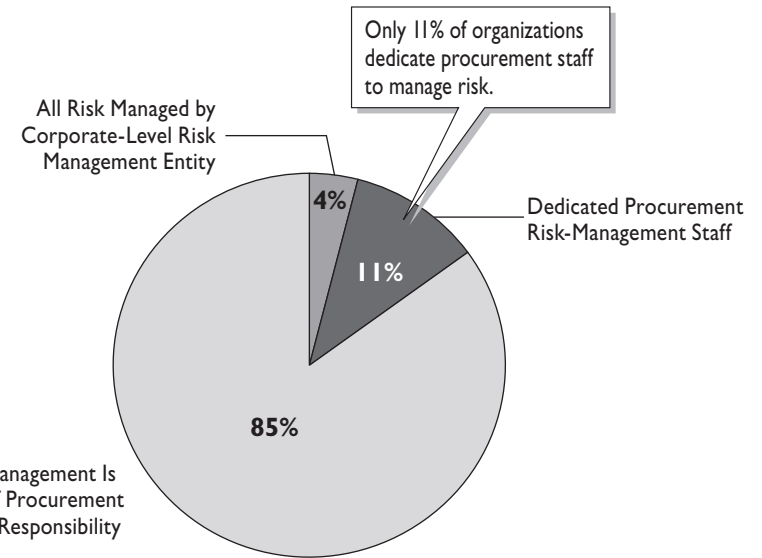
*Illustrative*



***...yet Supply Management's commitment to risk mitigation is often lacking***

Supply Risk\* Management Organization

*Percentage of Respondents, 2003*



n = 76 companies responding.

## Solution: Targeted Resource Allocation

Leading practitioners focus on pinpointing the sources and magnitude of reputation risks before allocating mitigation resources.

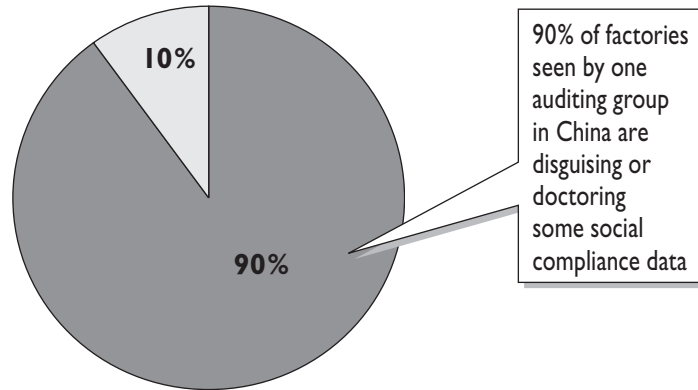
\* Survey covers all forms of supply management risk, including but not limited to reputation risk. Examples include supplier financial viability, supplier quality and delivery performance, political risk, currency risk, commodity price risk, and unexpected demand swings.

Source: Communications Executive Council; Procurement Strategy Council research.

# GAMING THE SYSTEM

## ***Doctoring and Disguising of Social Responsibility Performance By Suppliers Frustrates Audit Efforts***

### Supplier Doctoring of Social Compliance Data



### “Common Tricks” for Disguising Social Responsibility Underperformance

- Fake IDs for underage workers
- Multiple sets of books
- Fake facilities
- Pre-stamped timecards
- Employee coaching
- False wage slips
- Movement of production around the factory
- Re-registering/changing names of companies
- “Aging” time cards by rubbing them in dirt

### —EVADING DETECTION—

“At one subcontractor, if there was an injury on the site, they would put the person in the trunk of a car, drive them off the premises, and report the incident from there so that it didn’t count against their EH&S performance.”

Director of Supplier  
Management,  
*Utility Company*

### —PLAYING TO THE AUDIENCE—

“One supplier factory used velcro to attach fire extinguishers to the wall at three different levels, to meet the safety standards of three different customers.”

Head of Procurement  
*Telecommunications  
Company*

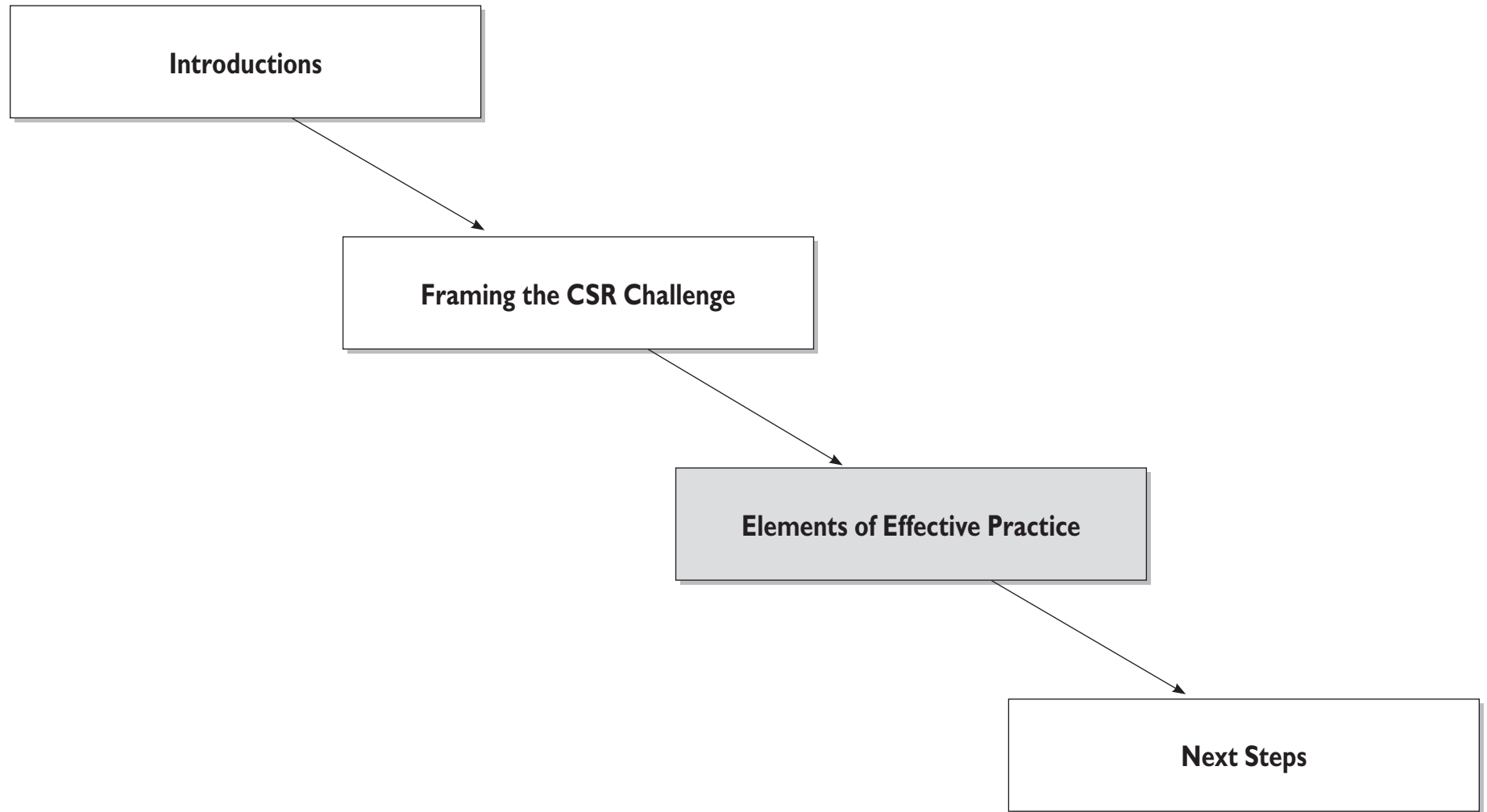
### —SELECTIVE REPORTING—

“The subcontractor reported that a fire drill evacuation met our time requirements. However, when we visited the site, none of the staff remembered a fire drill. It turned out they had conducted the drill in one small part of the plant, to avoid lowering productivity.”

Vendor Manager,  
*Manufacturing  
Company*

Source: Chan, Dr. Anita, “The Anti-Sweatshop Movement and Asian Factories,” Asian Analysis (October 2003); Foster, Lauren, Alexandra Harney, “Why Ethical Sourcing Means Show and Tell,” Financial Times (22 April 2005); McCafferty, Joseph, “The Price of a Cheap Suit,” CFO Europe (September 2005); Procurement Strategy Council research.

# ROAD MAP FOR TODAY'S DISCUSSION



# ELEMENTS OF EFFECTIVE PRACTICE

*Four characteristics underlie the success of leading-edge supply organizations' CSR initiatives:*

**Place Analysis In  
the Appropriate  
Context**

**Move Beyond a  
One-Size-Fits-All  
Approach**

**Find Resource-Efficient  
Ways to Improve  
Quality of  
CSR Audit Data**

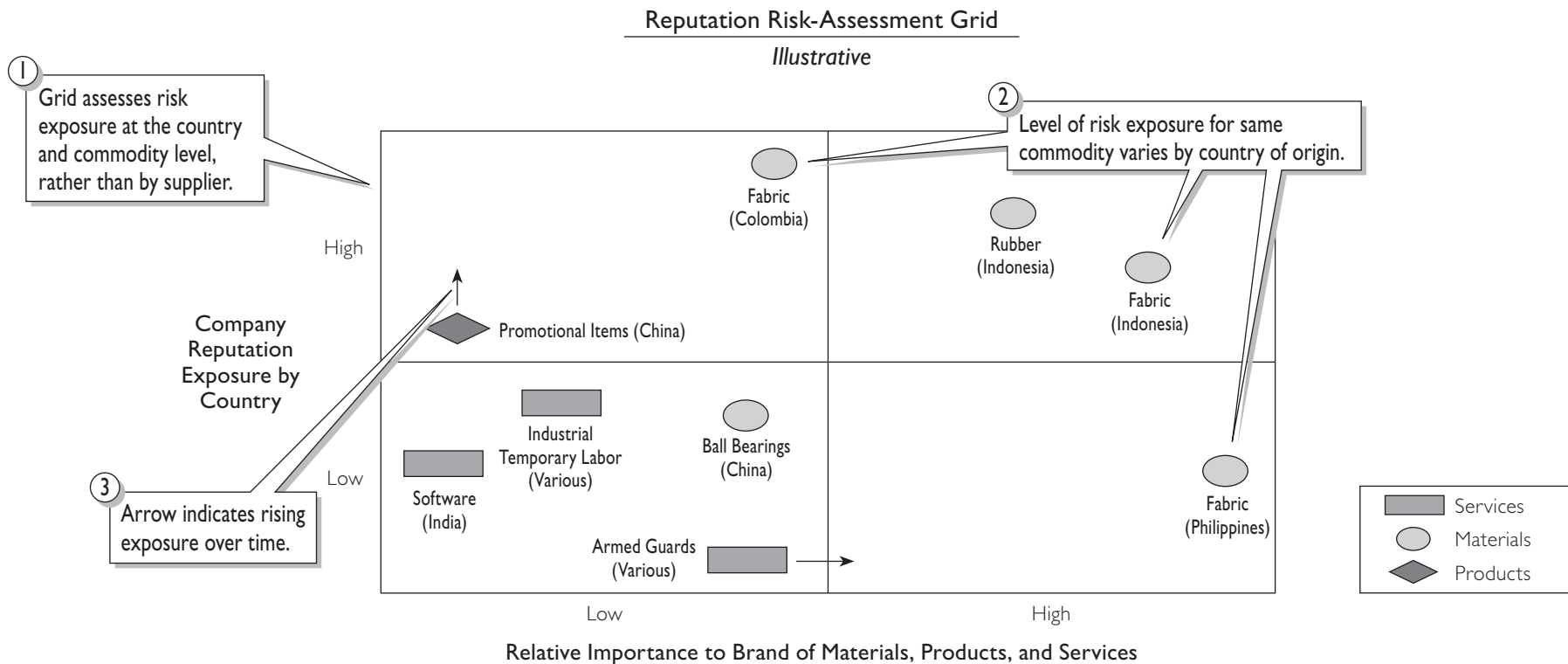
**Leverage  
Supply Chain  
Partners**





## DIGGING DEEPER

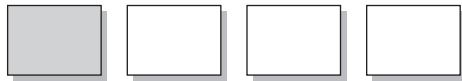
### Multidimensional Risk-Exposure Grid Enables Assessment Beyond the Supplier Level



### GRID INPUT

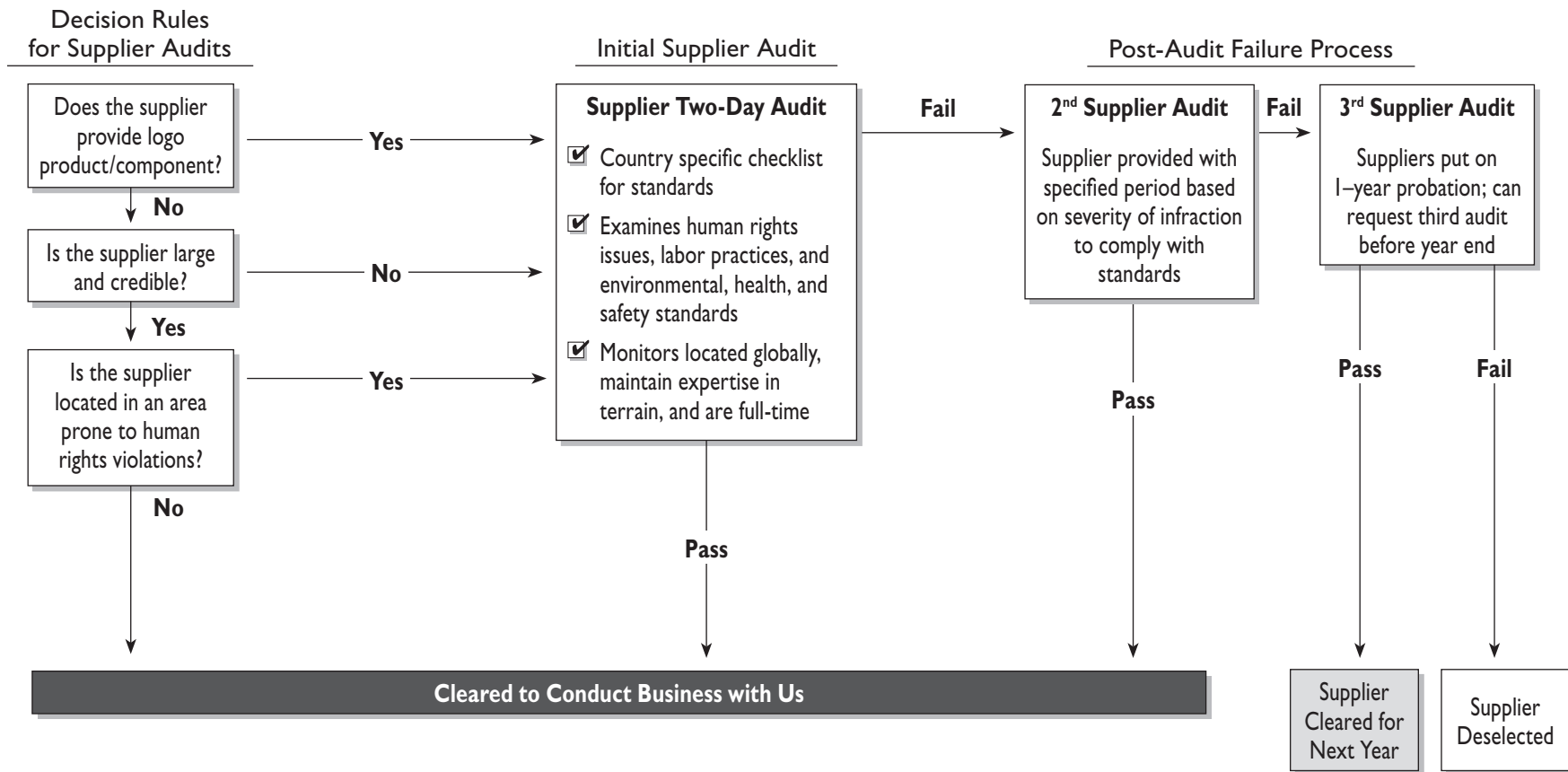
- Placement on vertical axis is informed by periodic NGO-published watch lists (e.g., from Amnesty International, International Labor Organization).
- Placement on horizontal axis is informed by level of direct association between company brand and commodity, as well as total spend and volume sourced.
- Grid developed by partnership of Audit and Risk Management teams with Supply Management, then vetted by enterprise Corporate Social Responsibility group.

Source: Procurement Strategy Council research.



# WORLDWIDE MANUFACTURING STANDARDS

## *Supplier Review Process Enables Structured Assessment and Mitigation of Reputational Risks*



Source: Procurement Strategy Council research.



## A FOCUSED APPROACH





**Formal performance categories...**

**...supported by a detailed questionnaire...**

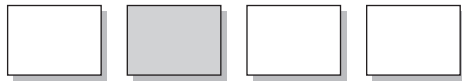
Assessment Finding Categories
<b>Zero Tolerance</b> —There is no corrective action that fixes this violation and the facility will be scheduled for termination. <i>Violations result in a “Z” grade.</i>
<b>Highly Critical</b> —Total compliance is a top priority. These findings have the potential for very negative publicity, criminal or civil liability, and could have serious impact on employee safety or the environment. Must be corrected immediately. <i>Violations result in an “H” grade.</i>
<b>Critical</b> —These findings could have a serious impact on employee welfare, employee safety, or the environment. Must be corrected within three months, can be extended for up to six months upon approval. <i>Violations result in four demerits.</i>
<b>Major</b> —These findings could impact employee welfare, employee safety, or impact the environment. Must be corrected within six months, can be extended upon approval. <i>Violations result in two demerits.</i>
<b>Minor</b> —These findings could impact employee comfort or living conditions; no danger to employees or the environment. Limited potential for liability or negative publicity. Must be corrected within nine months, can be extended upon approval. <i>Violations result in one demerit.</i>

Standards Checklist
<b>Zero Tolerance Questions</b>
✓ Are all employees hired in the facility above the age of 16?
✓ Is each employee at the facility employed at his or her own free will?
<b>Highly Critical Questions</b>
✓ Are all employees paid correctly for hours worked?
✓ Are all wages paid in legal tender and at least monthly?
✓ Are all deductions from gross wages allowed under the labor law regulations?
✓ Is all overtime voluntarily worked?
✓ Are employees provided with the appropriate holidays off?
✓ Do the time records correctly reflect the hours worked by employees?
✓ Is the dormitory building separated from the production building and warehouse?
✓ Are all emergency exit doors kept unlocked when building is occupied?

**...allow monitors to quickly track factory performance and take appropriate next steps**

Demerits are given to indicate the number and severity of infractions identified		Grades reflect the number of demerits received, signifying a corresponding percentage of compliance with standards	
<b>Factory Status</b>	 <b>Acceptable</b>	 <b>Probation</b>	 <b>Watch List</b>
<b>Compliance Grade</b>	A; B; C	F; H (First audit)	F; H (Second audit)
<b>Demerits</b>	A = 0–26; B = 27–64; C = 65–102	F = 103 or more; H = any “highly critical” finding	F = 103 or more; H = any “highly critical” finding
<b>Action Plan</b>	Corrective Action Report required until findings closed; next audit is annual	F = Second audit in 6 months; H = Second audit in 3 months	Third audit in 2 months
			 <b>Termination</b>
			F/H (Third audit); Z (any audit)
			F = 103 or more; H = any “highly critical” finding; Z = any “zero tolerance” finding
			Terminate in 30 days

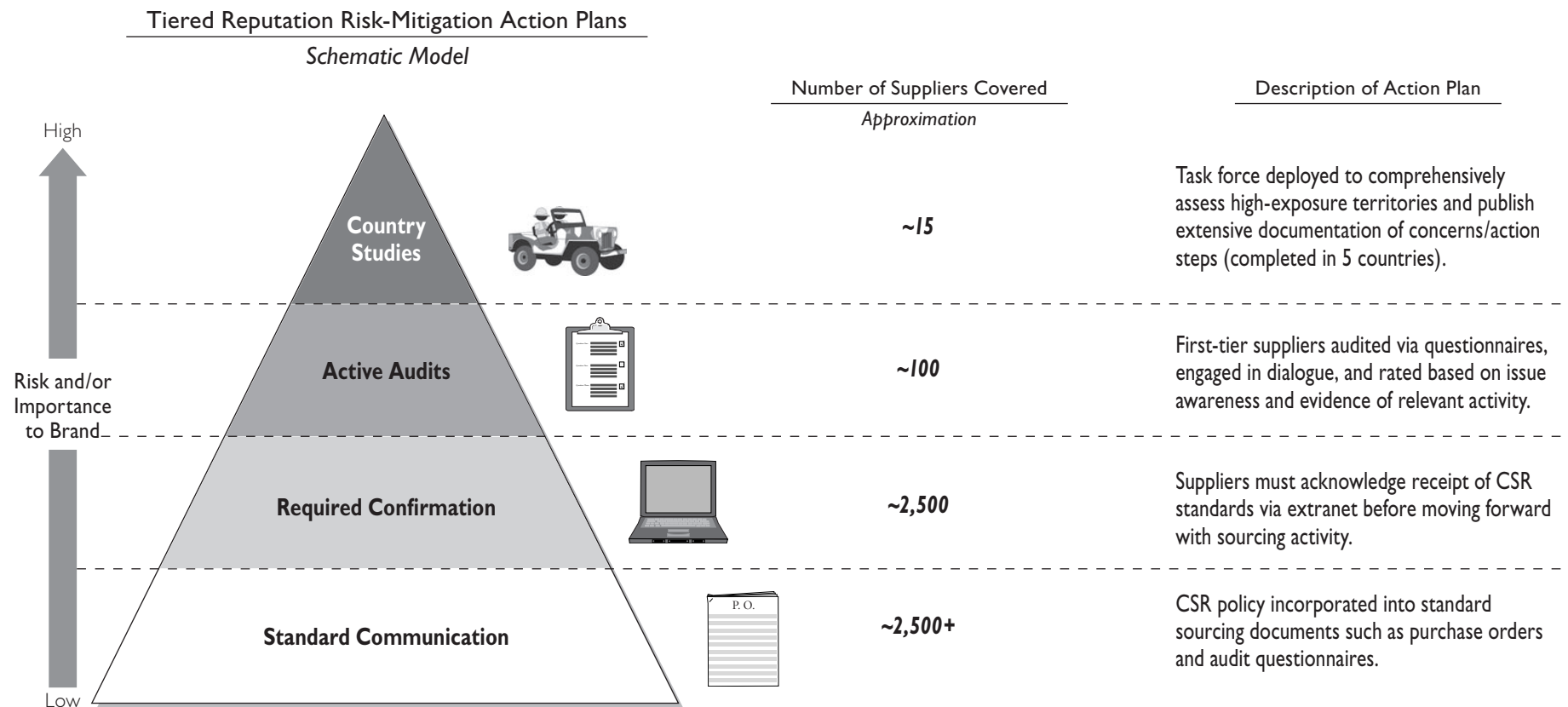
Source: Procurement Strategy Council research.



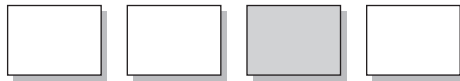
# POINTS OF ENGAGEMENT

## *A Tiered Approach to Ethical Sourcing Assessment*

### *Allocates Scarce Resources to the Highest-Exposure Sourcing Flows*



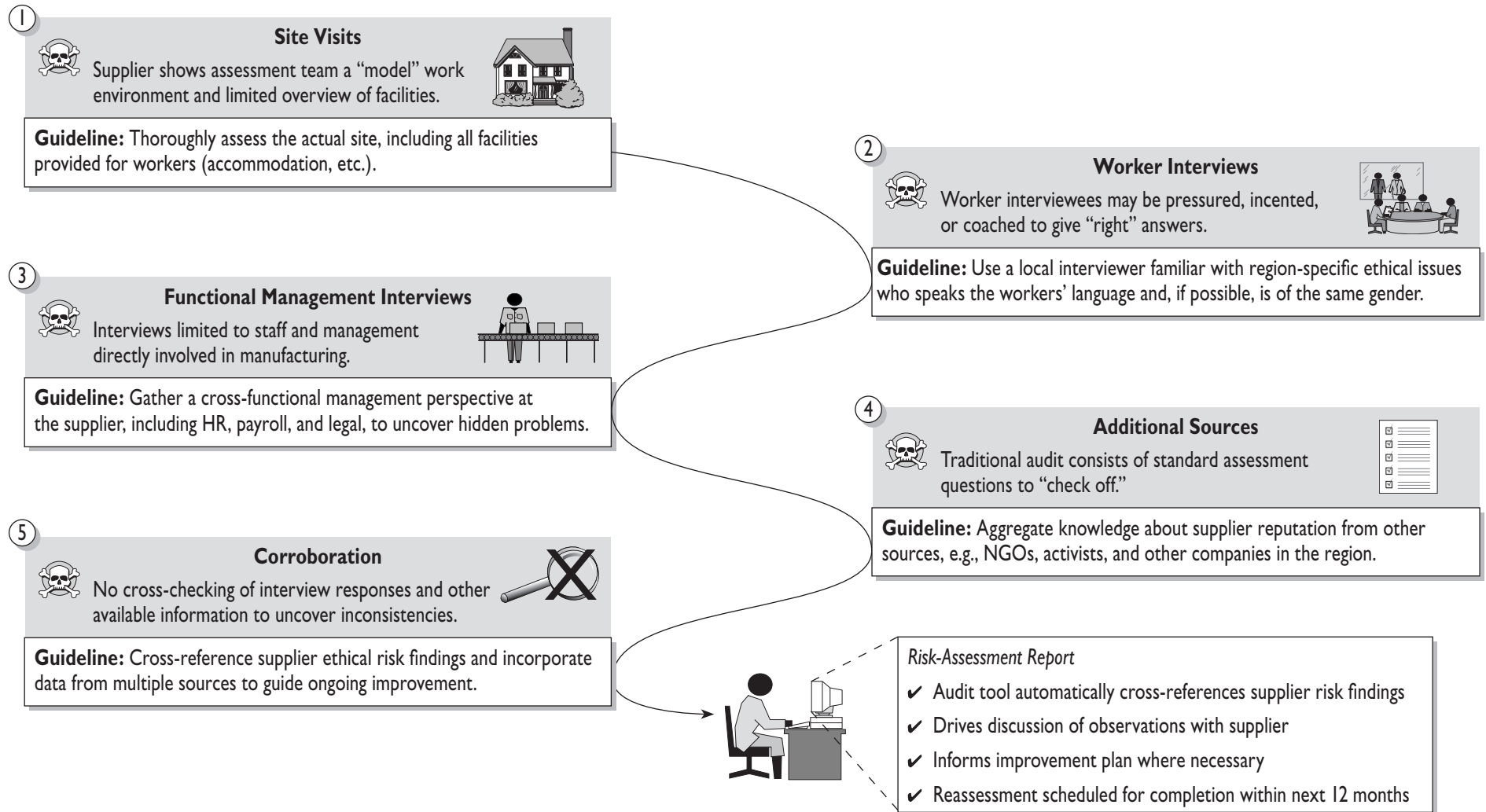
Source: Procurement Strategy Council research.



# BENEATH THE SURFACE

## *Replacement of a Checklist Approach with Cross-Referencing of Information from Multiple Sources Produces a Credible Evaluation*

### Common Audit Process Deficiencies and Corresponding Mitigation Guidelines



Source: Procurement Strategy Council research.



# GETTING ONTO THE SAME PAGE

## Enfranchising Partners Cascades Proven Reputation Risk-Mitigation Approaches Across the Supply Network

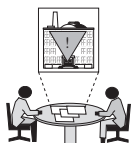
### Risk-Mitigation Practice Cascade

### CSR Questionnaire (Excerpt)

Completed by Partner Supplier

1

#### Demonstrating Urgency



##### Individual Awareness Generation Sessions

- Sessions highlight shared reputation risk exposure and drive supplier buy-in for collaborative mitigation.

2

#### Establishing a Shared Response

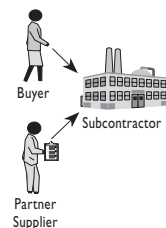


##### Shared Mitigation Development Workshop

- Workshop enables scalable and informed best practice sharing to complement industry-wide standards initiatives.

3

#### Embedding Better Practice



##### Joint Assessments

- Buyer and member of central CSR team assess partner supplier and upstream supply chain.
- Buyer owns relationship and embeds improvement plan into supplier management.
- Supplier executes on plan, including subcontractor improvement, subject to periodic review by buyer and CSR team.

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#### Section 4: Procedures

4a. Does your company have any procedures in place that seek to ensure our principles and standards are met in your supply chain?

☐ Yes ☐ No (If No, proceed to 4c.)

4b. Please provide a brief summary of your procedures: \_\_\_\_\_

4c. Does your company have any procedures for reporting any nonconformances of these principles and standards in the supply chain?

☐ Yes ☐ No (If No, proceed to Section 5.)

4d. Please provide a brief summary of your procedures for reporting nonconformances: \_\_\_\_\_

#### Section 5: Contract

5a. Please indicate how many supply chain levels, including your own company, are involved in the delivery of this contract.

☐ 1 ☐ 2 ☐ 3 ☐ >3

5b. Select all the countries that you and your supply chain source from to deliver this contract.

IMPORTANT: Where applicable, answers MUST include all countries where major production or service delivery occurs.

☐ Afghanistan ☐ Albania ☐ Algeria ☐ Angola ...

#### Section 6: Standards

6a. Do any of the products or services provided by your company in the contract, either directly or via subcontractors, fail to meet our CSR standards due to the working conditions they are produced under? Please indicate for each section below.

(Please note: Suppliers are encouraged to provide honest answers. We welcome suppliers that identify activities undertaken by themselves or subcontractors which fall below CSR standards, provided the supplier works collaboratively with us toward achieving them.)

Sourcing Standards	Failures Do Exist	Failures Potentially Exist	Failures Do Not Exist
The Law Is Applied			
Employment Is Freely Chosen			
Freedom of Association			
Working Conditions			
Child Labor			
Living Wages			
Working Hours			
Discrimination			
Regular Employment			
Harsh/Inhumane Treatment			

If you have responded "Failures Do Not Exist" for all of the sections above, please proceed to Section 7.

6b. You have answered "Failures Do Exist" or "Failures Potentially Exist" to some or all of 6a. Please give further details concerning these specific areas, including products/services/countries concerned and who we can contact for further information: \_\_\_\_\_

Reporting of problems does not result in automatic disqualification.

Source: Procurement Strategy Council research.

## KEY TAKEAWAYS

### **Place Analysis In the Appropriate Context**

- Start CSR risk assessment with a commodity/service- and country-level analysis, in order to put supplier-level analysis in a more informed context.

### **Move Beyond a One-Size-Fits-All Approach**

- Use multi-dimensional analysis to focus your organization's risk mitigation resources, and catch red flags that might otherwise be overlooked
- Deploy a tailored mix of incentives and enforcement tactics to encourage compliance and positive action on the part of suppliers

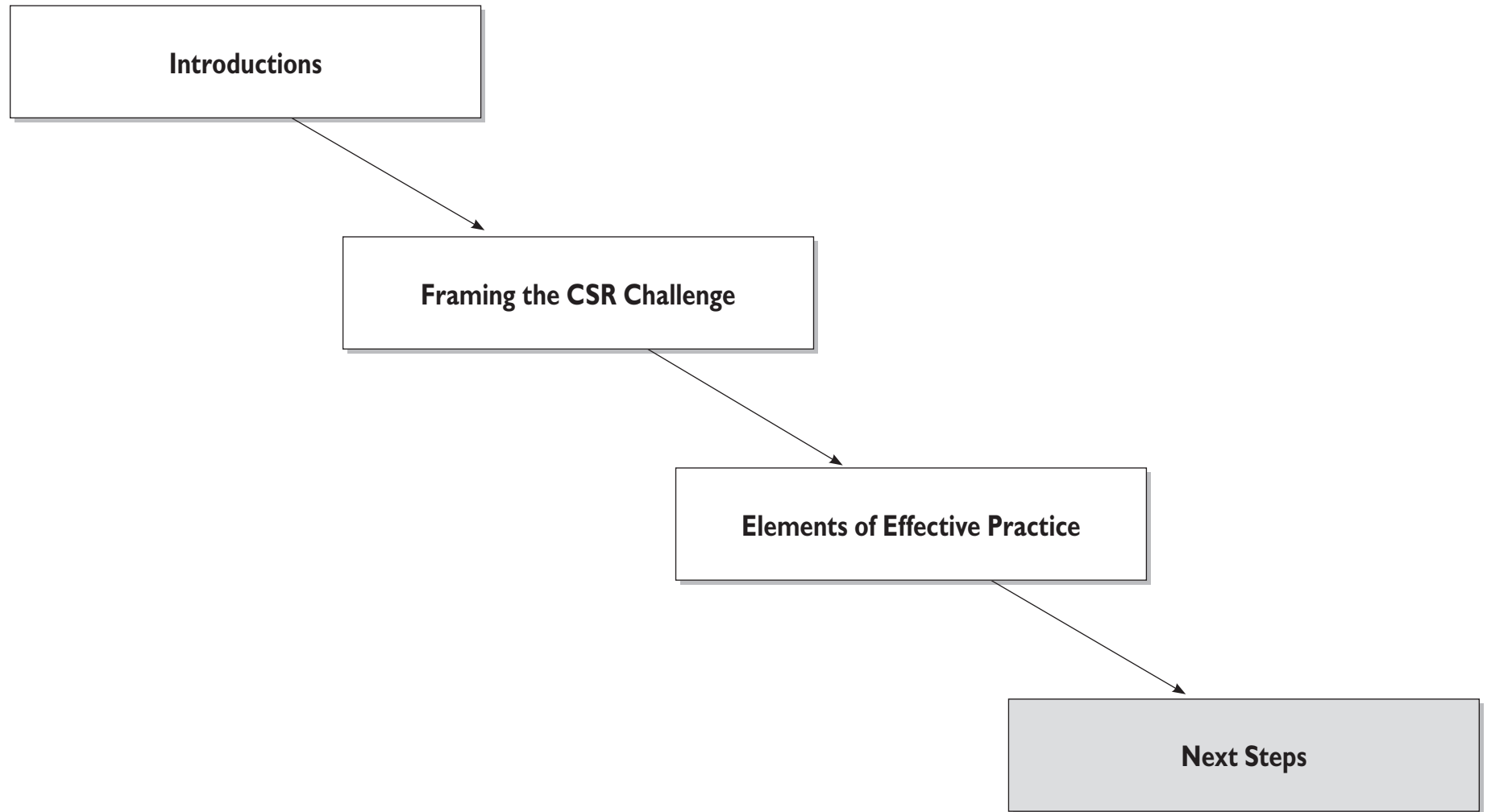
### **Find Resource-Efficient Ways to Improve Quality of CSR Audit Data**

- Ensure that data collectors are well-equipped to make accurate assessments
- Take advantage of (and help to strengthen) the “network effect” of multi-company and industry-level CSR initiatives

### **Leverage Supply Chain Partners**

- Enlist strategic suppliers to act as risk managers on your organization's behalf

## ROAD MAP FOR TODAY'S DISCUSSION





# SELF-ASSESSMENT TOOL

*Use this diagnostic as a guide to inform discussions within your organization on CSR initiatives*

## Identifying At-Risk Suppliers/Placing Analysis in the Appropriate Context

	No	Somewhat	Yes
We incorporate country and commodity issues into our CSR risk analysis to expose threats not uncovered by supplier-level analysis alone.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
We maintain a comprehensive set of data sources that regularly informs risk assessment and monitoring activities	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
We share risk management information with other corporate functions, to ensure that all supply base intelligence is considered	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
We employ CSR risk evaluation metrics and decision rules to quickly direct attention to the areas of highest priority	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

## Finding Resource-Efficient Ways to Improve Data Quality

We provide evaluators with tools and guidelines to enable cross-checking of data and testing for data credibility	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
We establish links to all relevant corporate areas to minimize duplication of effort and ensure an enterprise-based view of CSR performance and risk	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
We actively participate in multi-company and/or industrywide CSR monitoring efforts to maximize return on resources invested and minimize reporting burdens on small suppliers	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

## Moving Beyond a One-Size-Fits All Approach

	No	Somewhat	Yes
We use a tiered model that targets CSR management efforts and activities to areas of greatest exposure, resulting in a greater span of coverage for the same resource investment.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Our CSR enforcement policies are tailored to different levels of risk or different infraction types, corresponding to the number and severity of performance problems and violations.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
We employ incentives as well as enforcement tactics, in order to encourage suppliers to fully disclose issues or problems as they happen.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
We identify reliable signposts to inform management of changes in CSR risk status and trigger activation of contingency plans.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
We use a comprehensive reporting system to proactively communicate CSR issues to senior management	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

## Leveraging Supply Chain Partners

We involve our tier-one global suppliers in CSR risk monitoring activities to extend visibility and impact further back in the supply chain, to include our suppliers' suppliers	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Our evaluation tools are easily transferable to suppliers, in order to ensure the accuracy and consistency of upstream CSR audit data.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Source: Procurement Strategy Council research.

PROCUREMENT STRATEGY COUNCIL

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